HIGH COURT OF JUSTICE (CHANCERY DIVISION)—
4TH, 5TH AND 11TH DECEMBER 1967

COURT OF APPEAL—16TH, 17TH AND 20TH MAY 1968

HOUSE OF LORDS—10TH, 11TH, 12TH AND 13TH MARCH, AND 29TH APRIL 1969

Commissioners of Inland Revenue *v.* Land Securities Investment Trust Ltd.[1]

Profits tax—Deduction—Property company—10-year rentcharges payable as consideration for lessor's interest in properties leased to company—Finance Act 1937 (1 *Edw.* 8 & 1 *Geo.* 6, *c.* 54), *s.* 20(1) *and Sch.* 4, *para.* 4; *Finance (No.* 2) *Act* 1940 (3 & 4 *Geo.* 6, *c.* 48), *s.* 14; *Income Tax Act* 1952 (15 & 16 *Geo.* 6 & 1 *Eliz.* 2, *c.* 10), *s.* 177.

The Respondent Company carried on business as a property investment company. In January 1960 *the Church Commissioners sold to the Company (or a subsidiary grouped with it for profits tax purposes), in consideration of rentcharges reserved for ten years, the Commissioners' freehold or leasehold interest in seven properties which were already let by them to the Company (or its subsidiary) for terms with between* 60 *and* 990 *years to run. Three of the properties were burdened with head rents totalling* £22,000 *per annum; the rentcharges totalled* £96,000 *per annum; the aggregate rents payable for the properties by the group before the transaction were* £62,500 *per annum. The rentcharges were paid under deduction of income tax on the footing that s.* 177, *Income Tax Act* 1952, *applied.*

On appeal against assessments to profits tax for the chargeable accounting periods of twelve months ending 31*st March* 1960 *to* 1964, *the Company contended* (a) *that the rentcharges were rentcharges to which s.* 177 *applied and should be deducted in computing its profits, and* (b) *that no part of them could be regarded as of a capital nature. For the Crown it was contended* (i) *that s.* 177 *did not extend to rentcharges of a capital nature;* (ii) *that for the purposes of s.* 177 *the rentcharges should be dissected into capital and income payments by reference to the terms of correspondence between the Company and the Church Commissioners, and that only the part representing an income payment was an admissible deduction for profits tax purposes; alternatively,* (iii) *if the whole of each rentcharge was within s.* 177, *nevertheless, by virtue of s.* 14, *Finance (No.* 2) *Act* 1940, *such part as on income tax principles represented a capital payment was not an admissible deduction. The Special Commissioners held* (1) *that s.* 177 *applied to the whole of any rentcharge, whether or not it contained a capital element;* (2) *that the assets acquired by the Company were the reversions to their leases and underleases,*

[1] Reported (Ch. D.) [1968] 1 W.L.R. 423; 112 S.J. 16; [1968] 1 All E.R. 955; (C.A.) [1968] 1 W.L.R. 1446; 112 S.J. 524; [1968] 3 All E.R. 33; (H.L.) [1969] 1 W.L.R. 604; 113 S.J. 407; [1969] 2 All E.R. 430.

which were doubtfully of any monetary value, and from a commercial point of view the whole of the payments were rents and as such deductible. A

Held, *that, irrespective of whether s.* 177 *applied, the rentcharges were the cost of acquiring capital assets, viz., the reversions of the properties, and therefore not admissible deductions on income tax principles.*

CASE B

Stated under the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 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 20th and 21st July 1965, The Land Securities Investment Trust Ltd. (hereinafter called "the Company") appealed against the following assessments to profits tax: C

Chargeable accounting period from			
	1st April 1959 to 31st March 1960	in a sum of	£30,000 (tax)
do.	1st April 1960 to 31st March 1961	do.	£50,000 (tax) D
do.	1st April 1961 to 31st March 1962	do.	£45,000 (tax)
do.	1st April 1962 to 31st March 1963	do.	£24,000 (tax)
do.	1st April 1963 to 31st March 1964	do.	£168,750 (tax) E

2. Shortly stated, the question for our decision was whether the Company was entitled, in computing its profits for the purpose of the assessments under appeal, to deduct amounts paid by it in respect of certain rentcharges.

3. (1) The following documents were admitted or proved:

(*a*) An agreement dated 5th January 1960 between the Church Commissioners for England (hereinafter called "the Church Commissioners") and the Company and Associated London Properties Ltd. (exhibit A([1])). F

(*b*) Copies of seven deeds of transfer, all dated 25th March 1960, of the properties referred to in the said agreement. So far as the arguments before us were concerned, no distinction was drawn between these deeds, and one only (that relating to Title no. LN 57344) is annexed (exhibit B([2])).

(*c*) The Company's printed reports and accounts for the years ended 31st March 1960, 1961, 1962, 1963 and 1964. G

Such of the above documents as are not annexed hereto are held available for inspection by the Court if required.

(2) The following additional documents were tendered in evidence on behalf of the Commissioners of Inland Revenue as being relevant and admissible if we should accept either the second or the fourth of the Crown's contentions of law (set out in para. 9 of this Case), but it was agreed that they would not otherwise be admissible. For the Company the admissibility of these documents was contested in any event. As we did not accept the said contentions of the Commissioners of Inland Revenue it did not become necessary for us to determine their admissibility, nor did we take them into H

([1]) *See* page 509 *post*. ([2]) *See* page 501 *post*.

consideration in arriving at our decision, although by agreement between the parties they had been placed before us and referred to. These documents, which are held available for inspection by the Court if required, are: a bundle of letters passing between Sir Harold Samuel and the Church Commissioners, relating to negotiations prior to making the said agreement, and a bundle of copies of file notes and inter-office memoranda of the Church Commissioners relating to the said negotiations.

(3) We found the facts set out in paras. 4 to 7 below.

4. The Company is a very large public company carrying on business as a property investment trust company. Its issued share and debenture capital total some £85 million, and it holds (either itself or through subsidiaries) properties valued at over £100 million. It does not carry on any trade of dealing, and is not assessed to income tax under Case I of Schedule D. Its chairman and managing director at all relevant times was Sir Harold Samuel. One of its wholly-owned subsidiaries is Associated London Properties Ltd. (hereinafter called "Associated"). Associated was a party to the agreement and to one of the deeds of transfer referred to later in this Case, but we were informed that nothing turned upon this because Associated is grouped with the Company for the purpose of assessment to profits tax.

5. The Church Commissioners owned certain freehold and leasehold properties which were let or underlet to the Company (or, in the case of one property, to Associated) on long leases. By agreement dated 5th January 1960 (exhibit A[1]) the Church Commissioners agreed to sell to the Company their freehold or leasehold interest (or, in the case of the property let to Associated, to sell to Associated) subject to the leases and underleases to the Company in consideration of rentcharges. Particulars of the properties, the leases to the Company or to Associated, and the rentcharges are set out in a schedule to this agreement, but for convenience brief particulars are set out below.

Property	*Particulars of lease or underlease to the Company*	*Rentcharge*
No. 1 Freehold	993 years from 1953 at £5,000	£12,000
No. 2 Freehold	150 years from 1948 at £2,000	£4,800
No. 3 Freehold	150 years from 1947 at £2,000	£4,800
No. 4 Underlease 71 years from 1949 at £7,500 per annum	whole term less 3 days at £17,500	£23,450
No. 5 Leasehold 99 years from 1935 at £5,000 per annum	whole term less 3 days at £7,000	£4,700
No. 6 Leasehold 99 years from 1934 at £9,500	whole term less 3 days at £20,000	£24,650
No. 7 Freehold	999 years at £9,000 (this was the lease to Associated)	£21,600

The agreement provided that the transfers of the properties should be in a form agreed, and the transfers were duly made on 25th March 1960. These provided (exhibit B[1]) that the rentcharge reserved in each case was a yearly

(1) *See* page s. 509–10 *post*.

rentcharge for the period of ten years from 1st April 1959 charged on and issuing out of the property transferred. A

6. (*a*) It will be seen from para. 5 above that the Company and Associated, which had previously owned long leases or underleases for varying terms at rents totalling £62,500 per annum, acquired by the transfers freeholds and leaseholds, subject to head rents totalling £22,000 per annum, burdened with rentcharges totalling £96,000 per annum for ten years. B

(*b*) It was common ground that prior to the transfer the rents paid by the Company or Associated (totalling £62,500 per annum) were deductible in computing profits for profits tax purposes; it was also common ground that after the transfer the head rents (£22,000 per annum) were so deductible. The dispute concerned the rentcharges.

