REPORTS OF CASES IN HOUSE OF LORDS AND PRIVY COUNCIL DEALING WITH QUESTIONS OF INTEREST IN SCOTS LAW.

(Continued from page 444 ante.)

HOUSE OF LORDS.

Monday, February 26, 1917.

(Before the Lord Chancellor (Finlay), Earl Loreburn, Lords Parker, Sumner, and Wrenbury.)

BROOKE *v.* PRICE.

(ON APPEAL FROM THE COURT OF APPEAL IN ENGLAND.)

Revenue—Income Tax—Contract—Annuity Payable out of Net Income without Deduction of Income Tax—Income Tax Act 1842 (5 *and* 6 *Vict. cap.* 35), *secs.* 102, 103.

By a deed of settlement the settlor, the appellant, undertook to pay the respondent annually one-fourth of the net income (after deduction of income tax) of a certain fund, or £2500 without deduction of income tax, whichever sum was the greater. Subsequently when a fourth share of the fund fell below £2500 the appellant sought to have it declared that the contract to pay £2500 without deduction of income tax was void under section 103 of the Income Tax Act 1842, and that section 102 enjoining deduction was applicable.

Held that the sections of the Act have no application to contracts for division of net income on which duty has been paid.

Decision of the Court of Appeal, [1916] 2 Ch. 345, *affirmed.*

The *facts* appear from their Lordships' considered judgment.

LORD CHANCELLOR (FINLAY)—The question on this appeal is whether the provisions of a deed making a settlement of income upon the respondent free of income tax are overridden by sections 102 and 103 of the Income Tax Act 1842. In my opinion the deed takes effect according to its terms and is not affected by these sections.

The respondent was the husband of the appellant, and there was one child of the marriage—Betty Gillian Price. The marriage was dissolved at the instance of the husband, the decree *nisi* being dated the 14th December 1911 and the decree absolute the 24th June 1912. The appellant was entitled to a considerable income under the will of her father, by which the income of one-sixth of his estate was settled upon her for life. The income accruing to the appellant for the year ending on 31st October 1911 amounted to £9359 net after payment of income tax, and next year was increased by the falling-in of an annuity of £3000, and it was contemplated that it might be further increased. The respondent on the 14th March 1912 presented a petition to the Divorce Court asking for an order that a settlement should be made by the appellant for the benefit of the respondent and of the child of the marriage. The Registrar reported that the parties had agreed upon the terms of the settlement to be made, and this arrangement was embodied in the deed of the 24th June 1912 made between the appellant therein described as the settlor and the respondent. The most material clauses of this deed are the first, the second, and the third.

The first clause charges all the income which the settlor was entitled to under her father's will with the payment of the sums mentioned in clause 3.

By the second clause the settlor declares and directs that the trustees should make payment of the sums settled by deed out of the income which would otherwise go to the settlor.

The third clause is as follows:—"As from the date of these presents and thenceforth during the period of the joint lives of the settlor and the said Owen Talbot Price and Betty Gillian Price, and whilst the said Betty Gillian Price shall be under the age of twenty-one years, an annual sum equal to one-fourth part of the annual net income (after income tax on the whole income has been paid) which shall from time to time during the period aforesaid accrue, and would but for these presents be payable to the settlor or her assigns from or in respect of the settlor's settled share, or if one-fourth part of the annual net income shall be less than the clear sum of £2500, then the clear annual sum of £2500 (without deducting income tax therefrom) out of such annual net income shall be paid to the said Owen Talbot Price for the maintenance of himself and the said Betty Gillian Price."

On the 27th July 1915 an originating summons was taken out by the appellant to have it declared that the provisions of the deed making the £2500 payable without deduction of income tax were void under sections 102 and 103 of the Income Tax Act 1842, and that the appellant was entitled to deduct or to direct the trustees of the will to deduct the income tax from the £2500 payable to the respondent.

Neville, J., decided in favour of the respondent, holding that income tax could not be deducted, and his decision was affirmed by the Court of Appeal.

