

PART IX.] HENRY (H.M. INSPECTOR OF TAXES) v. 605
ARTHUR FOSTER.
HENRY (H.M. INSPECTOR OF TAXES) v.
JOSEPH FOSTER.
HUNTER (H.M. INSPECTOR OF TAXES) v.
DEWHURST.

No. 819.—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—
8TH DECEMBER, 1930.

COURT OF APPEAL.—19TH FEBRUARY AND 26TH MARCH, 1931;
1ST MAY, 1931.

HOUSE OF LORDS.—25TH AND 26TH FEBRUARY AND 14TH APRIL, 1932.

- (1) HENRY (H.M. INSPECTOR OF TAXES) v. ARTHUR FOSTER.⁽¹⁾
- (2) HENRY (H.M. INSPECTOR OF TAXES) v. JOSEPH FOSTER.⁽¹⁾
- (3) HUNTER (H.M. INSPECTOR OF TAXES) v. DEWHURST.⁽²⁾

Income Tax, Schedule E—Emoluments of office—Payments to retiring directors.

The Respondents in these cases were directors of a limited company. They had no written contracts of service with the company. Article 109 of the company's articles provided that in the event of any director, who had held office for not less than five years, dying or resigning or ceasing to hold office for any cause other than misconduct, bankruptcy, lunacy or incompetence, the company should pay to him or his representatives by way of compensation for loss of office a sum equal to the total remuneration received by him in the preceding five years. All three directors had held office for not less than five years.

In cases (1) and (2) the Respondent resigned office as director and received from the company as "compensation" a payment calculated in accordance with article 109.

In case (3) the Respondent desired to retire from active management of the company, but his co-directors wished to be able still to consult him, and it was agreed that he should resign the office of Chairman, receive as "compensation" a lump sum in lieu of the provision under article 109, waiving any future claim under that article, and remain on the board of the company at a reduced rate of remuneration.

Held, in the Court of Appeal, in cases (1) and (2) that the payment constituted a profit of the office of director and was properly assessable to Income Tax under Schedule E for the last year of office. (In these cases there was no appeal to the House of Lords.)

Held, in the House of Lords, in case (3) that in the circumstances of that case the sum received was not income assessable to Income Tax.

⁽¹⁾ Reported 145 L.T. 225.

⁽²⁾ Reported (K.B.D. and C.A.) 145 L.T. 225 and (H.L.) 146 L.T. 510.

CASES.

(1) *Henry (H.M. Inspector of Taxes) v. Arthur Foster.*

CASE

Stated by the Commissioners for the Special Purposes of the Income Tax Acts under the Income Tax Act, 1918, Section 149, for the opinion of the High Court.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at York House, Kingsway, London, on 25th October, 1929, for the purpose of hearing appeals, Arthur Foster appealed against an assessment of £6,396 made upon him under Schedule E of the Income Tax Acts for the year 1925-26 by the Additional Commissioners for the Division of Preston.

1. The company of G. & R. Dewhurst (1920), Ltd., hereinafter called the company, was incorporated on 16th March, 1920, to take over, as a going concern, a long established cotton business belonging to Geo. & R. Dewhurst, Ltd. Arthur Foster, who had been long employed by the previous company, took up shares in the new company and became one of the first directors of the company. He had no written contract of service with the company, apart from the articles and resolutions hereinafter mentioned. At all material times he held the necessary number of qualifying shares as required by the articles. By articles 104 and 109 of the company it was provided as follows :

“ 104. The directors shall be paid out of the funds of the company by way of remuneration for their services such sums as the company in general meeting shall from time to time determine. Such remuneration shall be divided among them in such proportions and manner as the directors may determine and, in default of such determination within the year, equally. Such remuneration may be either by way of fees or commission or participation in profits, or by any or all of those modes or otherwise as the company in general meeting shall determine. The directors shall also be paid all hotel, travelling and other expenses incurred by them in connection with the business of the company, including their travelling expenses of attending and returning from board and committee meetings.”

“ 109. In the event of any director dying or resigning his office, or in the event of any director ceasing to hold office for any cause other than misconduct, bankruptcy, lunacy or incompetence, the company shall pay to him or his representatives (as the case may require) by way of compensation for the loss of office a sum equal to the total amount of the remuneration which in his five years of office last preceding the commencement of the financial year

“ in which his death, resignation or cesser of office shall occur, shall have been received by him under clause 104 hereof, but so that in computing the amount of the remuneration so received, there shall be excluded from account all sums received by him by way of commission or participation in profits or otherwise than by way of director's fees. No such compensation shall be paid in the case of a director who, at the commencement of the financial year in which his death, resignation or cesser of office occurs, shall have held the office of director (whether continuously or discontinuously) for less than five years; but in the case of any person who shall have been a director of this company for less than five years, any period during which he held office as a director of the old company shall be added to, and computed with, the period for which he was a director of this company, and in that case the remuneration received by him in his character as a director of the old company and by way of fees shall be deemed to have been remuneration received by him as a director of this company. In computing for the purposes of this clause the amount of the fees received by any director, any sums deducted therefrom for Income Tax shall be reckoned as part of such fees. It shall rest solely with the directors to determine for what cause any director ceased to hold office, and their decision shall be final and conclusive.”

A print of the memorandum and articles of association of the company is hereto annexed, marked “ A ”, and forms part of this Case⁽¹⁾.

2. At a meeting of the directors held on the 27th day of April, 1920, the following resolutions were passed :

That in pursuance of article 124, Mr. Harry Dewhurst be, and he is hereby appointed, chairman of the meetings of directors. That the total yearly directors' fees which may be voted by the company in general meeting shall be divided amongst the directors in the following shares and proportions, namely, three-fifths of such total to Messrs. Harry Dewhurst, Gerard Powys Dewhurst and Cyril Dewhurst in equal proportions, and the remaining two-fifths of such total fees equally between Messrs. Thomas Percy Shelmerdine, Malcolme George Dewhurst Melville, Edward Sydney Arliss, Joseph Foster and Arthur Foster.

3. At an extraordinary general meeting of the company held on the 11th day of May, 1920, the following resolution was passed :

That the remuneration of the directors commencing from the 31st March, 1920, shall be £12,500 per annum, to be divided in the proportions as fixed and approved of at the

(1) Not included in the present print.

directors' meeting held 27th April last, viz :

Harry Dewhurst	...	...	£2,500	per annum
Gerard P. Dewhurst	...	...	£2,500	„ „
Cyril Dewhurst	...	...	£2,500	„ „
T. P. Shelmerdine	...	...	£1,000	„ „
M. G. D. Melville	...	...	£1,000	„ „
E. S. Arliss	...	...	£1,000	„ „
Joseph Foster	...	...	£1,000	„ „
Arthur Foster	...	...	£1,000	„ „

all payable half-yearly on the 31st March and the 30th September, Income Tax on the same to be borne by the company.

Arthur Foster received additional remuneration from the company for his services and his whole remuneration from year to year averaged over £5,000 a year and was quite adequate for his services.

4. In the autumn of 1925 Arthur Foster fell ill and offered to the other directors to resign his directorship. They pointed out to him, however, that he had not yet served five years so as to be entitled to "compensation" under article 109 and suggested that he should wait till the five years had expired at the beginning of 1926.

5. He accordingly renewed his offer of resignation at the end of the year, and on 5th January, 1926, the directors passed the following resolution :

That the board accept with regret the resignation of Mr. Arthur Foster as a director of the company as from the 1st January, 1926, and that compensation be paid to him for loss of office in accordance with clause 109 of the articles of association of this company.

6. On 5th January, the following letter was sent to Arthur Foster by the secretary to the company :—

" 5th January, 1926.

" Dear Mr. Foster,

" Your letter tendering your resignation as a director of this company, as from the 1st instant, was placed before a meeting of the board to-day, and your resignation was accepted with regret. I enclose cheque value £5,337 10s. 0d. made up as follows :

" Compensation for loss of office	...	...	£4,900	0	0
" Director's fees for the quarter ending					
" 31st December last	...	...	£250	0	0
" Income Tax at 4s. on £750 being your					
" fees for the 9 months ended 31st					
" December	...	...	£187	10	0
			<u>£5,337</u>	<u>10</u>	<u>0</u>

" which I trust you will find correct.

“ As requested, I also enclose herewith copy of the resolution passed at the meeting. Kindly acknowledge receipt.

“ Yours faithfully,

“ (Signed) JAMES BENTLEY,

“ Secretary.”

7. On 7th January, 1926, Arthur Foster sent the following reply:—

“ 7th January, 1926.

“ My dear Mr. Bentley,

“ I am obliged for your letter of the 5th instant with contents as stated therein.

“ You have apparently made a mistake in the amount of the compensation figure, having taken the net amount of fees, and overlooked the fact that these fees are paid free of tax, therefore, to get at the amount of fees, the amount paid by you for tax should be added.

“ If you refer to article 109, there is a paragraph near the end which states:

“ ‘ In computing for the purposes of this clause, the amount of the fees received by any director, any sums deducted therefrom for Income Tax shall be reckoned as part of such fees.’

“ Yours very truly,

“ (Signed) ARTHUR FOSTER.”

8. On 15th January, 1926, Arthur Foster received the following letter:—

“ 15th January, 1926.

“ Dear Mr. Foster,

“ I have been instructed by the directors to hand you the enclosed cheque, value £1,496 14s. 5d., being the amount paid to you for tax on your fees for the past five years as follows:

“ For the year 1921-22	£428	11	5
“ “ “ “ 1922-23	£300	0	0
“ “ “ “ 1923-24	£290	6	6
“ “ “ “ 1924-25	£290	6	6
“ “ “ “ 1925-26	£187	10	0
	<u>£1,496</u>	<u>14</u>	<u>5</u>

“ which I trust you will find correct.

“ I am also to state that the directors regret that this was overlooked in computing the amount of compensation for loss of office.

“ Yours truly,

“ (Signed) JAS. BENTLEY,

“ Secretary.

“ P.S.—Kindly acknowledge receipt.”

9. The assessment appealed against was made to cover the amounts so paid to Arthur Foster. These sums were allowed in making the assessments under Schedule D upon the company.

10. Two other directors who had received "compensation" payment by reference to article 109 appealed to us on the same day and at the same time as Arthur Foster. The facts relating to their appeals are fully set forth in Cases stated and signed by us on the same day as this Case. In the one case, that of Commander Dewhurst, who resigned his position as chairman of the company but continued to remain on as a director but upon a reduced scale, payment was made as by way of compromise of existing and future rights; whilst in the other case, that of Mr. Joseph Foster, payment was made to some extent as the result of negotiation.

11. On behalf of Arthur Foster it was contended that the assessment appealed against was wrongly made the amounts received by him being in no sense income.

12. On behalf of the Inspector it was contended (*inter alia*):

- (1) That regard must be had to the true legal nature of the payments in question rather than to the particular words by which they were described in the articles and resolutions.
- (2) That article 109 formed part of the Respondent's original contract of service and under it the Respondent had an absolute right to the payments therein mentioned upon fulfilment of the prescribed conditions.
- (3) The payments of £5,337 10s. 0d. and £1,496 14s. 5d. in question flowed from and were payable by virtue of the Respondent's original contract of service and formed part of the consideration for his services. They were, therefore, payments for his services and profits of his office.
- (4) The fact that the time of payment was the termination of the office was immaterial.
- (5) The fact that the payments took the form of a lump sum did not prevent their being profits of the office.
- (6) The payments were neither compensation for loss of income nor a solatium or testimonial, but were profits of the office and were income.
- (7) That the said assessment was rightly made and should be confirmed.

13. We, the Commissioners who heard the appeal, having before us also, as stated, the appeals of Commander Dewhurst and Mr. Joseph Foster, did not think that we could or ought to draw any distinction between the three cases, although in one case, that

of Commander Dewhurst, payment was made as by way of compromise of existing and future rights, Commander Dewhurst remaining on as a director but upon a reduced scale; in Mr. Joseph Foster's case payment was made to some extent as the result of a negotiation; and in the present case it was made directly under the article. We considered that the payments in all three cases were not to be regarded as remuneration paid to directors *qua* directors and continuing to be directors, but as given to the directors when they resigned and because they had resigned. We held therefore that they were not payments for services, but a solatium given upon retirement. Such payments are not in our opinion "taxable as a profit" (see *Chibbett v. Robinson*, 9 T.C. at page 61). We accordingly discharged the assessment.

