sustained, because there would be no antecedently agreed *modus solutionis*. On the contrary, there would be merely an antecedent agreement as to how the parties were mutually to conduct two distinct sets of commercial transactions; and the discharge of those transactions would have to await settlement by compensation either pled or agreed to, or by some balancing of accounts between them, or by some other transaction having the effect of a legal discharge, and appropriate to the situation recorded in the two sets of contra accounts. But I am unable to give the oath the construction contended for, and think it bears the simpler and more natural construction which I have put upon it above. One other point requires to be noticed. It appeared at one stage as if we might have to consider the question whether the deposition involved an attempt to establish as at its date the resting-owing by Miss Thomson of the defender's contra account for butcher-meat, although owing to lapse of time that contra account was then prescribed. Plainly, however, the circumstances in this case involve no question of the kind.

In these circumstances it appears to me that we are compelled to revert to the interlocutor of the Sheriff-Substitute, which has the effect of assoilzieing the defender.

LORD MACKENZIE—I am of the same opinion, and I agree with the view of the Sheriff-Substitute, which is to the effect that the oath is negative of the reference. My view depends on a construction of what the deponent says. The particular passage is that in which he depones—"The agreement that my account for butcher-meat should be put against the deceased's account for dressmaking goods was made at the beginning when I started business in 1909." I think that, looking to the evidence, the fair construction to put upon that passage is that the agreement was that butcher-meat should be put against the dressmaking goods. The argument which was forcibly stated by Mr Gibson that the whole weight was to be put upon the form of the account as a contra account I am unable to accept. If the bargain really meant what he contended for, then it simply means this, that there was in truth no bargain at all, but merely a statement by the one party to the other. "Of course, whatever you run up against me will be put against my account which I am running up against you." That seems to me not to be the true nature of their bargain at all. Of course, if that had been the true relation of parties the observations of the Sheriff would have been applicable. It is because I construe the passage I have read to a different effect that I think there is no legal difficulty in the case when once that view is taken. The other passages in the evidence are to the effect that the agreement was acted upon and carried out, and the amount sufficiently vouched. The matter having been referred to the oath of the deponent, he swears the amount is correct.

LORD SKERRINGTON—I agree with your Lordships in regard to the interpretation of the defender's oath of reference. If that interpretation is right, then the present case falls within the first of the three categories mentioned by Lord Deas in his opinion in the case of *Cowbrough & Company* v. *Robertson*, 6 R. 1301, at p. 1312.

I respectfully think that Lord Deas' summary of the law is consistent both with the earlier authorities and with legal principle. It follows that the judgment of the Sheriff-Substitute ought to be restored.

LORD CULLEN—As I construe the deposition of the defender, the agreement which the parties made as *pars contractus* was not a mere agreement that there should be two accounts, and that these should be susceptible of compensation according to the common law rule—which is in effect the construction maintained by the pursuer—but was an agreement for a mode of solution of the debt sued on alternative to payment in money. On that footing I think the defender's statement that he followed such alternative mode of solution, and made deliveries of goods to the deceased and thereby extinguished *pro tanto* his debt, is necessarily intrinsic to the oath. I accordingly concur in the judgment which your Lordships propose.

The Court sustained the appeal, recalled the interlocutor of the Sheriff dated 27th January 1920, affirmed the interlocutor of the Sheriff-Substitute dated 13th November 1919, and of new assoilzied the defender.

Counsel for Pursuer and Respondent—Morton, K.C.—Gibson. Agents—Hamilton & Burnet Mackie, S.S.C.

Counsel for Defender and Appellant—Mackay, K.C.—J. A. Christie. Agents—Manson & Turner Macfarlane, W.S.

Wednesday, December 8.

SECOND DIVISION.

BISHOP *v.* NICOL'S TRUSTEES.

Partnership — Construction — Goodwill — "Profits of the Business"—Deduction of Excess Profits Duty—Finance (No. 2) Act 1915 (5 *and* 6 *Geo. V, cap.* 89), *sec.* 38.

