No. 1408—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—20TH AND 21ST MAY AND 6TH JUNE, 1946

COURT OF APPEAL—10TH, 11TH AND 12TH MARCH AND 2ND APRIL, 1947

HOUSE OF LORDS—19TH, 20TH, 22ND AND 23RD APRIL AND 14TH JULY, 1948

RUSHDEN HEEL CO., LTD. *v.* KEENE (H.M. INSPECTOR OF TAXES) (1)

RUSHDEN HEEL CO., LTD. *v.* COMMISSIONERS OF INLAND REVENUE (1)

Income Tax, Schedule D, and Excess Profits Tax — Deduction — Expenses in connection with Excess Profits Tax appeal to Commissioners —Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.* 40), *Schedule D, Cases* I *and* II, *Rule* 3(*a*); *Finance* (*No.* 2) *Act,* 1939 (2 & 3 *Geo.* VI, *c.* 109), *Sections* 14(1) *and* 18.

In August, 1943, *the Appellant Company successfully appealed to the Special Commissioners against a direction made by the Commissioners of Inland Revenue, under the powers conferred on them by Section* 35(1) *of the Finance Act,* 1941, *relating to avoidance or reduction of Excess Profits Tax. In prosecuting their appeal the Company spent* £142 *on legal costs, accountancy fees and witnesses' travelling expenses.*

On appeal to the General Commissioners against assessments to Income Tax under Case I *of Schedule D and to Excess Profits Tax the Company contended that, since Excess Profits Tax was, by virtue of Section* 18(1), *Finance* (*No.* 2) *Act,* 1939, *allowed as a deduction in computing the profits for Income Tax purposes, the expenditure of* £142, *incurred in ascertaining the amount of Excess Profits Tax to be so allowed was itself allowable as a deduction in computing the profits for Income Tax purposes, and therefore also for Excess Profits Tax purposes by virtue of Section* 14(1) *of the Finance* (*No.* 2) *Act,* 1939. *The Crown contended that the deduction claimed was not authorised by Section* 18 *of the Finance* (*No.* 2) *Act,* 1939, *and that the expenditure in question was not money wholly and exclusively laid out for the purposes of the Appellant's trade within the meaning of Rule* 3(*a*) *of the Rules of Cases* I *and* II *of Schedule D. The General Commissioners dismissed the appeals.*

Held, *following the decision in the cases of* Smith's Potato Estates, Ltd. *v.* Bolland *and* Smith's Potato Crisps (1929), Ltd. *v.* Commissioners of Inland Revenue, 30 T.C. 267, *that the expenditure was not an allowable deduction for Income Tax and Excess Profits Tax purposes.*

CASE

Stated by the Commissioners for the General Purposes of the Income Tax for the Division of Wellingborough in the County of Northampton

(1) Reported (K.B.) [1946] 2 All E.R. 141; (C.A.) 63 T.L.R. 401; (H.L.) [1948] L.J.R. 1570.

pursuant to the provisions of Section 149 of the Income Tax Act, 1918, for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Wellingborough in the County of Northampton held at Wellingborough on 6th June, 1945, the Rushden Heel Co., Ltd. (hereinafter referred to as "the Appellant") appealed against assessments to Income Tax, Schedule D, and Excess Profits Tax as under:—

(i) Income Tax, Case I, Schedule D, for the year ended 5th April, 1945, in the estimated amount of £2,750, less £109 wear and tear allowance;

(ii) Excess Profits Tax for the chargeable accounting period ended 19th September, 1943, in the estimated amount of £198 11*s.* 0*d.* (after allowance of £61 9*s.* 0*d.* for National Defence Contribution);

(iii) Excess Profits Tax for the chargeable accounting period ended 19th September, 1944, in the estimated amount of £100 0*s.* 0*d.*

2. In computing their profits for both Income Tax and Excess Profits Tax purposes the Appellant sought to charge as a deduction from such profits the costs and expenses of a successful appeal, in respect of the incidence of Excess Profits Tax, to the Commissioners for the Special Purposes of the Income Tax Acts on 31st August, 1943, and the sole question for our determination was whether such costs and expenses were:—

(*a*) allowable as a deduction for Income Tax purposes;

(*b*) allowable as a deduction for Excess Profits Tax purposes.

3. The following agreed statement of facts was admitted and accepted by both parties as correctly summarising the facts upon which our decision was required:—

(1) The Rushden Heel Co., Ltd. (hereinafter called "the Company") carries on the business (*inter alia*) of manufacturers of heels for boots and shoes. The issued share capital of the Company was at all material times £2,000 divided into 2,000 shares of £1 each.

(2) Prior to 20th January, 1941, the shareholding of the Company was as follows:—

William Childs senior ...	1,971	
William Childs junior ...	6	Children of William Childs senior
Eric Childs	6	
Nellie Abington	6	
Amy Sharpe	6	
Ivy Whiteman	5	

(3) On 20th January, 1941, William Childs senior transferred 100 of the shares held by him to each of his children, William Childs junior, Eric Childs, Nellie Abington and Amy Sharpe. He also transferred a further 101 of his shares to Ivy Whiteman and 106 shares to another daughter, Queenie Hobbs. All the six children then held 106 shares each, 1364 being held by William Childs senior. No consideration for the transfer passed to William Childs senior from the transferees.

(4) On 24th February, 1942, a claim was made on behalf of the Company to the Commissioners of Inland Revenue that William Childs

senior, William Childs junior and Eric Childs were "working proprietors" in the business carried on by the Company, within the meaning of Section 13 (2), Finance (No. 2) Act, 1939, and that the Company was pursuant to the said Section 13 entitled in computing its standard profits for the purposes of Excess Profits Tax liability to an allowance of £1,500 for each "working proprietor" claimed. The effect of this claim if successful would have been to reduce the amount of the Company's liability for Excess Profits Tax.

(5) On 26th March, 1943, the Commissioners of Inland Revenue having considered the transactions of 20th January, 1941, by which 100 shares each in the Company were transferred to William Childs junior and Eric Childs, and being of the opinion that the main purpose for which the transactions were effected was the avoidance or reduction of liability to Excess Profits Tax, directed by virtue of the powers conferred on them by Section 35(1), Finance Act, 1941, that the Excess Profits Tax liability of the Company for the chargeable accounting period ended 21st September, 1941, should be computed on the basis that William Childs junior and Eric Childs were not to be regarded as "working proprietors" for the purpose of computing the Company's standard profits, but that a deduction should be made in computing the profits of the said chargeable accounting period of the remuneration paid to them.

The Commissioners also directed that the liability to Excess Profits Tax for chargeable accounting periods subsequent to 21st September, 1941, should be computed on the said basis so long as the circumstances remained the same and the remuneration paid to William Childs junior and Eric Childs continued to be reasonable in amount.

(6) By making the said directions the Commissioners were in effect refusing to admit the Company's said claim for a reduction of the amount of its liability for Excess Profits Tax.

(7) Accordingly, on 31st August, 1943, the Company appealed to the Commissioners for the Special Purposes of the Income Tax Acts pursuant to Section 35(3), Finance Act, 1941. The appeal was allowed on the ground that the avoidance or reduction of liability to Excess Profits Tax was not a purpose for which the transactions were effected, and the direction of the Commissioners of Inland Revenue was discharged. The Company's said claim for a reduction of the amount of its liability for Excess Profits Tax therefore succeeded.

(8) In the accounts of the Company for the accounting periods 20th September, 1942, to 25th September, 1943, and 26th September, 1943, to 30th September, 1944, there were charged against the profits of the Company the following items, being expenses by the Company in connection with the above-mentioned successful appeal to the Special Commissioners:—

Accounting period 20th September, 1942, to 25th September, 1943.

