

JOHN EMERY &amp; SONS

JOHN EMERY & SONS *v.*

COMMISSIONERS OF INLAND REVENUE

No. 992—COURT OF SESSION (FIRST DIVISION)—

26TH AND 27TH JUNE, 1935

HOUSE OF LORDS—25TH AND 26TH MAY, 1936

COMMISSIONERS OF INLAND REVENUE *v.* JOHN EMERY & SONS<sup>(1)</sup>JOHN EMERY & SONS *v.* COMMISSIONERS OF INLAND REVENUE<sup>(1)</sup>

*Income Tax, Schedule D—Profits of trade—Ground annuals created by builders and retained by them—Whether realisable value to be included in trading receipts.*

*A firm of builders acquired certain land upon which they erected dwelling-houses. In a number of cases they created ground annuals over the houses and the ground attached thereto, and thereafter sold the houses and ground for a cash payment, subject to the ground annuals which they retained in their possession.*

*Held, that the realisable value of the ground annuals created and retained by the builders should be added to the amount of the receipts credited in their accounts for the purpose of ascertaining the amount of their trading profits chargeable to Income Tax.*

## CASE

At meetings of the Commissioners for the Special Purposes of the Income Tax Acts held on 4th July, 1933, and 7th March, 1934, for the purpose of hearing appeals, Messrs. John Emery & Sons (hereinafter called "the Appellants") appealed against an additional assessment to Income Tax on the sum of £541 for the year ending 5th April, 1927, and an estimated assessment to Income Tax on the sum of £8,000 for the year ending 5th April, 1929, made upon them under the provisions of the Income Tax Act, 1918, Schedule D.

I. The following facts were admitted or proved :—

(1) In the years to which the assessments relate and in earlier years the Appellants carried on as a partnership firm the business of builders and building contractors.

(2) By a feu contract dated 7th and 13th and recorded in the Division of the General Register of Sasines applicable to the County of the Barony and Regality of Glasgow on 26th, all days of August, 1924, there was disposed to the partners of the Appellants' firm as trustees for their said firm (hereinafter referred to as "the partners") 2.643 acres of land at a yearly feu duty of £79 5s. 10d.

<sup>(1)</sup> Reported (C. of S.) 1935 S.C. 802; (H.L.) 1936 S.L.T. 361.

Upon this land the partners as trustees foresaid bound themselves to erect within two years from the date of the deed at least 15 self contained dwelling-houses or villas, or such number as the feu duty should have been allocated upon, upon one-half of the ground, and within three years from the date of the deed at least other 16 self contained dwelling-houses or villas on the remaining half of the ground. Each house was to be of the value of at least £900 and was to be built according to plans approved by the superior. The houses were to be upheld and kept in good repair by the feuars, so as to remain of the foresaid value in all time coming. The feuars were bound to fence off the land with walls or railings, and it was declared that whereas the superior had formed or was about to form a certain road or street and lanes, and common sewers, etc., with which the drainage system of the houses to be erected would be connected, the feuars were to repay to the superior the cost thereof and were to maintain the said road or street and lanes, common sewers, etc., until taken over by the Corporation of Glasgow. It was further provided that the feuars should in the event of their erecting more than one house on the ground thereby feued have power to sell and dispoise the said ground and buildings thereon in parcels, and to allocate thereon the feu duty, but only on condition that buildings of the description and values before mentioned had been previously erected on the ground so to be sold and dispoised, and also that the proportion of feu duty applicable to each part and portion of ground so to be sold and dispoised should be at the rate of £60 per acre, and it was further declared that after the whole of the said feu duty had been allocated in terms thereof on houses of the description and value before specified erected on one-half of the ground, the feuars should be entitled to feu or dispoise the remaining ground for payment of such feu duties and other prestations as they might deem proper, but only for the erection of buildings of the description and value before specified.

(3) By another feu contract dated 26th and 29th April and recorded in the Division of the General Register of Sasines applicable to the County of the Barony and Regality of Glasgow on 28th May, 1926, there was dispoised to the partners as trustees for their said firm a further area of 3.920 acres of land at a yearly feu duty of £117 12s., and the partners as trustees foresaid bound themselves to erect within two years from Whitsunday, 1926, at least 24 self contained dwelling-houses or villas or such number as the feu duty should have been allocated upon on one-half of the ground and within three years from Whitsunday, 1926, at least other 24 self contained dwelling-houses or villas on the remaining half of the ground. Each house was to be of the value of at least £900 and was to be built according to plans approved by the

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superior. In all other respects the provisions of the feu contract were similar to those of the feu contract mentioned in the preceding paragraph hereof.

