No. 1169—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—5TH, 6TH AND 7TH JUNE, 1940

COURT OF APPEAL—27TH AND 28TH NOVEMBER, AND 2ND DECEMBER, 1940

(1) COMMISSIONERS OF INLAND REVENUE *v.* PAYNE[1]
(2) COMMISSIONERS OF INLAND REVENUE *v.* GUNNER

Sur-tax—Deduction—Payments under deed of covenant—Power of revocation—Finance Act, 1938 (1 *& 2 Geo.* VI, *c.* 46), *Section* 38, *and Part* II *of the Third Schedule.*

(1) *The Respondent in the first case covenanted by a deed of the 29th March*, 1938, *to pay to Derwent, Ltd. (a company which he controlled by his shareholding), for the remainder of his life or until an effective resolution for winding up the company was passed, such a weekly sum as after deduction of tax would amount to* £72, *the aggregate of* 52 *weekly payments up to the 31st March*, 1938, *to be paid on or before that day. On the 6th October*, 1938, *it was resolved that the company should be wound up. The Respondent had paid to the company* £3,744 *net after deduction of tax for the period to the 31st March*, 1938. *He claimed the corresponding gross sum of* £4,992 *as a deduction for Sur-tax purposes for* 1937–38 *on the grounds* (1) *that the terms of the deed of the 29th March*, 1938, *did not confer upon him any such power of revocation or determination as is mentioned in Section* 38 (1) (*a*) *of the Finance Act*, 1938, *and* (2) *that the deed was exempted from the operation of Section* 38 *by virtue of Paragraph* 1 (*a*) *of Part* II *of the Third Schedule to that Act.*

(2) *In the second case the Respondent covenanted by a deed dated the 25th October*, 1937, *to pay to himself and his wife jointly as trustees for their son, during the joint lives of the Respondent and the son, such a monthly sum as after deduction of tax would amount to* £88. *The first payment, the aggregate of twelve monthly sums, was to be made on the 31st October*, 1937, *and thereafter the sums were to be paid each month. The Respondent had power, with the consent of one of four named persons, to revoke the trusts in whole or in part. The deed was revoked in part on the 18th October*, 1938, *the monthly sum payable being reduced to one shilling as from the 1st April*, 1938. *The next day the Respondent revoked the first deed entirely and entered into a*

[1] Reported (C.A.) 110 L.J.K.B. 323.

new irrevocable covenant to pay the trustees as from the 1st April, 1938, such a monthly sum as after deduction of tax would amount to one shilling.

On appeal against an assessment to Sur-tax for 1937–38 *the Respondent claimed the deduction of a sum of* £1,994 13*s.* 4*d. representing seventeen monthly payments made under the deed with the appropriate additions for Income Tax. He contended that the deed of 25th October,* 1937, *satisfied the conditions either of Paragraph* 1 (*a*) *or of Paragraph* 1 (*c*) *of Part* II *of the Third Schedule, Finance Act,* 1938, *and that therefore the provisions of Section* 38 *of that Act did not apply to the sum of* £1,994 13*s.* 4*d.*

Held, *that on the terms of the deed of 29th March,* 1938, *the first Respondent had power, through his control of the company, " to revoke or otherwise determine the settlement ", that in neither case did the deed of covenant satisfy the conditions of Part* II *of the Third Schedule, Finance Act,* 1938, *and that the deductions claimed were accordingly inadmissible.*

CASES

(1) *Commissioners of Inland Revenue* v. *Payne*

CASE

Stated under the Finance Act, 1927, Section 42 (7), and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 27th July, 1939, Mr. Walter Payne (hereinafter called " the Respondent ") appealed against an assessment to Sur-tax in the sum of £9,356 for the year ending 5th April, 1938.

2. The question for the opinion of the High Court is whether a sum of £4,992 paid by the Respondent under a deed of covenant dated 29th March, 1938, to a company called Derwent, Ltd. is an admissible deduction in computing his total income for the purposes of Sur-tax for the said year.

3. Derwent, Ltd. was incorporated under the Companies Act, 1929, on 13th March, 1937.

At all material times the issued capital of Derwent, Ltd. was £100 and the Respondent was the beneficial owner of 95 redeemable preference shares of £1 each and Brompton Investment Co., Ltd. was the beneficial owner of 5 fully paid ordinary shares of £1 each. The rights attaching to each of these two classes of shares were originally as set out in article 4 of the articles of association but by

a special resolution of Derwent, Ltd. passed on 23rd March, 1938, they were as follows. The preference shares were entitled to a fixed cumulative preferential dividend at the rate of 5 per cent. per annum, the balance of any divisible profit being divided among the holders of the ordinary shares. In the event of a winding up of the company the assets available for distribution among the members were to be applied first in paying to the holders of the preference shares the amounts paid up on such shares and thereafter the balance to be distributed among the holders of the ordinary shares.

The said special resolution further provided however that the company might at its option redeem all or any of the said preference shares at the price of £500 per share upon giving notice to the holders of such shares.

By article 13 of the articles of association it was provided that on a poll every member should have one vote for each share of which he is the holder.

A copy of the memorandum and articles of association of Derwent, Ltd. is attached hereto, marked " A ", and forms part of this Case(1).

4. The Respondent and Mrs. L. M. Monckton, a nominee of his, were sole directors of Derwent, Ltd.

5. By a deed of covenant dated 29th March, 1938, between the Respondent of the one part and Derwent, Ltd. of the other part, the Respondent covenanted " to pay weekly to the Company as on " and from the First day of April One thousand nine hundred and " thirty seven and during the remainder of his life or until an " effective resolution shall be passed or order made for the winding " up of the Company (other than for the purposes of reconstruction " or amalgamation) whichever shall be the shorter period such a " sum as after the deduction of Income Tax at the standard rate " for the time being in force shall leave the clear weekly sum of " Seventy two Pounds (hereinafter called ' the weekly sum ') in " manner following :—

> " (i) Each weekly sum shall be paid to the Company on the " Thursday of each week to which such weekly sum " relates.
>
> " (ii) The aggregate of fifty-two of the weekly sums in respect " of the period from the First day of April One thousand " nine hundred and thirty seven to the Thirty first day " of March One thousand nine hundred and thirty eight " shall be paid to the Company on or before the Thirty " first day of March One thousand nine hundred and " thirty eight."

