No. 457.—Court of Session (Scotland), First Division.
16th and 17th February, 1922.

House of Lords.—27th July and 3rd November, 1922.

The North British Railway Company *v.* Scott (H.M. Inspector of Taxes). (1)

Income Tax, Schedule E—Railway Company—Salaries of officers paid by Company without deduction of Income Tax—Income Tax Act, 1842 (5 & 6 *Vict.*, *c.* 35), *Section* 146, *Schedule E—Income Tax Act*, 1853 (16 & 17 *Vict.*, *c.* 34), *Section* 2, *Schedule E—Income Tax Act*, 1860 (23 & 24 *Vict.*, *c.* 14), *Section* 6.

The North British Railway Company had been assessed under the provisions of Section 6 *of the Income Tax Act*, 1860, *to Income Tax under Schedule E for the year ended 5th April*, 1919, *in respect of all offices or employments of profit held*

(1) Reported Ct. Sess., 1922, S.C. 247; H.L., 1923, S.C. (H.L.) 27, and [1923] A.C. 37

under the Company. In pursuance of a contract with its officers the Company did not exercise its statutory right to deduct on payment of the salaries the tax in respect thereof payable by the Company, and the Schedule E assessment had accordingly been made upon the Company in a sum representing the amount of salaries actually paid plus the amount of Income Tax thereon borne by the Company on behalf of its officers.

Held, *that the contract to pay the salaries free of Income Tax constituted in effect an agreement to pay the salaries plus the tax thereon and that the Schedule E assessment upon the Company had been correctly computed by reference to the amount of salaries actually paid plus the tax thereon borne by the Company.*

CASE.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 23rd June, 1920, for the purpose of hearing Appeals the North British Railway Company (hereinafter called the Appellants) appealed against an assessment to Income Tax Schedule E for the year ending 5th April, 1919, made upon them under the provisions of the Income Tax Acts.

It is not necessary to trouble the Court with figures, as the point at issue is solely a point of law as hereinafter set out.

I. The following facts were admitted or proved:—

(1) The assessment under appeal was in respect of offices and employments of profit held in or under the Appellants, and was made upon the Appellants pursuant to Section 6 of the Income Tax Act, 1860 (23 and 24 Vict., c. 14) which enacts:—

> "In like manner as aforesaid the commissioners for special purposes "shall assess the duties payable under Schedule (E.) in respect of all offices "and employments of profit held in or under any railway company, and "shall notify to the secretary or other officer of such company the par- "ticulars thereof; and the said assessment shall be deemed to be and shall "be an assessment upon the company, and paid, collected, and levied "accordingly; and it shall be lawful for the company or such secretary or "other officer to deduct and retain out of the fees, emoluments, or salary "of each such officer or person the duty so charged in respect of his "profits and gains."

(2) In a letter from the Appellants' solicitor addressed, on 24th May, 1920, to the Inspector of Taxes it is stated: "The Railway Company are under "contractual obligation to the officer that they will not exercise their statutory "discretionary right to deduct tax from his salary."

(3) The Appellants accordingly pay to each of their officers the agreed amount of salary in full, without any deduction on account of income tax.

(4) In arriving at the amount of the assessment an addition was made, in the case of each officer, to the amount actually paid to him by the Appellants in respect of income tax paid thereon by the Appellants.

For the purposes of this Case it is admitted by the Appellants that, if any such addition has to be made, the amounts so added are to be taken to have been correct.

(5) In addition to the appeal to which this Case relates, the Appellants, on 23rd June, 1920, appealed to us against certain assessments made upon them under Schedule D of the Income Tax Acts. In connection with that appeal, it was contended by the Inspector of Taxes that the amount of income tax paid

by the Appellants on assessments, in respect of offices and employments of profit held under them, was not an admissible deduction in computing the amount of the Appellants' liability to income tax in respect of their trading profits. On this point we decided against the Inspector; he has acquiesced in the decision; and the said amount has, in fact, been allowed as a deduction in computing the liability of the Appellants under the said Schedule D.

(6) Prior to the making of the assessment to which this appeal relates, the Appellants have never been assessed to Income Tax Schedule E in sums greater than the amounts actually paid by them to their officers, though they have not at any time deducted income tax upon payment to their officers of the said amounts.

