NO. 909.—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—
15TH AND 16TH JUNE AND 13TH OCTOBER, 1932

COURT OF APPEAL.—13TH AND 14TH DECEMBER, 1932, AND
19TH JANUARY, 1933

HOUSE OF LORDS.—14TH, 16TH, 17TH, 22ND AND 23RD NOVEMBER,
1933, AND 1ST FEBRUARY, 1934

NEUMANN v. THE COMMISSIONERS OF INLAND REVENUE(1)

Sur-tax—Return of total income—Dividend paid without deduction of Income Tax by property-owning company out of rents received in excess of Schedule A assessments—Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.* 40), *Rule* 20 *of the General Rules; Finance Act,* 1927 (17 & 18 *Geo.* V, *c.* 10), *Sections* 38 *and* 39; *Finance Act,* 1931 (21 & 22 *Geo.* V, *c.* 28), *Section* 7.

The Appellant was a shareholder in the Salisbury House Estate, Ltd. On the 4th April, 1930, *the House of Lords, in the case of* Salisbury House Estate, Ltd. *v.* Fry (15 T.C. 266), *decided that the rents of the company's properties, which greatly exceeded the annual values as assessed to Income Tax under Schedule A, were profits arising from the ownership of land, in respect of which the assessments under Schedule A were exhaustive, and that such rents in excess of the Schedule A assessments could not be included in assessments under Schedule D as trade receipts of the company.*

Pending the final decision in the case, the company had created a reserve fund representing a surplus of accumulated rents which remained in its hands after profits had been distributed to the amount of the Schedule A assessments on its properties. Immediately upon the decision of the House of Lords, the company distributed the whole of the reserve fund by way of dividend to its shareholders.

The dividend was described by the company, at the time of payment, as an " interim dividend of five per cent., free of tax ", and the proportionate part paid to the Appellant, amounting to £4,275, *was stated to be equivalent to a gross amount of* £5,343 15*s.* 0*d.*, *less Income Tax* £1,068 15*s.* 0*d.* *Later, in consequence of the decision in* Gimson *v.* Commissioners of Inland Revenue (15 T. C. 595), *the company informed the Appellant*

(1) Reported (K.B.) 49 T.L.R. 1, (C.A.) [1933] 1 K.B. 728 and (H.L.) [1934] A.C. 215.

that their earlier description of the dividend as a dividend of five per cent., free of tax, was erroneous, and that the dividend should have been described as a dividend of " five per cent., actual ", being a distribution of untaxed income which was not taxable in the hands of the company or in his hands and, therefore, should not be included in any Income Tax or Sur-tax returns made by him.

The Appellant was assessed to Sur-tax in respect of the dividend in the amount of £5,343 15s. 0d. He appealed, contending, inter alia, *that the dividend had been paid out of profits which were not liable to Income Tax, and that accordingly there was no liability to Sur-tax. The Special Commissioners confirmed the assessment.*

Held, (a) *that the dividend was paid out of profits and gains charged on the company in accordance with the provisions of the Income Tax Acts, and that the dividend was income to be included in a return of total income for the purposes of Sur-tax;* (b) *that, although deduction of tax from the dividend was authorised by the Income Tax Acts, no deduction had in fact been made, and the sum paid to the Appellant,* viz., *£4,275, was not a " net amount " to which, by virtue of Section* 7 (2) *of the Finance Act,* 1931, *an addition was required in order to arrive at the amount returnable for Sur-tax purposes.*

CASE

Stated under the Finance Act, 1927, Section 42 (7) and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 21st October, 1931, Ludwig Neumann (hereinafter called " the Appellant ") appealed against an assessment to Sur-tax made upon him for the year 1929–30.

2. On the basis of a letter dated the 4th April, 1930 (hereinafter set out in paragraph 7 hereof), from Salisbury House Estate, Limited (hereinafter called " the company "), the Appellant included in his return for the purposes of this assessment an item of £5,343 15*s*. 0*d*. which, according to the said letter, was the gross amount applicable to a net interim dividend of £4,275 received by the Appellant from the company in 1929–30. The assessment, as made upon him, included the said sum of £5,343 15*s*. 0*d*. Later, the Appellant was informed by the company that the said sum of £4,275 had been erroneously described by the company as a dividend of five per cent., free of tax, and that, in fact, it represented a sum, distributed out of the untaxed income of the company, which should not have been included in any Sur-tax return made by the Appellant. By a letter dated the 1st October,

1930, the Appellant informed the Clerk to the Special Commissioners that he had been notified that the dividend should not have been returned, that the company informed him that it was in communication with the Board of Inland Revenue on the matter, and that, in the meantime, the Appellant gave notice of appeal against the assessment.

3. The company has, year by year, paid ordinary annual dividends to its shareholders (including the Appellant) and, in the year 1929–30, the company declared such a dividend (in addition to making the interim distribution which is the subject of dispute in this Case) upon which no question arises in this appeal, it being admitted for the purposes of this appeal that the proportionate part thereof, to which the Appellant was entitled, was rightly included in the assessment. The only question for the opinion of the Court is whether or not, in the circumstances more particularly set out in paragraphs 4 to 8 hereof, the item of £5,343 15*s.* 0*d.* (or any part of it) was properly included in computing the assessment.

4. The company owns a property in the City of London, the rents from which greatly exceed the amount on which the company is assessed to Income Tax, Schedule A, in respect of the property. For several years, and at all times material to this appeal, both (*a*) the profits of the company available for dividend, and (*b*) the ordinary annual dividends of the company, have been greater than the amount on which Income Tax has been paid by the company. It had been contended on behalf of the Crown that the company was carrying on a trade and that, in computing its profits for the purposes of assessment under Schedule D, it was necessary to take into account all its receipts, including receipts from rents, an allowance being made for the amount of the assessment under Schedule A. Assessments under Schedule D were made upon the company upon this basis, against which the company appealed. It was held by the House of Lords on the 4th April, 1930, that the company was not so assessable and that liability to tax in respect of the rents was covered by the Schedule A assessments, and the rents could not be brought into the computation of any liability under Schedule D (*Salisbury House Estate, Ltd.* v. *Fry*, 15 T.C. 266).

5. While the above-mentioned litigation was pending, the company had put aside £18,325 out of its profits to the credit of an Income Tax reserve. The House of Lords' decision in favour of the company rendered that reserve no longer necessary, and the company at once, on the 4th April, 1930, declared and paid thereout a further dividend described at the time as an " interim dividend " of 5% free of tax ". It was not disputed by the Respondents that this sum of £18,325 was paid out of a surplus of accumulated rents which remained in the hands of the company, after profits had been distributed to the amount of any assessments made upon the company.

6. The resolution of the board of directors of the company reads as follows :—

"4th April, 1930.

"Income Tax appeal.

"It was reported that the Crown's appeal to the House of "Lords against the judgment of the Court of Appeal had been "dismissed.

"Interim dividend.

"As a result of the above, it was resolved that an interim "dividend of 5% free of tax on account of the year ending "25th December, 1930, be declared payable to-day."

7. As a result of this declaration of dividend, the Appellant received a cheque for £4,275 together with a letter from the company, dated the 4th April, 1930, in the following terms :—

"Salisbury House Estate, Limited,
"Salisbury House,
"Finsbury Circus,
"London, E.C.2,
4th April, 1930.

"L. Neumann, Esq.,
"Salisbury House,
"London Wall, E.C.2.

"Dear Sir,

"I hand you herewith cheque for £4,275 0*s*. 0*d*. in respect "of an interim dividend for the year ending 25th December, "1930, of 5% free of tax, on the 85,500 shares registered in "your name.

"This dividend is equivalent to a gross "amount of	£5,343 15 0
"*Less* Income Tax at 4*s*. in the	1,068 15 0
	"£4,275 0 0

"NOTE.—I hereby certify that the Income Tax deducted as "shown herein has been or will be duly paid to the proper "officer for the receipt of taxes and in the event of any "application being made for exemption from Income Tax, "this certificate can be produced to the Inland Revenue "authorities and should be retained for that purpose.

"Yours faithfully,
"(*Sgd.*) N. E. MUNNS,
"*Secretary*."

8. On the 9th May, 1930, the case of *Gimson* v. *The Commissioners of Inland Revenue*, 15 T.C. 595, was decided in the King's Bench Division and, in consequence of that decision, the company came to the conclusion that the terms of its directors' resolution and of its letter to shareholders of the 4th April, 1930, were wrong. After correspondence between the company and the Commissioners of Inland Revenue, in which the company vainly tried to persuade the Commissioners of Inland Revenue that the dividend in question fell within the authority of *Gimson's* case and was not income liable to Sur-tax in the hands of its shareholders, the company (which had previously informed its shareholders as to the attitude it was adopting in its correspondence with the Inland Revenue) sent to the Appellant and to its other shareholders a letter dated the 28th February, 1931, of which the material part was as follows :—

" Salisbury House Estate, Limited,
" Salisbury House,
" Finsbury Circus,
" London, E.C.2,
28th February, 1931.

" L. Neumann, Esq.,
" Salisbury House,
" London Wall, E.C.2.

" Dear Sir,

" With reference to my letter of 4th April, 1930, enclosing " a cheque in respect of an interim dividend for the year ending " 25th December, 1930, described as of an amount of 5% free " of tax, I have to inform you, in conformity with the opinion " of the company's legal advisers, that the dividend should have " been described as a dividend of 5% actual, being a distribution " of untaxed income, and that this income not having been " taxable in the hands of the company is not taxable in your " hands and should therefore not be included in any Income " Tax or Sur-tax returns made or to be made by you. Such " returns should include only what is ' income ' for Income Tax " purposes. The certificate at the foot of the letter of 4th April, " 1930, is hereby withdrawn and should accordingly be ignored " by you and, in place of the gross amount of the dividend as " stated in the letter, the following should be substituted, in " order to comply with Section 33 of the Finance Act, 1924 (if " applicable), *viz* :—

" Gross amount of dividend	£4,275 0 0
" Rate and amount of Income Tax appropriate thereto	Nil.
" Net dividend	£4,275 0 0

" At the same time I have to inform you that the Board of " Inland Revenue do not concur in this opinion."

9. It was contended by Counsel for the Appellant, *inter alia* :—

(*a*) that, since Sur-tax is an additional duty of Income Tax, no liability to Sur-tax could exist in respect of the dividend in question, unless the sum in question was liable to Income Tax in the hands of the company, and that the company, in fact, made the payment out of moneys which were not liable to Income Tax ;

(*b*) that rents, as such, are not liable to Income Tax, but the liability to Income Tax is in respect of annual value only, and that the dividend in question was made by the company out of a surplus of accumulated rents which were available after distributing profits year by year to the full amount of the annual value on which the company was assessable ;

(*c*) that the decision in *Gimson* v. *The Commissioners of Inland Revenue*, 15 T.C. 595, was applicable, and that the case of *Hamilton* v. *Commissioners of Inland Revenue*, [1931] 2 K.B. 495([1]), was distinguishable ;

(*d*) that, in any case, the matter was concluded in favour of the Appellant by Section 7 of the Finance Act, 1931, which was retrospective ;

(*e*) that, in construing Section 7 of the Finance Act, 1931, regard should be had to Rules 19 and 21 respectively of the All Schedules Rules, Income Tax Act, 1918, and to the decisions in *Attorney-General* v. *Metropolitan Water Board*, 13 T.C. 294, and the *Luipaards Vlei Estate* case, 15 T.C. 573 ;

(*f*) that the dividend should not be included in a computation of the Appellant's total income for the purposes of Sur-tax 1929-30.

10. For the Crown it was contended :

(*a*) that the income of the company, as represented by rents, had been assessed to Income Tax under Schedule A of the Income Tax Act, 1918, the difference between the amount of the rents and the amount of the assessment being due to the measure applied under the said Schedule and the Valuation (Metropolis) Act, 1869, in ascertaining the amount of the assessment ;

(*b*) that the said dividend had been paid out of the said income ;

(*c*) that the said dividend was a dividend to which Section 7 of the Finance Act, 1931, applied ;

(*d*) that the company, on paying the said dividend, had deducted tax at the standard rate on the gross amount of the dividend paid ;

([1]) 16 T.C. 213.