(1) Not included in the present print.

6. On 31st March, 1938, the Respondent paid to Derwent, Ltd. £3,744 being the aggregate of 52 weekly payments of £72 in respect of the period 1st April, 1937, to 31st March, 1938.

The said sum of £3,744 with the appropriate addition for Income Tax amounts to £4,992.

7. On the 29th March, 1938, Derwent, Ltd. purchased for £3,739 from the Respondent his holding of 3,000 shares in a company known as Syndicate Varieties, Ltd. and on the 6th April, 1938, received a dividend of £750 on these shares.

8. On 6th October, 1938, the Respondent paid a further sum of £1,944 to Derwent, Ltd. being 27 weekly payments of £72 in respect of the period 1st April to 6th October, 1938, and on the same date Derwent, Ltd. also received the sum of £3,320 as the price of the said 3,000 shares in Syndicate Varieties, Ltd. sold back to the Respondent.

9. At a meeting of the directors of Derwent, Ltd. held on 6th October, 1938, it was resolved that 12 preference shares of the company (part of the 95 preference shares in issue) should forthwith be redeemed at the price of £500 per share, and accordingly £6,000 was paid by Derwent, Ltd. to the Respondent on that date in respect of such redemption.

10. At a subsequent extraordinary general meeting of Derwent, Ltd. also held on 6th October, 1938, it was resolved that Derwent, Ltd. should be voluntarily wound up and the Respondent was appointed liquidator.

11. Derwent, Ltd. had no income except the said annuity and dividend and the net result of the transactions hereinbefore mentioned was that the liquidator was left with a sum of £92 9*s*. 6*d*. in cash, £83 of which was paid to the Respondent in payment of the capital paid up on his balance of 83 unredeemed preference shares and the balance of £9 9*s*. 6*d*. was paid to Brompton Investment Co., Ltd., the holders of the ordinary shares.

12. Copies of the following documents are attached hereto, and form part of this Case[1] :—

(*a*) The minutes of Derwent, Ltd. (marked " B ");
(*b*) Bank pass book of Derwent, Ltd. (marked " C ");
(*c*) Accounts of Derwent, Ltd., 13th March, 1937, to 5th April, 1938 (marked " D ").

13. In computing the Respondent's total income for Sur-tax 1937–38 the Respondent's claim to deduct the said sum of £4,992 was refused by the assessing Special Commissioners on the ground that the said sum must be treated as income of the Respondent by virtue of Section 38 (1), Finance Act, 1938.

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[1] Not included in the present print.

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

(*a*) The said deed of covenant dated 29th March, 1938, did not by its terms confer upon the Respondent any such power of revocation or determination as is referred to in Section 38 (1) (*a*), Finance Act, 1938.

(*b*) Under the said deed of covenant the Respondent was liable (but only liable) to make annual payments for one of two alternative periods, i.e. for life or until a resolution was passed for Derwent, Ltd. to be wound up.

(*c*) The passing of the winding up resolution by Derwent, Ltd. merely defined the period during which the Respondent was liable to make the said annual payments and did not amount to a determination of the " settlement " or of any provision thereof.

(*d*) The Respondent at no time ceased to be liable to make any of the annual payments which the provisions of the deed made payable.

(*e*) The said deed of covenant, having been made before 27th April, 1938, was by virtue of Section 38 (7) (*c*) of the Finance Act, 1938, subject to the provisions of Part II of the Third Schedule to the said Act and was exempted from the provisions of Section 38 (1) of the said Act by virtue of Paragraph 1 (*a*) of Part II of the Third Schedule.

(*f*) The Respondent was entitled to deduct the said sum of £4,992 in computing his total income for Sur-tax for the year ending 5th April, 1938.

(*g*) The assessment should be reduced to £4,369.

15. It was contended on behalf of the Crown that :—

(*a*) The said deed of covenant of 29th March, 1938, together with the whole framework of Derwent, Ltd. which was controlled by the Respondent was a settlement as defined by Section 41 (4) (*b*) of the Finance Act, 1938.

(*b*) The said deed of covenant contained the condition on which the Respondent's obligation to make payments was to determine.

(*c*) The Respondent alone could determine that obligation by virtue of his control of Derwent, Ltd.

(*d*) The Respondent was the settlor, as he was the person who entered into the said deed of covenant, and was also the person responsible for the setting up of Derwent, Ltd. with control resting in himself.

(*e*) The sums payable by the Respondent under the said settlement fell to be treated as his income.

(*f*) Paragraph 1 (*a*) of Part II of Schedule III of the Finance Act, 1938, only applied to continuing settlements which were in existence and operation on 28th October, 1938, i.e. at the expiration of three months from the date of the passing of the Finance Act, 1938.

(*g*) The assessment should be confirmed.

16. Having considered the evidence and arguments adduced before us we refrained from expressing any opinion on the main contentions of the parties, because we were bound by a previous decision of the Special Commissioners to uphold the Respondent's contention (paragraph 14 (*e*) hereof) based upon Paragraph 1 (*a*) of Part II, Third Schedule to the Finance Act, 1938.

We therefore allowed the deduction of £4,992 and reduced the assessment to £4,364.

