HIGH COURT OF JUSTICE (CHANCERY DIVISION)—21ST, 22ND AND 24TH JULY, 1953

COURT OF APPEAL—5TH, 6TH AND 7TH JULY, 1954

HOUSE OF LORDS—19TH, 20TH AND 21ST JULY, AND 7TH NOVEMBER, 1955

Sharkey (H.M. Inspector of Taxes)

v.

Wernher[1]

Income Tax, Schedule D — Stud farm — Horses transferred to racing stables — Whether figure to be credited in stud farm accounts cost of breeding or market value.

The wife of the Respondent carried on a stud farm, the profits of which were agreed to be chargeable to Income Tax under Case I of Schedule D. She also carried on the activities of horse racing and training, which were agreed not to constitute trading. Five horses were transferred from the stud farm to the racing stables.

The cost of breeding these horses had been debited in the stud farm accounts. On the question of the amount to be credited as a receipt the Respondent contended before the Special Commissioners that the proper figure to be brought in in respect of the transferred horses was the cost of breeding. The Crown contended that the market value of the animals, which was considerably higher, was the proper figure. The Commissioners decided in favour of the Respondent and the Crown demanded a Case.

Held, *that the figure that should be credited was the market value.*

CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 19th June, 1951, Sir Harold Wernher (hereinafter called "the Respondent") appealed against an assessment to Income Tax in the estimated sum of £5,000 for the year 1949–50 under Case I of

[1] Reported (Ch. D.) [1953] Ch. 782; [1955] 3 W.L.R. 549; 97 S.J. 573; [1953] 2 All E.R. 791; 216 L.T. Jo. 419; (C.A.) [1954] Ch. 713; [1954] 3 W.L.R. 367; 98 S.J. 556; [1954] 2 All E.R. 753; 218 L.T. Jo. 80; (H.L.) [1955] 3 W.L.R. 671; 99 S.J. 793; [1955] 3 All E.R. 493; 99 S.J. 793.

Schedule D, made upon him in respect of the profits of his wife, Lady Zia Wernher (hereinafter referred to as "Lady Zia"), arising to her from a stud farm.

The facts proved or admitted before us are as hereinafter set forth.

2. Lady Zia carries on the activities of a stud farm at property known as Someries Stud and Red Lodge Stud, Newmarket. It is common ground between the parties that these activities constitute "farming" which, by virtue of Section 10 of the Finance Act, 1941, and Section 31 (1) (*a*) of the Finance Act, 1948, is to be treated as the carrying on of a trade and the profits whereof are to be charged to tax under Case I of Schedule D.

In addition, she also carries on activities of racing and training. It is common ground between the parties that these activities are not "farming" or "trading" but are purely recreational activities.

At her stud farms Lady Zia breeds horses for her racing stables, and from time to time transfers horses from her stud farms to her stables. In the year ended 31st December, 1948 (being the basic year for the year of assessment 1949–50), she transferred five horses from her stud farm to her stables. The cost of breeding these horses had been debited in the stud farm accounts, and it was common ground between the parties that, consequent upon such transfer, for Income Tax purposes some figure in respect of the transferred horses fell to be brought into the stud farm accounts as a receipt.

The market value of these horses if they had been sold was considerably in excess of their cost, and the sole ground of appeal against the assessment put forward on behalf of the Respondent was that the figure proper to be brought into the accounts as aforesaid was the cost of the transferred horses and not, as contended on behalf of the Appellant, their market value on an assumed sale.

3. At her stud farms Lady Zia keeps stallions, and, in addition to breeding horses for herself, she allows mares of other people to be brought to her stud farms to be serviced by her stallions. For these services she charges the owners fees. Although no ground of appeal in relation to this activity was put forward on behalf of the Respondent, an alternative contention with regard thereto was sought to be put forward on behalf of the Appellant, as hereinafter appearing.

4. The following documents put in evidence before us are hereto annexed, marked respectively as under, and form part of this Case[1], namely:—

"A". Statement headed "Value of horses as at 31st December, 1948", setting out particulars of the five transferred horses, and their value as shown in Lady Zia's accounts and as assessed by the Inland Revenue respectively.

"B". Accounts, consisting of balance sheet of Someries Stud at 31st December, 1948, capital account, profit and loss accounts of Someries Stud and Red Lodge Stud respectively for the year 1948, horse account for the same year and account of "Persian Gulf Syndicate".

5. In amplification of the facts shortly summarised in paragraphs 2 and 3 above, we refer to paragraphs 3 to 15 of the Case stated by the Special Commissioners in the appeal of *Lady Zia Wernher* v. *Commissioners of Inland Revenue*, 29 T.C. 20, at pages 21 to 25. It was agreed between the parties at the hearing before us that the facts as stated in these paragraphs

[1] Not included in the present print.

are equally applicable to the year involved in the present appeal, with the following additions, namely:—

As regards paragraph 9, the numbers of the stock of horses owned by Lady Zia at the end of each of the years 1947 and 1948 were as follows:—

	1947	1948
Stallions	2	2
Teaser	1	0
Brood mares	8	9
Yearlings	6	1
Foals	0	3

As regards paragraph 10, the numbers of the services of Lady Zia's stallions to her own mares and to visiting mares (i.e., those of other owners) for the years 1947 and 1948, and the fees received by her in respect of services to visiting mares, were as follows:—

	1947 Precipitation	1948 Casanova
Services to own mares ...	2	0
Services to visiting mares ...	39	24
Fees	£15,540	£3,552

As regards paragraph 11, in the year 1948 Lady Zia made two purchases of bloodstock. There were no sales.

6. Mr. A. W. Britton Harvey, a certified accountant, spoke to the accounts exhibited, and also testified that the facts set out in paragraphs 3 to 15 of the said Case referred to in paragraph 5 hereof were still correct (with the additions aforesaid).

In cross-examination on behalf of the Appellant, he further testified that at the beginning of the year 1948 there were 8 brood mares. 2 were purchased during the year from Boussac. One of the 10 died, leaving 9. During the five years 1944 to 1948 20 foals were born at the stud. 2 of these were transferred to Lady Zia's daughter, Mrs. Phillips. 11 were transferred to Lady Zia's racing and training stables and 3 were sold, leaving 4 at the end of the period. 2 were sold in 1947 as yearlings for £1,200, which was quite an average price. They had not raced. He did not know why Lady Zia sold them. She bred to sell as well as to race. He did not admit the suggestion put to him that she bred primarily to race. Paragraph 8 of the said Case accurately represented the facts as prevailing in 1948.

7. It was contended on behalf of the Respondent that:—

(*a*) the reasoning of the Court of Appeal in *Laycock* v. *Freeman, Hardy & Willis, Ltd.*, 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C. 414, established that there could not be a sale from a person to himself giving rise to a taxable profit;

(*b*) the decision in the case of *Watson Bros.* v. *Hornby*, 24 T.C. 506, relied on by the Appellant, was distinguishable or, in the alternative, was irreconcilable with the reasoning of the Court of Appeal in the two cases above mentioned and should not be followed;

(*c*) there being no sale in the present case the figure proper to be brought into the accounts in respect of the transferred horses was not their market value on an assumed sale but their cost.

8. It was contended on behalf of the Appellant that :—

(*a*) the present case was indistinguishable in principle from *Watson Bros.* v. *Hornby*(1) and, on the authority of that case, the figure proper to be brought into the accounts in respect of the transferred horses was their market value, namely, the price which they would have fetched if they had then been sold ;

(*b*) in the alternative, even if the figure proper to be brought in was that of cost, the figure of £1,888 credited as cost in the accounts was wholly inadequate. In particular, the figure of "cost" to be brought in should include not merely a proportion of overhead charges, but the total cost of the general activity of breeding at the farm for Lady Zia's own stables ;

(*c*) in the further alternative, Lady Zia's activity of letting out the services of stallions at the stud farm for fees was separable from the general activity of breeding at the farm for her own stables, this latter activity was a recreational one, not attracting liability to tax, and consequently no profit or loss arising out of the breeding at the farm for her own stables fell to be taken into account in the assessment to Income Tax.

9. In reply to the further alternative contention of the Appellant set out in paragraph 8 (*c*) above, it was contended on behalf of the Respondent that it was not open to the Appellant to raise this contention, and, in any event, it was bad in law.

10. We, the Commissioners who heard the appeal, were of opinion that :—

(*a*) the facts of *Watson Bros.* v. *Hornby* were distinguishable, in that in that case there were, for Income Tax purposes, two businesses, namely, a farm (then assessed under Schedule B) and a hatchery (assessed under Schedule D) and stock was transferred from the hatchery to the farm and became stock-in-trade of the latter. In the present case, the horses were simply taken out of the stock of Lady Zia's stud farm and did not become stock-in-trade of any other business ;

(*b*) the horses were not sold or otherwise disposed of by way of trade, but simply taken out of the stud farm stock as aforesaid, and in these circumstances the reasoning of the Court of Appeal in *Laycock* v. *Freeman, Hardy & Willis, Ltd.*(2) and *Briton Ferry Steel Co., Ltd.* v. *Barry*(3), rendered it inadmissible to postulate a notional sale, so as to assume a notional profit which had never in fact been realised ;

(*c*) the effect of bringing into the accounts the market value figure would be to assume a profit which had not been realised, and the proper course, therefore, was to bring into credit, not the market value, but the relative figures of "cost", with the effect of eliminating from the accounts the cost of the horses charged therein.

We accordingly allowed the Respondent's appeal in principle.

We gave no decision on the Appellant's first alternative contention, being of opinion that the materials before us were insufficient to enable us to do so, but we left the figures of cost to be agreed between the parties, on the understanding that, in the event of failure to agree, the appeal would be re-listed for us to hear further evidence and argument.

(1) 24 T.C. 506. (2) 22 T.C. 288. (3) 23 T.C. 414.

As regards the Appellant's further alternative contention (namely, that set out in paragraph 8 (*c*) above) we had some doubt whether it was open to the Appellant to raise this by way of an alternative as distinct from a primary contention, and even if it was, we were not satisfied that the contention had been shewn to be good in law. We accordingly rejected it.

The parties having subsequently agreed that, on the basis of our decision as above, there were no assessable profits, we discharged the assessment.

11. The Appellant immediately after the determination of the appeal declared to us his 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 (now replaced by the Income Tax Act, 1952, Section 64), which Case we have stated and do sign accordingly.

The question of law for the opinion of the Court is whether our decision, as set out in paragraph 10 above, is erroneous in point of law.

F. N. D. Preston,
Norman F. Rowe, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94-99, High Holborn,
London, W.C.1.

5th July, 1952.

The case came before Vaisey, J., in the Chancery Division on 21st and 22nd July, 1953, when judgment was reserved. On 24th July, 1953, judgment was given in favour of the Crown, with costs.

The Solicitor-General (Sir Reginald Manningham-Buller, Q.C.) and Sir Reginald Hills appeared as Counsel for the Crown, and Mr. Frederick Grant, Q.C., Mr. John Senter, Q.C., and Mr. Peter Rowland for the taxpayer.

Vaisey, J.—This is an appeal by the Crown from a decision of the Special Commissioners discharging an assessment to Income Tax in the estimated sum of £5,000 for the year 1949–50 on the Respondent, Sir Harold Wernher. The assessment was made in respect of the profits of the Respondent's wife, Lady Zia Wernher, arising from a stud farm.