14. Immediately upon our so determining the appeal, the Inspector of Taxes expressed 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.

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

York House,
23, Kingsway,
London, W.C.2.

8th April, 1930.

(2) *Henry (H.M. Inspector of Taxes) v. Joseph Foster.*

CASE

Stated by the Commissioners for the Special Purposes of the Income Tax Acts under the Income Tax Act, 1918, Section 149, for the opinion of the High Court.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at York House, Kingsway, London, on 25th October, 1929, for the purpose of hearing appeals, Joseph Foster appealed against an assessment of £6,325 made upon him under Schedule E of the Income Tax Acts for the year 1927-28 by the Additional Commissioners for the Division of Preston.

1. The company of G. & R. Dewhurst (1920), Ltd., hereinafter called the company, was incorporated on 16th March, 1920, to take over, as a going concern, a long established cotton business belonging to Geo. & R. Dewhurst, Ltd. Joseph Foster, who had been long employed by the previous company, took up shares in the new

company and became one of the first directors of the company, being one of its promoters. He was also one of the signatories to the memorandum and articles of association of the new company. He had no written contract of service with the company, apart from the articles and resolutions hereinafter mentioned. By articles 104 and 109 of the company it was provided as follows:—⁽¹⁾

A print of the memorandum and articles of association of the company is hereto annexed, marked "A", and forms part of this Case⁽²⁾.

2. At a meeting of the directors held on the 27th day of April, 1920, the following resolutions were passed:—

That in pursuance of article 124, Mr. Harry Dewhurst be, and he is hereby appointed, chairman of the meetings of directors. That the total yearly directors' fees which may be voted by the company in general meeting shall be divided amongst the directors in the following shares and proportions, namely, three-fifths of such total to Messrs. Harry Dewhurst, Gerard Powys Dewhurst and Cyril Dewhurst in equal proportions, and the remaining two-fifths of such total fees equally between Messrs. Thomas Percy Shelmerdine, Malcolm George Dewhurst Melville, Edward Sydney Arliss, Joseph Foster and Arthur Foster.

3. At an extraordinary general meeting of the company held on the 11th day of May, 1920, the following resolution was passed:—

That the remuneration of the directors commencing from the 31st March, 1920, shall be £12,500 per annum, to be divided in the proportions as fixed and approved of at the directors' meeting held 27th April last, *viz*:

Harry Dewhurst	...	...	£2,500	per annum
Gerard P. Dewhurst	...	...	£2,500	,, ,,
Cyril Dewhurst	...	...	£2,500	,, ,,
T. P. Shelmerdine	...	...	£1,000	,, ,,
M. G. D. Melville	...	...	£1,000	,, ,,
E. S. Arliss	...	...	£1,000	,, ,,
Joseph Foster	...	...	£1,000	,, ,,
Arthur Foster	...	...	£1,000	,, ,,

all payable half-yearly on the 31st March and the 30th September, Income Tax on the same to be borne by the company.

Joseph Foster received additional remuneration from the company for his services and his whole remuneration from year to year averaged over £5,000 a year and was quite adequate for his services.

⁽¹⁾ These articles are not printed here. See pp. 606/7 *ante*.

⁽²⁾ Not included in the present print.

4. At the commencement of the financial year in which his resignation (mentioned in the next paragraph) occurred, the Respondent had held office as a director of the company continuously for not less than five years. At all material times he held the necessary number of qualifying shares as required by the articles.

5. In the autumn of 1927, differences of opinion on questions of policy, involving no question of personal conduct, arose between Joseph Foster and the remaining directors. He decided to resign, and the following agreement was come to between him and the company on 10th November, 1927 :—

“ 1. Mr. Joseph Foster tenders his resignation as a director
“ of Geo. & R. Dewhurst, Ltd.

“ 2. He shall be paid compensation as provided for by
“ article 109.

“ 3. The compensation shall be applied in the first place in
“ discharge of the amount owing to the Geo. & R. Dewhurst
“ Trust on the security of Mrs. Foster's house at St. Anne's,
“ and the balance shall be paid to Mr. Foster in cash.

“ 4. The Geo. & R. Dewhurst Trust shall take over
“ Mr. Foster's shares in the company and shall cancel the
“ debt owing to it in respect of such shares.

“ 5. Mr. Foster shall be paid his remuneration (including
“ salary) as a director in all respects as if he had continued in
“ office until the 31st day of December, 1927.

“ 6. The company shall pay Mr. Foster a retiring pension
“ of £500 a year (gross) for 3 years to run from 1st January,
“ 1928.

“ 7. After the expiration of three years the directors will
“ take into further consideration the question of pension.

“ Dated 10th November, 1927.

“ For Geo. & R. Dewhurst, Ltd.

“ For Geo. & R. Dewhurst Trust.

6d. Stamp.

“ (Signed) GERARD P. DEWHURST,

“ Chairman.

“ (Signed) JOS. FOSTER.”

It was admitted that Mr. Joseph Foster ceased to hold office for some cause other than “ misconduct, bankruptcy, lunacy or “ incompetence.”

6. The amount due to Joseph Foster under article 109 was £6,324 6s. 6d., and this sum was paid, or accounted for, to him on the 18th November, 1927, in accordance with paragraph 2 of the said agreement.

The assessment appealed against was made to cover this payment. The payment was allowed as a deduction in making the assessment under Schedule D upon the company.

7. Two other directors who had received " compensation " payment by reference to article 109 appealed to us on the same day and at the same time as Joseph Foster. The facts relating to their appeals are fully set forth in Cases stated and signed by us on the same day as this Case. In the one case, that of Commander Dewhurst, who resigned his position as chairman of the company but continued to remain on as a director but upon a reduced scale, payment was made as by way of compromise of existing and future rights; whilst in the other case, that of Mr. Arthur Foster, the payment was made directly under the article.

8. On behalf of Joseph Foster, it was contended that the assessment appealed against was wrongly made, the amounts received by him being in no sense income.

9. On behalf of the Inspector it was contended (*inter alia*) :

- (1) That regard must be had to the true legal nature of the payment in question rather than to the particular words by which it was described in the articles and resolutions.
- (2) That article 109 formed part of the Respondent's original contract of service and under it the Respondent had an absolute right to the payment therein mentioned upon fulfilment of the prescribed conditions.
- (3) The payment of £6,324 6s. 6d. in question flowed from and was payable by virtue of the Respondent's original contract of service and formed part of the consideration for his services. It was, therefore, a payment for his services and profits of his office.
- (4) The fact that the time of payment was the termination of the office was immaterial.
- (5) The fact that the payment took the form of a lump sum did not prevent it being a profit of the office.
- (6) The payment was neither compensation for loss of income, nor a solatium or testimonial, but was a profit of the office and was income.
- (7) That the said assessment was rightly made and should be confirmed.

10. We, the Commissioners who heard the appeal, having before us also, as stated, the appeals of Commander Dewhurst and of Mr. Arthur Foster, did not think that we could or ought to draw any distinction between the three cases, although in one case, that

of Commander Dewhurst, payment was made as by way of compromise of existing and future rights, Commander Dewhurst remaining on as a director but upon a reduced scale; in Mr. Arthur Foster's case payment was made directly under the article; and in the present case payment was made to some extent as the result of negotiation. We considered that the payments in all three cases were not to be regarded as remuneration paid to directors *qua* directors and continuing to be directors, but as given to the directors when they resigned and because they had resigned. We held, therefore, that they were not payments for services, but a solatium given upon retirement. Such payments are not in our opinion "taxable as a profit" (see *Chibbett v. Robinson*, 9 T.C. at page 61). We accordingly discharged the assessment.

11. Immediately upon our so determining the appeal, the Inspector of Taxes expressed 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.

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

York House,
23, Kingsway,
London, W.C.2.
8th April, 1930.

(3) *Hunter (H.M. Inspector of Taxes) v. Dewhurst.*

CASE

Stated by the Commissioners for the Special Purposes of the Income Tax Acts under the Income Tax Act, 1918, Section 149, for the opinion of the High Court.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at York House, Kingsway, London, on 25th October, 1929, for the purpose of hearing appeals, Commander H. Dewhurst appealed against assessments of £10,000 and £2,900 made upon him for the years 1923-24 and 1925-26 to Income Tax under Schedule E by the Additional Commissioners for the City of Manchester.

1. The company of Geo. & R. Dewhurst (1920), Limited, hereinafter called the company, was incorporated on 16th March, 1920, to take over, as a going concern, a long established cotton business

belonging to Geo. & R. Dewhurst, Ltd. Commander Dewhurst was one of the promoters of the company and a large shareholder. He had been for some time a director of the previous company and he also became chairman and a director of the new company. He was also one of the signatories to the memorandum and articles of association of the new company. He had no written contract of service with the company apart from the articles and resolutions hereinafter mentioned. By articles 104 and 109 of the company it was provided as follows :—⁽¹⁾

A print of the memorandum and articles of association of the company is hereto annexed, marked " A ", and forms part of this Case⁽²⁾.

2. At a meeting of the directors held on the 27th day of April, 1920, the following resolutions were passed :—

That in pursuance of article 124, Mr. Harry Dewhurst be, and he is hereby appointed, chairman of the meetings of directors. That the total yearly directors' fees which may be voted by the company in general meeting shall be divided amongst the directors in the following shares and proportions, namely, three-fifths of such total to Messrs. Harry Dewhurst, Gerard Powys Dewhurst and Cyril Dewhurst in equal proportions, and the remaining two-fifths of such total fees equally between Messrs. Thomas Percy Shelmerdine, Malcolm George Dewhurst Melville, Edward Sydney Arliss, Joseph Foster and Arthur Foster.

3. At an extraordinary general meeting of the company held on the 11th day of May, 1920, the following resolution was passed :—

That the remuneration of the directors commencing from the 31st March, 1920, shall be £12,500 per annum, to be divided in the proportions as fixed and approved of at the directors' meeting held 27th April last, *viz* :

Harry Dewhurst	...	...	£2,500	per annum
Gerard P. Dewhurst	...	...	£2,500	" "
Cyril Dewhurst	...	...	£2,500	" "
T. P. Shelmerdine	...	...	£1,000	" "
M. G. D. Melville	...	...	£1,000	" "
E. S. Arliss	...	...	£1,000	" "
Joseph Foster	...	...	£1,000	" "
Arthur Foster	...	...	£1,000	" "

all payable half-yearly on the 31st March and the 30th September, Income Tax on the same to be borne by the company.

(1) These articles are not printed here. See pp. 606/7 *ante*.

(2) Not included in the present print.

4. The following table shows the remuneration received by Commander Dewhurst as a director from Geo. & R. Dewhurst, Ltd. and the company for the five years up to 1922 inclusive together with the appropriate Income Tax which was also paid by the companies.

	<i>Fees.</i>		<i>Income Tax.</i>	
1918	...	£1,150	...	£492 15 0
1919	...	£2,000	...	£857 5 0
1920	...	£2,375	...	£1,017 15 0
1921	...	£2,500	...	£1,071 10 0
1922	...	£2,125	...	£708 0 0
		<hr/>		<hr/>
		£10,150		£4,147 5 0

5. In 1923, Commander Dewhurst had removed his home to Scotland from Cheshire and wished to retire from active management of the company. After consulting his fellow directors, who wished to be able still to consult him about the business, he wrote the following letter :—

“ July 10th, 1923.

“ My dear Powys,

“ I wish to give you notice that, at the next meeting of the directors of the company, it is my intention to resign my office as chairman.

“ With regard to my future position in the company, and to the suggestions you submitted a short time ago, I have carefully considered these and venture to put the following proposal before you and my fellow directors :—

“ I waive any future claim under section 109 in the articles of association.

“ I be paid the sum of £10,000 (ten thousand) in cash.

“ I remain on the board of the company, with a remuneration of £250 (two hundred and fifty) per annum, free of Income Tax.

“ Will you be good enough to submit these proposals at the next meeting.

“ Yours ever,

“ (*Signed*) HARRY DEWHURST.”

6. The following resolution was passed at the meeting of directors held 9th August, 1923 :—

That the board accept with great regret the resignation of Commander Harry Dewhurst as chairman of the company and that he be paid the sum of £10,000 as compensation for loss of office, in lieu of the provision under clause 109 of the articles of association of the company and that he be paid the sum of £250 per annum free of Income Tax as director of the company as from the 1st August last.