(*c*) The Company or Associated deducted income tax at the standard rate on paying the rentcharges, on the footing that s. 177 of the Income Tax Act 1952 entitled them so to do, and the Church Commissioners did not challenge their right to do so. Section 177 applies to (*inter alia*): C

> "any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land", D

and provides that any such payment shall be subject to deduction of income tax as if it were a royalty or other sum paid in respect of the user of a patent.

7. It was common ground that in the negotiations leading up to the agreement of 5th January 1960 there was no legally enforceable agreement between the Company or Associated and the Church Commissioners for the purchase of any of the properties for a lump sum. E

8. It was contended on behalf of the Company:

(1) that the rentcharges reserved in the transfers were rentcharges to which s. 177 applied, and that (by reference to the statutory provisions concerning the computation of profits for profits tax) they should be deducted in computing the profits assessed, and the assessments should be reduced accordingly; F

(2) it was further contended (in answer to the Crown's contentions) that the rentcharges were not payments of a capital nature, nor could any part of them be regarded as of a capital nature.

9. It was contended on behalf of the Commissioners of Inland Revenue:

(1) that the documents referred to in para. 3(2) above were admissible and relevant to the enquiry as to the true nature (capital or income) of the payments made in respect of the rentcharges; G

(2) that the reference to "rentcharge" in s. 177 was a reference to a rentcharge of an income nature and did not extend to a rentcharge which was of a capital nature;

(3) that on the evidence referred to in para. 3(2) above the rentcharges were part capital and part income, and should be dissected, and that s. 177 applied only to such part as (on dissection) should be found to represent an income payment, and that accordingly the Company was only entitled to a deduction, in computing its profits for profits tax purposes, of that part of the rentcharges in question and no more: H

(4) that if (contrary to the above contentions) the whole of each rentcharge was within s. 177 and the Company was accordingly entitled to deduct income tax therefrom, it was nevertheless not entitled to deduct the payments I

for profits tax purposes by virtue of s. 14(1) of the Finance (No. 2) Act 1940, since on income tax principles they were payments of a capital and not of a revenue nature; and that the documents mentioned in para. 3(2) of this Case were relevant and admissible evidence in relation to this contention.

10. We, the Commissioners who heard the appeal, decided as follows:

(1) We held that the reference in s. 177 to "any . . . rentcharge" was an unqualified reference to any rentcharge reserved or charged upon land; that the rentcharges reserved by the deeds of transfer were rentcharges reserved or charged on land; that, in determining whether s. 177 applied to such rentcharges, it was irrelevant to enquire whether on dissection (if any dissection be allowable in law, and we thought it was not) they contained a capital and income element; that the said rentcharges were rentcharges from which s. 177 authorised the Company to deduct income tax.

(2) The only other issue before us we understood to be that deduction of the rentcharges in computing assessable profits was prohibited by s. 14(1), Finance (No. 2) Act 1940, the rentcharges being (it was contended) payments made to secure capital assets.

The only assets which might be said to have been acquired by the Company under the transfers were the reversions to their leases and underleases. Having regard to the length of time unexpired on the latter it seemed to us doubtful whether these reversions had any real monetary value. From a commercial point of view we thought the reality of the matter was that the Company had substituted larger rents for a ten-year period for smaller rents for varying longer periods. The payments claimed were in their nature rents, and as such were income payments properly deductible in computing the Company's profits. We left figures to be agreed.

11. Figures having been subsequently agreed we determined the appeals on 15 August 1966 by adjusting the assessments as under:

Chargeable accounting period from		
	1st April 1959 to 31st March 1960	£42,036 6*s.* (tax)
do.	1st April 1960 to 31st March 1961	£59,386 17*s.* 6*d.* (tax)
do.	1st April 1961 to 31st March 1962	nil
do.	1st April 1962 to 31st March 1963	nil
do.	1st April 1963 to 31st March 1964	£169,498 4*s.* (tax)

12. The Commissioners of Inland Revenue immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Management Act 1964, s. 12(5), and the Income Tax Act 1952, s. 64, which Case we have stated and sign accordingly.

The question of law for the opinion of the Court is whether we erred in law in holding (1) that the rentcharges were within s. 177 of the Income Tax Act 1952; (2) that they were not payments of a capital nature; and (3) that the said payments were deductible in computing the Company's profits for the purpose of the assessments to profits tax under appeal.

R. A. Furtado
W. E. Bradley
} Commissioners for the Special Purposes of the Income Tax Acts

Turnstile House,
94–99 High Holborn,
London W.C.1.
3rd July 1967

The case came before Cross J. in the Chancery Division on 4th and 5th December 1967, when judgment was reserved. On 11th December 1967 judgment was given in favour of the Crown, with costs.

W. A. Bagnall Q.C. and *J. Raymond Phillips* for the Crown.

F. Heyworth Talbot Q.C. and *M. P. Nolan* for the Company.

The following cases were cited in argument in addition to those referred to in the judgment:—*Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153; *Commissioners of Inland Revenue* v. *Wesleyan & General Assurance Society* (1948) 30 T.C. 11.

Cross J.—The Respondent, Land Securities Investment Trust Ltd., is a large public company carrying on business as a property investment trust company. Immediately before 5th January 1960 it held leases or underleases from the Church Commissioners of six properties in London, details of which were as follows: (1) in respect of Marcol House, Regent Street, the freehold of which was vested in the Commissioners, the Company held a lease for 993¼ years from 29th September 1953 at an annual rent of £5,000; (2) in respect of 158–160 City Road, the freehold of which was vested in the Commissioners, the Company held a lease for 150 years from 25th December 1948 at an annual rent of £2,000; (3) in respect of 55, 57 and 59 Oxford Street and 2 Soho Square, the freehold of which was vested in the Commissioners, the Company held a lease for 150 years from 25th December 1947 at an annual rent of £2,000: (4) in respect of King William Street House, of which the Commissioners held an underlease for 71½ years less 2 days from 24th June 1949 at a rent of £7,500, the Company held a sub-underlease for 71½ years less 3 days from 24th June 1949 at a rent of £17,500; (5) in respect of Granite House, Cannon Street, of which the Commissioners held a lease for 99 years from 25th March 1935 at a rent of £5,000, the Company held an underlease for 83½ years less 3 days from 29th September 1950 at a rent of £7,000; (6) in respect of Regis House, King William Street, of which the Commissioners held a lease for 99 years from 25th March 1934 at a rent of £9,500, the Company held an underlease for 83¼ years less 3 days from 25th December 1949 at a rent of £20,000; further, (7) in respect of 112, 113, and 114 Fenchurch Street and 17 and 18 Billiter Street, the freehold of which was vested in the Commissioners, Associated London Properties Ltd., which is a wholly-owned subsidiary of the Company and which is grouped with it for profits tax purposes, held leases of 112 and 113 Fenchurch Street and 18 Billiter Street for 999½ years from 24th June 1954 and of 114 Fenchurch Street and 17 Billiter Street from 25th March 1955 to 25th December 2946 at an aggregate rent of £9,000.

