No. 810.—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—10TH AND 11TH DECEMBER, 1930.

COURT OF APPEAL.—11TH MAY, 1931.

HOUSE OF LORDS.—23RD AND 25TH FEBRUARY AND 15TH MARCH, 1932.

MUNICIPAL MUTUAL INSURANCE, LIMITED *v.* HILLS (H.M. INSPECTOR OF TAXES.[1])

Income Tax, Schedule D—Profits—Mutual insurance.

The Appellant Company was formed by the representatives of various local authorities primarily for the purpose of enabling local authorities and other public bodies by co-operation to insure against fire on the most favourable terms. The effective control of the Company was in the hands of the fire policy holders, who alone were entitled, in the event of a winding-up, to the surplus assets of the Company. The Company's memorandum of association prohibited the transfer of any part of the Company's income or property by way of profit to the members.

In course of time the Company undertook, in addition to fire insurance, an extensive business in employers' liability and miscellaneous insurance. Cumulative reductions were allowed in fire insurance premiums, but no similar reductions were allowed in the case of policies of other classes than fire.

The Crown admitted that the fire insurance business of the Company was a business of mutual insurance which did not attract liability to assessment to Income Tax. The Company admitted liability to Income Tax in respect of profits from employers' liability and miscellaneous business done with persons who were not fire policy holders, but contended that it was not liable in respect of any surplus arising from such business done with fire policy holders.

Held, *that the surplus on employers' liability and miscellaneous business done with fire policy holders did not arise from mutual insurance.*

CASE

Stated under the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

(1) Reported 48 T.L.R. 301.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 16th July, 1929, for the purpose of hearing appeals, Municipal Mutual Insurance, Ltd., (hereinafter called the Company) appealed against assessments to Income Tax in the estimated sums of £12,000 for the year ending 5th April, 1921, £13,000 for the year ending 5th April, 1922, and £13,000 for the year ending 5th April, 1923, made upon the Company by the Additional Commissioners of Income Tax for the Division of Finsbury under the provisions of the Income Tax Acts.

2. The Company was incorporated under the Companies Acts in 1903 as a company limited by guarantee and not having capital divided into shares. Its main object was to enable local authorities and other public bodies by co-operation to insure against fire and other risks on the most favourable terms. The memorandum of association provided that no part of its income and property should be paid or transferred by way of dividend, bonus, or otherwise, by way of profit to the members of the Company and every member undertook, in the event of winding-up, to contribute such amount as might be required, not exceeding £10, for the payment of the debts and liabilities of the Company, contracted before the time at which he ceased to be a member, and the expenses incidental to winding-up. The original articles of association were superseded by a special resolution passed in 1910, and other articles substituted therefor. A copy of the memorandum of association and the articles adopted in 1910 is attached hereto and forms part of this Case.(1)

3. The Company undertakes practically all classes of insurance business except life and marine insurance. In its origin, it was the outcome of a conference of the London central and local authorities, which first met in 1900 with the object of establishing a system of mutual insurance against fire upon the view that, as a class, the properties belonging to municipal authorities were less liable to damage by fire than properties in general and the cost of insurance against fire at the ordinary rates quoted by insurance companies was therefore excessive, but that it was undesirable that individual authorities should take the risk of relying upon insurance funds of their own. The conference was advised that a scheme by which a number of authorities should simply insure each other by a mutual contract to contribute to any fires that might occur on the properties of any of the contracting parties in a certain ratio would be open to objection on the ground that it would be *ultra vires* for an authority to make payment out of its rates towards an expense incurred outside its own area, and a scheme was mooted for the payment of insurance premiums to a body of trustees constituted by a trust deed for the purpose of receiving, managing and applying them. Eventually, this proposal was modified and it was decided

(1) Not included in the present print.

that the representatives of the authorities which approved of the revised scheme should form a company and appoint trustees as managers thereof, and the Company was registered in pursuance of this decision.