	£	*s.*	*d.*
Messrs. Scott & Son, solicitors, legal costs, including fees to Counsel	47	19	0
Mr. Victor Bayley, chartered accountant, fees for consultations and advice	31	10	0
Travelling expenses of witnesses	14	10	0
	93	19	0

Accounting period 26th September, 1943, to 30th September, 1944.

Messrs. F. Roberts & Co. (accountants acting generally for the Company), fees for professional services specially in connection with the said appeal ... ... £48 0*s.* 0*d.*

4. The accounts for fees and charges rendered by the solicitors and accountants and charged in the Company's profit and loss accounts were handed to us. These accounts, in one bundle and marked "A", together with the Company's balance sheets and trading and profit and loss accounts for the period ended 25th September, 1943, and 30th September, 1944, marked "B" and "C" respectively, are annexed hereto and form part of this Case (1).

5. Counsel for the Appellant contended:—

(i) That since Excess Profits Tax was by Section 18(1), Finance (No. 2) Act, 1939, allowed as a deduction in computing the Company's profits for Income Tax purposes, the costs of ascertaining the quantum of tax as to be deducted must be a deductible expense of the Company's trade or business since (*a*) it satisfied the test laid down by Lord Davey in *Strong and Company of Romsey, Ltd.* v. *Woodifield*, 5 T.C. 215, at page 220, and (*b*) the deduction was not prohibited by Rule 3(*a*) of of the Rules applicable to Cases I and II of Schedule D of the Income Tax Act, 1918.

In support of these contentions the Appellant referred to:—

Strong and Company of Romsey, Ltd. v. *Woodifield*, 5 T.C. 215.

Usher's Wiltshire Brewery, Ltd. v. *Bruce*, 6 T.C. 399.

Commissioners of Inland Revenue v. *E. C. Warnes & Co., Ltd.*, 12 T.C. 227.

Commissioners of Inland Revenue v. *Alexander von Glehn & Co., Ltd.*, 12 T.C. 232.

Allen v. *Farquharson Brothers and Company*, 17 T.C. 59.

Worsley Brewery Co., Ltd. v. *Commissioners of Inland Revenue*, 17 T.C. 349.

Patent Castings Syndicate, Ltd. v. *Etherington*, [1919] 2 Ch. 254.

L.C., Ltd. (in liquidation) v. *G. B. Ollivant, Ltd. and Others*, [1944] 1 All E.R. 510.

Income Tax Commissioner, Bihar and Orissa v. *Singh*, [1942] 1 All E.R. 362.

Southern v. *Borax Consolidated, Ltd.*, 23 T.C. 597.

Spofforth and Prince v. *Golder*, [1945] 1 All E.R. 363; 26 T.C. 310.

(ii) If the expenses in question were rightly so claimed as deductions for Income Tax purposes then it followed, by virtue of Section 14(1), Finance (No. 2) Act, 1939, that the said expenses were properly claimed as deductions from the Appellant's profits for purposes of computing its liability to Excess Profits Tax.

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(1) Not included in the present print.

6. It was contended on behalf of the Crown that:—

(1) Section 18, Finance (No. 2) Act, 1939, did not authorise the deduction of the said costs and expenses in computing, for the purposes of Income Tax, the profits and gains arising from the Appellant's trade or business.

(2) The said costs and expenses were not money wholly and exclusively laid out or expended for the purposes of the Appellant's trade within the meaning of Rule 3(*a*) of the Rules applicable to Cases I and II of Schedule D, Income Tax Act, 1918.

(3) The said costs and expenses were not admissible deductions in computing the profits and gains arising from the Appellant's trade either for the purposes of Income Tax or for the purposes of Excess Profits Tax.

7. After hearing the whole of the facts, evidence and arguments, we, the Commissioners who heard the appeal, intimated our desire to take time for consideration of our decision, and accordingly, on 5th July, 1945, our decision in writing was delivered to the Appellant by our Clerk in the following form:—

"re Rushden Heel Company's appeal

"I am instructed to inform you that the appeals by the above Com-"pany which were heard on the 6th ultimo have been dismissed by my "Commissioners."

The Respondent was also informed in writing by our Clerk that our decision was as follows:—

"That the expenses claimed be disallowed both for Income Tax and "Excess Profits Tax and that the appeals be accordingly dismissed."

8. At the date of the hearing of the appeal the amounts of the assessments, set out in paragraph 1 hereof, were estimated only and had not been agreed between the parties. Our decision was therefore given in principle only.

9. The Appellants immediately upon the determination of the appeal declared their dissatisfaction with the Commissioners' determination as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to Section 149 of the Income Tax Act, 1918, which Case we have stated and do sign accordingly.

Dated this 23rd day of January, 1946.

C. W. HORRELL,
A. ALLEBONE,
JOHN LEA,
ERNEST BARKER,
S. BOOTH,
} Commissioners.

The cases came before Atkinson, J., in the King's Bench Division on 20th and 21st May, 1946, when judgment was reserved. On 6th June, 1946, judgment was given against the Crown, with costs.

Mr. J. Millard Tucker, K.C., and Mr. J. W. P. Clements appeared as Counsel for the Company, and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Atkinson, J.—In this Case Stated there are three appeals dealt with in one Case. I am asked to draw attention to the fact that this is contrary to the usual procedure. There ought to be a Case for each appeal. The taxing authorities for Excess Profit Tax and Income Tax appeals are different. The taxes are levied under different statutes and this may lead to inconvenience. Three Orders would have to be drawn up in this case, apparently. I am saying this without any knowledge of my own, but, as far as the King's Remembrancer and the office are concerned, they think this is not the better practice, but that there ought to be one Case for each appeal.

These appeals arise in the following way. The Rushden Heel Co., Ltd. carries on a business, among other things, of manufacturing heels for boots and shoes. Its capital consists of 2,000 £1 shares. Before 20th January, 1941, Mr. William Childs senior held 1,971 shares, William Childs junior six shares, and Eric Childs another six. There were three other children who held six or five shares apiece. In January, 1941, Mr. Childs transferred 100 shares to each of his six children so that each of them had 106 shares, leaving 1,364 in his own hands. On 24th February, 1942, the Company claimed that Mr. Childs senior and William Childs junior and Eric Childs were "working proprietors" within Section 13 (2) of the Finance (No. 2) Act, 1939. Section 13, which deals with the computation of standard profits, says: "(1) For the purposes of this Part of this Act, the standard "profits of a trade or business shall, in relation to any chargeable account-"ing period, be taken, if the person carrying on the trade or business so "elects, to be the minimum amount specified in subsection (2) of this "section". Then Sub-section (2) provides: "The minimum amount "referred to in subsection (1) of this section is one thousand pounds, or, "in the case of a trade or business carried on by a partnership or by a "company the directors whereof have a controlling interest therein, such "greater sum, not exceeding three thousand pounds, as is arrived at by "allowing seven hundred and fifty pounds for each working proprietor in "the trade or business." Section 31 (1) of the Finance Act, 1940, amended that last Sub-section and provided: "For subsection (2) of section "thirteen of the Finance (No. 2) Act, 1939, there shall be substituted the "following subsection—'(2) The minimum amount referred to in sub-"'section (1) of this section is one thousand pounds, or, in the case of a "'trade or business carried on by a single individual, or by a partner-"'ship, or by a company the directors whereof have a controlling interest "'therein, such greater sum, not exceeding six thousand pounds, as is "'arrived at by allowing one thousand five hundred pounds for each "'working proprietor in the trade or business'". Therefore, if the Company's claim was well founded, their standard would be at least £4,500, because there was no question, if the transaction were bona fide, about these three men being controlling directors and working directors.

But on 26th March, 1943, the Assessing Commissioners took the view that the main purpose of the transfer was to avoid Excess Profits Tax, they refused to accept Mr. Child's assurance that it was not, and directed that the liability for that tax for the chargeable accounting period ending 21st September, 1941, should be computed on the basis that the two sons were not working proprietors, but that their remuneration be allowed as an expense, and they gave a similar direction for all future accounting periods.

