Counsel for the Pursuer (Respondent)—Kinnear—Jameson. Agents—J. & J. Ross, W.S.

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Friday, January 7, 1881.

FIRST DIVISION.

[Court of Exchequer.

COLTNESS IRON COMPANY *v.* INLAND REVENUE.

(*AMENDED CASE.*)

*Revenue—Income-Tax—*5 *and* 6 *Vict. c.* 35, *sec.* 100, *Schedule D.*

Held that in computing the profits for assessment of income-tax a tenant of minerals is not entitled to deduct a sum representing the amount of capital expended in sinking pits which have been exhausted by the year's working.

This was the sequel of the case reported Feb. 6, 1879, 6 R. 617, and Aug. 1, 1879, 6 R. (H. of L.) 123. The Coltness Company having appealed to the House of Lords, that House was of opinion, after hearing counsel, that the statement of facts contained in the case submitted to the Court of Session was not sufficiently full for a final disposal of the points of law raised, and remitted the cause to the First Division of the Court of Session as the Court of Exchequer in Scotland, that the said Court might direct it to be amended in terms of 37 and 38 Vict. c. 16, and that an adjudication might be had on the amended case, and report made to the House of Lords thereon. The parties accordingly petitioned the First Division to remit the case to the Commissioners, in order that the same might be amended by adding thereto, in form of schedules or otherwise—"(1) Statement of the amount expended by the company in sinking pits, and charged to capital account, from 30th June 1858 to 30th June 1878; (2) statement of pits exhausted from 30th June 1858 to 30th June 1878, showing the total cost in sinking the pits, the depth of them, and the length of time they were in operation; (3) statement of the amount expended on pit-sinking, and charged to capital account, from January 1872 till 30th June 1878, giving the depth of each pit; (4) list of pits exhausted from January 1872 to 30th January 1878, giving the depth of each pit, when the sinking of the pit commenced, when each pit was exhausted, and the cost of sinking each pit; (5) ist of pits at present working, giving the depth of each pit, when the sinking of each pit commenced, and when the output commenced, and the expense of sinking each pit; also by adding a statement as to the schedules and rules of the schedules of the Income-tax Acts on which the assessment of the duty was made on the appellants; also by adding a statement explaining how the sum of £9027, claimed as a deduction from the assessment by the appellants, is arrived at."

The Commissioners accordingly amended the case. The facts regarding pit-sinking in the company's mineral field, as amplified and explained in the amended case, were summarised by the Lord President in giving judgment, as follows:—"*First*, During twenty years, from 30th June 1858 to 30th June 1878, the appellants expended in sinking pits £165,825, 3s. 6d., or on an average annually about £8500. This includes the costs of many pits used only as air-pits and pits for pumping water, as well as the expenses of bores made in searching for minerals. *Secondly*, During the same period many pits have become exhausted. The total cost of sinking these pits, including air-pits, pumping-pits, and bores as above, was £102,678, 6s. 10d., being about an annual average of £5000, varying from £639, 4s. 4d. in one year, being the lowest, to £11,284, 15s. 1d. in another, being the highest. The depth of these pits varies from 9 fathoms to 114 fathoms. Their endurance in a state of usefulness varies from about one year to twenty-three years. *Thirdly*, Taking a shorter period of about six and a-half years, from January 1872 to June 1878, the total cost of pit-sinking is £71,964, 10s. 2d., including £10,337, 10s. 9d. for air-pits and boring, or an average annual expenditure of about £11,000. Those pits vary from 4 to 134 fathoms in depth. *Fourthly*, During the period of six years, from January 1872 to January 1878, the nineteen pits which became exhausted had cost £44,013, 13s. 1d., or about £2300 each pit on an average. They vary from 13 to 100 fathoms in depth, and lasted on an average about nine and a half years. *Fifthly*, The pits at present working—that is, in June 1878—are forty-three in number, and cost £97,537, 7s. 1d., or an average of about £2250 for each pit. They vary in depth from 14 to 134 fathoms, and were sunk, the earliest of them in 1849 and the latest in 1876."