By a contract of copartnery between three partners made in 1912 and renewed in 1917 an option was given to the surviving partners, in the event of the death of one of their number, to pay out his interest and continue the partnership. This interest included a sum in name of goodwill which was defined as a sum equal to the deceasor's proportion of the profits of the business for the four preceding financial years, as such profits should be ascertained from the profit and loss accounts for the eight preceding half years of the copartnery. One of the partners having died and the surviving partners having decided to exercise this option, a question arose as

to whether, in ascertaining the share of the profits due to the deceased's trustees in name of goodwill, a deduction fell to be made in respect of excess profits duty imposed by the Finance (No. 2) Act 1915. *Held* that the duty formed an appropriate deduction from the amount of the profits at the credit of the company before the sum payable in name of goodwill could be ascertained.

Thomas George Bishop and Andrew Henderson Bishop, grocers and tea merchants, Glasgow, *first parties*, and Mrs Margaret Graham Robertson or Nicol and others, the testamentary trustees of the deceased Robert Nicol, formerly a partner with the first parties in their business, *second parties*, brought a Special Case for the opinion and judgment of the Court for the determination of the proportion of profits payable to the second parties in name of goodwill under the contract of copartnery.

The Special Case stated, *inter alia*—"1. The first parties and the said Robert Nicol carried on business as grocers and tea merchants in Glasgow under the firm name of Cooper & Company, under a contract of copartnery dated 14th and 17th February 1912, and relative minute of agreement dated 20th and 23rd March 1917. [By the minute of agreement the copartnery was continued for three years.] 2. By article twelfth of the said contract of copartnery it was provided as follows, *videlicet*—'In the event of any of the partners dying, and in consequence his interest falling to be ascertained and paid out, it shall be in the power of the surviving partners, provided they give the notice hereinafter referred to, to pay out the amount of such interest, which in such event shall be held to be the sums standing to his credit in the capital of the copartnery as may be shown by the half-yearly balance sheet preceding his death with a sum added thereto or subtracted therefrom, as the case may be, equal to the proportion of such deceased partner's interest in profits and losses for the period from the date of the balance prior to decease until the date of decease, the same being calculated on the basis of the profits or losses shown by the two previous half-yearly balance sheets. The surviving partners shall be bound within six weeks after the date on which the death of the deceasing partner comes to their knowledge to give notice to the representatives of the deceasing partner that they have resolved to exercise the foresaid power conferred upon them, and on the interest of such deceasing partner being so ascertained the amount thereof (together with the sum in name of goodwill as is hereinafter provided for) shall be paid out to his trustees. . . .' 3. By article thirteenth of the said contract of copartnery it was provided as follows, *videlicet*—'In addition to the sums payable as is before provided for in respect of the deceasor's right and interest in the copartnery, there shall be due and payable to the trustees and executors of the deceasor, in the event of the surviving partners electing to exercise the power conferred in the preceding article, a sum in name of goodwill, the amount of which shall be held to be a sum equal to the deceasor's proportion of the profits of the business for the four preceding financial years, after payment of interest on capital account as such profits shall be ascertained from the profit and loss accounts for the eight preceding half years of the copartnery, and if the amount of such profits fall to be ascertained prior to the copartnery being in existence for four years, then to the profits during the period in which the copartnery has been in existence there shall be added a proportion of the profits earned during the period requiring to make up the four years of the first party's previous copartnery with the said John Henderson, excluding, however, the last year of said previous partnership, the proportion being the same as in the case of the period following under this contract, *videlicet*—three-fifths in the case of the first party, and one-fifth in the case of the second and the third parties. As an illustration of the working out of this article, if the four years' profits equals a sum of £100,000, the proportion payable to the trustees and executors of the first party would be the sum of £60,000, and the proportion payable to the trustees and executors of each of the second and third parties would be the sum of £20,000. In the case of an insolvent partner, no sums shall be paid to his representatives in respect of goodwill.' 4. The said Robert Nicol died on 8th September 1919, at a date when the copartnery had been in existence for more than four years, and the surviving partners, the first parties hereto, gave notice to his trustees and executors, the second parties hereto, that they intended in exercise of the power conferred upon them by article twelfth of the contract of copartnery to pay out the amount of the interest of the said Robert Nicol in the copartnery. 5. By section 38 of the Finance (No. 2) Act 1915 (5 and 6 Geo. V, cap. 89) it is provided as follows, *videlicet*—'(1) There shall be charged, levied, and paid on the amount by which the profits arising from any trade or business to which this part of this Act applies, in any accounting period which ended after the fourth day of August Nineteen hundred and fourteen, and before the first day of July Nineteen hundred and fifteen, exceeded by more than Two hundred pounds the pre-war standard of profits as defined for the purposes of this part of this Act, a duty (in this Act referred to as "excess profits duty") of an amount equal to fifty per cent. of that excess.' 6. By subsequent Acts of Parliament the liability to excess profits duty has been continued, but the rate of the duty fixed has varied from time to time. 7. The parties are agreed that the business carried on under the said contract of copartnery was a business to which Part III of the Finance (No. 2) Act of 1915 and the subsequent Acts relating to excess profits duty applied. 8. The parties are agreed as to the correctness and accuracy of the balance sheets of the copartnery, but a dispute has arisen as to the ascertainment of the sum falling to be paid to the second parties in name of goodwill under

