HIGH COURT OF JUSTICE (CHANCERY DIVISION)—11TH, 12TH AND 17TH JULY, 1956

COURT OF APPEAL—12TH, 13TH AND 14TH DECEMBER, 1956

HOUSE OF LORDS—25TH AND 26TH NOVEMBER, 1957, AND 23RD JANUARY, 1958

Wigram Family Settled Estates, Ltd. (in liquidation)

v.

Commissioners of Inland Revenue[1]

Surtax—Investment company—Apportionment of income " in accordance with the respective interests of the members "—Finance Act, 1922 (12 & 13 *Geo.* V, *c.* 17), *Section* 21 *and First Schedule, Paragraph* 8 ; *Finance Act,* 1939 (2 & 3 *Geo.* VI, *c.* 41), *Section* 14.

The Appellant Company, which had originally been formed to deal in real estate but was at the material times an investment company to which Section 14, *Finance Act,* 1939, *applied, had issued to an assurance company non-voting redeemable first preference shares on the terms that it would maintain a redemption fund out of the profits which would otherwise be available for dividend. In the years ended* 31*st March,* 1950, 1951 *and* 1952, *the sums of* £4,000, £10,000 *and* £4,000 *respectively out of the Company's taxed profits were transferred to the redemption fund ; all the classes of shares prior to the ordinary shares were well secured or covered.*

The Company's income for the years 1949–50, 1950–51 *and* 1951–52 *was apportioned for Surtax purposes among the members in accordance with their respective interests on the footing that the assurance company's interest was represented only by its right to a dividend on the redeemable preference shares. On appeal, the Company contended that the amounts transferred to the redemption fund should also be taken into account as constituting an interest of the assurance company ; for the Crown it was contended that the method adopted was the most equitable and fair, having regard not only to income rights and to voting rights but also to the interests of the ordinary shareholders on a winding-up. The Special Commissioners accepted the Crown's contentions, holding that the contract for the maintenance of a redemption fund was no more than a security for the repayment of the capital and that it would be wrong to attribute to the assurance company a double interest measured by both the dividend rights and the amounts credited to that fund.*

Held, *that the Commissioners' decision was correct.*

Commissioners of Inland Revenue *v.* F.P.H. Finance Trust, Ltd. (No. 2), 28 T.C. 209, *applied.*

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[1] Reported (Ch.D.) [1956] 3 All E.R. 118; 222 L.T. Jo. 80; (C.A.) [1957] 1 W.L.R. 233; 101 S.J. 128; [1957] 1 All E.R. 311; 223 L.T. Jo. 64; (H.L.) [1958] 1 W.L.R. 213; 102 S.J. 137; [1958] 1 All E.R. 338; 225 L.T. Jo. 74.

CASE

Stated under the Income Tax Act, 1952, Sections 229 (4) and 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 7th and 8th June, 1955, Wigram Family Settled Estates, Ltd. (in liquidation) (hereinafter called " Wigram ") appealed against directions made upon it by the Special Commissioners under the provisions of Section 21, Finance Act, 1922, and Section 14, Finance Act, 1939, in respect of the years of assessment 1949–50, 1950–51, and 1951–52 and against the consequential apportionments among the members of the actual income of Wigram for the said years. The sole point for our determination in the said appeal against the directions was whether or not Wigram existed wholly or mainly for the purpose of carrying on a trade or for the purpose of co-ordinating the administration of a group of two or more companies each of which was under its control within the meaning of Section 14 (7), Finance Act, 1939. It was common ground between the parties that if Wigram did so exist the directions for the said years fell to be discharged. In the alternative Wigram objected to the apportionments of its actual income for the said years among its members on the ground that they had not been made in accordance with the provisions of Paragraph 8, First Schedule, Finance Act, 1922.

2. At the conclusion of the hearing of the appeals we gave our decision confirming the directions and the apportionments in principle. Our decision on the appeal against the directions has been accepted by Wigram and no question now arises upon that part of the case.

3. (i) At the hearing of the appeal against the apportionments the following documents were produced in evidence before us and are attached to and form part of this Case[1]:

Summary of balance sheets and profit and loss accounts of Wigram for the years 1948 to 1952 inclusive and for the period ended 19th May, 1952 (exhibit A).

Memorandum and articles of association of Wigram (exhibit B).

Composition of provisions made to the redeemable preference shares redemption fund during the years ended 31st March, 1950 to 1952, inclusive (exhibit C).

(ii) The following documents, which were produced in evidence before us in reference to Wigram's appeal against the directions for the said years of assessment 1949–50 to 1951–52 inclusive, are not part of this Case but are available if required for the information of the High Court:

Consolidated accounts of Wigram and subsidiary companies (exhibit D).

Statutory declaration of the directors of Wigram dated 16th June, 1937 (exhibit E).

Summary of balance sheets and profit and loss accounts of Wigram's subsidiary companies (exhibit F).

Statement of subsidiary companies' bankers (exhibit G).

(iii) The facts found by us on the foregoing evidence or admitted and/or proved before us are stated in the following paragraphs numbered 4 to 12 inclusive.

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[1] Not included in the present print.

4. Wigram was incorporated on 12th December, 1932, to acquire and deal in real estate, its objects as set out in paragraph 3 (*a*) and (*b*) of its memorandum of association (exhibit B) being to

> "purchase . . . or otherwise deal in any real or personal property . . . develop and turn to account any land by laying out and preparing the same for building purposes . . . and entering into contracts and arrangements of all kinds with builders, contractors, tenants and others."

The promoters and principal shareholders of Wigram were the late Mr. Lionel Wigram, a solicitor, who died on 3rd February, 1944, and Mr. F. B. Winham, sole proprietor of the firm of Messrs. Royds & Co., estate managers. At the time of Wigram's incorporation the late Mr. Wigram and Miss D. E. Chapman were the first directors, and at all times material to this appeal the directors of Wigram were Mr. A. F. Ferguson and Mr. H. L. Denton.

5. (i) At the time of its incorporation the authorised capital of Wigram was £5,000 divided into 3,500 preference shares of £1 each and 1,500 ordinary shares of £1 each, all of which were issued for cash.

(ii) By special resolution dated 6th April, 1933, the authorised capital of Wigram was increased to £7,500 by the creation of 2,500 participating cumulative preference shares of £1 each, of which 2,000 shares have been issued for cash.

(iii) By special resolution dated 12th December, 1934, Wigram's authorised capital was further increased to £57,500 by the creation of 50,000 6 per cent. redeemable preference shares of £1 each, all of which have been issued for cash.

(iv) By special resolution dated 14th April, 1936, Wigram's authorised capital was further increased to £107,500 by the creation of an additional 50,000 6 per cent. redeemable preference shares of £1 each, all of which were issued for cash on 22nd April, 1936, to the holders of the original issue of redeemable preference shares.

(v) The terms of issue of the first issue of redeemable preference shares were, *inter alia,* that they were to be repaid within five years from 31st March, 1935, and that Wigram was to set aside out of profits available for dividend in each year beginning with the year ended 31st March, 1936, a sum of £9,050, such sum to be credited to a redeemable preference shares redemption fund until that fund amounted to £50,000.

(vi) By the amendments effected by the special resolution of 14th April, 1936, providing for the second issue of redeemable preference shares (see sub-paragraph (iv) above) the following provisions (shortly stated) were made for the redemption of the 100,000 redeemable preference shares and incorporated in article 14A of Wigram's articles of association (exhibit B), namely, they were to be redeemed on the expiration of ten years from 31st March, 1935, and for the purpose of such redemption Wigram was to carry to the credit of a redeemable preference shares redemption fund, out of the profits of Wigram which would otherwise be available for dividend, for the year ended 31st March, 1936, the sum of £9,050, and for every subsequent year the sum of £7,797.

(vii) Under article 14A (*c*) the profits of Wigram were to be calculated, for the purpose of this article, without any deduction of any sums payable to Mr. Wigram and to Mr. Winham, or any firms in which they or either of them might be a partner, in respect of services as directors, solicitors, surveyors or otherwise.

(viii) Both the first and second issues of redeemable preference shares were made to the Equity and Law Life Assurance Society (hereinafter called "the Society"), and the said provisions as regards the redemption of the

preference shares were imposed by the Society as a condition precedent to subscribing for the shares in cash.