Lady Zia carries on the activities of a stud farm on certain premises at Newmarket, and those activities, that is to say the whole of such activities, are admitted, for the purposes of the present appeal, to be "farming" activities, which by virtue of Section 10 of the Finance Act, 1941, and Section 31 (1) (*a*) of the Finance Act, 1948, are to be treated as the carrying on of a trade of which the profits are charged to tax under Case I of Schedule D. She also carries on separately other activities, namely, those of racing and training horses; such activities are neither farming nor any other kind of trading but are purely recreational in character, not giving rise to any liability to tax.

Lady Zia breeds horses at her stud farms for her racing stables, and from time to time transfers, or moves, horses from the farms to the stables. In the relevant year five horses were so transferred or moved by her. In the stud farm accounts the cost of breeding these horses had been debited, and the question is what sum in respect of the five horses ought, consequent upon such transfer or move, to be brought into such accounts as a receipt or credit.

(Vaisey, J.)

The Respondent says that the proper figure to be so brought into the accounts was the cost of breeding the transferred horses, the same figure appearing on both sides of the accounts, or, alternatively, omitted altogether. The Crown, on the other hand, contends that it should be the market value of the animals, namely, the price which they would have fetched on an assumed or notional sale, such value being considerably more than the cost of breeding them.

My decision in this case is based on the fact that it is, in my judgment, indistinguishable in principle from an earlier decision, namely, that of Macnaghten, J., in *Watson Bros.* v. *Hornby*, 24 T.C. 506. Mr. Grant, for the Respondent, now admits this, but contends that case ought not to be followed on the grounds (1) that it was plainly wrong, and (2) that it was irreconcilable with the decisions of the Court of Appeal in *Laycock* v. *Freeman, Hardy & Willis, Ltd.*, 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C. 414. I am not altogether satisfied on either point, but taking the second one first it seems to me that the statements in the two Appeal Court cases upon which Mr. Grant relies (to which I will refer in a moment) ought not necessarily to be treated as axiomatic, but rather as being of general though not universal application. Those two cases both dealt with the question of succession to discontinued businesses, and there is no doubt that the judgments in each case were based on the general principle that it is not legitimate to charge a man with the notional profits of a notional sale made or assumed to be made by himself to himself. In the *Briton Ferry* case, at page 430 of the report, Sir Wilfrid Greene, M.R., said:

> "It is not legitimate, in my view, to apply the Sub-rule . . ."

—that is Rule 11 (2) of Schedule D, Cases I and II—

> ". . . in such a way as to introduce some element of notional profit with the result of charging the taxpayer in respect of a profit which he has never realised."

I turn at once to the case which, in my view, governs the present case. I will read the headnote.

> "The Appellants carried on the business of poultry breeders and dealers. In addition to keeping birds on their farm for laying purposes, they had a hatchery which produced chicks primarily for sale as 'day-old chicks', although some were transferred to brooder houses and became part of the stock on the farm. In accordance with the decision in *Thornber Bros., Ltd.* v. *Macinnes.* 21 T.C. 221, the Appellants were assessed to Income Tax for the years 1931–32 to 1934–35 under Schedule D in respect of the profits of the hatchery part of their business, and under Schedule B in respect of the profits of the farm.
>
> On appeal against the assessment under Schedule D, the Appellants contended that, in computing the profits of the hatchery, the day-old chicks transferred to the farm should be credited as stock at the average price at which they were sold, and could have been bought, in open market, viz., 4*d.* per chick, and that the difference between that price and the admitted cost of production of each saleable day-old chick, 7*d.*, was an allowable loss. The Crown contended that the hatchery and the farm were two activities of the same person who could not make a loss by transferring from one department to the other; that no allowance could be given for an unrealized loss, and that the chicks should be credited to the hatchery account at production cost. The General Commissioners accepted the Crown's contention.
>
> *Held*, that in the notional sale between the hatchery and the farm, which should be treated for this purpose as separate entities, the price to be credited was the 'reasonable price' laid down by Section 8 of the Sale of Goods Act, 1893, and that on the admitted evidence this reasonable price must be the market price of 4*d.* per chick."

Note that the decision was (1) that a notional sale must be assumed between the two businesses of Messrs. Watson Bros., and (2) that the two businesses must be treated for the purpose of the notional sale as separate entities.

Obviously that decision could not be reconciled with the two cases in the Court of Appeal if the proposition upon which those cases were based is universally and in all circumstances valid. The Commissioners thought that the decision was distinguishable on the following ground, viz., that

> "in that case, there were, for Income Tax purposes, two businesses, namely, a farm (then assessed under Schedule B) and a hatchery (assessed under Schedule D) and stock was transferred from the hatchery to the farm and became stock-in-trade of the latter."

They add:

> "In the present case, the horses were simply taken out of the stock of Lady Zia's stud farm and did not become stock-in-trade of any other business".

With respect, I cannot see that this is a true distinction. The justification for departing in *Watson Bros.* v. *Hornby*(1) from the general principle that a man cannot trade with himself, buy from himself, sell to himself, and make notional profits out of himself, was obviously this: that the Income Tax Act itself had, by splitting the personality of the taxpayer, and putting the two parts of him into different Schedules, made such a notional dichotomy inevitable. If that is the explanation, I cannot see why a similar consequence should not follow from the splitting of Lady Zia's activities between farming which is taxable and racing which is not. I am by no means convinced that *Watson Bros.* v. *Hornby* was wrongly decided, and I think that it is my duty to follow it.

I was very much impressed by Mr. Grant's arguments, and apart from authority I might well have accepted them, though the point is, on any view of the matter, a doubtful and difficult one.

It is not necessary for me to refer in detail to the other cases to which my attention was directed. The Crown's contentions are supported by the authority of *Commissioners of Inland Revenue* v. *William Ransom & Son, Ltd.*, 12 T.C. 21. On the general principle that the notion of a man trading with himself is not an admissible conception, see *Dublin Corporation* v. *M'Adam*, 2 T.C. 387. From the judgment in that case I may quote what Palles, C.B., said at page 397 of the report:

> "No man, in my opinion, can trade with himself; he cannot, in my opinion, make, in what is its true sense or meaning, taxable profit by dealing with himself".

This principle is unexceptionable in itself, but the Legislature itself has, in my view, made inevitable some invasion of it. I must allow this appeal.

There was a further point raised in the case, but that was withdrawn, for the purpose of this case only, for the reason that some doubt was felt as to whether it could be raised here consistently with certain of the admissions made before the Commissioners.

Sir Reginald Hills.—The appeal will be allowed, with costs? The case must be remitted, I submit, to the Commissioners to adjust the assessment (which was an estimated one) in accordance with your Lordship's judgment. Your Lordship sees that the amount of the market value was never gone into by them.

Vaisey, J.—That is quite right.

Sir Reginald Hills.—It will have to be now.

Vaisey, J.—The Order will be in the terms you mention.

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(1) 24 T.C. 506.

The taxpayer having appealed against the above decision, the case came before the Court of Appeal (Sir Raymond Evershed, M.R., and Jenkins and Hodson, L.JJ.) on 5th, 6th and 7th July, 1954, when judgment was given unanimously against the Crown, with costs.

Mr. L. C. Graham-Dixon, Q.C., Mr. John Senter, Q.C., and Mr. Peter Rowland appeared as Counsel for the taxpayer, and the Solicitor-General (Sir Reginald Manningham-Buller, Q.C.) and Sir Reginald Hills for the Crown.

Sir Raymond Evershed, M.R.—The question in this case relates to the liability of the Appellant, Sir Harold Wernher, for Income Tax for the year 1949-50 in respect of an enterprise carried on by his wife—Lady Zia Wernher—namely, a stud farm. No issue of fact arises in this case; that is to say, it cannot be said that the matter depends upon a finding of fact by the Special Commissioners. The question is a short one and is a question of law, which may be stated thus: In the accounts of the farm for the year in question, which accounts are exhibited to the Case Stated and which are assumed to be the basis of assessment, what figure should be set against certain colts and fillies transferred (to use the word used in the Case Stated) or moved during the year out of and away from the stud farm for Lady Zia's own racing purposes? Should it be the figure which represents the cost of these animals up to the date of their movement? Or should it be their market value, that is to say, the sum which they would have fetched if sold in the ordinary course on the date of transfer? The Special Commissioners were of opinion that the former was the proper figure. Vaisey, J., regarding himself as bound by the decision in *Watson Bros.* v. *Hornby*, 24 T.C. 506, concluded for the latter view.

The facts are set out or referred to in the Case Stated, and I can briefly summarise them thus: The stud farm, known as Someries, was a farm where Lady Zia carried on the enterprise of breeding racehorses. For this purpose she maintained at the farm a number of stallions and brood mares, from which she raised young stock, some of which she sold.' In one or two instances she gave the animals to her daughter; in other cases—and this is the most significant fact for present purposes—the young colts and fillies were transferred (I use again the word used in the Case Stated) altogether from the stud farm to be trained and used by Lady Zia for racing. In the year in question five such colts and fillies were so moved from the stud farm.

For the purposes of this case certain concessions were made on the part of the Appellant and the Crown, which I must state. First, it was agreed that the enterprise of the Someries stud farm was husbandry, and therefore fell, by virtue of the joint effect of Section 10 of the Finance Act, 1941, Section 28 of the Finance Act, 1942, and Section 31 of the Finance Act, 1948, to be taxed under Case I of Schedule D. It is, I think, not out of place to refer to the relevant language of that part of the Act. Paragraph 1 of Schedule D reads:

> "Tax under this Schedule shall be charged in respect of—(*a*) The annual profits or gains arising or accruing . . . (ii) to any person residing in the United Kingdom . . . from any trade, profession, employment, or vocation".

Paragraph 2 reads:

> "Tax under this Schedule shall be charged under the following cases respectively; that is to say,—Case I.—Tax in respect of any trade not contained in any other Schedule".

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Secondly, it was agreed that Lady Zia's racing enterprises were purely recreational and, therefore, that she was not taxable in respect of any profits or gains which she might make thereout. Thirdly, it was agreed that the five colts and fillies moved or transferred from the farm during the year in question must be treated as having left the farm as completely and effectually for all purposes as if they had been sold outright or as if, indeed, they had died or had been destroyed. I emphasise the third point of concession because I must not be taken, in the course of this judgment, to be indicating any opinion on what the position might be for tax purposes if any of these animals had been or were thereafter sold or transferred or moved back to the farm. It will be seen that Lady Zia, at all relevant dates, was pursuing two distinct activities, both concerned with racehorses, namely, (1) the taxable business of the stud farm, and (2) the non-taxable activity of racing horses. The question we have to decide concerns the movement of an item of property or stock from the scope of one activity to the scope of the other.

I now turn to the accounts, which I have mentioned, and which consist of a balance sheet, capital account, profit and loss account, and horse account. On the left-hand side of the horse account appear, by name, the various animals—stallions, brood mares and young stock—which, at the beginning of the year covered by the accounts, formed the stock of the stud farm. The first item is the stallion "Precipitation", against which appears the figure of £40,000, representing (I take it) its value at the beginning of the year. Under the heading "Yearlings" appear, amongst others, the five colts and fillies with which we are concerned. I take one to illustrate them all. A chestnut colt, by "Hyperion" out of "Doubleton", appears at the opening of the account with the figure of £572 12*s.* against it. That figure represents, as I understand, the cost to Lady Zia of that colt up to 1st January, 1948. At the end of the account on the left-hand side is a reference to certain other animals bred during the year, which appear with no figure against them because they were non-existent at the opening of the year.

