No. 436.—IN THE HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—17TH AND 18TH JUNE AND 24TH JULY, 1919.

COURT OF APPEAL.—14TH AND 15TH APRIL AND 3RD MAY, 1920.

HOUSE OF LORDS.—4TH, 7TH, 8TH, 10TH, 11TH, 14TH AND 15TH MARCH AND 3RD JUNE, 1921.

(1) THE COMMISSIONERS OF INLAND REVENUE *v.* JOHN BLOTT.(1)

(2) THE COMMISSIONERS OF INLAND REVENUE *v.* BENJAMIN ISAAC GREENWOOD.(1)

Super-tax.—Total Income.—Shareholder in Limited Company is allotted fully paid-up shares in satisfaction of bonus declared by Company.—Finance (1909-10) *Act*, 1910 (10 *Edw.* 7. *c.* 8), *Section* 66 (2).

The Respondent in each of these cases was a shareholder in a Limited Company, which, under the authority of its Articles of Association, had declared a bonus out of its undivided profits and, in satisfaction of such bonus, had allotted to its shareholders as fully paid up certain ordinary shares forming part of the Company's authorised but unissued capital.

The shareholders had no option to receive cash in lieu of shares in satisfaction of the bonus.

Held (*Lords Dunedin and Sumner dissenting*), *that the shares credited to the Respondent in respect of the bonus, being distributed by the Company as capital, were not income in the hands of the Respondent, which he was required to include in his return of total income from all sources for the purposes of Super-tax assessment.*

CASES.

(I.)

STATED under the Finance (1909–10) Act, 1910, Section 72 (6), and the Taxes Management Act, 1880, Section 59, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a Meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 13th May, 1918, at Windsor House, Kingsway, London, W.C. 2, for the purpose of hearing Appeals, Mr. John Blott, of 38, Villiers Avenue, Surbiton (hereinafter called the Respondent), appealed against additional assessments to Super-tax in the sum of £500 for the year ending 5th April, 1916, and £750 for the year ending 5th April, 1917, made upon him under the provisions of the Finance (1909–10) Act, 1910, and subsequent enactments.

2. The Respondent is a shareholder in the Company of Hepburn, Gale and Ross, Limited (hereinafter referred to as the Company), being a company registered and established under the Acts relating to Public Companies. The

(1) Reported (K.B.D.) [1920] 1 K.B. 114; (C.A.) [1920] 2 K.B. 657; (H.L.) [1921] 2 A.C. 171.

Memorandum and Articles of Association of the Company are annexed to this Case, as is also a copy of a Special Resolution duly passed and confirmed at Extraordinary General Meetings of the Company held on 18th February, 1918, and 5th March, 1918.(1)

By the Company's Articles it is provided *inter alia* as follows :—

"Art. 50. The Company may from time to time, whether all the "shares for the time being authorised shall have been issued, or all the "shares for the time being issued shall have been fully called up or not, "by Special Resolution increase its capital by the creation and issue of "new shares, such aggregate increase to be of such amount and to be "divided into shares of such respective amounts as the Company by the "Special Resolution authorising such increase directs, but no shares "shall at any time be issued on terms which shall in any way prejudice "the preference given by these Articles to the original Preference Shares."

"Art. 123. The profits of the Company available for dividend shall "be applied first in payment of a fixed cumulative preferential dividend "at the rate of five per cent. per annum upon the amounts credited as "paid up on the First Preference Shares of the Company; secondly, in "payment of the dividend payable upon any further or other Preference "Shares, created or hereafter to be created by the Company in accordance "with the terms on which the same may be created and issued, and "subject thereto such profits shall be applied in payment of dividends "upon the amounts credited as paid up on the Ordinary Shares of the "Company."

"Art. 127. Any General Meeting declaring a dividend may direct "payment of such dividend wholly or in part by the distribution of specific "assets, and in particular of paid-up shares of the Company or paid-up "shares of any other company, and the Directors shall give effect to "such Resolution, and where any difficulty arises in regard to the distri- "bution, they may settle the same as they think expedient, and in par- "ticular may issue fractional certificates, and may fix the value for dis- "tribution of such specific assets, or any part thereof, and may determine "that cash payments shall be made to any members upon the footing "of the value so fixed, in order to adjust the rights of all parties, and may "vest any such specific assets in trustees upon such trusts for the persons "entitled to the dividend as may seem expedient to the Directors. Where "requisite, a proper contract shall be filed in accordance with Section 88 "of the Companies (Consolidation) Act, 1908, and the Directors may "appoint any person to sign such contract on behalf of the persons entitled "to the dividend, and such appointment shall be effective."

"Art. 128. The Directors may, before recommending any dividend, "set aside out of the profits of the Company such sum as they think proper "as a reserve fund, which shall at the discretion of the Directors be applic- "able for meeting contingencies, for the gradual liquidation of any debt "or liability of the Company, or for repairing or maintaining the works "connected with the business of the Company, or shall be as to the whole "or in part applicable for equalising dividends or for distribution by way "of bonus among the Members of the Company for the time being, on "such terms and in such manner as the Company in General Meeting "shall from time to time determine."

(1) Omitted from the present print.

3. The Company's accounts are made up to 31st December every year, and its profits are assessed to Income Tax.

For the year to 31st December, 1914, the Company made a profit of £58,851 10*s.* 10*d.*, which, together with the sum of £3,051 10*s.* 5*d.* carried forward from the previous year, made a total available for distribution of £61,903 1*s.* 3*d.* dividends on the Preference and Ordinary Shares in the Company amounting to £13,288 8*s.* 0*d.* were paid in cash out of this amount, £10,000 was placed to the credit of General Reserve Fund, and upon the recommendation of the Directors a bonus was also declared at the rate of 33⅓ per cent. on the Ordinary Shares, which the Directors were authorised to satisfy by the distribution of unissued Second Preference Shares of £1 each, credited as fully paid.

Under the Resolution of the Shareholders dated 8th February, 1915, no provision was made for the payment of the bonus in cash in any case except so far as such distribution would otherwise involve (which it did not in the Respondent's case) the issue of fractional Certificates for an amount less than £1. An Agreement dated 8th February, 1915, between the Company and Mr. Samuel Joseph Bradford, on behalf of the Shareholders, was entered into for the purpose of carrying out the distribution.

Similarly, for the year to 31st December, 1915, the Company made a profit of £249,091 14*s.* 6*d.*, which, together with the sum of £4,881 6*s.* 7*d.* carried forward from the previous year, made a total available for distribution of £253,973 1*s.* 1*d.* Out of this amount £75,000 was carried to General Reserve Fund, £25,500 was paid in cash as Dividends on Ordinary and Preference Shares, and Second Preference Shares of £50,000 (face value) were distributed under the terms of a Resolution dated 7th February, 1916, the distribution being carried out under an Agreement dated 10th February, 1916, between the Company and Mr. Charles Walker on behalf of the Shareholders.

Copies of the Directors' reports and accounts for the years 1914 and 1915, of the Resolutions dated 8th February, 1915, and 7th February, 1916, and of the Agreements dated 8th February, 1915, and 10th February, 1916, are annexed and form part of this Case. (1)

4. In the year ended 5th April, 1914, the Respondent received, as his share of the said distribution, shares of the face value of £500, and in the year ended 5th April, 1915, shares of the face value of £750. As these amounts had not been included in the first assessments made upon him to Super-tax for the years ending 5th April, 1916, and 5th April, 1917, the additional assessments which form the subject of this appeal were made in respect thereof.

At the hearing of the Appeal no question was raised as to the amount of the Assessment nor as to the value of the shares distributed, beyond a contention on behalf of the Respondent that the issue of additional shares to him in proportion to his existing holding automatically reduced the value of each individual share held.

5. In these circumstances Counsel on behalf of the Respondent contended—

(1) That by reference to the decision in the Case of *Bouch* v. *Sproule* (1887 12 A.C. 385) the distributions of shares must be treated as distributions of capital and not of income ;

(1) Omitted from the present print.

(2) That there had not been any actual payment by the Company of any sums receivable by the Appellant which were taxable for Super-tax within the meaning of the Finance (1909–10) Act, 1910, Section 66 (2) (d); and

(3) That by reference to previous decisions by the Special Commissioners of Income Tax the assessments should be discharged.

6. On behalf of the Commissioners of Inland Revenue it was contended (*inter alia*)—

(1) That the rule laid down in *Bouch* v. *Sproule* for the guidance of Trustees in distinguishing income belonging to persons with life interests from capital forming part of the corpus of the estate had no application in the present case;

(2) That a distribution of shares was a distribution of money's worth taxable for Super-tax; and

(3) That in the present case the rule of *Bouch* v. *Sproule* would not in any event apply, and that previous decisions of the Special Commissioners of Income Tax were therefore inapplicable.

7. We the Commissioners who heard the Appeal gave our determination as follows:—

"In our opinion the decision in *Bouch* v. *Sproule* where the point at "issue was as to the respective rights of a tenant for life and a remainder-"man, does not apply to the question *re* Supertax now to be determined "by us, the Appellant here not being a tenant for life.

"There have however been a number of appeals as the result of which "liability to Super-tax has been determined by applying the rule laid "down in *Bouch* v. *Sproule* to cases other than those of life interests.

"We are satisfied that in the present case that rule would deprive a "person with only a life interest of the right to receive the bonus shares, "and having regard to the grave inconvenience that would arise from "differing determinations by Special Commissioners upon the same point "we consider it our duty to follow the determinations already given by "our colleagues.

"We therefore discharge the two Additional Assessments appealed "against."

8. The Appellants immediately upon the determination of the Appeal declared to us their 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 Finance (1909–10) Act, 1910, Section 72 (6) and the Taxes Management Act, 1880, Section 59, which Case we have stated and do sign accordingly.

G. F. HOWE,
W. J. BRAITHWAITE,
} Commissioners for the Special Purposes of the Income Tax Acts.

Windsor House,
83, Kingsway,
London, W.C.2.

17th December, 1918.

(2.)

STATED under the Finance (1909–10) Act, 1910, Section 72 (6) and the Taxes Management Act, 1880, Section 59, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

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1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 12th of June, 1918, for the purpose of hearing Appeals, Mr. Benjamin Isaac Greenwood hereinafter called the Respondent, appealed against additional assessments to Super-tax in the respective sums of £1,089, £1,172, £1,344, and £1,388 for the years ending the 5th April, 1915, 1916, 1917, and 1918, made upon him under the provisions of the Finance (1909–10) Act, 1910, and subsequent enactments.

2. The only question which was raised at the appeal and on which the opinion of the High Court is desired is whether the value of certain ordinary shares in the Vulcan Foundry Limited, allotted as fully paid up to the Respondent in the circumstances herein stated in the years immediately preceding the respective years of assessment ought to be included in the computation of his total income from all sources under the provisions of Section 66 of the Finance (1909–10) Act, 1910. The value of these shares had not been included in the returns made by the Respondent or in the first assessments made upon him for the purposes of Super-tax, and the additional assessments against which appeal was made represented in each case the nominal value of the shares received by him in the previous year.

3. The Vulcan Foundry Limited (hereinafter referred to as the Company) is a company limited by shares, incorporated under the Companies Act, 1862, on the 27th August, 1864.

4. By the Company's Articles of Association it is provided, *inter alia*, as follows :—

"Art. 168. The Board may, before recommending any dividend, "set aside out of the funds of the Company such sum as it, in its absolute "discretion, shall think proper as a reserve fund or reserve funds for the "redemption of the Capital of the Company, for meeting contingencies, "or for equalising dividends, or for purchasing and leasing further lands, "houses, or property, or to comply with the requirements of any con- "cessions in which the Company may have any interest, or for providing "against losses or depreciation, or for new works, or for renewal of stock, "plant, or machinery, or to provide against bad or doubtful debts, or to "be used as a sinking fund to pay off the debentures, mortgages, bonds, "obligations or encumbrances of the Company, or to meet the depreciation in value of wasting property, or for any other purposes of the "Company. All moneys so set aside and all other moneys of the Company not immediately applicable for any payment to be made by the "Company, may, subject to the provisions of these presents with respect "to the purchase by the Company of its own shares, be invested by the "Board in such manner as the Board from time to time thinks proper. The "Board may from time to time carry such reserve fund or any part thereof "to capital account and may issue fully paid up shares in respect thereof "to the members, or to any class of members, according to their priorities "in proportion to their holdings, or may divide and appropriate such "reserve fund or any part thereof in specie amongst the members, or any "class of members, according to their priorities in proportion to their "holdings.

"Art. 170. The funds of the Company available for dividend in any "year shall be the sum declared by the Board in its absolute discretion "to be such, after setting aside such sum (if any) to reserve fund as it may in "its absolute discretion think fit, and out of such funds the Company "in general meeting may declare a dividend or bonus on the share capital "of the Company or otherwise deal with the same as may be determined. "All dividends shall (subject to any special conditions upon which any "shares may be issued and to the provisions herein contained in respect "of payment in advance of calls) be paid in proportion to the amounts "from time to time paid or credited as paid upon the shares of the Com- "pany, and according to the priority and respective rights and attributes "for the time being, if any, of the different classes of shares.

"Art. 171. Any General Meeting declaring a dividend or bonus may "direct payment of such dividend or bonus wholly or in part by the "distribution of specific assets and in particular of paid-up shares, deben- "tures or debenture stock of the Company, or in any one or more of such "ways, and the Directors shall give effect to such resolution, and where "any difficulty arises in regard to the distribution, they may settle the "same as they think expedient, and in particular may issue fractional "certificates and may fix the value for distribution of such specific assets "or any part thereof, and may determine that such cash payments shall "be made to any members upon the footing of the value so fixed, in order "to adjust the rights of all parties, and may vest any such specific assets "in trustees upon such trusts for the persons entitled to the dividend or "bonus as may seem expedient to the Directors. Where requisite a "proper contract or statement in lieu thereof shall be filed in accordance "with the Statutes, and the Directors may appoint any person to sign "any such contract on behalf of the persons entitled to the dividend, "and such appointments shall be effective.

"Art. 174. Every dividend after it is declared shall, subject to the "power to capitalise the reserve fund hereinbefore contained, forth- "with be paid to the person entitled thereto, in such manner as the Board "shall from time to time determine, and if more persons than one are "registered as the holder of a share payment to the person whose name "stands first on the register of members shall be sufficient."

5. The Company has year by year been charged to and paid Income Tax upon its profits, and has transferred the whole of those profits (excluding a reserve commenced to be formed in the year ending 30th June, 1913, now amounting to £50,000, for maintenance and renewals) to a Revenue Reserve Account, out of which all dividends have been paid. The Company had not distributed the whole of its profits by way of annual dividend, but it has on several occasions made bonus distributions to its ordinary shareholders of fully paid ordinary shares. The first of these distributions was made in the year 1909, and in the month of March in each of the five years from 1913 to 1917 inclusive the Company distributed new shares to its shareholders at the rate of one fully paid ordinary share for each ten ordinary shares held.

6. The method of distribution adopted, *e.g.*, in the year 1913, was as follows:—

At Directors' Meeting held on the 13th March, 1913, it was resolved that subject to the sanction of a General Meeting a bonus distribution of ten per cent. in Ordinary Shares to the Ordinary Shareholders out of the Revenue Reserve Account be made. At an Extraordinary General Meeting of the Company held on the 26th March, 1913, it was resolved

that the sum of £25,286 being part of the undivided profits of the Company standing to the credit of the Company's Revenue Reserve Account be distributed as a bonus amongst the holders of the Ordinary Shares of the Company in proportion to the Ordinary Shares held by them respectively, and that the Directors be authorised to allot and issue 25,286 of the unissued Ordinary Shares credited as fully paid, to the Holders of the outstanding Ordinary Shares in satisfaction of the said Bonus. At a Directors' Meeting held on the same date a resolution was passed for the allotment of the said 25,286 Shares accordingly. On the 15th April, 1913, a notice in the following terms was sent to the Shareholders :—

"The Vulcan Foundry, Limited,
"Finsbury Pavement House,
"London, E.C.
"15th April, 1913.

"To.....

.....