(*e*) that the gross amount of the said dividend had been properly included in the Sur-tax return and assessment, and that the assessment should be confirmed;

(*f*) that the case was concluded by the decision in *Hamilton* v. *Commissioners of Inland Revenue*, [1931] 2 K.B. 495([1]);

(*g*) that the case of *Gimson* v. *The Commissioners of Inland Revenue*, 15 T.C. 595, was distinguishable.

11. The following cases were referred to :—

Salisbury House Estate, Ltd. v. *Fry*, 15 T.C. 266.

Gimson v. *The Commissioners of Inland Revenue*, 15 T.C. 595.

Rossdale v. *Fryer*, [1922] 2 K.B. 303.

Miller (Lady) v. *The Commissioners of Inland Revenue*, 15 T.C. 25.

Hamilton v. *The Commissioners of Inland Revenue*, [1931] 2 K.B. 495([1]).

Attorney-General v. *Metropolitan Water Board*, 13 T.C. 294.

Luipaard's Vlei Estate & Gold Mining Co., Ltd. v. *Commissioners of Inland Revenue*, 15 T.C. 573.

Attorney-General v. *London County Council*, 4 T.C. 265.

12. We, the Commissioners who heard the appeal, held that the dividend in question formed part of the Appellant's total income for the purposes of Sur-tax for the year 1929–30 and we confirmed the assessment.

13. The Appellant, immediately upon the determination of the appeal, declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1927, Section 42 (7) and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

H. M. SANDERS, } Commissioners for the Special
P. WILLIAMSON, } Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
12th March, 1932.

The case came before Finlay, *J.*, in the King's Bench Division on the 15th and 16th June, 1932, when judgment was reserved. On the 13th October, 1932, judgment was given against the Crown, with costs.

Mr. A. M. Latter, K.C., and Mr. J. H. Bowe appeared as Counsel for the Appellant and the Attorney-General (Sir Thomas Inskip, K.C.) and Mr. R. P. Hills for the Crown.

([1]) 16 T.C. 213.

JUDGMENT.

Finlay, J.—I regret the delay in delivering this judgment, due to the fact that I was detained on circuit until the very last day of last term.

The point is one not, I should think, likely to arise frequently, but it is a curious point and I think rather a difficult one. It arises on a Case stated by the Commissioners for Special Purposes and the facts are very clearly seen from the Case, facts which are certainly rather curious. The second paragraph of the Case, which I will read because it sets out the thing very clearly, is this : " On the basis of a letter dated the 4th April, 1930 . . . . " the Appellant included in his return for the purposes of this " assessment "—that is an assessment on him to Sur-tax—" an " item of £5,343 15*s*. 0*d*. which, according to the said letter, was " the gross amount applicable to a net interim dividend of £4,275 " received by the Appellant from the company in 1929–30. The " assessment, as made upon him, included the said sum of " £5.343 15*s*. 0*d*. Later, the Appellant was informed by the " company that the said sum of £4,275 had been erroneously " described by the company as a dividend of five per cent. free " of tax, and that in fact it represented a sum, distributed out " of the untaxed income of the company, which should not have " been included in any Sur-tax return made by the Appellant. " By a letter dated the 1st October, 1930, the Appellant informed " the Clerk to the Special Commissioners that he had been notified " that the dividend should not have been returned, that the com- " pany informed him that it was in communication with the Board " of Inland Revenue on the matter, and that, in the meantime, the " Appellant gave notice of appeal . . . . ."

The facts are set out in the following paragraphs which I will also read : " 3. The company has year by year paid ordinary " annual dividends to its shareholders (including the Appellant) " and in the year 1929–30 the company declared such a dividend " (in addition to making the interim distribution which is the " subject of dispute in this Case) upon which no question arises in " this appeal, it being admitted for the purposes of this appeal that " the proportionate part thereof, to which the Appellant was " entitled, was rightly included in the assessment. The only ques- " tion for the opinion of the Court is whether or not, in the " circumstances more particularly set out in paragraphs 4 to 8 " hereof, the item of £5,343 15*s*. 0*d*. (or any part of it) was " properly included in computing the assessment. 4. The company " owns a property in the City of London the rents from which " greatly exceed the amount on which the company is assessed " to Income Tax, Schedule A, in respect of the property. For " several years, and at all times material to this appeal both (*a*) the " profits of the company available for dividend, and (*b*) the " ordinary annual dividends of the company, have been greater

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"than the amount on which Income Tax has been paid by the "company. It had been contended on behalf of the Crown that "the company was carrying on a trade and that in computing its "profits for the purposes of assessment under Schedule D it was "necessary to take into account all its receipts, including receipts "from rents, an allowance being made for the amount of the "assessment under Schedule A. Assessments under Schedule D "were made upon the company upon this basis, against which the "company appealed. It was held by the House of Lords on the "4th April, 1930, that the company was not so assessable and "that liability to tax in respect of the rents was covered by the "Schedule A assessments, and the rents could not be brought into "the computation of any liability under Schedule D. 5. While "the above-mentioned litigation was pending, the company had put "aside £18,325 out of its profits to the credit of an Income Tax "reserve. The House of Lords' decision in favour of the company "rendered that reserve no longer necessary, and the company at "once, on the 4th April, 1930, declared and paid thereout a "further dividend described at the time as an 'interim dividend "'of five per cent. free of tax.' It was not disputed by the "Respondents that this sum of £18,325 was paid out of a surplus "of accumulated rents which remained in the hands of the com-"pany, after profits had been distributed to the amount of any "assessments made upon the company." Then there follow the resolution and a letter from the secretary of the company to the Appellant enclosing the sum due to him and saying: "This "dividend is equivalent to a gross amount of £5,343 15*s.* 0*d.* less "Income Tax at 4*s.* in the £, £1,068 15*s.* 0*d.*" In consequence apparently of a decision of Mr. Justice Rowlatt in a case of *Gimson* v. *The Commissioners of Inland Revenue*[1], the company then came to the conclusion that the terms of the resolution were wrong; they found themselves at issue with the Inland Revenue upon the matter and they wrote accordingly (and quite properly) to the Appellant another letter in which they said that they now found their former view was erroneous and "that the dividend should "have been described as a dividend of five per cent. actual, being a "distribution of untaxed income, and that this income not having "been taxable in the hands of the company is not taxable in your "hands and should therefore not be included in any Income Tax or "Sur-tax returns made or to be made by you. Such returns should "include only what is 'income' for Income Tax purposes." The letter went on, quite properly, to say that that, which was the advice which the company had received, was not assented to by the Board of Inland Revenue.

The position is a peculiar one. The case in 15 T.C. 266[2] decides (and indeed I think it is familiar law) that there is no

(1) 15 T.C. 595. (2) Salisbury House Estate, Ltd. *v.* Fry.

(Finlay, J.)

charge on rents as such; the charge is a charge under Schedule A and is on the annual value. The fact that the annual value is often, though not always, measured by rent, is not to the point. Here the rents exceeded, and very substantially exceeded, the annual value, that annual value being of course measured, as it must be measured, in the manner which the statute directs, and the statute directs a particular measurement where the property happens to be, as this property was, in London. It was decided that the excess of rent received was not liable to tax, not under Schedule A because that had been exhausted, and not under Schedule D—and this was the exact point that the House of Lords decided—because the rents could not be brought in as being the profits of any trade or business being carried on. I may in that connection refer, without reading it, to a passage in the judgment of Lord Justice Scrutton in *Rossdale* v. *Fryer*, [1922] 2 K.B. 303 at page 312, where he alludes to the fact that rents received, so to speak, in excess of annual value are not liable to tax.

Now, the matter depends of course upon the Rules. There is a series of Rules, Rules 19 to 21 of the General Rules applicable to all the Schedules. Rules 19 and 21 relate to annual sums payable (*a*) out of profits brought into charge and (*b*) out of profits not wholly charged. Rule 20 is the Rule applicable to dividends and it must be considered as amended by Section 7 of the Act of 1931. It is necessary in the light of that Rule to consider what this distribution is. It seems to me that it is a distribution which is not made out of profits and gains which are charged to tax. It follows, of course, that the company not having borne tax—in my opinion, it has not borne tax on these sums—cannot pass on tax not borne by itself to the shareholders. Manifestly the shareholder cannot be made to bear a share of that tax which the company has not borne and is not liable to bear. The process by which the shareholder is made, so to speak, to bear his share of tax is too familiar to need development; it has been discussed in a good many recent cases. Of course, the company in no way pays as agent for a shareholder: it pays its own tax and then by the appropriate machinery it may pass on the tax which it, and it alone, is liable to bear and has borne. Here, if I am right, this distribution is a distribution of a fund which is not liable to tax and it seems to me to follow, and to follow inevitably, that the recipient is not liable to tax. He is not liable to tax by deduction for the reason that I have just indicated, and it cannot, I think, be suggested that he is liable to Income Tax by direct assessment. The analogy is not exact, but the fund may perhaps be compared with the fund produced by sales of land in a very well-known case, the *Hudson's Bay Company* case, 5 T.C. 424. There there was a dividend distributed, and the dividend was made up partly of ordinary trading profits and partly of the proceeds of sale of land.

(Finlay, J.)

In that case it was held that the fund produced by the sale of land was not the profits of any trade and was not liable to taxation. I apprehend it would be quite clear that in that case the sum distributed would not be liable to any taxation either by way of Income Tax or Super-tax, or Sur-tax, as it is now called, in the hand of the recipient. I repeat the cases are not analogous, but the principle seems to me to be rather the same here.

If it is true that this sum is not liable to tax, can it be liable to the additional duty of Income Tax called Super-tax, the place of which has now been taken by Sur-tax? It seems to me that it cannot be so liable, and for an extremely simple reason, a reason which applies equally to Super-tax and to its successor, Sur-tax. These additional taxes, additional duties of Income Tax, or whatever they are called—and Super-tax was, I think, called an additional duty of Income Tax—are levied on what I might conveniently call "Income Tax income", and it is impossible to go outside the ambit of income liable to Income Tax and to bring in that which in my view is not liable to Income Tax.

Various authorities were cited to me. None appears to me to be directly in point, but I think that the reasoning of Mr. Justice Rowlatt in *Gimson's* case(1) supports the view which I take. With regard to a case to which my attention was called and which indeed it was suggested, I think, governed the present, *F. H. Hamilton* v. *The Commissioners of Inland Revenue*(2), I have read carefully the judgments in the Court of Appeal in that case and they do not seem to me to touch the present case at all. The point there decided, as I think, was a different point and I do not think that, carefully considered, that case directly, at all events, bears upon the case before me.

As I have indicated, the case is a peculiar one and, in my view, it is a case which, while, of course, one derives great assistance from the authorities and from the principles laid down, is not directly covered by any authority. In these circumstances, one has, of course, to endeavour to look at the thing on principle and to consider the Sections. I have done that and the result is that though I regard the case, as I have already indicated, with some difficulty and some doubt, I differ from the view which commended itself to the Special Commissioners and this appeal must be allowed.

Mr. Latter.—The appeal will be allowed with costs, my Lord?

Finlay, J.—Yes, the appeal will be allowed with costs.

Mr. Latter.—Would your Lordship make the usual Order for the repayment of the tax that has been paid, with interest?

Finlay, J.—I suppose that is right, Mr. Hills?

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(1) 15 T.C. 595. (2) 16 T.C. 213.

Mr. Hills.—Yes, that would be quite in order; but I did want to say a word—I do not know whether my friend has any views on the subject—on the question of the rate of interest, which has been very much altered in recent times. I think about a year or two years ago it was four and a half per cent., but I should submit it ought not to be more than three per cent. now.

Finlay, J.—Has Mr. Justice Rowlatt given any recent decision with regard to that interest?

Mr. Latter.—I think the last one was four and a half per cent. or five per cent. I can understand my friend's point since the Conversion operations. I should have thought it ought to be three and a half per cent.

Finlay, J.—I should think three and a half per cent. is reasonable.

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 Slesser and Romer, *L.JJ.*) on the 13th and 14th December, 1932, when judgment was reserved. On the 19th January, 1933, judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below. The Court held, however, that the assessment on the Appellant should be made in the amount of the dividend actually received by him (£4,275) and not, as in the assessment appealed against, in the amount arrived at after the addition thereto of the appropriate amount of Income Tax (£5,343 15*s.* 0*d.*).