(4) On the ground feued under the first feu contract the Appellants built 33 houses, and the feu duty of £79 5s. 10d. was allocated on the first 15 completed at the rate of 13 houses at £5 5s., 1 at £4 14s. 10d. and 1 at £6 6s., leaving the remainder of the land (over which ground annuals were to be created as hereinafter mentioned) free of feu duty. On the ground feued under the second feu contract the Appellants built 47 houses, and the feu duty of £117 12s. was allocated on the first 22 completed (being 20 houses at £5 5s. each and 2 houses at £6 6s. each), leaving the remainder of the land free of feu duty. On the remaining 18 houses built on the ground first feued and on the remaining 25 houses built on the ground feued under the second feu contract, the Appellants created ground annuals of £5 5s. and £6 6s., amounting in all to £95 11s. and £134 8s. respectively.

(5) The contract of ground annual relating to the 18 remaining houses built on the ground first feued was dated 21st and 22nd and recorded in the Division of the General Register of Sasines applicable to the County of the Barony and Regality of Glasgow on the 25th, all days of April, 1925. The contract of ground annual relating to the remaining 25 houses built on the ground feued under the second feu contract was dated 6th and recorded in the said Division of the General Register of Sasines on the 8th, both days of September, 1927. These contracts of ground annual were entered into between the partners as trustees for their said firm on the one part and the partners' Solicitor, Daniel Gardner, on the other part, and by such contracts of ground annual the partners, as trustees foresaid, in consideration of the ground annuals and other prestations therein undertaken, sold, disposed and conveyed to the said Daniel Gardner the several plots of ground on which the remaining 18 houses and 25 houses mentioned in the preceding paragraph were erected or to be erected, under the burden of payment to them of the respective ground annuals and with and under in so far as applicable thereto and still subsisting the liens and burdens, reservations, conditions, provisions and others specified in the said feu contracts. The said Daniel Gardner bound and obliged himself, his heirs, executors and representatives whomsoever to pay to the partners as trustees foresaid the said ground annuals, and for further security of the payment of the said ground annuals the said Daniel Gardner assigned to the partners as trustees foresaid not only the ground annuals but also the several plots and the buildings erected or to be erected thereon disposed to him by the said contracts of ground annual, and that in real security of the payment of the ground annuals and of the performance of his obligations thereunder. The said contracts of ground annual further declared that

in the event of the said Daniel Gardner or his foresaids selling and conveying any of the said plots of ground thereby disposed to him, the personal obligation thereby undertaken by him including payment of the said ground annuals should thereupon cease and determine against him and his foresaids.

(6) At the time when the said contracts of ground annual were granted certain houses had been built or were in course of erection upon the lands thereby disposed to the said Daniel Gardner, and after the granting of such contracts of ground annual the Appellants completed the erection of buildings on all the plots thereby disposed.

(7) The amounts of the ground annuals were in accordance with the rates generally prevailing for well secured feu duties and ground annuals on built-up land in the district. Such rates are fixed generally with a view to rendering the ground annuals attractive and easily dealt with as trustee securities, regard being had to the rental value of the houses erected on the land.

(8) The Appellants tendered to the superior for the work of constructing the said roads and sewers. Their tender was accepted, and they carried out the work at a total cost to them of £3,708.

(9) All the houses built by the Appellants upon the lands before mentioned were sold shortly after they were completed. All the houses built upon the land feued by the first feu contract were sold during the year ended December, 1925. The houses built upon the land feued by the second feu contract were sold at various times, the last being sold in December, 1929. In the case of houses sold subject to feu duties, a disposition of the land was given by the partners as trustees foresaid in favour of the purchaser, and in the case of houses sold subject to ground annuals, a disposition of the land was given by the said Daniel Gardner as the person heritably vest therein, with the consent and concurrence of the partners as trustees foresaid in favour of the purchaser. The disposition was granted in consideration of the purchase price being paid to the partners as trustees foresaid. No ground annuals were paid until the houses were sold. From the date of sale the feu duties have been paid by the purchasers direct to the superior and the ground annuals have been paid by the purchasers to the Appellants under deduction of Income Tax.