"SIR, OR MADAM,

"At an Extraordinary General Meeting of the Company held on 26th "March last it was resolved :—

"'That the sum of £25,286 being part of the undivided profits of the 'Company standing to the credit of the Company's Revenue 'Reserve Account be distributed as a Bonus amongst the 'holders of the Ordinary Shares of the Company on the Register 'on the 26th day of March, 1913, in proportion to the Ordinary 'Shares held by them respectively and that the Directors be 'and they are hereby authorised to allot and issue 25,286 of the 'unissued Ordinary Shares, credited as fully paid, to the 'holders of the outstanding Ordinary Shares in satisfaction of 'the said Bonus, such new Shares to be held upon the same 'terms and conditions respectively as the outstanding Ordinary 'Shares in respect of which they are allotted are held and to be 'allotted as nearly as may be in proportion to the number of 'Ordinary Shares held by them respectively (with full power 'to make such provision by the issue of fractional Certificates 'or otherwise as they think expedient for the case of fractions). 'And further that the secretary be authorised to sign on behalf 'of the Company any necessary returns required by the provi- 'sions of the Companies' Acts.'

"You are registered the holder of Ordinary Shares and, in "pursuance of the above Resolution, the Board has therefore allotted to "you Ordinary Shares credited as fully paid, the certi- "ficate for which I enclose herewith.

"Kindly sign and return the enclosed form of receipt.

"Yours faithfully,
"C. V. HICKS,
"Secretary."

The same course was followed in making the distributions in each of the years 1914, 1915, 1916 and 1917.

7. The balance of undivided profits standing to the credit of the Company's Revenue Reserve Account at the 30th June, 1912, amounted to £117,864 10*s.* 3*d.* of which £27,757 was distributed in dividends for the year ended on that date. A profit of £63,101 8*s.* 10*d.* was transferred to the Revenue Reserve Account from the Revenue Account for the 12 months ended 30th June, 1913, and interest amounting to £4,505 was credited to the Revenue Reserve Account for the same period of 12 months. The profit shown by the Revenue Account for this period, and for each of the years ended respectively the 30th June, 1914, 1915 and 1917, was sufficient to pay the cash dividends for the year, and to cover the amount of the bonus distributed in fully paid Shares within the year, but for the year ended the 30th June, 1916, the profit shown by the Revenue Account for this period was not by itself sufficient but with the interest credited to the Revenue Reserve Account was only insufficient for both purposes by the sum of £1,331 12*s.* 0*d.* On no occasion was the Company in possession of a cash balance at the time of the authorisation or of the making of the bonus distribution of fully paid shares sufficient to pay the bonus in cash, but it was admitted that by realising investments, sufficient cash for this purpose might have been obtained. On some occasions the cash balance at the 30th June, when the Company's annual balance sheet was prepared, exceeded the amount which would have been required to pay in cash the bonus authorised in the preceding March.

8. Copies of the following documents are attached to and form part of this Case (1) :—

Memorandum and Articles of Association of the Company adopted by Special Resolution confirmed on the 19th March, 1909, and the Special Resolutions of the Company in force on the 20th March, 1909.

Resolutions passed at the Directors' Meetings held on the 13th March and 26th March, 1913.

Notice convening the Extraordinary General Meeting of the Company held on the 26th March, 1913.

Notice informing the shareholders of the Resolution passed at that Meeting and of the allotment of the shares in conformity therewith.

The corresponding resolutions and notices relating to the bonus distributions in the years 1914, 1915, 1916 and 1917.

Reports of the Directors and Statements of Accounts of the Company to 30th June, 1913, 30th June, 1914, 30th June, 1915, 30th June, 1916, and 30th June, 1917.

9. The Respondent was a holder of Ordinary Shares in the Company, and in accordance with the above-mentioned Resolutions Ordinary Shares credited as fully paid were allotted to him as under :—

In March, 1914	..	..	..	1,089	one pound	shares
In March, 1915	..	..	..	1,172	,,	,, ,,
In March, 1916	..	..	..	1,344	,,	,, ,,
In March, 1917	..	..	..	1,388	,,	,, ,,

10. It was contended on behalf of the Respondent that he had received Capital and not Income, that the question was as to the intention of the Company in making the distributions, and that the facts showed that the Company had transferred reserve funds to capital account and intended to distribute and had distributed capital and not income, that the shareholders had at no time any right to money payment even if cash had been available

(1) Omitted from the present print.

or to anything except a proportional share of the increased capital of the Company, and that the interests of the Shareholders in the assets of the Company had not been increased by the distribution made ; and it was further contended that there was no distinction between cases where the shareholder was absolutely entitled and cases where he had only a life interest in the shares allotted and that on the principle laid down in *Bouch* v. *Sproule* (1887) 12 A.C. 385, the shares in the Company distributed by way of bonus must be regarded as and were capital in the hands of the recipients, and not income, and that consequently they should not be taken into account in computing the Respondent's income for purposes of Super-tax.

11. On behalf of the Crown it was contended, *inter alia*

(*a*) that in the present case the Company had not capitalised a reserve fund and made a distribution of capital among its shareholders, but had declared a dividend payable in shares, and the shares distributed would not as between tenant for life and remainderman be capital under the principle laid down in *Bouch* v. *Sproule* ;

(*b*) that the decision in *Bouch* v. *Sproule* and other similar cases in which questions arose between life tenant and remainderman do not affect the question of liability to Super-tax in a case where accumulated profits of a Company are distributed in the form of shares to a person who thereupon becomes entitled to them absolutely.

(*c*) that the shares distributed to the Respondent represented income chargeable with Income Tax by way of deduction and receivable by him in the year in which the distribution was authorised, and should be included in the computation of his total income from all sources for the purposes of Super-tax for the following year.

12. We, the Commissioners who heard the appeal, were of opinion that on the principle laid down in *Bouch* v. *Sproule*, the Shares distributed by the Company would, as between life tenant and remainderman, fall to be treated as capital. Although it does not, in our opinion, necessarily follow that the same considerations would apply in the determination of the question of a claim by the Crown to Super-tax where, as in the present case, the recipient of the shares is entitled to them absolutely, the result of a number of previous appeals has been that liability to Super-tax has been determined by applying the principle laid down in *Bouch* v. *Sproule* to cases other than those of life interests, and having regard to the grave inconvenience that would arise from a diversity of practice we considered it our duty to discharge the additional assessments.

The representative of the Crown immediately upon the determination of the Appeal declared to us his 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 Finance (1909–10) Act, 1910, Section 72 (6), and the Taxes Management Act, 1880, Section 59, which Case we have stated and do sign accordingly.

P. WILLIAMSON,
W. J. BRAITHWAITE, } Commissioners for the Special Purposes of the Income Tax Acts.

Windsor House,
83, Kingsway,
London, W.C.2.
10th January, 1919.

The cases were heard together before Mr. Justice Rowlatt on the 17th and 18th June, 1919, when judgment was reserved.

The Attorney-General (Sir Gordon Hewart, K.C., M.P.), the Hon. Frank Russell, K.C., and Mr. T. H. Parr appeared as Counsel for the Appellants; Sir John Simon, K.C., and Mr. A. M. Latter as Counsel for Mr. Blott, and Sir John Simon, K.C., Mr. A. C. Clauson, K.C., and Mr. A. M. Bremner on behalf of Mr. Greenwood

Judgment was delivered on the 24th July, 1919, in favour of the Respondents, with costs.

JUDGMENT.

Rowlatt, J.—This was an appeal by the Commissioners of Inland Revenue from a decision of the Special Commissioners holding, shortly stated, that the Respondent was not answerable to Super-tax in respect of a certain bonus allotment of shares. The shares in question, which before their distribution to the Respondent and his fellow shareholders had been authorised but unissued shares, were allotted fully paid-up in satisfaction of a bonus declared out of the profits of the current year. The Company by their Articles had power to do this. The machinery adopted was that the bonus was declared and the shareholders, by an agreement executed on their behalf by a representation appointed for that purpose by the Directors under powers conferred by the Articles, accepted the shares fully paid up in satisfaction of the bonus. The shareholders had no option to receive the bonus in cash. This procedure was followed with no appreciable difference in form, and certainly with none of substance, in two successive years, to both of which the appeal relates.

Under these circumstances it was held by the Special Commissioners, and it seems to me manifest (nor did the Attorney-General dispute it at the bar) that the Company, having the power to do so, made the assets resulting from the profits of the year, against the retention of which this bonus was declared, capital of the Company, and that in any question between tenant for life and remainderman the bonus and the shares representing it would be capital in accordance with the principles laid down in *Bouch* v. *Sproule* (1887 12 App. Cas., 385), and the other authorities. But it was said that, the original shares being the absolute property beneficially of an individual, the bonus forms an item on which he is answerable to Super-tax. It is to be observed that the figure on which he had been assessed was the face value of the shares, and it is stated in the case that at the hearing of the appeal no question was raised as to the amount of the assessment nor as to the value of the shares distributed, beyond a contention on behalf of the Respondent that the issue of the additional shares to him in proportion to his existing holding automatically reduced the value of each individual share held. Similarly, in the arguments before me, the case put for the Revenue was that the bonus declared, which was of the same amount as the face value of the shares, became upon declaration income of the Respondent liable to Super-tax, and that the satisfaction of such bonus by the allotment of shares did not alter that position. It was, however, correctly pointed out by the Attorney-General that the amount of the bonus cannot be the correct sum upon which the Respondent should be assessed, because Income Tax paid by the company on the profits before division has to be added. The true amount to be brought into the Respondent's Super-tax assessment (if anything) would, therefore, be such a sum as after deduction of Income Tax would yield, as a net sum, the amount of the bonus. Subject to this correction, the question is whether the bonus declared was income assessable to Super-tax.

By Section 66 (2) of the Finance (1909–10) Act, 1910, the income of an individual for Super-tax purposes is his total income from all sources as it would be estimated for the purpose of exemption or abatement under the Income Tax Acts. That sends us to the Act of 1842. By virtue of Sections 40 and 54 of that Act, every corporation, fraternity, fellowship, company or society, corporate or not corporate, was answerable to Income Tax on the collective profits or gains. Under Section 100, Schedule D, 1st and 2nd Cases, Rule 3, trading partnerships were also so assessable. Co-partners, joint tenants and tenants in common of land and partners in the occupation of land were also necessarily so assessable under Schedules A and B. The dividends or drawings of corporators, shareholders, partners, joint tenants and the like were not again taxable as a new subject matter. Corporators or shareholders bore their share of the tax by the deduction of such share (*i.e.*, a share of the collective tax, not an individual tax) from their dividends under the express authority of Section 54. Partners and the like also necessarily bore their share by the diminution through the tax of the divisible fund. It does not matter (except in the case of fixed or preferential dividends) whether the deduction of tax is expressly made or whether the distribution is said to be tax free. In either case no more can be divided out of profits than the tax collector has left to divide, and where a dividend is declared tax-free the truth is that the dividend is such larger sum as after deduction of tax will leave the net sum which is described as the tax-free dividend. At least, this is the way in which the matter has always been looked at for the purpose of computing individual incomes whether for the purpose of exemption or of Super-tax.

For the main purpose of the assessment and collection of Income Tax, therefore, the Act regarded solely the collective profits and gains. When, however, it came to deal with exemptions in respect of individual incomes it was necessary to segregate those incomes and it is important to see how this was provided for in the several cases. In the case of trading (including professional) partnerships, it was enacted by a proviso to the rule already quoted that a partner claiming exemption might declare the proportion of his share and be separately assessed accordingly. His income for the purposes of exemption was, therefore, his proportion of the collective taxable profits of the partnership. His actual or permissible drawings were wholly irrelevant. This proviso (in order, as was explained to me upon the argument, to avoid the formality of a separate assessment) is now replaced by a Section (Section 20 of the Finance Act, 1907) which provides that, for the purpose of exemption and the like, the income of an individual partner from the partnership may be treated separately. The change from the precise language of 1842 to the loose word "income" perhaps not unnaturally gave rise to litigation, but it has been held by my brother Horridge in *Gaunt* v. *Commissioners of Inland Revenue* (1) ([1913] 3 K.B. 395) that the share of the partner in the collective profits, and not, as was contended, his drawings, is still the figure to be looked for. So much for the case of partners. In the case of joint tenants and the like the principle was the same, it being provided by Section 168 that they might claim exemption according to their respective shares and interests.

Turning now to the case of corporate bodies, and societies whether corporate or not, we find a marked difference. No individual corporator or shareholder, either by the formality of a separate assessment or without such

(1) 7 T.C. 219.

formality, can treat himself as having been individually taxed upon a proportion of the total collective gains corresponding to his own interest in the corporate concern, and he cannot, therefore, get allowed to him by exemption or return, the tax paid by the corporation in respect of such proportion. There is no special direction for the calculation of the individual income of a corporator or shareholder. It is clear, however, that it is to be measured by his dividends. The only way that he can make the provision for exemption apply to his case is by bringing in his dividends among his " particular sources of income " under Section 164, and then, treating them as diminished by the collective tax in the way already described, obtain a refund under Section 165 as a person who " has been charged to and has paid " duty " by way of deduction from any rent, annuity, interest, or other annual payment ". Of course, before he can do this, he must add to his actual dividend the proportion of the collective tax relating thereto and bring the total into the account of his aggregate income in order to show that such aggregate is low enough to entitle him to the exemption. I have said advisedly the collective tax, because if the profits made by the company and taxed in their hands are not divided in that year but are carried forward and divided in a subsequent year when the rate of tax is different, I know of no provision (and I do not overlook Section 66 (2) (*d*) of the Finance (1909-10) Act, 1910) which either obliges or entitles the shareholder to treat his dividend as having suffered a deduction (whether described as having done so or not) at the rate obtaining in the year of distribution. If he could, he might, if the Income Tax had risen, recover back more than the Revenue had received. This situation may in some cases, if an accurate calculation is to be achieved, occasion great difficulties. I need not, however, go into them in this particular case. For the present purpose all that is necessary—and that has been the object of what I fear has been a somewhat trite recital—is to bring out clearly that, in order to estimate for the purpose of exemption the income of an individual from company shares, all that the Act of 1842 gives one to go upon is the " annual payment " derived by the shareholder from his holding. I lay no stress of course upon the word " annual ". A dividend for the year is annual for this purpose though only paid once. What I do lay stress on is that one has to look for a " payment ". Now I do not think that there is a payment of a dividend to a shareholder unless a part of the profits of the company is thereby liberated to him in the sense that the company parts with it and he takes it. If in this case the Company could have found means to capitalise their profits and divide them as capital without adopting the machinery of declaring a bonus and allotting shares by agreement (not, be it observed, a voluntary agreement) in satisfaction of such bonus, I do not think the case would have been arguable. I am asked to decide that there was a payment of this bonus upon the strength of what I consider bare machinery. I cannot do so. The fact is simply that the shareholder was given shares instead of a bonus. The Sections of the Act of 1842, to which we are remitted for Super-tax purposes, dealt with the computation of income for exemption purposes, and it is at least permissible to look at this case as if it had arisen in that connection. Suppose this bonus share distribution had taken place, as no doubt many such did take place, a dozen years ago, before the introduction of Super-tax, and one of the shareholders being a person of small income, within the exemption limit, had sought to recover Income Tax on the amount of the face value of his bonus shares. Would not the Revenue have justly objected that he had not, in the language of Section 165, been charged to, nor had he paid, duty " by way of deduction from any rent, annuity,

interest, or other annual payment" ? They would have said, in my judgment unanswerably, that the company had never parted with the money and that he had never received any payment out of which any deduction such as that he sought to recover could take effect.

I was properly pressed in the course of the argument with the case of the *Swan Brewery* ([1914] A.C. 231). There it was held that a shareholder receiving bonus shares, as in the present case, was receiving an "advantage" within the meaning of a highly artificial definition of the word "dividend" in a Colonial Act notwithstanding that his proportionate interest in the assets of the company remained the same after the transaction as it had been before. It was further recognised that such advantage was the same as that which he would have received, if he had been paid the bonus in cash and expended it in subscribing for the new shares. Here the question is whether he has been paid, and in my opinion the decision has but little, if any, bearing.

For these reasons, I am of opinion that the Appeal of the Commissioners must be dismissed with costs and, as the decision disposes also of the case of the Commissioners and Greenwood, the result will be the same in that case.

Notice of Appeal against the decision of Mr. Justice Rowlatt having been given, the cases were heard together in the Court of Appeal on the 14th and 15th April, 1920, before the Master of the Rolls (Lord Sterndale) and Warrington and Scrutton, L.JJ., when judgment was reserved.

