NO. 1016—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—
9TH JULY, 1934, AND 11TH JANUARY, 1935

COURT OF APPEAL—12TH JULY AND 23RD OCTOBER, 1935

HOUSE OF LORDS—16TH OCTOBER AND 27TH NOVEMBER, 1936

JOHN CRONK & SONS, LTD. v. HARRISON (H.M. INSPECTOR OF TAXES)(1)

Income Tax, Schedule D—Profits of trade—Sales of houses—Guarantees given by builders to building society for sums advanced to purchasers—Part sum guaranteed deposited with society and repayable in certain events—Whether whole purchase price to be brought in as trading receipt at time of sale.

The Appellant Company built houses and sold them to persons of small incomes. In most cases the purchaser was able to pay only a small sum down, and the balance of the purchase money was advanced on mortgage by a building society. The sum advanced by the building society exceeded the amount which would in the ordinary way have been advanced by it on the security of the mortgaged property, and the Company entered into an arrangement with the society under which it guaranteed to the society part of the advance and was required to deposit with the society, as collateral security, the whole or part of the sum guaranteed. The deposit was released when the purchaser had reduced the mortgage debt by an agreed amount. In the meantime the society allowed to the Company on the deposit the current rate of interest payable by the society on ordinary deposits.

On appeal against assessments to Income Tax under Schedule D the Company contended that sums deposited with the building society were not trading receipts for Income Tax purposes until they were released by the society; alternatively, that, if they were to be treated as receipts at the respective dates of sale of the houses, then either (a) *the deposits should be included at their actual "present values" (having regard to the risk of loss, etc.) as assets of the Company's trade, or* (b), *if brought in at their nominal amount, a deduction should be made in respect of the differences between such amounts and the "present values" of the deposits.*

The Special Commissioners decided that the whole of the purchase money should be brought in as a trading receipt of the Company at the time of completion of the sale, and that any loss under the contingent guarantee should be allowed as and when it arose.

(1) Reported (K.B. & C.A.) 153 L.T. 366; (H.L.) [1937] A.C. 185.

Held, *that the sums deposited with the building society should be taken into account at the time of completion of the sales of the houses at their actual value at that time, and not at their face value, but that, in the event of an actuarial valuation being impracticable, they should not be treated as receipts of the Company's trade except in so far as such sums or any part thereof were released to the Company during the trading periods in question.*

CASE

Stated under the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 17th November, 1933, for the purpose of hearing appeals, John Cronk & Sons, Limited, hereinafter called "the Company", appealed against assessments to Income Tax in the sums of £11,500 and £9,816 for the years ending 5th April, 1932, and 5th April, 1933, respectively, made upon the Company under Case I of Schedule D of the Income Tax Act, 1918, in respect of its profits as builders.

2. The Company was incorporated on the 30th January, 1929. It took over the business of builders previously carried on by the firm of John Cronk & Sons.

A copy, marked "A", of the Memorandum and Articles of Association of the Company is annexed hereto and forms part of this Case(1).

3. The main business of the Company, as of the firm before it, was the development of building estates in the neighbourhood of London. The Company bought an area of land, made the necessary roads and sewers, and covered the land with houses. The Company sold the houses as soon as possible after they were built. The majority of the houses were sold at prices between £525 and £625. The purchasers were people of small incomes, postmen, policemen, and others in the same rank of life.

4. In only a few cases were the purchasers able to find for themselves the purchase money for the houses. In the other cases they paid only a very small sum down, usually between £20 and £35, and the rest of the purchase money was advanced on mortgage by a building society, whereupon the house was transferred by the Company to the purchaser, and the deed of transfer contained an acknowledgment of the receipt by the Company of the full amount of the purchase money.

A specimen copy, marked "B", of a deed of transfer used in such cases where the title is registered, is attached hereto and forms part of this Case(1).

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(1) Not included in the present print.

A building society will not in the ordinary way make an advance in excess of 75% of the value of the property mortgaged, and this was insufficient to enable the purchasers to pay the balance of the purchase money. In order that the advance by the building society to a purchaser might be for the full amount of the balance of the purchase money, an arrangement was entered into by the Company with the society, under which the Company guaranteed to the society a proportion of the amount advanced. In addition to giving the guarantee the Company was required to make a deposit with the society of the whole or a part of the sum guaranteed, and on the amount of this deposit the society allowed the Company interest at the current rate payable by the society on ordinary deposits. The amount deposited with the society usually was one-third of the amount guaranteed. For example, on a house which was sold for £625, the purchaser provided from his own pocket a sum of £35. The society advanced £590 to the purchaser and the Company gave a guarantee for £95, as security for which it deposited the sum of £31 13*s*. 4*d*. with the society. The actual procedure on the completion of the sale was as follows :—The representatives of the building society attended at the office of the Company's solicitors and handed to the solicitors a cheque or banker's draft for the net sum of £558 6*s*. 8*d*. as representing the difference between £590, the amount advanced to the purchaser, and £31 13*s*. 4*d*., the amount of the Company's deposit with the building society. The solicitors thereupon paid over the cheque or draft for the net sum to the Company. All the arrangements with the society were made through the Company's solicitors.

5. A separate agreement was entered into between the Company and the society for each advance. Copies, marked " C1 " and " C2 ", of two different forms of agreement are annexed hereto and form part of this Case. The form of agreement " C1 " was used in the case in which the whole amount guaranteed was deposited with the society, and form " C2 " was used where a portion only of the amount guaranteed was so deposited. The form of agreement " C2 " was the one much the more commonly used.

6. A list, marked " D1 ", is annexed[1] giving particulars of 34 houses which were sold by the firm in 1928 or early in 1929, on which the firm gave guarantees to the society. The total sum deposited in respect of these guarantees was £1,500. The loss to the firm (or to the Company as successors to the firm) under these guarantees down to October, 1933, was £698. In four cases the guarantee had been released by that date. A list, marked " D2 ", is annexed[1] giving particulars of 317 houses which were sold by the Company between 1929 and October, 1931, on which guarantees were given by the Company. The total sum deposited in respect of these guarantees was £12,569, and the loss to the Company on these houses was £672 down to October, 1933. In seven cases the guarantee had been released by that date.

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[1] Not included in the present print.

7. In the Company's trading account a deduction was made from the receipts from the sale of houses of the net amount deposited with the society during the year under the guarantees, *i.e.*, the sums deposited under the guarantees given during the year less any sums received back during the year on the release of guarantees. The interest received from the society on the deposits is shown as a receipt in the profit and loss account, but the deposits are not shown as an asset in the Company's balance sheet. Copies, marked "E1" and "E2", of the Company's accounts for the years ended the 31st January, 1931, and the 31st January, 1932, are annexed hereto and form part of this Case[1].

8. It was stated in evidence by Mr. J. W. G. Cronk, Managing Director of the Company, that it would have only been possible to sell a very few of these houses if the purchasers had been unable to obtain an advance of more than 75% from the building society, and, in order to carry on its business in the way it did, it was absolutely necessary for the Company to enter into these arrangements with the building society. The great majority of builders of working-class houses had entered into similar arrangements. Builders had been pressed by the Ministry of Health to build as cheaply as possible, and to accept from the purchasers as small a deposit as they could.

9. Evidence was given also by Mr. J. Bacon, F.I.A., senior partner of a firm of consulting actuaries. On the particulars given in the documents "D1" and "D2" he estimated that the loss on the guarantees owing to defaults of the purchasers would amount to, at least, 17% of the deposits. If the period of review had been longer than four years the percentage of loss would probably have been higher. He admitted, however, that the number of cases was insufficient to arrive at an actuarial valuation, and that in forming his estimate he had no knowledge of the financial position of the individual tenants.

He was of the opinion that, in valuing the deposits, account should also be taken of the facts that the Company was not free to withdraw the deposits, and that it earned less interest on them than it could earn if the money were used in its business. He agreed that life insurance companies did not, in valuing the deposits that they were compelled to make by the governments of the countries in which they did business, write down the value of those deposits because of their non-liquid character and of their earning less than the average rate of interest on their investments. He did not consider that the years 1931 and 1932 were exceptionally bad years, in which a large number of defaulters were to be expected.