The Attorney-General (Sir Thomas Inskip, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. A. M. Latter, K.C., and Mr. J. H. Bowe for the Respondent.

JUDGMENT.

Lord Hanworth, M.R.—On 4th April, 1930, the Respondent to this appeal was sent a cheque for £4,275 0*s.* 0*d.* by the Salisbury House Estate Company, Limited, as the quota due to him out of a sum reserved by the company to meet a possible liability which might have fallen upon it if the House of Lords had reversed the decision of this Court reported as *Fry* v. *Salisbury House Estate, Limited*, [1930] 1 K.B. 304[1]. The decision was that day affirmed, [1930] A.C. 432. When sending this sum to the Respondent the company wrote treating it as a sum from which tax had been deducted, and if tax at the appropriate rate, namely, 4*s.*, had been taken from it, the gross amount of the Respondent's quota would have been £4,275 plus £1,068 15*s.*, equal to a total of £5,343 15*s.* 0*d.* On the 9th May, 1930, the case of *Gimson* v. *Commissioners of Inland Revenue*[2] was decided by Mr. Justice

(1) 15 T.C. 266. (2) 15 T.C. 595.

(Lord Hanworth, M.R.)

Rowlatt, when he held that where no payment of Income Tax had been made upon, or deducted from, the sum paid over to the shareholder, no charge for Sur-tax could be made upon it. Thereupon the directors amended the note accompanying the payment of the £4,275 and explained that there was no Income Tax appropriate to it, and therefore that it was a net sum receivable by the shareholder, the present Respondent.

In accordance with the terms of the letter of the 4th April, 1930, the Respondent included in his return the larger sum of £5,343 15*s.* 0*d.*, and he was duly assessed upon it to Sur-tax. Afterwards, upon the decision of *Gimson* v. *Commissioners of Inland Revenue* becoming known, he claimed that Sur-tax was not payable upon either the sum of £5,343 15*s.* 0*d.* or £4,275, and he appealed against the assessment made upon him. The Commissioners for the Special Purposes of the Income Tax Acts heard the appeal and confirmed the assessment. From that decision the Respondent appealed to Mr. Justice Finlay, who reversed the decision of the Commissioners and discharged the assessment. The Crown now appeal to this Court, and the question to be decided is whether the Respondent is liable to pay Sur-tax, either on the £4,275 actually received, or on the larger sum of £5,343 15*s.* 0*d.*, as being the sum reached if the amount paid over is to be treated as having borne Income Tax.

In view of the fact that the Respondent has in fact received £4,275, it will be convenient to state the grounds on which he claims, and the learned Judge has held, that he is entitled to immunity in respect of it from Sur-tax. It is argued that the £4,275 was not paid out of profits and gains charged to Income Tax, and that no Sur-tax can be charged on sums in respect of which no Income Tax has been paid. The learned Judge held that(1) "it "is a distribution which is not made out of profits and gains which "are charged to tax. It follows, of course, that the company not "having borne tax—and in my opinion it has not borne tax on "these sums—cannot pass on tax not borne by themselves to the "shareholders. Manifestly, the shareholders cannot be made to "bear a share of that tax which the company has not borne and is "not liable to bear."

This statement appears to me to overlook certain principles of Income Tax law which are not in doubt. For Income Tax purposes, the company and a shareholder are separate entities. No doubt for the purposes of collection, the system of deduction at the source has been long established and maintained. But the relations of the company and of the shareholder to the Inland Revenue are separate and distinct. A shareholder may have quite independent rights as against the Crown, both in the matter of his liability at all and of certain deductions to be made from his liability which

(1) *See* page 341 *ante*.

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are appropriate to him alone. There is no agency on the part of the company as between it and the shareholder; see per Lord Cave in *Commissioners of Inland Revenue* v. *Blott* where he says(1) : " a " company paying Income Tax on its profits does not pay it as " agent for its shareholders. It pays it as a taxpayer. . . . . But " no agency, properly so-called, is involved." The company pays tax on the full amount of its profits or gains " before any dividend " thereof is made," and the amount deducted from any dividend paid over to a shareholder is the amount at the standard rate on the gross amount of the dividend so paid over and not a proportionate part of the tax paid by the company. (See *Hamilton* v. *Commissioners of Inland Revenue*, [1931] 2 K.B. 495(2), and also *Commissioners of Inland Revenue* v. *Dalgety & Co., Ltd.*, [1930] 1 K.B. 1, at pages 25 and 26(3).)

Next, I do not think that it is right to treat the corpus of £18,325—the " surplus of accumulated rents which remained in the " hands of the company " (see paragraph 5 of the Case)—as moneys which were not liable to Income Tax. The surplus remained from the profit rents charged by the Salisbury House Company, and the company paid Income Tax under Schedule A on the annual value of the properties out of which those profits accrued to the company. The measurement was under Schedule A, but the tax, whether under one Schedule or another, is a tax charged in respect of all property, profits or gains respectively described or comprised in the Schedules marked A, B, C, D and E (See Section 1 of the Act of 1918). " It is one tax, not a collection " of taxes essentially distinct," measured " differently under each " Schedule." (See per Lord Macnaghten in *London County Council* v. *Attorney-General* [1901] A.C., pages 35 and 36(4).) If the rents had not paid tax according to the appropriate measure, they would have been caught under Case VI of Schedule D, which charges tax " in respect of any annual profits or gains not falling " under any of the foregoing Cases, and not charged by virtue of " any other Schedule." This is made clear by the speeches in the case of *Fry* v. *Salisbury House Estate, Ltd.*, [1930] A.C. 432, of Lord Dunedin, who said(5) " The income of the Respondents, as " represented by rents, is admittedly assessed, and properly " assessed, under Schedule A;" and of Lord Warrington, who said(6) " Now the effect of the Crown's contention if it be correct " would be indirectly to convert this tax on annual value to a tax " on rents." The passage quoted from the judgment of Lord Justice Scrutton in *Rossdale* v. *Fryer*, [1922] 2 K.B. 303, is not contrary to the above, for at page 313 he makes it clear " that the " tax on land is not according to the actual receipts but the assessment . . . . the actual rent is not a sum on which the landlord

(1) 8 T.C. 101 at p. 136. (2) 16 T.C. 213. (3) 15 T.C. 216, at pp. 230–231.
(4) 4 T.C. 265, at pp. 293–294. (5) 15 T.C. 266 at p. 307. (6) *Ibid.* at p. 315.

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"can be taxed; . . . Schedule A only relates to the tax on assess-
"ment, and not on actual rent." When profits and gains were estimated on a three years' average, the measure of the average may have in any year differed from the receipts of the year of assessment.

In the present case there is no question but that £4,275 was received by the Respondent in the year in question. He had to return his total income, and by Section 38 (1) (*b*) of the Finance Act, 1927, pay Sur-tax upon the amount of it which is in excess of a certain limit. The expression " total income " in relation to any person is defined by Sub-section (2) to mean " the total income
" of that person from all sources estimated, as the case may be,
" either in accordance with the provisions of the Income Tax Acts
" as they apply to income tax chargeable at the standard rate or
" in accordance with those provisions as they apply to sur-tax."
In my opinion, the Respondent's " total income " estimated upon either of these alternatives must include this £4,275 received by him. He must estimate his own income received by him, and upon that basis the decision of the Commissioners was right and must be restored.

In *Gimson's* case[1] the sum of £35 was received by the subject, and was an amount paid on the division of a sum in respect of which Income Tax had not, owing to the principles of admeasurement, been payable, or paid. Mr. Justice Rowlatt explains (see *Hamilton* v. *C.I.R.*, [1931] 2 K.B. at page 504[2]) that the decision had no reference to such a question as was under consideration in *Hamilton's* case and is under consideration here, namely, whether the entity of the shareholder and company must be considered separately. But, in my judgment, Mr. Justice Rowlatt applied a wrong test in *Gimson's* case. The liability to Sur-tax does not depend upon, and cannot be resolved only by, ascertaining whether Income Tax has been paid on an item claimed to be included in a Sur-tax return, and if it has not paid Income Tax, then the item is to fall out of the Sur-tax return. That principle is contrary to the terms of Section 38, Sub-sections (1) and (2), already referred to. Nor do I find any authority for it in what was said by Lord Sands in *Lady Miller's* case, 15 T.C. at page 60, and approved by Lord Warrington at page 84, with which we were pressed in argument. It must be remembered that what was under consideration in that case was whether the enjoyment of certain premises by a tenant for life could be estimated and brought into account for the purpose of her assessment to Super-tax; and it was held that the life tenant was properly assessed upon a sum which included both the assessments of the mansion house and grounds under Schedules A and B, and the amounts of the payments for rates upon the premises made by the trustees of the settlement.

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(1) 15 T.C. 595. (2) 16 T.C. at pp. 221/2.

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The truth is that confusion is introduced into a case like *Gimson's* or the present by too great attention being paid to the mode of collection by deduction, under Rules 19 and 21 and Rule 20, as now to be interpreted by Section 7 (1) and (2) of the Finance Act, 1931. The cases of the *Metropolitan Water Board,* [1928] 1 K.B. 833[1], and of *Luipaard's Vlei Estate and Gold Mining Company,* [1930] 1 K.B. 593[2], illustrate the difficulties that arise in construing and applying the Rules 19, 20 and 21. I agree with the examination of the former case to which Lord Justice Romer has in his judgment subjected it, and it does not seem to me to be necessary to examine it further. Section 7 (1) was passed to avoid any danger to the Revenue such as was suggested in the *Metropolitan Water Board* case, and I hold that the sum of £18,325 has not been deemed immune from Income Tax. Though not directly charged, as it would have been if it had been a profit made within the ambit of Schedule D, nevertheless it belonged to, and arose from, a source which had suffered its appropriate charge to tax under Schedule A.

The fact that no deduction was made from the sum paid over to the Respondent, but that the £4,275 was the quota due to him upon a direct and simple division of the corpus arising from the accumulated rents, renders Section 7 (1) and (2) inapplicable. The deduction that is " authorised " under Sub-section (1) was not exercised, and it is not necessary to consider whether it could have been exercised. Equally there is no occasion to alter the figure actually received into another under Section 7 (2). The sum paid was £4,275 *simpliciter* and is not to be " deemed to represent " another amount.

For these reasons, in my judgment, the appeal should be allowed with costs here and below, and an assessment made upon the Respondent in the sum of £4,275.

Slesser, L.J.—On 4th April, 1930, the directors of the Salisbury House Estate, Limited, carried the following resolution : " Income " Tax appeal. It was reported that the Crown's appeal to the " House of Lords against the judgment of the Court of Appeal had " been dismissed. Interim dividend. As a result of the above, it " was resolved that an interim dividend of 5 per cent. free of tax " on account of the year ending 25th December, 1930, be declared " payable today." On the same day, they sent Mr. Neumann a cheque for £4,275, stated to be as follows :

" This dividend is equivalent to a gross " amount of	£5,343 15 0
" *Less* Income Tax at 4*s*. in the £ ...	£1,068 15 0
	£4,275 0 0."

(1) Attorney-General *v.* Metropolitan Water Board, 13 T.C. 294.

(2) Luipaard's Vlei Estate and Gold Mining Co., Ltd. *v.* Commissioners of Inland Revenue, 15 T.C. 573.

(Slesser, L.J.)

This dividend was the Respondent's share of an Income Tax reserve of the company of £18,325 which they had held back in case they might have been called upon to pay more Income Tax had the House of Lords decided in favour of the contention of the Crown that the company were liable to be assessed on their rents received to be regarded as profits and gains under Schedule D. In fact, the company succeeded and the House of Lords affirmed the decision of this Court that the rents of the company were profits arising from the ownership of land in respect of which the assessment under Schedule A was exhaustive, so that the reserve of £18,325 became distributable as part of a surplus of accumulated funds or rents. In these circumstances, the Respondent included in his return for assessment for Sur-tax for 1929–30 the sum of £5,343 15*s.* 0*d.*

On 28th February, 1931, the company wrote to the Respondent saying that " the dividend should have been described as a dividend " of 5 per cent. actual, being a distribution of untaxed income, and " that this income not having been taxable in the hands of the " company is not taxable in your hands and should, therefore, not " be included in any Income Tax or Sur-tax returns made or to be " made by you." They accordingly substituted for the statement of dividend above-mentioned the following :

" Gross amount of dividend	£4,275 0 0
" Rate and amount of Income Tax appro- " priate thereto	nil
" Net dividend	£4,275 0 0."

