

HOUSE OF LORDS.—19th and 20th March and 8th April, 1908.

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THE GENERAL ACCIDENT, FIRE, AND LIFE ASSURANCE CORPORATION, LTD. v. M'GOWAN (Surveyor of Taxes).⁽¹⁾

Income Tax, Schedule D, First Case.—A Company carries on the business of fire, sickness, accident and guarantee insurance. It is assessed on the basis of actual income less expenses and losses actually accrued.

Held, that no deduction is admissible from profits to meet estimated losses on unexpired risks.

APPELLANTS' CASE.

This is an Appeal from a certain Interlocutor of the First Division of the Court of Session as the Court of Exchequer in Scotland in a case for the above-named Appellants on appeal by them under the Taxes Management Act, 1880, against James M'Gowan, Surveyor of Taxes, Perth, for the opinion of the Court of Session as the Court of Exchequer in Scotland, in which the Appellants appealed against an assessment made upon them under Schedule D of the Income Tax Acts in respect of the profits of the business carried on by them for the year ending 5th April, 1906.

The following is the—

I.—Case for the General Accident Assurance Corporation, Limited, Perth, against James M'Gowan, Surveyor of Taxes, Perth, for opinion of the Court of Session as the Court of Exchequer in Scotland.

At a meeting of the Commissioners for the general purposes of the Income Tax Acts and for executing the Acts relating to Inhabited House Duties for the District of the City of Perth, held at Perth on the 15th day of December, 1905,

⁽¹⁾ Reported 1908. A.C. 207.

the General Accident Assurance Corporation, Limited, General Buildings, Perth (hereinafter referred to as "The Company"), appealed against an assessment for the year ending 5th April, 1906, on the sum of £20,950 (duty, £1,047 10s.) made upon it under Schedule D of the Income Tax Acts in respect of the profits of the business carried on by it, on the ground that in arriving at the assessable profits no deduction had been allowed to meet losses on unexpired risks.

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The assessment was made under 5 and 6 Vict. c. 35, s. 100 First Case, 16 and 17 Vict. c. 34, s. 2, and 5 Edw. 7 c. 4, s. 6; and the sum assessed is the amount, on an average of the three years ending 31st December, 1904, arrived at by reference to the Company's revenue accounts as follows:—

Year ending 31st December, 1902.

Balance of Revenue Account	- - -	£25,659 10 7
Less balance brought forward from previous year's account	- - - -	3,694 7 5
		<hr/>
		£21,965 3 2
Add sums debited in Revenue Account and not allowable as deductions	- -	1,071 19 4
		<hr/>
		£23,037 2 6
Deduct interest and rents of properties already taxed, and the annual value of the Company's offices	- - -	6,199 14 2
		<hr/>
Amount of profit	- -	16,837 8 4

Year ending 31st December, 1903.

Amount of profit (after making similar addition and deductions as above)	- - -	£22,503 6 8
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Year ending 31st December, 1904.

Amount of profit (after making similar addition and deductions as above)	- -	£23,509 18 2
		<hr/>
Total profits for three years		£62,850 13 2
		<hr/>
One-third whereof is	-	£20,950 0 0

The Company claimed a deduction from the total premium income of each year to meet the estimated losses on risks un-

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expired at the end of each year, as shown by the following statement:—

Surplus income: Year to 31st December, 1902	- - - - -	£16,837 8 4
<i>Add</i> for unexpired risks at 31st December, 1901, 33 $\frac{1}{3}$ % of total premiums (£170,338 8s. 2d.)	- - - - -	56,779 9 4
		<u>£73,616 17 8</u>
<i>Deduct</i> for unexpired risks at 31st December, 1902, 33 $\frac{1}{3}$ % of total premiums (£231,354 14s. 10d.)	- - - - -	77,118 4 11
Loss	- - - - -	<u>£3,501 7 3</u>
Surplus income: Year to 31st December, 1903	- - - - -	£22,503 6 8
<i>Add</i> for unexpired risks at 31st December, 1902	- - - - -	77,118 4 11
		<u>£99,621 11 7</u>
<i>Deduct</i> for unexpired risks at 31st December, 1903, 33 $\frac{1}{3}$ % of total premiums (£262,479 8s. 3d.)	- - - - -	£87,493 2 9
Profit	- - - - -	<u>£12,128 8 10</u>
Surplus income: Year to 31st December, 1904	- - - - -	£23,509 18 2
<i>Add</i> for unexpired risks at 31st December, 1903	- - - - -	87,493 2 9
		<u>£111,003 0 11</u>
<i>Deduct</i> for unexpired risks at 31st December, 1904, 33 $\frac{1}{3}$ % of total premiums (£306,258 2s. 6d.)	- - - - -	£102,086 0 10
<i>Add</i> 50 % of one month's monthly payment premiums (the total amount of which for this year is £52,940 12s. 3d.)	- - - - -	£2,205 17 2
		<u>£104,291 18 0</u>
Profit	- - - - -	<u>£6,711 2 11</u>

Summary: Year 1903—Profit	-	-	-	£12,128	8	10
„ 1904—Profit	-	-	-	£6,711	2	11
				£18,839	11	9
„ 1902—Loss	-	-	-	3,501	7	3
				£15,338	4	6

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One-third whereof is - - £5,112 14 10

The amount on which the Company claims to be assessed.