II. On the foregoing facts the Appellants contended:—

(*a*) That the assessment made upon them under Schedule E should be on the amount actually paid by them to their officers, and not on a greater amount.

(*b*) That the income tax paid by them on their officers' salaries is not income of the officers. (*Tennant* v. *Inland Revenue*, 19 R. (H.L.) 1, *and Tennant and Smith* (1892) A.C. 150.) (1)

(*c*) That the income tax paid by the Appellants on their officers' salaries is, under Section 6 of the Act of 1860, a statutory debt of the Appellants, and is not a debt of the officers, and is not and cannot be income of the officers.

(*d*) That railway officers in virtue of Section 6 of the Act of 1860 are exempted from liability for income tax on their salaries, and the income tax thereon is not their income.

III. It was contended on behalf of the Inspector of Taxes:—

(*a*) That the sum paid by the Appellants as income tax in respect of the salaries of their officers, and which the Appellants had agreed not to deduct, was part of the officers' income for income tax purposes.

(*b*) That the combined effect of Rule 1, Section 146, Schedule E, of the Income Tax Act, 1842, and Section 6 of the Income Tax Act, 1860, was that the officers were charged through the medium of the Appellants, and that Section 6 was merely machinery for purposes of collection (*Attorney-General* v. *Lancashire and Yorkshire Railway Company* (1864) 33 L.J. Ex. 163).

(*c*) That as the income tax in respect of the salaries of the officers was paid by the Appellants and not deducted, the officers received their salaries free of income tax; and

(*d*) That the assessment ought to be confirmed.

IV.—We were of opinion that the contentions advanced on behalf of the Inspector of Taxes were correct in law—vide *Mrs. M. M. A. S. Meeking* v. *Commissioners of Inland Revenue*, K.B.D. 2nd June, 1920(2)—and, no question having been raised by either side as to the figures, we confirmed the assessment.

V. The Appellants immediately upon the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act, 1880, Section 59, which Case we have stated and do sign accordingly.

---

(1) Tennant v. Smith, 3 T.C. 158. (2) 7 T.C. 603.

VI.—The question of law for the opinion of the Court is whether the sum paid by the Appellants as income tax in respect of the salaries of their officers, and not deducted from the salaries paid to such officers, is part of the officers' income for income tax purposes.

G. F. HOWE,

J. JACOB,

Commissioners for the Special Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
14th December, 1920.

The case was heard before the Lord President and Lords Mackenzie and Cullen in the First Division of the Court of Session on the 16th and 17th February, 1922, when Mr. Macmillan, K.C., and Mr. Graham Robertson appeared as Counsel for the Appellants, and Mr. Wark, K.C., and Mr. Skelton as Counsel for the Respondent.

Judgment was delivered on the 17th February, 1922, unanimously in favour of the Respondent, with expenses.

I. INTERLOCUTOR.

Edinburgh, 17th February, 1922. The Lords of the First Division having considered the Case and heard Counsel for the parties, Answer the Question of Law in the Case in the affirmative: Affirm the Determination of the Commissioners and Decern; Find the Appellants liable to the Respondent in expenses and remit the Account thereof to the Auditor to tax and to report.

(Signed) J. A. CLYDE, I.P.D.

II.—OPINIONS.

The Lord President.—My Lords, the duties to which this appeal relates are duties payable for and in respect of profits and gains of the class described or comprised in Schedule E of Section 2 of the Act of 1853, namely, public office or employment of profit. In the language of Schedule E, Section 146, of the Income Tax Act of 1842, the duty is chargeable on the holder of such public office or employment. The particular office or employment concerned in this case is held in or under a railway company, and is accordingly subject to Section 6 of the Income Tax Act of 1860. By that enactment the duties though imposed for and in respect of the profit of office or employment, are directed to be assessed not on the officer or employee in the actual enjoyment of the profit which attracts the duty, and which is the true subject of taxation, but on the railway company in or under which the office or employment is held. That section goes on to provide that it shall be lawful for the company to deduct and retain out of the emoluments of the office or employment the duties so charged in respect of his profits or gains. This leaves the railway company free to pay the officer's or employee's salary after deduction of Income Tax, or free from Income Tax, exactly as it pleases. In the present case the railway