4. By article 2 of the articles of association the number of members of the Company was declared not to exceed twenty, but the trustees were empowered to register an increase in the number of members whenever they thought fit. Under article 3, the subscribers to the Company's memorandum of association were members by original subscription, and any person thereafter desiring to become a member was required to apply in writing to the Company for admission to membership in a prescribed form and it was for the managing trustees to accept or reject such application. Under article 8, the Company was to keep a register of fire policies sealed and issued and, by article 1, " fire policy holders " were defined as the holders for the time being of fire policies in accordance with the said register. Under article 13, every member, trustee and fire policy holder who had not appointed a trustee was entitled to attend a general meeting which was to be held once at least in every calendar year. If and so long as a fire policy holder had appointed a trustee, the trustee was to be so entitled and the fire policy holder was not to be so entitled to attend. By article 15, the managing trustees were empowered and were required, upon a requisition made in writing by any five or more persons, each of whom must be either a member of the Company or a trustee, to convene an extraordinary meeting. Fire policy holders who had not appointed a trustee were not entitled to join in any such requisition. Under article 21, the business of an ordinary meeting was to be to receive and consider the profit and loss account and balance sheet, the reports of the managing trustees and of the auditors, to elect or remove managing trustees, trustees and other officers, to fix the remuneration of the auditors and to transact any other business which under the articles ought to be transacted at an ordinary meeting. Under articles 26 to 30, every question submitted to a meeting was to be decided by show of hands or by poll if demanded. By article 31, on a show of hands, every member, every fire policy holder who had not appointed a trustee and every trustee (present in person or by proxy in each case) had one vote, and, at a poll, every member present in person or by proxy had one vote and every fire policy holder who had not appointed a trustee and every trustee (present in person or by proxy) had one vote, and an additional vote for each sum of £25,000 above £25,000 and up to £100,000, and for each sum of £50,000 above £100,000 insured by him or by the fire policy holder appointing him. By article 36, every person insured against fire with the Company was given power to appoint some one person to be one of the trustees of the Company, to remove the trustee so appointed and to appoint some other person to be a trustee in the place of any trustee so removed, or otherwise

vacating office. By article 47, the management of the Company's business was vested in a body of persons called managing trustees, of whom three-fourths at least were to be trustees appointed under article 36, and who were to be regarded as directors. By article 48, the number of the managing trustees was not to be less than five nor more than fifteen. By article 95, it was provided that, in the winding-up of the Company, the surplus assets which shall remain after paying off and satisfying all the debts and liabilities of the Company and providing for the costs of the winding-up, shall be divided among the persons who shall be fire policy holders of the Company at the commencement of the winding-up and in proportion to the amounts of the aggregate premiums which shall have been paid by them respectively upon the fire policies at any time effected by them with the Company.

5. In the early days of the Company the business done was mainly that of fire insurance, but from 1913 onwards a relatively small though increasing miscellaneous business was done. In 1918, it was considered desirable that the Company should undertake an extensive business of employers' liability insurance. This would have involved a deposit of £20,000 under the Assurance Companies Act, 1909, if the Company had not been able to satisfy the Board of Trade that its business under this head was that of mutual insurance of its members. To this end, after correspondence with the Board of Trade and following the suggestions of that Department, the articles of association were amended by special resolutions passed on 11th March, 1918, and confirmed on 27th March, 1918, by the insertion of provisions that no person should be capable of becoming a member unless he were insured or about to be insured either against fire risks or against employers' liability risks, and that a member of the Company should *ipso facto*, and immediately, cease to be a member if he ceased to be insured against fire risks or employers' liability risks so that he was no longer insured with the Company against either of such risks. A copy of a letter from the Board of Trade dated the 7th March, 1918, is annexed hereto and forms part of this Case.(1)

6. Since 1918, the Company has undertaken a large and rapidly growing business of employers' liability insurance without being required by the Board of Trade to make a deposit under the Assurance Companies Act. The miscellaneous business has also largely expanded. By 1922, the annual net premiums both from the miscellaneous business and from the employers' liability business exceeded those from the fire business. At the present time about one-half of the policies issued by the Company are held by fire policy holders on the fire policy register and one-half by other persons and about one-quarter of the total net premiums received by the Company are paid in respect of fire policies.

(1) Not included in the present print.

7. Copies of the Company's accounts and the reports of the managing trustees for the years 1920, 1921, 1922 and 1923 are attached hereto and form part of this Case.(1) The reports show that cumulative reductions of fire insurance premiums were allowed each year to those authorities which had been insured with the Company against fire for four years or more. No similar reductions of premiums were granted in the case of policies of other classes than fire. It was explained that in the case of employers' liability policies the premiums varied, and while the prosperity of the department as a whole would be taken into account in fixing the premiums, the case of each policy holder would be considered individually and the premiums increased or decreased according to the experience as regards claims in each particular case.

8. In giving their evidence the officers of the Company drew no distinction between members and policy holders. They appeared to take it for granted that any public authority which took out a policy with the Company was a member and no information was forthcoming from them as to the extent to which policy holders had been formally constituted members in accordance with the articles of association. It was admitted that some policies, at all events in the miscellaneous section, had been issued to persons who were not members, *e.g.*, to servants of local authorities. Many of the employers' liability policies and of the miscellaneous policies had been issued to authorities which also held fire policies.

9. It was admitted on behalf of the Crown that the fire insurance business of the Company was a business of mutual insurance and that there was no liability to assessment to Income Tax under Case I of Schedule D in respect thereof. It was admitted on behalf of the Company that the Company was liable to assessment to Income Tax in respect of any surplus arising from miscellaneous business done by the Company with persons who were neither members, nor holders of fire insurance or employers' liability insurance policies.

10. It was contended on behalf of the Company :—

(*a*) That the Company was not assessable to Income Tax in respect of any surplus arising from any business done with members or with holders of fire insurance policies or of employers' liability insurance policies.