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In other words the Assessing Commissioners made a charge of bad faith against these gentlemen, which reduced their standard profits to £1,500.

On 31st August, 1943, the Company appealed to the Special Commissioners and the appeal was allowed, the direction of the Assessing Commissioners being discharged. It is quite plain, therefore, that the Company benefited to the extent of £3,000, less what salaries they would have been allowed as an expense, and the fund available for and subject to Income Tax was similarly increased.

The appeal cost the Company in legal and accounting expenses £141 19*s.* 0*d.* In the accounts for the year ending September, 1943, £93 19*s.* 0*d.* was charged against the receipts of the Company, and in the following year the balance of £48 was so charged and was, in fact, paid. The £48 might have been included in the earlier year as a debt, but nothing turns upon that. Of this sum of £141 the solicitor's costs amounted to £47 odd, the expenses of one set of accountants were £31 10*s.* 0*d.*, travelling expenses were £14 odd. The £48 was in respect of the accountants acting generally on behalf of the Company.

In assessing the Appellants for Excess Profits Tax for the year these payments on account of costs were disallowed as deductible expenses. In the following Income Tax assessment, although the profits assessable to Income Tax had been increased by a substantial sum, the expenses of obtaining that increase were again disallowed.

The first and main appeal is in respect of the Income Tax assessment for the year 1944-45, which, of course, was based on the previous year's accounts. In this year 1943-44 the Company had successfully resisted a claim for Excess Profits Tax, reducing the amount claimed by a very substantial sum, thereby increasing the divisible profits of the Company and the profits assessable to Income Tax to an equivalent amount. It is said that the expenses of securing that increase are to be disallowed. It is not claimed that the disallowance was fair or in accordance with commonsense or ordinary business methods, because, plainly, it was not, but it is said it is the result of certain decisions by which I am bound.

The only statutory direction is Rule 3 of the Rules applicable to Cases I and II of Schedule D: "In computing the amount of the profits or "gains to be charged, no sum shall be deducted in respect of—(*a*) any "disbursements or expenses, not being money wholly and exclusively laid "out or expended for the purposes of the trade, profession, employment or "vocation", the material words here being "for the purposes of the trade".

An explanatory dictum very much relied upon by the Respondents was the statement by Lord Davey in the case of *Strong and Company of Romsey, Ltd.* v. *Woodifield,* 5 T.C. 215, at page 220, where Lord Davey said that the expenditure must be made for the purpose of earning the profits. It might be just as well to read a little more of what he said: "I "think that the payment of these damages was not money expended 'for "'the purpose of the trade.' These words are used in other rules, and "appear to me to mean for the purpose of enabling a person to carry on "and earn profits in the trade, etc. I think the disbursements permitted "are such as are made for that purpose. It is not enough that the dis-"bursement is made in the course of, or arises out of, or is connected with, "the trade or is made out of the profits of the trade. It must be made for "the purpose of earning the profits." It is as well to remember that only

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a few lines before he had expressed himself a little more fully in the words: "It appears to me to mean for the purpose of enabling a person "to carry on and earn profits in the trade".

It is not unimportant, I think, to realise what the question in that case was. A brewery company, which owned licensed houses in which they carried on the business of innkeepers, incurred damages and costs to the amount of nearly £1,500 on account of injuries caused to a visitor staying at one of their houses by the falling of a chimney. It was held that the damages and costs were not allowable as a deduction in computing the company's profits. Lord Loreburn, L.C., in dealing with the matter, said this, on page 219: "In my opinion, however, it does not follow that if a "loss is in any sense connected with the trade, it must always be allowed as "a deduction; for it may be only remotely connected with the trade or it "may be connected with something else quite as much as or even more "than with the trade. I think only such losses can be deducted as are "connected with it in the sense that they are really incidental to the trade "itself. They cannot be deducted if they are mainly incidental to some "other vocation, or fall on the trader in some character other than that of "trader. The nature of the trade is to be considered. To give an illustra-"tion, losses sustained by a railway company in compensating passengers "for accident in travelling might be deducted." It is very difficult to say that expenditure of that kind is incurred for the purpose of earning profits, but the statement of Lord Davey has been so often referred to and accepted that Lord Macmillan in the case of *L.C., Ltd.* v. *G. B. Ollivant, Ltd.*, [1944] 1 All E.R. 510, at page 517, could say: "It is indeed a "commonplace in tax law that in ascertaining what deductions are permis-"sible in computing the amount of the taxpayer's profits or gains the "question is whether the deduction claimed represents an outlay in order to "earn profits or is a disbursement of profits earned." I must say that I could not help sympathising with and appreciating more and more as the case went on what Lord Greene, M.R., said in the case of *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.*, [1946] 1 All E.R. 58, at page 60 (29 T.C. 155, at page 161): "Speaking for myself, I am always dis-"inclined to accept any general definition or test for the purpose of solving "this type of question. The question whether or not a particular piece of "income is income received from an investment must, in my view, be "decided on the facts of the case. The facts must be ascertained, and then "the question has to be answered. For the Court to find itself fettered by "some apparently comprehensive attempt at a definition directed to the "solution of the problem in relation to one type of property, I cannot help "thinking is unfortunate." I cannot help thinking the same thing here.

If one were permitted to interpret unaided the words in Rule 3 there would be no great difficulty about the case. But accepting as I must what Lord Macmillan said, the problem I have to solve, as far as I can see, is this: Is the expense of ascertaining the profits an expense which is an outlay in order to earn profits, or is it a disbursement of profits earned? That seems to me to be the problem.

It is very difficult to know exactly what is meant by an outlay in order to earn profits. Are the costs of an appeal against an assessment of business premises for rating purposes directed to the earning of profits? Is the expense of the charwoman who cleans the floors directed to such an end? Is the expense incurred in resisting an unjust claim so directed?

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The statutory rule is comparatively simple of application. Was the expense a purely business expense, an expense purely for the purpose of the trade, not of trade, but of the trade? Clearly it is a necessary operation for every trader to ascertain the sum due from him to the Crown for taxes. It is a part of the trade. It is a legal burden imposed upon him. Yet it is directed to the earning of profits only in the sense that it is made for reducing the claims of the Crown and thereby increasing the divisible profits. Profits, as it seems to me, must not be confused with receipts. Profits consist of a sum arrived at by adding up the receipts of a business and by deducting all the expenses and losses, including depreciation and the like, incurred in carrying on the business.

In the case of *Vulcan Motor and Engineering Co.* (1906), *Ltd.* v. *Hampson,* [1921] 3 K.B. 597, the Court of Appeal held that the words "profit earned by the company" meant "profits divisible among the "shareholders, in other words 'net profits'".

Expenses necessarily and properly incurred in carrying on a business, in my judgment, are directed to the earning of profits. Profits are increased or earned by reducing expenses, just as much as by increasing receipts. Therefore an expenditure directed to reducing expenses is just as much directed to earning profits as is an expenditure directed to increasing receipts. In both cases the expenditure must be of a revenue character.

In taxation matters there are three different ascertainments of profits. First you have the commercial ascertainment, usually carried out—and indeed in the case of companies it must be so carried out—by qualified accountants. It cannot be suggested that the expenditure in question could be treated by the company as anything but revenue expenditure, reducing the profits available for dividends. There is no auditor in the world who would pass such a payment as a capital payment in the computation for business accounts. It is clear that it would inevitably be treated as an expenditure reducing the divisible profits. The ascertainment of these profits cannot be reached finally until after the second computation, that is to say, until the computation for the purpose of arriving at the Excess Profits Tax has been completed, because Excess Profits Tax is an expense and a debt to the Crown. Until that amount is ascertained even the first ascertainment of profits cannot be more than provisionally arrived at.