The Attorney-General (Sir Gordon Hewart, K.C., M.P.), Mr. J. H Cunliffe, K.C., Mr. T. H. Parr and Mr. R. P. Hills appeared as Counsel for the Appellants, Sir John Simon, K.C., and Mr. A. M. Latter as Counsel for Mr. Blott, and Sir John Simon, K.C., Mr. Clauson, K.C., and Mr. A. M. Bremner on behalf of Mr. Greenwood.

Judgment was delivered on the 3rd May, 1920, in favour of the Respondents, with costs, confirming the decision of the Court below.

JUDGMENT.

The Master of the Rolls.—The facts of this case so far as it is necessary to state them are as follows. The Respondent, Mr. Blott, is a shareholder in a company called Hepburn, Gale and Ross, Limited, which I shall call the Company, and the question to be decided is whether he is assessable to Super-tax in respect of an allotment of what were called bonus shares in the Company. The Company had by its Articles power to increase its capital and to distribute its profits in the usual way, including a distribution of paid-up shares in that or any other company. It had also the usual power to create reserve funds.

In the year 1914 the Company had available for distribution, including a small carry-over, £61,903 1s. 3d. After carrying £10,000 to the general reserve fund and paying a dividend on the Preference and Ordinary Shares, a bonus of 33⅓ per cent. was, on the recommendation of the directors, declared, such bonus to be satisfied by the distribution amongst the shareholders of shares in the Company credited as fully paid up. The actual report and resolution was as follows:—"It will be appreciated while the "Company has heavy commitments which call for all its available capital, "it would be unwise to make any exceptional distribution; the Directors "therefore propose to pay the usual dividends of 5 per cent. on the First "Preference Shares (of which 2½ per cent. had already been paid) of 6 per

"cent. on the Second Preference Shares (of which 3 per cent. has already "been paid), and 10 per cent on the Ordinary Shares, all less Income Tax. "This will absorb £13,288 8s., leaving £38,614 13s. 3d. In addition it is pro- "posed to declare a further dividend to the Ordinary Shareholders to be "satisfied by the allotment of one Second Preference Share fully paid for "every three Ordinary Shares held by them which will absorb £33,333, leaving "£5,281 to be carried forward subject to the usual sums voted to the Directors "at the Annual Meeting."

The resolution by which that was carried out is in these terms: "Re- "solved: That it is desirable to capitalise the sum of £33,333 6s. 8d., being "part of the undivided profits of the Company, and accordingly that a bonus "at the rate of 33⅓ per cent. per share free of income tax on each of the "issued Ordinary shares of the Company be and the same is hereby declared "and that the Directors be and they are hereby authorised to satisfy such "bonus by the distribution among the members holding Ordinary shares "rateably of 33,316 of the unissued Second Preference Shares of £1 each in "the Company credited as fully paid in satisfaction of such bonus."

It will be noticed that the resolution does not use the word "dividend" which occurs in the report, but I do not think much importance is to be attributed to that fact. The actual resolution calls it a "bonus".

A similar bonus was declared in respect of the profits of the year 1915, the only difference being in the amount of the profits and the number of shares.

By reason of these resolutions the Respondent received in respect of the years 1914–15 shares of the face value of £500 and £750 respectively.

The allotment of the shares was carried out by an agreement between the Company and a Mr. Charles Walker on behalf of the shareholders.

The Crown sought to assess the Respondent on the face value of the shares, and on the argument before Mr. Justice Rowlatt and before us it was pointed out that there should be added to that face value the proportion of the Income Tax paid by the Company on the profits before division. In fact, by such an allotment a shareholder does not receive the face value of the shares allotted. To take a simple case; if the capital of the company be doubled and the half newly created allotted to the shareholders, the result is that the profits have to be divided amongst twice the amount of shares and the benefit to the shareholder remains the same as before. Probably, in theory, the value of the shares originally held and those allotted would be half that of the former, but practically that is not always the case, and the value of the shares allotted depends not only upon the extent to which they participate in profits, but upon the prospects of the company and the state of the money market. In the case of *Bouch* v. *Sproule* (12 A.C., 385), to which reference will be made later, it was stated that, on the issue of £7 10s. shares fully paid, the original shares fell to £7. I do not mention these facts merely to question the amount of the assessment but to show the principle upon which it proceeds, *i.e.*, that the allotment of shares must be regarded as a cash payment of the face value of the shares, regarding as immaterial the fact that the shareholder never does receive any cash and can only obtain fully paid shares, increasing the capital of the company and decreasing the participating value of the shares. In other words, the Crown contend that the Respondent must be treated as if he had received the two sums of £500 and £750, and had then been free to spend them as he liked in buying shares in this or another company, Government securities or land or anything else or not to invest them at all but spend them in his own amusements.

It seems to me that he is obviously not in fact in this position, and the question is whether he is to be considered to be so in law.

In my opinion, it has been decided by the House of Lords in the case of *Bouch* v. *Sproule* (1) that he is not. In that case bonus shares in a company were allotted in circumstances similar to those in this case. They were, as here, stated to be allotted as dividend and the only difference in the circumstances was that in that case the shareholder had an option whether he would take the allotted shares or the dividend. This, however, was disregarded by the House of Lords because, although the shareholder had legally an option, the circumstances of the case made it only a nominal one, for the shares were worth so much more than the dividend that there was no real option at all. The case, therefore, in my opinion, was indistinguishable in principle from the present. The House of Lords held that, when a company has the power of distributing or capitalising its profits, that company has the decision as to whether the shares issued shall be dividend or capital. This was also held by Mr. Justice Neville *In re Evans* ([1913], 1 Ch. 23, 30 and 31) and in the Court of Appeal *In re Thomas* ([1916], 2 Ch. 331). Lord Herschell's words seem to me to be exactly applicable to this case. He said: "I cannot "therefore avoid the conclusion that in substance the whole transaction was "and was intended to be to convert the undivided profits into paid up capital "upon newly created shares and the form in which the operations were founded "points in the same direction." Lord Watson also at page 404 said: "I am "unable to resist the conclusion that in adopting the scheme recommended by "the directors the company must have intended that each shareholder should "get an allotment of new shares, and that the money declared as dividend, "which was not in the coffers of the company and did not exist in a form "available for distribution, should not be paid to the shareholder, but should "simply, by means of an entry in the company's books, be imputed in payment "of the call of £7 10s. upon each new share."

It was argued for the Crown that this decision turned upon the relationship of tenant for life and remainderman and was not of general application. It is true that the question in that case was whether the shares allotted belonged to the tenant for life or the remainderman, and the House of Lords, after holding them to be capital and not income, applied that decision to the rights of those parties, but I cannot see that their determination on that depended in any way on the relationship to which they had to apply it.

I have, however, felt great difficulty about the case of the *Swan Brewery Company* v. *The King* ([1914], A.C. 231), where Lord Sumner, delivering the judgment of Lord Moulton, Lord Parker of Waddington and himself, said that in a transaction similar to this the shares in ordinary language would not be called a dividend nor would the allotment of them be the distribution of a dividend; but, in another part of his judgment, that both in business and in law the shareholder received so much dividend out of undivided profits and then used it in paying up the new shares. The actual decision was upon the special words of a Colonial Act containing, what Mr. Justice Rowlatt calls, a highly artificial definition of the word "dividend" and the learned Judge distinguished the case on that ground.

Lord Sumner also stated that the question turned merely on the construction of a particular Act and the case may be distinguishable from *Bouch* v. *Sproule* on that ground; but I find it very difficult to reconcile the reasoning of the two cases. If, however, they cannot be reconciled, I consider that we are bound to follow *Bouch* v. *Sproule*.

(1) [1887] 12 A.C. 385

I think the appeal should be dismissed with costs. In the case of *Commissioners of Inland Revenue* v. *Greenwood*, it is admitted that this case is not distinguishable in principle from that just decided and this appeal must also be dismissed with costs.

Warrington, L.J.—The question in these two cases, *The Inland Revenue Commissioners* v. *Blott* and *The Inland Revenue Commissioners* v. *Greenwood*, is whether the Respondents respectively are liable to be assessed to Super-tax in sums equal to the nominal value of certain shares issued by way of bonus by companies of which they were respectively members.

I propose to state shortly the facts in Blott's case, and my view on the law applicable thereto.

The Respondent, Blott, was, at the material times, a shareholder in Hepburn, Gale and Ross, Limited, which I will call the Company. I do not propose to repeat here the terms of the Articles of Association relevant to the question; it is enough to say that the action of the Company and the directors hereinafter mentioned was in every respect within the authority of the Articles. The accounts of the Company are made up to the 31st December in each year.

For the year ending the 31st December, 1914, the accounts showed a net profit (including £3,051 10s. 5d. carried forward from the previous year) of £61,903 1s. 3d. Of this sum, £10,000 was carried to the credit of the General Reserve Fund and £13,288 8s. was distributed in dividends. In their report accompanying the accounts, the directors inserted a paragraph in which they say: "It will be appreciated while the Company has heavy commitments "which call for all its available capital, it would be unwise to make any "exceptional distribution; the Directors therefore propose to pay the usual "dividends"—specifying them, and they proceed: "In addition it is proposed "to declare a further dividend to the ordinary shareholders to be satisfied by "the allotment of one Second Preference Share fully paid for every three "Ordinary Shares held by them."

The directors thus express their intention of not making an exceptional distribution of profits but of using the profits over and above the amount of the usual distribution to increase their capital in view of the heavy commitments of the Company.

The annual meeting of the Company for the consideration of the report and the declaration of dividends, and so forth, was held on the 6th February, 1915. A declaration of the usual dividend was made, as recommended by the directors, and the following resolution was then passed: "That it is "desirable to capitalise the sum of £33,333 6s. 8d., being part of the "undivided profits of the Company, and accordingly that a bonus at the rate "of 33⅓ per cent. per share free of Income Tax on each of the issued Ordinary "Shares of the Company be and the same is hereby declared, and that the "Directors be and they are hereby authorised to satisfy such bonus by "the distribution among the members holding Ordinary Shares rateably "of 33,316 of the unissued Second Preference Shares of £1 each in the "Company credited as fully paid in satisfaction of such bonus." It will be seen that the resolution emphasises the intention to capitalise the undivided profits, and substitutes the word "bonus" for the word "dividend" used in the Directors' Report.

By an agreement dated the 8th February, 1915, made between the Company of the one part and a shareholder properly acting on behalf of himself and all other ordinary shareholders of the other part, and duly filed with

the Registrar of Joint Stock Companies, it was agreed that the Company should allot and issue the shares mentioned in the resolution, that they should be credited as fully paid up and should be accepted in satisfaction of the said bonus.

The Respondent, Blott, duly received, prior to the 5th April, 1915, 500 £1 Preference Shares credited as fully paid up as his proportion of the bonus. Precisely the same thing happened in the next year except that the profits were larger and 20 per cent. dividend was paid on the Ordinary Shares, and the bonus was at the rate of 50 per cent. instead of 33⅓ per cent. The Respondent, prior to the 5th April, 1916, received an allotment of 750 Second Preference Shares of £1 each credited as fully paid in satisfaction of the bonus.

The Commissioners sought to include in his total income for the purposes of Super-tax, the sum of £500 as income of the year ending the 5th April, 1915, and the sum of £750 as income of the year ending the 5th April, 1916, treating those sums as dividends invested by the recipient in the Second Preference Shares. To be logical, the Commissioners on their view of the position, should have charged the Respondent with an additional sum representing Income Tax, but they have not done so and I do not think the omission alters the legal position.

These being the material facts, I now turn to the law. Super-tax was imposed for the first time by the Finance (1909–10) Act, 1910. The tax is charged in respect of the income of an individual the total of which from all sources exceeds a certain sum, and it is charged by the name and description of " an additional duty of income tax in this Act referred to as a super-tax ". It is further provided that the total income from all sources shall be taken to be the total income from all sources for the year previous to the year of assessment estimated in the same manner as the total income from all sources is estimated for the purposes of exemptions or abatements under the Income Tax Acts. It is, I think, unnecessary to refer to the provisions of the last-mentioned Acts in any detail. For the purposes of both Acts it is income and income only which is brought into charge, and the Commissioners accordingly have to make out in the present case that the £500 and £750 respectively are income of the year preceding the year of assessment.

The scheme of the Income Tax Acts with regard to companies and their shareholders is that the company is assessed on the total amount of its profits. This was done in the present case and the tax was paid and the shareholder when paid his dividend is bound to allow thereout a proportionate deduction in respect of the duty so charged (see Income Tax Act, 1842, Section 54). For the purpose of exemption or abatement the claimant is required to make a declaration in the prescribed form of, amongst other things, the particular sources from which his income is derived and the particular amount arising from each such source. The form is prescribed by Section 190, Schedule (G), Rule XVII. The material portion is the second paragraph, viz., " Declaration " of the amount of rents, interests, annuities, or other annual payments, " for which the party is liable to allow and deduct the duty."

It will thus be seen that another element is added to the description of that which is liable to the Super-tax. The subject matter is not only to be income but " payments ". Did the Respondent, Blott, in the several years in question, receive that on which he has been assessed as a payment by way of income? On the facts, I think it is clear that as between the Company and its shareholders the same conclusion must be arrived at as that

at which the House of Lords arrived in *Bouch* v. *Sproule* (12 A.C., 385) as expressed by Lord Herschell at page 399 :—" The Company did not pay " or intend to pay any sum as dividend but intended to and did appropriate " the undivided profits dealt with as an increase of the capital stock in the " concern." There was, in the present case, not even an option in form given to the shareholders of receiving the bonus in cash. The intention of the Directors is clearly shown by them in the passage quoted above from the report for the year 1914, and that of the Company by the opening words of the resolution on each occasion. It is material also to bear in mind that at the material dates the Company had no power under their Articles directly to capitalise profits. This could only be effected by the machinery to which they resorted, and in my opinion the declaration of the bonus was in each case mere machinery for carrying into effect the desire of the company to capitalise part of the undivided profits.

It is said that in *Bouch* v. *Sproule* the question arose as between a tenant for life entitled to income, and remainderman entitled to capital under the will of a testator of whose estate the shares in question form part, and that the principle of the decision is inapplicable to the present case. I confess I am unable to see the distinction. In this case, as in the other, the question is whether the bonus shares are to be treated as a dividend and therefore income, or as an accretion to capital. The question according to the view of the House of Lords, is one of fact, and the fact to be ascertained is the real intention of the company. This seems to me to determine the nature of the transaction between whatever parties the question may arise. I think, therefore, that these bonus shares were not income of the Respondent. Further, I agree with Mr. Justice Rowlatt that there was in this case no " payment " such as is mentioned in Schedule (G), Rule XVII. I cannot express my views better than in the words of the learned judge : " I do not think that there is a pay- " ment of a dividend to a shareholder unless a part of the profits is thereby " liberated to him in the sense that the company parts with it and he takes " it." There was clearly no such liberation of any part of the profits in the present case. Of course, I do not mean to say that no payment can be made except in money. It may well be that if the profits or part of them were represented by tangible assets the transfer of a part thereof in kind to a shareholder by way of dividend would be a payment of dividend. In fact, this point was conceded by the Respondent in argument and nothing I have said must be so construed as to negative such a view.

Much stress was rightly laid by Counsel for the Crown upon the reasoning of the judgment of the Privy Council in *The Swan Brewery Company* v. *The King* ([1914] A.C. 231). The members present were Lord Moulton, Lord Parker, and Lord Sumner, the judgment being delivered by Lord Sumner ; it is therefore of the highest authority. The decision itself was on the construction of an Act of Western Australia imposing on a company declaring a dividend a duty on the amount or value of such dividend and providing that " dividend " should include " every dividend, profit, advantage " or gain intended to be paid or credited to or distributed among any " members or directors of any company except the salary or other ordinary " remuneration of directors." The appellant Company had increased its capital by the creation of new shares and the transfer of the accumulated profits of the nominal amount of the new shares to the credit of the share capital account, and had allotted such new shares amongst the shareholders *pro rata*. It was held that the Company had in effect declared a dividend within the meaning of the Act equal to the nominal amount of the new shares.