10. Evidence was also given by Mr. F. L. Cooke, F.S.A.A., a member of the firm of accountants who audited the Company's accounts. He stated that in preparing the accounts of the Company he endeavoured to ascertain the position regarding the deposits and

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(1) Not included in the present print.

that, in view of their intangible nature, he decided that it was better to write them off entirely. If, by a direction of the Board of the Company, they had been included in the balance sheet at their nominal value he would not have given an unqualified certificate, but would have referred to the matter in his report on the face of the balance sheet. His experience was not sufficient to enable him to say whether the deposits were of any value or not. He stated that accountants employed different methods in dealing with such assets. Some took a percentage, others showed the sale price of the property at the net figure after deducting the deposit and many showed the deposits as assets. If he were preparing a balance sheet for the sale of the business he would value them and show them as assets, but for the purpose of his valuation he would want much more information about them. He differentiated the deposits from ordinary debts of the business because the value of the deposits depended on a contingency, which had nothing to do with the relationship of debtor and creditor. He did not know of any other case, other than these cases, in which an asset had been valued at less than its full value merely because, if it had been employed in the business, it would have earned a higher rate of interest.

11. Mr. C. Way, an insurance broker, and a representative of Messrs. Robert Crawford and Company, Limited, Insurance Brokers, stated that on the instruction of the Company he had endeavoured to obtain quotations for (*a*) the purchase of the deposits and (*b*) insurance against the risks involved. He had submitted full particulars to all the leading tariff and non-tariff offices. In every case the risk was declined. Their reasons for declining were not given by the offices, but in the opinion of the witness the risk was too big to underwrite.

12. It was contended on behalf of the Company :—

(1) That in the computation for Income Tax purposes of the profits of the Company for the years ended the 31st January, 1931 and 1932, sums deposited by the Company with the building society in the circumstances herein described ought not to be treated as receipts of the Company's trade except in so far as such deposited sums were released to the Company during those years; or

(2) Alternatively, that if the deposited sums are to be treated as receipts as at the respective dates of sale of the houses then either :—

(i) The deposits should be brought into account at figures not exceeding their actual "present "values" as assets of the Company's trade; or

(ii) If the deposits are brought to credit at their nominal amounts, deductions should be allowed in respect of the differences between such nominal amounts and the actual "present "values" of the deposits as assets; and

(3) That in any valuation of the deposits for the purposes of the foregoing contentions, regard should be had to the following considerations, *viz.* :—

(*a*) The risk of loss, under the terms of the guarantees, by reason of defaults on the part of mortgagors;

(*b*) The fact that the interest received on the deposits was less than the interest that would have been earned if the amount were used in the Company's business; and

(*c*) The fact that the Company was not at liberty to withdraw the deposits until the release of the respective guarantees.

13. It was contended on behalf of the Crown :—

(1) That the full nominal purchase money for the houses sold should be brought in as receipts at the respective times of sale, and that any losses under the guarantees should be allowed at the time when they occurred; and

(2) That the assessments were correct in principle and ought to be confirmed, subject to any necessary adjustment of figures.

14. The following cases were referred to :—

Commissioners of Taxes v. *Melbourne Trust, Limited,* [1914] A.C. 1001.

Californian Copper Syndicate v. *Harris*, 5 T.C. 159.

Anderton and Halstead, Limited v. *Birrell*, 16 T.C. 200.

In re Spanish Prospecting Company, Limited, [1911] 1 Ch. 92.

Spargo's case, 8 Ch. App. 407.

Whimster v. *Commissioners of Inland Revenue,* 12 T.C. 813.

J. H. Young & Company v. *Commissioners of Inland Revenue*, 12 T.C. 827.

Edward Collins & Sons, Limited v. *Commissioners of Inland Revenue*, 12 T.C. 773.

15. We held that the purchase price of each house was fully paid in cash at the time of each completed sale with a contingent liability on the Company in respect of its guarantee to the building society. The whole of the purchase money should therefore be brought in as a receipt of the Company's trade at the time of completion of the sale, and any loss under the contingent guarantee should be allowed at the time when the loss arose. If we were wrong in this

view and a question of valuation arises, this was not, in our opinion after hearing the evidence, a case in which an actuarial valuation was possible, there being too many factors which are not capable of statistical evaluation. Further, we think that the fact that less interest is earned on the deposits than could be earned if the money were used in the Company's business would not affect the valuation.

We accordingly dismissed the appeal, and we subsequently reduced the assessment for the year ending the 5th April, 1932, to £11,495, less wear and tear £360, and confirmed the assessment for the year ending the 5th April, 1933, in the amount assessed, less wear and tear £337.

16. Counsel on behalf of the Company immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and we were in due course required to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

J. JACOB, } Commissioners for the Special
R. COKE, } Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
5th March, 1934.

EXHIBITS

EXHIBIT C1

Agreement dated 25th November, 1931.

Form A.I.

Agreement made the 25th day of November 1931 Between John Cronk & Sons Limited duly authorised in this behalf of 38, Holborn Viaduct, in the County of London (hereinafter called " the Guarantor " which expression includes his assigns) of the first part Herbert Bex Traveller of 77, Wembley Avenue, Lancing, in the County of Sussex (hereinafter called " the " Borrower " which expression shall include his executors administrators and assigns) of the second part and the Abbey Road Building Society whose chief office is at Abbey House, Baker Street, in the County of London by Harold Bellman their General Manager (hereinafter called " the Society ") of the third part Whereas :—

1. The Society has at the request of the Guarantor advanced to the Borrower £760 repayable with interest in 20 years by equal monthly instalments of £5 10*s*. 10*d*. upon the security of a Mortgage

(hereinafter so called) of the estate of the Borrower in property known as No. 122, Hook Rise, Kingston Bye Pass Road, Tolworth, in the County of Surrey.

2. Part of the arrangements with the Borrower for the said loan were that

(*a*) The Guarantor should deposit money and enter into agreements with the Society as hereafter stated.

(*b*) The Guarantor and the Society might carry such agreements into effect without the consent of or reference to the Borrower.

In consideration of the premises it is agreed as follows :—

1. On the signing of this agreement the Guarantor shall pay to the Society £150 upon which the Society shall allow the current rate of interest payable on deposits with the Society and such sum shall be retained by the Society until the Borrower or his assigns shall have repaid to the Society £300 of the said principal sum of £760 upon the happening of which event the said sum of £150 shall be repaid to the Guarantor or his assigns upon request in writing.

2. If the Society by its Directors shall resolve before the said principal sum is reduced by £300 to exercise any mortgagee powers then or at any time thereafter

(1) The said sum of £150 may be transferred by the Society to the credit of the repayment account relating to the Mortgage and interest thereon shall cease.

(2) The Guarantor if required by the Society will

(*a*) Purchase the mortgaged property or

(*b*) Take a transfer of the mortgage,

in either case at a sum which shall be equal to the principal interest and costs due to the Society at the date of the completion of the sale or transfer.

3. In calculating the amount due under Clause 2 (2) the Society may but need not

(*a*) Take into account the money deposited by the Guarantor and if not so taken into account such money may be repaid to the Guarantor

(*b*) Enforce any agreement of the Guarantor herein contained.

4. The consent of the Guarantor shall not be required prior to the exercise by the Society of any rights and powers contained in the Mortgage.

5. Upon the question of accounts the books of the Society shall without question be accepted as correct and final.

If by virtue of any agreement to which the Guarantor and the Society shall be parties the said sum of £150 or any part thereof may be liable to be transferred by the Society then notwithstanding Clauses 1 and 3 hereof such sum shall only be repayable to the

Guarantor subject to the provisions of such agreement and as if the said sum had been specifically charged to the Society thereby.

Witness to the signature of the said Guarantor } Albert Cronk.

A. J. Sweet, For and on behalf of
100, Caithness Road, John Cronk & Sons, Limited.
Mitcham, Sy.

Witness to the signature of the said Borrower } H. Bex.

R. D. Higgs,
12, John Street,
Bedford Row,
W.C.1.
Solicitor.

EXHIBIT C2

Agreement dated 13th November, 1930.

Form B. (Special Arrangement).

