A HIGH COURT OF JUSTICE (CHANCERY DIVISION)—25TH AND 26TH NOVEMBER 1969 AND 11TH AND 12TH NOVEMBER 1970

COURT OF APPEAL—18TH, 19TH AND 20TH OCTOBER AND 3RD NOVEMBER 1971

B

Odeon Associated Theatres Ltd. *v.* Jones (H.M. Inspector of Taxes)(1)

Income tax, Schedule D—Trade—Deduction—Expenses—Repair of fixed assets—Attributable to dilapidation prior to acquisition—Whether chargeable against capital or income.

C *The Appellant Company carried on the trade of proprietors of cinematograph film theatres, as did other companies in the same group. In order to expand during and immediately after the war of* 1939–45 *it purchased a number of theatres from other proprietors both within and outside the group. The purchase price paid for any theatre was not affected by its state of repair. From the beginning of the war until the early* 1950*s the building of theatres was prohibited, as was decorating and repair work except for a small amount of essential maintenance, which was* D *inadequate to keep theatres in a proper state of repair. If a theatre was in a poor state of repair on acquisition the effect on public attendance was minimal, since all competing theatres were in a similar state. The type of work necessary to put the Company's theatres into a proper state of repair was maintenance and repair work, which in normal times is carried out continuously. Such repairs were carried out by the Company in due course, and were charged in their entirety to trading* E *account, whether attributable to current user or ranking as deferred repairs which could be related back for the purposes of excess profits tax to periods for which that tax was chargeable.*

Evidence was accepted that, in accordance with the standard practice of commercial accounting in relation to groups of companies, where a theatre with outstanding deferred repairs was transferred from one member of a group to another the best F *method was to take it out of the transferor's and into the transferee's balance sheet at book value irrespective of the amount of the deferred repairs, so that the consolidated group balance sheet showed no increase in total assets, and to charge the deferred repairs in the transferee's profit and loss account and the group's consolidated profit and loss account. If the deferred repairs were capitalised in the transferee's accounts the consolidated accounts would give an incorrect view of* G *the state of the group's affairs unless a compensating adjustment were made in the consolidated accounts.*

On appeal against assessments to income tax under Schedule D for the years 1946–47 *to* 1955–56, *the Company contended that there should be allowed as an expense sums expended on repairs to cinemas owned by it notwithstanding that the expenditure could be related to their condition when it acquired them. For the* H *Crown it was contended that no allowance fell to be made for expenditure on repairs to cinemas relating to user prior to their acquisition by the Company. The Special Commissioners held, following* Law Shipping Co. Ltd. *v.* Commissioners of Inland Revenue 12 T.C. 621, *that the said expenses did not accrue in the process of earning the Company's profits or gains and were therefore capital expenses.*

I

(1) Reported (Ch.D.) [1971] 1 W.L.R. 442; 115 S.J. 224; [1971] 2 All E.R. 407; (C.A.) [1972] 2 W.L.R. 331; 115 S.J. 850; [1972] 1 All E.R. 681.

On a remission, the Commissioners found that, if all the theatres had been acquired from vendors outside the group, the disputed expenditure would, in accordance with current principles of sound commercial accounting, have been dealt with as a charge to revenue in the purchasers' accounts.

Held, *that the Company was entitled to the deductions claimed.*

Law Shipping Co. Ltd. *v.* Commissioners of Inland Revenue 12 T.C. 621; 1924 S.C. 74 *distinguished on the grounds that in that case* (a) *the purchase price was substantially less than if the vessel had been in a fit state of repair;* (b) *the vessel could not continue as a profit-earning asset without being repaired shortly after acquisition;* (c) *there was no evidence of accountancy practice.*

CASE

Stated under the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 20th, 21st and 22nd November 1967, Odeon Associated Theatres Ltd. (hereinafter referred to as " the Appellant ") appealed against the undermentioned assessments to income tax made upon it under the provisions of Schedule D of the Income Tax Acts 1918 and 1952.

		£
1946-47	Cinema proprietors	75,000
1947-48	Cinema proprietors	150,000
1948-49	Cinema proprietors	328,000
1949-50	Cinema proprietors	587,600
1950-51	Cinema proprietors	370,000
1951-52	Cinema proprietors	510,000
1952-53	Cinema proprietors	340,000
1953-54	Cinema proprietors	350,000
1954-55	Cinema proprietors	375,000
1955-56	Cinema proprietors	400,000

The grounds of the appeal were that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, there should be allowed as an expense sums expended by the Appellant on repairs to certain cinemas owned by it which could be related to the condition of the cinemas at the time of their acquisition by the Appellant.

2. Evidence was given at the hearing of the appeal by John Davis (hereinafter referred to as " Mr. Davis "), the chairman and chief executive of the Rank Organisation Ltd.; John Cecil Edward Ashby Rolls F.C.A., the chief accountant of the Rank Organisation Ltd.; Walter Basil Scarlett Walker F.C.A., a partner in the firm of Peat, Marwick, Mitchell & Co., chartered accountants; Derek Oswald Bailey F.C.A., a partner in the firm of Price, Waterhouse & Co., chartered accountants; and (*inter alia*) the following documents, which were produced and admitted or proved, are annexed to and form part of this Case[1]:

(i) an agreed statement of facts relating to the Odeon Cinema, Bedminster (exhibit A);

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[1] Not included in the present print.

A (ii) an agreed statement of facts relating to the Hippodrome Cinema, Putney (exhibit B);

(iii) an agreed statement of facts relating to the Odeon Cinema, Accrington (exhibit C);

(iv) an agreed statement of facts relating to the Odeon Cinema, Marble Arch (exhibit D).

B The facts found by us on the evidence adduced at the hearing of the appeal are set forth in the following paragraphs.

3. In 1938 the sole business carried on by Odeon Theatres Ltd. was that of an exhibitor of films. Although Odeon Theatres Ltd. itself had no direct interest in other aspects of the film industry, it was controlled by a private company, Odeon Cinema Holdings Ltd., in which United Artists Corporation, C a substantial United States film production and distribution company, had a 50 per cent. interest but not voting control. Control of Odeon Cinema Holdings Ltd. was then in the hands of a Mr. Oscar Deutsch, who had founded the Odeon circuit. In 1940 the controlling interest was transferred to Foy Investments Ltd., a company formed by Lord Rank (then Mr. J. Arthur Rank) with Mr. Deutsch and his associates. Lord Rank's interest was held through a D further company, Manorfield Investments Ltd. In 1942, after the death of Mr. Deutsch, Manorfield Investments Ltd. acquired Mr. Deutsch's shares in Foy Investments Ltd., thereby gaining control of Foy Investments Ltd. and thus of Odeon Cinema Holdings Ltd. and Odeon Theatres Ltd. Manorfield Investments Ltd. already had over a 40 per cent. interest in General Cinema Finance Corporation Ltd., the company which controlled the Gaumont group, E and had further interests in both the production and distribution of films. Thus in 1942 Odeon Theatres Ltd., although itself an exhibiting company, was associated with interests operating in all aspects of the film industry. By April 1944 Manorfield Investments Ltd. and its subsidiary Foy Investments Ltd. had acquired sufficient further shares to give them control over General Cinema Finance Corporation Ltd.

F 4. In the late 1930s the number of theatres being built in the United Kingdom showed a considerable increase and a tendency, at least as regards the larger theatres, to be concentrated in the ownership of a few companies. By 1938 the main circuits were those owned and operated by Associated British Picture Corporation Ltd., with rather more than 400, Gaumont British Ltd., with about 300, and Odeon Theatres Ltd., with about 250 theatres. This gave G a total number of theatres controlled by the three main circuits of around 950, almost one-fifth of the total number of theatres in the country. The importance of these circuits was greater than this fraction would suggest. Firstly, the three main circuits had a disproportionate number of pre-release and large first-run theatres in London and other principal cities. Secondly, it was common practice for a number of non-circuit theatres to follow automatically one or other of H the major circuits in selecting films for exhibition. Both factors increased the booking importance of the major circuits.

5. Odeon Theatres Ltd. had achieved its position as the third largest circuit during the 1930s both by building new theatres and by buying existing theatres and theatre-owning companies. Wartime restrictions put an end to building, and the only way the circuit could be expanded was by buying theatres I and theatre-owning companies. Expansion was desirable for the following reasons:

(*a*) *Booking strength.* A film exhibitor with greater booking strength (that is, a circuit of theatres likely to provide larger film hire on a film than competitors)

is in a stronger position to secure the best films from a distributor who is responsible for achieving the maximum exploitation of a film after production is completed. A circuit's booking strength is not dependent on its number of theatres alone. Other relevant factors include the proportion of pre-release and first-run theatres. A pre-release theatre is a large prestige theatre which is used to bring a film to the public's attention before it goes on general release. On general release a film is normally shown more than once in a district. It is first shown in the largest or most important theatre available. Such a theatre is known as a first-run theatre. It is normally situated in an area of high population or in the centre of a community and yields greater film hire than a second-run theatre or a theatre in a rural area. It was essential to increase the circuit's booking strength so as to secure a larger share of the best films from more distributors.

(*b*) *National advertising.* The more theatres there are in a circuit the greater the value of national advertising both to the exhibitor and the distributor.

(*c*) *American domination.* The basic policy of Foy Investments Ltd. and Odeon Cinema Holdings Ltd. from 1942 and of Manorfield Investments Ltd. from 1944 at all relevant times was aimed at protecting the British film industry from control and domination by United States film companies, which would have adversely affected domestic British film production. It was believed that the major threat was against the exhibiting side of the industry; if American companies had been able to secure control of exhibition in this country, or an important part of it, they would have been able to discriminate against British production in favour of American films. At that time the output of American and British films was in excess of theatre requirements. To forestall this threat it was desirable for at least one leading circuit to remain under British control and for that circuit to be comparable in size or larger than its main competitors. This policy on the part of the group as ultimately developed and controlled by Lord Rank, and the parallel policy on the part of its principal rival, Associated British Picture Corporation Ltd., were a major factor in preventing the domination of the British film industry by American or American-controlled companies.

(*d*) *Individual theatres.* During the war there was a sharp increase in the number of theatre attendances. No new theatres could be built to meet this demand due to building restrictions, and indeed the overall number of theatres decreased as a result of enemy action. As a result theatres were more profitable than before the war.

6. Where the directors were considering acquiring a theatre otherwise than from within the group, the normal procedure was that Mr. Davis would ask the firm of Messrs. Goddard & Smith to prepare a valuation. Mr. Davis would then have discussions with the partner responsible, and in the light of these discussions would subsequently conduct negotiations with the theatre's owner for its possible acquisition. Mr. Davis understood that a valuation was made as between a willing buyer and a willing seller and related purely to the circumstances affecting the particular theatre. Mr. Davis expected Messrs. Goddard & Smith in making these valuations to take account of the general factors affecting the profitability of the theatre, such as its location, capacity and facilities. Although Messrs. Goddard & Smith had acted for the Odeon group for a considerable number of years and attended meetings at which operating policy decisions were taken on acquisitions, Mr. Davis did not expect them to advise in the light of all the various considerations on which the operating policy was based, and indeed they were not in a position to do so. Mr. Davis naturally used the valuation as a base price in the course of negotiations, but as a commercial operator he had to take into account

A those factors which were peculiar to the group's needs and the overriding factor of the prospective increase in booking strength. The result was that the purchase price was sometimes more and sometimes less than the valuation. In particular, if a capital deduction was made in the valuer's report because of a theatre's poor state of repair, it would not have had a material effect on the price the group was prepared to pay for the following reasons. (*a*) The B overall necessity to expand the number of theatres owned, particularly those in London and other urban areas, and consequently to improve the group's booking strength. (*b*) During the second world war there was a complete prohibition on building, decorating and repair work of any kind except for essential maintenance, and even then the consent of the Ministry of Works was required. Each theatre was granted an annual permit to carry out essential C maintenance work up to a stated amount. The amounts varied from as little as £75 to £800 per annum, but in any event were totally inadequate to keep the theatres in a proper state of repair. In addition a supplemental licence was required to carry out any specific work costing more than £100. Theatres rightly had a low priority in securing supplemental licences. The result was that no one in the industry was in a position to carry out work of this type D apart from such minor essential repairs as could be covered by the annual permit. If a theatre was in a poor state of repair on acquisition, the effect on public attendance was minimal, since all competing theatres were in a similar state. (*c*) For the most part the deficiencies were not of a nature requiring immediate remedy. There was no question of danger to the public or of any theatre having to be closed for repairs. (*d*) Building restrictions continued E in force until the early 1950s.

During the war, when negotiations for the acquisition of the Odeons at Accrington and Marble Arch and other theatres were taking place, Mr. Davis foresaw that this was likely to happen, and as a result did not pay so much attention to a theatre's state of repair as might otherwise have been the case. The type of work necessary to put these theatres into a first-class state of repair F was maintenance and repair work, which in normal circumstances is carried out continuously. Mr. Davis's attitude was that in the normal course the theatres would be redecorated when the restrictions were removed, but that the same work would not be done twice merely because the period since maintenance work was last carried out was much longer than normal. As a result the deduction from purchase price which might otherwise have been made G was ignored. If the directors had not bought, others would have bought on a similar basis.

