No. 306.—Court of Session (Scotland).—Lord Johnston.—14th and 19th May, 25th June, and 9th and 30th July, 1908.

Court of Session (Scotland).—First Division.—2nd, 3rd, and 9th December, 1908.

House of Lords.—9th, 20th, and 21st July and 9th December, 1909.

Edinburgh Life Assurance Co. v. Lord Advocate.

Edinburgh Life Assurance Company *v.* Lord Advocate.[1]

Income Tax.—Retention.—Customs and Inland Revenue Act, 1888.—*The Appellants are a proprietary Company carrying on the business of life insurance and of selling annuities. On payment of the annuities they deduct Income Tax. The Appellants are not charged under the First Case of Schedule D, the receipts of the Company, apart from their income derived from investments and taxed at the source, being less than the expenditure. Including the taxed income there is a considerable surplus. The annuities are not paid out of the taxed income specifically, and are not charged on any particular fund but indiscriminately on the whole of the funds of the Company.*

Held, *that the annuities must be treated as payable out of the taxed income, so far as it will reach, and that, as the taxed income of the Appellants exceeds the annuities, they are entitled to retain the whole of the tax deducted from the annuities.*

Appellants' Case.

This is an Appeal against an Interlocutor of the First Division of the Court of Session, as the Court of Exchequer in Scotland, in an action at the instance of the Lord Advocate for and on behalf of the Commissioners of Inland Revenue, Pursuer, against the Edinburgh Life Assurance Company, Defenders, for recovery of Income Tax for which they are alleged to be accountable.

The question at issue between the parties is as to the true meaning and effect of Section 24, sub-section (3), of the Customs and Inland Revenue Act of 1888. The Commissioners of Inland Revenue have recently put forward claims against various insurance companies based on a certain construction of that sub-section, and have now brought this action in order to have the general question decided.

The facts of the case are simple and not in dispute. The Appellants carry on the ordinary business of a life insurance company, including *inter alia* the selling of annuities, both immediate and deferred. An immediate annuity is purchased by the single payment of a lump sum; a deferred annuity may be

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[1] Reported [1910] A.C. 143.

purchased either by such a single payment or by a series of instalments. The revenue of the Company consists of (1) interest on investments, dividends, and rents; (2) premiums for life insurances; (3) consideration money for annuities; and (4) a small sum representing assignment and transference fees and other miscellaneous receipts. Similarly, its outgoings consist of (1) claims under policies; (2) surrenders; (3) annuities; (4) commission and expenses of management; (5) dividends to shareholders; and (6) Income Tax.

The interest, &c., which the Company receives from its investments forms a large part of its revenue, and but for it there would be a large annual deficit. From this interest, &c., Income Tax is deducted at the source, and it therefore does not fall to be included by the Company in striking the balance of profits and gains for the purpose of direct assessment under the Income Tax Acts under Case 1 of Schedule D. The Company therefore regularly returns its profits and gains under Rule 1 of Case 1 of Schedule D as nil, and this return has always been and cannot but be accepted by the Income Tax Commissioners. The Crown is however no loser, for the Income Tax deducted from the interest, &c., on the Company's investments greatly exceeds the amount which would be yielded by an assessment on its profits as a trading concern if such assessment were possible.

In paying the annuities for which they are liable the Company deduct Income Tax at the proper rate. This deduction, at one time optional to the Company, is said by the Pursuers to have been made compulsory by the Customs and Inland Revenue Act of 1888, Section 24, sub-section (3), which is in the following terms:—"Upon payment of any interest of money or annuities "charged with Income Tax under Schedule D, and not payable, "or not wholly payable, out of profits and gains brought into "charge to such tax, the person by or through whom such interest "or annuities shall be paid shall deduct thereout the rate of "Income Tax in force at the time of such payment, and shall "forthwith render an account to the Commissioners of Inland "Revenue of the amount so deducted, or of the amount deducted "out of so much of the interest or annuities as is not paid out "of profits or gains brought into charge as the case may be."

The annuities paid by the company for the period from 5th April, 1905, to 30th November, 1907, amounted to £116,259 13*s*., and the Income Tax deducted by the Company in paying these annuities amounted to £5,809 3*s*. 7*d*. The Commissioners of Inland Revenue allege that under this section the Company are bound to pay this sum to the Crown; while the Company maintain that they are entitled to retain it in respect that the annuities are paid and, in any event, are payable out of profits and gains already brought into charge. Payment of the said sum of £5,809 3*s*. 7*d*., is accordingly what is contended for in the present action.

The demand of the Commissioners of Inland Revenue involves the proposition that neither in whole nor in part are the

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annuities in question paid or payable out of profits and gains already brought into charge. This argument was strenuously maintained both before the Lord Ordinary and also before the First Division, and on both occasions it was rejected without hesitation. It was confessedly based on the decision of your Lordships' House in the case of the *Gresham Life Assurance Society* v. *Styles*,(1) which the Inland Revenue represented as deciding that, whatever might be the case with a private individual, a company trading in annuities cannot maintain that these are payable out of profits and gains brought into charge. For such a contention it is submitted there is no foundation. The sole question in that case was how, in estimating the profits under the first case of Schedule D, a large sum paid out in the form of annuities should be treated. The Company contended that, as part of their business consisted in selling annuities, the annuities which they sold should be treated as part of their business expenditure necessarily made for the earning of profits, and deducted before these profits could be ascertained. The Inland Revenue maintained that this deduction should not be allowed. It was decided by your Lordships' House that the contention of the Company was well founded, and that in such a case the amount paid in annuities did not form part of the commercial profits and gains on which the Company fell to be assessed to Income Tax under the first case of Schedule D. Between such a case and the present, where commercial profits are not in question, there is obviously no analogy, and the argument for the Inland Revenue was only made possible by persistently ignoring that essential fact. The words "profits and "gains" in the Income Tax Acts no doubt include commercial profits, but they also include much else. The salary of a Government official, the earnings of a professional man, the income derived from invested capital. all fall within those words, and are therefore subject to the tax every whit as much as the commercial profits of a trading concern. And it is therefore plain that an annuity or other payment which falls to be deducted in the process of ascertaining commercial profits may yet be payable out of profits and gains on which Income Tax has been paid. Both the Lord Ordinary and the First Division held that the Gresham case had no bearing on the present question, and that there was no authority for the proposition that the annuities paid by an assurance company could not be paid out of profits and gains brought into charge; and both alike held that the Judgment of your Lordships' House in the case of the *Attorney-General* v. *The London County Council*(2) was on this point conclusive in favour of the defence. In this view it is respectfully submitted that their Lordships are right.