6. (i) Mr. F. B. Winham was never a director of Wigram but was at all material times its (unpaid) general manager. He also controlled Wigram during the material period by virtue of holding 1,000 out of 1,500 ordinary shares in the Company. Mr. Winham was the sole proprietor of the firm of Messrs. Royds & Co., estate managers, and the management of Wigram and, as they came into existence, of the subsidiary companies within the group was centred in his firm in conjunction with Wigram's solicitors, Messrs. Wigram & Co., in which firm the late Mr. Wigram was a partner. Properties acquired by Wigram in the course of its business were bought and sold by Messrs. Royds & Co. as Wigram's agents and that firm decided what to buy and what to sell. Accounts of Wigram and its subsidiaries were kept by the accounts department of Messrs. Royds & Co., who also undertook all architectural work and collected rents on behalf of Wigram and its group. Mr. Denton, one of the two directors of Wigram during the material period, was also a partner in Messrs. Wigram & Co., solicitors. The auditors of Wigram were Messrs. Thomson McLintock & Co.

(ii) Messrs. Royds & Co. were entitled to receive remuneration from Wigram for the work done on behalf of it and of its subsidiary companies, but during the material years no payments from Wigram were made because of the terms of the agreement with the Society (*vide* paragraph 5 (vii)).

(iii) Wigram at all material times paid dividends on its preference shares, but it declared no ordinary dividends.

7. (i) The intention of the promoters of Wigram was that Wigram should acquire and deal in real estate both on its own account and by the medium of subsidiary companies to be formed for that purpose, which would constitute the Wigram group and would themselves also have power to acquire and deal in property. At an early stage in its history it became clear that Wigram had insufficient capital to finance the operations which the directors desired to carry out. This difficulty was met partly by increasing the capital of Wigram, as described in paragraph 5 above. The additional capital of £100,000 also made possible expansion in borrowing and in dealing, and by the year 1937 it had property to the value of some £870,000. Wigram was also able to expand its business by the medium of a number of subsidiary companies.

(ii) Of these there were 13 wholly-owned subsidiaries formed before the year 1940, and during the material period the directors thereof were Mr. Denton and Mr. Ferguson, who held their qualification shares as nominees of Wigram. The facts given in evidence before us relating to these subsidiaries were mainly relevant to the appeal of Wigram against the directions (*vide* paragraph 2 above) but we summarise the facts we found in so far as they bear upon the point of law on which Wigram has requested us to state this case.

(*a*) Baring Estates, Ltd., incorporated in the year 1927 with the object of dealing in and holding investments. It dealt in property until 1st April, 1949, when its remaining freehold and leasehold properties were transferred to another wholly owned subsidiary company of Wigram called P.I.T. (see paragraph 9 below).

(*b*) Boundary Property Co., Ltd., incorporated in the year 1934 with the object of carrying out a particular transaction in property. It has been dormant since the year 1940.

(*c*) McBain Family Estates, Ltd., formed in the year 1934. It dealt in property until the end of the year 1938–39 and since then has been dormant.

(*d*) Magdalen Property Trust, Ltd., formed in the year 1934. It dealt in property until the end of the year 1938–39 and since then has been dormant. Its remaining freehold property was transferred to P.I.T. on 1st April, 1949.

(*e*) Multiple Shops (Holdings), Ltd., formed in the year 1934. It never dealt in property and its assets were transferred to Town and Country Shop Premises, Ltd. (*vide* sub-paragraph (*g*) below) in the year 1938.

(*f*) R.M.C. Family Trust, Ltd., formed in the year 1935. It dealt with property until the end of the year 1937–38 since when it has been dormant. Its remaining properties were transferred to P.I.T. on 1st April, 1949.

(*g*) Town and Country Shop Premises, Ltd., formed in the year 1934. It took over property from Multiple Shops (Holdings), Ltd. (*vide* sub-paragraph (*e*) above) and dealt in property until the end of the year 1939–40 since when it has been dormant.

(*h*) Davies Property Trust, Ltd., formed in the year 1934. It dealt in property up to the end of the year 1937–38 and since then has been dormant.

(*i*) Clarges Property Trust, Ltd., formed in the year 1934. It dealt in property until 1st April, 1949, when all its remaining properties were transferred to P.I.T. Thereafter it acquired further properties the facts as to which have no relevance to this case.

(*j*) Rochester Construction Company, Ltd., formed in the year 1939 for the purpose of building at Rochester. It later began to do business in general contracting work and continued that business during the material period after disposing of its remaining freehold properties to P.I.T. on 1st April, 1949.

(*k*) The remaining wholly-owned subsidiaries in the original Wigram group, Southern District Fisheries, Ltd., Suburban Fisheries, Ltd., and General Mortgage and Finance Co., Ltd., were investment companies only.

8. The policy of the Wigram group as stated in paragraph 7 above continued uninterrupted until the outbreak of war in 1939. It then became impossible for either Wigram or any of its companies to continue active dealing to any extent. There were restrictions on building and also on borrowing. The Wigram group continued, however, to hold substantial properties throughout the war period and in the years succeeding, and at 31st March, 1948, Wigram held freehold properties to the value of £48,657 and leasehold properties to the value of £285,022. By 31st March, 1949, it held freeholds £47,616 and leaseholds £118,169 but by 31st March, 1950, it had only £5,434 freeholds and no leaseholds. In the Wigram group (exhibit D) the corresponding figures were :

1948	Freeholds	£77,238
	Leaseholds	£329,654
1949	Freeholds	£76,197
	Leaseholds	£161,530
1950	Freeholds	£5,434
	Leaseholds	Nil

The substantial reduction between the years 1949 and 1950 marks the transfer of the real property owned by Wigram and its group to a new company called P.I.T.

9. The general policy was to transfer the said property to a company outside the group, and P.I.T. was formed on 1st April, 1949, for the main purpose of tidying up group finances, the relevant transfers being made on or about that date. As stated above, the financing of the subsidiary companies had been mainly by means of bank loans, and it was then considered by Mr. Winham to be desirable to collect all the properties in one company and to arrange a long term institutional mortgage through an insurance company. P.I.T. had an initial capital of £50,000 and the properties held by all the Wigram companies were transferred to it with the relevant bank loans. The institutional mortgage was with the Clerical and Medical Insurance Co., Ltd., which was used to repay these loans. The institutional mortgage raised a sum of £175,000, and the security was the property owned by the Wigram group which was eventually transferred to P.I.T. Existing bank and mortgage loans were paid up, the new loan contracted and the equity on the properties sold to P.I.T.

10. By 31st March, 1949, i.e., the commencement of the first material accounting period of Wigram, a sum of £77,000 derived from profits of Wigram in accordance with article 14A stood to the credit of the redeemable preference shares redemption fund (exhibit A, page 5). During the material years transfers to this fund out of taxed profits of Wigram were made as follows (exhibit C):

Year ended 31st March, 1950	£4,000
Year ended 31st March, 1951	£10,000
Year ended 31st March, 1952	£4,000

The larger transfer in the year ended 31st March, 1951, was made because Wigram had previously fallen into arrears with its transfers to the redemption fund under article 14A (see paragraph 5 (vi) above).

On 30th August, 1950, 80,000 redeemable preference shares were redeemed by applying £80,000 standing to the credit of the preference shares redemption fund, and thereafter until Wigram was liquidated on 31st May, 1952, the Society's holding of redeemable preference shares in Wigram was 20,000 only.

11. The shareholdings of the Company at 31st March or 5th April, 1950, to 31st March or 5th April, 1952, inclusive, were as follows:

	5th April, 1950	5th April, 1951	5th April, 1952
6% cumulative redeemable preference shares			
Equity & Law Life Assurance Society	100,000	20,000	20,000
6% participating cumulative preference shares			
Ashton Family Settled Estates, Ltd.	2,000	2,000	2,000
6% cumulative non-participating preference shares			
F. B. Winham	667	667	667
Executors of L. Wigram ...	2,833	2,833	2,833

	5th April, 1950	5th April, 1951	5th April, 1952
Ordinary shares			
F. B. Winham	1,000	1,000	1,000
Executors of L. Wigram ...	498	498	498
H. L. Denton, nominee for Executors of L. Wigram ...	1	1	1
A. F. Ferguson, nominee for Executors of L. Wigram ...	1	1	1

12. (i) The actual income of Wigram for the years for which directions were made was as follows:

Year ended 31st March, 1950	£13,154
Year ended 31st March, 1951	£21,885
Year ended 31st March, 1952	£13,527

In apportioning the actual income of Wigram for the said years the Special Commissioners apportioned it to the members of the Company whose names are set out in sub-paragraph (ii) below. In so doing they apportioned to the Society as a member of Wigram such portion only of the said income of Wigram as was represented by its right to a 6 per cent. dividend on the amount of redeemable preference shares held by it at the relevant times, namely 100,000 up to August, 1950, and 20,000 thereafter.