The Crown, nevertheless, claimed that the whole sum of £5,343 15*s.* 0*d.* or, alternatively, the sum of £4,275, formed part of the Appellant's total income for the purposes of Sur-tax, and the Commissioners confirmed the assessment as originally made by the Respondent for the full amount. The Respondent appealed, and Mr. Justice Finlay allowed the appeal as to the whole sum. From his decision appeal has been brought by the Crown to this Court.

In the first place, it is said that, whether the sum of £18,325 is or is not liable to Income Tax beyond the Schedule A assessment already made, the liability of the Respondent for £4,275 remains and, in my view, the Crown are right in this contention. By Section 38 (2) of the Finance Act, 1927, the total income means " the total income of that person from all sources estimated, as " the case may be, either in accordance with the provisions of the " Income Tax Acts . . . . or in accordance with those provisions " as they apply to Sur-tax." I am unable to see why this sum of £4,275 was not a part of the Respondent's total income.

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The learned Judge has come to the conclusion that the distribution " is a distribution of a fund which is not liable to tax "[1], and, he says that : " It seems to me to follow, and to follow inevit-" ably, that the recipient is not liable to tax." He continued : " It " cannot, I think, be suggested that he is liable to Income Tax by " direct assessment." I am unable to accept this conclusion. Because the liability of the company in respect of their profits is to be ascertained under Schedule A in regard to their profits arising from the ownership of land, it does not follow that the individual recipient of a dividend is not directly assessable under Schedule D as being in receipt of a profit or gain.

It is true that in *Gimson* v. *Commissioners of Inland Revenue*, 15 T.C. 595, at page 601, Mr. Justice Rowlatt said : " He " (the shareholder) " can only be liable to Super-tax in respect of a " dividend which is taxable." But this view fails in my opinion sufficiently to distinguish between the company and its shareholders. In *Hamilton* v. *Commissioners of Inland Revenue*, [1931] 2 K.B. 495, Lord Hanworth, *M.R.*, at page 517, said[2] : " They " —the company and shareholder—" are two separate and different " entities, and the shareholder is not merely paying an aliquot part " of the taxation imposed upon the company." And, again[3] : " I think it is plain that the taxpayer must be treated as a separate " entity, the company being treated as a collector, as has been said " in one of the cases, for and on behalf of the Crown." The principle stated in *Blott's* case, [1921] 2 A.C. 171, by Lord Cave, that[4] : " A company paying Income Tax on its profits does not pay " it as agent for its shareholders," and the *Scottish Union* case, [1921] 1 A.C. 172[5], and, indeed, the whole current of authority, establish the position that, notwithstanding the special powers of deduction given to companies in appropriate cases under the Rules in the Income Tax Acts, and by Section 7 of the Finance Act, 1931, such powers do not operate to prevent the recipient of the profit or gain in the form of dividend from being liable to Income Tax by direct assessment.

The learned Judge was influenced in his decision by *Gimson's* case, which I have already mentioned. But, in my view, that decision cannot be supported so far as it is here relied upon by Mr. Justice Finlay. In that case, the Attorney-General had said that : " If you get a dividend which does somehow or other come to " the man from a fund which is not taxed, it became an annual payment charged with tax under Schedule D." Mr. Justice Rowlatt refused to accept this view, but, in my opinion, it is correct, and the source of the profit or gain which the individual receives is not material when the liability of the individual to pay tax on the

(1) *See* page 341 *ante*. (2) 16 T.C. at p. 232. (3) *Ibid.* at p. 233.
(4) Commissioners of Inland Revenue *v.* Blott, 8 T.C. 101, at p. 136.
(5) Scottish Union and National Insurance Co. *v.* New Zealand and Australian Land Co., Ltd.

(Slesser, L.J.)

profit or gain is considered. Nor do I see that the liability to Sur-tax is to be ascertained otherwise than in accordance with Sections 38 (1) and 38 (2) of the Finance Act, 1927, which Sections would be satisfied by requiring the return for Sur-tax to include the sum of £4,275.

On the other hand, I am unable to see that the Crown can claim more than this sum. And to the extent of the difference between that sum and £5,343 15*s.* 0*d.* the Commissioners were wrong. If the sum to be returned is the sum actually received, it is the lesser and not the larger sum. I do not think that the sum actually received can here be deemed to represent the larger amount, for the reasons stated by my Lord and by Lord Justice Romer, with which reasons I concur.

Romer, L.J.—It has been laid down on more than one occasion that for the purposes of taxation, just as for all other purposes, an incorporated company is one entity and its shareholders are separate and distinct entities. The most recent case in which this principle was approved and applied is that of *Hamilton* v. *Commissioners of Inland Revenue*, [1931] 2 K.B. 495(1), a decision of this Court. Stated shortly, the question in that case was whether a company when distributing a sum as dividend among its shareholders could deduct a greater sum in respect of Income Tax than the company had itself been charged with for such tax in respect of the sum so distributed. It was held that there was no connection whatever between the two taxes, that the company was one taxpayer and the shareholders were separate and distinct taxpayers, and that the company was entitled to deduct from the dividends paid Income Tax at the then current rate, regardless of the rate at which Income Tax had been paid by the company upon the profits from which the sum distributed had been derived. In the case of an individual A, who pays an annuity to another individual B, A is one taxpayer, and B is another, and the amount or rate of Income Tax chargeable in respect of B's annuity depends in no way whatsoever upon the amount or rate of Income Tax paid by A. The question of what A himself pays as Income Tax is only material for the purpose of ascertaining how the Income Tax on B's annuity is to be collected, as will presently appear. Now, the case is precisely the same if an incorporated company be substituted for A and its dividend receiving shareholders for B.

At this stage, however, it is necessary to refer to the decision of Mr. Justice Rowlatt in *Gimson* v. *Commissioners of Inland Revenue*, 15 T.C. 595. In that case an incorporated company had declared a dividend of £5 per cent. "actual" on its ordinary shares. A shareholder who held £1,500 ordinary shares received a sum of £75 without any deduction. Of this sum £40 represented a capital payment. But a question arose

(1) 16 T.C. 213.

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as to the remaining £35 for the purpose of ascertaining the shareholder's liability in respect of Super-tax. It seems to have been contended in the first instance that the shareholder must be deemed to have been paid £35 free of tax and was therefore assessable to Super-tax in respect of £44 as representing the gross dividend. In the argument before Mr. Justice Rowlatt, however, the Commissioners took up the position that the £35 was the amount of the gross dividend in respect of which the shareholder was himself directly assessable to Income Tax or from which the company ought to have deducted the tax at source. In ordinary circumstances the question whether the shareholder should have been assessed to Super-tax on £44 or £35 would or might itself depend upon the question whether or not the dividend was payable out of profits or gains of the company brought into charge, as will appear later. The shareholder, however, resisted assessment in either amount upon the ground that the £35 had been paid by the company out of a fund that in the hands of the company was not (as indeed was conceded) chargeable to Income Tax at all, and accordingly was not chargeable to Income Tax when paid over to the shareholders. This argument prevailed before the learned Judge. He said, speaking of the shareholder in question(1): "If "this gentleman had received this .... income himself and had "been liable to Income Tax in nil because of the regulations affecting "measurement, his income would not be subject-matter on which "he could .... pay Super-tax." Pausing there, no exception can, of course, be taken to what the learned Judge said. But he went on as follows: "So in the case of a company, although the "Attorney-General very properly referred to what I said in *Blott's* "case(2) which is a material case, although the case of a company is "different, in essence it is the same .... he can only be liable "to Super-tax in respect of a dividend which is taxable." Now this passage seems to indicate that a dividend is not taxable when the fund out of which it is paid is not taxable. With all respect to the learned Judge, this is wrong. It is contrary to the principle upon which *Hamilton's* case was decided and which had been enunciated in earlier authorities. A dividend (in which term, of course, I do not include a capital distribution) is taxable because it is charged with Income Tax by virtue of Schedule D. The fund out of which it is paid may be taxable under that Schedule or under one of the others. But the fact that the fund is taxable at a different rate or under a different Schedule involving a different method of computation for tax purposes is beside the mark, just as it would be beside the mark if it were an annuity or interest on a debenture that was being paid and not a dividend. In my judgment, *Gimson's* case was wrongly decided, and ought to be overruled.

(1) 15 T.C. at p. 601. (2) 8 T.C. 101.

(Romer, L.J.)

To return to the present case, it is said by the Respondent and was not disputed by the Crown, that the sum distributed by the company of which the £4,275 formed the Respondent's proportionate share, was paid out of a surplus of accumulated rents which remained in the hands of the company after profits had been distributed to the amount of any assessments made upon the company. I do not know how anyone could say that a sum of money in the company's coffers represented rents, but if the word " fund " be substituted for the words " surplus of accumulated rents ", it is no doubt an accurate statement. The matter is, however, of no importance to the question with which I am dealing. For, whatever was the source of that fund, the dividend, not being a capital distribution, was chargeable with Income Tax under Schedule D, and the fact (if fact it be) that the fund in the hands of the company had not been brought into charge when ascertaining the company's own liability to Income Tax is, in my judgment and for the reasons that I have given, a wholly irrelevant consideration.

For the purpose, however, of ascertaining what is to be considered for the purposes of Sur-tax the gross amount of that dividend, the fact possesses considerable importance. Had the payment to the Respondent been a payment of interest on debenture stock and not a dividend, the question whether the payment was or was not made out of profits and gains of the company brought into charge would be irrelevant for the purpose of the assessment of the Respondent to Sur-tax. For in either case Income Tax would be deductible by the company either by virtue of Rule 19 or by virtue of Rule 21 of the All Schedules Rules in the Income Tax Act of 1918. If deducted under Rule 19, the company could retain the tax for its own benefit; if under Rule 21, the company would have to account for the tax to the Crown. In either case, however, the Respondent would, of course, be assessed for Sur-tax in the gross amount of the interest paid. A dividend stands, however, on a somewhat different footing, for the deduction of the tax on payment was, before the passing of the Finance Act, 1931, governed by Rule 20 of the All Schedules Rules. The words of that Rule were difficult to construe. As I ventured to point out in *Hamilton's* case[1], the Rule, if construed strictly, only authorised the deduction of the tax from a dividend paid out of the profits or gains in respect of which the company was chargeable, and would not apply to a dividend paid out of profits and gains in respect of which the company was not chargeable. I should, however, but for Section 7 of the Finance Act of 1931, have been prepared to treat the Rule as applicable to all dividends paid by a company, even when paid out of profits and gains not brought into charge. That Section renders it difficult or, rather, impossible to do so.

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(1) 16 T.C. at pp. 234/5.

(Romer, L.J.)

