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No. 1243—High Court of Justice (King's Bench Division)—28th and 29th April, 1941

Court of Appeal—11th and 12th November and 16th December, 1941

House of Lords—8th, 9th and 10th December, 1942, and 11th February, 1943

Latilla *v.* Commissioners of Inland Revenue[1]

Income Tax and Sur-tax—Avoidance of liability to Income Tax—Transactions resulting in the transfer of income to persons abroad—" the " purpose of avoiding liability to taxation "—Partnership trading profits—Whether " income . . . payable " to the partners—Finance Act, 1936 (26 *Geo.* V *&* 1 *Edw.* VIII, *c.* 34), *Section* 18.

The Appellant's wife was for many years a member of a partnership owning a gold mine which was situated, managed and controlled in Rhodesia. Both the Appellant and his wife were ordinarily resident in the United Kingdom. After 1932 *only one partner continued to live in South Africa, and the other partners, who were in the United Kingdom, with a view to protecting their interests, formed a Rhodesian company which, by an agreement dated* 20*th March,* 1933, *acquired from them their shares in the partnership in exchange for* 10,000 £1 *ordinary shares and* £250,000 *non-interest bearing debentures. The company thereafter carried on the business in partnership with the South African partner; it declared no dividends, but applied the whole of its profits to redemption of debentures.*

Assessments to Income Tax and Sur-tax were made upon the Appellant to include his wife's share of the company's income from the partnership on the ground that it was deemed to be his income by the operation of Section 18, *Finance Act,* 1936. *On appeal against these assessments the Appellant contended* (1) *that the Rhodesian company's income was earned in the carrying on of a business in partnership and that no " income " became " payable " to the company in consequence of the transfer of assets effected by the agreement of* 20*th March,* 1933, *and* (2) *that in any event Section* 18 *did not apply because the transfer of assets under that agreement was a bona fide commercial transaction effected mainly for some purpose other than that of avoiding liability to taxation. The Special Commissioners rejected both contentions and confirmed the assessments in principle.*

Held, *that the Commissioners' decision was correct.*

Case

Stated under the Finance Act, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, and the Finance Act, 1936, Section 18, 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] Reported (K.B.) [1941] 2 K.B. 162; (C.A.) [1942] 1 K.B. 299; (H.L.) [1943] A.C. 377.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 8th February, 1940, Mr. Herbert George Latilla (hereinafter called "the Appellant") appealed against the following assessments to Sur-tax:—

(*a*) An assessment for the year ending 5th April, 1936.
(*b*) An assessment for the year ending 5th April, 1937.
(*c*) An additional assessment to Sur-tax for the year ending 5th April, 1938.

He also appealed against the following assessments to Income Tax:—

(*a*) An assessment for the year ending 5th April, 1937.
(*b*) An assessment for the year ending 5th April, 1938.

The figures of such assessments are not material to the points at issue in this case.

The question raised by the appeals relates to the inclusion in the said assessments of sums which have been deemed to be the income of the Appellant for the purposes of the Income Tax Acts by virtue of the provisions of Section 18 of the Finance Act, 1936.

2. About twenty-five years ago Mrs. Ethel May Latilla (the Appellant's wife), Mrs. Jane Johnson, the wife of Lieut. Col. Frank William Frederick Johnson, D.S.O., and Mr. John Mack acquired in equal one-third shares a number of mining claims in Rhodesia known comprehensively as the Golden Valley Mine (hereinafter referred to as "the said mine"). The said mine was acquired for £10,000 on the liquidation of Golden Valley Mines Co., Ltd.

3. At a later date the Appellant's wife transferred by way of gift a one-third share of her one-third interest in the said mine to each of her daughters, Mrs. Edith Mayo and Miss Gwen Latilla (now Mrs. Gwen Latilla Campbell), and from that time there was a partnership in the business carried on at the said mine consisting of the following partners:—

Mrs. Jane Johnson.	Mrs. Gwen Latilla Campbell.
The Appellant's wife.	Mr. John Mack.
Mrs. Edith Mayo.	

Mrs. Jane Johnson and Mr. John Mack had a third share each in the capital and profits of the partnership and the remaining partners a one-ninth share each.

The partners carried on in Rhodesia the business of winning and selling minerals from the said mine, and such business was managed and controlled in Rhodesia.

4. The Appellant's wife, Mrs. Mayo, and Mrs. Gwen Latilla Campbell have at all times material to this case resided in the United Kingdom.

Mrs. Jane Johnson and her husband resided in Rhodesia until March, 1933, and Lieut. Col. Johnson had looked after his wife's interest in the said partnership.