Agreement made the 13th day of November 1930 Between for and on behalf of John Cronk & Sons Limited of 38, Holborn Viaduct, in the City of London, Builders, (hereinafter referred to as " the Guarantor " which expression includes his assigns) of the one part and Harold Bellman for the Abbey Road Building Society whose chief office is at Abbey House, Upper Baker Street, in the County of London (hereinafter called " the Society ") of the other part.

Whereas the Society has at the request of the Guarantor advanced to Willie Wrigglesworth of 13, Mill Place, Kingston-on-Thames, House Porter, upon the security of a Mortgage (hereinafter so called) of the estate of the said Willie Wrigglesworth in a property 117, Cranborn Avenue, Tolworth, Surrey, £575 repayable with interest in twenty years by equal monthly instalments of £4 3*s*. 11*d*.

In consideration of the premises it is agreed as follows :—

1. On the signing of this agreement the Guarantor shall pay to the Society £150 upon which the Society shall allow the current rate of interest payable on deposits with the Society and such sum shall be retained by the Society until the said Willie Wrigglesworth or his assigns shall have repaid to the Society £300 of the said principal sum of £575 upon the happening of which event the said sum of £150 shall be repaid to and upon the request in writing of the Guarantor.

2. If the Society by its Directors shall resolve before the said principal sum is reduced by £300 to exercise any mortgagee powers then at any time thereafter the said sum of £150 may be transferred by the Society to the credit of the repayment account relating to the Mortgage and interest thereon shall cease.

3. Notwithstanding the terms of this agreement the following provisions shall apply :—

(1) The Society as a concession to the Guarantor will only require the Guarantor primarily to pay and the Guarantor has paid to the Society the sum of £73 6*s*. 8*d*. only upon the signing of this agreement.

(2) (*a*) In consequence and consideration of Sub-clause (1) of this Clause the Society shall be required to pay interest to the Guarantor upon the said sum of £73 6s. 8d. only and in accordance with the terms of this agreement.

(*b*) The Society shall under no circumstances be required to pay to the Guarantor any sum in excess of £73 6*s*. 8*d*. and for the purposes of repayment by the Society the sum of £150 hereinbefore mentioned shall mean the sum of £73 6*s*. 8*d*.

(3) If upon the exercise of its mortgagee powers there shall be due to the Society in excess of the actual and net amount realised and received by the Society for monies due in respect of the Mortgage a sum in excess of the said sum of £73 6*s*. 8*d*. at the option of the Society

(*a*) The Guarantor will pay to the Society on demand such further sum to make up such deficiency, but not exceeding the further sum of £111 13*s*. 4*d*. or

(*b*) The Society may withdraw from any other account of the Guarantor (whether deposit or share account) a sum not exceeding the said further sum of £111 13*s*. 4*d*. and no interest shall be payable by the Society to the Guarantor upon any sum so withdrawn.

4. The consent of the Guarantor shall not be required prior to the exercise by the Society of any rights and powers contained in the Mortgage.

5. Upon all questions of accounts the books of the Society shall without question be accepted as correct and final.

Witness to the signature of the said Guarantor.

The case came before Finlay, *J*., in the King's Bench Division on the 9th July, 1934, when judgment was reserved. On the 11th January, 1935, judgment was given in favour of the Crown, with costs.

Mr. F. Heyworth Talbot appeared as Counsel for the Appellant Company, and the Solicitor-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Finlay, J.—In this case the Appellants are a company carrying on building operations. A point arises as to the assessment of profits on houses which they build and sell. These are cheap houses sold to persons of modest means, and the point really arises by reason of the fact that the persons to whom the houses are sold are themselves unable, or anyhow usually unable, to pay at the time any substantial part of the purchase money. The facts are set out in paragraphs 3 to 7 of the Case stated by Mr. Jacob and Mr. Coke, the Special Commissioners, but an illustration which was put by Mr. Talbot in his very able argument makes the matter clear. Suppose a house to be sold for £600; of that sum, the purchaser can provide £30 only; the building society is, of course, prepared to make an advance, but in accordance with the usual practice it will advance 75 per cent. only, that is, £450. £120 is still wanting. This the building society provides, but only if there is a guarantee of the builders, supported by a deposit. The deposit is occasionally a deposit of the whole amount guaranteed, but more commonly a deposit of a part only. One-third was the sum taken in Mr. Talbot's illustration. £120 was guaranteed, £40 was deposited. The transaction is then complete. The £600 is duly provided, £30 by the purchaser and £570 by the building society, who are guaranteed as to £120 and with whom a deposit of £40 is made, that deposit so made earning interest. The point which arises is as to the effect of this arrangement. The Crown contends that the full amount, £600 in the illustration I have taken, must be brought in. The Company contends that a deduction should be made in respect of the amount deposited. There was an alternative contention with which I shall not fail to deal, but the main contention was as I have stated.

The matter came before the Special Commissioners and they made this finding, contained in paragraph 15: "We held that "the purchase price of each house was fully paid in cash at the "time of each completed sale with a contingent liability on the "Company in respect of its guarantee to the building society. "The whole of the purchase money should therefore be brought in "as a receipt of the Company's trade at the time of completion "of the sale, and any loss under the contingent guarantee should "be allowed at the time when the loss arose. If we were wrong "in this view and a question of valuation arises, this was not, in "our opinion after hearing the evidence, a case in which an "actuarial valuation was possible, there being too many factors "which are not capable of statistical evaluation. Further, we think "that the fact that less interest is earned on the deposits than "could be earned if the money were used in the Company's "business would not affect the valuation".

(Finlay, J.)

With regard to the latter part of that paragraph, I may say that in some circumstances it might have been necessary to send the Case back to the Commissioners. If I had thought that necessary, I should of course have done so, but in the view which I take of the case, which will appear in a moment, it is not necessary.

The main contention of the Solicitor-General was that that finding—the finding in the earlier part of the paragraph which I have read—was a finding of fact, and was conclusive unless there was no evidence, and he drew my attention to the document of sale, and said that at the very least that was evidence upon which the Commissioners might arrive at the conclusion at which they did arrive. The substance of Mr. Talbot's answer to that was that that was to neglect the substance and to look only at the form.

The view which I take, and which I think is in accord with that of the Special Commissioners, is that here the Appellants did receive the purchase price, though there was a collateral arrangement as to the guarantee and deposit. That was an application of the purchase price and the fact—I think it is undoubtedly a fact—that the transaction could not have gone through but for the guarantee and deposit does not, I think, alter this. It may be pointed out—indeed, it was pointed out in the course of the argument—that if a sufficiently lengthy period is taken, there is not much real difference between the view of the Crown and the view of the Company, because the Crown concedes that losses on deposits as and when they occur must be allowed as a deduction. Much difference there certainly is not, taking a long view, between the two views; some difference there would no doubt be by reason of the familiar fact that the rate of Income Tax varies in the different years.

This brings me to the alternative point. Mr. Talbot argued that if the sum deposited was now to be brought in, it must be brought in at a valuation, that is to say, he said it was not £40 to be received now, but £40 to be received much later, if at all, there being of course a risk that it might never be received at all. That really, I think, is an attempt to deduct a contingent liability which never may arise. If it does arise, it is deductible; otherwise, it is not. The substance of the view which I take—and it is a view which covers both points—is that the purchase price was truly received, but that part of the transaction was a guarantee and an application of part of the purchase money in a particular way. That being so, it is impossible for me to say that the Commissioners were wrong; indeed, I think they were right in their finding. If the full amount is received, it seems to me to be more in accord with Income Tax principles as well as business convenience that a loss should be allowed for only if and when it occurs.

(Finlay, J.)

My attention was called, as the attention of the Special Commissioners had been called, to several cases. I may mention the *Commissioners of Taxes* v. *Melbourne Trust, Limited*, [1914] A.C. 1001, a decision of the Privy Council depending, as I think, on rather special facts, and a very familiar case, the *Californian Copper Syndicate* v. *Harris*, 5 T.C. 159. The judgment of the Lord Justice Clerk in that case is constantly quoted, but my attention was particularly called to the judgment of Lord Trayner. Then several Excess Profits Duty cases were cited. Two I may mention, *Edward Collins & Sons, Limited* v. *Commissioners of Inland Revenue*, 12 T.C. 773, and *Whimster & Co.* v. *Commissioners of Inland Revenue*, 12 T.C. 813. I have looked at all these cases and at the others that were cited. They are none of them, I think, close to the present case, which, indeed, is a case which in my view stands upon its own particular facts; but I find nothing in them which is against the view which I take.

