
COURT OF APPEAL—20 AND 21 MAY AND 25 JUNE 1981

HOUSE OF LORDS—4, 5 AND 6 MAY AND 8 JULY 1982

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**Stanton (H.M. Inspector of Taxes) v. Drayton
Commercial Investment Co. Ltd.⁽¹⁾**

Corporation tax—Chargeable gains—Disposal of shares acquired in consideration of issue of new share—Whether amount or value of consideration the agreed issue price or other value—Income and Corporation Taxes Act 1970, ss 238 and 265—Finance Act 1965, Sch 6, para 4(1)(a)—Finance Act 1971, Sch 10, para 10.

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The Company appealed to the Special Commissioners against assessments to corporation tax in respect of chargeable gains accruing on the disposal of certain investments between 11 and 31 October 1972 and during 1973. These investments formed part of a portfolio which the Company agreed to acquire from Eagle Star Insurance Co. Ltd. by an agreement dated 21 September 1972 in consideration of the issue of its own shares. The issue price was £3,937,962 representing the mid-market prices of the investments on 31 August. The agreement was conditional on a Stock Exchange quotation for the new shares which was obtained on 11 October, when the agreement was completed and the new shares allotted; they were first quoted on 12 October. The Crown did not challenge the bona fides of the agreement or call evidence to show that the figures in the agreement were in any way unreal or uncommercial. The Crown contended that the amount or value of the consideration was the market value of these shares on 11 October represented by the middle market price on 12 October, i.e. £3,076,532. The Company successfully contended that the value was the issue price. The Crown appealed.

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The Chancery Division, allowing the Crown's appeal, held that for capital gains tax it is the value of the consideration given by the Company and not the cost of the consideration to it which is deductible under Sch 6, para 4(1)(a), Finance Act 1965, and it is to be ascertained at the date of the contract, which was 11 October when the contract became unconditional. The case was remitted to determine whether the market value of the Company's shares when issued to Eagle Star was in excess of the value arrived at by mere multiplication of Stock Exchange prices. The Company appealed.

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Osborne v. Steel Barrel Co., Ltd. 24 TC 293; [1942] 1 All ER 634; and *Craddock v. Zevo Finance Co., Ltd.* 27 TC 267 explained.

⁽¹⁾ Reported (Ch D) [1980] 1 WLR 1162; [1980] 3 All ER 221; [1980] STC 386; 124 SJ 361; (CA) [1981] 1 WLR 1425; [1982] 1 All ER 121; [1981] STC 525; 125 SJ 498; (HL) [1983] AC 501; [1982] 3 WLR 214; [1982] 2 All ER 942; [1982] STC 585.

- A The Court of Appeal, unanimously allowing the Company's appeal, held that the consideration given by the Company for the portfolio was not shares but the benefit of a contractual undertaking to issue and allot shares and credit them as fully paid; and the best valuation of that contractual benefit was the value which the parties themselves had set by the terms of an arm's length and bona fide contract. The Crown appealed and contended that the value fell to be determined by the best evidence, the market value on the day when the shares were first quoted not being conclusive.

Held, in the House of Lords, unanimously dismissing the Crown's appeal, that the consideration given by the Company was the shares but that their "value" for the purpose of para 4(1)(a), Sch 6 to the Finance Act 1965 was the value agreed between the parties.

- C *Per Lord Fraser*: The cases of *Osborne* and *Craddock* above are ample authority for saying that the Revenue is not entitled to go behind the agreed consideration in a case where, as in the present case, the transaction is not alleged to be dishonest or otherwise not straightforward.

- D *Per Lord Roskill*: I would not go as far as to say that in every case of this kind the value of the consideration in money's worth must always be determined by reference to the price at which the shares credited as fully paid were issued.

CASE

- E Stated under the Taxes Management Act 1970, s 56, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 3 November 1977, Drayton Commercial Investment Co. Ltd. (hereinafter called "Drayton") appealed against the following assessments to corporation tax: accounting period to 31 December 1972—£178,011; accounting period to 31 December 1973—£440,000.
- F 2. Shortly stated, the question for our decision was whether, in ascertaining the chargeable gains accruing to Drayton on the disposal of securities which it had acquired for a price satisfied by the allotment of ordinary shares in Drayton, the value of the shares so allotted was, for the purpose of para 4(1)(a) of Sch 6 to the Finance Act 1965, equal to the issue price of such shares (i.e. their *par* value plus the premium at which they were allotted) or the market value of these shares according to the first quotation in the Stock Exchange Official List following the allotment.
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3. No witnesses were called by either party.

4. The following documents, which are annexed hereto as exhibits A, B, C, D and E respectively and form part of this Case⁽¹⁾, were admitted before us:

- H A. Agreement for sale ("the agreement") dated 21 September 1972 made between Eagle Star Insurance Co. Ltd. (1) and Drayton (then called Union Commercial Investment Co. Ltd.) (2).

(¹) Not included in the present print.

B. Circular letter dated 22 September 1972 from the chairman of Drayton to the members of Drayton. A

C. Ordinary resolution passed 9 October 1972 at an extraordinary general meeting of Drayton.

D. The Stock Exchange Weekly Official Intelligence dated 14 October 1972.

E. Report and accounts of Drayton for year ended 31 December 1972. B

5. The following facts were admitted between the parties:—

(a) At all times relevant to this appeal, Drayton was called Union Commercial Investment Co. Ltd.

(b) On 21 September 1972 the agreement (exhibit A), which was a conditional agreement, was entered into. Eagle Star Insurance Co. Ltd. (“the vendor”) agreed to sell, and Drayton agreed to purchase, a portfolio of securities at the price of £3,937,962 to be satisfied by the allotment by Drayton to the vendor of 2,461,226 ordinary shares of 25p each in Drayton “the issue price of each such Share for the purpose of satisfying the consideration being one hundred and sixty pence (160p)”. Such ordinary shares (“the consideration shares”) were to be issued credited as fully paid up and to rank *pari passu* in all respects with the existing ordinary shares of Drayton save in respect of any final dividend in respect of the year ending 31 December 1972. The agreement was conditional upon: (i) the members of Drayton passing the necessary resolution to create the consideration shares; (ii) the Stock Exchange granting permission to deal in and quotation for the consideration shares before 31 October 1972. The price of £3,937,962 was agreed upon by reference to the middle market quotations of the securities in the said portfolio as at 31 August 1972. C
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(c) On 22 September 1972 the chairman of Drayton sent a circular letter (exhibit B) to each of the members of Drayton giving them particulars of the agreement and informing them that the consideration for the acquisition of the said portfolio of investments which had been valued on the basis of middle market quotations on 31 August 1972 at £3,937,962 was to be satisfied by the issue of 2,461,226 ordinary shares of Drayton and that on the basis of the middle market quotation of Drayton’s ordinary shares of 25p each at 31 August 1972 the portfolio was effectively being purchased for £3,494,941 at a discount of 11.25 per cent. on its market value. F

(d) On 9 October 1972 at an extraordinary general meeting of Drayton the necessary resolution to create the consideration shares was passed (exhibit C). G

(e) On 11 October 1972, the Stock Exchange granted permission to deal in and quotation for the consideration shares after allotment.

(f) The agreement was completed on 11 October 1972 when (*inter alia*) the consideration shares were allotted by Drayton to the vendor.

(g) The middle market quotation based on the daily official list of the ordinary shares of 25p each of Drayton was: (i) 142p on 31 August 1972, (ii) 134p on 21 September 1972, (iii) 125p on 12 October 1972 being the day on which the consideration shares were first quoted. H

(h) During the accounting periods under appeal, Drayton disposed of some of the securities comprised in the said portfolio.

A 6. It was common ground between the parties that the agreement was an arm's length transaction; and that the question in issue between them was what was the value of the consideration that had been "given" by Drayton for the purpose of para 4(1)(a) of Sch 6, Finance Act 1965.

7. It was contended on behalf of H.M. Inspector of Taxes that:

B (a) the said value was equal to the middle market price obtainable for the consideration shares on the Stock Exchange when they were first quoted on 12 October 1972 at 125p per share i.e. £3,076,532;

(b) the assessments under appeal should therefore be adjusted by attributing to the consideration shares for the purpose of the said para 4(1)(a) a value of £3,076,532.

8. It was contended on behalf of Drayton that:

C (a) the value of the consideration was £3,937,962 because that was both the consideration expressed in the agreement (based on the middle market quotations of the securities contained in the said portfolio on 31 August 1972), and the amount credited as paid in respect of the consideration shares;

(b) the assessments under appeal should be adjusted accordingly.

D 9. We were referred to the following authorities: *Osborne v. Steel Barrel Co., Ltd.* 24 TC 293; [1942] 1 All ER 634; *Craddock v. Zevo Finance Co., Ltd.* 27 TC 267; [1944] 1 All ER 566; *Murphy v. Australian Machinery & Investment Co., Ltd.* 30 TC 244; *Head (Henry) & Co., Ltd. v. Ropner Holdings Ltd.* [1952] 1 Ch 124; *Brooklands Selangor Holdings Ltd. v. Commissioners of Inland Revenue* L(SD) 56; [1970] 2 All ER 76; *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue* L(SD) 62; [1974] 1 All ER 811; [1975] 1 All ER 429 (CA).

E 10. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 29 November 1977 as follows:

It is common ground that the parties to the sale agreement of 21 September 1972 were at arm's length and that the consideration for the acquisition by the Appellant of the portfolio of investments under the agreement (£3,937,962) was fixed by reference to the middle market prices on 31 August 1972. The sale

F agreement provided that the "price of £3,937,962" was to be satisfied by the issue of 2,461,226 ordinary shares of 25p each in the Appellant at 160p each. It is not disputed by the Crown that there were bona fide commercial reasons for the figure of 160p being somewhat in excess of the price at which the Appellant's shares were currently being dealt in on the Stock Exchange. The sale agreement was a conditional contract. The conditions were satisfied on

G 11 October 1972 and, by virtue of para 10 of Sch 10, Finance Act 1971, the time of the disposal of the portfolio to the Appellant is to be taken as 11 October 1972.

H The Appellant says that the agreed price was £3,937,962, this was a bargain at arm's length and the consideration was duly satisfied by the issue at a premium of shares to that amount and accordingly £3,937,962 is the figure at which the shares were acquired for capital gains tax purposes. Counsel referred us to the observations in *Craddock v. Zevo Finance Co., Ltd.* 27 TC 267 and *Osborne v. Steel Barrel Co., Ltd.* 24 TC 293 to the effect that for Schedule D Case I income tax purposes, the cost to the trading taxpayer of acquiring assets for shares issued at par is, in the absence of evidence to the

contrary, the nominal value of the consideration shares. Lord Greene rejected an argument that consideration in the form of fully paid shares allotted by a company must, in all cases, be treated as being of the value of the shares, no more and no less; 27 TC 267, at page 277. So too, in *Brooklands Selangor Holdings Ltd. v. Commissioners of Inland Revenue*⁽¹⁾ [1970] 2 All ER 76 Pennycuik J., (*obiter*) rejected an argument that the consideration for the purpose of s 55(1)(c), Finance Act 1927, was anything other than the consideration which was based on a professional valuation of the assets of the particular existing company and expressed in the agreement for sale; page 88h.

The Crown contends that the tax authorities are distinguishable on the ground that they involved the question of issuing shares at a discount. As to the *Brooklands Selangor* case, the Crown contends that *dicta* in the later case of *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue*⁽²⁾ [1974] 1 All ER 811 and [1975] 1 All ER 429 (CA) equating the value of share consideration to the value of assets acquired for that consideration are to be preferred. Gains are computed in accordance with s 22(9), Finance Act 1965, which provides that they shall be computed in accordance with Part I of Sch 6 to that Act. Paragraph 4(1)(a) of Sch 6 provides that the gain shall be “restricted to”—

“the amount or value of the consideration, in money or money’s worth, given by him . . . wholly and exclusively for the acquisition of the asset . . .”.

Consequently one must find the consideration in money’s worth “given” by the Appellant. Is this the consideration received by the vendor or the consideration moving from the purchaser? Clearly, we think the latter for that is what is “given” in return for the asset acquired.

Counsel for the Appellant meets this approach by pointing to the term of the sale agreement which says that the price is £3,937,962 and, as that price was fully satisfied by the issue of 2,461,226 shares in the Appellant at 160p each, that is the money’s worth “given” to the vendor. The Crown, on the other hand, contends that this approach is not correct. True, says the Crown, the price was £3,937,962 but the agreement goes on to say that it shall be satisfied by the issue of 2,461,226 shares at 160p. Paragraph 4 directs that the value, not the price, of the consideration given is to be ascertained. The Appellant “gave” (i.e. parted with) 2,461,226 shares. Their “price” was 160p a share, but the best evidence of their “value” was what they were worth on 11 October 1972. It was said that this figure was in the region of 125p a share, that being the middle market figure on the Stock Exchange. The Crown relied on *Crane Fruehauf Ltd. v. Inland Revenue Commissioners*, and in particular, on the observation, *obiter*, of Russell L.J. in the Court of Appeal that in the circumstances of that case, the market value of the consideration shares at the moment of their issue would be a good indication of the amount or value of the consideration.

In our view, the approach of the Appellant is the correct one. *Crane Fruehauf* is not, it seems to us, of assistance because that case was concerned with the valuation, for the purpose of *ad valorem* “conveyance or transfer on sale” stamp duty, of “the consideration for the sale”, in other words, the valuation of the consideration received by the vendor (Finance Act 1963, s 55, as amended, and Stamp Act 1891, s 6), whereas in the present case we are concerned with the valuation of the consideration moving from the purchaser. The key to the solution of the present problem is, we think, as Counsel for the

(1) L(SD) 56, at p 13.