7. (*a*) The Odeon, Marble Arch, was an exceptionally large theatre occupying a prominent site in the West End of London. From the circuit's point of view it was eminently suitable for use as a pre-release theatre. The acquisition of such a theatre has a substantial effect on the booking strength of a circuit, H since there is only a limited number of such theatres.

(*b*) The Odeon, Accrington, was not comparable in size with the Odeon, Marble Arch. Nevertheless, it was an important provincial theatre which filled in a position where representation was needed, and its effect on circuit booking strength at large, especially when considered in conjunction with other similar theatres bought during the war, was considerable. The anticipated increase I in booking strength was the prime factor which led to the theatre being bought for a price in excess of the valuation. Prices paid on the acquisition of theatre-owning companies were governed by overall policy decisions in the same way as prices paid for individual theatres.

8. During the immediate post-war period there was a financial rationalisation programme for the Odeon group which had as its overall objective the

raising of what was in those days a very considerable sum of money, aggregating almost £13,000,000. The capital market at that time was not so sophisticated as it is today and was not equipped to meet such a heavy demand by a single public issue. It was necessary to approach the market in stages, so the theatres owned or controlled by the Odeon group were divided amongst three companies, Odeon Theatres Ltd., Odeon Properties Ltd. and Odeon Freehold and Ground Rents Ltd., now called Odeon Associated Theatres Ltd. (the Appellant). The two latter companies were wholly-owned subsidiaries of the first, and theatres were transferred to them to increase the value of their assets, thus enabling all three companies to obtain finance for the Odeon group by the issue of debenture stock and/or preference shares and so repay considerable short term borrowing. The ordinary share capital of both Odeon Properties Ltd. and the Appellant was still held by Odeon Theatres Ltd. It was this overall need to raise money which led to the transfer by Odeon Theatres Ltd. to the Appellant of the Odeon, Bedminster, and the Hippodrome, Putney. Similarly, the Odeon, Accrington, and the Odeon, Marble Arch, were acquired by the Appellant instead of Odeon Theatres Ltd. to increase the value of the former Company's assets.

9. In January 1947 the Appellant owned or had agreed to acquire just under 100 theatres, amounting to approximately one-third of all the theatres in the Odeon group. In that month the Company offered to the public £3,500,000 $3\frac{1}{4}$ per cent. first mortgage debenture stock at par and £1,250,000 $4\frac{1}{4}$ per cent. redeemable cumulative preference shares of £1 each at 21*s*. a share. For the purposes of these issues the theatres were valued at nearly £9,000,000. The issues were fully subscribed.

10. In 1947 the entire issued share capital of General Cinema Finance Corporation Ltd. was transferred to Odeon Theatres Ltd. General Cinema Finance Corporation Ltd. was the owner of General Film Distributors Ltd. (now called Rank Film Distributors Ltd.), a major distribution company, and through an intermediary company, Metropolis and Bradford Trust Co. Ltd., controlled Gaumont British Ltd.

11. When Gaumont British Ltd. became a subsidiary of Odeon Theatres Ltd. in 1947 there were still very substantial outside shareholdings in the Gaumont group. In particular the American company, Twentieth Century Fox, owned an important shareholding in the Metropolis & Bradford Trust Co. Ltd., the company having immediate control over Gaumont British Ltd. The existence of outside shareholdings limited the economies which might otherwise have been effected by combining the management of the two groups, since in dealing with individual theatres (and companies), especially when deciding which of two competitive theatres was to have the more attractive films, it was necessary to take into consideration the interests of outside shareholders, which could be at variance with those of the group taken as a whole. In 1947 it was intended to maintain both the Odeon and the Gaumont circuits in being. But in some cases it would have been more profitable from the overall point of view for individual theatres which had previously been used as first-run theatres to be relegated to the second-run class and *vice versa*. However, such a solution would clearly be disadvantageous to any outside shareholder interested only in the relegated theatre and not in the group's other exhibiting activities. To prevent the group's interests from overriding those of individual companies having outside shareholders it was necessary for many executive decisions to be made separately by different companies within the group.

As might be expected, considerable duplication of management resulted. So it was proposed that all exhibiting companies within the two groups should join a scheme (" the C.M.A. scheme ") to bring all theatres under one centralised management. The total number of theatres in the C.M.A. scheme was 564, having a written-down book value of nearly £40,000,000. A new company, Circuits Management Association Ltd. (C.M.A.), was incorporated to undertake the centralised management.

In outline C.M.A. undertook the management of all theatres. The gross receipts of all theatres were pooled, and after the deduction of certain operating expenses the net profit was divisible amongst scheme members in proportions based on the results of film exhibition for the years 1944, 1945 and 1946. The pool was concerned only with the operation of theatres and did not participate in other activities. There was some doubt whether the C.M.A. scheme would constitute a partnership, and it was decided to limit the number of members to 20. In order to bring the maximum number of theatres under centralised management, wholly-owned subsidiaries within the group transferred their assets to their immediate parent. Nearly 60 theatres were transferred in this way.

12. In the period under review the consideration payable on inter-group transfers was computed by reference to the transferor company's books of account. In this way unrealised profits or losses from the group point of view did not appear in the accounts of the transferor company. If there was a non-group shareholding in either the transferor or the transferee company, or if a transfer was being effected to provide security for a mortgage or other loan, the consideration for the asset transferred would be assessed by reference to a professional valuation made for the purpose. There were in fact very few—only four—inter-group transfers at valuation out of a total number of some 270 such transfers. Any profits resulting from a transfer at valuation were included in the capital reserves of the transferor companies, and on consolidation were applied against cost and depreciation of group fixed assets, so that cost, depreciation and net book value of the theatres in the group accounts were not affected.

13. In the case of the Odeon group, that is to say Odeon Theatres Ltd., the Appellant, Odeon Properties Ltd. and their respective subsidiaries, inter-group transfers were otherwise effected at net book value. Entries recording the transfer in the accounts would be made so that the transferee company showed in its books the same figures for cost and depreciation of the asset transferred as appeared in the transferor's books. This method was adopted when the Appellant acquired from Odeon Theatres Ltd. its leasehold interest in the Odeon, Bedminster. The reason why the prices paid by both Odeon Theatres Ltd. and the Appellant on the transfer of the lease of this theatre were the same was that Odeon Theatres Ltd. did not hold it for a full accounting year and did not therefore make any provision for depreciation. This procedure was followed on similar occasions, except for the transfer of 46 theatres from six subsidiaries to the Appellant early in 1947. These were transferred at historical cost as opposed to net book value.

14. In the case of the Hippodrome, Putney, the underlease from the Loughborough Playhouse Ltd. was transferred from London & Southern Super Cinemas Ltd. to Odeon Theatres Ltd. and later from the latter company to the Appellant without consideration. The explanation for this was that the underlease was considered to be at a rackrent.

15. Expenditure classified as capital in the statements of fact above referred to represented additions or improvements to the condition of the theatre. The whole of such expenditure was charged to capital, no deductions being made from the companies' profits for tax purposes. A

16. Expenditure classified as current repairs and renewals in the said statements of fact were such as could not be treated as attributable to user of the theatre during the excess profits tax period, and accordingly no relief was allowed against this tax. These repairs and renewals were charged in their entirety to trading account and were deducted from profits in income tax computations. B

17. All items of expenditure listed in the statements of fact as charged to deferred repairs account were to some extent attributable to user of the theatre during the excess profits tax period. Deferred repairs and renewals were treated in the same way as current repairs and renewals and were charged in their entirety to trading account. C

18. According to standard practice of commercial accounting in relation to groups of companies, where a theatre with outstanding deferred repairs is transferred from one member of the group to another the best method would be to take it out of the transferor company's balance sheet at its written-down book value irrespective of the amount of the deferred repairs, and to take it into the balance sheet of the transferee company at the same value; thus the consolidated group balance sheet would show no increase in total assets. The deferred repairs would be charged in the transferee company's profit and loss account and would also appear in the consolidated profit and loss account of the group. If the deferred repairs were capitalised in the accounts of the transferee company and no compensating adjustments made, the consolidated accounts would give an incorrect view of the state of the group's affairs. There would therefore have to be a compensating adjustment in the consolidated accounts to decrease the fixed assets and profits by the amount of such deferred repairs. D E

19. It was contended on behalf of the Appellant: F

(i) that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, there should be allowed as an expense sums expended by the Appellant on repairs (hereinbefore referred to as " deferred repairs ") to cinemas owned by it, notwithstanding that such expenditure could be related to the condition of the cinemas at the time of their acquisition by the Appellant; G

(ii) that the appeal should be allowed and the assessments adjusted accordingly.

20. It was contended by the Inspector of Taxes:

(i) that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, no allowance fell to be made for sums expended by the Appellant on repairs (hereinbefore referred to as " deferred repairs ") to cinemas owned by it which related to user prior to the acquisition of such cinemas by the Appellant; H

(ii) that the appeal should be dismissed and the assessments adjusted accordingly

21. We, the Commissioners who heard the appeal, gave our decision in the following terms:

(1) This is an appeal by Odeon Associated Theatres Ltd. (hereinafter referred to as " the Appellant ") against the undermentioned assessments to income tax made upon it under the provisions of Schedule D of the Income Tax Acts 1918 and 1952:

		£
1946–47	Cinema proprietors	75,000
1947–48	Cinema proprietors	150,000
1948–49	Cinema proprietors	328,000
1949–50	Cinema proprietors	587,600
1950–51	Cinema proprietors	370,000
1951–52	Cinema proprietors	510,000
1952–53	Cinema proprietors	340,000
1953–54	Cinema proprietors	350,000
1954–55	Cinema proprietors	375,000
1955–56	Cinema proprietors	400,000

The grounds of the appeal are that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, there should be allowed as an expense sums expended by the Appellant on repairs to certain cinemas owned by it which related to user prior to the acquisition of such cinemas by the Appellant.

(2) Upon consideration of the evidence adduced at the hearing of the appeal and the arguments addressed to us by and on behalf of the parties and the cases cited to us, namely *Usher's Wiltshire Brewery Ltd.* v. *Bruce* 6 T.C. 399; [1915] A.C. 433; *Law Shipping Co. Ltd.* v. *Commissioners of Inland Revenue* 12 T.C. 621; 1924 S.C.74; *Jackson* v. *Laskers Home Furnishers Ltd.* 37 T.C. 69; [1957] 1 W.L.R. 69; *Bidwell* v. *Gardiner* (1960) 39 T.C. 31; *Atherton* v. *British Insulated & Helsby Cables Ltd.* 10 T.C. 155; [1926] A.C. 205; *Naval Colliery Co. Ltd.* v. *Commissioners of Inland Revenue* (1928) 12 T.C. 1017; *Commissioners of Inland Revenue* v. *Barr* 35 T.C. 293; 1954 S.C. (H.L.) 71; *Commissioners of Inland Revenue* v. *Patrick Thomson Ltd.* (1956) 37 T.C. 145; *Hyam* v. *Commissioners of Inland Revenue* 14 T.C. 479; 1929 S.C. 384; *Commissioners of Inland Revenue* v. *Granite City Steamship Co. Ltd.* 13 T.C. 1; 1927 S.C. 705; *United Steel Companies Ltd.* v. *Cullington (No. 2)* (1940) 23 T.C. 91; *Commissioners of Inland Revenue* v. *Lithgows Ltd.* 39 T.C. 270; 1960 S.C. 405; *Commissioners of Inland Revenue* v. *Gas Lighting Improvement Co. Ltd.* 12 T.C. 503; [1923] A.C. 723; *Odhams Press Ltd.* v. *Cook* (1940) 23 T.C. 233; *Marshall Richards Machine Co. Ltd.* v. *Jewitt* (1956) 36 T.C. 511, we are of the opinion set out below.

(3) The Appellant and associated companies owned a large number of cinemas, which have been divided for the purposes of this appeal into four categories according to the manner in which they were acquired by the Appellant, and of which it is agreed the undermentioned are representative, namely: category 1, the Odeon, Bedminster, an inter-group transfer of ownership with succession to a trade; category 2, the Hippodrome, Putney, an inter-group transfer of ownership without succession to a trade; category 3, the Odeon, Accrington, an acquisition from outside the group with succession to a trade; category 4, the Odeon, Marble Arch, an acquisition from outside the group without succession to a trade. After acquisition the Appellant carried out repairs to each of these cinemas, some of which repairs it is admitted properly related to user prior to the acquisition of the property by the Appellant; for convenience these are referred to as " deferred repairs ".