My view is in accord with that of the Special Commissioners, and it accordingly follows that this appeal must be dismissed.

Mr. Hills.—It will be dismissed with costs?

Finlay, J.—Yes, dismissed with costs.

Mr. Hills.—If your Lordship pleases.

An appeal having been entered against the decision of the King's Bench Division, the case came before the Court of Appeal (Lord Hanworth, *M.R.*, and Romer and Maugham, *L.JJ.*) on the 12th July, 1935, when judgment was given unanimously against the Crown, with costs, reversing the decision of the Court below.

Mr. A. M. Latter, K.C., and Mr. F. Heyworth Talbot appeared as Counsel for the Appellant Company, and the Solicitor-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Hanworth, M.R.—We need not trouble you, Mr. Latter.

This appeal must be allowed. It raises one of those difficult questions on which I think I may say that different minds may take different views, because we have to estimate what is the effect of the transaction which has been entered into. The Appellants appeal against two assessments to Income Tax in the sums of £11,500 and £9,816 for the years ending 5th April, 1932, and 5th April, 1933. They are taxed on their profits and gains under Case I of Schedule D. They are builders, and the main business of the Company, as we are told in the Case, is the development of

(Lord Hanworth, M.R.)

building estates in the neighbourhood of London. The Company buy an area of land, make the necessary roads and sewers, and cover the land with houses. The Company sell the houses as soon as possible after they are built, and the majority of the houses in fact were sold at prices between £525 and £625 in the years which are the subject matter of the charge. The purchasers of these houses are people of small income—postmen, policemen, and others in the same rank of life, who want to get a house of this character and who, quite rightly, wish to buy their houses, to become the actual owners of their houses. In order to do that they go to a building society, being themselves—each of these purchasers—not able to find any large sum of ready cash. We are told in the Case that they are only able to put down a sum usually between £20 and £35; the rest of the money is advanced on mortgage by a building society. Now a building society, we are told, will not, in the ordinary way, make an advance in excess of 75 per cent. of the value of the property mortgaged. This, if you take the value of the house as £525 or £625, would not be a sufficient advance to enable the purchasers to complete the transaction when they themselves are only able to find out of their own pockets between £20 and £35, so there must be some further arrangement entered into. The cash down is insufficient; an advance on mortgage of three-quarters of the value produces an insufficient sum; therefore there must be some ancillary method adopted to enable the transaction between the builders who built the house and own the house, of the one part, and the purchaser of the house, of the other part, to be carried out. What is the scheme adopted? It really is this, that the builders are to give a guarantee in respect of the sum which represents the margin between the purchase price and the sum that is advanced. I will give the figures in a moment. Whatever you may call it, the builders themselves, as a guarantee of good faith, a guarantee that they will fulfil their own guarantee, deposit as security a sum with the building society, and that sum is estimated in the particular case, the particular purchase of a particular house, on a scale which is, I do not say inflexible, but which is adopted in all these sales of the houses.

To make my meaning as plain as I can, let me give the figures of a particular house. A house is sold at £595. A conveyance is entered into, and there is an out and out conveyance by the Company to the purchaser of the house at £595. Of that sum £20 is paid by the purchaser, and therefore there remains unpaid £575. The building society take a mortgage upon the house for the total of that £575. But that does not conclude the arrangement which is made between the parties, because, in fact, the builder is paid by the building society a sum of £501 13*s.* 4*d.*; the builder enters into an agreement under which he is called a "guarantor", guaranteeing to pay the society £150, but by another clause the

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building society, " as a concession " to the so-called guarantor, state that they " will only require the Guarantor primarily to pay " and the Guarantor has paid to the Society the sum of £73 6*s*. 8*d*. " only upon the signing of this agreement ". The society, so long as that £73 6*s*. 8*d*. remains in their hands, are to pay 4 per cent. on that money and they are to hold it and not to repay it or hand it back to the builder unless and until the transaction of sale and purchase and mortgage has ripened *inter partes*. When the mortgagor has reduced the amount of the mortgage debt by £300, so that the building society have got a very good security indeed in the house and do not require any further security, then they will pay back the £73 6*s*. 8*d*., but until that time it is to be retained. Meantime there is this risk to the builder, who has provided or paid the £73 6*s*. 8*d*., that if the transaction does not ripen in what might be hoped to be the ordinary course there may come a time when the mortgagees will want to enforce their security, and if they are not able to obtain the full amount of their debt they can hold the £73 6*s*. 8*d*. as a supplementary source to repay themselves the amount advanced.

Now it is quite true that the documents as they stand show that there was a conveyance at the sum of £595. As Maugham, L.J., has pointed out, that does not necessarily show conclusively that, as between the vendor and the purchaser, the purchase money has been fully paid. It may be that as a document of title it stands and that for the purpose of Stamp Duty and the like you are to take the purchase money, £595. That may be; but as between the parties to this whole transaction it is quite plain that one limb of it was that there should be a mortgage by the building society, and that another limb of it was that, to fill up what was wanted in the margin between the purchase money and the money which would be advanced on mortgage, the builders, Cronk & Sons, should enter into what is called a guarantee and should immediately hand over this sum—estimated, as I have said, not *aliunde*, but in reference to the figures of this particular sale of the house which they were all engaged upon. You do not, therefore, have to set aside the documents; it is not a case in which one is going to set aside the documents in order to get at what is called the substance of the matter. It is not that the documents are specious, or that they are misleading or fraudulent. It is this: that, for getting at the substance of the matter, you must look at all the documents and see the interconnection between the sale, the conveyance, the mortgage and the so-called guarantee, and also the term which is stated in exhibit " C2 ", paragraph 3, subclause (1), that : " The Society as a concession to the Guarantor will " only require the Guarantor primarily to pay . . . . the sum of " £73 6*s*. 8*d*." I am, therefore, not setting aside the documents or going at all in defiance of what the House of Lords said in the

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Westminster case([1]), but one is going to get what may be called the totality of the transaction, and I do not find it either possible or right to say that I ought to look only at one part of what might be called a tripartite transaction; I must look at the various parts of this transaction. It is said that the real transaction is this: purchase by Mr. Wrigglesworth at £595; a mortgage by Mr. Wrigglesworth to the building society; and that, out of funds belonging to Messrs. Cronk & Sons, Messrs. Cronk & Sons have entered into a guarantee of £150 and have made a loan of £73 6*s*. 8*d*., a loan which is to bear interest, and which, if it is to bear interest, represents some independent transaction in which Messrs. Cronk were laying out at interest £73 6*s*. 8*d*. for the purpose of receiving the 4 per cent. interest which they would be paid by the building society. Now if you can separate this tripartite arrangement into wholly separate integers that may be one view, but having regard to the difficulty that had to be overcome and which we are told was a difficulty that arose in the ordinary practice of selling these houses, namely, that the purchasers are not able to put down more than a small sum, that a building society will not in the ordinary way make more than an advance of 75 per cent., and that this scheme—quite a good scheme: I make no criticism upon it—was adopted to fill up the gap, I find it impossible to segregate one portion of the scheme from the other.

The taxing authorities have made a claim that the nominal purchase money for the houses sold should be brought in as receipts at the respective times of the sales and any losses under the guarantees which may arise later should be allowed at the time when they occur, and they say that the assessments were correct in principle. On the other hand, the contention on behalf of the Company is that, in the computation for Income Tax purposes of the profits of these years, the amounts deposited by the Company with the building society in the circumstances ought not to be treated as receipts of the Company's trading except in so far as such deposit sums were released to the Company during those years, or that the deposits should be brought into account at figures not exceeding their present values as assets of the Company's trading. As a matter of fact, I do not suppose that over a long period of years it would make very much difference which course is adopted, because if you run for a period of 10 or 15 years there ought to be a sufficient number of moneys coming back in the transactions in which the mortgagor has ultimately been able to pay up an adequate quota so as to release the guarantor's payment—that would be flowing in—and the stream would go on of these transactions which are being steadily completed and, I hope, carried out. But we have to determine whether the contention of the Crown is right, or the

([1]) Duke of Westminster *v*. Commissioners of Inland Revenue, 19 T.C. 490, at pp. 520/21 and 524.

