NO. 967—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—21ST MARCH, 1934

COURT OF APPEAL—28TH AND 29TH JUNE AND 2ND JULY, 1934

HOUSE OF LORDS—12TH, 14TH AND 20TH MARCH AND 7TH MAY, 1935

DUKE OF WESTMINSTER *v.* COMMISSIONERS OF INLAND REVENUE[1]

Sur-tax—Deductions—Annual payments to employees covenanted to be made by deeds—Substance of transaction.

The Appellant, by a number of deeds, covenanted to make payments to persons who, when the deeds were executed, were, and in most cases continued throughout the material period to be, in his employment. The deeds were not all in the same form but (with one exception) were substantially similar. In a typical case, it was recited that the Appellant desired to make provision for the employee in recognition of past services, notwithstanding that he might re-engage or continue in the Appellant's service, in which event he would become entitled to remuneration in respect of such future service; and the Appellant covenanted, in consideration of the employee's past services, to pay to the employee during their joint lives, or for a period of seven years, a certain weekly sum. It was explained to the employee by letter that the deed did not prevent him from being entitled to, and claiming, full remuneration for such future work as he might perform for the Appellant, but that he was expected to be content with the provision made for him by the deed, with the addition of such sum, if any, as might be necessary to bring the total periodical payments while he was still in the Appellant's service up to the amount of the salary or wages which he had lately been receiving. The employee acknowledged the letter and accepted the arrangement.

In one case the deed of covenant provided for the payment, in consideration of past services, to an employee or to his personal representatives of a yearly sum for a specified period. No letter of explanation was written to the employee in that case.

It was admitted that all the covenantees were, in fact, getting under their deeds of covenant (with or without other moneys) the amounts which they would respectively have received as wages or salaries if they lived during the period and continued in their employment and that, if they ceased to work, the payments must still be made.

It was admitted by the Crown that payments made to an employee who, prior to the execution of the deed or during its operation, ceased to be in the Appellant's employment, were, in respect of the period after retirement, proper deductions in the computation of the Appellant's Sur-tax income.

(1) Reported (K.B. & C.A.) 151 L.T. 489; (H.L.) 51 T.L.R. 467.

Held (*Lord Atkin dissenting, except as regards one employee*), *that the payments made by the Appellant to his employees under the deeds could not be said to be payments of salary or wages but were annual payments from which Income Tax was deductible, and they were accordingly admissible deductions in computing the Appellant's income for Sur-tax purposes.*

CASE

Stated under the Finance Act, 1927, Section 42 (7) (*d*), 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 meetings of the Commissioners for the Special Purposes of the Income Tax Acts held on the 3rd day of November, 1932, and the 3rd day of April, 1933, His Grace the Duke of Westminster, hereinafter called " the Appellant ", appealed against assessments to Sur-tax made upon him for the three years 1929–30, 1930–31 and 1931–32.

2. The question for the decision of the Court is whether certain payments, or any of them, made by the Appellant under various deeds of covenant constitute annual payments which are admissible as deductions in arriving at his liability for Sur-tax for the years under appeal.

3. The deeds referred to in the foregoing paragraph are not all in precisely the same terms but they are all deeds under which the Appellant covenanted to make payments to persons who in fact were when the deeds were respectively executed, and in most cases remained throughout the material period, in his employ. Apart from the deeds of covenant executed in favour of Mr. Detmar Jellings Blow, hereafter referred to in paragraph 8 of this Case, each of the deeds referred to above was in one or other of six forms. Copies are attached and form part of this Case(1).

4. Copies of letters of explanation and forms of acknowledgment which were sent to the covenantees with the exception of Mr. Blow are attached to and form part of this Case(2).

5. The case of Frank Allman, Gardener, is here set forth as a case typical of the cases covered by the before mentioned six forms of deed. Deed of Covenant made the 14th day of August, 1930, between the Appellant and Frank Allman, Gardener, recites that in recognition of services faithfully rendered to the Appellant for over 27 years past the Appellant desires to make provision for Allman notwithstanding that he may re-engage or continue in

(1) Copies of the deeds relating to D. J. Blow and F. Allman only are included in the present print.

(2) Copies of the letter of explanation and form of acknowledgment relating to F. Allman only are included in the present print.

the Appellant's service in which event he will become entitled to remuneration in respect of such future service. In consideration of Allman's past services the Appellant covenants to pay Allman during the joint lives of himself and Allman or for a period of seven years the weekly sum of £1 18*s*. 0*d*.

6. It was admitted that all the covenantees were in fact getting under their deeds of covenant (with or without other moneys) the amounts which they would respectively have received as wages or salary if they lived during the period and continued in their employment and that if they ceased to work the payments secured by the deed must still be made. It was also admitted on behalf of the Respondents that in the case of an employee of the Appellant who ceased to be in that employment at the date of the deed applicable to his case the payments made under that deed by the Appellant were proper deductions in computation of his Sur-tax income and that such payments made to any employee who though in the Appellant's employment at the before mentioned date ceased to be in that employment during the period covered by the deed were also—in respect of the period after retirement of the employee—proper deductions in computation of the Appellant's Sur-tax income. This case accordingly concerns only the payments made by the Appellant in respect of periods during which the covenantees were in the Appellant's service. No question of figures arises.

In some cases in which like deeds or substantially similar deeds were entered into the covenantees had retired and were still being paid under the deeds.

7. Except in the case of Mr. Blow the letters of explanation referred to in paragraph 4 were sent to the employees informing each of them before he signed the deed that there was nothing therein to prevent him from being entitled to and claiming full remuneration for such future work as he might do for the Appellant but stating that it was expected that in practice he would be content with the provision which was being legally made by the deed with the addition of such sum (if any) as might be necessary to bring the total periodical payments while he was still in the Appellant's service up to the amount of the salary or wages which he had lately been receiving. The letter asked in each case for an acknowledgment from the employee if he was satisfied to accept the provision made for him by the deed.

8. The case of Mr. Detmar Jellings Blow is different in its facts from the other cases. Mr. Blow was at the date of each of the undermentioned deeds and continued during the relative years to be in the Appellant's service. By Deed of Covenant dated the 2nd day of August, 1927, the Appellant in consideration of the past services of Mr. Blow covenanted to pay him or in the event of his death to his personal representatives and assigns for ten years from the date thereof a yearly sum of £2,000.

A new Deed of Covenant dated the 5th day of August, 1931(1), substitutes a period of twenty years from the 5th day of August, 1931, for the period of ten years covered by the former deed. No letter was written to or acknowledgment required from Mr. Blow in connection with either of the Deeds referred to in this paragraph.

9. It was contended on behalf of the Appellant :—

(1) that all the payments made under the before mentioned deeds so far as such payments were not already allowed or admitted as deductions should be allowed as deductions from the Appellant's income in arriving at his liability for Sur-tax for the years under appeal;

(2) that the assessments were severally excessive in amount.

10. It was contended on behalf of the Respondents that except as regards payments to covenantees who had left the Appellant's service all payments under the deeds with employees were (in effect) payments for services to be rendered to the Appellant and were not allowable as deductions from his income.

11. We, the Commissioners who heard the appeal, held that, in construing the true effect and substance of the deeds under which payments are made to the Appellant's employees, we were entitled to consider together with these deeds the letters of explanation and form of acknowledgment which were sent to the covenantees. These letters, like the deeds themselves, were not in one stereotyped form, but were sufficiently to the same effect to enable us to arrive at a decision in respect of them all. We held that the payments made under these deeds to persons who remain in the Appellant's employ were, in substance, payments for continuing service *ejusdem generis* with wages or salaries so long as the recipients in fact remain in the Appellant's service and as such were not annual payments which were a proper deduction from his assessment to Sur-tax.

We further held that the new deed of covenant with Mr. Blow did not alter the facts and that the payment to him must fall under the principle of the above decision so long as Mr. Blow remained in the Appellant's service.

12. The Appellant immediately upon the determination of the appeal by his Counsel declared to us his dissatisfaction with such determination as being erroneous in point of law and he 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) (*d*), and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

MARK STURGIS, } Commissioners for the Special
N. ANDERSON, } Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
2nd January, 1934.

(1) Not an exhibit to the Case.

EXHIBITS

Stamp £25

This Deed of Covenant is made the second day of August One thousand nine hundred and twenty seven between The Most Noble Hugh Richard Arthur Duke of Westminster D.S.O. (hereinafter called " the Covenantor ") of the one part and Detmar Jellings Blow of No. 3 Carlos Place, W.1. in the County of London F.R.I.B.A. (hereinafter called " Mr. Blow ") of the other part.

Whereas the Covenantor in consideration of the past services of Mr. Blow and from motives of concern for his interest is desirous of securing to him and his legal representatives an annual payment of Two Thousand Pounds a year for the period of ten years from the date hereof.

Now this deed witnesses as follows :—

The Covenantor for the consideration aforesaid hereby covenants with Mr. Blow that he the Covenantor and his personal representatives will pay to Mr. Blow or in the event of his death to his personal representatives and assigns for the period of ten years from the date hereof the yearly sum of Two Thousand Pounds to be paid by equal quarterly payments on the usual quarter days the first of such quarterly payments being a full quarterly payment to be made on the twenty ninth day of September next.

In Witness whereof the said parties to these presents have hereunto set their hands and seals the day and year first before written.

Signed Sealed and Delivered by the said Hugh Richard Arthur Duke of Westminster in the presence of : } Westminster (L.S.)

Percy H. Smith,
House Steward,
2, Davies Street, W.1.

Stamp 17/6 & Adjn.Stamp

This Deed of Covenant is made this fourteenth day of August One thousand nine hundred and thirty Between The Most Noble Hugh Richard Arthur Duke of Westminster D.S.O. (hereinafter called " the Duke ") of the one part and Frank Allman of Vine Cottage Aldford near Chester Gardener in the Duke's service (hereinafter called " the Annuitant ") of the other part.

Whereas in recognition of the services which for over twenty seven years past the Annuitant has well and faithfully rendered to the Duke the Duke desires to make provision for the Annuitant in manner hereinafter expressed notwithstanding that the Annuitant may re-engage or continue in the service of the Duke in which event he will become entitled to remuneration in respect of such future service.

Now this deed made in furtherance of the Duke's said desire and in consideration of the past services so rendered as aforesaid witnesses as follows :—

1. The Duke covenants to pay to the Annuitant as from the 2nd day of August One thousand nine hundred and thirty during the joint lives of himself and of the Annuitant or for a period of seven years the weekly sum of One pound eighteen shillings (amounting in each year to the sum of Ninety eight pounds sixteen shillings) the first of such payments having fallen to be made on the 9th day of August 1930.
2. The said payment shall be made from time to time on such days for such periods and in such proportions as shall from time to time be mutually agreed upon by the parties hereto and in default of agreement shall be made in weekly payments on the Saturday of each week.
3. It is hereby expressly agreed that the said payments are without prejudice to such remuneration as the Annuitant will become entitled to in respect of such services (if any) as the Annuitant may hereafter render to the Duke.