The next ascertainment, that is the one for the purpose of arriving at the amount of Excess Profits Tax, is quite a different computation. It is under Section 14 of the Finance (No. 2) Act, 1939: "(1) For the purposes "of this Part of this Act, the profits arising from a trade or business in the "standard period or in any chargeable accounting period shall be separately "computed, and shall be so computed on income tax principles as adapted "in accordance with the provisions of Part I of the Seventh Schedule to "this Act". In ascertaining profits for the purposes of Excess Profits Tax there are all sorts of different rules to bear in mind. Salaries can be revised, many transactions can be disregarded, any expense can be revised. It is really a different computation, it is enough to say that. The first or provisional ascertainment has to be corrected in accordance with those principles and with the Schedules.

Following on the ascertainment of the amount of Excess Profits Tax, you can then proceed to your computation for Income Tax purposes. There

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again that is a different computation because many of the rules, which are applicable when computing the profits for the purposes of Excess Profits Tax, do not apply to the computation for the purpose of arriving at the profits for the purposes of Income Tax.

There are two quotations one might profitably remember with regard to the broad view which has to be taken in making these assessments. In the case of *Gresham Life Assurance Society* v. *Styles*, 3 T.C. 185, at page 188, Lord Halsbury, L.C., said: "The word 'profits' I think is to be under-"stood in its natural and proper sense—in a sense which no commercial "man would misunderstand."

In the case of *Worsley Brewery Co., Ltd.* v. *Commissioners of Inland Revenue*, 17 T.C. 349, at page 356, Lord Hanworth, M.R., said: "Now, "it is quite true that the assessment of profits and gains for Income Tax is "an assessment which has to be corrected in accordance with the directions "laid down by the statute. That is clear and is stated in the judgment of "Lord Justice Warrington in the case of the *Inland Revenue Commissioners* "v. *von Glehn*[1]), but, subject to those corrections, the proper way to "ascertaining the profits and gains is by the ordinary business methods "whereby those profits and gains would be ordinarily determined by busi-"ness men." Would any business man, anywhere, treat this expenditure as anything but a business expense reducing the profits of the year? I suppose, notwithstanding this broad principle, it is clear that not every expense which a prudent trader would treat as a revenue expenditure can be deducted in computation of profits for tax purposes.

In the course of the second computation in this case the question arose as to the proper standard with regard to the Excess Profits Tax. There was no finality with regard to this question until it had been settled by the Special Commissioners. Before that finality had been reached, this expense had been incurred.

Then came the third computation necessary for the assessment of Income Tax. That assessment could not be made until the amount payable for Excess Profits Tax had been finally ascertained.

The point I want to emphasise here is this. All this expense which is in question was incurred before there was any ascertainment of profits, whether profits in the first sense, divisible among the shareholders, whether profits subject to Excess Profits Tax, or whether profits available for Income Tax. The expense was incurred before the ascertainment of profits in any one of those three senses.

By Section 18 of the Finance (No. 2) Act, 1939, the payment of Excess Profits Tax is to be deemed an expense. Three points can be noted in connection with this expense when considering the assessment for Income Tax purposes. The expense in dispute increased the profits available for Income Tax by a substantial sum. The expense incurred increased the profits available for Income Tax for all future years so long as Excess Profits Tax should exist. The expense incurred was incurred before the profits for Income Tax purposes or any other purpose were ascertained. Can it be said that this expenditure was not incurred solely for the purposes of the trade? Can it be said that it was not directed to earning profits? Lord Wright in *Ollivant's* case, [1944] 1 All E.R., at pages 519-20, pointed out that the amount payable for Excess Profits Tax never came into the

(1) 12 T.C. 232, at p. 238.

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divisible profits, "but is bodily taken away out of the profits, which must "be reduced accordingly". I know that Lord Simon, L.C., and Lord Macmillan took a different view, but the majority of the Law Lords took Lord Wright's view. The payment of Excess Profits Tax is not, therefore, to be deemed to be a payment of a part of the profits. It is an expense taken out of the volume of receipts. If there had been no appeal £4,500 would have been bodily taken out of the receipts of the Company. As a result of the appeal two-thirds of that was brought back.

What guidance can be obtained from the decided cases as to the meaning of this expression "directed to the earning of profits"? Expenditure to get rid of a troublesome director has been allowed. The expenditure of maintaining the assets of the business, where costs were incurred in upholding the trader's title to property, was allowed. Costs incurred in recovering a trade debt, costs incurred in resisting a claim for damages arising out of a business transaction, costs incurred in resisting a claim for conspiracy and fraud have all been allowed.

There is a sentence in the authority for the last example, *Income Tax Commissioner of Bihar and Orissa* v. *Singh*, [1942] 1 All E.R. 362, which is worth noting. I am looking at page 365. The Privy Council was dealing with the appeal, and Lord Thankerton was expressing the opinion of the Board. The question was whether expenses incurred by a Maharajah in defending a claim for damages for fraud could be allowed as a deduction. The Maharajah had won his case. Lord Thankerton, quoting Meredith, J., said: "'Defence of such suits must be regarded, in my view, as a "'necessary though unpleasant part of the business of moneylending'"—the Maharajah might have been sued in his personal capacity but he was sued in respect of transactions which had some connection with a moneylending business—"'I am satisfied that the suit was primarily against the "'Maharajah in his capacity as moneylender, and not merely as a rich "'nobleman, and it was based primarily too upon breach of contract by the "'moneylender.'" Lord Thankerton goes on: "In the opinion of their "Lordships, the only right view as to the nature of the Agra suit is that "expressed by these judges." In other words, if it was a necessary though unpleasant part of the business, the expense incurred was to be allowed.

I should imagine that the duty of the ascertainment of indebtedness to the Crown was a necessary though unpleasant part of the business of any trader.

Expenditure in order to reduce expenses (see *Anglo-Persian Oil Co., Ltd.* v. *Dale*, 16 T.C. 253) is an example of another kind of allowable deduction. Expenditure to get rid of an annual expense chargeable against revenue is allowable. The expense of keeping an accountant or an accountancy department is a proper deduction to be made. The expense of ascertaining profits by accountants, not merely for the purpose of the Companies Acts, but for the purpose of ascertaining profits for Income Tax and Excess Profits Tax purposes, is an expense which is also to be allowed. Indeed, the expenditure of accountants discussing and arguing the question with the Inspector of Taxes is properly to be deducted (*Allen* v. *Farquharson Brothers & Co.*, 17 T.C. 59). If the expense of computing profits for Excess Profits Tax or Income Tax is allowable and the expense of arguing matters arising with the Inspector of Taxes is an expense incurred for the purpose of earning profits, why is not the expense of arguing the same

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matters before the Special Commissioners on appeal also an expense for the purpose of earning profits? The expense of arguing the matter in one room is allowed; the expense of arguing before the Special Commissioners in another room and saving between £2,000 and £3,000 for the business, it is said, must be disallowed. There is no difference in object or purpose between the first set of expenses and the latter expenses. The amount of the Excess Profits Tax, as I have said, is to be treated as an expense. The expense in question reduces a larger business expense. It seems to me plain that the expense in dispute ought to be allowed, and unless I am precluded by authority from so doing, I shall proceed so to hold. May I? That is the real question in these appeals.