(ii) Apportionment

	6% cumulative redeemable preference shares	6% cumulative non-participating preference shares	6% cumulative participating preference shares	Ordinary shares
	£	£ s.	£	£ s. d.
1949–50				
Equity & Law Life Assurance Society ...	6,000	—	—	—
F. B. Winham ...	—	390 0	—	2,571 0 0
Executors of L. Wigram	—	1,657 10	—	1,285 10 0
Ashton Family Settled Estates, Ltd. ...	—	—	1,250*	—
	6,000	2,047 10	1,250	3,856 10 0
		£13,154		
1950–51				
Equity & Law Life Assurance Society ...	3,204	—	—	—
F. B. Winham ...	—	40 0	—	12,180 13 4
Executors of L. Wigram	—	170 0	—	6,090 6 9
Ashton Family Settled Estates, Ltd. ...	—	—	200*	—
	3,204	210 0	200	18,271 0 1
		£21,885		

1951–52	£	£ s.	£	£ s. d.
Equity & Law Life Assurance Society	1,200	—	—	—
F. B. Winham ...	—	40 0	—	7,944 13 4
Executors of L. Wigram	—	170 0	—	3,972 6 8
Ashton Family Settled Estates, Ltd. ...	—	—	200*	—
	1,200	210 0	200	11,917 0 0
		£13,527		

* The whole of these amounts being apportioned under Section 32, Finance Act, 1927, to F. B. Winham.

Assessments on Mr. F. B. Winham in the name of the Company

1949–50	£4,211	(£390 + £2,571 + £1,250)
1950–51	£12,420	(£40 + £12,180 + £200)
1951–52	£8,184	(£40 + £7,944 + £200)

13. It was contended on behalf of Wigram:

(i) That the apportionments of the actual income of Wigram to its members did not fully take into account the interest of the Society, because the Society in addition to its entitlement to a 6 per cent. dividend on its shareholding in Wigram had also an interest in the credit to the redemption fund made in each of the relevant years out of the profits of Wigram otherwise available for dividend;

(ii) that the sums transferred to the credit of the redemption fund were transferred as a matter of contract with the Society constituting an interest of the Society as a member within Paragraph 8 of the First Schedule, Finance Act, 1922;

(iii) that the Special Commissioners ought to have apportioned to the Society, as representing its interest in the material years, the following sums, namely:

Year ended 31st March, 1950: the sum of £4,000 grossed up at the appropriate standard rate; alternatively, the sum of £4,000;

Year ended 31st March, 1951: the sum of £10,000 grossed up at the appropriate standard rate; alternatively, the sum of £10,000;

Year ended 31st March, 1952: the sum of £4,000 grossed up at the appropriate standard rate; alternatively, the sum of £4,000,

in addition to a dividend for each of the said years at 6 per cent. on the amount of the Society's shareholding in Wigram.

14. It was contended on behalf of the Respondents, the Commissioners of Inland Revenue:

(i) That the method of measuring the respective interests of the members by reference to dividend rights was in the circumstances the most equitable and fair, having regard not only to income rights and to voting rights but also, and in particular, to the interests of the ordinary shareholders on a winding-up, and in view of the redemption of the majority of the preference shares in August, 1950;

(ii) that the apportionment should be affirmed in principle.

15. (i) We, the Commissioners who heard this appeal, rejected the contention that in apportioning the actual income of Wigram for the said years among its members insufficient account had been taken by the assessing Commissioners of the interest of the Society as a member. We held that the Society's interest as a member was adequately measured by taking 6 per cent. on the amount of its preference shareholding in the material years. We further held that the guarantee on which the Society had insisted as a condition of subscribing for its shares was no more than a security for the eventual repayment of its capital, and that it would have been wrong for the assessing Commissioners to impute a double interest to the Society, one measured by the income yield on its shares, the other by the amount credited in any relevant year to the preference shares redemption fund out of profits of Wigram otherwise available for dividend. We were fortified in the conclusion to which we came by the consideration that, if Wigram's contentions were well founded, the interest of the Society in the year ended 31st March, 1951, after 80,000 of its preference shares had been redeemed would, if measured by the grossed up equivalent of the £10,000 credited to preference shares redemption fund, have absorbed the whole of the actual income of the company to the exclusion of all other members' interests. We also considered whether any fairer method of apportionment could be devised than that adopted by the assessing Commissioners in measuring the respective interests of the members, but on the facts in this case we were unable to find one, after taking into account the voting rights and the rights of ordinary shareholders on a winding-up.

(ii) We therefore affirmed the principle on which the apportionments had been made and adjourned the appeal against them for the agreement of figures in accordance therewith.

(iii) On the footing of our decision the figures have been agreed and the apportionments stand as shown in paragraph 12 (ii) above.

16. Wigram, the Appellant, immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1952, Sections 229 (4) and 64, which Case we have stated and do sign accordingly.

17. The point of law for the opinion of the High Court is whether, on a proper construction of Section 21 of the Finance Act, 1922, and of Paragraph 8 of the First Schedule thereto, the apportionments of Wigram's actual income for the said years were properly made in accordance with the respective interests of the members.

A. W. Baldwin,
W. E. Bradley, } Commissioners for the Special Purposes of the Income Tax Acts.

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

22nd March, 1956.

The case came before Vaisey, J., in the Chancery Division on 11th and 12th July, 1956, when judgment was reserved. On 17th July, 1956, judgment was given in favour of the Crown, with costs.

Mr. Cyril King, Q.C., and Mr. Philip Sykes appeared as Counsel for the Company, and Mr. J. Pennycuick, Q.C., and Sir Reginald Hills for the Crown.

Vaisey, J.—This is an appeal from the Special Commissioners, who on 7th and 8th June, 1955, heard and decided an appeal by Wigram Family Settled Estates, Ltd. (in liquidation), to which I will refer as "the Company". There were then two points, of which only one remains. Now again, before me, the Appellants are the Company and the Respondents are the Crown.

The question arises under Section 21 of the Finance Act, 1922, to the terms of which, in order to make this judgment intelligible, I must allude briefly. The preamble to the Section states the object of the enactment as being to prevent the avoidance of the payment of Super-tax (now Surtax) through the withholding from distribution of income of a company which would otherwise be distributed. The Section then provides that, where it appears to the Special Commissioners that any company to which the Section applies has not within a reasonable time after the end of an accounting period distributed to its members, in such manner as to render the amount distributed liable to be included in the statements to be made by the members of the company of their total income for the purposes of Surtax, a reasonable part of its actual income from all sources for the period in question, the Special Commissioners are entitled by notice in writing to the company, first, to direct that for purposes of assessment of Surtax the income of the company should for the relevant period be deemed to be the income of the members and, secondly, to apportion the amount thereof among the members as therein provided. Pausing there, the Company argued before the Special Commissioners that no direction at all ought in the circumstances of this case to have been given. That point has been abandoned by the Company and is not now before me. The only point is as to the apportionment among the members, that is to say, whether it has been done upon a correct basis.

Now Section 21 (8) incorporates the First Schedule to the Act, and in particular Paragraph 8 of that Schedule, which is, so far as relevant, in these terms:

> "The apportionment of the actual income from all sources of the company shall be made by the Special Commissioners in accordance with the respective interests of the members, and the income as apportioned to each member . . . shall, for the purposes of super-tax, be deemed to represent . . . income from his interest in the company for the year or other period and shall be included in the statement of his total income or in an amended statement of total income which the Special Commissioners are hereby authorised to require and shall be deemed to be the highest part of that income."

Paragraph 10 of the same Schedule provides for the service on the company of notice of any apportionment and enacts that a company which is aggrieved by any such notice shall be entitled to appeal to the Special Commissioners upon giving an appropriate notice. It was under that provision that the appeal to the Special Commissioners was lodged, and it is from their decision rejecting such appeal on the sole remaining outstanding point that this case now comes before me.