Then, on the right-hand side, appear the animals in existence and forming the stock at the close of the accounting period. The account opens again with the stallion "Precipitation", which, I take it, at this date was ageing, because its value is shown there at the reduced sum of £30,000. Going down the page to the animals with which we are concerned, which appear under the heading "Animals transferred to training", the chestnut colt I have mentioned, by "Hyperion" out of "Doubleton", appears with the figure of £692 against it, the difference between that and the former figure representing the added cost or expenditure on the animal from 1st January up to the period of its movement from the stud farm. In order to illustrate the nature of the amount involved in this dispute there also appears in the account, set against this young animal, a further figure of £3,900, that being, for the purposes of this argument, the figure which should appear against the colt if its market value were appropriate to be there inserted.

Upon the accounts as they stood, the total of the figures on the right-hand side—that is, the value of the stock at the close of the period—was less than that of the corresponding figures at the beginning of the period, by the sum of £16,373. That balance figure is then brought into the profit and loss account. I do not wish to take up too much time on these figures, but a word or two is not out of place on the profit and

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loss account. That really consists of two parts. The first part, on the left-hand side, consists of the various items of expenditure in the ordinary course—wages, forage, horse keep, veterinary charges and so forth, including rates, telephone and the usual expenses of any industry or enterprise. On the right-hand side the main item consists of service fees, and it is a fact that in addition to breeding horses on the farm the stallions—and particularly the stallion "Precipitation"—were made use of by serving mares belonging to other owners, for which services fees were received. In the year in question "Precipitation" earned £15,540 in this way.

So far, the service fees and other receipts exceed the wages, upkeep and so forth, by £4,851. There is, however, then brought in the adverse balance on horse account and certain other items—"Reserve for Taxation" and so on—so that, in the end, for the year in question there is shown an adverse balance, transferred to capital account, of £10,423. Again, so that the figures involved may be borne in mind, if there had been substituted for the cost figures on the right-hand side of the horse account the valuation figures, the adverse balance on the horse account would have been reduced by approximately £7,000, and the adverse balance on the profit and loss account would likewise have been reduced by that figure, or thereabouts.

I have now stated sufficiently the facts and the figures, and I can restate the question for our determination. The five colts and fillies which I have mentioned were part of the farm stock at the beginning of the period covered by the account. They had been bred, not bought. It was a principal object of the farm so to breed them. They had been brought into the horse account at figures representing their cost up to the beginning of the accounting period. Having been moved out of the stock before the end of the accounting year, some corresponding figure, admittedly, has to be placed on the right-hand side of the appropriate account. What figure? Should it be the cost figure up to the date of removal or the market value?

The argument of the Crown, in a sentence, is this: Since the stud farm is a business and, moreover, is a business largely or substantially carried on for the purpose of providing Lady Zia with racehorses, in order to form a realistic view of the result of the business carried on, in fact the relevant figure should be the true value of the stock produced and disposed of, that is to say, the market value. The Solicitor-General denies that he is seeking to introduce any imaginary sale. It is, he says, a matter of properly valuing the animals, and that their proper and true value is their market value.

On the other hand, it is said by Mr. Graham-Dixon that whatever might for one purpose or another have been the true value of these young horses, in fact, and as a matter of business, such value was never realised, any more than it would have been realised if the animals had been given away by Lady Zia to her daughter or to some third party. The animals were and remained, at all relevant dates before and after the removal from the farm, Lady Zia's own horses, with which she could do exactly what she liked. To take one of the many examples cited—a professional grower of roses could plant one of his own roses for his own enjoyment in his own garden. In these circumstances, says the Appellant, to take for the purpose in question the market value is inevitably to suppose that which never occurred, and to create a non-existent item of receipt solely for the purpose of taxation.

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If this matter were *res integra,* I think that as a matter of common sense there would be much to be said for the Solicitor-General's view that since, for the purpose of this horse account, you are seeking to put a value on these animals, the value is that which they are in fact worth. But this matter is not *res integra* and my view, as a result of considering the authorities which expound the general principle proper to be applied, is that we should decide this matter for the Appellant.

As I have said, Vaisey, J., took the view that he was bound by the decision in *Watson Bros.* v. *Hornby*(1). In his judgment he said(2):

> "My decision in this case is based on the fact that it is, in my judgment, indistinguishable in principle from an earlier decision, namely, that of Macnaghten, J., in *Watson Bros.* v. *Hornby,* 24 T.C. 506. Mr. Grant for the Respondent now admits this, but contends that case ought not to be followed on the grounds (1) that it was plainly wrong, and (2) that it was irreconcilable with the decisions of the Court of Appeal in *Laycock* v. *Freeman, Hardy & Willis, Ltd.,* 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry,* 23 T.C. 414. I am not altogether satisfied on either point, but taking the second one first it seems to me that the statements in the two Appeal Court cases upon which Mr. Grant relies (to which I will refer in a moment) ought not necessarily to be treated as axiomatic, but rather as being of general though not universal application. Those two cases both dealt with the question of succession to discontinued businesses, and there is no doubt that the judgments in each case were based on the general principle that it is not legitimate to charge a man with the notional profits of a notional sale made or assumed to be made by himself to himself."

The learned Judge then referred to the *Briton Ferry* case and to the *Watson Bros.* v. *Hornby* case. He rejects the alleged distinction between the present case and that of *Watson Bros.* v. *Hornby* and concludes thus(3):

> "The justification for departing in *Watson Bros.* v. *Hornby* from the general principle that a man cannot trade with himself, buy from himself, sell to himself, and make notional profits out of himself, was obviously this: that the Income Tax Act itself had, by splitting the personality of the taxpayer, and putting the two parts of him into different Schedules, made such a notional dichotomy inevitable. If that is the explanation, I cannot see why a similar consequence should not follow from the splitting of Lady Zia's activities between farming which is taxable and racing which is not. I am by no means convinced that *Watson Bros.* v. *Hornby* was wrongly decided, and I think that it is my duty to follow it."

I shall, therefore, first turn to the case of *Watson Bros.* v. *Hornby,* for I agree with Vaisey, J., that this case is really indistinguishable from it. It is therefore necessary for us to express a view whether that case was rightly decided, whether it was in accordance with the principle as that principle was expounded in the Court of Appeal cases referred to by Vaisey, J., and particularly the latter of them, the *Briton Ferry* case. In *Watson Bros.* v. *Hornby* the matter arose because the taxpayer was carrying on two enterprises, one of which fell to be taxed under Schedule B and another under Schedule D. The Schedule B enterprise was that of a poultry farm and the Schedule D enterprise that of a hatchery. The number of chicks hatched during a year in the hatchery was remarkably large—no less than 900,000—but it appeared that at the date in question the trade was such that the cost of hatching these chicks for the most part greatly exceeded their market value. Put in figures, the market value of a day-old chick was 4*d.*, and the cost of its production was 7*d.*

(1) 24 T.C. 506. (2) *See* page 280 *ante.* (3) *See* page 281 *ante.*

(Sir Raymond Evershed, M.R.)

As regards those chicks which the taxpayer chose to transfer from his hatchery to his own farm for brood purposes, the question was, should he be bound to credit himself in his accounts for the purposes of his hatchery business with the market value of 4*d.* or the cost figure of 7*d.* per chick? To make the parallel with the present case clear, it is as though the day-old chicks transferred from the hatchery were the fillies and colts transferred from the stud farm. It was contended by the Crown that the proper sum to be put in as representing the chicks transferred to the farm was the cost figure of 7*d.* per chick and not the market value of 4*d.* Thus, it was contended on behalf of the Inland Revenue as follows: The hatchery and the farm are two activities of the same person. He cannot trade with himself or make a loss by transferring from one department to another. The credit of 4*d.* was, in effect, a writing-off of the unrealised loss of 3*d.* per chick, which could be arrived at only by treating the appellant as trading with himself and by writing off a loss not actually incurred, and the correct valuation was 7*d.*, the admitted cost of production. It will be seen that, if the Crown's argument is correct, the putting of 7*d.* into the right-hand side of the hatchery account very substantially decreases the loss of the hatchery business or increases its profits, as the case may be.

The appellants, however, succeeded, the learned Judge holding that in that case the proper sum to be placed in the account as representing the value of each chick transferred was its market value of 4*d.* The matter was expressed by Macnaghten, J., in the following terms on page 509 of 24 T.C.:

> "The question now before the Court is: What is the price at which the chicks should be deemed to have been bought by the farm from the hatchery? The Appellants are the proprietors of both the hatchery and the farm and it is said that a person cannot trade with himself. That, no doubt, is quite true; but for the present purpose it is, I think, necessary to regard the hatchery and the farm as separate entities. Where one person buys goods from another but the contract of sale does not specify the price to be paid, the contract is, nevertheless, valid and enforceable. The law provided that the purchaser must pay a reasonable price."

And, as the learned Judge pointed out, the reasonable price is now determined by applying the Sale of Goods Act. I confess that there seems to me to be a certain unreality in introducing the Sale of Goods Act in a matter concerning the notional sale by a man to himself, and the Solicitor-General has made it plain in this case that he is not saying that there was a notional sale. The question, however, is whether, on his analysis, he can avoid it. Whatever may be the argument here, it is not in doubt that Macnaghten, J., did decide *Watson Bros.* v. *Hornby*[1] on the footing that he must treat the taxpayer as having sold from himself, as a hatchery owner, to himself, as a farmer.

It will be noted that in that case, as in the present one, there were two enterprises or activities. It is true that in that case both enterprises were liable to be taxed, though they were taxable under different Schedules. But, as the Solicitor-General himself accepted, it is not relevant or conclusive that the enterprises or activities, if there are more than one, should be taxable. In that case, as in this, the question was: At what figure should an item of property belonging to the owner of both enterprises be entered in the accounts when it is transferred from one to the other?

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(1) 24 T.C. 506.

(Sir Raymond Evershed, M.R.)

One other matter must be noted. So far as the report shows, the two Court of Appeal cases, *Laycock* v. *Freeman, Hardy & Willis*(1) and *Briton Ferry Steel Co., Ltd.* v. *Barry*(2), were not cited to Macnaghten, J., though it would appear to be plain that the argument of the Inland Revenue, which I have read, would have been substantially supported by at least a citation of the latter of those cases. It is, however, now said by the Solicitor-General that the argument put forward by the Inland Revenue in *Watson Bros.* v. *Hornby*(3) is no longer accepted by the Inland Revenue as correct. The argument of the Crown in this case involves necessarily a denial of the correctness of their earlier argument.

Before I pass to the two Appeal Court cases I should make a brief reference to *Commissioners of Inland Revenue* v. *William Ransom & Son, Ltd.*, 12 T.C. 21. In some respects there is no doubt that that case shows a close analogy to the present one. The taxpayer carried on the activities of a herb grower and a manufacturer of chemicals from those herbs. He had been taxed in respect of these activities without distinguishing between them, that is, on the footing that they all formed part of a single business enterprise. The taxpayer claimed, and claimed successfully, that the two parts of his enterprise should be treated as distinct. His point in so claiming was that the herb growing activities, being a kind of husbandry, did not attract Excess Profits Duty. As an incident to the decision of the case, memoranda were produced in which had been recorded the market values or prices of the herbs transferred from the herb growing part of the taxpayer's enterprises to the factory. It was therefore suggested before us that the facts in *Ransom's* case supported the view that the market value—or, in other words, the true value in a commercial sense—was the right value to enter for accounting purposes for assets transferred from one kind of a taxpayer's activities to another.