But while the Lord Ordinary went on to assoilzie the Defenders their Lordships of the First Division have taken a different view of the meaning and effect of Sectio. 24, sub-section (3), and

(1) 3 T.C. 185. (2) 4 T.C. 265.

have recalled his Interlocutor. This view. which has commended itself to their Lordships, was not put forward by the Crown either before the Lord Ordinary or in the Inner House. The conclusion of the Inner House is that the annuities paid by the Appellants in any year fall to be debited proportionally against their revenue on which Income Tax has been paid and their revenue on which Income Tax has not been paid in each year, and that they are bound to account to the Crown for Income Tax on the portion of the annuities thus paid out of revenue which has not paid Income Tax. And their Lordships were further pleased to remit to the Lord Ordinary to fix the amount of Income Tax due in terms of these findings.

Against this Interlocutor of the First Division the present Appeal, with leave of their Lordships, is now taken.

In submitting that this Interlocutor should be reversed, and the Interlocutor of the Lord Ordinary restored, the Appellants desire to make clear at the outset their position with regard to these annuities by a reference to their operations for the quinquennial period ending 31st December, 1907. During that period their total receipts were:—

Premiums	£1,529,502
Consideration for annuities...	178,074
Assignment and transfer fees	684
Profits on investments realised	2,122
	£1,710,382
Interest, dividends and rents	804,731
	£2,515,113

The total expediture, on the other hand, was £1,973,096, whereof expenses of management came to £168,204, while annuities amounted to £218,463. To this there falls to be added a sum of £207,567 in respect of increased liabilities actuarially ascertained, amounting in all to £2,180,663, and leaving a net surplus of receipts of £334,450, which, however, but for bringing into account the £804,731 of interest, dividends, and rents, would have been a deficit of £470,281.

The effect of the judgment of the First Division, if it be applied to this period, is that the Appellants must apportion the sum of £218,463 paid by them as annuities rateably between (1) the £804,731 of interest, dividends, and rents, on which they pay Income Tax, and (2) the rest of their receipts amounting to £1,710,382 on which Income Tax is not paid. So far as known to the Appellants there is no warrant for such an apportionment. As the First Division has held that no specialty exists in the case of annuities paid by an insurance company, it may be permissible to show how this judgment would work out in the case of a private individual. Suppose that a wealthy manufacturer becomes bound to pay to his son an allowance of £500 per annum. His income from investments taxed at the source is £5,000 a

year, and the total turnover of his mills amounts to £100,000. This latter sum, of course, does not represent the profits of the mills, which may indeed be running at a loss, and therefore pays no tax. But yet, if the Appellants correctly appreciate the effect of the judgment of the Inner House, he would be bound to apportion the £500 annuity between his income from investments on the one hand and the gross turnover of the mills on the other, and to account to the Crown for such proportion of the Income Tax deducted from his son's allowance as corresponds to the revenue of the mills on which *ex hypothesi* he may be losing money.

The claim of the Inland Revenue is admittedly based on Section 24, sub-section (3), of the Act of 1888 already quoted.

The Appellants contend at the outset that the deduction of Income Tax by the payer of interest and annuities is not, by that sub-section, made compulsory in all circumstances. The introductory words of that sub-section, it is submitted, amount to a condition precedent which must be purified before any such obligation emerges. It would have been easy to enact that every person paying interest or annuities should be bound to deduct the tax; but that is not what has been done. The obligation is imposed on the person paying only in certain specified circumstances, viz., when the interest or annuities are "not payable or not "wholly payable out of profits or gains brought into charge." And, accordingly, when it happens that the interest or annuities are payable out of profits and gains brought into charge, no obligation is imposed by this sub-section to deduct the tax, or to account for it to the Crown. If this contention be well founded it is submitted that this sub-section has no application to the present case, in which it has been expressly held by the Lord Ordinary, and is not disputed by the pursuer, that the annuities are charged on and payable out of their whole effects, including the interest, dividends, and rents which have been taxed at the source, and the rights of the Crown must be regulated, not by it, but by Section 102 of the Act of 1842 and Section 40 of the Act of 1853.

The Appellants further contend that the effect of this sub-section is to free them entirely from the demand of the Crown, and that this has been finally determined by the London County Council cases(1) already mentioned.

Two matters seem to require consideration.

(1) Are the annuities *in fact* paid out of profits and gains brought into charge? If so, then whether in law they are or are not so payable, the Appellants are entitled to retain the tax for their own use. The evidence, including the Appellants' accounts, and Mr. John S. Tait, an expert witness for the Inland Revenue, shows clearly that, but for the taxed interest, &c., there would be a large yearly deficit, and that these are absolutely necessary for the payment of the annuities. No formal appropriation is made of this interest, &c., in the Appellants' books. Practically there is a common till into which all drawings go and from which all outgoings are paid. But just as the Crown cannot be pre-

(1) 4 T.C. 265.

judiced by the system of book-keeping adopted by a taxpayer, so it is submitted the Appellants cannot lose the benefit of this sub-section merely because they have not gone through the form of specially appropriating in their books the amount of the interest necessary for the payment of the annuities.