(2) L(SD) 62.

A Appellant submitted, to be found in the following extract from the judgment of Lord Greene M.R. in *Osborne v. Steel Barrel Co., Ltd.* 24 TC 293 at pages 306-7:

B “The primary liability of an allottee of shares is to pay for them in cash; but when shares are allotted credited as fully paid, this primary liability is satisfied by a consideration other than cash passing from the allottee. A company, therefore, when in pursuance of such a transaction it agrees to credit the shares as fully paid, is giving up what it would otherwise have had, namely, the right to call on the allottee for payment of the par value in cash . . . when fully paid shares are properly issued for a consideration other than cash, the consideration moving from the company must be at the least equal in value to the par value of the shares and must be based on an honest estimate by the directors of the value of the assets acquired.”

C Lord Greene’s remarks are not in terms confined to income tax computations and are expressed in general terms. Although he refers to shares issued at *par*, his reasoning applies equally to shares issued at a premium.

D Paragraph 4 of Sch 6 does not specify “market value” (cf s 22(4), Finance Act 1965). It is the “value . . . given” which has to be ascertained and the means by which that “value” is to be ascertained are not specified. On Lord Greene’s analysis, the Appellant in the present case has, in pursuance of a perfectly genuine transaction including the issue of its ordinary shares at 160p each, “given up” the right to call on Eagle Star Insurance Co. Ltd. to pay to it the sum of £3,937,962, being the issue price of the shares and the value of the assets acquired by the Appellant. That sum therefore represents the value of the consideration “given” by the Appellant within the meaning of para 4.

E We accordingly decide that the gain is to be computed on the basis that the Appellant gave value to the extent of £3,937,962 for the acquisition of the portfolio of investments and adjourn the appeal for the figures to be agreed.

F 11. Figures were in due course agreed between the parties and on 12 June 1978 we adjusted the assessments by reducing that for the period to 31 December 1972 to nil and that for the period to 31 December 1973 to £349,429.

G 12. The Appellant immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and on 15 June 1978 required us to state a case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and do sign accordingly.

13. The question for the opinion of the Court is whether our decision was correct in law.

J. B. Hodgson { Commissioners for the Special Purposes of
A. K. Tavaré { the Income Tax Acts

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28 February 1979

The case was heard in the Chancery Division before Vinelott J. on 25 and 26 February 1980 when judgment was reserved. On 24 March 1980 judgment was given in favour of the Crown, with costs.

Peter Gibson for the Crown.

Michael Nolan Q.C. and *R. Venables* for the Company.

The following cases were cited in argument in addition to those referred to in the judgment:—*In re Press Caps Ltd.* [1949] Ch 438; *In re Wragg, Ltd.* [1897] 1 Ch 796; *Stanyforth v. Commissioners of Inland Revenue* [1930] AC 339; *Battle v. Commissioners of Inland Revenue* [1980] STC 86; *Lap Shun Textiles Industrial Co. Ltd. v. Collector of Stamp Revenue* [1976] AC 530; *Wilkins v. Rogerson* 39 TC 344; [1961] Ch 133; *Smirk v. Lyndale Developments Ltd.* [1975] Ch 317; [1975] 1 All ER 690.

Vinelott J.—By clause 1 of an agreement for sale dated 21 September 1972 and made between Eagle Star Insurance Co. Ltd. (which I shall call “Eagle Star”), of the one part, and the Respondent, Drayton Commercial Investment Co. Ltd. (which was then known as Union Commercial Investment Co. Ltd. and which I shall call “Drayton”), of the other part, Eagle Star agreed to sell and Drayton to purchase a portfolio of investments specified in an agreed schedule at the price of £3,937,962 “to be satisfied by the allotment by the Purchaser to the Vendor of 2,461,226 Ordinary Shares of 25 pence each in the Purchaser the issue price of each such Share for the purpose of satisfying the consideration being 160 pence”. The ordinary shares were to be issued credited as fully paid up, and were to rank *pari passu* with the then existing ordinary shares of Drayton save that they were not to participate in any final dividend paid on the ordinary shares in respect of the year ending 31 December 1972. The vendor was to be entitled, in lieu of such dividend, to a gross dividend equal to the aggregate of the gross dividends paid to Drayton (or which would have been paid but for any disposal) in respect of the investments comprised in the portfolio during the period from 1 September 1972 to 31 December 1972, after deducting gross dividends received by Drayton but claimed by Eagle Star on investments quoted ex-dividend on 31 August 1972. It was provided by clause 2 that the agreement was conditional upon:

“(i) the Members of the Purchaser passing the necessary Resolution of the Company in general meeting creating the new shares in the Purchaser required to satisfy the consideration above mentioned; (ii) the Stock Exchange (London) granting permission to deal in and quotation for such new shares subject to allotment before 31st October, 1972.”

Clause 3 provided that the agreement should be completed within seven days after these conditions were both satisfied. In the event, the necessary resolution was passed at an extraordinary general meeting of Drayton on 9 October 1972, and permission to deal in and a quotation for the shares to be issued by Drayton was given by the Stock Exchange on 11 October 1972. The agreement was completed on 11 October 1972, when the shares which Drayton had agreed to issue were allotted to Eagle Star. The shares so allotted were first quoted on the Stock Exchange on 12 October 1972. Clause 4 provided that, as the portfolio had been valued at mid-market quotations on 31 August 1972, Eagle Star was to be entitled to all the dividends and interest on investments quoted ex-dividend on that day, and Drayton to dividends and interest declared and paid after that day.

- A Between 11 October 1972 and 31 October 1972, and during 1973, Drayton disposed of certain of the investments comprised in the portfolio. Assessments to corporation tax were made upon the footing that, in ascertaining the chargeable gains accruing to Drayton on the disposal of these investments, the value of the portfolio should be taken as equal to the market value of the shares issued by Drayton ascertained in accordance with Stock Exchange quoted prices on the day on which the shares were first quoted in the Stock Exchange Official List after the allotment. Drayton successfully appealed against those assessments on the ground that the value of the shares allotted was the price at which they were issued; that is, the par value plus the premium entered into Drayton's books. As I have said, the issue price was ascertained by reference to mid-market prices of the investments comprised in the portfolio quoted on the Stock Exchange on 31 August 1972. On that day the mid-market price of Drayton's ordinary shares was 142p. If that price is applied to the shares which Drayton agreed to issue as consideration for the acquisition of the portfolio, the portfolio was effectively purchased for £3,494,941, representing a discount of 11.25 per cent. on its value. On 21 September 1972 the mid-market quoted price of shares of Drayton was 134p and on 12 October 125p.
- D Corporation tax is chargeable in respect of chargeable gains of companies computed in accordance with the principles applicable to capital gains tax (see the Income and Corporation Taxes Act 1970, ss 238 and 265). Schedule 6 to the Finance Act 1965 contains provisions governing the computation of the amount of a gain accruing on the disposal of an asset. Paragraph 4(1) restricts the sums allowable as a deduction from the consideration for the disposal to sums falling under three heads, one of which (embodied in sub-para (a)) allows the deduction of the consideration given for the acquisition. It allows the deduction by the taxpayer, in terms of sub-para (a), of "the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset". The main issue in this appeal is simply whether the amount or value of the consideration given by Drayton for the portfolio of investments was the price—namely, £3,937,962—which under the terms of clause 1 was to be satisfied by the allotment of 2,461,226 shares of Drayton or the value of those shares. Although the paragraph does not specifically so provide, "value" must, I think, mean market value. There is a subsidiary question whether, if the answer to this question is that "the amount or value of the consideration" was the market value of the shares of Drayton issued in satisfaction of the sum of £3,937,962, the market value should be ascertained at 21 September or at 11 October 1972; and, in the latter event, whether it should be ascertained by reference to prices quoted on the Stock Exchange on 12 October 1972.
- H The Crown's contention is that under the agreement the consideration for the portfolio given by Drayton consisted of the shares of Drayton which Drayton were contractually bound to issue. As the agreement was conditional, the disposal of the portfolio by Eagle Star and its acquisition by Drayton must both be taken to have been made when the conditions in clause 2 were first satisfied (see para 10(2) of the Finance Act 1971, Sch 10); that is, 11 October. The market value on 11 October must be ascertained by reference to the price at which the shares were first quoted on the Stock Exchange on 12 October, either by analogy to s 44(3) of the 1965 Act or because quoted prices must be taken as the *prima facie* measure of value—although, of course, as s 44(3) recognises, there may be special circumstances which make it inappropriate as a measure of market value.

The argument for the Respondent (which, as I have said, persuaded the Special Commissioners) was shortly as follows. It is said that where a company acquires property in return for the issue of its shares then, unless the contract for the acquisition of the property is merely colourable or is illusory or fraudulent, the amount or value of the consideration given by the company is the amount of the credit which it gives to the vendor of the property for the value of the property acquired. That amount or value falls to be determined by reference to the terms of the contract. This proposition is said to be established by the decisions of the Court of Appeal in *Osborne v. Steel Barrel Co. Ltd.* 24 TC 293 and *Craddock v. Zevo Finance Co. Ltd.* 27 TC 267 and to these cases I now turn.

In *Osborne v. Steel Barrel Co. Ltd.* a Mr. Hood Barrs, a well-known figure to those familiar with the Tax Cases, entered into a contract with the receiver of a company in liquidation (which I shall call "the old company") for the purchase of its business premises, goodwill, stock-in-trade and effects at the price of £10,500. Subsequently, he entered into an agreement with the respondent company under which the respondent company in effect took the benefit of the contract with the receiver, Mr. Hood Barrs constituting himself a trustee thereof; and, in consideration therefor and for other services performed by Mr. Hood Barrs on its behalf, and of his agreement to serve the respondent company as managing director in the future, the respondent company allotted him 29,997 shares credited as fully paid. On completion of the agreement with the receiver, the business and assets of the old company were entered into the books of the respondent company at £10,500, the price paid to the receiver, which, of course, the respondent company became liable to pay under the original agreement. Of that sum, £2,493 was apportioned to stock. Subsequently, the stock was revalued and the opening figure of the stock was entered at £21,375 19s. 8d. The Special Commissioners found that the value of the stock when the respondent company acquired it was £10,000 and that the profits of the respondent company for the year ended 5 April 1933 and subsequent years should be determined on that footing. An appeal by the Crown was allowed by Macnaghten J. on the ground that (to quote the summary in the judgment of Lord Greene M.R. on the subsequent appeal⁽¹⁾) "the issue of the shares did not cost the Appellant Company anything; that accordingly the shares issued in respect of the stock added nothing to the price, and the only thing that the Company paid for the stock was a proportionate part of the cash"; that is, of the £10,500 paid under the original agreement. In relation to this argument Lord Greene M.R., in a passage which has often been cited and which I hope I shall be forgiven for citing again, said⁽¹⁾:

"It was strenuously argued on behalf of the Crown that if a company acquired stock in consideration of the issue of fully paid shares to the vendor, that stock must, for the purpose of ascertaining the company's profits, be treated as having been acquired for nothing, with the result that when it comes to be sold, the Revenue is entitled to treat the whole of the purchase price obtained on the sale as profit. This is a remarkable contention and it would require conclusive authority before we could accept it. The cases relied on in its support were *Commissioners of Inland Revenue v. Blott*⁽²⁾ . . . and *Lowry v. Consolidated African Selection Trust Ltd.*,⁽³⁾ . . . neither of which, in our view, has any bearing on the point. The argument really rests on a misconception as to what happens when a company issues shares credited as fully paid for a consideration

(1) 24 TC 293, at pp 306-7.

(2) 8 TC 101; [1921] 2 AC 171.

(3) 23 TC 259; [1940] AC 648.

A other than cash. The primary liability of an allottee of shares is to pay for them in cash; but when shares are allotted credited as fully paid, this primary liability is satisfied by a consideration other than cash passing from the allottee. A company, therefore, when in pursuance of such a transaction it agrees to credit the shares as fully paid, is giving up what it would otherwise have had, namely, the right to call on the allottee for

B payment of the par value in cash. A company cannot issue £1,000 nominal worth of shares for stock of the market value of £500, since shares cannot be issued at a discount. Accordingly, when fully paid shares are properly issued for a consideration other than cash, the consideration moving from the company must be at the least equal in value to the par value of the shares and must be based on an honest estimate by the directors of the

C value of the assets acquired.”

