Privy Council Appeal No. 79 *of* 1932.

Rhodesia Railways, Limited - - - - - - *Appellants*

v.

The Collector of Income Tax of the Bechuanaland Protectorate - *Respondent*

FROM

THE SPECIAL COURT OF THE BECHUANALAND PROTECTORATE.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 21ST FEBRUARY 1933.

Present at the Hearing:

LORD ATKIN.
LORD RUSSELL OF KILLOWEN.
LORD MACMILLAN.

[*Delivered by* LORD MACMILLAN.]

The appellants, Rhodesia Railways, Limited, a company registered in the United Kingdom, own a railway between Vryburg and Buluwayo. The line is 588 miles in length, of which 112 miles are in the Union of South Africa, 394 in the Bechuanaland Protectorate and 82 in Southern Rhodesia. The company are liable to income tax under the Bechuanaland Protectorate Income Tax Proclamation, 1922, in respect of the profits derived by them from carrying on their undertaking in the Protectorate.

In making their return to the respondent of their income for the year of assessment to the 30th June, 1931, based on their accounts for the year to the 30th September, 1930, the appellants debited a sum of £252,174 under the heading "renewals of permanent way" and brought out a loss for the year over all of £97,445. In the notice of assessment subsequently sent to the appellants the respondent wrote back the item of £252,174 deducted by the appellants, thereby converting the loss of £97,445 into a profit of £154,729, on which latter sum the respondent claimed tax amounting to £17,188 1*s*. 6*d*. The appellants objected to the

assessment in respect of the disallowance of the deduction of £252,174 for renewals of permanent way and on the respondent overruling their objection they appealed to the Court of the Resident Commissioner, being the Income Tax Appeal Court for the purposes of the Proclamation. The appeal was thereafter on the appellants' application removed under section 39 (6) of the Proclamation to the Special Court of the Bechuanaland Protectorate, by whom it was dismissed on the 22nd June, 1932. Leave to appeal to His Majesty in Council having been granted by the Special Court, the matter now comes before their Lordships for review.

The facts are not in dispute. They were spoken to in evidence by an engineer who had been employed in the work of renewal of the appellants' permanent way and by the appellants' chief accountant. It appears that the track was originally laid down in 1896–97 and was thereafter maintained in ordinary course. In the year in question there was a charge of £41,223 for maintenance of ways and works to which the respondent did not take exception. This normal maintenance involved the occasional replacement of a split rail or a bad sleeper. By November, 1929, the track generally was found to be in a worn and dangerous state and to require heavy repairs beyond what could be dealt with in the ordinary way, and a scheme or programme of renewal was adopted. In pursuance of this scheme the appellants first dealt with the bad portions of the line in which they laid new sleepers, new rails and new fastenings to a length in all of 33½ miles. The line as so re-laid was of the same weight as the old line. On a further 40½ miles of track the old rails were relaid but new sleepers were put in, steel sleepers for 38½ miles and wooden sleepers for 2 miles. Of the 394 miles of track in the Protectorate 74 miles were thus the subject of treatment in the year in question. Two additional steel sleepers per rail length were introduced in carrying out the work but the cost of these additional sleepers, which were regarded as an improvement, was charged by the appellants to capital and was not included in the sum of £252,174 claimed as a deduction. The scrap value of discarded rails and sleepers was credited back to renewals in diminution of the cost of the work. The result of the renewals, apart from the additional sleepers, was to bring the track back to normal condition and the line as renewed was not capable of giving more service than the original line. The appellants' accountant stated that "from day to day throughout the year charges arise for ordinary maintenance and at certain periods there are periodical repairs or delayed maintenance, and in common railway practice they are distinguished as maintenance in the first named and renewals in the second. This relaying of the line would be periodical." He further stated that for income tax purposes the cost of renewals had been allowed as a deduction in the Union of South Africa and in Rhodesia and that actual

expenditure on renewals was also allowed to be deducted in the United Kingdom.