By an agreement made on 5th January 1960 between the Church Commissioners of the first part, the Company of the second part and Associated of the third part it was agreed that the Commissioners should sell and the Company should purchase the first six properties before mentioned and that the Commissioners should sell and Associated should purchase the property seventhly mentioned in consideration, in each case, of a rentcharge for ten years from 1st April 1959 of the following amounts: property (1) £12,000 per annum; property (2) £4,800 per annum; property (3) £4,800 per annum; property (4) £23,450 per annum; property (5) £4,700 per annum; property (6) £24,650 per annum; property (7) £21,600 per annum. The said agreement was duly completed by seven transfers, of which I take that in respect of Marcol House, Regent Street, as an example. That is dated 25th March 1960 and reads:

> "1. In consideration of the rentcharge hereinafter reserved and the covenant by Land Securities hereinafter contained the Commissioners being seised in fee simple hereby transfer to Land Securities (and so that the same covenants shall be implied herein as if the Commissioners had been and had been expressed to convey or transfer as Beneficial Owners) the land comprised in the Title above referred to reserving out of the premises to the Commissioners a yearly rentcharge of Twelve Thousand Pounds (£12,000) for the period of Ten years from the First day of April One thousand nine hundred and fifty nine charged on and issuing out of the property hereby transferred and to be paid without any deductions except for property or income tax by equal yearly payments on the Twenty fifth day of March in every year the first payment of £12,000 for and in respect of the full year commencing on the First day of April One thousand nine hundred and fifty nine to be made on the Twenty fifth day of March One thousand nine hundred and sixty and the last payment to be made on the Twenty fifth day of March One thousand nine hundred and sixty nine. 2. Land Securities hereby covenant with the Commissioners that Land Securities will at all times hereafter during the continuance of the term thereof pay the said yearly rentcharge (including the said sum of £12,000 for and in respect of the said full year commencing on the First day of April One thousand nine hundred and fifty nine) at the times hereinbefore appointed for payment thereof. 3. For the removal of doubt It Is Hereby Declared that in the event of the exercise in any manner whatsoever by the Commissioners of their powers or any of them under Section 121(4) of the Law of Property Act 1925 the surplus of all moneys received by or under or by virtue of or arising in consequence of the exercise of the said powers or any of them after satisfaction of all sums to which the Commissioners may be entitled as rentcharge-owners hereunder shall in all circumstances be held in trust for and payable to Land Securities. 4. It Is Hereby Further Declared that the rights of the Commissioners under Section 121(4) of the Law of Property Act 1925 shall continue in being for so long as any part of the rentcharge herein reserved remains unpaid notwithstanding the expiration of the period of ten years hereinbefore mentioned."

Then there are provisions for insurance and against the premises being altered, which I need not read.

It will be seen that as a result of this transaction the Company and Associated, which had previously owned long leases or underleases at rents totalling £62,500 per annum, acquired four freeholds and three leaseholds (subject, as to the leaseholds, to head rents totalling £22,000 per annum) burdened with seven rentcharges totalling £96,000 per annum for ten years. The Company or Asso-

(Cross J.)

ciated have always deducted income tax at the standard rate on the whole of the rentcharges on the footing that s. 177 of the Income Tax Act 1952 entitled them to do so, and the Church Commissioners have never challenged their right to do so. The Church Commissioners are, of course, a charity, and if income tax has been properly deducted from the rentcharges it will be repayable by the Revenue to the Commissioners; but the question whether or not it is so deductible and repayable has not yet been decided as between the Revenue and the Commissioners. The question at issue in this appeal is how the transaction has affected the profits tax liability of the Company. It is common ground that prior to the transfers the rents payable by the Company and Associated were deductible for profits tax purposes and it is also common ground that after the transfers the head rents of £22,000 became deductible for these purposes. The question is whether the rentcharges or any part of the rentcharges are deductible.

I will now set out the statutory provisions which may affect the question. Finance Act 1937, s. 20(1):

> "For the purpose of the national defence contribution, the profits arising from a trade or business in each chargeable accounting period shall be separately computed, and shall be so computed on income tax principles as adapted in accordance with the provisions of the Fourth Schedule to this Act. For the purpose of this subsection, the expression 'income tax principles' in relation to a trade or business means the principles on which the profits arising from the trade or business are computed for the purpose of income tax under Case I of Schedule D, or would be so computed if income tax were chargeable under that Case in respect of the profits so arising."

Then, turning to Sch. 4, I will read para. 4:

> "The principles of the Income Tax Acts under which deductions are not allowed for interest, annuities or other annual payments payable out of the profits, or for royalties, or (in certain cases) for rent, and under which the annual value of lands, tenements, hereditaments or heritages occupied for the purpose of a trade or business is excluded, and under which a deduction may be allowed in respect of such annual value, shall not be followed: Provided that nothing in this paragraph shall authorise any deduction in respect of—(*a*) any payment of dividend or distribution of profits; or (*b*) any interest, annuity or other annual payment paid to any person carrying on the trade or business, or any royalty or rent so paid; and, for the purpose of paragraph (*b*) of this proviso, where the trade or business is carried on by a company the directors whereof have a controlling interest therein, the directors shall be deemed to be carrying on the trade or business."

Then, Finance (No. 2) Act 1940, s. 14(1):

> "No deduction in respect of any interest, annuity or other annual payment shall, by virtue of paragraph 4 of Part I of the Seventh Schedule to the Finance (No. 2) Act, 1939, or paragraph 4 of the Fourth Schedule to the Finance Act, 1937, be allowed in computing the profits of a trade or business for the purposes of excess profits tax or the national defence contribution unless the interest, annuity or other annual payment would, on income tax principles, be an allowable deduction in computing profits but for the express provision contained in paragraph (*l*) of Rule 3 of the Rules applicable to Cases I and II of Schedule D that no deduction is to be made in respect of any annual interest or any annuity or other annual

payment payable out of the profits or gains. In this subsection, the expression 'income tax principles' has the same meaning as it has for the purposes of subsection (1) of section fourteen of the Finance (No. 2) Act, 1939, and subsection (1) of section twenty of the Finance Act, 1937."

Then, coming to the Income Tax Act 1952, I should briefly refer to ss. 122 and 123.

"122. The Schedule referred to in this Act as Schedule D is as follows:—Schedule D. 1. Tax under this Schedule shall be charged in respect of—(*a*) the annual profits or gains arising or accruing—(i) to any person residing in the United Kingdom from any kind of property whatever, whether situate in the United Kingdom or elsewhere; and (ii) to any person residing in the United Kingdom from any trade, profession, employment or vocation, whether carried on in the United Kingdom or elsewhere; and (iii) to any person, whether a British subject or not, although not resident in the United Kingdom, from any property whatever in the United Kingdom, or from any trade, profession, employment or vocation exercised within the United Kingdom."

Section 123, so far as relevant, reads:

"Tax under Schedule D shall be charged under the following Cases respectively, that is to say—Case I—tax in respect of any trade carried on in the United Kingdom or elsewhere; Case II—tax in respect of any profession or vocation not contained in any other Schedule".

Section 137:

"Subject to the provisions of this Act, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of— . . . (*f*) any capital withdrawn from, or any sum employed or intended to be employed as capital in, such trade, profession or vocation; . . . (*n*) any rent, royalty or other payment which, under any of the provisions of this Act, is declared to be subject to deduction of tax under Chapter I of Part VII of this Act as if it were a royalty or other sum paid in respect of the user of a patent."

Then s. 169:

"(1) Where any yearly interest of money, annuity or other annual payment is payable wholly out of profits or gains brought into charge to tax—(*a*) no assessment shall be made on the person entitled to the interest. annuity or annual payment; and (*b*) the whole of the profits or gains shall be assessed and charged with tax on the person liable to the interest, annuity or annual payment, without distinguishing the interest, annuity or annual payment; and (*c*) the person liable to make the payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making the payment, to deduct and retain out of it a sum representing the amount of the tax thereon at the standard rate for the year in which the amount payable becomes due; and (*d*) the person to whom the payment is made shall allow the deduction on receipt of the residue of the payment, and the person making the deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid." I need not read subs. (2). "(3) Where—(*a*) any royalty or other sum paid in respect of the user of a patent; or (*b*) any rent, royalty or other payment which, under any of the provisions of this Act, is declared to be subject to deduction of tax

under this Chapter as if it were a royalty or other sum paid in respect of the user of a patent, is paid wholly out of profits or gains brought into charge to tax, the person making the payment shall be entitled on making the payment to deduct and retain out of it a sum representing the amount of the tax thereon at the standard rate for the year in which the amount payable becomes due."