company has come under contract with the officer or employee not to retain or deduct the duty to which his salary is subject. The salary, in short, is paid to him free of tax, and the amount of his emoluments is accordingly increased precisely by the amount of the duty. A contract to pay a salary without deduction of tax is neither more nor less than a contract to pay the amount of the salary plus the amount of the tax, and in such a case the profit of the office or employment is measured by the sum of those two figures. I see that in *Kinloch's Trustees* v. *Kinloch* reported in 1880 in the 7th volume of Rettie, page 596, Lord Gifford made this remark, "A bequest free of legacy duty "is just a bequest of an additional sum equal to the legacy duty, and occurs "very frequently. It is precisely the same with the Income Tax." It was contended for the Railway Company that the effect of the relief from direct assessment which is provided to the railway employee by Section 6 of the Act of 1860 is to convert what would otherwise be a charge or impost on his profits or gains ascertained in the usual way, into a Crown debt due by the railway company and measured by the amount of the salary actually paid him. This ignores the fact—as it appears to me, the fundamental fact—that the subject of the tax (on whomsoever the tax may be assessed) is the profit of the office or employment. The question merely is, what is the amount of that profit, and the answer is that the amount is more or less according as the profit is received after deduction of the tax to which it is subject, or whether it is received free of that tax. The Railway Company's argument really involves, as indeed the Railway Company's Counsel admitted, that the effect of Section 6 is to exempt the profit of railway office or employment from taxation under the Income Tax Acts. I have found myself quite unable to reconcile these views either with the general scheme of the Income Tax Acts or with the particular provisions of the Acts of 1842, 1853 or 1860 on which the question immediately turns.

Lord Mackenzie.—I am of the same opinion. It was urged upon us that we ought to apply the analogy of the case of the bank agent whose occupation of a dwelling house was a matter of consideration in the case of *Tennant* v. *Smith*(1). It was there held that, unless what came into the bank agent's hands was money or money's worth, it was not subject to Income Tax, and it was put that what saved the pocket was not chargeable to Income Tax, only what goes into the pocket. It appears to me that that analogy does not apply to the present case: that the true analogy in the present case is a dividend which is paid free of Income Tax, and one from which Income Tax is paid before the dividend is received. If the amount of tax-free dividend is £100, then of course when the fortunate or unfortunate recipient requires to make up his Super-tax return he requires to add 6*s.* in the pound, and it becomes apparent from his return that what he has truly received is not £100 but £130. In short, he has received x plus y, x being the amount of his dividend which goes into his pocket, y the amount of the Income Tax which goes to the Inland Revenue, but which is nevertheless money or money's worth in a question with the recipient of the dividend. So in the same way, when you have to reckon the amount of the profit or gains, the person who receives a particular sum free of tax receives more than the person who receives that sum subject to deduction of tax. Once those principles are applied to the present case I think it necessarily follows that the result would be as your Lordship has indicated.

Lord Cullen.—My Lords, I am of the same opinion. The charge here is on the profits arising from a particular office or employment. Now, if there be one

(1) 3 T.C. 158.

employee who has a bare contract for a salary, say, of £100 a year, and another employee who has the species of contract actually used by the Railway Company, that is to say, for payment of a salary of £100 free of all deduction, it seems perfectly clear that the profits arising from the employment in the second case are greater than the profits arising from the employment in the first case in respect of the direct pecuniary receipts; and, if the profits arising from the employment in the second case are greater than in the first, so must the taxable amount be correspondingly greater.

An appeal having been entered against the decision in the Court of Session, the case was argued before Lords Dunedin, Atkinson, Sumner, Wrenbury and Carson in the House of Lords on the 27th July, 1922, when judgment was reserved. Mr. Graham Robertson, K.C., and the Hon. Geoffrey Lawrence appeared as Counsel for the Appellants, and the Attorney-General (Sir Ernest Pollock, K.C., M.P.), the Lord Advocate (Mr. C. D. Murray, K.C., M.P.), Mr. R. P. Hills and Mr. Skelton for the Respondent.