In retrospect, and with the benefit of Lord Greene M.R.'s analysis, it can be seen that the argument advanced by the Crown was an absurd one. It amounted to saying that whenever a company acquires property and issues fully paid shares in exchange for it (the relevant “property” being in that case the benefit of the contract with the receiver) then because it pays nothing in

D cash it gives nothing for the property. The same fallacy, in a more subtle form, underlay the argument of the Crown in *Craddock v. Zevo Finance Co. Ltd.*⁽¹⁾. In that case, the respondent company, a finance dealing company, was formed to take over a portfolio of investments belonging to another investment dealing company. The investments in the portfolio were purchased by the respondent company at the prices at which they stood in the books of the vendor company,

E though that was a figure far in excess of the value of the portfolio ascertained in accordance with mid-market prices quoted on the Stock Exchange. Under the agreement for the purchase of the portfolio, the agreed price was satisfied in part by the assumption by the respondent company of certain liabilities of the vendor company, and in part by the allotment of shares of the respondent company which were credited as fully paid. It was argued by the Crown that in

F computing the profits of the respondent company the amount to be debited as the cost of the investments (being stock-in-trade of the respondent company) was their market value and not, as the respondent company contended, the price which the respondent company paid; namely, the aggregate of the liabilities which the respondent company took over and the amount credited as paid up on the shares of the company which were issued at par. That, as Lord

G Greene M.R. pointed out, necessarily led to the conclusion that the shares issued by the respondent company were issued at a discount, and he said, at pages 277-8:

“The fallacy, if I may respectfully so call it, which underlies the argument is to be found in the assertion that where a company issues its own shares as consideration for the acquisition of property, these

H shares are to be treated as money's worth as though they were shares in another company altogether, transferred by way of consideration for the acquisition. This proposition amounts to saying that consideration in the form of fully paid shares allotted by a company must be treated as being of the value of the shares, no more and no less. Such a contention will not bear a moment's examination where the transaction is a straightforward

I one and not a mere device for issuing shares at a discount. In the everyday case of reconstruction, the shares in the new company allotted to the shareholders of the old company as fully paid will often, if not in most cases, fetch substantially less than their nominal value if sold in the

(1) 27 TC 267.

market. But this does not mean that they are to be treated as having been issued at a discount, or that the price paid by the new company for the assets which it acquires from the old company ought to be treated as something less than the nominal value of the fully paid shares. The Crown in this case is in fact attempting to depart from the rule (the correctness of which it itself admits) that the figure at which stock-in-trade is to be brought in is its cost to the trader and substitute the alleged market value of the stock for its cost. Of course, in a case where stock which a company proposes to acquire for shares is deliberately overvalued for the purpose of issuing an inflated amount of share capital, very different considerations apply. But nothing of the kind is present in this case which, as I have already pointed out, is a perfectly proper and normal reconstruction. The propriety of the course adopted is manifest when the uncertainty as to the value of the investments, which is pointed out by the Commissioners, is borne in mind. It is, I think, true as a general proposition that where a company acquires property for fully paid shares of its own, the price paid by the company is, *prima facie*, the nominal value of the shares. It is for those who assert the contrary to establish it, as could be done, for example, in the suggested case of a deliberately inflated valuation. In the present case the Crown has failed to establish the contrary on the facts as found, and there is no justification for the proposition that, on these facts, the Commissioners were bound in law to decide the appeal in favour of the Crown.”

The decision of the Court of Appeal was affirmed in the House of Lords. I do not propose to cite extensively from the speeches there. Lord Simon said, at page 287⁽¹⁾:

“The crucial transaction, albeit in a reconstruction, is a transaction of sale and purchase, and the proper figure to be debited in respect of the purchased investments is the cost thereof to the Respondent. That cost is set out in the agreement between the Zevo Syndicate and its liquidator of the one part and the Respondent of the other part dated 15th June, 1932, and the shares allotted as part of the purchase price are allotted ‘credited as fully paid up’.”

Then, after citing from the judgment of the Master of the Rolls, he continued:

“The contrary proposition amounts to saying that consideration in the form of its fully paid shares allotted by a company must be treated as being the value of the shares, no more and no less. I agree with the Master of the Rolls that such a contention will not bear a moment’s examination when the transaction is a straightforward one and not a mere device for issuing shares at a discount. To put the matter in its simplest form, the profit or loss to a trader in dealing with his stock-in-trade is arrived at for Income Tax purposes by comparing what his stock in fact cost him with what he in fact realised on resale. It is unsound to substitute alleged market values for what it in fact cost him.”

Lord Wright, at page 289, said:

“It is well established that the issue of shares at a discount is illegal. It has also been held that, if the consideration for the issue of shares is a sum of money which is less than the nominal value of the shares, the shares will be treated as issued at a discount. If, on the other hand, the shares are issued for something other than a money consideration, the position

⁽¹⁾ 27 TC 267.

A is different because the Court does not enquire into the adequacy of the consideration so long as the transaction is a genuine and honest agreement deliberately entered into between two persons or companies.”

I have set out the facts in *Steel Barrel*⁽¹⁾ and *Craddock*⁽²⁾, and extracts from the judgments and speeches, at some length because examination of them shows that, far from supporting the proposition for which the taxpayer relies on them, they are in fact inconsistent with it. The cost of the portfolio to Drayton was unquestionably the sum of £3,937,962. It could be nothing else. That was the cost that had to be entered into Drayton's books to balance the sums which were in part applied in paying up shares at par and in part credited to share premium account. If Drayton had been a share dealing company and if the portfolio had been acquired as stock-in-trade, that is the sum that would have been debited against sums realised on subsequent disposals in order to ascertain its trading profit. But in ascertaining the amount of the gain to be computed in accordance with Part III of the Finance Act 1965 the amount to be deducted in respect of the consideration for the acquisition is the amount or value of that consideration. To equate the cost to Drayton of issuing the shares in satisfaction of the agreed price with the “amount or value” of that consideration is in my judgment to repeat the fallacy which Lord Greene M.R. found to underly the argument of the Crown in the *Steel Barrel* and *Zevo Finance Co.* cases. To repeat what Lord Greene M.R. said in the *Zevo Finance Co.* case, at page 278:

E “In the everyday case of reconstruction, the shares in the new company allotted to the shareholders of the old company as fully paid will often, if not in most cases, fetch substantially less than their nominal value if sold in the market.”

Mr. Nolan sought support for his submission in the observations of Lord Wilberforce in *Aberdeen Construction Group Ltd. v. Commissioners of Inland Revenue* [1978] AC 885, where he said, at pages 892–3⁽³⁾:

F “The capital gains tax is of comparatively recent origin. The legislation imposing it, mainly the Finance Act 1965, is necessarily complicated, and the detailed provisions, as they affect this or any other case, must of course be looked at with care. But a guiding principle must underlie any interpretation of the Act, namely, that its purpose is to tax capital gains and to make allowance for capital losses, each of which ought to be arrived at upon normal business principles. No doubt anomalies may occur, but in straightforward situations, such as this, the courts should hesitate before accepting results which are paradoxical and contrary to business sense. To paraphrase a famous cliché, the capital gains tax is a tax upon gains: it is not a tax upon arithmetical differences.”

As the price of £3,937,962 was entered, and admittedly properly entered, into the books of Drayton as the cost of the shares, that figure should, Mr. Nolan said, be taken on proper accounting principles as the base from which the gain to Drayton should be calculated. But in the *Aberdeen Construction Group Ltd.* case the total investment of the appellant company in another company consisted in part of share capital and in part of a loan. It sold the shares at a price in excess of the price it had paid for them (by way of subscription) but on terms that it would “waive the loan”. The aggregate of the price it had paid for the shares and the loan which was to be waived exceeded the cash price at which it sold the shares. In the House of Lords the opinion of

(1) 24 TC 293.

(2) 27 TC 267.

(3) 52 TC 281, at p 296.

the majority of their Lordships who heard the appeal was that the “business reality” was that the appellant company had made a loss on the disposal of its total investment. Here, it seems to me, the “business reality” is that, while the cost entered into the books of Drayton as the price of the acquisition of the portfolio was and could only have been the agreed sum of £3,937,962, the value of the consideration which it gave for the portfolio was the value of the shares which it was entitled and bound to issue in satisfaction of that price. That was the value received by Eagle Star, which would of course go into its books as arising on the disposal of the portfolio. As I see it, for capital gains tax purposes it is the value of the consideration given by Drayton and not the cost of the consideration to Drayton which is deductible under para 4(1)(a). A
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Mr. Nolan submitted in the alternative that the amount or value of the consideration should be determined for commercial as well as for tax purposes at the date of the agreement. For this proposition he relied upon the decision of the House of Lords in *Varty v. British South Africa Co.*⁽¹⁾ 42 TC 406. That, again, was a Schedule D case. The question was whether, when the respondent company, which acquired an option to subscribe for shares of another company, exercised the option, it realised a profit, the profit being the difference between the price at which it was entitled to subscribe for the shares and their market value at the time of the exercise of the option. It paid nothing for the option which was granted as part of a wider transaction. It was held in the House of Lords that it did not. I can see nothing in that decision which in any way supports Mr. Nolan’s submission. Paragraph 10 of Sch 10 to the Finance Act 1971 requires that in the case of a conditional contract the contract is to be treated as coming into existence when it became unconditional. Paragraph 4(1)(a) requires that the amount to be deducted in respect of consideration be limited to the amount or value of the consideration, and that must be the amount or value of the consideration at the date of the contract, that latter date being, in accordance with para 10, the date when it becomes unconditional. C
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In my judgment, therefore, the Crown’s contentions are well-founded. I reach that conclusion simply upon the language of para 4(1)(a) of Sch 6 to the Finance Act 1965 and para 10 of Sch 10 to the Finance Act 1971. But Mr. Gibson, for the Crown, referred me to two cases in the field of stamp duty which lend some support to this conclusion. In *Brooklands Selangor Holdings Ltd. v. Commissioners of Inland Revenue*⁽²⁾ [1970] 1 WLR 429 the question was whether a very elaborate scheme was “a scheme for the reconstruction of any company or companies or the amalgamation of any companies” within s 55 of the Finance Act 1927; and, if so, whether it satisfied the conditions for exemption from stamp duty contained in that section. It was held by the Commissioners that it was not a scheme of reconstruction or amalgamation within s 55, and that decision was upheld by Pennycuik J. The Commissioners also decided in favour of the Crown on another ground; namely, that one of the conditions in s 55 was not satisfied. That condition, so far as material, required that the consideration for the acquisition of not less than 90 per cent. of the share capital of an existing company must consist “as to not less than 90 per cent. thereof . . . in the issue of shares in the transferee company to the holders of shares in the existing company in exchange for the shares held by them in the existing company”. In *Brooklands* the “consideration” that was relevant for the purposes of the condition consisted of 3,003,991 stock units of £1 each plus £115,593 in cash. The Commissioners held that the condition was not satisfied on the ground that the market value of the stock units was F
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⁽¹⁾ [1966] AC 381.

⁽²⁾ L (SD) 56.

A £722,835, so that the cash element was more than 10 per cent. of the aggregate. In his judgment, Pennycuick J. said, at page 447⁽¹⁾:

B “I am wholly unpersuaded that the contention advanced on behalf of the commissioners on this point is well founded. In the first place I am not persuaded that the word ‘consideration’ in paragraph (c) of section 55(1) means anything other than the expressed consideration. I do not find it necessary to equate, and I do not think I would be justified in equating, that word ‘consideration’ there with the expression ‘amount or value of the consideration’ in the charge for transfer duty.”

He referred to the passage in the speech of Lord Greene M.R. in the *Zevo Finance* case⁽²⁾ which I have cited and commented that “that passage goes some way towards meeting the contention of the commissioners in this case”.

C In the case now before me, the Commissioners seem to have taken the view that these observations by Pennycuick J. supported the case advanced by Drayton. But it seems to me that in that passage Pennycuick J. is drawing precisely the distinction between the “consideration” entered into the books of a company which acquires property in exchange for its own shares and the “amount or value” of the shares so given which is fundamental to the Crown’s
D case.

The other case is the decision of Templeman J. in *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue*⁽³⁾ [1974] 1 All ER 811, and of the Court of Appeal affirming his decision at [1975] 1 All ER 429. That was another case which turned on s 55 of the Finance Act 1927. The directors of Crane Fruehauf (which I shall call “Crane”) negotiated the acquisition of the entire
E shareholding of Boden Trailers Ltd. (which I shall call “Boden”), the consideration being the issue of 1,800,000 shares of Crane and £100,000 cash. But one of the shareholders of Crane was a company called Fruehauf International Ltd. (which I shall call “F.I.L.”), which held one-third of the shares of Crane and did not want to see its proportionate shareholding watered down by the issue of shares to the Boden shareholders. That was something it
F was in a position to prevent because it had a shareholding sufficient to stop the necessary increase in the capital of Crane. To satisfy F.I.L., an arrangement was entered into under which the shareholders of Boden agreed to sell their shares to Crane in exchange for the issue of 1,800,000 ordinary shares of £1 each and £100,000 cash, and under which F.I.L. was given an option to acquire
G from each of the Boden shareholders one-third of the newly-issued Crane shares (600,000 in all) at £1 per share. The option was exercised before the shares were issued. The purchase of the Boden shares by Crane and the purchase of one-third of the new Crane shares by F.I.L. were completed on the same day, the new Crane shares being issued to the Boden shareholders, who then executed transfers of 600,000 of them and delivered the transfers and share certificates to F.I.L. The question was whether Crane were entitled to
H relief under s 55 and that question turned on whether it could be said that the consideration for the acquisition of the Boden shares consisted as to not less than 90 per cent. in the issue of shares of Crane. It was held by Templeman J. and by the Court of Appeal that it did not so consist because, in the words of Russell L.J., the consideration was⁽⁴⁾ “1,200,000 shares plus £100,000, plus 600,000 shares subject to an immediate obligation (which the very mechanics of the transaction made inescapable) and right to receive £600,000: and this situation was procured by Crane in the bargain offered by Crane to the Boden shareholders”. But there was a subsidiary question. On the footing that s 55 did
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⁽¹⁾ L(SD) 56, at p 13.

⁽²⁾ 27 TC 267.

⁽³⁾ L(SD) 62.

⁽⁴⁾ *Ibid*, at p 10.

not apply, the transfers of the Boden shares attracted ad valorem stamp duty and under s 55 of the Stamp Act 1891 the value on which ad valorem duty was payable included the value of the 1,800,000 shares of Crane, which were part of the consideration for the Boden shares. It was conceded by the Crown that the 600,000 shares which were subject to F.I.L.'s option fell to be valued at the option price of £600,000. As to the balance of 1,200,000 shares, it was argued that those shares ought to be valued at the price at which they were issued, that being the cost brought into the accounts of Crane. That argument precisely reflects the arguments advanced on behalf of Drayton in the present case. The *Brooklands*⁽¹⁾ and *Zevo Finance Co.*⁽²⁾ cases were cited to Templeman J., although he does not refer to them in his judgment. He rejected the argument upon the ground that Crane's accounts⁽³⁾

"are not decisive of the real value of the Crane shares required to be assessed by s 55 of the Stamp Act 1891. By s. 6 of that Act the value must be assessed as on 'the date of the instrument'. The date of the instrument is either the date when each transfer was signed between 1st and 22nd September, as counsel for Crane contends, or 12th October, when the transfers were delivered to Crane. In my judgment the value is the Stock Exchange value on the correct date, which is 12th October. Before that date each instrument was in escrow, conditional on Crane issuing 1,800,000 Crane shares and paying £100,000. On that date each share could have been sold for the Stock Exchange price."