In Witness whereof the said parties to these presents have hereunto set their hands and seals the day and year first above written.

Signed Sealed and Delivered by the above named Hugh Richard Arthur Duke of Westminster in the presence of :— } Westminster (L.S.)

St. G. Clowes,
Broadwater,
Framlingham,
Capt. late 19th Hussars.

Signed Sealed and Delivered by the above named Frank Allman in the presence of :— } Frank Allman (L.S.)

F. A. Carlton-Smith,
The Grosvenor Office,
53 Davies Street,
London, W.1,
Solicitor.

Private.

The Grosvenor Office,
53 Davies Street,
Berkeley Square, London, W.1.
13th August, 1930.

To Mr. Frank Allman.

Dear Sir,

On Wednesday the 6th instant we read over with you a Deed of Covenant which the Duke of Westminster has signed in your favour under which you will be entitled to a gross sum of £1 18*s.* 0*d.* a week in consideration of your past faithful service and irrespective of any work which you may do for His Grace after the Deed comes into effect. The Deed will be in force for seven years if you and the Duke should so long live, and His Grace can reconsider the position at the end of that period. We explained that there is nothing in the Deed to prevent your being entitled to and claiming full remuneration for such future work as you may do, though it is expected that in practice you will be content with the provision which is being legally made for you for so long as the Deed takes effect, with the addition of such sum (if any) as may be necessary to bring the total periodical payment while you are still in the Duke's service up to the amount of the salary or wages which you have lately been receiving.

You said that you accepted this arrangement, and you accordingly executed the Deed.

We write, as promised, to confirm the explanation which we gave you on the 6th instant. If you are still quite satisfied we propose to insert the 6th instant as the date of the Deed and we shall be obliged by your signing the acknowledgment at the foot of this letter and then returning it to us.

Yours faithfully,

(*Signed*) Boodle, Hatfield & Co.
Stamp 6*d.*

Acknowledgment.

To The Duke of Westminster, D.S.O.

And to Messrs. Boodle, Hatfield & Co., his Solicitors.

I have read the above written letter, and I confirm that I accept the provision made for me by the Deed. I agree to the Deed being dated and treated as delivered by and binding upon the Duke of Westminster and myself.

(*Signed*) Frank Allman.

The case came before Finlay, *J.*, in the King's Bench Division on the 21st March, 1934, when judgment was given in favour of the Crown, with costs.

Mr. Raymond Needham, K.C., Mr. W. C. Cleveland-Stevens, K.C., and Mr. Cyril L. King appeared as Counsel for the Appellant and the Attorney-General (Sir Thomas Inskip, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Finlay, J.—In this case I do not see my way to differ from the conclusion which has been arrived at by the Special Commissioners. I say that notwithstanding the skilful arguments which have been addressed to me. I am going, in a moment, to state quite shortly the point, but the Commissioners arrived at a conclusion and, of course, in so far as it was a conclusion of fact, it is not for me to deal with it. I can deal with the matter only if and so far as I can say that, on the facts, the Commissioners arrived at an erroneous finding in law.

The case concerns the Super-tax or Sur-tax, as one ought now to call it, income of the Duke of Westminster. He appealed against the assessment to Sur-tax made upon him for three years, and the point in the case was as to whether certain sums paid by the Duke under certain covenants to certain servants of his ought, or ought not, to be treated as a part of his total income for the purposes of assessment.

It is necessary to look a little at the documents, but the general nature of the thing is clear enough. The Duke had in his employment, and I doubt not still has, various old servants, some who have served him both in London and in the country for a great number of years, and he conceived the idea of making a provision for those servants. That provision was made while they were still in his employment, and it was a provision which was to inure for their benefit both while they remained in the Duke's service and later on, when, I suppose, owing to age, and so forth, they retired and ceased to be in his service. What the Special Commissioners have done really is this : they have, so to speak, dissected the payments and have said that, so far as these payments were made to persons actually in His Grace's employment, they must be regarded as in the nature of wages or salaries, and as, therefore, not forming a deduction in computing the Duke's income. On the other hand, the Crown have admitted that, where a sum under these circumstances is covenanted to be paid and is paid to a retired servant of the Duke, to a servant who renders no service to him, then, in that event, the deduction is proper. The question for my consideration is whether I can say that, in arriving at their conclusion, the Special Commissioners have made any error in law.

(Finlay, J.)

There are a number of deeds of covenant—seven—scheduled to the Case and, in all cases excepting one, these deeds of covenant are accompanied by letters defining the position as between the Duke and the person with whom he was entering into the contract. I do not propose to examine in detail all the cases, and it does not matter very much which I take. It was not suggested that there was any special difference really, though there is a specific charge upon some property in some. The language is slightly different, but, in substance, the point appears to me to be the same. In substance, I think the point is the same in the case of the six deeds where there were letters, and, in the case of the seventh, a gentleman named Mr. Detmar Blow, in which there was no letter. I do not see my way to draw any distinction, as indeed the Special Commissioners did not either, between these cases. I propose to take, because it will do as well as any other, the case of Mr. Frank Allman, and to look at the deed in his case and at the letter in his case. The deed is a deed which recites that "in recognition of the services which for over twenty "seven years past the Annuitant has well and faithfully rendered to "the Duke the Duke desires to make provision for the Annuitant in "manner hereinafter expressed notwithstanding that the Annuitant "may re-engage or continue in the service of the Duke in which "event he will become entitled to remuneration in respect of such "future service." Then the deed, in consideration of the past services, witnesses as follows: "The Duke covenants to pay to "the Annuitant as from the 2nd day of August One thousand nine "hundred and thirty during the joint lives of himself and of the "Annuitant or for a period of seven years the weekly sum of "One pound eighteen shillings." Then the third clause is: "It is hereby expressly agreed that the said payments are without "prejudice to such remuneration as the Annuitant will become "entitled to in respect of such services (if any) as the Annuitant "may hereafter render to the Duke." With regard to that, it is not suggested on behalf of the Crown that it is not a genuine covenant. It is not suggested that it is not a covenant upon which Mr. Allman, in the very unlikely event of its becoming necessary, could sue to enforce his rights, and there is no doubt about that. On the other hand, one has got to remember the principle to which my attention was called, which is expressed in the judgment of Lord Justice Lawrence in *Perrin* v. *Dickson*, 14 T.C. 608, at page 626, where the Lord Justice says this: "However that may be, I think that the "cases referred to afford ample authority for the proposition that "the Court will in each case look at the real nature of the transaction, "whatever may be the form in which it is expressed, and will if "the circumstances warrant it dissect a payment, even though it be "called an annuity, so as to prevent so much of it as represents capital "from being charged with Income Tax." The principle, as I understand it, is that one has got, of course guiding oneself by the

(Finlay, J.)

documents and of course remembering that, unless the documents are impeached, which is not the case here, they must be taken as being genuine documents, to look none the less at the substance of the thing.

If the matter rested upon the deed itself, I should have thought that the Duke was entitled to succeed, but it does not rest upon the deed itself, and I cannot help thinking that the real nature of the transaction, to adopt the words of Lord Justice Lawrence, is got at when one looks at the letters. The letter to Mr. Allman—I take his case because it is better to take the same case again—was this: "On Wednesday the 6th instant we read over with you a Deed of "Covenant which the Duke of Westminster has signed in your favour "under which you will be entitled to a gross sum of £1 18*s.* 0*d.* a "week in consideration of your past faithful service and irrespective "of any work which you may do for His Grace after the Deed comes "into effect. The Deed will be in force for seven years if you and the "Duke should so long live, and His Grace can reconsider the position "at the end of that period. We explained that there is nothing in "the Deed to prevent your being entitled to and claiming full "remuneration for such future work as you may do, though it is "expected that in practice you will be content with the provision "which is being legally made for you for so long as the Deed takes "effect, with the addition of such sum (if any) as may be necessary "to bring the total periodical payment while you are still in the "Duke's service up to the amount of the salary or wages which you "have lately been receiving. You said that you accepted this "arrangement, and you accordingly executed the Deed. We write, "as promised, to confirm the explanation which we gave you on "the 6th instant. If you are still quite satisfied we propose to "insert the 6th instant as the date of the Deed and we shall be "obliged by your signing the acknowledgment at the foot of this "letter and then returning it to us." That is signed by the Duke's solicitors. Then the acknowledgment is this: "I have read the "above written letter, and I confirm that I accept the provision "made for me by the Deed. I agree to the Deed being dated "and treated as delivered by and binding upon the Duke of "Westminster and myself." That is signed by Mr. Allman, and the document—my attention was called to it—bears a stamp. When one tries to see what the substance of the transaction is in the light of that, I cannot bring myself to doubt what it was. I do not know what was the figure of wages which this gentleman, Mr. Allman, who was in His Grace's employ, was getting, but I have assumed an imaginary figure of £4, and I may as well stick to it. He is, under covenant, getting 38*s.* now, and he is, if his wages are to be made up, entitled to get £2 2*s.* 0*d.* I cannot doubt that the whole scheme, the whole intention, and it was really carried out, was this, that Mr. Allman should get after, as before, the £4, the imaginary figure I am

(Finlay, J.)

taking, to which he was entitled, and which he was getting for his work. He was to get 38*s.* under covenant, and for that he could sue. His action for it would be different from his action with regard to the rest. He was getting £2 2*s.* 0*d.* by way of wages, and he was getting, and to get, no more. I do not fail to notice the fact—Mr. Cleveland-Stevens very properly drew strong attention to it—that he was told that there was nothing in the deed to prevent his being entitled to, and claiming, full remuneration, but with regard to the other words in the letter, I can only say that I think the words : " you accepted this arrangement, and you accordingly executed the " deed " do mean this, that the person—Mr. Allman, in this case—had assented to the terms and had accordingly precluded himself from claiming any sum beyond the difference between the sum paid to him under covenant and his wages. That seems to be the meaning of the thing. I think that, in the result, this might probably be held to be a legal bar to his recovering more, but be that as it may, the substance of the thing, I am perfectly satisfied, was this, that it was perfectly understood between the Duke and the various servants concerned that they were to get the same wages as before. They were to get part of those wages under covenant in this way, and to get the rest in the ordinary way.