(*b*) Alternatively, that there was no liability to assessment to Income Tax in respect of any surplus arising from employers' liability or miscellaneous business done with fire policy holders.

11. It was contended on behalf of the Crown that the Company was assessable to Income Tax under Case I of Schedule D in respect of any profit arising to or from its business otherwise than from its fire insurance business.

(1) Not included in the present print.

12. We, the Commissioners who heard the appeal, gave our decision thereon in the following terms :—

" There is no doubt that those concerned in the promotion " and in the subsequent extension of the scope of this Company " intended it to be (*a*) an association of owners or occupiers " of buildings carrying on business mainly for the purpose of " the mutual insurance of its members against damage by or " incidental to fire and (*b*) an association of employers carrying " on business mainly for the purpose of the mutual insurance " of its members against liability to pay compensation or " damages to workmen employed by them.

" But, in the first instance, no provision was made for the " establishment of any identity between the members of the " insuring association and the persons insured, and though in " 1918 it was provided that members of the association must " be holders of either fire or employers' liability policies, there " is still no necessity that policy holders of either class should " be members of the association. The articles of association " make and maintain throughout a distinction between mem- " bers and fire policy holders and make no mention of " employers' liability policy holders except as being eligible " for membership. The position is thus different from that " considered in the cases of the *New York Life Co.*(1), the " *Cornish Mutual*(2) and the *South West Lancashire Coal* " *Owners' Association*(3), in which the policy holders dealt " with were *ipso facto* members of the association and " interested in its funds.

" Membership of this company is a barren honour. The " members have no privileges except a possible liability to pay " £10 on winding-up and a smaller voice in the management " than is given to the fire policy holders. As members, they " cannot receive any benefit from any surplus of contributions " except protection against a call under their guarantee.

" It is common ground that the fire business is a purely " mutual business. The fire policy holders, irrespective of " membership, have votes, they can appoint trustees who form " the majority of the managing trustees, they are entitled to " have the surplus assets divided amongst them on a winding-up " and they receive progressive reductions of their premiums " according to the age of their policies.

" On the other hand, it is admitted that any surplus arising " on miscellaneous business done by the Company with persons

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(1) Styles *v.* New York Life Insurance Company, 2 T.C. 460.

(2) C.I.R. *v.* Cornish Mutual Assurance Company, Ltd., 12 T.C. 841.

(3) Jones *v.* The South-West Lancashire Coal Owners' Association, Ltd., 11 T.C. 790.

" who are not members, fire policy holders, or employers' " liability policy holders is a trading profit and as such assess- " able to Income Tax.

" The question left for our consideration is whether any " surplus arising from miscellaneous business done with " members, fire policy holders, or employers' liability policy " holders, or employers' liability business done with members " or fire policy holders, is a taxable trading profit, or is outside " the charge to the tax as being a mere excess of contributions " over immediate requirements for a mutual purpose. In our " opinion, no distinction can be drawn between the miscel- " laneous business and the employers' liability business, or " between the different classes of persons taking out policies " under these heads. In no case is any redundant part of the " premiums returnable to the contributors as contributors, " either in the shape of a reduction of premiums or in cash on " cessation of the policy or on winding-up. The fire policy " holders may receive a portion of a surplus of miscellaneous " or employers' liability premiums, but only as fire policy " holders and not as contributors of those premiums, and any " benefit that the miscellaneous or employers' liability policy " holders may receive from the accumulation of a surplus of " premiums is indirect only and of the same nature as the " advantages which any insured person may receive from the " accumulation of reserve by an ordinary trading company.

" We accordingly hold that the surplus arising from " employers' liability and miscellaneous business is taxable as " a trading profit.

" Figures to be agreed."

13. The Company, immediately after the determination of the appeal, declared to us its 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 Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

14. It has been agreed between the parties that when the questions of principle at issue have been determined by the Court the Case should be remitted to us for settlement of the amount of the liability.

P. WILLIAMSON, J. JACOB, } Commissioners for the Special Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
27th March, 1930.

The case came before Rowlatt, *J.*, in the King's Bench Division on the 10th and 11th December, 1930, when the Company abandoned its main contention (paragraph 10 (*a*) of the Stated Case) and contended only that it was not liable to Income Tax in respect of any surplus arising from employers' liability or miscellaneous business done with fire policy holders. Judgment was given in favour of the Crown, with costs.

Mr. R. W. Needham, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Company and the Solicitor-General (Sir Stafford Cripps, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT.