The Company was incorporated on 12th December, 1932. Its original capital was increased from time to time as set out in detail in the Case, but at the relevant times down to the liquidation of the Company, which took place on 31st May, 1952, its capital structure was as follows. First in order comes an issue originally of 100,000 of 6 per cent. cumulative redeemable preference shares of £1 each, which I will describe as "Equity's shares", because they were at all material times held by the Equity and Law Life Assurance Society; secondly, there were certain 6 per cent. participating

(Vaisey, J.)

cumulative preference shares of £1 each, 2,000 in number; thirdly, there was an issue of 6 per cent. cumulative non-participating preference shares, and finally there were some ordinary shares. These various classes of shares ranked for dividend in the order in which I have named them. The next point to be observed is that the holders of Equity's shares were contractually entitled under the Company's articles of association to the benefit of a redemption fund created out of the profits of the Company's trading for the purpose of providing for the redemption of Equity's shares. By the operation of that redemption fund 80,000 of such shares had in fact been redeemed before 5th April, 1951, the amount of Equity's shares issued and outstanding being thereby reduced to 20,000.

The arguments advanced on behalf of the Company can be very shortly stated as follows. It is said that the apportionments of the actual income of the Company between its members ought to have taken into account two facts, that is to say, not only the fact that there was a first preferential 6 per cent. dividend on Equity's shares but also the fact that the holders of Equity's shares had an interest in the sums liable to be, and in fact, credited to the redemption fund in each of the relevant years. Seeing that such credits were made out of the profits of the Company which would otherwise have been available for dividend and that the sums transferred to the credit of the redemption fund were so transferred as a matter of contract, the Company argues that an interest accrued to the holders of Equity's shares as members within the meaning of Paragraph 8 of the before-mentioned First Schedule, the sums in question being in fact £4,000 for 1949–50, £10,000 for 1950–51 and £4,000 for 1951–52.

Mr. Cyril King, for the Appellants, the Company, put his case very attractively in the form of a series of four propositions, as follows. He said (1) that by Section 21 of the Act of 1922 the actual income of the Company was deemed to be the income of the members and fell to be apportioned accordingly; (2) that under Paragraph 8 of the First Schedule to the same Act such apportionment had to be made in accordance with the interests of the members; (3) that in each of the years under appeal the holders of Equity's shares had an interest in the Company's income to the extent of 6 per cent. per annum on their paid-up capital and also an interest in the sums carried to the redemption fund; and (4) that such last-mentioned interest must be taken into account as well as the 6 per cent. On the other hand, it was urged by the Respondents, the Crown, that the simple method of measuring the respective interests of the members by their dividend rights was in the circumstances the fair and proper method, and attention was called to the fact that the voting rights belonged exclusively to the ordinary shareholders.

The Special Commissioners rejected the Company's contentions and held in favour of the Crown that it would have been wrong to take into account the redemption rights afforded to Equity's shares, and with that view I agree. It seems to me that the contractual guarantee providing for the creation of the redemption fund was, as the Special Commissioners put it, in essence merely a security for the eventual repayment of the capital and in no way and in no sense a double interest attached to the shares—double, that is, as consisting of the 6 per cent. dividend and also of the benefit of the credits to the redemption fund. It seems to me that the fallacy in the Company's argument consists in treating the redemption fund as providing something in the nature of a bonus or premium to the holders of Equity's shares, whereas in truth all that it did was to provide for their payment off or redemption, which may or may not have been welcome

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or beneficial to such holders. When the credits were made to the redemption fund Equity's shares remained 6 per cent. first preference shares, exactly as they were before. The holders of the junior classes of shares were all *pro tanto* benefited, and as it would appear that all the prior classes of shares were very well secured or covered, the only people who really gained by the application of the appropriate amounts of profits to the redemption fund were the holders of the ordinary shares.

I was at first puzzled by this problem and it may be that my conclusions are unduly simple. However, it seems to me that the sums carried to the redemption fund, though they originated in income, were in fact converted into, and applied as, capital. The holders of Equity's shares could never have been liable either to Income Tax or to Surtax except in regard to their 6 per cent. dividends. I was referred to *Commissioners of Inland Revenue* v. *F.P.H. Finance Trust, Ltd.* (*No.* 2), 28 T.C. 209. At page 246, Lord Russell of Killowen, after pointing out that everyone who falls within the extended definition of " member " is not necessarily to be included in an apportionment, said this :

> " In my opinion the Commissioners, in apportioning the income among the members, should determine who are the persons of whom it can be said (1) that they fall within the definition, and (2) that they are the persons who, in view of all their interests in the company, are the persons really interested in the income in question and in what proportions."

Applying that principle, it seems to me that the holders of Equity's shares are perhaps less, and certainly not more, interested in the income carried to the redemption fund than the holders of any of the other classes of shares, and particularly the holders of the ordinary shares. I think the Special Commissioners applied the appropriate test and came to the right conclusion.

The result of this is apparently that there is now no disagreement as to the right figures, and nothing remains for me to do except to dismiss this appeal with, I suppose, the usual consequences as to costs.

Sir Reginald Hills.—If your Lordship pleases.

Vaisey, J.—Very well. The appeal is dismissed.

The Company having appealed against the above decision, the case came before the Court of Appeal (Lord Evershed, M.R., and Birkett and Romer, L.JJ.) on 12th, 13th and 14th December, 1956, when judgment was given unanimously in favour of the Crown, with costs.

Mr. Cyril King, Q.C., and Mr. Philip Sykes appeared as Counsel for the Company, and Mr. J. Pennycuick, Q.C., Sir Reginald Hills and Mr. Montagu Temple for the Crown.

Lord Evershed, M.R.—Section 21 of the Finance Act, 1922, was enacted, as appears from what has been called its preamble, for the purpose of preventing the avoidance of the payment of Super-tax (now Surtax) through the withholding from distribution of income of certain companies which would otherwise be distributed. The scheme of that Section, as later

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amended, was that the income of such companies, notwithstanding that it had not been, or had not been entirely, distributed, was liable to be deemed to be treated as the members' income. The point of course was that, whereas individuals are liable to Super-tax or Surtax, limited companies are not. So Parliament provided that in the cases to which the legislation applied the income in question should be liable to be assessed for Surtax although it remained the income of the company ; and by way of further discouragement, the income is to be treated as though it were the highest part of the income of the company's members respectively. In order to give effect to that scheme it was provided by the Act of 1922 and the later Acts of 1936, 1937 and 1939, that it should be made applicable to certain classes of companies, one of which is described as an investment company. The Company with which we are concerned in this present case, Wigram Family Settled Estates, Ltd., is a company of that category, so that this legislation is undoubtedly applicable to it.

The mechanics of the legislation were such that two stages operated towards the obtaining of the taxation: (1) a direction is given by the Commissioners, and (2) as a result of that direction the income is deemed to be the income of the members. The second stage itself may be regarded as sub-divided ; for having deemed it to be the income of the members it is then necessary for the Commissioners to divide it " in accordance with the respective interests of the members ". Those last words are taken from Paragraph 8 of the First Schedule to the Finance Act, 1922, and the problem in this case really turns upon the effect of those words :

> " The apportionment of the . . . income . . . shall be made . . . in accordance with the respective interests of the members ".

This being an investment company, the question whether there should be a direction was, as a result of the amending legislation, no longer made to depend upon whether in fact there had been reasonable distribution of the income. In other words, in a case of the kind with which we are concerned the first stage, direction, was mandatory, given that the company was one, as was this Company, to which the legislation applied.

To that introduction of the relevant legislation I must add now some statement of the actual facts with which we are concerned. The Company, Wigram Family Settled Estates, Ltd., was a company which at the opening of the period in 1949 to which the claim of the Crown is directed had a share capital consisting altogether of four different classes of shares. In the first place there was an issued number of 100,000 £1 redeemable cumulative preference shares. Subject to that issue there were two classes of cumulative preference shares, each carrying the right to 6 per cent. cumulative preferential dividend, the first being also participating shares but the second being non-participating. Finally there was a class of ordinary shares. For the purposes of the present case, or at any rate for explaining it at this stage, I propose to leave out of account (while not forgetting what Mr. King said in his reply) the two so-called junior classes of preference shares, the participating cumulative preference shares and the non-participating preference shares, and to confine my attention accordingly to the redeemable preference shares on the one hand and the ordinary shares on the other.