17. The Appellants 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 Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

N. ANDERSON,
H. H. C. GRAHAM, } Commissioners for the Special Purposes of the Income Tax Acts.

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

8th January, 1940.

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(2) *Commissioners of Inland Revenue* v. *Gunner*

CASE

Stated under the Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 15th June, 1939, Ernest Robert Gunner (hereinafter called " the Respondent ") appealed against an assessment to Sur-tax in the sum of £4,884 for the year ending 5th April, 1938, made upon him under the provisions of the Income Tax Acts.

2. The appeal raises the question as to whether the Respondent is entitled to deduct the sum of £1,994 13*s.* 4*d.* in computing his total income for the purposes of Sur-tax for the year in question by reason of the matters hereinafter set out.

3. A deed of covenant made the 25th October, 1937, between the Respondent of the one part and the Respondent and his wife as trustees of the other part recites that the Respondent is desirous of making provision for his son, Robert Alan Gunner, who was born on the 31st August, 1937.

By clause 1 of this deed, the Respondent covenanted to pay to the trustees, during the joint lives of the Respondent and his said son such a calendar monthly sum as after deducting Income Tax would amount to the clear calendar monthly sum of £88, the first payment to be the aggregate of 12 calendar monthly sums and to be payable on or before 31st October, 1937, and thereafter the monthly sums to be payable on the last day of each calendar month.

It was also provided by the said clause 1 that the Respondent might at any time or times by deed or deeds revocable or irrevocable, with the consent of one of four persons named, revoke in whole or in part the trusts, powers and provisions declared by and contained in the deed.

By clause 2 of the said deed it was provided that the trustees should apply the said monthly sums for the benefit of the Respondent's said son as therein set forth.

A copy of this deed, marked " A ", is annexed to and forms part of this Case(1).

4. By a deed made the 18th October, 1938, the Respondent (with the requisite consent) revoked in part the said deed dated 25th October, 1937, so that as from the 1st April, 1938, the said monthly sum which should be covenanted to be paid by the Respondent as aforesaid should be reduced to such a calendar monthly sum as after deducting Income Tax would amount to the clear calendar monthly sum of one shilling. A copy of this deed, marked " B ", is annexed to and forms part of this Case(1).

5. By a deed made the 19th October, 1938, the Respondent (with the requisite consent) revoked the said deed of covenant dated 25th October, 1937, as from 1st April, 1938. A copy of this deed, marked " C ", is annexed to and forms part of this Case(1).

6. By a deed of covenant made the 19th October, 1938, between the Respondent of the one part and the Respondent and his wife as trustees of the other part, the Respondent covenanted to pay to the trustees as from the 1st April, 1938, and during the remainder of his life, such a calendar monthly sum as after deducting Income

(1) Not included in the present print.

Tax would amount to the clear calendar monthly sum of one shilling, such monthly sums to be applied by the trustees for the benefit of the Respondent's said son as therein set forth. A copy of this deed, marked " D ", is annexed to and forms part of this Case(1).

7. A bank account was opened at Barclays Bank, Ltd., Camden Town Branch, in the names of the Respondent and his wife. A copy of a letter dated 25th October, 1937, signed by the Respondent, requesting the bank manager to transfer to the credit of this account the sum of £1,056 and further sums of £88 on the last day of each month, marked " E ", is annexed to and forms part of this Case(1).

A copy of a letter dated 25th October, 1937, signed by the Respondent and his wife, requesting the said bank manager to transfer from the joint account to the Respondent's account the sum of £1,055 and further sums of £88 each month, marked " F ", is annexed to and forms part of this Case(1).

A copy of the said joint account at the said bank, marked " G ", is annexed to and forms part of this Case(1).

8. The sum of £1,994 13*s*. 4*d*. mentioned in paragraph 2 hereof is composed of the sums of £1,056, being the amount transferred to the joint account at the bank on 2nd November, 1937, and five monthly payments of £88 to 31st March, 1938, amounting to £440, paid to the said joint account, with the addition of Income Tax at the appropriate rate thereto.

9. The Finance Act, 1938, was passed on 29th July, 1938.

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

(1) That the conditions laid down in Paragraph 1 (*a*) of Part II of the Third Schedule to the Finance Act, 1938, were satisfied in the case of the said deed dated the 25th October, 1937.

(2) Further or alternatively, that the conditions laid down in Paragraph 1 (*c*) of the said Schedule were satisfied in the case of the said deed;

and that accordingly the provisions of Section 38 (1) of the said Act did not apply to the said sum of £1,994 13*s*. 4*d*. or any part thereof, and the Respondent was entitled to deduct the said sum in computing his total income for the purpose of Sur-tax.

11. It was contended on behalf of the Appellants that :—

(1) Where the settlement had been completely revoked at the material date Paragraph 1 (*a*) of Part II of the Third Schedule to the Finance Act, 1938, did not apply.

(2) Not included in the present print.

(2) Since the Respondent had not recovenanted to make " the " like annual payments ", that is payment of £88 a month, but had only recovenanted to make payments of one shilling a month, the conditions laid down in Paragraph 1 (*c*) of Part II of the said Schedule were not satisfied.

(3) The deduction claimed should be disallowed by reason of the provisions of Section 38 of the Finance Act, 1938.

(4) Alternatively, the initial payment of £1,056 was a capital payment.

(5) In any event no greater sum than the aggregate of twelve monthly payments could be allowed as a deduction in one fiscal year.

12. We, the Commissioners, held that the effect of the said deed dated 18th October, 1938, marked " B ", modified the said deed dated 25th October, 1937, marked " A ", which was in existence until 19th October, 1938. In our opinion this did not amount to a revocation within the meaning of Part II, 1 (*c*) (i) of the Third Schedule to the Finance Act, 1938. We held that at the expiration of three months from the date of the passing of the Act, the Respondent had, or could have, no power of revocation of the said deed dated 25th October, 1937, marked " A ", that deed having been completely revoked on the 19th October, 1938. The Respondent had not received, and was not entitled to receive, any consideration in respect of the release of the power of revocation. In our opinion, the provisions of Section 38 (1) of the Finance Act, 1938, do not apply to the present case by reason of the provisions of 1 (*a*) of Part II of the said Third Schedule to that Act.