In pursuance of the above resolution £5,000 was paid to the Respondent on 1st December, 1923, and a further £5,000 on 31st December, 1923.

7. In January, 1926, Mr. Arthur Foster, who was also a director of the company, gave up his directorship and received compensation as provided by article 109 of the company. This payment was calculated as shown in the following letter :—

“ 5th January, 1926.

“ Dear Mr. Foster,

“ Your letter tendering your resignation as a director of this company, as from the 1st instant, was placed before a meeting of the board to-day, and your resignation was accepted with regret. I enclose cheque value £5,337 10s. 0d. made up as follows :

“ Compensation for loss of office	£4,900 0 0
“ Director's fees for the quarter ending	
“ 31st December last	£250 0 0
“ Income Tax at 4s. on £750 being your	
“ fees for the 9 months ended 31st	
“ December	£187 10 0
	<hr/>
	£5,337 10 0

“ which I trust you will find correct.

“ As requested, I also enclose herewith copy of the resolution passed at the meeting. Kindly acknowledge receipt.

“ Yours faithfully,

“ (Signed) JAMES BENTLEY,
“ Secretary.”

Mr. Arthur Foster objected that Income Tax had been overlooked in calculating the above compensation and wrote to the secretary of the company on 7th January, 1926, the following letter :—

“ 10, St. George's Square,
“ St. Annes-on-Sea,
“ 7th January, 1926.

“ Jas. Bentley, Esq.,

“ Messrs. Geo. & R. Dewhurst (1920), Ltd.,
“ Gt. Marlborough St., Manchester.

“ My dear Bentley,

“ I am obliged for your letter of the 5th inst. with contents as stated therein.

“ You have apparently made a mistake in the amount of the compensation figure, having taken net amount of fees, and

“ overlooked the fact that these fees are paid free of tax, therefore, to get at the amount of fees, the amount paid by you for tax should be added.

“ If you refer to article 109, there is a paragraph near the end which states :

“ ‘ In computing for the purposes of this clause, the amount of the fees received by any director, any sums deducted therefrom for Income Tax shall be reckoned as part of such fees.’

“ Yours very truly,

“ (Signed) ARTHUR FOSTER.”

In due course he received the following reply :—

“ 15th January, 1926.

“ Dear Mr. Foster,

“ I have been instructed by the directors to hand you the enclosed cheque, value £1,496 14s. 5d., being the amount paid to you for tax on your fees for the past five years as follows :—

“ For the year 1921-22	£428 11 5
“ ” ” ” 1922-23	£300 0 0
“ ” ” ” 1923-24	£290 6 6
“ ” ” ” 1924-25	£290 6 6
“ ” ” ” 1925-26	£187 10 0
	£1,496 14 5

“ which I trust you will find correct.

“ I am also to state that the directors regret that this was overlooked in computing the amount of compensation for loss of office.

“ Yours truly,

“ (Signed) JAS BENTLEY,

“ Secretary.

“ P.S.—Kindly acknowledge receipt.”

8. Having made the above payment to Mr. Arthur Foster the directors of the company, without any request from Commander Dewhurst, reconsidered the amount paid to him and on 2nd February, 1926, passed the following resolution :—

That the sum of £2,900 be paid to Mr. Harry Dewhurst representing five years' Income Tax in respect of the amounts

paid to him on the 1st and 31st December, 1923, as compensation for loss of office, in full settlement of any sum due or to become due to him under article 109 of the articles of association of the company.

It is agreed that the sum of £2,900 was not calculated to represent the Income Tax exactly.

9. The assessments appealed against were made to cover the amounts of £10,000 and £2,900 so paid to Commander Dewhurst. These sums were allowed as deductions in making the assessments under Schedule D upon the Company.

10. At the commencement of the financial year in which Commander Dewhurst resigned the office of chairman of the board of directors, he had held the office of director (either of the old company or the new company) continuously for not less than five years. At all material times he held the necessary number of qualifying shares as a director, both of the old and new companies as required by the respective articles.

11. Evidence (which we accepted) was given by Commander Dewhurst to the following effect. Prior to 1923, he was residing in Cheshire and attending the company's office at Preston, very often. When he removed to Perthshire his attendance necessarily became only occasional. If he had chosen, he would have been entitled to resign his position as director and then could have demanded the payment under article 109. He was quite willing, however, not to resign his directorship altogether. He realised, however, that having moved to Perthshire and being unable, in consequence, to attend the company's office as theretofore, he could not expect to receive as large a remuneration as director as he had hitherto received. He also realised that owing to the reduction of his salary as a director to £250, the amount payable to him under article 109 when he finally retired, would automatically decrease during each of the five succeeding years. His desire, therefore, on his resignation of the chairmanship, was to receive payment forthwith under article 109. He realised, of course, that he could not reasonably ask for payment of the sum due under article 109 twice over, and therefore, in consideration of the company paying to him £10,000 in 1923, he agreed to make no further claim under article 109 when he finally retired.

12. We had before us on the same day and at the same time as the appeal of Commander Dewhurst appeals by Mr. Arthur Foster and by Mr. Joseph Foster, a third director who had also received "compensation" payable by reference to article 109. The facts relating to their appeals are fully set forth in cases stated and signed by us on the same day as this case. In the one case, that of Arthur Foster, payment was made directly under article 109, whilst in the other case, that of Mr. Joseph Foster, payment was made to some extent as the result of negotiation.

13. On behalf of Commander Dewhurst it was contended that the assessments appealed against were wrongly made, the amounts received by him being in no sense income.

14. On behalf of the Inspector it was contended (*inter alia*) :

- (1) That regard must be had to the true legal nature and substance of the payments in question rather than to the particular words by which they were described in the articles and resolutions.
- (2) That article 109 formed part of the Respondent's original contract of service and under it the Respondent had an absolute right to the payment therein mentioned upon fulfilment of the prescribed conditions.
- (3) That the payments in fact made to the Respondent were not (as contended on his behalf) payments made as compensation for relinquishing his rights under article 109. The whole essence of the transaction was not that the Respondent should give up his rights under that article, but that he should receive the payment which had accrued due to him thereunder, in 1923, instead of on his subsequent retirement. The arrangement was simply a modification by mutual consent of the terms of the original contract of service.
- (4) The case therefore did not differ in principle from the cases of Mr. Arthur Foster and Mr. Joseph Foster before referred to.
- (5) The payments of £10,000 and £2,900 in question flowed from and were payable by virtue of the Respondent's original contract of service as subsequently modified and formed part of the consideration for his services. They were, therefore, payments for his services and profits of his office.
- (6) Even if the time of payment had been the termination of the office, this would have been immaterial, but, in point of fact, the office in respect of which the payments were made, namely, that of director, had not terminated at the time of payment or subsequently.
- (7) The fact that the payments took the form of a lump sum did not prevent their being profits of the office.
- (8) The payments were neither compensation for loss of income, nor a solatium or testimonial, but were profits of the office and were income.
- (9) That the said assessments were rightly made and should be confirmed.

15. We, the Commissioners who heard the appeal, had, as stated, before us at the same time the appeals of Mr. Arthur Foster and Mr. Joseph Foster. We did not think that we could or ought to draw any distinction between the three cases, although payment under article 109 in one case, that of Mr. Arthur Foster, was made directly under the article, in the second case, that of Mr. Joseph Foster, was made to some extent as the result of negotiation, and in the present case was made by way of compromise of existing and future rights, Commander Dewhurst remaining on as a director but upon a reduced scale. We considered that the payments in all three cases were not to be regarded as remuneration paid to directors *qua* directors and continuing to be directors, but as given to the directors when they resigned and because they had resigned. We held therefore that they were not payments for services, but a solatium given upon retirement. Such payments are not in our opinion "taxable as a profit" (see *Chibbett v. Robinson* 9 T.C. on page 61). We accordingly discharged the assessments.

16. Immediately upon our so determining the appeal, the Inspector of Taxes expressed 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.

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

York House,
 23, Kingsway,
 London, W.C.2.
 8th April, 1930.

The cases came before Rowlatt, *J.*, in the King's Bench Division on the 8th December, 1930, when judgment was given against the Crown, with costs.

The Attorney-General (Sir W. A. Jowitt, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown; Mr. A. M. Latter, K.C., and Mr. F. Grant for Arthur and Joseph Foster and Mr. R. W. Needham, K.C., and Mr. N. Laski for Commander Dewhurst.

JUDGMENT.

Rowlatt, J.—In these cases I do not think the question is whether the payments to these three gentlemen are to be regarded as in the nature of gifts, or as in the nature of remuneration, which is the question which was so much debated in the case of *Herbert v. McQuade*⁽¹⁾, and the other clergyman's case, and in the Kent cricketer's case⁽²⁾ and in the Lancashire football professional's case⁽³⁾. I do not think that is the question in dispute here, but I think the question really is whether it is an income payment at all. Of course, in order to be taxable, any payment must be an annual profit or gain, and then it must be an annual profit or gain in respect of a public office or employment of profit under Schedule E, and under the Rule it must be also "salaries, fees, wages, perquisites or profits whatsoever therefrom for the year of assessment" from the public office or employment of profit. I think that is the question, on which side of the line of division the case falls. It seems to me that in *Duncan's* case⁽⁴⁾ it was laid down by Lord Dunedin, sitting, as he then used to do, in Scotland, that if there is a payment in respect of the cessation of office that cannot be taxable as a salary or profit of the office. In that case it was a pension paid to a retired minister because he was retired, and on the condition of his being retired, and it was held that it could not be taxed as the profit of an office, but was taxable as being an annuity, under Schedule D. In this case there is no question of there being any annuity or anything of that sort. It is one payment of a kind that does not permit of recurrence, and it seems to me that if it is not a profit of the office it is not taxable at all. It is not said to be taxable at all. It is not a profit of the office, according to what Lord Dunedin said, if it is paid in respect of the cessation of the office. Therefore, the question is whether it was paid in respect of the cessation of the office, or whether it really was paid in respect of the services rendered in the office. That it was legally payable and could have been exacted by process of law in the events that happened, there is no doubt in either case. Clearly the sums were paid after the office ceased, and, according to the article, were so payable. One event in which it was payable was if the man had died; it did not become payable until after the director died. You cannot vacate an office better than by dying in it. It seems to me that illustrates it; but, apart from that, it is clear that these payments were made, and fell to be made, after the office terminated. But that does not conclude it. It is quite clear that you can have a payment made after the office has terminated, which nevertheless, having regard to what was said in the

(1) 4 T.C. 489. (2) *Reed v. Sevmour*, 11 T.C. 625.

(3) *Davis v. Harrison*, 11 T.C. 707. (4) *Duncan's Executors v. Farmer*, 5 T.C. 417.

(Rowlatt, J.)

secretary's case, *Cowan v. Seymour*⁽¹⁾, is taxable; but then it must be, as I understand it, in the nature of a payment made later in respect of a title to payment earned before, that is to say, bringing a past annual profit up to the proper mark by a payment afterwards. That is what I understand that sort of case is. The question is now whether this is that sort of case at all.

In the three cases there is a good deal of difference. In Mr. Arthur Foster's case he simply took this payment under article 109. In Mr. Joseph Foster's case he took that, but there were some other questions outstanding, and he took some other payments too, and this payment was embedded in those other payments. I do not think that can make any difference at all. In Commander Dewhurst's case it was rather different, because there he wanted to retire, practically, but not altogether, and it would not do for him to stay to the end and take his payment under article 109, because, as they were reducing his remuneration to £250, it would come to nothing. On the other hand, he could not take it both now and afterwards; therefore, he came to an arrangement whereby he took £10,000 down in respect of his rights under article 109, assuming that article 109 continued, and that the company continued to earn profits until he did retire. He took his £10,000 down, and afterwards it was found it had been calculated on the net sum without including Income Tax, and it was made up by another £2,900 so as to put it on the basis which it should have occupied all through. It seems to me that that is a mere substitute for his rights under article 109 and stands in the same position.

