No. 603.—High Court of Justice (King's Bench Division).—18th June, 1925.

Court of Appeal.—26th November, 1925, 23rd March, and 26th April, 1926.

House of Lords.—17th, 18th and 21st February, and 4th April, 1927.

Betts (H.M. Inspector of Taxes) *v.* Clare and Heyworth, and Clare and Heyworth, Limited.[1]

Income Tax, Schedule D—Business set up within the three years preceding the year of assessment—Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.* 40), *Schedule D, Cases* I *and* II, *Rule* 1 (2).

A firm of textile manufacturers commenced business on the 1*st March*, 1919, *and made up their first account for the period of ten months to the* 31*st December*, 1919. *In February*, 1920, *as was contemplated from the beginning, the partners in the firm formed a limited company to take over the business as from the* 1*st January*, 1920. *The company decided to make up its accounts annually to the* 31*st March in each year, and an account was made up for the three months to the* 31*st March*, 1920, *showing a heavily increased rate of profit compared with that for the preceding ten months. The company's accounts for years subsequent to* 1920 *were made up to the* 31*st March.*

The Crown contended that the Income Tax assessment in respect of the business for the year 1919–20 *should be arrived at by taking* 12/13*ths of the aggregate profits shown by the two accounts for the periods of ten months to the* 31*st December*, 1919, *and three months to the* 31*st March*, 1920.

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[1] Reported K.B.D., [1925] 2 K.B. 402; C.A., [1926] 2 K.B. 289; and H.L., [1927] A.C. 433.

The firm and company, between whom the assessment fell to be apportioned, contended on the other hand that the assessment for that year should be made in the amount of 12/10*ths of the profits shown by the first account for the ten months to the* 31*st December,* 1919, *and the Special Commissioners decided in their favour.*

Held, *that the assessment for the year* 1919–20 *should be based on the average of the profits for the period preceding the year of assessment—i.e., for the period from the* 1*st March,* 1919, *to the* 5*th April,* 1919.

Burntisland Shipbuilding Co., Ltd. *v.* Weldhen (8 T.C. 409) *approved.*

CASE

Stated under the Income Tax Act, 1918, Section 149, 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 11th February, 1924, for the purpose of hearing appeals, Arthur Clare and Herbert Heyworth, formerly trading as Clare and Heyworth (hereinafter called the Respondent firm), and Clare and Heyworth, Limited (hereinafter called the Respondent Company), appealed against an assessment to Income Tax made on the 3rd April, 1922, in the sum of £6,250, and an additional assessment made on the 14th February, 1923, in the sum of £4,358 upon the Respondent firm, and an assessment to Income Tax made on the 3rd April, 1922, in the sum of £6,250 upon the Respondent Company for the year ending 5th April, 1920, in respect of profits of trade, by the Additional Commissioners of Income Tax for the East Morley Division of the West Riding of Yorkshire under the provisions of the Income Tax Acts.

2. On the 1st March, 1919, the Respondent firm set up and commenced a new business as textile manufacturers. On the 31st December, 1919, acting upon the advice of their accountant, they took stock and made up the first account of their business for the period of ten months from 1st March to 31st December, 1919. They took this course because their accountant anticipated that the Excess Profits Duty would be terminated at the 31st December, 1919, and that an accurate account for the period ending on that date would be required for the purposes of that tax. The profits of the business for the said period of ten months amounted, according to this account (the accuracy of which was not challenged), to £1,000.

3. On the 12th February, 1920, the Respondent firm entered into an agreement for the sale of the goodwill and assets of their business to the Respondent Company as from the 1st January, 1920. The Respondent Company was incorporated on the 16th February, 1920, and adopted the said agreement of 12th February, 1920, on the 1st March, 1920. The members of the Respondent firm were the sole shareholders in the Respondent Company.

4. The Respondent Company has since continued to carry on the business acquired from the Respondent firm. It decided to make up its accounts annually to the 31st March in each year, and to this end it made up an account of the business for the period of three months from the 1st January, 1920, to the 31st March, 1920. This period was one of great prosperity in the textile industry, and the profits of the business for these three months amounted to £12,150. This figure is not disputed.

5. The Respondent Company has made up its accounts for each year subsequent to 1920 to the 31st March. It was admitted that the Respondent firm had from the first contemplated the formation of a limited liability company to take over the business, and that apart from considerations of Excess Profits Duty the first account of the business would in all probability have been made up for the period of thirteen months from the 1st March, 1919, to the 31st March, 1920.

6. The Respondent firm was assessed on the 3rd February, 1923, for the year 1918–19 to Income Tax in respect of profits of trade for the period 1st March to 5th April, 1919, in the sum of £117, being a due proportion of the profit of £1,000 shown by the account for the period of 10 months ending 31st December, 1919. It was not disputed that this assessment was correct.

7. It was contended on behalf of the Respondent firm and the Respondent Company that the assessment to Income Tax for the year ending 5th April, 1920, ought to be made in the sum of £1,200, being twelve-tenths of the profit of £1,000 shown by the first account for the period of ten months ending 31st December, 1919, and apportioned between the Respondent firm and the Respondent Company under Rule 9 of the Rules applicable to Cases I and II of Schedule D.

(2) That under Rule 1 (2) of the Rules to Cases I and II, Schedule D, Income Tax Act, 1918, the computation for the year 1919–20 (the second year of assessment) should be made on the average of the profits from the date of the first setting up of the trade, viz., the 1st March, 1919.

(3) That profits arising in the year of assessment are incapable of being made the subject of the retrospective method of computation applicable to profits of trade under the

relevant provisions of the Income Tax Act, 1918, and that the method of assessment adopted by the Revenue in this case involved a departure from this method which was not warranted.

(4) That the proper method of assessment was to expand the profits for the ten months to 31st December, 1919, to terms of one year.

(5) That the fact that the making of assessments was delayed or that assessments were not made until after preparation of an account of profits arising in the year of assessment did not justify the bringing into computation of those profits for assessment under Case I of Schedule D.

(6) That the assessments appealed against should be reduced to the sum of £1,200.

Reference was made to S.S. "*Glensloy*" *Company, Limited* v. *Lethem*, 6 T.C. 453, and *Burntisland Shipbuilding Company, Limited* v. *Weldhen*, 8 T.C. 409.

8. It was contended on behalf of the Crown (*inter alia*) that the assessment for the year ending 5th April, 1920, ought to be made in the sum of £12,138, being twelve-thirteenths of the profits of £13,150, arrived at by combining the two accounts for the periods of ten months from the 1st March to the 31st December, 1919, and three months from the 1st January to the 31st March, 1920. It was agreed that the assessment ought to be apportioned between the Respondent firm and the Respondent Company.

9. We, the Commissioners who heard the appeal, allowed the claim that the liability to Income Tax for the year ending 5th April, 1920, should be based on the account for the ten months to 31st December, 1919, without regard to the account for the three months to 31st March, 1920, and we accordingly reduced the assessment to the sum of £1,200 to be apportioned between the Respondent firm and the Respondent Company.

10. The Appellant 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 Income Tax Act, 1918, Section 149, which case we have stated and do sign accordingly.

P. WILLIAMSON,
N. ANDERSON,
Commissioners for the Special Purposes of the Income Tax Acts.

YORK HOUSE,
23, KINGSWAY,
LONDON, W.C.2.

22nd January, 1925.

The case came before Rowlatt, *J.*, in the King's Bench Division on the 18th June, 1925, when judgment was given against the Crown with costs.

The Attorney-General (Sir Douglas Hogg, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown, and Mr. Cyril King for the Respondents.

JUDGMENT.

Rowlatt, J.—In this case the facts are these : A firm commenced a business on March 1st, 1919. Then arrived April 6th, which is the beginning of the financial year. They had not made up any accounts up to that date, naturally. When the 31st December came they made up accounts to that date, and showed a profit of £1,000 for ten months—£100 a month, roughly speaking. In the course of the early part of 1920 they transferred their business to a company; practically the same people are interested in the company, and they turned their business (as the phrase is) into a limited company, and the result of that was so salutary to the business that the profits increased forty times, because between 1st January and 31st March they made £12,000. For the broken end of the year preceding they were assessed by taking the proportion of the £1,000 (for the ten months) which could be attributed to the first month of their trading. Now comes their assessment for the next year, 1919–20. The point between the parties is this : The Crown, who is the Appellant, says that the three months of the company's time, from January to March, must be brought into account. The Respondents say that it must not. Nothing turns upon the change from the firm to the company ; you have got to find out what was the year's profits of the business, and how it is divided does not matter ; both parties are agreed upon that.