(10) The Appellants have not sold any of the ground annuals, but have kept them all in their own possession. In August, 1930, the Appellants' business was sold to a limited company in which the partners of the Appellants' firm were the shareholders. There were excepted from the assets sold by the Appellants to such limited company the ground annuals created by the two contracts of ground annual before mentioned (which were and have since been retained) and the annual sums received each year are divided among the partners equally.

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(11) The total sum realised by the Appellants by the sale of the 80 houses was £88,652. The total cost incurred, including the above mentioned sum of £3,708 spent on the construction of roads and sewers and a sum of £287 representing legal expenses in connection with the allocation of feu duties and the creation of ground annuals, amounted to £86,151. These figures were credited and debited respectively in the Appellants' trading accounts. No account of the ground annuals, except so far as payments thereof were received (under deduction of Income Tax) in the year of account, was taken in the Appellants' trading accounts or balance sheets.

(12) In computing the additional assessment of £541 appealed against for the year ended 5th April, 1927, the value of the ground annuals amounting *in cumulo* to £95 11s. created during the Appellants' financial year ended 31st December, 1925, by the contract of ground annual first above mentioned was estimated at 17 years' purchase, namely £1,624, and this sum was treated as increased profit of the Appellants during such year to 31st December, 1925. The sum of £541, being one-third of £1,624, represented the average of the capital value, calculated at 17 years' purchase, of the ground annuals created within the three preceding years. A figure similarly calculated in respect of the ground annuals created in the year 1927 was included in the estimated assessment for the year ending 5th April, 1929.

(13) Evidence which we accepted was given on behalf of the Crown by James A. French, Chartered Accountant, Glasgow, and William Anderson, Chartered Accountant, Glasgow, that the correct commercial method of arriving at the cost of the ground annuals was to take the same proportion of the selling value of the ground annuals that the total cost of the land and houses bore to the combined sum of the selling value of the ground annuals and the prices realised by the sale of the houses. The Appellants in evidence and in argument challenged the validity of this evidence and maintained that the correct method of arriving at the cost of the ground annuals was to take only the legal costs incurred in the allocation of the feu duties and the creation of the ground annuals.

(14) The legal costs incurred in the allocation of feu duties and the creation of ground annuals amounted in the present case to £286 15s. 5d. constituted as follows:—(1) *First Contract*—(a) Expenses of feu contract, minute of allocation and contract of ground annual, £137 1s. 9d.; (b) Sum paid in respect of agricultural tenants' claim, £20,—Total £157 1s. 9d.; (2) *Second Contract*—Expenses of feu contract, minute of allocation and contract of ground annual, £129 13s. 8d., *i.e.*, a *cumulo* sum of £286 15s. 5d.

II. It was contended on behalf of the Appellants:—

(1) That the profits of the Appellants' business were properly shown by their trading accounts and balance sheets.

(2) That the Appellants had not realised any profit by the creation of the ground annuals, which required to be brought into their trading accounts.

(3) That the only effect of the contracts of ground annual entered into by the Appellants was the creation of a right to receive an annual payment. No capital sum was involved, and, although a different question might arise if the Appellants were to sell the ground annuals, so long as they retained them in their own possession no liability to Income Tax was incurred by them apart from the tax on the ground annuals themselves, which would be paid by deduction year by year as the ground annuals were received.

(4) That if any adjustment of the accounts was required in order to arrive at the true profits of the Appellants' business, the only expenses which should be disallowed were the legal expenses incurred in connection with the allocation of feu duties and the creation of ground annuals.

III. H.M. Inspector of Taxes (Mr. S. D. Easton) contended on behalf of the Crown :—

(1) That by the transactions into which they had entered, the Appellants had acquired the land and had subsequently disposed of it, together with the houses built thereon, for money or money's worth.

(2) That the right to receive the ground annuals for all time to come was a part of the consideration for which they had disposed of the land and houses, and was a right which could readily be turned into money.

(3) That when a builder acquires land and builds houses upon it and sells or disposes of the land and the houses in consideration of a cash payment and a ground annual, the correct method of computing his profits is to credit in his accounts the value of the whole consideration received by him in respect of the lands and the houses, whether in money or in money's worth, and to debit the whole costs of acquisition and development of the land and of the construction of the houses, the difference being the profit or the loss.