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contention of the subject. The Crown want to treat the whole of the purchase money as actually received, although they have to admit that if anybody had been asked to put down the whole of the purchase money it would have been impossible to carry out the transaction, that the purchaser could only put down a small sum, and that some what I have called ancillary device should be resorted to in order to make the transaction of sale and purchase of the house possible at all. In those circumstances it appears to me that the £73 which has been paid is not to be treated as paid out of an independent fund belonging to Messrs. Cronk & Son, a fund which they wanted to lay out at interest, a fund which, so to speak, was seeking employment; it was paid over because by that means and that means alone the full transaction could be carried out. It was not in that sense a voluntary loan or deposit. It was a loan, or guarantee, or whatever you like to call it, made in relation to the house; it was part of a scheme. As Mr. Hills has pointed out, the point that arose in *Hunter* v. *Attorney-General*(1) was, of course, a very different one, in this sense: what had to be ascertained was, what was the amount that the insured person had paid to the insurance company; and one very learned Lord, Lord James, took the view that he had paid because an entry was made of the payment and that he was entitled to treat the sum as fully paid on his part, but the Court of Appeal and the remainder of the noble Lords in the House of Lords, Lord Halsbury, Lord Macnaghten, Lord Davey, Lord Robertson and Lord Lindley, all said that he had not paid: all that had passed was a sum of £33 17*s*. 6*d*.; he had been loaned a sum of £33; and I think that Lord Davey rightly describes the transaction in these words(2): "Looking at the whole trans-"action it appears to me that it was a scheme of some ingenuity "whereby the Insurance Company invited people to insure their "lives in their office on the footing of half the annual premiums "for seven years not having to be found in cash; and the very "merit of the scheme . . . . is that the insured will not have to "pay in cash the whole of the premiums". So, here, the very merit of the scheme is that the margin between the sum available by way of mortgage and the sum required to make up the purchase money is to be found in a particular way, and the builders are not able to touch the full sum for which the house is sold; they have got, under the very merit of the scheme, to make use of a certain portion, an aliquot portion, of the purchase price in the manner which the scheme carries out and which deprives the builders certainly at the time, and it may be altogether, of the sum which they have parted with in accordance with the scheme.

For those reasons it appears to me that the profits of the Company ought to be estimated on the smaller figure, the figure that remains when the deduction has been made. I do not know

(1) 5 T.C. 13. (2) 5 T.C., at pp. 23/4.

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whether it is possible at all to put a figure to the present values of the sums which have been lent or guaranteed, or whatever you like to call it, but I think the right course will be to send the Case back to the Commissioners for them to ascertain at what figure, on this principle, the liability of the Company should stand. If it is possible to agree it, that may be done; if not, the Commissioners must do it.

The appeal, therefore, will be allowed, with costs here and below.

Romer, L.J.—I agree.

The learned Commissioners in paragraph 15 of the Stated Case state this: "We held that the purchase price of "each house was fully paid in cash at the time of each "completed sale with a contingent liability on the Company in "respect of its guarantee to the building society". If that were all that existed in this case, it is quite plain that the Company could not set against the proceeds of sale of any house a contingent liability under guarantee given to the building society. But the statement I have read is wholly insufficient. It makes no mention of the one material fact in the case, which is that, in most of the cases where the Company have sold a house, the Company made a deposit of money with the building society which was financing the transaction. We must take into consideration the fact that that deposit was made. The question that arises for decision is whether we are to regard that deposit as being only part of the consideration accruing to the Company on the occasion of the sale of the house, or whether we are to treat the Company as receiving from the purchaser the whole of the consideration mentioned in the conveyance and thereafter, by way of investment or otherwise, handing over to the building society the deposit. I confess that to that question I can only see one answer. In my opinion it is plain that the deposit retained by the building society was a credit sum which formed part of the consideration accruing to the Company, just as though part of the consideration had been left out on mortgage. It is true that it is not necessary for the Crown to show that the Company received the whole of the consideration in cash: it is sufficient if the Crown were to show that they received the consideration in money or money's worth. Therefore, if part of the purchase money was left out on mortgage, amply secured, the Company would be deemed to have received, as part of the consideration accruing to them on the sale, the face value of the mortgage debt. But where, as here, the debt owing—that is to say, the amount of the deposit—by the building society is not worth its face value, then it appears to me that the Company are entitled to say that for the purposes of Income Tax they are only bound to bring into their accounts that debt at its real value. Supposing this sum were owing by the purchaser, if the purchaser were likely

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to prove insolvent the debt would not be brought in at its face value. There is no suggestion in this case that the building society are in any way likely to make default in payment: their credit is good enough. But it matters not that the debt is not worth its face value, because somebody other than the debtor may make default in payment, may prove insolvent. If, in the present case, the purchaser in respect of whom the deposit is made makes default in payment of his instalments, that debt ceases to be worth its face value. It may become worth nothing. That being so, it appears to me, with great respect to the learned Judge, that this appeal must be allowed, with the consequences that the Master of the Rolls has indicated.

I only want to say this further. It is true that if you look, not at the real transaction between the parties, but at the form in which it was carried out (and properly carried out) by the conveyancers or conveyancing clerks, you will find, as you would expect to find, a receipt of the whole money given by the purchaser in the conveyance to him, and the statement that the whole of the money advanced on mortgage to the building society has been advanced to the purchaser. That is merely the conveyancing way of carrying out the transaction, and, of course, a conveyancer who knows his job would carry it out in that way, because if you are making a conveyance to a purchaser you do not want some subsequent purchaser to make enquiries as to whether there is not some still undischarged vendor's lien. The conveyance of the purchaser would naturally recite that the money had been paid to the vendor, and the latter would make an acknowledgment of the receipt. So, too, in the mortgage, the mortgage would recite that the money had been advanced by the building society to the purchaser. But when one looks at the real transaction as set out in paragraph 4 of the Stated Case one finds this, dealing with the figures set out in that paragraph. "The actual procedure on the completion of the sale was "as follows:—The representatives of the building society attended "at the office of the Company's solicitors and handed to the "solicitors a cheque or banker's draft for the net sum of "£558 6*s*. 8*d*. as representing the difference between £590, the "amount advanced to the purchaser, and £31 13*s*. 4*d*., the amount "of the Company's deposit with the building society. The solicitors "thereupon paid over the cheque or draft for the net sum to the "Company." So that, in that case, the £590 was not paid by the building society to the purchaser. It was not indeed paid in full even to the Company. £558 6*s*. 8*d*. was paid to the Company and the £31 13*s*. 4*d*. was retained, or paid back by the Company to the building society. The truth of the matter, of course, is that the purchaser paid nothing except a small balance, which he was able to pay. The rest of the transaction was carried out in the way that is suggested there, by a cheque being drawn for one sum

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and one sum only and handed over to the Company, and nothing more happened—not even cross cheques passing between the building society and the Company. That being the true transaction, I think we are not compelled to take a different view of it merely because of the conveyancing form that has been adopted, and, as I have said before, properly adopted.

Maugham, L.J.—I am of the same opinion.