At the time when the redeemable preference shares were issued the articles of association were altered so as to give specific effect to the rights of the holders and to the terms upon which the issue was made. Those rights and terms are found in article 14A of the Company's articles of association. That article provides in the first place that the redeemable

preference shares should be redeemed at the expiration of the period of ten years there mentioned, and should be redeemed out of the profits of the Company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for purposes of the redemption; and then provision is made for the payment of the cumulative preferential dividend up to the date of redemption. So far, the article followed, in regard to the redeemable preference shares, the statutory requirements which were introduced into company law recently and now find their place in Section 58 of the Companies Act, 1948. Briefly, that Section requires that redeemable preference shares, if not redeemed out of the proceeds of a fresh issue of shares, should be redeemed out of profits otherwise available for dividend. Returning to article 14A, paragraph (*b*) provides that for the purposes of such redemption the Company should create and thereafter maintain what was called a redeemable preference share redemption fund out of the profits of the Company otherwise available for dividend, and provision is made for putting aside out of such profits, if available, for each year certain sums of money. In fact the actual provisions of the article, so far as they specified the sums to be set aside, were not exactly followed; but nothing in the present case turns upon that variation or upon the fact that the dates which were mentioned in the article were not strictly adhered to. So far as is relevant it is sufficient to say that for the years with which we are concerned, the tax years 1949–50, 1950–51 and 1951–52, the following sums were put to the credit of the specially created redemption fund, namely, in the first and the third of those years £4,000, and in the second £10,000, in each case being sums taken from the income of the Company which would otherwise be available for distribution by way of dividend to the shareholders. I will, for simplicity, confine myself in this judgment to the first of the three years, when the sum of £4,000 was, as I have said, taken from the profits available for distribution and put to the credit of the specially created redeemable preference share redemption fund.

It is, I think, right to say at once that there is in this case no question whatever of the Company having withheld from distribution, unreasonably or otherwise, unduly large sums. There is here, indeed, no question whatever of this Company having been used, at any relevant date or at all, for the purpose against which the legislation was designed, namely, the avoidance of the payment of Surtax by individuals by keeping the funds in question in a limited company not liable for Surtax. In the result, if the Crown's view is right, it must I think be conceded that this might fairly be regarded as something of a hard case. All the Company did by way of retention of income otherwise liable to be distributed was to apply it in accordance with its contractual obligations so to do. But the point has arisen and taken the sharp features which it has because the sole holder of the redeemable preference shares was a company, the Equity and Law Life Assurance Society, not itself liable to pay Surtax at all. On the other hand the ordinary shareholders (and it will be remembered that I am leaving deliberately out of account the other preference shareholders, although the same would in effect apply to them) were individuals themselves liable to pay Surtax. The Company being within the scope of the legislation, the necessary direction for the year I am discussing was given. When the matter was first before the Special Commissioners the Company, as I understand it, took, among other points, the point that the Company, although being an investment company, was within certain exceptions in the Statute so that the direction was wrongly given. That point has now disappeared

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from the case. There is no doubt now that the direction was properly given, and the consequences of the direction therefore must flow, whatever they may be.

The direction having been given, it thereupon fell to the Commissioners to apportion the income of the Company among the members on the footing that it was deemed to be or to have been the members' income in accordance with their respective interests. The way in which it has been apportioned is set out in figures attached to the Case Stated. In paragraph 12 (ii) of the Case will be found also a table or summary, and the table (speaking generally, but I think sufficiently for present purposes) shows this, that the interest of the redeemable preference shareholders was taken to be confined to their right to a 6 per cent. cumulative preferential dividend. The dividend not, I understand, being in arrear, their interest in the Company's income for that year was therefore taken as having been and as being £6,000, 6 per cent. of £100,000. Similarly, the junior preference shareholders had attributed to their interests sums arrived at by reference to the preferential dividend to which they in turn were entitled, and that left the rest of the income to be apportioned and attributed to the ordinary shareholders. It so works out that the ordinary shareholders in the end of all are, so to say, saddled with a very large portion of the total sum of the Company's income ; and since they are Surtax payers they therefore have to be assessed to a large sum for Surtax. Under the scheme of the Act, unless they happen to be willing to pay the Surtax—which I will assume they are not—the Surtax falls to be paid in fact by the Company. The net result for practical purposes is this, that a part (and the part with which we are concerned here) of the accumulated profits of the Company, carried in fact to this redemption fund, brings down upon the Company a claim, and a large claim, for Surtax.

What is said, again putting it quite briefly, on behalf of the Company is that that method of apportionment wholly neglects what is in truth an important and certainly a relevant interest of the redeemable preference shareholders, the Equity and Law Society, namely, their right by contract and under the articles to have the £4,000 set aside and put to this redemption fund for their benefit, as creating and building up the fund out of which the shares ultimately would be and were in fact redeemed. Treating the case as one of figures, what the Company says is that of the Company's total income the £4,000 which has been apportioned to the ordinary shareholders should be transferred from their account, so to speak, and attributed to or apportioned to the Equity and Law Society, the practical effect being that since the Society is not a Surtax payer the Company's liability for Surtax will be correspondingly reduced. I said earlier in this judgment that this is admittedly not a case in which the structure and the transactions of the Company can be regarded as directed to the avoidance of Surtax. The hardship of the case seems therefore to be this. The ordinary shareholders have been treated as having had this income and therefore rendered themselves or this Company liable to assessment, though they could not have had a penny piece of it, having regard to the obligations of this Company to the Equity and Law Society. So the Company is made to pay a sum of Surtax in respect of part of its income which it could not deal with in any other way than it did in fact.

The question (and I am repeating what I said a little earlier) depends upon those few simple words in Paragraph 8 of the First Schedule to the Act: " the apportionment . . . shall be made . . . in accordance with the

respective interests of the members". It was the view of the Special Commissioners that the right of the Equity and Law Society under this contract and under the articles was in truth, in substance, in reality, whichever phrase you like to use, no more than a right to have the obligations of the Company for redemption of the preference shares secured, or better secured. Paragraph 15 of the Case expresses their conclusion in these terms:

> "We . . . rejected the contention that in apportioning the actual income of Wigram for the said years among its members insufficient account had been taken by the assessing Commissioners of the interest of the Society as a member. We held that the Society's interest as a member was adequately measured by taking 6 per cent. on the amount of its preference shareholding in the material years. We further held that the guarantee"

—that is a reference to the contract—

> "on which the Society had insisted as a condition of subscribing for its shares was no more than a security for the eventual repayment of its capital, and that it would have been wrong for the assessing Commissioners to impute a double interest to the Society, one measured by the income yield on its shares, the other by the amount credited in any relevant year to the preference shares redemption fund out of profits of Wigram otherwise available for dividend."

That view of the Special Commissioners found favour with Vaisey, J., when the case came before him.

> "It seems to me",

he said[1],

> "that the contractual guarantee providing for the creation of the redemption fund was, as the Special Commissioners put it, in essence merely a security for the eventual repayment of the capital and in no way and in no sense a double interest attached to the shares . . . It seems to me that the fallacy in the Company's argument consists in treating the redemption fund as providing something in the nature of a bonus or premium to the holders of Equity's shares, whereas in truth all that it did was to provide for their payment off or redemption, which may or may not have been welcome or beneficial to such holders."

The learned Judge then referred to the case to which our attention was also drawn, *Commissioners of Inland Revenue* v. *F.P.H. Finance Trust, Ltd.* (*No.* 2), 28 T.C. 209. That was a case, of a surety, in which the company's formation and transactions had been directed to the avoidance of Surtax; and I think it right to say that the language of Lord Russell of Killowen, who delivered the only speech in the House of Lords, was primarily at any rate directed to that feature of the case. But his language is also of general application, certainly in some respects, and any opinion of that noble Lord naturally receives the greatest possible attention. There was one passage in it to which Vaisey, J., was referred, and to which we also have had much argument directed. He said this, at page 246:

> "In my opinion the Commissioners, in apportioning the income among the members, should determine who are the persons of whom it can be said (1) that they fall within the definition,"

—that is, of being members—

> "and (2) that they are the persons who, in view of all their interests in the company, are the persons really interested in the income in question and in what proportions."

Some of the argument turned upon the adverb "really". I think again it is fair to say that the word was no doubt used with particular reference

[1] *See* pages 648–649 *ante*.