I.—The following facts were admitted or proved:—

1. The Company was incorporated on 23rd February, 1891, under the Companies Acts as a Company limited by shares. The subscribed capital of the Company as on the 31st December, 1904, was £400,000 divided into 400,000 shares of £1 each. The paid-up capital then amounted to £99,997.
2. The objects of the Company as set forth in the third Article of its Memorandum of Association then in force were, *inter alia*: “(a) To undertake and carry “on the business of Accident, Employers’ Liability, “Fidelity, Guarantee, Third Party, Burglary or “Theft, Fire, Marine, Vehicle, Plate Glass, and “Mortgage, or other investment insurances, or any “of them, and all or any other kinds of Insurances “of the like or a similar nature . . . excepting “Life Insurance.”
3. The Company’s Articles of Association provide *inter alia*:—
 - “87. The Directors may, with the sanction of the Company in general meeting, declare a dividend to be paid to the members in proportion to the amount paid up in pursuance of calls upon the shares held by them, having regard to any preference or priority attaching to such shares respectively.”
 - “88. The Directors may at any time, without calling a general meeting, if they shall consider that the prospects of the Company warrant them in so doing, pay to the shareholders an interim dividend on account, and in anticipation of the dividend which may be declared at the general meeting.”
 - “89. No dividend shall be payable except out of the income and profits arising from the investments and business of the Company.”
 - “90. The Directors may, before paying or recommending any dividend, set aside out of the profits of the Company such sums as they think

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proper as a Reserve Fund, to meet contingencies or for equalising dividends, bonuses, or for other matters required by or connected with the business of the Company, or any part thereof; and the Directors shall invest separately from other funds the sums so set apart as a Reserve Fund."

- "96. Once at least in every year the Directors shall lay before the Company in general meeting a balance-sheet and statement of the income and expenditure made up to a date not more than four months before such meeting, and shall send to each shareholder, at least seven days prior to such meeting, a printed copy of such balance-sheet and statement, and two copies of each of these documents shall at the same time be forwarded to the Secretary of the Share and Loan Department, Stock Exchange, London, and to the Secretary of any other Stock Exchange in the Official List of which the Company may for the time being be quoted."
4. The Company makes up its accounts to the 31st December in each year. For each of the years ending 31st December, 1902, 31st December, 1903, and 31st December, 1904, the Company paid the dividends shown in its reports and accounts, copies⁽¹⁾ of which are appended hereto and form part of this case.
 5. The business carried on by the Company up to 31st December, 1904, consisted of fire, sickness, accident, and guarantee insurances. The net premium income for the year 1902 was £231,354 14s. 10d.; for the year 1903 £262,479 8s. 3d.; and for the year 1904 (exclusive of £52,940 for monthly payment premiums) £306,258 2s. 6d.
 6. Insurances are effected with the Company at all periods of the year. All its fire policies, and much the larger proportion of all its other policies, are granted for one year. Some of the policies endure for one month only.
 7. It is the practice of Insurance Companies to estimate the unexpired risk at any given date on yearly policies of insurance, whether against fire, sickness, or accident, at 33½ per cent. of the total premium income of the year. In the case of policies granted by this Company for one month, it estimates the unexpired risk at any given date at 50 per cent. of one month's premium income.

(1) Omitted from the present print.