Before dealing with that Section, however, it is necessary to point out another difficulty that might formerly have occurred in the case of the payment of a dividend. As a rule, the resolution declaring a dividend makes it clear whether it is going to be paid tax free or after deduction of tax. But suppose the resolution is silent upon the matter and the dividend declared is paid by the company in full. Is the dividend to be treated as gross or net? Rule 20 did not make it compulsory upon the company to deduct the tax even in the case of a dividend paid out of profits and gains not brought into charge, and it certainly seems doubtful in view of the language of that Rule whether Rule 21 applies to a dividend at all. This particular difficulty has to a large extent been removed by Section 7 (2) of the Finance Act, 1931. But Sub-section (1) of that Section creates another. That Sub-section enacts that Rule 20 shall, in relation to a dividend paid whether before or after the commencement of the Act, be construed as authorising the deduction of tax from the full amount paid out of profits and gains which have been charged to tax, or which, under the provisions of the Income Tax Acts, would fall to be included in computing the liability of the company to assessment to tax for any year, if the said provisions required the computation to be made by reference to the profits and gains of that year and not by reference to those of any other year or period. Sub-section (2) is, so far as material, in these terms: " Subject as hereinafter provided, a dividend paid by a body " of persons, whether before or after the commencement of this " Act, shall, to the extent to which it is paid out of such profits and " gains as are mentioned in subsection (1) of this section, be " deemed, for all the purposes of the Income Tax Acts, to represent " income of such an amount as would, after such deduction of tax " as is authorised by the provisions of the said Rule 20, be equal " to the net amount received." It will be seen that Sub-section (1) provides for a construction being put upon Rule 20 that would have justified the deduction of tax from the dividend paid in *Gimson's* case, and that Sub-section (2) would have justified the assessment of Gimson for Super-tax in the sum of £44 in respect of the payment to him of the dividend of £35. For the dividend had been paid out of profits and gains which would have fallen to be included in computing the liability of the company if the computation had to be made by reference to the profits and gains of the year of assessment. But, while bringing such a dividend as was paid in *Gimson's* case within the provisions of Rule 20, Sub-section (1) renders it, in my opinion, impossible to bring the dividend paid in this case within those provisions or within the provisions of Sub-section (2). Had Sub-section (1) provided that Rule 20 should be construed as authorising the deduction of tax from the full amount paid out of profits and gains, whether such profits and gains had or had not been charged to tax, a construction that I should, I think, have been

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prepared to put upon Rule 20 as it stood, the question arising upon this appeal could not have arisen. The Sub-section, however, renders such a construction impossible. It was indeed contended by the Attorney-General that the rents received by the company in the present case in excess of the annual value of the premises that were subjected to tax under Schedule A were, in truth, profits and gains charged to tax. As a general proposition, I think that that is true. Under Schedule A, tax is charged in respect of the property in all lands, tenements, hereditaments and heritages in the United Kingdom, and then are added these words: "for every twenty "shillings of the annual value thereof." Such words, however, do no more, in my opinion, than indicate the method in which the amount of the tax is to be ascertained, and do not substitute for a tax in respect of the property a tax in respect of its annual value. The annual value is merely the measure of the liability of the tax. This was, I think, the view taken by the House of Lords in the *Salisbury House* case, 15 T.C. 266. It will be sufficient to refer to what was said by Lord Warrington and Lord Tomlin. The former, when speaking of a landowner, who turned his land to profitable account, said this[1]: "Such a person would, I think, ... be "assessable under Schedule A only, and his taxable income would "be measured by the conventional annual value and not by the "amounts of the rents he actually received." Lord Tomlin said[2]: "When once the annual value has been ascertained and "fixed for the purposes of Schedule A it is irrelevant to consider "whether the landlord in fact receives by way of rent more or less "than, or the same as, the assessed annual value. The subject-"matter, namely, land in respect of its property quality, being "necessarily taxed under Schedule A, cannot be brought again "under any other Schedule. To do so would offend the rule against "double taxation." Indeed, if the House of Lords had not held the view that I have attributed to them, their decision in the case must have been in favour of the Crown. For, if only annual value was taxed under Schedule A, and not the income of the property, the excess of the rents over annual value was clearly taxable under Schedule D, Case VI. But I need not pursue this subject because the words "profits and gains brought into charge" as used in Rules 19 and 21, have been given a more restricted meaning than they would receive in general and apart from the context of these Rules.

In the case of the *Attorney-General* v. *Metropolitan Water Board*, 13 T.C. 294, the facts for the present purpose can be taken to have been as follows. The profits of the Water Board were assessable to Income Tax by reference to the profits of the year preceding the year of assessment. For the tax year 1921–22 the

(1) 15 T.C. at pp. 315/6. (2) *Ibid.* at p. 325.

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Board earned no profits. Accordingly, for the year ending 5th April, 1923, they paid no Income Tax. In that year, however, they in fact made a very large profit, and out of such profit paid the interest on their debenture stock after deducting Income Tax. The question then arose between the Commissioners of Inland Revenue and the Board whether the interest had been deducted out of profits or gains brought into charge within the meaning of Rules 19 and 21. If it had, the Board were entitled to retain the tax deducted for their own benefit. If not, they were accountable to the Crown for such tax. It was held by this Court that the interest had not been paid out of profits or gains brought into charge within the meaning of that Rule. The argument on behalf of the Water Board was as follows. The profits or gains of the Board brought into charge to tax for the year 1922–23 were the actual profits of that year, though the liability to Income Tax for that year was to be measured by the amount of the profits of the preceding year. This argument did not succeed. It was in effect held that for the purpose of the Rules the words " profits or gains brought into charge " mean the sum that is taken to measure the liability for the charge. In the case of the Water Board that sum for the year 1922–23 was nil. The interest, though in fact paid out of the actual profits of the year, had not therefore been paid out of profits or gains brought into charge. In the following year, even if the Board made no profit at all, the interest, however it was in fact provided, would be deemed to have been so paid, for the Board would have been chargeable to Income Tax by reference to the profits earned during the preceding year. Applying that decision to the present case, it would seem to follow that the dividend of £4,275 was not paid out of profits or gains brought into charge within the meaning of Rules 19 and 21. Had any part of the " surplus rents " been applied in payment of interest on debenture stock the company would, in accordance with the decision, have had to account to the Crown for the tax deducted. The words in Sub-section (1) of Section 7 of the Finance Act, 1931, are " profits and gains . . . . which have been charged " to tax," differing slightly from the words in the Rules. I do not, however, see any justification for giving the former a different construction from that placed by this Court upon the latter. The addition, in the Sub-section, of the words that follow seem, moreover, to be an indication by the Legislature that the preceding words are to bear the same construction as the words in the Rules, and are to bear the same construction as was placed upon those Rules by this Court in the *Metropolitan Water Board* case. The Crown cannot now avail itself of an argument that it defeated so successfully when advanced by the Metropolitan Water Board.

If I am right so far, it would seem to follow that Section 7 does not apply to the present case and that Rule 20 cannot be read as authorising a deduction of tax by the company from the dividend

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paid to the Respondent. That being so, the company must be deemed to have paid him a gross dividend of £4,275. This should have been included by the Respondent when making his return of income from all sources for the year 1929–30, and he was properly assessable in that sum for Sur-tax. It was contended on his behalf by Mr. Latter that he could not be so assessed, inasmuch as he had not been assessed to Income Tax in respect of the dividend. This, however, appears to me to be immaterial. Had he included it in his return as he should have done, I cannot see how he could have escaped paying Income Tax upon it in due course. He cannot be in any better position by having failed to make a proper return.

For these reasons, I am of opinion that this appeal should be allowed.

Mr. Hills.—With regard to the form of the Order, the effect of your Lordships' decision is that the decision of the Commissioners is restored, subject to the sum of £4,275 and not the whole sum of £5,343 15*s*. being included in the total income of the taxpayer?

Lord Hanworth, M.R.—Yes.

Mr. Hills.—We shall want an Order to that effect, either remitting it, or, if my learned friend and I cannot agree, also an Order for the repayment to the Crown of the Sur-tax which has already been repaid under Mr. Justice Finlay's Order.

Lord Hanworth, M.R.—It having been repaid, you want an Order for a fresh assessment of £4,275 being made and payment of that sum. It is not a question of repayment again. The money has gone back and it has lost its identity. It will be an assessment and, consequently, a payment.

Mr. Hills.—We have already repaid with interest a sum, of course, greatly in excess of the sum we are now shown ought to have been repaid. We should only have repaid upon the sum of about £1,000.

Lord Hanworth, M.R.—You mean the identity of it is sufficiently marked as between you?

Mr. Hills.—What I was going to suggest was that the Order should be made in accordance with your Lordships' decision, and remitted to the Commissioners, if we cannot agree the sum. That is the only point.

Lord Hanworth, M.R.—Very well, Mr. Hills; and we will say, "Payment back."

Mr. Hills.—Yes, that is it: "Payment back."

Romer, L.J.—You want further interest on that sum?

Mr. Hills.—No, my Lord, we are not allowed it. We merely want the interest we have paid repaid.

Slesser, L.J.—You are worrying about any interest that you have paid? You have paid interest which you need not have paid?

Mr. Hills.—We have repaid more tax to them than we need have repaid, with interest on it.

Both sides having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Lords Tomlin, Warrington of Clyffe and Wright) on the 14th, 16th, 17th, 22nd and 23rd November, 1933, when judgment was reserved. On the 1st February, 1934, judgment was given unanimously dismissing both the appeal and the cross-appeal, with costs.

The Attorney-General (Sir Thomas Inskip, K.C.), the Solicitor-General (Sir Donald Somervell, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. A. M. Latter, K.C., Mr. Wilfrid Greene, K.C., and Mr. J. H. Bowe for Mr. L. Neumann.

JUDGMENT

Lord Tomlin.—My Lords, this appeal and cross-appeal arise out of an assessment to Sur-tax for the year 1929–30 made upon the Appellant by the Commissioners for the Special Purposes of the Income Tax Acts.

The facts can be stated shortly, A company called the Salisbury House Estate, Limited, owned and managed a block of buildings, in the City of London, containing numerous rooms, let unfurnished, as offices, to many tenants. The company, for appropriate considerations, provided, for the tenants who required them, services in connection with the cleaning and heating of the rooms. For the four years ending 5th April, 1925, 1926, 1927 and 1928, the company were assessed under Schedule A to Income Tax on the gross value of the building as appearing on the valuation list under the Metropolis (Valuation) Act, 1869. In regard to the profits and gains derived from the services rendered to the tenants, the company admitted liability to be assessed to Income Tax under Schedule D, but the Crown claimed that, in making the assessment under Schedule D, the rents, which far exceeded the annual value as assessed under Schedule A, must be included, allowance being made for tax assessed under Schedule A. The matter came on appeal before your Lordships' House and, on 4th April, 1930, your Lordships held (see *Fry* v. *Salisbury House Estate, Limited*, [1930] A.C. 432[1]) that the rents were profits arising from the ownership of land in respect of which the assessment under Schedule A was exhaustive and that such rents, therefore, could not be included in the assessment under Schedule D as trade receipts of the company.

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[1] 15 T.C. 266.

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Pending that appeal to your Lordships' House, the company distributed in dividend (from which the appropriate amounts for Income Tax were deducted) sums equal to their profits in respect of services assessable under Schedule D, and also sums equal to the amounts of the assessments made under Schedule A. The company, however, set aside the sum of £18,325 (representing the amount by which their net rents exceeded the amounts of the assessments under Schedule A) to the credit of an Income Tax reserve account to meet such liability, if any, as might be established against them in the litigation then pending. On 4th April, 1930, immediately after the decision of your Lordships' House was announced, the company distributed the sum of £18,325 so set aside among their shareholders by way of dividend. The Appellant, who held 85,500 shares of £1 each in the company, received from the company a cheque for £4,275, together with a letter from the company, dated 4th April, 1930, informing him that the sum of £4,275 was in respect of an interim dividend of 5 per cent., free of tax, on the shares registered in his name and that it was equivalent to a gross amount of £5,343 15*s*. 0*d*. Later, the Appellant was informed by the company that the sum of £4,275 had been erroneously described by the company as a dividend of 5 per cent., free of tax, and that, in fact, it represented a sum distributed out of the untaxed income of the company which should not have been included in any Sur-tax return made by the Appellant. Nevertheless, the Commissioners for the Special Purposes of the Income Tax Acts, in making upon the Appellant an assessment to Sur-tax for the year 1929–30, included the sum of £5,343 15*s*. 0*d*. as being the gross amount applicable to a net dividend of £4,275.

Mr. Justice Finlay held that, in respect of the dividend in question, nothing at all ought to have been included in the assessment, and the Court of Appeal have held that the sum of £4,275, and not the sum of £5,343 15*s*. 0*d*., ought to have been so included.

The case is a difficult one, and the difficulty in part arises from the fact that the amendments from time to time made to the Income Tax Acts, directed as they frequently are to stopping an exit through the net of taxation freshly disclosed, are too often framed without sufficient regard to the basic scheme upon which the Acts originally rested.