article thirteenth of the contract of copartnery. 9. The excess profits duty payable in respect of the profits for any particular half-year was not paid out of the profits earned during that half-year, but was paid at a later date, and out of the profits earned during the half-year in which it was paid. It was charged in the accounts of the company for the half-year in which it was paid. The parties are, however, agreed that in the event of it being held that the excess profits duty falls to be deducted before arriving at the proportion of profits payable to the second parties in name of goodwill, the payments should be written back to the different half-years in respect of which they were payable. 10. The first parties maintain that in estimating under the said article the deceasor's proportion of the profits of the business for the four preceding financial years, the amounts paid in name of excess profits duty fall to be taken into account and treated as payments before the profits in the sense of the said article are arrived at. 11. The second parties maintain that in ascertaining the amount of profits payable to the second parties in name of goodwill no deductions fall to be made for payments made in respect of excess profits duty."

The *question of law* for the opinion and judgment of the Court was—"On a sound construction of said contract of copartnery do the sums paid in respect of excess profits duty fall to be deducted before arriving at the proportion of profits payable to the second parties in name of goodwill?"

Argued for the first parties—The deed showed that what was to be allowed in name of goodwill was the deceasor's share in the net profit. "Profits of the business" meant net profits. Excess profits duty was an expense of the business. As such it was within the knowledge of the partners at the date of the extension of the copartnery in 1917. It was not a personal tax but a tax on the business, and was expressly created a charge on a special fund. It was further an emergency tax, and there was no warrant for inflating the profits for the purpose of goodwill so as to give the deceasor a larger share than he otherwise would have had. In this respect excess profits duty was different from income tax, and it was assessed according to special rules. Further, by section 35 of the Finance Act (No. 2) 1915 (5 and 6 Geo. V, cap. 89), re-enacted in the Finance Act 1918 (8 and 9 Geo. V, cap. 90), Sched. D, Cases I and II, Rule 4, sub-section 1, it was provided that excess profits duty should be deducted before the fund for income tax was arrived at. This exhibited it in its true light as a charge on the business—an expense or outgoing of the business. In *Patent Castings Syndicate, Limited* v. *Etherington*, [1919] 2 Ch. 254, net profits were interpreted as the fund available for division after deduction of excess profits duty—*ibid.*, *per* Warrington, L.J., pp. 265-6, 267, Duke, L.J., p. 272, and Eve, J., p. 275. This decision approved and followed *in re Condran*, [1917] 1 Ch. 639, where the same principle was stated, *per* Peterson J., at p. 644. Further, the fact that no question arose on the revenue item was highly significant in answering this question, because it had never been maintained that in measuring out this revenue payment the deceasor's proportion could cover profits without deduction of excess profits duty. Similarly it was clear that the share of each partner in the goodwill must be determined by his revenue interests. It was entirely fallacious to consider only the partner whose interest was being paid out. The case of *William Hollins & Company* v. *Paget*, [1917] 1 Ch. 187, founded on by the second party, could not stand with the case of *Patent Castings Syndicate, Limited* v. *Etherington*.

