Privy Council Appeal No. 32 *of* 1962

The Commissioner of Taxes – – – – – – *Appellant*

v.

Nchanga Consolidated Copper Mines Limited – – – *Respondent*

FROM

THE FEDERAL SUPREME COURT OF THE FEDERATION OF RHODESIA AND NYASALAND

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 15TH JANUARY 1964

Present at the Hearing:
VISCOUNT RADCLIFFE
LORD MORRIS OF BORTH-Y-GEST
LORD UPJOHN
(*Delivered by* VISCOUNT RADCLIFFE)

This is an appeal from a judgment of the Federal Supreme Court of the Federation of Rhodesia and Nyasaland concerning the income tax assessment of the respondent for the year ending 31st March 1959. The respondent in computing its profit had claimed to charge against its trading receipts a sum of £1,384,569 paid away during the year in circumstances that will later be mentioned: the appellant had disallowed this claim, and on the respondent's appeal to the High Court of Southern Rhodesia the appellant had been upheld by the judgment of Young, J. given on the 9th May 1961. This judgment was in its turn reversed by the unanimous judgment of the Supreme Court, who held the respondent to be entitled to the deduction claimed, and it is from that judgment, which was delivered on the 7th November 1961, that the appellant has appealed to this Board.

The argument before the Board was confined to the single issue whether the sum of £1,384,569 was properly chargeable to income or to capital for the purpose of determining the company's assessable profit. That indeed appears to have been the only issue of substance that could divide the parties, once the facts of the case had been sufficiently ascertained. Before coming to those facts it is necessary to state only that, so far as statutory provisions go, section 13 of the Income Tax Act 1954 of the Federation is the governing enactment, for the combined effect of sub-section (1) and sub-section (2)(a) of that section is to lay down that in determining the taxable income of any person expenditure of a capital nature is not to be allowed as a deduction, even though wholly and exclusively incurred for the purposes of the taxpayer's trade or in the production of his income. So far as general principles go, on the other hand, it can be taken that the Federal income tax system would recognise and seek to apply the same basic conceptions as have been adopted by other systems, including that of the United Kingdom, which have been faced with the task of separating income receipts from capital receipts, income expenditure from capital expenditure, in computing the profits of manufacturing or commercial ventures.

The relevant facts then are these. The respondent's business is that of copper-mining. Together with two other companies, Rhokana Corporation Ltd. and Bancroft Mines Ltd., it formed what was known as the Anglo-American group of copper mines in Northern Rhodesia. Each of the three

operated a separate mine and was independent of the others, but there were overlapping directorates, and a Mr. Acutt, the joint deputy-chairman of the Anglo-American Corporation of South Africa Ltd., was deputy-chairman of each company.

Anglo-American acted as secretary and technical adviser to the group. There was also a common sales department for handling the disposal of their output, which was marketed through the British Metal Corporation. It was, apparently, the practice that the Corporation should sell the copper forward on the basis of production estimates supplied by each of the members of the group. The sales were not at prices fixed in advance: they were commitments to supply, but only at the market price current when the copper was actually made available. Each company was expected to meet the Corporation's commitments to the extent of its production estimates, but the copper itself was not sold as the specific product of any one of the three mines.

In the year 1957 the price of copper on the world market was falling steeply. Supply was in excess of demand, and during the year a number of the large producers in different parts of the world imposed upon themselves voluntary cuts in production. There was no binding agreement between them to effect this, but the individual decisions must have become known to all those actively interested in the copper-mining business.

Down to the close of 1957 the Anglo-American group had not adopted any policy of reducing output. For 1958 the planned production of the three mines was an aggregate figure of 270,000 tons, 140,000 for the respondent, 90,000 for Rhokana, and 40,000 for Bancroft. By the beginning of 1958 it was accepted by those reponsible for these companies that the Anglo-American group could not continue to make no contribution in the way of a cut in production, and a figure of 10% was taken as the appropriate measure of the cut. That would reduce the estimated aggregate of 270,000 to 243,000 tons. The question was, if the group was to sacrifice 27,000 tons, how was the sacrifice to be distributed among the three members of the group?