Finally, s. 177:

"(1) This section applies to the following payments, that is to say—(*a*) rents under long leases; and (*b*) any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land, not being rent under a short lease or an annuity within the meaning of the Tithe Acts, 1936 and 1951. (2) Any payment to which this section applies shall, so far as it does not fall under any other Case of Schedule D, be charged with tax under Case VI of Schedule D and be subject to deduction of tax under Chapter I of this Part of this Act as if it were a royalty or other sum paid in respect of the user of a patent."

The submissions made to, and the decision of, the Commissioners fell into two parts. First, there was the question whether in applying s. 177 of the Income Tax Act to the case one could dissect the rentcharge in question into two portions, one representing capital and the other income. The Company argued that no such dissection was permissible. It was submitted on behalf of the Crown, on the other hand, that s. 177 only applied to so much of the rentcharge as was of an income nature, and for the purpose of ascertaining what that portion was, they tendered in evidence certain correspondence passing between Sir Harold Samuel, the chairman of the Company, and the Church Commissioners during the negotiations leading up to the agreement, and also a bundle of copies of file notes and inter-office memoranda of the Church Commissioners relating to the negotiations.

The Special Commissioners dealt with this point as follows (see para. 10(1) of the Case):

"We held that the reference in s. 177 to 'any . . . rentcharge' was an unqualified reference to any rentcharge reserved or charged upon land; that the rentcharges reserved by the deeds of transfer were rentcharges reserved or charged on land; that, in determining whether s. 177 applied to such rentcharges, it was irrelevant to enquire whether on dissection (if any dissection be allowable in law, and we thought it was not) they contained a capital and income element; that the said rentcharges were rentcharges from which s. 177 authorised the Company to deduct income tax."

In view of this decision it was not necessary for them to decide upon the admissibility of or to consider the material which the Crown wished to put in. It is not annexed to the Case Stated, and although it was available for me to see if I wished, I have not in fact looked at it.

The second question was whether, even if the Company was entitled to deduct income tax from the whole of each instalment of the rentcharges when it paid them, it nevertheless was not entitled to deduct the payments for profits tax since on income tax principles they were payments of a capital and not of a revenue character. The Special Commissioners dealt with this contention as follows (see para. 10(2)):

"The only other issue before us we understood to be that deduction of the rentcharges in computing the assessable profits was prohibited by s. 14(1), Finance (No. 2) Act 1940, the rentcharges being (it was con-

tended) payments made to secure capital assets. The only assets which might be said to have been acquired by the Company under the transfers were the reversions to their leases and underleases. Having regard to the length of time unexpired on the latter it seemed to us doubtful whether these reversions had any real monetary value. From a commercial point of view we thought the reality of the matter was that the Company had substituted larger rents for a ten-year period for smaller rents for varying longer periods. The payments claimed were in their nature rents, and as such were income payments properly deductible in computing the Company's profits. We left figures to be agreed."

The Crown asked for a Case to be stated, which concludes as follows:

"12. . . . The question of law for the opinion of the Court is whether we erred in law in holding (1) that the rentcharges were within s. 177 of the Income Tax Act 1952; (2) that they were not payments of a capital nature; and (3) that the said payments were deductible in computing the Company's profits for the purpose of the assessments to profits tax under appeal."

I must say at once that I find the conclusion of the Special Commissioners that the Company had not acquired any capital assets in consideration for the rentcharges difficult to follow. No doubt if a man buys a freehold property subject to a lease which has only a few years to run it is natural for him to regard himself as buying two things: first, the right to receive the rent for the rest of the lease and, second, the right in the not very distant future to come into possession of the property. In this case, having regard to the length of the leases to which the freeholds were subject and the fact that the leaseholds purchased were subject to underleases for their whole duration less a day or so, the second element was absent. But the right to receive the rents for the remainder of the leases was itself a capital asset. If the reversions on the Company's leases had been purchased by a third party who was not a property dealer it could hardly be said that he had not acquired capital assets, and the position surely cannot be different because the Company purchased the reversions itself and thereby extinguished its liability to go on paying the rents. No doubt what from a commercial point of view would have been a similar result might have been achieved by an agreement between the parties increasing the rents payable under the leases to £96,000 for the ensuing ten years and reducing them to a nominal figure thereafter. But that is not what the parties did. The Church Commissioners sold and the Company purchased a capital asset. Of course, a capital asset may be acquired in consideration of payments of a wholly income character. This might have been the case here if the reversions had been purchased in consideration of perpetual rentcharges which would have been equivalent to interest on a purchase price payment of which was indefinitely postponed. But when a capital asset is acquired in consideration of a rentcharge for ten years it is natural to suppose that some part of each instalment will have a capital character, and one would expect to find an Act which professes to tax income providing that the recipient of the rentcharge is only to be liable for tax on the income element and the payer is only to be entitled to deduct tax from the income element.

This brings me to consider s. 177 of the Income Tax Act 1952. I had to consider a somewhat analogous question six years ago in the case of *Vestey* v. *Commissioners of Inland Revenue*[1] 40 T.C. 112. I wish very much that that case had gone to appeal so that I could have had some guidance other than my

(1) [1962] Ch. 861.

(Cross J.)

own in solving the present problem. I will not repeat all that I said there. The essence of the matter, as I see it, is that in *Secretary of State for India* v. *Scoble*[1] [1903] A.C. 299 the House of Lords held that you might have an annuity payable under a contract only part of which was an annuity for the purposes of the Income Tax Acts. The annuity there in question was of £1,300,000 odd charged on the Revenue of India and payable each year from 1901 to 1948 as the consideration for a railway and works the purchase price of which if the Secretary of State had chosen to pay a gross sum would have been £34,850,000. The Secretary of State claimed to deduct tax on the whole annuity but the House of Lords decided that he was only entitled to deduct tax from that part of it which represented interest as opposed to payment of the capital value. I cannot think that the decision would have been different if, instead of being liable to pay an annuity charged on the Revenue of India, the Secretary of State had been liable to pay a rentcharge charged on lands belonging to the Government of India. It is true that the provisions in the income tax legislation permitting deduction of tax on payment of annual sums charged on land have always been separate from those relating to ordinary annuities, no doubt because tax in respect of property in land was charged under a separate Schedule; but the principle which applies to annuities charged on personalty must surely also apply to rentcharges.

That does not, of course, mean that, as between the Church Commissioners and the Company, such part of the rentcharges as may represent capital stands on a different footing from such part as may represent income. If the rentcharges fell into arrear the Church Commissioners would have exactly the same remedies in respect of every pound owing. The dissection is simply for the purposes of the Income Tax Acts. It is true that in *Scoble's* case it was apparent on the face of the contract that part of the annuity represented a capital repayment. Further, the contract mentioned the rate of interest applicable, so that the dissection could be worked out without recourse to outside evidence. But, as I said in the *Vestey* case[2], later cases—particularly *Perrin* v. *Dickson*[3] [1930] 1 K.B. 107—have shown that if necessary the Courts will have recourse to outside evidence to establish what the true position is. In this case I have not looked at the documentary evidence which the Crown wished to adduce, and Counsel for the Respondent said that if the point of principle was decided against him he would wish to call Sir Harold Samuel to give oral evidence. In these circumstances I express no view as to what the outcome of this case will be. All that I do is to remit it for further consideration by the Special Commissioners in the light of this judgment. That is all I can do, I think, Mr. Phillips, is it not?

Phillips—I think so, my Lord.

Cross J.—I do not know what the result of the evidence will be at all.

Phillips—I have prepared a form of Order, which my learned friend has seen, in the event that your Lordship decided the dissection point in our favour.

Cross J.—What is that?

Phillips—I will hand in a copy, if I may. I was not altogether clear as to exactly what your Lordship said on the second point.