The Appellants here, John Cronk & Sons, Limited, are a firm of builders who buy areas of land in or near London, "develop" them, as the phrase is, cover the land with houses, and proceed to sell the houses with the assistance of the building societies, who, of late years, have become financial institutions of great social importance. The nature of the business is a very peculiar one, although we are all becoming accustomed to it, because the houses, which have cost from, we will say, £500 to £1,000 each, are sold to people who are unable to pay, as a general rule, more than a very small sum at the date of the transaction of purchase. For instance, in the sort of cases which we have before us, which are included in documents which form part of the Case, the sums paid on completion by the purchasers as a rule are some £20 or £25, or sometimes a little more. The rest of the money has got to be found in the way described in paragraph 4 of the Stated Case. The building society will not make an advance in excess of 75 per cent. of the value of the property mortgaged; £20 or £30 is being found by the purchaser, and there is, therefore, a considerable amount which has to be found in some other way. What is in fact done is this. The builder does not get the whole of the purchase money as provided for by the purchaser and by the mortgage to the building society; he has himself to find a sum which is described as a "deposit"—for the moment I am not wanting to come to a conclusion on the word—which is, in fact, deducted from the total purchase money paid at the date when the transaction is completed and retained by the building society. It is not paid to the builder until a substantial amount of the sum due in respect of the mortgage and in respect of the purchase is paid by the purchaser by equal monthly instalments, which are generally intended to last over 20 years. My brethren have given an example of one case. The case in exhibit "C2" of the transaction between the taxpayer, who is described as the "guarantor" and the building society (which happens to be in that case the Abbey Road Building Society), was of this nature: the house had its sale price fixed at £595. The building society here were willing in form to advance £575 on mortgage, repayable with interest in 20 years by equal monthly instalments of £4 3*s*. 11*d*. The Appellants, Messrs. John Cronk & Sons, Limited, were to have deducted from the purchase money of £595 payable to them on completion the sum of £73 6*s*. 8*d*., which the building

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society were going to retain; the society were to pay interest to Messrs. Cronk upon that sum in accordance with the terms of the agreement; the society were to become liable to repay the sum of £73 6*s*. 8*d*. if and when the purchaser should reduce the sum due on mortgage by £300; and it is to be added that if, on the exercise of their mortgagee powers, the society should find that a sum was due to them in excess of the actual net amount realised and received by the society, they might call upon the builders, Messrs. Cronk, to pay a sum in excess of the sum of £73 6*s*. 8*d*. at their option, but such excess sum was not to exceed £111 13*s*. 4*d*., namely, a total of £185. I have stated the effect of that transaction, and in my opinion the question to be determined here is this: Is the Court to consider the form rather than the substance of the transaction, which, in these very numerous cases, always assumes the same form, as between the builders, the purchaser and the building society? I ask myself this question: In a business sense, have the builders, the Appellants, received the whole of the purchase money and lent (to take the transaction in exhibit "C2") a sum of £73 6*s*. 8*d*. to the building society, or is it a truer view to say that the builders have received only £521 13*s*. 4*d*. in respect of the transaction, £501 13*s*. 4*d*. from the building society and £20 from the purchaser, leaving a sum of £73 6*s*. 8*d*. in the hands of the building society to be repaid when the sum of £300 has been, by equal monthly instalments of £4 3*s*. 11*d*., paid by the purchaser, and that they are not to be repaid anything if there is a default? For my part, I am convinced that the latter is the true view of this transaction which, as I have said, I consider, although it is a transaction which takes place every day all over the country, to be one of a remarkable character. I think one has to consider whether there have been profits or gains in these cases by the tests applied in ordinary business, and in my opinion the Appellants, Messrs. Cronk, would not, according to ordinary business notions, be acting properly in regarding themselves as having received the whole of the purchase money in a case where they never have received, and never could receive, the whole of the purchase money except subject to the chance of a number of small instalments being paid monthly by people of the sort who enter into these transactions, and who are able only to pay the small monthly instalments out of their wages. All the various circumstances have to be taken into consideration, and, as I have said, I come to the conclusion that the true nature of the transaction is that part only of the purchase money is paid. The balance is made up by an asset of an uncertain character which ought to be subject to valuation, and which is one of the trade receipts of the Appellants which ought to be taken into account for the purposes of ascertaining their profits or gains as traders.

For those reasons, in addition to those given by my brethren, I think this appeal should be allowed.

The Solicitor-General.—My Lord, I would ask for leave to appeal to the House of Lords on, I think, two grounds. First of all, of course, this case does cover a very large number of transactions. This business is going on all over the country. I am not saying it is always exactly in this form, but this is a very common form of transaction. The other ground is that, although I agree the facts here are very special, the argument, and your Lordship's decision in a sense, I think, is based on rather fundamental principles as to what is a receipt and when is it to be treated as a receipt for Income Tax purposes.

Lord Hanworth, M.R.—Are there a great number of cases of this sort with the builders, Mr. Solicitor?

The Solicitor-General.—Yes, my Lord. I understand this is the common form, the way in which the vast number of houses of this class are disposed of all over the country.

Lord Hanworth, M.R.—I only want to know whether there are a large number of these cases. You might say: Well, this is rather a special case and it would not govern any others; or you might say the system is a very widespread one. It is so, is it?

The Solicitor-General.—The system is certainly very widespread. I do not want to bind myself down to the fact that the documents in all cases are in identical form, but I think my friend would agree that this is a very common system of disposing of this class of house, of which there have been so many built in recent years.

Lord Hanworth, M.R.—Yes, Mr. Solicitor, we will give leave to appeal.

Mr. Latter.—My Lord, there has been payment of the tax. I am making the ordinary application in the circumstances that there be an Order to repay, with interest at the rate of 4 per cent., I think it is.

The Solicitor-General.—I think it is 3½ per cent. The only point is that this would be remitted on your Lordship's judgment for these amounts to be valued.

Lord Hanworth, M.R.—Yes.

Mr. Latter.—There is no reason why my friend should sit on it for a week.

The Solicitor-General.—It is not the ordinary case where one knows at once how much should be paid back.

Lord Hanworth, M.R.—But inasmuch as we have said we disagree with the view which has been taken so far I think you must repay the money.

The Solicitor-General.—Very well.

Lord Hanworth, M.R.—With interest, because we do not leave you in the position of secured creditors, Mr. Solicitor.

The Solicitor-General.—I do not think really on my friend's case he is suggesting the whole amount should go back.

Lord Hanworth, M.R.—I really do not know; but inasmuch as we have, so to speak, discharged the assessments as they stand you ought to repay the money that has been paid. You cannot hold any part because we do not know what the part of it should be. The Order of the Court below has been discharged, and the money ought to go back. I have no doubt there will be no difficulty about your getting the money when the assessments have been properly determined.

The Solicitor-General.—If your Lordship pleases.

On the 23rd October, 1935, on an application by the Crown, the Court of Appeal (Greer, Romer and Scott, *L.JJ.*) made their Order, allowing the appeal, in the form which had been agreed between the parties.

The Solicitor-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. A. M. Latter, K.C., and Mr. F. Heyworth Talbot for the Company.

PROCEEDINGS

Greer, L.J.—Yes, Mr. Latter, you want to mention a case.

The Solicitor-General.—My Lord, it is my application.

Greer, L.J.—Very well, Mr. Solicitor.

The Solicitor-General.—It is an application in a case called *John Cronk & Sons, Limited* v. *Harrison*, which was tried before Lord Hanworth, M.R., Romer, L.J., and Maugham, L.J., and the application is that the Order in that case should be in the form which has been agreed between the parties. The difficulty has arisen because of the terms of this draft Order as to repayment; it is not as to any real issue in the appeal, but as to repayment, that is to say, the amount which the Inland Revenue, having lost the appeal, should repay to the other side pending a possible appeal to the House of Lords. The way in which that matter is dealt with in the draft Order appears to depart from or to qualify what Lord Hanworth said with regard to that matter at the conclusion of the case. The difficulty has arisen from my own fault in not appreciating the position fully at the time. If I may just very briefly say how the difficulty has arisen—and Romer, L.J., will, perhaps, recollect the case—the assessments in question were assessments on Messrs. Cronk who are builders; they build houses which they sell, and the purchase price is in effect provided by a building society. It was part of the arrangement that a proportion of that price should remain on deposit with the building society for a certain period and therefore was not freely at the disposal of the builders. The question

(The Solicitor-General.)