(4) That the realisable value of the ground annuals ought to be added to the amount of the Appellants' trading receipts in their accounts, in order to ascertain their trading profits chargeable to Income Tax.

(5) Alternatively, if the realisable value of the ground annuals ought not to be added to the amount of the Appellants' trading receipts in order to ascertain their profits on the ground that the reservation by the Appellants of the ground annuals was the reservation of part of their assets, that a proportion of the total costs and expenses incurred by the Appellants in acquiring and developing the lands and building the houses should be disallowed as a deduction,

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as being the cost of creating the ground annuals retained or the expenditure incurred in putting the lands into a condition capable of producing the ground annuals.

(6) That the sum to be disallowed was the cost price of the ground annuals or the expenditure incurred in putting the lands into a condition capable of producing the ground annuals, and that such sum was the proportion of the selling value of the ground annuals that the total costs and expenses of the land and of erecting the houses and developing the land bore to the combined sum of the selling value of the ground annuals and the prices realised by the sale of the houses.

IV. We, the Commissioners who heard the appeal, held that it would not be correct to include the realisable value of the ground annuals created and retained by the Appellants among the sums credited in their trading or profit and loss account, as this would involve charging Income Tax upon a profit which was not and might never be realised. On the other hand, we considered that it was by developing the land and building houses in the ordinary course of their business that the Appellants were enabled to create the ground annuals. They could readily have sold the ground annuals, and had they done so the proceeds of sale would clearly have formed part of their trading receipts, but they had preferred to retain them in their own hands, and we held that in computing their profits on the sale of what they had sold they were not entitled to charge as a deduction against the purchase price received the proportion of the expenses attributable to the creation of what they had retained. After hearing the evidence of Chartered Accountants on both sides, we were satisfied that for the purpose of ascertaining as accurately as possible the true amount of the profits of the Appellants' business a fair and reasonable method of computing the expenses attributable to the creation of the ground annuals would be to take the same proportion of the selling value of the ground annuals (estimated at the market price of 17 years' purchase) that the total expenses incurred bore to the combined sum of the said selling value of the ground annuals and the prices realised by the sale of the houses. The accounts as prepared by the Appellants should be adjusted by reducing the expenses debited by the figure thus obtained or (which would come to the same thing) by adding this figure as a credit in the trading or profit and loss account in the same way as the cost value of such unrealised assets as stock in trade is normally entered as a credit item. We accordingly amended the assessments to figures which are agreed to be correct on the basis thus adopted by us.

V. Both the parties immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law, and having duly required us to state and

sign a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland, this Case is stated and signed accordingly.

VI. The questions of law for the opinion of the Court are :—

- (1) Whether the realisable value of the ground annuals created and retained by the Appellants ought to be added to the amount of the receipts credited in their accounts for the purpose of ascertaining the amount of their trading profits chargeable to Income Tax.
- (2) (a) If not, whether the Appellants were entitled to charge the whole of the expenses incurred against the cash prices realised by the sale of the houses, or whether a deduction should be made from such expenses in respect of the cost of creating the ground annuals, and, if so,
  - (b) (i) Whether such cost is the amount of the legal expenses incurred in connection with the creation of the ground annuals, or, if not, (ii) whether the method of computing such cost adopted by us is correct, or, if not, (iii) how should such cost be computed?

P. WILLIAMSON,            } Commissioners for the Special  
W. J. BRAITHWAITE, } Purposes of the Income Tax Acts.

York House,  
23, Kingsway,  
London, W.C.2.

4th February, 1935.

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The case came before the First Division of the Court of Session (the Lord President and Lords Morison and Fleming) on the 26th and 27th June, 1935, and on the latter date judgment was given unanimously in favour of the Crown, with expenses.

Mr. J. B. Paton, K.C., and Mr. J. Wheatley appeared as Counsel for John Emery & Sons, and the Solicitor-General (Mr. T. M. Cooper, K.C.) and Mr. T. B. Simpson for the Crown.

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#### I.—INTERLOCUTOR

Edinburgh, 27th June, 1935. The Lords having considered the Stated Case on Appeal and having heard Counsel for the parties, Answer the first question of law in the Case in the Affirmative; Find the remaining questions to be superseded; Sustain the Appeal of the Commissioners of Inland Revenue; Dismiss the Appeal of John Emery & Sons; Reverse the determination of the Special Commissioners and remit to them to reconsider assessments and to proceed as accords, and Decern; Find John Emery & Sons liable to



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the Commissioners of Inland Revenue in expenses of the Stated Case on Appeal, on the higher scale where applicable, and remit the Account thereof, when lodged, to the Auditor to tax and to report.