(4) The evidence given in chief by the witnesses is not really controverted by the Crown, and it seems to us, therefore, that there is no real dispute as to the facts in this case. The parties are agreed that in the hands of the vendors there was no capital element in the deferred repairs, and so far as the Appellant was concerned there was no diminution in price on account of the deferred repairs which are in issue in this appeal. A

(5) The real dispute in this appeal seems to us to be whether expenditure on assets which, if it had been incurred by the vendor, would have been allowable in computing the profits or gains of a trade carried on by the vendor for the purpose of arriving at his liability to tax should, if in fact incurred by a purchaser of that asset, be allowed in computing the profits or gains of a trade carried on by the purchaser for the purposes of arriving at his liability to tax, and, if not, whether it makes any difference if the purchaser in addition to buying the asset also succeeds to the trade carried on by the vendor in which that asset was used, or that there is no allowance in respect of such expenditure in the purchase price. B C

(6) It is not a trade which is assessed to tax, it is a person. If a person carries on a trade, the measure of his liability to tax is the profits or gains derived by him from carrying on such trade. Expenses of a trade which accrued prior to the carrying on of that trade by the person presently to be taxed cannot be taken into account in determining the profits or gains derived by him for the purpose of ascertaining his liability to tax. Such expenses did not accrue in the process of earning his profits or gains, and if paid by him they are not revenue expenses but something over and above, and therefore capital. It is nothing to the point that had such expenses been incurred in earning somebody else's profits or gains they might have been allowed as a revenue expense. It seems to us that this is the proposition which stems from the *Law Shipping* case[1], upon which all the Judges in the Court of Session were unanimous, and also the *Granite City Steamship Co.* case[2] which cases are binding on us. Furthermore, in the light of the cases cited it seems to us that it makes no difference if there is a succession or if there is no allowance from the price of the asset purchased. D E

(7) It was also put to us that since the Companies Act 1948 the consolidated accounts required in the case of a group of companies by the provisions of ss. 150, 151 and 152 of the Companies Act 1948 would, if produced on sound commercial principles, necessarily involve that the cost of deferred repairs should be eliminated from the balance sheet by charging such cost to revenue accounts. This may be so, but we do not think that a form of accounts required for the purposes of the Companies Act 1948 is conclusive as to what items may be properly charged to revenue in computing profits or gains for income tax purposes. F G

(8) Our decision is, therefore, that this appeal fails in principle, and we adjourn the appeal for the agreement of the amounts of the assessments between the parties on the basis of our decision set forth above.

22. On 15th March 1968, the amounts of the assessments having been agreed between the parties on the basis of our decision in principle set forth above, we determined the appeal as follows: H

1946–47 assessment increased to £86,016 [agreed capital allowances £18,234]
1947–48 assessment increased to £346,573 [agreed capital allowances £42,968]
1948–49 assessment increased to £370,568 [agreed capital allowances £34,705] I
1949–50 assessment increased to £616,842 [agreed capital allowances £42,511]

(1) 12 T.C. 621. (2) 13 T.C. 1.

A 1950–51 assessment increased to £460,928 [agreed capital allowances £37,352]
1951–52 assessment increased to £571,336 [agreed capital allowances £35,445]
1952–53 assessment increased to £393,204 [agreed capital allowances £71,989]
B 1953–54 assessment increased to £361,928 [agreed capital allowances £35,378]
1954–55 assessment increased to £404,186 [agreed capital allowances £29,349]
1955–56 assessment reduced to £363,064 [agreed capital allowances £42,106]

23. Immediately after our determination of the appeal dissatisfaction C therewith as being erroneous in point of law was expressed to us on behalf of the Appellant, and we were required to state a Case for the opinion of the High Court of Justice pursuant to the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 64, which Case we have stated and do sign accordingly.

24. The question of law for the opinion of the High Court of Justice is D whether, on the facts found by us as hereinbefore set forth, there was evidence on which we could properly arrive at our decision and whether on the facts so found our determination of the appeal was correct in law.

N. F. Rowe } Commissioners for the Special Purposes
R. A. Furtado } of the Income Tax Acts.

Turnstile House,
E 94–99 High Holborn,
London W.C.1.
9th May 1969

F The case came before Pennycuick J. in the Chancery Division on 25th and 26th November 1969, when it was remitted to the Special Commissioners to state a Supplemental Case.

SUPPLEMENTAL CASE

Stated under the Income Tax Management Act 1964, s. 12(5), and the Income G Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the High Court of Justice.

1. Pursuant to the Order of the High Court of Justice, Chancery Division, 1969 No. 28, made by Pennycuick J. on 26th November 1969, a meeting of the Commissioners for the Special Purposes of the Income Tax Acts (hereinafter referred to as " the Special Commissioners ") was held on 18th, 19th and 23rd H February 1970.

The said Order of the High Court of Justice was made in the following terms, *inter alia*:

" Whereas pursuant to the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 64, a Case has been stated at the request of the Appellant by the Commissioners for the Special Purposes of the I Income Tax Acts for the opinion of this Court; And Whereas the said

Case came on to be heard on the 25th day of November 1969 and on this day; And Upon Hearing Counsel for the Appellant and for the Respondent; And Upon Reading the said Case; And the Appellant making application that the Case be remitted to the said Commissioners for them to make the finding hereinafter mentioned; And the Respondent not objecting to this Order; A

This Court Orders that the said Case be remitted to the Special Commissioners for them to make and state in a Supplemental Case a finding on the following question, viz: On the assumption that all theatres with which this Case is concerned were acquired from vendors outside the group but that all other facts were as found in the existing Case Stated, how, in accordance with the principles of sound commercial accounting, would the disputed expenditure be dealt with in the purchasers' accounts? B C

And It Is Ordered that both parties are to be at liberty to adduce expert evidence before the Special Commissioners on the making of such finding."

2. Evidence was given at the meeting of the Special Commissioners by Ronald George Leach C.B.E., the President of the Institute of Chartered Accountants and a partner in the firm of Peat, Marwick, Mitchell & Co., chartered accountants; Walter Edmund Parker C.B.E., a Past President of the Institute of Chartered Accountants and the senior partner in the United Kingdom in the firm of Price, Waterhouse & Co., chartered accountants; Derek Oswald Bailey F.C.A., a partner in the firm of Price, Waterhouse & Co., chartered accountants; Gerald Hartley Lawson M.A. (Durham), A.A.C.C.A., Professor of Business Administration in the University of Manchester; Edward Lawson F.C.A., Principal Advisory Accountant to the Board of Inland Revenue. D E

A letter dated 21st May 1965 from Peat, Marwick, Mitchell & Co. to H.M. Inspector of Taxes, Westminster 3rd District, enclosing a copy of the directors' report and the profit and loss account for the 52 weeks ended 27th June 1964 of the Appellant together with computations, was produced and admitted, but is not attached to and does not form part of this Case. F

3. Upon consideration of the evidence adduced at the meeting and the arguments addressed to us on behalf of the parties and the publication "Practical Auditing" by Spicer & Pegler (15th edn.), which was cited to us, we found that, on the assumption that all theatres with which this case is concerned were acquired from vendors outside the group but that all other facts were as found in the principal Case Stated, in accordance with the principles of sound commercial accounting at the present time the disputed expenditure referred to in the principal Case as the "deferred repairs" would be dealt with as a charge to revenue in the purchasers' accounts. G

N. F. Rowe, R. A. Furtado — Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94–99 High Holborn,
London W.C.1.
27th April 1970 H

The case came again before Pennycuick V.-C. in the Chancery Division on 11th and 12th November 1970, when judgment was given against the Crown, with costs. I

A *F. Heyworth Talbot Q.C.*, *Michael Nolan Q.C.* and *Denis Carey* for the Company.

Roderick Watson Q.C. and *Patrick Medd* for the Crown.

The following cases were cited in argument in addition to those referred to in the judgment:—*Jennings* v. *Barfield* 40 T.C. 365; [1962] 1 W.L.R. 997; *Patrick* v. *Broadstone Mills Ltd.* 35 T.C. 44; [1954] 1 W.L.R. 158; *Whimster &*
B *Co.* v. *Commissioners of Inland Revenue* 12 T.C. 813; 1926 S.C. 20; *Hinton* v. *Maden & Ireland Ltd.* 38 T.C. 391; [1959] 1 W.L.R. 875.

Pennycuick V.-C.—In this case the Appellant is Odeon Associated Theatres Ltd. The Respondent is H.M. Inspector of Taxes. The appeal is brought by the Appellant Company from a decision of the Special Commissioners made in
C November 1967 against assessments to income tax under Schedule D in respect of its trade as cinema proprietor for the years 1946–47 to 1955–56 inclusive. Summarily, the question before the Commissioners was whether sums expended by the Appellant Company on what are known as deferred repairs to certain cinemas could be brought in by the Appellant Company as deductions in computation of its taxable profit. The sums involved are very considerable.

D The case came before this Court upon 26th November 1969, but with the concurrence of Counsel on both sides it was remitted to the Special Commissioners for a finding upon one particular further matter, which finding is contained in a Supplemental Case as the result of a hearing on 23rd February 1970.

The Case Stated is rather lengthy, and it will only be necessary to read certain extracts from it. Paragraph 1 sets out particulars of the assessments and
E says:

> " The grounds of the appeal were that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, there should be allowed as an expense sums expended by the Appellant on repairs to certain cinemas owned by it which could be related to the condition of the cinemas at the
F time of their acquisition by the Appellant."

Paragraph 2 sets out the evidence which was given by an officer of the Company and by a number of chartered accountants of distinction. Certain agreed statements of fact are annexed. They relate to four cinemas which are taken as examples of four types of case: one of an inter-group transaction with succession; one of an inter-group transaction without succession; an outside acquisition
G with succession, and an outside acquisition without succession. In the course which this appeal has taken the questions of succession and inter-group transfer have not been argued, and the distinction between the four types of case is of no present significance. Paragraph 3 says: " In 1938 the sole business carried on by Odeon Theatres Ltd. was that of an exhibitor of films." The paragraph then goes into the particulars of that. Paragraph 4 is concerned with history.
H Paragraph 5 says:

> " Odeon Theatres Ltd. had achieved its position as the third largest circuit during the 1930s both by building new theatres and by buying existing theatres and theatre-owning companies. Wartime restrictions put an end to building, and the only way the circuit could be expanded was by buying theatres and theatre-owning companies."

I The paragraph then sets out why expansion was desirable. In para. 6 the Special Commissioners say: " Where the directors were considering acquiring a theatre

(Pennycuick V.-C.)

otherwise than from within the group, the normal procedure was that Mr. Davis ", who was the chairman of Odeon Cinema Holdings Ltd., " would ask the firm of Messrs. Goddard & Smith to prepare a valuation." That paragraph proceeds to set out the manner in which the purchase price with an outsider was arranged by Mr. Davis on behalf of the Company. I do not think, upon the course which this appeal has taken, it would be useful for me to read that rather lengthy paragraph, but it should be referred to in full. Paragraph 7 deals with two particular cinemas. Paragraph 8 says: A B

> " During the immediate post-war period there was a financial rationalisation programme for the Odeon group . . . It was necessary to approach the market in stages, so the theatres owned or controlled by the Odeon group were divided amongst three companies, Odeon Theatres Ltd., Odeon Properties Ltd. and Odeon Freehold and Ground Rents Ltd., now called Odeon Associated Theatres Ltd.", C

which is the Appellant Company. This company is a wholly-owned subsidiary of the first. Theatres were transferred to it to increase the value of its assets. I need not read paras. 9, 10 and 11. Paragraph 12 says: " In the period under review the consideration payable on inter-group transfers was computed by reference to the transferor company's books of account." That paragraph and para. 13 elaborate that statement. Paragraph 14 is concerned with particular cinemas. [His Lordship read paras. 15 to 20 of the Case Stated, at page 264 *ante*, and continued:] In para. 21 the Special Commissioners say: D