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to the circumstance in the *F.P.H.* case[1] that the real interest of the shareholders had been somewhat disguised by the regulations of the company with a view to avoiding the tax liability which would otherwise have fallen upon them. But still the speech does, I think, lay down for us the general rule that you should not merely confine yourself to looking at what at first sight may appear to be the income rights in any given case of the classes of shareholders in the company with which you are concerned; you must see what really is the interest in the fund of those shareholders.

Although I have said more than once that this is not a tax avoidance case, as that phrase is commonly understood, yet it is relevant to bear in mind, as Mr. Pennycuick made clear to us in his very cogent argument, if he will allow me so to describe it, how in such a case as this the matter would work if the Company is right. It is never to be forgotten that this is an investment company, and that therefore a direction perforce must be given with the inevitable consequence that the income of the Company, that is the income available for distribution, is to be deemed to be the income of the members. Let me apply that phrase to the income with which we are concerned for the year here in question. If the income in question is so to be deemed, then *prima facie* it would be deemed to be their income in accordance with their rights to receive it. The structure of the Company here is in perfectly normal and ordinary form. The preference shareholders are entitled to preferential dividends and no more, subject again to the limited right of participation by one of the junior classes of preference shareholders. Subject to those rights, everything which is distributed goes to the ordinary shareholders; and they, as you would expect, are the persons eventually entitled in a winding-up to the Company's distributable assets after the prior classes of shareholders have been repaid the equivalent of their capital. The ordinary shareholders, therefore, if they received, let us say, this sum of £4,000, would have paid in respect of it a large sum, a very high proportion, in the way of Surtax. By not distributing this sum, by keeping it in the Company (albeit pursuant to a contractual obligation and for the purpose of providing for the redemption of the redeemable preference shares), no Surtax would apart from this legislation be paid upon it. If therefore the object of this legislation is that, *quoad* companies of this kind, Surtax should be exigible on the footing that you deem all the income distributable to be the income of the members, then the result would be, if the Company is right, that so much Surtax has been lost to the Revenue. Put the other way round, and from the point of view of the ordinary shareholders, it may fairly be said that instead of their having received this sum by way of dividend it has been kept in the Company and upon the liquidation of the Company, which has now in fact occurred, they will be able to get those sums which were kept in reserve and get them free of tax.

I mention those facts in order to show that there is in truth force and cogency in the point made by Mr. Pennycuick, that if you do look at the real interest, that is, the eventual proprietary interest, however you describe it, of the ordinary shareholders they have indeed that interest in the case and in the sum with which we are concerned. Against that view can undoubtedly be set the fact that by contract, by the articles, the Company here could not distribute this sum of £4,000. It was conceded by Mr. Pennycuick that if it had threatened to do so the Court would almost certainly have granted an injunction to prevent the distribution.

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(1) 28 T.C. 209.

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Therefore the question must be posed and answered: Has the Equity and Law Society, by virtue of that contractual right, which it can call upon the Court of Chancery to enforce, not got a real interest in the £4,000 such as should have been taken into account by the apportioning Commissioners? That is the problem.

The Special Commissioners and Vaisey, J., answered it negatively, and I have already referred to the reasons stated by the Judge. For my part I think that conclusion was correct. I agree with Vaisey, J., shutting our eyes as we will to the hardship perhaps in this case, that nevertheless the interest of the Equity and Law Society in this sum was in truth no more than a concern to see that the profits of this Company, so far from being dissipated by distribution among the shareholders, should be retained so that there would be available, and available at the end of the limited period stated, a sufficient fund of undistributed profits, out of which, and out of which alone in the absence of a reissue of shares, these preference shares could be redeemed. That I venture to think is the whole sum of the matter and I do not think I should improve it at all by much elaboration.

But two points at this stage I think it right to mention. Mr. Pennycuick also invoked the provisions of Section 14 (3) of the Finance Act, 1937, which provides that in making the apportionment, in cases of companies of the kind of which this is one, the apportioning Commissioners may, if they think it proper so to do, attribute to the members an interest corresponding to their interest in the assets of the Company available for distribution in the event of a winding-up. What Mr. Pennycuick said was that in a winding-up the sensible way of computing the interest of the preference shareholders, during the period when the Company was in fact a going concern, was to award them their preferential dividend and give the rest to the ordinary shareholders. With all respect, I do not myself think that the argument and the reference to that Section materially advance the Crown's case. It seems to me that it is merely stating in another form, and I am not quite sure that it is in as accurate a form, what are the true rights *inter se* of these classes of shareholders to dividend while the Company is a going concern.

It was said by Mr. King in reference to this Section—and this is the second point—that if you are going to pay regard to interests in a winding-up, then what about the interests of the junior classes of preference shareholders, because they are, after all, entitled in a distribution to redemption before the ordinary shareholders get anything? What I have already said about the invocation of this Sub-section inferentially answers Mr. King's point. We have to look at this sum as being, as it is, the distributable income of the Company in the year in question, and as such the question arises, and must be answered, what are the respective rights of the members to or in that sum of undistributed income. It therefore always comes back, I think, to the single point: Is the contractual right of the Equity and Law Society to have the £4,000 set aside a relevant interest for the purposes of this apportionment? I have said that in my judgment, with all respect to the force of the arguments on the other side, it is not.

I add by way of conclusion a reference to an illustration which I ventured myself to put during the course of the argument, and which I think lends some emphasis to the view which Vaisey, J., took, and as I think rightly took. If it be supposed that for the better securing of the Equity and Law Society's shares the Company was under covenant to apply some

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portion of its income available in any year for distribution towards the discharge of some debts properly so called, e.g., some debenture debt or some other debt of the Company, could the income so applied or the right to have the income so applied be regarded as an " interest " of the Equity and Law Society in that income for present purposes? In that case it is more plainly seen, to my mind, that the answer should be in the negative. It makes it to my mind more plain that the real object of article 14A is not to provide something for the Equity and Law Society, what Vaisey, J., called something in the nature of a bonus or premium, but merely to make proper provision by way of security for the final obligation for redemption.

For those reasons I conclude that Vaisey, J., rightly answered this problem, and I would dismiss the appeal.

Birkett, L.J.—I am of the same opinion, and I only desire to add a very few words. I think that the issue to be determined in this appeal can be stated now quite shortly and, indeed, quite simply; and I think that after the arguments to which we have listened the answer also can be given equally shortly and equally simply. It has been necessary to listen to a somewhat elaborate argument from both sides before that simplicity could be achieved, but as a result of the argument I find myself in the position of saying that I entertain no doubt that the Special Commissioners in this case and Vaisey, J., came to a right conclusion, and that this appeal ought to be dismissed.

The essential problem I think turns upon the word " interest " or " interests ". There was never any doubt that the Equity and Law Life Assurance Society did have an interest, in the ordinary use of language, in the particular sums with which we are dealing. In the Case Stated all the history of the Company, all the structure of the capital of the Company and all the resolutions dealing with the capital of the Company are most carefully set out in detail, and the situation of this fund out of income for the purpose of paying off the redeemable preference shares is made quite plain. What was really said here was this. When you come to the wording of Section 21 of the Finance Act, 1922, and the words of Paragraph 8 of the First Schedule incorporated therein, there was such an interest that the Special Commissioners when dealing with this matter ought to have taken it into account when making the apportionments; and as they did not do so, complaint is made that they went wrong.

The argument which was put before the Special Commissioners was simply this, based of course upon the history set out in this rather elaborate Case Stated. It was said that the apportionment of the actual income did not take into account fully the interest of the Equity and Law Society because, whilst it is common ground that it was entitled to the 6 per cent. dividend upon the preference shares, this further interest ought to have been taken into account, namely, the credit to the redemption fund which was set up, as the Case shows, out of the profits of the Company in the relevant years, which profits would otherwise have been available for dividend. That was the cardinal mistake. Further it was said in support of it that those sums taken out of dividend and so put to the credit of this account to redeem the preference shares were a matter of contract between the Equity and Law Society and Wigram. That was the contention, and the only contention. Indeed, Vaisey, J., when coming to deal with this, said[1]:

> " The only point is as to the apportionment among the members, that is to say, whether it has been done upon a correct basis."

[1] *See* page 647 *ante*.

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All the argument turned upon what really was the interest.