Accordingly a meeting between their representatives took place at Salisbury, Southern Rhodesia, in the month of January 1958. Three alternative courses of action were reviewed in turn at that meeting. First, each mine could cut its programme by 10%. But to Bancroft, which was the most recent to come into production and was, comparatively, a high cost producer, such a cut was altogether unacceptable, owing to the adverse influence on its costs of production. A second alternative was that Bancroft should be left with an unreduced programme, Nchanga and Rhokana adding to their own cuts the 4,000 tons of reduction that would have been due from Bancroft. But again this proposal had to be rejected, as it was felt that it could not be defended from the point of view of the separate interests of those two companies. There then emerged and was accepted the idea that Bancroft should go out of production altogether for twelve months, beginning as early in 1958 as was practicable, and Nchanga and Rhokana should be left to undertake between them the whole group programme for the year, reduced by the overall cut of 10%. Relatively, this would suit them, since their combined output of 230,000 tons, as planned, would rise to 243,000 tons, Nchanga adding 9,000 tons and Rhokana 4,000 tons. At any price for copper that could reasonably be expected even at the current low level of price the additional production would be profitable to them; and they would pay a sum to Bancroft to compensate it for the abandonment of its production for the year.

Nchanga's share of this compensation sum, £2,165,000 in all, was the £1,384,569 which is in dispute in the appeal, the balance being found by Rhokana. The basis upon which the compensation was calculated was that Bancroft should receive enough to cover (a) the interest charges on its outstanding loans and notes, (b) the cost of the development work necessary to bring the mine into a position to produce at its full rated capacity, and (c) the cost of pumping operations at its No. 1 shaft. At the end of the twelve months Bancroft was to be free to resume full production, with, it was hoped, the benefit of the lower cost per ton resulting from the further development work.

The terms of the arrangement set out above were recorded in a letter dated 27th January 1958 from Nchanga to Bancroft. It has not been in dispute that that letter did accurately record what the arrangement was and state the consideration for which the £1,384,569 was paid.

No doubt there is more than one way of describing the effect of the agreement. Their Lordships think however that its essential features are plain. What Nchanga actually acquired by its payment was the right to have Bancroft out of production for twelve months. It would not be accurate to say that it bought Bancroft's production, much less that it bought the right to produce Bancroft's copper or any right to produce more of its own copper. It did not need such a right. But in a commercial sense it might fairly be said that it and Rhokana bought Bancroft's production programme for the year and, having bought it, they felt themselves at liberty, as a matter of policy, to increase their planned output to the extent that was necessary to fill the 243,000 tons that would be looked for from the Anglo-American group on the basis of an overall cut of 10%.

The forward sales contracts effected for the group do not appear to their Lordships to have been regarded by the parties to the arrangement as presenting any problem of their own. Some 240,000 tons had been committed, but, as the sales were not made ex any specified mine, the purchasers would not be concerned so long as the required amounts came forward; and, so long as they did come forward, Bancroft would not be left in any difficulty through not having raised its own planned quota. The sales, as has been said, were not at fixed prices. There was no question therefore of Nchanga and Rhokana taking over or paying to take over the benefit of advantageous price arrangements. No element of such a consideration seems to have contributed to the terms ultimately agreed upon.

In its operating account for the year ended 31st March 1959, the balance on which was carried to the profit and loss account, Nchanga entered the £1,384,569 as a deduction from the figure of £26,290,987 representing " sales of metals and concentrates " and thus attributed £24,906,418 to that item for the year. The appellant, on the other hand, disallowed the £1,384,569 as an admissible item in the computation of taxable profit for the same period. He objected to it on two separate grounds. One was that the expenditure was not wholly and exclusively incurred by Nchanga for the purpose of its trade or in the production of its income, since it was made in the interests of Bancroft's trade. This contention was rejected by Young, J., after investigating the evidence produced at the hearing in the High Court, and it has disappeared from the case. The alternative ground was that the expenditure was of a capital nature.