Cross J.—I said that I thought they had acquired a capital asset. That, I think, will be apparent to anyone who reads the judgment.

Phillips—Yes. With respect, my Lord, what I said sounded rather discourteous. I understood that, but I was not quite clear whether the effect of

(1) 4 T.C. 478 and 618. (2) 40 T.C. 112, at pp. 122–3. (3) 14 T.C. 608.

that on the matters at issue in this particular case meant that, having acquired a capital asset, in any event and apart from the dissection point, these payments were not deductible.

Cross J.—I do not know. I do not know what the evidence is going to be. I can say nothing about that. What do you say, remit the case?

Phillips—The proposal on the dissection point was that the case be remitted to consider the documents referred to in para. 3(2) of the Stated Case and such other evidence as the parties may tender; secondly, to determine whether any part, and if so how much, of the rentcharge payments made by the Company to the Church Commissioners is deductible by the Company in computing its profits for the purposes of the assessments to profits tax under appeal.

Cross J.—Nothing that I said with regard to the capital point would prevent the deduction of anything which has got an income element.

Phillips—If your Lordship pleases.

Cross J.—That is what I intended, but I do not know how much has.

Phillips—On that footing, then, in my submission this, so far as the form of Order is concerned, would be a proper Order.

Cross J.—Do you agree to that?

Nolan—I do, my Lord.

Cross J.—Does that simply leave the question of costs?

Phillips—On the question of costs, that has been left suspiciously blank. My submission is that at this stage the appropriate Order would be that the Crown should have their costs. We have had to come here to establish this point.

Cross J.— Whatever the result on remission?

Phillips—Whatever the result hereafter.

Cross J.—What do you say about that?

Nolan—My Lord, when the result is largely uncertain it would seem, in my submission, a little hard that the Crown should be given their costs in any event. I would respectfully suggest that the question of costs should be reserved with liberty to apply to your Lordship after the matter has been back to the Special Commissioners. That would guard against the possibility that it might not come up before the Court again.

Cross J.—Yes, but after all, even if they decide that it was all income having regard to the evidence, the Crown would still have established a point of principle which, if I am right, the Commissioners decided against them on s. 177. I do not quite see how the Crown could do other than appeal about it, and as far as I am concerned they were right.

Nolan—I respectfully follow that, my Lord. On the other hand, if the result is that the substance of the Commissioners' decision is upheld in the sense that these payments are deductible, it would seem perhaps a little hard that the taxpayer should pay for the Crown's point of principle.

Cross J.—Yes, I hear what you say. What do you say about it, Mr. Phillips?

Phillips—I can test my submission in this way, my Lord: suppose the case as it is now remitted, and after hearing this further evidence the Special Commissioners decide that the whole of the payment is income—

Cross J.—That is the most favourable thing that could happen. Sir Harold Samuel is so open that he convinces them 100 per cent.?

Phillips—100 per cent., yes. I still come back here and say we are entitled to our costs of this hearing because what the Commissioners have decided is that they were not entitled to look into the evidence and consider the question at all.

Cross J.—They decided it simply on the construction of s. 177.

Phillips—And we have demonstrated that that is wrong, and therefore we have succeeded in any event, and whatever happens hereafter the Crown, in my submission, must be entitled to its costs so far.

Cross J.—I think that is right. I think I must make an Order for costs. The costs of the Crown must be paid by the taxpayer.

Phillips—I am much obliged, my Lord. The Order otherwise will be in the terms handed up to your Lordship?

Cross J.—That is right.

The Company having appealed against the above decision, the case came before the Court of Appeal (Danckwerts, Salmon and Fenton Atkinson L.JJ.) on 16th, 17th and 20th May 1968, when judgment was given unanimously against the Crown, with costs.

W. A. Bagnall Q.C. and *J. Raymond Phillips Q.C.* for the Crown.

F. Heyworth Talbot Q.C. and *M. P. Nolan Q.C.* for the Company.

The following cases were cited in argument in addition to those referred to in the judgments:—*Foley* v. *Fletcher* (1858) 3 H. & N. 769; *Perrin* v. *Dickson* 14 T.C. 608; [1930] 1 K.B. 107; *Duke of Westminster* v. *Commissioners of Inland Revenue* 19 T.C. 490; [1936] A.C. 1; *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79; *Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153; *Sothern-Smith* v. *Clancy* 24 T.C. 1; [1941] 1 K.B. 276; *Lomax* v. *Peter Dixon & Son Ltd.* 25 T.C. 353; [1943] K.B. 671; *Coltness Iron Co.* v. *Black* (1881) 1 T.C. 287; 6 App. Cas. 315; *Jones* v. *Commissioners of Inland Revenue* 7 T.C. 310; [1920] 1 K.B. 711.

Danckwerts L.J.—This is a profits tax case. It is an appeal from a judgment given on 11th December 1967 by Cross J., who decided in favour of the Crown, reversing the decision of the Special Commissioners. The question is simply whether certain rentcharges which were created by the parties in regard to the relevant transactions are deductible under the provisions of s. 177 of the Income Tax Act 1952.

I will start by reading from the observations of the Commissioners in relation to their findings in the Stated Case. [His Lordship read or summarised paras. 4 to 10 of the Case Stated, at pages 497–499 *ante*, and continued:]

The Commissioners, therefore, found in favour of the taxpayer; of course, an odd feature of this case is that the contentions of the parties are reversed in regard to what usually happens in these Revenue cases, that is to say, that the taxpayer Company is arguing that the rentcharges are subject to income tax and that they can deduct tax, and the Church Commissioners have accepted that position. I think the position which annoys the Crown in this case is that, being a charity, the Church Commissioners claim to be entitled to recover the tax which has been deducted against them and therefore that presents a favourable feature to them.

A The case before Cross J. is reported at [1968] 1 W.L.R. 423, and the relevant Statutes, including the Finance (No. 2) Act 1940, are conveniently set out at the beginning of the report. I do not propose to read through them in detail. The only one I intend to read is s. 177 of the Income Tax Act 1952, which is the relevant section for the purposes of the present case. The provisions of that section are as follows:

B "(1) This section applies to the following payments, that is to say—(*a*) rents under long leases; and (b) any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land, not being rent under a short lease or an annuity within the meaning of the Tithe Acts, 1936 and 1951. (2) Any payment to which C this section applies shall, so far as it does not fall under any other Case of Schedule D, be charged with tax under Case VI of Schedule D and be subject to deduction of tax under Chapter I of this Part of this Act as if it were a royalty or other sum paid in respect of the user of a patent."

I do not think I need trouble with the rest of that section.

Cross J., with second sight or otherwise, found a capital ingredient in D these rentcharges, and the course which he adopted was to send back the case to the Special Commissioners so that they, in effect, might dissect these annual rentcharges and separate the capital element from the income element for the purposes of the provisions of the Act. I am bound to say I find it difficult to agree with his decision. In the first place, it is to be observed that, as has already been stated in the Case by the Commissioners, there never was any E agreement as to any capital sum. No doubt it may be that the Church Commissioners were disposing of a capital asset, but they were disposing of a capital asset entirely for a consideration expressed in the form of rentcharges which were agreed between the parties.

I therefore turn to the exhibits to the Stated Case. The first one is the contract between the parties. It was dated 5th January 1960, and it is between F the Church Commissioners, the Appellant Company and Associated London Properties Ltd. It provides as follows:

"1. The Commissioners shall sell and the First Purchaser shall purchase the properties described in Items 1 to 6 inclusive of Column One of the Schedule hereto And the Commissioners shall sell and the Second Purchaser shall purchase the property described in Item 7 of Column One G of the said Schedule Subject to the Leases mentioned in Column Three of the said Schedule and Subject and Except and Reserved as hereafter mentioned"—those are leases to which the sale was subject, being in favour of other persons. "2. The properties are sold subject to the following conditions and stipulations and to the General Conditions of Sale of the Law Society 1953."

H Then there is a reference to the Church Commissioners' solicitor, which I need not read. Clause 4 is an important one.