8. The annual accounts made up by the Company, in terms of the Companies Acts, show the results of the Company's business in all its branches in one Revenue Account. Each year's Revenue Account credits premiums, interest, and other income received, and debits losses, expenses of management, and other disbursements made during the year, and brings out a balance which, for each of the years 1902, 1903, and 1904, was a credit balance or surplus.
9. This surplus is described in the reports by the Directors of the Company as "the balance at credit of Revenue Account after providing for 'estimated claims' (*i.e.*, claims made but not settled) 'and outstanding accounts.'" In their reports the Directors recommend that a certain proportion of this surplus shall be appropriated to the payment of dividend, interim (previously declared) and final; that a certain proportion shall be placed to reserve; and that the balance shall be carried forward to next year's account, and these recommendations are considered at the annual meeting of the Company held in March or April each year and adopted, a fixed amount of the balance of the Revenue Account being thus appropriated to interim dividend, final dividend, and reserve.
10. The amount paid in dividends for each of the years 1902, 1903, and 1904 was £9,999. The amount placed to reserve for the year 1902 was £14,000, and for each of the years 1903 and 1904, £20,000.
11. The amount of the reserve as at 31st December, 1904, was £150,000, made up of £85,500 set aside from Revenue Account and £64,500 derived from premiums on the issue, during the period from the year 1896 to the year 1902, of new shares in the Company, which latter sum was carried direct to reserve, and was not credited in the Revenue Accounts, and on which no income tax has been paid. The amount of the deduction claimed by the Company for unexpired risks at 31st December, 1904, is £104,291 18s. The reserve is described in the annual balance-sheets as "Reserve Fund, including reserve for 'unexpired risks.'" In the opinion of the Commissioners no part of the Company's revenue is specifically appropriated to a reserve for unexpired risks, and no losses arising during the period of unexpired risks are charged to Reserve Fund. The income of each year has hitherto been sufficient to meet the losses on the unexpired risks of the previous year as well as its own losses, and to allow of an addition being made to the reserve. The losses on the unexpired risks of any year are paid out of the income of the following year, and in arriving at the amount of the profits for such

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following year for the purposes of the Income Tax Acts, a deduction is allowed in respect of such payments.

12. In arriving at the assessable profits of the Company for the purposes of the Income Tax Acts in any year a deduction for the unexpired risks of that year has never been allowed.

II.—The Company contended that, before arriving at the profits for the year for Income Tax purposes, the deductions for unexpired risks made in the foregoing particulars of income should be allowed; that, in the case of any insurance company with yearly policies, and in particular in the case of a company whose premium income was rapidly increasing, it was clearly necessary to provide for unexpired risks before the true profit could be ascertained; and that, if this were so, the Appellants were entitled to the deductions claimed, whether they had made provision for unexpired risks in their annual accounts or not. It was further contended that, in point of fact, such provision had been made in the annual accounts, because the balance-sheet contained an account entered as "Reserve Fund, including amount reserved for 'unexpired risks,'" and to that account the Company had each year carried a large proportion of the balance of revenue. It was further contended that the case differed entirely from that of the *Scottish Union and National Insurance Company v. Inland Revenue*⁽¹⁾, (1889, 16 R. pp. 461 and 474), relied on by the Surveyor of Taxes, in respect (1) that in that case the premium income was practically stationary, and (2) that no provision whatever had been made in the accounts for unexpired risk.

III.—The Surveyor of Taxes (Mr. James M'Gowan) maintained (1) that in arriving at the amount of the assessable profits of the Company the whole of the premiums received by the Company in any year ought to be taken into account as profits of that year, notwithstanding that the risks covered by a portion of such premiums may extend into the subsequent year (*Imperial Fire Insurance Company v. Wilson*, 1876, 85 L.T.R. 271; 1 T.C. 71); (2) that the Company is not entitled to make yearly the deduction claimed for unexpired risks in respect that the deduction is not one of the expressly enumerated deductions authorised by the provisions of the Income Tax Act to be made in estimating its annual profits (5 and 6 Vict. c. 35, ss. 100 and 159); (3) that the unexpired risks ought not to be taken into account in ascertaining the amount of Income Tax payable by the Company, in respect that the accounts of the Company, on which the assessment made is based, show that such risks are not taken into account for the purpose of ascertaining the amount of profits divisible among the shareholders of the Company, and that it is only after declaring the dividend out of the profits that any sum is placed

(1) 2 T.C. 551.

to general reserve; and (4) that the present case is governed by the opinion of the Court in the cases of the *Scottish Union and National Insurance Company*, and the *North British and Mercantile Insurance Company v. Inland Revenue*(¹), (1889, 16 R. 461 and 474). In the latter case it was stated that, "in the Fire Department of the business it has for many years been the custom of the Company, on 31st December, when the books are closed for the year, to set aside one-third of the net premiums received during the past year to provide for liabilities on current policies" (Stated Case, p. 6).

IV.—The Commissioners on consideration of the facts and arguments submitted to them, being of opinion that the assessment on the Company was made in accordance with the instructions given by the Court in the cases of the *Scottish Union and National Insurance Company and others v. Inland Revenue*(¹), dismissed the appeal and confirmed the assessment.

V.—Whereupon the Company declared its dissatisfaction with the determination of the Appeal as being erroneous in point of law; and having duly required the Commissioners to state and sign a case for the opinion of the Court of Session as the Court of Exchequer in Scotland, this case is stated and signed accordingly.