That decision was affirmed in the Court of Appeal. Russell L.J. said, at page 434⁽⁴⁾:

"On the basis that Crane was not entitled to relief under s 55 of the 1927 Act it was submitted on behalf of Crane, as well in this court as before Templeman J., that the appropriate dates for valuing the 1,200,000 Crane shares, being part of the consideration for the transfer of the Boden shares within s 55 of the 1891 Act, were the respective dates on which the transfers of the Boden shares were signed by the holders. Section 6 of the Stamp Act 1891 provides that where an instrument is chargeable with ad valorem duty in respect of any stock (which includes shares)—'the duty shall be calculated on the value, on the day of the date of the instrument . . . of the stock or security according to the average price thereof.' At the respective dates when the Boden shareholders signed the transfers of their shares the Crane shares had not been issued and accordingly, so the argument ran, s 6 had no application and the value of the Crane shares ought to be taken to be the issue price attributed to those shares in the books of Crane. Templeman J rejected these submissions, taking the view that until the issue of the Crane shares on 12th October 1967 each of the transfers of the Boden shares was in escrow conditional on the issue of the Crane shares. The date of the several transfers was accordingly 12th October 1967, on which date each share could have been sold for the stock exchange price. In my judgment, Templeman J came to a correct conclusion for the reason which he gave. I would, however, add this. Where s 6 of the 1891 Act does not apply, the commissioners must do the best they can and, if it were correct that the transfers were executed prior to the issue of the Crane shares, the market value of the latter at the moment of their issue plus the cash payable to the vendors would in my view be a good indication of the amount or value of the consideration for the transfers."

(1) L (SD) 56.

(2) 27 TC 267.

(3) L (SD) 62, at p 6.

(4) *Ibid*, at pp 11-12.

A The Special Commissioners distinguished *Crane Fruehauf*⁽¹⁾ upon the ground that (and I cite from para 10 of the Case)

B “*Crane Fruehauf* is not, it seems to us, of assistance because that case was concerned with the valuation, for the purpose of ad valorem ‘conveyance or transfer on sale’ stamp duty, of ‘the consideration for the sale’, in other words, the valuation of the consideration received by the vendor (Finance Act 1963, s 55, as amended, and Stamp Act 1891, s 6), whereas in the present case we are concerned with the valuation of the consideration moving from the purchaser.”

C I cannot see that that can be a valid ground of distinction. Under the joint effect of s 55 of the Finance Act 1963 and of s 55(1) of the Stamp Act 1891 the ad valorem duty payable on the transfer of the Boden shares fell to be computed by reference to the value of the Crane shares, and that in turn fell to be ascertained “on the value, on the day of the date of the instrument” of the Crane shares “according to the average price thereof”. The argument before Templeman J. and before the Court of Appeal was that the value of the Crane shares ought to be taken as the issue price brought into its books. It may be that in the Court of Appeal, at least, that argument was put forward, not as a general proposition but as an exception founded on the special circumstance that when the Boden shareholders signed their transfers the Crane shares had not been issued, so that (as I envisage the argument) the issue price was the only available measure of value. But, however the argument was put in the *Crane Fruehauf* case, the decision of Templeman J. and of the Court of Appeal, as I see it, is inconsistent with the general proposition that when shares of a company are issued at par or at a premium in consideration for the acquisition of property, the value of the consideration is the cost to the company of the acquisition of the property; that is, the par value of the issued shares plus any premium.

F Mr. Gibson also relied on the contrast between the provisions of the now defunct short-term capital gains tax, under which the base for ascertaining capital gains was ascertained in accordance with Schedule D principles—that is, the cost to the company—and the very different approach in the 1965 Act. As I have reached the clear conclusion from the language of para 4(1)(a) alone that this appeal succeeds, I do not propose to enter into any comparison of the contrast between these two very different fiscal structures.

G It is common ground that Drayton is entitled to adduce evidence and argument in favour of its contention that the market value of its shares when issued to Eagle Star was in excess of the value arrived at by mere multiplication of Stock Exchange prices. In these circumstances, I propose to refer the assessments back to the Commissioners for the determination of their value; and, unless I hear any argument to the contrary, I shall make the usual order that the Respondent pay the Crown their costs of the appeal.

H *Appeal allowed, with costs. Case remitted for determination of the value of the shares.*

(1) L (SD) 62.

The Company's appeal was heard in the Court of Appeal (Waller, Fox and Oliver L.J.J.) on 20 and 21 May 1981 when judgment was reserved. On 25 June 1981 judgment was given unanimously against the Crown, with costs. A

Michael Nolan Q.C. and *R. Venables* for the Company.

C. H. McCall for the Crown.

The following cases were cited in argument in addition to those referred to in the judgment:—*In re Press Caps Ltd.* [1949] Ch 438; *In re Wragg, Ltd.* [1897] 1 Ch 796; *Stanyforth v. Commissioners of Inland Revenue* [1930] AC 339; *Battle v. Commissioners of Inland Revenue* [1980] STC 86; *Lap Shun Textiles Industrial Co. Ltd. v. Collector of Stamp Revenue* [1976] AC 530; *Wilkins v. Rogerson* 39 TC 344; [1961] Ch 133; *Smirk v. Lyndale Developments Ltd.* [1975] Ch 317; [1975] 1 All ER 690. B

Waller L.J.—I will ask Fox L.J. to deliver the judgment of the Court. C

Fox L.J.—This is an appeal by the taxpayer company (which we will call “Drayton”) from a decision of Vinelott J., concerning, in effect, capital gains tax though the material assessment is to corporation tax. We set out the facts in the numbered paragraphs below:

(1) By an agreement of 21 September 1972 and made between Eagle Star Insurance Co. Ltd., of the one part and Drayton (then called Union Commercial Investment Co. Ltd.) of the other part, Eagle Star agreed to sell and Drayton agreed to purchase a portfolio of investments at the price of £3,937,962 to be satisfied by the allotment by Drayton to Eagle Star of 2,461,226 ordinary shares of 25p. each in Drayton credited as fully paid up, the issue price of each of such shares for the purpose of satisfying the consideration being 160p. The shares (we will call them the new shares) were to rank *pari passu* with the existing ordinary shares of Drayton save in respect of any final dividend for the year ended December 1972, as to which Eagle Star was to be entitled to receive certain payments in lieu. The agreement was expressed to be conditional upon: (i) the shareholders in Drayton passing the resolution necessary to create the new shares; (ii) the Stock Exchange granting permission to deal in and quotation for such shares subject to allotment before 31 October 1972. The agreement was to be completed within 7 days after those conditions were satisfied. D

(2) The price of £3,937,962 (which we will refer to as £3,900,000) was agreed upon by reference to the middle market values of the portfolio of investments on the Stock Exchange on 31 August 1972. E

(3) The resolution of Drayton creating the new shares was passed on 9 October 1972. The Stock Exchange gave permission to deal in and a quotation for the new shares on 11 October 1972. The agreement, therefore, became unconditional on 11 October 1972. The sale was completed on 11 October 1972 when Drayton allotted the new shares to Eagle Star. F

(4) The agreement of 21 September 1972 was an arm's length transaction; the Crown do not suggest that the parties were at any time acting otherwise than in good faith. G

(5) The middle market price of ordinary shares of 25p. in Drayton on the following dates were: (i) 142p. on 31 August 1972; (ii) 134p. on 21 September H

A 1972; (iii) 125p. on 12 October 1972 being the day on which the new shares were first quoted.

(6) At dates after 11 October 1972 Drayton sold certain of the investments comprised in the portfolio.

(7) Drayton was, at the material times, an investment holding company.

B The question on this appeal is the basis of the computation of any capital gain by Drayton upon those disposals. The Revenue made assessments to tax on the footing that, in computing the chargeable gains, the consideration given by Drayton for the acquisition of the portfolio was to be taken as equal to the market value of the new shares ascertained in accordance with Stock Exchange quoted prices on the day on which the shares were first quoted after allotment. Drayton appealed to the Special Commissioners against those assessments on the ground that the consideration was the price at which the new shares were issued i.e. par value, plus the premium entered in Drayton's books—which together amounted to the £3,900,000. That figure is based upon an issue value *per* share of 160p. (the figure agreed between the parties in the agreement of 21 September 1972). The first quoted price of the new shares after allotment, however, was only 125p. *per* share; upon that basis the aggregate value of the consideration was £3,076,532. The difference between the two bases for valuation is, therefore, about £800,000. The Special Commissioners upheld Drayton's contention. The Revenue appealed from the decision of the Special Commissioners. Vinelott J. allowed the appeal and remitted the case to the Commissioners for valuation. His judgment is reported in [1980] 1 WLR 1162⁽¹⁾.

E We come now to the statutory provisions. Corporation tax is chargeable in respect of chargeable gains of companies computable in accordance with the law relating to capital gains tax (see Income and Corporation Taxes Act 1970, ss 238 and 265). One refers, therefore, to the provisions of the Finance Act 1965 dealing with capital gains tax. Paragraph 4(i) of Sch 6 of that Act provides as follows:

F “Subject to the following provisions of this Schedule, the sums allowable as a deduction from the consideration in the computation under this Schedule of the gain accruing to a person on the disposal of an asset shall be restricted to—(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition or, if the asset was not acquired by him, any expenditure wholly and exclusively incurred by him in providing the assets.”

We should also refer to para 10 of Sch 10 to the Finance Act 1971, which is in the following terms:

H “(1) Subject to section 45(5) of the Finance Act 1965 and sub-paragraph (2) below, where an asset is disposed of and acquired under a contract the time at which the disposal and acquisition is made is the time the contract is made (and not, if different, the time at which the asset is conveyed or transferred). (2) If the contract is conditional (and, in particular, if it is conditional on the exercise of an option) the time at which the disposition and acquisition is made is the time when the condition is satisfied.”

(¹) Page 292 *ante*.

Accordingly, in the present case, the disposal and acquisition took place on 11 October 1972. A

It is clear from para 4(1)(a) of Sch 6 to the 1965 Act that the allowable deduction is "the amount or value of the consideration in money or money's worth, given by" Drayton for the acquisition of the portfolio. The crucial matter is the identification of that consideration. The Crown say that it was the new shares. Drayton's contention, in effect, is this: that when a company acquires property in return for an issue of its own shares, the amount or value of the consideration given by the company, where the bona fides of the transaction is not in question, is the amount of credit which is given to the vendor on account of the issue price of the shares. In the present case the issue price was £3,900,000; Eagle Star were given credit for the whole of that amount. It is not in dispute between the parties that Drayton's accounts would properly show that the cost to Drayton of acquiring the portfolio was £3,900,000; and similarly that for the purpose of computing a trading profit under Schedule D, the cost of the acquisition of the portfolio would be £3,900,000. B C

The Crown's contention is that the position in relation to the taxation of capital gains is quite different; cost must not be confused with consideration. That was accepted by Vinelott J. The basis of his judgment is, we think, stated at page 1170 of the report as follows⁽¹⁾: D

"The cost of the portfolio to the taxpayer company was unquestionably the sum of £3,937,962. It could be nothing else. That was the cost that had to be entered into Drayton's books to balance the sums which were in part applied in paying up shares at par and in part credited to share premium account. If Drayton had been a share dealing company and if the portfolio had been acquired as stock-in-trade, that is the sum that would have been debited against sums realised on subsequent disposals in order to ascertain its trading profit. But in ascertaining the amount of the gain to be computed in accordance with Part III of the Finance Act 1965 the amount to be deducted in respect of the consideration for the acquisition is the amount or value of that consideration. To equate the cost to Drayton of issuing the shares in satisfaction of the agreed price with the 'amount or value' of that consideration is in my judgment to repeat the fallacy which Lord Greene M.R. found to underly the argument of the Crown in the *Steel Barrel*⁽²⁾ and *Zevo Finance Co.*⁽³⁾ cases. To repeat what Lord Greene M.R. said in the *Zevo Finance Co.* case at page 278: 'In the everyday case of reconstruction, the shares in the new company allotted to the shareholders in the old company as fully paid will often, if not in most cases, fetch substantially less than their nominal value if sold in the market.' E F G

Vinelott J.'s conclusion was that the Crown's contention was correct and that the consideration given by Drayton for the portfolio was the new shares. H

To test that conclusion it is, we think, necessary to analyse the legal position which arises when a company issues shares credited as fully paid up for a consideration other than cash. The position is stated by Lord Greene M.R. in *Osborne v. Steel Barrel Co., Ltd.* at pages 306-7 (in a passage referred to by Vinelott J.) as follows:

"The primary liability of an allottee of shares is to pay for them in cash; but when shares are allotted credited as fully paid, this primary I

⁽¹⁾ Page 297 *ante*.

⁽²⁾ 24 TC 293.

⁽³⁾ 27 TC 267.