"4. The consideration for the Transfers shall be the respective rentcharges described in Column Five of the Schedule and the covenants on the part of the respective Purchasers for the payment of the said rentcharges. 5. The purchase shall be completed on the Twenty fifth day of I March One thousand nine hundred and sixty at the office of the Comissioners' Solicitor."

I need not refer to the schedule; I have stated the effect of it. There are a number of rentcharges, and they add up, as I say, to the sum of £96,000 a year.

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The transfer is also exhibited. The properties being registered under the Land Transfer Acts, it is in the form of a transfer according to the Land Registration Acts 1925 and 1936.

> "Deed of transfer between the Church Commissioners for England"—and then the address—"(hereinafter called 'the Commissioners') of the one part and the Land Securities Investment Trust Limited"—and then their registered office—"(hereinafter called 'Land Securities') of the other part. 1. In consideration of the rentcharge hereinafter reserved and the covenant by Land Securities hereinafter contained the Commissioners being seised in fee simple hereby transfer to Land Securities (and so that the same covenants shall be implied herein as if the Commissioners had been and had been expressed to convey or transfer as Beneficial Owners) the land comprised in the Title above referred to reserving out of the premises to the Commissioners a yearly rentcharge of Twelve thousand pounds (£12,000) for a period of Ten years from the First day of April One thousand nine hundred and fifty nine charged on and issuing out of the property hereby transferred and to be paid without any deductions except for property or income tax by equal yearly payments on the Twenty fifth day of March in every year the first payment of £12,000 for and in respect of the full year commencing on the First day of April One thousand nine hundred and fifty", and so on.

Then there are certain remedies attached to this, being a rentcharge. The Law of Property Act 1925, by s. 121, provides certain remedies which apply to rentcharges to enforce the same if they are not paid. There is no doubt that that document describes exactly what a rentcharge is, "issuing out of and charged on land", and there is no doubt whatever that these are rentcharges. There are other documents reserving rentcharges in the same way; whether they were upon freeholds or upon long leaseholds, they were also included in the transaction.

The case as argued on behalf of the Crown is based to a large extent upon analogy with cases which relate to annuities, in particular, *Scoble* v. *Secretary of State of India*(1) [1903] A.C. 299, which is one of the two cases upon which Cross J. relied, and a decision of his own, *Vestey* v. *Commissioners of Inland Revenue*(2) 40 T.C. 112. I do not propose to go in detail into the facts of those cases.

Scoble's case was a very different case from the present. It was a case where the Government of India was purchasing a railway undertaking, and a capital sum was named and then there was an option which was exercised by the Indian Government. Apparently they had not enough money in their possession to pay the very large capital sum which was concerned, and they exercised the option and elected to pay the sum over a period of years by payments which were obviously payments of capital as well as interest. That seems to me to be an entirely different case, and of no assistance really in the present case at all. But it was relied upon by the Crown because they pointed out that in that case annuities—which, of course, are mentioned in the same section as rentcharges—were shown in that way to be capable of comprising both capital and interest and they were dealt with accordingly. As to the other case, Cross J.'s decision in *Vestey* v. *Commissioners of Inland Revenue,* it is not necessary for me to say whether it was rightly or wrongly decided and I do not propose to say; but of course, it was a different case, as it seems to me, from the present case. There again there was a capital price reached in agreement

(1) 4 T.C. 478 and 618. (2) [1962] Ch. 861.

between the parties and then periodical payments were provided for for paying off that sum. It seems to my mind quite a different case from the present.

On the other hand, in the present case there seems to be no evidence to support the view of Cross J. that there was any capital sum agreed between the parties at all, and that seems to me also to be inconsistent with the finding of the Special Commissioners. What appears to be the case here is that the Church Commissioners were minded to dispose of their properties and their long leaseholds for payments in the form of rentcharges, which, *prima facie* at any rate, are completely payments of income and fall within the direct terms of s. 177, which is the relevant section for the purposes of this matter; and except where modern legislation such as s. 28 of the Finance Act 1960 (which produces financial murder in regard to certain transactions between parties) expressly interferes, it always has been the law that a taxpayer is entitled to arrange his affairs in such a way as to produce the minimum chargeable amount to tax. I rely on, and propose to apply, the observations of Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan & General Assurance Society* (1948) 30 T.C. 11, and I propose to read some extracts from his observations which seem to me particularly relevant to the present case. At page 16, Lord Greene M.R. says:

> "It is perhaps convenient to call to mind some of the elementary principles which govern cases of this kind. The function of the Court in dealing with contractual documents is to construe those documents according to the ordinary principles of construction, giving to the language used its normal ordinary meaning save in so far as the context requires some different meaning to be attributed to it. Effect must be given to every word in the contract save in so far as the context otherwise requires. Another principle which must be remembered is this. In considering tax matters a document is not to have placed upon it a strained or forced construction in order to attract tax, nor is a strained or forced construction to be placed upon it in order to avoid tax. The document must be construed in the ordinary way and the tax legislation then applied to it. If on its true construction it falls within a certain taxing category, then it is taxed. If on its true construction it falls oustide the taxing category, then it escapes tax. In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable. It is sufficient to refer to the quite common case where property is sold for a lump sum payable by instalments. If a piece of property is sold for £1,000 and the purchase price is to be paid in ten instalments of £100 each, no tax is payable. If, on the other hand, the property is sold in consideration of an annuity of £100 a year for ten years, tax is payable"—of course he was talking about income tax. "The net result from the financial point of view is precisely the same in each case, but one method of achieving it attracts tax and the other method does not."

Lord Simon, in the House of Lords, said much the same thing. He said, at page 25:

> "It may be well to repeat two propositions which are well established in the application of the law relating to Income Tax. First, the name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is really an annuity does not assist the taxpayer, any more than to call an item a capital payment would prevent it from being regarded as an income pay-

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ment if that is its true nature. The question always is what is the real character of the payment, not what the parties call it"—and then he refers to the result of a particular case, which I need not read. A

It seems to me those propositions apply in the present case. On the face of it these are a series of rentcharges, and as such they plainly fall within the terms of s. 177.

Mr. Bagnall, in his able argument, attempted to persuade us that we should give a different meaning to the transactions in the present case by applying the cases relating to annuities, because in some cases, as I have already mentioned, annuities are treated as not genuine annuities, or they are treated as comprising capital payments as well as payments of income; but those are cases, as I have already said, which on the terms of the transaction admit of those constructions. I am not prepared to say that in no circumstances could rentcharges be subject to the application of similar principles, but I am satisfied that in the present case nothing of that sort can be said. There is no suggestion that the transaction was not a perfectly bona fide one with the intention of creating rentcharges, and rentcharges, unless there is some element in the transaction which shows that a different construction should be applied, are payments of income and nothing else, it seems to me. B C D

In the present case the Crown desired to introduce some evidence—which was objected to, and therefore, I think properly, not given—that the parties might have had some sort of calculations in their minds in reaching the figures which were eventually decided upon for the rentcharges. Well, it may be so; but they were entitled to carry out the transaction in the manner which they adopted, and the notable feature of the present case, compared with the various authorities to which we have been referred, is that there is no lump sum throughout mentioned in any way whatsoever. In my view, this is simply a case where the Church Commissioners disposed of their assets for a number of rentcharges which were income payments, and received a higher income for ten years, and that appears to be the purpose they had in the transaction. On the other hand, the purchasing Companies were prepared to pay a higher rent for a limited period with a view to getting a more favourable financial position at the end of that period. It is a perfectly straightforward transaction, as I see it, and it seems to me that the Special Commissioners reached the right conclusion. I would allow the appeal and restore the decision of the Special Commissioners. E F

Salmon L.J.—I agree. I must confess that during the course of the hearing my mind has fluctuated somewhat, but in the end I consider that the findings of fact by the Special Commissioners make it necessary for us to allow the appeal. G