The case which is said to have settled the question adversely to the Appellants is the case of *Allen* v. *Farquharson Brothers & Co.*, 17 T.C. 59. That was a decision of Finlay, J. Farquharson Brothers had appealed against an adjustment in an assessment, which had the effect of reducing the sum to be assessed from £10,000 to £2,570, less a deduction of £413 for wear and tear, which had been agreed. But the respondents claimed a further deduction of £100, which would leave the assessment in the sum of £2,470, less £413 for wear and tear. The sum of £100 so charged in the accounts in the assessment consisted of the legal costs incurred by the respondents in the appeal to the Special Commissioners, and the question to be decided was whether that sum of £100 was an admissible deduction. The subject-matter of the appeal had been whether the respondents had succeeded to a business formerly carried on by somebody else, and the appeal was decided after two hearings. At the first hearing the Special Commissioners gave their decision in principle in favour of the respondents, that the respondents had succeeded to the business, and left the figures to be agreed between the parties. At the second hearing a subsidiary point arose out of the terms of the previous decision and was decided in favour of the Crown. In the result a very considerable reduction in the amount of profits assessed and Income Tax payable by the respondents for those four years was obtained by them. There were the usual contentions, the respondents saying that it was money wholly and exclusively and necessarily expended for the purposes of the trade, and the Inspector contending that it was not. The Commissioners, who were business people, took the natural view, saying: "We . . . determined that the sum of £100 "having been expended to ascertain the true profits of the business distri- "butable amongst the partners and assessable on the firm for Income Tax, "was money necessarily, wholly and exclusively laid out for the purpose of "the business . . . and was also a monetary loss connected with the trade", and so on. There was an appeal, and Finlay, J., allowed it. It is important to observe that the appeal had nothing to do with the question of Excess Profits Tax; it was merely concerned with the computation for Income Tax. On page 63 the learned Judge, I think, clearly shows the distinction between the question that would have arisen if it had been an Excess Profits Tax appeal, and the question arising in relation to Income Tax. He says: "The distinction, of course, is perfectly familiar and, in a general way, is "recollected by anybody who has ever had anything to do with these "things. Income Tax is not a deduction before you arrive at the profits; "it is a part of the profits. It is, as has been expressed by some well- "known person—I cannot remember who, but it does not matter—the "Crown's share of the profits. Excess Profits Duty was quite a different

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"sort of thing. That was a deduction, the sum to be deducted before you "arrived at the profits for the purpose of computation, with the result "that you deducted the Excess Profits Duty in arriving at the computation "and then if, as sometimes happened, later on, some Excess Profits Duty "was got back, that Excess Profits Duty had to be brought in. Nothing of "that sort, of course, is true of the Income Tax." It seems to me the learned Judge is saying that expenses incurred before arriving at the profits, as is the case in an Excess Profits Tax appeal, would be in a different position from the expenses which he was considering. That seems to me the distinction that he is drawing there. If that is so then the case does not at all decide the point with which I have to deal.

But I have felt considerable difficulty in following the argument of the learned Judge on the bottom of page 65. The learned Judge says: "I do "not doubt that there are expenditures connected, for example, with the "accounts, which are habitually allowed and rightly allowed; I do not "doubt that the expenditure of keeping an accountant or, it may be, in the "case of some of the very great businesses with which we are familiar, "keeping a whole accountants' department, is a proper deduction to be "made. I do not doubt, further, that the accountants' department will deal "with matters of Income Tax in the sense that they will prepare the "accounts for Income Tax and, as I suppose, sometimes discuss questions "with the Inspector of Taxes or representatives from Somerset House "which arise, and I do not suppose it would be sought to say that, by "reason of that, the expenses of the accountants' department were not "proper to be allowed. I have got to decide the case, in spite of the "invitation which has to some extent been given to me from both sides "of the Bar, on the facts as they are found in the case, and in this case "it seems to me that it is impossible to say that this was an "expenditure for the purpose of earning the profits. The answer "seems to me to be simple, that it was not an expenditure for "the purpose of earning the profits and could not be." May I stop there for a moment? I ask, in all humility, why the accountant's charges should be allowed as an expense for the purpose of earning profits, and the costs of defeating the Crown's claim not be allowed as an expense for the same purpose? The learned Judge goes on: "I cannot see that the profits were "in the slightest degree altered, either decreased or diminished, as the result "of this expenditure." I do not know what that means in view of the finding that, in the result, a very considerable reduction in the amount of profits assessed for these four years was obtained. I do not follow that. "I feel compelled, on these facts as they are set out in this Case, to hold "that this was an application—I should think, as far as I can judge, an "exceedingly proper application—of profits after they have been earned and "was not an expenditure necessary to earn the profits." That is the ground of the decision—an application of profits after they have been earned.

But, if that is the right view, logically, every accountancy expense incurred after the close of the chargeable accounting period should be disallowed. Ascertaining the true figures is something which is necessarily done after the profits have been earned. But the ascertainment of profits is a business duty cast upon the company. At the close of the accounting period it is a liability still to be discharged. A necessary preliminary step to the performance of the statutory duty of paying Excess Profits

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Tax is the ascertainment of profits computed in accordance with the Finance Act. A necessary preliminary duty to the payment of Income Tax is the ascertainment of the expense of Excess Profits Tax and of the profits as computed for that purpose. If the correct ascertainment involves bringing the figures before the Special Commissioners on appeal, I cannot myself see any ground upon which the costs of so doing can be held to be money not wholly and exclusively expended for the purposes of the trade. It seems to me there are two reasons why I am free to give effect to my own view. First, this case does not touch the question with which I have got to deal. It does not touch the costs of an Excess Profits Tax appeal. But the other reason, and perhaps the more important one, is this. In my view that judgment is inconsistent with the later case, in the Court of Appeal, of *Worsley Brewery Co., Ltd.* v. *Commissioners of Inland Revenue,* 17 T.C. 349. I think the judgment in that case confirms the view I have formed. The Worsley Brewery Company had their accounts made up for seven years, ending with 1920. The accounts had been agreed. The amount due had been paid. Then five years afterwards, for some reason which is not stated, they had reason to suppose that the accounts had been made out on a wrong basis, or, at any rate, if the profits had been properly computed, they would not have had to pay so much. New accountants were engaged to go into the whole question of the seven years' accounts. They did, and at an expenditure of £900 odd they found out that a sum of £6,491 had been overpaid. A claim for repayment was made, the facts were put before the Commissioners, and repayments were made. £3,000 was repaid in the accounting year 1928 and the balance in the year 1930. The expenses incurred in securing the return of those sums amounted to £973.

There was no question, as far as I can see, but that those expenses would be properly allowable in the two years in which the repayments were received. But that would not have helped the company as much as if they could get the expenses thrown back to the earlier years, because Excess Profits Duty had ceased to be payable. Therefore, their claim was that those expenses should be thrown back and divided up over the seven years in respect of which the accounts had been reopened, so that they could recover still further money which had been paid in Excess Profits Duty. It would have been a very simple answer to say: "But this is an expenditure of profits after they have been earned. The "account is closed. The profits were earned years ago." It would have been the simplest thing in the world to say: "There is really "nothing to discuss." Yet it was conceded, as far as I can see; at any rate it was held that it would be a proper allowance in the years in which the two sums were received, but that they could not be thrown back to the years in question.

Rowlatt, J., dealt with it in this way, in the middle of page 353: "It "seems to me that the accountants' charges which are allowed are not "allowed as cleaving to any item". That had been argued, that they ought to be deemed to be cleaving to the item that was dealt with in the earlier years. "They are charged as a current item of the expenses in the "current year and no more. It is a little bit metaphysical, but if that is "right, this charge is simply a current item of the expenses of the

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"Company. It is incurred in the later year; it may have become "necessary in the later year because of some fumbling which was made "in the preceding year." Lord Hanworth, M.R., in the Court of Appeal, said, in the middle of page 355: "It would appear from the facts that "it is the custom, and it is right, to allow accountancy charges in the "computation of the profits for the purpose of Excess Profits Duty. I do "not desire to say more; I accept that proposition as one which is "not contested in the present case. Secondly, it may be that it is right "to employ not one but two sets of accountants. Again I make no "comment upon that; I am going to assume that it was a legitimate expense "for the Company to undertake, but it is to be remembered that the "expense was incurred by reason of the retainer given in the year 1925, "and not before." Then he proceeded to deal with the question whether this expense could be thrown back a number of years.