- A liability is satisfied by a consideration other than cash passing from the allottee. A company, therefore, when in pursuance of such a transaction it agrees to credit the shares as fully paid, is giving up what it would otherwise have had, namely, the right to call on the allottee for payment of the par value in cash. A company cannot issue £1,000 nominal worth of shares for stock of the market value of £500, since shares cannot be issued at a discount. Accordingly, when fully paid shares are issued for a consideration other than cash, the consideration moving from the company must be at the least equal in value to the par value of the shares and must be based on an honest estimate by the directors of the value of the assets acquired.”

- C Let us suppose that A. B. Ltd., by a bona fide agreement, contracts to purchase property from X for £100,000 to be satisfied by the issue of 100,000 £1 ordinary shares in A. B. Ltd. credited as fully paid. It seems to us that the value of the consideration given by A. B. Ltd. is £100,000. X has committed himself to accept an allotment of the shares and the company has given up its right to call upon X for payment of the par value of the shares. But on the Crown’s case the consideration is the shares themselves the value of which, D upon issue, may and probably will be considerably less in the market than their par value of £100,000. That would, in our view, be a quite unreal result. It disregards the commercial reality of the consideration moving from the company (i.e. the consideration “given” by the company) which, as explained by Lord Greene M.R., must be at least equal to the par value of the shares. We are therefore, led to doubt whether the shares themselves can in truth be E regarded as constituting the consideration “given” by the company. We do not think that the solution is to be found in the proposition that the £100,000 is merely cost to the issuing company and not the consideration given by the company. It seems to us to be, in the fullest sense, consideration given by the company. It may also be the cost to the company; but it can nevertheless be the consideration.

- F In our judgment the consideration given by the issuing company in such a case is not the shares themselves. And in principle the present is no different. In *Craddock v. Zevo Finance Co., Ltd.* (*supra*)⁽¹⁾ the respondent company purchased a portfolio of investments belonging to another company; both were dealing companies. The investments in the portfolio were purchased by the respondent at the prices at which they stood in the books of the vendor which G was far in excess of their market value on the Stock Exchange. Under the sale agreement the agreed price was to be satisfied in part by the assumption by the respondent company of certain liabilities of the vendor and in part by the allotment of shares in the respondent company credited as fully paid. The Crown claimed that in computing the profits of the respondent company the amount to be debited as the cost of the investments was their market value, H and not as the respondent contended the price paid by the respondent namely the aggregate of the liabilities taken over and the amount credited as paid upon the allotted shares. In rejecting the Crown’s argument, Lord Greene M.R. whose judgment was approved by the House of Lords said at page 277:

- I “The fallacy, if I may respectfully so call it, which underlies the argument is to be found in the assertion that where a company issues its own shares as consideration for the acquisition of property, these shares are to be treated as money’s worth as though they were shares in another company altogether, transferred by way of consideration for the

(1) 27 TC 267.

acquisition. This proposition amounts to saying that consideration in the form of fully paid shares allotted by a company must be treated as being of the value of the shares, no more and no less. Such a contention will not bear a moment's examination where the transaction is a straightforward one and not a mere device for issuing shares at a discount." A

Lord Greene M.R. then went on to make the observation, cited by Vinelott J., in the passage which we have set out, to the effect that fully paid shares, when issued, will often fetch less in the market than their par value. Lord Greene M.R. continued⁽¹⁾: B

"But this does not mean that they are to be treated as issued at a discount, or that the price paid by the new company for the assets which it acquired from the old company ought to be treated as something less than the nominal value of the fully paid shares." C

We cannot read that passage (which is dealing with the fallacy referred to by Vinelott J. at page 1170⁽²⁾) as containing any support for the Crown's contentions; it seems to us to run counter to them. It is, of course, dealing specifically with the argument that the price paid ought to be regarded as something *less* than the nominal value of the shares (an issue that does not arise in the present case) but the principle with which it is concerned is, we think, in point; the principle is that allotted shares cannot be treated as money's worth as if they were shares in another company and valued accordingly. That proposition is not directed simply to the case of a Schedule D trading computation. Lord Greene M.R. is stating it in general terms as a matter of identifying the nature of the consideration given by way of allotment of shares credited as fully paid. The importance of Lord Greene M.R.'s analysis, we think, is that it emphasises the fact that attention must be given to the value of the credit which the allotting company is providing; it is because of the credit that the value of the consideration given by the allotting company may be in excess of the value of the shares themselves. D E

In our view the consideration given by Drayton in the present case was the benefit of an agreement by Drayton (i) to issue and allot the shares, and (ii) to credit them as fully paid. We should mention here that, as we understand it, the new shares did not exist at the time when the agreement became unconditional (and when, therefore, the acquisition took place). They were issued later on the same day. Mr. McCall says that the word "given" is in the past and that therefore there is nothing to value before the issue of the shares. We do not think that is right; the consideration must have existed when the agreement became unconditional. That is consistent with the proposition that the consideration was the benefit of the agreement by Drayton to allot the shares and credit them as fully paid. F G

What then is the value of the consideration? The value cannot be less than the par value of the new shares; *Craddock v. Zevo Finance Co., Ltd.*⁽³⁾ is authority for that. But plainly it can be more since shares can be issued at a premium. The parties, in fact, agreed upon a purchase price in the clearest terms. They agreed that the purchase of the portfolio should be at the price of £3,900,000. That price was to be satisfied by the issue of the new shares of 160p. *per* share credited as fully paid up. The shares, were, therefore, to be issued at a premium of 135p. *per* share. The agreement of 21 September 1972 was an arm's length transaction. No attack was made by the Crown upon its bona fides. No evidence was called before the Commissioners to suggest that H I

⁽¹⁾ 27 TC 267, at p 278.

⁽²⁾ Page 297 *ante*.

⁽³⁾ 27 TC 267.

A the figures in the agreement were in any way unreal or uncommercial. In those circumstances, we can see no reason for putting upon the consideration given by Drayton any value other than that which the parties themselves, a leading insurance company and an investment holding company, honestly chose to put upon it.

B “Then”, says Lord Simonds, in *Craddock v. Zevo Finance Co., Ltd.* at page 295⁽¹⁾, “the agreement goes on to provide for the consideration moving from the new company. I cannot distinguish between consideration and purchase price, and (using again the language of the Master of the Rolls) I find that, acquiring the investments ‘under a bona fide and unchallengeable contract’⁽²⁾, they paid the price which that contract required a price which, whether too high or too low according to the views of third parties, was the price upon which these parties agreed.”

C Paragraph 4(1) of Sch 6 to the Finance Act 1965 refers merely to the “amount or value of the consideration in money or money’s worth”. It seems to us that, on the facts of this case, the best evidence we have of the value of the consideration is the value which the parties themselves, in an arm’s length and bona fide transaction, agreed to put upon it. We see no justification for disturbing that. The result, in our view, is that the value of the consideration given by Drayton for the acquisition of the portfolio was £3,900,000. In business terms we cannot regard that as an unsatisfactory conclusion. Commercial firms agree upon a sale and purchase of assets at a specified price. There is nothing to suggest that it is not a wholly genuine arm’s length transaction upon commercial terms. In these circumstances, it seems to us realistic that the agreed purchase price should be the value of the consideration given by the purchaser and should provide the base value of the assets for capital gains tax purposes when the purchaser subsequently disposes of the asset.

D There are two further matters which we should mention. Reference was made to the stamp duty cases of *Brooklands Selangor Holdings Ltd. v. Commissioners of Inland Revenue*⁽³⁾ [1970] 1 WLR 429 and *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue*⁽⁴⁾ [1975] 1 All ER 429. In the first of these cases Pennycuik J. said that he was unpersuaded that the word “consideration” in s 55(1)(c) of the Finance Act 1927 meant anything other than the expressed consideration. The language of the enactment is different from that with which we are concerned in the present case, and we do not think the judgment helps either party. As regards the *Crane Fruehauf* case the point was taken in that case that the allotted shares had not been issued at the date of the transfer which was the relevant date for valuation. It was held, however, that until the issue of the Crane shares the transfers were escrows. That situation does not arise here where the effect of Sch 10 to the Finance Act 1971 is that the contract became unconditional and the disposals took place before the issue of the new shares. But in any event it was not in dispute that the property which had to be valued was the Crane shares. In the present case the identity of the consideration is directly in issue and we do not think that it was the new shares. Vinelott J. said that *Crane Fruehauf* is inconsistent with the proposition that if shares are issued fully paid as consideration for an acquisition the value of the consideration is the cost to the company. The central problem in the present case is not whether the value of the new shares was necessarily the cost to the company. The problem is to identify the consideration and then to determine what, upon the facts as found, can properly be regarded as the value of that consideration. In the circumstances, we do not think that *Crane Fruehauf* is of assistance.

(1) 27 TC 267.

(2) *Ibid*, at p 280.

(3) L (SD) 56.

(4) L (SD) 62.

Secondly, Mr. McCall drew our attention to the provisions of the Finance Act 1962 relating to the short-term capital gains tax. He points out that by s 13(i) the computation of the gain is by reference to Schedule D. The language of para 4 of Sch 6 to the 1965 Act is different; it contains no reference to Schedule D. The short-term gains tax was, however, an income tax on capital gains. It was, therefore, understandable that the draftsmen should have provided for the computation to be by reference to Schedule D. We do not think that gives us any guidance on the present point. We must construe the 1965 Act on its own language.

Accordingly, we allow the appeal.

Appeal allowed, with costs. Leave to appeal to the House of Lords granted on terms as to costs.

The Crown's appeal was heard in the House of Lords (Lords Fraser of Tullybelton, Russell of Killowen, Keith of Kinkel, Roskill and Brandon of Oakbrook) on 4, 5 and 6 May 1982 when judgment was reserved. On 8 July 1982 judgment was unanimously given against the Crown, with costs.

S. A. Stamler Q.C. and *C. H. McCall* for the appellant. Paragraph 4 of Sch 6 to the Finance Act 1965 provides for sums allowable as deductions from the consideration when computing chargeable gains. Under para 4(1)(a) the deduction consists of (i) the amount of consideration in money, or (ii) the value of consideration in money or money's worth given for the asset. It is the second that is in issue, and three questions arise: (1) how to identify the consideration; (2) the time when the consideration is to be valued; and (3) the value of the consideration at the correct date.

There are three contenders for the answer to the question what the consideration was: (a) the new shares allotted by the respondents ("Drayton") to Eagle Star Insurance Co. Ltd. ("Eagle Star"), those shares being taken as fully paid, as the Crown submit and Vinelott J. held; (b) the benefit of the agreement to issue and allot the shares and credit them as fully paid, as the Court of Appeal held; (c) (slightly different from (b)) not the shares themselves, but the credit of £3,900,000 allowed by Drayton to Eagle Star, as Drayton submit in their case.

The question, as appears to be common ground, should be answered in terms of the commercial reality of the situation. A good test for arriving at the answer is to ask the question which Russell L.J. asked in *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue*⁽¹⁾ [1975] 1 All ER 429, 433, i.e., in the present case, what would Drayton say if they were asked "What did you give for the portfolio?" and what would Eagle Star say if they were asked "What did you get for the portfolio?". The answer as a matter of substance is manifestly the new shares fully paid. Any commercial man would so see it, and that was the way Drayton themselves described the matter, as the evidence shows. The analysis of the Court of Appeal is over-subtle, unrealistic and not justified. The credit allowed by Drayton could only have been used for one purpose, namely the acquisition of the shares. It was merely the machinery for acquiring the shares which, once the contract was executed, was the true consideration. If Eagle Star were minded to assign the benefit of the consideration, its price

⁽¹⁾ L (SD) 62.

A would be assessed not by reference to a credit of £3,900,000, but by reference to what the shares were expected to be worth. It may be that the cost to the one party and the benefit to the other, seen from their respective points of view, are different, but the consideration given by the one and taken by the other must be the same.

B In the courts below Drayton relied strongly on *Osborne v. Steel Barrel Co. Ltd.*⁽¹⁾ [1942] 1 All ER 634 and *Craddock v. Zevo Finance Co. Ltd.*⁽²⁾ [1944] 1 All ER 566. Underlying both those cases is the proposition enunciated in *In re Wragg Ltd.* [1897] 1 Ch 796 that where shares have been issued for a consideration other than cash, it must be assumed that the directors have done their duty and not issued the shares at a discount; unless, therefore, the transaction is impeached for fraud, it is not permissible to inquire into the adequacy of the consideration. *Osborne* establishes that it is nonsense to suggest that when a company issue shares in return for stock, the cost to the company of acquiring the stock is nothing, because the directors would be acting improperly if they allotted the shares at a discount and hence, if impropriety is not alleged, the cost to the company of the stock must be at least equal to the par value of the shares. The case was solely concerned with the cost to the company of acquiring the stock, and not with valuation. When Lord Greene M.R. refers to "consideration" at [1942] 1 All ER 634, 638⁽³⁾, he clearly means "cost", in the context of the case. Walton J.'s explanation of that passage in *Shearer v. Bercaïn Ltd.*⁽⁴⁾ [1980] 3 All ER 295, 306, is adopted. Lord Greene M.R. was not purporting to lay down any general proposition for company law. The Special Commissioners thought that wherever there is a genuine transaction, Lord Greene M.R. is generally applicable, but that is wrong since *Osborne* was not concerned with value.

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In *Craddock v. Zevo Finance Co. Ltd.* [1944] 1 All ER 566, affirmed in the House of Lords 27 TC 267, exactly the same point arose, although the facts were more complicated. Again, the court was only dealing with the question of the cost to the company of acquiring stock-in-trade: see [1944] 1 All ER 566, 569. The transaction was accepted as unimpeachable, and the inference was that the cost must be not less than the nominal value of the shares. Lord Simonds, 27 TC 267, 295, appeared to lay down that "consideration" was the same as "purchase price", and the Court of Appeal in the present case⁽⁵⁾ [1981] 1 WLR 1425, 1433, cited that passage in support of their proposition. But they took the passage out of context. Lord Simonds said, 27 TC 267, 294, that "purchase price" equalled "cost", and all he was doing at page 295 was to say that, on the proper construction of the agreement in that case, consideration equalled purchase price.