In my judgment, the case does not really provide any authority for that view, because the question of the right amount was never in issue. It was never debated; indeed, in the course of the judgment of Sankey, J., I find this language (at page 27):

> "Upon the other side of the account there is set out the stocks in hand on 31st December together with three other items, the first of which is the produce which is sold to the factory amounting to £276; the second is produce sold generally to the public . . ."

That, I think, shows that the matter can never have been really debated or considered, because there never was any sale from the farm to the chemical factory; and, as I have more than once stated, the Solicitor-General is not here contending that there was any sale of these colts and fillies by Lady Zia to herself.

I come, then, to the first of the two Appeal Court cases—*Laycock* v. *Freeman, Hardy & Willis*. Mr. Graham-Dixon relied upon a number of passages from the judgment of Sir Wilfrid Greene, M.R., as expounding the general principle upon which he founds his argument, namely, that you are taxed on profits that are actual and not imaginary. I agree on the whole with the Solicitor-General that this case, though containing expressions of general utility, is not conclusive or decisive in the present instance. Messrs. Freeman, Hardy & Willis were retailers of boots and shoes. They had, up to a date in 1935, wholly owned and controlled separate entities which manufactured large numbers of boots and shoes, sold later by them in their shops.

(1) 22 T.C. 288. (2) 23 T.C. 414. (3) 24 T.C. 506.

(Sir Raymond Evershed, M.R.)

So long as the manufacturing businesses were separate entities, even though they were controlled by the retail company, the transfer of boots and shoes from the manufacturing business to the retail business took the form, inevitably, of a sale, notwithstanding the fact that the prices might well be controlled by the retail buyer. Then, on the date I have mentioned, the whole business of the company was reorganised. The manufacturing businesses were put into liquidation and the retail business acquired the assets and the undertaking of the manufacturers so that thenceforward they were not two entities but one single enterprise of the manufacture and sale to the public of boots and shoes.

The question involved in the case was concerned with the "succession" to what was described as the manufacturing business; and the Court held that Messrs. Freeman, Hardy & Willis were a single entity, which both manufactured and sold shoes; that the activity of manufacture was not of itself a profit-making business; and therefore that there was no ground for suggesting that some notional figure must be ascribed to the manufacturing activities as though they had formed a separate business selling to the retail house.

On the other hand, I have come to the conclusion that in the *Briton Ferry* case, 23 T.C. 414, the principles which ought to be here applied were stated in a form which inevitably applies to and covers the present case. In a sense, it was the converse of the *Freeman, Hardy & Willis*[1] case because the Briton Ferry Steel Co., Ltd., which had at one time sold its manufactured products, namely, steel bars, to subsidiary companies which made tinplate, put the tinplate companies into liquidation and acquired their businesses and made the tinplate manufacturing business a branch of its own undertaking. For the sake of simplicity I will assume that there was but one tinplate business. After the amalgamation and reconstruction, therefore, the situation was this. The Briton Ferry Steel Co., Ltd., carried on two enterprises or activities. One was the manufacture of steel bars from raw materials and the other was the manufacture of tinplate from the steel bars, which for such purpose became the primary product.

It is true that the case was concerned with "succession" for Income Tax purposes; but the question debated—the passage relating to which I shall read—was, at what figure, for the purposes of the tinplate business, ought the manufactured raw material of steel bars to be brought into account? I think, therefore, that the analogy is close. If the business of steel bars is treated as the stud farm, then the steel bars become the colts and the fillies. It is true, as I have said, that the racing enterprise does not happen itself to be taxable, but it is also true that that fact itself, as I understand the Solicitor-General, is not relevant. If the question is, "At what figure for the purposes of the racing activity ought the colts and fillies"—that is, the steel bars—"to be brought into account?" then, inevitably, that same figure must be the figure at which those same colts and fillies—that is, the same steel bars—should be shown as having left the stud farm—that is, the steel bar manufacturing business.

The passage which seems to me to state the principle involved and, as I have earlier indicated, to require us to conclude this case in the Appellant's favour, begins on page 434. Sir Wilfrid Greene, M.R., said:

> "The problem, therefore, is to arrive at the taxpayer's profit in accordance with the Section, and anything in the shape of a notional sale must be rejected if that would involve ascribing to the taxpayer a profit which he has never earned."

(1) 22 T.C. 288.

Then, at the bottom of the page, he goes on:

> "The solution, in my judgment, is along different lines. It seems to me that the business acquired may properly, for the purposes of the Sub-rule, be treated, and should be treated, as beginning at the steel bar stage, namely, the stage when those branches of the business procure for themselves a steel bar Obviously in order to arrive at profits of those branches of the business on that basis, some figure must be brought into account to represent the cost of the steel bar. If that figure is based on an imaginary sale price at a profit, it is an unreal figure. If, on the other hand, it is brought in at the actual cost of producing that steel bar, it is a real figure; and treating—as we are bound by the Rule to do—the two parts of what is in truth one business as though they were held apart, the only way in which, in my judgment, that direction can logically be carried out is the way that I have indicated, of bringing in the raw material, namely, the steel bar, at the actual cost of production."

The present is a case, as it seems to me, in which we are bound (to use the language of Sir Wilfrid Greene, M.R.) to treat as consisting of two parts what is in fact one thing, that is to say, we are bound to treat as divided into two Lady Zia Wernher's activities in connection with racehorses, part one being the stud farm and part two being her racing activities. As I have already said many times, it seems to me irrelevant that what in the *Briton Ferry* case[1] was being considered was what I would call the entry figure for the moved item when it arrived in the second part of the total of the activities. The same figure must equally have been applied to the removal figure of the same item when it went from the first part of the total activities. That being so, if there were substituted for steel bars the words "colts and fillies" it seems to me that the language of the *Briton Ferry* case must apply in this case. That case states a principle which I think it is our duty to apply, namely, that for the purpose in hand, there being an artificial division imposed by Parliament on the total of the activities of a single individual, we must bring or insert into the horse account a real figure and not an unreal figure.

It follows from what I have said that, in my judgment, the principle stated and the reasoning underlying the judgment of Sir Wilfrid Greene, M.R., in the *Briton Ferry* case are inconsistent with the conclusion in *Watson Bros.* v. *Hornby*[2], and, therefore, inconsistent with the conclusion of Vaisey, J., which followed that case. A number of other cases were cited and instances given in the course of argument, but I do not think it is necessary to refer to them. They, I think, add nothing to the reasons which I have attempted to state. For those reasons I think this appeal must be allowed.

Jenkins, L.J.—I agree. Lady Zia Wernher carries on a stud farm. That is an activity which, for Income Tax purposes, is classed as husbandry and, as the law now stands, husbandry is taxable under Case I of Schedule D as a trade and not, as formerly, on an annual value basis, under Schedule B. Lady Zia also indulges in the sport of racing and for that purpose she carries on a racing stable where horses are trained and entered for races. It is common ground that this is an activity in respect of the profits of which, if any accrue, no tax is exigible.

Lady Zia sells some of the produce of her stud farm from time to time, and she also uses her stallions for the purpose of serving, for fees, mares brought in by other owners, but it is clear that the main purpose for which she conducts her stud farm is to supply suitable horses to her racing stable.

(1) 23 T.C. 414. (2) 24 T.C. 506.

(Jenkins, L.J.)

In the year material to this case, that is to say, the year ending on 31st December, 1948, Lady Zia transferred or moved five yearling horses to her racing stable. It is common ground that inasmuch as these horses have been withdrawn from the stock-in-trade of the stud farm business it is necessary, according to proper principles of accountancy, to credit the accounts of that business with some figure in respect of the stock so withdrawn. The matter in dispute is as to the appropriate figure. Mr. Graham-Dixon, for the Appellant, claims that the proper figure is the cost of breeding these horses—the cost being the figure at which they were carried in the books of the stud farm business down to the date of their withdrawal. On the other hand, the Crown contend that the proper figure is a figure representing the market value of the five horses at the time of their withdrawal. That would be a figure substantially in excess of the cost, the cost figure being £1,800 or thereabouts, whereas the market value figure was about £10,600.

In contending for the figure of cost, Mr. Graham-Dixon goes back to first principles. He begins his argument by referring to the relevant charging provisions in Paragraph 1 of Schedule D to the Income Tax Act, 1918, under which the tax extends to

> " profits or gains arising or accruing . . . from any trade . . ."

He says that those words mean profits and gains really and truly arising or accruing from the trade, and refer to actual realised profits and nothing else. He claims that, according to the first principles of Income Tax law, no man is bound to make a profit in his trade; he can trade or not, as he pleases, and sell his stock-in-trade or not, as he pleases, and is not to be charged upon any hypothetical basis for profits which he might have made had he been so minded, or profits which he has elected to forgo. Applying these general principles to the present case, Mr. Graham-Dixon says that there is no more ground here for crediting the stud farm business with the market value of the five horses withdrawn than there would be for charging Lady Zia with the market value of horses which she might choose to withdraw from the stud farm business and dispose of by way of gift. He submits that unless and until the horses are sold no profit enters into the case; there is no actual realised profit, there is merely the possibility of sale at a profit at some future date, and that possibility cannot attract tax.

In support of his argument Mr. Graham-Dixon referred us to a number of general statements in the authorities, in particular to *Dublin Corporation* v. *M'Adam*, 2 T.C. 387, which he cited for the proposition stated by Palles, C.B., that a man cannot trade with himself. He also referred us to *Gresham Life Assurance Society* v. *Styles*, 3 T.C. 185, at page 188, for the statement of Lord Halsbury, L.C., to this effect:

> "The thing to be taxed is the amount of profits and gains. The word 'profits' I think is to be understood in its natural and proper sense—in a sense which no commercial man would misunderstand. But when once an individual or a company has in that proper sense ascertained what are the profits of his business or his trade, the destination of those profits, or the charge which has been made on those profits by previous agreement or otherwise is perfectly immaterial."

Again, for the general principle, Mr. Graham-Dixon referred us to *Glenboig Union Fireclay Co., Ltd.* v. *Commissioners of Inland Revenue*, 12 T.C. 427, at page 449, for an observation by Lord Clyde, the

matter under discussion being the quality of a sum received by a fireclay company in respect of the sterilisation of a seam of fireclay for the purpose of ensuring support to a railway. Lord Clyde said:

> "But, even so, it is a consideration or substitute, not for profits earned or capable of being earned, but for profits irretrievably lost and incapable of being ever earned. The taxing acts deal with profits made, not with profits lost—with actual, not with hypothetical profits—and it is by the words of the taxing acts that we are bound."

Mr. Graham-Dixon also relied on the cases to which my Lord has referred of *Laycock* v. *Freeman, Hardy & Willis*, 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C. 414. Whilst these cases admittedly deal with a different question, that is to say, succession to a trade or business, he relied on certain observations of Sir Wilfrid Greene, M.R., which, he claimed, supported his contention in this case. My Lord has already referred to the more material passages in the *Briton Ferry* case, and I will not repeat his citations. I would, however, add a reference to a passage from the *Freeman, Hardy & Willis* case, which seems to me to assist Mr. Graham-Dixon's contention. The question was whether the appellant company, Freeman, Hardy & Willis, having absorbed two subsidiary companies, which formerly manufactured boots and shoes and sold them to the parent company for resale in their retail shops, had succeeded to the wholesale business formerly carried on by the subsidiaries, and at page 300 Sir Wilfrid Greene, M.R., said:

> "The profit that Freeman, Hardy and Willis, Ltd., now make by selling those products retail in their shops is realised by the intervention of the retail business, which was their business all along, and is their old business. It therefore seems to me impossible to predicate of the profits which they make by selling in their retail shops these boots and shoes, manufactured in these factories, that they are profits referable, for the purpose of the Rule, to the trade to which they succeeded."