Now what is the position of these sums? These gentlemen when they went into this company went in under articles. Their rights were continually governed by the article from the time it was passed. The articles might, at any time, be altered, of course, to put a new complexion upon things for the future, but the articles provided that they should receive remuneration such as was voted and divisible in the way they determined. They did determine in a particular way. The articles also provided that after five years, if they died or retired, they should have this very special right, namely, to have a lump sum—I call it a lump sum without prejudice, but I mean a sum once and for all—one complete sum equal to the remuneration for the past five years of their directorate. They would not get any more if they served for many years before retiring, and, of course, their right was liable to fail by reason of the directors not being voted remuneration, or by reason possibly of the articles being altered at the last moment; but if the articles remained as they were, then, on death or retirement, this sum became payable.

(1) 7 T.C. 372.

(Rowlatt, J.)

In Commander Dewhurst's case there is this peculiarity, because he was entitled to a substantial sum if he retired at the very moment he joined the board of the new company, because the time served with the company which preceded this company in the conduct of the business was counted as time served in the new company, so when Commander Dewhurst joined the company as director he might, the next day, have retired and claimed a sum equal to his remuneration for the past five years in the old company, on the spot.

In those circumstances it does not seem to me that this is a case where a sum is being added to the annual earnings of these directors by way of supplementing the annual profits of their offices. That is what it ought to be, I think, to make it taxable. I think that is what it is not. I think this is a special sum which it was provided that these gentlemen were to have when this employment came to an end—a lump sum to be given to them then. I may have been wrong in that case, but it is certainly covered by what I said in *Chibbett's* case⁽¹⁾, and I still hold that opinion. It is a very important point. What I said was: "If it was a payment in respect of the termination of their employment I do not think that is taxable. I do not think that is taxable as a profit. It seems to me that a payment to make up for the cessation for the future of annual taxable profits is not itself an annual profit at all." I adhere to that, and that is what I think this was. Therefore, in these circumstances, I must dismiss all these appeals with costs.

(1) *Henry (H.M. Inspector of Taxes) v. Arthur Foster.*

(2) *Henry (H.M. Inspector of Taxes) v. Joseph Foster.*

The Crown having appealed against the decision in the King's Bench Division in these two cases, the cases came before the Court of Appeal (Lord Hanworth, *M.R.*, and Lawrence and Romer, *L.JJ.*) on the 19th February and 26th March, 1931, and on the latter date judgment was given unanimously in favour of the Crown, with costs, in both cases, reversing the decision of the Court below.

The Attorney-General (Sir W. A. Jowitt, *K.C.*) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. A. M. Latter, *K.C.*, and Mr. F. Grant for the Respondents.

⁽¹⁾ *Chibbett v. Joseph Robinson and Sons*, 9 T.C. 48 at p. 61.

JUDGMENT.

Lord Hanworth, M.R.—We need not trouble you, Mr. Attorney.

This case raises a well known and difficult point, and its difficulty is illustrated by the various judicial decisions which have been given in a number of cases which have been cited to us on facts closely approaching, and in some ways analogous to, the present.

We have come to the conclusion that the decision of Mr. Justice Rowlatt is one with which we cannot agree, although one comes to that conclusion with reluctance having regard to the great experience that Mr. Justice Rowlatt has in these cases. Nevertheless, as in the previous cases such as the cricketer's case, *Reed v. Seymour*⁽¹⁾, it is quite obvious that there may be a wide divergence of judicial opinion upon the same facts.

Now what we have got to determine is whether or not these two directors, Arthur Foster and Joseph Foster, are liable to Income Tax in respect of a sum which they received as a totality at the conclusion of their directorship of a company in which they were interested, namely a company called Geo. & R. Dewhurst (1920) Limited. First of all, let me go to the very beginning and shew how it is that the tax is charged upon them. I turn at once to the Income Tax Act, 1918, which by Section 1 imposes the charge: "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 A, B, C, D, and E." It is claimed in the present case by the Crown that this profit is one which is described or comprised in Schedule E, and Schedule E says that the "Tax under Schedule E shall be charged in respect of every public office or employment of profit", and by Rule 1, "Tax under this Schedule shall be annually charged on every person having or exercising an office or employment of profit mentioned in this Schedule, or to whom any annuity, pension, or stipend, as described in this Schedule, is payable, in respect of all salaries, fees, wages, perquisites or profits whatsoever therefrom."

It is said that these directors, holding an office which is within Schedule E—that is not challenged—have received therefrom, from the office, profits in the sum which they were paid at the conclusion of their term of directorship. Now it is said that what has been paid to them is a sum which is not in the nature of a reward or profits derived from the office, because upon the facts which I am going to state, it was paid to them at the conclusion and upon the cesser of the office.

(¹) 11 T.C. 625.

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A number of cases have been referred to. They are well known to us. In some cases the sum received has been held to be liable to the tax, such as in *Herbert v. McQuade*⁽¹⁾, where a sum received by a curate in aid of his stipend from a sustentation fund was held taxable, or in the case of *Cooper v. Blakiston*⁽²⁾, where Easter offerings were received by an incumbent and were held liable to tax. Again, there is the case of *Davis v. Harrison*⁽³⁾, in 11 T.C., where a sum received by a footballer in respect of a benefit was held liable to tax, whereas in the case of *Reed v. Seymour*⁽⁴⁾, also in 11 T.C., it was held that the sum received from a benefit match granted to Seymour as a cricketer was not subject to tax, it being a sum which, so to speak, was a fortuitous addition to his other receipts, not arising from any contract with him and not payable to him in respect of any rights acquired by him.

The Attorney-General has, I think, rightly dwelt upon the case of *Reed v. Seymour*, for it is illustrative of the principles on one side and the other by which any case is to be determined. Lord Phillimore⁽⁵⁾ points out in that case that in the case of *Cooper v. Blakiston* the Easter offerings were due as of common right from a householder to the vicar or curate in his capacity, and under a rubric. He also points out that there was no inducement or basis of the employment of the cricketer that there should be a benefit granted to him, and upon that assumption he holds that the case is differentiated from the cases to which I have referred, such as *Herbert v. McQuade*, *Cooper v. Blakiston*, and the like. On the other hand, Lord Atkinson⁽⁶⁾ holds that in the case of *Seymour* the money did come to the man by virtue of his office, and that it was a part of the remuneration to be paid to him, even if that remuneration were subject, as to its mode of payment and the ultimate purpose to which it should be devoted, to the discretion of the authorities of the county club. I have referred to these cases in order to make it plain that I have not overlooked the principles which are to guide the Court in any case like this.

Now I turn to the facts of the present case. Mr. Arthur Foster became a member and director of this company, which was incorporated on the 16th March, 1920, to take over a long-established cotton business belonging to Geo. & R. Dewhurst, Limited, and although there is no condition in writing stating the terms on which the directors were serving, we have got the articles, which refer to the tenure of office by the directors and their remuneration, with the result that, as was said by Lord Halsbury in *Swabey v. Port Darwin Gold Mining Company*, "While the articles do not themselves constitute a contract, they are merely the regulations by

(¹) 4 T.C. 489. (²) 5 T.C. 347. (³) 11 T.C. 707. (⁴) *Ibid.* at p. 625.

(⁵) *Ibid.* at pp. 653/4. (⁶) *Ibid.* at pp. 647/653.

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“ which provision is made for the way the business of the company
“ is to be carried on, a person who acts as director with those
“ articles before him enters into a contract with the company to
“ serve as a director, the remuneration to be at the rate contemplated
“ by the articles.”

Now Mr. Arthur Foster served for some years, and in the autumn of 1925 he fell ill and offered the other directors to resign his directorship. It was suggested to him that he should continue, in order that he might enjoy the advantage given to a director who had served five years under article 109, and so at the end of the year he renewed his offer of resignation, and on the 5th January, 1926, the directors accepted it, and passed the following resolution :
“ That the board accept with regret the resignation of Mr. Arthur
“ Foster as a director of the company as from the 1st January 1926
“ and that compensation be paid to him for loss of office in accordance
“ with clause 109 of the articles of association of this company.”
A certain payment was made to him ; he then pointed out that the sum which was paid to him was not calculated at the full amount which he ought to have been deemed to have received, for the sum paid to him as a director was paid to him free of Income Tax, or immune from Income Tax ; and he writes a letter pointing out that a mistake has been made in the compensation figure, because the right sum can only be obtained by adding the amount paid by the company for Income Tax year by year in his favour. To that the company reply on the 15th January and send him a further sum of £1,496, accepting his view that this remuneration which was payable to him upon the cesser of his directorship had been calculated on too small a basis, and they say : “ The directors regret that this
“ was overlooked in computing the amount of compensation for
“ loss of office.”

Now, they call it, and he calls it, “ compensation for loss of office ” but as in all tax cases we have to look at the substance of the matter, and the substance of the matter involves an examination of, and correct interpretation of, these articles which are the terms incorporated into the contract of service between the director and the company. Under the heading of “ directors ” there are a number of articles stating who they are to be, and then article No. 104 says that there is to be paid a remuneration, and that “ Such remuneration may be either by way of fees or commission or “ participation in profits, or by any or all of those modes or otherwise
“ as the company in general meeting shall determine.” Then in article 109 provision is made that : “ In the event of any director
“ dying or resigning his office, or in the event of any director ceasing
“ to hold office from any cause other than misconduct, bankruptcy,
“ lunacy or incompetence, the company shall pay to him or his
“ representatives (as the case may require) by way of compensation

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“for the loss of office a sum equal to the total amount of the remuneration which in his five years of office last preceding the commencement of the financial year in which his death, resignation or cesser of office shall occur, shall have been received by him under clause 104 hereof”—then there is a further statement of how the five years is to be computed, with benefit to the director that if he has not served a full five years in this new company, Geo. & R. Dewhurst (1920), Limited, the service that he gave in the old company, the business of which was taken over by the new company, may be counted by him. It says that “any period during which he held office as a director of the old company shall be added to, and computed with, the period for which he was a director of this company, and in that case the remuneration received by him in his character as a director of the old company and by way of fees shall be deemed to have been remuneration received by him as a director of this company.”

Now it is argued that those sums which became payable under the terms recorded in article 109 were compensation for the loss of office. Is that the substance of the matter? When a man has died he is not compensated for the loss of his office; if he resigns voluntarily, why should he be paid compensation for the loss of his office? It would seem as if those words were put in in view of the possibility thereunder of escaping the charge to tax; but, as I have said, we have got to look at the substance of the matter, and the substance of this payment is this: It is contemplated as a part of the remuneration of the director payable to him, and estimated according to his service during a certain time, and in addition to the amount paid to him under clause 104, there shall be estimated a sum which is to fall to be paid to him under clause 109. That seems to me to be by way of deferred remuneration and to enure to his benefit at a time when it may be very convenient to him to find himself entitled to a lump sum. In the case of his death, it cannot be said that it is by way of compensation for loss of office that this sum falls to his executors. It surely must be this, and the only way to construe article 109 is this, that it is a sum which has been saved up by him so as to fall to his executors in the form of a deferred payment. So, in the case of his resigning, it may be convenient to him to find that he has stored a sum which will then become payable to him.

Now, for what is it payable? As Lord Justice Romer pointed out early to-day, if he is to be entitled to it, as it is said in the article, “the company shall pay to him”, it must be for services rendered. That is the consideration which he gives to the company and which moves the company to pay him. In the alternative, if his office had ceased, if he had resigned, if he had died, if we are not to take into

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account services rendered, for which a deferred payment is to be made, what right or power would the company have of making a present to his executors by way of what is called in one of the cases, a solatium, which means, I suppose, by way of a charitable payment wholly detached from any contract entered into between the director and the company, and wholly independent of any services received by the company from the director? When this relation of directorship in the company is examined with due regard to the interests of the company, it seems impossible to hold that the nature of this payment is that it is a fortuitous sum falling from the skies to the directors out of the coffers of the company, not in respect of any earnings or services rendered to the company, but merely of the nature and quality such as was held to escape tax in the case where a man who had acted as liquidator was held to have received a bonus without any liability to tax attaching to the sum paid to him. That is the case of *Cowan v. Seymour*⁽¹⁾, where a sum was found to be in hand when the liquidation of the company was completed and by a unanimous decision of the shareholders the sum in question was voted in equal shares to the chairman of the company and to the appellant. That was after the liquidation of the company had taken place and when there was no service in respect of which it had been held out as a reward, but it was entirely a fortuitous sum falling to be dealt with as the shareholders of the company in their unfettered discretion might think right.