(2) Even if it be held that the Appellants have failed to establish conclusively that the annuities are *in fact* paid out of the taxed interest, &c., it is sufficient for their success that the annuities are in law payable out of this interest, &c. It is not disputed that the annuities form a charge over this taxed income as well as over the whole of the Company's other assets; and the words of the sub-section seem as little open to question. But even if these were open to another construction the Appellants have the authority of Lord Davey for the proposition "that it is "not required by the Income Tax Acts in order to raise the right "of deduction and retention that the interest or annual payment "shall be exclusively charged upon or payable out of profits or "gains brought into charge. It is enough if the interest is charged "upon or payable out of the taxable income, though there may "be other subjects of charge. But the mortgagor cannot of "course retain against the Crown more Income Tax than he has "paid."

This statement, the Appellants submit, applies to the present case. Whensoever annuities fall to be paid by a person who has already paid Income Tax on a fund out of which they are payable, he is entitled to retain for his own ease and reimbursement the tax deductible by law from these annuities up to the sum which he has paid; for that sum represents, to quote the words of Lord Macnaghten, "Income Tax on what is not really available in-"come, because it includes money which he has to pay over to "someone else."

The Lord President admits that "the London County Council "case conclusively settles the principle on which the case falls to "be determined." But his Lordship finds a material difference between the facts of that case and those of the present, which in his view the Lord Ordinary has omitted to notice. And on that footing the First Division, instead of granting absolvitor, pronounced the Interlocutor under appeal.

The Appellants further submit that no distinction between the two cases can justify the particular apportionment ordered.

The London County Council had not sufficient taxed income to meet the interest which it had to pay, and it had accordingly to impose rates to supply this deficiency as well as to pay its administrative and other expenses. On these rates, of course, no Income Tax was paid, and therefore, had the County Council proposed to retain the whole income tax deducted from the interest payable to its creditors, it would have been doing what Lord Davey pointed out the taxpayer cannot do, viz., attempting to retain against the Crown more Income Tax than he had paid. But the London County Council put forward no such contention. It admitted that, in so far as the Income Tax deducted effeired to the portion

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of the interest paid out of rates, that could not be retained, and had to be accounted for to the Crown. It, however, resisted the claim put forward by the Crown, which was this, "that an apportionment should be made of the mixed fund out of which the interest was payable, and that the amount that the London County Council could retain should be determined not by the amount of its taxed income alone, but by the proportion which that taxed income bore to the rest of the fund." This claim is distinctly set out in Article II. of the Information for the Attorney-General and in the arguments of counsel. No doubt the mixed fund consisted to some extent of capital, *e.g.*, monies appropriated under statute for the redemption of debt, but it also consisted largely of income, and this fact was emphasised in the Court of Appeal by the distinction drawn by Vaughan Williams, L.J., who said, "The sum to which the interest payable by the local authorities must bear a rateable proportion is so much of the consolidated fund as is properly carried to the receipts of the income account."

The whole theory of apportionment was negatived by the judgment of your Lordships' House, which held, *inter alia*, in the words of the rubric, "that the allowance in respect of the rents and interests received should be full and not proportional." In these circumstances the Appellants submit that there is no application to the present case of the rule of law referred to by Lord M'Laren when he says, "When you have two funds which are both not literally yet practically charged with the payment of these annuities, I think the rule of law is that you must apportion the liability rateably between them."

It only remains to add that in the London County Council case the whole taxed income was treated as applicable to the payment of interest, and the whole burden of administrative and other expenses was charged on the portion of the fund raised from rates —in striking contrast to the statement of the Lord President: "It seems to be clear that the Company have no right to say we pay the annuities out of funds on which we pay Income Tax, we pay our other debts out of funds which have paid none."

Finally, the Appellants submit that even if some form of apportionment not yet suggested must be applied to the present case, the particular form ordered by the First Division certainly ought not to receive effect.

It appears to proceed on the assumption that the Appellants' "revenue on which Income Tax has not been paid" consists of receipts of the nature of income. The evidence shows clearly that this is not the case. The large sums paid to the Appellants for the purchase of annuities and the life assurance premiums, for instance, are not income in the sense of the Income Tax Acts, but trade receipts every whit as much as the turnover of a coal merchant or millowner.

It is also submitted that their Lordships erred in refusing to the Appellants their expenses in the Inner House.

Upon the whole matter the Appellants submit that the Interlocutor appealed against is erroneous and ought to be reversed, and the Interlocutor of the Lord Ordinary restored, for the following among other

REASONS:

I. Because on a sound construction of Section 24, sub-section (3), of the Customs and Inland Revenue Act, 1888, there is no obligation upon the Appellants either to deduct Income Tax from the annuities which they pay or to account therefor to the Crown.

II. Because the annuities which form the subject of the action have in fact been paid out of profits and gains already brought into charge.

III. Because the said annuities are payable out of profits and gains already brought into charge.

IV. Because the interest on investments is pure income, while the other receipts upon which payment of the annuities has been apportioned by the said Interlocutor partake of the nature of capital payments.

V. Because the apportionment of Income Tax ordered by the said Interlocutor is not warranted by the statutes and is contrary to the law as laid down by your Lordships' House.

R. B. FINLAY.
CHARLES SCOTT DICKSON.
J. R. N. MACPHAIL.

RESPONDENT'S CASE.

The Respondent in this Appeal is the Lord Advocate, for and on behalf of the Commissioners of Inland Revenue, and the Appellants are the Edinburgh Life Assurance Company, incorporated by Act of Parliament. The action was raised at the instance of the Respondent against the Appellants for declarator that the Appellants were bound to render to the Commissioners of Inland Revenue a full account of the sums deducted by them in respect of Income Tax during the period from 5th April, 1905, to 30th November, 1907, upon their making payment of annuities charged with Income Tax under Schedule D, and for payment of a sum of £5,809 3*s.* 7*d.* more or less, in respect of Income Tax deducted by them, with interest thereon, said sum being the amount in fact deducted by the Appellants in paying annuities during the said period.