Now I come to a very important judgment of Romer, L.J., which, in my humble opinion, entirely confirms the view I have formed. He says, at the bottom of page 359: "I am prepared to assent to the view that, "when ascertaining profits of a trading concern, whether for the purposes "of Income Tax or Excess Profits Duty, the expense of having the "accounts investigated by an accountant usually employed, or by any "accountant, and the preparation of the profit and loss account and of "the balance sheet, is an expense which the trading concern is entitled "to deduct from its receipts for the purposes of ascertaining its profits." Now, why?—"That appears to be, or, at any rate, may be taken, I "think, to be an expense incurred wholly and exclusively for the purposes "of the trade, which means, in view of the statement made by Lord "Davey in *Strong* v. *Woodifield*(1), [1906] A.C. 448, an expense made for "the purpose of earning profits." That is saying, in very plain language, that all these accountancy charges to which he had been referring are expenses incurred for the purpose of ascertaining the profits, and if so incurred they are expenses incurred for the purpose of earning the profits. Then he says: "I am not prepared to hold that, when all that "has been done and the profits have been ascertained after the employ-"ment of the accountants in the normal way and a question arises at "some subsequent period between the trading concern and some third "party, which involves a consideration of the question whether the "profits so ascertained were correctly ascertained, the expense of further "investigating the accounts is an expense incurred for the purpose of "earning the profits." Where does the Lord Justice draw the line? It seems to me he draws the line in this way. All expenses incurred for the purpose of ascertaining the profits are allowable, but, when the profits have been ascertained, any further expenditure is not allowable.

When were the profits ascertained? If one looks up the word "ascertain" in a dictionary one find this: "to render certain: to fix: to "determine: to find out for a certainty." I think this is the dividing line. Any expense incurred in ascertaining the profits in that sense, in ascertaining them for a certainty, in finally determining what they amount to, comes within the first part of Lord Macmillan's statement(2); in other

(1) 5 T.C. 215, at p. 220.

(2) L.C. Ltd. *v.* G. B. Ollivant, Ltd., [1944] 1 All E.R., at p. 517.

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words, as Romer, L.J., said(1), expense incurred for the purposes of ascertaining the profits may be said to be an expense for the purpose of earning profits. The profits were not ascertained when the Commissioners or the Inspector of Taxes made a charge of bad faith against the Appellants and directed that the transaction in question should be disregarded. They were not ascertained until the appeal had been heard and a final decision given. None of the profits in any of the three senses to which I have referred were ascertainable until after that decision had been given. Then, and not until then, did the Company know what the divisible profits were. Then, and not until then, did they know what the expense in connection with Excess Profits Tax was to be; then, and not until then, could one determine what were the profits assessable to Income Tax.

In my judgment the true principle, if I may repeat it once more, is that an expense properly and reasonably incurred in the final ascertainment of profits may properly be considered an outlay in order to earn profits. It is not an outlay of profits, certainly not ascertained profits, as the profits were at all times subject to that outstanding expense.

Two further remarks may be made. It was a payment which reduced expenses not merely for the years in question but for future years, and it was a payment which added a substantial sum to the profits subject to Income Tax.

I think that the Income Tax appeal must be allowed and the two appeals as to Excess Profits Tax follow suit, because the same reasoning applies to those as to the Income Tax appeal. The appeals will be allowed with costs.

Mr. Clements.—Both appeals will be allowed with costs, I understand.

Atkinson, J.—Yes, the appeals are allowed with costs.

Mr. Hills.—Would your Lordship allow me to make an observation, not only on behalf of my clients, but on behalf of a considerable number of taxpayers, arising out of an observation in the earlier part of your Lordship's judgment when you were referring to the facts of the case, not a matter of fact stated in any way at all in the Case, but I think there fell from your Lordship a passage from which it might be implied that a direction made either under Section 35 of the original Act or under the first part of the amending Act(2), involves a charge of bad faith? A considerable number of these directions have been made and a considerable number have been confirmed on appeal and submitted to. There has never been any idea on the part of my clients that such a direction involved a charge of bad faith. I think a good many taxpayers would feel somewhat surprised if it were thought, if a direction was confirmed or if they had submitted to it, that bad faith was thereby being established. All that the Section says, if I may make the observation, is that where the main purpose of some transaction was to avoid Excess Profits Tax a direction can be made. But it has always been assumed that a taxpayer has a perfect right to do anything legal, that is to say, to appoint a director, which is a perfectly legal thing to do, in order to avoid Excess Profits Tax. All that the Section says is that, if it is shown it has certain Excess Profits Tax results, then certain conse-

(1) Worsley Brewery Co., Ltd. *v.* Commissioners of Inland Revenue, 17 T.C., at pp. 359-60.

(2) Finance Act, 1941, Section 35, as amended by Finance Act, 1944, Section 33.

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quences follow. I think your Lordship did not mean to say that every direction was necessarily an imputation of bad faith.

Atkinson, J.—I have nothing to do with any other direction, but I have to do with a suggestion that this transaction was merely a blind in order to reduce or to get out of paying taxation. If it was not a genuine transaction, that would seem to imply bad faith.

Mr. Hills.—If it is not a genuine transaction, that is quite true.

Atkinson, J.—That is what it means as it seems to me. Here is a father, who brings in two sons and turns them into controlling directors, and gives them shares. Then, it is said, you have done that, not because they are really and truly controlling directors, or because they ought to be treated in that way, but you have done it only in order to dodge taxation and we don't believe you when you say you did not. I should have thought that was a suggestion of bad faith myself. I should have taken it in that way if I were Mr. Childs.

Mr. Hills.—I do not think the directions are understood to mean that, and I do not think the taxpayer would treat it as having been accused of bad faith merely because of the direction.

Atkinson, J.—It is a suggestion that they have not been clever enough.

Mr. Hills.—No charge was made against anyone.

Mr. Clements.—Yes, it was.

Atkinson, J.—I only meant it in that sense, that it is a suggestion that the transaction was not for the purpose for which they said it was.

Mr. Hills.—If your Lordship pleases.

The Crown having appealed against the decision in the King's Bench Division, the cases came before the Court of Appeal (Lord Greene, M.R., and Morton and Somervell, L.JJ.) on 10th, 11th and 12th March, 1947, when judgment was reserved. On 2nd April, 1947, judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills (Mr. Norman Rowe with them) appeared as Counsel for the Crown, and Mr. J. Millard Tucker, K.C., and Mr. J. W. P. Clements for the Company.

JUDGMENT

Lord Greene, M.R.—These two appeals can conveniently be dealt with in one judgment. The questions for decision may be stated succinctly in this way: Are the costs and expenses of a successful appeal in respect of the incidence of Excess Profits Tax allowable as a deduction in the computation of profits (*a*) for the purposes of Income Tax, (*b*) for the purposes of Excess Profits Tax? In order to decide these questions it is not necessary to state the facts set out in the Case by the General Commissioners for the Division of Wellingborough, whose decision was as follows: "That the expenses claimed be disallowed both for Income Tax "and Excess Profits Tax and that the appeals be accordingly dismissed."

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On appeal to the King's Bench Division Atkinson, J., reversed this decision both as to Income Tax and as to Excess Profits Tax.