Rowlatt, J.—In this case the fact that the Appellant is a Company may, I think, be disregarded. In this judgment I shall use the word " members " to describe the fire policy holders, who are the people who are, in a winding-up, interested in the assets, and they are the people who benefit by anything in the shape of a reduction of premiums, by an accumulation of reserves, and so on, and by any surplus—not to use the question-begging word " profit " —which arises in the operation of the Company in all its spheres. Now, the fire policy holders, as I have said, are interested in what profit is made from the fire policies. They are interested also in the surplus that emerges from the miscellaneous business and the employers' liability business. The position is this, that, in addition to the fire policy business—which is conceded to be strictly mutual for the purpose of bringing the case within the *New York Company's* case(1)—there is this miscellaneous business and there is this employers' liability business. Those two last-mentioned heads of business can be and are done with anybody, and it is not disputed that what can be made out of that business by dealing with complete outsiders is simply nothing more than the profits of the body of people who form the fire policy holders, whom I have called the members, and who are represented, for the purposes of machinery and technical purposes, by the Company. There can be no doubt about that.

What I have to deal with here is the surplus or the increment which can be obtained from those classes of business where the person with whom it is done happens to be also a fire policy holder, so that the profit or surplus from his operation comes back into a body of which he himself is a member. It is said that that makes it mutual, and that, being mutual, therefore it is not taxable under the decision in the *New York Company's* case(1). Now I do not think that one can make cases on this point turn upon an analysis of the word " mutual ", a word that is very much abused, as I pointed out in the argument, in certain very well known instances.

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(1) Styles *v.* New York Life Insurance Company, 2 T.C. 460.

(Rowlatt, J.)

Of course the word " mutual " is used in insurance language to describe a certain class of company, and so on. But for the purposes of these decisions the point is, as I have pointed out before —and I think the Solicitor-General adopted what I said—whether there is any profit; that is to say, whether you get more than this, that a certain class of people are associating together to put up money to achieve an object for each other, and divide what is not wanted among themselves in that character, namely, in the character of the persons who put it up. That is what I understand is at the bottom of it. If you like to call that " mutuality ", well, it is a convenient word. That is what the essence of it is. In this case, I am bound to say, now that I think I understand it, the point seems pretty nearly unarguable, because I cannot see the slightest distinction between what is made out of a member in respect of non-fire business and what is made out of a stranger in respect of non-fire business; *qua* that business the member is a stranger. He is not, as a miscellaneous policy holder, getting any share in the miscellaneous policy business. The miscellaneous policy business is done for the benefit of the body of fire policy holders. They get it, and it might just as well be a stranger. I think this person is exactly in the same position as a shareholder of a railway company who takes a ticket by a train; for this purpose he is merely an outsider.

Now I do not feel inclined to elaborate it. I think it is extremely well put, if I may say so, by the Commissioners. They gave a reasoned judgment in this case, and they say: " In our " opinion no distinction can be drawn between the miscellaneous " business and the employers' liability business, or between the " different classes of persons taking out policies under these heads." They say no distinction can be drawn between the different classes of persons taking out policies under these heads, the different classes being fire policy holders and other policy holders. " In no " case is any redundant part of the premiums returnable to the " contributors as contributors,"—that is the point—" either in " the shape of a reduction of premiums or in cash on cessation of " the policy or on winding-up. The fire policy holders may receive " a portion of a surplus of miscellaneous or employers' liability " premiums, but only as fire policy holders and not as contributors " of those premiums,"—it could not be put, in my judgment, better or more shortly—" and any benefit ", they continue, " that the " miscellaneous or employers' liability policy holders may receive " from the accumulation of a surplus of premiums is indirect only " and of the same nature as the advantages which any insured " person may receive from the accumulation of reserve by an " ordinary trading company." In other words, it is the position of the shareholder in a railway company who takes a ticket by the railway.

(Rowlatt, J.)

For these reasons (I hope I have not overlooked anything) it seems to me perfectly clear that the appeal must be dismissed with costs.

Has this case to be remitted?

Mr. Hills.—No, I do not think so. It is according to the Commissioners' decision.

The Company having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Hanworth, *M.R.*, and Lawrence and Romer, *L.JJ.*) on the 11th May, 1931, when judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. R. W. Needham, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Company and the Solicitor-General (Sir Stafford Cripps, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT.

Lord Hanworth, M.R.—We need not trouble you, Mr. Solicitor. This appeal fails. I really find a difficulty in adding anything to what has been said by Mr. Justice Rowlatt and to his appreciation of the finding and decision given by the Commissioners. I think indeed it is better, for the purpose of avoiding confusion, not to add to or subtract from those two decisions and judgments. I think, therefore, the right course is to say that I agree with the judgment of Mr. Justice Rowlatt, for the reasons that he has given, and upon those reasons supporting the decision of the Commissioners, who dealt with the matter in a most lucid fashion, the appeal is dismissed with costs.

Lawrence, L.J.—I agree.

Romer, L.J.—I agree.

The Solicitor-General.—May I give your Lordship the explanation now, so that no question may arise hereafter, as to why this took so long?

Lord Hanworth, M.R.—Yes.

The Solicitor-General.—Perhaps I might just read this note: Prior to 1926 the Revenue had assumed that the Company was purely mutual and had not made a minute examination of its affairs and had not charged it to Income Tax. For Corporation Profits Tax the Inspector had taken the view, wrongly, that the

(The Solicitor-General.)