Judgment was delivered on the 3rd November, 1922, unanimously in favour of the Crown, with costs, affirming the decision of the Court below.

JUDGMENT.

Lord Dunedin.—My Lords, this appeal has to do with an Income Tax assessment for the year ending 5th April, 1919.

By the Income Tax Act of 1860 it is provided in Section 5 that assessments for Income Tax on a railway company shall be made by the Special Commissioners in lieu of the General Commissioners, who are debarred from making any such assessment. Section 6 of the same Act is in these terms:—"6. In "like manner as aforesaid the commissioners for special purposes shall assess "the duties payable under Schedule (E.) in respect of all offices and employ- "ments of profit held in or under any railway company, and shall notify to the "secretary or other officer of such company the particulars thereof; and the "said assessment shall be deemed to be and shall be an assessment upon the "company, and paid, collected, and levied accordingly; and it shall be lawful "for the company or such secretary or other officer to deduct and retain out of "the fees, emoluments, or salary of each such officer or person the duty so "charged in respect of his profits or gains."

There are certain officials of the Appellant Company whose salary is fixed at a specified sum in cash, the Company at the same time coming under contractual obligation to make no deduction in respect of the Income Tax paid by them in terms of the said Section.

A test case was taken. The Special Commissioners assessed the Income Tax by taking, first, the sum of the agreed salary of the official and adding thereto the amount of Income Tax which had been paid by the Company on behalf of the official in the previous year, and then calculating the Income Tax on the aggregate of those two sums. This they claim to do each year in succession.

A Case was stated for the opinion of the First Division of the Court of Session, in which Case the above-mentioned facts were set forth and the question for the Court stated thus:—"The question of law for the opinion of the Court

" is whether the sum paid by the Appellants as income tax in respect of the " salaries of their officers, and not deducted from the salaries paid to such " officers, is part of the officers' income for income tax purposes."

The First Division of the Court of Session affirmed the determination of the Commissioners. Appeal has now been taken to your Lordships' House.

Turning back to the sixth Section of the Act we find that the first duty of the Commissioners is to assess the duties payable under Schedule E in respect of offices and employments held in or under the railway company. That necessarily sends us to Schedule E. Schedule E which is to be found in the Act of 1853 imposes the duties " for and in respect of every . . . employ- " ment of profit ", and by Rule 1 which is contained in Section 146 of the Act of 1842 and is applicable to Schedule E of the Act of 1853 " the duties . . . . " shall be payable for all salaries, fees, wages, perquisites, or profits whatsoever " accruing by reason of such office ".

Now each office must be dealt with separately. It is obvious that if the official here in question were asked," What profits whatsoever do you get from " your office ? " his answer would have to be, " I get x pounds in cash and I get " the Income Tax due in respect of my salary paid by the company." It would therefore be on the aggregate of these two sources of profit that the duty would have to be calculated. Now it is true that when that is done the duty so assessed is by the second part of the clause in Section 6 made to be an assessment on the company ; it has to be laid on and paid by the company ; the official himself has no concern with it. Most of the Appellants' argument was rested on the fact that this was a company debt and not the official's debt ; and it was contended that the company could not be asked to pay an assessment on an assessment. The fallacy of this argument consists in ignoring the fact that though this is a company debt the measure of that debt is not any liability of the company, but is what would be the liability of the official under Schedule E if that liability were not transferred to the company by the Section ; and the concluding words of the Section are strictly accurate when, dealing with the power given to the company to deduct from the salary of the official the sum they have had to pay, they characterise the duty as so paid in respect of his, *i.e.*, the official's, profits and gains.

The Appellants further attempted to urge that the decision appealed against practically took away from the company the option given by the Section to deduct or refrain from deducting. It does no such thing. The power to deduct was necessary in order to deprive the official of the contention that the debt being made a company debt there could be no right to make him pay by way of deduction what was not his debt. And if the company chooses to deduct (in cases where they have not as here bound themselves of contract not to do so), it follows that the official's total emolument is the conditioned salary of x pounds from which the Income Tax was deducted. Then, if as here they elect not to deduct, they are by their action making it that the total emolument of the official is not only the cash salary but also the sum necessary to maintain that cash salary at its undiminished figure.