Sir Wilfrid Greene, M.R., proceeded thus:

> "Now the Crown endeavour to get out of that difficulty by an argument to this effect. They say: the profit which is made by selling the boots and shoes retail in the shops can, for the present purpose, be dissected and split up into two profits, the wholesaler's profit and the retailer's profit, and in so far as the profit is referable to the head of the wholesaler's profit, that is to be deemed for the purpose of the Rule to be the profit derived from the carrying on of the trade taken over. In my judgment, that is wholly illegitimate. There is no such thing in a case of this kind, for any Income Tax purpose, as a wholesaler's profit; it is wholly non-existent. The expression is a convenient one from the point of view of accountants, whose task it is to dissect profits and attribute them in part to one aspect of their client's activities, and in part to another aspect of their client's activities. Obviously a wholesaler makes a wholesaler's profit; a retailer makes a retailer's profit; but to say of a manufacturer who sells retail that he makes two profits, a wholesaler's profit and a retailer's profit—although for accountancy purposes it may be very convenient and useful that the accounts should be kept on that basis—has no reality in fact, since no profit is realised until the goods are sold, and the profit that is realised is the profit realised by disposing of the goods by sale."

In my view, that passage, as well as the passages in the *Briton Ferry* case to which my Lord has referred, does support Mr. Graham-Dixon's contention. There has been no sale in this case—no realisation of any profit—and there is no justification for assuming a sale for the purpose of imputing to Lady Zia a profit which she has never in fact realised.

On the Crown's side it is urged that the market value must be taken in order to give a true picture of the financial results to Lady Zia of the

(Jenkins, L.J.)

carrying on of the stud farm, and they say that is so because, as I have already mentioned, Lady Zia's main object in breeding horses is to supply her racing stable, and the effect of her operations in carrying on the stud farm is to supply her racing stable with horses. I confess that I am unable to follow that argument. The Crown say that the figure of market value can be adopted without assuming a sale of these five horses by Lady Zia. I cannot agree. It seems to me that the phrase " market value " necessarily means the price which the property in question would fetch if sold in the market, and, therefore, charging Lady Zia with a market price figure does mean assuming, for the purpose of calculation, that she has realised the horses by sale. That assumption, to my mind, by no means gives a true picture of the financial results to Lady Zia of carrying on the stud farm. There is no sale and no realisation of the market value. All that has happened is that these horses, for reasons which seemed sufficient to Lady Zia, have been withdrawn from the trade and placed at the racing stable. They are the same horses as they were when they were included in the assets of the stud farm. Their value has not increased merely by their being moved to the racing stable. If Lady Zia did not choose to realise these horses in the course of the stud farm business but preferred to withdraw them and send them to the racing stable, it cannot in my view be said that she has by that transaction made any profit in her trade or business of a stud farm, even though she may sell them at a profit at some future date.

For these reasons, both on principle and on the authorities, the conclusion contended for on behalf of the Appellant is in my opinion the right one, and the figure to be credited to the books of the stud farm in relation to these five horses should be the cost figure. The learned Judge took a different view, but, as appears from his judgment, he did that largely because he considered himself bound by *Watson Bros.* v. *Hornby* (1). In my view, the learned Judge, sitting as a judge of first instance, was right in considering himself so bound, and though I agree with the Master of the Rolls that *Watson Bros* v. *Hornby* cannot stand with the *Freeman, Hardy & Willis* case(2) and the *Briton Ferry* case(3), it is to be observed that the case of *Watson Bros.* v. *Hornby* was later in date than either of those two cases, which would have made it difficult for the learned Judge, sitting at first instance, to do otherwise than hold that they were distinguishable from the case of *Watson Bros.* v. *Hornby,* since it was not necessarily to be assumed that Macnaghten, J., when he decided that case, had not those two earlier cases in mind. Accordingly, in the state of the authorities, the learned Judge in my view really had no option but to conclude as he did in favour of the Crown.

There is, I think, nothing further that I can usefully add, except to express agreement with what the Master of the Rolls has said about *Commissioners of Inland Revenue* v. *William Ransom & Son, Ltd.*(4), where the figure of market value was taken in a case in which, according to the principles which in my view should prevail, the cost would have been the appropriate figure. There was no argument in that case as between the cost figure and the market value figure, and it cannot in my view be regarded as any authority for saying that the market value figure ought to be adopted in the present case. Accordingly, for the reasons my Lord has given, and such reasons as I have been able to add myself, I agree that this appeal should be allowed.

(1) 24 T.C. 505. (2) 22 T.C. 288. (3) 23 T.C. 414. (4) 12 T.C. 21.

Hodson, L.J.—I agree. The learned Judge said that he based his decision in this case on the fact that it was, in his judgment, indistinguishable in principle from Macnaghten, J.'s decision in *Watson Bros.* v. *Hornby*(1). I agree with him that this case is so indistinguishable, and I agree with my Lords that, in the circumstances, the learned Judge was right in following that decision. But in my judgment, for reasons which have been given, the decision in *Watson Bros.* v. *Hornby* is inconsistent with the principle and authority and ought to be overruled.

The position in this case is that there was no sale from the stud farm to Lady Zia Wernher in her capacity as racehorse owner, and there is no justification for valuing the horses at market value, which is, I think, the same thing as treating the horses which passed from the stud farm to herself in the latter capacity as having passed by a notional sale. I am of the opinion that the authorities quoted by the Master of the Rolls—*Laycock* v. *Freeman, Hardy & Willis*(2) and *Briton Ferry Steel Co., Ltd.* v. *Barry*(3)—are both strongly in favour of the contention of the Appellant and illustrate the general principle for which he has contended. I agree that the appeal should succeed.

The Solicitor-General.—My Lord, the Order will be that the appeal should be allowed and the Order of the Special Commissioners should be restored?

Mr. John Senter.—I ask your Lordships to order that the appeal should be allowed with costs here and below and that the appropriate Order is that the assessment be discharged.

Sir Raymond Evershed, M.R.—Yes. We order that the assessment be discharged.

The Solicitor-General.—My Lords, I desire to ask your Lordships for leave to appeal to the House of Lords. I do so for this reason: The case of *Watson Bros.* v. *Hornby* has stood for some little time. The Crown have sought to establish the view your Lordships have declared today in that case without success. This decision of your Lordships affects every assessment on the stud farm of Lady Zia Wernher, not only for the year 1948 but certainly every year which follows. The total involved will amount to a substantial sum. In my submission it is an important point of principle, because it does more than affect Lady Zia Wernher; it will affect every other racehorse owner who breeds his own racehorses. It will mean, if this case stands, a change of practice in relation to all those people. It will also affect all the producers of day-old chicks, and it may affect other industries as well. Primarily for the reason that it is of great importance so far as this case is concerned, but—while I do not want to say anything about your Lordships' judgments—also because this point was never considered in either *Laycock* v. *Freeman, Hardy & Willis* or *Briton Ferry Steel Co., Ltd.* v. *Barry,* I ask your Lordships' leave to appeal to the House of Lords.

Mr. Senter.—I recognise that the matter is one for your Lordships. I should like to be allowed to make three very short submissions before your Lordships come to a decision. The first is that there has been virtual unanimity throughout your Lordships' judgments, in taking into account the reason why Vaisey, J., decided as he did. Your Lordships' decision has restored the reasoning of the Special Commissioners, where we succeeded.

(1) 24 T.C. 506. (2) 22 T.C. 288. (3) 23 T.C. 414.

(Mr. Senter.)

The second point is that the Solicitor-General has mentioned the importance of this case to Lady Zia in future assessments. It is perfectly clear from what he went on to say that the Crown's concern to have this matter further debated is because of the general importance of the principle laid down by this Court. I would respectfully submit that if your Lordships do give leave—and I submit that for my first reason your Lordships should not—that Sir Harold's net income should not be further imperilled in order that the Crown should have this further discussion.

Sir Raymond Evershed, M.R.—Have you anything to say, Mr. Solicitor-General, about the last point? Are the Crown willing to make any suggestion about costs?

The Solicitor-General.—No, my Lord, except to say that this would not be the right case for the Crown to undertake any such terms.

(The Court conferred.)

Sir Raymond Evershed, M.R.—We give leave to appeal.

The Crown having appealed against the above decision, the case came before the House of Lords (Viscount Simonds, and Lords Porter, Oaksey, Radcliffe and Tucker) on 19th, 20th and 21st July, 1955, when judgment was reserved. On 7th November, 1955, judgment was given in favour of the Crown, with costs (Lord Oaksey dissenting).

The Attorney-General (Sir Reginald Manningham-Buller, Q.C.), Mr. Roy Borneman, Q.C., and Sir Reginald Hills appeared as Counsel for the Crown, and Mr. L. C. Graham-Dixon, Q.C., and Mr. Peter Rowland for the taxpayer.

Viscount Simonds.—My Lords, this appeal arises upon an assessment to Income Tax for the year 1949–50 made upon the Respondent, Sir Harold Wernher, in respect of profits made by his wife, Lady Zia Wernher, from a stud farm owned and carried on by her. The question in dispute is what amount should be entered on the credit side of the trading account of the stud farm in respect of animals bred there and transferred to a racing establishment also carried on by her.

It is common ground between the parties that some amount must be credited in respect of these animals upon their transfer (a matter upon which I shall say something later) and the issue has been whether this amount should be the cost of production of the animals so transferred or their market value at the date of transfer.

The course of proceedings before the matter reached your Lordships' House has been as follows: an estimated assessment in an amount of £5,000 was made upon the Respondent for the year 1949–50 in respect of the profits arising from the stud farm. He appealed from this assessment to the Special Commissioners, the only material ground of appeal being that which I have already indicated, that in principle the assessment was based on crediting the trading account of the stud farm with the market value of the transferred

animals, instead of with the cost of their production. The Special Commissioners allowed his appeal, and at the request of the present Appellant stated a Case for the opinion of the High Court. The case duly came before Vaisey, J., and on 24th July, 1953, that learned Judge gave judgment allowing the appeal. In his opinion the case was indistinguishable in principle from *Watson Bros.* v. *Hornby*, 24 T.C. 506, and he was bound by it. I shall have to consider this case in some detail presently. The Respondent appealed to the Court of Appeal, which unanimously reversed the judgment of Vaisey, J., being, I think, largely influenced to that course by a previous decision of the Court of Appeal in *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C. 414. The question at issue has therefore so far been resolved by saying that in principle the stud farm trading account must be credited only with the cost of production of the transferred animals. The question of figures is still at large. The Crown now appeals and contends that it is the market value of the transferred animals, not the cost of their production, with which the account must be credited. Before I examine the rival contentions and the authorities by which they are supported, I must make certain further observations which are not, I think, controversial.