DAVID M SMYTHE, JOHN DAVID SYM, ADAM STEEL, JAMES BARLAS.	}	Commissioners.
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Perth, 1st March, 1907.

II.—INTERLOCUTORS.

The following have been the Interlocutors and steps of procedure in the Court below:—

The Appellants having obtained a case under the said Act and having in terms of Section 59th sub-section (1) of the Statute within seven days after receipt thereof transmitted the same (marked to the First Division) to the process clerk of the Lord Ordinary in Exchequer Causes (Lord Johnston), and at the same time a copy thereof to the opposing party's agent, and the case having been laid before the said Lord Ordinary, he pronounced the following Interlocutor:—

"19th March, 1907.—Lord Johnston.—Act. Young-Alt.
 " .—The Lord Ordinary in Ex-
 " chequer Causes appoints the case to be heard by the Lords
 " of the First Division, for which Division it has been marked,
 " in terms of the Act of Sederunt of 9th December, 1880.

"HENRY JOHNSTON."

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The Lords of the First Division thereupon pronounced the following Interlocutor:—

“Edinburgh, 14th May, 1907.—The Lords appoint the Cause to be put to the Summar Roll.

“DUNEDIN, I.P.D.”

Thereafter Counsel for the parties were heard on the case by the Judges of the said Division, who pronounced the Interlocutor of 4th June, 1907, appealed from, which is in the words following:—

“Edinburgh, 4th June, 1907.—The Lords of the First Division having considered the case and heard Counsel for the Appellants affirm the determination of the Commissioners, sustain the Assessment, and Decern: Find the Appellants liable in expenses, and remit the account thereof to the Auditor to tax and to report.

“JOHN M'LAREN, I.P.D.”

III.—SUPPLEMENTARY STATEMENT.

The question raised by this Appeal is whether, in ascertaining for Income Tax purposes the annual profits of a Company carrying on the business of fire and accident insurance, there should be taken into account the unexpired risk on policies current at the end of each year under consideration.

The Appellants are a Company who, at the period to which the Appeal relates, carried on the business of fire, sickness, accident and guarantee insurance, and the general question above stated arises out of the mode adopted by the Assessor for ascertaining the profits upon which they were assessed for the year beginning 5th April, 1905. The accounts of the Appellants are made up to 31st December in each year and under the Statute 5 and 6 Vict. c. 35, Section 100, First Case, the profits for the year in question fell to be fixed on a fair average of the profits of the years 1902, 1903, and 1904. All the fire policies issued by the Appellants, and much the larger proportion of their other policies, are issued for one year only. Some of their policies endure for one month only. It is the invariable practice of insurance companies, founded on long and wide experience of the normal operation of insurance risks, to estimate the unexpired risk at any given date on yearly policies of insurance, whether against fire, sickness or accident, at one-third of the total premium income of the year. In the case of their monthly policies the Appellants estimate the unexpired risk at any given date at one-half of one month's premium income. Accordingly, in submitting to the Assessor a statement of their profits for the years 1902, 1903, and 1904, the Appellants allowed for the element of unexpired risk by crediting to each year's revenue account the estimated unexpired risk of the premium income of the previous year and

by debiting the estimated unexpired risk of the premium income of the year under consideration. These items were, however, deleted by the Assessor of Income Tax, thus leaving the profits of the Appellants to be determined on an account of actual income on the one hand, and expenses and losses actually accrued within the year on the other hand. The Assessor's decision was affirmed on appeal by the Income Tax Commissioners, and again, on further appeal, affirmed by the Court of Session on the broad, general ground that it was settled by authority and inveterate practice that, in the case of policies involving contracts for one year only, no such allowances should be made.

In the case of a Company with a more or less stationary premium income, the element of unexpired risk is not of material importance, because in such a case the amount representing such risk which is brought forward from the previous year is just balanced by the amount which is debited as representing the unexpired risk of the year under consideration. But in the case of a Company with a progressively increasing premium income, the element of unexpired risk becomes most material, because the amount brought forward from the previous year is always exceeded by the amount debited for the year under consideration. The Appellants' premium income during the period to which the Appeal relates rapidly increased, having advanced from over £232,000 in 1902, to over £262,000 in 1903, and to over £306,000 in 1904; and in consequence the amount of the Appellants' profits for the year 1905-6, calculated according to the method of the Assessor, is over £15,000 in excess of the amount calculated according to the method contended for by the Appellants.