For these reasons I am of opinion that the judgment appealed from is right and that the appeal should be dismissed with costs.

Towards the end of the argument a point was mooted as to whether the calculation of the amount payable as tax was correct. The question is not open, for in the Case it is stated that the Appellants admit that upon the assumption that they were wrong on the general question the assessment was correct. I shall therefore express no opinion on the point.

Lord Atkinson.—My Lords, the facts have already been stated. The 146th Section of the Income Tax Act of 1842 (5 & 6 Vict., cap. 35) provides that the duties thereby granted contained in Schedule E shall be assessed under the rules thereto following, which rules are to be deemed and construed as part of the Act.

Under the first of these rules these duties are to be annually charged on the persons respectively having, using, or exercising the offices or employments of profit mentioned in Schedule E, or to whom the annuities or stipends mentioned in the Schedule shall be payable, for all salaries, fees, wages, perquisites, or profits whatever accruing by reason of such offices, employments, or pensions, after deducting the amount of the sum or sums payable or chargeable on the same by virtue of any Act of Parliament where the same shall have been really and bonâ fide paid and borne by the party to be charged.

The case of *Beaumont* v. *Bowers* (1) ([1900] 2 Q.B. 204) illustrates what is the nature of the sums to which these last words of this rule apply. Beaumont was the Clerk of the Guardians of a Poor Law Union. Under the provisions of the 12th Section of the Poor Law Officers' Superannuation Act of 1896, he contributed annually for the purposes of the Act a sum of £15 10*s.*, which was deducted from his salary. He claimed and was held to be entitled to deduct this contribution from the sum on which he was assessed for Income Tax under this Rule. The Officer was apparently under this Section compelled to make this contribution if he was to derive any benefit from the Superannuation Fund.

In *Hudson* v. *Gribble* and *Bell* v. *Gribble* (2) ([1903] 1 K.B. 517), the decision in *Beaumont* v. *Bowers* (1) was criticised and its soundness doubted, and it was held that deductions made in respect of a contribution to a Superannuation Fund agreed to as part of the terms of the employment of an officer of a Corporation did not come within these words of the Section, even though the Corporation framed the Superannuation Scheme constituted by it in exercise of statutory powers. These deductions were held to be voluntary payments by the officer and should not be deducted from the sum at which he was assessed for Income Tax. The case of *London County Council* v. *Attorney-General* (3), 1901, referred to in argument in the last-mentioned case, was wholly irrelevant, and Lord Macnaghton's well-known judgment in that case has no application to this case; but *Hudson* v. *Gribble* (2) does, I think, establish that if the railway company had, before the Act of 1860 was passed, arranged with the officers of their staff, employed for profit, as part of the terms of their hiring, that to spare those officers the inconvenience of being each visited by a Revenue Officer to collect the amount of the Income Tax for which they were respectively liable, the company would pay in one sum all the Income Tax for which the staff were collectively liable, and would set off against the salary of each officer the sum paid on his behalf to the Revenue, the entire salary of the officer would have been assessed for Income Tax. No deduction would have been allowed for the tax so paid by his employer on his behalf. I think the same result would have followed even if the company either from benevolence, or for any other motive, declined to set off the amount they had paid for or on behalf of an officer in discharge of that officer's statutory liability, because in truth the sum paid by the company is not a sum outside of the officer's salary or independent of it, but is a part of his salary, and if the employer did not set off this sum against the employee's salary, the latter would simply pocket his full salary, his debt to the Revenue having been paid by another, not by himself, that is all.

---

(1) 4 T.C. 189. (2) 4 T.C. 522. (3) 4 T.C. 265.