The point turns upon the construction of the Rules applicable to Cases I and II of Schedule D, Rule 1, sub-Rule (2), where the trade, profession, employment or vocation has been established or commenced within the period of three years from, but not within, the period of assessment. Then you are to take an average. When you have to calculate an average to give you a figure expressing relation of quantity to time, you have to have two periods : First of all you have to have the period for which you are to take the average, that is to say, is it to be the average of monthly profits, the average of weekly profits, the average of daily profits, the average of hourly profits, or whatever it may be? That is the period for which you are to take the average. But you also have another period, which is the period over which you are to calculate the average : Is it to be over a year, over ten years, over a century, or what is it to be? Now in this Rule here they use the phrase : " the average of the profits or gains for one year " from the period of the first setting up of the same." I think that means the average yearly profits : that is, a year is to be the

period for which you are to take the profits, and the period over which you calculate the profits is a period which is to run from the first setting up of the business, and is to end on a date which is not specified in this Rule. The point between the parties is whether that period over which one calculates the average is to end at the beginning of the year of assessment or is to run into the year of assessment. If it runs into the year of assessment, does it run to the end of the year of assessment, or can it be determined at a point in the year of assessment at the election of the Crown or of the taxpayer; or does it run past the year of assessment, and then end at some date which is determined at somebody's election in the future, subject to the expiry of the time when the assessment is made? It seems to me the matter is decided by the Scottish Courts. In the *Glensloy* case(1), the judgment of Lord Johnston, which was a dissenting judgment, expressed perfectly clearly the view that the *terminus ad quem* of the period over which you calculate the average was the beginning of the year of assessment, that is to say, in this case the antecedent facts alone were to be looked at. In the subsequent case of the *Burntisland Shipbuilding Company*(2), it is put beyond any sort of doubt, in my judgment, by Lord Cullen, and I think the Lord President says exactly the same thing, and Lord Skerrington concurs, but I think Lord Cullen puts it more shortly, and I will read what he says(3): "I think "the natural reading of the statutory enactment in question is "that where the period of trading antecedent to the year of "assessment is shorter than three complete years, the materials "for computing the artificial amount of profit for the year of "assessment consist of the results of the trading for such shorter "antecedent period"—that means the period antecedent to the year of assessment—"Thus, if that period had been $2\frac{1}{2}$ "years, the cumulo profits made during that period fall to be "divided by $2\frac{1}{2}$, similarly as would the profits of 3 complete "years' antecedent trading be divided by 3." That is what the Lord President has pointed out is the sense that must be given to the calculation of the average where there is not a large enough amount to apply the word "average," in the sense of an arithmetical mean, with absolute strictness. That is what they say upon the point of construction, and that is the result at which the Courts of Scotland arrive. There remains to be dealt with the *Glensloy* case(1), and that is explained in the *Burntisland* case. The *Glensloy* case was like the present case in this respect, that no figure had been arrived at by balance sheet for the broken first year of assessment, and the authorities got at it, as they did in this case, by looking at the first published balance sheet, and that got the assessment for that first year out of the way.

(1) The Steamship "Glensloy" Co., Ltd. *v.* Lethem, 6 T.C. 453.
(2) The Burntisland Shipbuilding Co., Ltd. *v.* Weldhen, 8 T.C. 409.
(3) 8 T.C. at p. 420.

Then for the assessment in question they looked at that balance sheet again. The Lord President says the *Glensloy* case decided that(1). " Great stress was laid in the judgment of the majority " —very properly as I venture to think—on the fact that there " was no balance sheet, and therefore no profits ascertained, " until after the commencement of the second year of assessment; " and, where that is the case, I desire to say nothing against the " view that a first balance sheet, though struck within the second " year of assessment may—at any rate in circumstances such as " were present in the *Glensloy* case(2)—be used evidentially in order " to ascertain the ' average of the profits for one year from the " ' period of the first setting up ' of the trade." I think he is plainly saying that what has to be ascertained is the average for one year of the profits from the setting up of the business to the beginning of the year of assessment, and that it is only as evidence of these profits and not as varying the principle of assessment, that figures running into the second year of assessment could be looked at. Now that is this case, if you take the balance sheet which was rendered on the 31st December. You may look at that, which runs into the first year of assessment, but includes the period antecedent to the year of assessment, as evidence of what was the profit in the included period antecedent to the year of assessment. The Lord President says that he does not agree in going beyond that. What the Crown here says is : " Extend " your evidentiary proceedings and take the next balance sheet " which was made out "—a balance sheet which was sundered from the one before, and brings in the highly increased profits of a period which did not include the period antecedent to the year of assessment—" and say that is going to be evidence of what in " fact were profits antecedent to the year of assessment." It seems to me there is no warrant for that at all. It is not supported by the *Glensloy* case(2), and it is certainly not supported by that case according to the construction put upon it by the *Burntisland* case(3). Therefore, in my judgment, the Commissioners in this case were right, and the appeal must be dismissed with costs.

The Crown having appealed against this decision, the case came on for hearing in the Court of Appeal (Lord Hanworth, *M.R.*, and Scrutton and Sargant, *L.JJ.*) on the 26th November, 1925, and the 23rd March, 1926, when judgment was reserved. On the 26th April, 1926, judgment was given in favour of the Crown with costs (Scrutton, *L.J.*, dissenting), reversing the decision of the Court below.

The Attorney-General (Sir Douglas Hogg, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown, and Mr. Cyril King for the Respondents.

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(1) 8 T.C. at p. 420.
(2) The Steamship "Glensloy" Co., Ltd. *v.* Lethem, 6 T.C. 453.
(3) The Burntisland Shipbuilding Co., Ltd. *v.* Weldhen, 8 T.C. 409.

JUDGMENT.

Lord Hanworth, M.R.—This is an appeal from a judgment of Mr. Justice Rowlatt given on the 18th June, 1925, upon a Case stated by the Commissioners for Special Purposes, whereby he confirmed the decision of the Commissioners. The facts must be shortly stated. On the 1st March, 1919, the Respondent firm set up and commenced a new business as textile manufacturers. On the 31st December in the same year they took stock and made up the first account of their business for the period of ten months from the 1st March to 31st December, 1919. This was done for a special purpose, because it was anticipated that the Excess Profits Duty would be terminated at the latter date, and that an accurate account for the period down to that date would be required in connection with that tax. For that period of ten months the profits of the business amounted to £1,000. On the 12th February, 1920, an agreement was made between the Respondent firm and the Respondent Company, and subsequently carried into effect, whereby the firm sold to the Company its goodwill and assets, and the Company has thereafter carried on the business of the firm. The members of the Respondent firm were the sole shareholders in the Respondent Company. The Company made up its accounts to the 31st March, 1920, and has continued in each subsequent year to treat that date as the close of its financial year. The three months from the 1st January to 31st March, 1920, proved to be a period of great prosperity, and the profits of the business for those three months reached the total of £12,150. The Case proceeds: "It was admitted that the Respondent firm "had from the first contemplated the formation of a limited "liability company to take over the business, and that, apart "from considerations of Excess Profits Duty, the first account of "the business would in all probability have been made up for the "period of thirteen months from the 1st March, 1919, to the 31st "March, 1920. The Respondent firm was assessed on the 3rd "February, 1923, for the year 1918–19 to Income Tax in respect "of profits of trade for the period 1st March to 5th April, 1919, "in the sum of £117, being a due proportion of the profit of £1,000 "shown by the account for the period of ten months ending 31st "December, 1919. It was not disputed that this assessment was "correct. It was contended on behalf of the Respondent firm "and the Respondent Company that the assessment to Income "Tax for the year ending 5th April, 1920, ought to be made in "the sum of £1,200, being twelve-tenths of the profit of £1,000 "shown by the first account for the period of ten months ending "31st December, 1919, and apportioned between the Respondent "firm and the Respondent Company under Rule 9 of the Rules "applicable to Cases I and II of Schedule D."

No question arises as to the apportionment of the amount to be paid by the firm and the Company respectively. The question which we have to determine is how ought the assessment for the

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year ending 5th April, 1920, to be ascertained. Ought the period down to the 31st December, 1919, the date of the first account, only to be taken and expanded to twelve months by a simple arithmetical calculation; or ought the profits of the whole year to 31st March, 1920, to be taken? The first of these methods excludes the large sum of £12,150 from the assessment; the latter includes it. The Commissioners and Mr. Justice Rowlatt decided in favour of the first method, and the Crown appeals. The Crown claims that the full period of business down to the close of the first period of thirteen months, on the 31st March, 1920, ought to be taken, and that twelve-thirteenths of the total, reached by adding the £1,000 for the first ten, to the £12,150 for the last three months, making together £13,150, namely, £12,138, is the amount on which the Respondents are to be assessed.

Income Tax in the year ending 5th April, 1920, was charged by Section 1 of the Income Tax Act, 1918, for there was in that year an Act (8 & 9 Geo. V, cap. 15) which, by Section 17, charged Income Tax at 6*s.* in the £.