In the course of the case, I put to Counsel the question as to what would be the result if one covenanted in a deed to pay to one's housemaid her wages. I rather understood that Mr. Needham did not shrink from that, and said : " Oh well, it would be a deed and " you would be entitled to deduct it"; but Mr. Cleveland-Stevens, I think, took rather a different view. He said : " No, if you consider " it is wages, then, no doubt, it would not be deductible." I cannot doubt that the view which I understood Mr. Cleveland-Stevens to accept with regard to that was right. It seems to me to be clear that in such a case one would be entitled to say : " Well, no doubt, " there is a covenant, no doubt there is a legal obligation, but when " one looks at the substance of this, one can see that it is simply " paid to the housemaid in respect of the services she is going to " render." So here I think that, as long as these servants remain in the Duke's employment, this is going to be paid as part remuneration for the services they render. That is the meaning of the cutting down of the wages, so as to prevent their getting more than they were getting before. After they leave the Duke's employ or after they retire, the matter becomes quite different, because then the payment is not a payment in respect of services rendered. It is then a payment wholly and exclusively as a recognition by the Duke of long service now over. What the Special Commissioners have done, as I said at the beginning, is to dissect the matter in that way and to hold, as they have held, that the payments under the deeds to persons who remain in the Appellant's employ were, in substance, payments for continuing service *ejusdem generis* with

(Finlay, J.)

wages or salary, so long as the recipients in fact remain in the Appellant's service. *Ejusdem generis* means of the same kind, and I think that, looking, not at the form, but at the substance, of the thing, this must be regarded, in the case of the servants remaining in His Grace's employ, as wages. That is the conclusion to which the Special Commissioners came and I do not for these reasons see my way to disturb it.

The result is that this appeal must be dismissed.

Mr. Hills.—Dismissed with costs, my Lord ?

Finlay, J.—Yes, dismissed with costs.

An appeal having been entered 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 28th and 29th June and the 2nd July, 1934, and on the last named date judgment was given unanimously against the Crown, with costs, reversing the decision of the Court below.

Mr. Wilfrid Greene, K.C., Mr. Raymond Needham, K.C., Mr. W. C. Cleveland-Stevens, K.C., and Mr. Cyril L. King appeared as Counsel for the Appellant and the Attorney-General (Sir Thomas Inskip, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Hanworth, M.R.—This appeal involves some very interesting questions that we have had well presented to us, and we have come to the conclusion that the appeal must be allowed. It arises upon somewhat special circumstances. The Appellant has appealed against assessments to Sur-tax made upon him for the three years 1929–30, 1930–31 and 1931–32. The first point of the appeal is this. He has raised a question for the decision, first of the Commissioners, then of the Court below and of this Court as to whether certain payments, or any of them, made by him under various deeds of covenant constitute annual payments which are admissible as deductions in arriving at his liability for Sur-tax for the years under appeal.

The deeds under which these payments are made are set out in the appendix to the Case. They are individual deeds. The first one is a deed under which there is a covenant by the Appellant to pay Mr. Frank Allman a sum of £1 18*s.* 0*d.* weekly during the joint lives of himself and the annuitant or for a period of seven years. The recital to the deed recognises that Mr. Frank Allman has rendered services to the Appellant for twenty-seven years past. The only

(Lord Hanworth, M.R.)

other term of the deed to which I need refer is the express agreement that these payments, which are made for these services rendered, are to be without prejudice to such remuneration as the annuitant will become entitled to in respect of such services (if any) as the annuitant may hereafter render to the Duke. The second deed was entered into with Mr. Barnes in recognition of services for over thirty-eight years past, and the deed is in substantially the same form. The next deed is a deed with Mr. George Arthur Codd in recognition of services which for over forty-five years had been rendered by him, and it is noticeable that, in some of these deeds—I take, for instance, this last one of Mr. Codd—the covenant is actually charged upon certain estates which are part of the Grosvenor settled estates and which are contingently charged with these periodical payments under the covenant from the period, if that event should arise, of the Duke's death. Then with regard to Mr. Mack there are services of four years ; in the case of Mr. Ernest Joseph Thomas recognition of services for forty years ; in the case of Mr. Mercer the period of service is not mentioned, but in a letter which accompanied it the services are recorded as "long and faithful service". Lastly, there is the case of Mr. Blow, with whom a covenant was made to pay him a sum of £2,000 a year for the period of ten years from the date thereof, he being an architect, apparently, who had been and was in the employ of or had rendered services to the Appellant.

At the time when these deeds were entered into there was written in almost all the cases—not quite all—a letter ; the letter, for instance, in the case of the first one, Mr. Allman, is to this effect. The solicitors, acting for the Appellant, say : "There is nothing "in the Deed to prevent your being entitled to and claiming full "remuneration for such future work as you may do, though it is "expected that in practice you will be content with the provision "which is being legally made for you for so long as the Deed takes "effect, with the addition of such sum (if any) as may be necessary "to bring the total periodical payment while you are still in the "Duke's service up to the amount of the salary or wages which you "have lately been receiving. You said that you accepted this "arrangement, and you accordingly executed the Deed. We write, "as promised, to confirm the explanation which we gave you on the "6th instant. If you are still quite satisfied we propose to insert the "6th instant as the date of the Deed", and then they would deliver what up to that time had been an escrow as a deed and covenant between the parties.

Certain definite considerations arise and must be stated upon these deeds. It is not suggested that they are all part of a device or stratagem improperly entered into for the purpose of defeating a proper charge under the Income Tax Acts. Their genuine nature is not impugned. It is not suggested in terms that they are incorrect.

(Lord Hanworth, M.R.)

These several persons with whom they are entered into were persons who had over these varying periods of years rendered services to the Appellant. They were therefore persons in ordinary course who were entitled to his consideration and his bounty. In the case of the last one, Mr. Blow, there was no letter, but he stands apart as a person of standing and position to whom the Appellant might desire to give, as is stated, from motives of concern for his interest, a permanent sum which might inure to good work, perhaps better work being done in the future than in the past, but there is no reason to suppose that there is anything else than a definite and binding deed of covenant in this case also.

That being so, let us consider the matter from one or two points of view. Supposing no further services were ever rendered by any of these persons to the Appellant, it is not contested that the covenants would stand good, that these payments would be made as ordinary payments or annuities and that, in respect of such payments, it would be perfectly right for the Appellant to make a deduction in arriving at his Sur-tax liability. That right would arise because they would be payments which fall within Rule 19 of the well-known Rules to All Schedules of the Income Tax Act, 1918.

If criticism must be directed to the deeds it is not a criticism directed to them so much individually as directed to them as a whole, as what may be called a system, and it is suggested that, having regard to the terms of the letters, the covenants must be taken to mean remuneration during such time as in fact the covenantees were actually rendering further services to the Appellant. Their purpose during that limited period was that they secured, in part, the wages that would be paid to those covenantees in respect of their services *pro tanto* and that beyond the sums so payable under the covenants there would be paid greater or less sums weekly which would bring up the payments to the wages which up to that time they had been earning for their services rendered in what I might call uncovenanted service of the Appellant.

I have some difficulty in seeing that it is legitimate to examine the deeds and the whole transaction from that point of view. On questions of fact we are bound by the finding of the Commissioners, if there is evidence on which that finding could be based. The Commissioners say this: "We . . . held that, in construing the true effect and "substance of the deeds under which payments are made to the "Appellant's employees, we were entitled to consider together with "these deeds the letters of explanation and form of acknowledgment "which were sent to the Covenantees. These letters, like the deeds "themselves, were not in one stereotyped form, but were sufficiently "to the same effect to enable us to arrive at a decision in respect of "them all. We held that the payments made under these deeds "to persons who remain in the Appellant's employ were, in substance, "payments for continuing service *ejusdem generis* with wages or

(Lord Hanworth, M.R.)

" salaries so long as the recipients in fact remain in the Appellant's " service and as such were not annual payments which were a proper " deduction from his assessment to Sur-tax."

I find it a little difficult to understand that holding and to appreciate on what grounds it is founded. The Commissioners seem to say that, if there were no services being rendered, if all these persons were pensioners, then their deeds of covenant would stand good, these payments would be proper deductions, General Rule 19 would apply, but that, during the time that the covenantees or any of them do remain in the service and receive other remuneration beyond the amount which is payable under the covenant, then during such time the covenants take on, chameleon-like, a different nature and colour and are to be looked at as, during that time, a mere device or stratagem, something which makes them inoperative and of no effect during that time. I find it impossible to accept that view. If the covenants are held to be, as I think the Commissioners hold they are, genuine covenants sincerely entered into and definitely effective for such time—it may be at recurrent periods—during which the covenantees are rendering no service and are earning no money, it appears to me that, unless the whole transaction is set aside, both as to the past and as to the future and as to the present, during any earning period, the covenants must stand for what they are and as effective.

It is perhaps hardly necessary, but it may be useful just for a moment to look at what is suggested by the Crown. By Section 18 of the Finance Act, 1922, profits or gains arising from an employment were thrown into Schedule E, subject to this, that there was carried into that Schedule Rule 2 of the Rules applicable to Cases I and II of Schedule D. That Rule is only a Rule that in respect of wage earners the tax should be exigible at the half-year instead of the whole year. Therefore we have now statutory authority that profits or gains arising from employment are to be chargeable under Schedule E. I turn back, therefore, to Schedule E and look at what is taxed there. It is this: " Tax " under this Schedule shall be annually charged on every person " having or exercising an office or employment . . . in respect of " all salaries, fees, wages, perquisites or profits whatsoever there- " from "; that is to say, there is a direct assessment upon the person who is exercising or enjoying the employment of profit. I think it is right to say that the effect is to exclude the right of deduction under General Rule 19. That Rule does not apply because it is directed to the cases where there is an annuity or annual sum paid wholly out of profits or gains brought into charge and where, correspondingly, the liability to assessment lies not upon the recipient, but is imposed upon the payer of the money or the annuity, and that person, the payer of the annuity or sum of money, is entitled to make the deduction and, equally, the recipient is bound to allow the

(Lord Hanworth, M.R.)

deduction. It will be noticed that there would be much difficulty if that right of deduction and non-assessment of the recipient were to apply to a case where, under Rule 1 of Schedule E, there is a direct charge laid upon the person who enjoys the profits from the employment.