Apart from authority, the Appellants humbly submit that the claim for an allowance for unexpired risks is just and equitable and in accordance with the Income Tax Acts. The premiums which are received upon policies issued in the course of a year of a Company's business cannot be properly treated as profits until the risks in respect of which the premiums have been received have run off, or unless the amount of such risks has been fairly estimated and allowed for. Until such risks have run off or been allowed for, the premiums have not been truly earned. It has been decided that directors of a company, who pay dividends out of a balance arising on an account of receipts and payments without making allowance for prospective risks, may be made personally liable, because such a balance does not truly represent profits (*Barrie's Case*, 1870, 6 Ch. 104), and it has been authoritatively laid down that the word "profits" in the Income Tax Acts is to be interpreted in its natural and proper sense of trading profits. (Per Lord Halsbury, L.C., and Lord Herschell in *Gresham Life Assurance Society v. Styles*,⁽¹⁾ 1892, A.C. at pp. 315, 323.) Nor

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is it any valid objection to the element of unexpired risks that it must necessarily be an estimated amount, because in the case of life policies it is well settled that future risks must be taken into account and estimated by actuarial calculation. (*Scottish Union and National Insurance Co. v. Inland Revenue*, 16 R. 461).⁽¹⁾ The experience of insurance companies over an extended period, upon which the rates of one-third has been fixed as a fair normal allowance for unexpired risks upon current yearly fire and accident policies, does not differ in kind from the experience upon which is based the actuarial calculation of the prospective risks of life policies. So strongly have these considerations weighed with the Inland Revenue authorities that as matter of practice, notwithstanding the decisions relied on by the Court of Session, they do allow the element of unexpired risk to be taken into account where the annual accounts of insurance companies are expressly framed on that footing, and that although the actual facts and circumstances, apart from the method of stating the accounts, are exactly similar to the facts and circumstances in the Appellants' case. It cannot therefore be affirmed that any such broad principle as that which forms the foundation of the judgment of the Court below has been followed in practice.

Turning to the decisions relied on in the Court below (*The Scottish Union and National Insurance Co. v. Inland Revenue*, 16 R. 461, 2 T.C. 551, and the *Imperial Fire Insurance Co. v. Wilson*, 35 L.T.R. 271; 1 T.C. 71), it is to be observed that in neither case had there been a material increase in the premium income on yearly policies. In the Scotch case the application of the unexpired risk principle could only have made a difference of £1,670 (*See* 16 R., p. 470); in the English case, during the three years which were under consideration, while the premium income had shown a large increase during the second year, it had shown a considerable fall for the third year, so that in neither case were the facts fitted to bring out the possible importance of the principle involved. Further, in all the cases, including the Judgment now appealed from, the principle applied was based on the reasoning that, in the case of Companies transacting on yearly policies over a period of years, the unexpired risk of one year is allowed for in the actual losses debited in the accounts of the following year, that approximate justice is thus done, taking one year with another, and that if and when the Company ceases business, Section 134 of the Act 5 and 6 Vict. cap. 35, allows repayment to be made of the assessment imposed for that year. This reasoning, the Appellants would humbly submit, ignores the consideration that in the case of a progressively increasing premium income the over-assessment which results from omitting to allow for unexpired risk is continuous and cumulative, and that the repayment of one year's assessment when business ceases to be done, even assuming that the rate of Income Tax

⁽¹⁾ 2 T.C. 551.

has continued to be the same, only provides a remedy for the final year and not for preceding years. A case may easily be figured, and is illustrated by the history of many insurance companies, where over a considerable number of years, if unexpired risk is allowed for, no true profit is made and no assessment should be imposed, and where, nevertheless, in consequence of a progressively increasing premium income, accounts made up by setting actual disbursements against income received annually show an apparent surplus. If this apparent surplus is assessed year by year, it is obvious that even approximate justice is not done, and that the abatement of the tax imposed on the apparent surplus of the last year is no compensation for assessments imposed on apparent surpluses over the whole period.

The point may be further illustrated by the following comparative statement showing the incidence of Income Tax, calculated (1) according to the method imposed by the Inland Revenue and (2) according to the method contended for by the Appellants, in the case of a Company starting and doing business for a period of three years, the hypothetical premiums being in each case taken at £90,000, £120,000, and £180,000 during three successive years, and the deductions for expenses and losses paid and actually incurred (exclusive of allowance for "unexpired risk") in these respective years being in both branches of the statement taken at £45,000, £75,000, and £112,500.

Total Income Tax for three years according to method imposed by Inland Revenue - - - -	£7,875
Total Income Tax according to method contended for by the General Accident, Fire, and Life Assurance Corporation, Ltd. - - - -	4,875
Difference - - - -	£3,000

I.—Method Imposed by the Inland Revenue.

Year 1.

Gross premiums - - - -	£90,000
Deduct expenses and losses actually paid or incurred - - - -	45,000
Surplus carried to reserve including reserve for unexpired risks - - - -	£45,000
Income Tax thereon at 1s. per £ - - - -	£2,250

Year 2.