The appellants now asks that these judgments should be set aside, and that it should be held that by virtue of sections 102 and 103 the income tax must be deducted notwithstanding the provisions of the deed. These sections so far as material are as follows:—Section 102—"And be it enacted that upon all annuities, yearly interest of money, or other annual payments, whether such payments shall be payable within or out of Great Britain, either as a charge on any property of the person paying the same by virtue of any deed or will or otherwise, or as a reservation thereout, or as a personal debt or obligation by virtue of any contract, or whether the same shall be received and payable half-yearly or at any shorter or more distant periods, there shall be charged for every twenty shillings of the annual amount thereof the sum of (sevenpence), without deduction, according to and under and subject to the provisions by which the duty in the third case of Schedule (D) may be charged, provided that in every case where the same shall be payable out of profits or gains brought into charge by virtue of this Act no assessment shall be made upon the person entitled to such annuity, interest, or other annual payment, but the whole of such profits or gains shall be charged with duty on the person liable to such annual payment without distinguishing such annual payment, and the person so liable to make such annual payment, whether out of profits or gains charged with duty, or out of any annual payment liable to deduction, or from which a deduction hath been made, shall be authorised to deduct out of such annual payment at the rate of (sevenpence) for every twenty shillings of the amount thereof, and the person to whom such payment liable to deduction is to be made shall allow such deduction, at the full rate of duty hereby directed to be charged, upon the receipt of the residue of such money, and under the penalty hereinafter contained, and the person charged to the said duties having made such deduction shall be acquitted and discharged of so much money as such deduction shall amount unto, as if the amount thereof had actually been paid unto the person to whom such payment shall and have been due and payable. . . ." Section 103—"And be it enacted, that if any person shall refuse to allow any deduction authorised to be made by this Act out of any payment of annual interest of money lent, or other debt bearing annual interest, whether the same be secured by mortgage or otherwise, he shall forfeit for every such offence treble the value of such principal money or debt; and if any person shall refuse to allow any deduction authorised to be made by this Act out of any rent or other annual payment mentioned in the ninth and tenth rules of No. IV, Schedule (A), or out of any annuity or annual payment mentioned in Schedule (C) (*a*) or (E) (*b*), or in the next preceding clause, save such annual interest as aforesaid, every such person shall forfeit the sum of fifty pounds; and all contracts, covenants, and agreements made or entered into, or to be made or entered into, for payment of any interest, rent, or other annual payment aforesaid, in full, without allowing such deduction as aforesaid, shall be utterly void."

The income tax on the whole proceeds of the funds in trust for the appellant under the will of her father had been deducted at the source or paid by the trustee, and no claim has ever been made by the Crown against the respondent for income tax on the payment to him under the deed of settlement.

In my opinion the conclusion arrived at in the Courts below was correct and the statutory provisions relied upon by the appellants have no application to the circumstances of this case.

Section 102 begins by charging with income tax all annuities and other annual payments. It then goes on to provide that where the same shall be payable out of profits or gains brought into charge by the Act no assessment shall be made upon the person entitled to the annual payment, but the whole of the profits or gains shall be charged on the person liable to such annual payment, and that he shall be authorised to deduct out of the annual payment the amount of the duty at the specified rate, and the person entitled to payment shall allow such deduction. Section 103 imposes a penalty upon any person who refuses to allow such deduction, and makes void all contracts for any such annual payments without allowing the deduction.

These sections therefore provide machinery for the collection of the tax imposed upon annual payments. It is obviously convenient that where such payments are made out of profits or gains liable to income tax the Crown should receive from the recipient of such profits or gains the whole of the tax, and that he should have the right to deduct from the recipients of the annual payments sums representing the tax attributable to their shares respectively.

Section 103 avoids any contract providing that such deduction shall not be made. One reason for this provision may be that the amount of the income tax varies from year to year and that the prohibition was deemed convenient in order to ensure that each beneficiary should bear his true proportion of the burden of the tax for the time being. In my opinion section 102 would not by itself prevent parties from contracting themselves out of the enactment. The prohibition is to be found in section 103, and would have been unnecessary there if it had already been applied in section 102.

Questions may arise as to the effect of these sections under very different states of fact. The following possible cases may be put:—(1) The parties may have arranged for the allocation as an annuity or annual payment of a certain proportion (say) one-fourth of the income arising from profits or gains, subject to the tax, without having deducted the income tax from the gross amount; or (2) the sum so allowed

may be a fixed sum payable out of the gross amount without having deducted the income tax; (3) the sum allocated may be a certain proportion (say) one-fourth of the net balance of profits and gains after income tax on the whole has been deducted; or (4) it may be a fixed sum payable out of the net balance of income after deduction of income tax on the whole.