Obviously, therefore, the question for decision was far away from that in the present case. The discussion both in argument and in the judgment was mainly on the question whether there was any " advantage " to anybody in the mere transfer of accumulated profits to capital and the allotment of shares representing the capital; but at the end the judgment contains the following passage :—" In business, as in contemplation of law, there were " two transactions, the creation and issue of new shares on the company's " part, and on the allottees' part the satisfaction of the liability to pay for " them by acquiescing in such a transfer from reserve to share capital as put " an end to any participation in the sum of £101,450 in right of the old shares, " and created instead a right of general participation in the company's " profits and assets in right of the new shares, without any further liability " to make a cash contribution in respect of them. In the words of Chief " Justice Parker, 'Had the Company distributed the £101,450 among the " 'shareholders and had the shareholders repaid such sums to the Company " 'as the price of the 81,160 new shares, the duty on the £101,450 would " 'clearly have been payable. Is not this virtually the effect of what was " 'actually done? I think it is.'" It was admitted in the argument (page 233) that *Bouch* v. *Sproule* and cases of that nature were inapplicable to the case under discussion, and I can hardly think that Lord Sumner intended by the expressions he used, to express a view of his own or to approve of a view of the Chief Justice which would conflict with that expressed by Lord Herschell in *Bouch* v. *Sproule*.

On the whole, I agree with the judgment of Mr. Justice Rowlatt on this point as on the rest of the case. The appeal fails and must be dismissed.

The facts in Greenwood's case, so far as they are material to the decision, are different from those in Blott's case only in this, that the Company there had power directly to capitalise profits, and the bonus declared by them was in the form of so many shares as fully paid, and there was no necessity for agreements such as those which in Blott's case were made and filed. It was admitted that the same principle must be applied in both cases. The appeal in Greenwood's case, therefore, also fails.

Scrutton, L. J.—These two cases raise the important question whether shareholders in a company who have received, in the year of assessment, bonus shares in the company fully paid up by use of undivided profits of the company are bound to return to Super-tax the face value of the shares being the amount actually paid up on them by transfer of undivided profits of the company in the capital account of the company.

In Blott's case the profits were those made in the year of assessment, except that a small sum had been carried over from a previous year, and the Company having in the shareholders' report spoken of " a further dividend " to the shareholders to be satisfied by the allotment of one Second Preference " Share for every three Ordinary Shares held by them " passed a resolution " That it is desirable to capitalise the sum of £33,333 being part of the " undivided profits of the Company, and accordingly that a bonus at the rate " of thirty three and one third per cent. per share free of Income Tax on " each of the issued Ordinary Shares of the Company be declared " and be satisfied by the distribution of 33,316 of the unissued Second Preference Shares credited as fully paid. This company had the ordinary power to increase capital, to devote profits to dividends after creating reserve funds available amongst other purposes for distribution by way of bonus amongst the members, to direct payment of dividends by the distribution of paid up

shares, with a proper contract where requisite, and after the date of the issue in question a specific power to capitalise profits, and allot fully paid up shares to the extent of the net amount capitalised.

In Greenwood's case similar issues of bonus shares were made, but in this case out of reserve funds which included a substantial amount of profit from preceding years. In this case the directors resolved to make a bonus distribution of 10 per cent. in Ordinary Shares out of the revenue reserve account and the company in General Meeting passed a resolution that a specified amount of undivided profits be distributed as a bonus, and that the directors be authorised to issue an amount of Ordinary Shares equivalent in face value to that specified amount to the holders of the outstanding Ordinary Shares in satisfaction of such bonus. This bonus was not stated to be free of Income Tax. The Company had at the time an express power to capitalise undivided profits. In this case no agreement was registered in respect of the bonus shares; in Blott's case such an agreement was registered.

In neither case had the shareholder any option whether he got cash or bonus shares; he received shares or nothing.

It is not alleged by the Crown in these cases that the shareholder can be assessed for Income Tax on these bonus shares or the profits used to pay for them, for the undivided profits which have paid for them are the profits of the Company, which pays Income Tax for them, though on a conventional basis. But the Company, not being an "individual", is not assessed to Super-tax on its profits, and it is, therefore, said that under Section 66 of the Finance (1909–10) Act, 1910, the shareholder must return those bonus shares or the cash dividend they represent as part of his "income from all sources". It is to be noted that the Company cannot issue fully paid up shares by simply capitalising the reserve fund and applying it to the payment of the shares. For the reserve fund is the Company's, and fully paid up shares must be paid for by someone other than the Company. As a matter of machinery, therefore, a bonus or dividend payable to the shareholders must be declared, and then appropriated to the payment up of the bonus shares, so that the shareholder pays for his shares by his bonus or dividend.

Under these circumstances it is argued for the Crown that the shareholder must receive a dividend with which he is to pay for the bonus shares; that having received the dividend he has income, and what he does with that income is immaterial to the Revenue. He may save it or spend it or invest it in shares of his own company or of some other company; it is still income when received and, as such, liable to Super-tax. This view undoubtedly finds considerable support from the language of Lord Sumner in delivering the judgment of the Privy Council in *Swan Brewery Company* v. *The King*(1). That case turns on the construction of an Australian Act which taxes "dividends", defining them as "every profit, advantage, or gain intended to be paid or "credited to or distributed among the members or directors of any com-"pany." The Privy Council held bonus shares paid up out of accumulated profits to be "dividends" under that Act, though saying (page 234), "In "ordinary language the new shares would not be called a dividend, nor would "the allotment of them be the distribution of a dividend." The judgment states that the question is merely the construction of the particular Act, but Lord Sumner treats the transaction as one both in business and in law, in which the shareholder receives so much dividend out of undivided profits, and then uses it in paying up the new shares.

(1) (1914) A.C. 231.

This decision, of course, is on another statute and is not binding on us, though entitled to the greatest respect, but in my view, and subject to a point to be hereafter mentioned, the line of reasoning goes a considerable way to support the argument of the Crown. But it is very difficult to reconcile it with the reasoning of a decision which is binding on us, the decision of the House of Lords in *Bouch* v. *Sproule*. That was the case of the issue of bonus shares by a company paid for by capitalising accumulated profits, where the shareholder in the view of the House of Lords had a legal option whether he would take the dividend or the shares, though commercially, as the dividend was £1,500 and the shares were worth £4,000, there was no doubt which way the option would be exercised. The exact question in the case was whether the shares were to go as income to the tenant for life or as capital to the remainderman. The House of Lords accepted the law stated by the Court of Appeal, that in the case of profits on shares in a company which had the power of distributing its profits as dividend or converting them into capital, it was the action of the company which settled whether the proceeds of shares should go as dividend or as capital. In the particular case they differed from the Court of Appeal, and held that both on the substance and form of the transaction, the Company converted and "intended to convert the undivided profits "into paid up capital upon newly created shares . . . that the Company "did not pay, or intend to pay, any sum as dividend, but intended to and "did appropriate the divided profits dealt with as an increase of the capital "stock in the concern." The present cases are stronger, for here the shareholder has no option to take cash; he gets shares or nothing.

It appears to me that the reasoning of Lord Sumner in the *Swan Brewery* case would have led the House of Lords to a different conclusion. If the transaction in form and substance commences with a payment out of profits of a dividend, the way the dividend is spent can hardly alter its character as a dividend; and if the fact that, as in that case, the dividend is compulsorily returned and shares substituted, does not affect the original payment of dividend, it would seem that in a case like *Bouch* v. *Sproule*, where it was optional to use the dividend to pay for shares, still less was the original dividend affected. The Privy Council do not state their view of *Bouch* v. *Sproule*, probably because for some reason, which I do not understand, Counsel for the Appellant treated that decision as irrelevant; but the reasonings of the two cases appear to me to be in conflict, and if so, we are bound by the decision of the House of Lords. For if in *Bouch* v. *Sproule* the transaction in form and substance was an increase of capital and not a payment of dividend, it is still more so in the present cases. It respectfully seems to me that, if the reasoning of Lord Sumner is the method to be applied, all the cases between tenant for life and remainderman, where the bonus has been adjudged to belong to the remainderman, should have been decided the other way.

The matter may be considered from another point of view. Super-tax is payable on "income from all sources"; but it is not every receipt during the year that is returnable as "income" to Super-tax. The owner of a ship loses it during the year and receives the insurance money, which may be more or less, (at the present time probably much more) than the capital he originally invested in the ship. No one would suggest that he should return to Super-tax either all the insurance money, or the excess of the insurance money over his original capital. A company is liquidated during the year of assessment, and the liquidator returns to the shareholders (1) their original capital, (2) accretions to capital due to increase in value of the assets of the company, (3) the reserve funds of undi··'ed profits in the company, (4) the

undivided profits of the last year of assessment. Heads (3) and (4) will have paid Income Tax through the assessment of the company; but it appears to me that none of the heads will be returnable to Super-tax for assessment. They are not income from property, but the property itself in course of division.

A shareholder holds a £10 share in a company, and for greater marketability the company divides it into 10 £1 shares. Usually the 10 shares are of greater value than the original one, but I did not understand it to be contended that the increase in value is " income " to be returned to Super-tax. The increased value is the property itself, not income from property. The capitalisation of undivided profits, as fully paid up shares, is by no means the bestowal of a benefit of the full face value of the shares. A company of £10,000 share capital has assets which have increased in value to £20,000, and it has £20,000 reserve fund of undivided profits. Its £1 shares may be worth £4. It thereupon capitalises £10,000 of its reserve fund and issues £10,000 new shares fully paid. The result is that the same profits and property which were divisible among 10,000 shares become divisible among 20,000 shares, with the probable result that the shares which were at £4 may fall to £2 each, the exact fall depending on the prospects of the company and the higgling of the market. The original shares in *Bouch* v. *Sproule* fell £7 a share on the issue of bonus shares £7 10s. (See 12 A.C. 391.) To say in this case that a shareholder has received £7 10s. when in fact he has also lost £7 seems to look only at one side of the matter and not at the whole. If in the language of Lord Herschell in *Bouch* v. *Sproule* the substance of the transaction is not a payment of income but an increase of capital, the capital increase does not appear to me to be income, but the property from which income will be derived; and indeed the increase of capital is only nominally an increase, if it is necessarily accompanied by a diminution of value of the original capital. To divide property into more shares does not necessarily increase the total amount of property; still less can one say that the additional shares are income.

I refer to and agree with a somewhat similar explanation of the transaction given by Mr. Justice Nevile, *In re Evans* ([1913] 1 Ch. at pages 30 and 31).

For these reasons as well as on the authority of *Bouch* v. *Sproule* it appears to me that these bonus shares, being capital of the Company, were not income from any source to be returned to Super-tax, and I agree with the result of the judgment of Mr. Justice Rowlatt and the Special Commissioners. The appeal should be dismissed.

Mr. Bremner.—I understand that both appeals are dismissed with costs, my Lord.

The Master of the Rolls.—Yes.

An Appeal having been entered against the decision of the Court of Appeal, the cases were heard together in the House of Lords before Viscounts Haldane, Finlay and Cave and Lords Moulton and Sumner, on the 4th, 7th and 8th March, 1921. In consequence of the death of Lord Moulton, on the 8th March, 1921, the cases were reheard (Lord Dunedin taking the place of the late Lord Moulton) on the 10th, 11th, 14th and 15th March, 1921, when judgment was reserved.

The Attorney-General (Sir Gordon Hewart, K.C., M.P.), Mr. J. H. Cunliffe, K.C., and Mr. Hills appeared as Counsel for the Appellants, Sir John Simon,

K.C., and Mr. A. M. Latter as Counsel for Mr. Blott, and Sir John Simon, K.C., Mr. A. C. Clauson, K.C., and Mr. A. M. Bremner on behalf of Mr. Greenwood.

Judgment was delivered on the 3rd June, 1921, against the Crown, with costs, confirming the decision of the Court below.

JUDGMENT.

Viscount Haldane.—My Lords, the Respondent in the first of these cases was a shareholder in a joint stock company, incorporated in 1895 under the then Companies' Acts. Its purpose, as defined by the Memorandum of Association was to manufacture and trade in leather goods. Under the Articles of Association, after providing for the distribution of profits by way of dividends, provision was made by Article 127 enabling a General Meeting among other things to direct payment of dividend wholly or in part by the distribution of specific assets and, in particular, of paid up shares in the Company. By Article 128 the directors were empowered, before recommending any dividend, to set aside out of profits a reserve fund to be applicable for, among other purposes, distribution by way of bonus among the members of the Company for the time being on such terms and in such manner as should be determined in General Meeting. At the end of each of the years 1914 and 1915 there were in hand after payment of dividends, surplus undivided profits, and on 8th February, 1915, the shareholders resolved in general meeting to capitalise over £33,000, being part of the undivided profits and that accordingly, "a bonus at the rate of 33⅓ per cent. per share free of "Income Tax on each of the issued Ordinary Shares of the Company be, and "the same is hereby declared, and that the Directors be, and they are hereby, "authorised to satisfy such bonus by distribution among the members holding "Ordinary Shares rateably of 33,316 of the unissued Second Preference Shares "of £1 each in the Company credited as fully paid in satisfaction of such "bonus." In the following year, on 7th February, a similar resolution was passed by which £50,000, part of the undivided profits for the preceding year, was capitalised, and a bonus of 50 per cent. was in like manner declared on each of the issued ordinary shares, and the Directors were in like manner authorised to satisfy the bonus by the distribution of 50,000 Second Preference unissued Shares of £1 each, credited as fully paid up. Among the shareholders who received some of these bonus shares was the Respondent. He neither paid nor received any cash in respect of them, but simply became an allottee of part of the unissued shares. Agreements between the Company and persons acting on behalf of the holders of ordinary shares in the Company for an allotment of these shares in pursuance of the resolutions I have quoted, were executed and filed in order to satisfy the requirements of the Companies' Act as to shares issued otherwise than for cash.

The question which arises for decision in this Appeal is whether the Respondent is liable for Super-tax in respect of his share in the benefits I have referred to. Super-tax arose under the Finance (1909–10) Act, 1910, which provided that, in addition to the Income Tax to be charged under that Act, there should be charged in respect of the income of any individual the total of which exceeded a prescribed limit, an additional duty of Income Tax, called a Super-tax, leviable on the total income for the preceding year. The income assessable for Super-tax is to be estimated in the same manner as the total income from all sources is estimated for the purposes of exemptions or abatements under the Income Tax Acts, subject to variations which are not material for the purposes of the question before us.

What we have to decide is whether the allotment of bonus shares to the Respondent was capital, or was in reality an allotment of annual profits which conferred a benefit chargeable in his hands with Income Tax, for, if so, it is not in controversy that the Super-tax provisions will apply. The Special Commissioners for Income Tax have stated a Case. They decided that the Respondent was not liable to Super-tax, because of the concurrence of previous decisions by the Commissioners that the judgment of this House in *Bouch* v. *Sproule* (12 A.C. 385) governed this case. They intimated, however, that, had they felt themselves free, they would have come to a different conclusion. Mr. Justice Rowlatt also took the view, but on more general grounds, that the Respondent was not liable and the Court of Appeal have unanimously affirmed his decision.

My Lords, the contention of the Crown is briefly this. It is said first that the Respondent's original shares in the Company were a source of profits, and that the further benefits in question arose out of these profits and really formed part of them. It is said further that in the reports of the directors, which the resolution of the general meeting carried out, it was proposed to declare a dividend out of profits in the hands of the Company to the ordinary shareholders to be satisfied by an allotment of shares. But the report did not, any more than the resolutions, recommend that this dividend, whatever the expression signified, should be paid in cash, and the resolutions, which are the operative factors in determining the titles conferred, give no right to shareholders to receive anything more than shares. Even if the expression " dividend " used in the directors' reports had been repeated in the resolutions, which it was not, I do not think that in its context it could be taken as meaning more than that something should be divided, either as capital or as income. The Crown further says that the so-called dividends, in whatever form distributed, imported a distribution of the annual profits of the Company to its shareholders as income, and that it was not open to the Company under the Companies Acts to retain the amount in satisfaction of liability on the shares issued. My Lords, there is no doubt that the money in question formed originally part of profits made by the Company on which it was liable to pay Income Tax. It is quite another question whether these profits as such ever reached the Respondent and the other shareholders as income so as to make them liable for Income Tax and entitled to a deduction on the score that the tax had already been paid by the Company. It is further contended that the decision of this House in *Bouch* v. *Sproule*,(1) to the effect that a distribution of new shares to shareholders in a certain company was a distribution of capital and not of income, is relevant only in such cases as that which it decided, where the question is one between tenant for life and remainderman, depending on the construction of a testator's intention, and that the decision has no application to the question whether a distribution by a company of annual profits applied to paying up the liability on further shares issued to a shareholder who is an absolute owner, gives rise to a taxable profit in the nature of income in his hands. For the Respondent it is argued that the distribution was one of capital, and not of income, and was made such for all purposes by the decision of the Company itself to that effect. *Bouch* v. *Sproule*(1) is relied on as decisive of the principle to be applied as being that the company itself can decide conclusively as to whether what is given is given as capital or income. It is further said that the increase in the number of shares entitled to participate did not increase the quantum of the total interest of the Respondent in the capital of the Company, and that at

(1) (1887) 12 A.C. 385.

no time did the Respondent acquire a right to demand any part of the profits added by it to capital from the Company.