Gross premiums - - - -	£120,000
Deduct expenses and losses actually paid and incurred - - - -	75,000
Surplus as above - - - -	£45,000
Income Tax thereon at 1s. per £ - - - -	£2,250

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		Year 3.		
Gross premiums	-	-	-	£180,000
<i>Deduct</i> expenses and losses actually paid and incurred	-	-	-	112,500
Surplus as above	-	-	-	£67,500
Income Tax thereon at 1s. per £	-	-	-	£3,375
				<u>£7,875</u>

II.—Method contended for by the General Accident, Fire, and Life Assurance Corporation, Limited.

		Year 1.		
Gross premiums	-	-	-	£90,000
<i>Deduct</i> expenses and losses actually paid and incurred	-	-	-	£45,000
One-third of premiums in respect of unexpired risks	-	-	-	£30,000
				<u>75,000</u>
Surplus carried to reserve	-	-	-	£15,000
Income Tax thereon at 1s. per £	-	-	-	£750

		Year 2.		
Gross premiums	-	-	-	£120,000
<i>Add</i> one-third deducted as above in respect of unexpired risk in Year 1	-	-	-	30,000
				£150,000
<i>Deduct</i> expenses and losses actually paid and incurred	-	-	-	£75,000
One-third of premiums in respect of unexpired risk	-	-	-	40,000
				<u>£115,000</u>
Surplus as above	-	-	-	£35,000
Income Tax therein at 1s. per £	-	-	-	£1,750

		Year 3.		
Gross premiums	-	-	-	£180,000
<i>Add</i> one-third deducted as above in respect of unexpired risk in Year 2	-	-	-	40,000
				£220,000
<i>Deduct</i> expenses and losses actually paid.	-	-	-	£112,500
One-third of premiums in respect of unexpired risk	-	-	-	60,000
				<u>£172,500</u>
Surplus as above	-	-	-	£47,500
Income Tax thereon at 1s. per £	-	-	-	£2,375

Total Income Tax for three years - - £4,875

The above figures show that, if the Company were to stop business at the end of Year 3, it would require a sum of at least £60,000 to meet its liabilities under current policies which would be expiring in the course of the year following the date of its ceasing to do business. Therefore it cannot be contended that this sum is profit upon which tax should be paid.

The Appellants accordingly submit that the Judgment of the Court below should be reversed for the following among other

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REASONS :

1. Because, in order to ascertain the trading profit of companies dealing in yearly policies of insurance, it is necessary to take into account the unexpired risk on current policies.
2. Because, in ascertaining the profits of such companies for the purpose of assessing Income Tax, an allowance for unexpired risk is just and equitable and in accordance with the provisions of the Income Tax Acts.
3. Because the rate of allowance proposed by the Appellants is fair and equitable and in accordance with the general experience and practice of insurance companies.
4. Because, in the case of companies with a progressively increasing premium income, like that of the Appellants, the method of ascertaining profits adopted by the Assessor involves continuous and cumulative over-assessment and fails to secure even approximate justice.
5. Because the Judgment appealed from, and the previous decisions which it follows, are founded upon an erroneous conception of the limited effect of the method of ascertaining profit adopted by the assessor.

JAMES AVON CLYDE.

A. H. B. CONSTABLE.

THE RESPONDENT'S CASE.

The question in this case is whether the Appellants, in ascertaining for Income Tax purposes their annual profits, are entitled to claim a deduction from their total premium income in each year to meet estimated losses on risks unexpired at the end of each year.

The Appellants were incorporated on 23rd February, 1891, under the Companies Acts, as a company limited by shares, for the purpose of carrying on the business of fire, sickness,

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accident, and guarantee insurances. Life insurance was expressly excepted from the business to be carried on by the Appellants.

An assessment of Income Tax was made on the Appellants under Schedule D of the Income Tax Acts, for the year ending 5th April, 1906, on the sum of £20,950 in respect of the profits of the business carried on by them on an average of the three years ending 31st December, 1904, arrived at by reference to their revenue accounts.

The Appellants claimed a deduction from the total premium income of each year to meet the estimated loss on risks unexpired at the end of the year, and after making such deduction, the amount on which the Appellants claimed to be assessed was £5,112 14s. 10d. The Respondent refused to give effect to the deduction claimed, whereupon the Appellants appealed to the General Commissioners of Income Tax for the district of the City of Perth.

The said Commissioners duly considered the Appeal, and on 15th December, 1905, decided that the assessment made on the Appellants was properly imposed, dismissed the Appeal, and confirmed the assessment.

The General Commissioners were thereupon required by the Appellants to state a case under the Taxes Management Act, 1880, for the opinion of the Court of Session as the Court of Exchequer in Scotland.