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What those two cases show is that (1) directors may not issue shares at a discount; (2) they may not therefore, when issuing them for consideration other than cash, issue shares the par value of which exceeds their own honest valuation of what they are acquiring in return; (3) when considering, in order to ascertain a company's profit, the cost to them of their stock or (which is the same thing) the price they paid for the stock, and where the price they paid was satisfied by the issue of their own shares, the principles above lead to one of two alternatives: either it must be accepted that they discharged their statutory duty, in which case the cost must have been at least the nominal value of the shares issued, or they did not do so and thus committed an offence, and the

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(1) 24 TC 293.

(2) 27 TC 267.

(3) 24 TC 293, at p 307.

(4) 53 TC 698, at p 712.

(5) Page 307 *ante*.

shareholders are liable for further calls; and (4) unless the latter is advanced and established, the former must be assumed to apply. They do not touch the present case. A

It is accepted that when acquiring stock in return for shares, a company may fix the cost to themselves of the shares, with some latitude. But cost to the company is not the same as consideration, and it was not the intention of Parliament to extend that latitude to the area of capital gains tax. Were it otherwise, the term "value in money's worth" would not have been used. Paragraph 4 of Sch 6 suggests that a distinction should be made between "value" and "cost", since it isolates four separate concepts: (1) the amount of consideration in money; (2) the value of consideration in money's worth; (3) the costs of acquisition ("incidental costs" are defined in sub-para (2)); and (4) expenditure incurred on the asset. The Finance Act 1962, providing for short-term capital gains tax in ss 10 to 16, used an entirely different formulation; there, cost to the company was relevant. The difference in the Act of 1965 is significant. B C

The Commissioners were only asked for a decision in principle. They held that the value of the consideration was the price agreed between the parties, and therefore did not address themselves to questions (2) and (3), and heard no evidence of valuation. The time for valuing the consideration is the date when the conditions to which the contract were subject were fulfilled, namely 11 October 1972; it is not the date of the contract. The time to value "consideration given" is when it is given. Consideration is "given" when it is exchanged for the asset acquired. The asset is acquired, in the case of a conditional contract, when the condition is satisfied: para 10 of Sch 10 to the Finance Act 1971. To say that valuation must be at the date of the contract is to ignore para 10. Moreover one would be valuing not the consideration itself, but a chose in action subject to conditions, which might have a different value from when the conditions are satisfied. It would be anomalous in the event of a long gap between contract and acquisition pursuant to para 10, since the values of the shares might have varied enormously by the time of acquisition. No unfairness to the taxpayer follows from the Crown's submission, in the round and on the swings and roundabouts principle, since if the shares go up before acquisition, the taxpayer pays less. D E F

On the third question, the Court of Appeal found it possible to assert simultaneously that the consideration was the benefit of the agreement to give £3,900,000 and that there could be an independent valuation: see [1981] 1 WLR 1425, 1432H-1433B⁽¹⁾. It is necessary to keep an eye on what is being valued. The Court of Appeal did not anywhere define "value". By their passage at page 1433c⁽²⁾, "In those circumstances, we can see no reason for putting on the consideration given by [Drayton] any value other than that which the parties themselves . . . honestly chose to put on it", they were either stating that they were driven to that conclusion as a matter of law (as a result of what Lord Simonds said in the *Craddock* case⁽³⁾), in which case they were wrong, or they were purporting to say something about the evidence, in which case they were ruling on a matter not raised below. The correct criterion for valuation is the market value of the consideration ascertained by the best evidence available. In the present case it was the Stock Exchange dealing price on the day after the exchange of shares took place. G H I

⁽¹⁾ Page 306 *ante*.

⁽²⁾ Page 307 *ante*.

⁽³⁾ 27 TC 267.

A [Lord Russell: Is not the best evidence the valuation which the parties themselves put on the shares?]

It is only one factor. If the Crown are right on the question of the consideration, they are content that the matter should be remitted to the Commissioners for a valuation exercise to take place. General guidelines would be welcomed. While the valuation honestly put on the shares by the parties is relevant and admissible evidence, it is not conclusive. The cost to one party and advantage to the other may assist, but it is not a good guide in principle, since there will be problems where for example a party holding 52 per cent. of shares in a company sells 5 per cent. and loses control—the cost to the seller will be much greater than the benefit to the buyer, or where a large parcel of shares is sold *en bloc*, so depressing the price compared to the sale of a small parcel. The concept of value involves measurement against an objective standard, without taking account of the particular circumstances of a party. The second meaning assigned to “value” in the Oxford English Dictionary is “the material or monetary worth of a thing; the amount at which it may be estimated in terms of some medium of exchange or other standard of a similar nature”. It would have been easy for the statute to say “the value to X” if that had been intended. What was intended was a direction to ascertain from all the circumstances what is the monetary worth not to a particular person, but in general, taking the total effect of all the market forces. The figure set by the parties was stated on 29 September 1972. If 11 October is the correct date for valuation, the only evidence available is the Stock Exchange market price on that date.

E *Michael Nolan Q.C.* and *Robert Venables* for the respondents. The question what was “the amount or value of the consideration” is one for lawyers and not for businessmen, though they would not necessarily differ on the answer. The consideration was the price payable by Drayton for the portfolio, namely the credit of £3,900,000 given to Eagle Star and used by Eagle Star to subscribe for the shares. It is common ground that that was the cost to Drayton. F It is artificial to draw a distinction between the price a person pays for an article and the consideration he gives for it. In any event, the consideration given by Drayton could not be the shares themselves, because Drayton never owned them: *non dat quod non habet*. Paragraph 4(1)(a) of Sch 6 to the Act of 1965 by its language is solely concerned with what the purchaser is paying, and not with what the vendor is receiving. What Eagle Star got was in any event what G Drayton gave, but there is no reference in the paragraph to consideration “received”. It is therefore wholly directed to the cost to the purchaser. That is supported by the reference to “expenditure incurred”. This construction would produce a sensible consistency with income tax law and reflect the natural commercial measurement of Drayton’s gain or loss on the portfolio.

H By their agreement, the parties bound themselves (subject to the conditions) to an irrevocable commitment, and the terms were fixed once and for all. They must both have known that prices quoted on the Stock Exchange vary from hour to hour, but the price as between them was fixed once and for all by the contract. Neither party contemplated any other figure than 160p. per share. It was essential for the Drayton directors to arrive at an exact price which they could justify to their shareholders and creditors, and which could be put in the books as the cost to them. That gives a guide to what was the consideration. I Drayton gave Eagle Star a credit of 160p. per share, and took the portfolio rather than calling in 160p. per share.

Osborne v. Steel Barrel Co. Ltd.⁽¹⁾ [1942] 1 All ER 634 and *Craddock v. Zevo Finance Co. Ltd.*⁽²⁾ [1944] 1 All ER 566 are illustrations of consideration moving from the purchaser, and they must be applicable in the present case unless the language of para 4(1)(a) rules that out, which it does not. The statutory provision, the subject of the above cases, was what is now s 130 of the Income and Corporation Taxes Act 1970, which closely resembles para 4. In *Osborne* at page 638A⁽³⁾ Lord Greene M.R. in fact uses the phrase "value in money's worth" specifically to describe the present situation, and he identifies the consideration moving from Steel Barrel Co. Ltd. as the credit given for the shares, and not the shares themselves. The contract in *Craddock* was on all fours with the present, and there again, at [1944] 1 All ER 566, 571H, Lord Greene M.R. used the language of para 4, perfectly appropriately, and the consideration moving from the acquiring company was held to be the credit and not the shares: see *per* Viscount Simon, 27 TC 267, 287. Lord Simonds said in terms at page 295 that consideration was the purchase price, and that the agreed price was conclusive. The draftsman must have had these precepts in mind when drafting para 4(1)(a). The subject-matter of those cases was the computation of trading profits for income tax purposes, but there is no relevant difference between income tax and capital gains tax. The principles involved were generally applicable principles of company law.

The approach of the Special Commissioners to *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue*⁽⁴⁾ [1975] 1 All ER 429, quoted by Vinelott J. [1980] 1 WLR 1162, 1174⁽⁵⁾, is adopted. The short-term capital gains tax was a very different sort of tax, and throws no light on the present case.

If the above submission is wrong and the consideration was the shares, they should be valued as at the date of the making of the contract: see *Varty v. British South Africa Co.*⁽⁶⁾ [1966] AC 381, 403–404, *per* Lord Donovan. That is when the consideration is fixed. Where it is a conditional contract, it is irrelevant that the value may have changed by the time the contract becomes unconditional. The purpose of para 10 of Sch 10 to the Finance Act 1971 is merely to state when the disposal and acquisition of an asset are deemed to be made for the purpose of the payment of the tax. Without that provision, a taxpayer might suffer hardship, in the case of a long interval between the making of a conditional contract and the satisfaction of the condition, or the condition never being satisfied, by having to pay tax on the making of the contract.

If the Crown's submission on the date of valuation is right, it is agreed that the matter must go back to the Commissioners.

Stamler Q.C. in reply. Section 130 of the Income and Corporation Taxes Act 1970, so far as material, resembles sub-para (2) of para 4 of Sch 6 to the Finance Act 1965, but not sub-para (1)(a). *Osborne v. Steel Barrel Co. Ltd.* [1942] 1 All ER 634 and *Craddock v. Zevo Finance Co. Ltd.* [1944] 1 All ER 566 are therefore not *in pari materia*.

(1) 24 TC 293.

(2) 27 TC 267.

(3) 24 TC 293, at p 307.

(4) L (SD) 62.

(5) Page 301 *ante*.

(6) 42 TC 406, at p 431.

- A *Michael Nolan Q.C.* and *R. Venables* for the Company.
S. A. Stamler Q.C. and *C. H. McCall* for the Crown.

The following cases were cited in argument in addition to those referred to in the judgment:—*Shearer v. Bercaïn Ltd.* 53 TC 698; [1980] STC 359; *Crane Fruehauf Ltd. v. Commissioners of Inland Revenue* L(SD) 62; [1974] 1 All ER 811; *Varty v. British South Africa Co.* 42 TC 406; [1966] AC 381.

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Lord Fraser of Tullybelton—My Lords, this appeal concerns the computation of chargeable gains for the purpose of corporation tax. They have to be computed in accordance with the rules for capital gains tax, although they are actually assessed to corporation tax, because the taxpayer is a company—see *Income and Corporation Taxes Act 1970*, ss 238 and 265.

- C The Respondent is Drayton Commercial Investment Co. Ltd. (“Drayton”). In 1972 Drayton (then called Union Commercial Investment Co. Ltd.) acquired from the Eagle Star Insurance Co. Ltd. (“Eagle Star”) a portfolio of investments at the price of £3,937,962 (which I shall refer to as £3,900,000). The price was satisfied, in accordance with the agreement between the companies, by the allotment by Drayton to Eagle Star of 2,461,226
- D ordinary shares of 25p each in Drayton, the issue price of each share being 160p. I shall refer to the number of shares allotted as 2,400,000. Drayton subsequently disposed of some of the investments, so that it became material, in order to ascertain the amount of its capital gains, to determine the amount or value of the consideration which it had given for the investments. Drayton contends that the value of the consideration was the issue price of the shares
- E allotted to Eagle Star (160p) multiplied by the number of shares allotted (2,400,000). The Appellant, on behalf of the Inland Revenue, originally contended that the consideration was the market price of the Drayton shares allotted on the day when they were first quoted, which was the day after their allotment, multiplied by 2,400,000. That price was 125p. During the hearing in your Lordships’ House the Appellant departed from that contention to some
- F extent and submitted that the value of the consideration fell to be ascertained by the best evidence, and that, although the market value on the day the shares were first quoted would be some evidence, it was not conclusive. The market value was probably the price paid for comparatively small parcels of shares, and evidence might well show that the price that could have been obtained for 2,400,000 shares, if they had all been offered for sale on the day they were first
- G quoted, would have been substantially lower. It was common ground between Counsel that the only question for decision at this stage was whether Drayton’s contention was sound in principle, and that, if not, (i.e. if the appeal succeeds on the question of principle) the matter must be remitted to the Special Commissioners to ascertain the true value of the consideration and to make any necessary amendment in the assessment consequent thereupon.
- H The Special Commissioners upheld Drayton’s contention. Vinelott J. reversed their decision and remitted the case to them to value the consideration. The Court of Appeal (Waller, Oliver, and Fox L.JJ.) allowed the appeal and restored the decision of the Special Commissioners.

The agreement under which the portfolio was acquired by Drayton was dated 21 September 1972. By clause 1 it provided, *inter alia*, as follows: A

“1. The vendor [Eagle Star] will sell and the purchaser [Drayton] will purchase all the securities in the said portfolio at the price of £3,937,962 to be satisfied by the allotment by [Drayton] to [Eagle Star] of 2,461,226 ordinary shares of 25p each in [Drayton] the issue price of each such share for the purpose of satisfying the consideration being 160p. The said ordinary shares in [Drayton] when issued will be credited as fully paid up . . .” B

The agreement was subject to two conditions set out in clause 2 which provides as follows:

“This agreement is conditional upon: (i) The members of [Drayton] passing the necessary resolution of the company in general meeting creating the new shares in [Drayton] required to satisfy the consideration above mentioned (ii) the Stock Exchange London granting permission to deal in and quotation for such new shares (subject to allotment) before the 31st October 1972.” C

The necessary resolution was passed at a general meeting of Drayton's shareholders on 9 October 1972, and Stock Exchange permission was granted on 11 October. The new shares were allotted on 11 October, and were first quoted on the Stock Exchange on 12 October 1972. I should mention that the portfolio had been valued at middle market quotation on 31 August 1972, and that is stated in clause 4 of the agreement. D

The statutory provision which is directly applicable is the Finance Act 1965, Sch 6, para 4(1)(a) which provides as follows: E

“4(1) Subject to the following provisions of this Schedule, the sums allowable as a deduction from the consideration in the computation under this Schedule of the gain accruing to a person on the disposal of an asset shall be restricted to—(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition . . .” F

The Appellant also relied on the Finance Act 1971, Sch 10, para 10, on the question of the date on which the consideration should be valued. I shall refer to that matter separately later.