was whether that amount left on deposit should be treated 100 per cent. as a trade receipt or should be valued at some lesser figure, such value to be determined by the Commissioners. We were contending that it should be taken 100 per cent. as a trade receipt. My learned friend was saying that it ought to be valued. The Court of Appeal decided that we were wrong and that it must go back to the Commissioners in order that the asset, if that is the right word, should be valued. My learned friend said he would contend that it should be taken at a nil value. Arguments could be advanced for taking it at some value greater than nil and less than 100 per cent. The Court having given me leave to appeal to the House of Lords, my learned friend, Mr. Latter, made an application for repayment. I had in my mind the possible point as to whether this was a proper case for repayment, it being impossible to say what value the Commissioners might put on these deposits, and I was considering whether I should urge that point and say that it was not a case for repayment at all or that in any case we, perhaps, should only repay half or repay on the basis that the value was taken at half the amount of the deposit. That was the point that was in my mind. What in effect happened was that Lord Hanworth used words, in which I acquiesced, which would have resulted in repayment not only on the amount in dispute, that is to say, the amount of my friend's clients' profits which could be related to this question in issue between us, but would also have led to repayment on that part of the assessments as to which there was no dispute at all. The assessments of course dealt with all my learned friend's clients' profits. As to a certain sum—the figures do not matter—there was no dispute at all and therefore it is, in my submission, wrong, and could not have been the intention of the Court, that that part as to which no dispute ever had arisen, or ever could arise, should be repaid. My Lord, I think it fair to those instructing me to say that they did try to draw my attention to this point but, in the hurry at the end of the case and listening to what the Master of the Rolls was saying, I thought those instructing me were still pressing me to take the point as to repayment on the basis of nil valuation, or some valuation, and that really was how the trouble arose.

My Lord, my learned friend agrees to the Order in this form which, in effect, provides that we shall repay the amount in dispute with interest, with a further proviso that if we succeed in the House of Lords the interest shall be repaid. What it does is to leave as it is that portion of the assessments, if that is the right way to put it, as to which there never has been any dispute.

Greer, L.J.—Does it mean repayment on the whole of the deposit that was in question?

The Solicitor-General.—It means repayment of the whole of the Income Tax referable to the deposit.

Romer, L.J.—At the end of the discussion[1] I see, Mr. Solicitor, you first of all said " I do not think really on my friend's " case he is suggesting the whole amount "—that is, the whole amount of the tax—" should go back ", and Lord Hanworth said : " I really do not know ; but inasmuch as we have, so to speak, dis- " charged the assessments as they stand you ought to repay the " money that has been paid. You cannot hold any part because " we do not know what the part of it should be ". You say you do know what the part of it should be.

The Solicitor-General.—Yes. We know what a certain part of it should be. There was the misunderstanding and I thought there was not any part except what was in dispute.

Romer, L.J.—It is quite clear that Lord Hanworth never made an Order for repayment. He suggested that there should be an Order for repayment of the whole because he thought it was impossible to ascertain what part should be payable in any event. You do know now that in any event a certain sum of Income Tax will be paid and that is not to be returned.

The Solicitor-General.—Yes, my Lord. My learned friend agrees, and we agree to pay the costs of this application.

Mr. Latter.—Yes, my Lord. I entirely agree with that.

Greer, L.J.—Be it so, Mr. Solicitor. The Order can be drawn up as you have agreed.

The Solicitor-General.—I am instructed to ask for an Order to tax the costs of this application, if necessary. I daresay there will be no dispute about that.

Mr. Latter.—No, so long as my friend pays them.

Romer, L.J.—Would the Order be dated as from to-day, and ought it in those circumstances to include the costs of this application? I suppose you were ordered to pay the costs of the appeal?

The Solicitor-General.—Yes.

Greer, L.J.—It will necessarily cover the costs of to-day. They will be taxed under the Order to tax.

The Solicitor-General.—Yes.

Greer, L.J.—In any case, if necessary, there will be an Order that you pay the taxed costs of this application.

The Solicitor-General.—Yes, my Lord.

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[1] *See* pages **633/4** *ante*.

ORDER OF THE COURT OF APPEAL

In the Court of Appeal

Wednesday the 23rd day of October 1935

Between :—

John Cronk & Sons Limited ... ... Appellants

and

W. Harrison (H.M. Inspector of Taxes) ... Respondent

Judicature Fees Two Shillings 6.11.35.

On appeal by the Appellants from an Order of the King's Bench Division of the High Court of Justice dated the 11th day of January 1935 confirming the determination of the Commissioners for the Special Purposes of the Income Tax Acts upon an Appeal by the above named Appellants by way of Case Stated from the said determination against assessments to Income Tax in the sums of £11,500 and £9,816 for the years ended 5th April 1932 and 5th April 1933 respectively

Upon reading the above mentioned Order and the Notice of Appeal herein and Upon hearing Mr. A. M. Latter K.C. and Mr. F. Heyworth Talbot of Counsel for the Appellants and Sir Donald Somervell His Majesty's Solicitor-General and Mr. R. P. Hills of Counsel for the Respondent on the 12th day of July 1935 and on this day

It is Ordered by the Court that this Appeal from the said Order be allowed and that the said Case be remitted to the said Commissioners for them to determine the values of the deposits with the Abbey Road Building Society and to adjust the assessments for the years ended 5th April 1932 and 5th April 1933 accordingly unless such values and adjustments of assessments can be agreed

And it is further Ordered that pending such determination or agreement the sum of £2,038 15*s*. 0*d*. in respect of the year ended 5th April 1932 and the sum of £513 in respect of the year ended 5th April 1933 being the amounts of Income Tax overpaid by the above named Appellants on the basis that the said deposits are of no value be repaid to them by the Respondent together with interest thereon from the date of payment to the date of repayment at the rate of three and one half per centum per annum the Appellants undertaking to repay such part of the said interest as is applicable to any portions of the said sums of £2,038 15*s*. 0*d*. and £513 ultimately found to be payable by the Appellants

And it is further Ordered that the costs of this Appeal including the costs of the Application to the Court of Appeal on this day and

of the hearing in the King's Bench Division be taxed by one of the Taxing Masters and paid by the above named Respondent to the above named Appellants or their Solicitors

Leave to appeal to the House of Lords granted.

(*Sgd.*) G. A. Bonner,
King's Remembrancer.

L.S.

5th November, 1935.

Entered.

Supreme Court of Judicature
Central Office
King's Remembrancer.

The Crown having appealed against the decision of the Court of Appeal, the case came before the House of Lords (Lords Atkin, Thankerton, Russell of Killowen, Macmillan and Roche) on the 16th October, 1936, when judgment was reserved. On the 27th November, 1936, judgment was given unanimously against the Crown, with costs, confirming the Order of the Court of Appeal subject to the addition that, in the event of the Commissioners finding an actuarial valuation impracticable, the sums deposited with the building society should not be treated as receipts of the Company's trade except in so far as such sums or any part thereof were released to the Company during the trading periods in question.

The Attorney-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. A. M. Latter, K.C., and Mr. F. Heyworth Talbot for the Company.

JUDGMENT

Lord Thankerton (Read by Lord Roche).—My Lords, the question to be determined in this appeal arises in connection with the ascertainment of the balance of the profits and gains of the trade carried on by the Respondents, assessable under Case I of Schedule D of the Income Tax Act, 1918. The assessments here in dispute were for the years ending 5th April, 1932, and 5th April, 1933.

The Respondents carry on business as speculative builders ; they purchase areas of suitable land, make the roads and sewers, and erect small dwelling-houses, which they sell for about £500 or £600 to persons of small means, who are not usually able to provide from their own resources more than a very small part of the purchase price. The rest of the purchase money is advanced to the purchaser on mortgage by a building society under certain arrangements which give rise to the present question, and which are described in the Case Stated as follows : " A building society will not in the ordinary " way make an advance in excess of 75% of the value of the property

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" mortgaged, and this was insufficient to enable the purchasers to
" pay the balance of the purchase money. In order that the advance
" by the building society to a purchaser might be for the full amount
" of the balance of the purchase money, an arrangement was entered
" into by the Company with the society, under which the Company
" guaranteed to the society a proportion of the amount advanced.
" In addition to giving the guarantee the Company was required to
" make a deposit with the society of the whole or a part of the sum
" guaranteed, and on the amount of this deposit the society allowed
" the Company interest at the current rate payable by the society
" on ordinary deposits. The amount deposited with the society
" usually was one-third of the amount guaranteed. For example, on a
" house which was sold for £625, the purchaser provided from his
" own pocket a sum of £35. The society advanced £590 to the
" purchaser and the Company gave a guarantee for £95, as security
" for which it deposited the sum of £31 13*s*. 4*d*. with the society.
" The actual procedure on the completion of the sale was as follows :—
" The representatives of the building society attended at the office of
" the Company's solicitors and handed to the solicitors a cheque or
" banker's draft for the net sum of £558 6*s*. 8*d*. as representing the
" difference between £590, the amount advanced to the purchaser,
" and £31 13*s*. 4*d*., the amount of the Company's deposit with the
" building society. The solicitors thereupon paid over the cheque
" or draft for the net sum to the Company. All the arrangements
" with the society were made through the Company's solicitors ".