A case was accordingly stated, and came before the First Division of the Court; and their Lordships, after having heard Counsel for the Appellants, and having considered the cause, pronounced an interlocutor, dated 4th June, 1907, affirming the determination of the Commissioners, and sustaining the assessment. It is against the decision of the First Division that the present Appeal is taken.

The circumstances in which the point in dispute has arisen are fully narrated in the Stated Case.

The Income Tax Act (1842) provides, Section 100, Schedule D, First Case, Rule 1, that the duty to be charged in respect of any trade, adventure, or concern in the nature of trade, "shall be computed on a sum not less than the full amount of the balance of the profits or gains of such trade, . . . upon a fair and just average of three years ending on such day of the year immediately preceding the year of assessment on which the accounts of the said trade . . . shall have been usually made up, or on the 5th day of April preceding the year of assessment, and shall be assessed, charged, and paid without other deduction than is herein after allowed."

The deductions not to be allowed are set forth in Schedule D.

Section 159 of the Act provides that "in computation of duty to be made under this Act in any of the cases before mentioned . . . it shall not be lawful to make any other

"deductions therefrom than such as are expressly enumerated "in this Act" The deduction claimed by the Appellants is not among those enumerated in the said statute.

The general purpose of the rules is to prohibit certain deductions being made from receipts, when profits are being ascertained for the purposes of Income Tax.

Provision is made in the rules for the deduction of loss connected with, or arising out of, the trade carried on. To be deductible, however, the loss must have been actually incurred. The deduction which the Appellants claim in respect of unexpired risks from the profits of each of the years coming into the average is estimated by the Appellants on yearly policies at $33\frac{1}{3}$ per cent. of the total premium income of the year, and in the case of monthly policies for the year 1904 at 50 per cent. of one month's premium income. These are mere arbitrary sums, being estimates of contingent losses. The Income Tax Acts make no provision for estimated or probable losses. They allow as deductions only actual losses incurred.

The profits of the Appellants were ascertained in the usual way by reference to their revenue accounts, that is, by subtracting the losses and expenses from the premiums and interest, &c., received by the Appellants during the year, and taking an average of three years. This is the method which has been invariably followed in the case of the Appellants.

The losses on the unexpired risks of any year are paid out of the income of a following year, and in calculating the profits of such following year a deduction is allowed in respect of such payments.

The Appellants do not specially appropriate any part of their revenue to a reserve for unexpired risks, nor do they charge any losses on unexpired risks to reserve fund.

The fair and proper mode of ascertaining the amount of net profits for the purposes of Income Tax is, it is respectfully submitted, to take on the one side the whole receipts and on the other the whole expenditure and disbursements for the given year, the balance remaining being net profits on which the tax should be ascertained.

This being done year by year, there is an absolute balance of accounts, and if any wrong has been done by losses afterwards occurring in respect of premiums on which, as profits, Income Tax has been assessed and paid, that is taken into consideration in the ensuing year.

The Respondent maintains that, in arriving at the amount of the assessable profits of the Appellants, the whole of the premiums received by the Appellants in any year ought to be taken into account as profits of that year, notwithstanding that the risks covered by a portion of such premiums may extend into a subsequent year, and that the Appellants are not entitled to make yearly the deduction claimed for unexpired

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risks; and the Respondent refers to the *Imperial Fire Insurance Company v. Wilson*, 1876, 35 L.T., 271, 1 T.C. 71, and *Scottish Union and National Insurance Company v. Inland Revenue*, 1889, 16 Session Cases, Fourth Series, 461 and 474, 2 T.C. 551.

The Respondent humbly submits that the judgment of the First Division appealed against ought to be affirmed, for the following among other

REASONS:

1. Because, on a sound construction of the Income Tax Acts, the Appellants are not entitled, in ascertaining for Income Tax purposes the annual profits of their business, to deduct the estimated losses on risks unexpired at the end of the year.
2. Because the Judgment appealed against is well founded in fact and in law.

ALEX. URE.

ROBERT MUNRO.

The case was argued before the House of Lords on the 19th and 20th March, 1908, when Mr. Danckwerts, K.C., Mr. Constable, and Mr. Beyfus appeared as Counsel on behalf of the Appellants and the Attorney-General (Sir W. Robson, K.C., M.P.), the Solicitor-General for Scotland (Mr. Alexander Ure, K.C., M.P.), and Mr. Munro appeared as Counsel on behalf of the Crown.

Judgment was delivered on the 8th April, 1908, in favour of the Crown.

JUDGMENT.