The action was raised before the Lord Ordinary in Exchequer Causes (Lord Johnston) who, after a proof, by Interlocutor, dated 30th July, 1908, assoilzied the Defenders from the conclusions of the Summons. The Respondent reclaimed against this Interlocutor to the First Division of the Court of Session, and their

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Lordships on 9th March, 1909, pronounced the Interlocutor under appeal to your Lordship's House, finding that the annuities paid by the Appellants fell to be debited proportionally against their revenue on which Income Tax had been paid and their revenue on which Income Tax had not been paid, and that they were bound to account for Income Tax on the portion of the annuities paid out of revenue on which Income Tax had not been paid.

The Appellants are a proprietary company, who carry on a life assurance and annuity business. The said annuities were paid in virtue of contracts entered into by them, and were payable out of funds of the Company and the capital stock so far as not paid up at the time. During the period in question, the Appellants were assessed to Income Tax or suffered such tax by deduction under Schedule D on their income from invested funds uplifted or received in the United Kingdom.

By Section 102 of the Income Tax Act, 1842, when annuities are payable out of profits or gains brought into charge, the person paying such annuities is authorised to deduct the Income Tax thereon, and is discharged of the amount deducted. By Section 40 of the Income Tax Act, 1853, every person liable to pay an annuity, either as a charge on any property or as a personal debt or obligation by virtue of any contract, is authorised to deduct the Income Tax thereon. By Section 24, sub-section (3), of the Customs and Inland Revenue Act, 1888, a person paying annuities which are not payable or not wholly payable out of profits or gains brought into charge is bound to deduct the Income Tax thereon, and to account to the Commissioners of Inland Revenue for the tax deducted, or for the tax deducted from so much of the annuities as is not paid out of profits or gains brought into charge.

The annuities paid by the Appellants were not made a charge on any particular fund or property; and the annuitants were in the position of ordinary unsecured creditors of the Company. The Appellants paid these annuities, as they became due, out of the first and readiest monies in their hands, irrespective of their source.

In making up their accounts, the Appellants did not ascribe the payment of annuities to any particular source of income. Nor are they entitled, merely for the purpose of an accounting with the Commissioners of Inland Revenue, to ascribe the payment of annuities to income derived from investments arising or received in the United Kingdom during the year of charge. The payment of annuities is in the same position as the payment of any of the other debts of the Company. If their payment can be ascribed to any definite sources of income in a question of accounting, it is submitted that the only method of doing so is to ascribe the several payments to the whole sources of income in the proportions which each source of income bears to the whole income.

In terms of Section 24, sub-section (3), of the Customs and Inland Revenue Act, 1888, the Appellants are bound to render

an account to the Commissioners of Inland Revenue of the amount of Income Tax deducted out of so much of the annuities as was not in fact paid out of profits or gains brought into charge. It is submitted that there is thereby laid on the Appellants the onus of proving that the annuities in question were in fact paid out of funds brought into charge, if they are entitled to retain the tax which they deducted. They, however, assert, and have proved, that all the annuities were paid out of the general funds of the Company, which included all their receipts; and they did not offer to produce evidence as to any of the said annuities having been paid in point of fact out of profits or gains which had been brought into charge. The Appellants do not have any separate fund out of which annuities are paid.

It is, therefore, submitted that the Appellants were under an obligation to account to the Respondent for the tax on that proportion of the annuities which must be taken, as already submitted, to have been paid out of profits and gains not brought into charge.

In the whole circumstances, the Respondent submits that the Interlocutor appealed against is well founded, and should be affirmed, for the following amongst other

REASONS:

1. Because the annuities, not being charged on any specific fund, fall to be met out of the readiest monies in the hands of the Appellants, irrespective of their source.
2. Because the Appellants have not offered to prove that any of the annuities were in fact paid out of profits or gains brought into charge for Income Tax.
3. Because the Appellants are bound to ascribe all payments which are not made a charge on any particular fund to their whole income, in proportions corresponding to the various sources of that income.
4. Because the Appellants are not entitled to ascribe the payment of annuities to one source of their income as distinguished from another.
5. Because the Income Tax payable on the said annuities does not form part of the tax which the Appellants have already paid.
6. Because, before the passing of the Customs and Inland Revenue Act, 1888, Income Tax deducted from annuities could only be retained against the Crown if such annuities were charged on profits and gains brought into charge, and the person deducting had in any other case to account to the Crown for the tax so deducted, and the Act of 1888 has not affected this liability.
7. Because the Interlocutor appealed against is well founded in law, and ought to be affirmed.

ALEX. URE.
FRAN. A. UMPHERSTON.

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The Appeal came before the House of Lords on the 9th, 20th, and 21st July, 1909, when Sir Robert Finlay, K.C., the Dean of Faculty (Mr. Scott Dickson, K.C., M.P.), and Mr. J. R. Macphail appeared as Counsel for the Appellants, and the Attorney-General (Sir W. S. Robson, K.C., M.P.), the Lord Advocate (Mr. Alexander Ure, K.C., M.P.), and Mr. Umpherston appeared as Counsel for the Respondent. On the 9th December, 1909, Judgment was given against the Crown.

JUDGMENT.

Lord Atkinson.—My Lords, in this case the Lord Advocate for Scotland filed an information against the Defendant Company to obtain an account of the Income Tax deducted by them from annuities payable by them and also to recover on behalf of the Commissioners of Inland Revenue payment of a sum of £5,809 3*s.* 7*d.*, alleged to have been deducted by the Company in respect of Income Tax from certain annuities, amounting to £116,259 13*s.*, paid by them from the 5th of April, 1905, to the 30th of November, 1907.

The question for decision turns on the true construction of Section 24, sub-section 3 of the Inland Revenue Act of 1888.

The Defendant Company carries on the ordinary business of a Life Insurance Company, including the selling of the annuities, both immediate and deferred. The immediate annuity is purchased by the payment to the Company of a lump sum; the deferred annuity either by the payment of a lump sum or of a series of instalments.

The income of the Company consists (1) of Interest on Investment, Dividends, and Rents, a considerable sum, upon which Income Tax is deducted at its source; (2) Premiums for Life Insurances; (3) the Purchase Money of the annuities; and (4) a small sum representing transfer fees, &c.; while the Company's outgoings consist of (1) Claims on Policies; (2) Surrenders of Policies; (3) Annuities; (4) Expenses of Management, including Commissions; (5) Income Tax; and (6) Dividends to Shareholders.

