pre-war period will be computed on the same basis and be subject to the same conditions as in the accounting period. That rule has been strictly followed in the present case.

It appears that the appellant company paid for their ground in the pre-war period a yearly sum of £584. In the accounting period they paid only £148. The Commissioners do not propose to treat them in both periods as paying £584, nor in both periods as paying £148. They have adopted a different method, which is not only unintelligible but has no statutory foundation. Deducting the one figure from the other they reach a burden on the trader of £437, a figure which does not exist in reality.

I think their decision, being entirely without statutory warrant, ought to be recalled and that we should remit the case back to them.

LORD MACKENZIE—I concur.

LORD SKERRINGTON—I agree with your Lordship that the Commissioners' decision cannot stand, but I do so exclusively upon the admissions made by the respondents in this case.

LORD SANDS—I concur.

LORD JOHNSTON was absent.

The Court reversed the determination of the Commissioners and remitted to them to refuse the appeal and sustain the assessment.

Counsel for the Inland Revenue, Appellants—The Lord Advocate (Clyde, K.C.)—R. C. Henderson. Agent—Sir Philip J. Hamilton Grierson, Solicitor of Inland Revenue.

Counsel for the Respondents—Blackburn, K.C.—Scott. Agents—Dundas & Wilson, C.S.

Wednesday, June 19.

FIRST DIVISION.

[Exchequer Cause.

BOYD & SONS *v.* INLAND REVENUE.

Revenue—Income Tax—Average Profits and Gains—Deductions—Patent—Royalty for User of Patent—Finance Act 1907 (7 *Edw. VII, cap.* 13), *sec.* 25.

The Finance Act 1907, section 25, enacts—"(1) In estimating, under any schedule of the Income Tax Acts, the amount of the profits and gains arising from any trade, manufacture, adventure, concern, profession, or vocation, no deduction shall be made on account of any royalty or other sum paid in respect of the user of a patent, but the person paying the royalty or sum shall be authorised, on making the payment, to deduct and retain thereout the amount of the rate of the income tax chargeable during the period through which the royalty or sum was accruing due."

In 1914, 1915, and 1916 a firm paid a royalty of £400 for the user of a patent. That sum was not deducted in returning their profits for each of those years. After 1916 they ceased to pay the royalty and for the year 1917 they were assessed upon the average of the profits of the three preceding years including therein the £400 paid in each of those years for the use of the patent. *Held* that the £400 had been rightly included, and that the assessment was correct.

Lanston Monotype Corporation, Limited v. *Anderson*, 1911, 2 K.B. 1019, *distinguished.*

The Finance Act 1907 (7 Edw. VII, cap. 13), section 25, is quoted *supra in rubric.*

James Boyd & Sons, *appellants*, being dissatisfied with a decision of the Commissioners for the Special Purposes of the Income Tax Acts at Glasgow, took a Case in which A. H. Havelock, surveyor of taxes, was the *respondent.*

The Case set forth—"I. The following *facts* were admitted or proved:—(1) During a period of five years, namely, in the years 1912, 1913, 1914, 1915, and 1916, the appellants were liable to pay and did pay a fixed sum of £400 royalty to Messrs G. N. Haden & Sons of Trowbridge, Wiltshire, heating engineers, in respect of the user of a patent. The said payment appeared as a debit in the trading accounts of the appellants for each of those five years. The last of such payments (namely, for the year 1916) was made on 1st January 1916. The appellants, pursuant to section 25 of the Finance Act 1907, deducted and retained out of each sum of £400, so paid as royalty as aforesaid, the amount of the rate of income tax chargeable under the Income Tax Acts. By such deduction and retention the appellants have recouped themselves to the full for the Income Tax which had been charged upon, and in the first instance paid over to the Crown by the appellants in respect of such royalties (amounting in the aggregate to £2000), such charge to income tax having formed a part of the duty paid by the appellants to the Crown in satisfaction of the assessment on the profits and gains of the appellants under Schedule D of the Income Tax Acts, made upon the appellants year by year during the currency of the royalty, that is to say, up to and including the assessment for the year ended the 5th April 1917. (2) The profits and gains of the appellants, without allowing for the deduction, as an expense, of the £400 royalty so paid and debited as aforesaid in each year were—

For the year ended 31st Dec. 1914	£2971
For the year ended 31st Dec. 1915	1155
For the year ended 31st Dec. 1916	4419
3)	£8545
representing an average of (as assessed 1917-18)	£2848