We allowed the appeal and adjusted the figures accordingly.

13. The representative of the Appellants, immediately after the determination of the appeal, declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

R. COKE,
MARK GRANT-STURGIS, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99, High Holborn,
London, W.C.1.
22nd November, 1939.

The cases came before Lawrence, J., in the King's Bench Division on the 5th, 6th and 7th June, 1940, and on the last-named date judgment was given in favour of the Crown in both cases, with costs.

The Attorney-General (Sir Donald Somervell, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills appeared as Counsel for the Crown, Mr. J. Millard Tucker, K.C., and Mr. Frederick Grant for Mr. W. Payne, and Mr. Frederick Grant for Mr. E. R. Gunner.

JUDGMENT

Lawrence, J.—These two cases have been argued with much ingenuity, and in both of them the main point is the same, though there are some subsidiary differences. In the case of *Commissioners of Inland Revenue* v. *Payne* the question is whether a sum of £4,992, paid by the Respondent Payne under a deed of covenant of the 29th March, 1938, to a company called Derwent, Ltd., is an admissible deduction in computing his total income for the purposes of Sur-tax for the year. Derwent, Ltd. was a company which appears to have been incorporated for the purpose of tax avoidance on the 13th March, 1937, and the Respondent controlled that company by being the beneficial owner of 95 redeemable preference shares of £1 each out of a total of 100 shares, there being only 5 ordinary shares of £1 each, and the voting rights being the same. It is, therefore, clear, and is not disputed, that the Respondent had complete control of Derwent, Ltd. The sole income of Derwent, Ltd. was a sum of money payable under a deed of covenant executed by the Respondent on the 29th March, 1938, under which he covenanted to pay to Derwent, Ltd. weekly, during the remainder of his life, from the 1st April, 1937, or until an effective resolution shall be passed, or an order made for the winding up of the company, whichever shall be the shorter period, such a sum as after deduction of Income Tax shall leave the clear weekly sum of £72. On the 31st March, 1938, the Respondent paid to Derwent, Ltd. a sum of £3,744, which was the aggregate of 52 weekly payments of the said sum, and the sum of £4,992, which is the sum now in question, is that sum with the appropriate addition for Income Tax. Arrangements were made under which the sum so paid was returned as capital to the Respondent by the redemption, in accordance with the articles of association, of a certain amount of the preference capital. The main question which arises in this case, and in the case of Mr. Gunner, is whether the Respondent Payne is entitled to deduct the sum of £4,992 for the purposes of Sur-tax, and whether Mr. Gunner is entitled to deduct the sum of £1,994 13*s.* 4*d.* for the purposes of Sur-tax. There is this distinction between the cases, that in the case of Mr. Gunner the deed of covenant conferred

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upon him expressly a power of revocation, whereas in the case of Mr. Payne there was no express power of revocation; but, as I have already said, the payment was to be made weekly during the remainder of his life or until an effective resolution should be passed for the winding up of the company.

The questions of law which arise turn upon Section 38 of the Finance Act, 1938, and upon the Third Schedule, Part II, thereto. Section 38 is in these words, so far as material: Sub-section (1): "If and so long as the terms of any settlement are such that— "(*a*) any person has or may have power, whether immediately or "in the future, and whether with or without the consent of any "other person, to revoke or otherwise determine the settlement or "any provision thereof and, in the event of the exercise of the "power, the settlor . . . . will or may cease to be liable to make "any annual payments payable by virtue or in consequence of any "provision of the settlement; . . . . any sums payable by the settlor ". . . . by virtue or in consequence of that provision of the "settlement in any year of assessment shall be treated as the "income of the settlor for that year and not as the income of any "other person: Provided that, where any such power as is referred "to in paragraph (*a*) of this subsection cannot be exercised within "the period of six years from the time when the first of the annual "payments so referred to becomes payable, and the like annual "payments are payable in each year throughout that period, the "said paragraph (*a*) shall not apply so long as the said power cannot "be exercised." The first point that is raised upon that Section in the Respondent Payne's case is that under this "settlement" (which by the definition clause is to be construed as including any arrangement) Mr. Payne had not the power to revoke or otherwise determine the settlement. It is also said that he did not cease to be liable within the meaning of that Sub-section because his liability was only to pay until an effective resolution should be passed. These contentions, although they were put forward before the Commissioners, were not dealt with by them. In my opinion, the words "revoke or otherwise determine" on their proper interpretation do cover the power which Mr. Payne had under this settlement. He controlled Derwent, Ltd., and he had, therefore, power under this covenant at any time to put an end to it; that is to say, in my opinion, to determine it within the meaning of Section 38.

As to the contention that he did not cease to be liable because his liability was only under the covenant until the effective resolution should be passed, it seems to me that there is nothing in this contention. The words "in the event of the exercise of the power, "the settlor . . . . will or may cease to be liable" seem to me to refer to the point of time, and clearly in this case he was liable

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before the resolution was passed; he was not liable after it had been passed. It seems to me to follow from that that he ceased to be liable in the event of the resolution being passed.

Reliance was placed in support of the argument for the Respondent on this point upon the case of *Trustees of Watson* (*a minor*) v. *Wiggins*, 17 T.C. 728, at page 740; but, in my opinion, that case is clearly distinguishable from the present case. It was dealing with the construction of Section 20 of the Finance Act, 1922, and the decision was that having regard to all the Sub-sections of that Section, when read together and contrasted, the limitation by virtue of which the income was payable for the benefit of the child for life did not cease to be such a limitation because there was a power or revocation in the deed. In my opinion, that case has really no bearing upon the present case, and I construe the words of Section 38 of the Act of 1938 in the way that I have already indicated.