I do not think it is necessary to refer to many cases, but it is important to remember a root distinction in the assessment under Schedule E and Schedule D which was pointed out by Lord Justice Scrutton, as he now is, in the case of *Lord Howe*. That case is to be found in 7 T.C. 289 and I refer to the passage in his judgment at page 303: "It is not all payments made every year from which Income Tax "can be deducted. For instance, if a man agrees to pay a motor "garage £500 a year for five years for the hire and upkeep of a car, "no one suggests the person paying can deduct Income Tax from "each yearly payment. So if he contracted with a butcher for an "annual sum to supply all his meat for a year, the annual instalment "would not be subject to tax as a whole in the hands of the payee, "but only that part of it which was profits." He is pointing out there the necessary distinction between a sum which is transferred from one person to another under a liability which exists upon the payer towards the recipient and the case in which the outlay is made by the person who is the payer as an outlay of his own income at his own volition. The man who buys meat from the butcher is making an outlay from his own income and such profits as are earned ultimately by the butcher are returned by the butcher in his return made under Schedule D. It cannot be said that a man who is making an outlay from his own income at his own volition is making a yearly payment within Rule 19. He is, in fact, disposing of his own income at his own will for his own purposes.

Again, the same point was made, and clearly made, by Lord Justice Scrutton in the case of *Rossdale* v. *Fryer*, [1922] 2 K.B. 303. He says, at the bottom of page 312: "If you are paying a garage "proprietor so much a year for letting you a car for four or five years, "you cannot deduct from every payment that you make to the "garage proprietor Income Tax on that payment. I do not desire "to repeat (because having considered it again I think it is accurate) "the view that I took in *Earl Howe* v. *Inland Revenue Commis-"sioners*(1), which was to this effect, that if the sum from which you "are deducting is properly taxable as part of the profits of the "recipient you can deduct; if it is not so taxable you cannot deduct, "but the amount must be treated as final. If I am right in the view "that I expressed", and so on.

It appears to me that the only way in which you can reach the conclusion adopted by the Commissioners is by throwing aside the deeds, and I see great difficulty in throwing them aside temporarily

(1) 7 T.C. 289.

(Lord Hanworth, M.R.)

during the time when services are rendered to the Appellant, and recognising them as valid and subsisting during all other times, whether present or future. It seems to me that, unless you are able to tear down these deeds as a cloak to shield a wholly different arrangement, you must accept them and, when you have accepted them, you have got a case in which the covenantor has bound himself to make these annual payments to the covenantee, and the covenantee, being the recipient, is bound, under the later part of Rule 19, to allow the deduction in the payment which he accepts and receives from the covenantor.

For these reasons I find myself unable to agree with the view expressed by Mr. Justice Finlay. Mr. Justice Finlay says this(1): "So here I think that, as long as these servants remain in the Duke's "employment, this is going to be paid as part remuneration for the "services they render. That is the meaning of the cutting down of "the wages, so as to prevent their getting more than they were "getting before. After they leave the Duke's employ or after they "retire, the matter becomes quite different, because then the pay-"ment is not a payment in respect of services rendered. It is then "a payment wholly and exclusively as a recognition by the Duke of "long service now over." It is because I find myself unable to take that alternating view of these covenants that I find myself regrettably unable to accept the confirmation by Mr. Justice Finlay of the views of the Commissioners, and I feel bound to give effect to the covenants which, as I say, were entered into under circumstances which no one has contended were otherwise than deservedly meeting the cases of the men who had rendered service of value and over a long period of time to the Appellant.

For these reasons, the appeal must be allowed, with costs here and below, and the direction must be made that in these assessments the right quantum for the deduction of these payments is to be allowed.

Slesser, L.J.—I agree. In this case the Duke of Westminster appeals against certain assessments made upon him in the years 1929–30, 1930–31 and 1931–32, in respect of that part of his Sur-tax income which is arrived at by including sums which he has paid to persons who are, or have been, in his employment in the manner stated in the Case. The question which has to be considered is this. If those sums so paid were paid under the provisions of Rule 19 of the General Rules of the Act of 1918, that is to say, sums of money paid by virtue of a deed, then there is a right under that Rule, upon the Duke so paying those sums, to deduct tax from the persons who would ultimately receive them; such sums are not to be included, for the purpose of computing his liability to Sur-tax, as part of his total income. If, on the other hand, these sums so paid are wages, then they are to be directly assessed upon the persons

(1) *See* page 500 *ante*.

(Slesser, L.J.)

receiving them and do form part of the Duke's total income for the purposes of Sur-tax. So that what has to be considered in this case is whether, in the circumstances of the case, these sums are or are not to be regarded as wages so as to fall within the provisions of Schedule E and not within the provisions of Rule 19 of the General Rules.

The learned Judge has come to this conclusion, to quote his language[1]: "Looking, not at the form, but at the substance, of the "thing, this must be regarded, in the case of the servants remaining "in His Grace's employ, as wages." I find myself unable to come to that conclusion. I think that there is a certain danger in using the word "substance" loosely. As Mr. Greene has pointed out, and as is indicated in the case of *Scoble*[2], and in the case of *Perrin* v. *Dickson* [3] and other cases, the real nature of the transaction must be looked at, and, as the Lord Chancellor in particular points out in *Scoble* v. *Secretary of State for India*[4], you may analyse the nature of the transaction and that nature may include the situation of the payer and the payee and all the surrounding circumstances, but yet, as Mr. Greene has pointed out, when you have looked at the whole of the substance, you are still to look at it from the point of view of the law and see what the effect is as a legal relation. If this present case be looked at from that point of view, including not merely these deeds but these letters and the whole of the transaction, I think it is clear that these moneys must be held, bearing in mind all the provisions of these letters as well as of the deeds, to have been paid under the deeds and in no other way.

The deeds themselves provide, in terms, that the payment shall be made without prejudice to such remuneration as the annuitant will become entitled to in respect of such service, if any, as the annuitant may render to the Duke. That is in clause 3. The preamble provides that: "The Duke desires to make provision "for the Annuitant in manner hereinafter expressed notwithstanding "that the Annuitant may re-engage or continue in the service of the "Duke in which event he will become entitled to remuneration in "respect of such future service." It is interesting to note that, in this case, in the case of those persons who are not to remain in the service of the Duke, it is conceded by the Crown that their payments are made under the deed and are properly the subject of Rule 19. If, therefore, the deed stood alone, it could hardly be argued, and indeed it is not argued, that, by itself, the deed would do anything but provide for payments under the deed within the meaning of Rule 19 of the General Rules. Then it is said that, by virtue of the fact that the deed was at one time an escrow and had not been delivered and that certain letters were written between the recipient of the Duke's benevolence and the Duke's agents, and that the deed was delivered under conditions of those letters, that has made a

(1) *See* page 501 *ante*. (2) 4 T.C. 618. (3) 14 T.C. 608.
(4) 4 T.C., at pp. 624/5.

(Slesser, L.J.)

difference. It may be that there might be circumstances in which the manner of tender and the acceptance of an escrow might make a difference, looking at the whole of the transaction, but, so looking at the nature of this transaction, I think that, at the highest, with these letters and these conditions, it can only be said of them that they may conceivably modify in some way the right to wages which a person in the employment or the service of the Duke may have after he has taken the benefit of the deed, but cannot, on any construction, affect his legal rights under the deed itself.

If we look, for example, at the letters, beginning with the one on the 13th August, 1930, which is written by Messrs. Boodle, Hatfield & Co., on behalf of the Duke and addressed to one of the servants, Mr. Allman—I take that as one case—it points out that they had read over to him a deed of covenant which the Duke has signed: "under which you will be entitled to a gross sum of £1 18*s.* 0*d.* a week "in consideration of your past faithful service and irrespective of "any work which you may do for His Grace after the Deed comes "into effect." In itself, that is a plain declaration that he is entitled to the £1 18*s.* 0*d.* a week irrespective of any work; that is to say, that the work which he may do for His Grace will not affect his right one way or the other. Then the letter says: "The Deed will be in "force for seven years if you and the Duke should so long live, and "His Grace can reconsider the position at the end of that period. "We explained that there is nothing in the Deed to prevent your "being entitled to and claiming full remuneration for such future "work as you may do"—that is perfectly true; the deed does, in terms, so provide—"though it is expected that in practice you will "be content with the provision which is being legally made for you "for so long as the Deed takes effect, with the addition of such sum "(if any) as may be necessary to bring the total periodical payment "while you are still in the Duke's service up to the amount "of the salary or wages which you have lately been receiving." I read that to mean that, having received under the deed a certain sum and being given a legal right to it, you will be content with that sum; in other words, that you will not make a demand for wages, which you might otherwise have made, in addition to the sum which you are entitled to under the deed. As I say, if Mr. Allman works on that agreement, which I may say he accepts in an acknowledgment, he accepts the provision made for him by the deed—it is to be observed that he does not in terms accept the qualification, but I assume he does; I assume all that—I am not prepared to say whether, if Mr. Allman at some future date, having got under the deed the full amount which he had always received in wages, were to sue the Duke for additional wages, or rather, I will not say for additional wages, but for wages in addition to the sum given him under the deed, he might or might not be met with the defence that, by accepting the deed on those conditions, he had impliedly waived any claim to

(Slesser, L.J.)

wages which amounted to more than the sum which he was already receiving under the deed. To my mind, in the present case, the problem is irrelevant. The question we have to consider is whether the sums which are being paid him are being paid under the deed, and whether he has or has not given up the right to claim wages in addition to the sums under the deed does not matter, because the sum here sought to be assessed to Sur-tax is, in my view, the sum paid under the deed, and we are not here considering whether he has or has not a right to wages beyond that.

Therefore, in my view, I do not decide this case on the ground that one is not entitled to look at the whole of the transaction. Indeed, I do look at the whole of the transaction and I look at the whole substance of the transaction and I consider these letters and I say that the effect of these letters, read with the deed, at most is an agreement modifying the right to wages which he might otherwise claim as well as the sum of money which he is entitled to under the deed, but that they do not and cannot indicate any intention on the part of the parties to waive any rights which obtain under the deeds themselves, and, since these moneys were paid under the deeds themselves and no question arises whatever of their being paid as wages, therefore, I say, looking at the substance of the whole matter, I think the case is entirely covered by Rule 19, and the appeal must succeed.

Romer, L.J.—I have arrived at the same conclusion. The question arising on this appeal is, as I see it, a question whether the sums covenanted to be paid by the Duke to such of his employees as have still remained in his service are sums paid by the Duke to them as remuneration for the services rendered to him ; in other words, I think the question is whether it is possible to regard deeds of covenant in such cases as contracts of employment.