> " We, the Commissioners who heard the appeal, gave our decision in the following terms ". Then sub-para. (1) sets out the nature of the appeal and continues: " The grounds of the appeal are that, in computing for income tax purposes the profits or gains of the Appellant for the accounting periods relevant to the assessments under appeal, there should be allowed as an expense sums expended by the Appellant on repairs to certain cinemas owned by it which related to user prior to the acquisition of such cinemas by the Appellant." In sub-para. (2) the Special Commissioners set out a considerable number of cases which were cited before them. " (3) The Appellant and associated companies owned a large number of cinemas, which have been divided for purposes of this appeal into four categories "—and I have already referred to those categories. " After acquisition the Appellant carried out repairs to each of these cinemas, some of which repairs it is admitted properly related to user prior to the acquisition of the property by the Appellant; for convenience these are referred to as deferred repairs. (4) The evidence given in chief by the witnesses is not really controverted by the Crown, and it seems to us, therefore, that there is no real dispute as to the facts in this case. The parties are agreed that in the hands of the vendors there was no capital element in the deferred repairs, and so far as the Appellant was concerned there was no diminution in price on account of the deferred repairs which are in issue in this appeal. (5) The real dispute in this appeal seems to us to be whether expenditure on assets which, if it had been incurred by the vendor, would have been allowable in computing the profits or gains of a trade carried on by the vendor for the purpose of arriving at his liability to tax should, if in fact incurred by a purchaser of that asset, be allowed in computing the profits or gains of a trade carried on by the purchaser for the purposes of arriving at his liability to tax, and, if not, whether it makes any difference if the purchaser in addition to buying the asset also E F G H I

succeeds to the trade carried on by the vendor in which that asset was used, or that there is no allowance in respect of such expenditure in the purchase price. (6) It is not a trade which is assessed to tax, it is a person. If a person carries on a trade, the measure of his liability to tax is the profit or gain derived by him from carrying on such trade. Expenses of a trade which accrued prior to the carrying on of that trade by the person presently to be taxed cannot be taken into account in determining the profit or gain derived by him for the purpose of ascertaining his liability to tax. Such expenses did not accrue in the process of earning his profit or gain and if paid by him they are not revenue expenses, but something over and above, and therefore capital. It is nothing to the point that had such expenses been incurred in earning somebody else's profit or gain they might have been allowed as a revenue expense. It seems to us that this is the proposition which stems from *Law Shipping Co. Ltd.* v. *Commissioners of Inland Revenue*(1) upon which all the Judges in the Court of Session were unanimous, and also *Commissioners of Inland Revenue* v. *Granite City Steamship Co. Ltd.*(2), which cases are binding on us. Furthermore, in the light of the cases cited it seems to us that it makes no difference if there is a succession or if there is no allowance from the price of the asset purchased. (7) It was also put to us that since the Companies Act 1948 the consolidated accounts required in the case of a group of companies by the provisions of ss. 150, 151 and 152 of the Companies Act 1948 would, if produced on sound commercial principles, necessarily involve that the cost of deferred repairs should be eliminated from the balance sheet by charging such cost to revenue accounts. This may be so, but we do not think that a form of accounts required for the purposes of the Companies Act 1948 is conclusive as to what items may be properly charged to revenue in computing profits or gains for income tax purposes. (8) Our decision is, therefore, that this appeal fails in principle and we adjourn the appeal for the agreement of the amounts of assessments between the parties on the basis of our decision set forth above."

Then para. 24 says:

"The question of law for the opinion of the High Court of Justice is whether on the facts found by us, as hereinbefore set forth, there was evidence on which we could properly arrive at our decision and whether on the facts so found our determination of the appeal was correct in law."

It will have been observed that, perhaps by some oversight, although there was a finding as to the standard practice of commercial accounting in relation to groups of companies, there was no finding as to the standard practice of commercial accounting in this connection where an asset is acquired from an outside purchaser. It was that matter which was remitted to the Special Commissioners, the Order which was agreed between Counsel being this:

"This Court Orders that the said Case be remitted to the Special Commissioners for them to make and state in a Supplemental Case a finding on the following question, viz.: On the assumption that all theatres with which this Case is concerned were acquired from vendors outside the group but that all other facts were as found in the existing Case Stated, how, in accordance with the principles of sound commercial accounting, would the disputed expenditure be dealt with in the purchasers' accounts?"

(1) 12 T.C. 621; 1924 S.C. 74. (2) 13 T.C. 1; 1927 S.C. 705.

(Pennycuick V.-C.)

By the Supplemental Case the Special Commissioners gave the following decision: A

"Upon consideration of the evidence adduced at the meeting and the arguments addressed to us on behalf of the parties and the publication 'Practical Auditing' by Spicer and Pegler (15th edn.), which was cited to us, we found that, on the assumption that all theatres with which this case is concerned were acquired from vendors outside the group but that B all other facts were as found in the principal Case Stated, in accordance with the principles of sound commercial accounting at the present time the disputed expenditure referred to in the principal Case as the 'deferred repairs' would be dealt with as a charge to revenue in the purchasers' accounts."

Upon the hearing before me it was agreed between Counsel as a matter of C convenience that the Appellant Company's contentions based upon succession and on the fact that most of these were inter-group transactions should not be pursued until I had given my decision on the case as it stood apart from those two issues. In the event, I am satisfied that I ought to allow this appeal quite apart from those two issues. They remain, of course, open in a higher Court.

It is necessary to consider first the principle upon which the profits of a D trader fall to be ascertained for the purpose of income tax, and in particular how expenditure should be dealt with by way of deduction in the computation of profits. On this point there is a good deal of authority. I propose only to refer to the well-known statements in *Usher's Wiltshire Brewery Ltd.* v. *Bruce*(1) [1915] A.C. 433. Lord Parker of Waddington, at page 458(2), said:

"The expression 'balance of profits and gains' implies, as has often E been pointed out, something in the nature of a credit and debit account, in which the receipts appear on the one side and the costs and expenditure necessary for earning these receipts appear on the other side. Indeed, without such account it would be impossible to ascertain whether there were really any profits on which the tax could be assessed. But the rule proceeds to provide that 'the duty shall be assessed, charged and paid F without other deduction than is hereinafter allowed'."

Lord Sumner, at page 468(3), said:

"The effect of this structure, I think, is this, that the direction to compute the full amount of the balance of the profits must be read as subject to certain allowances and to certain prohibitions of deductions, but that a deduction, if there be such, which is neither within the terms of G the prohibition nor such that the expressed allowance must be taken as the exclusive definition of its area, is to be made or not to be made according as it is or is not, on the facts of the case, a proper debit item to be charged against incomings of the trade when computing the balance of profits of it."

The expression "ordinary principles of commercial accountancy" is not contained in that paragraph, but it is contained in other passages of high author- H ity. I will endeavour in a moment to explain in rather more detail what that expression means. The effect of the principles laid down in the *Usher's Wiltshire Brewery* case and other cases, including those in which the expression "ordinary principles of commercial accountancy" is used, is this. First, one must ascertain the profits of the trade in accordance with ordinary principles of commercial accountancy. That, of course, involves the bringing in as items of expenditure I such items as would be treated as proper items of expenditure in a revenue

(1) 6 T.C. 399. (2) *Ibid.*, at p. 429. (3) *Ibid.*, at p. 436.

account made up in accordance with the ordinary principles of commercial accountancy. Secondly, one must adjust this account by reference to the express prohibitions contained in the relevant Statute, those being now contained in s. 137 of the Income Tax Act 1952. That is to say, an item of expenditure, even if it would be allowed as a deduction in accordance with the ordinary principles of commercial accountancy, must be struck out if it falls within any of those statutory prohibitions. I believe that to be the true principle upon which the profit of the Appellant Company's trade must be ascertained for the present purpose.

Mr. Watson, who appeared for the Crown, contended that there is a third and distinct requirement, namely that the profit of the trade must be ascertained for the purpose of income tax. It was not clear to me (I do not suppose that is Mr. Watson's fault) precisely what standard the Court should adopt, apart from that of the ordinary principles of commercial accountancy, in arriving at the profit of a trade for the purpose of income tax. Mr. Watson used the word " logic ". If by that he intended no more than to say that one must apply the correct principles of commercial accountancy, I agree with that, as I will explain in a moment. I think, however, he intended to go beyond that and meant that the Court must ascertain the profit of a trade on some theoretical basis divorced from the principles of commercial accountancy. If that is what is intended, I am unable to accept the contention, which I believe to be entirely novel.

I think that, in deference to the arguments of Mr. Watson and also of Mr. Medd and to the authorities which were cited, I ought to say a few words by way of explanation of the time-honoured expression " ordinary principles of commercial accountancy ". The concern of the Court in this connection is to ascertain the true profit of the taxpayer. That and nothing else, apart from express statutory adjustments, is the subject of taxation in respect of a trade. In so ascertaining the true profit of a trade the Court applies the correct principles of the prevailing system of commercial accountancy. I use the word " correct " deliberately. In order to ascertain what are the correct principles it has recourse to the evidence of accountants. That evidence is conclusive on the practice of accountants in the sense of the principles on which accountants act in practice. That is a question of pure fact, but the Court itself has to make a final decision as to whether that practice corresponds to the correct principles of commercial accountancy. No doubt in the vast proportion of cases the Court will agree with the accountants, but it will not necessarily do so. Again, there may be a divergency of view between the accountants, or there may be alternative principles, none of which can be said to be incorrect, or, of course, there may be no accountancy evidence at all. The cases illustrate these various points. At the end of the day the Court must determine what is the correct principle of commercial accountancy to be applied. Having done so, it will ascertain the true profit of the trade according to that principle, and the profit so ascertained is the subject of taxation. The expression " ordinary principles of commercial accountancy " is, as I understand it, employed to denote what is involved in this composite process. Properly understood it presents no difficulty, and I would not be at all disposed to attempt any alternative label.

Mr. Watson placed particular reliance on *Atherton* v. *British Insulated and Helsby Cables Ltd.*(1) 10 T.C. 155, and he read in full all the speeches in the House of Lords, including the speeches of the two dissenting members of the House. I hope I will not be thought unmindful of his argument if I say I do not think it would be useful to go in detail through all those speeches in order

(1) [1926] A.C. 205.

(Pennycuick V.-C.)

to prove a negative. I am not persuaded that there is anything in that case which supports the contention that there is some third and different test to be applied in computing the profit of a trade for the purpose of tax. It will be borne in mind, as appears from the speech of Lord Cave L.C., at page 192, that there was in that case no finding by the Commissioners upon the question of commercial accountancy. Mr. Watson also relied on the recent case in the Court of Appeal of *B.S.C. Footwear Ltd.* v. *Ridgway*(1) [1971] Ch. 427. In that case the Court of Appeal rejected a particular basis of commercial accountancy which had been followed for many years, although saying it was a legitimate basis for ascertaining profit. But there is nothing, I think, in the judgments in that case which goes outside the requirement based on the ordinary principles of commercial accountancy when that principle is properly understood.

I turn now to consider the present case, and I will do so first apart from the decision of the Court of Session in *Law Shipping Co. Ltd.* v. *Commissioners of Inland Revenue*(2), upon which Mr. Watson very properly placed the greatest reliance, as did the Commissioners, and one or two other cases which followed it.

The evidence of the accountants, as accepted by the Special Commissioners, was that in accordance with the principles of sound commercial accountancy at the present time the disputed expenditure referred to in the Case as " deferred repairs " would be dealt with as a charge to revenue in the Appellant Company's accounts. I do not see any reason at all to conclude that the principles of commercial accountancy as currently adopted in this respect by accountants are incorrect. It seems to me, on the contrary, that those principles are correctly applied for the purpose of ascertaining the true profit of a trade. Generally speaking, the attribution of a particular item, whether of receipt or of expenditure, to capital or to income depends upon the nature of the receipt or expenditure. The circumstances in which the particular receipt or expenditure takes place may favour either income or capital at the expense of the other. On the other hand, the law does not, apart from exceptional circumstances, require or permit any artificial adjustment so as to produce a result which might be regarded as theoretically or logically fair as between capital and income. That general statement is, I think, true not only as regards income tax but also as regards company law and as between life tenant and remainderman. So far as company law is concerned, the obvious instance lies in the ascertainment of profits which are available for distribution in dividend. More specifically, expenditure on repairs is an item which, from its nature, is *prima facie*, in the absence of special circumstances, attributable to income or revenue account. That, I think, is none the less so by reason that the repairs are effected upon some particular asset which was acquired in poor condition and consequently requires more expenditure upon repair in the future—that is, after its acquisition— than it would if it had been kept properly in repair up to the date of the acquisition. Apart from special circumstances, and I can see none here, I see no reason in principle why this particular item of expenditure—i.e. the expenditure upon repairs to an item which is acquired in poor condition—should not be brought into account according to its natural character in ascertaining the profits of a trade according to the correct principles of commercial accountancy. To avoid misunderstanding, the position is, of course, different in respect of improvements. Again it is different in respect of expenditure incurred in order to make an asset commercially viable on its acquisition. Obviously the dividing line between cases of one or the other type is one of fact and degree.

(1) 47 T.C. 495. (2) 12 T.C. 621.

A Mr. Watson expressed his contention of principle on this point in the following terms. A trader, buying a capital asset part worn, serviceable or not, for less than the price of a like asset as mint, cannot deduct the cost of deferred repairs in computing his profit for tax purposes because that cost is capital expenditure. It seems to me that attribution as between capital and income on the basis of that proposition would be contrary, not only to the ordinary prin- B ciples of commercial accountancy as adopted by accountants, but also to any correct principle of commercial accountancy designed to ascertain the true profit of a trade. Such a principle would apparently involve this, that the trader would make no revenue profit until he had made good the entire difference between the value of the asset in the condition in which it was purchased and its value as good as new. That is not, the accountants tell us, in accordance with C the ordinary principles of commercial accountancy, and I do not think it represents a proper way of ascertaining the profits of a trade. It is difficult to elaborate the point. I would, however, add that the application of this principle as regards the ascertainment of profits for the purpose of dividend would be entirely contrary to well-recognised principles of company law. I conclude, therefore, that upon the ordinary principles of commercial accountancy, as D correctly adopted, this expenditure falls to be brought in as a deduction in ascertaining the profit of the Appellant Company's trade.