It is not in dispute that the enterprise of a stud farm carried on by Lady Zia Wernher is what has been called a taxable activity, which is another way of saying that the Respondent is chargeable in respect of any profits arising therefrom in accordance with the Rules of Case I of Schedule D of the Income Tax Act, 1918, relating to trades. Nor is it in dispute that the racing establishment carried on by Lady Zia is not a taxable activity: her profits, if any, of that activity are not subject to taxation; her losses, if any, cannot be set off against any other taxable income. This has been called a recreational activity. Further, it is common ground that the stud farm enterprise is a farming enterprise which is, by virtue of Section 10 of the Finance Act, 1941, and Section 31 (1) (*a*) of the Finance Act, 1948, to be treated as the carrying on of a trade, and, accordingly, that its profits are chargeable in the way that I have mentioned. Again, it is not disputed that, to take the year ending 31st December, 1948, as an example, Lady Zia transferred five horses from her stud farm to her racing establishment and that their then market value exceeded their cost of production. Nor, I think, is it in doubt that a main purpose, if not the main purpose, of the stud farm was to supply the racing establishment.

These, my Lords, are the simple facts of the case, and it is perhaps surprising that in the year 1955 there should be any room for doubt about a position which cannot in its essentials differ from a great many other cases. I wish at the outset to say that I attach no importance to the fact that of Lady Zia's two activities to which I have referred the one is taxable and the other is not. I do not understand how her taxable profits in respect of the stud farm can in principle be the greater or the less because the profits of the racing establishment are or are not taxable. The problem, therefore, in all its simplicity is whether a person, carrying on the trade of farming or, I suppose, any other trade, who disposes of part of his stock-in-trade not by way of sale in the course of trade but for his own use, enjoyment, or recreation, must bring into his trading account for Income Tax purposes the market value of that stock-in-trade at the time of such disposition. But for the fact that this case has throughout proceeded upon the footing as stated in the Stated Case that

> "some figure in respect of the transferred horses fell to be brought into the stud farm accounts as a receipt",

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I should have stated the problem differently. I say this because, since it is the Respondent's case that Lady Zia did not dispose of the transferred horses in the way of trade, I do not understand why it is admitted that she should be credited as a receipt with the cost of production. In fact as a trader she received no more the cost of production than the market value: I do not understand, therefore, why the argument did not proceed that, as she received nothing, her trading account should be credited with nothing; that she suffered, so far as her trade was concerned, a dead loss in respect of these animals, and that the accounts of the stud farm should be made up so as to show this like any other dead loss. I do not understand how the adjustment could take the form of the fictitious entry of a receipt which had not been received.

My Lords, I am the more puzzled by the basis on which this case has proceeded because learned Counsel for the Respondent has throughout insisted on what is an elementary principle of Income Tax law that a man cannot be taxed on profits that he might have, but has not, made: see, for example, *Dublin Corporation* v. *M'Adam*, 2 T.C. 387; *Gresham Life Assurance Society* v. *Styles*, 3 T.C. 185. But this is only saying in another way that a trader is not to be charged with the receipt of sums that he might have, but has not, received, and this is equally true whether the sum with which it is sought to charge him is market value or production cost, whether it will result in a notional profit or a notional balancing of receipts with expenditure and whether the reason for his not in fact receiving such a sum is that the goods which are his stock-in-trade have perished in the course of nature or that he has chosen to use them for his own pleasure or otherwise dispose of them. The true proposition is not that a man cannot make a profit out of himself but that he cannot trade with himself. The question is whether and how far this general proposition must be qualified for the purposes of Income Tax law.

An attempt has been made to justify the notional receipt of a sum equal to the cost of production by treating such a receipt as the equivalent of an expenditure which in the event proved not to have been for the purpose of trade, since the article was not disposed of in the way of trade. But this is pure fiction. Up to the very moment of disposition, in this case the transfer of a horse from stud farm to racing stable, the article was part of the trader's stock-in-trade and the cost of its production was properly treated as part of his expenditure for Income Tax purposes. I see no justification for an *ex post facto* adjustment of account which in effect adds to a fictional receipt a false attribution of expenditure.

This is, however, the position with which we are faced. Your Lordships may not think it necessary to express any opinion on the question whether, if the Crown is not right in requiring market value to be brought into account in the present case, it is nevertheless entitled to require the cost of production to be brought in. This is said to be of no importance in this case, though it might well be of great importance in other cases. Yet I cannot refrain from calling attention to what must be fundamental to the solution of the question. For I cannot escape from the obvious fact that it must be determined whether and why a trader, who elects to throw his stock-in-trade into the sea or dispose of it in any other way than by way of sale in the course of trade, is chargeable with any notional receipt in respect of it, before it is asked with how much he should be charged.

It is, as I have said, a surprising thing that this question should remain in doubt. For unless, indeed, farming is a trade which in this respect differs

from other trades, the same problem arises whether the owner of a stud farm diverts the produce of his farm to his own enjoyment or a diamond merchant, neglecting profitable sales, uses his choicest jewels for the adornment of his wife, or a caterer provides lavish entertainment for a daughter's wedding breakfast. Are the horses, the jewels, the cakes and ale to be treated for the purpose of Income Tax as disposed of for nothing or for their market value or for the cost of their production?

It is convenient at this stage to refer to *Watson Bros.* v. *Hornby*(1) which I have already mentioned. In that case the taxpayers, who were the appellants in the appeal, carried on a business of poultry dealers and breeders of poultry at a hatchery belonging to them which was conceded to be an enterprise chargeable as a trade under Case I of Schedule D of the Income Tax Act, 1918. The business of the hatchery was to produce and sell day-old chicks. They also carried on farming activities which were conceded to be for Income Tax purposes a separate enterprise from the hatchery business and, as the law then stood, were an Income Tax source chargeable under Schedule B of the Income Tax Act, 1918. Most of the produce of the hatchery was sold, but a substantial number of day-old chicks were from time to time transferred to the farm and became part of the stock of poultry of the farm. The question in the appeal was whether, in computing the profits of the hatchery business, the day-old chicks transferred to the farm should be brought in at cost or market value. The market value was at the material times much below cost, namely, 4*d.* as against 7*d.* per chick. It was contended for the taxpayers that market price and for the Crown that cost of production should be adopted as the appropriate figure in the accounts. It was decided by Macnaghten, J., that the taxpayers' contention was right, and they were accordingly chargeable upon the footing that as traders in respect of their hatchery business they received 4*d.* only per chick. This decision, which your Lordships were told has ever since been adopted as the basis of assessment by the Revenue in similar cases, involves two things, first, that the taxpayer may in certain cases be subject to a sort of dichotomy for Income Tax purposes and be regarded as selling to himself in one capacity what he has produced in another, and, secondly, that he is regarded as selling what he sells at market price. It is a decision upon which the Appellant relies in the present case, and which, as I have said, Vaisey, J., regarded as an authority binding him. The learned Judge also derives some assistance from *Commissioners of Inland Revenue* v. *William Ransom & Son, Ltd.*, 12 T.C. 21, in which it was at least recognised that for tax purposes two parts of an enterprise carried on by a taxpayer should be treated as distinct. But it was not, I think, an issue in that case at what price goods should be deemed to be transferred from one part of the enterprise to the other.

In the Court of Appeal two cases were relied on which appear not to have been cited to Macnaghten, J., in *Watson Bros.* v. *Hornby*. They were *Laycock* v. *Freeman, Hardy and Willis, Ltd.*, 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C. 414. The value of these cases lies less in their direct bearing upon the present case than in the observations of Lord Greene, which must always have great weight with any Court. In the former case the primary question was whether there had been a succession for the purpose of Rule 11 (2), as enacted in Section 32 of the Finance Act, 1926, of Cases I and II of Schedule D of the Income Tax Act, 1918, and, though the decision contains a valuable exposition of the general

(1) 24 T.C. 506.

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principle that Income Tax is payable upon profits that are actual, not imaginary, the Court in fact held that there had been no "succession" and the question of the price of transfer of goods from predecessor to successor did not arise. In the *Briton Ferry* case(1), on the other hand, the Court held that there was a "succession" for the purpose of the relevant Rule and, though the learned Attorney-General was, I think, right in saying that in that case the real issue was what the basis period should be rather than how the profits of that period when ascertained should be computed, once again the observations of Lord Greene justified the Court of Appeal in the present case in thinking that they ought to regard the cost price rather than the market value of transferred commodities as affording the correct method of computation.

I do not think that there is any other authority to which I can usefully call your Lordships' attention, and it appears to emerge from the cases that I have cited that Vaisey, J., was amply justified in saying that, if any of them was correctly decided, the Legislature had made inevitable some invasion of the principle that the taxpayer cannot make a profit by selling to himself. For I repeat that I see no valid distinction between a trader crediting himself with a price (market value) which produces a profit or with a price (production cost) which strikes a balance or reduces his loss. Yet it is the basis equally of the judgment of Macnaghten, J., in *Watson Bros.* v. *Hornby*(2) and of the observations of Lord Greene in the *Laycock*(3) and the *Briton Ferry* cases that something has to be brought into account where the Legislature recognises a sort of artificial dichotomy and a taxpayer is regarded as carrying on more than one taxable activity. And so also, as I have more than once pointed out, in this case it is conceded by the taxpayer that some figure must appear in the stud farm account as a receipt in respect of the transferred horses, though Lady Zia in her capacity as transferee did not carry on a taxable activity. In the same way it would, I suppose, be claimed that if Lady Zia were to transfer or re-transfer a horse from her racing establishment to her stud farm, some figure would have to appear in the stud farm accounts in respect of that horse, though it cost her nothing to make the transfer: if it were not so and she subsequently sold the transferred horse and the proceeds of sale were treated as receipts of the stud farm, she could justly complain that she had been charged with a fictitious profit.

My Lords, how far is this principle, which is implicit in the judgments that I have cited and in the admission upon which this case has proceeded, supportable in law? That it conflicts with the proposition, taken in its broadest sense, that a man cannot trade with himself is, I think, obvious. Yet it seems to me that it is a necessary qualification of the broad proposition. For if there are commodities which are the subject of a man's trade but may also be the subject of his use and enjoyment, I do not know how his account as a trader can properly be made up so as to ascertain his annual profits and gains unless his trading account is credited with a receipt in respect of those goods which he has diverted to his own use and enjoyment. I think, therefore, that the admission was rightly made that some sum must be brought into the stud farm account as a receipt though nothing was received and so far at least the taxpayer must be regarded as having traded with himself. But still the question remains, what is that sum to be. I suppose that in the generality of cases in which the question arises in a farming or any other business, for example, where the farmer supplies his own house with milk, or a market gardener with vegetables,

(1) 23 T.C. 414. (2) 24 T.C. 506. (3) 22 T.C. 288.

an arbitrary or conventional sum is agreed. The House was not given any information as to the prevailing practice. Now the question precisely arises. In answering it I am not influenced by the fact that a change in the law has made the farmer liable to tax under Schedule D instead of under Schedule B, nor does Section 10 of the Finance Act, 1941, affect my mind beyond the fact that it emphasises the artificial dichotomy which the scheme of Income Tax law in many instances imposes. But it appears to me that when it has been admitted or determined that an article forms part of the stock-in-trade of the trader, and that upon his parting with it so that it no longer forms part of his stock-in-trade some sum must appear in his trading account as having been received in respect of it, the only logical way to treat it is to regard it as having been disposed of by way of trade. If so, I see no reason for ascribing to it any other sum than that which he would normally have received for it in the due course of trade, that is to say, the market value. As I have already indicated, there seems to me to be no justification for the only alternative that has been suggested, namely, the cost of production. The unreality of this alternative would be plain to the taxpayer, if, as well might happen, a very large service fee had been paid so that the cost of production was high and the market value did not equal it.

In my opinion, therefore, the judgment of the Court of Appeal was wrong and should be reversed and the judgment of Vaisey, J., restored.