Mr. Hills, on behalf of the Crown, says that we must arrive at the conclusion that these sums are provided as remuneration and as nothing else, if we regard the substance and not the form of the transaction. But, in my opinion, it is not permissible, under the plea of looking at the substance of the matter, to re-write contracts between the parties. The legal effect of the contract as it stands must be ascertained and not what would or might be the legal effect if the words of the contract be disregarded and the substance of the matter be considered. Having ascertained the legal effect of the contract, then for the purpose of ascertaining the Income Tax position resulting from that legal effect it is permissible to regard the substance of the matter, regardless of how that legal effect may have been described in the contract ; that is to say, what name the parties may have chosen to give to the legal effect. That, as I understand it, is the result of the cases that have been cited to us upon the matter. Take the present case. If we had here nothing but a contract by the Duke to pay an annual sum to each employee,

(Romer, L.J.)

it would no doubt be permissible, for the purpose of ascertaining the Income Tax position resulting from the legal effect produced by that covenant, to ascertain for what purpose the sum was in substance being provided, and it might be, on looking into the substance of the matter, that the Court would arrive at the conclusion that the sum was being provided as remuneration for services to be rendered in the future. But if one looks at the contract in the present case, it is not permissible to arrive at the conclusion that this is a contract of service. One cannot disregard the statement in the first of the recitals that, if the annuitant re-engages or continues in the service of the Duke, he will become entitled to remuneration in respect of such future service, nor is it permissible to disregard the express provision in clause 3 of the deed that the payments "are without "prejudice to such remuneration as the Annuitant will become "entitled to in respect of such services (if any) as the Annuitant may "hereafter render to the Duke". Unless those passages be disregarded, it appears to me quite impossible to regard this as a contract of service or as a contract providing for remuneration for the services to be rendered. The annuity to be paid continues after the employee leaves the service of the Duke and, if the employee so wishes, then, according to the precise words of the document, he will be entitled to further remuneration.

Mr. Justice Finlay, as I read his judgment, put the same construction upon the documents as I have done; that is to say, he attributed, in each case, to the covenant the same legal effect that I attribute to the deed, but, having said that, he then departed from the legal effect and refused, as I read his judgment, to give effect to the legal effect, because he said that the substance of the thing was that the various servants were to get the same wages as before. Looking at what, in fact, took place afterwards, it is no doubt permissible to say that the substance of the thing was that the servants were to continue to receive, under the deed and as wages together, the same sum that they were receiving before the deed was entered into. In my opinion it is not permissible to say, in face of the words of the deed itself, that its substance was that they were to get the same wages as before.

For those reasons I agree that this appeal must be allowed.

The Crown having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Lords Atkin, Tomlin, Russell of Killowen, Macmillan and Wright) on the 12th, 14th and 20th March, 1935, when judgment was reserved. On the 7th May, 1935, judgment was given against the Crown (Lord Atkin dissenting, except as regards one employee), with costs, confirming the decision of the Court below.

The Attorney-General (Sir Thomas Inskip, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown and Mr. Wilfrid Greene, K.C., Mr. Raymond Needham, K.C., Mr. W. C. Cleveland-Stevens, K.C., and Mr. Cyril L. King for the Respondent.

JUDGMENT

Lord Atkin.—My Lords, in the year 1930 and in subsequent years the Respondent, the Duke of Westminster, executed a series of deeds in which he covenanted to pay to the several parties mentioned in the deeds certain weekly sums for a period of seven years or the joint lives of the parties. The recipients in all the cases in question were persons then in the employ of the Respondent at fixed wages or salaries; and after the completion of the deeds they continued in the employment and continued to receive such sums as with the sum payable by the deed made up the amount of the wages or salary payable before the deed, and no more. The sums varied from 12*s*. to £2,000, the employment from gardener and laundryman to architect, and the past periods of employment from four years to forty-five. The Crown say that the payments made under the deed were made, in the circumstances given in evidence, as remuneration for services and could not be deducted from the Respondent's total income for purposes of Sur-tax. The Respondent says that the payments were annual payments which he was entitled to deduct. It is agreed between the parties that the question in this case is whether the payments were for remuneration of services or not; if the former the Respondent is chargeable, otherwise not. It is unnecessary, therefore, to trouble your Lordships with the various relevant Sections and Rules of the Income Tax Act, 1918, and subsequent Finance Acts. It is sufficient to say that your Lordships were satisfied that the admission was correct.

It was not, I think, denied, at any rate it is incontrovertible, that the deeds were brought into existence as a device by which the Respondent might avoid some of the burden of Sur-tax. I do not use the word device in any sinister sense: for it has to be recognised that the subject, whether poor and humble or wealthy and noble, has the legal right so to dispose of his capital and income as to attract upon himself the least amount of tax. The only function of a court of law is to determine the legal result of his dispositions so far as they affect tax. In the present case Mr. Justice Finlay, affirming the Commissioners, decided in favour of the Crown, while the Court of Appeal have set aside that decision and given judgment in favour of the Respondent.

The Commissioners have taken six cases as typical in which the documents differ slightly in form, but in their opinion have the same effect. They chose for special example the case of Frank Allman, a gardener, and I will adopt the same course, though reference may have to be made later to some of the other instances.

(Lord Atkin.)

The deed is in the following terms :—" This Deed of Covenant " is made this fourteenth day of August One thousand nine " hundred and thirty between The Most Noble Hugh Richard " Arthur Duke of Westminster D.S.O. (hereinafter called ' the " ' Duke ') of the one part and Frank Allman of Vine Cottage " Aldford near Chester Gardener in the Duke's service (herein- " after called ' the Annuitant ') of the other part. Whereas in " recognition of the services which for over twenty seven years past " the Annuitant has well and faithfully rendered to the Duke the " Duke desires to make provision for the Annuitant in manner " hereinafter expressed notwithstanding that the Annuitant may " re-engage or continue in the service of the Duke in which event " he will become entitled to remuneration in respect of such future " service. Now this deed made in furtherance of the Duke's said " desire and in consideration of the past services so rendered " as aforesaid witnesses as follows :—1. The Duke covenants to " pay to the Annuitant as from the 2nd day of August One " thousand nine hundred and thirty during the joint lives of himself " and of the Annuitant or for a period of seven years the weekly " sum of One pound eighteen shillings (amounting in each year " to the sum of Ninety eight pounds sixteen shillings) the first " of such payments having fallen to be made on the 9th day " of August 1930. 2. The said payment shall be made from time " to time on such days for such periods and in such proportions " as shall from time to time be mutually agreed upon by the " parties hereto and in default of agreement shall be made in " weekly payments on the Saturday of each week. 3. It is hereby " expressly agreed that the said payments are without prejudice to " such remuneration as the Annuitant will become entitled to in " respect of such services (if any) as the Annuitant may hereafter " render to the Duke. In witness whereof the said parties to these " presents have hereunto set their hands and seals the day and year " first above written.

" Signed Sealed and Delivered by the " above named Hugh Richard Arthur " Duke of Westminster in the " presence of :— } Westminster (L.S.).

" St. G. Clowes,
" Broadwater,
" Framlingham,
" Capt. late 19th Hussars.

" Signed Sealed and Delivered by the " above named Frank Allman in the " presence of :— } Frank Allman (L.S.).

" F. A. Carlton-Smith,
" The Grosvenor Office,
" 53, Davies Street,
" London, W.1,
" Solicitor."

(Lord Atkin.)

Counsel for the Respondent took the view that the period of the covenant was the joint lives or seven years, whichever was the shorter: and that the deed was to be without prejudice to the recipient receiving full remuneration for his future services. I shall assume that this construction is correct. No contention was raised in the present case that the payments, though expressed to be weekly, were not annual payments within the Income Tax Act and Rules.

It will be convenient to consider the legal relations which would exist between the Duke and his servant on the supposition—which is that of the Respondent—that the deed came into force without any further agreement of any kind being made between the parties.

The servant was serving the Duke under a contract of employment under which he was entitled to receive an agreed weekly wage of, we will suppose, £3, which contract would continue until terminated by notice or summarily, or varied by agreement. On this footing, when the deed came into operation the servant remaining in the employment would be entitled to 38*s*. a week in addition to the 60*s*. wages, and it is obvious that, so far from benefiting himself by avoiding Income Tax, the Duke would be adding several thousand pounds annually to his expenditure. I conceive it to be self-evident that no single party to the transaction ever contemplated that the servant would in fact draw the full contract wages in addition to the 38*s*. under the deed. In fact, as we learn from the Case, the servant continued after the deed to receive weekly the exact former amount of his wages 60*s*., *i.e.*, he received 38*s*. and such additional sum as made the total weekly payment the equivalent of his contractual wages. We are to assume, however, on the Respondent's contention, that no contract was made modifying either the terms of the deed or the contract of employment. The position of the Duke, therefore, was that, assuming the servant was content to draw only 60*s*. a week, the Duke would remain at all times liable to pay to the servant the arrears of the contractual wages, *i.e.*, 60*s*. minus 22*s*., in other words a sum equal to the payment under the deed. However long a time the service continued the servant would be entitled to this sum within the limit, if the Duke of Westminster chose to plead the Statute of Limitations, of six years arrears. The arrears would be a debt due to the servant, and could be attached by any creditor of the servant, and would on death be assets of his which his personal representative would be bound to recover. It is perhaps worth mentioning that if in fact the Duke were only paying as wages 22*s*. peculiar results might follow if the wages were regulated by statute as by the Agricultural Wages Act or similar legislation: but as we have no evidence of such a position it is unnecessary to dwell on it. A nice question might also arise as to the amount which the Duke would be bound to tender as wages in lieu of notice.

(Lord Atkin.)

The embarrassments, however, are not all on the Duke's side. One result to the servant, perhaps unexpected, would be that his total income having become 98*s.* a week, he would incur liability to Income Tax, for salary or wages that he is entitled to but voluntarily forgoes must be included in his total income. And on what footing his " earnings " in his last employment would be calculated for purposes of workmen's compensation, whether on 22*s.* or 60*s.*, is a problem which I am glad we have not to decide. Such being the position if the matter rested upon the deed and no more, it seems to me plain that the Duke's advisers were not prepared to leave him exposed to the liabilities I have mentioned. In every case before the deed became operative a letter was written by the Duke's solicitors to the servant, the effect of which seems to me to be the material question in this case. The letter is not in the same form in every case, though its effect is the same. In Allman's case it is on a typed form and is signed by the solicitors over a 6*d.* stamp. It is as follows :—

" Private.

" The Grosvenor Office,

" 53 Davies Street,

" Berkeley Square, London, W.1.

" 13th August, 1930.

" To Mr. Frank Allman.

" Dear Sir,

" On Wednesday the 6th instant we read over with you a Deed " of Covenant which the Duke of Westminster has signed in your " favour under which you will be entitled to a gross sum of " £1 18*s.* 0*d.* a week in consideration of your past faithful service " and irrespective of any work which you may do for His Grace " after the Deed comes into effect. The Deed will be in force " for seven years if you and the Duke should so long live, and " His Grace can reconsider the position at the end of that period. " We explained that there is nothing in the Deed to prevent your " being entitled to and claiming full remuneration for such future " work as you may do, though it is expected that in practice you " will be content with the provision which is being legally made " for you for so long as the Deed takes effect, with the addition of " such sum (if any) as may be necessary to bring the total " periodical payment while you are still in the Duke's service up to " the amount of the salary or wages which you have lately been " receiving.

