affirmative, and answered all the other questions of law in the negative.

Counsel for the First Parties—Clyde, K.C.—D. P. Fleming. Agents—Drummond & Reid, W.S.

Counsel for the Second and Third Parties—Macmillan, K.C.—Strain. Agents—Watt & Williamson, S.S.C.

Counsel for the Fourth Party—Ingram—Mitchell. Agents—Mackenzie & Fortune, S.S.C.

Counsel for the Fifth Party—Sandeman, K.C.—J. A. T. Robertson. Agents—J. & R. A. Robertson, W.S.

Counsel for the Sixth Party—Moncrieff, K.C.—Hon. W. Watson. Agents—J. & A. F. Adam, W.S.

Friday, January 31.

FIRST DIVISION.

(EXCHEQUER CAUSE.)

DARNGAVIL COAL COMPANY, LIMITED *v.* FRANCIS (SURVEYOR OF TAXES).

Revenue—Income Tax—Sale on Hire—Profits—Deductions—Hiring Agreement for Waggons with Option to Purchase.

A coal company made an agreement with a waggon company under which the coal company agreed to pay for ten years a certain yearly sum for a certain number of waggons. The coal company bound themselves to keep the waggons, which were to be at their risk, in good repair. At the end of the ten years the coal company were to have the option of purchasing the waggons at the nominal price of one shilling per waggon.

Held that in striking the profits of the coal company for purposes of income tax, there must be allowed as deductions that portion of the yearly payments which represented the consideration paid by the coal company for the use of the waggons, but not that which represented the consideration paid for the option to purchase.

The Darngavil Coal Company, Limited, *appellants*, appealed to the Commissioners for the General Purposes of the Income Tax Acts, and for executing the Acts relating to Inhabited House Duties for the Middle Ward of Lanark, against assessments under Schedule D of the Income Tax Acts for each of the years ending the 5th April 1910, 1911, and 1912, in respect of the profits of their business as coalmasters carried on in the parish of New Monkland, in the county of Lanark, and claimed deductions from the respective assessments in respect of payments made under certain agreements in the circumstances set forth below.

The Commissioners, after hearing parties, were of opinion that the transaction in question was a purchase by instalments and dismissed the appeal.

The Darngavil Coal Company were dissatisfied with this determination, and required the Commissioners to state a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland.

The Case stated, *inter alia*—"The following *facts* were admitted or proved:—(1) The appellant company carry on the business of coalmasters, and in the course of such business they have to convey the coal from the collieries to their customers in railway waggons. (2) In order to obtain waggons for this purpose the appellant company has from time to time entered into agreements in the form of the agreement between them and the Scottish Waggon Company, Limited, of which a copy is annexed hereto. [See *infra.*]

"In particular they have entered into the following agreements with the Scottish Waggon Company, Limited, viz.:—

No. of agreement.	Date.	No. of Waggons.	Period of Years.	Annual Payments.
1	19th Feb. 1902	50	7	£550. This agreement was duly carried through and the waggons in due course became the property of the company.
2	30th Aug. 1906	25	10	£223, 4s. 7d. This agreement is still running.
3	30th March 1909	100	10	£801, 5s. This agreement is still running.

These agreements were in existence during the years on the profits of which the assessments under appeal fall to be computed. . . . (4) The waggons comprised in the three agreements referred to above were all new at the date of the respective agreements, and they have not been the subject of any prior or subsequent agreement. (5) At the termination of the respective agreements the various waggons, the subject thereof, having regard to the average life and rate of depreciation applicable to such waggons, had or will have a substantial value in excess of the one shilling referred to in clause vii of the agreements. (6) In the appellant company's own accounts the whole of the annual payments paid under the agreements have been treated as an expense of carrying on the business and have been debited to the waggon revenue account. . . . (7) In the returns for income tax assessment, however, the appellant company have divided the said payments between revenue and capital, and have deducted as a trading expense that portion only of the annual payments which the Scottish Waggon Company, Limited, certified had been treated by them as revenue and had entered into the computation of their profits for income tax assessment. . . . (9) Prior to 29th May 1909, at which date the Secretary of Inland Revenue, Somerset House, London, issued to H. M. Surveyors of Taxes the circular of which a copy was produced to the Commissioners, . . . it was the practice of H. M. Surveyors

of Taxes to allow to the taxpayer as a deduction in ascertaining profits chargeable under Schedule D of section 100 of the Income Tax Act 1842 that portion of the payments made under agreements similar to the one annexed hereto, which the Waggon Finance Companies certified that they had treated as revenue, depreciation being allowable on that portion of the payments which had not been so treated as revenue. Subsequent, however, to that date no such deduction in ascertaining profits has been admitted, the whole payments under the agreements having been regarded by the Crown as payments of capital which should be treated as part of the cost price to be taken into consideration in calculating the annual allowance for wear and tear. The present appeal has been taken in consequence of the departure indicated in the circular from the practice which formerly prevailed."