In each case the Company and the society entered into an agreement providing for the guarantee by the Company of repayment by the purchaser of the advance by the society to him, the amount of the guarantee being limited, and further providing for a deposit by the Company with the society of an amount equal to the whole, or, as was usual, only a part of the amount guaranteed. Two specimen agreements are annexed to the Case. It appears that the amount advanced to the purchaser on mortgage was usually repayable with interest in twenty years by equal monthly instalments.

The title of the purchaser was completed by a deed of transfer by the Company to him, in which the Company acknowledged receipt of the whole purchase price. The Case further states : " In the
" Company's trading account a deduction was made from the receipts
" from the sale of houses of the net amount deposited with the
" society during the year under the guarantees, *i.e.*, the sums
" deposited under the guarantees given during the year less any
" sums received back during the year on the release of guarantees.
" The interest received from the society on the deposits is shown as
" a receipt in the profit and loss account, but the deposits are not
" shown as an asset in the Company's balance sheet ".

The Crown maintains that the full amount of the purchase money of the houses should be brought in as a trading receipt at the

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time of purchase, and that any subsequent losses under the guarantees should be allowed at the time when they occur.

The Respondents maintained before the Special Commissioners and in the Courts below (1) that the sums deposited by the Company with the building society ought not to be treated as receipts of the Company's trade at the time of purchase, but only when and in so far as such sums should subsequently be released to the Company by the society ; or (2), alternatively, that if the deposited sums are to be treated as receipts at the time of sale, they should be brought into account at figures not exceeding their actual " present values " as assets of the Company's trade. These were the main contentions of the Respondents.

The Special Commissioners dismissed the Respondents' appeal, their decision being as follows : " We held that the purchase price " of each house was fully paid in cash at the time of each completed " sale with a contingent liability on the Company in respect of its " guarantee to the building society. The whole of the purchase " money should therefore be brought in as a receipt of the Company's " trade at the time of completion of the sale, and any loss under the " contingent guarantee should be allowed at the time when the loss " arose. If we were wrong in this view and a question of valuation " arises, this was not, in our opinion after hearing the evidence, a " case in which an actuarial valuation was possible, there being too " many factors which are not capable of statistical evaluation. " Further, we think that the fact that less interest is earned on the " deposits than could be earned if the money were used in the " Company's business would not affect the valuation ".

The appeal by the present Respondents to the King's Bench Division, on the Case stated by the Special Commissioners, was dismissed by Finlay, J., who affirmed the determination of the Special Commissioners, but both these decisions were reversed by the unanimous decision of the Court of Appeal, which held that the sums deposited with the building society should be brought in as trading receipts at the time of each sale, not at their face value, but on a proper valuation, and the Case was remitted to the Commissioners for determination of such values and adjustment of the assessments.

The Crown now appeals from the Order of the Court of Appeal, but the Respondents have not appealed, and are therefore not in a position to maintain their first contention above referred to.

My Lords, I take it that in finding that the purchase price of each house " was fully paid in cash at the time of each completed sale ", the Commissioners meant that the payment of the cheque or banker's draft for the whole amount advanced to the purchaser, less the amount of the deposit, was merely the shorthand way of giving a cheque for the whole advance in exchange for a cheque from the Company for the amount of the deposit. Taking the example

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given in the Case Stated, we are not told when, or by whom, the payment of the £35 provided by the purchaser was made to the Company, but it is clear that as regards the balance of the price the building society acted as the agent of the purchaser. In my opinion, the whole arrangement was a tripartite one, which should not be separated up. It never was part of the arrangement that the Company were to be entitled to payment of the whole price at the time of sale, and that the Company were to hand over to the society the amount of the deposit. It is enough to say that the purchaser was never entitled to get the whole amount advanced paid over to him or paid over to the Company by the society as the purchaser's agents. It was clearly a condition of the advance to the purchaser by the society that the latter should retain the amount of the deposit. The acknowledgment of receipt of the whole price in the deed of transfer, which is conclusive in favour of a purchaser for value without notice, was necessary to give a good title, but cannot prevent the true facts being regarded in such a question as the present one.

I am, therefore, unable to agree with the view of the Commissioners and of Finlay, J., that the whole of the purchase price should be brought into the account as a trading receipt at the time of sale.

In my opinion, it would be more correct to treat the retention of the deposit as a retention of part of the nominal purchase price with the consent of the Company, such sum to be applicable to reduction of the advance made by the society to the purchaser in the event of the latter's default, any surplus going eventually to the Company. In other words, in the example referred to, the true purchase price was not £625, but two sums of £35 and £558 6*s*. 8*d*., payable at the time of the sale, with a further addition of any balance eventually available from the deposit.

On the other hand, I am not prepared to say that the view taken by the Court of Appeal is not a legitimate one, though I should prefer my own view expressed above. The view of the Court of Appeal, as I understand it, is that, at the time of the sale, the Company received, in addition to the £35 and the cheque for £558 6*s*. 8*d*., an asset in the shape of a credit in the books of the building society, on which interest was payable to the Company, but which was subject to a contingent liability, which materially affected its value to the Company; that such asset should be valued as at the time of the completion of the sale, and that such value should be entered as part of the price received for the house. It is unnecessary to consider now whether such valuation will be subject to revision or readjustment on its eventual realisation.

I am, therefore, of opinion that the case of the Crown has not been made out and that the appeal fails, and, in the absence of a cross-appeal, the decision of the Court of Appeal will fall to be

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affirmed. But I have serious doubt as to whether the valuation ordered by the Court of Appeal is practicable in any proper sense; the Commissioners, after hearing evidence, have expressed the view that an actuarial valuation is not possible, and it may well be that no proper valuation is possible. I propose, therefore, that the Order of the Court of Appeal should be varied by adding that, in the event of the Commissioners finding such valuation to be impracticable, the sums deposited with the building society under the circumstances described in the Case Stated should not be treated as receipts of the Company's trade except in so far as such sums, or any part thereof, were released to the Company during the trading periods in question.

One other point should be mentioned. Counsel for the Crown drew your Lordships' attention to that part of the Order of the Court of Appeal which ordered repayment by the Crown, pending determination of the matter, of the amount of Income Tax overpaid by the Company on the basis that the deposits were of no value to them. The Crown has made the repayment, but Counsel suggested that such an Order was not within the capacity of the Court, in view of the provisions of Section 149 (4) of the Income Tax Act of 1918. Counsel for the Crown did not press the point, but I desire to reserve any opinion on it.

I therefore propose that the appeal should be dismissed with costs, and that the Order of the Court of Appeal should be affirmed subject to the variation above suggested.

Lord Roche.—My Lords, I am requested by my noble and learned friends **Lord Atkin** and **Lord Macmillan** to express their concurrence in the opinion which I have just read, and in the reasons for arriving at the conclusion which is proposed. For myself, I also desire to express my concurrence both in the result and in the reasons.

Lord Russell of Killowen.—My Lords, I also concur.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order of the Court of Appeal be varied by adding that, in the event of the Commissioners finding an actuarial valuation impracticable, the sums deposited with the building society under the circumstances described in the Case should not be treated as receipts of the Company's trade except in so far as such sums or any part thereof were released to the Company during the trading periods in question, and that subject to such variation the said Order be affirmed and the appeal dismissed with costs.

The Contents have it.

[Solicitors:—Stooke-Vaughan & Taylor; Solicitor of Inland Revenue.]