Company was assessable on investment income only and not on its surplus. The decision of the House of Lords in the *Cornish Mutual* case(1), given on 21st January, 1926, resulted in the question of Corporation Profits Tax being reopened and the Company accepted liability on its surplus. At the same time the Inspector went into the whole question of Income Tax and investigated the accounts, reports, etc. This investigation went on from 1926 to 1929. Part of the delay was caused by the death of the Company's solicitor. As a result, the Revenue came to the conclusion that the business was not wholly mutual. Hence these additional assessments were made in 1929.

Lord Hanworth, M.R.—Of course delay ought to be avoided really where it is possible. It is too hard on a trader not to have some finality as to what his liability is to tax.

The Solicitor-General.—I quite appreciate that, my Lord, and I am sure the Inland Revenue will bear that in mind.

The Company having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Dunedin, and Lords Warrington of Clyffe, Atkin, Thankerton and Macmillan) on the 23rd and 25th February, 1932, when judgment was reserved. On the 15th March, 1932, judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. W. A. Greene, K.C., Mr. R. W. Needham, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Company and the Attorney-General (Sir T. W. Inskip, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT.

Viscount Dunedin.—My Lords, in this case I am content with the judgment of the Commissioners as expressed by them and affirmed by Mr. Justice Rowlatt.

The point may be stated as a question whether the facts in this case, so far as the point of controversy extends, fall under the decision in the case of *New York Life Insurance Company* v. *Styles*, 14 App. Cas. 381(2), or under the case of *Last* v. *The London Assurance Corporation*, 10 App. Cas. 438(3).

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(1) Commissioners of Inland Revenue *v.* The Cornish Mutual Assurance Co., Ltd., 12 T.C. 841.

(2) 2 T.C. 460. (3) 2 T.C. 100.

(Viscount Dunedin.)

Any person, or set of persons, or company, carrying on the business of insurance, charges premiums and has to meet claims on the policies for which the premiums have been paid and, if it transpires in the course of business that the amount obtained by the premiums has been more than sufficient to meet the claims, this is a surplus. If that surplus is a profit it must bear Income Tax, *secus* if it is not; and whether it is a profit or not depends, as was found in the two cases, upon the question: To whom does it go? If it goes to the insurer or insurers it is a profit. If it simply goes back to the insured either in reduction of his premium or in enhancing the sum insured, it is in essence merely a return of his own money which he has overpaid and is not a profit.

Now, it is found in this case as a fact, that as regards employers' liability business and miscellaneous business—and that is the only point disputed—" in no case is any redundant part of the premiums " returnable to the contributors . . . . either in the shape of a " reduction of premiums or in cash on cessation of the policy or on " winding-up." All surpluses eventually go to the fire policy holders. In so far as the surplus arises from a fire policy, they are really entitled to the money as being those who contributed it and, accordingly, it has been admitted that any profit made on the fire policies is governed by the *New York*(1) case. But as regards employers' liability business and miscellaneous business, it does not go to the contributors for, as fire policy holders in a body, they have not contributed and therefore this business is in the same position as business with complete outsiders, the surpluses in which are admitted to be profit.

I move that the appeal be dismissed.

Lord Warrington of Clyffe.—My Lords, this is an appeal from an Order of the Court of Appeal, dated 11th May, 1931, dismissing an appeal from an Order of Mr. Justice Rowlatt, whereby an appeal from the Special Commissioners was dismissed and their decision was affirmed. The question is whether in arriving at the amount of the profits of the Appellants' trade under Case I of Schedule D, premiums received by the Appellants from holders of fire policies in respect of insurance business, other than fire policy business, ought to be treated as receipts of the trade, or whether those premiums should be excluded as derived from mutual insurance business on the principle of decisions in this House of which *New York Life Insurance Company* v. *Styles*, 14 App. Cas. 381(1), is the leading example.

Mutual insurance business is now perfectly well known. It consists essentially in the association of a number of persons who insure each other against certain risks by contributing by way of premiums to a common fund to be used, together with further

(1) 2 T.C. 460.

(Lord Warrington of Clyffe.)

contributions if necessary, for the purpose of indemnifying any member or members who may have suffered injury in consequence of a risk insured against, any surplus being either carried forward or used to reduce future premiums as the members may determine.

It is now settled by the decisions above referred to, and is not disputed, that the mere carrying on of such a business is not a trade, nor are the surpluses profits, for the purposes of Income Tax.

In the present case certain local bodies, conceiving that through mutual insurance against fire and other risks they would be able to insure on terms more favourable to themselves than by insuring with any of the fire insurance companies, determined to associate together for that purpose and to work the business by means of a company incorporated under the Companies Acts and limited by guarantee.

On the 9th March, 1903, the Appellant Company was so incorporated, the memorandum of association being signed by eight persons, each a member or an officer of a local authority.