Now, it appears to me that the Act of 1860 does little more than embody in a statutory form such an arrangement as I have mentioned. The duties payable under Schedule E in respect of all offices and employments of profit held under the company are to be assessed; but the only duties assessed and charged under Schedule E are the duties annually charged on persons having, using or exercising the offices or employments of profit mentioned in the Schedule. And that charge is measured in this way; it is to be payable for all wages, fees, perquisites or profits whatsoever accruing in respect of or by reason of such office, etc., each assessment in respect of such office or employment to be in force for one year. The amount with which officers are charged and for which they are assessed must be ascertained for the purposes of the Act of 1860, else the retention from or the deduction from their salaries never could be properly made. It would be a mistake in my view to hold that the officer is not assessed. He must be assessed, for it is the duty charged in respect of his profits and gains that is to be retained or deducted. Then, for the purpose of the collection, the sums due by those officers of the company, their separate assessments, are deemed to be an assessment of the company, one assessment, and to be paid and collected accordingly. By this last provision the company is thus made responsible for the debts, thus lumped together, of their individual officers, and obliged to pay them, and then they can, by retaining out of or deducting from what they owe to each officer, recoup themselves for their outlay in this respect. Whether the company avails itself or not of the means provided by statute to enable it to recoup itself for its outlay in paying the debts of its officers is its own concern. Its action in that respect cannot, in my view, affect prejudicially the rights of the Revenue. The sums paid by the company to satisfy the debts which those officers respectively owed to the Revenue remain part of the profits and gains those officers derive from the offices they respectively hold, and are liable to be assessed to Income Tax just as the amount of the Income Tax deducted by a railway company from the dividends it pays its shareholders is part of the income of those shareholders. In truth the whole scheme of the Statute is to apply the common and convenient method of deducting Income Tax at the source. I accordingly think that the question submitted in the Case as stated for opinion in Court was rightly answered by the First Division of the Court of Session.

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

Lord Sumner.—My Lords, I agree that the appeal fails.

Lord Wrenbury.—My Lords, this case was argued upon the sections of the Income Tax Acts, 1842, 1853 and 1860, and not upon the corresponding sections of the Income Tax Consolidation Act of 1918.

Under the First Rule of Schedule E of 1842, the assessment is to be made upon the person having the office or employment "for all salaries, fees, wages, "perquisites or profits whatsoever accruing by reason of such offices, employ- "ments, or pensions". Under the Income Tax Act, 1860, Section 6, the persons to make the assessment are the Special Commissioners and they are to assess the duties payable under Schedule E in respect of offices and employments of profit held under a railway company (this being the assessment to be made under Schedule E of 1842) and are to notify the secretary of the company "and the said assessment shall be deemed to be and shall be an assessment "upon the company, and paid, collected and levied accordingly", and it is to be lawful for the company to deduct out of the salary of the officer the duty charged "in respect of his profits and gains". These last words are material.

The assessment therefore remains as regards its amount the same as it was under the Act of 1842 and is to be deemed something which it is not (viz., an

assessment on the company) and being so deemed is to " be an assessment upon the company " and be paid accordingly. The result is that the company becomes debtor for that which would otherwise have been—and seemingly under the Act of 1842 still is—the debt of the officer and which is measured by the profits and gains of the officer.

In the case before us " the railway company are under contractual obligation " to the officer that they will not exercise their statutory discretionary right " to deduct tax from his salary ". In other words, having paid the tax on his income they will not charge him with it. The question is what are the " profits " and gains " for Income Tax purposes of an officer employed upon those terms ?

If the salary which the officer is to receive net is £100, the " salaries, fees, " wages, perquisites or profits whatsoever " which form the reward of his service, are the £100 and the contractual benefit that when the company has paid the tax due for his Income Tax (whose payment is imposed upon the company by the Statute), they will not deduct it against him as they might. This is a further valuable consideration or profit accruing to the officer by reason of his office and is a factor in arriving at his assessable income for Income Tax purposes. His total " profits and gains " are the aggregate of these sums. The Appellants say that by such an assessment the Revenue takes tax on tax. Certainly, so it does. But every one who pays 5*s*. in the pound Income Tax pays tax, not only on the 15*s*. which he retains, but also on the tax of 5*s*. which he has to pay. The question for the opinion of the Court is therefore to be answered by saying that the sums paid by the Appellants as Income Tax on the officer's profits and gains form part of the officer's income for Income Tax purposes. It follows that this appeal must be dismissed with costs.

Lord Carson.—My Lords, I concur that this appeal should be dismissed with costs.

Questions Put.

That the Interlocutor appealed from be reversed.

The Not Contents have it.

That the Interlocutor appealed from be affirmed and this Appeal dismissed with costs.

The Contents have it.