Argued for the second parties—This case was distinguishable from the English cases founded on by the first parties, in respect that these dealt with contracts between partners under which were to be distributed between them the fruits of the year's trading. In the present case the question was as to the value of a capital item, viz., goodwill, and the reference to profits was merely made for the purpose of arriving at that item. That was a sum equal to the deceasor's proportion of the profits of the business, but was not necessarily what he actually received. Profit was all that came in, less the expense of earning it. Net profit, however, was profit available for division among the partners or as dividend. It would not, for example, include reserve fund. In *Fisher* v. *Black and White Publishing Company*, [1901] 1 Ch. 174, this distinction was clearly recognised. Unless net profits were expressly mentioned there was no warrant for taking off excess profits duty in arriving at goodwill. In this respect it was similar to income tax. In *Patent Castings Syndicate, Limited* v. *Etherington* the word used was "net," *per* Warrington, L.J., at p. 264, and *per* Younger, J., [1919] 1 Ch. 306. In *William Hollins & Company, Limited* v. *Paget*, [1917] 1 Ch. 187, the word used was "profits," not "net profits," and excess profits duty was held not to be deductible. This decision was recognised as sound in *Patent Castings Syndicate, Limited* v. *Etherington* (*cit. sup.*), *per* Warrington, L.J., p. 269, foot. *In re Condran* was to the same effect as *Patent Castings Syndicate* v. *Etherington*, and interpreted "net profits" as profits available for dividend. To the same effect were *Thomas* v. *Hamlyn & Company*, [1917] 1 K.B. 527, and *Johnston* v. *Chestergate Hat Manufacturing Company*, [1915] 2 Ch. 338. It did not follow that the remaining partners would bear all the excess profits duty if the second parties' contention was sustained. Repayment was provided for under the Act if the profits fell, and they might quite well get it back in future years. Excess profits duty was meant to be a temporary war impost. There was nothing surprising therefore in not treating it as a fair deduction in estimating goodwill, more especially when, by the nature of the legislation imposing it, it was constituted an insurance fund to meet losses, was subject to repayment, and so far as repaid was subject to income tax. If the first parties' argument were right the claim for repayment would be a benefit which was not to be paid for by the surviving partners but by the deceasor.

LORD JUSTICE-CLERK—This Special Case raises a question of some difficulty, for the solution of which I should have preferred to have had before me the profit and loss accounts of the company for the period in question. These are not available, but I think we can dispose of the case without them, and at anyrate under the Special Case these are not submitted to us. The company originated in 1912. Excess profits duty was not at that time exigible. That duty first appeared in our finance scheme in 1915. In March 1917 a memorandum of agreement was entered into by the three partners of this company, by which the duration of the agreement of copartnery was extended for a further period of three years from and after 12th October 1916. Accordingly that extension was agreed upon at a time when the parties were in the knowledge of the existence of excess profits duty. After that agreement Mr Nicol, the junior partner of the firm, died on 8th September 1919. The remaining partners, in exercise of an option given to them under article 12 of the contract of copartnery, resolved, instead of winding up the concern, to carry it on, and to pay out the interest of the deceasing partner. In that state of matters Mr Nicol's representatives were entitled under the partnership writs to three things—(1) to get the sum which was standing to Mr Nicol's credit in the capital of the copartnery as appeared from the books; (2) to get his proportion of the profits, determined as provided for by those writs, for the broken term caused by his death; and (3) to receive under article 13 a payment in respect of goodwill. The estimation of this last sum forms the subject of controversy between the parties in this case.