Section 1 of the Act of 1918 is as follows: "Where any Act "enacts that income tax shall be charged for any year at any "rate, the tax at that rate shall be charged for that year in "respect of all property, profits, or gains respectively described "or comprised in the schedules marked A, B, C, D, and E, con- "tained in the First Schedule to this Act and in accordance with "the Rules respectively applicable to those Schedules." And by Section 2 every assessment and charge to tax is made for the year commencing 6th April, 1919, and ending 5th April, 1920. Schedule D is the Schedule which comprises the profits or gains of the Respondents, and the tax is to be charged in accordance with the Rules applicable to that Schedule. I have set out the original charging Section because it is important to remember that, while the Schedule and the Rules provide the machinery whereby the profits and gains that fall within the Schedule are to be measured, the primary liability is enacted by Section 1. Annual profits or gains arising or accruing to any person residing in the United Kingdom from any trade not contained in any other Schedule fall within Schedule D, and are charged to tax under Case I.

The Rules applicable to Schedule D now come into consideration. The relevant part of the Rule applicable to Case I is as follows: "The tax . . . shall be computed on the full amount "of the balance of the profits or gains upon a fair and just average "of three years ending on that day of the year immediately pre- "ceding the year of assessment on which the accounts of the said "trade have been usually made up, or on the fifth day of April pre- "ceding the year of assessment." It is thus that the three years' average referred to in the later Rule is introduced, and the conclusion of those three years may fall either on the last day of the

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financial year of the business preceding the year of assessment, or on the last day of the Income Tax year under Section 2 of the Act of 1918. The option thus given is determined, so we are told, by the facts of each case. If the accounts of the trade or business are made up to a particular date, that is taken: if not, the last day of the Income Tax year is used. In the present case the business was commenced but a few weeks before the year of assessment, and the three years' average does not apply. Thus, Rule 1 (2) of Cases I and II, Schedule D, applies, which is as follows: "Where "the trade, profession, employment, or vocation has been set "up and commenced within the said period of three years, the "computation shall be made on the average profits or gains for "one year from the period of the first setting up of the same, and "where it has been set up and commenced within the year of "assessment, the computation shall be made according to the "rules applicable to Case VI." It may be added that by Section 207 the rules and directions contained in the Fifth Schedule are to be observed, "so far as the same are respectively applicable."

I have now referred to all the relevant parts of the Act—Schedule, Case and Rules. In no part of them can I find any authority for making the year of assessment, or the limit of time, at which the period from which the assessment is to be calculated determine at the 31st December, 1919, the date which was adopted by the Commissioners and approved by Mr. Justice Rowlatt. That date was chosen for a particular purpose, namely, as the close of an accounting period under the Finance (No. 2) Act, 1915, which imposed the Excess Profits Duty. It was not the close of the financial year or half-year of the business. I cannot find any justification for the selection and approval of that date.

Coming back then to the part of the Rule relevant to such facts as are present here, where the business has been set up and commenced within three years preceding the year of assessment "the computation shall be made on the average of the profits or "gains for one year from the period of the first setting up of the "same." The *terminus a quo* is expressly laid down, that is in the present case the 1st March, 1919. What is the *terminus ad quem*? The word "average" appears to indicate a period longer than that for which the assessment is to be made, for all cases have to be determined under this part of the Rule in which the trade "has been set up and commenced within "the said period of three years"—that is the three years preceding the year of assessment, while it could only be shorter if the commencement of the business was just before the year of assessment began and the financial year of the business closed at a date earlier than twelve months from its commencement. The words "profits or gains for one year" are, I think, substituted as a synonym for "annual profits or "gains." The clause cannot mean that the period for computation

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is to be twelve months running from the first setting up of the business. Such an interpretation gives no effect to the word "average," and selects an arbitrary termination of the year, at a moment which may be neither coincident with a balance sheet, with the year of assessment, nor with any anniversary in the business. Such a capricious date is not consonant with the general system of the Act. Inasmuch as the case supposed is that of a business which "has been set up and commenced within the said "period of three years," and the *terminus a quo* starts from the period of the first setting up of the same, it seems not irrational to take the last date down to which figures for the average are to be taken, as the close of the financial year of the business or of the year of assessment, selected as above indicated—that is in the present case the 31st March, 1920.

If it is objected that this method may involve some estimate or prophecy as to what will be, or will have been, the profits and gains for a year not concluded at the date when the return for assessment purposes has to be made, it may be answered that in some cases where the three years' average system is not available this very method is enjoined, as in the case of "profits of an un-"certain value and of other income described in the rules applic-"able" to Case III (see Finance Act, 1922, Section 17) and those falling under Case IV. When the computation thus formed on estimate or prophecy is not realised, under Rule 8 of the same series of Rules, on proof at the end of the year to the satisfaction of the Commissioners that the actual profits or gains fall short of the amount so computed, the trader is entitled to be charged on the actual amount instead of upon the amount so computed, and if there has been payment of the sum in excess of the adjusted figure, the trader is entitled to repayment of the amount over-paid.

It is further to be noticed that in cases which fall within the last clause of Rule 1 (2)—that is those businesses which have been set up and commenced within the year of assessment and in respect of which the computation is to be made according to the Rules applicable to Case VI, "the computation shall be made, "either on the full amount of the profits or gains arising in the "year of assessment, or according to an average of such a period, "being greater or less than one year, as the case may require, and "as may be directed by the commissioners." There is thus power in them to require a period of such length as down to the end of the year of assessment may give a fair average—and an arbitrary shorter limit than the end of the year of assessment is not imposed. It is difficult to find reason why in the cases of businesses commenced in the year of assessment, the term for computation may be to the end of the year of assessment; whereas, in the cases of businesses commenced before the year of assessment, a shorter term is imposed. Mr. Justice Rowlatt said that

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the question to be decided by him had been decided by the Scottish Courts, and he followed the decisions of the *Burntisland Shipbuilding Co., Ltd.* v. *Weldhen*, 8 T.C. 409, explaining the case of *The Steamship "Glensloy" Co., Ltd.* v. *Lethem*, 6 T.C. 453. Those cases are not binding upon this Court, but it is necessary to examine them.

I have great difficulty in following the reasoning of the majority of the Court in the *Glensloy* case(1). It is more easy to accept the opinion of Lord Johnston, if it gave a period sufficiently long on which reasonably to base an average: but the uncertainty and danger of accepting his view is forcibly explained by the Lord President on page 462. The *Glensloy* case appears to me to be unusual upon its facts, and the opinions of the learned Judges overlooked the procedure under the Income Tax Act in other cases than the particular one before them. The effect of the judgment was to base the computation on a period down to a date when a balance sheet was in fact made up in the year of assessment, adjusting it to a period of twelve months. It is said that this balance sheet was only used as evidence; but its effect was such that it increased the computation of profits from £1,762 to £5,274, and that by carrying on the period into the year of assessment.

The *Glensloy* case was considered in the *Burntisland Shipbuilding Co., Ltd.* v. *Weldhen*, 8 T.C. 409. The *ratio decidendi* of that case is shortly put by Lord Cullen, who says at page 420: "I think the natural reading of the statutory enactment in question "is that where the period of trading antecedent to the year of "assessment is shorter than three completed years, the materials "for computing the artificial amount of profit for the year of "assessment consist of the results of the trading for such shorter "antecedent period." The cases that fall within Rule 1 (2) are cases where no trading for three years antecedent to the year of assessment is available. It cannot be assumed that where a different rule has to be adopted, because the measure used in the other cases does not exist, that measure, *pro tanto*, is to be retained. The methods adopted for assessments under Cases III and IV in the year of assessment do not appear to have been considered. Bearing these in mind, and others to which I have referred, I cannot discover any "natural" reading of the statutory enactment unless, *a priori*, one deems that an average based upon an antecedent period of less than three years must have been intended. The safer course to my mind is to take the words of the Rule as they are. They provide for cases different from those that fall under the Rule applicable to Case I, and I see no inherent objection or impossibility in acceding to the argument which the Lord President rejects as untenable(2)—"to get an 'average for one "'year' by departing—*ad hoc*—from the retrospective ascertain-"ment of trading profits, and by bringing into account profits

(1) 6 T.C. 453. (2) 8 T.C. at p. 418.

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"which cannot be ascertained until a future balance sheet is "struck." The objection to the argument appears to be based upon an assumption as to the method intended apart from the actual words of the Rule itself, which covers businesses which began before, and also in, the year of assessment.

With great respect to the Court and the Judges who decided it, the *Burntisland* case(1) was in my judgment wrongly decided, and I cannot follow it.