I do not wish, however, to be understood as accepting the argument that was advanced on behalf of the Appellant Company to the effect that, whenever a capital asset is transferred in consideration of a rentcharge, that transaction necessarily falls within s. 177. The case was put in the course of argument of a transfer of property for a rentcharge of £1,000,000 a year for two years. I am far from convinced that in a case such as that the rentcharge could be regarded in its entirety as an income payment or an income receipt. So to regard it would be to open up tempting but illusory vistas to those acquiring properties from charities. It would mean that tax could be deducted from the payments and then recovered by the charity concerned from the Revenue. Thus the Revenue would be making a large contribution to what might in reality be regarded as a purchase price of £2,000,000. H I

A The case, however, with which we have to deal is quite different. There is no evidence before the Court that the parties approached this transaction as, or intended the transaction in reality to be, the transfer of property for a capital sum payable with interest over a certain period: indeed, there is a finding by the Commissioners, as I read it, that this did not occur. It is very different case, as my Lord has said, from *Vestey's* case(1), because there shares B admittedly of a market value of £2,000,000 were sold for £5,500,000 payable by 125 yearly instalments of £44,000 each. The Commissioners found in that case that on an actuarial basis the annual sum required to pay £2,000,000 at 2 per cent. interest in equal instalments over 125 years was £43,670, which is just under £44,000. Cross J. came to the conclusion that the irresistible inference in that case was that the annual payment of £44,000 contained an element of C capital repayment plus an element of interest, and I am far from saying that he came to the wrong conclusion. As at present advised, I think *Vestey's* case was correctly decided but is wholly distinguishable from the present case.

For the reasons that my Lord has given, I think *Scoble's* case(2) [1903] A.C. 299 is also clearly distinguishable from the present case. To my mind, the Commissioners' basic finding here is that from a commercial point of view D there was in reality a substitution of larger rents over a ten years' period for smaller rents over longer periods of varying duration. The payments were in their nature rent, and as such were income payments properly deductible in computing the Appellant's profits.

It is conceded that one can transmute a capital asset into a right to receive income. Rent and rentcharges *prima facie* are income. There certainly were no E facts to contradict that presumption or to support that the findings of the Commissioners were not entirely justifiable. On that hypothesis, there is merely an exchange of rents: instead of smaller rents being paid for very long periods, larger rents were payable over a shorter period. In my view, the Commissioners were entitled to come to the conclusion that these were income payments and income receipts, and for my part I cannot agree with the learned Judge in F holding that that decision was wrong.

I would allow the appeal.

Fenton Atkinson L.J.—I agree. If I had been left to decide the matter on my own I think I would have been inclined to go the whole way with Mr. Heyworth Talbot's argument. I would have been inclined to say that s. 177 refers to payments in respect of any rentcharge; that the agreement between G the parties created certain rentcharges totalling £96,000 over ten years; that it is conceded that these were genuine rentcharges, there being no question here of the fixing of the label "rentcharge" to misdescribe the true nature of the transaction, the true meaning and effect of the contract between the parties being to sell certain assets in consideration of rentcharges, and that therefore, on the plain words of the section, the taxpayer Company was entitled to deduct H the tax from the payments and there could be no legal basis for embarking on a dissection of the rentcharges to see what part was capital and what was income. But having listened to my Lords' judgments I feel that that approach over-simplifies the matter, and in any case goes further than is necessary to decide this appeal on its own particular facts. For the reasons my Lords have given, I agree that this appeal should be allowed.

I **Talbot Q.C.**—In those circumstances, I take it your Lordships' Order will be that the appeal is allowed with costs here and below, and the Commissioners' decision is restored?

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(1) 40 T.C. 112. (2) 4 T.C. 618.

Danckwerts L.J.—That is right, I think.

Phillips Q.C.—I am instructed to ask for leave to appeal to the House of Lords if the Commissioners of Inland Revenue, after considering your Lordships' judgments, should be so advised.

Danckwerts L.J.—I expected that. I think you can have leave.

Phillips Q.C.— I perhaps ought to tell your Lordships that s. 177 has now been repealed as a result of the abolition of Schedule A, but none the less the matter is of importance.

Danckwerts L.J.—Does that make much difference on the question of appeal? Will you have any other cases involving the same point?

Phillips Q.C.—Probably not identical cases, but your Lordships' judgments will have repercussions in similar situations.

Danckwerts L.J.— Very well, you can have leave.

The Crown having appealed against the above decision, the case came before the House of Lords (Lords Reid, Hodson, Pearce, Donovan and Diplock) on 10th, 11th, 12th, and 13th March 1969, when judgment was reserved. On 29th April 1969 judgment was given unanimously in favour of the Crown, with costs.

W. A. Bagnall Q.C., J. Raymond Phillips Q.C. and *Patrick Medd* for the Crown.

F. Heyworth Talbot Q.C. and *M. P. Nolan Q.C.* for the Company.

The following cases were cited in argument in addition to those referred to in the speeches:— *Atherton* v. *British Insulated & Helsby Cables Ltd.* 10 T.C. 155; [1926] A.C. 205; *Strick* v. *Regent Oil Co. Ltd.* 43 T.C. 1; [1966] A.C. 295; *Associated Portland Cement Manufacturers Ltd.* v. *Commissioners of Inland Revenue* (1945) 27 T.C. 103; *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79; *Ralli Estates Ltd.* v. *Commissioner of Income Tax* [1961] 1 W.L.R. 329; *Hume* v. *Asquith* page 251 *ante*; [1969] 2 Ch. 58; *Campbell* v. *Commissioners of Inland Revenue* page 427 *ante;* [1970] A.C. 77; *Darngavil Coal Co. Ltd.* v. *Francis* 7 T.C. 1; 1913 S.C. 602; *Littlewoods Mail Order Stores Ltd.* v. *McGregor* page 519 *post*; [1968] 1 W.L.R. 1820; *Duke of Westminster* v. *Commissioners of Inland Revenue* 19 T.C. 490; [1936] A.C. 1; *Sothern-Smith* v. *Clancy* 25 T.C. 1; [1941] 1 K.B. 276; *Commissioners of Inland Revenue* v. *Wesleyan & General Assurance Society* (1948) 30 T.C. 11; *Perrin* v. *Dickson* 14 T.C. 608; [1930] 1 K.B. 107.

Lord Reid—My Lords, I agree with the speech of my noble and learned friend Lord Donovan. I would allow the appeal and remit the case as my noble and learned friend proposes.

Lord Hodson—My Lords, I have had the advantage of reading the opinion of my noble and learned friend Lord Donovan, with which I agree. I would allow the appeal.

Lord Pearce—My Lords, I concur.

Lord Donovan—My Lords, the Respondent carries on business as a property investment company. It acquires properties for letting and makes its profits from the rentals received. These properties are its capital assets. It does not buy and sell them as a property-dealing concern would do.

In 1960 the Company purchased interests in a number of properties from the Church Commissioners. The consideration was expressed in the sale agreement as follows:

> "4. The consideration for the Transfers shall be the respective rentcharges described in Column Five of the Schedule and the covenants on the part of the respective Purchasers for the payment of the said rentcharges."

The reference to "respective purchasers" is a reference to the Respondent Company and one of its wholly-owned subsidiaries, Associated London Properties Ltd. This company bought one of the seven properties in question, but since it is grouped with its parent for the purposes of the assessments to tax under appeal nothing turns on this feature of the case. The "respective rentcharges" referred to in the sale agreement added up to the gross sum of £96,000 per annum for ten years from 1st April 1959, charged on and issuing out of the properties acquired. When they came to pay the rentcharges in question to the Church Commissioners the Respondent Company deducted income tax at source, relying upon the provisions of s. 177, Income Tax Act 1952. When they came to making up their profit and loss account, they debited these rentcharges as though they were an expense of earning their revenue.