In cases 1 and 2 the provisions of sections 102 and 103 for deduction of the income tax from the annual payment, and forbidding any bargain to the contrary, will obviously apply. But in case 3, where the parties agree for the allocation in certain proportions of the net balance of profits and gains arrived at after income tax on the whole has been deducted, it is obvious that the provisions of these sections as to deduction on payment can have no application, inasmuch as the deduction has been already made in arriving at the sum to be allocated. In such a case fluctuations in the rate of the income tax necessarily fall upon the recipients in proportion to their shares.

The appellant made no claim in respect of the earlier portions of clause 3 of the deed providing for the payment of an annual sum equal to one-fourth part of the annual net income after income tax on the whole had been paid, and for the reason above stated it is clear that no such claim could have been substantiated.

The appellant's attack was directed entirely against the latter portion of clause 3, which provides that if the one-fourth settled should be less than £2500 then in that case the clear annual sum of £2500, without deducting income tax therefrom, out of such annual income shall be paid.

The appellant's case was that where the parties have agreed, as in the fourth case put above, that fixed sums should be paid out of the net balance of the profits and gains after deduction of the income tax, the recipient of such fixed sums would not be affected by fluctuations in the amount of the income tax, and that he would receive these fixed sums without any deduction in respect of any rise on the tax. It was strenuously argued, first, that such an arrangement contravenes the prohibitions of section 103, and is *pro tanto* avoided by that section, and second, that the latter part of clause 3 of the deed providing for the payment of £2500 falls under this category.

In my opinion it is unnecessary to pronounce any judgment on the first of these two propositions, inasmuch as the second proposition has not been established. The appellant's argument was that the provision in question amounts to an infringement of the statutory prohibition against non-deduction, and that the respondent must submit to a deduction of the income tax upon the whole of the £2500. But the provisions of the clause must be read as a whole. The portion of the clause impugned was obviously meant to secure that the one-fourth payable under the earlier part of clause 3 should always be made up to £2500, but the result of the appellant's contention would be that if the one-fourth falls short of £2500 by any sum, however small, the respondent instead of having it brought up to £2500 as was intended must submit to a further deduction, which with income tax at 5s. in the pound would bring the sum receivable down to £1875. Such a result is obviously not merely contrary to the expressed intention of the parties, but preposterous in itself, and can be accepted only if the statute makes it imperative. In my opinion the words of the statute have no application to a case such as the present, in which a certain proportion of the balance remaining after payment of income tax is assigned, coupled with a stipulation that the sum to be received shall not fall below a certain amount.

The substance of the matter, and not merely the form of the words, must be looked at. The provision for a payment of £2500 cannot be divorced from the preceding words providing for payment of a fourth share of the settlor's income to which they are ancillary.

The substance of the deed is that one-fourth is assigned to be supplemented if necessary, so as to bring the assigned income up to £2500. No attempt was made on behalf of the appellant to dissect the sum of £2500 and to distinguish between the portion of it representing one-fourth of the net income and the supplement required to bring the amount up to £2500. The claim was to the tax upon the whole £2500, and is in effect that the appellant should be allowed to deduct again what, to a large extent at all events, she has already deducted.

For these reasons, in my opinion, the decision of the Courts below was right, and this appeal should be dismissed with costs.

EARL LOREBURN—I agree. The substance of this disposition is that the trustees are left free to deduct income tax from the annuity, and that the annuity is to vary in amount so as to compensate the annuitant for that deduction. I cannot find in the Act of Parliament the smallest trace of a prohibition against so sensible an arrangement, nor can I imagine why this taxing Act should go out of its way to worry private people in managing their own affairs without any benefit to the Revenue.

LORD PARKER—I agree. There cannot, I think, be any real doubt as to the true construction of the settlement of the 24th June 1912. The life interest of the appellant under her father's will is thereby charged in favour of the respondent with an annual sum equal to one-fourth part of the annual income arising therefrom after income tax on the whole has been paid, or alternatively, if such one-fourth part shall be less than £2500, with the clear annual sum of £2500, without deducting income tax. The object is clearly to secure to the respondent a minimum annual payment of £2500 after the claims of the revenue in respect of income tax have been satisfied. To construe the settlement as conferring in the event contemplated an annuity of £2500, subject to income tax, would be to turn it into a provision for the relief of the appel-

lant in case the income tax was raised, instead of a provision intended to secure to the respondent a minimum available income.