In the present case, we have got far different facts. It appears to me that, if this sum were not paid, the executors, or the representatives, could require the company to pay to them this sum, that is to say, if the terms on which it is payable had been fulfilled by their testator. It therefore comes back to the consideration of what, in substance, this payment was made for and, inasmuch as the company, to my mind, would have no power to dispose of its funds in the same way as was done in *Cowan v. Seymour*, this payment must be related to the services rendered, and if related to the services rendered, it comes back to being a sum which is a profit which can be asked for and demanded as a profit arising from the office or employment of profit which had up to that time been enjoyed by the director. The fact that it falls to be paid after the office has come to an end does not divorce it completely from the office, but I have said enough to show that, in my judgment, there must be the direct relation between the holding of the office and the right to have this payment made.

The last point that I need refer to is the one which was put forward very cogently by Mr. Grant, namely, that if the sum is payable it must be distributed over the years during which the qualification

(1) 7 T.C. 372.

(Lord Hanworth, M.R.)

for it lasted, that is to say, not less than five years. To my mind, interesting as that argument may be, it is fallacious. There are certain conditions to be fulfilled before the sum as a totality falls to be paid, but when the conditions have been fulfilled the sum as a total is to be paid. There is no indication that it is to be distributed over the number of years served. It seems that after the appropriate period of five years service in the one company or the other had been completed, the director became entitled to receive this sum, if and when his directorship came to an end, or he died, but he might continue to be a director for another three or four or five years, and are you to say when ultimately the sum is paid, that it is distributable over the number of years respectively during which the service as a director has been fulfilled? I do not think so. It seems to me that the conditions, once they are fulfilled, entitle the director to a lump sum by way of deferred payment, and that deferred payment cannot be split up into component parts, for there is no scheme or system laid down in article 109 whereby that can be done.

Under those circumstances, it appears to me that the judgment of Mr. Justice Rowlatt must be set aside, and the decision of the Commissioners, and an Order must be made that an assessment in respect of these sums must be made upon the directors.

With regard to Mr. Joseph Foster, I do not think that the facts altered that case. It is quite true that some adjustment of the figures had to be made in the payment passing between Mr. Joseph Foster and the company, but those are details incidental to the accounts between them, and the nature and quality of the payment made to Mr. Joseph Foster was the same as that made to Mr. Arthur Foster.

Lawrence, L.J.—The question in this case is whether the sum of £6,000 odd paid by the company to the Respondent, Arthur Foster, on his retirement from the office of director in accordance with the terms of his contract of service which are contained in article 109 of the articles of association, and there stated to be by way of compensation for loss of office, is a profit from the office of director for the year of assessment, 1925–1926, within the meaning of Schedule E, Rule 1, of the Income Tax Act, 1918. The Special Commissioners held that the sum so paid was a solatium given to the Respondent upon retirement, and not a payment for services, and upon that ground discharged the assessment which had been made upon the Respondent. Mr. Justice Rowlatt upheld the conclusion of the Commissioners, but upon a different ground. The learned judge founded himself on the decision of Lord Dunedin in the case of *Duncan's Executors v. Farmer*, which is reported in 5 T.C.

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at page 417, and held that the sum paid to the Respondent, although payment could legally have been enforced, was a payment made in respect of the cessation of the office of director and therefore was not a profit of that office.

In my opinion, the view taken both by the Commissioners and by the learned judge is erroneous. As pointed out by Lord Sterndale, Master of the Rolls, in the case of *Cowan v. Seymour*, 7 T.C. at page 379, the judgment of Lord Dunedin in *Duncan's* case must be read in the light of the facts of that case, which were that the allowance there was in the nature of a compassionate allowance made after the minister had retired on the ground of ill health. In my opinion neither *Duncan's* case nor any other case dealing with voluntary payments made on the relinquishment of an office or an employment of profit has any bearing on the question which we have to decide. In my judgment, the determining factor in the present case is that the payment to the Respondent whatever the parties may have chosen to call it was a payment which the company had contracted to make to him as part of his remuneration for his services as a director. It is true that payment of this part of his remuneration was deferred until his death or retirement or cesser of office, and that in the articles it is called "compensation for loss of office." It is, however, a sum agreed to be paid in consideration of the Respondent accepting and serving in the office of director, and consequently is a sum paid by way of remuneration for his services as director.

In those circumstances, the inevitable conclusion to my mind is that the sum was a profit from the office of director, the payment of which could have been enforced by action, or by proof as a creditor in a winding-up. (See *Swabey v. Port Darwin Gold Mining Company*, 1 Megone's Reports, page 385, and *Ex parte Beckwith*, [1898] 1 Ch. page 324.)

Now the sum which was paid to the Respondent, in my judgment, arose and accrued in the last year of the office of director and is therefore properly included in the assessment which was made upon him for the year of assessment, 1925-1926, as a profit from the office in that year, and is not distributable, as has been suggested, either over the whole term of service of the Respondent or over the last five years of such service.

The only other point that I desire to mention is the argument that this payment is not an income payment at all but is a capital payment. I think that that point is covered by what I have said as to the character of the payment, namely that it is remuneration for the Respondent's services as a director.

For these reasons I agree that the Respondent was rightly assessed under Schedule E, and that the appeal ought to be allowed.

Romer, L.J.—I agree. The first question that has to be determined is what were the terms upon which the directors were serving the company. Admittedly there is no express agreement here, and that being so we must look at the articles of association relating to directors, not as articles of association, but as containing the terms upon which the company must be deemed to have invited persons to serve it as directors. That has frequently been laid down in the cases, and I think the last case in which it is so laid down was the *City Equitable* case, in [1925] Ch. at pages 520/521 where Lord Justice Warrington, as he then was, referring to certain articles of association which provided that auditors and directors should not be responsible except for wilful negligence, said: "I think that that article . . . does in such a case as the present form part of the contract between the company and the auditors, and for the reason that auditors are engaged without any special terms of engagement. When that is the case, then if the articles contain provisions relating to the performance by them of their duties and to the obligations imposed upon them by the acceptance of the office, I think it is quite plain that the articles must be taken to express the terms upon which the auditors accept their position."

I therefore look at the articles in the present case and see what are the articles relating to remuneration, that is to say, what are the terms as to remuneration upon which the directors accepted office. As I read the articles of association those terms are to be found in articles 104 and 109. I am not going to read them through at length, but it is sufficient to say that article 104 provides for the annual remuneration of the directors. The Article does not in terms use the word "annual", or provide for "annual" remuneration, but that that is the effect of it is, I think, clear from the provision that the money voted by the company shall be equally divided amongst the directors in default of the directors otherwise determining within a year. Then article 109 provides that in the last year of the office of the director, if the director shall have served a certain time, there shall be paid to him in addition to the annual remuneration a sum made up or calculated in the method prescribed by that article.

Now, supposing that a director is employed upon the terms that he is to be paid in each year of his service a sum of £1,000, and in the last year of his service a sum of £5,000 in addition to the £1,000, no one I think could doubt in such a case that the £5,000 was a profit of his office, paid to him in respect of his office, that it was liable to Income Tax, and was to be treated for the purposes of tax as forming part of his salary for the last year of his office.

The case before us is precisely that case, with two exceptions: Firstly, that the sum is not fixed, but has to be ascertained by reference to events which will not be determined until the last year

(Romer, L.J.)

of office—that can make no difference at all—and secondly, that article 109 expresses that the sum to be paid in the last year of office is to be compensation for loss of office. Now, do those words make any difference? In my opinion they do not. In the first place, it cannot matter what the parties call the money which is to be paid in the last year of office if one finds, as here, that the only consideration for the payment by the company of that sum is the service by the director and that it is a sum for which the director must be deemed to have stipulated when offering his services to the company and that it is paid to him by reason of his having performed those services. In the second place, it does appear to me that the words on the face of them are wholly inapplicable to describe the payments to which they are by the article made to refer. “Compensation for loss of office” is a well-known term, and, as I understand it, it means a payment to the holder of an office as compensation for being deprived of profits to which as between himself and his employer he would, but for an act of deprivation by his employer or some third party such as the Legislature, have been entitled.

In the present case, the payments are to be made on the death or resignation or cesser of office on any ground other than those specially excepted in the article, events, be it observed, on which in the very terms of the man’s employment, his office, and therefore his emolument, would come to an end. It is impossible, therefore, in such a case, to say that when he dies or resigns or his office otherwise comes to an end he has lost any salary or any profits at all. The words “compensation for loss of office” in such a case seem to me to be wholly misleading.

For those reasons, I agree that this appeal should be allowed.

Mr. Hills.—Then the appeal will be allowed, with costs, my Lord?

Lord Hanworth, M.R.—Yes, and the assessment will be confirmed in both cases.

Mr. Hills.—If your Lordship pleases.

[Solicitors:—Solicitor of Inland Revenue; Gregory, Rowcliffe & Co., for Finch, Johnson & Lynn, Preston and Blackpool.]

(3) *Hunter (H.M. Inspector of Taxes) v. Dewhurst.*

The Crown having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Hanworth, *M.R.*, and Lawrence and Slesser, *L.JJ.*) on the 1st May, 1931, when judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Attorney-General (Sir W. A. Jowitt, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. R. W. Needham, K.C., and Mr. N. Laski, K.C., for the Respondent.

JUDGMENT.

Lord Hanworth, M.R.—We need not trouble you, Mr. Attorney.

This case must follow the decision that we have already given in the *Foster* cases. Mr. Needham has suggested that this case differs *toto cælo* from the *Foster* cases because, he says, the money was paid for the purpose of securing that Commander Dewhurst should not resign but should continue as a director though at a smaller salary, and was an arrangement made between Commander Dewhurst and the company to secure the Commander's continuance of holding the directorship.

I am going to deal first with the £10,000, as Mr. Needham rightly says we have to deal with the substance of the matter in these cases. It is unnecessary for me to go through the process by which a charge is made and falls upon those who hold offices within Rule 1 of the Rules to Schedule E; I have done that in the *Foster* cases.

The substance of the matter appears to me to be this. Commander Dewhurst wrote a letter on the 10th July, 1923, in which he said: "With regard to my future position in the company, and to the suggestions you submitted a short time ago, I have carefully considered these and venture to put the following proposal before you and my fellow directors:—I waive any future claim under Section 109 in the articles of association. I be paid the sum of £10,000 in cash." Looking at that letter and the subsequent action performed, it appears clear, indeed I think the Commissioners have found, that the root of this payment was the right that Commander Dewhurst had under clause 109 of the articles of association, or, put otherwise, under the contract he had as a director of the company to be paid on the basis of the terms contained in articles 104 and 109. That being so, I cannot see that there is any distinction to be drawn between this case and the *Fosters'* cases.

With regard to the sum of £2,900 which is to make good the mistake in calculation by deduction of the Income Tax which was pointed out in the year 1926 by Mr. Foster, it is clear from the

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resolution of the 2nd February, 1926, under which the payment was made, that that sum was paid to Commander Dewhurst in respect of the amounts paid to him on the 1st and 31st December, 1923, as compensation for loss of office; it was not paid as an independent sum by way of solatium or anything else. The board felt that when they had acceded to Mr. Foster's claim in reference to Income Tax it was only just and right that they should put Commander Dewhurst on the same basis, and the resolution records that this sum of £2,900 is paid in respect of the amounts which had been paid in December, 1923. The £2,900, therefore, follows the same course and stands on the same basis as the payment of the £10,000.

One other point occurs to me. I think it would be very difficult for the directors to have justified this payment if there had not been a complete consideration of the articles of association. Mr. Needham says those articles gave Commander Dewhurst a basis or a jumping-off ground from which he could approach the company; but they are not to be treated as a basis; it appears to me that they must be treated as an integral part of the terms on which Commander Dewhurst was holding his office, and thus that the payments are within the Rule which imposes the tax.

For these reasons and for the reasons already given in the *Fosters'* cases, the appeal must be allowed with costs here and below and the assessments must be confirmed.

Lawrence, L.J.—I agree. Mr. Needham contended that this case can be differentiated from the *Foster* cases in that Commander Dewhurst remained in office and that therefore the sum which would have been payable to him under article 109 had he retired had not in fact become payable. It seems to me that that point tells rather against the contention advanced by Mr. Needham than in favour of it. It may well be that the company thought it worth while to remunerate Commander Dewhurst for remaining in office, in other words, made the payment to prevent him from retiring from the company altogether; and it seems to me that what really happened was that the company considered it advisable, in order to secure Commander Dewhurst remaining on the board, to compromise with him in respect of the payment to which he would have been entitled under article 109 had he retired. It seems to me that such a payment comes directly under Rule 1 of the Rules applicable to Schedule E, as being either a fee or wage or profit derived from the office of director, and is therefore taxable as such.