That brings me to the main point which is common to both these cases, namely, whether in the event of the covenantor revoking the covenant completely within the expiration of three months from the passing of the Act of 1938, in accordance with the Third Schedule, he is exempted from the operation of Section 38 of the Act of 1938. That question depends upon the construction of the Third Schedule, Part II, Paragraph 1 (*a*) (*b*) and (*c*), and Paragraph 4. Paragraph 1 provides: " Subject to the provisions of this Part of this " Schedule, in the case of a settlement made before the twenty- " seventh day of April nineteen hundred and thirty-eight,"—that covers these settlements—" subsection (1) of the relative section " —that is to say Section 38—" shall not, by reason only of the " provisions of paragraph (*a*) thereof, apply to sums payable " by the settlor by virtue or in consequence of any provision " of the settlement in a year to which this Part of this Schedule " applies, if—(*a*) at the expiration of three months from " the date of the passing of this Act—(i) no person has or can " have any such power as is referred to in the said paragraph (*a*); " and (ii) the settlor has not received and is not entitled to " receive any consideration in respect of the release or disclaimer " of any such power; or (*b*) the like annual payments have been " payable by the settlor by virtue or in consequence of that " provision of the settlement in each of the seven years of assess- " ment ending with a year to which this Part of this Schedule " applies; or (*c*) before the expiration of three months from the " date of the passing of this Act—(i) the settlement, or the pro- " vision by virtue or in consequence whereof the annual payments " are payable, has been revoked; and (ii) a new settlement has " been made by the settlor by virtue or in consequence whereof " the settlor is liable to make the like annual payments and

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" cannot, except in the event of his death, cease to be liable to " make those payments before the expiration of six years from the " date when the first of the annual payments payable by virtue " or in consequence of the revoked settlement became payable ". It is not necessary, I think, to read the proviso. What is said on behalf of the two Respondents in these two cases is that the words of Sub-paragraph (*a*) (i) are perfectly plain and cover these cases because, the two covenantors having revoked *in toto* the settlements, no person has or can have any such power as is referred to in the said paragraph (*a*) and it is obvious that in one sense those words do cover such cases as the present; but it is said on behalf of the Crown that those words have to be read in their context, not only with Sub-paragraph (*a*) (ii), but also with Sub-paragraphs (*b*) and (*c*) and with Paragraph 4, and that when read with those Sub-paragraphs and Paragraph it is clear that the words of Sub-paragraph (*a*) (i) contemplate the continued existence of the settlement and cannot apply to a case where that settlement is entirely revoked. The main argument on behalf of the Crown is that the case of complete revocation is specifically dealt with in Sub-paragraph (*c*), and that that special provision with reference to a complete revocation excludes the possibility of a complete revocation being intended to be referred to by the general words of Sub-paragraph (*a*) (i). In my opinion that contention of the Crown is right. I think moreover that the words of Sub-paragraph (*a*) (i) when read with Sub-paragraph (*a*) (ii) point in the same direction. If a complete revocation was intended to be covered by Sub-paragraph (*a*) (i) it is obvious that the settlor in such circumstances has received a very considerable consideration, because if he has revoked the whole covenant he has got rid of his obligation to pay. It is, in my opinion, very difficult, if not impossible, to read the terms of Sub-paragraph (*a*) (i) as covering a complete revocation, in view of the words of Sub-paragraph (*a*) (ii). I think that Sub-paragraph (*a*) (ii), which is an additional condition to Sub-paragraph (*a*) (i), indicates that Sub-paragraph (*a*) (i) contemplates only cases in which there has been a release or disclaimer of the power and not a complete revocation of the settlement. Turning to Sub-paragraph (*c*), Sub-paragraph (*c*) deals expressly with a power of revocation, but it only confers the exemption where added to the complete revocation is the obligation to enter into a new settlement by virtue of which the settlor becomes liable to make the like annual payments and cannot, except in the event of his death, cease to be liable to make those payments before the expiration of six years from the date when the first of the annual payments payable by virtue or in consequence of the revoked settlement became payable. That Sub-paragraph deals expressly with the possibility of getting this exemption when a

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complete revocation is made, and it is, in my opinion, a provision that in order to do so the settlor must make a new settlement which must be for six years at least from the beginning of the original settlement. Moreover, Sub-paragraph (*c*) (ii) does not give any exemption with reference to the new settlement. That exemption is given by Paragraph 4.

It was also contended on behalf of the Respondents that this construction led to great hardship in the case of a settlement which might have run out by effluxion of time; but, in my opinion, that consideration does not necessitate any other construction of the Paragraph, and the provision of Sub-paragraph (*c*) is such that, in my opinion, it is impossible to read the Section together in any other sense. It is also contended on behalf of the Respondents that the covenantee could always release the covenant; but I accept the argument of Mr. Stamp that this is a misuse of the word "power", and that the covenantee's right to release the benefit of the covenant is not a power, but a right of property; so that has no effect upon the argument.

For all these reasons I am of opinion that by the revocations in question in these two cases the Respondents have not obtained the exemption which is conferred by the Third Schedule, and that, therefore, the sums in question are not admissible deductions in computing their total income for the purposes of Sur-tax for the year in question, and the two appeals will be allowed with costs.