The first object of the Company, as expressed in the memorandum, is to enable public bodies and authorities by co-operation to insure against fire and other risks on the most favourable terms. In addition power was taken in wide terms to carry on any form of insurance business except life insurance. It was provided that the income and property of the Company, whencesoever derived, should be applied solely towards the promotion of the objects of the Company and no portion of it should be paid or transferred by way of profit to the members of the Company. Every member undertook to contribute, in the event of a winding-up, for the purposes specified in the memorandum, such amount as might be required, not exceeding £10.

Under the provisions of the articles the members of the Company are the original subscribers and such other persons as may apply for admission and be accepted by the managing trustees. It is a condition of a person becoming a member that he is insured or about to be insured either against fire risks or against employers' liability risks. In the event of a winding-up the surplus assets, if any, are divisible amongst the fire policy holders at the date of the commencement of the winding-up in proportion to the amounts of the aggregate premiums paid by them respectively upon fire policies.

Since the year 1913 the Company have, in addition to the fire insurance business, conducted on the mutual system, carried on an extensive insurance business of a miscellaneous character and particularly employers' liability business.

Considerable profits are derived from this miscellaneous business and it is admitted that in general the Appellants are liable to be assessed to Income Tax in respect of these profits, but they claim

(Lord Warrington of Clyffe.)

to be exempt in respect of any surplus arising from employers' liability or other miscellaneous business done with fire policy holders. The Commissioners and both Courts below have rejected this claim and I entirely agree.

No part of the surplus arising from the employers' liability or other miscellaneous business is paid to the assured, whether fire policy holders or not, in reduction of premiums or otherwise. In fact, in this part of the business, the principle of mutual insurance business does not prevail at all. I fail to understand how the surplus arising from any part of this business can be treated otherwise than as profits and gains under Schedule D. The fact that a surplus in a possible winding-up is divisible amongst those who happen to be fire policy holders at the time cannot, in my opinion, affect the character of the current profits.

In my opinion, the appeal must be dismissed with costs.

Lord Atkin.—My Lords, I agree with the judgments which have just been delivered and with those which are about to be delivered by my noble and learned friends, which I have had the opportunity of reading, and I have nothing to add.

Lord Thankerton.—My Lords, the Appellants were incorporated under the Companies Acts in 1903 as a company limited by guarantee and not having a capital divided into shares. Their main object was to enable local authorities and other public bodies by co-operation to insure against fire and other risks on the most favourable terms. The memorandum of association provided that no part of the Company's income and property should be paid or transferred by way of dividend, bonus or otherwise by way of profit to the members of the Company, and every member undertook in the event of winding-up to contribute such amount as might be required, not exceeding £10, for the payment of the debts and liabilities of the Company contracted before the time at which he ceased to be a member and the expenses incidental to winding-up.

The Appellants carry on (a) fire insurance business, (b) employers' liability insurance and (c) miscellaneous insurance business. It was common ground between the parties that, under the present constitution of the Company, the members of the Company are, in effect, the fire policy holders, who have the substantial control of the Company through their votes and through the trustees—forming the majority of the managing trustees—whom they appoint; upon a winding-up the fire policy holders are alone entitled to any surplus assets.

It has been conceded by the Crown that the fire insurance business done by the Appellants with the fire policy holders is mutual business and that any annual surplus arising therefrom is not profit subject to Income Tax.

(Lord Thankerton.)

On the other hand, it is not now disputed by the Appellants that employers' liability insurance business or miscellaneous insurance business done with persons other than fire policy holders is not mutual business and that profits arising therefrom are subject to Income Tax.

The question at issue in this appeal is whether the annual surplus arising from employers' liability insurance or miscellaneous insurance business done with fire policy holders forms profits and gains subject to Income Tax.

At first the Company's main business was that of fire insurance, but since 1913 a progressively increasing miscellaneous business has been undertaken; in 1918 the Company started the business of employers' liability insurance which has developed on an extensive scale. It is stated that they were exempted by the Board of Trade from the statutory deposit in respect of the latter business on satisfying the Board that their business under this head was that of mutual insurance of the members. By 1922, the annual net premiums both from the miscellaneous business and from the employers' liability business exceeded those from the fire business. At the present time about one-half of the policies issued by the Company are held by fire policy holders on the fire policy register and one-half by other persons, and about one-quarter of the total net premiums received by the Company are paid in respect of fire policies.

The accounts of the Company show that the fire policy holders alone receive progressive reductions of their premiums according to the age of their policies and, as already stated, the fire policy holders are alone interested in any surplus assets arising upon the winding-up of the Company, such surplus being divided among the holders of such policies at the commencement of the winding-up in proportion to the amounts of the aggregate premiums paid by them upon fire policies at any time effected by them with the Company.