The second contention was accepted by Young, J., but his acceptance was based on an interpretation of the facts that appeared to the Federal Court and appears to their Lordships to be unsupported by the evidence. In his view the chief object of Nchanga in accepting the arrangements of January 1958 was " to preserve from impairment and dislocation Nchanga's organisation. The probabilities are that the advantage of this to Nchanga's business was lasting, or at any rate sufficiently lasting to qualify as an ' enduring advantage ' within the meaning of Viscount Cave's dictum." Leaving aside the undesirability of determining the nature of a payment by the motive or object of the payer, their Lordships cannot find in the evidence any support for the idea that the preservation of Nchanga's business was in fact the purpose of the arrangement or that the benefit obtained by its payment was to endure in any other sense than that it was to condition the year's production. It should be added, in passing, that preservation expenditure, which in one form appears as maintenance, does not suggest itself to their Lordships as being in itself a satisfactory category of expenditure for capital purposes.

The arguments advanced by the appellant before their Lordships were not rested on the trial Judge's reading of the facts. What was said was that Nchanga's payment had been made in order to acquire a right or a " quasi-right " to carry on its trade more extensively, that this secured for it an " enduring benefit " comparable with that described in *British Insulated &*

Helsby Cables Ltd. v. Atherton [1926] A.C. 206 at 213, that it was expenditure forming " part of the cost of the income earning machine or structure ", as opposed to part of " the cost of performing the income-earning operations ". These various descriptions were summed up in the submission that, properly understood, Nchanga's payment was the cost of acquiring a " source of income " and, therefore, a capital asset.

These phrases are, of course, used with intended reference to earlier judicial decisions that distinguish between capital and income for the purpose of assessing profit. Since a question of capital or income is always capable of giving rise to a question of law, such a form of argument is unavoidable in any legal system that governs itself by appeal to precedent. Nevertheless, it has to be remembered that all these phrases, as, for instance, " enduring benefit " or " capital structure " are essentially descriptive rather than definitive, and, as each new case arises for adjudication and it is sought to reason by analogy from its facts to those of one previously decided, a Court's primary duty is to inquire how far a description that was both relevant and significant in one set of circumstances is either significant or relevant in those which are presently before it. For example, while it is certainly important that in *Atherton's* case expenditure that did secure an enduring benefit for a company's business was spoken of as being for that reason a capital expenditure, it would be a misuse of that authority to suppose that it gives any warrant for the idea that securing a benefit for the business is prima facie capital expenditure, so long as the benefit is not so transitory as to have no endurance at all. The present case is one in which the advantage obtained was conditioned to last for not more than twelve months, the very period adopted for the ascertainment of each successive profit balance, and in their Lordships' opinion its essential facts are so unlike those of the *Atherton* case that no useful analogy can be constructed between them.

Judicial decisions have from time to time applied various tests in seeking to distinguish income from capital. There is the distinction between fixed and circulating capital resorted to by Lord Haldane in the case of *John Smith & Son v. Moore* 12 T.C. 266, to which reference will be made later; and, so long as the expenditure in question can be clearly referred to the acquisition of an asset which satisfies one or other of the accepted categories, as in the ordinary framework of a manufacturing or merchanting business, such a test must be a critical one. But at the same time, even putting aside the special circumstances of the extraction industries which regularly convert part of their fixed capital for which they have paid into part of their stock in trade which they sell, there are many forms of expenditure which, though not falling easily within these categories, have nevertheless to be allocated to capital or revenue account respectively in the ascertainment of profit, and with regard to all these some other and rather different distinction has to be looked for.