I agree that the appeal should be allowed.

Slessor, L.J.—I agree and have nothing to add.

Hunter (H.M. Inspector of Taxes) v. Dewhurst.

An appeal having been entered against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Dunedin and Lords Warrington of Clyffe, Atkin, Thankerton and Macmillan) on the 25th and 26th February, 1932, when judgment was reserved. On the 14th April, 1932, judgment was given against the Crown, with costs (Viscount Dunedin and Lord Macmillan dissenting) reversing the decision of the Court below.

Mr. R. W. Needham, K.C., and Mr. J. H. Stamp appeared as Counsel for the Appellant and The Attorney-General (Sir T. W. Inskip, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT.

Viscount Dunedin.—My Lords, the question in this case is whether certain sums of money which were paid by a company, G. & R. Dewhurst, Ltd., to the late Commander Dewhurst, who was a director, were liable to be assessed for Income Tax under Schedule E. Commander Dewhurst was, as said, a director of the limited company and his remuneration depended on two articles of association, 104 and 109, which were in the following terms: “ 104. The directors shall be paid out of the funds of the company “ by way of remuneration for their services such sums as the “ company in general meeting shall from time to time determine. “ Such remuneration shall be divided among them in such proportions and manner as the directors may determine and, in default “ of such determination within the year, equally. Such remuneration may be either by way of fees or commission or participation “ in profits, or by any or all of those modes or otherwise as the “ company in general meeting shall determine. The directors shall “ also be paid all hotel, travelling and other expenses incurred by “ them in connection with the business of the company, including “ their travelling expenses of attending and returning from board “ and committee meetings. 109. In the event of any director dying “ or resigning his office, or in the event of any director ceasing to “ hold office for any cause other than misconduct, bankruptcy, “ lunacy or incompetence, the company shall pay to him or his “ representatives (as the case may require), by way of compensation “ for the loss of office, a sum equal to the total amount of the “ remuneration which in his five years of office last preceding the “ commencement of the financial year in which his death, resignation or cesser of office shall occur, shall have been received by him

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“ under clause 104 hereof, but so that in computing the amount of
 “ the remuneration so received, there shall be excluded from account
 “ all sums received by him by way of commission or participation
 “ in profits or otherwise than by way of director’s fees. . . .
 “ In computing for the purposes of this clause the amount of the
 “ fees received by any director any sums deducted therefrom for
 “ Income Tax shall be reckoned as part of such fees. It shall rest
 “ solely with the directors to determine for what cause any director
 “ ceased to hold office and their decision shall be final and con-
 “ clusive.” There were among the other directors, two directors,
 Arthur and Joseph Foster. At an extraordinary general meeting of
 the company held on the 11th day of May, 1920, the following
 resolution was passed: “ That the remuneration of the directors
 “ commencing from the 31st March, 1920, shall be £12,500 per
 “ annum, to be divided in the proportions as fixed and approved of
 “ at the directors’ meeting held 27th April last, viz. :

	Per annum
	£
“ Harry Dewhurst	2,500
“ Gerard P. Dewhurst	2,500
“ Cyril Dewhurst	2,500
“ T. P. Shelmerdine	1,000
“ M. G. D. Melville	1,000
“ E. S. Arliss	1,000
“ Joseph Foster	1,000
“ Arthur Foster	1,000

“ all payable half-yearly on the 31st March and the 30th September,
 “ Income Tax on the same to be borne by the company.”

Arthur Foster resigned on 1st January, 1926, and Joseph Foster on 10th November, 1927. In both cases, sums were calculated under the terms of article 109 and paid. As to Arthur, no question was raised. As to Joseph, there were certain questions, but they may be disregarded. In the end, he was paid the sums which were agreed to be due under article 109.

Commander Dewhurst wished to retire in 1923, but the other directors wished to keep him, although he was going to change his residence and would not be able to attend the company’s meetings with the same regularity as before. Commander Dewhurst, on July 10th, 1923, wrote the following letter :—

“ July 10th, 1923.

“ My dear Powys,

“ I wish to give you notice that, at the next meeting of the
 “ directors of the company, it is my intention to resign my office as
 “ chairman. With regard to my future position in the company,

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“ and to the suggestions you submitted a short time ago, I have
“ carefully considered these and venture to put the following
“ proposal before you and my fellow directors:—I waive any
“ future claim under section 109 in the articles of association.
“ I be paid the sum of £10,000 (ten thousand) in cash. I remain
“ on the board of the company, with a remuneration of £250
“ (two hundred and fifty) per annum free of Income Tax. Will you
“ be good enough to submit these proposals at the next meeting.

“ Yours ever,

“ (*Signed*) HARRY DEWHURST.”

The following resolution was passed at the meeting of directors held 9th August, 1923: “ That the board accept with great regret
“ the resignation of Commander Harry Dewhurst as chairman of the
“ company and that he be paid the sum of £10,000 as compensation
“ for loss of office, in lieu of the provisions under clause 109 of
“ the articles of association of the company and that he be paid
“ the sum of £250 per annum free of Income Tax as director of
“ the company as from the 1st August last.”

In pursuance of the above resolution £5,000 was paid to the Appellant on 1st December, 1923, and a further £5,000 on 31st December, 1923.

When the Fosters were both settled with, the directors, without any application by Commander Dewhurst, on 2nd February, 1926, passed the following resolution: “ That the sum of £2,900 be
“ paid to Mr. Harry Dewhurst representing five years' Income Tax
“ in respect of the amounts paid to him on the 1st and 31st Decem-
“ ber, 1923, as compensation for loss of office, in full settlement of
“ any sum due or to become due to him under article 109 of the
“ articles of association of the company.”

The Additional Commissioners for the City of Manchester assessed for Income Tax the said sums of £10,000 and £2,900, and also the sums paid to the Fosters. All three appealed to the Commissioners for Special Purposes who discharged the assessments but stated a special case. Mr. Justice Rowlatt confirmed the judgment of the Special Commissioners. Appeal being taken by the Inspector of Taxes, the Court of Appeal reversed the judgment of Mr. Justice Rowlatt, and restored the amount taxed by the Additional Commissioners.

The two Fosters have not appealed, but Commander Dewhurst has appealed. He has since died and his executors are substituted for him.

Mr. Justice Rowlatt treated all three cases as raising the same point and decided them on that point. He considered that the sums

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in question did not fall within the description in Schedule E, holding that they were not paid in respect of the office of director, but were compensation for retirement from the office. He considered that what he was holding was in accordance with what had been laid down in the case of *Duncan v. Farmer*, 1909 S.C. 1212, and alluded to a sentence of mine in my judgment on that case⁽¹⁾. The sentence in question is, I believe, the following: "I confess "I have never been able to see how it could possibly be said to "be in respect of his office, when the whole reason it was given to "him was that he was no longer in the office."

My Lords, the case of *Duncan v. Farmer* is not binding on your Lordships, but I think it was rightly decided and I had in accordance with my own view the weighty authority of Lord Kinnear. But what were the facts? A completely extraneous society granted Mr. Duncan, the minister of the parish of Crichton, an annuity of £100 a year on condition of his complete resignation of the position of minister. He did resign and was then given the annuity. Applied to the facts, I think the sentence quoted was correct. The payment came to him in no sense by virtue of his office, but I think it has no relation to the facts here. Here the payment made was part of the contract under which they all served and in respect of the services rendered while they served. I do not consider that the mention of the words "in consideration of loss of office" can be allowed to make a change in the true nature of the payment and the true nature of the payment, in my opinion, was just deferred remuneration. The distinction between *Duncan's* case and a case of this sort was seen and commented on by the Master of the Rolls in *Cowan v. Seymour*, 7 T.C. 372, at page 379.

Nor do I think that *Chibbett's* case, 9 T.C. 48, which of course does not bind me, is really antagonistic to what I am saying. I do not need to say that I think the decision in *Chibbett's* case was wrong. Indeed, I think it was right. In that case the payment was purely voluntary. The *ex post facto* alteration of the articles did not make it contractual. The mere statement that it was in respect of the loss of service as manager does not alter the voluntary quality of the payment. Here the whole point is that the payment is contractual and the contract is as to the terms of remuneration for the office.

Assuming, however, that the view of the Court of Appeal, and my own view, is right, on consideration of how the question stood upon the sole consideration of the rights arising under article 109, it is obvious that there is still another question to be raised before the present case can be disposed of.

⁽¹⁾ 5 T.C. 417, at p. 422.

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Commander Dewhurst was not paid in terms of article 109. He entered into a new bargain which was concluded by the letter quoted. Now it is urged for him that the payment of £10,000—and the other payment is a mere corollary to it—was a lump sum given in consideration, not of ceasing to be a director, for he did not cease, but of giving up his potential claims under article 109, and that that is not income. The reason for the arrangement is clear enough.

If it had not been made, and his salary had been reduced to £250, then, if he still remained a director for some time, the five years calculated under article 109 would be on a very reduced figure. Therefore, he said: "Give me £10,000 down and pay me £250 and "I will give up all claim under article 109."

My Lords, in my opinion, that was a mere change of calculation and the quality of the payment remained as before and, as I have said, was deferred payment for past services rendered. I am therefore of the opinion that the appeal should be dismissed with costs.

Lord Warrington of Clyffe.—My Lords, the Appellants are the executors of Commander Harry Dewhurst, deceased, and the question is whether the said Harry Dewhurst was liable to be assessed to Income Tax under Schedule E in respect of three sums of £5,000, £5,000 and £2,900 paid to him by George and R. Dewhurst (1920), Ltd., as to the two sums of £5,000 each in December, 1923, and as to the sum of £2,900 in February, 1926, as being profits from his employment as a director of the company.

The Special Commissioners decided against the Crown, and their decision was upheld by Mr. Justice Rowlatt, but his judgment was reversed by the Court of Appeal (Lord Hanworth, Master of the Rolls, and Lords Justices Lawrence and Slesser). Harry Dewhurst died on the 27th June, 1931, and the present Appellants were made parties to the proceedings in his place.

George and R. Dewhurst (1920), Ltd., hereinafter called "the company", was incorporated in the year 1920 to take over an old-established cotton-spinning business then carried on by George and R. Dewhurst, Ltd. The said Harry Dewhurst had been a director of that company and was an original director and chairman of the company.

The remuneration of the directors was fixed by the joint operation of article 104 of the articles of association and a resolution of an extraordinary meeting of the company held on the 11th May, 1920, at the sum of £12,500, of which the share of the said Harry Dewhurst was £2,500, free of Income Tax, which was borne and paid by the company.

By article 109 of the articles of association, provision was made for the payment to a director who resigned his office "by way of

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“ compensation for the loss of office,” of a sum equal to the total amount of his remuneration for the preceding five years, including in the case of a director of the old company his service with that company, and sums deducted for Income Tax were to be treated as part of his fees. This article is printed in full in the Appendix at page 3⁽¹⁾.

The total remuneration of the said Harry Dewhurst for the five years 1918 to 1922 inclusive was £10,150 and the Income Tax thereon amounted to £4,147. Accordingly, had he retired in July, 1923, he would under his then existing contract with the company have been entitled to receive under article 109 “ by way of “ compensation for loss of office,” £14,297.

In 1923, he had removed his home to Scotland from Cheshire and wished to retire from active management of the company. After consulting with his fellow directors, who wished still to consult him about the business, he wrote to the secretary of the company a letter dated the 10th July, 1923, in the following terms: “ I wish “ to give you notice that, at the next meeting of the directors of the “ company, it is my intention to resign my office as chairman. With “ regard to my future position in the company, and to the sugges- “ tions you submitted a short time ago, I have carefully considered “ these and venture to put the following proposal before you and “ my fellow directors :—I waive any future claim under section 109 “ of the articles of association. I be paid the sum of £10,000 in “ cash. I remain on the board with a remuneration of £250 per “ annum free of Income Tax. Will you be good enough to submit “ these proposals at the next meeting.” On the 9th August, 1923, the directors passed the following resolution: “ That the board “ accept with great regret the resignation of Commander Harry “ Dewhurst as chairman of the company and that he be paid the “ sum of £10,000 as compensation for loss of office in lieu of the “ provisions under clause 109 of the articles of association of “ the company and that he be paid the sum of £250 per annum free “ of Income Tax as director of the company as from the 1st August “ last.”