" You said that you accepted this arrangement, and you " accordingly executed the Deed.

" We write, as promised, to confirm the explanation which we " gave you on the 6th instant. If you are still quite satisfied we

(Lord Atkin.)

" propose to insert the 6th instant as the date of the Deed and we " shall be obliged by your signing the acknowledgment at the foot " of this letter and then returning it to us.

" Yours faithfully,

" (*Signed*) Boodle, Hatfield & Co.

" Stamp 6*d*.

" Acknowledgment.

" To The Duke of Westminster, D.S.O.

" And to Messrs. Boodle, Hatfield & Co., his Solicitors.

" I have read the above written letter, and I confirm that I " accept the provision made for me by the Deed. I agree to the " Deed being dated and treated as delivered by and binding upon " the Duke of Westminster and myself.

" (*Signed*) Frank Allman."

It will be observed from the letter that on 6th August the solicitors had produced to the servant the deed already executed by the Duke but undated and had made the explanation set out in the letter, and that the servant had accepted " this arrangement " and had executed the deed. Now, what was the object of the letter and the signed acknowledgment which formed part of the document? The Respondent gravely says that it was merely to provide evidence that the servant was satisfied with the provision made for him by the deed and to protect the Duke against claims against him in the future for any increased pension. But the servant in no case had any legal claim to pension and in any case the deed was not to last for more than seven years : and finally, and as I suggest, conclusively, the servant had already signified his acceptance of the provision made in the deed by executing it " accordingly ". Execution by the servant had been in law unnecessary.

In my opinion, the facts and the terms of the letter indicate that the transaction was intended to have, and had, far more substantial results than the interchange of unnecessary assurances between master and servant. The document was intended to bind the servant, exactly to what terms I will shortly discuss. They must depend on the terms of the letter. But that the document was intended to be contractual is a conclusion that I find irresistible.

For what reason is the signature of the solicitors placed by them over a contract stamp? Can there be any reason except that they thought that the letter contained an offer of a contract which would be completed by the signature of the acknowledgment by the party to whom it was addressed? I am satisfied that a letter signed over a contract stamp and requiring the addressee to return it with the appended acknowledgment signed, addressed by the employer's

(Lord Atkin.)

solicitors to a workman employed at weekly wages, would inevitably be understood by the recipient and would be intended by the writers to be understood as a representation that he was being asked to make a contract in the terms of the document.

It still remains to consider whether the document discloses the parties to be agreed and sufficiently defines the terms. I have already pointed out the urgent necessity there was to relieve the Duke from the obligations which would exist if the deed stood alone. I read the letter as saying there is nothing in the deed to prevent your claiming 60*s.* in addition to the sum mentioned in the deed, but you are expected in practice to be content with the provision, etc., with the addition, etc. : you have already said that you accept this arrangement and will you now bind yourself by a formal contract to this effect. The acknowledgment " I confirm " that I accept the provision made for me by the Deed " in my opinion plainly relates to the only matter previously recited as being said by the servant, viz., " I confirm that I accept this arrange- " ment : and the arrangement is that I will be content with the " provision in the deed, with the addition, etc., of any sum neces- " sary, etc." We are thus, I think, inevitably forced to the conclusion that before the deed was executed there was a contract between master and servant as to the effect of the deed on the existing contract of service.

The only remaining question is relatively simple. Is the contract one which radically alters the terms of the existing contract of service? I will make a new contract of service and I will serve you as gardener for 22*s.* a week : or, as in some of the other cases, I will serve you for nothing. Or is it a contract which maintains the existing contract of service? I will continue to serve you as gardener for 60*s.* a week : but I will take payment of that 60*s.* as to 38*s.* by the payment under the deed, and as to the balance by the ordinary weekly payment? In the latter case the employer remains under an obligation to pay 60*s.*, and discharges 38*s.* of that obligation by making the payment under the deed, which has been delivered with that bargain in existence.

I quite agree that the former is a possible bargain. A servant may agree to work for nothing or for some sum which is merely a fraction of the current rates of wages. But such agreements are in my experience very exceptional. In the present case they would apply, it is said, to about a hundred employees. And I cannot contemplate so many servants consciously making bargains so alien to their traditions and for a period which would not be longer than seven years and might be shorter. The better construction appears to me to be that the servants were never asked to abandon the existing contractual rate. If it were otherwise, one bears in mind the strange position of what were neatly called the uncovenanted servants serving for higher wages, together with the other difficulty earlier referred to as to wages statutes and wages in lieu of notice.

(Lord Atkin.)

With great respect to the members of the Court of Appeal, they seem to ignore what seems to me the essential fact of the document of 13th August signed by both parties. Lord Justice Slesser alone makes what seems to me the necessary assumption that it is contractual but for the reasons given I cannot assent to his view of the ensuing legal effect. Nor am I impressed with the fact that the deed would have a different effect on the Sur-tax liability of the Duke if later he did not happen to be employing the recipient. That seems to me a very ordinary result if the circumstances of the covenantor and covenantee alter for Income Tax purposes. The fact is that what would make the difference in the tax position would be that the recipient would no longer be employed: the letter would not be in operation: and there could be no ground for alleging that the Duke was paying the money as remuneration.

I do not myself see any difficulty in the view taken by the Commissioners and Mr. Justice Finlay that the substance of the transaction was that what was being paid was remuneration. Both the Commissioners and Mr. Justice Finlay took the document of 13th August into consideration as part of the whole transaction, and in my opinion rightly. I agree that you must not go beyond the legal affect of the agreements and conveyances made, construed in accordance with ordinary rules in reference to all the surrounding circumstances. So construed, the correct view of the legal effect of the documents appears to me to be the result I have mentioned. I think the difficulty has probably arisen from the wording of the Commissioners' finding that "the payments made under these "deeds . . . . were, in substance" payments by way of remuneration. I do not think that that phrase, standing alone, would be justified. Reference to the immediately preceding sentence indicates that the Commissioners had taken into consideration the letters and form of acknowledgment before expressing their findings as above. Though they have not analysed the transaction as fully as I have endeavoured to do, I have little doubt that they and Mr. Justice Finlay arrived at the same result as I, and it may be noted that so far as there is any question of fact involved, the finding of the Commissioners, if there is evidence, is final.

Basing as I do my conclusion on the preliminary contract contained in the letter and acknowledgment, I find myself unable to accept the Commissioners' conclusion in the case of Mr. Detmar Blow. No letter appears to have been written to him and there was no evidence before the Commissioners as to any agreement made with him. In those circumstances, on the facts as they were made known to the Commissioners, it appears necessary to treat the legal relations between him and the Duke in respect of the payment of £2,000 a year as governed by the deed alone. The assessment therefore should be reduced by that sum. Except as thus varied, in my opinion the order of the Commissioners should be restored and the appeal allowed with costs here and below.

Lord Tomlin.—My Lords, it cannot, I think, be doubted that each one of the annuities payable under the deeds of covenant brought to your Lordships' attention, if considered with reference to the deed creating it and without regard to the other matters upon which the Appellants rely, falls into that class of payments which are treated as part of the taxable income of the payee and not of the payer. Each annuity is on this footing, therefore, an item from which the payer is entitled to deduct Income Tax and which he is entitled to treat as deductible from his total income in making his return for Sur-tax purposes.

So far as concerns the annuity payable to Detmar Jellings Blow I can discover no element in the case which upon any view of the law or facts can alter the position as I have stated it, and in my opinion the appeal in regard to this annuity must fail.

With regard to the other annuities, the correspondence in each case contemporaneous with or following upon the execution of the deed of covenant, together with the fact that after the deed the payee, being in the Duke's employment, was in fact getting under the deed (with or without other moneys) the amount which he would have received as salary or wages if no deed had been executed, is said by the Appellants to alter the whole position and so long as the payee continues in the Duke's service to render it impossible for the Duke to treat the annuity under the deed as a deductible item in his return of income for Sur-tax purposes.

It is agreed that as between the annuities under consideration, other than that of Blow, no distinction can be drawn and that Allman's annuity is typical. A decision in Allman's case must therefore govern the remainder.

So far as I understand the argument, the Appellants, while admitting that Allman's annuity is payable under the deed, say that there is, having regard to the correspondence and in all the circumstances, another collateral contract between the Duke and the payee to the effect that the payee will serve the Duke in consideration of a salary or wage equal to the salary or wage he was receiving before the deed of covenant was executed and that he will accept what he receives under the deed in part satisfaction of this salary or wage and therefore that the annuity, so long as the payee remains in the Duke's service, is of a changed nature and is no longer a payment which the Duke is entitled to deduct from his income for the purposes of Sur-tax.

In the first place I would observe that if any such contract is proper to be inferred from the correspondence and circumstances, the contract must be a separate independent contract in the case of each payee and could only be inferred from a full examination of each case separately and, unless the contract alleged is wholly in the correspondence, only after hearing evidence from the parties to the alleged contract or their representatives. In fact no evidence

(Lord Tomlin.)

of this kind was called before the Commissioners and the Commissioners have not found that any such contract existed. Their only finding is expressed in paragraph 11 of the Case Stated and is as follows: " We, the Commissioners who heard the appeal, held " that, in construing the true effect and substance of the deeds " under which payments are made to the Appellant's employees, " we were entitled to consider together with these deeds the letters " of explanation and form of acknowledgment which were sent to " the covenantees. These letters, like the deeds themselves, were " not in one stereotyped form, but were sufficiently to the same " effect to enable us to arrive at a decision in respect of them all. " We held that the payments made under these deeds to persons " who remain in the Appellant's employ were, in substance, " payments for continuing service *ejusdem generis* with wages or " salaries so long as the recipients in fact remain in the Appellant's " service and as such were not annual payments which were a " proper deduction from his assessment to Sur-tax." I will deal later with that part of the finding which says that the payments were " in substance " payments for continuing service *ejusdem generis* with salaries or wages.

In the next place I would note that a contract in the terms alleged is nothing more than a contract that the payee will serve the Duke for a salary or wage equal to the difference between the amount received under the deed and the amount of the original salary or wage. In any event, whether he serves the Duke or not, the payee is entitled under the deed to the amount of the annuity, less tax, and the annuity already legally payable cannot become part of the consideration for a new contract of service.