Article 6 of the original contract provided that, after interest at the rate of 5 per cent. had been credited to the parties on the amount from time to time standing to credit of their respective capital accounts, the first party should be interested in the profits to the extent of three-fifths, and each of the other parties to the extent of one-fifth. The provision with regard to goodwill was contained in article 13, and was expressed thus—in addition to the two sums first above referred to, there should be due and payable to the executors of the deceasor a sum in name of goodwill, the amount of which should be held to be a sum equal to the deceasor's proportion of the profits of the business for the four preceding financial years after payment of interest on capital account, as such profits should be ascertained from the profit and loss accounts for the eight preceding half-years of the copartnery. That article then proceeds—"As an illustration of the working out of this article, if the four years' profits equals a sum of £100,000 the proportion payable to the trustees and executors of the first party would be the sum of £60,000, and the proportion payable to the trustees and executors of each of the second and third parties would be the sum of £20,000." This is to say that the sum fixed as the value of the goodwill was to be payable in the same proportions as the profits were annually divided. Article 9 of the Special Case states that the excess profits duty payable in respect of the profits for any particular half-year was not paid out of the profits earned during that half-year, but was paid at a later date out of the profits earned during the half-year in which the duty was paid. That article further states that the parties were agreed that in the event of it being held that excess profits duty fell to be deducted before arriving at the proportion of profits payable to the second parties in name of goodwill, the actual payments of duty should be written back to the different half-years in respect of which they were payable. It is therefore apparent that the agreement really was that the payment for goodwill should be four years' purchase of the profits. Mr Nicol died in 1919. By that time eight half-years' trading upon the contract had expired, and about eight half-years had expired since the date of the imposition of the excess profits duty.

The question before us is whether the excess profits duty, so far as paid by the company, is to be deducted from the profits before calculating the sum which is payable to the second parties in name of goodwill. That depends upon the construction to be put upon the terms of the agreement, and upon the Act imposing excess profits duty. The judicial deliverances upon the meaning of the statute itself are not quite consistent; there have been a number of decisions in England which are not easy to reconcile. Indeed I think it is not possible to reconcile them all. The last two of them were a decision of Younger, J., as he then was, in the case of the *Patent Castings Syndicate, Limited* ([1919] 1 Ch. 306), and a decision of the Court of Appeal consisting of Warrington, L.J., and Duke, L.J., and Eve, J., in the same case ([1919] 2 Ch. 254). In that case two judgments by Peterson, J., in two cases reported in 1917 were accepted and followed—*Collins* v. *Sedgwick*, [1917] 1 Ch. 179; *in re Condran*, [1917] 1 Ch. 639. Though these decisions are not binding upon this Court they are entitled to great weight, and in my opinion rightly decided the questions involved. In particular, I think the views taken in these cases as to the supposed analogy between income tax and excess profits duty are sound. They show that excess profits duty is not payable by the taxpayer who shares in the profits; it is not a debt of his, but it is paid by the parties who carry on the business, and before profits are divided among the partners or shareholders. Section 35 of the Finance (No. 2) Act 1915 provides that "where any person has paid excess profits duty under this Act the amount so paid shall be allowed as a deduction for the purposes of income tax in computing the profits and gains of the year, which included the end of the accounting period in respect of which the excess profits duty has been paid." I think it is quite plain that in paying the income tax the firm or company is acting merely as the agent of the shareholder or partner and pays it on his behalf. Consequently income tax and excess profits duty are placed on totally different footings

as regards incidence. In all the English cases to which we have been referred, except that of *Hollins* ([1917] 1 Ch. 187), the words under consideration were "net profits." I do not desire to say anything about the case of *Hollins* except that in my opinion it cannot be reconciled with the judgment given in the *Patent Castings Syndicate* case, and that Eve, J., who decided *Hollins'* case, himself admitted that certain observations by him in that case had been too broadly put. The reasoning in *Hollins'* case does not commend itself to me, but I accept as sound the judgments in the Court of Appeal in the *Patent Castings Syndicate* case.