(Signed) W. G. NORMAND, I.P.D.

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II.—OPINIONS

**Lord Morison.**—This is a case in which a question arises in connection with an assessment to Income Tax under Schedule D. I think that any apparent difficulty in deciding this question disappears when the real effect of the charging Sections in Schedule D is set forth. It will be convenient, therefore, if, in the first place, I express my view on the question of law. Schedule D says that tax under the Schedule "shall be charged in respect of . . . .  
"annual profits or gains arising or accruing . . . . to any person  
"residing in the United Kingdom from any trade", etc.<sup>(1)</sup>. The tax ". . . . shall be computed on the full amount of the balance  
"of the profits or gains upon a fair and just average of three  
"years", etc.<sup>(2)</sup>. Rule 1 of the Rules applicable to Cases I and II says in imperative language: "The tax shall be charged without  
"any other deduction than is by this Act allowed". Speaking generally, I think it is correct to say that the only admissible deductions from the profits are the expenses necessary to earn them. Further, it is quite immaterial in what form the profits or gains are taken—money or kind or money's worth. If they arise from sales, the consideration may be cash or kind or even an annual payment for an indefinite period. The full amount of the profits and gains arising or accruing from such transactions is affected with Income Tax.

Keeping these considerations in view, I do not think any difficulty arises in this case. The Appellants are builders and building contractors, and one part of their business is conducted in feuing a plot of ground, erecting houses upon the land so feued and selling the houses thus erected for a consideration which takes the form of a ground annual secured over the subjects and in favour of the builder or his nominee. The nature of a ground annual and the part it plays in the speculations of contractors on building ground are explained in Bell's Principles (10th Edition), Sections 887 *et seq.* It is, in my opinion, quite clear that the ground annual is the price, or may at least be part of the price, which the Appellants recover for the houses they sell. Ground annuals are a trustee security and have at any given date an ascertainable cash value. If an accurate account of the Appellants' business is to be made up for the purpose

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<sup>(1)</sup> Paragraph 1 of Schedule D of the Income Tax Act, 1918.

<sup>(2)</sup> Rule applicable to Case I, Schedule D, Income Tax Act, 1918.

(Lord Morison.)

of ascertaining the profits or gains arising in any year, it must contain the capital value of each of the ground annuals affecting the houses built and sold by the Appellants. In short, the profits of the Appellants' business cannot be ascertained unless the whole consideration which they receive for the houses sold is definitely ascertained.

It was argued that this would involve the Appellants in an Income Tax chargeable upon a profit which they might not ultimately realise when they sold the ground annuals. It is, of course, true that the value of ground annuals fluctuates, but they are capable of actual valuation at any given time. The profits of the Appellants' business for the purposes of chargeability to Income Tax during any given year cannot be held to vary according as the Appellants sell or do not sell their ground annuals. If they had sold the houses for a price in money, no question could have arisen in this case. It is, I think, equally clear that the Appellants could have realised their ground annuals, and the proceeds must have formed part of their trading receipts. On this view of the facts no other question arises in the case, and all I need say is that we are not concerned with the commercial method of arriving at the cost of the ground annuals. Ground annuals have a definite market value—apparently seventeen years' purchase—and this gives the value of the ground annuals for the purposes of the Appellants' trading receipts.

For these reasons, I think that the first question in the case must be answered in the affirmative. The Statute requires us to hold that the realisable value of the ground annuals created and retained by the Appellants must be added to the amount of the receipts credited in their accounts for the years of assessment, and if that question is answered, I think all the other questions in the case disappear.

I merely wish to add, with regard to the argument in support of the view that was taken by the Commissioners, that, so far as I know, there is no rule in the Statute which warrants their calculation, or gives any support to the so-called correct commercial method of arriving at the cost of ground annuals. Ground annuals have a market value, and the Commissioners were bound to accept the market value of these ground annuals as part of the profits which should appear in the Appellants' accounts. I think, therefore, that the other questions of law do not arise and need not be answered.