This statement was also made—"The sum of £9027 claimed as a deduction from the assessment by the appellants does not represent the cost of pit-sinking during the year, but is a sum arrived at by calculating two shillings a ton on iron made, and a penny half-penny a ton on coal sold, during the year, it being estimated that this will properly represent the amount of capital expended on making bores and sinking pits which have been exhausted by the year's working. The cost of making bores and sinking pits is charged in the books of the company to an account called 'Sunk Capital Account,' and is written off annually by a sum computed at the respective rates above specified on the quantities of iron made and coal sold in the year, as representing the capital expended on pit-sinking exhausted by the year's working. The working charges deducted and allowed in ascertaining the profits for assessment include the whole cost of getting and raising the minerals after the pits are sunk, and of manufacturing the metal and selling the iron and coal, and the general expenses of the concern."

At advising—

LORD PRESIDENT—In the case originally presented to the Court on the 28th of January 1879 by the Coltness Iron Company against the determination of the Commissioners of Income-Tax for the Middle Ward of Lanarkshire, they maintained that from the amount of the profits of their business for the year ending 5th April 1878, as assessed for income-tax, there ought to have been deducted a sum of £9027, being the cost incurred by them in sinking new pits.

The case stated as matter of fact that for a number of years the appellants have "carried on business as coal and iron masters, and have opened up several mineral fields, sinking new pits at their own expense from time to time as the old ones have become exhausted;" "that when a mineral field is wrought out, the pits on it become useless to them, and they receive no compensation from the landlord or anyone else in respect of them; and that they have no means of compensating themselves for the loss of those pits other than out of the gross annual returns derived from the minerals worked from them."

Upon these facts "the appellants maintained that there could be no profits till the expenditure of sinking was repaid, any more than there could be profits before the wages of the miners in working the minerals were repaid; that, in fact, the sinking of the pits was expenditure in winning the minerals, and not an investment of capital; that in the case of wages expended in sinking, there is nothing to represent capital, and the money so expended cannot be an investment, because it can never be recovered."

On these statements and this contention the Court gave judgment on the 6th of February 1879, holding that the case thus presented to them did not in principle differ from the case of the tenant of a mineral field sinking one pit, and one only, and proceeding by means of that pit to work out the whole minerals let to him. They therefore affirmed the determination of the Commissioners, and refused the proposed reduction, on the grounds stated in the judgment, and on the authority of the earlier case of *Addie* v. *The Solicitor of Inland Revenue*, Feb. 16, 1875, 2 R. 431, in which it was expressly decided that the cost of sinking a pit and carrying on the business of mining is an expenditure of capital, and cannot be taken into account in assessing the profits of the business to the income-tax.

The Coltness Company appealed to the House of Lords, and it appears that in the course of the appellant's argument at the bar facts and considerations were advanced and urged which were not stated or suggested in the case on which the Court gave judgment. On the conclusion of the argument the House of Lords, "being of opinion that the statement of facts contained in the case submitted to the Court of Session on this matter is not sufficiently full to enable this House finally to dispose of the points of law on which its decision is asked," was pleased to remit the case to this Court in order that it might be amended, "pursuant to the power conferred for that purpose by the Act of Parliament of the 37th and 38th years of her present Majesty, cap. 16, and that an adjudication be had on such amended case and reported to this House."

The case was amended accordingly, and the Court having heard a full argument from counsel, will now proceed to give their judgment in compliance with the order of the House.

The amended case contained the following new and important statements in addition to certain details as to pit-sinking, which will be immediately noticed:—

"*First*, The working charges deducted and allowed in ascertaining the profits for assessment include the whole cost of getting and raising the minerals after the pits are sunk, and of manufacturing the metal and selling the iron and coal, and the general expenses of the concern.

"*Secondly*, The sum of £9027 claimed as a deduction from the assessment does not represent the cost of pit-sinking during the year, but is a sum arrived at by calculating 2s. per ton on iron made, and 1½d. per ton on coal sold, during the year, it being estimated that this will properly represent the amount of capital expended in making bores and sinking pits which have been exhausted by the year's working."