My Lords, the questions so raised are of much importance. Speaking for myself, I think that they can only be answered if the relation of a shareholder to a company incorporated under the relevant Companies Acts, as they stood both before and after their consolidation in 1908, has been determined. It must be borne in mind that the provisions of the Companies (Consolidation) Act of 1908, with the powers it confers. apply where the context does not exclude this, to existing companies incorporated under the Act of 1862 as well as to new companies. My Lords, as I understand the law relating to companies to which the Act of 1908 applies, as it does in the present case, the position of such a company is this. It can do nothing which is not authorised by its memorandum of association, excepting so far as the Act expressly enables it to do so. But one of the powers which the Act expressly gives to it is that of increasing its capital as named in the memorandum. Such a company is a corporate entity separate from those of its shareholders, but the latter can control its action by passing resolutions in general meeting. If these resolutions are directed to what falls within the capacity of the company as the Act of Parliament defines it, they are treated as concerned with internal management and, if they have been passed in accordance with the statute and the articles of association, no Court has jurisdiction to interfere in a question which is for the proper majority of the shareholders alone. The company, acting with the assent so given of the shareholders, can decide conclusively what is to be done with accumulated profits. It need not pay these over to the shareholders. It can convert them into capital as against the whole world, including, as I think the principle plainly implies, the Crown claiming for taxing or any other purposes. The only question open is therefore whether the Company has really done so. If there were any doubt as to the power of the Company, in point of principle, to convert such accumulated profits into capital, it seems to me that the principle is recognised by Section 40 of the Act of 1908, which expressly enables a company to return accumulated profits in reduction of the paid up capital of the company. Clearly on such a return the profits cease to be income and become capital. But the general principle does not rest merely on this section. It appears to follow from reasons of a wider kind. A shareholder is not entitled to claim that the company should apply its undivided profits in payment to him of dividend. Whether it must do so or not is matter of internal management to be decided by the majority of the shareholders. He cannot sue for such a dividend until he has been given a special title by its declaration. Until then, no doubt, the profits are profits in the hands of the company until it has properly disposed of them, and it is assessable for Income Tax in respect of these profits. But if, acting within its powers, it disposes of these profits by converting them into capital instead of paying them over to the shareholders, that, as I conceive it, is conclusive as against all the outside world, including the Crown, and the form of the benefit which the shareholder receives from the money in the hands of the company is one which is for determination by the company alone. Subject to anything to the contrary provided in the articles, the directors, where, as is usually the case, there are directors, exercise the powers of the company as its agents. On their powers to deal with the share capital and on the power in this regard of the company itself there are well-known restrictions. These appear in the group of sections in the Act of 1908 which commences with Section 40. That section expressly enables the company, when it has accumulated undivided profits,

instead of dividing them as dividend or bonus, to return them, on complying with certain formalities, to the shareholders in reduction of capital actually paid up on their shares, the liability for what will thus remain unpaid being increased proportionally. This section is concerned with shares that have been issued and paid up in part or entirely. The next section, among other things, enables the company to cancel unissued shares without the diminution of nominal capital thereby occasioned becoming a reduction of share capital within the meaning of the Act. Section 46 confers a general power, subject to confirmation by the Court, to reduce share capital by extinguishing unpaid liability, or by cancelling lost paid-up capital, or by paying back paid-up share capital which is in excess of the wants of the company.

My Lords, none of the provisions which I have just referred to affect the question before us excepting on one point. They do show that, when a company has share capital which has remained unissued, it is free to cancel it as the alternative to issuing it. Nowhere in either the Act of 1908 or in the earlier Act is there any provision restricting its capacity, if the memorandum of association permits of it, to apply funds which form no part of its share capital but are surplus profits at its disposal, in providing, for the benefit of shareholders who desire to take up unissued capital, the funds requisite for so doing, and to apply such funds directly to the purpose. On a liquidation these funds would have belonged to the existing shareholders as surplus assets. While the Company is a going concern, Clauses Y and Z of the memorandum of association expressly enable the Company to distribute among the members in specie any property or proceeds of property of the company, so long as this does not amount to a reduction of capital requiring sanction by law, and to do anything conducive to such an object. There was therefore power conferred on the Company to do what was done in the case before us. It was, doubtless, an act for which it was expedient, if not necessary, to have the direction of the shareholders in general meeting, and by the 127th and 128th Articles of Association, which I have already quoted, express provision on the point is made. It is by no means certain that the majority in such a general meeting would consist of persons liable to Super-tax and assembling to devise a method of escaping it. Why, as matter of law they should not attempt to escape it by any means that is not made unlawful, I do not see. But even this question does not necessarily arise. The majority may on any occasion consist of persons who escape from Super-tax because their incomes, even with the additions to be derived from the distribution by the company, are below the level required for the tax. My Lords, for the reasons I have given I think that it is a matter of principle within the power of an ordinary joint stock company with articles such as those in the case before us to determine conclusively against the whole world whether it will withhold profits it has accumulated from distribution to its shareholders as income, and as an alternative not distribute them at all, but apply them in paying up the capital sums which shareholders electing to take up unissued shares would otherwise have to contribute. If this is done, the money so applied is capital and never becomes profit in the hands of the shareholder at all. What the latter gets is no doubt a valuable thing. But it is a thing in the nature of an extra share certificate in the company. His new shares do not give him an immediate right to a larger amount of the existing assets. These remain where they were. The new shares simply confer a title to a larger proportion of the surplus assets if and when a general distribution takes place, as in the winding up. In these assets, the undistributed profits now

allocated to capital, will be included profits which will be used by the company for its business, but henceforth as part of its issued share capital. Such a transaction appears to me to be one purely of internal management, with which, for the reasons explained by Lord Davey in *Burland* v. *Earle* ([1902] A.C. 83 at page 93) no court can interfere.

But, my Lords, I do not think that the matter is one which rests merely on principle. It appears to me that the Court of Appeal have rightly held that the question is concluded adversely to the contention of the Crown by the decision of this House in *Bouch* v. *Sproule* (12 A.C. 385). In that case a testator had bequeathed his residuary estate in trust for his wife for life, and after her death to someone else absolutely. Part of the residue consisted of shares in a company whose directors had power, before recommending a dividend, to set apart out of the profits such sum as they thought proper as a reserve fund for certain purposes. On the recommendation of the Directors, the Company by special resolution passed a new article empowering the directors with the sanction of the Company in general meeting (afterwards given) to declare a bonus to be paid to the shareholders out of the reserve fund, with its purposes so enlarged, or out of any other accumulated profits, in proportion to their shares. The directors then issued a letter giving effect to this in a fashion which they had recommended in a report approved by the shareholders. They allotted to each shareholder new shares in proportion to his existing holding, crediting the amount taken from the reserve fund as paid up on the new shares. There was an ambiguity in the terms on which the directors made their communication to the shareholders which was thought by the Court of Appeal to have left open the view that the allocation was one substantially of dividend out of profits, claimable as such. On that point this House differed from the Court of Appeal, holding that the allocation by the company must be taken as having in substance been one to be treated as of capital. In connection with this question old authorities in analogous cases were discussed, but in reality only on the point of construction of the intention shewn. On the main question, which is the question really relevant to what we have to determine in the present Appeal, this House laid down distinctly what it held to be the law. Lord Herschell says:—"I quite agree "with the Court below that, apart from the authorities to which I have "alluded, the general principle for the determination of such a question as "that before us, and in my opinion the only sound principle, is that which "is well expressed in the judgment of Lord Justice Fry: 'When a testator or "'settlor directs or permits the subject of his disposition to remain as shares "'or stocks in a company which has the power either of distributing its "'profits as dividend or of converting them into capital, and the company "'validly exercises this power, such exercise of its power is binding on all "'persons interested under the testator or settlor in the shares, and conse-"'quently what is paid by the company as dividend goes to the tenant for "'life, and what is paid by the company to the shareholder as capital, or ap-"'propriated as an increase of the capital stock in the concern, enures to the "'benefit of all who are interested in the capital.'" Lord Watson says: "In these circumstances it was undoubtedly within the power of the company, "by raising new capital to the required amount, to set free the sums thus "spent out of the reserve fund and undivided profits for distribution among "the shareholders. It was equally within the power of the company to "capitalise these sums by issuing new shares against them to its members in "proportion to their several interests." My Lords, it is contended for the Crown that in using this language, Lord Herschell and Lord Watson were

doing no more than stating a principle which was to apply merely to the respective rights of a tenant for life and a remainderman, and were merely guarding against the application of the well-known rule laid down by Lord Eldon in *Howe* v. *Lord Dartmouth* (7 Vesey 177) that, where there is a residuary bequest to persons in succession and no trust for conversion and such property is not invested in securities which would be approved by the Court, then, unless there is an express or implied statement of the testator's intention that such property is to be enjoyed *in specie*, the general rule is that the property is to be converted and properly invested. Now, I think that it is evident that the noble and learned Lords would not have used the sweeping language they did had they not intended it to be taken as expressing a principle of much wider application. *Bouch* v. *Sproule* was argued in April, 1886. Judgment was not given until June, 1887. In between, in March, 1887, the well-known case of *Trevor* v. *Whitworth* reported in the same volume (12 A.C.) was heard. The question there was one very different from that now before us. It was whether a company incorporated under the Act of 1862 could purchase its own shares under a power purporting to be conferred by the articles, and it was held, reversing the opinion of the Court of Appeal, that it could not do so consistently with the provisions of the Companies Acts. What is important is that Lord Herschell, and Lord Watson also, sat to hear *Trevor* v. *Whitworth*, and that in the course of the discussion a minute examination was made of the principles and structure of the Acts as regards the power of a company to deal with its own capital. Judgment was given in July, 1887, very shortly after that in *Bouch* v. *Sproule*. My Lords, it is hardly conceivable for those who remember the habitual accuracy in the use of language of these two noble and learned Lords that they should have said what they did unless they had in mind what came before them in the argument in *Trevor* v. *Whitworth*, and what was the subject of the subsequent judgment in that case. I think it is clear that they must have intended to lay down that none of the restrictions on a company transacting with regard to its own share capital applied to the case of a company using a reserve over which it had full power of disposition, in order to make payments out of it for the benefit of the existing shareholders of capital sums which they would otherwise have had to contribute for the purchase of new shares. I am, therefore, of opinion both on principle and on authority, that the transaction in the present case was one in which the Company was in law dominant on the question whether the money in question was to be capital or income for all purposes and I do not think that, in the circumstances of this case, the Respondent received any income or profits at all. I think that Mr. Justice Rowlatt and the Court of Appeal were right in the conclusion they came to, and that the appeal of the Crown to your Lordships' House ought to fail.

My Lords, it is said that the point was decided otherwise by the Judicial Committee of the Privy Council in *Swan Brewery Company* v. *The King* (1914 A.C. 231). There the transaction was in many respects analogous to that here. But the taxing Statute was couched in very different language. The Dividend Duties Act, 1902, of Western Australia, had imposed a duty on the amount or value of every dividend declared by companies there. "Dividend" was defined to include "every dividend, profit, advantage or gain intended to be "paid or credited to or distributed among the members" of a company. It was held that new shares which were issued to the shareholders and paid for out of accumulated reserve were "advantages", and so taxable. There were expressions in the judgment which may be construed as having gone rather further, and treated the payment made by the company as equivalent

in substance to a payment by the company to the shareholders, and by them back to the company. It may have been so, and without a fuller knowledge of the facts in the case and of the local law than the report discloses, it is difficult to be quite sure about the point, but what is clear is that the wide character of the word "advantages" was a primary consideration in what was said by their Lordships who took part in advising His Majesty. I therefore do not feel embarrassed by the decision in that case. On the other hand I have not allowed myself to treat the decision of the Supreme Court of the United States in the case of *Eisner* v. *Macomber* (1920, 252 S.C. of U.S.A. Reports 189) as a reason for the conclusions at which I have arrived. For the taxing statute then in question was of a different order and the jurisprudence invoked was also on certain points different, but none the less I have read with great pleasure and instruction the judicial discussion in which the varying opinions of the eminent Judges who decided the case occur. If I am right in the conclusion at which I have arrived, it is agreed that this conclusion disposes also of the Appeal which immediately follows on your Lordships' List.

Viscount Finlay.—My Lords, the Respondent was a shareholder in Hepburn Gale and Ross. In the Income Tax year ending 5th April, 1915, he received from the Company 500 fully-paid up Second Preference Shares of the nominal value of £1 each, and in the Income Tax year ending 5th April, 1916, he received 750 like shares. He was assessed to Super-tax in respect of these shares in each year, and the question in the case is whether these assessments were properly made. The Special Commissioners discharged these assessments. A Case was stated for the opinion of the High Court, and the decision of the Special Commissioners was affirmed by Mr. Justice Rowlatt and by the Court of Appeal. The present Appeal is brought for the purpose of having it established that Super-tax is payable on these transactions. Super-tax is payable under the Finance (1909–10) Act, 1910, in respect of the income of any individual the total of which exceeds £5,000, as an additional duty of Income Tax (Section 66 (1)). For the purpose of the Super-tax the total income is to be taken to be the total income of the individual from all sources for the previous year, estimated in the same manner as the total income from all sources is estimated for the purpose of exemptions or abatements under the Income Tax Act (Section 66 (2)). Income Tax under Schedule D is levied under the Income Tax Act, 1853 (Section 2 and Section 5) in accordance with the regulations of the Income Tax Act, 1842. Section 163 of the latter Act provides that any person who proves that the aggregate amount of his income is less than a certain amount shall be exempted from Income Tax, and Section 164 provides that the claim for such exemption is to be sent to the Commissioners, together with a declaration and statement setting forth all the particular sources from which the income arises. For the purpose of Super-tax the individual person is dealt with and income from every source is to be taken into account. The whole question in this case is whether the income of the Respondent was increased by the transactions resulting in the issue of the Second Preference Shares to which I have referred. The Company had accumulated in each of the years 1915 and 1916 a considerable amount of profits. It was, of course, open to them to distribute these amounts by way of dividend to the shareholders. In each of these years, however, a resolution was passed that the profits in hand should be capitalised. The resolution in 1915 was dated 8th February and was in the following terms: "Resolved: 1. That it is desirable to capitalise the sum "of £33,333 6s. 8d., being part of the undivided profits of the company, and

" accordingly that a bonus at the rate of 33⅓ per cent. per share free of income " tax on each of the issued Ordinary Shares of the Company be, and the same " is hereby declared, and that the Directors be, and they are hereby authorised " to satisfy such bonus by the distribution among members holding Ordinary " Shares rateably of 33,316 of the unissued Second Preference Shares of £1 " each in the Company credited as fully paid in satisfaction of such bonus. " 2. That so far as such distribution would otherwise involve the issue of " fractional certificates for an amount less than £1 such amount shall be paid " and satisfied in cash." The resolution in 1916 was in the same terms except that the amount to be capitalised was £50,000 and the procedure adopted in the two years was identical. For convenience I take the year 1915.

