No. 285.—IN THE HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—13th April, 1905.

COURT OF APPEAL.—26th May, 1905.

HOUSE OF LORDS.—14th June and 30th July, 1906.

STRONG AND COMPANY OF ROMSEY, LIMITED *v.* WOODIFIELD (Surveyor of Taxes).(1)

Income Tax.—Deductions.—Rule 3 *of* 1*st Case and Rule* 1 *of* 1*st and* 2*nd Cases of Schedule D, Section* 100 *of* 5 *and* 6 *Vict. cap.* 35.—*A Brewing Company, which also own licensed houses, in which they carry on the business of Innkeepers, incur damages and costs to the amount of* £1,490 *on account of injuries caused to a visitor staying at one of their houses by the falling in of a chimney.*

Held, *that the damages and costs were not allowable as a deduction in computing the Company's profits for Income Tax purposes.*

CASE.

At a meeting of the Commissioners, for the general purposes of the Income Tax Acts, for the Division of Romsey, in the County of Southampton, held at the Town Hall, Romsey, on the 21st day of April, 1904, Strong & Company, of Romsey, Limited (hereinafter called "the Appellants"), appealed against an estimated assessment of £60,000 made upon them for the year ending 5th of April 1904 under Schedule D of the Act 16 & 17 Vict., c. 34.

The Appellants are Brewers carrying on business at Romsey, and at other places principally in the Counties of Hampshire, Wiltshire, and Dorsetshire, such business comprising the businesses of Brewers, Maltsters and Wine and Spirit Merchants and Manufacturers and Vendors of Mineral Waters, and any other businesses subsidiary or auxiliary to the said Businesses or any of them.

The Memorandum and Articles of Association of the Appellants and their prospectus accompanying this case and it will be observed from paragraph 3 (4) of such Memorandum and Articles of Association that one of the objects of the Company is (*inter alia*) the acquiring for any of the purposes of the Company and Hotels, Beerhouses, Public Houses or any share right or interest therein.

Accounts were submitted by the Appellants and the profits for the years ending 30th September 1900 and 30th September 1901 were agreed as £48,359 and £51,122 respectively.

(1) Reported [1906] A.C. p. 448.

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For the year ending 30th September 1902 a deduction was claimed by the Appellants of an item of £1,490 being Damages and costs incurred by them in defending an Action brought against them for injuries sustained on the 2nd March 1901 by a Guest at one of their Licensed Houses, known as The Lion & Lamb Inn, Poole, caused by the falling in of a Chimney during a gale. The House was owned by the Appellants and was under management at the time of the accident. If the deduction be not allowable, the profits for the year in question were agreed as £52,797.

On behalf of the Appellants it was contended that as in the course of their business as Brewers it became necessary for the Appellants at times to carry on business as Innkeepers and that the profits of such business as Innkeepers were included in the accounts of the Company that as the expenditure was incurred by the Appellants in the course of and incidental to the conduct of the concern the profits of which were assessed, allowance must be made on account of such expenditure before the profits for the year in question could be ascertained.

The Surveyor of Taxes on behalf of the Crown contended that the expenditure in question fell to be excluded within the terms of 5 & 6 Vic. c. 35, s. 100 Cases 1 & 2 Rule 1 by which "no sum shall be set against, or deducted from, or "allowed to be set against or deducted from such profits or "gains for any disbursements or expenses whatever not being "money wholly and exclusively laid out or expended for the "purposes of such trade manufacture adventure or concern" and that therefore no allowance could be made therefor and in support of this view referred to the case of "Smith v. The Westinghouse Brake Co." (2 T.C.357) in which case expenditure although incidental to the business was held not to be a deduction allowable for the purpose of arriving at Income Tax liability inasmuch as such expenditure was not "money "wholly and exclusively laid out or expended for the purposes "of such concern."

After hearing the arguments on both sides and further upon reference to the case of "Watney v. Musgrave" (1 T.C. 272) we were of opinion that the deduction claimed was not allowable. We therefore reduced the assessment to £50,759 being the average of the profits as shown for the three years ending September 1902, viz :—

30th September 1900	..	..	£48,359	0	0
,, ,, 1901	..	..	51,122	0	0
,, ,, 1902	..	..	52,797	0	0
		3)	£152,278	0	0
			£50,759	0	0

The Appellants thereupon expressed dissatisfaction with our decision as being erroneous in point of law and subsequently required us by notice in writing to state a case for the opinion of the High Court of Justice.