Reference was made to the speech of Lord Russell of Killowen in *Commissioners of Inland Revenue* v. *F.P.H. Finance Trust, Ltd.* (*No.* 2)(1), and his use of the words "really interested in the income in question". I think there Lord Russell was using the word "really" because of the peculiar and special facts of the case; and "really" became of some point in the context in which he was using it. The complete sentence reads(2):

> "In my opinion the Commissioners, in apportioning the income among the members, should determine who are the persons of whom it can be said (1) that they fall within the definition, and (2) that they are the persons who, in view of all their interests in the company, are the persons really interested in the income in question and in what proportions."

When he gets to the end of that paragraph he says:

> "If the same individuals figure in each answer, those are obviously the persons who, according to their interests in the company, own the real and paramount beneficial interest in the fund in question."

That is the sense in which he was using it there.

Here in the case before us, as I think, something of the same nature has got to be determined. There is no question that the 6 per cent. dividend ranks under the meaning of the word "interest" within the Section. The question is this. Is the beneficial interest of the Equity and Law Society in that income of the Company set aside for the purpose of redeeming the redeemable preference shares in the same category? The Special Commissioners said No; Vaisey, J., said No. For my own part I was much impressed by the argument of Mr. Pennycuick, particularly when he put into a few words what he submitted was the real distinction between the interest of the Equity and Law Society in this fund and the interest of the ordinary shareholders. Mr. Pennycuick contended that the real interest (or the paramount interest, to use the same word as Lord Russell) really lies in the holders of the ordinary shares and not in the Equity and Law Society. The distinction that he made, as I understood it, was this. The interest of the holders of the ordinary shares is in the accretion of the assets whilst the Company is a going concern. But when you set aside out of profits so much to this fund, by so doing there is an accretion of assets of the Company, and if you consider it from the point of view of winding up, why then it is available for distribution and belongs to the ordinary shareholders. That is the real interest; that is the paramount beneficial interest. So far as the Equity and Law Society are concerned Mr. Pennycuick said that their interest was to have an additional security for the repayment of their money, and although it is true that they could have restrained by an injunction any attempt on the part of the Company to distribute the money instead of fulfilling its contractual obligation, none the less it was not to be considered as a real interest in the sense in which the words are used in the Statutes and in the Schedule.

I have come to the clear conclusion that the decision of the Special Commissioners and the judgment of Vaisey, J., were correct, and that this appeal ought to be dismissed.

Romer, L.J.—I agree. I think this is a very hard case. I feel it is not at all the sort of case at which this legislation was aiming. The object of the

(1) 28 T.C. 209. (2) *Ibid.*, at p. 246.

(Romer, L.J.)

legislation sufficiently appears from the beginning of Section 21 of the Finance Act, 1922, where it says:

> "With a view to preventing the avoidance of the payment of super-tax through the withholding from distribution of income of a company which would otherwise be distributed".

That was the mischief at which the legislation was directed. Here there is no question of withholding the distribution of income which would otherwise be distributed in order to avoid the payment of Surtax, as it now is; it was withheld from distribution because the Company was under a contractual obligation so to withhold it. Nevertheless the legislation, so far as an investment company is concerned, applies automatically whatever the company does with its income. The relevant provisions automatically apply, and so applying them I cannot avoid the conclusion that the Special Commissioners and the learned Judge arrived at a right decision in this case, for the reasons which the Master of the Rolls has given and to which I cannot usefully add anything.

Mr. J. Pennycuick.—I would ask your Lordships for the costs of this appeal.

Mr. Cyril King.—I have an application to make, my Lord. I am bound to make it at this stage, but I do not know whether it will commend itself to your Lordship. If my clients on considering your Lordships' judgments are so minded, may they have leave to appeal? It seems to me a question of principle relating to investment companies is involved in this appeal.

Lord Evershed, M.R.—The Crown does not say anything, as a rule. Has the Revenue anything to say?

Mr. Pennycuick.—No, it has not, my Lord.

(*The Court conferred.*)

Lord Evershed, M.R.—Mr. King, we have in mind that there has been a unanimity of view, at any rate so far. On the other hand these tax cases are somewhat in a class by themselves, and in all the circumstances we think it would be right to give leave. Whether the application commends itself to us, as you put it, is perhaps another matter, but we give leave.

Mr. King.—If your Lordship pleases.

Lord Evershed, M.R.—Appeal dismissed, with cases.

The Company having appealed against the above decision, the case came before the House of Lords (Viscount Simonds and Lords Reid, Keith of Avonholm, Somervell of Harrow and Denning) on 25th and 26th November, 1957, when judgment was reserved. On 23rd January, 1958, judgment was given unanimously in favour of the Crown, with costs.

Mr. Cyril King, Q.C., and Mr. Philip Sykes appeared as Counsel for the Company, and Mr. J. Pennycuick, Q.C., and Mr. Alan Orr for the Crown.

Viscount Simonds.—My Lords, this appeal is from an Order of the Court of Appeal affirming an Order of Vaisey, J., who upon a Case stated by the Commissioners for the Special Purposes of the Income Tax Acts had

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affirmed their determination. I have not been persuaded that a wrong conclusion has been reached.

The facts are set out in great detail in the Case Stated, which can be referred to if necessary. I shall content myself with a brief summary. The Appellant Company, which has been in liquidation since 19th May, 1952, had at the relevant dates the following capital structure: (A) 100,000 6 per cent. redeemable preference shares of £1 each; (B) 2,500 6 per cent. participating cumulative preference shares of £1 each; (C) 3,500 6 per cent. cumulative non-participating preference shares of £1 each; (D) 1,500 ordinary shares of £1 each. All these shares were issued and fully paid up except 500 of the (B) shares. The special feature in this structure upon which, in effect, this appeal turns, lies in the provisions relating to the redeemable preference shares. These were (*a*) that such shares should be redeemed on the expiration of 10 years from 31st March, 1935, out of the profits of the Company which would otherwise be available for dividend or out of the proceeds of a fresh issue made for the purposes of such redemption; (*b*) that for the purposes of such redemption the Company should create and, so long as any such shares should remain outstanding, should in each year beginning with the year ended 31st March, 1936, carry to the credit of a separate fund out of the profits of the Company which would otherwise be available for dividend (i) for the year ended 31st March, 1936, the sum of £9,050, (ii) for each subsequent year ended 31st March, the sum of £7,797 or such larger sum as the directors might think fit, with the proviso that when and so long as the fund should amount in value to £100,000 no further sum should be carried to its credit; (*c*) that all sums carried to the fund should be invested in investments thereby authorised with power to vary such investments. The whole of these shares were taken up by the Equity and Law Life Assurance Society (whom I will call "the Society"). It may be assumed that they insisted on the redemption terms as a condition of taking up the shares.

The Appellant Company did not comply precisely with these provisions, no doubt with the assent of the Society, but by 31st March, 1949, the commencement of the first of the three relevant accounting periods of the Company (namely, the years of assessment 1949–50, 1950–51 and 1951–52), a sum of £77,000 out of the profits had been transferred to and stood to the credit of the fund. During the relevant years ending 31st March, 1950, 1951 and 1952, the following further transfers were made to the fund, namely, £4,000, £10,000 and £4,000. On 30th August, 1950, 80,000 of the shares were redeemed by applying to that purpose £80,000 standing to the credit of the fund. The remaining 20,000 shares continued to be held by the Society.

I need state only three further facts. First, it is plain from the facts as stated in the Case and the documents annexed to it that at all times the net assets of the Company were ample to meet its obligations in respect of its redeemable preference shares. Secondly, the Company was an "investment company" to which Section 20 (1) of the Finance Act, 1936, Section 14 (2) of the Finance Act, 1937, and Section 14 (1) of the Finance Act, 1939, applied. Thirdly, the actual income from all sources of the Company for the same three years ending 31st March was £13,154, £21,885 and £13,527.

It follows from what I have said that the Special Commissioners had no discretion in the matter but were bound to give directions that these sums should, however much or little thereof had been distributed to the members of the Company, be deemed for the purposes of Surtax to be their income.

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This was at one time, but is no longer, disputed. The directions having been duly given, it then fell to the Commissioners to apportion the same income among the several members of the Company, that is to say, among the several classes of preference shareholders and the ordinary shareholders. In doing so they have no other statutory guidance than is to be found in Paragraph 8 of the First Schedule to the Finance Act, 1922, the relevant words of which are:

> "The apportionment of the actual income from all sources of the company shall be made by the Special Commissioners in accordance with the respective interests of the members".