Again Courts have stressed the importance of observing a demarcation between the cost of creating, acquiring or enlarging the permanent (which does not mean perpetual) structure of which the income is to be the produce or fruit and the cost of earning that income itself or performing the income earning operations. Probably this is as illuminating a line of distinction as the law by itself is likely to achieve, but the reality of the distinction, it must be admitted, does not become the easier to maintain as tax systems in different countries allow more and more kinds of capital expenditure to be charged against profits by way of allowances for depreciation, and by so doing recognise that at any rate the exhaustion of fixed capital is an operating cost. Even so, the functions of business are capable of great complexity and the line of demarcation is sometimes difficult indeed to draw and leads to distinctions of some subtlety between profit that is made " out of " assets and profit that is made " upon " assets or " with " assets. It does not settle the question, for instance, to say merely that an expenditure has been made to acquire a " source of income ", as the appellant says here, unless one is clear that some forms of circulating capital itself, e.g. labour, raw material, stock in trade, are not themselves to be regarded as such a source.

With these considerations in mind their Lordships must address themselves to Nchanga's challenged expenditure. It bought one right only, the right to have Bancroft out of production for twelve months. While, no doubt, money paid to acquire a business or to shut a business down for good or to acquire some contractual right to last for years may well be capital expenditure, it seems a contradiction in terms to speak of what Nchanga thus acquired, which exhausted itself and was created to exhaust itself within the twelve months period within which profits are ascertained, as constituting an enduring benefit or as an accretion to the capital or income-earning structure of the business. If the expenditure is to be treated as capital expenditure at all, it cannot be for any reason such as that.

It is not the fact, as their Lordships understand the evidence, that the expenditure bought for Nchanga a right to produce any part of whatever its annual production for March 1958/March 1959 may have been. As has been remarked, it needed no such right. What happened was that, having settled as between Rhokana, Bancroft and itself what the production policies and programmes were to be for the group, it implemented its own production programme accordingly. It is not in evidence how the mine's working was adapted to the small increase of the planned total that was involved. There is nothing to suggest that there was required any structural enlargement of the mine. In any event, it was not for that that the £1,384,569 was paid.

In considering allocations of expenditure between the capital and income accounts, it is almost unavoidable to argue from analogy. An instance is taken which seems to fall beyond dispute on one or other side of the line and it is argued that the case under review is in substance more akin to that than to any comparable instance which falls beyond argument on the opposite side. Applying this method, their Lordships think that Nchanga's expenditure has no true analogy with expenditure for the purposes of acquiring a business or the benefit of a long-term or " enduring " contract. On the other hand it does bear a fair comparison with a monetary levy on the production of a given year. What Nchanga did was to charge its 1958/59 production with the payment of this money in order to settle its share of the group's production programme in the way that suited it best. The payment was wholly related to and an incident of its output of the year, and it is of no moment for this purpose that the factors of the calculation that produced the sum were certain financial requirements of Bancroft itself. Nor does it matter whether the sum is treated as a charge on the gross proceeds of the copper sales of the year, as it was in Nchanga's accounts, or as an extra charge on the additional production, as the learned Chief Justice described it in the Federal Supreme Court. Some of the year's production, he said, was produced " at very high cost ". The point in either case is the same. Nchanga's arrangement with Rhokana and Bancroft, out of which the expenditure arose, made it a cost incidental to the production and sale of the output of the mine. As such its true analogy is with an operating cost.

The appellant's argument relied largely, as was natural, upon the decision of the House of Lords in *John Smith & Son v. Moore* 12 T.C. 266. It would perhaps be more accurate to say that it relied on the speeches of Lord Haldane and Lord Sumner in that case, for of the four Lords who took part in the decision Viscount Finlay dissented and Lord Cave took a line of approach which is not relevant to the present dispute. In their Lordships' opinion the *John Smith* case determines nothing that could govern Nchanga's case.