It remains to consider whether it falls within any of the express prohibitions in s. 137 of the Act. The only paragraph which is relied upon—not, I think, very optimistically—by Mr. Watson is *(f)*: " any capital withdrawn from, or any sum employed or intended to be employed as capital in, such trade, profes- E sion or vocation ". It seems to me that the money expended on currently doing repairs cannot possibly be described as capital withdrawn from or as a sum employed or intended to be employed as capital in the trade.

So far I have considered this matter apart from the authorities dealing with this specific point. The case upon which most reliance is placed is *Law Shipping Co. Ltd.* v. *Commissioners of Inland Revenue* 12 T.C. 621, in the Court of Session. F The facts as they appear in the headnote are these:

> " The Appellant Company purchased a second-hand ship at a date when her periodical Lloyd's survey was overdue, but had been deferred pending the completion of a voyage then in contemplation. On her return six months later the survey was made and the Company was obliged to spend a large sum in repairs. The purchase was made in such circumstances G as not to constitute a succession by the Company to the vendor's business. The Company claimed that the whole cost of the repairs should be deducted in computing its profits for Income Tax purposes, and therefore for Excess Profits Duty purposes, for the accounting period in which such expenditure was incurred. *Held*, that except for such part of the cost of the repairs as was attributable to the period during which the ship was H employed in the Appellant Company's trade, the expenditure in question was in the nature of capital expenditure, and was not an admissible deduction in computing the Company's profits."

Lord President Clyde set out the facts, and, at page 626, he said this:

> " The purchasers started their trade with a ship already in need of extensive repairs. The need was not so clamant as to make it impossible I to employ her (as she stood at the time of the purchase) in the voyage she was then about to commence. So much is clear from the fact that she was allowed exemption from survey for the purposes of that voyage. But, while some portion of the repairs executed after her return was no doubt attribu-

(Pennycuick V.-C.)

table to her employment in the purchasers' trade between the date of their purchase and the return of the ship—and while such portion was therefore necessary to the earning of profits by them in that and subsequent voyages—it seems plain that a large portion of them was attributable solely to her employment by the purchasers' predecessors, in whose profits the purchasers had no interest whatever. The admissibility of deduction of the latter portion thus appears to be negatived by the terms of Rule 3 (*a*) of Cases I and II. It is obvious that a ship, on which repairs have been allowed to accumulate, is a less valuable capital asset with which to start business than a ship which has been regularly kept in repair. And it is a fair inference that the sellers would have demanded and obtained a higher price than they actually did, but for the immediate necessity of repairs to which the ship was subject when they put her in the market. The additional gains they had made by postponing repairs were thus counter-balanced by the diminished value of the ship on realisation; but it is not relevant to the question of the extent of the purchasers' assessibility to Income Tax on their own profits, that the Revenue may have gained by the inflation of the profits of their predecessors consequent on the postponement of repairs which—if regularly made—would have diminished them. Again, when the purchasers started trade with the ship, the capital they required was not limited to the price paid to acquire her, but included the cost of the arrears of repairs which their predecessors had allowed to accumulate; because, while their own trading with her would—in ordinary course—provide a revenue out of which the repairs incidental to such trading would be met, it would be unreasonable and abnormal—in any commercial sense—to saddle such trading with the burden of arrears of repairs incidental to the trading of their predecessors from which the purchasers derived no benefit. If the purchasers had 'succeeded to the trade' of their predecessors within the meaning of Rule 11 of Cases I and II of Schedule D, the case would have been otherwise; but this view of the purchasers' relation to the sellers is excluded by the case of *Watson Bros.* v. *Lothian* (1902 4 F. 795; 4 T.C. 441) mentioned in the Case."

Lord Skerrington's judgment was to the same effect. He said, at page 627:

"For the purpose of starting a new business the Appellants bought a ship which was out of repair to the extent of £39,558. They made good this defect at the first convenient opportunity. The cost of these repairs was in my opinion just as much a capital expenditure from the point of view of the Appellants' business as it would have been if the work had been executed by the seller before the sale and the cost had been added by him to the price of the ship."

Lord Cullen was again to the same effect. At page 628, he said:

"It is, in substance, the equivalent of an addition to the price. If the ship had not been in need of the repairs in question when bought, the Appellants would, presumably, have had to pay a correspondingly larger price."

Lord Sands put it, I think, a little differently. He said, at page 629:

"I have come to the conclusion, though not with complete satisfaction, that the Appellants are not entitled to make this deduction, and that the £40,000 must be treated as a capital outlay. I base this conclusion upon two grounds: (1) The case of the *Highland Railway Company* v. *Balderston*[1]

(1) 2 T.C. 485.

A 1889 16 R. 950 appears to me in point and the reasoning of the Lord President to be applicable. Repairs necessary at the time of purchase to render the subject of purchase serviceable fall to be added to the initial cost as a capital charge. (2) Upon ordinary business principles this outlay appears to me to be properly a capital charge. A prospectus of a company formed to purchase this ship would in ordinary course have shown the B purchase price and the repairs immediately required as part of the initial capital outlay. It may be that the Appellants' company did not raise capital to meet these charges, but paid them out of future income. But, as pointed out by the Lord President in the *Highland Railway Company* case[1], such considerations are not conclusive. The question is not from what source the charges were actually defrayed, but whether, according to C accounting principles, they ought to be charged to capital or to income."

It seems to me that although the reasoning of the learned Lords in that case has great weight it is distinguishable on two distinct grounds. The first is that they did not have before them evidence of accountancy practice. In the second place, the ship there was in such a condition that although she was able to complete one voyage it was necessary to do the repairs before the ship would D be further viable. Having regard to those distinctions, I do not think I am bound to apply the decision in that case to the present, where in the first place there is accountancy evidence and in the second place the cinemas were on their acquisition in such a condition as to be commercially viable. None of the other cases in the same line takes the matter any further. They are, perhaps, cases which are *a fortiori* the *Law Shipping* case[2]. The first is *Commissioners of Inland* E *Revenue* v. *Granite City Steamship Co. Ltd.* 13 T.C. 1. Then there are two recent decisions of Danckwerts J., *Jackson* v. *Laskers Home Furnishers Ltd.*[3] 37 T.C. 69 and *Bidwell* v. *Gardiner* (1960) 39 T.C. 31. In each of those cases, quite apart from accountancy evidence, the asset was in such a condition as not to be commercially viable until the repairs in question had been performed.

I conclude, then, that I am not compelled to arrive at a decision which F would be contrary to my own view, based upon what I conceive to be the correct accountancy principles after reading the findings of the Commissioners upon the accountancy evidence before them as to accountancy practice.

I ought, I think, to make one comment on the reasons given by the Commissioners themselves to which, naturally, one pays great respect. They were in part basing themselves upon the authority of the *Law Shipping* case. But G they also in para. (6) gave their own reason in principle for the view that that case laid down a general principle which they believed to be correct. They say:

"Expenses of a trade which accrued prior to the carrying on of that trade by the person presently to be taxed cannot be taken into account in determining the profit or gain derived by him for the purpose of ascertaining his liability to tax. Such expenses did not accrue in the process of H earning his profits or gains, and if paid by him they are not revenue expenses but something over and above, and therefore capital."

With all respect to the Commissioners, it seems to me that they have misled themselves by the use of this word " accrued ". The expense of repair was not a liability which had accrued prior to the acquisition of the cinemas. The expense had only accrued in the sense that if the repairs had been carried out I in a proper course of management then they would have been carried out before the acquisition. That is not accrual at all in the proper sense of the word. As I have, I think, already indicated, one must take these expenses as one finds

(1) 2 T.C. 485. (2) 12 T.C. 621. (3) [1957] 1 W.L.R. 69.

(Pennycuick V.-C.)

them when they are in fact incurred, and one is not entitled to spread them notionally according to some theory of what ought to have been done over the years when they were not in fact incurred. A

I have already mentioned that the Appellant Company has put before the Commissioners an argument based on the manner in which the price of the cinemas acquired from outside purchasers was decided upon by the officers of the Appellant Company. I do not myself find that a weighty argument, but it will, of course, be open to the Appellant Company in a higher Court. I do not think it would be useful for me to say anything more about it. B

The issues of succession and inter-group transactions have not been argued before me at all, and I say nothing more about them. I propose accordingly to allow this appeal.

Talbot Q.C.—Your Lordship will allow the appeal with costs and order that the case be remitted to the Commissioners to adjust the outstanding assessments in accordance with your Lordship's judgment? C

Pennycuick V.-C.—That must be right?

Watson Q.C.—Yes, indeed, my Lord.

Talbot Q.C.—I take it that the costs of the remission hearing will be costs in the cause? That, I think, must be so. D

Watson Q.C.—That must follow, my Lord.

Pennycuick V.-C.—The original costs nobody pays.

Watson Q.C.—No, not the costs of the original hearing.

Pennycuick V.-C.—But the costs of the remission would be costs in the cause?

Talbot Q.C.—That is right, my Lord.

Pennycuick V.-C.—You accept that, Mr. Watson? E

Watson Q.C.—Would you spare me just a moment?

Pennycuick V.-C.—Yes. Unless you are going to accept that, I am going to decide in your favour.

Watson Q.C.—My Lord, apart from that observation which has fallen from your Lordship I am instructed to oppose the payment of costs.

Pennycuick V.-C.—I think the remission was necessitated because the Appellants had not adduced certain evidence before the Commissioners in the first place. I do not see why you should pay for that. F

Talbot Q.C.—It is also true that the Crown had not led evidence on this point, and they were just as much concerned at first instance. They could have led evidence in the appeal to the effect that this expenditure should be charged to capital. G

Pennycuick V.-C.—The burden lay on you.

Talbot Q.C.—I am, of course, in your Lordship's hands.

A **Pennycuick V.-C.**—I think the right Order would be that the Crown pays the Appellant's costs of the appeal, but I do not think the Order should include the costs of the remitted hearing before the Commissioners.

Talbot Q.C.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came B before the Court of Appeal (Salmon, Buckley and Orr L.JJ.) on 18th, 19th and 20th October 1971, when judgment was reserved. On 3rd November 1971 judgment was given unanimously against the Crown, with costs.

The Solicitor-General (*Sir Geoffrey Howe Q.C.*), *Roderick Watson Q.C.* and *Patrick Medd* for the Crown.

F. Heyworth Talbot Q.C., *Michael Nolan Q.C.* and *Denis Carey* for the C Company.

The following cases were cited in argument in addition to those referred to in the judgments:—*Coltness Iron Co.* v. *Black* (1881) 1 T.C. 287; 6 App. Cas. 315; *Granite Supply Association Ltd.* v. *Kitton* (1905) 5 T.C. 168; 43 S.L.R. 65; *Whimster & Co.* v. *Commissioners of Inland Revenue* 12 T.C. 813; 1926 S.C. 20; *Naval Colliery Co. Ltd.* v. *Commissioners of Inland Revenue* (1928) 12 T.C. 1017; D *Commissioners of Inland Revenue* v. *Patrick Thomson Ltd.* (1956) 37 T.C. 145; *Stevens* v. *Boustead* 7 T.C. 107; [1918] 1 K.B. 382; *Commissioners of Inland Revenue* v. *Marshall* (1928) 14 T.C. 319; *Jennings* v. *Barfield* 40 T.C. 365; [1962] 1 W.L.R. 997; *Commissioners of Inland Revenue* v. *Barr* 35 T.C. 293; 1954 S.C. (H.L.) 71.

E **Salmon L.J.**—The relevant extracts from the Case Stated are all set out in Pennycuick V.-C.'s lucid judgment, and I need not repeat them. I wish, however, to draw attention to certain salient facts affecting this appeal.

Odeon Associated Theatres Ltd. (which I will call "Odeon") carry on business as exhibitors of films. They are, and have been since the 1930s, one of the largest exhibitors of films in England, and own very many cinemas F throughout the country. They are now members of one of the biggest groups of companies engaged in the cinema industry in England. In the immediate post-war years Odeon bought a large number of cinemas and cinema-owning companies. The object of these purchases was (*a*) to prevent this branch of the industry from falling under American domination, (*b*) to strengthen Odeon's negotiating power in booking films and of course (*c*) to enlarge their profits.