The sum of £10,000 was paid to Harry Dewhurst in two cheques of £5,000 each, one on the 1st December, 1923, and the other on the 31st December, 1923.

Subsequently, namely, in the year 1926, the directors, without any request in that behalf from Harry Dewhurst, reconsidered the amount paid to him, and on the 2nd February in that year passed the following resolution: “ That the sum of £2,900 be paid to “ Mr. Harry Dewhurst, representing five years’ Income Tax in “ respect of the amounts paid to him on the 1st and 31st December, “ 1923, as compensation for the loss of office, in full settlement of

(¹) See pp. 606/7 *ante*.

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"any sum due or to become due to him under article 109 of the articles of association of the company." This sum of £2,900 was duly paid in accordance with the resolution. It is agreed that this sum was not arrived at by an exact calculation of the amount of Income Tax.

The question then is: Can the sums of £10,000 and £2,900 properly be regarded as forming part of the annual income of Harry Dewhurst for the years 1923-24 and 1925-26 respectively?

It is hardly necessary to state that the tax in question is a tax on income under whichever of the Schedules it is charged.

In the present case, the tax is charged under Schedule E, namely: "in respect of every public office or employment of profit for every twenty shillings of the annual amount thereof." "Thereof" must in this connection mean "of such profit."

Under Rule 1, the tax is to be annually charged on "every person exercising an office or employment of profit mentioned in this Schedule in respect of all salaries, fees perquisites or profits whatsoever therefrom for the year of assessment." Amongst the offices of profit mentioned in the Schedule are offices or employment of profit under any company or society whether corporate or not corporate.

"Profits therefrom" seem to mean profits from the office. That the mere fact that the payment in question is made to the employee as the result of, or in connection with, his employment is not enough to render it liable to tax is shown by *Reed v. Seymour*, 11 T.C. 625. The circumstances under which the payment was made must all be taken into account.

This case may, in my opinion, be decided against the Crown on the very special circumstances under which the payments in question were made. The two sums of £5,000 each, being instalments of the sum of £10,000, were paid in performance of one item in a complex agreement, the main object of which was to enable Harry Dewhurst to be relieved of the necessity of regular attendance at the company's offices or works as chairman and, at the same time, to avoid his complete retirement from the board. He was desirous of going to live in Scotland and the company were willing that he should do so and attend occasionally only as a director. He was not retiring altogether and therefore had no claim under article 109, but unless some arrangement were made, there would be a claim on his future retirement or death and the amount would diminish with every year owing to the low salary payable to him as director under the new arrangements, and accordingly he disclaimed all rights for himself and his executors under article 109, the directors, on the other hand, agreeing to pay the sum in question.

In my opinion, this sum was not a profit from his employment as director. It was paid not by way of remuneration for past services

(Lord Warrington of Clyffe.)

or of services thereafter to be performed, but in performance of an arrangement under which Harry Dewhurst was enabled to give only occasional attendance at the board and thereby enjoy his residence in Scotland, while at the same time the company did not lose altogether the benefit of his help. No part of the sum so paid represented salary retained either in the past or in the future. On the whole, I think, in the special circumstances of this case, the sum of £10,000 cannot, according to the true construction of the Statute, be held liable to Income Tax as profits arising from the employment.

In the case of the £2,900, I think the same result must follow. This sum was a mere voluntary accretion to the original £10,000.

As this case in my opinion may be decided on its special circumstances, I think it is undesirable to discuss the more general question as to the position of sums payable under article 109 or similar provisions. This question arose in the two cases relating to the retirement of the two Messrs. Foster heard in the Court of Appeal prior to, and followed by them in, the present case, and may come before this House, and therefore should, I think, be left open. For myself, all I decide is that these sums are under the special circumstances purely capital sums paid as such under a special agreement and are therefore not liable to be charged as "profits" from the employment.

In my opinion, the appeal should be allowed with costs here and below and the order of Mr. Justice Rowlatt should be restored.

Lord Atkin (read by Lord Tomlin).—My Lords, the question is whether the sums of £10,000 paid to the Appellant in 1923 and £2,900 paid to him in February, 1926, were payable to him as "salaries, fees, wages, perquisites or profits whatsoever from" his office of director of George & R. Dewhurst (1920), Ltd., pursuant to Schedule E of the Income Tax Act, 1918.

Under the terms of the articles of association and resolution of the company of 11th May, 1920, the Appellant was a director entitled, until the company should otherwise resolve, to remuneration of £2,500. He would also be entitled under the articles, at any time that he vacated his office of director, to a lump sum payment equal to the total remuneration he had received for the last five years. This sum is expressed in the article to be "by way of compensation for the loss of office." I will assume, without expressing any opinion on the matter, that this sum, if received by any ex-director, would fall within the words "salary" "or profit whatsoever" and would come "from" the office of director, as being part of the remuneration which he was entitled to under his contract of employment. But the circumstances in which the first payment was made seem to me to negative the proposition that the payment was received "from" the office.

(Lord Atkin.)

Rule 1 appears to me to indicate emoluments either received from the employer or from some third party (such as tips, permitted commission and the like) as a reward for services rendered in the course of the employment. In the case of the Appellant the sum received was paid to him in consideration that he should not receive remuneration for his services as agreed. He desired to do his work in circumstances in which he could not expect the company to permit him to receive £2,500 per annum. His alternative was to retire, in which case he would be entitled to receive under article 109 a sum in excess of £10,000, or to continue as a director at a smaller remuneration, in which case on retirement he would get under the article a much smaller lump sum. To induce him not to retire, the company agreed to give him a lump sum of £10,000 in consideration of which he agreed to release them from the obligations under article 109, both in the past and in the future. He entered into no bargain to serve the company for any particular time; the only arrangement was that as long as he remained a director he was to get a salary of £250 a year with no recourse to article 109. The company were obviously content with this, for though he might retire at any time, they were under no obligation to pay him more; indeed, they had agreed to pay him less than he could have claimed if he had retired at the time the arrangement was made. The £10,000 was not paid for past remuneration, for the condition of its becoming payable, for instance, loss of office, never was performed. It was not paid for future remuneration, for that was expressed to be £250 per annum, which was to be the sole remuneration. It seems to me that a sum of money paid to obtain a release from a contingent liability under a contract of employment cannot be said to be received "under" the contract of employment, is not remuneration for services rendered or to be rendered under the contract of employment, and is not received "from" the contract of employment. On this short ground I think that the decisions of the Special Commissioners and of Mr. Justice Rowlatt were right, and that this appeal should be allowed and the decision of Mr. Justice Rowlatt restored with costs here and below.

Lord Thankerton.—My Lords, the question in this appeal is whether the late Commander H. Dewhurst was liable to be charged to Income Tax under Schedule E of the Income Tax Act, 1918, in respect of two sums of £10,000 and £2,900 paid to him by Geo. & R. Dewhurst (1920), Ltd., of which company he was a director, as being profits arising to him from the office of director of the company.

Geo. & R. Dewhurst (1920), Ltd. (hereinafter called "the company"), was incorporated in March, 1920, to take over an old-established cotton-spinning business, which had belonged

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formerly to a partnership of Geo. & R. Dewhurst and later to a company known as Geo. & R. Dewhurst, Ltd. Commander Dewhurst was a partner in Geo. & R. Dewhurst, a director of Geo. & R. Dewhurst, Ltd., and original director and chairman of the company. He had no written contract of service with the company, but the terms of his service rested on the articles of association and certain resolutions of the company referred to later.

Articles 104 and 109 of the company provide as follows:

“ 104. The directors shall be paid out of the funds of the company
“ by way of remuneration for their services such sums as the com-
“ pany in general meeting shall from time to time determine. Such
“ remuneration shall be divided among them in such proportions and
“ manner as the directors may determine and, in default of such
“ determination within the year, equally. Such remuneration may
“ be either by way of fees or commission or participation in profits,
“ or by any or all of those modes or otherwise as the company in
“ general meeting shall determine. The directors shall also be
“ paid all hotel, travelling and other expenses incurred by them in
“ connection with the business of the company, including their
“ travelling expenses of attending and returning from board and
“ committee meetings. 109. In the event of any director dying or
“ resigning his office, or in the event of any director ceasing to hold
“ office for any cause other than misconduct, bankruptcy, lunacy
“ or incompetence, the company shall pay to him or his representa-
“ tives (as the case may require), by way of compensation for the
“ loss of office, a sum equal to the total amount of the remuneration
“ which in his five years of office last preceding the commencement
“ of the financial year in which his death, resignation or cesser of
“ office shall occur, shall have been received by him under clause 104
“ hereof, but so that in computing the amount of the remuneration
“ so received, there shall be excluded from account all sums received
“ by him by way of commission or participation in profits or other-
“ wise than by way of director's fees. No such compensation shall
“ be paid in the case of a director who at the commencement of the
“ financial year in which his death, resignation or cesser of office
“ occurs, shall have held the office of director (whether continuously
“ or discontinuously) for less than five years; but in the case of any
“ person who shall have been a director of this company for less
“ than five years, any period during which he held office as a director
“ of the old company shall be added to, and computed with, the
“ period for which he was a director of this company, and in that
“ case, the remuneration received by him in his character as a
“ director of the old company and by way of fees shall be deemed
“ to have been remuneration received by him as a director of this
“ company. In computing for the purposes of this clause the amount
“ of the fees received by any director, any sums deducted therefrom

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“ for Income Tax shall be reckoned as part of such fees. It shall rest solely with the directors to determine for what cause any director ceased to hold office, and their decision shall be final and conclusive.”

By resolutions of the directors of 27th April, 1920, Commander Dewhurst was appointed chairman of the meetings of directors and the proportions were fixed for division among the eight directors of the total yearly sum for directors' fees which might be voted by the company in general meeting.

In 1923, Commander Dewhurst had removed his home to Scotland from Cheshire and wished to retire from active management of the company. After consulting his fellow directors, who wished to be able still to consult him about the business, he wrote a letter dated 10th July, 1923, in which he gave notice of his intention to resign his office as chairman at the next meeting of directors and further stated: “ With regard to my future position in the company, and to the suggestions you submitted a short time ago, I have carefully considered these and venture to put the following proposal before you and my fellow directors:—I waive any future claim under section 109 of the articles of association. I be paid the sum of £10,000 (ten thousand) in cash. I remain on the board of the company, with a remuneration of £250 (two hundred and fifty) per annum free of Income Tax. Will you be good enough to submit these proposals at the next meeting.”

At the meeting of directors held on 9th August, 1923, the following resolution was passed: “ That the board accept with great regret the resignation of Commander Harry Dewhurst as chairman of the company and that he be paid the sum of £10,000 as compensation for loss of office in lieu of the provisions under clause 109 of the articles of association of the company and that he be paid the sum of £250 per annum free of Income Tax as director of the company as from the 1st August last.” In pursuance of the above resolution, £5,000 was paid to Commander Dewhurst on 1st December, 1923, and a further £5,000 on 31st December. In January, 1926, Mr. Arthur Foster, who was also a director of the company, resigned his directorship and was paid compensation as provided by article 109 of the company. On receipt of a cheque for the amount, Mr. Foster questioned its accuracy in respect that in computing the fees received by him for the preceding five years, the provision of article 109 that any sums deducted therefrom for Income Tax should be reckoned as part of the fees had not been taken into account; the error was corrected and a further cheque was sent to Mr. Foster.

Having realised that this point had been absent from their minds also in the case of Commander Dewhurst, the directors—without any request from him—reconsidered the amount paid to him and,

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on 2nd February, 1926, passed the following resolution: "That the sum of £2,900 be paid to Mr. Harry Dewhurst representing five years' Income Tax in respect of the amounts paid to him on the 1st and 31st December, 1923, as compensation for loss of office, in full settlement of any sum due or to become due to him under article 109 of the articles of association of the company."