In my opinion, para 4(1)(a) means that the allowable deduction is to be restricted to “the amount of the consideration, if it is in money, or the value in money's worth if it is not in money”. In the present case the consideration was in money's worth and it is therefore necessary to ascertain its value. The first stage is to ascertain exactly what was the consideration given by Drayton. This has been the subject of acute controversy at all stages of the appeal. Vinelott J. held that the consideration was the shares in Drayton allotted to Eagle Star. The Court of Appeal held that it was not the shares but “the benefit of an agreement by Drayton (i) to issue and allot the shares and (ii) to credit them as fully paid”. They added “We should mention here that, as we understand it, the new shares did not exist at the time when the agreement became unconditional (and when, therefore, the acquisition took place). They were issued later on the same day”. When the appeal reached this House Counsel for Drayton, while still vigorously rejecting the view that the consideration was the Drayton shares, did not fully accept the Court of Appeal's view but submitted that the G
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A consideration was “the credit of £3,937,962 allowed to Eagle Star by [Drayton], which was offset against and extinguished Eagle Star’s liability to pay [Drayton] £3,937,962 in consideration of the issue of the new shares in [Drayton] at 160p each”.

In my opinion, the consideration was the Drayton shares. That is, I think, how any businessman would have seen the transaction, and it is the commercial reality. Counsel for Drayton argued that the correct legal analysis was not for businessmen, but for lawyers and I agree, subject to this, that the lawyer must have regard to the businessman’s view. From the lawyer’s point of view, it seems plain beyond argument that what Eagle Star received as consideration for its portfolio was the Drayton shares. It may be possible for Drayton to have given something different from that which Eagle Star received although that seems *prima facie* unlikely. I would only accept such a comparatively complicated analysis if it was the only satisfactory way of explaining what had occurred. But in this case I do not think it is. It is stated in the agreement that the price of £3,900,000 will be satisfied by the allotment of 2,400,000 shares and that seems entirely consistent with the view that the shares were the consideration. The view contended for by Drayton, and substantially accepted by the Court of Appeal, was based mainly on two decisions on questions of company law, namely *Osborne v. Steel Barrel Co., Ltd.*⁽¹⁾ [1942] 1 All ER 634 and *Craddock v. Zevo Finance Co., Ltd.*⁽²⁾ 27 TC 267. Neither of these cases was concerned with the question which arises here.

In *Osborne* a new company had acquired stock-in-trade for a consideration consisting partly of cash and partly of shares which it issued as fully paid. The Crown’s contention was that the shares had cost the company nothing and that the stock should be entered in its books simply at the amount of cash paid for it. It is perhaps not surprising that that contention failed. In the Court of Appeal Lord Greene M.R. said at page 638 G that “on the facts of [that] case” the issue of the fully paid shares represented a payment in cash equal to the par value of the shares, mainly because the only alternative would have been that the shares had been issued at a discount which would have been illegal, and no illegality was alleged. In the present appeal no question of issuing shares at discount arises and neither party contends that Drayton’s shares should be valued at par. The only part of Lord Greene’s opinion which seems to bear upon the present appeal is at page 638 A where he said this⁽³⁾:

“A company cannot issue £1,000 nominal worth of shares for stock of the market value of £500, since shares cannot be issued at a discount. Accordingly, when fully-paid shares are properly issued for a consideration other than cash, the consideration moving from the company must be at the least equal in value to the par value of the shares and must be based on an honest estimate by the directors of the value of the assets acquired.” (Emphasis added.)

As regards the nature of the consideration moving from the company, the decision was that the price paid for the stock was cash plus shares and it is thus entirely consistent with the contention of the Crown in the present case that the consideration moving from (which is the same as given by) Drayton was the shares themselves. But on the question of value, it supports the contention of Drayton that the value must be based on an honest estimate by the directors of the value of the assets acquired, which in this case was £3,900,000, and not upon the market value of the shares allotted.

(1) 24 TC 293.

(2) [1944] 1 All ER 566.

(3) 24 TC 293, at p 307.

The other case, much canvassed in argument, was *Craddock*⁽¹⁾ where there had been a reconstruction of a family company which dealt in investments. A new company had been formed to take over and hold some of the investments of the former company, and the question was as to the basis on which these investments should be valued for income tax purposes in the books of the new company. The decision of the Court of Appeal, which was upheld by this House, was that the value of the investments was their purchase price, which was the price that the new company had agreed to pay, and that the amount paid in shares of the new company should be taken to be the par value of the shares. The following passage in the judgment of Lord Greene M.R. at page 277 was relied on by Counsel for Drayton:

“The fallacy, if I may respectfully so call it, which underlies the argument [for the Crown in that case] is to be found in the assertion that where a company issues its own shares as consideration for the acquisition of property, these shares are to be treated as money’s worth as though they were shares in another company altogether, transferred by way of consideration for the acquisition. This proposition amounts to saying that consideration in the form of fully paid shares allotted by a company must be treated as being of the value of the shares, no more and no less. Such a contention will not bear a moment’s examination where the transaction is a straightforward one and not a mere device for issuing shares at a discount.”

In this House Lord Simonds said this (27 TC 267, at page 295):

“I cannot distinguish between consideration and purchase price, and . . . I find that, acquiring the investments ‘under a bona fide and unchallengeable contract’, they paid the price which that contract required, a price which, whether too high or low according to the views of third parties, was the price upon which these parties agreed.”

From these judgments I extract the following propositions relevant to the present appeal. 1. A company can issue its own shares “as consideration for the acquisition of property”—as Lord Greene said. 2. The value of consideration given in the form of fully paid shares allotted by a company is not the value of the shares allotted but, in the case of an honest and straightforward transaction, is the price upon which the parties agreed—as Lord Simonds said. The latter point was expressed even more forcibly in the House of Lords by Lord Wright at page 290 where he said: “No authority was cited for the claim of the Revenue in a case like this to go behind the *agreed consideration* and substitute a different figure” (emphasis added).

The Court of Appeal in the passage I have quoted from their decision seems to have thought that the fact that the new shares issued by Drayton were not in existence at the time when the agreement with Eagle Star became unconditional was a further reason why they were not the consideration given by Drayton. I confess that I do not follow their reasoning on this point. At the time when the agreement became unconditional Drayton came under an unconditional obligation to hand over the consideration (whatever it might be) to Eagle Star and they did so later the same day. The fact that the consideration in the form of shares did not come into existence until some hours after the obligation had become unconditional seems to me irrelevant. Indeed, if the view of the Court of Appeal is right it might lead to the consequence that the “benefit” or the “credit” given by Drayton must either have been transmuted

(1) 27 TC 267.

A into the new shares before it was received by Eagle Star, or must have been received by Eagle Star and subsequently disposed of by Eagle Star in exchange for the new shares. Such a double disposal seems quite unrealistic and I see no reason for importing it.

Accordingly, I am of opinion that the consideration given by Drayton was the same as that received by Eagle Star and was the new shares. The next step is to ascertain the value of that consideration. The argument for the Crown, which was accepted by Vinelott J., was that "value" in para 4(1)(a) of Sch 6 to the Finance Act 1965 meant "market value" and might be different from the price agreed between the parties. It was said that the value of consideration was something to be determined by reference to an objective standard, and not by reference to the cost to a particular party. I was at first attracted by this argument. But further reflection has convinced me that it is erroneous for two reasons. First, as a pure matter of construction of para 4(1)(a), I see no indication that value is used as meaning market value. The paragraph is part of the general provisions for computing the amount of gain accruing on the disposal of an asset in the ordinary case—see s 22(9) of the Act. It is to be contrasted with s 22(4) of the Act which makes provision for some special cases, including the case where a person acquires an asset "otherwise than by way of a bargain made at arm's length and in particular where he acquires it by way of gift". Section 22(4) shall be deemed to be for a consideration equal to the "market value" of the asset, and the obvious reason is that no agreed value, arrived at by an arm's length transaction, is available. But in the ordinary case under para 4(1)(a) such a value is available—namely the price agreed between the parties. Consequently there is no need to look to the market value, and no need to read in the word "market" before value where Parliament has not seen fit to use it. Further, the deduction permitted by para 4(1)(a) includes "the incidental costs to him [the taxpayer] of the acquisition" (emphasis added). The words that I have emphasised show that, at least so far as the costs of acquisition are concerned, it is the costs to the particular taxpayer that are relevant and they are some indication that the value of the consideration given by him is to be calculated on the same basis.

Secondly, the cases of *Osborne*⁽¹⁾ and *Craddock*⁽²⁾ *supra* are ample authority for saying, in the words of Lord Wright in the latter case, that the Crown is not entitled to go behind the agreed consideration in a case where, as in the present case, the transaction is not alleged to be dishonest or otherwise not straightforward.

If I am right in thinking that the agreed value of the newly allotted shares, in a bargain at arm's length, is conclusive, no question arises about the date at which the value of the shares should be ascertained. It is therefore unnecessary to refer to the contentions of the parties on that matter, or to the provisions of the Finance Act 1971, Sch 10, para 10, which was relied on by the Crown.

One consequence of taking the agreed value of the shares as conclusive is that cases may occur in which that value may seem surprising, because the market value of the newly allotted shares on the day when they are first quoted proves to be much higher or much lower than their value agreed between the parties. That might happen, for example, because of some unexpected political event occurring between the date of the agreement and the date of the first quotation. But, provided the agreed value has been honestly reached by a bargain at arm's length, it must, in my opinion, be final and it is not open to

(1) 24 TC 293.

(2) 27 TC 267.

attack by the Inland Revenue. Not only is that right in principle, but it is very much in accordance with practical convenience. Once it is accepted, as it was (rightly in my opinion) by Counsel appearing for the Crown, that market value could not necessarily be ascertained almost instantly by reference to the Stock Exchange price list, but might have to be proved by the evidence of accountants and other financial experts, the practical inconvenience of leaving agreements liable to be reopened to such enquiry becomes clear. I do not believe that Parliament can have intended to permit that inconvenience in cases where bargains have been made at arm's length. A B

For these reasons, which are somewhat different from those of the Court of Appeal, I would dismiss this appeal.

Lord Russell of Killowen—My Lords, I have had the advantage of reading in draft the speeches prepared by my noble and learned friends, Lord Fraser of Tullybelton and Lord Roskill. I concur with their opinions that this appeal be dismissed. C

Lord Keith of Kinkel—My Lords, I have had the benefit of reading in draft the speech prepared by my noble and learned friend, Lord Fraser of Tullybelton. I agree with it, and for the reasons which he gives, I, too, would dismiss the appeal. D

Lord Roskill—My Lords, this appeal from a decision of the Court of Appeal (Waller, Oliver and Fox L.JJ.) dated 25 June 1981, raises a short but to my mind difficult question under para 4(1) of Sch 6 to the Finance Act 1971. The essential facts are simple and have been fully set out in the judgments in the Courts below. I need only restate them in outline. On 21 September 1972 the Respondents—I shall call them “Drayton” though they bore a different name at that date—concluded a conditional agreement with Eagle Star Insurance Co. Ltd.—“Eagle Star”—for the purchase by the Respondents of a large portfolio of securities belonging to Eagle Star. The price was £3,937,962. That price was to be satisfied by the allotment by Drayton to Eagle Star of 2,461,226 ordinary shares of 25p each. Those shares were to be issued by Drayton and credited as fully paid, the issue price of each share being 160p. The agreement was subject to two conditions, first, the passing of the necessary resolution by Drayton creating those shares, and second, the grant by the Stock Exchange of permission to deal in them and of a quotation for them before 31 October 1972. The necessary resolution was passed by Drayton on 9 October 1972. The requisite Stock Exchange permissions were granted on 11 October 1972. On that date the agreement became unconditional. It was common ground that the agreement was an arm's length transaction. Later, Drayton sold some of the securities so purchased, and became liable to corporation tax on the resultant gains. That corporation tax is chargeable in accordance with the law relating to capital gains tax by virtue of ss 236 and 265 of the Income and Corporation Taxes Act 1970. The question which arises is how those capital gains are to be calculated. E F G H

My Lords, the Revenue made an assessment to tax on Drayton on the basis that the value of the consideration given by Drayton was to be taken as a sum equal to the market value of the new shares, determined by reference to Stock Exchange quoted prices on the day after those shares were first quoted after their allotment. Drayton appealed to the Special Commissioners, contending that the relevant figure was the price at which those shares were issued, namely their par value plus the premium, amounting in all to £3,937,962. Since that I

A figure was based on the issue price of 160p per share, and the first quoted price was said to be only 125p per share, the difference was considerable, and was stated in the Courts below to involve some £800,000.

My Lords, the Special Commissioners upheld Drayton's contentions. Before them it was argued, on Drayton's behalf, that as a matter of law they must hold that the value of the consideration given by Drayton was 160p per share, and the Special Commissioners were invited, first, to determine whether or not that contention was correct, it apparently being agreed that if it were held thereafter to be incorrect, the matter should be remitted to the Special Commissioners for determination of the value of the consideration in accordance with whatever might be held to be the correct principles.