G On 8th January 1945 Odeon bought what had formerly been called the Regal Cinema at Marble Arch for £240,000. During the war years, owing to the then current restrictions, it had been impossible to spend more than comparatively small sums on keeping cinemas in repair. Accordingly in 1945 the cinema at Marble Arch, like all cinemas in this country, was somewhat run down. During the previous five years many repairs and replacements which would normally H have been effected had necessarily been deferred because it had been impossible to obtain licences to carry them out. Nevertheless the Marble Arch cinema at the date of its acquisition was a fully effective profit-earning asset, and the price which Odeon paid for it had not been diminished nor in any way affected by reason of its lack of repair. During the period 1945 to 1954 Odeon spent considerable sums of money in making additions to building plant and equipment

(Salmon L.J.)

at this cinema. All these items were charged as capital expenditure by Odeon in their accounts. In each year from 1945 to 1954 Odeon also spent substantial sums of money on repairs and renewals at this cinema. Some of this money was charged in their accounts as revenue expenditure spent on current repairs and renewals; it was allowed without question by the Inland Revenue as a charge against Odeon's profits. On the other hand, some of the money spent during this period on repairs and renewals was charged in Odeon's accounts as revenue expenditure spent on deferred repairs and renewals. The reason for Odeon distinguishing in their accounts between current and deferred repairs and renewals was to avail themselves of the concessions relating to their liability for excess profits tax made by s. 37 of the Finance Act 1946. This tax had been in existence from about the middle of 1940 until the end of 1946. Section 37 provided in effect that any money spent after 1946 relating to repairs and renewals which had been necessarily deferred during the period when excess profits tax was exigible should be credited against liability for that tax. Between 1947 and 1954 Odeon charged £17,708 as their expenditure on deferred repairs and renewals. The amount spent during this period on deferred repairs and renewals obviously could not be precisely measured. The Inland Revenue challenged the figure of £17,708. Negotiations took place, and the amount attributable to deferred repairs and renewals was eventually agreed with the Inland Revenue at £11,510. It was also agreed that £7,969 of that sum related to the period prior to the acquisition of the cinema by Odeon on 8th January 1945 and the balance of £3,541 to the period from 8th January 1945 until 1st January 1947.

The Crown contends that the several sums amounting in all to £7,969 are not revenue expenditure but capital expenditure and therefore cannot be taken into account in assessing Odeon's liability for income tax in respect of any of the fiscal years in question. It is, I think, worth noting from annex 2 to the Case Stated how the expenditure of £7,969 was allocated over the years.

	£
1947	151
1948	752
1949	352
1950	1,602
1951	1,118
1952	2,701
1953	317
1954	976
Total	7,969

It is also perhaps worth noting that the work comprised in these items includes, for example, renewing carpets, decorating, rewiring, etc. It does not seem to me that any of this expenditure can *prima facie* properly be regarded as being in the nature of capital expenditure. It appears to me to be obviously revenue expenditure. Moreover, the first item of this expenditure was not incurred until two years after the acquisition of the cinema and the last not less than nine years after the acquisition. £7,969 may be a comparatively small sum of money, but the group of which Odeon is a member owns 564 cinemas. In many of these the same questions arise as in the present case. The total amount of tax liability depending upon the result of this appeal is accordingly very large. The evidence of a number of exceptionally distinguished accountants, accepted by the Special Commissioners, was that in accordance with the established principles of sound commercial accounting the disputed items of expenditure were a charge to revenue. The learned Vice-Chancellor held that in law these items were properly

A chargeable to revenue and that the profits for the years in question should be assessed for tax on that basis. From that judgment the Crown now appeals.

Few commercial questions have been responsible for so much litigation as what is the true profit in a particular year. Sometimes this question depends, as in *Duple Motor Bodies Ltd.* v. *Commissioners of Inland Revenue* (1) 39 T.C. 537, upon the correct method of assessing work in progress; sometimes, as in B *B.S.C. Footwear Ltd.* v. *Ridgway*(2) [1972] A.C. 544, upon the correct method of assessing stock-in-trade; and sometimes, as in the present case and many others, upon deciding which items of expenditure are to be attributed to capital and which to revenue. In solving this question as to what is the true profit:

> " . . . first, . . . the ordinary principles of commercial accounting must, as far as practicable, be observed, and, secondly, . . . the law relating C to income tax must not be violated . . . that is to say, by one means or another the full amount of the profits or gains must be determined "

—*per* Lord Simonds in the *Duple Motor Bodies* case, at page 566.

In *Lothian Chemical Co. Ltd.* v. *Rogers* (1926) 11 T.C. 508 Lord President Clyde observed, at pages 520–1:

> " My Lords, it has been said time without number . . . you deal in D the main with ordinary principles of commercial accounting. They do expressly exclude a number of deductions and allowances, some of which according to the ordinary principles of commercial accounting might be allowable. But where these ordinary principles are not invaded by Statute they must be allowed to prevail. It is according to the legitimate principles of commercial practice to draw distinctions, and sharp distinctions, E between capital and revenue expenditure, and it is no use criticising these, as it is easy to do, upon the ground that if you apply logic to them they become more or less indefensible. They are matters of practical convenience, but practical convenience which is undoubtedly embodied in the generally understood principles of commercial accounting."

I confess that in the present case I find it difficult to discern any conflict between F logic and the established principles of sound commercial accounting. Lord Clyde was merely restating a principle of law which has been laid down in countless other authorities: see, for example, *Stott* v. *Hoddinott* (1916) 7 T.C. 85, *per* Atkin J., at page 91; *Sun Insurance Office* v. *Clark* (3) [1912] A.C. 443, *per* Viscount Haldane, at page 455; *Roebank Printing Co. Ltd.* v. *Commissioners of Inland Revenue* (4) 13 T.C. 864, *per* Lord President Clyde, at page 874. In my G judgment the true proposition of law is well established, namely, that, in determining what is capital expenditure and what is revenue expenditure in order to arrive at the profit for tax purposes in any particular year, the Courts will follow the established principles of sound commercial accounting unless they conflict with the law as laid down in any Statute.

In the present case it is argued on behalf of the Crown that to charge the H items in question to revenue is contrary to the following provisions of s. 137 of the Income Tax Act 1952:

> " Subject to the provisions of this Act, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, 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 I purposes of the trade, profession or vocation; . . . (*d*) any sum expended for repairs of premises occupied, or for the supply, repairs or alterations

(1) [1961] 1 W.L.R. 739. (2) 47 T.C. 495. (3) 6 T.C. 59, at p. 78.
(4) 1928 S.C. 701.

(Salmon L.J.)

of any implements, utensils or articles employed, for the purposes of the trade, profession or vocation, beyond the sum actually expended for those purposes; . . . (*f*) any capital withdrawn from, or any sum employed or intended to be employed as capital in, such trade, profession or vocation; (*g*) any capital employed in improvements of premises occupied for the purposes of the trade, profession or vocation ". A

In my view the money laid out in respect of the disputed items was indubitably laid out by Odeon wholly and exclusively for the purposes of their trade. I certainly cannot think of any other purpose for which the money was in reality expended. It was argued that this money was being laid out in the years 1947 to 1954 partly for the purpose of a trade which had been carried on prior to 8th January 1945 by the company from which Odeon bought the cinema. I am afraid that I cannot accept this argument. It seems to me to be unreal on the facts and to involve an altogether too artificial construction of s. 137(*a*). For the same reasons I am equally satisfied that all the sums expended for repairs of the cinema occupied by Odeon or for the supply, repairs or alterations of any implements, utensils or articles for the purposes of Odeon's trade were actually expended for those purposes and therefore are not excluded by s. 137(*d*). I of course accept that if any of the disputed items in truth constituted capital expenditure they would be excluded by s. 137 (*f*) and (*g*). But no help can be derived from the Statute in deciding the question of what is capital expenditure. The Statute does not give even the faintest hint as to how this question should be answered. I am therefore wholly unable to accept the argument that the established commercial accounting practice (found by the Special Commissioners) of charging the disputed items to revenue and not to capital is in any way in conflict with the Statute. B C D E

That, in my view, really disposes of this appeal. I must, however, deal with *Law Shipping Co. Ltd.* v. *Commissioners of Inland Revenue* (1) 12 T.C. 621 out of respect for the interesting arguments which have been addressed to us upon it. In this connection it must be remembered that in the present case the Commissioners have found on ample evidence an established practice of sound commercial accounting. Sometimes, however, there is no evidence of such a practice; sometimes there is conflicting evidence; and sometimes there is evidence of two parallel but conflicting principles of commercial accounting. In such cases the Courts must do the best they can without evidence or choose between the conflicting evidence or decide which is the most appropriate principle of commercial accounting to adopt. Even in cases such as these, of which the *Law Shipping* case was one, the Courts have never attempted to define "capital expenditure" or "revenue expenditure". Such is the complexity of commerce and accountancy that no definition could be devised which would be appropriate in every case. In the many cases in which the Courts have had to determine what are the profits and gains they have often had to consider whether a certain item of expenditure is properly chargeable against capital or revenue without any evidence or with conflicting evidence of established commercial accounting practice. In such cases the Courts have used illustrations or phrases which seemed helpful in solving the problem confronting them in the light of the particular facts being considered. As Viscount Radcliffe observed in giving the judgment of the Board in *Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd.* [1964] A.C. 948, at page 959: F G H I

" . . . it has to be remembered that all these phrases . . . are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one

(1) 1924 S.C. 74.

A previously decided, a court's primary duty is to inquire how far a description that was both relevant and significant in one set of circumstances is either significant or relevant in those which are presently before it."

Where, however, there is evidence which is accepted by the Court as establishing a sound commercial accounting practice conflicting with no Statute, that normally is the end of the matter. The Court adopts the practice, applies it and B decides the case accordingly. It seems to me important to keep these considerations well in mind when considering the *Law Shipping* case [1], which was the sheet anchor of the Crown's case in this Court and which appeared to the Special Commissioners to be conclusive in the Crown's favour. In that case the taxpayers had bought a ship for £97,000 which at the time of purchase was ready to sail with freight booked. The periodical Lloyd's survey was then C considerably overdue. As a matter of grace an exemption from survey was obtained until the completion of the voyage which the vessel was then about to commence. At the conclusion of the voyage about six months later £51,558 had to be spent on repairs in order for the vessel to pass its survey. £12,000 of this sum was in respect of repairs caused by deterioration during the voyage. The balance of £39,558 was spent to remedy the state of disrepair in which the D vessel had been at the time of purchase. It was held that this latter sum was capital expenditure by the taxpayers and could not be charged against their profits. Before the taxpayers purchased the vessel they must have been aware that a large sum of money would have to be spent upon repairs before the Lloyd's certificate could be renewed. It must have been apparent, as Lord President Clyde pointed out, that if the vessel had been in a fit state of repair to pass E survey at the time of purchase its capital value, and therefore the price which the taxpayers would have had to pay, would have far exceeded the purchase price of £97,000.

There seem to me to be many important distinctions between that case and the present case. (1) In the *Law Shipping* case the purchase price was substantially less than it would have been had the vessel been in a fit state of F repair to pass the Lloyd's survey at the date of purchase. Lord Skerrington stressed, at page 627, that the taxpayers had bought a vessel which was out of repair to the extent of £39,558 and that they made good this defect at the first opportunity. He added:

"The cost of these repairs was . . . just as much a capital expenditure from the point of view of the Appellants' business as it would have been G if the work had been executed by the seller before the sale and the cost . . . added by him to the price of the ship."

In the present case the purchase price paid by the taxpayers was in no way affected by the fact that the cinema was in disrepair at the date of its acquisition. The sellers could not lawfully have executed the repairs prior to the acquisition since no licence to execute such work was then obtainable. (2) In the *Law* H *Shipping* case the vessel was not in a state to pass survey at the time of purchase, and in order to obtain a Lloyd's certificate and turn it into a profit-earning asset after the voyage upon which it was then embarking it was necessary to spend a very large sum on deferred repairs immediately after the conclusion of that voyage. In the present case the cinema was a profit-earning asset at the date of its acquisition in spite of its state of disrepair. It remained so, although I no money was spent on deferred repairs for a number of years after its acquisition. (3) In the *Law Shipping* case there was no evidence that on established principles of sound commercial accounting the £39,558 could properly be charged by the taxpayer as revenue expenditure. And I should have been very surprised if there had been any such evidence. Lord President Clyde thought it would have

(Salmon L.J.)

been abnormal to charge this outlay against the taxpayers' revenue expenditure. A
Lord Sands, at page 629, said: "Upon ordinary business principles this outlay appears to me to be properly a capital charge." In the present case, however, the Commissioners held, on ample evidence, that it was in accordance with the established principles of sound commercial accounting to charge the disputed items to revenue expenditure, and these principles in no way conflict with any Statute. To my mind the facts of the *Law Shipping* case [1] are so far removed from B
those of the present case that in spite of the most skilful arguments advanced on behalf of the Crown I am altogether unpersuaded that there is anything in that authority or any other which would make it permissible for us to hold in the present case that the sums spent on deferred repairs should be charged to capital expenditure in the teeth of sound commercial accountancy practice which conflicts with no Statute. C

I would accordingly dismiss the appeal.