In respect of the two sums of £10,000 and £2,900 so paid, Commander Dewhurst was assessed to Income Tax under Schedule E for the years 1923-24 and 1925-26, and he appealed to the Special Commissioners. At the same time, appeals were also taken by Mr. Arthur Foster above-mentioned and Mr. Joseph Foster, a third director, who had also resigned and received compensation payable by reference to article 109, against assessments made upon them under Schedule E in respect of the sums paid to them on resignation. The Commissioners sustained all three appeals, which were heard at the same time, and discharged the assessments. Their reasons are given in the stated Case as follows: "We did not think that we could or ought to draw any distinction between the three cases, although payment under article 109 in one case, that of Mr. Arthur Foster, was made directly under the article, in the second case, that of Mr. Joseph Foster, was made to some extent as the result of negotiation, and in the present case was made by way of compromise of existing and future rights, Commander Dewhurst remaining on as a director, but upon a reduced scale. We considered that the payments in all three cases were not to be regarded as remuneration paid to directors *qua* directors and continuing to be directors, but as given to directors when they resigned and because they had resigned. We held, therefore, that they were not payments for services, but a solatium given upon retirement. Such payments are not in our opinion 'taxable as a profit' (see *Chibbett v. Robinson*, 9 T.C. at page 61)."

On an appeal by the Crown in the three cases, the decision of the Commissioners was affirmed by Mr. Justice Rowlatt, who also heard the cases together. On a further appeal by the Crown, the Court of Appeal, in each case, allowed the appeal and reversed the determination of the Commissioners, although the appeal in Commander Dewhurst's case was heard and decided at a later date than the other two cases. No appeal has been taken against the order of the Court of Appeal in the two cases of Messrs. Foster, but, Commander Dewhurst having died shortly after the decision of the Court of Appeal, the present appeal is taken by his executors.

The decision of the appeal appears to depend on the answer to two questions, namely: (a) whether the two sums of £10,000 and £2,900 arose from the office of director within the meaning of Schedule E, Rule I; and (b) whether these sums constituted income or were of a capital nature.

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In order to answer the first question, it is necessary to have particular attention to the nature of the circumstances under which these two sums were paid to Commander Dewhurst. At the time when the £10,000 was paid, he could have chosen to resign his office of director and would then have been entitled under article 109 to a sum equal to the previous five years' fees, which amounted to £10,150, along with the amount of Income Tax deducted therefrom, which came to £4,147. As already explained, this latter point was not taken into account when the £10,000 was paid. But he remained a director and the payments made to him were not made under article 109; on the contrary, though he remained a director, he entered into a new contract with the company, under which he released the company from their obligations under articles 104 and 109, and received the sums of £10,000 and £2,900 and £250 per annum free of tax as director's remuneration, on the footing that his attendance as such would be only occasional. Accordingly, the £10,000 was not a voluntary payment or gift, but was an obligatory payment under the new contract and, looking at the substance of the transaction, there can be little doubt that it formed the consideration for the company's release from their contingent obligations under article 109. Although the £2,900 was not paid until over two years later, under the circumstances already referred to, neither party sought to differentiate it from the £10,000 in argument, and I therefore treat it as a payment of identical character with the £10,000 payment, although there would appear to be some ground for maintaining that it was a voluntary gift.

In the first place, it seems clear to me that the £10,000 did not, in any sense, represent a reward or return for services rendered as a director under the previous arrangement with the company and it is clear that it was not a reward or return for services as a director to be rendered in the future, for the payment of the £10,000 was in no way conditional on such service and the remuneration for such service was otherwise provided for by the new arrangement.

It is clear, in my opinion, that a payment in terms of article 109 to a director who has in fact resigned, is contractually part of the consideration for his services as a director and would be correctly described as arising from the office of director, but there would remain the question as to whether it was in the nature of income or not. In the view that I take of this case, I find it unnecessary to resolve that question.

The payments to Commander Dewhurst, although the basis of their calculation was similar to that of article 109, were made at a time when his rights under article 109 were contingent only and they were not made under that article, but

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in respect of the release of the company from their contingent liability. It also relieved Commander Dewhurst from the risk of misconduct, bankruptcy, lunacy or incompetence, and from the period of service in respect of which the right would accrue. They were payments for release from the obligations of article 109 and they did not arise from the contract of service; in my opinion, accordingly, they did not arise from the office of director, but in spite of it. It seems to follow clearly that they were not in the nature of income at all, but an isolated payment once and for all.

The whole question in the present case turns on the existence of the contractual article 109 and, therefore, cases of payments by parties other than the employer, such as *Duncan's Trustees*, 1909 S.C. 1212, 5 T.C. 417, and *Cowan v. Seymour*, [1920] 1 K.B. 500, 7 T.C. 372, the case of a gift by shareholders, appear to have little bearing on the present case. Nor do I find the other cases under Schedule E, which were cited, of much assistance, as none of them involved the release of an obligation in the contract of service—*Smyth v. Stretton*, 5 T.C. 36, which was not actually cited; *Seymour v. Reed*, [1927] A.C. 554, 11 T.C. 625; *Davis v. Harrison*, 11 T.C. 707. Similarly, cases under Schedule D have little relevance to the question whether a payment arises from an office within the meaning of Schedule E.

I am therefore of the opinion that the appeal should be allowed and that the judgment of the King's Bench Division, affirming the decision of the Special Commissioners, ought to be restored.

Lord Macmillan.—My Lords, the Appellants are the executors of the late Commander Dewhurst who was a director of Geo. & R. Dewhurst (1920), Limited, a company which was incorporated on 16th March, 1920, to take over, as a going concern, the business of a company known as Geo. & R. Dewhurst, Limited. Prior to his entering into the arrangement with the company which has given rise to the present question, Commander Dewhurst was entitled under article 104 of the company's articles of association and a relative resolution of the company of 11th May, 1920, to receive for his services as director an annual sum of £2,500 free of Income Tax. He was also entitled under article 109, in the event *inter alia* of his resigning his office as director, to payment from the company, "by way of compensation for the loss "of office", of a sum equal to the total amount of the remuneration received by him as a director during his five years of office preceding the commencement of the financial year in which his resignation should occur. It was provided that directors who, as was the case with Commander Dewhurst, had previously been directors of the old company, whose business had been taken over by the present company, should be allowed, for the purpose of

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calculating the payment to them on resignation, to reckon their years of service with the old company as years of service with the new company. Any sums deducted from a director's remuneration for Income Tax were to be reckoned as part of his fees for the purpose of computing the payment.

What happened was that Commander Dewhurst in 1923 proposed, for personal reasons, to retire from the board. On his resignation he would have been entitled to receive payment from the company of a sum calculated in terms of article 109. His colleagues, however, desired him to remain on the board for purposes of consultation and he accordingly put before them on 10th July, 1923, a proposal that (1) he should resign his office as chairman, (2) he should waive any future claim under article 109, (3) he should be paid £10,000 in cash and (4) he should remain on the board with a remuneration for the future of £250 per annum free of tax. The board, on 9th August, 1923, accepted his resignation of the chairmanship and resolved that " he be paid the sum of " £10,000 as compensation for loss of office, in lieu of the provisions " under clause 109 of the articles of association of the company and " that he be paid the sum of £250 per annum free of Income Tax " as director of the company as from 1st August last." The sum of £10,000 was duly paid to him. It was subsequently realised that in making this payment the provision in article 109 that Income Tax deducted from a director's fees should be reckoned as part of his fees for the purpose of computing the payment to be made under that article had been overlooked. The directors accordingly on 2nd February, 1926, without any request from Commander Dewhurst, reconsidered the amount paid to him and resolved to pay him a sum of £2,900 " representing five years' Income Tax in " respect of the " £10,000 previously paid to him. This additional sum was thereupon also paid to him. The sum of £2,900 did not represent the result of an exact calculation of the Income Tax. Both sums were allowed as deductions in the assessments on the company under Schedule D.

Assessments under Schedule E having been made on Commander Dewhurst in respect of the sum of £10,000 for the year 1923-24 and in respect of the sum of £2,900 for the year 1925-26, the Special Commissioners discharged these assessments on the ground that the sums in question had not been paid as remuneration for services but had been given as a " solatium " on retirement. They referred in support of this view to the case of *Chibbett v. Joseph Robinson & Sons*, 9 T.C. 48. Mr. Justice Rowlatt, on appeal, affirmed the decision of the Special Commissioners, his ground of judgment being that the sums in question were paid not in respect of services rendered in the office of director, but in respect of the cessation of that office. The learned judge quoted, and held applicable, the following words which he had used at page 61 in

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giving judgment in the case of *Chibbett v. Joseph Robinson & Sons* :
“ If it was a payment in respect of the termination of their employ-
ment I do not think that is taxable. I do not think that is
“ taxable as a profit. It seems to me that a payment to make up
“ for the cessation for the future of annual taxable profits is not
“ itself an annual profit at all.”

He also cited the Scottish case of *Duncan's Trustees v. Inland Revenue*, 1909 S.C. 1212⁽¹⁾, as authority for the proposition that a payment in respect of ceasing to hold an office cannot be taxable as a profit of that office.

The Crown appealed from the decision of Mr. Justice Rowlatt to the Court of Appeal, which unanimously reversed his judgment, holding that the payments came directly within the language of Rule 1 applicable to Schedule E. The question is now before your Lordships on the appeal of Commander Dewhurst's executors.

Under Rule 1 of the Rules applicable to Schedule E “ all “ salaries, fees, wages, perquisites or profits ” from any public office or employment of profit for the year of assessment are brought into charge. Do the two payments made to Commander Dewhurst fall within these comprehensive words? In my opinion they do. He received these payments in consideration of his agreeing to vary the existing terms on which he held his office of director and consenting to continue to hold that office on those altered terms. If he had not been prevailed upon to alter his original intention and had finally resigned his position of director, he would have been entitled there and then to payment from the company of a sum calculated under article 109. That payment would have been made to him in pursuance of the terms on which he had held his office of director and, as such, would have been a profit directly arising from his office. The circumstance that a payment is described as “ compensation for the loss of office ” is to my mind immaterial if the payment be in truth made as part of the bargain for remuneration on which the services in the office have been rendered.

As it happens, the cases of two of the other directors of this company, Mr. Arthur and Mr. Joseph Foster, who resigned in 1926 and 1927 and received payments under article 109, have been the subject of decision in the Court of Appeal, where it was held that the payments so made to them were taxable as profits arising from the office of director held by them. That decision has not been appealed to your Lordships' House, but the judgments of the Lords Justices are before your Lordships and show that they regarded the present case as covered by it if not indeed *a fortiori* of it. If that decision was well-founded, as I think it was, then what Commander Dewhurst did in accepting £10,000 down (with a sum subsequently added in name of Income Tax) “ in lieu of the

(1) 5 T.C. 417.

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“provisions of clause 109”, to quote the board’s resolution, was to take a substituted sum in place of a sum which would have been liable to tax as profits of his office of director. I cannot see why this substituted sum should be exempt if the sum for which it was substituted would not have been. Moreover, Commander Dewhurst did not lose his office of director; he agreed to continue to hold it but on a reduced remuneration and in consideration of a payment in cash down. The whole arrangement was nothing but a new bargain as to the payments he should receive from the company in respect of his services to it.

I would only add that the facts in *Duncan’s* case differ widely from those of the present case. There the retiring minister had no legal right to receive the annuity which the committee of a charitable fund of the Church of Scotland voted him. It was given to him not in respect of his services but in respect of his agreeing to cease to give his services. And as to *Chibbett’s* case, there a firm of ship managers who had been employed by a steamship company lost the benefit of this employment in consequence of the company going into liquidation and received by way of compensation a sum of money out of the surplus assets of the company. The terms on which the ship managers had been employed gave them no right whatever to this sum and their services had already received full remuneration. It was in the course of his judgment holding the payment to the ship managers not to be a taxable profit of their employment that Mr. Justice Rowlatt used the words which I have quoted above and which he himself quoted in his judgment in the present case. I am disposed to regard them as too widely expressed, for remuneration for services may take, in part, the form of a payment at the end of the employment, and a payment does not necessarily cease to be remuneration for services because it is payable when the services come to an end. Here, however, the circumstances, as I have pointed out, are quite different from those in *Chibbett’s* case.

I am accordingly of opinion with your Lordship on the Woolsack that the appeal should be dismissed.

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.

[Solicitors :—Solicitor of Inland Revenue ; Pritchard, Englefield & Co. for Wilson, Wright, Earle & Co., Manchester.]