On the same day on which the Resolution was passed an agreement was entered into between the Company and S. J. Bradford on behalf of the shareholders, in which the resolution above set out was recited, as also the appointment of Bradford by the directors pursuant to the 127th of the Company's Articles of Association, to enter into the agreement. The agreement went on to provide that the Company allotted and issued the new Second Preference Shares of £1 each as specified in the schedule to the agreement and that the shares should be " credited as fully paid up " and that the shares so credited should be accepted in satisfaction of the bonus. In pursuance of these agreements there were allotted to the Respondent the 500 and 750 shares to which this litigation relates. The relative Articles of Association are No. 123 and those following it. Article 123 provides that the profits of the Company available for dividend shall subject to the payment of Preferential dividends, be applied in payment of dividends on the ordinary shares. No dividend or bonus was to be payable except out of profits (Article 125). Article 127 reads as follows: " 127. Any General Meeting declaring a dividend may direct pay- " ment of such dividend wholly or in part by the distribution of specific assets, " and in particular of paid up shares of the Company or paid up shares of any " other Company, and the Directors shall give effect to such Resolution, and, " where any difficulty arises in regard to the distribution, they may settle the " same as they think expedient, and in particular may issue fractional certifi- " cates, and may fix the value for distribution of such specific assets, or any " part thereof, and may determine that cash payments shall be made to any " members upon the footing of the value so fixed in order to adjust the rights of " all parties, and may vest any such specific assets in trustees upon such trusts " for the persons entitled to the dividend as may seem expedient to the " Directors. Where requisite, a proper contract shall be filed in accordance " with section 88 of the Companies (Consolidation) Act, 1908, and the " Directors may appoint any person to sign such contract on behalf of the " persons entitled to the dividend and such appointment shall be effective." Article 128 provides for the formation of a reserve fund. The Article numbered 127A was not passed until 18th February, 1918, and it was confirmed on the 5th March, 1918, so that it does not directly affect the case in its operation. But it has been a good deal referred to in argument for the purpose of throwing light upon the nature of these transactions. Article 127A is as follows: " 127A. The Company may at any time and from time to time in " General Meeting by Resolution authorise the Directors to capitalise any " profits of the Company not required for the time being for payment of " dividend upon any Preference Shares of the Company or other shares " issued upon special conditions, whether standing to the credit of the Com- " pany's Reserve Fund or otherwise, and including profits arising from the " appreciation in value of capital assets, and to allot to the members holding

" Ordinary Shares of the Company in respect of the net amount capitalised " fully paid shares of the Company of equivalent nominal amount, and the " Directors shall give effect to any such Resolution accordingly and any shares " allotted pursuant to any such Resolution shall be distributed among the " members holding Ordinary Shares of the Company so far as practicable in " proportion to the number of Ordinary Shares held by them respectively, " and shall be credited as fully paid by means of the profits so capitalised, " and the Directors may make such provision by the issue of fractional certifi- " cates or by the payment of cash or by sale and distribution of the proceeds " or otherwise as they may think expedient for the case of fractions." The claim of the Crown to Super-tax has been put in two ways: (1) It was said that these transactions involved the payment of the dividend or bonus to the shareholders, and that this rendered them liable to Super-tax in respect of it, notwithstanding its return to the Company in respect of the new shares issued. (2) It was said that the allotment of the new shares amounted to a payment to the several shareholders of the dividends, though not in money but in money's worth.

The general scope and effect of these transactions is beyond dispute. There was an increase in the capital of the Company by the retention of the amounts available for dividends. Though the number of shares was increased by the issue of the new preference shares to the ordinary shareholders, this did not affect the proportions to which they were entitled in the undertaking and in any profits. All the shareholders received these new preference shares, so that the proportion in which they were to share in any profits remained the same. As the capital was increased, it might reasonably be expected that the profits of the Company would be increased, and that the shareholders would benefit in this way, but their relative shares in the undertaking remained the same. The use of the sums which had been available for dividend to increase capital would enable the Company to carry on a larger and more profitable business, which might be expected to yield larger dividends. These dividends, however, were to be in the future. So far as the present was concerned there was no dividend out of the accumulated profits; these were devoted to increasing the capital of the Company. The Company had power to do what it pleased with any profits which it might make. It might spend the accumulated profits in the improvement of the Company's works and buildings and machinery. These improvements might lead to a great accession of business and increase of profits by which every shareholder would benefit, but of course it could not for a moment be contended that such a benefit would render him liable to Super-tax in respect of it. The benefit would not be in the nature of income, and Super-tax can be levied only on income. It would be so levied on the dividends afterwards received. " It was equally within " the power of the company "—(I am using Lord Watson's words in *Bouch* v. *Sproule* (12 Appeal Cases at p. 403))—" to capitalise this sum by issuing new shares to its " members in proportion to their several interests." This is what the Company did in the present case. Article 127A now enables them to do anything of this kind by a direct and simple process. Under it the directors may be authorised to capitalise any profits, and to allot to the ordinary shareholders in respect of the net amount capitalised fully paid up shares of the Company of an equivalent nominal amount. This article, however, did not come into existence until 1918. It appears to me that there is no ground for saying that Article 127A is *ultra vires*. The Company has power to capitalise these profits if it pleases, and such an article as this enables them to carry out the process of capitalisation in a direct and simple

fashion. But before Article 127A was passed the machinery for carrying out capitalisation of profits had to be found in the other articles.

The article under which the capitalisation was carried out in 1915 and 1916 was Article 127, which provides that any general meeting declaring a dividend may direct payment of it by the distribution of paid-up shares of the Company, a proper contract, where necessary, being filed in accordance with Section 88 of the Companies (Consolidation) Act, 1908. The resolution of the 8th February, 1915, was that, for the purpose of capitalising £33,333 6s. 8d., part of the undivided profits of the Company, a bonus on each of the issued Ordinary Shares be declared, and that the directors be authorised to satisfy such bonus by the distribution among the members holding Ordinary Shares of 33,316 of the unissued Second Preference Shares of £1 each, credited as fully paid up. The effect of this operation was that the amount of the bonus was retained by the Company as additional capital, and that the shareholders got the new preference shares. No option was left to any particular shareholder. He was compelled by the action of the Company to take the preference shares. He could not have sued for the bonus in money, as the resolution which gave the bonus *uno flatu* declared that it was to be satisfied by the distribution of preference shares. Under these circumstances it seems to me impossible to treat the shareholders for the purpose of Super-tax as having received the bonus and paid it back to the Company to be retained as capital. They never received it at all. The case appears to stand exactly as Mr. Justice Rowlatt put it (Appendix, pp. 79 and 80) (1): "Now I do not think that there is a payment of a dividend to "a shareholder unless a part of the profits of the company is thereby liberated "to him in the sense that the company parts with it and he takes it. If "in this Case the Company could have found means to capitalise their "profits and divide them as capital without adopting the machinery of "declaring a bonus and allotting shares by agreement (not, be it observed, "a voluntary agreement) in satisfaction of such bonus, I do not think the "case would have been arguable. I am asked to decide that there was a pay-"ment of this bonus upon the strength of what I consider bare machinery. "I cannot do so. The fact is simple that the shareholder was given shares "instead of a bonus." There can be no Super-tax upon income unless it has been received by the taxpayer. I may be permitted to quote in this connection what was said by Mr. Justice Pitney in *Eisner* v. *Macomber*, a case decided in the Supreme Court of the United States in March of last year (252 U.S. 189). In dealing with the definition of "income" Mr. Justice Pitney in delivering the opinion of the majority of the members of the Court in that case said: "Here we have the essential matter not a gain accruing to "capital, not a growth or increment of value in the investment, but a gain, "a profit, something of exchangeable value proceeding from the property, "severed from the capital, however invested or employed, and coming in, "being 'derived,' that is, received or drawn by the recipient the 'taxpayer' "for his separate use, benefit, and disposal, that is income derived from "property; nothing else answers the description." In the present case, the bonus or so-called dividend was not severed from the capital; on the contrary it was added to it. For these reasons it appears to me that the first contention of the Crown must fail.

The second contention of the Crown is that the allotment of the preference shares was equivalent to the payment of the bonus. To appreciate this point it is necessary to consider closely what it was that the shareholder

(1) See page 112 of this Report.

got. Did he get anything in the nature of payment of income? It is obvious that he did not. He gave up any claim to the income. What might have been paid as income went to increase the capital of the Company. The shareholder got his proportionate share in the business of the Company as increased by the additional capital. The proportion of his share in that business as compared with the proportions of other shareholders was in no way affected by the issue of the preference shares, as all the shareholders alike got them. The benefit, and the sole benefit which the Respondent derived, was that the business in which he had a share was a larger one, with more capital embarked in it, precisely as might have been the case if the accumulated profits had been applied in the improvement of the Company's works and machinery. Instead of his getting any dividend, or anything in the nature of a dividend, the fund which might have been divided was impounded to increase the capital of the business. How is it possible to treat any advantage accruing from this as a payment of income? The case differs *toto caelo* from a case in which a dividend is paid not in money but in money's worth by the delivery, say, of goods or of securities. The preference shares are in themselves valueless. They are merely part of the machinery for carrying out the capitalisation, and if that capitalisation could have been carried out without their issue the Respondent would have been just as well off without them as he is with them. What he gained was that the business in which he had the same proportionate interest had become more valuable owing to the increase of capital. Super-tax cannot be levied on such an increase in the capital value of the business. It will be received from time to time on the larger dividend which it is hoped will be yielded by the increase in the capital put into the business. How much of the profits earned in the business of a company should be divided among the shareholders is a matter of the internal management of the company which the shareholders must decide for themselves. (*Burland* v. *Earle* [1902] A. C. 83, at p. 95.) They decided this matter for themselves in the present case, and the preference shares were within the limits of the authorised capital of the Company. They did not pay over the accumulated profits to the shareholders to enable them to pay up the new shares. They issued the new shares as fully paid up, as representing the increase of capital which resulted from the detention by the Company of the money which might otherwise have been paid as dividend. The contract filed under Section 88 of the Companies (Consolidation) Act, 1908, states that the new shares credited as fully paid up were to be taken in satisfaction of the bonus. If Article 127A had been in force in 1915 and 1916 the transaction would have assumed a simpler form, but the difference would have been one merely of machinery.

I now turn to the cases. *Bouch* v. *Sproule* (*ubi supra*) was invoked by the Respondent. On behalf of the Crown it was said that that case was one merely as between tenant for life and the remainderman, and that it had no bearing on the question as to whether duty was payable to the Crown. It is, however, to be observed that the question in that case, which was decided in the House of Lords after very mature consideration by Lord Herschell, Lord Watson, Lord Bramwell and Lord Fitzgerald was as Lord Herschell says at page 387, whether a " bonus of £2 10s. 0d. per share . . . . . was income " of the estate of William Bouch (' the testator ') or was capital of that " estate." It was held to be capital. The question whether it was income or capital could not be affected by the purpose which led to the institution of the inquiry. The incidence of the taxation depends upon the question, what is in fact the nature of the property on which the tax is claimed? If

it is income, it is liable to tax upon income: if it is capital, it is not so liable. The liability follows from the nature of the property and it seems impossible to me to say that the answer to the question whether it is income or not is to depend upon the purpose with which the question is asked. The circumstances which gave rise to the case of *Bouch* v. *Sproule* are very like those in the present case. They are stated at full length by Lord Herschell in his judgment. The Consett Iron Company had a large amount standing to credit of reserve fund, and also an undivided profit fund. At a meeting of the Company a resolution was passed for the payment of a bonus of £2 10s. 0d. per share out of the reserve fund and the undivided profit. A letter was sent to every shareholder enclosing a warrant and forms relating to the new shares. The letter to Sir T. Bouch, the trustee under the will of William Bouch, informed him that the Directors had, in respect of his 600 shares, allotted to him 200 new shares of £10 each, subject to £7 10s. 0d. being paid upon them by the 30th September, and there was enclosed a bonus dividend warrant payable on that date for £1,500 with a request that it should be returned signed when the amount would be applied in payment of the £7 10s. 0d. per share on the new shares. Sir T. Bouch signed the form acknowledging the receipt of the £1,500 and requesting that the amount should be applied in payment of the call of £7 10s. 0d. on the 200 new shares. Lord Herschell says at page 398 "I think "we must look both at the substance and form of the transaction. It is to be "observed, in the first place, that the amount of that portion of the new "capital created which was to be paid up was exactly equal to the amount of "profits to be distributed. And it was obviously contemplated, and was, "I think, certain, that no money would, in fact, pass from the company to "the shareholders, but that the entire sum would remain in their hands as "paid-up capital," and on page 339 he says that he could not avoid the conclusion that the substance of the whole transaction was to convert the undivided profits into paid up capital upon newly created shares. In that case it was held that the capital of the Company was increased by these amounts and that they did not constitute income. All that Lord Herschell there says applies *a fortiori* to the present case. In *Bouch* v. *Sproule* there was a nominal option left to the shareholders as to the application of the bonus dividend. Lord Herschell held that this must be ignored, as it was nominal only, and the circumstances showed that it was never intended that it should be exercised. In the present case there was no option at all; the application of the bonus to increase of capital was compulsory. It was argued for the Crown that the £1,500 in the dividend warrant in *Bouch* v. *Sproule* would have been assessable to Income Tax as it has been paid. I cannot agree. On the facts as found by the House of Lords, the receipt of this money by the shareholder was merely formal. It was not to be retained but handed over to the Company to go in increase of capital. There was never any effective payment of this dividend as such. Sir T. Bouch in receiving it acted as a mere conduit pipe for its transmi sion to the Company to increase its capital. It was not received as income, but to be converted into capital of the Company. In the present case there was no option at all, and there is no ground for saying that the bonus was ever received as income. The Super-tax applies only to income, and to income received in payment.

The case of the *Swan Brewery Company* (1914 Appeal Cases, 231) was much relied on by the Crown. I must, however, confess that the reasoning on which the judgment is rested appears to me to be inconsistent with the decision of this House in *Bouch* v. *Sproule*. By that decision we are of course bound, even if we had any doubt about its correctness. In the case of *Eisner*

v. *Macomber* (*ubi supra*), there is a most interesting and instructive judgment delivered by Mr. Justice Pitney as representing five out of the nine members of the Court. There were two dissentients, Mr. Justice Brandeis and Mr. Justice Clarke. Mr. Justice Holmes and Mr. Justice Day, while dissenting on a point as to the construction of an amendment to the Constitution of the United States, concurred on the general question. That judgment is of course not binding on us as an authority, but it contains a most instructive review of the principles which have been discussed in the present case, and the conclusion which was arrived at by seven out of the nine judges is in entire harmony with that which appears to me to be the true view of the present case.

On these grounds I think that the present Appeal ought to be dismissed.

Viscount Cave.—My Lords, in Blott's case, the question to be determined on this Appeal is whether, under the resolutions of the 8th February, 1915, and the 7th February, 1916, the Respondent received anything which can be called income, so as to be assessable to Super-tax under Section 66 of the Finance (1909-10) Act, 1910. I do not think he did. The circumstances that the profits dealt with by the above-mentioned resolutions were current profits of the Company and had borne Income Tax in the Company's hands is obviously not sufficient by itself to make them income of the shareholders. The Company's profits were at its own disposal and were in no sense income of the shareholders unless and until they were distributed among them. The question is whether there was a distribution of profits among the shareholders in money or money's worth. When the resolution of 1915 (which I take as an example) with its attendant documents is examined, it will be seen that the last thing which the Company or its directors desired was that the profits in question should be divided among the shareholders. The directors reported that, the Company having heavy commitments which called for all its available capital, it would be unwise to make any distribution beyond the usual dividends, and it was in order to avoid such a distribution that they recommended the shareholders to declare a further dividend to be satisfied in Second Preference Shares. The notice referred only to an additional payment in shares. The Resolution, which is the most important document, declared that it was desirable to capitalise the sum of £33,333 and accordingly that a bonus be declared and the Directors be authorised to satisfy such bonus by the distribution of shares credited as fully paid up. Did this amount to a distribution of profits? I think not. The resolution did not give to any shareholder a right to sue for the dividend in cash, his only right being to have an allotment of fully paid shares in the capital of the Company. The profits remained in the hands of the Company as capital, and the shareholders received a paper certificate as evidence of his interest in the additional capital so set aside. The transaction took nothing out of the Company's coffers, and put nothing into the shareholders' pockets; and the only result was that the Company, which before the resolution could have distributed the profit by way of dividend, or carried it temporarily to reserve, came thenceforth under an obligation to retain it permanently as capital. It is true that the shareholder could sell his bonus shares, but in that case he would be realising a capital asset producing income, and the proceeds would not be income in his hands. It appears to me that, if the substance and not the form of the transaction is looked to, the declaration of a bonus was, as Mr. Justice Rowlatt said, "bare machinery" for capitalising profits, and there was no distribution of profits to the shareholders. I think, therefore, that neither the shares nor

their face value should be treated as income of the Respondent. The same observations apply to the resolution of 1916. Some time was occupied in the discussion of the question, whether in paying Income Tax on its profits the Company acted as agent for its shareholders, and some cases were cited where this expression had been used. Probably the word was intended only to express in an abbreviated form the effect of Section 54 of the Income Tax Act, 1842. Plainly, a company paying Income Tax on its profits, does not pay it as agent for its shareholders. It pays as a taxpayer, and if no dividend is declared the shareholders have no direct concern in the payment. If a dividend is declared, the company is entitled to deduct from such dividend a proportionate part of the amount of the tax previously paid by the company; and, in that case, the payment by the company operates in relief of the shareholder. But no agency, properly so-called, is involved.