Having thus dealt with the cases which Mr. Justice Rowlatt felt to be binding upon him, there is no other authority to be considered. In my judgment the right interpretation of this difficult Rule is to hold that the average is to be ascertained from a period ending with the balance sheet in the year of assessment, that is the 31st March, 1920. The appeal must be allowed with costs here and below; the case must be remitted to the Commissioners, and the assessment must be altered, so that if I understand the figures aright, the sum of £12,138 will be substituted for that of £1,200.

Scrutton, L.J.—A trader might be assessed to Income Tax on the actual profits of the year of assessment; but this would involve waiting till the end of the year to ascertain the profits, and it is desired to collect the tax during the year; so a conventional rule has been enacted that the trader's profits for the year of assessment shall be computed on the average profits of the trading in the three years preceding the year of assessment or preceding the last day on which the accounts are usually made up preceding such year of assessment, with a power to the trader to diminish the assessment if he can show loss from some specific cause during the year of assessment, but with no power to the Crown to increase the assessment if the profits of the year of assessment in fact exceed the conventional average.

Now suppose a three years' average is impossible. Suppose the business only begins during the year of assessment. In such a case the profits are, by Rule 1 (2) of Rules applicable to Cases I and II of Schedule D, to be computed under Case VI; that Case by Rule 2 provides that the computation shall be made either on the actual profits of the year of assessment, or according to an average as directed by the Commissioners who are given a very free hand to do what they think proper. The latter part of this Rule appears not to apply to businesses set up within the year, for such a business has been carried on *ex hypothesi* for less than a year. There are, therefore, no materials for a period greater than a year from which an average can be taken; for before the business commences there are no profits to form the groundwork of an average, and the Attorney-General admits that profits after

(1) 8 T.C. 409.

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the year of assessment cannot be the subject of the average. You do not tax a man in the year 1925 because he has made profits in the year 1926.

There remains the present case, where the business was started before the year of assessment, but less than three complete years before the commencement of that year. The language of the Act of 1918 on the point is: "The computation shall be made on the "average of the profits or gains for one year from the period of "the first setting up of the same." This replaces the Act of 1842 which used the words: "The computation shall be made for one "year on the average of the balance of profits and gains from the "period of the first setting up of the same." The words "for one "year" have been shifted in position. Consideration of Schedule A, No. II, Rule 8, and No. III, Rule 9, and the Rules just quoted, leads me to the opinion that the somewhat cryptic words quoted mean that the figure of one year's profits is to be derived from an average of, or estimated in proportion to, the profits of a period commencing when the business was first set up. The question still to be answered is when that period whose profits are to give an average is to end. And I have had considerable doubt whether we are not being asked rather to legislate to replace an omitted provision, than to construe the words of the Statute.

The subject contends that just as the three years' average terminates at the beginning of the year of assessment, so the year's profits, if there are not three preceding years, must still be based on a period terminating at the commencement of the year of assessment. I can see no particular reason why this should be so, except that if by calculation you are to estimate a figure on an average derived from a different period, one would rather assume that the period affecting the average would be one of facts and not of estimates. Clearly when the business is started within the year of assessment, actual profits within the year are considered. But the difficulty of the Crown is to say exactly when the period from which the average is derived should end. Is it when the taxpayer makes his statement for assessment, when by paragraphs VII and VIII of the Fifth Schedule he is to declare the amount of the profits and gains of the year of assessment "upon a fair and just average of the three preceding years, or of "such shorter period as the trade or profession has been carried "on"? This view has the advantage that he will get his average from a period of actual profits. Is it to be up to the time when the appropriate tribunal finally adjudicates, which may be after the year of assessment, or is it to be on the average of a period from the first setting up of the business to the end of the year of assessment, a period which will be partly arithmetical computation, and partly estimate, and which may exceed three years, the period for the normal average? This view makes the statement to be

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made by the taxpayer a very difficult one, an average based partly on fact, partly on estimate; and an estimate of future profits is not an easy task.

There is no English authority on the subject. The Scottish cases do not seem to be in unison. In the case of *The S.S. "Glensloy" Co., Ltd.* v. *Lethem*, 6 T.C. 453, the year of assessment was April 6, 1912, to April 5, 1913. The trading began in September, 1911; the first balance sheet was made up to November 20, 1912. The Crown assessed on the average of the period from September, 1911, to November, 1912. The company desired an assessment on an average of the profits made on the first two voyages, which however terminated after April, 1912. The majority of the Scottish Court held the Crown's contention right, Lord Johnston dissenting. In the case of the *Burntisland Shipbuilding Co., Ltd.* v. *Weldhen*, 8 T.C. 409, the year of assessment was April, 1919, to April, 1920. The business had started in May, 1918. The Crown assessed on an average based on the 22 months May, 1918, to April, 1920, in two alternative ways. The taxpayer contended for a twelve months' assessment, based on an average derived from the profits of the 10 months May, 1918, to April, 1919. The Court held the company's contention right. The Lord President's judgment seems to lay stress on the company's balance sheet rather than the balance sheet for the statutory period, whatever that might be; Lord Cullen's to take the view that as the three years' average is on a period ending before the year of assessment, any shorter period for average must end at the same time.

I have so far dealt with principle. What the parties are really fighting about is this. The year of assessment is April 5, 1919, to April 5, 1920. The business was started on March 1, 1919, and it is agreed up to December 31, 1919, made a profit of £1,000. It was turned into a Company and from January 1 to April 5, 1920, there was made a profit of £12,150. Only one account had been made up before the end of the year of assessment, namely, in December, 1919, and that for the special purpose of Excess Profits Duty. The firm and Company desire to be assessed on an average derived from the month from March 1 to April 6, the profits for the month being themselves derived from an average derived from ten months up to December 31, when the first account was prepared. The Crown desire to get the twelve months' profit on an average derived from a period of 13 months, March, 1919, to April, 1920, that is, from the setting up of the business to the end of the year of assessment.

The Commissioners have adopted the contention of the taxpayer, and Mr. Justice Rowlatt, following as I think the decision in the *Burntisland* case[1] has affirmed their decision. He attaches apparently considerable importance to the balance sheet, which I

[1] 8 T.C. 409.

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do not understand. When a three years' average is possible it may either be of three years before the date to which the accounts are usually made up, preceding the year of assessment, or of three years up to the beginning of the year of assessment. In the present case, no balance sheet was made up before the year of assessment, and December 31 is not a usual date at all.

The Statute clearly prescribes that these profits are to be taxed, and if no rule were provided, presumably the amount of the profits of the year, either actual or estimated, would be the figure on which the trader should pay. But the Statute clearly gives this guidance that the year's profits are to be calculated on an average or by a rule-of-three sum, in which a period commencing before the year of assessment is a factor. If x represents the length of that period, the sum is: As x is to 12 months, so are the profits made during x to the profits to be taxed as representing those of the year of assessment.

The duty of the trader begins when he has received a notice from the assessors to make a declaration of his income within 21 days; he is then to declare the amount upon a fair and just average of the three preceding years or such shorter period as the trade has been carried on. (Fifth Schedule, paragraph VII.) These words contemplate that the period cannot be longer than three years, as it would be if he had to deal with profits up to the end of the year of assessment and the trader had started more than two years before the year of assessment. This appears to show that Parliament was not meaning profits up to the end of the year of assessment to be the basis of the average. In the same way, if the end of the period is when the trader makes his statement, this may be more than three years from the commencement of the business, and therefore not a shorter period. It may further be said that to get a figure by calculation on an average taken from another period rather assumes that the second period is one of fact, not of estimate, and points to the period from which the average is taken as one terminating before the year of assessment, which would be for the trader an actual period of which there would be no hardship in expecting him to know the profits, and use them as a basis of calculation.

If I were to legislate, I do not think I should take this view, as if a business starts a month before the year of assessment, it seems rather absurd to calculate the profits of the year of assessment on those of the first month of the business, which would probably be non-existent, while if the business started a month after the commencement of the year of assessment, you are to take the actual profits of the first eleven months, disregarding them if the business has continued for thirteen months.

But we are not to legislate; we are to construe the Act, and while the construction seems to me very difficult because we have very few bricks to build with, yet, considering that Parliament

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contemplates a shorter period than three years as the foundation of the average, and, I think, contemplates that the foundation of the average is a period of fact, not estimate, I have with considerable hesitation come to the conclusion that the Commissioners and Mr. Justice Rowlatt have taken a correct view of the case, and that the period from which the average is derived terminates at the commencement of the year of assessment, or possibly on the date preceding that year to which the accounts of the trader are usually made up, if such a date exists. Their view in the present case I understand to be that the period from which the average is to be obtained is that terminating on April 5, 1919, though these profits in turn are to be obtained by an average from the period up to December 31, 1919, the profits of which are known. The first part of the statement is, I think, the important one for general use, and is correct.