It will be convenient to deal first with the question whether these costs and expenses are allowable as a deduction for the purposes of Income Tax. Section 18 (1) of the Finance (No. 2) Act, 1939, which imposed Excess Profits Tax, provides that Excess Profits Tax payable in respect of a trade or business for any chargeable accounting period shall, in computing profits for the purposes of Income Tax, " be allowed " to be deducted as an expense incurred in that period ". The phrase " allowed to be deducted " echoes the language used in Rule 1 of the Rules applicable to Cases I and II of Schedule D to the Income Tax Act, 1918: " The tax shall be charged without any other deduction than is by " this Act allowed." Similar phraseology as to the allowance or non-allowance of deductions appears elsewhere in the Rules. The simplest argument submitted on behalf of the Respondents was to the effect that, as the amount of the tax has to be ascertained before the deduction allowed by the Section can properly be made, the cost of ascertaining it must by implication also be an allowable deduction, whether the ascertainment is effected by a simple calculation by accountants or by means of an appeal, successful or unsuccessful, to Commissioners and perhaps ultimately to the House of Lords. There is, in my opinion, a simple answer to this argument, that the deduction authorised by the Section does not extend beyond that expressly mentioned, viz., the tax itself, and I see no justification whatever for extending its scope beyond what the Section has in express terms provided. If the Legislature had wished to authorise the deduction of such costs and expenses it could easily have said so.

Once this special argument on the meaning of Section 18 (1) is disposed of, we are thrown back on the relevant Rules which are generally applicable to deductions for the purposes of Income Tax. I have already quoted Rule 1 of the Rules applicable to Cases I and II. Rule 3 of the same Rules, which alone requires to be considered, prohibits deductions in respect of " any disbursements or expenses, not being money " wholly and exclusively laid out or expended for the purposes of the " trade, profession, employment or vocation ". The meaning of these words has been debated in a number of cases. The question has most frequently arisen in cases where the disbursement sought to be deducted was what may be very broadly described as of a commercial nature, and the question has been whether it could be described as " money wholly and " exclusively laid out or expended for the purposes of the trade ". The present case differs in that an altogether different element is present, namely, a liability to tax the ascertainment of which necessitates the expenditure. It is true that the Excess Profits Tax is charged upon the profits of the trade and the assessment is upon the trader as a trader. Excess Profits Tax also differs from Income Tax in that it is not aptly described as the Crown's share of the profits. It is also said on behalf of the Respondents that it is a trade purpose to ascertain correctly the amount of Excess Profits Tax which the trader is liable to pay, and that if he did not do so his trade would suffer in the sense that either he would not know its financial position or he might be depleting his resources by submitting to excessive tax demands. From this is deduced the proposition, accepted by Atkinson, J., that the cost of arriving at the correct

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figure, whether by simple accountancy or by litigation, successful or unsuccessful, is money wholly and exclusively laid out for the purposes of the trade.

In answering the question raised I do not obtain any assistance from the cases that have been cited to us other than three to which I will now refer. Special reliance is placed by the Crown on the well-known dicta of Lord Davey in *Strong and Company of Romsey, Ltd.* v. *Woodifield*, 5 T.C. 215. The deduction there claimed was in respect of the damages and costs awarded against the appellants (who were brewers) to a visitor at one of their licensed houses who was injured by the fall of a chimney. The only decision by the Commissioners was that the deduction claimed was not allowable. Lord Davey (at page 220) expressed the view that the words "for the purpose of the trade" mean "for the purpose of "enabling a person to carry on and earn profits in the trade . . . . "It is not enough that the disbursement is made in the course of, or "arises out of, or is connected with, the trade or is made out of the "profits of the trade. It must be made for the purpose of earning the "profits."

I do not myself find in these dicta a completely satisfactory answer to the present problem. The language that we have to construe is the language of the Rule, and there is always the risk of finding oneself construing not the Rule but a paraphrase of the Rule expressed in a previous judgment. I should have thought that in *Strong and Company's* case it might have been said that an innkeeper who did not compensate a guest when the chimney of the inn fell upon him and injured him would be likely to suffer in his trade. But the House did not accept this argument. Lord Davey's formula, however, at once confronts us with the question: What is the meaning of the phrase "for the purpose of enabling a person "to carry on and earn profits in the trade" as applied to the present case? It is said, and said, I think, with some force (and Atkinson, J., agreed), that the ascertainment of a trader's liabilities is essential for the successful carrying on of his trade, whether they be trading liabilities in the strict sense or tax liabilities imposed upon him as a trader in respect of his trade.

I find, however, in *Strong and Company's* case what appears to me to be a clear answer to the present appeal. It is, I think, a matter not of dictum but of decision in that case that an expense is not deductible if it falls on a trader in some character other than that of a trader. This was the ground of the opinion of Lord Loreburn, L.C., with which Lords Macnaghten and Atkinson agreed. Their Lordships held that the expense there in question fell upon the appellants in their character not of traders but of householders. In the present case the Excess Profits Tax is charged on the trader who carries on the trade. But his obligation to pay it is his obligation as a subject and a taxpayer, and in ascertaining the amount of his liability he is putting himself in a position to discharge his duty to the Crown. If his trading activities had come to an end, his obligations as a taxpayer would still have remained in respect of previous years. I am prepared to assume (although I do not so decide) that the ascertainment of the proper amount of tax payable ought, as the Appellants argue, to be regarded as necessary for the proper carrying on of the trade and, therefore, for earning of profits in the future. But I cannot agree that the

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money can be said to have been laid out " wholly and exclusively " for that purpose. It was laid out, as it appears to me, just as much if not more for the purpose of ensuring that the Company, like any other taxpayer, should pay the proper amount of tax, no more and no less.

Only two cases have been referred to in which the element of expense connected with the payment of tax, as distinct from what I have called a commercial expense, had to be considered. The first is *Allen* v. *Farquharson Brothers & Co.*, 17 T.C. 59, a decision of Finlay, J., as he then was. The claim was for a deduction for Income Tax purposes of the costs of an appeal to the Special Commissioners against assessments to Income Tax under Schedule D in respect of trading profits. The appeal had been in the main successful and the assessments had been considerably reduced in consequence. General Commissioners had held that the amount claimed was money necessarily, wholly and exclusively laid out for the purpose of the business. Finlay, J., referred to the distinction between Income Tax and Excess Profits Duty, and said that the former was the Crown's share of profits while the latter was a sum deducted before the profits are arrived at, but he did not regard the distinction as material for the decision of the case. He approved the practice of allowing the expenses of keeping an accountant or, in the case of large businesses, an accountant's department. He referred to the probability that such a department would deal with Income Tax matters, and he did not suppose that this fact would be used as a reason for disallowing the expense of the department. With this I agree, and I may add that an apportionment of the expense of such a department between its ordinary activities and its purely tax activities would normally be difficult and vexatious and any resulting tax probably negligible in amount. If Finlay, J., meant more than this, e.g., if he meant that an accountancy expense incurred solely for the purpose of conducting tax controversy with the Crown can de deducted, I would respectfully disagree. On the substance of the case Finlay, J., held that the expenditure there in question was an application of profits after they had been earned, and not an expenditure necessary to earn the profits. He thus answered his question in the language of Lord Davey. It could, I think, have been as well answered on the ground which I have mentioned above, viz., that the expenditure was incurred by the company primarily in its capacity as a taxpayer, and for the purpose of regulating the position as between itself as a taxpayer and the Crown.