This Case is stated and signed accordingly the question for the opinion of the Honorable Court being whether the amount of £1,490 expended in damages and costs incurred by the Appellants in defending the Action brought against them as stated above is a deduction under the provisions of the Act 5 & 6 Vic., c. 35, s. 100.

If our decision was incorrect it is agreed that the liability for the year 1903/4 is £50,262 as under :—

30th September 1900	£48,359	0 0
,, ,, 1901	51,122	0 0
,, ,, 1902 .. .:	51,307	0 0
	3)£150,788	0 0
	£50,262	0 0

Dated this Second Day of July 1904.

(Signed) EVELYN ASHLEY
C. GRIFFITHS
THOS. SUCHLING
SPENCER F. CHICHESTER
WM. MCQUHAE
} Commissioners of Income Tax for the Division of Romsey.

This case was heard in the High Court before Mr. Justice Phillimore on the 13th April, 1905, when judgment was given against the Crown with costs. The judgment was reversed by the Court of Appeal on the 26th June, 1905, when costs in that Court and in the Court below were awarded to the Crown. An appeal against this decision, after being heard by the House of Lords on the 14th June, 1906, was dismissed with costs on the 30th July, 1906.

Danckwerts, *K.C.*, *Bremner*, and *Henriques* with him, for the Appellants.—The assessment on the Appellants is required by the First Rule of the First Case of Schedule D to be made on the "balance of the profits or gains" of their business. By the First Rule of the First and Second Cases, no disbursements or expenses are to be taken into account in estimating this balance except "money wholly and exclusively laid out for "the purposes of" the business. The Third Rule of the First Case further prohibits any deduction being made for "loss

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"not connected with or arising out of" the trade. The decided cases explain what is the net result of these enactments. Lord Halsbury, in the *Gresham Life Assurance Society* v. *Styles*,(1) pointed out that the word "profits' . . . is to "be understood in its natural and proper sense—in a sense "which no commercial man would misunderstand." A similar principle is laid down in the cases of *Coltness Iron Company* v. *Black*,(2) *Reid's Brewery Company* v. *Neale*,(3) and other cases. In accordance with this principle the Appellants are entitled to deduct the damages and costs in question in estimating the balance of their profits for Income Tax purposes. The ownership of licensed houses is a part of their business, provided for by their Memorandum and Articles of Association. A paying guest at one of their licensed houses is injured by the falling of one of the inn chimneys while he was sleeping at the inn, and the Company are condemned to pay damages and costs. This loss is, therefore, clearly "connected with or arising out "of" their business. The money is also "wholly and exclu- "sively laid out for the purposes" of the business, for it is expended for the purpose of making good a liability which is incurred in carrying on the trade, and so for the purpose of carrying on the trade, because you cannot carry on a trade without incurring liability.

The Attorney-General (*Sir J. Lawson Walton, K.C.*), *Sir Robert Finlay, K.C.*, and *Mr. William Finlay* with him, for the Crown.—The sum in question was, undoubtedly, a loss, and a loss in consequence of a liability that involved expenditure; but it is not an expenditure that can be taken into account in estimating the balance of the profits of the Appellants' business for Income Tax purposes. Money is not expended for the purposes of a business merely because it has to be paid under a legal liability which is in some way connected with the business, and which, but for the existence of the business, might never have arisen. In the present case the Appellants are brewers, and the injury to the guest at their inn was not connected with their business of brewing, but was an incident in the ownership of their licensed house. Consequently the damages and costs were not a loss "connected "with or arising out of" their business, nor was the money laid out for the purpose of carrying on their trade as brewers, but was due to a breach of their duty as landlords in not keeping their house in a proper state of repair. The money cannot, therefore, be allowed as a deduction in estimating the profits of their business for Income Tax purposes.

(1) 3 T.C. 185. (2) 1 T.C. 287. (3) III. T.C. 279.

JUDGMENT.

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The Lord Chancellor.

The Lord Chancellor.—My Lords, in this case the Appellants are a brewery company who owned an inn and conducted it through a manager. A customer sleeping in the inn was injured by the falling of a chimney upon him, and the Appellants had to pay £1,490 in costs and damages, because the fall of the chimney was due to the negligence of the Appellants' servants whose duty it was to see that the premises were in proper condition.

The Appellants claim to deduct this sum of £1,490 from the amount of their profits and gains assessable to Income Tax, and the question is whether the Commissioners were right in disallowing the deduction. The Court of Appeal held the Commissioners were right, and I am of the same opinion.