My Lords, the Special Commissioners stated a Case at the request of the Revenue. Vinelott J. reversed their decision. His judgment is reported at [1980] 1 WLR 1162⁽¹⁾. Drayton appealed to the Court of Appeal who restored the decision of the Special Commissioners. Their decision is reported at [1981] STC 525⁽²⁾. The Court of Appeal gave leave to appeal to your Lordships' House on condition that the Revenue did not seek to disturb the order as to costs which that Court had made.

D My Lords, the relevant statutory provision is to be found in para 4(1) of Sch 6 to the Finance Act 1965. It reads, so far as relevant, as follows:

"Subject to the following provisions of this Schedule, the sums allowable as a deduction from the consideration in the computation under this Schedule of the gain accruing to a person on the disposal of an asset shall be restricted to—(a) the amount or value of the consideration, in money or money's worth, given by him or on his behalf wholly and exclusively for the acquisition of the asset, together with the incidental costs to him of the acquisition . . .".

"Incidental costs" are defined in sub-para (b) which it is not necessary to quote. My Lords, I think the opening words of sub-para (a) must be read as meaning "the amount in money or the value in money's worth of the consideration". On this view the question is what is "the value in money's worth of the consideration given" by Drayton for the acquisition of the new shares issued to Eagle Star and credited as fully paid.

The Crown strenuously contended that the price specified in the agreement was not the value in money's worth of the consideration but was the cost. Value, it was said, was different from cost and was to be determined—at one time it was faintly suggested to be determined objectively—but at any rate not exclusively by reference to the cost, even though the transaction was an arm's length transaction.

My Lords, the argument for Drayton which found favour both with the Special Commissioners and the Court of Appeal for, as I read their respective reasoning, substantially the same reasons, was that the consideration which was given by Drayton was not the new shares themselves, but Drayton's agreement to issue and allot them and, most important, to credit them as fully paid. Drayton, it was said, had the right to require payment of the price of 160p per share but forewent that right, giving credit for that amount instead. It was the value of that credit which Drayton so provided to Eagle Star which was the consideration, and the value of that credit was 160p per share. The Crown were not entitled to go behind that figure in the case of an arm's length transaction unless they "impeached" the agreement of 21 September 1972, which the Crown accepted they could not do in the instant case.

(¹) Page 292 *ante*.

(²) Page 302 *ante*.

My Lords, the submission was that it was the value of the credit given by Drayton which was in truth the consideration the value of which had to be determined, and was founded upon authority. In his speech in your Lordships' House in *Ooregum Gold Mining Co. of India, Ltd. v. Roper* [1892] AC 125 at page 136, Lord Watson in a well-known passage said:

"A company is free to contract with an applicant for its shares; and when he pays in cash the nominal amount of the shares allotted to him, the company may at once return the money in satisfaction of its legal indebtedness for goods supplied or services rendered by him. That circuitous process is not essential. It has been decided that under the Act of 1862, shares may be lawfully issued as fully paid up, for considerations which the company has agreed to accept as representing in money's worth the nominal value of the shares. I do not think any other decision could have been given in the case of a genuine transaction of that nature where the consideration was the substantial equivalent of full payment of the shares in cash. The possible objection to such an arrangement is that the company may over-estimate the value of the consideration, and, therefore, receive less than nominal value for its shares. The Court would doubtless refuse effect to a colourable transaction, entered into for the purpose or with the obvious result of enabling the company to issue its shares at a discount; but it has been ruled that, so long as the company honestly regards the consideration given as fairly representing the nominal value of the shares in cash, its estimate ought not to be critically examined."

This statement of the law was subsequently applied both by Vaughan Williams J. and the Court of Appeal in *In re Wragg Ltd.* [1897] 1 Ch 796 at pages 813-4, and 831 and 835 respectively. Those decisions are also clear authority for the proposition that unless the agreement in furtherance of which the shares were issued for a consideration other than cash can be successfully impeached as, for example, colourable, the courts will not go behind it and consider whether or not it was commercially prudent, or whether a more advantageous bargain might have been made, since to do so would be to question the honest commercial judgment of the directors of the company concerned in the ordinary management of that company's business.

My Lords, a similar question arose in two later cases in the Court of Appeal, *Osborne v. Steel Barrel Co. Ltd.* (1) [1942] 1 All ER 634, and *Craddock v. Zevo Finance Co. Ltd.* [1944] 1 All ER 566, the latter decision having been affirmed by your Lordships' House at 27 TC 267 at page 284. Both those cases involved the determination of the cost to the taxpayer of "stock"—in the second case the "stock" was a number of investments—for the purpose of calculating the taxpayer's trading profit in connection with his liability to income tax. In both cases the "stock" had been acquired in whole or in part in return for the allotment of shares credited as fully paid, the shares being issued for a consideration other than cash. In both cases the taxpayer contended that the cost was what the taxpayer had paid. In both cases the Crown sought to go behind the agreement pursuant to which those shares were so issued, and to contend that the issue of the shares credited as fully paid had cost the taxpayer either nothing, or at any rate, less than the price for which the taxpayer contended. In both cases the Crown failed. They failed for substantially the same reason, namely, that their contention ignored the true nature of the issue

(1) 24 TC 293.

A of shares credited as fully paid for a consideration other than cash. In the former case Lord Greene M.R. at pages 637–8, said⁽¹⁾:

B “The argument really rests on a misconception as to what happens when a company issues shares credited as fully paid for a consideration other than cash. The primary liability of an allottee of shares is to pay for them in cash; but, when shares are allotted credited as fully paid, this primary liability is satisfied by a consideration other than cash passing from the allottee. A company, therefore, when, in pursuance of such a transaction, it agrees to credit the shares as fully paid, is giving up what it would otherwise have had—namely, the right to call on the allottee for payment of the par value in cash. A company cannot issue £1,000 nominal worth of shares for stock of the market value of £500, since shares cannot be issued at a discount. Accordingly, when fully paid shares are properly issued for a consideration other than cash, the consideration moving from the company must be at the least equal in value to the par value of the shares and must be based on an honest estimate by the directors of the value of the assets acquired.”

D In the latter case, Lord Greene M.R. at pages 569–70 said of the Crown’s argument⁽²⁾:

E “This proposition amounts to saying that consideration in the form of fully paid shares allotted by a company must be treated as being of the value of the shares, no more and no less. Such a contention will not bear a moment’s examination where the transaction is a straightforward one and not a mere device for issuing shares at a discount. In the everyday case of reconstruction, the shares in the new company allotted to the shareholders of the old company as fully paid will often, if not in most cases, fetch substantially less than their nominal value if sold in the market. But this does not mean that they are to be treated as having been issued at a discount; or that the price paid by the new company for the assets which it acquires from the old company ought to be treated as something less than the nominal value of the fully paid shares. The Crown in this case is in fact attempting to depart from the rule (the correctness of which it itself admits) that the figure at which stock-in-trade is to be brought in is its cost to the trader and to substitute the alleged market value of the stock for its cost. Of course, in a case where stock which a company proposes to acquire for shares is deliberately over valued for the purpose of issuing an inflated amount of share capital, very different considerations apply. But nothing of the kind is present in this case which, as I have already pointed out, is a perfectly proper and normal reconstruction. The propriety of the course adopted is manifest when the uncertainty as to the value of the investments, which is pointed out by the Commissioners, is borne in mind. It is, I think, true as a general proposition that, where a company acquires property for fully paid shares of its own, the price paid by the company is, *prima facie*, the nominal value of the shares. It is for those who assert the contrary to establish it, as could be done, for example, in the suggested case of a deliberately inflated valuation.”

This passage was expressly approved in your Lordships’ House—see Viscount Simon L.C. at 27 TC 267 at page 287, and Lord Simonds at page 294.

I My Lords, it is thus established beyond question, that in ascertaining the cost of acquiring “stock” for the purpose of arriving at the taxpayer’s trading

(¹) 24 TC 293, at pp 306–7.

(²) 27 TC 267, at pp 277–8.

profit when that stock has been acquired in return for shares credited as fully paid, being issued for a consideration other than cash, it is the cost to the taxpayer of that stock which is, at least *prima facie*, the relevant figure, and that unless the agreement can for some reason be “impeached”, the Crown are not entitled to go behind the price which the taxpayer has paid whatever the means by which that obligation to pay that price has by agreement between the parties been discharged. A
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My Lords, in those circumstances, the crucial question is how far these well-established principles are to be applied to the ascertainment of “the value of the consideration . . . in money’s worth given by [the taxpayer] . . . wholly and exclusively for the acquisition of the asset” for the purposes of para 4(1)(a) of Sch 6 to the 1965 Act. For the taxpayer it is forcibly argued that there is no logical reason why its liability for corporation tax on its gains should be determined in some different way from its liability to corporation tax on its trading profits. For the Crown it is forcibly argued that the decisions to which I have referred are decisions concerning the ascertainment of the cost of “stock” for the purpose of arriving at the taxpayer’s trading profit for income tax purposes, that that cost has been held in the circumstances in question to be the price which the taxpayer paid, that cost is different from value, and that value has to be determined by reference to matters other than cost, though ultimately it was conceded by learned Counsel for the Crown before your Lordships though not, I think, in the Courts below, that cost might be relevant to the determination of value. C
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But, my Lords, if it be correct as both the Special Commissioners and the Court of Appeal thought, to say that in the present case the consideration given by Drayton was Drayton’s agreement to issue and allot the shares and to credit them as fully paid, the Respondents must unquestionably succeed, for it is obvious, since the agreement between Eagle Star and Drayton cannot be impeached, that the value of that credit was 160p per share. But in the passages, the judgments of Lord Greene M.R. to which I have referred, he was explaining the nature of an agreement to issue shares credited as fully paid and otherwise than for cash, in order to lay the foundation for the rejection of the Crown’s argument that the “stock” in question had cost the taxpayer nothing. I do not think that the learned Master of the Rolls was intending to lay down a rule that in every case where there is an arm’s length transaction, such as that now in question, the consideration must always be taken to be the value of the credit given by the company whose shares are being issued and credited as fully paid, and not the shares themselves. What the consideration is in any particular case must be determined by reference to the contract which the parties concerned have concluded. If one looks at paragraph 1 of the agreement of 21 September 1972, it seems to me plain that the consideration was the shares themselves. I do not think that any businessman if asked would say that the consideration was the giving of the credit by Drayton of 160p per share, and if it be permissible to see how the parties themselves regarded the matter, Drayton in their next annual report informed their shareholders that the authorised share capital of Drayton had been increased and that the new shares had been allotted to Eagle Star at “160p per share in exchange for a portfolio of investments . . .”. E
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My Lords, I think that this statement reflects both the commercial reality of this arm’s length transaction and the true nature of the consideration given by Drayton. Accordingly, I think, in respectful disagreement with the Court of Appeal and the Special Commissioners, that the consideration in money’s worth which has to be valued is the value of the shares and not the value of the I

- A credit of which I have spoken. This was, I think, the view of Vinelott J. [1980] 1 WLR 1162 at page 1170⁽¹⁾. But, my Lords, to reach that conclusion is not, with respect, to accept the rest of the learned Judge's judgment. What then is the value of the shares? The Crown contended that it must be determined by reference to Stock Exchange prices on the day after the shares were first dealt in. I ask, why? Lord Greene himself in *Craddock's* case, at page 569, said⁽²⁾:
 B "Published market quotations, which often relate to quite small and isolated transactions, are notoriously no guide to the value of investments of this character, particularly when the amounts involved are large". Lord Greene's warning is particularly apposite in the present case, and is as much applicable to-day as forty years ago when it was uttered.

- My Lords, as I have already said, the agreement was concluded on 21
 C September 1972. It became unconditional on 11 October 1972. My Lords, by virtue of para 10(2) of Sch 10 to the Finance Act 1971, I think it was on the latter date that the acquisition by Drayton is to be treated as having been made. But I am quite unable to regard the evidence of some Stock Exchange dealings at or about that time as sufficient evidence to displace what I would regard as the almost overwhelming evidence of the value of the consideration in money's
 D worth on 11 October 1972, afforded by the agreement of 21 September 1972. For myself I would not go as far as to say that in every case of this kind the value of the consideration in money's worth must always be determined by reference to the price at which the shares credited as fully paid were issued, for it is possible that there might be a very long delay between the conclusion of the conditional agreement and the agreement becoming unconditional, during
 E which period some catastrophic event might occur gravely affecting the value on the latter date. I would wish to reserve for future consideration whether in such a case it might not be legitimate to adduce evidence, if the evidence were available, pointing to the conclusion that the value of the consideration in money's worth was less than the price previously agreed between the parties. But on the facts of the instant case, I can see no basis on which it would be
 F legitimate to go behind the figure of 160p per share. I think this conclusion is strongly reinforced by the finding of the Special Commissioners in paragraph 10 of the stated Case: "It is not disputed by the Crown that there were bona fide commercial reasons for the figure of 160p being somewhat in excess of the price at which the appellant's shares were currently being dealt in on the Stock Exchange".

- G My Lords, for the reasons which I have endeavoured to give I agree that this appeal fails and should be dismissed.

Lord Brandon of Oakbrook—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Fraser of Tullybelton. I agree with his conclusion that the appeal should be dismissed and with the reasons which he gives for arriving at that conclusion.

- H *Appeal dismissed, with costs.*

[Solicitors:—Messrs. Ashurst Morris Crisp & Co.;
 Solicitor of Inland Revenue.]

⁽¹⁾ Page 297 *ante*.

⁽²⁾ 27 TC 267, at p 277.