**Lord Fleming.**—The question to be decided in this case is one of novelty, but I do not think it is attended with real difficulty. The Appellants are builders, and the transactions, in regard to which the Revenue are seeking to impose liability upon them for tax, may be described as the acquisition of vacant building sites, the erection thereon of dwelling-houses, and the sale of these

**(Lord Fleming.)**

dwelling-houses to purchasers. The only point which requires to be considered arises as follows:—In a number of cases the Appellants created ground annuals over the houses and the ground attached thereto, and thereafter sold the houses and the ground, subject to the ground annuals. In other words, for the house and ground they received a money price and they also received a ground annual, that is, a perpetual annuity of a specified sum of money secured over the house and ground. The question is, must the realisable value of the ground annual be taken into account as a consideration received by the Appellants in making up their accounts for Income Tax purposes? The Appellants maintain it should not. They contend that a consideration must be quantified in money before account can be taken of it, and that, accordingly, until the ground annual has been realised and converted into cash, its value cannot be entered in the accounts. Admittedly the annual sum received by the Appellants is subject to tax, but so would be the interest on the money price if it had been invested. I am unable to accept the Appellants' contention. It was suggested that it was supported by the case of *Cardonald Feuing Co.*, 1907 S.C. 36, but the point in that case was quite different. There building contractors had acquired ground upon which they erected buildings. They then created feu duties over the buildings and ground and sold the feu duties. They retained the buildings and lands in their own hands. The Crown claimed tax on the profit which had been made by the sale of the feu duties, and maintained that the amount of this profit fell to be ascertained by deducting the cost of the ground from the price obtained for the feu duties. Their claim was negatived on the ground that there was no material before the Commissioners or before the Court to enable the amount of profit to be ascertained.

The Appellants' Counsel, in the course of his argument, said—and I assume he was right in saying—that if a house had not been sold the Appellants would not have been obliged to enter its value in their accounts as an item received by them. But the point of the case, to my thinking, is just that the houses were sold and that the Appellants parted completely with the right of ownership in them. What they received in exchange was, first, a money price—and, of course, there is no doubt that this price comes into the account—and second, something which was not very different from a specified sum of money, *viz.*, a right in perpetuity to receive annually a specified sum of money. Their right of ownership, in so far as it was not represented by the money price, was converted by this transaction into quite a different type of property, namely, a ground annual. So different was its character that what previously was a right of ownership, carrying with it all the advantages of ownership and also all its risks, was transformed into a trustee security.

**(Lord Fleming.)**

It seems to me that in these circumstances it is impossible to say that the Appellants' right of ownership in the houses and ground has not been "realised or converted" (*Californian Copper Syndicate, Ltd. v. Harris*, (1904) 6 F. 894<sup>(1)</sup>). If this be so, it follows that the realisable value of the ground annuals must be taken into account as an item received by the Appellants. It is not immaterial to observe that a ground annual, being a trustee security, is usually readily convertible into money, and there is no serious difficulty, so far as appears, in ascertaining its realisable value at any particular date with reasonable certainty. If there is any difference of opinion on that matter it must be solved, like any other question of fact, by the Special or General Commissioners.

I am accordingly of opinion that the first question should be answered as proposed. In that view question 2 does not arise and I desire to express no opinion upon it.

**The Lord President (Normand).—**I agree.

I think that the fallacy of the argument for the Appellants is the supposition that no annual profits or gains can arise unless the whole consideration for the houses is paid in actual cash. The supposition is not only unsupported by authority but is inconsistent with the terms of the Act and is in direct conflict with authority. I need not go further than the case of *Californian Copper Syndicate v. Harris*, 6 F. 894<sup>(1)</sup>. That was a case where a trading company had sold a mining property for £300,000 to another company, the price to be payable in 300,000 ordinary shares of the purchasing company. In that case the Lord Justice Clerk said, at page 897<sup>(2)</sup>: "It is quite a well-settled principle in dealing with questions of assessment to Income Tax, that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than that for which he originally acquired it, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842, and therefore is not assessable to Income Tax. But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable, where what is done is not merely a realisation or change of investment, but is an act done in what is truly the carrying on or carrying out of a business. The simplest case is that of a person or association of persons buying and selling land or securities speculatively in order to make gain, dealing in such investments as a business, and thereby seeking to make profits". Accordingly I think that a person or association of persons carrying on the kind of trade which was carried on by the Appellants in this case realises a profit where there is an enhanced value obtained from the realisation of the

<sup>(1)</sup> 5 T.C. 159.<sup>(2)</sup> *Ibid.*, at pp. 165/6.