It will be observed that while in the original case the deduction asked by the appellants was in respect of "the cost incurred by them in sinking new pits," and it was contended "that in fact the sinking of the pits was expenditure in winning the minerals, and not, as the surveyor stated, an investment of capital," the appellants no longer maintain that the deduction claimed does not represent capital invested or expended in carrying on the business of the company. On the contrary, it is now distinctly stated that the sum proposed to be deducted from the profits "represents the amount of capital expended on pits and exhausted by the year's working."

The facts regarding pit-sinking in the appellants' mineral field, as now amplified and explained, may be summarised as follows:—

First, During twenty years, from 30th June 1858 to 30th June 1878, the appellants expended in sinking pits £165,825, 3s. 6d., or on an average annually about £8500. This includes the costs of many pits used only as air-pits and pits for pumping water, as well as the expenses of bores made in searching for minerals.

Secondly, During the same period many pits have become exhausted. The total cost of sinking these pits, including air-pits, pumping-pits, and bores as above, was £102,678, 6s. 10d., being about an annual average of £5000, varying from £639, 4s. 4d. in one year, being the lowest, to £11,234, 15s. 1d. in another, being the highest. The depth of these pits varies from 9 fathoms to 114 fathoms. Their endurance in a state of usefulness varies from about one year to twenty-three years.

Thirdly, Taking a shorter period of about six and a-half years, from January 1872 to June 1878, the total cost of pit-sinking is £71,964, 10s. 2d., including £10,337, 10s. 9d. for air-pits and boring, or an average annual expenditure of about £11,000. These pits vary from 4 to 134 fathoms in depth.

Fourthly, During the period of six years from January 1872 to January 1878 the nineteen pits which became exhausted had cost £44,013, 13s. 1d., or about £2300 each pit on an average. They vary from 13 to 100 fathoms in depth, and lasted on an average about nine and a-half years each.

Fifthly, The pits at present working—that is, in June 1878—are forty-three in number, and cost £97,537, 7s. 1d., or an average of about £2250 for each pit. They vary in depth from 14 to 134 fathoms, and were sunk, the earliest of them in 1849 and the latest in 1876.

The question thus comes to be, Whether the statutes authorise any deduction to be made from profits on account of capital expended and exhausted in the conduct of the company's business? The general principle of the property and income-tax to which effect is given by the statutes is

that everything of the nature of income shall be assessed, from what source soever it may be derived—whether from invested capital or from skill and labour, or from a combination of both, and whether temporary or permanent, steady or fluctuating, precarious or secured. Nor does it make any difference on the incidence of the tax that the income has been created by the sinking of capital, as in the case of purchased annuities, instead of being merely the natural annual product of an invested sum which remains unconsumed and undiminished by the consumption of the income which it yields.

In applying this general principle to an assessment on profits of trade, the Act 5 and 6 of Her present Majesty, chapter 35, speaks in very clear language. The first rule, sec. 100, Schedule D, provides that "the duty to be charged in respect thereof shall be computed on a sum not less than the full amount of the balance of the profits or gains of such trade, &c., upon a fair and just average of three years, and shall be assessed, charged, and paid without other deduction than is hereinafter allowed." The third rule provides that in estimating the balance of profits and gains no deduction shall be allowed "for any sum employed or intended to be employed as capital in such trade, &c., nor for any capital employed in improvement of premises occupied for the purposes of such trade, nor on account of or under pretence of any interest which might have been paid on such sums if laid out at interest." And the fourth rule provides that "no deduction shall be made on account of any annual interest on any annuity or any annual payment payable out of such profits or gains."

The term "full amount of the balance of profits" in the first of these rules is something very different from the amount of the nett profits of the year which would appear in the ordinary annual balance-sheet of a trading company; for in ascertaining nett profits there falls to be deducted not only annual working expenses, but interest on capital employed in the business, and every kind of annual payment which either by the original constitution of the company or by its subsequent obligations falls to be paid out of the profits.