In the Proclamation provision is made for deductions in section 15, of which the first subsection, as amended by a subsequent Proclamation of 1929, reads *inter alia*, as follows :—

"15.—(1) For the purpose of ascertaining the taxable income of any person there shall be deducted from the income of such person—

(*a*) losses and outgoings actually incurred in the territory by the taxpayer in the production of his income, and including also such expenses incurred outside the territory in the production of the taxable income as the collector may allow ; provided such losses or outgoings are not of a capital nature ;

(*b*) sums expended for the repairs of property occupied for the purpose of trade or in respect of which income is receivable, and sums expended for the repair of machinery, implements, utensils, and articles employed by the taxpayer for the purposes of his trade ; such sums shall be the actual expenditure incurred by the taxpayer during the year of assessment ;

(*c*) such sum as the Collector may think just and reasonable as representing the diminished value by reason of wear and tear during the year of assessment of any machinery, implements, utensils, and articles used by the taxpayer for the purposes of his trade ; provided that where a deduction has been allowed under paragraph (*b*) of this sub-section the Collector shall take into consideration the sum allowed under that paragraph in determining the sum to be allowed under this paragraph ; provided that in no case shall any allowance be made for the depreciation of buildings or other structures or works of a permanent nature ;

* * * * *

(*f*) an allowance in respect of any machinery, implements, utensils and articles used by the taxpayer for the purposes of his trade which have been scrapped by such taxpayer during the year of assessment, such allowance to be the difference between the original cost to such taxpayer of such machinery, implements, utensils or articles and the total amount arrived at by adding all the allowances made in respect thereof under paragraph (*c*) of this sub-section to any amount or the value of any advantages accruing to the taxpayer in respect of the sale or other disposal of such machinery, implements, utensils and articles."

By section 40 of the Proclamation the burden of proof that any income is entitled to any deduction is imposed on the person claiming such deduction.

Before their Lordships the appellants maintained that they were entitled to deduct the expenditure in question alternatively under paragraph (*a*) or under paragraph (*b*) of section 15 (1). In the Court below it was held that the outgoing was of a capital nature and so excluded from the benefit of paragraph (*a*) ; and that the work in question was one of reconstruction and not of repair and so excluded from the benefit of paragraph (*b*).

Their Lordships do not agree with the conclusions reached by the Special Court. In their Lordships' opinion the sum in question was within the meaning of paragraph (*a*) an outgoing "not of a capital nature" and was "expended for the repairs of property occupied for the purpose of trade or in respect of which

income is receivable" within the meaning of paragraph (*b*). As was pointed out by Buckley L.J. (as he then was) in *Lurcott* v. *Wakely and Wheeler* [1911], 1 K.B. 905, at p. 923, "repair and renewal are not words expressive of a clear contrast," and at p. 924, "repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal as distinguished from repair is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject matter under discussion." The periodical renewal by sections of the rails and sleepers of a railway line as they wear out by use is in no sense a reconstruction of the whole railway and is an ordinary incident of railway administration. The fact that the wear although continuous is not and cannot be made good annually does not render the work of renewal when it comes to be effected necessarily a capital charge. The expenditure here in question was incurred in consequence of the rails having been worn out in earning the income of previous years on which tax had been paid without deduction in respect of such wear and represented the cost of restoring them to a state in which they could continue to earn income. It did not result in the creation of any new asset; it was incurred to maintain the appellants' existing line in a state to earn revenue. The analogy of a wasting asset which appears to have affected the minds of the Special Court has really no application to such a case as the present. Nor do their Lordships agree that expenditure in order to form a permissible deduction must have been incurred in the production of the actual year's income which is the subject of the assessment, if by this it is meant that the benefit of the expenditure must not extend beyond the year of assessment, for very many repairs have the result of enabling income to be earned in future years as well as in the year in which they are effected. In the case of *Ounsworth* v. *Vickers, Ltd.* [1915], 3 K.B., 267 ; 6 T.C., 671, where the expense of dredging a channel and constructing a deep water berth which was undertaken in connection with the launching of a specially large vessel was disallowed as a charge against income, Rowlatt, J., a very experienced authority on all income tax questions, expressed at p. 272 his agreement with the view that "assuming that dredging the channel is income expenditure if the respondents dredged year by year, it is none the less income expenditure because the dredging was not done for a year or two because it was not worth while to do so and was only done when it was seriously required to get rid of the mischief which had been growing all the time and which theoretically ought to have been kept down coincidently with its growth."