What then were the respective interests of the members in the actual income of the Company? The Commissioners apportioned to the redeemable preference shareholders (i.e., to the Society) £6,000 (being 6 per cent. on the 100,000 shares) for the first year and £3,204 and £1,200 for the second and third years respectively (being 6 per cent. on the unredeemed shares during those years) and no more. They apportioned 6 per cent. per annum to the holders of the other preference shares and the remainder they apportioned to the ordinary shareholders.

The Appellant Company appealed against the apportionment, contending that the Society in addition to their interest in the income of the Company to the extent of 6 per cent. on their shares also had a relevant interest in the income in respect of the amounts carried in each of the three years to the redemption fund out of the profits available for dividend, that is to say, the several sums of £4,000, £10,000 and £4,000.

The Commissioners rejected this contention. They held that the Society's interest as a member was adequately measured by taking 6 per cent. on the amount of its preference shareholding in the material years, and, further, that the guarantee on which the Society had insisted as a condition of subscribing for its shares was no more than a security for the eventual repayment of its capital. They further stated that they had also considered whether any fairer method of apportionment could be devised, but on the facts of the case were unable to find one after taking into account the voting rights and the rights of ordinary shareholders on a winding-up.

My Lords, as I have said, the determination of the Commissioners was sustained by Vaisey, J., and by the Court of Appeal and I have no doubt that they were right. I have already pointed out how little guidance is given to the Commissioners in their task of apportionment, but it should, I think, be remembered that Section 21 of the Finance Act, 1922, from which this branch of taxation stems, opens with the words:

> "With a view to preventing the avoidance of the payment of super-tax through the withholding from distribution of income of a company which would otherwise be distributed".

I should therefore expect any apportionment of the actual income of a company to proceed upon the footing that what any member received upon an apportionment would be a share which, if it had been distributed instead of being withheld, would have the character of income in his hands and as such be liable to Super-tax or Surtax if he was an individual. But I find myself at once in this difficulty. It would be a fantastic result of this legislation if it increased even notionally the income of a 6 per cent. preference shareholder. But if it does not have that effect, and the apportionment beyond his 6 per cent. is to be regarded as a capital payment, then the purpose of the Section is defeated. Surtax is neither payable nor avoided.

The strength of the Appellant Company's case lies in this, that the obligation imposed on it by its articles did preclude it from distributing the

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whole of its income. It was contractually bound to carry yearly sums to the redemption fund. It may therefore be said that it would be a hardship on the ordinary shareholders that an apportionment should be made to them in any year of income upon which they could not lay their hands. But the question is not whether such an apportionment would be a hardship on them but what are the respective interests of the different classes of shareholders in the actual income of the Company. I do not intend to lay down any general rule. It would be hazardous to do so in face of the very general words by which the duty of apportionment is cast upon the Commissioners. But on the facts of the present case I cannot fail to be impressed by the consideration that neither at the end of any year nor at the commencement of the liquidation was there any doubt as to the capital of the redeemable preference shares being well secured apart from the redemption fund. The Commissioners in their determination regarded the fund as a security for eventual repayment of capital. I think they were right in doing so, and, further, that, if in the event the security proved unnecessary because the capital was secure without it, they were well justified in treating the Society's interest in it as negligible. They might ask the simple question whether the Society in fact got any benefit from the fund. The answer could only be that it may have got some peace of mind from the knowledge that the fund was there, but that it was the ordinary shareholders who would eventually get the income which was temporarily withheld. And that is what in fact happened.

I was further impressed by the admission which, as I understood him, Counsel for the Company felt constrained to make, that if the Appellant Company had built up the same fund out of profits not under the compulsion of its articles but as a matter of prudent finance, the Society could not be said for the purpose of apportionment to have any relevant interest in it. Yet upon the facts of the case the material interest of the Society was precisely the same whether the fund was established voluntarily or under a contractual obligation. It may be observed too that, though in one sense the Company were obliged to carry some part of their profits to the fund, yet this was an obligation into which they had voluntarily entered.

Reference was made both in the Courts below and in argument before this House to the case of *Commissioners of Inland Revenue* v. *F.P.H. Finance Trust, Ltd.* (*No.* 2), 28 T.C. 209. I agree with Vaisey, J., and Lord Evershed, M.R., in thinking that it gives no support to the Company's contention. In that case Lord Russell of Killowen said (at page 246) that it was the duty of the Commissioners in apportioning the income among the members to determine who are the members

> " of whom it can be said . . . that they are the persons who, in view of all their interests in the company, are the persons really interested in the income in question and in what proportions."

This seems to me to be just what the Commissioners in the present case set out to do and fairly did.

The appeal must, in my opinion, be dismissed with costs.

My noble and learned friend, **Lord Denning,** who is unable to be here today, has asked me to say that he concurs in the opinion which I have just delivered.

Lord Reid.—My Lords, in consequence of directions given by the Special Commissioners under Section 21 of the Finance Act, 1922, in respect of the years 1949-50, 1950-51, and 1951-52, the actual income of the Appellant

(Lord Reid.)

Company for these years was deemed to be the income of its members ; and the Special Commissioners had to apportion that income to them " in accordance with the respective interests of the members ", income so apportioned to each being " deemed to represent his income from his interest in the company " (Finance Act, 1922, First Schedule, Paragraph 8). As a result the Appellant Company became liable to pay Surtax on sums apportioned to individual members at rates appropriate to them. But as Surtax is a tax on individuals there is no liability to pay it in respect of any sum apportioned to a non-individual member. It is therefore in the Appellant's interest to have as large sums as possible apportioned to its non-individual member, the Equity and Law Life Assurance Society, which held all the 6 per cent. redeemable preference shares in the Appellant Company.

The Special Commissioners have apportioned to that Society the sums required to pay the 6 per cent. on their shares, holding that the Society's interest as a member was adequately so measured. By virtue of an agreement made when these preference shares were issued the Appellant Company was bound to carry certain sums out of its profits to the credit of a redemption fund for these shares, and in the years in question it paid into that fund under the agreement sums of £4,000, £10,000 and £4,000. The Appellant's contention is that these sums ought to have been apportioned to the Society in addition to the 6 per cent. on its shares, because the Society had an interest in these sums.

The Society was concerned not merely to receive annually the 6 per cent. on its shares but also to have its shares redeemed in accordance with the agreement between it and the Appellant, and in order that funds might be available for the redemption at the stipulated date it was concerned to see that the redemption fund was built up by the Appellant carrying part of its profits to that fund. I shall assume, without deciding the point, that this could properly be regarded as an " interest " within the meaning of the Finance Act, 1922. But it would, in my opinion, be erroneous to hold that such an interest necessarily required the apportionment to the Society of the whole of the sums carried to the redemption fund. The other shareholders also had an interest in these sums, and it appears to me that in the present case the Society's interest was negligible in comparison with the interest of the other shareholders. The real interest of the Society, beyond payment of its 6 per cent. annually, was to receive payment in due course of its capital. In the present case the assets of the Appellant were amply sufficient to enable the Society's preference shares to be redeemed in full in any foreseeable event, and the only importance of building up the redemption fund was to facilitate the redemption. Carrying these sums to the redemption fund did not in any way increase the amount of money which the Society would receive. It meant in effect that the sums available for distribution to the other shareholders were diminished for the time being, but that the other shareholders' shares became more valuable. They were entitled in the end to the whole of the Appellant's assets beyond what was required to redeem the Society's shares, and the amount of the Appellant's assets was increased by carrying these sums to the redemption fund instead of distributing them. In other words, retaining these sums in this fund postponed the enjoyment of them by the other shareholders but did not in any substantial way add to the financial return which the Society would receive or the probability that they would be paid in full. That appears to me to justify the apportionment made by the Special Commissioners.

It has been said in the Court of Appeal that this is a hard case for the Appellant and the other shareholders. No doubt all high taxation is a

hardship for the taxpayer but I do not see any special hardship in this case. If an individual, in order to raise more capital, chooses to undertake to set aside part of his income to provide for repayment, he cannot thereby diminish his liability for Surtax. I see no reason why a company should be entitled to expect to be better off.

I would dismiss this appeal.

Lord Keith of Avonholm.—My Lords, I agree with the speech delivered by my noble and learned friend on the Woolsack.

Lord Somervell of Harrow.—I agree.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dismissed with costs.

The Contents have it.

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

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