There was another point in the *Gunner* case which does not arise upon the view that I have taken. I do not think it is necessary for me to decide it, but it was argued before me that in any event the £1,056, which was a sum made up of a number of payments, all of which were paid on the 31st March, 1938, I think, were not income payments, and reliance was placed by the Crown upon the case of *Mallaby-Deeley*, [1938] 3 All E.R. 463(1), and in *D'Ambrumenil's* case, [1940] 2 All E.R. 71(2). Some complaint was made about the fact that the argument was put in a slightly different way from what had been put before the Commissioners. But, as I have said, I do not think it is necessary for me to decide that point in these cases, and I express no opinion upon it.

The appeals will be allowed with costs.

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(1) Commissioners of Inland Revenue *v.* Mallaby-Deeley and another (as personal representatives of Mallaby-Deeley, deceased), *et e contra*, 23 T.C. 153.

(2) D'Ambrumenil *v.* Commissioners of Inland Revenue, 23 T.C. 440.

(1) *Commissioners of Inland Revenue* v. *Payne*

The Respondent having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Sir Wilfrid Greene, M.R., and Clauson and Goddard, L.JJ.) on the 27th and 28th November, and the 2nd December, 1940. On the last-named date judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. Frederick Grant appeared as Counsel for Mr. W. Payne, and the Solicitor-General (Sir William Jowitt, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Sir Wilfrid Greene, M.R.—In the beginning of the year 1938 Mr. Walter Payne engaged in a scheme, the object of which was to enable him to reduce his taxable income and, at his own volition, to receive back the sum by which he had reduced it in the form of capital, thereby evading taxation. The scheme adopted was ingenious, and, to those who think it right to use these devices, attractive; and, at the time it was entered into, it was effective within the law: but in the year 1938 a Finance Act was passed containing provisions directed against devices of this kind. Those provisions were, to a limited extent, retrospective, and it is upon the effect of that legislation upon this particular transaction that the present question turns.

Under the scheme Mr. Walter Payne entered into a deed of covenant with a company called Derwent, Ltd., under which he paid, in the events which happened, a total sum of very nearly £5,000. That covenant had, apparently, no business purpose whatsoever. It was linked up with the rest of the scheme, the essential parts of which were that Mr. Payne should put himself in such a relationship to the company that he could entirely control it by means of his voting power. The terms of the covenant were that Mr. Payne should make the payments mentioned during the remainder of his life, or until an effective resolution should be passed or order made for the winding up of the company other than for the purpose of reconstruction or amalgamation, whichever should be the shorter period. By virtue of his voting power, he could bring his obligations to an end at any moment that he pleased, and he was also in a position so to order the constitution of the company that he could, by way of repayment of the nominal amount of the preference shares which he held, obtain repayment to himself of the sums that he had paid under the covenant, or such part of them as he thought fit. Such payments would, of course, be

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capital in their nature and would, therefore, not be liable to tax. Those were the relations to the company into which he placed himself. The other facts I need not recite, because they appear in the Case Stated, and there is no need to repeat them.

The Finance Act of 1938 made provision in Section 38, Sub-section (1), for certain types of transaction which the Legislature was minded to bring within the scope of the ordinary tax legislation. Sub-section (1), taking the relevant terms of it, provides as follows: " If and so long as the terms of any settlement are " such that—(*a*) any person has or may have power, whether " immediately or in the future, and whether with or without the " consent of any other person, to revoke or otherwise determine " the settlement or any provision thereof and, in the event of the " exercise of the power, the settlor or the wife or husband of the " settlor will or may cease to be liable to make any annual pay- " ments payable by virtue or in consequence of any provision of " the settlement; . . . . any sums payable by the settlor or the " wife or husband of the settlor by virtue or in consequence of that " provision of the settlement in any year of assessment shall be " treated as the income of the settlor for that year and not as " the income of any other person ". The result of that, of course, would be that in a return of total income the sums covenanted to be paid under such an instrument could not be deducted as a charge. By Sub-section (7) the provisions which I have read were to apply " for the purposes of assessment to income tax for the year " 1937–38 and subsequent years " and were to apply " in relation " to any settlement, wherever made and whether made before or " after the passing of this Act." If, therefore, this was a settlement, and if the other terms of the Section were complied with, the result would be that, beginning with the year 1937–38, Mr. Walter Payne would be liable to include the sums paid in his return of total income, and, therefore, would be subject to Sur-tax upon them. I need not read the rest of that Sub-section, except paragraph (*c*), which is important. That paragraph says: " the " provisions of this subsection shall have effect, in relation to a " settlement made before the twenty-seventh day of April nineteen " hundred and thirty-eight, subject to the provisions of Part II " of the Third Schedule to this Act, and in that Part of that " Schedule this section is referred to as ' the relative section '." Section 41, Sub-section (4), contains certain definitions, and the important ones are (*b*) and (*c*); (*b*) says: " the expression " ' settlement ' includes any disposition, trust, covenant, agree- " ment or arrangement, and the expression ' settlor ' in relation " to a settlement means any person by whom the settlement was " made "; and (*c*): " a person shall be deemed to have made a " settlement if he has made or entered into the settlement directly

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" or indirectly, and in particular (but without prejudice to the " generality of the foregoing words of this paragraph) if he has " provided or undertaken to provide funds directly or indirectly " for the purpose of the settlement ".

Now the first question that arises in this appeal, a question which Lawrence, J., answered in favour of the Crown, is whether or not there is here any settlement in relation to which Mr. Walter Payne was the settlor. The word in the definition clause of " settlement " which is relevant to that question is the word " arrangement ". The word " arrangement " is not a word of art. It is used, in my opinion, in this context in what may be described as a business sense, and the question is : can we find here an " arrangement " as so construed? It is said that the only element in this transaction which falls within the definition of " settlement " is the deed of covenant itself. I am unable to accept that argument. It appears to me that the whole of what was done must be looked at; and when that is done, the true view, in my judgment, is that Mr. Walter Payne deliberately placed himself into a certain relationship to the company as part of one definite scheme, the essential heads of which could have been put down in numbered paragraphs on half a sheet of notepaper. Those were the things which it was essential that Mr. Payne should do if he wished to bring about the result desired. He did it by a combination of obtaining the control of the company, entering into the covenant, and then dealing with the company in such a way as to achieve his object. Now, if a deliberate scheme, perfectly clear cut, of that description is not an " arrangement " within the meaning of the definition clause, I have difficulty myself in seeing what useful purpose was achieved by the Legislature in putting that word into the definition at all. I am clearly of opinion that, by placing himself into these relationships with the company, Mr. Walter Payne was engaged in making an " arrangement " within the meaning of that clause. That he was the settlor under it is manifest, and I need not take up time in dealing with that aspect of the matter.