The appellants received no allowance for depreciation of their rails and sleepers under paragraph (*c*) and the Court below, following a decision of the Appellate Division of the Supreme Court of the Union under a similar statute, held that they were not entitled to any such allowance, on the ground that a railway

line was a work of a permanent nature. Oddly enough, the inference was drawn from this that what the appellants could not get by way of depreciation they cannot have been intended to get by way of repairs. The inference, their Lordships would have thought, was rather the other way, namely, that having been allowed a deduction in name of repairs the appellants were not intended to get a deduction in name of depreciation in respect of the same permanent structure.

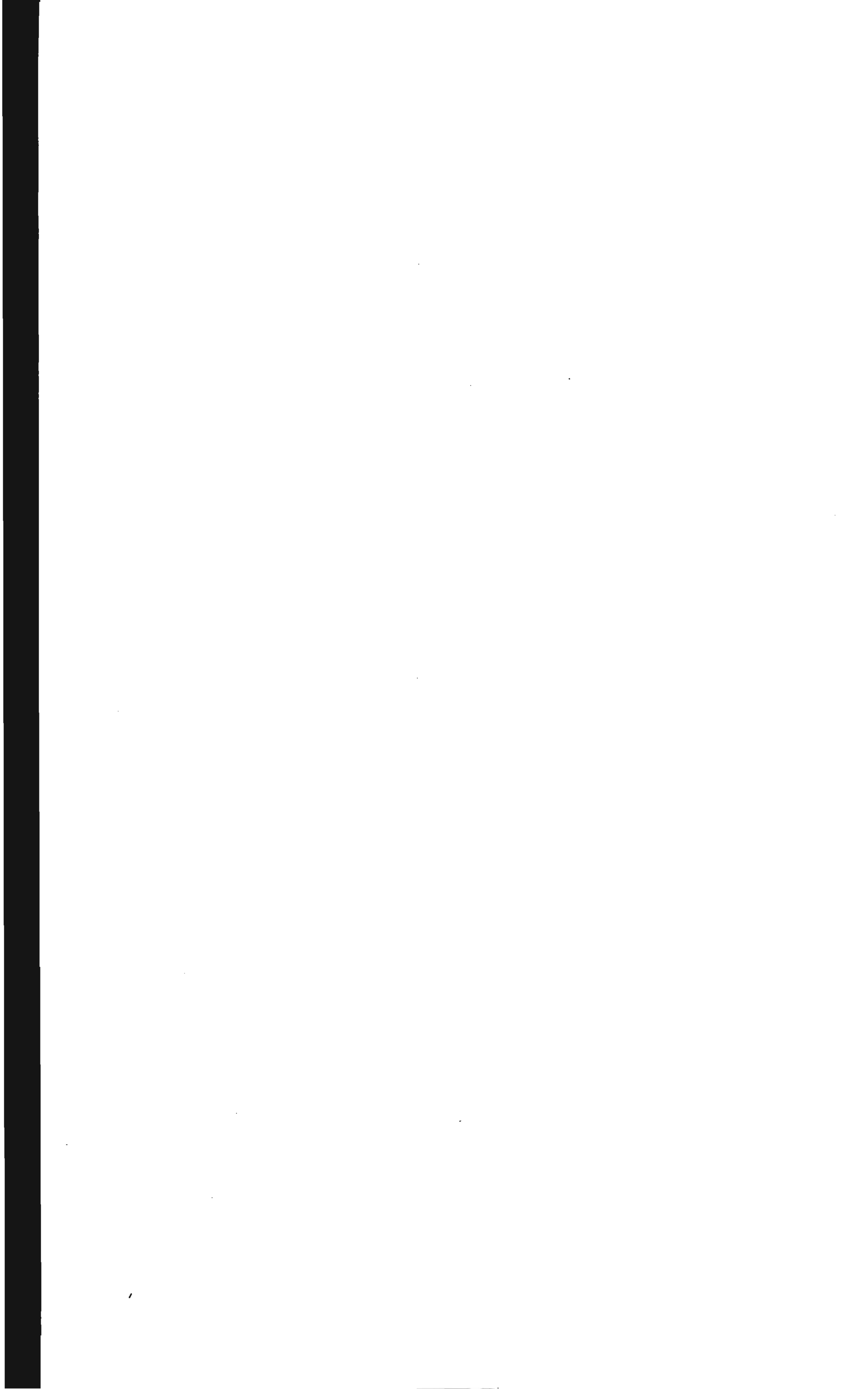
Their Lordships find an excellent illustration of the accepted practice in such matters in the United Kingdom, to which the appellants' chief accountant spoke, in the case of the *Highland Railway Company* v. *Special Commissioners of Income Tax*, 1889, 16 R., 950 ; 2 T.C. 485. There the Highland Railway Company had relaid a portion of their main line and in doing so had substituted steel rails of greater weight for the previous iron rails. No question was raised as to the cost of relaying the rails except as regards the additional weight and cost of the improved rails as compared with the original rails. The railway company claimed to deduct the additional cost as a proper charge against revenue on the ground that no permanent improvement of their property had been effected by the substitution of the heavier and costlier steel rails and that they derived no additional revenue from the outlay. The Lord President (Inglis) in rejecting the Company's contention said, at p. 954 :—