The question then arises whether the settlement thus construed contains anything contrary to the provisions of sections 102 and 103 of the Income Tax Act 1842. Those sections contemplate, *inter alia*, the case of a trustee in receipt of income for which he is accountable to a beneficiary. The trustee is made primarily liable for the tax, but is given the right to deduct as against the beneficiary the amount paid for tax to the Revenue authorities. Any contract affecting the trustee's right or the beneficiary's obligation in this respect is avoided. Here the trustees of the will are primarily liable for the tax and have a right of deduction against all their beneficiaries, including the respondent. Is there any contract by which the trustees are precluded from making the deduction or the appellant is entitled to payment without deduction? The only contract is the settlement to which the trustees are not parties, and this settlement manifestly proceeds upon the footing that the trustees are to deduct all sums paid to the Revenue in respect of income tax before division of the income between the parties entitled. It follows that the provisions of the two sections are entirely unaffected by the settlement. There is nothing in the Act to invalidate the creation of an annuity such that after the deduction of the income tax for the time being it will amount to a fixed yearly sum, and this appears to be the effect of the settlement in question.

In my opinion the appeal fails, and should be dismissed with costs.

LORD SUMNER agreed in the appeal being dismissed.

LORD WRENBURY—I also am of opinion that this appeal fails; indeed I do not hesitate to say that from the first the question has seemed to me unarguable.

I am unable to agree with the Court of Appeal that the charge given by article 1 of the deed is a charge upon the net income dealt with in articles 2 and 3. The deed I think creates a charge upon the gross income for payment of a part of or a sum payable out of the net income. But the order which the Court of Appeal made I think is right.

The deed is a contract between the divorced wife and her former husband securing to the latter either (*a*) a certain fractional part of net income—of a fund that is remaining after the Revenue has already received all that in any case is due for income tax; or (*b*) a clear sum of £2500 out of that fund in case the one-fourth should be less than £2500. The £2500 is not under the Income Tax Act subject to income tax or to any deduction for income tax, it is part of a larger sum which has already discharged all its liability to income tax. A contractual division of net income does not give rise to a further claim for income tax. There is no income tax upon the £2500 as such. The appellant contends that the deed contains a contract that income tax shall not be deducted and that this is void under section 103. The first answer is that there is as regards the £2500 no income tax for whose deduction the statute provides and section 103 has nothing to do with it.

The object and effect of the statute is to make the payer of income a collector of the income tax for the Revenue, empowering him to recoup himself by deduction from the recipient. If there be several recipients he has that right against each of them. But there is nothing whatever in the statute to prevent the recipients making such contract as they like as to the division of the net income among themselves.

I put a homely illustration during the argument. If A has a vessel containing twenty quarts of beer out of which each of twenty persons B, C, D, &c., is entitled to a quart, but an outside party (the Revenue) is entitled to half-a-pint out of each quart, the effect of the statute is that the Revenue is entitled to take not half-a-pint out of each quart after division but twenty half-pints out of the aggregate twenty quarts before division, and A in distribution is entitled to recoup himself by delivery to each of B, C, D, &c., of one half-pint short. This right of recoupment cannot be avoided by contract. But there is nothing to prevent B from saying to C, You are a thirstier man than I am; I will bear the loss of the half-pint deduction against you as well as that deduction against me. You shall take a full quart and I will go a pint short.

That bargain between B and C affects in no way A's right to deduct. It is only one by which when A deducts as against C the latter is indemnified by B against the deduction.

There is a second answer to the contention on section 103. The contract there referred to is a contract between the payer, who is entitled to deduct, and the payee, who is bound to allow the deduction. In the present case the payers are the trustees. They are no parties to the deed of 1912. There is no contract within section 103 even if the section otherwise applied, which it does not.

The contention that the statute avoids some part of the contract fails.

It remains only to construe the contract. There are two alternatives, namely (*a*) one-fourth of the net income, and (*b*) if the one-fourth "shall be less than the clear sum of £2500 then the clear annual sum of £2500 (without deducting income tax therefrom)." I can see only one meaning to the words of the latter alternative. It is this—"If the fourth is less than £2500 you shall have a clear annual sum of £2500, and by clear I mean that you shall suffer no deduction of income tax. You and I will be dividing a sum arising from a larger sum which was subject to income tax. You shall not bear any of that income tax. I will bear it all."

If the net income is £10,000 the grantee is to receive under the deed £2500, being one-fourth. If the net income is £9999, the grantee, according to the appellant's contention, is to receive £1875, being £2500 less income tax at 5s. in the pound. The contract says exactly the contrary. He is to

receive a clear £2500 without deducting any thing for income tax.