The financial position of the Company is best shown by the result of their operations during the five years ending on the 31st December, 1907. Their total receipts during that period amounted to £2,515,113, of which nearly one third, £804,731, represents interest, dividends and rent, on which Income Tax is deducted at the source, while their expenditure, including a sum of £207,567 actually ascertained, to meet increased liabilities, amounted to £2,180,663, leaving a net surplus of £334,450, so that, if the sum of £804,731 were not brought into account and applied by the Company to meet its liabilities, there would be a deficit on the five years trading of £470,281.

No formal appropriation of the interest from these investments in the books of the Company is made, nor is any particular

fund set apart, earmarked, or specially charged with the payment of these annuities, but as the before-mentioned figures demonstrate these annuities must, since they have been paid in full, have been paid in part out of this sum of £804,731 so brought into account. The income of the Company from all sources is treated as paid into a common fund, from which all outgoings are discharged. And by the 18th Article of the Contract of Co-partnership of the Company it is provided, amongst other things, that every policy of insurance or other obligation entered into by the directors for the behoof of the Company shall contain a clause declaring that the capital stock and funds of the Company for the time being shall be the only fund answerable for any demand under such policy or other obligation. Such a clause is invariably inserted in these documents as directed by this article.

These facts are not disputed. An account in a particular form had been furnished to the Inland Revenue, and therefore the real object of the action is the recovery of this money demand. From the accounts furnished it is clear that had the Company been assessed upon their trade profits for the five years ending the 31st December, 1907, the Inland Revenue would have received from them Income Tax on £334,450, and have received from the annuitants Income Tax upon £218,463, making together the sum of £552,913. The Inland Revenue did not take that course; they collected the tax upon the Company's investments, the Company returning its net profits each year under Rule 1, Case 1, of Schedule D as "nil," with the result that they have already received Income Tax on a much larger sum (a sum amounting, after deducting the tax, to £804,731) than they would have received had they taxed it on its profit. And if the contention on which their present claim is based be sound, they would be entitled to receive Income Tax on the amount of the annuities paid, namely, £218,463, besides; that is Income Tax on over £1,023,194 instead of on £552,913. But whether this contention be sound or not, it is obvious that the Inland Revenue have taken the course most profitable for the Crown and most burdensome to the subject. They cannot assess the Company on one basis and call them to account upon another. It is assumed that the Company make no net profits, and the Crown must admit that even if the fact were so it would not affect the validity of their claim or the question to be decided.

The Lord Ordinary decided in favour of the Company. The Commissioners appealed to the First Division, contending before both tribunals that these annuities could not be treated as in whole or part paid or payable out of gains and profits brought into charge. That contention was rejected by both Courts, but the First Division, by their decree, dated the 9th March, 1909, found "That the annuities paid by the Defenders in every year "fall to be debited proportionally against their revenue on which "Income Tax has been paid and their revenue upon which

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"Income Tax has not been paid in each year"; and further, that the Defenders were bound to account for the portion of the annuities paid out of revenue which had not paid Income Tax; and remitted the case to the Lord Ordinary to fix the amount of Income Tax due on those findings.

From this decree the Company have appealed to your Lordships' House. The Respondents now endeavour to support their decree on grounds entirely inconsistent with those on which they relied in the Scotch Courts. They now admit, as indeed they must admit, in order to hold their decree, what before they strenuously disputed, namely, that the income from these investments of the Company are "profits and gains brought into "charge" within the meaning of the 24th Section of the Act of 1888. But they contend that as the annuities are not made a special charge on any particular fund belonging to the Company, and are in fact paid out of a mixed fund, the payments must be ascribed to the whole sources of income in the proportions which each source of income bears to the whole income.

It cannot be disputed that the annuities, though not exclusively charged upon this taxed income, are payable out of it, in the sense that they are charged upon it, may legitimately and properly be paid out of it, and can be paid out of it in fact, as it is ample to meet them.

The case of the *London County Council* v. *The Attorney-General* (A.C. (1901) p. 26) (1) resembles the present case in this: that Stock A issued by the Council and the dividends upon it and the sums required to form a sinking fund were charged upon all the property of the Council together with the rates. It differs from the present case, however, in this: that the income of the Council liable to Income Tax was less by many thousands of pounds than the interest paid to the stockholders; and it necessarily followed that stockholders to a considerable amount must have been paid out of non-taxed income, namely the rates.

The case was clearly covered by the concluding portion of the 24th Section. The Council were quite willing to pay the Income Tax deducted on the interest so paid out of the *rates*, but claimed the right to retain the Income Tax deducted on the interest paid out of the tax-bearing portion of their income. The claim of the Crown in that case, as originally in this, was based upon the contention that the income of the Council derived from their property, as distinguished from the rates, was not "gains and "profits brought into charge" to the Income Tax payable under Schedule D within the meaning of Section 24; and alternatively in that case, as now in this, that the interest payable to the stockholders was a charge upon a mixed fund comprising the income from their property and the rates; that only a portion of that fund could be brought into charge to the Income Tax under D, and that consequently only a rateable proportion of the dividends on the stock could be treated as payable out of "profits "or gains brought into charge."

(1) 4 T.C. 265.

The decision of your Lordships was against the Crown on both these points. In dealing with the second, Lord Macnaghten, at page 33 of the report,(1) expresses himself thus: "That is an "ingenious, but not, I think, very business-like suggestion. It "is enough to say it is the plain duty of the Council, not being "beneficial owners of the funds which they administer, to keep "down annual charges out of annual income as far as it will "extend." Lord Davey, at page 46,(2) deals with the latter contention thus: "On the second point it is difficult to express "oneself with becoming respect. The contention is that as the "interest on their consolidated stock is charged upon the whole "lands rents and property belonging to the Corporation and on "their rates, such interest ought, for the benefit of the Crown, "to be apportioned rateably, over all subjects of the charge, and "only a rateable proportion deemed to be paid from rents or "from interest receivable by them from their own debtors. The "proposition has the merit of novelty; admittedly there is no "authority for it. The attention of your Lordships has not "been called to any statutory enactment directing such pro-"cedure, or to any principle of law which prescribes it. On the "contrary, the general principle of payment in due course is to "pay annual charges in the first place out of annual income. "It is not required by the Income Tax Acts, in order to raise the "right of deduction and retention, that the interest or annual "payment should be exclusively charged or payable out of profits "or gains brought into charge. It is enough if the interest is "charged upon or payable out of the taxable income, though "there may be other subjects of charge." With this reasoning the other Lords concurred.