For these reasons, in my opinion the appeal should be dismissed. I agree with the result obtained by the Commissioners and Mr. Justice Rowlatt, by the Court in the *Burntisland* case(1), and Lord Johnston in the *Glensloy* case(2), if the question is the proper interpretation of the Statute.

Sargant, L.J.—The decision of the questions involved in this appeal depends entirely, or almost entirely, on the true view of the relationship between two Rules which under the Income Tax Act, 1918, are applicable to cases within Schedule D to that Act. The first of these two Rules (which may for brevity be referred to as the earlier Rule) is the single Rule applicable to Case I. The second of the two Rules (which may for brevity be referred to as the later Rule) is Sub-rule (2) of Rule 1 of the Rules applicable to Cases I and II. By the earlier Rule the tax on a trade is to be computed "on the full amount of the balance of the profits or "gains upon a fair and just average of three years ending on that "day of the year immediately preceding the year of assessment "on which the accounts of the said trade have been usually made "up, or on the fifth day of April preceding the year of assessment." Under this Rule, therefore, the period of computation is one of which both termini are necessarily fixed prior to and outside of the year of assessment. Under the later Rule where the trade "has "been set up and commenced within the said period of three "years"—which is the case here—"the computation shall be "made on the average of the profits or gains for one year "from the period of the first setting up of the same, and "where it has been set up and commenced within the year "of assessment, the computation shall be made according to "the rules applicable to Case VI." And under the second Rule of Case VI the computation is to be made "either on "the full amount of the profits or gains arising in the year of

(1) 8 T.C. 409. (2) 6 T.C. 453.

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"assessment, or according to an average of such a period, being "greater or less than one year, as the case may require, and as "may be directed by the commissioners." It is clear therefore, that the earlier part of the later Rule fixes the beginning or *terminus a quo* of the period of assessment, but does not in terms fix the end or *terminus ad quem* of that period. While on the other hand the later part of the later Rule does not absolutely fix either terminus of the period of computation, but leaves both to the determination of the Commissioners.

A great majority of the trades in respect of which returns have to be made under Schedule D have of course been set up for more than three full years before the year of assessment. Accordingly the earlier Rule is that which applies in the great majority of cases, and is naturally stated in general terms without any express words of limitation or exception. If then the later Rule is to be regarded as being in the nature of an exception to or qualification of the earlier Rule, it may follow that the general terms of the earlier Rule apply to the later Rule, except so far as expressly or impliedly provided in the later Rule; and accordingly that, though the later Rule does not state any *terminus ad quem* for the period of computation, the *terminus ad quem* must be one which, like the corresponding *terminus* under the earlier Rule, lies altogether outside of the year of assessment. On the other hand if the later Rule is not of the nature of an exception from or qualification of the earlier Rule, then it would seem that no implication could properly be drawn from the earlier Rule that the *terminus ad quem* in the later Rule must correspond with that in the earlier Rule in lying outside the year of assessment. Now a careful consideration of both the earlier Rule and the later Rule drives me to the conclusion that the later Rule is not of the nature of an exception from the earlier Rule, and does not merely qualify certain classes of cases which prima facie lie within or form part of those comprised in the earlier Rule. For the language of the earlier Rule clearly implies that it extends only to trades that have completed three full trading years before the year of assessment, that is, to trades which, however great their majority may be, do not include any trades that have not completed these three full years. On the other hand it is to this latter class of trades and to them alone that the later Rule is directed. And, accordingly, the two Rules deal separately with two separate and mutually exclusive classes of cases, and that none the less because the class dealt with by the earlier Rule is much more numerous than the class or classes dealt with by either part or both parts of the later Rule.

This conclusion is rendered even clearer if attention is paid to the class of trades dealt with by the second part of the later Rule. In these trades there is no fixed *terminus* for either end of the period of computation, there is not even the *terminus a quo* which

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is set up in the earlier part of the Rules. The period for computation may coincide with that from the setting up to the end of the year of assessment, or it may be a shorter or longer period, in the latter of which cases it must necessarily include a period after the expiration of the year of assessment. It is obvious therefore that an approximation to accuracy is, in this case at least, preferred to promptitude in calculation; and that there is no radical objection to a delay occasioned by an ascertained result being substituted for a mere estimate. If then a comparison is made between a case where a trade is set up a month before the beginning of the year of assessment and one where a trade is set up a month after, why should the profits in the first case be computed on an estimate based solely on the result of the first month's trading, while in the later case the profits can be computed on the ascertained result of eleven months' trading or even of a longer period? I can see no satisfactory answer to this question on the Respondents' view. And it is not unimportant to note that in the Act itself, the two classes of cases under the first and second part of the later Rule are more closely associated than are the two classes of cases under the earlier Rule and the first part of the later Rule respectively; and that, so far as this goes, one ought perhaps in considering the provisions of the first part of the later Rule to pay rather more attention to the second part of the later Rule than to the earlier Rule.

It has indeed been pointed out by Counsel for the Respondents, that in the corresponding Section of the Act of 1842 the substance of the later Rule is contained in two provisos to a Section, the main part whereof is similar to the language of the earlier Rule; and it has been argued that since the Act of 1918 is a consolidating Act the same effect must be given to the later Rule as if it had been expressed by way of proviso to the earlier Rule. But, if the substance of the Section in the Act of 1842 is looked at, it appears to me that, for the reasons already mentioned, the two provisos in question though expressed as provisos were in fact independent enactments dealing separately with classes of cases not previously touched by the earlier part of the Section. And I think that the Attorney-General completely met this argument by the reply that the Act of 1918 did not alter the Act of 1842 in this respect, but merely recognised that the provisions which had previously been expressed by way of provisos were really independent enactments and should be so treated in the consolidating Act.

If then, in construing the later Rule, no inference can properly be drawn from the mention of a *terminus ad quem* in the earlier Rule, and the words of the later Rule are to be read as they stand and as constituting a separate and independent enactment, is there anything in the words themselves to prevent the computation from embracing the whole or a part of the year of assessment? I

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cannot find anything in the words to suggest such a prohibition, nor does it seem reasonable that such a prohibition should be imposed. After all, the object of the legislation is to provide a fair and reasonable method of computing, with a view to taxing, the profits of the year of assessment. In the ordinary case, where the trade has been set up for more than three years, there are obvious practical advantages in estimating the profits of the year of assessment on the average of the three preceding years. But, in cases where this method is not practicable, I can find no reason or advantage in an arbitrary limitation of the period for the computation of profits to the period, however short it may be, which has occurred between the date of setting up and the commencement of the year of assessment. The result of such a rule would be in many cases, of which the present is an instance, to introduce quite unnecessary elements of hazard and chance into the computation. The learned Judge here obviously felt himself bound in comity, if not technically, to follow the reasoning in the decision of a Scottish Court of first instance in *The Burntisland Shipbuilding Co., Ltd.* v. *Weldhen*, 8 T.C. 409, which distinguished and to some extent doubted a previous decision of a Scottish Court in *S.S. "Glensloy" Co., Ltd.* v. *Lethem*, 6 T.C. 453. The actual decisions in these cases were on facts somewhat different from those here; and in any case they do not in any sense bind this Court. But they are of course to be treated with respect and must be duly considered.

In the *Glensloy* case(1) the trade had been begun on the 13th September, 1911, the year of assessment was that from April, 1912, to April, 1913, and the first profit and loss account was for the period ending on the 20th November, 1912. The Inland Revenue claimed to compute the profits for the year of assessment on an average of the profits from 13th September, 1911, to the 20th November, 1912. The company objected to this contended that there was an inflexible rule of Income Tax law ".that you must never in assessing the trading profits for "one year encroach upon that year" (page 461), and claimed to be assessed on an average of the profits from the 13th September, 1911, to the 5th April, 1912. The majority of the Court rejected the company's general contention and adopted the period for computation of the Inland Revenue. This is, in my view, a direct decision against the importation into the later Rule above referred to of the *terminus ad quem* fixed by the earlier Rule. But it may be that the decision is somewhat weakened not only by the dissent of Lord Johnston but also by the fact that the alternative method of computation suggested by the company did in fact, though not in name, take into account profits earned in some part of the year of assessment,

(1) 6 T.C. 453.

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since they arrived at the profits of the period 13th September, 1911, to 5th April, 1912, on an average of the estimated profits from the 13th September, 1911, to the 25th July, 1912.