"II. Mr John MacRobert, solicitor, Glasgow, on behalf of the appellants, *contended*—(*a*) That inasmuch as the royalty of £400 ceased to be payable after the year 1916, and thenceforth the appellants were not able to recoup themselves by deduction of income tax in respect of such royalty, the actual sums paid as royalty should be deducted before arriving at the profits for the years on the average of which the said

assessment is based. (*b*) That the £400 appearing as a debit for royalty paid in each of the years 1914, 1915, and 1916 being, but for the terms of section 25 of the Finance Act 1907, a proper deduction in order to arrive at the average profit of these years, should be so allowed, since the latter part of the section had become inoperative; in other words, that the statutory disallowance of an otherwise legitimate deduction could only be operative if the corresponding statutory relief were available. (*c*) And that as no additional taxation was imposed by the section in question the amount of the assessment for the year ended the 5th day of April 1918 must accordingly be calculated upon the average profits and gains of the three years in question, reckoning the £400 as a proper debit in each year before arriving at the profit. Thus he contended that the assessable profits in fact and in law were—

For the year ended 31st Dec. 1914 (£2971, less £400)	£2571
For the year ended 31st Dec. 1915 (£1155, less £400)	755
For the year ended 31st Dec. 1916 (£4419, less £400)	4019
3)	£7345
representing an average of	£2448

to which the assessment should, in his opinion, be reduced. In support of these contentions reference was made by Mr MacRobert to the reported case of the *Lanston Monotype Corporation Limited* v. *Anderson*, (1911) 2 K.B. 1019, 5 Tax Cases 675.

"III. The Surveyor of Taxes (Mr A. H. Havelock) contended that the assessment of £2848 was correct and should be confirmed.

"IV. We were of the *opinion* that the reported case cited did not decide the question at issue in this appeal. Having regard to the evidence, we found that inasmuch as the appellants had admittedly recouped themselves the whole of the income tax which they had paid during the five years for which such royalty was accruing, the sum of £2448 so claimed by the appellants to be the proper amount for assessment for the year ended 5th April 1918 would be less than the full amount of the balance of the profits or gains of the trade of the appellants upon a fair and just average of the three years ended 31st December in 1914, 1915, and 1916. We accordingly confirmed the assessment in the sum of £2848, and determined the appeal in favour of the Crown."

The *question of law* was—"Whether the assessment should be on the sum of £2848 or on the sum of £2448?"

Argued for the appellants—If section 25 of the Finance Act 1907 (7 Edw. VII, cap. 13) applied to the appellants it must be applied as a whole, and if so the appellants must have been in a position to deduct income tax from the royalty when paying it. But here it was impossible for them to do so, for no royalty was payable in the year of assessment. Consequently section 25 could not apply to them, and if so they were entitled to deduct the royalties paid in the three years upon which the average was calculated, for that was a payment necessary to enable them to make their profits. That contention was supported by *Lanston Monotype Corporation, Limited* v. *Anderson*, [1911] 2 K.B. 1019. The Income Tax Act 1842 (5 and 6 Vict. cap. 35), section 100, Schedule D, case 1, rule 1 and rule 4, were referred to.

Argued for the respondent—There was no hardship on the appellants, for during the first three years in which the royalty was paid the appellants deducted the income tax, but were not bound to account to the Crown for it until the fourth year. Consequently it was only fair that they should in the three years after the royalty had ceased to be paid be bound to account to the Crown for the deduction of tax which they had made in the prior three years. Section 25 was not a charging section. It merely altered the mode of collection. It applied in terms to the present case, and treated each year separately. The first part of the section was not intended to be subject to exception when in the assessment year the second part did not apply. Upon the three years of average the appellants had fully recouped themselves. They paid tax upon their profits, including the royalty, but paid the royalty less income tax. *Anderson's* case (*cit.*) was really in favour of the respondent, for it merely decided that section 25 of the Act of 1907 was not retrospective. In that case the year of assessment was 1907-8, which was based upon the average of the years 1904, 1905, and 1906, and that case decided that section 25 could not be applied in calculating the profits for those years.

LORD PRESIDENT — This Stated Case relates exclusively to the application of section 25 of the Finance Act of 1907. No question arises regarding the construction of that section, which seems to me to be expressed in plain and unambiguous terms. In estimating the profits of a business for the year the owner of the business who pays a royalty for the user of a patent is not to deduct the amount of the royalty charged upon his business before striking profits, but when he pays the royalty he is entitled to deduct the income tax appropriate to the year from the payment which he makes to the owner of the patent. The object of the statute is equally clear. It is, to use the words of the argument in the case of *Lanston Monotype Corporation, Limited* v. *Anderson*, [1911] 2 K.B. 1019, "an enactment which is only providing machinery for facilitating the collection of the tax by extending the principle of taxing at the source;" or to use the words of Farwell, L.J.—"This is a section for the improvement of the machinery for collecting the tax, and not a charging section at all;" and as Kennedy, L.J., observes—"The object of the section is to provide for the tax on payment of the royalties by deduction."