Again, such a contract, if it could be inferred at all, is in flat contradiction of the deed. Under the deed the payments are expressed to be without prejudice to such remuneration as the annuitant would become entitled to in respect of such services (if any) as the annuitant might thereafter render to the Duke. It is also in flat contradiction of the terms of the letter to which I will presently refer. In fact I do not think that upon the true construction of the relevant letter and written acknowledgment, even when regarded in the light of such facts as are admitted or found in paragraph 6 of the Case Stated, there was any such collateral contract as alleged.

The letter of the 13th August, 1930, told the annuitant that there was nothing in the deed to prevent his being entitled to and claiming full remuneration for such future work as he might do though it was expected that in practice he would be content in effect with the difference between the annuity and salary or wages which he had been lately receiving. I cannot think that a letter so framed can be construed as constituting a contract that the payee would serve the Duke upon terms in contradiction of the language

(Lord Tomlin.)

of the letter, namely, that he should be entitled to less than the salary or wages which he had been then lately receiving. Further, the arrangement which the annuitant is stated in the letter to have accepted must, I think, on a proper reading of the letter, refer to all that is set out in the letter as well as what is contained in the deed, and includes his right to full remuneration over and above what is received under the deed. Again, the acknowledgment signed by the annuitant at the foot of the letter is that he accepts the provision made for him by the deed, and that is a provision without prejudice to his right to full remuneration over and above what he receives under the deed. In short, it seems to me that there is no such contract as that which the Appellants suggest can be inferred.

Apart, however, from the question of contract with which I have dealt it is said that in Revenue cases there is a doctrine that the Court may ignore the legal position and regard what is called " the substance of the matter " and that here the substance of the matter is that the annuitant was serving the Duke for something equal to his former salary or wages and that, therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine (upon which the Commissioners apparently acted) seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled and the supposed doctrine given its quietus the better it will be for all concerned, for the doctrine seems to involve substituting " the uncertain and crooked cord of discretion " for " the " golden and straight mete wand of the law " (4 Inst. 41).

Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of " the substance " seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable.

The principal passages relied upon are from opinions of Lord Herschell and Lord Halsbury in your Lordships' House. Lord Herschell, L.C., in *Helby* v. *Matthews*, [1895] A.C. 471, observed at page 475 : " It is said that the substance of the transaction " evidenced by the agreement must be looked at, and not its mere " words. I quite agree ", but he went on to explain that the substance must be ascertained by a consideration of the rights and obligations of the parties to be derived from a consideration of the whole of the agreement. In short, Lord Herschell was saying that the substance of a transaction embodied in a written instrument is to be found by construing the document as a whole.

(Lord Tomlin.)

Support has also been sought by the Appellants from the language of Lord Halsbury, L.C., in *Secretary of State in Council of India* v. *Scoble*, [1903] A.C. 299, at page 302(1). There Lord Halsbury said, " Still, looking at the whole nature and substance of " the transaction (and it is agreed on all sides that we must look " at the nature of the transaction and not be bound by the mere " use of the words), this is not the case of a purchase of an annuity ". Here again Lord Halsbury is only giving utterance to the indisputable rule that the surrounding circumstances must be regarded in construing a document.

Neither of these passages in my opinion affords the Appellants any support or has any application to the present case. The matter was put accurately by my noble and learned friend Lord Warrington of Clyffe when, as Lord Justice Warrington in *In re Hinckes, Dashwood* v. *Hinckes*, [1921] 1 Ch. 475, at page 489, he used these words : " It is said we must go behind " the form and look at the substance. I do look at the " substance, but, in order to ascertain the substance, I must look " at the legal effect of the bargain which the parties have entered " into."

So here the substance is that which results from the legal rights and obligations of the parties ascertained upon ordinary legal principles, and having regard to what I have already said, the conclusion must be that each annuitant is entitled to an annuity which, as between himself and the payer, is liable to deduction of Income Tax by the payer and which the payer is entitled to treat as a deduction from his total income for Sur-tax purposes.

There may, of course, be cases where documents are not *bonâ fide* nor intended to be acted upon but are only used as a cloak to conceal a different transaction. No such case is made or even suggested here. The deeds of covenant are admittedly *bonâ fide*, and have been given their proper legal operation. They cannot be ignored or treated as operating in some different way because as a result less duty is payable than would have been the case if some other arrangement—called for the purpose of the Appellants' argument " the substance "—had been made.

I find myself, therefore, in regard to the annuities other than that of Blow unable to take the same view as the noble and learned Lord upon the Woolsack.

In my opinion, in regard to all the annuities the appeal fails and ought to be dismissed with costs.

Lord Russell of Killowen.—My Lords, I would dismiss this appeal.

It is conceded that the deeds are genuine deeds, *i.e.*, that they were intended to create and do create a legal liability on the Duke

(1) 4 T.C.618, at p. 624.

(Lord Russell of Killowen.)

to pay in weekly payments the annual sum specified in each deed, whether or not any service is being rendered to the Duke by the covenantee. Further, it is conceded that the sums specified in the deeds were paid to the covenantees under the deeds.

The question for our decision is whether those sums so paid constitute part of the Duke's income for the purpose of computing his liability for Sur-tax in the particular years in question.

I need not consider in detail the various statutory provisions which are relevant to the consideration of this matter. The result may for the purposes of this case be summarized thus: if the payment of these sums is payment of salary or wages within Schedule E, from which tax is not deductible by the Duke, then he is not entitled to exclude the amounts paid in ascertaining his total income for Sur-tax purposes, but if the payment is an annual payment within Schedule D, from which tax is deductible by the Duke, then he is entitled to exclude the amounts paid in ascertaining such total income.

There can, I think, be no doubt that if the deeds stood alone the payments are annual payments within Schedule D. Indeed, this is not, I think, disputed. It is, however, argued that certain letters written by the Duke's solicitors to the covenantees and certain acknowledgments signed by the covenantees at the foot of those letters effect a complete change in the situation and turn the payments made under the deeds into payments of salary and wages within Schedule E.

I will consider this suggestion in relation to the case of Frank Allman. The argument centred round his case, and it was common ground that all the cases (with the exception of the case of Mr. Blow) stood or fell together notwithstanding any difference of wording which might exist among them.

The legal position created by Allman's deed is clear. He is entitled during the defined period to his annual sum of £98 16*s*. by weekly payments of £1 18*s*., commencing on the 9th August, 1930. He is not bound to do a stroke of work in order to be entitled to payment. If he does in the future render any service to the Duke, he will be legally entitled to claim remuneration for it, over and above the payments under the deed, which are to be without prejudice to his remuneration for future services. The deed expressly so provides.

The letter to Allman states the effect of the deed, but says that it is expected that in practice he will be content with the legal provision made by the deed " with the addition of such sum (if any) " as may be necessary to bring the total periodical payment while " you are still in the Duke's service up to the amount of the salary " or wages which you have lately been receiving ". That is an expression of hope or anticipation that the covenantee will not enforce his legal right to remuneration for future services beyond a

(Lord Russell of Killowen.)

certain amount. The letter states that the covenantee had " accepted this arrangement " and asks him to sign an acknowledgment in a form already written out at the foot of the letter. The arrangement said to have been accepted can be nothing more than what the letter states, viz., the execution of a deed which was to be binding and in full force, coupled with an expectation on the part of the Duke that the covenantee's legal right to full remuneration for future services would not be enforced. There is no evidence of any other arrangement. Acceptance of that arrangement cannot turn the expectation into an enforcible legal right. The acknowledgment signed by the covenantee is in strictly limited terms. It accepts the provision made by the deed; it in no way admits or suggests that the deed has to any extent been qualified by the letter.

My Lords, for myself I can find nothing in the letter and acknowledgment which constitutes or resembles a contract, notwithstanding the fact that the names of the solicitors were written across an adhesive stamp. There is an expression of a hope or anticipation or expectation that the covenantee will pursue a certain line of conduct, but he nowhere binds himself to do so, nor indeed is he even asked to do so. In my opinion, the letter has no operation at all and has no effect upon the legal rights and liabilities of the parties created by the deed.

If I am wrong in this view, and some contract *dehors* the deed was brought into existence by means of the letter and acknowledgment, it can be no more than a contract by Allman that his remuneration for future services shall not be full remuneration but only the additional sum referred to in the letter. I can see no grounds for extracting from the language used a contract that the remuneration for future services shall, despite the deed, be the sums payable under the deed in respect of past services plus the additional sum mentioned in the letter. I can find no possible justification for this. A suggestion was made that such a contract can be found by reason of the presence in the letter of the words " to bring the total periodical payment . . . . up to the amount of " the salary or wages which you (were) receiving (previously to the " deed of covenant)." I fail to see how these words can bear this strain. Indeed, to me they seem to point in the opposite direction. They recognise that full remuneration for future services will not be paid, and that the total periodical payment will be composed in part of salary and in part of something which is not salary at all. If the true view is that, contrary to my opinion, a contract has been made to accept less than full remuneration for future services, the position is still the same, viz., that the legal rights and liabilities of the parties created by the deed remain unqualified and unaffected.

The result is that payments, the liability for which arises only under the deed, are not and cannot be said to be payments of

(Lord Russell of Killowen.)

salary or wages within Schedule E. They cannot with any regard to the true legal position be said to arise from an employment. They are, and can only be said to be, annual payments within Schedule D. Tax was deductible on payment; they are income of the recipient, and are accordingly not part of the Duke's total income for the purpose of calculating his liability for Sur-tax.

The Commissioners and Mr. Justice Finlay took the opposite view on the ground that, as they said, looking at the substance of the thing the payments were payments of wages. This simply means that the true legal position is disregarded and a different legal right and liability substituted in the place of the legal right and liability which the parties have created. I confess that I view with disfavour the doctrine that in taxation cases the subject is to be taxed if, in accordance with a Court's view of what it considers the substance of the transaction, the Court thinks that the case falls within the contemplation or spirit of the statute. The subject is not taxable by inference or by analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case. As Lord Cairns said many years ago in *Partington* v. *Attorney-General*, (1869) L.R. 4 E. & I. App. H.L. 100, at page 122: "As I understand the principle of all fiscal legislation, it is this: "If the person sought to be taxed comes within the letter of the "law he must be taxed, however great the hardship may appear to "the judicial mind to be. On the other hand, if the Crown, seeking "to recover the tax, cannot bring the subject within the letter of "the law, the subject is free, however apparently within the spirit "of the law the case might otherwise appear to be." If all that is meant by the doctrine is that having once ascertained the legal rights of the parties you may disregard mere nomenclature and decide the question of taxability or non-taxability in accordance with the legal rights, well and good. That is what this House did in the case of *Secretary of State in Council of India* v. *Scoble*, [1903] A.C. 299 (1); that and no more. If, on the other hand, the doctrine means that you may brush aside deeds, disregard the legal rights and liabilities arising under a contract between parties, and decide the question of taxability or non-taxability upon the footing of the rights and liabilities of the parties being different from what in law they are, then I entirely dissent from such a doctrine.