In the *Burntisland* case(1) the trade was set up in the middle of May, 1918; the first accounts were made up to the 31st March, 1919, and the second accounts for the twelve months to the 31st March, 1920; and the year of assessment was April, 1919, to April, 1920. The Inland Revenue claimed to assess on the average of the profits for the 22½ months from the middle of May, 1918, to the 31st March, 1920, or on an alternative basis, taking in part of the profits after the 31st March, 1919, which need not be further referred to. The company contended that the computation should be on the average of the profits for the 10½ months from the middle of May, 1918, to the 31st March, 1919, and the Court unanimously held this to be the right principle. The decision is one on facts substantially different from those in the present case, but its importance lies in the reasoning of the judgments and particularly in the observations there made on the *Glensloy* case(2). There are indications all through the judgment of the Lord President, and a clear statement in the judgment of Lord Cullen, that the true reading of the first part of what I have called the later Rule is that "where the period of trading antecedent to the "year of assessment is shorter than three complete years, the "materials for computing the artificial amount of profit for the "year of assessment consists of the result of trading for such "shorter antecedent period." And the Lord President went so far as to justify the decision in the *Glensloy* case(2) on the ground that the results of the first balance sheet, though not directly relevant, might be used evidentially in order to ascertain the average of the profits for one year from the period of the first setting up. (See page 420.)

In the present case the learned Judge has, as I understand his judgment, acted on this suggestion of the Lord President, and while in fact calculating the taxable profits of the Company for the year of assessment as £1,200, being twelve-tenths of the actual profits from the 1st March, 1919, to the 31st December, 1919, has avoided bringing in directly any profits in the year of assessment (namely, April, 1919, to April, 1920) by the double process of first treating the £1,000 profits for the period of ten months as mere evidence that the profits for the month of March alone were £100, and then multiplying this monthly profit of £100 by twelve so as to arrive at the ultimate profit of £1,200 for the year 1919–20.

This process is in my judgment more ingenious than sound. It first treats the later Rule as impliedly prohibiting any computation based on profits during any part of the year of assessment; and then, while really taking into account some of those profits,

(1) 8 T.C. 409. (2) 6 T.C. 453.

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namely those from 31st March to 31st December, 1919, suggests that they are not so brought in, because they are merely used evidentially in arriving at the real profits for the month of March, 1919, and because it is this single month's profits only that are subsequently used as a basis for calculating the profits of the whole twelve months of the year of assessment. It seems to me impossible to hold that the employment of this double process makes any real difference. It must be the same thing, whether the actual profits for the month of March, 1919, and for the succeeding nine months are at once multiplied by the fraction twelve-tenths to arrive at the profits for the year April, 1919, to April, 1920, or whether the profits for the same month of March and the same nine succeeding months are first divided by ten to arrive at the profits for the single month of March, 1919, and are subsequently multiplied by twelve to ascertain the profits for the year April, 1919, to April, 1920. In either case the actual profits for the nine months of the year of assessment are employed to precisely the same extent in the process of ascertaining the profits of the year of assessment. But if once there is eliminated from the later Rule, as I think there should be, any implication that the period for computation should be entirely prior to the year of assessment, it seems to me that the period suggested by the Crown here is a much more natural one than that suggested by the Respondents. The Crown's thirteen months end with the close of the first complete trading year of the Respondents, a date at which in the ordinary course of events there would have been the first ascertainment of the profits of the trade. The Respondents' ten months end at a purely arbitrary date, unconnected with their ordinary trading, a date which happens to be that on which accounts were made up for an altogether distinct purpose. I agree therefore, that the judgment of Mr. Justice Rowlatt should be reversed, and that the assessment for Income Tax for the year 1919–20 on the Respondent firm and the Respondent Company together should be made in the sum of £12,138, leaving that total sum to be subsequently apportioned between the Respondent firm and the Respondent Company. The form of our Order will be that stated by the Master of the Rolls.

Lord Hanworth, M.R.—Then it will be sent back for assessment?

Mr. Reginald Hills.—I do not know whether it will be necessary, whether the exact figure has been dealt with.

Lord Hanworth, M.R.—The Case states that, I think; but still, I will leave it open.

Mr. Reginald Hills.—Yes, it will be satisfactory if your Lordship leaves it open.

Lord Hanworth, M.R.—I left it in this way: The case must be remitted to the Commissioners, with costs here and below, and the assessment must be altered, so that, if I understand the figures aright, £12,138 will be substituted for £1,200.

Mr. Reginald Hills.—If your Lordship pleases.

The Respondents having appealed against the decision in the Court of Appeal, the case came on for hearing in the House of Lords before Viscount Sumner and Lords Atkinson, Wrenbury, Carson and Blanesburgh, on the 17th, 18th and 21st February, 1927, when judgment was reserved. On the 4th April, 1927, judgment was given against the Crown, with costs, reversing the decision of the Court of Appeal and restoring the decision of Rowlatt, *J.*

The Attorney-General (Sir Douglas Hogg, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown, and Sir John Simon, K.C., and Mr. Cyril King for the Respondents.

JUDGMENT.

Viscount Sumner.—My Lords, this appeal raises the question how the Income Tax Act, 1918, computes taxable profits, where a trade has been first set up a few weeks before the commencement of the year of charge. The Crown affirms and the subject denies that, in such a case, the Inland Revenue is at liberty to bring into the computation the profits of so much of the year of charge itself as will make up a complete twelvemonth and even, if circumstances require it, the profits of the whole of the year of charge. The subject contends that, except in the case of a trade set up within the year of assessment, the profits must be computed without bringing in any profits of the year of charge at all.

The Appellants, Clare and Heyworth, started a trade and then sold it to Clare and Heyworth, Ltd. Both are joined in this appeal because the firm was assessed in respect of one year and the company in respect of the next, but nothing now turns on the distinction between them, for the partners in the firm hold the shares in the company. It is also admitted by the Appellants that the business is for assessment purposes one continuous business.

The dates are as follows. The firm began business on 1st March, 1919. The company was incorporated on 16th February, 1920, and on 1st March, 1920, it adopted the agreement for the purchase of the firm's business. Since then the company has carried on the business begun by the firm.

In 1922 and 1923 assessments were made on the firm and on the company for the year 6th April, 1919, to 5th April, 1920. The practical importance of the dispute turns on the liability

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to tax in respect of a sharp increase of profit made in the three months from 1st January to 31st March, 1920. When the assessment for the year 1919–20 came to be made, the question arose whether this profit could be included in the computation of the tax for that year under Schedule D.

The firm was assessed for the year 1918–19 in respect of the period 1st March, 1919, to 5th April, 1919, in the sum of £117. This was ascertained as follows. The firm made up a balance sheet to 31st December, 1919, for the ten months from 1st March, 1919, which showed £1,000 profit. The sum of £117 was computed as the proportional part of this profit for the period from 1st March to 5th April, 1919. The date, 31st December, 1919, was selected for the purposes of Excess Profits Duty. This has not been adopted by the Company as the date at which to make up its annual balance sheets. The date selected in subsequent years has been 31st March.

For the year 1919–20 the Appellants (who have to apportion between themselves whatever tax may be payable) have contended that the assessment on the company ought to be on the profits actually made between 1st March, 1919, and 5th April, 1919, expanded to an entire twelvemonth by a process of "averaging", thus representing for Income Tax purposes the profits of the following year of charge. The Inland Revenue contends that the statutory mode of computation allows the profits actually made after 5th April, 1919, during the year of charge, to be brought in, thus including the three months of exceptional prosperity in 1920. Whether the part of the year of charge thus to be included is only such part as would make up a complete twelve months, when added to the period from 1st March to 5th April, 1919, or is extended to the whole of the year of charge in a similar case, constituted an alternative contention.

The Commissioners adopted the subjects' contention and their conclusion was affirmed by Rowlatt, *J.* His decision was reversed in the Court of Appeal, Scrutton, *L.J.*, dissenting. The only authorities on the point were both decided in the Court of Session, viz., *S.S. "Glensloy" Co., Ltd.* v. *Lethem*[1] (1914 S.C. 549) and *Burntisland Shipbuilding Co., Ltd.* v. *Weldhen*[2] (1923 S.C. 449).

It is to the actual wording of the relevant Cases and Rules under Schedule D that one must first turn, and these are the Rule applicable to Case I and the first Rule, Sub-section (2), of those applicable to Cases I and II. These must be read together, the latter being in the nature of a proviso to the former, and for this purpose the Rule applicable only to Case II, which comes between them in the Act, may be ignored. With great respect

(1) 6 T.C. 453. (2) 8 T.C. 409.

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to Lord Justice Sargant, I am unable to adopt the principle on which his judgment is so largely founded, namely, that these Rules should be treated as entirely independent enactments.

By the Rule applicable to Case I the tax (that is the tax under Schedule D charged under Case I " in respect of any trade " not contained in any other Schedule ") " shall be computed " on the full amount of the . . . profits . . . upon a fair and " just average of three years " ending in this case, where the accounts of the trade had not been usually made up to any date, on 5th April, 1919. As, however, there were not three years of trading before that date, it becomes necessary to proceed to the words of Rule 1 (2) of the Rules applicable to Cases I and II, viz., " Where the trade . . . has been set up . . . within the " said period of three years " (i.e., before the eve of the year of charge) " the computation shall be made on the average of the " profits . . . for one year from the period of the first setting up " of the same . . . ."