The Appellants contended that, it being admitted that the fire policy holders in substance were the members of the Company, any business done by them with the Company, whether it was fire, employers' liability or miscellaneous, was mutual business of the same character as that which was held not to be subject to tax in *New York Life Insurance Co.* v. *Styles*, (1889) 14 App. Cas. 381[1], and that accordingly none of the business done with the fire policy holders was subject to tax. Although the New York Company issued both participating and non-participating policies, the question in that case related only to the former. Lord Watson (at page 392) describes the two classes[2]: " The company issues life policies of " two kinds, participating and non-participating; but the relations " existing between the corporation and the two classes of insured

[1] 2 T.C. 460. [2] *Ibid.* at pp. 469/70.

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" differ materially. There are no shares and no shareholders, in " the ordinary sense of the term; but each and every holder of a " participating policy becomes, *ipso facto*, a partner of the company, " with a voice in its administration, entitled to a share of its assets, " and liable for all losses and expenses incurred by it. On the other " hand, the holder of a non-participating policy is not a partner of " the company; he is a creditor merely without any interest in its " assets, and without any liability for its debts. The rate of " premiums paid for participating is different from that which " applies to non-participating policies, and is moreover not fixed, but " fluctuating." After expressing the view that incorporation did not prevent the company being regarded as an association of individuals for their mutual purposes, Lord Watson proceeds (at page 394)(1): " When a number of individuals agree to contribute " funds for a common purpose, such as the payment of annuities, " or of capital sums, to some or all of them, on the occurrence of " events certain or uncertain, and stipulate that their contributions, " so far as not required for that purpose, shall be repaid to them, I " cannot conceive why they should be regarded as traders, or why " contributions returned to them should be regarded as profits." Lord Herschell says (at page 409)(2): " Let us see how the so-" called profit arises. It is due to the premiums which the members " are required to pay being in excess of what is necessary to provide " for the requisite payments to be made upon the deaths of members, " and not being, as the case states they were intended to be, com-" mensurate therewith. This may result either from the " contributions having, from an erroneous estimate or over-caution, " been originally fixed at a higher rate than was necessary, or from " the death rate being lower than was anticipated. Can it be said " that, under these circumstances, the association of mutual insurers " has earned a profit? The members contribute for a common " object to a fund which is their common property; it turns out that " they have contributed more than is needed, and therefore more " than ought to have been contributed by them, for this object, and " accordingly their next contribution is reduced by an amount equal " to their proportion of this excess. I am at a loss to see how this " can be considered as a ' profit ' arising or accruing to them from " a trade or vocation which they carry on. It is true the alternative " is allowed to them of leaving the excess in the common fund, and " so increasing their representatives' claim upon it in case of death, " but I cannot think that this makes any difference."

Reference may also be made to *Jones* v. *South-West Lancashire Coal Owners' Association*, [1927] A.C. 827(3), which was the case of a purely mutual concern formed to indemnify its members, who were all coalowners, against liability for compensation in respect of fatal accidents to workmen in their employment. The association

(1) 2 T.C. at p. 471. (2) *Ibid.* at pp. 482/3. (3) 11 T.C. 790.

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was limited by guarantee and the funds were supplied by calls from time to time on members, the surplus in each year being carried to a reserve fund. There was provision for ascertainment and payment to a retiring member of a certain sum out of the reserve fund, but, subject to this, the funds were to remain with the company and in the event of a winding-up were to be divided among the members in the proportions prescribed. It was held that the surplus of the calls received from members over the expenditure for the year did not constitute profits liable to Income Tax. Lord Cave, the Lord Chancellor, (at page 832) says(1) : "In this case, as in the *New York* "*Life Insurance Company's* case, there are no shareholders "interested, and the whole of the yearly surplus remains to the "credit of the members, and must either be applied to meeting "their future claims or be returned to them on retirement. Sooner "or later, in meal or in malt, the whole of the company's receipts "must go back to the policy holders as a class, though not precisely "in the proportions in which they have contributed to them; and "the association does not in any true sense make a profit out of their "contributions." My learned and noble friend, Lord Dunedin, says (at page 833)(2) : "The whole case for the Crown rests on the idea "that because in a single year the premiums received exceed the "sums paid in respect of the losses in that year the balance repre-"sents a profit. It represents no such thing. It is simply a sum "of money which is carried forward in order that it may be available "to meet excessive losses in a future year, or, if it is found in the "end to be redundant, be returned to the shareholders either in the "form of reduced premiums or of cash."

My Lords, I find myself quite unable to reconcile the disposal of the surplus arising on the employers' liability and miscellaneous policies held by fire insurance policy holders in the present case with the tests of mutuality expressed in the opinions above quoted. The premiums on these policies are fixed and not fluctuating; the fire policy holders, as holders of employers' liability or miscellaneous policies, have no interest or share in any surplus arising on such policies; such surplus belongs to all the fire policy holders, irrespective of whether they hold any other policies or not. The surplus arising on employers' liability and miscellaneous policies held by fire policy holders is dealt with in exactly the same way as the surplus arising on such policies held by persons who are not fire policy holders, which is admittedly subject to Income Tax. I agree with Mr. Justice Rowlatt when he says(3) : "I cannot see the slightest "distinction between what is made out of a member in respect of "non-fire business and what is made out of a stranger in respect of "non-fire business; *qua* that business the member is a stranger.