It is unnecessary to recite the different sections of the Income Tax Act, 1842, which govern the present appeal. They are Section 100, Schedule D, Case 1, Rules 1 and 3, and Rule 1 of the Rules applying to both the Cases 1 and 2. That which has to be assessed is the balance of the profits or gains of a trade; that is to say, the sum left after subtracting the proper deductions from the profits and gains. A deduction may be allowed on account of loss, and this is a loss. The Act does not affirmatively state what losses may be deducted. It furnishes merely negative information. A deduction cannot be allowed on account of loss not connected with or arising out of such trade. That is one indication. And no sum can be deducted unless it be money wholly and exclusively laid out or expended for the purposes of such trade. That is another indication. Beyond that the Act is silent.

In my opinion, however, it does not follow that if a loss is in any sense connected with the trade, it must always be allowed as a deduction; for it may be only remotely connected with the trade or it may be connected with something else quite as much as or even more than with the trade. I think only such losses can be deducted as are connected with it in the sense that they are really incidental to the trade itself. They cannot be deducted if they are mainly incidental to some other vocation, or fall on the trader in some character other than that of trader. The nature of the trade is to be considered. To give an illustration, losses sustained by a railway company in compensating passengers for accident in travelling might be deducted. On the other hand, if a man kept a grocer's shop, for keeping which a house is necessary, and one of the window shutters fell upon and injured a man walking in the street, the loss arising thereby to the grocer ought not to be deducted. Many cases might be put near the line, and no degree of ingenuity

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can frame a formula so precise and comprehensive as to solve at sight all the cases that may arise. In the present case, I think that the loss sustained by the Appellants was not really incidental to their trade as innkeepers, and fell upon them in their character not of traders but of householders. Accordingly, I think that this appeal must be dismissed.

Lord Macnaghten.

Lord Macnaghten.—My Lords, I am of the same opinion.

Lord Davey.

Lord Davey.—My Lords, the question in this Appeal is whether a sum of £1,490, which the Appellants have had to pay for costs and damages occasioned to a person staying in their inn by the fall of a chimney, is a proper deduction in arriving at the profits of the Appellants' trade for the purpose of the Income Tax. The answer to that question, in my opinion, depends on the answer to be given to another question, whether the deduction claimed was a disbursement or expense wholly and exclusively laid out or expended for the purpose of the Appellants' trade, within the meaning of Rule 1 applying to both Cases 1 and 2 of Schedule D in Section 100 of the Income Tax Act, 1842.

It has been argued that the deduction claimed was a loss connected with or arising out of the Appellants' trade within Rule III., applying to Case I. only. Case 1 relates to trades, manufactures, adventures, or concerns in the nature of trade, and I think that the word "loss" in Rule III. means what is usually known as a loss in trading or in speculation. It contemplates a case in which the result of the trading or adventure is a loss, wholly or partially, of the capital employed in it. I doubt whether the damages in the present case can properly be called a trading loss. I prefer to decide the case upon Rule I., which applies to profits of trades and also to professions, employments, or vocations. I think that the payment of these damages was not money expended "for the purpose of the trade." These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, &c. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade or is made out of the profits of the trade. It must be made for the purpose of earning the profits. In short, I agree with the judgment of the Master of the Rolls.

I therefore think that the appeal should be dismissed with costs.

Lord James of Hereford.

Lord James of Hereford.—My Lords, I confess I did entertain some doubts during the discussion of this case at the Bar, but they are not doubts sufficient to cause me to differ from the judgments which have been delivered.

Lord James of Hereford.

In order to explain my position I may say that I concur entirely with the principle laid down by my noble and learned friend the Lord Chancellor. The only question is as to the application of that principle in one small matter to the facts of this case. If the fact were that the accident had occurred to a stranger walking in the street, then I should have no doubt at all. The doubt that did arise in my mind was when the accident occurred to a person who was a customer in the house, who would not have been injured unless the business of an innkeeper was being carried on, and when it was in the course of the carrying on of a portion of that business that the customer injured was there; then I think a different principle might arise and my doubts consequently existed. But, my Lords, my doubts are not strong enough in relation to this application of a principle about which there is no question to cause me to dissent from the judgment proposed.

Lord Robertson.

Lord Robertson.—My Lords, I am clearly of opinion that the judgment is right.

The Lord Chancellor.

The Lord Chancellor.—I have been requested by Lord Atkinson, who unfortunately is unable to be present, to say that he concurs in the opinion I have offered to your Lordships.

Questions put.

That the order appealed from be reversed.

The Not Contents have it.

That this appeal be dismissed with costs.

The Contents have it.