The facts were that the taxpayer, a coal merchant, had taken over his deceased father's business under powers given by the father's trust disposition and settlement. By the terms of that disposition he succeeded to the business under the obligation of paying for its net value, excluding goodwill from the assets for the purpose of valuation. The business assets included contracts giving a call on the output of certain collieries at what had become very favourable prices, none of the contracts having longer than nine months to run at the date of the father's death. A value of £30,000 was put upon the benefit of these contracts as an item of a coal-merchant's business, although in fact the total sum that had to be paid for the business came out at less than £28,000. The taxpayer had sought to deduct £30,000

from his assessable profits for the accounting period that followed his father's death. The claim was disallowed by the Court of Session in Scotland and the majority of the House of Lords on the ground that the sum was capital expenditure in relation to the son's business.

It appears clearly from a close study of the speeches of Lord Haldane and Lord Sumner that two elements in the case, or rather the combination of those two elements, determined their decision. First, no sum of £30,000 had ever been paid. What was acquired was a business consisting of a variety of assets, among which was the benefit of the contracts, and involving a number of liabilities; the only money that the son had paid was the sum representing the net value of that business. " He bought a business and its assets ", said Lord Sumner (p.295), " at a valuation . . . He bought no coals; the business had none, nor any stock in trade; nor did he acquire any stock in trade in any business sense of the term . . . He did not pay this sum as the consideration for an assignment of the benefit of the contracts to himself: he took no assignment." It is evident that both the learned Lords felt it to be impossible to say that a sum paid to acquire a business as representing the net value of that business, but not specifically allocated to individual assets of the business, was anything but a capital expenditure upon a fixed asset. Lord Sumner regarded the case as being in effect governed by the earlier decisions of *City of London Contract Corporation v. Styles* 2 T.C. 239 and *Alianza Co. v. Bell* 5 T.C. 60 and 172. And so it was according to the terms in which he dealt with it.

The second feature that was treated as of importance was the fact, alluded to by Lord Sumner, that in paying something in respect of the benefit of the contracts the son had not acquired stock in trade or anything like such stock. It is not difficult to suppose that in a different context a sum paid by a running concern to a trader for the right to take over his supply contracts at fixed prices, if limited to the year of profit ascertainment, might fairly be regarded as part of the cost of acquiring the commodity to be supplied and, as such, chargeable against the gross proceeds of its sale. Lord Sumner indeed seems to have visualised this, when he said (p.296) in explanation of the Styles decision " this sum was paid with the rest of the aggregate price to acquire the business and thereafter profits were made in the business; the sum was not paid as an outlay in a business already acquired, in order to carry it on and to earn a profit out of this expense as an expense of carrying it on."

The *John Smith* decision therefore turned upon the combination of two elements as the facts of the case: an aggregate price paid as the net value of a business taken over, and the inclusion in the assets of that business of the benefit of short-term supply contracts which were not in a form allowing them to be treated as analogous to stock in trade. But for the combination of those elements it is not to be assumed that the decision would have been the same, for it is difficult to accept as a sound general proposition that if a man acquires and pays for stock in trade for his own business on the taking over of another he is not entitled to set off against the gross proceeds of realising the stock the identifiable cost of acquiring it. However that may be, neither of the determining elements in the *John Smith* case is present here. Nchanga did not pay for Bancroft's business nor did it pay for the benefit of its contracts. Bancroft remained a potential producer and in fact, as was intended, resumed production with enlarged capacity at the end of the year. The compensation paid to Bancroft resembled much more closely, to use Lord Sumner's words, an outlay of a business, " in order to carry it on and to earn a profit out of this expense as an expense of carrying it on ".

For these reasons, which are substantially the same as those given by the learned Chief Justice Sir John Clayden, and agreed in by his colleagues in the Supreme Court, their Lordships are of opinion that the appeal must fail, and they will humbly advise Her Majesty to this effect. The appellant must pay the respondent's costs of the appeal.

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In the Privy Council

THE COMMISSIONER OF TAXES

v.

NCHANGA CONSOLIDATED COPPER MINES LIMITED

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