The relative positions of a company and the shareholders of the company in relation to Income Tax under the Income Tax Acts have always been recognised as special in character. It was never, I think, doubted that, under the Act of 1842, the profits of a business carried on by a company were taxable against the company under Schedule D, and were not taxable again, after distribution, in the hands of the shareholders under Schedule D or any other Schedule. At the same time, it was permissible to the company, under Section 54 of the Act of 1842, to deduct from the dividend

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the proportionate part of the tax paid to the tax collector, and the shareholders entitled to exemption from or abatement of Income Tax could, upon the footing of the deduction, obtain the necessary return of tax. I cannot but think that the position under the Act of 1842 upon its proper construction is correctly described in the following passage from the speech of Lord Phillimore in *Bradbury* v. *English Sewing Cotton Company, Limited*, [1923] A.C. 744, at page 769[1]: " A joint stock company is under the Income Tax " Act, 1842, treated as a person and is directed to make a return " of its profits or gains according to Schedule D upon a conven- " tional figure, arrived at by taking an average of the three " preceding years, and is liable to be assessed and taxed thereupon. " If the principle of its being a distinct person, distinct from its " shareholders or the aggregate of its shareholders, had been carried " to a logical conclusion, there would have been no reason why " each shareholder should not, in his turn, have to return as part " of his profits or gains under Schedule D, the money received " by him in dividends. Their taxation would seem to be logical, " but it would be destructive of joint stock company enterprise, so " the Act of 1842 has, apparently, proceeded on the idea that for " revenue purposes a joint stock company should be treated as a " large partnership, so that the payment of income tax by a com- " pany would discharge the quasi-partners. The reason for their " discharge may be the avoidance of double taxation, or to speak " accurately, the avoidance of increased taxation. But the law is " not founded upon the introduction of some equitable principle as " modifying the statute; it is founded upon the provisions of the " statute itself; and the statute carries the analogy of a partnership " further, for it contemplates a company declaring a dividend on " the gross gains, and then on the face of the dividend warrant " making a proportionate deduction in respect of the duty, so that " the shareholder whose total income is so small that he is exempt " from income tax or pays at a lower rate, can get the income tax " which has been deducted on the dividend warrant returned to " him."

In practice, the matter did not work out quite so simply. It has to be remembered that the amount distributable in dividend in any year might, in view of the assessment of profits or gains under Schedule D being upon the basis of the average of the three preceding years, as it then was, be much more or much less than the amount of the assessment for that year, so that if this proportionate deduction was treated as meaning the rateable proportion of the tax paid by the company in respect of the year of distribution, it might much exceed or be much less than the amount which would be deducted from the dividend if the current rate of tax in respect of the gross dividend had been deducted. At any rate, a practice

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(1) 8 T.C. 481 at pp. 518/9.

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seems to have grown up of companies deducting from dividends tax appropriate to the amount of the dividend at the current rate of tax, quite irrespective of the amount of tax paid by the company to the Revenue, and of the shareholders claiming exemption or abatement being treated by the Revenue as having paid tax to the extent of that deduction. As the company making the deduction lay under no obligation to pay to the Revenue anything more than the tax based upon its own assessment, the result was that the tax returned to those claiming exemption or abatement could rarely, if ever, have had any exact relation to the amount of tax received by the Revenue from the recipient of returned tax.

When Super-tax was imposed in 1910, the return of total income—that is, what may be called total Income Tax income—made for the purpose of obtaining exemption or abatement became also the basis of the assessment to Super-tax and, therefore, of increased importance, and the Revenue then seem to have stood to gain, on the whole, to a greater extent by the continuance of the system which I have described. In fact, when the Act of 1918 was passed, a change was made in the language which, I think, gave effect to the practice. Rule 20 of the General Rules applicable to Schedules A, B, C, D and E took the place of Section 54 of the Act of 1842, and is in the following terms: "The profits or gains "to be charged on any body of persons shall be computed in accord-"ance with the provisions of this Act on the full amount of the "same before any dividend thereof is made in respect of any "share, right or title thereto, and the body of persons paying such "dividend shall be entitled to deduct the tax appropriate thereto." Under Section 237 of the Act of 1918, unless the context otherwise requires: "'Body of persons' means any body politic, corporate, "or collegiate, and any company, fraternity, fellowship and society "of persons, whether corporate or not corporate." By Section 33 of the Finance Act, 1924, a company is required, on every dividend warrant, or statement annexed thereto, to show "(*a*) the gross "amount of the dividend which, after deduction of the income tax "appropriate thereto, corresponds to the net amount actually "paid; and (*b*) the rate and the amount of income tax appropriate "to such gross amount; and (*c*) the net amount actually paid."

As the result of the Finance Act, 1927, Sur-tax, in and from the year 1929–30, took the place of Super-tax, and, for the year 1928–29 and every subsequent year, Income Tax became chargeable at a standard rate instead of at a single rate. Section 38 (2) of the last-mentioned Act defines total income upon which Sur-tax is based. It is in the following terms: "The expression 'total "'income' in relation to any person means the total income of "that person from all sources estimated, as the case may be, either "in accordance with the provisions of the Income Tax Acts as they "apply to income tax chargeable at the standard rate or in accord-

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"ance with those provisions as they apply to Sur-tax." Section 39 of the same Act, so far as it is material, provides as follows: "(1) Such of the provisions of the Income Tax Acts as "provide that income tax may be deducted from any payment at "the rate or rates of tax in force during the period through which "the payment was accruing due, or that there may be deducted "from any dividend the tax appropriate thereto, or that a propor-"tionate deduction of the tax charged shall be allowed by any "person out of any produce or value payable to him, shall have "effect as if they provided that tax may be deducted or shall be "allowed at the standard rate for the year in which the amount "payable becomes due. . . . . (2) In estimating under the "Income Tax Acts the total income of any person, any income "which is chargeable with income tax by way of deduction at the "standard rate in force for any year shall be deemed to be income of "that year, and any deductions which are allowable on account of "sums payable under deduction of income tax at the standard rate "in force for any year out of the property or profits of that person "shall be allowed as deductions in respect of that year, notwith-"standing that the income or sums, as the case may be, accrued or "will accrue in whole or in part before or after that year."

The effect of this last-mentioned Section seems to place beyond doubt this, that, where tax may be deducted from a dividend, the amount deductible is the sum which equals the standard rate of tax for the year of payment upon the gross amount of the dividend and that, whenever the profits were earned, the sum from which the deduction is made, and the deduction itself, are to be treated as income and deduction in respect of the year in which the payment is made. Thus, the deduction permissible from the dividend clearly had no relation to the figure of tax payable by the company to the Revenue, though there was still no obligation on the company to account to the Revenue for what was deducted. The deduction, in fact, was only part of a system by which was measured (1) the extent of the shareholders' right to have exemption or abatement, and (2) the liability of the shareholder to Sur-tax.

One other subsequent provision of the law important to this case must be referred to. By Section 7 of the Finance Act, 1931, it was enacted, so far as material for the present purpose, as follows: "(1) The provisions of Rule 20 of the General Rules, which "authorise the deduction of the appropriate tax from any dividend "paid by a body of persons, shall, in relation to a dividend paid by "any body of persons, whether before or after the commencement "of this Act, be construed as authorising the deduction of tax "from the full amount paid out of profits and gains of the said "body which have been charged to tax or which, under the pro-"visions of the Income Tax Acts, would fall to be included in "computing the liability of the said body to assessment to tax for

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"any year if the said provisions required the computation to be "made by reference to the profits and gains of that year and not by "reference to those of any other year or period. (2) . . . . a "dividend paid by a body of persons, whether before or after the "commencement of this Act, shall, to the extent to which it is "paid out of such profits and gains as are mentioned in sub-"section (1) of this section, be deemed, for all the purposes of the "Income Tax Acts, to represent income of such an amount as "would, after such deduction of tax as is authorised by the "provisions of the said Rule 20, be equal to the net amount "received."

Now, how do the foregoing provisions apply and with what effect to the facts of this case? On the one hand, it is said by the Appellant: (1) that, except so far as the dividend can be reduced by deduction, it is not liable to tax, because dividends as such are not directly assessable to tax; (2) that the rents in excess of the annual value, as assessed under Schedule A, are not, in the hands of the company, taxable to Income Tax at all and, therefore, that a dividend paid out of such excess rents is not, in the hands of the shareholders, taxable to Income Tax, either by deduction or by direct assessment; (3) that if the dividend is not liable to any deduction in respect of tax or taxable to Income Tax in the hands of the shareholder, it is not taxable to Sur-tax and, therefore, that no part of the sum of £4,275 ought to have been included in the assessment of the Appellant to Sur-tax. On the other hand, the Respondents say: (1) that dividends, as such, are taxable under Schedule D if not taxed by deduction and, therefore, upon any view of the case the dividend was Income Tax income; (2) that the rents out of which the dividend in question was paid were in fact charged to tax within the meaning of Section 7 (1) of the Finance Act, 1931, and the dividend must therefore be treated as a dividend from which deduction of tax was permissible; (3) that, upon this footing, inasmuch as the sum of £4,275 was the net amount received, the gross dividend must, under the provisions of Section 7 (2) of the Finance Act, 1931, be treated for Sur-tax purposes as the sum of £5,343 15*s.* 0*d.*

I may say at once that, having regard to the view which I have expressed as to the general scheme and operation of the Income Tax Acts in regard to dividends, I am unable to accept the view that dividends, as such, are taxable under Schedule D. I do not think they are. I think it is accurate to say, as Mr. Justice Rowlatt said in *Purdie* v. *Rex*, [1914] 3 K.B. 112, at page 116: "There is, "strictly speaking, no tax upon dividends at all." They are, however, under Rule 20 of the General Rules and Section 39 of the Finance Act, 1927, and apart altogether from Section 7 of the Finance Act, 1931, liable, where the dividends are made out of profits or gains charged on the company, to suffer deduction of a

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sum equal to tax at the standard rate on the gross amount of the dividends and, in such cases, the gross amount of the dividend is the Income Tax income to be taken into account, whether it be for computing the amount of tax which the shareholder is entitled to have returned, or for fixing his liability to Sur-tax.

It is not disputed that, if a dividend is paid out of the profits produced by a sale of a capital asset, it is not made out of profits or gains charged on the company and, therefore, no deduction from the dividend is authorised, and the dividend itself is not liable to be taken into account in fixing the liability to Sur-tax of the shareholder. Again, where the dividend was paid out of profits or gains not chargeable on the company by reason of the application of the Rules relating to the measurement of taxable income, it was held in *Gimson* v. *Inland Revenue Commissioners*, [1930] 2 K.B. 246[1], (decided before the passing of the Finance Act, 1931) that no deduction was permissible and that the dividend ought not, therefore, to be taken into account for the purposes of Sur-tax. The Court of Appeal in the present case have held that the decision was wrong. I do not think that it was wrong. The profits or gains in that case were not profits or gains assessed by reason of the Rules at nil, but profits or gains not assessable at all. They were, therefore, not profits or gains to be charged on the company and no deduction was permissible from a dividend paid out of them. It is unnecessary to express any opinion as to the effect, if any, of Section 7 (1) of the Finance Act, 1931, upon such facts as those dealt with in that case.

In the present case, dividends have been paid out of rents arising from hereditaments assessed to tax under Schedule A, the rents exceeding the annual value fixed by the assessments. In my opinion, the rents are profits and gains to be charged on the company within the meaning of Rule 20. The fact that the measure of liability in respect of them is an artificial one does not render the rents any the less the things to be charged. In *Coman* v. *Governors of the Rotunda Hospital, Dublin*, [1921] 1 A.C. 1, at page 12[2], Lord Birkenhead, Lord Chancellor, said that Schedule A " clearly shows that the object is to tax what for the " sake of brevity may, with substantial accuracy, be called the " landlord's income." In this connection, I may observe that I do not think that the case of the *Attorney-General* v. *The Metropolitan Water Board*, [1928] 1 K.B. 833[3], affords support to a contrary view. Whether rightly or wrongly decided (as to which I express no opinion), it dealt with a different subject matter, *viz.*, the deduction of tax from interest, with different Rules, *viz.*, Rules 19 and 21, and with words differing both from those used in Rule 20 and from those used in Section 7 (1) of the Finance Act, 1931.

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(1) 15 T.C. 595. (2) 7 T.C. 517 at p. 579. (3) 13 T.C. 294.