Before parting with this case I should mention, however, that when this case came before the Commissioners and the Vice-Chancellor, the Marble Arch cinema was selected as an example of a class of transaction in which a cinema was acquired by Odeon from an outside source without succession. Examples of three other classes of transaction were also considered, namely, transactions D
in which a cinema was acquired from (*a*) an outside source with succession, (*b*) as the result of a transfer within the group without succession and (*c*) as the result of a transfer within the group with succession. It was conceded that if deferred repairs in respect of the Marble Arch cinema were properly chargeable as revenue expenditure then they should also properly be so charged in respect of each of the other three classes of transaction. This no doubt was because the E
three other classes of transaction were even further away from the *Law Shipping* case than the Marble Arch transaction—if that be possible. Accordingly, since I have come to the conclusion at which I have arrived in respect of the Marble Arch cinema, I find it unnecessary, as did the learned Vice-Chancellor, to deal with the other classes of transaction. I would only add that, had I considered that deferred repairs in respect of the Marble Arch cinema were F
properly chargeable against capital, I think, although I am expressing no concluded view on this point, that I should probably have held that they were equally chargeable against capital in the case of all the other three classes of transaction to which I have referred. The question in each type of transaction must always be the same: What were the profits earned by Odeon for the fiscal years in question? The source from which Odeon acquired the cinemas with which they earned their G
profits does not seem to me, as at present advised, to be relevant to this question. Nor does it seem to me to be relevant whether Odeon acquired the cinemas with or without succession to the trade of the sellers or transferors.

Buckley L.J.—The question for decision in this case is whether substantial sums expended by the Appellant Company, Odeon Associated Theatres Ltd. (the Respondent in this Court), in the accounting periods relevant to its assess- H
ment to income tax for the fiscal years 1946–47 to 1955–56 inclusive, which sums were expended in effecting repairs, redecoration and refurnishing of a number of cinema theatres acquired by the Appellant Company during and soon after the second world war, should, in computing for income tax purposes the profits of the Appellant Company for the relevant periods, be allowed as revenue expenditure, or whether so much of such expenditure as was attributable I
to dilapidations which occurred before the acquisition of those theatres respectively should be treated as capital expenditure.

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[1] 12 T.C. 621.

A I need not restate the facts, but these points need to be stressed. First, all the disputed expenditure was of a kind which, if the theatres had remained in the ownership of the owners from whom they were acquired by the Appellant Company and the expenditure had been incurred by those owners, would have been deductible as revenue expenditure. Secondly, the amount of dilapidation which occurred before the acquisition by the Appellant Company of a theatre B (in the Case Stated called " deferred repairs ") did not in any case significantly affect the price paid by the Appellant Company for the theatre. Thirdly, the deferred repairs were not for the most part such as to require immediate remedy, and there was no question of danger to the public or of any theatre having to be closed for repairs. Fourthly, all cinema theatre owners were in a like position of being unable, on account of wartime restrictions, to carry out any C but the most urgent repairs, redecorations or refurnishing of their theatres: there was no competition in this respect: this state of affairs continued until the early 1950s.

The cost of acquiring or creating a physical capital asset for use in a trade or business is clearly capital expenditure. The cost of improving such an asset by adding to it or modifying it may well be capital expenditure. On the other D hand, the cost of works of recurrent repair or maintenance of such an asset attributable to the wear and tear occurring in the course of use of the asset in his trade or business by the person carrying out the works is revenue expenditure, and so constitutes a proper debit item in the profit and loss account of the business. Whether, where there has been a change of ownership, the cost of works of repair or maintenance attributable to wear and tear which occurred before E the change of ownership should be regarded as revenue expenditure or capital expenditure is a question the answer to which must, in my opinion, depend upon the particular facts of each case. The Solicitor-General has argued that any repair must improve the article repaired, and, avoiding undue cynicism, I think that that proposition must be accepted. He says further that, if the state of the article when repaired is better than its state was when it was acquired by the F person carrying out the repairs, the cost of repairs should *pro tanto* be regarded as capital expenditure. A tradesman, for example, who acquires a dilapidated shop in which to carry on his business and, either before he commences business or as soon thereafter as he can afford to do so, puts the shop into a state of repair and decoration suitable for his business, has incurred the cost not only of acquiring the shop but also of repairing and decorating it in a suitable manner in order to G provide himself with a capital asset of a character which he regards as appropriate to his business. The whole of this expenditure, it is said, is capital expenditure because it constitutes the cost of acquiring such a capital asset as the trader requires for the purpose of his business. The argument is an attractive one, but should not, in my opinion, be accepted without careful consideration.

The Solicitor-General contends that the expenditure on deferred repairs H was what he described as " a once for all jacking-up of the value of the principal asset ", and so was non-recurrent expenditure by the Appellant Company for the enduring benefit of its trade. He says that the fact that the prices paid for theatres took no account of the circumstance that at the dates of purchase repairs had already been deferred is of no importance. He contends that the cost of doing the deferred repairs was an additional cost to the Appellant I Company of acquiring the capital assets, that is, the theatres. Such expenditure, he says, should be regarded as capital expenditure. As Lord Reid observed in *Strick* v. *Regent Oil Co. Ltd.* (1) [1966] A.C. 295, at page 313:

(1) 43 T.C.1, at p. 29.

(Buckley L.J.)

> "The question [whether a particular outlay can be set against income or must be regarded as a capital outlay] is ultimately a question of law for the court, but it is a question which must be answered in light of all the circumstances which it is reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on strict application of any single legal principle."

In answering that question of law it is right that the Court should pay regard to the ordinary principles of commercial accounting so far as applicable. Accountants are, after all, the persons best qualified by training and practical experience to suggest answers to the many difficult problems that can arise in this field. Nevertheless, the question remains ultimately a question of law. No one, I think, would dispute that the cost of ordinary current repairs in the normal course of maintenance of a fixed capital asset employed in a business is revenue expenditure. Such cost arises out of the wear and tear of the asset in the course of earning the profits of the business and so is a proper debit to be set against the revenue of the business in its profit and loss account. I would myself think that, save in exceptional circumstances, this is true even in the case of the first repairs in the normal course of maintenance of an asset acquired in a part-worn condition. A tradesman who acquires a shop, the outside painting of which was last done two years before his purchase, will have to repaint the shop earlier than if it had been redecorated immediately before acquisition, but this, I think, is something which, as a commercial matter, he will take into account in considering the prospective profitability of the shop during the early years of his ownership. In other words, he will regard it as a revenue expense. He will not say to himself: "When I have to repaint the outside of the shop perhaps three years hence, only three-fifths of the cost will be chargeable against revenue in my profit and loss account: the balance will be a capital investment in my business." This view is, I think, borne out by the finding of fact contained in the Supplemental Case stated by the Special Commissioners in the present proceedings. Any other view would lead to great difficulty and confusion. Whenever a taxpayer made a capital investment in the acquisition of a part-worn capital asset for the purposes of his business it would be necessary to record the state of dilapidation of the asset at the date of acquisition in order to determine, when repairs were carried out at a later date, what proportion of the cost should be attributed to improvement on the state of repair at the date of acquisition. Although maybe in practice such a principle would be applied for fiscal purposes in relatively few cases, logically it would apply to every case of the acquisition for business purposes of a part-worn capital asset, however long or short the time before any repairs came to be done to it.

Such a principle should not, in my judgment, be accepted as of general application unless logic or law demand this. It is said that *Law Shipping Co. Ltd* v. *Commissioners of Inland Revenue* 12 T.C. 621 demonstrates that in Scotland the law has adopted and applied this principle. In my judgment, that case does not indicate that the Court of Session considered that there was any such principle of general application. The appellant company in that case had purchased a second-hand ship at a date when her periodical Lloyd's survey was overdue but had been deferred pending the completion of a voyage then in contemplation. On her return six months later the survey was made and the company was obliged to spend a large sum in repairs. The Court held that, except for such part of the cost of the repairs as was attributable to the period during which the ship was employed in the appellant company's trade, the expenditure in question was in the nature of capital expenditure and was not an admissible deduction in computing the company's profits. In that case the

(Buckley L.J.)

A capital asset which the appellant company acquired (that is, the ship) was at the time of purchase burdened with the necessity for its owners to carry out at the earliest practicable moment the repairs required to satisfy the Lloyd's survey. Unless and until such repairs were done the ship could not be further used in the owner's business after the termination of the one voyage. It may be that those repairs could have been said to have been of a routine maintenance character, B but in my judgment the case is clearly distinguishable on its facts from a case in which someone has acquired an asset which, though part-worn at the date of acquisition, is not burdened with the necessity to carry out immediate or nearly immediate works of renovation, The *Law Shipping Co.* case (1) is, in my view, more nearly analogous to the case of a trader who has bought a capital asset which at the date of acquisition was not in working order and has to put it into C working order before being able to use it in his business. When the Law Shipping Co. bought the ship they knew that in order to be able to use her in their business beyond the one voyage they would need to spend not only the purchase price of the ship but also the cost of the necessary repairs. The facts of the present case are quite different. All the theatres acquired by the Appellant Company were, when they were acquired, in a condition fully suitable for immediate D profitable use in the Appellant Company's business and capable of continuing to be so used in the conditions then existing for some years.

Jackson v. *Laskers Home Furnishers Ltd.* (2) 37 T.C. 69 is a case in which expenditure on repairs by a tenant of a building was, in my judgment, properly held to constitute capital expenditure. In that case the respondent company obtained a lease of the building which contained a covenant on their part to E reinstate the demised property in a good state of repair. The cost of carrying out the repairs was part of the consideration for the grant of the lease: it was in truth part of the price paid by the company for the lease, notwithstanding that the expenditure was expenditure purely upon repairs. *Royal Insurance Co.* v. *Watson* (3) 3 T.C. 500 was another case in which the sum under consideration was held to be a capital expenditure on the ground that it formed part of the F consideration for the acquisition of an asset. Of the other authorities relied upon by the Crown on this appeal, it is perhaps sufficient if I say that *Highland Railway Co.* v. *Balderston* (4) (1889) 2 T.C. 485 was a case in which the expenditure there under consideration was clearly incurred in making physical alterations to and improvements to the assets of the appellant company, and that *Commissioners of Inland Revenue* v. *Granite City Steamship* G *Co. Ltd.* (5) 13 T.C. 1 was a case in which the expenditure there under consideration was incurred in making good damage suffered by a capital asset of the respondent company which had resulted during the respondent company's ownership from matters entirely foreign to the carrying on of that company's business. Neither of these cases appear to me to assist the Crown on this appeal.

In consequence of the state of affairs existing during and immediately H following the war, the Appellant Company's theatres remained unrepaired and unredecorated for much longer than would have otherwise been the case, but the disputed expenditure, when it came to be made in the years 1947 to 1954, was all expenditure on works and matters of a kind which can properly be described as maintenance, and which would be bound to recur in later years. It seems to me to be misleading to describe this expenditure as " once for all ". I It was expenditure on maintenance which had then for the first time become possible and worth while for the Appellant Company to carry out. It was expenditure which, in the then existing altered conditions, was necessary to preserve the profitability of the theatres. There is no indication in the Case that the cost

(1) 12 T.C. 621. (2) [1957] 1 W.L.R. 69. (3) [1897] A.C. 1. (4) 16 R. 950. (5) 1927 S.C. 705.

(Buckley L.J.)

was greater than it would have been, having regard to the passage of time, if the theatres had been in a good state of decoration and repair when the Appellant Company acquired them. The facts as found do not, in my judgment, establish that the Appellant Company was put to any greater expense in the way of repairs and redecoration by reason of the deferred repairs than would have been the case if there had been no deferred repairs. The Appellant Company did not, as the result of some non-recurring payment, acquire some new asset or benefit, and the present case appears to me to be distinguishable from *Atherton* v. *British Insulated and Helsby Cables Ltd.* [1] 10 T.C. 155, relied upon by the Crown.

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In my judgment Pennycuick V.-C. was right in reaching the conclusion that, apart from the statutory prohibitions contained in the Income Tax Act 1952, s. 137, the disputed expenditure was proper to be taken into consideration as a debit against revenue in arriving at the Appellant Company's profits in the relevant years. In my judgment, there is nothing in that section which requires any of the disputed expenditure to be excluded in the computation of the company's profits. The expenditure was incurred wholly and exclusively for the purposes of the Appellant Company's trade, so that s. 137 (*a*) and (*d*) do not apply. No capital was withdrawn from the Appellant Company's trade, nor, in my judgment, for reasons already indicated, was any part of the expenditure employed or intended to be employed as capital in the Appellant Company's trade, so that s. 137 (*f*) does not apply. Nor, in my judgment, for reasons already given, can any part of the expenditure be said to constitute capital employed in the improvement of any premises occupied for the purposes of the Appellant Company's trade, so that s. 137 (*g*) does not apply. It has not been suggested that any other paragraph of s. 137 could apply in the present case.