If these words mean on the average of the profits for one year from the first setting up, if and when the date of the setting up was as much as one year from the commencement of the year of charge, then they do not apply to this case. If so, however, the Rule itself does not apply to this case at all, for the following words only relegate the computation of the profits to another Case, viz., Case VI, where the trade has been set up within the year of assessment, and thus no Rule deals with the case of a trade set up within three years of the beginning of the year of charge but not so much as a complete year before it.

On such a construction what at first sight appears to have been a complete formula for computing tax in all the possible cases, dividing them into the cases where the trade has been, and the cases where it has not been, set up before the commencement of the year of charge, contains an obvious gap, in which the present case falls and remains unprovided for. Does the formula really leave such a gap, or does it, truly construed, cover this case as well as the other?

My Lords, the words in Rule 1 (2) of the Rules applicable to Cases I and II—" within the said period of three years "—refer to the Rule applicable to Case I and virtually incorporate them as follows: " three years ending on . . . the fifth day of April " preceding the year of assessment." If these words be written into the later Rule, clearly the present case falls within them in point of time. The question then is whether or not it is nevertheless taken out of them again, because the words following are inapplicable to it, viz., " on the average of the profits . . . for " one year from the period of the first setting up of the same ". It is not " profits made during one year, etc.," nor would there be any occasion to employ the device of an average, if the only reference is to a case where the trade has been set up for a year

(Viscount Sumner.)

or more and the amount of the last year's profits can be taken and taxed as the profits of the next year, namely, the year of charge. What is contemplated is a computation which, by means of an average, will get at profits for a year, as well as one which will proceed on a computation of " profits for a year "—that is of annual profits—extracted out of a period of a year or more by the process of averaging the profits of that more extended period.

The language of the Rule in the present Consolidation Act differs from that in which it is expressed in the Act of 1842. It previously ran : " Provided always, that in cases where the trade " . . . shall have been set up . . . within the said period of " three years, the computation shall be made for one year on the " average of the balance of the profits and gains from the period " of first setting up the same ". This, though archaic and cumbrous, at any rate as a proviso to the case of trades set up three years or more before the year of charge, covers both the remaining cases of setting up trade before the commencement of the year of charge, viz., a setting up more and a setting up less than one year before it, and the same formula is used for both. Presumably a Consolidation Act introduces no changes except of words and arrangements. If this change in words, or rather the change made in their order by transposing the words " for one " year ", nevertheless made a change in the meaning on ordinary principles of construction, it would be necessary to give effect to it, but on consideration I do not think that it does.

No real assistance seems to be derivable from the Rules applicable to other Schedules than Schedule D, or to other forms of taxable property than profits and gains. I think that Counsel for the Inland Revenue was warranted in saying that, if the Act does not confine the computation to a period ending just before the commencement of the year of charge by the express language in which the Rule is couched, then nothing is prescribed as to the method by which the computation in the present case is to be made, and it must be made on such facts as are available. This would permit recourse to the profits made in the year of charge or part of it. The symmetry of the general scheme might be thereby impaired, but the method of computation in question must necessarily be a matter for express prescription, and not an inference from other cases, in which it is expressly prescribed, to the present, as to which it is not. In any case, the so-called scheme, which substitutes a notional year's profits, taken before the year of charge, for the actual profits made in the year of charge, is departed from, symmetry or no symmetry, when the business is set up in the year of charge. If the scheme is inapplicable in one case, why not in two? The Act leaves it there. I should agree with this, if I did not think that, on the proper construction of the material Rule, the present computation falls within it.

(Viscount Sumner.)

So far as authority goes the *Burntisland* case(1) supports the view which I have felt constrained to take. The Lord President and Lord Cullen have given clear and terse explanations of the method prescribed, which I respectfully adopt. The contrary construction, adopted in the earlier *Glensloy* case(2), is weakened by the misapprehension, into which the Court seems to have fallen there, as to the connection of the words " balance of " profits or gains " with some balance sheet of the taxpayer's, supposedly drawn up for a period of a year ending during the year of charge. I think that the appeal should be allowed and that the judgment of Rowlatt, *J.*, which affirmed the Commissioners' decision, should be restored on the grounds above mentioned. There may have been other points arising out of the assessment which, had the amount at stake been greater, would have been successfully disputed. These have not been raised before your Lordships and accordingly no opinion upon them is involved in this conclusion. I move your Lordships accordingly.

I am desired to add that my noble and learned friend Lord Carson concurs in this opinion and motion.

Lord Atkinson.—My Lords, this is an appeal from an Order of His Majesty's Court of Appeal (Lord Hanworth, Master of the Rolls, Lords Justices Scrutton and Sargant), dated the 26th of April, 1926, reversing an Order of Mr. Justice Rowlatt dated the 18th of June, 1925, affirming the decision of the Commissioners for the Special Purposes of the Income Tax Acts (hereinafter referred to as " the Commissioners ") upon a Case stated by the Commissioners for the opinion of the King's Bench Division of the High Court of Justice, pursuant to Section 149 of the Income Tax Act, 1918.

The question for decision in the case turns upon the construction of the relevant provisions of the Income Tax Act, 1918, and resolves itself into this, whether in computing the trading profits of the Appellants for assessment under Case I of Schedule D, Income Tax Act, 1918, for the year ending the 5th April, 1920 (the Appellants' second year of assessment), the trading profits made in that year should be taken into account in arriving at the measure of the liability to be taxed. No question of figures arises in the case.

Profits of trade are subjected to Income Tax under Case I, Schedule D, the relevant statutory provisions contained in the Income Tax Act of 1918.

Those portions of the Schedule run as follows :—" 1. Tax under this Schedule shall be charged in respect of—(*a*) The " annual profits or gains arising or accruing— . . . (ii) to any " person residing in the United Kingdom from any trade, profes- " sion, employment, or vocation, whether the same be respec- " tively carried on in the United Kingdom or elsewhere . . . in

(1) 8 T.C. 409. (2) 6 T.C. 453.

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" each case for every twenty shillings of the annual amount of " the profits or gains. 2. Tax under this Schedule shall be " charged under the following cases respectively; that is to say,— " Case I.—Tax in respect of any trade not contained in any other " Schedule . . . and subject to and in accordance with the rules " applicable to the said Cases respectively ".

The Rule applicable to Case I runs as follows: " The tax " shall extend to every trade carried on in the United Kingdom or " elsewhere, other than a trade relating to lands, tenements, " hereditaments, or heritages directed to be charged under " Schedule A, and shall be computed on the full amount of the " balance of the profits or gains upon a fair and just average of " three years ending on that day of the year immediately preced- " ing the year of assessment on which the accounts of the said " trade have been usually made up ". This is the main and general provision of the Act. From its terms it is clear that the materials upon which the assessment is to be made are the average of the profits and gains made in the three years immediately preceding the year of assessment. The profits and gains made in any particular portion of the year of assessment are apparently not to be taken into account in making this assessment. That would seem to be clear.

Provision is made in Rule 1 (2) of the Rules applicable to Cases I and II for cases where a trade, profession, employment, or vocation is set up and commenced within this period of three years. The Rule in clear and explicit language enacts that the computation shall in that case " be made on the average of the " profits or gains for one year from the period of the first setting " up of the same ". This portion of the Rule is very inappropriately worded. It apparently refers only to the profits and gains for one year, the first year of the trading, but an average, properly speaking, can only be made when one has two or more things to compare. What the provision may fairly be construed to mean, I think, is that the rate of profit made in the first year of trading may be taken to have continued to be reached during the period from the end of the first year in which the trade is carried on up to the first day of the year of assessment. For instance, if the profits made in the first year of trading were on an average of the 52 weeks £10 per week, the profits for the second year of trading may be taken as £10 per week. The rate of profit can be ascertained by taking an average on the 52 weeks of the first year. There is nothing unreasonable or unfair to a trader in holding that during the time which elapses between the end of the year in which he commenced to trade and the first day of the subsequent year of assessment he will be assumed to continue to make profits at the same rate at which he made them during the first year of his trading. This would appear to be, to me at all

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events, clear, that the general rule is not to be departed from, and that profits made during any portion of the year of assessment are not to be taken into account in cases such as this. Where the trade has been set up within the year of assessment neither the general rule nor the last-mentioned method of calculation can apply, and accordingly a special provision is made for it. That provision is contained in the last two and a half lines of Rule 1, Sub-rule (2), Cases I and II, and runs thus : " where " it " (i.e., the trade, &c.) " has been set up and commenced " within the year of assessment, the computation shall be made " according to the rules applicable to Case VI ". On turning to those Rules one finds that by the second of them it is provided that : " The computation shall be made, either on the full amount " of the profits . . . arising in the year of assessment, or " according to an average of such a period, being greater or less " than one year, as the case may require, and as may be directed " by the commissioners " ; and by Rule No. 3 it is provided that " Every such statement and computation shall be made to the " best of the knowledge and belief of the person in receipt of or " entitled to the profits or gains ".