The agreement between the Scottish Waggon Company, Limited (therein called the Waggon Company) and the Darngavil Coal Company, Limited (therein called the lessees) provided, *inter alia* — "I. The Waggon Company hereby agrees to let on hire to the lessees, and the lessees agree to take on hire from the Waggon Company, 100 railway waggons, having plates thereon marked 'Scottish Waggon Company, Limited, Owners,' . . . and that for the term of 10 years from the 23rd day of February 1909. II. The lessees bind and oblige themselves and their successors whomsoever to pay to the Waggon Company the yearly sum of £801, 5s. sterling, without deduction, as rent or hire for the use of said waggons, and that by quarterly payments of £200, 6s. 3d. sterling, on the first day of January, the first day of April, the first day of July, and the first day of October in every year during the said term of 10 years, with interest on each payment at the rate of 10 per cent. per annum from the date at which it falls due until paid, the first payment of £79, 0s. 7d. sterling to be made on the first day of April 1909 for the proportion of quarterly payment then due. III. The lessees hereby agree at their own expense to maintain the said waggons in good repair and working order throughout the said term of 10 years, and if any accident or other damage shall happen to any of them during said term the lessees agree to have the same repaired or rebuilt to the satisfaction of the Waggon Company, who shall neither be bound to repair or rebuild any of said waggons, nor to supply other waggons in lieu of any which may be damaged or rendered unfit for use. The waggons are to be at the risk of the lessees, who shall not be entitled to any deduction from the rent or hire in respect of damage to or destruction of waggons, and the lessees shall be bound to relieve the Waggon Company of all claims for damages or otherwise arising from or connected with the said waggons or their use. . . . V. If any quarterly payment, or any part thereof, shall remain unpaid by the lessees for one month after the same shall become payable, the Waggon Company shall be entitled immediately thereafter to seize and take possession of all the said waggons without any process of law, and this agreement shall thereupon be held to have been broken and put an end to by the lessees, and the Waggon Company shall be entitled to recover payment from the lessees of all loss and damage occasioned by their failure to implement this agreement, including all expenses which they may incur in recovering possession of the said waggons. VI. Immediately on the expiration of the said term of ten years the lessees shall be bound, unless they shall exercise the option of purchasing the said waggons and shall pay the price thereof as after mentioned, to deliver at Edinburgh to the Waggon Company or to any person authorised by them to receive the same, the whole of the said waggons in good repair and condition (reasonable tear and wear only excepted) and in case of their failure to deliver the said waggons as aforesaid the lessees shall be bound to pay to the Waggon Company as rent or hire the sum of one shilling per day per waggon during the period of non-delivery, after the expiration of the said term, and this without prejudice to the Waggon Company adopting such proceedings as they may think fit to enforce delivery. VII. Instead of delivering up the said waggons to the Waggon Company at the expiration of the said term, as provided in article VI hereof, the lessees shall have the option of purchasing the same from the Waggon Company at the price of one shilling sterling for each waggon upon giving notice in writing to the Waggon Company, three months before the expiration of said term, of their intention to avail themselves of such option, and upon such notice being given and the price being paid, and the whole quarterly payments before specified being also paid with any interest due, and upon the lessees' part of this agreement being fully implemented, the said waggons shall become the property of the lessees, but if at the expiry of said term the estates of the lessees shall be in liquidation or insolvent, and if there shall be any other contract between the Waggon Company and the lessees the waggons hereby let on hire shall not become the property of the lessees or of their estate till implement of the lessees' part of such other contract. VIII. The lessees shall not be entitled without the written consent of the Waggon Company to sub-let any of the waggons or to transfer the use or charge thereof to any person during the said term."