So, also, in ascertaining the amount of nett profits for the purpose of division, the state of the capital account necessarily affects the balance-sheet. If any part of the capital is lost, or if from the nature of the business the capital employed can never be recovered or restored, that is an element of primary importance in fixing the financial condition of the company and the true amount of its nett earnings.

But the statute refuses to take an ordinary balance-sheet, or the nett profits thereby ascertained, as the measure of the assessment, and requires the full balance of profits, without allowing any deduction except for working expenses, and without regard to the state of the capital account, or to the amount of capital employed in the concern, or sunk and exhausted, or withdrawn.

Any other construction of the statute would not only be inconsistent with the leading principle on which it is based, and with its express words, but would lead to very embarrassing consequences.

A man who employs his whole capital in the purchase of terminable annuities increases his income and is assessed to the income-tax for the full amount of the annuities; but after the step has been taken he is in practical effect living on his capital, and when the annuities terminate it will all be gone. He might have left his money on an ordinary investment, and have consumed every year a portion of the capital in addition to the interest. Nay, he might calculate the matter so nicely that the whole capital would be gone just at the same time that the annuities would terminate. In this case his assessable income would be only the interest accruing annually on the principal sum, gradually diminishing year by year, and would not include the portion of the capital which he chose to expend year by year. But when he purchases an annuity he converts his whole estate into an income which represents no capital but that which he has paid away and exhausted to procure the income. But the statute takes no heed of his exhausted capital, and makes no deduction from the actual amount of his income on that account.

In like manner, one may buy a business which is necessarily of a temporary character, but the endurance of which may extend over a series of years. He realises a large income from the business, and in the end he may find that the profits derived from the business while it lasted have repaid him the full amount he paid for it, with interest, and left an ample margin of gain beyond. On the other hand, he may find that though he drew considerable profits from the business annually during its continuance, the balance is the wrong way in the end, and he has lost a great part of the money he paid for it. But the statute is not concerned with the failure or success of his speculation, and looks only to what is the income derived from the business year by year.

To come nearer to the case before us, one man takes a lease of the minerals under the ground of a certain estate, which have never been wrought, and to which there is as yet no access by pit or otherwise. Another buys from a former tenant the unexpired term of a lease of minerals which are in the course of being wrought by means of numerous and well-constructed shafts. Are these two men to be assessed to the income-tax on different rules? Is the former to have such an allowance or deduction as is claimed in the present case, on account of capital expended and exhausted in the sinking of pits, and is the other to have no such allowance when the pits sunk by his predecessor in the mine become exhausted and useless? Such a result would seem very unjust to the latter, for his pits have possibly cost him quite as much, in the shape of purchase-money of the lease, as the former has expended in actually sinking his. And yet to give the latter the same kind of allowance as is now claimed for the former would involve such an inquiry as the Legislature could never have contemplated, and as seems almost inextricable—an inquiry into the manner in which the purchase-money of the lease ought to be apportioned between the minerals themselves and the pits, and the other advantages and conveniences of the going mine at the date of the purchase, including an estimate of the worth of each pit at that date, its probable continuance as a useful pit, and the expense of maintaining it. But besides all this, the supposed claim of the purchaser of the lease would be nothing less than a proposal to deduct

from the income arising from the subject purchased a proportion year by year of the purchase-money. This would be to establish a distinction between temporary and permanent income in the mode of imposing the assessment to which the statute gives no countenance.

As already noticed, the contention of the appellants in the original case was that the expenditure in respect of pit-sinking was not outlay of capital at all, but the ordinary working expenses of the mine. For the reasons given in our former judgment, we thought that argument unsound, and in the amended case it is abandoned, and the expense of pit-sinking is admitted to be outlay or investment of capital. But the claim of the appellants, as made in the amended case, though thus differing in form, does not differ in any material respect from the claim made in the original case. Capital expended in the sinking of pits must necessarily become exhausted and lost sooner or later, and that is foreseen when the expenditure is made. The only distinction between the two claims is, that in the original case the deduction was asked of expenditure actually made in the year of assessment, while in the amended case the deduction is asked to be made in the year of assessment in which the pits created by the expenditure ceased to be useful. But it is not the less in the one case than in the other a deduction from annual profits of capital employed in the business of the appellants' company, which the statute expressly prohibits.