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It follows, therefore, that, in my opinion, the dividend was one from which deduction was authorised and, having regard to Section 39 of the Finance Act, 1927, authorised at the standard rate for the year of payment in respect of the whole dividend. This result, in my view, follows, in the circumstances of the present case, from the true construction of Rule 20 and Section 39, irrespective of Section 7 (1) of the Finance Act, 1931. Section 7 (1) was intended to extend the authority to deduct, and seems to me to be directed to meeting the case where a dividend is paid out of a company's actual trading profits for the year, though, under Schedule D, the company's liability to tax in respect of them is assessed by reference to the profits of the previous year. It does not seem to me to have any appreciable effect in such cases as the present.

It follows, from what I have said, that the dividend in question was part of the Income Tax income of the Appellant to be taken into account in fixing his liability for Sur-tax. The question, however, remains as to the figure at which it is to be brought in. I think it would be repellent to most minds that the Appellant should be charged as a part of his income with a sum which not only has never come to him but has never existed in fact. It is plain that the Respondents' cross-appeal, which seeks to treat the sum of £4,275 as a net sum, corresponding to a gross sum of £5,343 15*s*., assumes that the amount divisible by the company was something in excess of anything it ever had to divide. It is said, however, that Section 7 (2) of the Finance Act, 1931, compels the conclusion that the sum of £5,343 15*s*. is the correct figure to be brought into computation. I do not think that the effect of the statutory provision is as contended for by the Respondents. The Sub-section, in effect, provides that it is the gross amount before deduction which is to be treated as the income for the purposes of the Acts. If a deduction from the gross sum was authorised but was not in fact made, as was the case here, there is, in my opinion, nothing in the language of the Sub-section which entitles the Inland Revenue to treat the gross sum as being greater than in fact it was. From the Income Tax point of view, it makes no difference to the Revenue whether the deduction is made or not, because the company does not have to account for what it deducts.

In my opinion, for the reasons which I have endeavoured to indicate, but which do not accord in all respects with those relied upon by the Court of Appeal, both the appeal and the cross-appeal fail and should be dismissed with costs, and I move your Lordships accordingly.

Lord Warrington of Clyffe.—My Lords, the Appellant is a shareholder in a company called Salisbury House Estate, Limited. In the tax year 1929–30, the Appellant received from the company a sum of £4,275 described as a net interim dividend of £4,275, free

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of tax. This sum represented, with the addition of tax at the standard rate for that year, a sum of £5,343 15*s*. The question is whether any sum, and, if so, what sum, in respect of such interim dividend ought to be included in the Appellant's return of income from all sources for the purposes of Sur-tax in the year 1929–30. The Appellant contends that he is under no obligation to include in his return any item in respect of such dividend or, at all events, no larger sum than the £4,275. The Respondents contend that he is bound to include the gross sum of £5,343 15*s*., and such sum was accordingly included in the assessment for the year 1929–30. On appeal to the Special Commissioners, this assessment was confirmed. On appeal to the King's Bench Division, Mr. Justice Finlay allowed the appeal and discharged the assessment, but, on appeal to the Court of Appeal, that Court by an order of the 19th January, 1933, reversed the order of Mr. Justice Finlay and confirmed the assessment, but for the sum of £4,275 only. The Appellant seeks to restore the order of Mr. Justice Finlay, and the Commissioners seek to have the assessment confirmed for the total amount of £5,343 15*s*.

The company owns a property in the City of London, the rents of which greatly exceed the " annual value " on the amount of which the company is assessed to tax under Schedule A as the owner of the property in question. The profits of the company available for dividend and the ordinary annual dividends have for many years exceeded the amounts on which, under Schedule A, Income Tax has been paid by the company. The Crown then raised the contention that the company was carrying on a trade under Schedule D and that, for the purposes of an assessment under that Schedule, all its receipts, including receipts from rents, must be included. This contention on the part of the Crown was finally disposed of by this House on the 4th April, 1930, in *Fry* v. *Salisbury House Estate, Ltd.*, [1930] A.C. 432[1]. In that case, it was decided that, so far as the ownership of the house was concerned, the company had been fully assessed under Schedule A in respect of the annual value and was under no liability to be further assessed under Schedule D. The company then made to the Appellant the payment of £4,275 above referred to. The payment was made out of a sum of £18,325 put aside out of its profits as an Income Tax reserve pending the decision above-mentioned. This last-mentioned sum had been taken from a surplus of accumulated rents which remained in the hands of the company after profits had been distributed to the amount of any assessment made upon the company. The letter accompanying the cheque for £4,275 stated that it was an interim dividend for the year ending the 25th December, 1930, at 5 per cent., free of tax, and was equivalent to a gross amount of £5,343 15*s*. less Income Tax at 4*s*. in the £, £1,068 15*s*. = £4,275, and it contained the usual certificate that the Income Tax

(1) 15 T.C. 266.

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deducted had been, or would be, duly paid to the proper officer for the receipt of taxes. Later, the company adopted the position that the fund, out of which the dividend was paid, was untaxed income in the hands of the company and not taxable in the hands of the Appellant, and should not be included in any return of total income. They also withdrew the certificate relating to the payment of tax.

The present appeal raises two questions: first, whether in the hands of the Appellant as a shareholder, the dividend in question is subject to tax and, secondly, if it is, should the Appellant include in his return of total income from all sources the gross sum of £5,343 15*s*. or the £4,275. In the Court of Appeal, the first of these questions was decided in favour of the Crown and the second in favour of the Appellant.

As to the first, in my opinion, the judgment of the Court of Appeal was correct. I have had the advantage of reading and considering the opinion of my noble and learned friend on the Woolsack and I am clearly of the opinion that the views he has expressed are correct. In particular, I agree that dividends, as such, are not taxable under Schedule D, but that, where they are made out of profits and gains charged on the company they are liable to suffer deduction under the provisions of Rule 20 of the General Rules and Section 39 of the Finance Act, 1927, and that the gross amount is Income Tax income to be taken into account, whether it be for determining a claim for return of tax or for fixing the liability to Sur-tax.

In the present case, the dividend has been paid, not out of capital, but out of rents arising from property assessed to tax under Schedule A, and these rents are, in my opinion, profits and gains to be charged on the company under Rule 20, notwithstanding that the measure of liability is not the amount of the rents themselves but the annual value of the hereditaments from which they arise. If this is so, then the dividend was one from which deduction of tax was authorised and would be Income Tax income to be included in the return of income from all sources for the purposes of Sur-tax.

This brings me to the second question, namely, at what figure is the dividend to be brought in? Here, again, I agree with my noble and learned friend. In such a case as this, namely, where no deduction is in fact made, there is no distinction between a gross sum and a net sum. The actual sum paid, and not some wholly fictitious sum, is, therefore, that which should be included in the return of income.

I concur in the order proposed by my noble and learned friend.

Lord Wright.—My Lords, I also agree.

By Paragraph XVII of the Fifth Schedule to the Income Tax Act, 1918, a person claiming any allowance or deduction is required, *inter alia*, to state " the amount of rents, interests, annuities, or

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"other annual payments in respect of which the claimant is liable "to allow the tax" as an item in the declaration and statement of his total income. After Super-tax was imposed in 1910 (the place of which is now taken by Sur-tax), a taxpayer is similarly required to declare his total income including the same item. Thus, the statement of total income which was originally required to enable the taxpayer to claim a benefit is now required to enable the Revenue authorities, in proper cases, to compute the Sur-tax, and, no doubt, this latter purpose is now more important than the original object. Under the head of "annual payments" fall dividends from companies in which the taxpayer is a shareholder.

There are now certain Rules with regard to such dividends which, so far as relevant to this appeal, are to be found in the Income Tax Act, 1918, in Rule 20 of the General Rules applicable to all Schedules, and in certain subsequent amending Acts. Rule 20 is in these terms: "The profits or gains to be charged on any body "of persons shall be computed in accordance with the provisions of "this Act on the full amount of the same before any dividend "thereof is made in respect of any share, right or title thereto, "and the body of persons paying such dividend shall be entitled "to deduct the tax appropriate thereto." As I interpret this Rule, the profits or gains in respect of which the right of deduction is so given are profits or gains which have been charged to tax. "Body "of persons", by the definition in Section 237 of the Act, includes companies; partnerships are separately dealt with. By Section 33 of the Finance Act, 1924, every warrant or cheque of a company in payment of any dividend must have annexed thereto, or be accompanied by, a statement in writing showing (*a*) the gross amount which, after deduction of the Income Tax appropriate thereto, corresponds to the net amount actually paid; (*b*) the rate and the amount of Income Tax appropriate to such gross amount; and (*c*) the net amount actually paid. By Section 39 of the Finance Act, 1927, it is enacted, *inter alia*, that the provisions for the deduction from any dividend of the tax appropriate thereto shall have effect as if they provided that the tax may be deducted at the standard rate for the year in which the amount payable became due. Section 7 of the Finance Act, 1931, which is retrospective, by Sub-section (1) provides that Rule 20 shall be considered as authorising the deduction of tax from the full amount paid out of profits and gains which have been charged to tax, or which, under the provisions of the Income Tax Acts, would fall to be included in computing the liability of the said body to assessment to tax for any year, if the said provisions required the computation to be made by reference to the profits and gains of that year and not by reference to those of any other year or period. By Sub-section (2) any dividend paid by a body of persons shall, to the extent that it is paid out of such profits and gains as are mentioned in Sub-section (1),

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be deemed, for all the purposes of the Income Tax Acts, to represent income of such an amount as would, after such deduction of tax as is authorised by the provisions of the said Rule 20, be equal to the net amount received.

Rule 20 is, in effect, based on Section 54 of the Income Tax Act, 1842, with the substitution of the words " the tax appropriate " thereto " for the words " the tax proportionate thereto ". The scheme of these provisions, as I understand them, is to impose the tax on all the profits of the company at the source; if and so far as these profits have been so taxed, they are not liable to any further tax, other than Sur-tax, in the hands of the shareholder receiving the dividend. The shareholder and the company are, no doubt, separate entities; the company is not an agent for the shareholder to pay tax on the dividend, nor is the company the collector for the Revenue to deduct the tax from the dividend. The company is the taxpayer. The shareholder has no right to any share in the profits till a dividend is declared; the company may use the profits in any way it pleases *vis-à-vis* any shareholder; it may put them to reserve or capitalise them or use them for extensions or improvements; the profits declared and paid as dividends in one year may have been made in previous years, when the standard rate of tax was different. It is only very rarely, and in exceptional cases, that dividends are paid out of any particular source of profit; usually they are paid out of the general revenue fund of the company. What is essential to the requirements of the Inland Revenue is that all the profits of the company should be taxed and, if that is done, the Revenue is not concerned with what is done with these profits. The company is not bound, but only authorised, to deduct tax in paying dividends; whether it deducts or not is left to its discretion, because the profits, once having been taxed in the company's hands, do not bear further tax—apart from Sur-tax—in the shareholders' hands. There is, in fact, only one profit, no new profit being created from the fact that the shareholder gets his share; the tax is a tax on the profits and not on the dividend. But, if tax is deducted from the dividend, the Acts have provided that it is to be at the standard rate of tax of the year of dividend, in order to avoid obvious difficulties which might arise because profits divided in one year may have been earned in other years. The provisions of Section 7 of the Finance Act, 1931, will be considered by me more particularly in connection with the cross-appeal.

On a careful review of these provisions, I reach the conclusion that a shareholder is not separately taxable—I disregard Sur-tax—on a dividend, as a profit individual to himself, under Schedule D, Case VI, as the Court of Appeal held, or at all. Apart from what I conceive to be the clear effect of the Acts in this regard, I think the position has been so stated by this House more than once, at least as a matter of observation. Thus, in *Inland Revenue Com-*

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missioners v. *Blott*, [1921] 2 A.C. 171, at page 201([1]), Viscount Cave thus explained the system :—" Plainly, a company paying " income tax on its profits does not pay it as agent for its share- " holders. It pays as a taxpayer, and if no dividend is declared " the shareholders have no direct concern in the payment. If a " dividend is declared, the company is entitled to deduct from such " dividend a proportionate part of the amount of tax previously " paid by the company; and in that case the payment by the " company operates in relief of the shareholder." In *Bradbury* v. *English Sewing Cotton Company*, [1923] A.C. 744, at page 766([2]), Lord Wrenbury thus expressed the same idea in concise form : " The corporator bore his share of the tax by the deduction " of the appropriate share of the collective tax paid by the corpora- " tion from his dividend." Lord Phillimore expresses the same view at page 771([3]) : " the shareholder "—in the ordinary case of a taxed company—" is taken to have paid the tax upon his " dividends through the company and is not . . . . taxed upon " them."