Argued for the appellants—(1) The agreement was simply one of hire; the yearly sums paid were rent or hire of the waggons. They were consequently entitled to deduct the whole of these sums as a necessary expense. (2) Alternatively the contract was one of hire with an option to purchase at the expiry of the ten years, and so far as the payments represented hire as distinct from the price of the option they were entitled to deductions. The agreement was of the same kind as that in

Helby v. *Matthews and Others*, [1895] A.C. 471, and was not a purchase by instalments as in *Lee* v. *Butler*, [1893] 2 Q.B. 318. Reference was also made to *Yorkshire Railway Waggon Company* v. *Maclure*, 1882, 21 Ch. D. 309; *Marston* v. *Kerr's Trustee*, May 13, 1879, 6 R. 898; *M'Entire* v. *Crossley Brothers, Limited*, [1895] A.C. 457; *Cropper & Company* v. *Donaldson*, July 8, 1880, 7 R. 1108, 17 S.L.R. 749; *Murdoch & Company, Limited* v. *Greig*, February 6, 1889, 16 R. 396, 26 S.L.R. 323.

The respondent was not asked to reply on the appellants' first argument that all the payments were deductible. On the second point it was argued for the respondent—The agreement was one of sale, the price being paid by instalments, there being a suspensive condition that the property was not to pass until the last instalment was paid.

At advising—

LORD PRESIDENT—This case raises a question under the Income Tax Acts as to the deductions which are to be allowed for necessary expenses before striking the profits of a coal company. The company claims a deduction in respect of payments which were made by them to a waggon company under a hire and purchase agreement under which they get waggons. Hitherto there does not seem to have been any difficulty in adjusting this matter, because the practice of the Crown has been to split the payment, to allow a deduction of such portion of it as they thought fairly represented the hire, and, on the other hand, not to allow any deduction for the portion that represented a payment towards the eventual purchase. But matters were altered by a circular which was sent by the Secretary of the Inland Revenue to surveyors of income tax and which gave instructions in very dogmatic terms that no deduction was to be allowed at all, because all such instalments were not hire at all, but were merely payments towards purchase. I think it is very much to be regretted that circulars of that sort should be sent forth without taking the advice of the law officers, and the proof of that has come in this case, where the law officers have found themselves practically unable to support the contention of the circular.

I think the case is too clear for argument. Here is a company which gets its waggons under what is known as a hire-purchase agreement. It pays so much a year. It undertakes to keep the waggons in repair. It pays so much a year for a period of years and at the end of that period of years it has an option, if it chooses, to make what is practically a nominal payment and then the waggon belongs to it. It is perfectly clear, on the decided cases, that during the course of the period of years the waggon is the property of the Waggon Company and not of the Coal Company. But the Coal Company wishes to use it, and accordingly an extra payment is made in respect of that. No discrimination is made between the two kinds of payment; it is a slump sum that is paid. In that case there are two things going on concurrently—there is the sale and purchase agreement on certain terms—not a sale at the moment, but an option to buy the waggons on certain terms at a future date—and on the other hand there is also concurrently a hiring agreement. It is clear that so far as the Coal Company have the use of the waggon by the hiring of it during that time, that is an expense which they are entitled to deduct, just as if they owned no waggons at all but simply hired them from day to day. It is equally clear that they could not claim to deduct the whole of what they paid to the Waggon Company, because a large portion of what they pay is really a payment for an option at a future date to get a waggon at a sum far under its real value.

We have not before us in the case the materials for splitting up that payment and saying what is truly hire and what is truly payment towards eventual purchase. The practice in the past has been to deal with this upon the indication that is given by the way that the Waggon Company choose to treat these payments in their accounts. Well, that was quite a fair basis if the parties chose, but it is obvious that what the Waggon Company choose to do in their accounts is not a real criterion in a question as to what is the true nature of the Coal Company's payments. It is merely an accountant's and an actuary's question, and I should hope that the parties will be able to agree. But I think the proper course for your Lordships is to remit to the Commissioners with an instruction that they are bound to allow as a deduction such portion of the yearly payments made by the Coal Company under these waggon agreements as represents the hire of waggons which are not yet their property, and that then the Commissioners must take up the question of apportionment and decide it for themselves if the parties do not agree.

LORD JOHNSTON and LORD MACKENZIE concurred.

LORD KINNEAR was absent.

The Court pronounced this interlocutor—

"Recal the determination of the Commissioners and remit to them to proceed in the case, with instructions that they are bound to allow as deductions that portion of the yearly payments made in respect of the waggon agreements referred to in the case which represents the consideration paid for being allowed to use the waggons which under the contract are not yet their property," &c.

Counsel for Appellants—Murray, K.C.—Hon. W. Watson. Agents—Macpherson & Mackay, S.S.C.

Counsel for Respondents — Solicitor-General (Anderson, K.C.)—J. A. T. Robertson. Agent—Sir P. J. Hamilton Grierson.