The other case is that of *Worsley Brewery Co., Ltd.* v. *Commissioners of Inland Revenue*, 17 T.C. 349, a decision of this Court. The company had employed accountants to audit their accounts for the seven years 1914 to 1920, and to settle with the Commissioners their Excess Profits Duty position for each year. The fees paid for this work had been allowed as deductions both for Income Tax and Excess Profits Duty purposes. In 1925 the company instructed other accountants. They completed their investigations in 1928, and as a result it was found that the appellants had paid too much duty and large sums were repaid to them. The company claimed that the costs of this investigation constituted an allowable expense for Excess Profits Duty purposes, and ought to be spread over the seven accounting periods in question. It does not appear to what extent the actual question of deductibility was argued. There was no reason why it should have been, since as Lord Hanworth, M.R., said, at page 355, it was quite unnecessary to decide it. No advantage would have been gained

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by the company unless the expense could be written back into the seven years, since Excess Profits Duty had come to an end. The sole question, therefore, was whether or not such a sum if allowable could be written back, and it was held that it could not. Lord Hanworth, at page 355, referred to the custom (which he appears to have approved) to allow accountancy charges in the computation of the profits for the purpose of Excess Profits Duty. Romer, L.J., at pages 359-60, was " prepared to assent " to the view " that the expense of an investigation by an accountant usually employed, or by any accountant, and the preparation of the profit and loss account and the balance sheet was a legitimate deduction both for Income Tax and for Excess Profits Duty purposes. This, he thought, " appears to " be, or, at any rate, may be taken " to be an expense made for the purpose of earning profits. But the expense of a later investigation made for the purposes of settling a question " between the trading concern and some " third party " as to the correctness of the original ascertainment he was unable to regard as an expense incurred for the purpose of earning the profits. " It is not incurred for that purpose at all ", he said, " it is incurred " merely for the purpose of settling the dispute which has arisen."

These observations of Romer, L.J., were relied on by the Respondents in the present appeal. The argument is, I think, based upon a misconstruction of what the Lord Justice said. His reference to the deductibility of accountancy expenses related only, as I read his words, to the ordinary investigation of a company's accounts for the purpose of drawing up or checking its profit and loss account and balance sheet " in the normal " way ", which are properly allowed as deductions. That this is what he meant is, I think, made clear by the contrast which he draws between work of that description and work undertaken for the purpose of a dispute between the company and a " third party ", by which, of course, he meant the Crown. It appears to me that the reference to the deductibility of accountant's fees does not extend to cover the case of accountant's fees incurred solely for the settlement of a tax question: *a fortiori* it cannot be relied upon as indicating a view that all the costs incurred in connection with a tax dispute, including the costs of litigation, are deductible. Romer, L.J.'s language, in my opinion, and with all respect to Atkinson, J., who thought otherwise, was not intended by him to convey any such meaning.

This disposes of the question so far as deduction for the purposes of Income Tax is concerned. Under Section 14(1) of the Finance (No. 2) Act, 1939, profits are to be computed for Excess Profits Tax on Income Tax principles as adapted in accordance with the provisions of Part I of the Seventh Schedule to the Act. There is nothing material in those provisions, and it follows that the costs and expenses in question cannot be deducted for Excess Profits Tax purposes.

Both appeals must be allowed with costs here and below.

Morton, L.J.—I agree, but as we are differing from the view of the learned Judge, I desire to add a few words on what is, I think, a crucial portion of his judgment. He relies upon the judgment of Romer, L.J. (as he then was), in *Worsley Brewery Co., Ltd.* v. *Commissioners of Inland Revenue*, 17 T.C. 349, at pages 359-60, and says it entirely confirms his own view. I think he understands Romer, L.J., as saying that any expenses incurred for the purpose of ascertaining the profits of a business are money

(Morton, L.J.)

wholly and exclusively laid out or expended for the purposes of that business. I do not think that Romer, L.J., intended to say this, and I respectfully agree with the construction which the Master of the Rolls has placed upon the judgment of Romer, L.J. If that judgment were given the wider meaning, it would, I think, lead to remarkable results. In the course of the argument it was put to Mr. Tucker that, if the expenses of a successful appeal to the Special Commissioners were allowable as a deduction, there was no logical reason why the expenses of a further appeal to the High Court, to the Court of Appeal and, if leave were given, to the House of Lords should not also be an allowable deduction. He agreed. It was then put to him that the same result must follow whether the taxpayer was ultimately successful or unsuccessful, and he agreed that this was so. He rightly qualified his answer by pointing out that such expenses must be "reasonable and necessary, having regard to the requirements of the trade" in view of Section 32 of the Finance Act, 1940, but he admitted that that Section could only affect the amount of the expenses allowed and had no bearing on the question whether the expenses which I have mentioned were or were not an allowable deduction within Rule 3 of the Rules applicable to Cases I and II.

I agree with the Order proposed.

Lord Greene, M.R.—I have the authority of **Somervell, L.J.**, to say that he has read my judgment and agrees with it.

Mr. Rowe.—In the *Rushden Heel* case the case will be remitted to the General Commissioners to make their directions in accordance with your Lordships' judgment?

Lord Greene, M.R.—Yes.

Mr. Rowe.—The decision in principle is made on an estimated assessment.

Lord Greene, M.R.—There is an amount to be fixed?

Mr. Rowe.— Yes.

Lord Greene, M.R.—The appeal will be allowed with costs, and there will be a reference to the relevant Commissioners.

Mr. Rowe.—I am much obliged.

Mr. Clements.—May I ask your Lordships for leave to appeal in the two *Rushden Heel* cases? Your Lordships will appreciate that both those cases are of some interest to many taxpayers, and although there is unanimity in this Court there has been a conflict of judicial opinion, and I would ask for leave to appeal to the House of Lords.

Lord Greene, M.R.—Do you oppose that, Mr. Rowe?

Mr. Rowe.—I have nothing to say in opposition.

Lord Greene, M.R.—We have had an opportunity of having a preliminary discussion about this with Somervell, L.J., and he agrees with the view which we now take, that this case, having regard to the number of persons who may be affected, and the fact that this particular question has not come in any form before the House of Lords before, is a case which might properly be submitted to their Lordships. So you shall have leave in the *Rushden Heel* cases.

Mr. Clements.—If your Lordship pleases.

RUSHDEN HEEL CO., LTD. *v.* COMMISSIONERS OF INLAND REVENUE

Appeals having been entered against the decision in the Court of Appeal, the cases came before the House of Lords (Viscount Simon and Lords Porter, Simonds, Normand and Oaksey) on 19th, 20th, 22nd and 23rd April, 1948, when judgment was reserved. On 14th July, 1948, judgment was given in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. J. W. P. Clements appeared as Counsel for the Company, and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Viscount Simon.—My Lords, the dissenting view that I have expressed in my opinion in the last appeal would have led me to think that these appeals should be allowed. But the House has just laid down in deciding the case of *Smith's Potato Estates, Ltd.*(1) that the contrary view is the law of the land, and I of course accept this as governing these later appeals and accordingly I move that these appeals be dismissed with costs.

Lord Porter.—My Lords, these appeals were argued at the same time as and in conjunction with the appeals in *Smith's Potato Estates, Ltd.* and *Smith's Potato Crisps* (1929), *Ltd.*(1). They are concerned with similar facts and give rise to the same considerations as are found in the latter two cases, nor are there any matters of fact or law which require any qualification in the opinions expressed in those cases. In these circumstances these appeals must be subject to the same treatment and must be dismissed with costs.

Lord Simonds (read by Lord Normand).—My Lords, these consolidated appeals raise the same general questions in regard to the deduction of certain expenses for the purpose of computing Excess Profits Tax and Income Tax as have just been discussed in the appeals of *Smith's Potato Estates, Ltd.* and *Smith's Potato Crisps* (1929), *Ltd.*(1). There are no facts that require special consideration. The same result must follow and the appeals must be dismissed.

Lord Normand.—My Lords, I concur in the opinions which have been delivered.

Lord Oaksey.—My Lords, I agree with the motion which has been proposed in view of the Order which your Lordships' House has made in the appeal of *Smith's Potato Estates, Ltd.* v. *Bolland*(1).

Questions put:

That the Orders appealed from be reversed.

The Not Contents have it.

That the Orders appealed from be affirmed and the appeals dismissed with costs.

The Contents have it.

[Solicitors: — Scott & Son; Solicitor of Inland Revenue.]

(1) Page 267 *ante*.

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