A certain appearance of plausibility is given to the appellants' argument by the number and variety of pits sunk and worked by them. The constant employment of capital year by year in such sinking, by reason of the great extent of their business, gives to this expenditure a certain similarity to ordinary working. But the likeness is merely on the surface. If a man buys an unwrought mineral field and sinks one pit, by means of which he works out all the minerals, he has converted the dormant, inaccessible, and unproductive subject into a going mine. He has made a new subject, which differs from the unwrought mineral field just as a railway or canal is a different subject altogether from what the ground on which it is constructed originally was. The miner has invested his capital in creating the subject, which consists partly of the minerals and partly of the access by which the minerals are approached and worked; but the cost of the one, equally with the cost of the other, is an employment of capital, and it would be quite as reasonable to ask for an allowance for the general exhaustion and loss of capital embarked in paying the price of the mineral as of that employed in sinking the pit.

The Court had occasion in the case of *Miller* v. *Farie* (Nov. 29, 1878, 6 R. 270) to decide that no allowance could be made for depreciation of the subject or the gradual extinction of the capital employed by the constant diminution of the quantity of minerals remaining to be won, and we have seen no reason to doubt the soundness of that judgment. But if these considerations are conclusive in the case of a small mine with a single pit, it seems impossible to dispute their equal applicability to a large subject of the same kind. Instead of 50 acres in the case supposed, the mineral field may extend to 1000 acres; but the extension of the area, and the multiplication of the strata worked, and of the pits sunk to reach them, do not alter the character of the subject or the nature of the trade, and cannot make that in the latter case working expenses which in the former is employment of capital.

Having regard to the express words of the statute, and the principle of assessment which runs through all its provisions, the Court are of opinion that the claim of the appellants ought to be rejected and the determination of the Commissioners ought to be affirmed.

As to the matter of expenses, we apprehend that we have no power to dispose of that question, at least at present.

The Court of new affirmed the determination of the Commissioners of the Middle Ward of Lanarkshire, dated November 7, 1878, and decerned; and appointed the Clerk to report this judgment to the House of Lords, in terms of the order to that effect of date August 1, 1879.

Counsel for Appellants—Asher—Mackintosh. Agents—Murray, Beith, & Murray, W.S.

Counsel for Respondents—Solicitor-General (Balfour, Q.C.)—Rutherfurd. Agent—D. Crole, Solicitor of Inland Revenue.

Friday, January 7.

FIRST DIVISION.

[Sheriff of Lanarkshire.

ROBERTSON *v.* FRASER.

Bankruptcy — Landlord and Tenant — Claim — Obligation for Rent by Bankrupt Tenant.

A tenant in an urban subject was sequestrated between terms. He remained on in the house for some months by the permission of his trustee in sequestration. F having paid the rent for him for the period from the date of his sequestration to the date of his leaving the house, raised an action, with concurrence of the landlord for his interest, against the bankrupt for recovery. *Held* that the rent for the current year being a debt for which the tenant was liable at the date of his sequestration, the claim should have been made against the trustee in sequestration, and was not good as against the defender personally. Action *dismissed* accordingly.

Question—Whether an action of ejectment would be competent to the landlord in such a case?

Duncan Fraser, residing at Brownlee, Blantyre, brought an action in the Sheriff Court of Lanarkshire, with consent of John Watson of Earnock, "for all right competent to him as landlord of the house in Clydesdale Street, Hamilton, occupied by the defender," against John Robertson, there residing, for payment of £27, 13s. 4d.

He averred, and it was admitted by defender, that "(Cond. 2) For several years the defender has been tenant of the dwelling-house in Clydesdale Street, Hamilton, presently occupied by him, and belonging to John Watson, Esq. of Earnock, at the yearly rent of £42 sterling. The estates of the defender were sequestrated on 21st October 1879, and since then he has occupied,