From what Counsel for the Respondent Company told your Lordships, it seems reasonably clear that the Church Commissioners had some initial misgivings. Being a charity, they would want to reclaim from the Revenue the tax deducted from the rentcharges. If, however, s. 177 did not for any reason entitle the Respondent Company to deduct tax at source, then the Church Commissioners, in reliance on the contract of sale, would have to look to the Company to make good the underpayment. This may well be the explanation why, in the litigation which has ensued concerning the Respondent Company's claim to deduct these rentcharges as a business expense, so much emphasis has been put on the question whether s. 177 applies to them. It was put in the forefront of the Company's case before the Special Commissioners: and one finds Danckwerts L.J., in the Court of Appeal, commencing his judgment by saying(1):

> "The question is simply whether certain rentcharges which were created by the parties in regard to the relevant transactions are deductible under the provisions of s. 177 of the Income Tax Act 1952."

(I read this as meaning whether income tax was deductible at source under that section, for this is the only "deduction" with which the section deals.) Yet I think all your Lordships are agreed that whether or not tax was so deductible at source from these rentcharges is quite inconclusive of the question whether they are deductible expenses in computing the Company's taxable profits. The Crown's argument before House was that the true question is, not the nature of the rentcharges as receipts in the Church Commissioners' hands, but their nature as disbursements by the Respondent Company, and the answer to the first question does not provide the answer to the second. I find myself doubting whether the case could have been so put to the Court of Appeal; otherwise I think the tenor of the judgments there delivered would have been different.

For my part, I am content to assume, without expressly deciding, that these rentcharges are income in the Church Commissioners' hands and are in their entirety liable to deduction of tax at source under s. 177. This, however, does

(1) *See* page 508 *ante*.

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not, I repeat, necessarily qualify them as allowable deductions in computing the Respondent Company's profits for tax purposes—which is the present issue. It falls to be decided in relation to assessments to profits tax made on the Company for each of five chargeable accounting periods ending in 1964. In those assessments the Crown disallowed any deduction for the rentcharges here in question. Profits for the purpose of profits tax are computed on the same principles as profits are computed for the purpose of Case I of Schedule D, subject to certain adaptations, of which one is that the rule of Case I which prohibits the deduction of annual payments in computing profits is excluded. "Annual payments" for this purpose would include the rentcharges here in question. This does not mean that they are automatically allowed as deductions. For that purpose they must still satisfy the other tests prescribed expressly or impliedly by the rules of Case I of Schedule D: Finance Act 1937, s. 20 and Sch. 4, para. 4; Finance (No. 2) Act 1940, s. 14(1); Finance Act 1946, s. 44; Income Tax Act 1952, s. 137(*l*) and (*m*) and s. 177. The Respondent Company duly appealed against the aforesaid assessments, claiming that the rentcharges were allowable deductions. The Special Commissioners upheld the claim. On appeal by the Crown by way of Case Stated Cross J. reversed that decision. The Court of Appeal restored it, and the Crown now appeals to your Lordships.

The effect of the enactments which provide that profits for profits tax purposes shall be computed on the same principles as profits are computed under Case I of Schedule D for income tax purposes (subject to certain adaptations) is that in the present case the Respondent Company in order to succeed must establish three things: (1) that the payments in question were wholly and exclusively laid out for the purposes of the Respondent Company's trade—this is conceded; (2) that there is no enactment expressly prohibiting their deduction —this also is conceded; (3) that, applying the principles of ordinary commercial accounting, these rentcharges are proper items to debit against the Company's incomings when computing its profits for profits tax purposes (*Usher's Wiltshire Brewery Ltd.* v. *Bruce*[1] [1915] A.C. 433, at pages 467–8). It is here that the conflict comes.

By the payments in question the Respondent Company acquired the freeholds of three properties of which it already had leases. In the case of two others it acquired a head-lease, being already owners of an underlease. In the case of one other, it acquired an underlease, being already owners of a sub-underlease. Its subsidiary company, Associated Properties Ltd., acquired the freehold of a property of which it was already owner of a lease. The rents payable by the Respondent Company and its subsidiary under their previous titles were admittedly deductions in computing their profits for the purpose of profits tax. When confronted with the Crown's contention that by the transactions here in question the Company had acquired capital assets, the Special Commissioners doubted it. They thought: "the reality of the matter was that the Company had substituted larger rents for a ten-year period for smaller rents for varying longer periods." This may be the financial result of the purchases, but, like Cross J., I am clear that the legal result was that the Company purchased reversions which were capital assets in its hands. Why in these circumstances should it, as a property-holding company, be entitled to set against the rents it receives the cost of acquiring these capital assets so as to diminish its profits for profits tax purposes? I have heard no convincing answer to this question. It is not an answer to say that tax may be deducted at source from the rentcharges when they are paid. This merely establishes that they are income in

(1) 6 T.C. 399, at pp. 435–6.

the hands of the recipient. I put to Mr. Talbot, who appeared for the Respondent Company, the analogy of a company using its own works department to build an extension to its factory. It would pay out wages to its workmen, and perhaps yearly interest on money borrowed to finance the building. Both would be income in the hands of the recipients and both be liable to deduction of tax at source. But, as Mr. Talbot agreed, no accountant would debit these items in any account except the capital account relating to the new extension. The difference in the present case, he said, was that the Company acquired no capital asset by virtue of paying these rentcharges—an argument which I have already rejected.

I would, therefore, hold that on ordinary principles of commercial accounting these rentcharges should not be debited against the incomings of the Company's trade in order to compute its profits liable to profits tax. It is true that capital assets may be purchased by income payments; and what the position would be if perpetual rentcharges had been the consideration in the present case does not have to be determined. Furthermore, though the deduction of income tax at source from the rentcharges and its retention by the Company (because it has sufficient taxed profits out of which to make the payments) may yield the same result for income tax purposes as though the rentcharges had been deducted in a profit and loss account and the deduction allowed, I cannot treat this circumstance as relevant. We are dealing here with profits tax, and, if a different result is yielded, it must be regarded I think as another of those anomalies which the system of deducting tax at source for income tax purposes at times throws up.

Cross J., in the Chancery Division, thought that the rentcharges could, for the purposes of tax only, be dissected into capital and interest components and the latter alone allowed as a deduction. In this respect he considered that the present case was similar to *Secretary of State for India* v. *Scoble*[1] [1903] A.C. 299 and *Vestey* v. *Commissioners of Inland Revenue*[2] [1962] Ch. 861. Like the Court of Appeal, I do not think these cases are really in point. In the former a capital sum had been agreed as the purchase price, and the inference could be drawn that the so-called "annuity" was the payment of this sum by instalments together with interest. Cross J. was able to draw a like inference in the latter case. But in the present it is common ground that no such capital sum was agreed beforehand; and, furthermore, Mr. Bagnall, for the Crown, said (as apparently he also did in the Court of Appeal—see the judgment of Fenton Atkinson L.J.[3]) that he disclaimed any right to go behind the contract and shew that the payments were not rentcharges. His main argument was simply that they were not proper items to debit in the revenue account for profits tax purposes.

Nevertheless, on the basis (apparently) that some element of interest had been used to calculate the amount of the rentcharges, he said that, interest being an allowable deduction for profits tax purposes, the Crown were prepared to allow as an expense what, for want of a better term, I might call the "interest content" of the rentcharges on the basis aforesaid. I cannot say that I understand how this offer squares with the Crown's main contention, and its admissions, but since it was made, and accepted by Mr. Talbot on behalf of the Respondent Company, I leave the matter there without further comment. I would therefore allow the appeal, and remit the matter to the Special Commissioners to restore the assessments, but adjusting them in the manner offered by

(1) 4 T.C. 478 and 618. (2) 40 T.C. 112. (3) *See* page 513 *ante*.

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the Crown. The rate of the interest to be employed for this purpose should be 5·6045 per cent. per annum, a rate which your Lordships have now been informed has been agreed between the parties. A

Lord Diplock—My Lords, I too have had the advantage of reading the opinion of my noble and learned friend Lord Donovan, with which I agree.

I would allow the appeal.

Questions put: B

That the case be remitted to the Special Commissioners with a direction to adjust the assessments under appeal in the manner offered by the Appellants.

The Contents have it.

That the Respondents do pay to the Appellants their costs here and below.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Nabarro Nathanson & Co.] C