The substance of the transaction between Allman and the Duke is, in my opinion, to be found and to be found only by ascertaining their respective rights and liabilities under the deed, the legal effect of which is what I have already stated.

The case of Mr. Blow's deed, which is uncomplicated by any letter, is necessarily decided, in my view, in the same way as Allman's case.

(1) 4 T.C.618.

(Lord Russell of Killowen)

For these reasons I am of opinion that the order of the Court of Appeal was right and ought to be affirmed.

Lord Macmillan.—My Lords, the Respondent recently entered into certain transactions with a number of his employees, and the question to be determined in this appeal is whether these transactions have affected his liability to Sur-tax. It has been agreed that, to test the matter, the Respondent's transaction with Frank Allman may be taken as typical of the series.

Allman was employed by the Respondent as a gardener at a weekly wage the amount of which is not stated, but which was in excess of 38*s*. a week. The wages paid by the Respondent to Allman were profits arising to Allman from his employment within the meaning of Schedule E to the Income Tax Act, 1918. Consequently the Respondent was not entitled to deduct tax on paying Allman his wages, nor was he entitled to deduct his payments to Allman in computing his total income for Sur-tax purposes. Such being the position of the parties, they executed in 1930 a deed of covenant which has been quoted in full by my noble and learned friend Lord Atkin.

It is agreed on all hands that the legal effect of this deed was to give Allman thereafter for the period of its endurance the right to a weekly payment of 38*s*. irrespective of whether he remained in the Respondent's employment or not, but without prejudice to Allman's right to remuneration for such services as he might thereafter render to the Respondent. I do not think that there can be any doubt, and indeed none was suggested, that, if this deed had stood alone, the sums paid to Allman in pursuance of it would have been of the nature of an annual payment payable as a personal debt or obligation by virtue of a contract within the meaning of Rule 1 applicable to Case III of Schedule D of the Income Tax Act, 1918, with the result of entitling the Respondent, under Rule 19 (1) of the Rules applicable to all Schedules, to deduct Income Tax on making the covenanted payments to Allman and consequently to deduct the amount of these payments in computing his total income for Sur-tax purposes.

But the deed of covenant did not stand alone. There were in addition a letter addressed to Allman by the Respondent's Solicitors and an acknowledgment by Allman, which have also been quoted in full by my noble and learned friend. In my opinion, these two documents formed part of the transaction between the parties. It has been suggested that they had no legal efficacy. The Respondent's Solicitors do not appear to have held that view. They may have been mistaken in their belief that the letter and the acknowledgment embodied a binding arrangement, but I confess that I share it. In my opinion these documents embody an agreement between the parties that, notwithstanding Allman's unqualified right under the deed to 38*s*. a week, work or no work,

(Lord Macmillan.)

and to full remuneration for any future work he may do for the Respondent, nevertheless, so long as he remains in the Respondent's employment, he will be content with the covenanted payments under the deed plus the difference between them and the wages he was previously receiving. In other words, Allman agrees that in view of the Respondent having undertaken to pay him 38*s*. a week in the future independently of his employment, he will not expect or be entitled to any further payment from the Respondent, so long as he remains in the Respondent's employment, beyond the difference between the covenanted payments and the wages he previously received.

Allman has, I understand, remained in the Respondent's service and receives in fact the same sum of money weekly from the Respondent as he received before the transaction in question. Has that sum to the extent of 38*s*. altered its legal character in consequence of the transaction? In my opinion it has. Whereas previously Allman was entitled to the 38*s*. a week as wages, he is now entitled to payment of this sum weekly whether he is employed by the Respondent or not. That is the effect of the deed of covenant. The arrangement embodied in the two collateral documents does not alter that effect, whatever else it does. It is difficult to see how a sum which is payable irrespective of employment can be said to be a profit arising from employment. If the collateral documents had affected the absolute independent nature of the obligation under the deed of covenant different considerations might have arisen. But the absolute obligation to pay irrespective of employment remains unaffected by the collateral documents, which recognise that Allman will in future have an unqualified right to a weekly payment of 38*s*. from the Respondent whether the Respondent employs him or not.

My Lords, I venture to suggest that the proper approach to the problem is to ask the question in the language of Rule 1 applicable to Case III of Schedule D of the Income Tax Act, 1918: Is the 38*s*. a week of the nature of an annual payment payable by the Respondent as a personal debt or obligation by virtue of a contract? Plainly it is, and none the less so because of the collateral arrangement which, whatever it does, does not convert the deed of covenant into a contract of employment, for the 38*s*. remains payable, employment or no employment. It is agreed that if Allman leaves the Respondent's employment the weekly payments which he will continue to receive under the deed will fall within Rule 1 applicable to Case III of Schedule D. But the payments made to him while he remains in the Respondent's employment are exigible by him under precisely the same legal obligation on the part of the Respondent. If, then, the question which I have put must be answered in the affirmative, Rule 19 (1) of the Rules applicable to all Schedules automatically applies and the Respondent is entitled to deduct tax on making the covenanted payments to Allman, and

(Lord Macmillan.)

if he is entitled to deduct tax from the payments he is also entitled to deduct the amount of these payments in computing his total income for Sur-tax purposes. The same reasoning is applicable to the Respondent's transactions with his other employees, except that in the case of Mr. Blow there was only a deed of covenant and no collateral letters. His case is consequently *a fortiori* of the others.

I am fully conscious of the anomalous consequences which might conceivably arise in other connections from the course adopted by the Respondent, but your Lordships are concerned only with the technical question whether the Respondent has brought himself within the language of the Income Tax rule as to contractual payments, and I think that he has succeeded in doing so. That is enough for the decision of the case. It is not likely that many other employers will follow the Respondent's example, for few employers would care to take the risk to which the Respondent has left himself exposed, namely, that his servants may quit his employment and take their services elsewhere and yet continue to exact the covenanted weekly payments from him.

The result of the views which I have expressed is that in my opinion the appeal should be dismissed and the judgment of the Court of Appeal affirmed.

Lord Wright.—My Lords, the difference of opinion which this appeal has elicited has caused me some doubt, but after careful consideration I am bound to say that, speaking for myself, I have come to the conclusion that the appeal must fail.

If the case were one in which it was found as a fact in regard to each of the deeds in question that it was never intended to operate as a legal document between the parties, but was concocted to cover up the payment of salary or wages and to make these payments masquerade as annuities in order to evade Sur-tax, it may well be that the Court would brush aside the semblance and hold that the payments were not what they seemed. But there is no such finding by the Commissioners; indeed no such case was even suggested; on the contrary, it is admitted that the deeds are genuine and carry an obligation according to their tenor, irrespective of whether the various payees are or are not in the Respondent's service at any material date. This is clearly so in the cases not here questioned in which the covenantees are no longer in the Respondent's employment. All your Lordships are of opinion that this is so in the case of Blow, though he is still in the Respondent's service, and that the payments in his case are properly deductible.

What, then, is the difference which distinguishes Blow's case from that of the other covenantees whose cases are to be considered in this appeal? The only difference is to be found in the accompanying letter and form of acknowledgment, both of which are

(Lord Wright.)

absent in Blow's case. It is on these documents that the Commissioners arrive at their conclusion that the payments under the deeds are not annual payments but " in substance, payments for con-
" tinuing service *ejusdem generis* with wages or salaries " so long as the recipients remain in the Respondent's service.

Like others of your Lordships, I shall take as typical the case of Allman. The covenant in the deed to pay him is unconditional. It is not conditioned by the contingency of Allman re-engaging or continuing in the Respondent's service; the relevance of that contingency is expressly negatived in the recital; and by Clause 3 it is expressly agreed that the payments are to be without prejudice to such remuneration (what that may be is unspecified) as the annuitant will become entitled to in respect of such services, if any, as he may thereafter render to the Respondent.

On the footing that the deed is genuine, I do not see any possibility of going behind what appears on the face of the document, or qualifying its effect by documents *dehors* the deed and in no way embodied in it, or regarding the payments as other than annual payments, as it is admitted that *ex facie* they are. What the legal effect is as between the covenantor and the covenantee must determine for Revenue purposes the character of the payments actually made. That character is not to my mind changed if the letter of explanation and the letter of acknowledgment can be taken into account. The letter of explanation quite correctly, and in accordance with the actual terms of the deed, states that there is nothing to prevent Allman from claiming full remuneration for future work from the Respondent; the letter goes on to state what is expected, namely, that Allman will " in practice " be content " with the provision made by the deed with such additional payment as will, with the payments under the deed, bring his salary up to what he had been previously receiving. This seems to me to be merely the language of hope and expectation and not to be language capable of being construed as an offer which, if accepted by Allman, would bind him to work for the Respondent at the reduced rate; that is, if in future he did so work, because no one suggests that if he did not work for the Respondent his right under the deed would be affected.

But if the letter of explanation, together with the acknowledgment, were treated as constituting a contract, it could only be a contract to pay and accept what may be called the additional sum. I cannot extract from the actual words a promise or right to pay or receive what is called the " full remuneration for future work ". It is true that Allman would under the deed be entitled to claim " full remuneration " if he were so minded, as a condition of working, but I cannot find any ground for thinking that he ever did so, and still less that the Respondent employed him on that footing.

(Lord Wright.)

Whatever view is taken, the nature of the obligation embodied in the deed appears to me to be unaffected. I do not stop to examine what is the precise position of Allman and those in like case with him if they go on working in the Respondent's employment. It may be that the true inference of fact is that they are working for the additional sum and nothing else, the reason why they are content with this reduced rate being that they are receiving also the annuities under the deed. There may be difficulties in that position. But in any event any such agreement would be merely collateral to the deed.

I may add that I do not understand what is meant by the expression " payments for continuing service *ejusdem generis* with " wages or salaries ". The payments must be one thing or the other, either annual payments or wages; there is no room for anything intermediate or in the nature of *cy près*. And once it is admitted that the deed is a genuine document, there is in my opinion no room for the phrase " in substance ". Or, more correctly, the true nature of the legal obligation and nothing else is " the substance ". I need not develop this point, as I agree with what has been said by my noble and learned friends, Lord Tomlin and Lord Russell of Killowen.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors :—Boodle, Hatfield & Co.; Solicitor of Inland Revenue.]

(27707) Wt. 950/1894 5,000 11/35 Hw. G.383

373