The feature which, in addition to the insufficiency of the tax-bearing income to pay all the claims upon it, distinguishes that case from the present, is that there the taxed income had been set apart as a separate fund, and the interest and dividends on which the income tax required to be returned had been paid were, in fact, paid out of the fund so set apart. The question is whether a manipulation such as that by the Company of its funds, a setting apart of less than one-third of their taxed income, to pay these annuities, which they can any day readily accomplish, and which if done could not have any effect on their balance sheet or financial position, is a condition precedent which must be performed in order to entitle them to retain under the provisions of Section 24 of the Customs and Inland Revenue Act of 1888 the sum deducted and now sued for.

In my opinion, where annuities such as these are charged upon a tax-bearing fund amply sufficient to pay them in full, though not set apart for that purpose, they cannot be held to be "not payable" or "not wholly payable" out of gains and profits brought into charge within the meaning of the 24th Section. For the purposes of that section I think that the interest

(1) 4 T.C. 292. (2) 4 T.C. 301.

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on annuities charged upon the tax-bearing fund must under such circumstances be treated as payable out of that fund, so far as it will reach. If the taxed fund be insufficient to pay all the interest and annuities, then the Income Tax deducted on the interest or annuities not satisfied out of it must be accounted for. In short, I attach no special virtue to the manipulation of the funds of a corporation, in the manner above mentioned, as a means of escape from a liability to pay Income Tax. To do so would, in effect, be, I think, to lose sight of what appears to me to be one of the main objects, if not the main object, of the section, namely, to avoid obliging a subject to pay Income Tax twice over on the same sum. That object would, in the result, be defeated, if the subject were obliged first to pay Income Tax on a given fund and then to pay Income Tax on sums properly payable out of it, simply because he had omitted formally to dedicate the funds specially to that use and formally to pay those sums out of it.

On this ground I think the Appeal in this case should be allowed. But if I were of a contrary opinion I should have great difficulty in determining what, for the purposes of the decree, is to be taken to be the "revenue of the Company which has "not paid Income Tax," or on what basis it is to be ascertained. The case of *Gresham* v. *Styles* (1892 A.C. 309)(1) establishes that, in order to ascertain what are trade profits for the purposes of taxation under the Income Tax Acts antecedent to this Act of 1888, annuities, such as those paid in this case, cannot be treated as paid out of profits and gains "brought into charge" to the tax; and *e converso* that the amount paid by the annuitant in respect of them, that is, the amount paid to purchase them, whether in a lump sum, or by instalments cannot be taken in its bulk as such "profits or gains" either; but that the expenditure, including these annuities, must be deducted from the receipts to ascertain the net profits, upon which alone Income Tax is to be levied. In this case the Company has been taxed on the assumption that its net profits are *nil*; and it is admitted that Section 24 is merely a machinery section, neither extending existing charges, nor imposing new ones. The rates levied by the London County Council bear no analogy whatever to the sums paid to purchase these annuities, nor, indeed, it would appear to me, to the premiums on ordinary policies of life insurance either. The rates are income in the ordinary sense. The price received by a trader for the goods he purchases and then vends is to a great extent capital and is not to be treated as income or "gains and profits" for the purpose of the Income Tax Acts; yet, by the decree, the annuities are to be apportioned between receipts in their nature portions of capital, and the income from investments, as if they were two ascertained portions of revenue as distinguished from capital, Income Tax being leviable on the one and not on the other, while it is admitted that

(1) 3 T.C. 185.

these receipts might be very considerable and yet the net profits made by the trading, apart from the income from investment, be nothing or less than nothing. In the view I take on the other points raised it is unnecessary for me to determine what is the true principle upon which the account directed should be taken, but I own, with all respect to the learned Judges of the First Division, I think great injustice might result from the application of the principle on which the decree appears to be based.

As I have already said, I think this appeal should be allowed with costs against the Crown.

Lord Gorell.—My Lords, the facts which give rise to the question in this case are simple. The Appellants carry on the ordinary business of a life insurance company, including, *inter alia*, the selling of annuities both immediate and deferred. An immediate annuity is purchased by a single payment of a lump sum; a deferred annuity may be purchased either by a single payment or by a series of instalments. The revenue of the Company consists of (1) interest on investments, dividends, and rents; (2) premiums for life insurances; (3) consideration money for annuities; (4) a small sum representing assignment and transfer fees and other miscellaneous receipts. Its outgoings consist of (1) claims under policies; (2) surrenders; (3) annuities; (4) commission and expenses of management; (5) dividends to shareholders; (6) Income Tax.

The interest, &c., which the Company receives from its investments, forms a large portion of its revenue, and but for it there would be a large annual deficit. From this interest, &c., Income Tax is deducted at the source, and it is not included by the Company in arriving at the balance of profits and gains for the purpose of direct assessment under the Income Tax Acts under Case 1 of Schedule D. The Company therefore returns its profits and gains as nil, and the return has been accepted by the Income Tax Commissioners. The Income Tax deducted from the interest, &c., on the investments largely exceeds the amount which would be yielded by an assessment on the profits as a trading concern.