The question before us relates exclusively to assessment. The appellants, it appears, were assessed to income tax for the year ending the 5th of April 1918 upon a sum of £2848, but they contend that for that figure there should be substituted a sum of £2448—less by £400, it will be observed, than the figure at which they had been assessed. That £400 represents a royalty payable by

the appellants to the owner of the patent of which they have the user. The £2848 was arrived at by estimating the average profits of the three years ending 31st December 1914, 1915, and 1916. From the profits of these three years there was not deducted the £400 payable in each of these years by the appellants to the owner of the patent of which they had the user, but in each of these years when the appellants paid their £400 they deducted from the payment the amount of the income tax payable in that particular year. Thus it will be observed that the 25th section of the 1907 Act was strictly observed. It is common ground that the profits of those years was estimated in compliance with the provisions of section 25. We are now asked, however, to undo all that, which it is common ground was legally and properly done, and to revise the estimate of profits for each one of these three years for the purpose of arriving at the figure on which the appellants are to be assessed for the year ending the 5th of April 1918. Why? Because we are told that after the year 1916 the appellants ceased altogether to pay royalties. That appears to me to be a very obvious example of a *non sequitur*. I am wholly unable to follow the reasoning on which we are asked to delete the 25th section of the 1907 Act altogether because a particular trader has ceased to pay a royalty which he was formerly in the habit of paying, and where the statute has been quite properly and stringently complied with. This case, I conjecture, would never have been brought had it not been for, as I think, a clear misreading and misunderstanding of the case of the *Lanston Monotype Corporation, Limited* v. *Anderson* in the Court of Appeal in England, which was urged upon us as an authority directly in point. But as soon as one realises that the year's profits in controversy in that case were profits earned in years anterior to the Statute of 1907, then it is quite apparent that the case referred to has no bearing whatever upon the question which we are called upon to decide. The Court of Appeal held, contrary to the opinion of Hamilton, J., that the 25th section of the 1907 Act was not retrospective, and had no application whatever to years prior to the date when the statute came into force. Although at first sight—and if one were to confine one's attention exclusively to the head-note of the case—it would seem to be an authority in favour of the appellants, when closely examined it will appear that it has no relation to the question which we are now called upon to decide. The Commissioners of Inland Revenue, I think, were well founded when they said that *Lanston's* case did not decide the question at issue in this appeal. They reached, it seems to me, a correct conclusion, and I move your Lordships therefore to answer the question put to us thus — that the assessment of the appellants should be on the sum of £2848, and not upon the sum of £2448.

LORD MACKENZIE—I come to the same conclusion as your Lordship. I think there has been here exact compliance with the requirements of section 25 of the Finance Act of 1907, and that the account has been made up in accordance with the direction of the Act, and that what we are now asked to do on behalf of the appellants is to re-state the account. If we acceded to that it would be clearly against the express terms of the Act of Parliament. The balance of profits or gains upon which duty is chargeable is to be ascertained upon a fair and just average of three years ending on such day of the year immediately preceding the year of the assessment on which the accounts of the business are usually made up. In this case that was the 31st of December, and the three years with which we are concerned are the three years immediately prior to 31st December 1916. Those are all years after the Finance Act of 1907 had come into operation, and accordingly in dealing with those three years the imperative direction of section 25 was followed that no deduction is to be made on account of any royalty paid in respect of the user of any patent, but the person paying the royalty shall be authorised on making the payment to deduct the amount of income tax chargeable during the period through which the royalty or sum was accruing due. That has been done in this case, and although that was done what we are now asked to sanction is that there shall be a deduction made on account of the sums of royalty paid, amounting to £400 in each of the years. I do not think that that argument could have been maintainable but for the aid which it was said the appellants could derive from some of the expressions in the judgments in the case of *Lanston Monotype Corporation, Limited*, [1911] 2 K.B. 1019. But that case dealt with three years, all antecedent to the coming into operation of the Finance Act of 1907, and what was there decided was that the Act was not retrospective but prospective; that a royalty which is not to be deducted is one from which it is competent for the user of the patent to deduct the income tax, which could not be said of the three years that were there being dealt with, with the result that the Court came to the conclusion that section 25 did not apply to the case that they there had before them. Section 25 does apply in terms to the case that we have to deal with, and therefore I do not think that the appellants can derive any support from what was decided in the case of *Lanston*.