Dealing then with the question before us I am of opinion that the excess profits duty which seems to me to have been actually paid by the company for all the years with which we are concerned, and which in view of the agreement of parties must be dealt with as having been paid in the years for which it was due, formed an appropriate deduction from the amount of the profits at the credit of the company before the profits of the business in the sense of article 13 could be struck. The payments of that duty were in no sense payments for or on behalf of the parties. They were payments made direct by the company as a debt due by the company to the Government. The same construction must be put upon the statute in Scotland as in England, and I do not think it makes any difference that we in Scotland regard a company as having a *persona* separate from any of the partners, because the English decisions were reached on the basis that payment should be by the company and not by the individual partners. To my mind it is clear that the payment of excess profits duty is a payment made out of a fund which no doubt contains the divisible amount of profits, but is made before the divisible amount of profits can be ascertained. Therefore when it is provided that the payment for goodwill is to be a sum equal to the deceasor's proportion of the profits of the business for the four financial years, that in my opinion means that excess profits duty is to be deducted before arriving at the profits which are to be apportioned for the purpose of fixing what is to be payable in name of goodwill. I think the fair reading of the agreement is that goodwill was to be paid for at four years' purchase of the profits which the partner deceasing had actually received in respect of his interest in the business. If so, excess profits duty must be deducted before the sum which the deceasing partner's representatives are entitled to can be arrived at. The result is that the question in this case should be answered in the affirmative.

LORD DUNDAS—I concur. I think that upon a construction of the contract before us, and having regard to the cases referred to, we ought to answer the question in the affirmative. I do not think I can usefully add anything to what your Lordship has said, and I content myself with an expression of concurrence.

LORD SALVESEN—I am of the same opinion. The earlier English decisions would have supported the contention for the second parties, but in my opinion they are overruled by the Court of Appeal, and are no longer authorities which we can follow. But even on that assumption it was argued that the words we have to construe are "profits of the business for the four preceding financial years," and not net profits of the business, which were the words under consideration in the English cases. I do not think there is any distinction between "net profits" and "profits" in a commercial sense. There may be room for such a distinction in cases where the question relates, not to payment of income tax or matters of that kind, but as to the powers of directors of a company to appropriate what are profits by setting them aside, and so withdrawing them from division among the shareholders. No such question can arise when an ordinary commercial partnership is being dealt with. But even if that were not so, the profits here are to be ascertained from the profit and loss accounts of the eight preceding half-years of the copartnery—that is to say, from the actual profit and loss accounts of this copartnery rectified, as the parties have agreed they should be rectified, by article 9 of the case. Now it is a matter of admission that the charge for excess profits duty in these balance-sheets was actually paid, and that the profits available for division amongst the partners were arrived at after that charge had been debited to revenue. I think this case is a clearer case than any of those decided in the Courts of England. In this case the partners have provided that the sum to be paid in respect of goodwill is to be measured by the profits of the concern during the eight preceding half-years, according to the method which the partners themselves adopted in dealing with these profits. No commercial man would consider the profits for the purpose of valuing goodwill were the total profits, seeing that out of these a charge of 60 or 80 per cent. had to be met before a partner was entitled to share in profits at all. I think that on that short ground the judgment which your Lordship in the chair has proposed is the only one that is consistent with common sense.

LORD ORMIDALE was absent.

The Court answered the question of law in the affirmative.

Counsel for the First Parties—Moncrieff, K.C. — Cooper. Agents — Macpherson & Mackay, W.S.

Counsel for the Second Parties — Chree, K.C.—R. C. Henderson. Agents—Morton, Smart, Macdonald, & Prosser, W.S.