With regard to the authorities, *Bouch* v. *Sproule* (1887 L.R. 12 A.C. 385) appears to me to be directly in point. It is true that the actual decision related to the rights *inter se* of a tenant for life and remainderman under a will; but for the purpose of deciding that question it was necessary to determine whether a transaction such as is here in question was or was not a distribution of income. The conclusion of the House is expressed in the statement of Lord Herschell that "the substance of the whole transaction "was, and was intended to be, to convert the undivided profits into paid-up "capital upon newly-created shares," and in his further statement that "the "company did not pay, or intend to pay, any sum as dividend, but intended to "and did appropriate the undivided profits dealt with as an increase of the "capital stock in the concern." I think it right to add that if in the present case (as in *Bouch* v. *Sproule*) an option had been given to the shareholders to take or refuse the bonus shares, different considerations would have arisen; and I desire to reserve my judgment as to the effect of such an option upon the liability to tax. In the *Swan Brewery Company* v. *The King* ([1914] A.C. 231) it was held that transactions similar to those now in question were, in effect, a declaration of a dividend within the meaning of the Dividend Duties Act, 1902, of Western Australia, and accordingly that duty was payable under that Act. The decision in that case is no doubt fully supported by the definition clause in the Western Australia Act; but if it were not for that definition clause the decision would, I think, be inconsistent with the decision of this House in *Bouch* v. *Sproule*. In an American case of *Eisner* v. *Macomber* (1920, 252 U.S., 189), a similar question arose for the decision of the Supreme Court of the United States. The question there was whether Congress had power, under the 16th Amendment to the Constitution, to tax as income of the stockholder and without apportionment among the States a stock dividend made in good faith by a corporation; and the question was decided by a majority of the Court in the negative. The law there in question, no doubt, differs from ours; but the luminous reasoning of Mr. Justice Pitney in that case is relevant to the question now under consideration and compels my assent.

For the above reasons, I am of opinion that the order made by Mr. Justice Rowlatt and affirmed by the Court of Appeal was right, and that this Appeal should be dismissed.

In Greenwood's case, your Lordships were informed that the facts of this case were not distinguishable in any material respect from those in Blott's case, and I think that the result should be the same.

Lord Dunedin (read by *Lord Sumner*).—My Lords, I have found it difficult to come to a conclusion on this case. As the majority of your Lordships have determined that the Appeal should be dismissed it would be easy for me to acquiesce in that result and say no more, but I have not thought it right to refrain from expressing an opinion, as to the soundness of which I must not, after what your Lordships have said, be confident, but which represents the view which, on the best consideration I could give to the subject, I had formed.

I may say at once that I do not feel that the case is concluded by a decision. The *Swan Brewery* v. *The King* was a decision upon an Australian statute in the words of which if anything became "an advantage" it would fall within the tax. *Bouch* v. *Sproule* was a decision whether, according to the expressed wishes of a testator, certain shares in a company were to be handed over in their entirety to the tenant for life or were to be held for the remainderman, the produce thereof only going to the tenant for life. Whether the dicta in these cases afford material to settle this is another matter, to which I shall refer hereafter. My Lords, the way the question presents itself to my mind is this; the Company accumulate a large sum of profits on which they duly pay Income Tax. What could they do with them? They might have done nothing, in which case the money would just have remained part of the assets of the Company. The expression "floating "capital" is rather a convenient form of description than a legal definition of the nature of the fund. It might have paid it to its shareholders as dividends, in which case it is obvious that the recipient shareholder, if his income was above the minimum figure, would have had to include the dividend in his specification of his income for Super-tax. Lastly, however, it is said the Company might and did "capitalise" their profits. I confess I am shy of the word "capitalise". It seems to me to leave one in a hazy state of mind as to what is the legal operation which is so described. Undoubtedly it is to add something to capital. Now how can a company add to its capital? It has an authorised capital. There are certain ways in which authorised capital may be increased, but assuming the company has not taken advantage of what it can do in this way it can only issue shares to the extent to which it still has shares authorised but not issued. If, however, it does so, it cannot issue the shares for nothing. They must be paid for in money or under certain conditions in money's worth. Further, it cannot itself provide the money to pay for the new shares. If it did so it would do what would be equivalent to buying its own shares, and that it cannot do (*Trevor* v. *Whitworth*). It must, therefore, get the money from someone else. It may get it from the public or it may say to its shareholders:—"We will give you the option of subscribing "before we apply to the public", and when I say "it may" I always mean the same thing, namely, that the company can do and must do what the majority of its shareholders decide it shall do. In the present case the Company did neither of these things, but it did a thing which it was in its power to do. It may say and it did say to the shareholders; "There is "a large sum of undivided profits. We shall allot to each shareholder his "proportional amount of these profits, but we will not pay that amount in "cash, but will impute it to the payment of the shares we are issuing, and "give each shareholder the shares for which his allotted amount effectuated "payment." I cannot myself escape from the feeling that that is just giving to the shareholder his share of the undivided profits, not in cash but in the shape of paid-up shares, and if that is so, it seems to me to fall within the description of taxable income. Let me by way of illustration put the following

possibilities. Undivided profits distributed as dividend in cash—there is no question. Next, suppose that profits are in the shape of some chattels, and that the chattels are distributed; here, again, it is conceded in argument that these chattels would be income. Next, let me suppose that a company had power to acquire shares of another company, that it had used its profits to buy such shares and distributed these shares to its own shareholders. There, again, would be something which is the equivalent of profit, though viewed in the light of the other company's affairs it would be capital. The last step is to do what was done here, to use its own profits to pay up the shares which it then gave to its shareholders. I fail to see any difference in this position.

I am, however, of necessity compelled to consider the case of *Bouch* v. *Sproule*. As I have already said I do not think the decision rules the matter. It remains to see whether the dicta of Lords Herschell and Watson do so. It is evident that their Lordships had no such case as the present before their minds. Super-tax did not at that time exist. I am of opinion that the judgment in *Bouch* v. *Sproule* can be considered as based on propositions which have no application to the present case. The legal title to all the property in that case was in trustees. Shares in the Company, representing the capital of the Company, and dividends declared in respect of these shares alike fell within that legal title. But the beneficial title was, by the provisions of the testators' will, shared between two persons. One took the life interest, the other the remainder. The testator knew that his shares, and all interest flowing from the possession of those shares, were subject to be affected by such powers as the Company lawfully possessed. If, therefore, the Company decided that profits, instead of being divided and paid as dividend, should be used for the purpose of increasing the capital account, and that that increase should be divided among the shareholders, the testator might well be content that the decision of the Company should affect the rights *inter se* of his beneficiaries. If the Company settled that the profits were to be added to the capital, then they would form part of the *corpus* which must remain intact for the remainderman when his time of enjoyment emerged. If the profits were paid over as dividend, then the tenant for life would receive that dividend. That does not however, so far as I can see, settle that for the proper interpretation of a taxing Act the profits, because added to the capital of the Company, are to lose their nature as profits; and I think that the expressions used by the noble and learned Lords must be taken *secundum subjectam materiam*, and not given such a universal application as to meet a case which was far from their thoughts.

In conclusion, I would only add that I have in this opinion of set purpose refrained from relying on the dictum of Lord Sumner delivering the judgment of the Judicial Committee of the Privy Council in the Australian case(1), not because I in any way disagree with it, but because I recognise that if it is in conflict with the necessary grounds of decision in *Bouch* v. *Sproule*, then as I am sitting in this House I should be bound to follow the latter mentioned case. I think the Appeal should be allowed.

Lord Sumner.—My Lords, I hope I may be excused for repeating what seem to me the essential facts. Briefly they are these. In 1915, Hepburn, Gale and Ross, Limited, made £48,851 on a paid-up capital of £163,140. When the time came round for holding the annual meeting to declare dividends and for other purposes, the directors proposed a dividend of 10 per cent. on the ordinary shares, and, on the ground that " while the Company has heavy

(1) Swan Brewery Company v. The King [1914] A.C. 231.

" commitments, which call for all its available capital it would be unwise to " make any exceptional distribution," they also proposed " to declare a further " dividend to the ordinary shareholders, to be satisfied by the allotment of one " Second Preference Share fully paid for every three Ordinary Shares held by " them." It is a mistake to suppose that the Directors' reason for not paying a larger dividend in cash was their desire to carry on a larger and more profitable business in the future by means of an addition of £33,000 to their trading resources. They gave no such reason. They said, and very prudently too in view of rising prices and the precarious duration of the war, that they wished to keep in hand this part of the year's profits owing to their commitments, that is in order to pay possible liabilities. They had to satisfy the shareholders, yet they shrank from dissipating their reserves. Provided these two ends were attained all their objects were secured. Why should they desire to distribute 10 per cent. in cash, which was to be income in the shareholders' hands and something more which was not to be income in their hands ? What could it matter either way, except in the case of persons liable to Super-tax ? Income Tax had been paid on the Company's profits already and it was not proposed to deduct anything in respect of it from the dividend. For all we know Mr. Blott may have been the only shareholder liable to Super-tax and there is not the slightest evidence that liability to Super-tax was ever thought of by anybody. People who pay Super-tax do not usually get much consideration from people who do not. Whether the money remained in the Company's hands throughout or went out to the shareholders as dividends paid and returned to the Company as payments of calls on shares, made no difference to the Company, and if it attracted Super-tax to Mr. Blott *en route*, the result to everybody else was just the same. So far as the argument in this case is rested on an intention of anybody concerned to avoid Super-tax that intention is, in my view, a mere assumption ; so far as it assumes that the Board or the Company preferred to create bonus shares, fully paid, without any payment of a dividend beyond 10 per cent. to creating them by means of a payment of the amount due upon them and a repayment in account, it equally begs the question. The one thing that is, however, quite clear is that nobody—directors, or shareholders, or Mr. Blott—ever intended or supposed that the allottees were to be liable to pay calls on the newly issued shares out of their own property, so as to provide the Company with new money. It must also be presumed that all concerned meant to comply with the law. I think the real crux of this case was to discover what was involved in carrying out the plan and yet complying with the law, to see what was done and not be guided by the name which the Company chose to use. To call it " capitalisation " is neither here nor there, for, apart from the Companies Acts, profits may be capitalised in more ways than one. What has to be asked and answered in this case is how could they be " capitalised " in accordance with those Acts, without either leaving the holder of the new shares liable to pay them up with new money or sharing out the profits to the allottees, whether in cash or in account, so that the share-out of the money should be used to pay up the shares. To my mind there was either a payment to the shareholder of the nominal amount of the shares or the Company paid up the shares itself and gave them away for nothing. It is a question of English Company Law and no decision on the statutes or the Constitution of the United States of America can throw any light upon it. In accordance with the Board's proposals, £33,333 of the realised profits would be absorbed over and above the amount of the 10 per cent. dividend, and the carry-over would still be larger than the sum brought forward from the previous year by more than £2,000. Nothing turns on this,

however, for, by Article 128, the directors had power to set aside profits to a reserve fund (applicable, among other purposes, to the equalisation of dividends or to a distribution in case of losses), and, whether or not the surplus of the previous year was deemed to have been carried to reserve and then applied in the way proposed, enough had been made in the year in question for the purposes suggested. The shareholders adopted the Directors' proposal and a resolution was passed "That it is desirable to capitalise the "sum of £33,333 6s. 8d. being part of the undivided profits of the Company, "and accordingly that a bonus at the rate of 33⅓ per cent. per share free of "income tax on each of the issued Ordinary Shares of the Company be, and "the same is hereby declared, and that the Directors be and they are hereby "authorised to satisfy such bonus by the distribution among the members "holding Ordinary Shares rateably of 33,316 of the unissued Second "Preference Shares of £1 each in the Company credited as fully paid in "satisfaction of such bonus."

Two quite distinct matters are dealt with in this resolution, the declaration of a "bonus", and the manner in which the bonus is to be satisfied. I cannot see that including two separate things in one resolution, neither being expressed to be in any way dependent on the other can prevent each by itself from having in full whatever legal or practical consequence attaches to it as such. They are in the same position and have the same effect as if they had been separately expressed in two distinct resolutions. The first would be an ordinary declaration of a dividend, and a very handsome one too, unless there is some magic in dividing money under the term "bonus", without the use of the word "dividend"; the second is either a resolution to issue and give away shares for nothing, or it recognises a right in the shareholder to a distribution or division in cash, which is to be satisfied without cash passing and must also satisfy what the law requires, that is, some consideration moving to the Company for the issue and allotment of the shares. It is reasonably plain that this carefully worded resolution was intended to be, and was, an exercise of the powers given by Articles 125 and 127 as follows: "125. No dividend "or bonus shall be payable except out of profits arising out of the business "of the Company. 127. Any General Meeting declaring a dividend may "direct payment of such dividend wholly or in part by the distribution of "specific assets and in particular of paid-up shares of the Company. . . . "When requisite a proper contract shall be filed in accordance with Section "88 of the Companies Consolidation) Act, 1908. . . ." In effect a contract was so filed, by which it was agreed between the Company and a shareholder, duly nominated to contract "on behalf of himself and all others the holders of "Ordinary Shares in the capital of the Company and as trustee for them," that the Company should allot and issue Second Preference Shares in accordance with the resolution, to be considered as fully paid up, and that the shares so divided "shall be accepted in satisfaction of the said bonus". The result was that a "bonus" at the rate of 33⅓ per cent. per share free of Income Tax was duly declared, and that the consideration of this contract for the issue by the Company to the shareholder of its own shares fully paid was that the shareholders severally agreed by their agent and trustee by way of accord and satisfaction to take shares at the rate of 33⅓ per cent. per share, instead of the money to which they would otherwise have been entitled. As the article stood, there was no other way in which the Company could distribute paid-up shares of the Company than in payment of a dividend, duly declared out of profits, and this is what the resolution purported to do.

My Lords, I do not think that anything which took place in the following year, 1916, is sufficiently different from the facts above stated to make any separate examination of it necessary, nor is the circumstance important that the shares issued were preference and not ordinary shares. I do not, however, wish to confine my opinion to the bare terms of the resolution and contract of 1915 or of the articles then existing. The result would be the same, to my mind, if there had been no contract at all and if the resolution had contained no language of special significance, and if the articles under which the Company acted had included the article subsequently adopted, namely 127A, which enabled the Company to authorise the directors to capitalise any profits and to allot to the members holding ordinary shares of the Company in respect of the net amount capitalised, fully paid shares of the Company of equivalent nominal amount. In either case the nature of the operation performed seems to me in itself to involve the conclusion that one of its details is the declaration and payment of a dividend. My Lords, what has to be considered is what the Company was trying to do and what was involved under the Companies Acts in doing it. The word "bonus" suggests, as was the fact, that the shareholders were getting a windfall for the year, which might not recur in another year, but the term "Stock Dividend", which is common in the United States, might just as well have been used. All, I take it, that is meant by the word "capitalise" is that, when the operation authorised by the resolution has been completed, the result will be that the issued statutory capital will have been increased, and the calls due on the increase will have been paid up to an amount equal to the decrease in the reserve fund accumulated from profits previously undistributed. To the intermediate steps involved in producing this result the word in itself has nothing to say. It is quite true that where the directors recommended a "further dividend", to be satisfied by an allotment of shares, the resolution declared a "bonus", but I do not apprehend that a company can affect the taxing rights of the Crown against a shareholder by the particular name that it chooses to attach to its proceedings. Bonus or dividend (and neither word has any statutory definition), call it which you will, there was a distribution at a rate per cent. on the nominal amount of each share, which distribution was deemed to be capable of suffering deduction for tax, for it was declared free of Income Tax, and this distribution was something to be satisfied in the particular way specified, which implies that it would otherwise have been satisfied by payment of money at the rate declared.