The next question that arises is whether he was in a position to revoke or otherwise determine the settlement or any provision thereof. In my opinion, there is only one answer to that question. The position in which he had placed himself was one in which he could bring to an end his liability under his deed of covenant. That deed of covenant was a provision of the settlement; it was an integral part of it; and his liability under it could be determined by him at any moment that he pleased by the mere exercise of his voting rights in such a way as to put the company into liquidation. But the most sustained argument on this branch of the case was

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upon the meaning of the word " power ". It was said that that word must have a very restricted meaning and, indeed, must be confined to a power in what I may call the strict conveyancing sense. It was said that if it was not so limited in its application it would extend to the exercise of a mere right of property and, indeed, would give to the Section a scope which the Legislature could not possibly have intended. It is then said that in the present case the power to determine the settlement, if it existed, could only be the power derived from Mr. Walter Payne's control of the voting rights of the company; and that is, no doubt, the case. But it is said that those rights, which he exercised in the way that he did, are not aptly described as a " power "; they are rights which are inherent in his ownership of the shares. That argument, in my opinion, is putting much too limited a meaning on the word " power ". As Clauson, L.J., pointed out in the course of the argument, the point would have had more substance if such a word as " arrangement " had not appeared in the definition clause. In relation to such a word it is impossible, it seems to me, to confine the word " power " to a strict power in the conveyancing sense. It must, therefore, have a wider and more popular meaning. The argument that the exercise of a mere right of property cannot be a " power " is, in my opinion, beside the point. The question in the present case is not as to the bare exercise of a voting right looked at by itself. That voting right was brought into the scheme and was an essential part of the scheme, and it was used as the mechanism by which Mr. Walter Payne should be in a position to bring his liability to an end. It so happens that under the particular device adopted the method of bringing that liability to an end was by exercise of the votes attached to his shares. But those voting rights, used for the purpose for which they were used, and playing the part in the scheme which they did play, are, in my opinion, properly described in the context of this Section as a " power ". In my judgment, therefore, that argument fails.

The next question that arises on the meaning of Section 38, Sub-section (1) (*a*), is whether or not, in the event of the exercise of the power, Mr. Walter Payne would or might " cease to be " liable to make any annual payments payable by virtue or in " consequence of any provision of the settlement ", the relevant provision in this case, of course, being the covenant. It was said that, as by the winding up of the company the liability of Mr. Walter Payne to make payments came to an end by the very force and nature of the covenant itself, these words are inappropriate to cover such a case, and that they are contemplating, not the termination of a liability according to the terms of the contract, but, so to speak, a premature termination of a liability which would

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otherwise have continued. In my opinion, that argument also fails. The question is: did Mr. Walter Payne cease to be liable to make any annual payments? The answer is that he did. The fact that he so ceased because his liability had been brought to its conclusion, instead of being revoked by a superimposed power of revocation, appears to me to be irrelevant. The language, in my opinion, is amply clear to cover this case.

I therefore come to the conclusion that the present case is covered by the Section; but that still leaves the question whether or not Part II of the Third Schedule to the Act applies. A word of explanation of the apparent purpose of the Legislature may be usefully given. As the operation of the Act was made retrospective, the Legislature was minded to give persons who had entered into transactions of the kind at which the Section was aimed an opportunity of putting their affairs in that connection in order. There were at least two types of transaction which the Legislature intended to hit, and to hit retrospectively. One was a transaction under which a power had been taken which, if exercised, would put an end to a liability to make payments. Another was the case where a power to revoke a settlement had been given. Powers of that kind might have been given to the settlor, or they might have been given to some other person as part of the settlement, or to the settlor with the consent of other persons, and there were various methods of achieving the results desired. But it was evidently thought a hardship that persons who had entered into covenants of that kind, or settlements of that kind, at a time when there was no objection to them from the tax point of view, should find that they were bound for ever thereafter, without any opportunity of getting rid of the offending provisions, to stand by their covenants or their settlements and be bound by them. Accordingly, the Schedule provides that " in the case of a settlement made before " the twenty-seventh day of April nineteen hundred and thirty-" eight, subsection (1) of the relative section shall not, by reason " only of the provisions of paragraph (*a*) thereof, apply to sums " payable by the settlor by virtue or in consequence of any pro-" vision of the settlement in a year to which this Part of this " Schedule applies ". Those years appear in Paragraph 7 as being the years 1937–38 and 1938–39. Now, the conditions which must be fulfilled to qualify for that exemption are as follows. Sub-paragraph (*a*) is the first alternative. Sub-paragraphs (*a*), (*b*) and (*c*) are dealing with the particular types of transaction which I have just mentioned. Sub-paragraph (*a*): " if—(*a*) at " the expiration of three months from the date of the passing of " this Act "—those three months would expire on the 29th October, 1938—" (i) no person has or can have any such power as is referred " to in the said paragraph (*a*); and (ii) the settlor has not received