> " It must be kept in view that this is not a mere relaying of line after the old fashion. It is not taking away rails that are worn out or partially worn out and renewing them in whole or in part along the whole line. That would not alter the character of the line ; it would not affect the nature of the heritable property possessed by the company. But what has been done is to substitute one kind of rail for another—steel rails for iron rails. Now, that is a material alteration and a very great improvement in the *corpus* of the heritable estate belonging to the company, and so stated, surely is a charge against capital. All that is done, it will be observed from the details given with reference to this matter, is to charge the price of the rails and chairs—that is to say, the weight in addition to what was the original weight of the rails and chairs. That is the whole charge and that is a charge made entirely for the improvement of the property—a permanent improvement of the property. Now, how that can be anything but a charge against capital, I am unable to see."

The contrast between the cost of relaying the line so as to restore it to its original condition and the cost of relaying the line so as to improve it is well brought out in the passage just quoted and while the former is recognised as a legitimate charge against income the extra cost incurred in the latter case in the improvement of the line is equally recognised as a proper charge against capital. In the present instance the renewals effected constituted no improvement ; they merely made good the line so as to restore it to its original state. As such, in their Lordships' opinion, they were " repairs " within the meaning of section 15 (1) (*b*) of the Proclamation and the cost of them did not constitute an outgoing of a capital nature within the meaning of section 15 (1) (*a*). It

follows that the sum of £252,174 expended on this work by the appellants is deductible from their income for the purpose of ascertaining their taxable income.

Their Lordships will humbly advise His Majesty that the appeal be allowed, the judgment of the Special Court of the Protectorate of Bechuanaland of the 22nd June, 1932, be reversed and the case be remitted to the Special Court with a direction to allow the deduction of £252,174 claimed by the appellants from the respondent's assessment of their taxable income for the year ended the 30th June, 1931. The appellants will have their costs here and below.



In the Privy Council.

RHODESIA RAILWAYS, LIMITED

v.

THE COLLECTOR OF INCOME TAX OF THE BECHUANALAND PROTECTORATE.

DELIVERED BY LORD MACMILLAN.

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