In paying the annuities for which they are liable the Company deduct Income Tax at the proper rate. The annuities paid for the period from 5th April, 1905, to 30th November, 1907, amounted to £116,259 13*s.*, and the Income Tax deducted by the Company on payment of these annuities amounted to £5,809 3*s.* 7*d.*

The Respondent brought the present suit by summons on the 18th June, 1908, to recover the latter sum from the Appellants, on the ground that under the Income Tax Acts the Appellants are bound, as the Commissioners of Income Tax allege, to pay this sum to the Crown; whereas the Appellants claimed to retain it, on the ground that the annuities were payable and had been paid out of profits and gains already brought into charge for Income Tax.

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It will be convenient here to show the position of the Appellants with regard to the annuities by a reference to their operations for the quinquennial period ending 31st December, 1907. During that period their total receipts were:—Premiums, £1,529,502: Consideration for annuities, £178,074: Assignment and transfer fees, £684: Profits on investments realised £2,122, making £1,710,382, and interest, dividends, and rents, £804,731. Total, £2,515,113.

The total expenditure was £1,973,096, of which expenses of management amounted to £168,204 and annuities paid to £218,463. In addition there was a sum of £207,567 in respect of increased liabilities actuarially ascertained, which with the £1,973,096 made a total of £2,180,663, so that the surplus of receipts over expenditure was £334,450. If the sum of £804,731 for interest, dividends, and rents were not brought into account, there would have been a deficit of £470,281.

The Lord Ordinary, by Interlocutor of the 30th July, 1908, assoilzied the Appellants from the conclusions of the summons, but on appeal the First Division of the Court of Session decided the case on a ground which was not put forward by the Crown, either before the Lord Ordinary or in the Inner House. They held that the annuities paid by the Appellants in any year fall to be debited proportionally against their revenue on which Income Tax has been paid and their revenue on which Income Tax has not been paid in each year; and that the Appellants were bound to account to the Respondent for Income Tax on the portion of the annuities thus paid out of revenue which had not paid Income Tax; and they remitted to the Lord Ordinary to fix the amount of Income Tax due in terms of their findings.

The effect of this Judgment, if it be applied to the quinquennial period above mentioned, will be that the Appellants must apportion the sum of £218,463 paid by them to their annuitants rateably between (1) the £804,731 of interest, dividends, and rent on which they paid Income Tax, and (2) the rest of their receipts, amounting to £1,710,382, on which Income Tax has not been paid; and therefore, although they have paid Income Tax on the sum of £804,731, they would have to pay to the Crown in addition rather more than two-thirds of the Income Tax deducted by them from the annuities paid by them.

The Appellants appeal against this decision and seek to have the Interlocutor of the Lord Ordinary restored. There is no cross Appeal, and therefore the question is whether the Appellants are entitled to retain the whole of the Income Tax deducted by them from the annuities paid by them, or only a portion thereof, to be ascertained by the method above stated.

My Lords, the question depends upon the meaning and effect of Section 102 of the Property Tax Act, 1842, Section 40 of the Property Tax Act, 1853, and Section 24, subsection 3, of the Customs and Inland Revenue Act, 1888. I need not trouble your Lordships by a full statement of these sections and of their operation, because I find on reading the Judgment delivered in

the case of the *London County Council* v. *The Attorney-General*(1) (L.R. 1901, A.C. 26), to which your Lordships were referred in the course of the argument in the present case, that Lord Macnaghten has examined these sections very fully. At pages 38-40 he points out how they authorise a person who has paid Income Tax on what is not really available income, because it includes money which he has to pay over to some one else, to deduct and retain the tax upon that payment.

To understand the effect of Section 24, sub-section 3, of the Act of 1888, which was so much discussed in argument before your Lordships, it is necessary to refer back to Section 102 of the Act of 1842, which charges with tax "all annuities" and other annual payments "whether they are payable . . . as a "charge on any property of the person paying the same by virtue "of any deed or will or otherwise or as a reservation thereout or "as a personal debt or obligation by virtue of any contract." Then follows the proviso that "in every case where the same shall "be payable out of profits or gains brought into charge by virtue "of this Act no assessment shall be made upon the person entitled "to such annuity, interest, or other annual payment, but the "whole of such profits or gains shall be charged with duty on the "person liable to such annual payment, without distinguishing "such annual payment, and the person so liable to make such annual "payment, whether out of the profits or gains charged with duty, "or out of any annual payment liable to deduction or from which "a deduction hath been made, shall be authorised to deduct out "of such annual payment at the rate of," etc. It will be seen further on in the section that in cases where the annual payment was not payable out of profits or gains brought into charge the payment was charged in the hands of the recipient. The change made by Section 40 of the Act of 1853 is explained in the Judgment referred to. Deduction of the duty was authorised in the case of every annual payment either as a charge on any property or as a personal debt or obligation by virtue of any contract.

Section 24, sub-section 3, of the Act of 1888, made the deduction compulsory in all cases, and the person making the annual payment is bound to account to the Crown for the amount deducted unless the annual payment is payable out of profits or gains brought into charge.

The first question then in the present case is whether the annuities were payable by the Appellants out of profits or gains brought into charge.

The form of annuity bond granted by the Appellants is given at page 23 of the Record, and according to this the funds of the Company and the capital stock, so far as not paid up at the time, are alone answerable for any claim or demand under or by means of an annuity bond.

The funds of the Company, according to the articles of co-partnership, are the paid-up capital and sums appropriated to the proprietors by way of profit, and the interest, dividends, and

(1) 4 T.C. 265.

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accumulations thereof. They also include all premiums and other sums to be received for assurances, &c., and the interest, dividends, and accumulations thereof respectively, which are to form a separate fund called "the Assurance and Annuity Fund," which fund is to be in the first instance the fund for answering all claims and demands on the Company in respect of its assurances or otherwise and for defraying the expenses of carrying on the business of the Company.

The annuities are, in my opinion, payable, within the meaning of the Acts, out of the interest, dividends, and rents received by the Company from which Income Tax is deducted before the moneys are received by the Company—they are payable out of profits or gains brought into charge by virtue of the Acts. But they are not payable out of these profits and gains exclusively, and the question appears to be whether that prevents the Company from having the right of deduction and retention to the extent which they claim.