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" and is not entitled to receive any consideration in respect of the " release or disclaimer of any such power; or (*b*) the like annual " payments have been payable by the settlor by virtue or in " consequence of that provision of the settlement in each of the " seven years of assessment ending with a year to which this Part " of this Schedule applies ". Pausing there, and speaking quite broadly, Sub-paragraph (*a*) is providing for the case where what I may call an offending power, by which liability to make annual payments can be got rid of, can be eliminated from the settlement, assuming that it is possible to do so and that those concerned desire to do so; and if that is done the retrospective provisions of the Act will not apply. The settlor concerned would have put himself right for the future, because such a covenant would then stand as a covenant containing no such power to revoke or determine, and therefore would not be caught in the future; but exemption for the past can be obtained if the settlor, so to speak, repents and puts the matter right for the future. Sub-paragraph (*b*) is a special case of exemption to which I need not refer. Sub-paragraph (*c*) gives exemption if " before the expiration of three months from " the date of the passing of this Act—(i) the settlement, or the " provision by virtue or in consequence whereof the annual pay- " ments are payable, has been revoked;" and (ii) a new settlement has been made by which annual payments fall to be made for a period there stated. I need not read it. What was provided for there was getting rid of the matter of offence, not by the elimination of an offending power but by the cancellation of the settlement itself and the substitution of a new inoffensive settlement. Those were the two classes of things to which exemption in that Part of the Schedule was directed.

Now it is argued that the present case comes within Paragraph 1 (*a*) (i) because it is said that, the company having gone into liquidation before the 29th October, 1938, no person on that date had or could have " any such power as is referred to in the " said paragraph (*a*) " of Sub-section (1) of Section 38 of the Act, that is to say, a power " to revoke or otherwise determine the " settlement or any provision thereof ". The learned Judge declined to accept that view, and he held that the provisions of Paragraph 1 (*a*) (i) of Part II of the Schedule did not apply to the present case in view of the fact that the covenant had come to an end, or rather that the obligation under the covenant had come to an end on the liquidation of the company. The reasons that he gave for that view commend themselves so completely to my mind that I do not find it necessary to repeat them or to express my own views upon the subject, except to say this. If this Sub-paragraph (*a*) (i) be written out at length, it will run as follows: if no person has or can have power, whether immediately or in the future, and whether with or without the consent of any other

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person, to revoke or otherwise determine the settlement or any provision thereof. It seems to me that that language is completely unsuitable to describe the case where the non-existence of any such power is not due to the fact that it has been revoked or eliminated, but is due to the fact that the settlement in which it is embedded has disappeared altogether. That language, it seems to me, does not fit such a case. That is all that I wish to say upon the construction of that Schedule.

There is another argument which was put forward on behalf of the Appellant with regard to this point. It was said that it would be very unfair to construe the provisions of the Schedule in such a way, because the result would be that, whereas existing covenants and existing settlements could be put right, there was nothing to protect a settlement that had run its course before the 29th October, 1938, from the retrospective operation of the Act. That is an argument which does not disturb me in the least. The Legislature was not in any way bound, nor do I see that in fairness it was bound, to deal with cases of that kind. It might be that the settlor in such a case had the power but would not have exercised it, even if he had been given the opportunity to do so, and it might be that the power was one the exercise of which he could not bring about, because he could not get some necessary consent; and therefore it is not to be assumed that every settlor under a defunct settlement would have been in a position, or would have been willing, to do the things, the doing of which would obtain exemption for a settlement that was still alive. In my view, the case of the defunct settlement was one which the Legislature thought fit to disregard.

In the result, the appeal fails and must be dismissed with costs.

Clauson, L.J.—I agree with the result and with all the reasons which my Lord has stated. I therefore confine myself to expressing my concurrence.

Goddard, L.J.—I agree.

Mr. Tucker.—My Lord, I am instructed that this is one of a number of cases of the same kind, and in those circumstances I am instructed to ask your Lordships for leave to appeal.

Sir Wilfrid Greene, M.R.—Do you mean that there are a number of cases pending before Commissioners?

Mr. Tucker.—Yes; they are held up.

Sir Wilfrid Greene, M.R.—And that this case is one which has happened to come first, or has been chosen as coming first?

Mr. Tucker.—Yes. The Solicitors instructing me are, I think, concerned in a number of them, and the position is that the actual appeals to the Special Commissioners are in abeyance, awaiting the final result of this particular case, which will clarify the position.

Sir Wilfrid Greene, M.R.—This will be the final result, Mr. Tucker, unless you obtain leave to go to the House of Lords. They will be able to go ahead with the other cases.

Mr. Tucker.—Quite.

Sir Wilfrid Greene, M.R.—Are you prepared to regard this as a test case in which you are so interested that you will pay the Crown's costs in any event?

Mr. Tucker.—No, my Lord. Your Lordships' Court has never yet imposed such a term upon the taxpayer.

Sir Wilfrid Greene, M.R.—I am asking you a question.

Mr. Tucker.—I thought I was answering it indirectly, my Lord.

Mr. Hills.—I confess I had been waiting for your Lordship to do so. My learned friend says he has a test case. I know nothing about that at all. I should have submitted that there cannot be a great many of these gentlemen; they are not the community, or anything of that sort. I should have thought that the decisions of Lawrence, J., and of your Lordships were sufficient to settle the matter.

(Their Lordships conferred.)

Mr. Tucker.—My Lord, I have just been consulting the Solicitors instructing me, and, in the circumstances, I shall not press the application.

Sir Wilfrid Greene, M.R.—Mr. Tucker, you are not doing that under any idea that what I said a moment ago was, in any way, a threat?

Mr. Tucker.—No, not in the least. It is simply this, that, at the present time, perhaps taxpayers may take a different view of their duties to the country than they might otherwise have done, and, in those circumstances, I shall not press the application.

Sir Wilfrid Greene, M.R.—So be it.

[Solicitors:—Solicitor of Inland Revenue; Ashurst, Morris, Crisp & Co.]

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