**(The Lord President (Normand).)**

houses which they built, and that that enhanced value need not be actually paid to them in the form of ready money. Lord Trayner, at page 899<sup>(1)</sup>, makes the point quite clear when he says: "It was said that the profit, if it was profit, was not realised profit, and therefore not taxable. I think the profit was realised. A profit is realised when the seller gets the price he has bargained for. No doubt here the price took the form of fully paid-up shares in another company, but if there can be no realised profit except when that is paid in cash, the shares were realisable and could have been turned into cash if the appellants had been pleased to do so. I cannot think that Income Tax is due or not according to the manner in which the person making the profit pleases to deal with it. Suppose, for example, a seller makes a profit on a trade transaction, but leaves the price (including the profit) in the hands of the buyer at so much per cent. interest. That he so deals with it rather than take the cash into his own pocket would not affect the claim of the Revenue for the tax payable on the profit". In my opinion, all that applies, in terms, to the present case.

It was sought to distinguish the present case by pointing out that in *Californian Copper Syndicate*, 6 F. 894<sup>(2)</sup>, the bargain was for the sale of the property at a sum of £300,000, and that the price was to be payable in shares, and the distinction sought to be made was that in this case no lump sum had been fixed which was to include the cash which was paid on the sale of the house and a capital value representing the ground annual. But, in my opinion, that argument ignores the true character of the transaction. The amount of the capital sum which in any given case a purchaser would be prepared to pay for a particular house was necessarily dependent on the amount of the annual sum which he had to pay in name of ground annual. It is a commonplace of all transactions of the kind that the amount of the ground annual affects the amount of the price which a purchaser is prepared to pay for any house, whether new or old. The amount of the ground annual was a constituent part in the total consideration payable for the house, and that total consideration was readily measurable by reference to the market price of ground annuals on the date when the transaction or sale took place. The total consideration which the house realised was just the actual sum transferred by the purchaser to the seller, and the market value of the ground annual.

For these reasons I think it plain that the first question should be answered in the affirmative, and the remaining questions are accordingly superseded.

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(1) 5 T.C. 159, at pp. 167/8. (2) 5 T.C. 159.

An appeal having been entered against the decision of the Court of Session, the case came before the House of Lords (Lords Blanesburgh, Atkin, Thankerton, Macmillan and Maugham) on the 25th and 26th May, 1936, and on the latter date judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

The Dean of Faculty (Mr. James Keith, K.C.), Mr. Raymond Needham, K.C., Mr. J. S. Scrimgeour and Mr. J. Wheatley appeared as Counsel for John Emery & Sons, and the Attorney-General (Sir Donald Somervell, K.C.), the Lord Advocate (Mr. T. M. Cooper, K.C.), the Solicitor-General for Scotland (Mr. Albert Russell, K.C.), Mr. Reginald P. Hills and Mr. T. B. Simpson for the Crown.

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#### JUDGMENT

**Lord Blanesburgh.**—My Lords, notwithstanding the careful, full and able arguments which your Lordships have heard from the Dean of Faculty and from Mr. Needham, I believe you are all of opinion that the judgments in this case which were delivered in the First Division of the Court of Session stand undisturbed. They express my own view quite truly, and I do not feel that I could usefully add anything to them.

This appeal must, I think, be dismissed, and I move your Lordships accordingly.

**Lord Atkin.**—My Lords, I agree that this appeal should be dismissed, and for the reasons which have been given in the Court of Session.

Put quite simply, the position is that the Appellants, who carried on the business of builders and dealers in real estate, entered into a transaction, or two transactions, by which they bought certain land, built houses upon it, and (without going into detail) disposed of their entire interest in the land for cash and for certain ground annuals. The position of the ground annuals seems to be this, that there was an obligation created in the several purchasers of the land by which the land became subject to what we in this country should call a rentcharge, which was not a personal obligation of the purchasers, but which was an annual charge which could be realised out of the land—a real burden upon the land. It is established that that obligation, or that right on the part of the Appellants, was a realisable right, a marketable security in the sense of something which they could have realised at any moment by going into the market.