Lord Porter.—My Lords, I have had an opportunity of reading the opinion of my noble and learned friend, Viscount Simonds, and the opinion about to be delivered by my noble and learned friend, Lord Radcliffe, and I agree with them both.

Lord Oaksey.—My Lords, the question in this case is whether a farmer or market gardener is liable, under Section 10 of the Finance Act, 1941, to pay Income Tax under Schedule D, Case I, on the market values of goods which he does not sell but takes or uses for his own purposes.

The Respondent's wife, Lady Zia Wernher, owns two studs of horses at which she breeds racehorses, some of which she sells and some of which she puts into training. It is common ground that stud farms are trades for the purposes of Income Tax and that a racing stable is not. The Inland Revenue contend that the Respondent is liable under Section 10 of the Act of 1941 for Income Tax on the market value of the horses his wife puts into training as well as the prices she obtains for the horses she sells.

The words of Section 10 of the Act of 1941 are, so far as material, as follows:

> "(1) Subject, as respects farming and farm land, to the provisions of the next succeeding section, farming and market gardening shall be treated as trades for the purposes of income tax and accordingly—
>
> (*a*) the profits or gains thereof shall be charged under Case I of Schedule D; and
>
> (*b*) income tax shall not be charged under Schedule B in respect of the occupation of any farm land or market garden land:
>
> . . . . . .
>
> (2) For the purposes of this and the next succeeding section the following expressions have the meanings hereby respectively assigned to them, that is to say,—
>
> 'market garden land' means land occupied as a nursery or garden for the sale of the produce (other than land used for the growth of hops) and 'market gardening' shall be construed accordingly;

(Lord Oaksey.)

> 'farm land' means land wholly or mainly occupied for the purposes of husbandry, not being market garden land, and includes the farm house and farm buildings, if any, and 'farming' shall be construed accordingly".

In my opinion, the Court of Appeal and the Commissioners were right in holding that the Respondent is not liable. His wife has not, in my opinion, made a profit or gain on the horses in question within the meaning of Section 10 of the Act of 1941.

I think this follows from two principles which have long been established on the construction of the Income Tax Acts. The first principle is that the "profits or gains" taxed are actual commercial profits and not mere benefits (see *Tennant* v. *Smith*(1), [1892] A.C. 150, and *Gresham Life Assurance Society* v. *Styles*(2), [1892] A.C. 309). The second is that a man cannot trade with himself in the sense in which the word "trade" is used in the Income Tax Acts.

As Palles, C.B., said in *Dublin Corporation* v. *M'Adam*, 2 T.C. 387, at page 397:

> "On the other hand, I think it is perfectly clear that, in order to bring this case within the operation of the Income Tax Act, it is necessary that there shall be this trading in its strict true sense. There must be, at least, two parties —one supplying water, and the other to whom it should be supplied and who should pay for it. If these two parties are identical, in my opinion there can be no trading. No man, in my opinion, can trade with himself; he cannot, in my opinion, make, in what is its true sense or meaning, taxable profit by dealing with himself; and in every case of this description it appears to be a question on the construction of the Act whether the two bodies—the body that supplies and the body or class that has to pay—were either identical, or, upon the true construction of the Act, must be admitted to have been held by the Legislature to be identical, and so legislated for upon that basis."

In my opinion Palles, C.B., was right and no authority inconsistent with his view was cited to your Lordships. The idea of a person trading with himself is inconsistent with the idea of ownership. An owner can do as he likes with his own property apart from legislation: he cannot be compelled to sell his own property to himself either at the market or any other value apart from legislation to that effect. Any sale so called which a trader makes to himself must be "notional" and not "actual". He cannot make a commercial profit or loss by transferring an asset from himself to himself or by a gift to someone else no matter what price he notionally ascribes to the transaction.

It may be said that such things rarely happen, and that the maxim *de minimis* is applicable, but it is impossible to answer the difficulty in that way because a trader's assets may be of great value, for example a diamond tiara or, for that matter, a thoroughbred two year old. It follows from this that an owner in trade can withdraw any asset he chooses from his trade for his own use provided, of course, that he does so *bona fide* and not with the intention of selling it outside his trade to someone else.

But then it is argued that, even if Palles, C.B., was right that a trader cannot trade with himself and the words "profits or gains" have the meaning of actual commercial profits in Schedule D, Section 10 of the Finance Act, 1941, by transferring the trades of farming and market gardening to Schedule D, has altered the meaning of the words "profits or gains" in such a way that a farmer is taxable upon the market value of the produce he uses for his own consumption. It is clear, however, from the definition of "market

(1) 3 T.C. 158. (2) 3 T.C. 185.

gardening" that this is not the rule in reference to that trade, but it is said that husbandry is different and that the dictionary definition of "husbandry" has no reference to sale of the produce of the land.

In my opinion, the meaning of the words "profits or gains" in Section 10 (1) (*a*) of the Act of 1941 must be the same as their meaning in Schedule D. It cannot be that by such words as those of Section 10 of the Act of 1941 the Legislature intended to introduce a new principle with reference to the profits or gains of farming and market gardening, that is to say, to tax the profits or gains of farming and market gardening on one principle under Schedule D and all other trades on another principle under the same Schedule.

The argument of the Crown was also supported on the ground that Lady Zia Wernher's stud account, which had been debited with the cost of rearing the yearlings which she subsequently transferred to her racing stable, was then credited with the same figure. In my opinion, there is no substance in this argument. Traders must show in their trading accounts the value of their assets. If they sell those assets they must credit the price obtained. If they do not sell them but get rid of them, either by using them themselves or in any other way, they must credit the figure at which the assets stand in their accounts or the profits of the account will be improperly diminished by the amount entered in the account as the value of the asset. Taxation under Schedule D is imposed on the balance of profits and gains. Profits and gains are actual commercial profits and gains and similarly the deductions allowed by the Act which produce the balance are deductions which are considered to be properly attributable to the profits as being commercial expenses incurred in order to earn the profits. It follows, in my opinion, that such expenses as have been incurred to produce an asset which is withdrawn from the trade cannot properly be deducted and must therefore be withdrawn from the account, which can only be done in accordance with accounting practice by crediting the amount of the expenses.

For these reasons I am of opinion that the findings of the Commissioners and the judgment of the Court of Appeal were right.

Lord Radcliffe.—My Lords, this is a short, but very difficult, point. I believe that the most convenient way of expressing an opinion is to discuss in order some of the lines of argument that seem to have been most dwelt upon during the course of the case.

First, there is the point that the Respondent's wife carries on a stud farm and the activities of the stud farm constitute "farming" within the meaning of Section 10 of the Finance Act, 1941. This much is common ground and it is given to us by paragraph 2 of the Case Stated. It is worth observing that what is common ground is that the activities themselves constitute farming, not that only such of them constitute farming as can be seen *ex post facto* to have been devoted to the production and rearing of foals subsequently sold or to the obtaining of stallion fees. What follows, according to the Appellant, is all quite simple. The Act has declared that farming is to be treated as a trade for the purposes of Income Tax and its profits or gains charged under Case I of Schedule D: therefore stock taken over by the owner or given away which was trading stock at the moment of disposal must be treated as if sold in the course of trade and a receipt equivalent to its market value entered accordingly. Such an entry, it is said, is required by the principles of ordinary commercial accountancy. Your

(Lord Radcliffe.)

Lordships need not pause on the figure of market value: the Case states that the market value of the transferred horses was considerably in excess of their cost.

Now I think that this line of argument offers the right introduction to the question, but it is too much of a simplification to say that it solves it. For the trader who supplies himself out of his stock-in-trade is a special case, by no means confined to the farmer, and we must not begin by assuming, without any evidence, that "ordinary commercial accounting" has any settled rule for such a case which would make it necessary to enter a receipt equivalent to market value in place of the stock disposed of. What we can say is that, prior to the Finance Act, 1941, the occupation of land for the purpose of husbandry was a source of income charged under Schedule B and, *prima facie*, the computation of the tax was based on an imputed profit taxed as income, whether the occupier consumed some, or even the whole, of the produce of the activity. The Respondent's argument would lead to what would certainly be the odd result that the transfer to Case I of Schedule D effected in 1941 would give a complete exemption from tax to the occupier who supplies all his produce to himself. Moreover, it would be wrong to treat the question now before us as if it originated with the enactment of Section 10 of the Finance Act, 1941. Rule 5 of the Schedule B Rules in the Income Tax Act, 1918, allowed any person "occupying lands for the purposes of husbandry only" to elect to be assessed and charged under Schedule D instead of under this Schedule. What was the fate of the farmer who made such an election and then proceeded to show that all or some of his produce went to himself at cost or even, more logically, at no charge at all? Again, Rule 6 gave an occupier a chance of satisfying his General Commissioners that the profits from the occupation during the year fell short of the assessable value of the land under Schedule B and, if he did, the imputed income so assessed was reduced to the "actual amount" of the profit and any tax paid adjusted accordingly. What happened when an occupier came forward and showed little or no "actual" profit in the year because he had taken most of the produce at cost price?

I do not know the answers to these questions. But I think that they are relevant enough to make me feel rather suspicious of the Respondent's tempting scheme of marking everything out to the owner at cost. On the other hand, I think that it throws too much weight on the bare enactment that farming is to be treated as a trade for Income Tax purposes to deduce from it that all disposals are to be assumed to have been made in the course of trading and that consequently a receipt must be entered equivalent to the market value of the stock disposed of. That may indeed be the right result: but, if there is any general principle of Income Tax law with which it conflicts, as the Respondent says that there is, then I would not say that the mere wording of the Statute stands in his way.

What, then, is the importance to this case of a general proposition such as that of Palles, C.B.:

> "No man, in my opinion, can trade with himself: he cannot, in my opinion, make, in what is its true sense or meaning, taxable profit by dealing with himself . . ."

(*Dublin Corporation* v. *M'Adam*, 2 T.C. 387, at page 397)? Later decisions have shown that this simple proposition may cover what are to be regarded as two separate questions, whether a man can trade or deal with himself and whether a man can make taxable profit by so doing (see, for instance, *Commissioners of Inland Revenue* v. *Cornish Mutual Assurance Co., Ltd.*,

12 T.C. 841). Having regard to the explanation of the decision in *Styles* v. *New York Life Insurance Co.*, 2 T.C. 460, which is afforded by the last-mentioned case, I think that it must now be said that people can carry on trade or business with themselves, as by way of mutual insurance, but that if they do, a resulting surplus from their operations is not a profit from a trade for the purposes of Income Tax, or, put another way, their operations do not for the same purposes constitute a trade from which a profit can result.

In my opinion, the composite proposition that a man cannot make taxable profit out of trading with himself is of unquestioned validity when it is applied to the two kinds of activity with which it is habitually associated in Income Tax history, mutual insurance and certain public utilities financed by rates. The one line of cases stems from *Styles* v. *New York Life Insurance Co.*, the other from In re *Glasgow Corporation Waterworks*, 1 T.C. 28. Moreover, the proposition is a truism if it is merely resorted to to emphasise that no sale in the legal sense can take place between an individual as trader and the same individual as supplier : or that the taxable pocket from which the thing supplied comes is not likely to be refilled with money or money's worth from the taxable pocket into which the thing supplied goes. But, when we are asked to treat such a proposition as providing a universal solution that covers even the difficult problem which we are now faced with, it is necessary to remember that in the mutual insurance and water supply cases there was no question that the accounts of the operations did show a surplus ; the question was whether the surplus shown constituted a profit within the meaning of the Income Tax Act. The situation presented to us is a different one. For we are required to assume, what those decisions in effect denied, that the activities to which the accounts relate do constitute a trade for Income Tax purposes ; and our problem is to determine what upon that basis are the proper entries to make in those trading accounts in relation to certain transactions with trade stock. I doubt very much whether the result of those decisions could have been what it was if the Income Tax Statute had declared that the operations in question were to be regarded as a trade and, as such, a source of taxable profit. So all things considered, I do not think that we ought to treat the Respondent's general proposition as precluding the possibility that the Income Tax scheme may be found to require that in certain situations a taxpayer should be treated as if he had dealt with himself on commercial terms.