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(1) 11 T.C. at pp. 838/9. (2) *Ibid.* at pp. 839/40.
(3) See p. 438 *ante*.

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" He is not, as a miscellaneous policy holder, getting any share in " the miscellaneous policy business."

Accordingly, I am of opinion that the appeal should be dismissed with costs.

Lord Macmillan.—My Lords, the Appellant Company carries on several branches of insurance business, classified as fire insurance, employers' liability insurance and miscellaneous. Notwithstanding its name, it is admitted that some of its business is not conducted on a mutual basis and the constitution of the Company differs in several respects from that of the ordinary mutual insurance company. In particular, its policy holders do not by the mere fact of taking out policies become members of the Company and membership is limited to the original subscribers of the memorandum of association and such persons as may be admitted on approved application in writing. The position of a member seems indeed to offer little attraction, for, apart from certain voting power, his only privilege consists of a possible liability to contribute £10 in the event of liquidation. If the contributions of policy holders yield a surplus after meeting claims the members do not benefit by it except as a protection against the remote possibility of a call under their guarantee. The actual business of the Company is conducted by a board of managing trustees. A feature of the constitution is the distinctive and predominant position accorded to the holders of fire policies, who form a privileged class by themselves. Their names are entered in a special register and, in addition to rights in the matter of voting and appointing trustees, they are entitled to have the surplus assets divided among them on a winding-up, while they and they alone benefit directly by any surplus arising in the conduct of any branch of the Company's business.

It was conceded, on behalf of the Crown, that the fire insurance business of the Company is conducted on a mutual basis and that any surplus arising therefrom is not taxable profit being " a mere " excess of contributions over immediate requirements for a mutual " purpose." The Company, on the other hand, admitted that, as regards so much of the employers' liability business and the miscellaneous business as is done with persons who are not fire policy holders, any surpluses arising are taxable profits, such surpluses not arising from business conducted on a mutual basis. But as regards employers' liability business and miscellaneous business done with fire policy holders, the Company maintains that any surpluses arising are not taxable profits inasmuch as they arise from mutual insurance business.

My Lords, the principle on which the surpluses arising in the conduct of a mutual insurance scheme are not taxable as profits is now well understood. The essence of the matter is that a number of persons who are exposed to some contingency, whether the inevitable

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contingency of death or such possible contingencies as fire, employees' claims, marine casualties or the like, associate themselves together as contributors to a common fund on the footing that if the contemplated contingency befalls any contributor he or his representatives shall receive a compensatory payment out of the common fund proportional to his contribution. The scale of contribution or premiums is fixed on experience and estimate. If it is found to yield more than enough to satisfy the claims that emerge the contributors receive the entire benefit in the shape of bonuses, reduction of future contributions or otherwise. As the common fund is composed of sums provided by the contributors out of their own moneys, any surplus arising after satisfying claims obviously remains their own money. Such a surplus resulting merely from miscalculation or unexpected immunity cannot in any sense be regarded as taxable profit. This was clearly laid down in the case of the *New York Life Insurance Company* v. *Styles*, 14 App. Cas. 381(1), and is now beyond dispute.

The cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial.

Now this cannot be predicated of the employers' liability insurance and the miscellaneous insurance business conducted by the Appellant Company. The common funds created to meet employers' liability claims and miscellaneous claims are contributed by those who have taken out policies against these risks respectively, and these contributors include both persons who have and persons who have not taken out fire policies, but the surpluses arising redound, not to the benefit of all the contributors to the common funds, but to the benefit only of those contributors who happen also to be holders of fire policies. Certain of the contributors to these common funds thus benefit at the expense of the other contributors. This is, in my opinion, sufficient to negative the contention that either the employers' liability business or the miscellaneous business of the Appellant Company is conducted on a mutual basis. That being so, I do not think it is admissible to attempt to segregate that part of the business of employers' liability insurance or of the business of miscellaneous insurance which is done with persons who happen to be also fire policy holders and to characterise that part as mutual. The benefits derived by the fire policy holders from the surpluses on employers' liability and miscellaneous business are augmented by the contributions of those who, not being fire policy holders, do not

(1) 2 T.C. 460.

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participate in these surpluses. The fire policy holders receive these benefits not in their capacity as contributors to the employers' liability and miscellaneous funds but in their capacity as fire policy holders.

I am accordingly of opinion that the contention of the Appellant Company is not well-founded, and I concur in the motion that the appeal be dismissed with costs.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and this appeal dismissed with costs.

The Contents have it.

[Solicitors :—Ridsdale & Son; Solicitor of Inland Revenue.]