The three cases are thus provided for. First, where the trade has been carried on during the full period of three years anterior to the first day of the year of assessment; second, where the trade has been first started within those three years; and third, where the trade has been set up within the year of assessment : but I have searched in vain to discover any case in which the period of years on the profits made in which the trader may be assessed may comprise a certain period lying without the year of assessment and a certain period within it. I do not believe such a hybrid period is ever recognised by the Legislature on the subject of the Income Tax as a period the profits made in which are to be subjected to taxation. The House has no power to come to the aid of the Legislature and insert such a period as a unit of computation where the Legislature has failed to do so.

The facts of this case are as follows : The Appellant firm set up and commenced a new business on the 1st of March, 1919. They took stock and made up the first account of their business on the 31st December in the same year 1919. Why they did this is irrelevant. The profits of this business for this period of ten months amounted, according to this account—the accuracy of which is not challenged—to £1,000. On the 6th February, 1920, that is before the first day of the year of assessment, they agreed to sell their business, its goodwill and assets, as and from the 1st January, 1920, to the Appellant Company, which latter was incorporated on the 16th February, 1920, and on the 1st March adopted the agreement for sale of the 12th February previous. The members of the Appellant firm were the sole members of the Appellant Company. The Appellant Company

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has since continued to carry on the business so acquired. From motives wise or unwise it made up an account of its business from the 1st January, 1920, to 31st March, 1920. For this period the profits—it is not disputed—amounted to £12,150. The Appellant firm was assessed on the 3rd February, 1923, for the year 1918-19 to Income Tax in respect of the profits of their trade from the 1st March, 1919, to the 5th April, 1919, in the sum of £117, the same being a due proportion of the sum of £1,000 shown by their accounts to have been their profits for the 10 months ending 31st December, 1919.

The Commissioners decided that for 1919-20 the liability of the Appellants should be based on the accounts to the 31st December, 1919, without regard to the accounts up to the 31st March, 1920, and reduced the figure contended for by the Crown to £1,200. As I understand the judgment of Mr. Justice Rowlatt, he held in accordance with the decisions in the two Scottish cases, namely, the *Glensloy* case[1] and the *Burntisland* case[2], that the period over which the profits were to be calculated in such a case as this is that though no *terminus ad quem* is distinctly named in Rule 1 of the Rules applicable to Cases I and II of Schedule D, yet according to the principle underlying the general provision of the Statute, that *terminus* must be the first day of the year of assessment. If so, I entirely concur with him. As I understand the judgment of the Court of Appeal, the profits of the Appellants are to be computed over a period extending beyond the first day of the year of assessment and extending to the end of the 13 months, that is, to the end of the first trading year of the Appellants' trading, which would necessarily include a portion of the year of assessment. With all respect, I am quite unable to concur in that conclusion. Lord Justice Scrutton, on page 24 of the Appendix, is reported to have expressed himself thus[3]: "Yet, considering that "Parliament contemplates a shorter period than three years as "the foundation of the average, and, I think, contemplates "that the foundation of the average is a period of fact, not "estimate, I have with considerable hesitation come to the "conclusion that the Commissioners and Mr. Justice Rowlatt "have taken a correct view of the case, and that the period "from which the average is derived terminates at the commence-"ment of the year of assessment, or possibly on the date "preceding that year to which the accounts of the trader are "usually made up, if such a date exists." I concur with the learned Lord Justice in the conclusion at which he has arrived; and as I have failed to find a single instance in the whole Income Tax Code in which, the trader's trading having commenced outside the year of assessment, that year or any portion of it has

(1) 6 T.C. 453. (2) 8 T.C. 409.
(3) Pages 484 and 485 *ante*.

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been included in the period for which the trader's profits are to be measured and assessed, I concur in the learned Lord Justice's conclusion without the hesitation to which he gives expression. I think the appeal should be allowed and the judgment of Mr. Justice Rowlatt should be restored and approved.

Lord Wrenbury.—My Lords, the language of Section 100 of the Act of 1842 was " the computation shall be made for one " year on the average of the balance of the profits and gains " from the period of first setting up the same." The language of the Act of 1918 is " the computation shall be made on the " average of the profits or gains for one year from the period " of the first setting up of the same ". I agree with Lord Sumner in thinking that the transposition of the words " for " one year " in a Consolidation Act does not make a change in the meaning.

The language of the Act of 1918 can be read as if it were " the computation shall be made on the average of the profits " or gains (for one year) from the period of the first setting up " of the same." The " one year " is the year of assessment. The " period of the first setting up of the same " must, I think, mean " the period from the date of the first setting up of the " same ". Even then the date is not named at which " the " period " is to end. This must, I think, be the date referred to in Schedule D, Rule applicable to Case I; that is to say, a date not later than the first day of the year of assessment. This " period " may be more or less than a year.

Further the words " profits or gains " are followed not by the preposition " of " but by the preposition " for ", a word which is appropriate if it is to be read in the connection " the " computation shall be made for, etc." which was the sequence of the words in the Act of 1842.

Neither the Act of 1842 nor the Act of 1918 specifies the items whose average is to be ascertained. It is impossible to have an average unless two or more sums are under consideration. An average of the profits for a period is not intelligible unless the period is to be in some way considered as consisting of several parts. This consideration is reached if the meaning is that the average of the weekly or monthly profits over the number of weeks or the number of months that have elapsed during " the period " is the average to be computed, and that this average sum is to be attributed to the whole of the " one " year ", i.e., the year of assessment. I think this is the meaning. I agree with Lord Sumner's judgment and think that the appeal should be allowed.

Lord Blanesburgh.—My Lords, for convenience of reference and at the risk of repetition I will begin by setting out Rule 1 (2) of the Rules applicable to Cases I and II of Schedule D,

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with the words placed in the order in which it is agreed that for the purpose of construing the Rule they may properly stand. "Where the trade . . . . . has been set up and commenced within the said period of three years, the computation "shall be made for one year on the average of the profits or "gains from the period of the first setting up of the same, and "where it has been set up and commenced within the year of "assessment, the computation shall be made according to the "rules applicable to Case VI". My Lords, on this Sub-rule I venture to observe as follows: First of all, it is sufficiently clear that the expression "the profits or gains from the period "of the first setting up of the same" are the equivalent of "the profits or gains arising or accruing during the period "commencing with the first setting up of the same". In other words, except that the profits are those arising during a different period, the operation of averaging and its purpose and result are the same under this Sub-rule as is the operation directed by Case I.

Secondly, the "period" whose profits are to be averaged is identified by reference to another period referred to in the Sub-rule as "the said period of three years"—and the reference is made in a form which to my mind connotes that it is a shorter period than the period so referred to.

Thirdly, it is a period which commences after the other period has, in point of time, begun. It commences "within" that period. These considerations together strike me as almost necessarily and without more leading to the conclusion that the two periods are treated as ending at the same date. But when to them is added this further consideration that the shorter period in question must *commence* before the year of assessment —a condition shown by the later part of the Sub-rule and one not only consistent with but confirmatory of the view that it does not continue after that date—this conclusion becomes inevitable if it be found that the same characteristic applies to the said period of three years itself. Now that this is so appears from the description of that period given in Case I to which this Sub-rule is, as I entirely agree, in the nature of a proviso. That period is there described as one of three years: "ending on that day of the year immediately preceding the year "of assessment on which the accounts of the said trade have "been usually made up or on the fifth day of April immediately "preceding the year of assessment."

In the present case I cannot doubt that the "period" ended on the 5th of April, 1919, and, as it seems to me, the profits of this trade for the year 6th April, 1919, to 5th April, 1920, must be computed on a fair and just average, for a year, of the profits or gains which arose or accrued between the 1st March, 1919, when the trade was first set up, and the 5th April, 1919.

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My Lords, I think that much of the difficulty which has beset this particular case is attributable to the final importance wrongly, as I believe, attached to the balance sheet made up to 31st December, 1919—a date which, in itself, has no relevance to the question at issue. I think the difficulty is further due to the fact that the light cast upon the whole of Sub-rule (2) by the reference in it to " the said period of three years " has not been fully utilised.

I am in entire agreement with the rest of your Lordships as to the effect to be attributed to that Sub-rule and as to the proper result of this appeal.

Questions put:

That the Order appealed from be reversed.

The Contents have it.

That the Order of Mr. Justice Rowlatt be restored, and that the Respondent do pay to the Appellants their costs here and in the Court of Appeal.

The Contents have it.