The Lord Chancellor.—My Lords, in this case the Appellants, a Fire and Accident Insurance Company, appeal against an assessment for Income Tax. The Commissioners arrived at the assessment by calculating income as the balance of receipts from premiums and other unquestioned sources over payments made in respect of losses and other unquestioned deductions. This balance they treat as the Company's income for each of the three preceding years, and thence derive the average for which they assess the Appellant Company in respect of the year 1905-6.

On the other hand the Company claim that an allowance should be made for unexpired risks in the way following. They say that 33 $\frac{1}{3}$ per cent. of the premiums received in any one year, say 1903, represents that part of the risk covered by such premium which runs on into the following year. Accordingly they seek to deduct from the gross income of, say 1903, 33 $\frac{1}{3}$ per cent. of the premiums received in that year because it really represents the money they earn for taking

risks which run on into 1904. But at the same time they add to the gross income of 1903, $33\frac{1}{3}$ per cent. of the premiums received in 1902, upon the ground that 1903 has in fact borne that proportion of the risks paid for in 1902.

Now, in my opinion, there is one sufficient reason for rejecting this contention. It is not found as a fact that $33\frac{1}{3}$ per cent. does represent the real value of the risks that run on into 1904 in respect of premiums received in 1903. I am not prepared to assume that it is so, for all the statement of the Commissioners that it is the practice of insurance companies to estimate $33\frac{1}{3}$ per cent. as the proper figure to represent that value. We are not told either for what purpose such an estimate is made, or that it corresponds with the reality. If I am to conjecture, I should incline to the view that this percentage is very far from the proper figure. For, if this estimate be accepted, then in the three years 1902, 1903, and 1904, taken together, the total profit of this Company, making certain deductions, was £15,338, whereas we know that, for its own purposes, the total profit, after the same deductions, was treated by the Company as £62,850, and dividends were paid and moneys carried to reserve on that footing.

During 32 years, since the decision of Wilson's case,⁽¹⁾ the method of assessing fire and accident companies has been that adopted by the Commissioners in the present case. It is not scientifically unassailable, for it obviously proceeds upon the supposition that the unexpired risks at the beginning and at the end of each year are in substance the same, or that, if an average of three years is taken, they are upon an average the same. But no method is scientifically unassailable that does not enter into an analysis of the contracts made and contracts current in each year so minute that it is in a business sense impracticable. I think the particular correction sought by the Appellants in this case is quite indefensible upon the materials before us, and further that the method adopted by the Commissioners is a good working rule in the present instance and generally. If in any particular case an insurance company can show it works hardship, no doubt the rule ought to be modified, so that the real gains and profits may be ascertained as near as may be. I am for dismissing this Appeal with costs.

Lord Ashbourne: My Lords, I concur with the Lord Chancellor.

Lord Macnaghten: My Lords, I think your Lordships would probably agree with Mr. Danckwerts in thinking that the present mode of assessing the profits of a fire insurance company for the purpose of the Income Tax is neither accurate nor scientific. But it has been established for a very long time. It is very simple, and it does not appear that in the long run

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it is productive of injustice. The alternative mode first proposed by the learned Counsel for the Appellants is certainly not more accurate. The enquiry afterwards suggested would, I think, be interminable. It is impossible to obtain anything approaching complete accuracy by any conceivable method.

In a somewhat similar case—it was a rating case—Mr. Justice Blackburn, delivering the Judgment of the Queen's Bench, after stating that the Court had endeavoured to lay down a rule more satisfactory than the one then in force, makes the following observations: "We have not, however, succeeded in laying down a rule which would be consistent with the existing legislation and decisions on this subject, and would at the same time be capable of being satisfactorily worked, and we are strongly impressed with the importance of not unsettling the law as established by past decisions where we cannot lay down a rule that is not open to exception." (12 Q.B.D.) I think there is much good sense in that observation, and I think it is apposite to the present case.

I think the Appeal must be dismissed.

Lord James of Hereford.—My Lords, I concur.

Lord Robertson.—My Lords, I concur.

Lord Atkinson.—My Lords, I agree.

Lord Collins.—My Lords, this is, in effect, an Appeal after 32 years from the decision of the Court of Exchequer in 1876 in the case of the *Imperial Fire Insurance Company v. Wilson*⁽¹⁾ (35 Law Times, page 271). In my opinion, the proposed method of taking the accounts of the insurance companies is open to the same objections that prevailed in that case, which has been acted upon in the interval. I am far from satisfied that it arrives at a result at all more approximately accurate than the less complex method suggested by the Legislature itself, and adopted by the Commissioners. I am of opinion, therefore, that the Appeal should be dismissed.

Questions put.

That the Order appealed from be reversed.

The Not Contents have it.

That this Appeal be dismissed with costs.

The Contents have it.

(¹) 1 T.C. 71.