These cases, and other similar statements of the principle which I need not quote, were, no doubt, made with reference to Section 54 of the Income Tax Act, 1842, but I do not think that the substitution in the later Act of the word " appropriate " for the word " proportionate " in the earlier Act, affects the principle. In 1842, the modern development of limited companies was not in contemplation; " proportionate " was an apt word for the simple cases of corporators where each year the corporators shared, in definite proportions, the available net income. " Appropriate " tax, which is more precisely defined by the Finance Act of 1927 as being at the standard rate of the year of payment, is clearly a more apt term in connection with the dividends of a company. But the same view has been expressed in regard to Rule 20 of the Act of 1918, for instance, by Lord Sterndale and Lord Warrington in *Sheldrick* v. *South African Breweries Limited*, [1923] 1 K.B. 173.

The Court of Appeal, in deciding against the Appellant, on the ground that the dividend he received was separately taxable in his hands at the standard rate (because charged with Income Tax under Schedule D), found some support for their decision in *Hamilton* v. *Inland Revenue Commissioners*, [1931] 2 K.B. 495([4]) : in that case, the shareholder claimed that he was only liable to be taxed to the extent of a proportionate part—that is, in the proportion that his shareholding bore to the total issued capital of the company—and not on the basis of the tax appropriate to his actual dividend. That contention was rightly rejected both by Mr. Justice Rowlatt and by the Court of Appeal. But the decision did not involve, or require, as I think, any conclusion that dividends were

([1]) 8 T.C. 101 at p. 136. ([2]) 8 T.C. 481 at p. 516.
([3]) *Ibid.* at p. 519. ([4]) 16 T.C. 213.

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separately taxable in the shareholder's hands under Schedule D, nor did Mr. Justice Rowlatt so think, though certain dicta in the Court of Appeal may seem to point that way. I cannot, with respect, go with the Court of Appeal in dismissing the Appellant's appeal on the ground that the dividend, not being a capital distribution, was chargeable with Income Tax under Schedule D. For the reason I have stated, I think that is not in accordance with the provisions of the Acts.

But there still remains to be considered the question whether the company was authorised to deduct tax from the dividend, either under Rule 20 or, now, under Section 7 of the Act of 1931. The answer to that question depends on determining whether the dividend paid to the Appellant was paid out of profits and gains charged to tax. Thus, where a dividend was paid out of profits which were not chargeable to Income Tax, it was held by Mr. Justice Rowlatt in *Gimson* v. *Inland Revenue Commissioners*, [1930] 2 K.B. 246[1], that Super-tax was not payable. Part of the dividend was in respect of profits of a capital nature, part out of profits which were not assessable by reason of the rules of admeasurement. I think the decision was correct as the law then stood, though, as regards the latter class of profits, the case may now need to be considered afresh in the light of Section 7 of the Finance Act, 1931, that is, on the question whether such profits were or were not chargeable. The present case is peculiar in that the moneys out of which the dividend came are taken to be identified as paid out of the sums put aside from the profits of the company, the Salisbury House Estate, Limited, as a reserve pending the decision of their dispute with the Inland Revenue; the dispute was eventually settled by the decision of this House in *Fry* v. *Salisbury House Estate, Limited*, [1930] A.C. 432[2], which went in favour of the company. The company's main business, being that of letting premises, which were its property, for use as flats, was assessed under Schedule A, that is, the property tax. The rents or profits amounted to a sum largely in excess of the assessment, but it was held that the excess beyond the amount of the Schedule A assessment could not be the subject of a separate and further assessment under Schedule D. The sum put to reserve by the company was therefore free, and out of that sum the dividend in question was thereupon paid. It was contended, on behalf of the Appellant, that this sum, segregated in this way, was not taxable at all and, hence, neither Rule 20 nor Section 7 applied. Only so much, it was contended, was charged to tax as corresponded to actual figures of assessment, so that the Schedule A assessment exhausted the taxable capacity of the company's income from the flats and, hence, the surplus fund, out of which the dividend was paid, was not charged to tax. But the reasoning of this House, in the case just

(1) 15 T.C. 595. (2) 15 T.C. 266.

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cited, seems to me to show that the income or profits from the rents, whatever their amount, were exhaustively dealt with in their taxable capacity by the Schedule A assessment, so that no part of that income could be described as untaxed. The actual attempt to split up the fund into the amount taxed under Schedule A and the balance remaining beyond that amount was, in my opinion, a purely artificial segregation; the fund in truth was, I think, a single fund of profits which was assessed and charged as a whole and once for all under Schedule A. I think this is clear from the reasoning of the noble and learned Lords. Thus, if I may quote a few brief excerpts, Lord Dunedin says, at page 440([1]) : "The rents, having "been assessed under Schedule A, are, so to speak, exhausted as a "source of income." Lord Atkin says, at page 458([2]), that even if the company "trade in letting houses, their income, so far as it "is derived from that part of their trading, must be taxed under "Schedule A and not Schedule D." Lord Macmillan says, at page 467([3]) : "Property in land . . . . is dealt with, and can only "be dealt with under Schedule A, and the rules of that "Schedule prescribe how the income from landed property "is to be ascertained and measured. If the measure is "an imperfect one and when applied does not ascertain "the actual income derived from the property so much "the worse for the revenue." In my judgment, the dividend in question was paid out of the income, or profits and gains, from the company's property, which were taxed as a whole, and comprehensively, under Schedule A, irrespective of any subsequent dissection, and was accordingly paid out of profits and gains charged to tax.

The Court of Appeal, in deciding that the segregated portion of the rents, out of which the dividend in question was paid, had not been charged to tax, placed some reliance on the case of the *Attorney-General* v. *The Metropolitan Water Board*, [1928] 1 K.B. 833([4]), where large sums of interest were paid out of the actual profits of the year, but, owing to the Rules applicable, the profits were not assessable in that year because, in the preceding year, there had been no profits and hence the assessment in the year in which the payments were made was nil. That case was regarded by the Court of Appeal as involving a principle applicable to the facts of the present case—that the profits and gains charged to tax were limited to the sum taken to measure the liability for the charge. That case did not relate to dividends payable to shareholders, but to annual payments to creditors of the company: to such a case, not Rule 20, but Rules 19 and 21, apply. I desire to express no view in regard to that case; I do not regard it as relevant here. Furthermore, in the present case, there is no ques-

([1]) 15 T.C. at p. 308. ([2]) *Ibid.* at p. 321.
([3]) *Ibid.* at p. 328. ([4]) 13 T.C. 294.

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tion of a nil assessment: for the reasons I have attempted to summarise above, I think that there has been a full assessment of, and charge on, the profits and gains out of which the dividend was paid. On that view of the position, the dividend here in question was a dividend from which the deduction of tax was authorised, so that whether tax were deducted or not, the dividend must be brought into account by the Appellant in the return of his total income and, accordingly, becomes liable to Sur-tax. On this ground, the appeal should, in my opinion, fail.

I now turn to the cross-appeal of the Crown. The cheque, or warrant, originally sent to the Appellant was for £4,275, with a statement that it represented a gross amount of £5,343 15*s.* 0*d.*; this was later corrected by a statement that £4,275 represented a distribution of untaxed income and was an " actual " sum. It was, in fact, the Appellant's proportionate part of the total fund held in reserve as representing the amount of rents in excess of the Schedule A assessment. The Court of Appeal having held, as I have already stated, that the dividend of £4,275 was liable to Income Tax under Schedule D, and also held that the sum out of which it was paid was not charged to tax, went on to dismiss the cross-appeal on the ground that there could not be a charge of Sur-tax unless on sums liable to be charged to Income Tax and, hence, that £4,275 was all that the Revenue could bring into charge for Sur-tax. I have already explained why I cannot agree with this view and must go on to consider the question on the basis that £4,275 was paid out of a fund charged to tax. The claim of the Revenue in the cross-appeal is, no doubt, anomalous, because, if what was being distributed was, in fact, the whole balance of the rents in excess of the Schedule A assessment, the contention that the dividend is to be taken at the gross amount of £5,343 15*s.* 0*d.* means that so much more is taken to come out of the fund than was ever in the fund. It is, however, contended on behalf of the Respondents that, under Section 7 (2) of the Act of 1931, the dividend of £4,275, being paid out of profits such as are mentioned in Sub-section (1), must be deemed to represent the gross amount which results from adding the appropriate tax to £4,275, *viz.*, £5,343 15*s.* 0*d.* This result, it is argued, follows because the Sub-section has fixed a purely arbitrary and conventional standard. The company paying the dividend is not bound, but only authorised, to deduct tax—that is a matter between it and the shareholder—the Revenue is not concerned so long as it gets the tax from the company; but, the Revenue being further concerned, in regard to Sur-tax, with the position of the shareholder, the Act has provided that the shareholder, though he is not assessed to Income Tax on the dividend, is " deemed " to have paid it, because whatever actual sum he receives by way of dividend is " deemed " to have been reduced to its actual figure by deduction of the appropriate

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tax and, hence, it was contended, the returns of total income are to be taken at the higher or gross figure. This would, no doubt, redound to the benefit of the taxpayer in cases where he is entitled to claim an allowance or deduction, but, in such a case as the present, where Sur-tax is involved, it would be very beneficial to the Revenue.

Such was the argument. It is an argument which would involve, in this case, a purely fictitious figure; the Sur-tax would be levied on a figure of £5,343 15*s*. 0*d*., whereas the gross, or total, sum which the Appellant could receive as his share out of the whole fund of the profits which were being divided could be not more than £4,275. Yet, however anomalous the claim, it must receive effect if the actual language of the Section so requires. But I think the claim of the Respondents fails because it ignores the word " net " in Sub-section (2). That word involves the idea of deduction, which in this case must be a deduction of tax. Thus in Section 33 of the Finance Act, 1924, " the net amount " actually paid " is the amount arrived at by the deduction from the gross amount of the appropriate tax. In *Hamilton's* case (*supra*)(1), the very careful statement by the Commissioners speaks of " the almost universal practice to deduct from the " gross amount of the dividend the tax appropriate to that " amount, or, if the dividend is declared to be ' free of tax ', " to treat it, for the purposes of computing total income, as " equivalent to the gross amount which, after deduction of the " appropriate tax, corresponds to the net amount actually paid, " without any reference to the amount of the company's " ' statutory ' income." But the present case has proceeded on the basis of a specially segregated fund, the whole of which was distributed without any deduction for tax, nor was the dividend, in fact, nor could it be, described as " tax free ", a phrase which is used to indicate that the dividend is net and under prior deduction of tax. Such a case as the present is unusual, because a fund has been segregated and divided *in toto*; hence, if the company had deducted tax, it would have been from a gross amount, not of £5,343 15*s*. 0*d*., but of £4,275, and equally, if the dividend had been " tax free ", it would have been a dividend of the net amount after the appropriate deduction of tax had been made from the sum of £4,275. Furthermore, in the company's hands, no greater sum in respect of this fund was chargeable to Income Tax than £18,325, of which £4,275 was the Appellant's *aliquot* proportion. What was distributed—being £4,275—was, in my judgment, the gross amount; the company, though authorised to deduct tax from it, was not bound to deduct it and did not in fact do so. I cannot see any justification for describing the sum distributed as a " net

(1) 16 T.C. at p. 219.

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" amount " and, hence, I conclude that Section 7 (2) does not apply. I cannot treat the word " net " as mere surplusage or as simply meaning the actual amount, whether gross or net.

For these reasons, I think that both the appeal and cross-appeal should be dismissed.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and this appeal be dismissed with costs.

The Contents have it.

That the cross-appeal be dismissed with costs.

The Contents have it.

[Solicitors:—Holmes, Son and Pott; Solicitor of Inland Revenue.]