To begin with, I am not prepared to forget that the tax code already achieves this fictitious separation in various ways. The owner-occupier of business premises charges against his trade receipts the annual value of those premises for the purposes of his Case I, Schedule D assessment (Income Tax Act, 1918, Rules applicable to Cases I and II of Schedule D, Rule 5). No money passes, but he is treated as his own lessor. The non-resident producer or manufacturer who is liable to tax because he markets in the United Kingdom is entitled to have his assessment based on merchanting profit only (Income Tax Act, 1918, General Rules, Rule 12). For the purposes of assessment he is treated as if he, as producer or manufacturer, had sold to himself as merchant or retailer, and had made the sale on trade terms. The provisions which are contained in treaties for relief against double taxation habitually set up a system under which the profits made by the producer or manufacturer of one country but sold through a " permanent establishment " of his in another are divided between the two taxing jurisdictions on the basis of a similar fictitious division of the taxpayer's personality and a similar fictitious trading with himself.

(Lord Radcliffe.)

My Lords, it may be objected that these situations are all provided for and regulated by statutory enactment, that these indeed are planned departures from what would otherwise be the general rule, and that it is just because there is no provision which deals with the present type of case that our decision should be for the Respondent. I do not see great force in this. The statutory enactments have, of course, settled the matter wherever they operate by providing definite rules for their particular occasions: but what we are looking for is some principle to determine the Respondent's assessability to taxation, and I think that it is a wrong sort of approach to look for principles in judicial decision only and to treat the whole Income Tax code as if it made law but could not itself contain principle. But, apart from that, it seems to me that we are dealing with a problem that must have arisen in hundreds of thousands of cases under various forms, and I think that there are traces that the Courts have not found this general proposition that a man cannot trade with himself or make profit out of himself a satisfactory guide for all purposes.

To begin with, there is *Watson Bros.* v. *Hornby,* 24 T.C. 506, which explicitly decided that it may be necessary, for a proper assessment of trade profits under Case I of Schedule D, to treat a man who supplies himself in his trade as trading with himself on ordinary commercial terms. The decision was given in 1942: it laid down a principle that must continually affect a great many taxpayers: and only now is it said that the case was wrongly decided. I find another instance in *Back* v. *Daniels,* 9 T.C. 183, which raised again the difficult problem of taxing part of a taxpayer's activities under Schedule B and another part under Schedule D. The taxpayers in that case were a firm of wholesale potato merchants who carried on business in London, where they sold all the potatoes raised by them on land in the Fen district. The effect of the decision was that the Schedule B assessment on the profits of occupation prevented any assessment under Schedule D in respect of the profit the firm made when they sold the potatoes as wholesale merchants in London. But the interesting point is that the taxpayers did not dispute that

> "they may be taxable, in addition to their Schedule B amount, with something in the nature of a commission to themselves for selling their own potatoes, as they sell other people's in London on the market"

(*per* Rowlatt, J., at pages 195–6). The admission did not seem a strange one to the learned Judge. On the contrary,

> "It seems to me",

he said,

> "that that is the limit of their liability."

But the "limit" required them to include in the receipts of their London business a commission from themselves, which, of course, they never paid, for selling for themselves their own potatoes. The accounts as between the growing department and the wholesale business were in fact kept on the basis of the one being charged and the other receiving such a commission at the same rate as was charged to other growers. The Special Commissioners who had heard the original appeal had approved a Schedule D assessment on this basis, and the taxpayers did not challenge that computation in the Courts.

Back v. *Daniels* went to the Court of Appeal, but the only member of that Court who made any reference to the commission was Scrutton, L.J., whose judgment (at page 201) refers to the Special Commissioners' assessment as including a

> "conventional commission assigned to them as salesmen for selling their own potatoes",

(Lord Radcliffe.)

but makes no comment upon the computation. I ought, too, to refer to the Excess Profits Duty case of *Commissioners of Inland Revenue* v. *William Ransom & Son, Ltd.*[1], since it was cited to us in argument. It does afford an instance of the "disintegration" for tax purposes of the profits of a business carried on by a taxpayer in two departments. The produce of one department was transferred to another for processing and distillation, and the internal accounts upon which the separation depended showed that the producing department was credited with a transfer price equal to the market value of the produce on the day of transfer. There was no dispute about figures before the learned Judge (Sankey, J.), the point before him being whether a part of the profits assessed to Excess Profits Duty should be excluded as being profits of husbandry and exempt as such. He decided that it should. It would not be right to attribute to him any view on the question of principle which is now before your Lordships: but it is fair to say that he decided in favour of attributing separate profits to one department of a business which, upon the available accounts, was being charged at market price for the stock transferred from another department.

The last point that I must mention before I can offer my opinion to your Lordships on the present appeal is the place that we should assign to the two decisions *Laycock* v. *Freeman, Hardy and Willis, Ltd.*, 22 T.C. 288, and *Briton Ferry Steel Co., Ltd.* v. *Barry*, 23 T.C 414. To the Court of Appeal they have seemed to have so direct a bearing upon the present question as to leave them no option but to decide the appeal in favour of the Respondent. I am bound to say, with sincere respect for their point of view, that I cannot follow that. I do not regard those decisions as having any true bearing at all upon this appeal. As decisions, obviously, they have not. They are decisions upon the difficult and, often, unsatisfactory question of what constitutes succession to a trade for the purpose of the relevant section of the Income Tax code. That is a long way from the question now before us. But even the expository passages upon which reliance was placed appear to me to fall short of suggesting any general principle that should guide us, unless it be that if interdepartmental transfers of stock are made at cost, that, somehow, represents a "real" figure, whereas a transfer at cost plus a figure of conventional profit represents an unreal one. I am afraid that I do not think that metaphysical distinctions of this sort assist to solve the problem. What do "real" and "unreal" mean in this connection? If reality depends on the existence of a genuine contract of sale between two independent parties, neither figure is more real than the other. Whether the transfer is between two departments of one legal entity or between two limited companies under the same control, the transfer is effected either by an entry in account or by a dictated sale at a prescribed price. On the other hand, if cost is supposed to be more real than cost plus as a transfer figure because it represents (or by sufficient analysis of general overheads can be thought to represent) expenditure actually incurred, this seems to me a very unsatisfactory test of reality. When transfer is in question it is the current realisable value of what is transferred that presents itself as the natural figure to enter rather than the historical record of what has previously been spent upon it. It is the article, having a current monetary equivalent, that is disposed of, not the previous expenditure. I do not doubt that either figure could be defended as reasonable business practice, but I do demur to a preference for the cost figure being supported by the plea that it somehow enjoys a greater measure of "reality".

(1) 12 T.C. 21.

(Lord Radcliffe.)

My Lords, with these considerations in mind, I must now say what I believe to be the right way to deal with the present case. When a horse is transferred from the stud farm to the owner's personal account, there is a disposition of trading stock. I do not say that the disposition is made by way of trade, for that is a play on words which may beg the question. At least three methods have been suggested for recording the result in the stud farm's trading accounts. There might be others. Your Lordships must choose between them.

First, there might be no entry of a receipt at all. This method has behind it the logic that nothing in fact is received in consideration of the transfer, and there is no general principle of taxation that assesses a person on the basis of business profits that he might have made but has not chosen to make. Theoretically, a trader can destroy or let waste or give away his stock. I do not notice that he does so in practice, except in special situations that we need not consider. On the other hand, it was not argued before us by the Respondent that this method would be the right one to apply: and a tax system which allows business losses to be set off against taxable income from other sources is in my opinion bound to reject such a method because of the absurd anomalies that it would produce as between one taxpayer and another. It would give the self-supplier a quite unfair tax advantage.

Secondly, the figure brought in as a receipt might be cost. That is what the Respondent contends for. It is not altogether clear what is to be the basis of such an entry. No sale in the legal sense has taken place nor has there been any actual receipt: the cost basis, therefore, treats the matter as though there had been some sort of deal between the taxpayer and himself but maintains that in principle he can only break even on such a deal. I do not understand why, if he can be supposed to deal at all, he must necessarily deal on such self-denying terms. But then the Respondent argues that the cost figure entered as a receipt is to be understood as a mere cancellation of the cost incurred to date. The item of stock transferred to the owner's private account is shown by that very event to have been "withdrawn" from the trade and the only practical course is to write out of the trader's accounts the whole of the cost *bona fide*, but mistakenly, entered in respect of it. I think this a very attractive argument, but its weakness is that it does not explain why such cancellation should take place. This is not put to us as a case in which, there being no market, cost is the best available estimate of value. The fact that an item of stock is disposed of not by way of sale does not mean that it was any the less part of the trading stock at the moment of disposal. On the contrary, it was part of the stock of the venture at every moment up till then and whatever was spent upon it was rightly entered as a part of the costs and expenses of the trade. Its disposal does not alter that situation. The trade of which the receipts and expenses are in question is the whole activity of farming and the disposal of the produce is only one, though a very important, incident of that activity. I think it a fallacy, therefore, to suppose that the method of disposal can give any warrant for treating costs hitherto properly charged to the trade as if, *ex post facto*, they never ought to have been charged at all. Yet, if a cancelling entry is not to be made, there must either be a figure entered as a receipt which, admittedly, does not represent any actual legal transaction or the costs incurred up to the date of disposal must remain on the books to create or contribute to a "loss" of income which common sense suggests to be a fiction.

(Lord Radcliffe.)

In a situation where everything is to some extent fictitious, I think that we should prefer the third alternative of entering as a receipt a figure equivalent to the current realisable value of the stock item transferred. In other words, I think that *Watson Bros.* v. *Hornby*(1), was rightly decided and that its principle is applicable to all those cases in which the Income Tax system requires that part of a taxpayer's activities should be isolated and treated as a self-contained trade. The realisable value figure is neither more nor less "real" than the cost figure, and in my opinion it is to be preferred for two reasons. First, it gives a fairer measure of assessable trading profit as between one taxpayer and another, for it eliminates variations which are due to no other cause than any one taxpayer's decision as to what proportion of his total product he will supply to himself. A formula which achieves this makes for a more equitable distribution of the burden of tax, and is to be preferred on that account. Secondly, it seems to me better economics to credit the trading owner with the current realisable value of any stock which he has chosen to dispose of without commercial disposal than to credit him with an amount equivalent to the accumulated expenses in respect of that stock. In that sense, the trader's choice is itself the receipt, in that he appropriates value to himself or his donee direct, instead of adopting the alternative method of a commercial sale and subsequent appropriation of the proceeds.

Lord Tucker.—My Lords, I would allow this appeal for the reasons which have been stated by my noble and learned friend, Lord Radcliffe.

Questions put:

That the Order appealed from be reversed and the judgment of Vaisey, J., be restored.

The Contents have it.

That the Respondent do pay to the Appellant his costs here and in the Courts below.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Withers & Co.]

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(1) 24 T.C. 506.

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