LORD SKERRINGTON—Section 25 of the Finance Act of 1907 is not a charging section, but none the less it affects or may affect the amount which the taxpayer has to pay. In the English decision to which we were referred, it was laid down that the section was not retrospective; but no satisfactory reason has been adduced against its application to the circumstances of the present case. I demur to the suggestion that the imperative declaration at the beginning of the section must be construed as conditional upon the taxpayer being in a position to take advantage of the benefit mentioned in the later part of the clause.

LORD SANDS—When I first read the rubric in *Lanston's* case, [1911] 2 K.B. 1019, I was under the impression that it was directly in point. My own *prima facie* impression upon the section was the other way, and I conceived that the question might arise how far we should regard it as appropriate and proper in construing a revenue statute to depart from a decision of the Court of Appeal in England of several years' standing. But it appears on examining that case that what was decided was really a very narrow and special point. I confess that after perusing the opinions of the learned judges more than once I am not quite satisfied that they themselves realised how narrow and how special was the point that they were deciding, but what was decided I think was merely that the statute was not retrospective.

Now if we can regard the case apart altogether from the authority of *Lanston*, I do not think that it presents much difficulty. What is assessed is not the income of the year but an artificial income which is ascertained by an average of the three preceding years. The year current does not enter into the calculation at all. Each of the three past years leaves a shadow behind it, and as you go on year after year one drops out and another comes on. We do not need to look behind 1907, because it was only in 1907 that the system of deducting the income tax on payment of the patent duty came into existence. During the first three years when this duty was paid, whether it began in 1907 or began at some later date when the patents were first used, the users of the patents paid less to the Crown than they withheld or deducted from those to whom they paid the royalties. I mean that on account of this system of averaging on previous years they were not required in the first three years to give full effect to the deductions they made so as to be under the necessity of accounting to the Crown for all that they deducted; it was not until the fourth year of the royalty that they had to account to the Crown for the full amount of the sum which they annually retained in name of income tax, and which as a matter of fact they had retained in full in each of the three previous years. That was an advantage to them. When they ceased to use the patents, on the other hand, the previous years came into account in a similar way. They cast their shadow behind and in this way the matter rectified itself. But if it be looked into carefully, I think it will be found that, supposing a person begins to use a patent who has not used patents before, and continues to do so for five years, or ten years, and then ceases doing so, under the system which the Crown say is the proper interpretation of the statute, I say I think it will be found that while he pays too little to begin with and perhaps too much at the end, over the whole period he exactly accounts to the Crown for the amount that he deducts from those whom he pays his royalties to. I do not think therefore that a proper construction of the statute really leads to an unreasonable result. I concur in the judgment proposed.

LORD JOHNSTON was absent.

The Court found in answer to the question in the case that the assessment should be on the sum of £2848.

Counsel for the Appellants—Constable, K.C.—Greenhill. Agents—Fyfe, Ireland, & Company, W.S.

Counsel for the Respondent—The Lord Advocate (Clyde, K.C.)—R. C. Henderson. Agent—Sir Philip Hamilton Grierson, Solicitor of Inland Revenue.

Thursday, June 20.

FIRST DIVISION.

MURDOCH'S TRUSTEES *v.* MURDOCH AND OTHERS.

Succession—Trust—Construction—"Free Revenue"—Incidence of Income Tax as between Trust and Annuitant.

By his will a testator left his widow the free revenue and proceeds of the free residue of his estate. By a codicil he provided that "in the event of the income of the free residue of my estate exceeding in any year the sum of £2000, my trustees shall restrict the payment to my wife out of the said income to the sum of £2000." For a number of years after the testator's death the trustees paid the widow (the income of the residue always exceeding £2000) £2000 less income tax. *Held*, in a Special Case, that the widow was entitled to £2000 per annum without deduction of income tax if the income of the free residue permitted, and that she was entitled to recover the tax which had been deducted, with interest, less the income tax on the interest.

Mrs Catherine Hutchison or Murdoch, widow of Alexander Murdoch, wine and spirit broker, Glasgow, and others, his testamentary trustees, *first parties*, the said Mrs Catherine Hutchison or Murdoch, *second party*, and Alexander Norman Murdoch and others, the testator's children, *third parties*, brought a Special Case for the determination of questions with regard to the incidence of income tax upon provisions made by the testator in favour of the second party.

The *trust-disposition and settlement* conveyed the whole estate to the first parties for various purposes, which included—"(*Fifth*) I direct my said trustees to hold the whole of the free residue and remainder of my estate for behoof of my said wife in liferent for her liferent alimentary use only, and to pay to her the free revenue and proceeds thereof so long as she remains my widow and unmarried, burdened always with the maintenance and education of our children in a manner suitable to their station in life while they continue to reside in family with her and are unable to support themselves."

A *codicil* dated 21st September 1899 provided, *inter alia*—"And (*Second*) I direct that in the event of the income of the free