In those circumstances the case appears to me to be as plain as could be. It is a case where people have sold in the course of business part of their stock for money plus money's worth, namely, the equivalent of a marketable security. The position in respect of ground annuals appears to me to be precisely the same as though

(Lord Atkin.)

they had sold the land for money plus an annuity or plus a bond conditioned for the payment of these particular sums, or for debentures under which those sums were payable annually; it could be put in a great many different ways. However you put it, the result is not that they exchange part of their stock for a different kind of stock, but that they dispose of the whole of their stock for money plus money's worth. In those circumstances it seems to me on the plainest principles that the value of that marketable security has to be brought into account for the purpose of assessing the profits which they made in the particular years of trade. Those appear to be the principles upon which the Court of Session proceeded. It appears to me that they are right, and I concur in the motion which has been proposed.

**Lord Thankerton.**—My Lords, I concur.

The first important point to observe in this case, to my mind, is that the transactions in question were admittedly part of the ordinary trading of this particular firm; and secondly, as the learned Dean of Faculty admitted, that the transactions between the Appellants as sellers of the houses and land, and the buyers of the houses and land, were completed transactions of sale. Then it needs to be observed: what did the Appellants get as the consideration for that sale? They got two things; they got sums of money, and they got the obligations—the real burdens—in the nature of ground annuals which had been constituted by them in the course of the transactions. I have difficulty in seeing, even on Mr. Needham's argument, how in any real sense you can arrive at the cost of those ground annuals; and on the other hand it is perfectly clear, and must have been familiar to these Appellants, as to anybody else in Scotland, that ground annuals such as these have a well-known market value and that they are constantly traded in, and in that respect they seem at least as good money's worth as any ordinary security quoted on the Stock Exchange. It does seem to me that the proper view of that part of the transaction is that in effect the Appellants agreed to leave part of the price as a real burden on the property to the extent of the well-known marketable value or thereabouts at the time. The main argument of the learned Dean of Faculty was that you could not bring this in until they realised it, as he admitted they could do, in the market. That in itself seems to me to amount at once to an admission that there was money's worth received at the time when the transaction of sale was completed, and if part of the price paid for the land and buildings consisted of money's worth, the marketable value of which asset is immediately ascertainable, I fail to see why that should not be brought into computation in the ordinary accounts of the trader for the purpose of bringing out the results of his year's trading.

**(Lord Thankerton.)**

Finally, I may say that I agree generally with the opinions of the majority in the Court below and particularly with that of the Lord President in the Court below, and I concur in the motion which has been proposed.

**Lord Macmillan.**—My Lords, your Lordships who have preceded me have so clearly set out the reasons which satisfy me that the judgment below was right that I have nothing to add except to express my agreement.

**Lord Maugham.**—My Lords, I will add only a very few sentences to what has fallen from your Lordships, with which I entirely agree.

I think Lord Fleming was right when in his opinion he used these words<sup>(1)</sup>: “The Appellants’ Counsel, in the course of his argument, said—and I assume he was right in saying—that if a house had not been sold the Appellants would not have been obliged to enter its value in their accounts as an item received by them”. The emphasis there, however, is on the word “value”. Lord Fleming did not, I think, mean that nothing ought to be entered in their accounts, and it would no doubt have been right in that case to enter the houses which were not sold at cost or market value, whichever was the lower. Then he goes on to say<sup>(1)</sup>: “But the point of the case, to my thinking, is just that the houses were sold and that the Appellants parted completely with the right of ownership in them”. It is precisely for that reason that there is no ground for putting an artificial cost of production, so to speak, on the ground annuals which have been obtained as the result of the sale of this property, since the ground annuals have a definite market value which can readily be ascertained. I agree with what has been said, that the right of ownership has, by the transaction in question, been converted into a different type of property, namely, ground annuals.

On those grounds I am satisfied that the opinions of the learned Judges of the Court of Session are perfectly correct.

*Questions put:*

That the Interlocutor appealed from be reversed.

*The Not Contents have it.*

That the Interlocutor appealed from be affirmed and that this appeal be dismissed with costs.

*The Contents have it.*

[Solicitors:—Kenneth Brown, Baker, Baker, for Weir & MacGregor, S.S.C., Edinburgh, and Sellar & Christie, Glasgow; Solicitor of Inland Revenue, England, for Solicitor of Inland Revenue, Scotland.]

(<sup>1</sup>) See page 223 ante.