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The Special Commissioners in their decision treated the disputed expenditure as expenses of operating the theatres which " accrued " before the Appellant Company began to operate them. This is perhaps elliptical language. The deferred repairs—i.e. the pre-acquisition dilapidations—occurred before the Company acquired the theatres. No expenses were incurred, or, in my opinion, can be accurately said to have accrued, until the repairs were carried out. When those expenses were incurred they were incurred by the Appellant Company in the course of carrying on its business and for the purposes of that business. The question whether they should be regarded as a proper charge against the Appellant Company's capital account or its revenue account cannot, in my judgment, be answered merely by saying that such expenses did not accrue in the process of earning the Appellant Company's profits or gains. If this language means, as I think it must, that the expenditure was not occasioned by anything which happened in the process of earning the Appellant Company's profits, I would make two observations about this. First, this is not, I think, a satisfactory test. Many kinds of expenditure—for example, insurance premiums—are proper to be regarded as revenue expenditure without their having been occasioned by anything which has occurred in the process of earning profits. Secondly, as I have already pointed out, the Case does not establish that the expenditure was any greater in consequence of the deferred repairs than it would have been if there had been none.

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I find no reason in law for dissenting from the finding of fact in the Supplemental Case that, on the assumption made for the purposes of that finding, viz. that all the theatres were acquired from vendors outside the Odeon group but that all other facts were as found in the Case, the disputed expenditure would, in accordance with the principles of sound commercial accounting, be dealt with as a

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(1) [1926] A.C. 205.

A charge to revenue in the Appellant Company's accounts. No distinction, I think, is to be drawn in this respect between transfers of theatres within the group and purchases from vendors outside the group. Accordingly I am of opinion that all the disputed expenditure was properly deductible in computing the Company's profits for income tax purposes in the relevant years.

For these reasons, which make it unnecessary to consider the point referred B to in the Appellant Company's cross-notice relating only to acquisitions which involved succession to a trade, I would dismiss this appeal.

Orr L.J.—In this appeal it has been common ground that, although the expenditure in question, if incurred by the previous owners of the theatres, would have been deductible in computing their profits for income tax purposes, it would have fallen to be treated as capital if incurred by the Appellant C immediately after acquisition of the theatres; and it has been simply and attractively argued for the Crown that delay by the Appellant in incurring the expenditure cannot alter its essential character.

The proposition advanced for the Crown is that, where a capital asset acquired by a trader for use in his trade was at the time of its acquisition in need of repairs, any expenditure subsequently incurred by the trader which has the D effect of improving the asset beyond the state in which it was at its acquisition is of necessity a capital expenditure. We are concerned with the application of this proposition, if it be correct, to the facts of the present case, but the proposition as formulated would, as I understand it, apply to expenditure incurred at whatever interval of time after the acquisition, and in whatever circumstances, and would apply not only, as in this case, to premises and their E furnishings, but also to such capital assets of a trader as lorries and cars and items of plant of all kinds. In the present case the information and material necessary to support the Crown's argument became available to the Revenue in a convenient form as a result of a claim made by the Appellant under s. 37 of the Finance Act 1946, which relates to "terminal expenses" for the purposes of the excess profits tax. In other cases the application of the Crown's proposition, F if it be correct, would involve detailed investigation of the condition of the premises or other asset at the time of acquisition and thereafter a detailed comparison of that condition with items of expenditure subsequently incurred, and it seems to me that these difficulties would in many cases make it impossible to apply the proposition save perhaps on a very arbitrary basis, but the Crown are entitled to say that this is not an answer to their case if it is on principle and G authority well founded.

It has been sought for the Crown to support the proposition, as applied to the expenditure in question in this case, on the three grounds: first, that the expenditure was by its nature capital; second, that its deduction is expressly prohibited by one or other of paras. (*a*), (*d*), (*f*) and (*g*) of s. 137 of the Income Tax Act 1952; and third, that it is not a "proper debit item" for the purpose H of computing the income tax profits of the trade; but in my judgment the Crown's case must stand or fall on the first of these grounds. As to s. 137 (*a*), there is clear authority in all the speeches in the House of Lords in *Atherton* v. *British Insulated and Helsby Cables Ltd.* 10 T.C. 155 (a case in which the expenditure in question was held to be capital by a majority of three to two) for the proposition that expenditure does not, by reason of its being capital, fall with-I in the prohibition contained in that paragraph, and the same reasoning, in my judgment, applies equally to s. 137 (*d*). As to s. 137 (*f*) and (*g*), the position plainly is that if the expenditure in question was on general principles capital the Crown does not need to rely on these paragraphs, and if it was not capital they do not help the Crown. In my judgment, therefore, the Crown's case

(Orr L.J.)

cannot derive any assistance from the express prohibitions contained in s. 137. A As to the third ground, it was argued for the Crown that, even if the expenditure was on general principles of a revenue nature, it is to be disallowed on the basis of the test laid down by Lord Sumner in *Usher's Wiltshire Brewery Ltd.* v. *Bruce* ([1]) [1915] A.C. 433, at page 468, that a deduction " . . . is to be made or not to be made according as it is or is not, on the facts of the case, a proper debit item to be charged against incomings of the trade. " But this reference B to a " proper debit item " was in the context of an issue between capital and revenue expenditure. In my judgment it means no more than that, to be deductible, the expenditure must be of a revenue nature, and the passage was so understood by Lord Cave in the *Atherton* case 10 T.C. 155, at page 192.

In support of this argument, however, the Crown also relied on a passage in the *Law Shipping* case 12 T.C. 621, in which Lord President Clyde, before C holding that the expenditure in question was by its nature capital, and alone amongst the members of the Court, expressed the view that the expenditure appeared to be prohibited by what is now s. 137 (*a*) of the Income Tax Act 1952; and reliance is further placed on certain passages in the judgments in *Commissioners of Inland Revenue* v. *Granite City Steamship Co. Ltd.* 13 T.C. 1; *Jackson* v. *Laskers Home Furnishers Ltd.* 37 T.C. 69; and *Bidwell* v. *Gardiner* D (1960) 39 T.C. 31. But in all these cases save the last the expenditure in question was clearly of a capital nature, and in the last, which involved expenditure in the first year after acquisition, and in which the argument was mainly upon the "succession" point, the question for the Judge was whether the Commissioners were entitled, on their view of the facts, to hold the expenditure to have been in part capital. If the Crown's proposition in the present case cannot be derived E from general principles, the passages in these cases relied on by the Crown seem to me to provide too slender a basis to support it. I would add that if, as seems possible, Lord President Clyde in the *Law Shipping* case was taking the view that the expenditure was prohibited by what is now s. 137 (*a*) on the ground that it was capital, his view was inconsistent with that taken in the House of Lords in the *Atherton* case. Finally, as regards this argument, the Crown's F case involves that there is some third test of deductibility, additional to that of capital or revenue expenditure, and additional to that of specific statutory prohibition; but in my judgment the existence of any such third test would be inconsistent with the proposition contained in more than one decided case and most recently repeated by Lord Reid in *B.S.C. Footwear Ltd.* v. *Ridgway* ([2]) [1971] 2 W.L.R. 1313, at page 1315, that in the framing of a profit and loss G account for the purposes of income tax " . . . it is well settled that the ordinary principles of commercial accounting must be used except in so far as any specific statutory provision requires otherwise. " For all these reasons, I agree with Pennycuick V.-C. that there is no such third test.

If I am right in the above conclusions the question in this case is whether on general principles and on authority the expenditure in question was a capital H or a revenue one. The Crown rely strongly on the *Law Shipping* case. Mr. Heyworth Talbot accepts the validity of that decision on its own particular facts, but claims that the present facts are distinguishable. In my judgment there are a number of important differences between that case and this. One is that in that case the purchaser knew at the time of acquisition of the ship that after one further voyage a Lloyd's survey would be required and would involve I very substantial expenditure if the ship were to continue to be used in the trade, whereas here what was in the purchaser's contemplation was that the theatres

([1]) 6 T.C. 399, at p. 436. ([2]) 47 T.C. 495, at p. 524.

(Orr L.J.)

A could be used profitably (as in the event they were) without making good the deferred repairs, and that substantial expenditure in making them good could not be lawfully incurred for an indefinite period of time. A second difference is that in the *Law Shipping* case (1) the Court drew, and in my judgment correctly drew, the inference that if the Lloyd's survey had not been overdue the seller would have exacted and the buyer would have paid a larger price, whereas here B it has been found as a fact that the dilapidated state of the theatres did not materially affect the price. A third difference is that there was not in the *Law Shipping* case any accountancy evidence, whereas in the present case there was such evidence which was accepted by the Commissioners. A fourth difference is that in the *Law Shipping* case the repairs or replacements necessary to satisfy the Lloyd's survey were carried out after the first voyage C of the ship, whereas in the present case the repairs and replacements in question were carried out over a period beginning two years and ending ten years after the acquisition, and there is no evidence to indicate that (apart from inflation, which was taken into account in the percentage calculation or estimate) they cost any more than would have been incurred if the theatres had been acquired in good repair and subsequent dilapidations had been made good in the ordinary D course of prudent maintenance. It has been pointed out to us, and is not in dispute, that the main items of the expenditure in question were carpets, decoration and upholstery, and that 60 per cent. of the overall total of £17,000 represents carpets. In my judgment it is a reasonable supposition that if dilapidations under these headings had been made good in 1945 they would in all probability have required further repair and replacement before the end of E 1954. These facts pose the question why, if a trader has acquired capital assets for use in his trade and is commercially able, and desires, to continue to use these assets in a dilapidated state up to a time when, if he had acquired them new, they would in any event have required repair or replacement, he is to be deemed, when he does effect repair or replacement, to have done so by way of capital rather than revenue expenditure; and if, as here, the position is that the F trader is prohibited by law from effecting the repairs or replacements, why he should be treated as if he had elected to carry them out immediately. Because of these differences, which in my judgment are crucial and compelling, between the facts of the *Law Shipping* case and those of the present case, I would uphold the decision of Pennycuick V.-C. as to the expenditure incurred in relation to the Odeon Theatre, Marble Arch.

G Before this Court additional points were taken on behalf of the Appellant as to the expenditure incurred in relation to certain other theatres on the ground that they were acquired from within the Appellant's group of companies and/or that there was a succession to the trade carried on by the previous owner. These points do not arise in the light of the conclusion which this Court has reached, but if that conclusion is wrong I would not have acceded to Mr. H Heyworth Talbot's argument on either of these points. As to the first, I cannot accept that the group accounts would present any insuperable difficulty. As to the second, Mr. Heyworth Talbot based his argument on a difference between the wording in rule 11 of the Rules applicable to Cases I and II of Schedule D in the Income Tax Act 1918, as amended by s. 32 of the Finance Act 1926, and the wording in the subsequent s. 19 of the Finance Act 1953; but in my judgment I the wording of rule 11 as amended—" the tax payable for all years of assessment by the person succeeding . . . shall be computed as if he had set up and commenced the trade . . . at that time "—is amply wide enough to exclude deduction of the expenditure in question if, contrary to our conclusion, the

(1) 12 T.C. 621.

(Orr L.J.)

corresponding expenditure incurred in respect of the Odeon Theatre, Marble Arch, is not deductible. I consider that this point is covered, adversely to the Appellant, by the reasoning of the House of Lords in *United Steel Companies* v. *Cullington* (*No. 2*) [1] 23 T.C. 91, although the particular subject-matter of that case was wear and tear allowances and the carry forward of losses, and not deduction of trade expenses. A

For these reasons, and those given by my Lords, I agree that this appeal should be dismissed. B

Talbot Q.C.—Would your Lordships dismiss the appeal with costs?

Salmon L.J.—Yes.

Medd—My Lord, in view of the unanimity of your Lordships' judgments and the obvious care and fullness of them, I hope your Lordships will not think me either disrespectful or impertinent if I tell you that I am instructed to ask for leave to appeal to the House of Lords. A large amount of tax, very nearly £500,000, turns on this decision, and it is, in the view of the Revenue, a principle of considerable importance. C

Salmon L.J.—Mr. Medd, of course you are absolutely justified in asking for leave to appeal. What bothers me on that is that it seems to have been settled for years in the House of Lords that if there is a principle of sound commercial accounting that requires an item to be dealt with as revenue expenditure or as capital expenditure, as the case may be, then unless that principle conflicts with any Statute it prevails. Now here there is an absolutely firm finding in the Supplemental Case that in accordance with the principles of sound commercial accounting at the present time the disputed expenditure referred to in the principal Case as " deferred repairs " would be dealt with as a charge to revenue in the purchaser's accounts. I am troubled by this, that I have not been able to find a case in which there has been such a finding where it has ever been thought worth going to the House of Lords. The fight has always been: what ought to happen in the absence of any such evidence or in the absence of any such finding? D E

Medd—I think I must accept that, although I perhaps ought not to commit myself to it. Obviously we would not go further without very careful consideration of your Lordships' judgments. The way it strikes me—and I say this I hope again without any sense of impertinence—is that the distinctions in the *Law Shipping* case [2] which your Lordships have drawn might be thought to be on the thin side. I do not think I can put it any further than that, and the reasons are the ones I have given your Lordship. F G

(*The Court conferred.*)

Salmon L.J.—No, we do not give leave.

[Solicitors:—Richards Butler & Co; Solicitor of Inland Revenue.]

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[1] [1940] A.C. 812. [2] 12 T.C. 621.