I think that insufficient attention has been paid to the scheme of the Companies Acts as interpreted in decisions, none of which as I understood was disputed in argument (*Ooregum* case [1892] A.C. at pages 136 and 144); in re *Eddystone Insurance Company* ([1893] 3 Ch. 9); in re *Wragg* ([1897] 1 Ch. 796). It makes no difference whether the capital in question is part of the capital with which the company was originally constituted when first it started business or is capital subsequently created (per Lord Macnaghten ([1892] A.C. at page 144)). It is not a question merely of the time, whether before or after the issue of the shares, for registering a contract for satisfying liability for calls on the shares otherwise than by payment in cash in full, or of the penalty which follows on disregard of due registration. It is not a question of the mode, if any, in which a shareholder could question the action of the company in legal proceedings, but of the defence which the taker of the shares would have had to any proceedings for payment of contributions or calls. It is a question of the statutory conditions, under which alone a company can act, when it issues shares. Not only is the validity of what is done dependent

on compliance with the statutory conditions, as interpreted and reduced to principle in the decided cases, but, when something has been done in fact, it is to be presumed, till the contrary is shown, that it has been so done as to satisfy those conditions and to accord with those principles; and however compressed the business steps adopted, and however short the cuts taken, they must be given such effect for legal purposes as to represent something that satisfies, instead of disregarding, the law, What is it that happens in law and in business, when a company, instead of distributing its reserves of undistributed profit, issues shares to a like amount fully paid or credited as fully paid? If language has any accurate meaning, which in company matters is not always the case, someone has to pay the company for these shares and someone has to be credited by the company with the payment. Now the money with which the payment is supposed to have been made in the present case was the Company's money, and was and remained in the Company's possession. The Company could not pay itself with its own money. Physically, it never parted with a penny. I suppose that £33,333 6s. 8d. would be included in the first line of the balance sheet, viz., "To capital," which otherwise would have been included a few lines lower down in "Reserve Account," and that, in some account kept of payments made on the several shares, the shareholders, whether named or not, would have credit given them for payment in full, amounting in the aggregate to the same amount. Apart from what the law has to say to it, this merely records that the Company has given away for nothing a number of full participant rights in its business, its assets and its income, and on the other hand has not given away any of the money, which would otherwise have been available for distribution. No doubt the transaction results in the company having more statutory capital issued than before, and less accumulated and undistributed profit, but the present question is not one of the result but of the process by which the result is attained.

The scheme and the principle of the statute law on this subject are clear. It takes two to make a paid-up share. A share issued, whether it is part of the Company's original issue of capital or is one issued on the occasion of surplus profit arising, is a share to be paid for: paid for by the allottee in meal or in malt; in money, unless by contract between himself and the Company he is enabled to satisfy his obligation to pay by some other consideration moving from himself to the company. Under the contract in question what consideration so moves from the shareholders? None that I can see, except the discharge of the Company's debt for a dividend, which has become due to him by being declared. When debt for dividend is set off against debt for calls and the account is squared, the equivalent of payment of a dividend takes place. If the word "bonus" has some effect to the contrary, then no consideration has moved from the shareholder and his shares are not fully paid. The Company can choose whether it will divide its profits in meal or in malt; if it decides to divide otherwise than in cash, a contract to accept something in lieu of cash operates nothing, for no right to cash has accrued. A contract to accept shares in satisfaction instead of cash implies, first a declaration which gives a right that has to be satisfied, and second a satisfaction of that right, which is equivalent to payment. A shareholder's agreement, even though made by an agent duly authorised, that the company shall allot and issue certain shares credited or fully paid up has no validity in itself and adds nothing to what was resolved at the general meeting. His agreement that the shares are to be accepted "in satisfaction of the said bonus" either accepts, in lieu of something substantial, a benefit which is illusory, namely,

a fully paid share which is not fully paid but has still to be paid for or otherwise lawfully satisfied, or else must accept it in a way which can satisfy the scheme of the statutes. The shareholder must remain liable to pay up the full amount of the share unless by a contract between himself and the Company a consideration is given by him for the share, which will have the effect of payment by way of set off, accord and satisfaction, or otherwise.

My Lords, the classic way in practice of carrying out the perfectly well-known operation which this Company had in view is stated in Palmer's "Company Precedents" (11th ed., vol. 1, page 1062). Your Lordships were not informed that there was any other known form which is valid and in use, and I know of none. It is not necessary for present purposes to decide that no other mode of producing the desired result and yet complying with the law is feasible. It is enough to say that what was done should be referred to and is best explained by the standard practice on the subject, and that the rational and normal effect must be deemed to be such as will satisfy the principle of the Companies Acts. If that effect is attributed to what was done here, a dividend was paid to the Respondent. It cannot matter for the purposes of the Revenue what he did with the money or money's worth distributed to him, or whether its disposal was the subject of prior agreement or not. Suppose Mr. Blott had had to sue the Company to get these shares, is it to be said that his action would fail? If not, he would succeed by virtue of a legal right, founded on the Company's resolution, to receive his portion of that which had become divisible among the shareholders. He would be entitled to have this brought into his hands by action. True, he would have to claim and take it in the form of newly issued capital stock, but it would come to him as dividend. If, peradventure, the Company sued Mr. Blott for calls on his shares, what would his defence be? Why, that by payment or set-off, he had satisfied his liability. It would not be that the Company had contracted not to ask for calls, for there is no consideration for any such contract, yet some defence he must have; for, if he had none, everybody's intention would be defeated. If he had, it must be because dividends have been paid to him or to his use, for no other source of payment exists. If I do not mistake, the contrary view is put shortly in three ways. The first is that it is a question of the form of the articles and of their being *intra vires* the memorandum, there being a power in a company, by a direct and simple process, to pay up its own shares in full and then give them away, so long as it only uses for this purpose profits already made, which, as such, are at its disposal to deal with as it pleases. It may be necessary in view of Section 88, to declare a bonus and allot shares by agreement, but as Mr. Justice Rowlatt says this is "bare machinery. The fact is simply that the shareholders were given shares instead of a bonus." The second is that a shareholder gets no right *in rem* to the company's profits, unless he has a right of action to recover a dividend duly declared, and the tax is only attracted to what reaches his hands or might be brought into them by action, whether the Company's action in not letting the dividend actually reach his hands is or is not in itself regular. The third is that, on principle and by decision, a company can, as against all the world, the Inland Revenue included, decide whether to divide its profits as income or convert them into capital, and, on giving away the one or the other, decides conclusively whether what is given is capital or income. The principle is supposed to be derived from the Companies Acts, and the decision relied on is *Bouch* v. *Sproule*, a case that has, I think, never before been regarded as a Revenue decision.

My Lords, I am not sure that these three ways of putting the matter are by any means identical or are even reconcilable. A company may choose not to divide profits among shareholders, but to use them whether it makes them part of the wealth with which it trades, or no longer trades with that wealth but applies it to the creation of further paid up statutory capital in such fashion as the law requires. When it decides this, why must it be assumed to decide anything more? Why should its decision bind utter strangers, for example, the Inland Revenue? There is no ground that I know of for saying that money is not paid to a shareholder unless the intention is that he may dispose of it just as he pleases, any more than there is for saying that money may not be duly paid by book entries but can only be paid in cash. There will be a payment even though by pre-arrangement there is a repayment immediately afterwards. Money, though it comes with a clog on it, is taxable, if and because it comes. How can mere nomenclature affect rights, which depend on what has to be done in order to satisfy the law? Could a company declare and pay a dividend in the ordinary way and yet, by first calling it "capital" and saying it was not "income", prevent the cash from being taxable as income in the shareholders' hands? Granting that a company is free to give a shareholder the money with which to pay up his calls on shares newly issued to him, this is paying money to him or to his use, and to send him this money out of the year's profits along with his dividend warrant or to apply it to his use in the same way and at the same time is surely to put in his hands an annual profit or gain, whether the company chooses to call it capital or nothing at all. Again, to say that the matter depends on the question whether or not the articles are *intra vires*, or that the intention of the resolution is dominant, and all the rest is "mere machinery" is, I say it humbly, to beg the question. How can articles authorise a company to disregard the scheme of the Acts, though they may enable a company to do collectively what otherwise must be agreed with the shareholders individually? To call the steps that might be relied on as satisfying that scheme "mere machinery" is to evade the difficulty. It is just as reasonable to call the shares allotted "mere machinery" for wrapping up a distribution of profit as to call bonus shares "mere machinery" for effecting a distribution of capital. "Looking at the substance and not at the form" is a good guide for judicial conduct, but what is substance? If a form has to be gone through in order to satisfy the law for my part I should think it was pretty substantial. A final opinion, on these questions need not, however, be expressed to-day. Whatever innate powers a company may have, the present question must depend on the legal effect of what it did, not on names given and objects or desires kept in view.

My Lords, apart from authority, my conclusion is that the Company made this distribution of bonus shares to its shareholders out of its annual profits or gains; that it adopted a machinery for doing so which involved the payment of a dividend; that cross cheques, one for dividend and another for calls, were not exchanged because in business that would be a useless procedure, and the same results with the same liabilities and incidents could be obtained by an obvious short cut; and that Mr. Blott, having in effect received a dividend from which, if called upon to do so, he must have allowed a deduction for duty previously paid by the Company so as to fall as a burthen on him, is bound to bring in this dividend as one of his sources of income for Super-tax. Having arrived at this conclusion on the general law of statutory companies as now settled by decisions, I turn to the case of the *Swan Brewery* (1).

(1) Swan Brewery Company v. The King [1914] A.C. 231.

I have re-examined the cases of the Appellants and the Respondents presented to the Privy Council and the Record on that Appeal, the report in the Court below (14 W. Australia L.R.177) and the Companies Act of West Australia applicable to the case, that of 1893. I am quite clearly of opinion that what was said by the Judicial Committee, as to the effect in law and in business of a distribution of bonus shares, was part of the decision and cannot be distinguished from the present case. Of course it does not bind your Lordships, but I think it ought to be followed by all who do not feel themselves prepared to say that it was wrong and to say clearly why it was wrong. That case did not turn on the special definition of dividend in the taxing statute of West Australia. The argument both in West Australia and on Appeal was, as it has been here, that the transaction was solely one of allotting shares; that it was indivisible, and that nothing equivalent to the payment of a dividend occurred. *Bouch* v. *Sproule* (1) was cited and was considered. The passage in question was an essential part of the decision. It is in point now and I adhere to it. My Lords, no authority has been cited to the contrary of the proposition laid down in the *Swan Brewery* case, apart from *Bouch* v. *Sproule* and, with all respect to the Court of Appeal, I do not think there is anything in the opinions there expressed which really touches the present case. In *Bouch* v. *Sproule* before any question arose or could arise between tenant for life and remainderman, shares had been issued upon a plan which had completely succeeded, for they were offered upon terms which only sheer carelessness or sheer folly could fail to accept. The offer was, of course, accepted by everybody, the trustee of the fund in question among the rest. I should think refusal would have been a breach of trust on his part, for his business was not to throw an obviously good thing away. It was only when all this had been done that any question could arise. Everybody approbated this issue of the shares and the way in which it had been made. Both the tenant for life and the remainderman claimed the benefit of it, and therefore affirmed it. Neither could be heard to say he would take the shares but repudiate the scheme. The only question was how the settlement operated in the events which had happened as between these beneficiaries.

In any literal sense of the word intention had nothing to do with the matter. The testator had none, for he never gave the question a thought; the trustee had none, for his duty was to leave the law to settle the incidence of the benefits. He had no right, by electing to take the shares, to benefit the tenant for life to the prejudice of the remainderman. The directors and the shareholders were strangers to the settlement and heard and knew nothing about it. The Company, in so far as intention is a mental act, was incapable of having any intention at all. The tenant for life and the remainderman had no intention except to get the most out of what had been done; in the doing of it they had and could have had no hand at all. The intention, which the final decision assumed, was one of those so-called intentions which the law imputes; it is the legal construction put on something done in fact. The testator had disposed of shares with regard to which the Company could take a certain course. He was not affected by the Companies Acts but could determine for himself what should be capital and what income to the objects of his bounty, or could leave to be determined by others, including the Company, just as he chose. The law deemed him to intend his disposition to apply according to whatever course in fact was taken, and, by means of this assumption of his intention, an effect was given to his disposition which was

(1) (1887) 12 A.C. 385.

consistent with the fact that the parties derived their rights solely from his bounty, although in circumstances in which, as a matter of fact, he had made no conscious disposition at all. My Lords, needless to say, I fully accept everything laid down in *Bouch* v. *Sproule* unreservedly, but I think it is only indirectly a decision upon the power of companies to capitalise undistributed profits and, as regards the steps by which this is or is not deemed to be done, it is not a decision at all. Doubtless a company can capitalise its own undistributed profits, and can, by taking the appropriate steps, turn them into new fully paid shares and no corporator can say it nay, still less can persons who only claim through and under a corporator. The question here is what is further involved in such action on the Company's part, but *Bouch* v. *Sproule* only decides the effect as between a tenant for life and a remainderman of a valid capitalisation and issue of shares and tests it by the design carried out and accomplished by the company, by whatever intermediate steps this may have been done. What I wish to point out is that the machinery by which the issue of shares was effected, never came in question at all, nor did any question of taxation. Super-tax was unthought of. The Company had paid its Income Tax and need not deduct if it did not choose. No rights of third parties arose, and the issue of shares was doubly a domestic matter for it not only turned on the construction to be placed on the status of these shares, as fixed by the Company for its corporators, but further, the dispute arose only between beneficiaries, the aggregate of whose separate interests made up the total interest in each share held by the trustee. However, it was decided the Crown lay outside the circle of corporators. Its right to tax was a wholly external matter, and never was brought before the House at all. There is then nothing in the reasoning required for the solution of that problem, which touches the present question, namely, whether or not the machinery by which an issue of bonus shares is effected does or does not involve payment of a profit or gain to the actual shareholder who is taxed, within the meaning of the Income Tax Acts, and as one would expect very few words are to be found in the case which can be said to bear on the present matter at all. The whole weight of *Bouch* v. *Sproule* for present purposes rests on the passage at the end of Lord Herschell's opinion at the bottom of page 399, where he says "The company did not pay, or "intend to pay, any sum as dividend, but intended to and did appropriate "the undivided profits dealt with as an increase of the capital stock in the "concern."

My Lords, if Lord Herschell meant to say, as surely he did not, that no dividend had been paid, it was not true. A dividend warrant had been sent out in the form of a negotiable instrument which, had it been presented for payment, must have been paid in cash. The obligation to do so was only satisfied because the shareholder did not choose to cash his warrant, but applied it by agreement in another way. Lord Herschell looked at the whole plan and not merely at one step in it. What he meant was something highly germane to the issue, namely, that the plan, which the Company carried out, was not a mere plan for paying the usual dividend in a novel form, but was a more far-reaching design to bring about an increase in statutory capital without physically parting with cash. Such a design has a legal effect on those whose rights only arise on the footing that the design has been accepted and affirmed; it has none on the officers of the Revenue, whose rights are statutory and independent, and intervene before the point is reached at which the interests of parties like those in *Bouch* v. *Sproule* become concerned. It cannot be said that, if what is done falls within the statutory charge, a meeting of

shareholders can prevent the charge from attaching by agreeing within its own doors on the use to which the members severally will put their money. Of the four noble Lords who took part in the decision, two, Lords Bramwell and Fitzgerald, say nothing about payment of a dividend whatever, while Lord Watson says, at page 404, that payment for the amount due on the share was imputed in the " company's books "; in other words that when the trustee accepted the offer of shares and sent back his dividend warrant to pay them up with, the Company so entered the transaction and gave him credit in its books for his payment. I am, therefore of opinion that the actual decision and the principle of *Bouch* v. *Sproule* are limited to the case in hand and do not affect the present Appeal, and that, alike in principle and on the authority (if I may call it so) of the *Swan Brewery* case there was a payment here, which clearly was to Mr. Blott an income payment. Accordingly he is liable and the Appeal should be allowed.

Questions put:

In *Commissioners of Inland Revenue* v. *Blott.*

That the Judgment of the Court below be reversed.

The Not Contents have it.

That the Judgment of the Court below be affirmed and this Appeal dismissed, with costs.

The Contents have it.

In *Commissioners of Inland Revenue* v. *Greenwood.*

That the Judgment of the Court below be reversed.

The Not Contents have it.

That the Judgment of the Court below be affirmed and this Appeal dismissed, with costs.

The Contents have it.

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by PERCY LUND, HUMPHRIES & CO. LTD.

(10921) Wt. 3662/1228/Ps. 5910. 500. 3/35. P.L.H. & CO. LTD. G.922.