The contention was raised in the case above referred to that, as the interest on Metropolitan Stock was charged on all the property of the Council—capital and income alike—and on their rates, such interest ought for the benefit of the Crown to be apportioned rateably over all the subjects of the charge, and only a rateable proportion deemed to be paid out of income from rents or from interest received by them from their own debtors. This contention was rejected. Lord Davey said: "The general prin-"ciple of payment in due course of administration is to pay "annual charges in the first place out of annual income. It is "not required by the Income Tax Acts in order to raise the right "of deduction and retention that the interest on annual pay-"ments shall be exclusively charged upon or payable out of profits "or gains brought into charge. It is enough if the interest is "charged upon or payable out of the taxable income, though "there may be other subjects of charge. But the mortgagor can-"not, of course, retain against the Crown more Income Tax than "he has paid. One of the learned Judges in the Court of Appeal "seems to have thought the case might be different if the County "Council had made some appropriation of their funds, though it "is difficult to see how any account-keeping by the debtor could "alter the rights of the Crown." The point there decided, upon which these remarks were made, no doubt was affected by the difference between capital and income, in due course of administration; but when the terms of the Acts and the object to be effected are considered in relation to such a case as the present, it would seem that the principles indicated in that judgment should also apply where money, out of which annual payments are payable, is derived from two sources, that coming from one being charged with Income Tax while that coming from the other is not so charged.

The Acts are drawn in general terms to meet various cases, but their application which is thus suggested to the present case produces the result which would seem to have been intended to be

reached in such cases by taxing at the source; for although the £804,731 for interest, dividends, and rents is not really available income, the Crown receives the tax on the whole of that sum, and the Company only get back the tax on £218,463. If they also have to account for the tax on rather more than two-thirds of the latter sum, there will be a payment twice over on that account. There does not seem to be any authority applicable to this case for the proposition on which the learned Judges of the First Division acted, that because there are two funds practically charged with the payment of the annuities the liabilities must be apportioned rateably between them. The Appellants may pay the annuities out of which funds they please, and the question of their rights and liabilities with regard to the Crown must depend on the sections of the Acts above referred to, according to which the tax may be deducted and retained, although the annuities are not payable exclusively out of the taxable income of the Company.

But then it was argued for the Respondent that it has not been shown that the annuities have been paid out of the taxable income. This argument would seem to make the rights of the Crown depend upon the book-keeping of the Company; but this cannot be, nor do I think the liabilities of the Company can be made to depend upon their system of accounts. This argument could hardly be open if the Company had, in fact, kept the interest, dividends, and rents from their investments apart from their other moneys, and paid the annuities out of the former. Can it then make any difference to their rights and liabilities if they choose to mix the funds for the purpose of their accounts and pay thereout whatever sum is necessary to discharge their liabilities to the annuitants?

It may be that, as Lord Macnaghten said in the above case, at p. 34,(1) in commenting on the change of language in section 24, sub-section 3, of the Act of 1888, from "payable" to "paid," "so far as interest of money or annuities chargeable under "Schedule D are in fact paid out of profits or gains 'brought "into charge,' whether in law payable thereout or not, the person "who makes the payment and deducts the rate of Income Tax "is not accountable to the Crown for the duty deducted." But it does not appear to me to follow that where the annuities are payable out of profits or gains brought into charge it is necessary to use in paying the annuities the actual moneys received in respect of the profits or gains in order to obtain the benefit of the deduction and retention. In the case of a business like the Appellants', and taking into account the language and object of the three Acts, it seems to me that, if the annuities are made payable out of the interest, dividends, and rents charged with the tax, it is immaterial whether the money to pay them is taken out of the general till of the Company or not, provided that it does not exceed the amount of income on which tax is charged.

I am of opinion that the appeal should be allowed and the Interlocutor of the Lord Ordinary restored with costs here and in the First Division.

(1) 4 T.C. 292.

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Lord Ashbourne.—My Lords, in this case I concur in the opinions which have been delivered by my noble and learned friends.

Lord Gorell.—My Lords, in the case which was before your Lordships yesterday your Lordships were referred to a statute in which it was stated that costs in Revenue cases were to be allowed as between subject and subject. I should presume therefore that in this case, unless there are some exceptional circumstances, the costs would be awarded as in an ordinary case.

The Lord Chancellor.—My Lords, I agree on the question of costs. We certainly have, at all events recently, awarded costs for and against the Crown in Revenue cases. I do not know whether it is desired to argue any point or to make any submission on behalf of the Crown.

Sir Robert Finlay.—I am told, my Lord, that unfortunately neither the Attorney-General nor the Lord Advocate is able to be here. My submission is that the subject should have the costs, as has, I believe, been usual. I should say that the Lord Ordinary gave the Company costs; he decided in their favour with costs. In the First Division his Order was varied, and it was decided that there should be no costs. What I ask your Lordships is that we should have the costs here and below in the ordinary way.

The Lord Chancellor.—I should have liked to be referred to the statute which, I think, was quoted yesterday.

Sir Robert Finlay.—I think I can find it.

The Lord Chancellor.—The Solicitor-General referred to it, I think.

Sir Robert Finlay.—I have had handed to me the Statute 22nd and 23rd Vict. chapter 21, Section 21, which deals with the point. The effect of it is given at page LXXXIV. in the introduction of Dowell's Income Tax Acts: "The costs in all proceedings and "interlocutory matters on the revenue side are to be adjudged as "betwen subject and subject. In *Attorney-General* v. *Countess* "*Blucher de Wahlstatt* (1864) (3 H. & C. 390) it was held that in "Revenue cases where decrees were pronounced for the Crown "or Defendant costs followed the event unless otherwise ordered."

(Their Lordships consulted together.)

Mr. Umpherston.—My Lords, my learned friend the Attorney-General is unable to be here this afternoon, and on his behalf, if you will allow me, I should like to mention that I am instructed by the gentlemen who instructed the Attorney-General on behalf of the Crown to say that they do not desire to raise any point upon this question of costs.

Questions put.

That the Order appealed from be reversed.

The Contents have it.

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

The Contents have it.