The appeal, I think, should be dismissed with costs.

Appeal dismissed.

Counsel for the Appellant — Disturnal, K.C.—Latter. Agents—Nicholson, Patterson, & Freeland, Solicitors.

Counsel for the Respondent — Hon. F. Russell, K.C.—A. M. Bremner. Agents—Capron & Company, Solicitors.

HOUSE OF LORDS.

Monday, March 19, 1917.

(Before Lords Buckmaster, Dunedin, Parker, Sumner, and Wrenbury.)

EBBW VALE STEEL, IRON, AND COAL COMPANY, LIMITED *v.* MACLEOD & COMPANY.

(ON APPEAL FROM THE COURT OF APPEAL IN ENGLAND.)

Contract — War — Mines and Minerals — Suspensory Condition — Applicability of the Condition.

The respondents were entitled, under a contract with the appellants for a supply of ore, to determine the contract in the event of war affecting the mine. Owing to loss of business with Germany caused by the war the mine was closed. The respondents claimed to determine the contract, although it was still possible for them to supply the appellants with ore from previous accumulations. The appellants claimed that the effect of the war upon the mine was not sufficiently direct to make the condition operative. *Held* that the mine was affected by the war, although its closing was not directly caused by the operations of war.

The *facts* are given in the opinions of their Lordships, and were as follows:—

LORD BUCKMASTER—The appellants in this case are a coal, steel, and iron company carrying on business at Ebbw Vale, in the county of Monmouth, and the respondents are a firm of iron ore merchants having their chief place of business at Glasgow and a branch house at Bilbao. The business of the respondents is to import ore into the United Kingdom, partly to satisfy contracts already made and partly to store and sell as opportunity offers. One special class of ore in which they deal comes from a mine in Spain, situate about thirty miles from Bilbao, called the Axpe Arrazola Mine, and it was with the ore from these mines that the present dispute is concerned.

On the 16th March 1914 the respondents contracted with the appellants for the sale to them of 15,000 tons of this ore, to be delivered by monthly deliveries from May to September 1914, *ex* steamer, at one of the appellants' wharves at Newport. The contract contained special provisions as to the size of the steamer by which delivery was to be made, but in the view that I take of this matter those provisions are immaterial. The last clause of the contract was a clause entitling either party in certain events wholly or partially to suspend the contract. It is in these words—"In the event of war, restraint of princes or governments, revolutions, civil commotion, imminent hostilities, blockade of shipping or delivery ports, accidents, strikes, lock-outs, political disturbances, riots, epidemics, quarantine, fire, frosts, floods, snow, the act of God, perils and dangers of the seas and of navigation, explosions, negligence of pilot, master, or seaman, delays, interruptions, or stoppage of work through failure of usual coal supply, *force majeure*, breakdowns of machinery, or other occurrences beyond the personal control of the buyer or seller, affecting the mines, ships, railways, docks, wharves, furnaces, or works, from, by means of, or at which the ore is intended to be worked, conveyed, received, smelted, or manufactured, this contract shall, at the option of the party affected, be suspended, wholly or partially, according to the extent of the cause or occurrence during the continuance thereof. Any doubt, difference, or dispute to be settled by arbitration."

In order to give effect to the appellants' argument it will be necessary to examine the clause in detail, but a general consideration of its terms shows that the circumstances contemplated as giving rise to the option are not confined to matters which prevent the fulfilment of the contract. A strike at the buyers' works is one of the conditions enabling suspension, but this certainly does not prevent the contract being carried out, since the contract is completed when the ore is delivered at the appellants' wharves at Newport.

On the 2nd November 1914 a second contract was made between the same parties and in the same terms for the sale of a further 10,000 tons of the ore. Delays took place in the deliveries under the first contract. It is not necessary to inquire into the cause of these delays. They were due to the action of the appellants, but it is no part of the respondents' case on this appeal that that action constituted any breach of the contract. In February 1915, owing to these delays, only 7980 tons of the ore had been delivered. Consequently 7020 remained for delivery under the first contract and the full 10,000 under the second, making in round figures 17,000 tons.

The respondents had no control over the mine from which the ore was obtained. This was worked by a company which had very large trade transactions with Germany. Owing to the war these trade relations were severed, and in consequence on the 10th February 1915 the mine was closed down and all further deliveries ceased. On the 23rd February 1915 the respondents accordingly served upon the appellants notice of suspension under the clause to which reference had been made. The appellants deny that circumstances had arisen