5. By October, 1932, it was known that for reasons of health Lieut. Col. Johnson could not remain in Rhodesia and it was decided that he and Mrs. Johnson should return to the United Kingdom and reside there. In March, 1933, Lieut. Col. and Mrs. Johnson came to the United Kingdom. Mr. Mack remained resident in Rhodesia.

6. When it became known that Lieut. Col. Johnson could no longer remain in Rhodesia, it became necessary that steps should be taken to protect the interests of the partners, other than Mr. Mack.

Mr. Mack refused to consent to the formation of a limited company to take over the partnership business, but he consented to the transfer to such a

company of the partnership rights and interests of Mrs. Jane Johnson, the Appellant's wife, Mrs. Edith Mayo and Mrs. Gwen Latilla Campbell.

7. The Latjohn Trust, Ltd. (hereinafter called " the company "), a company registered with limited liability under the laws of Southern Rhodesia and having its registered office at Bulawayo, was accordingly formed on 20th March, 1933. The capital of the company is £10,007, divided into 10,007 shares of £1 each. A copy of the memorandum and articles of association of the company is attached hereto, marked " A ", and forms part of this Case(1).

8. By an agreement, dated 20th March, 1933, between Mrs. Jane Johnson, the Appellant's wife, Mrs. Edith Mayo and Mrs. Gwen Latilla Campbell (thereinafter called " the sellers ") of the one part and the company of the other part, after reciting that the sellers were carrying on business in partnership with John Mack on the said mine under the style or firm of John Mack and Company, it was agreed that the sellers should sell to the company as from 1st April, 1932, the shares and interests of the sellers in the firm of John Mack and Company for £260,000, to be paid and satisfied by the issue to the sellers of shares and debentures of the company as follows:—

	£1 *shares*	£1 *debentures*
Mrs. Jane Johnson	5,000	125,000
The Appellant's wife	1,667	41,667
Mrs. Edith Mayo	1,666	41,667
Mrs. Gwen Latilla Campbell	1,667	41,666
	10,000	250,000

The said debentures were non-interest bearing debentures. A copy of the said agreement of 20th March, 1933, is attached hereto, marked " B ", and forms part of this Case(1).

Mr. Mack formally consented to the said sale and agreed that as from 1st April, 1932, all the profits, moneys and other benefits of the sellers not already distributed should accrue to and be credited and paid to the company instead of the sellers. The company proceeded to carry on the said business in partnership with Mr. Mack.

9. Copies of the accounts of the company for the years ending 31st December, 1935, 1936 and 1937, are attached hereto, marked " C ", and form part of this Case(1).

From the said accounts it will be seen that the company's share of the profits of the partnership business was as follows:—

Year to 31st December, 1935	£23,314
Year to 31st December, 1936	£10,931
Year to 31st December, 1937	£19,295

No dividends were declared by the company in any of the years 1935, 1936 or 1937, but debentures were redeemed in each of the said years as follows:—
1935 ... 24,000. 1936 ... 22,500. 1937 ... 20,000.

10. The loans to Mrs. Johnson, the Appellant's wife, Mrs. Mayo and Mrs. Gwen Latilla Campbell shown in the company's accounts represent moneys advanced by the company in anticipation of redemption of debentures.

11. Mr. L. C. Walker, an accountant, was called as a witness before us and stated (*inter alia*) as follows:—

(*a*) He had been associated with the Appellant and Lieut. Col. Johnson for many years and advised them on business matters.

(1) Not included in the present print.

(*b*) He visited South Africa in 1932 and 1933 and had inspected the Golden Valley Mine on behalf of the Appellant, the Appellant's wife, Mrs. Mayo and Mrs. Gwen Latilla Campbell.

(*c*) On Lieut. Col. Johnson's return to England in 1933 it was essential that the interests of the partners, other than Mr. Mack, should be safeguarded, and this could best be done by the formation of the company with South African directors.

(*d*) The company also afforded limited liability to its shareholders.

(*e*) The company was not formed mainly with the object of avoiding British taxation.

(*f*) Questions of British and Rhodesian taxation were considered on the formation of the company.

(*g*) When he advised the issue of non-interest bearing debentures he had in mind both British and Rhodesian taxation.

(*h*) No dividends were declared by the company because it was desired to redeem the debentures; and there was a standard instruction that as cash became available it should be utilised in the redemption of the debentures.

(*i*) He agreed that the non-remission of income to the United Kingdom avoided British taxation under Rule 2 of Case V of Schedule D; and he also agreed that this was pointed out to the parties as a secondary advantage of the scheme.

(*j*) He agreed that no double taxation in Rhodesia would have been incurred by the declaration of dividends by the company.

(*k*) Since the Income Tax Ordinance of 1918, the company was liable to Rhodesian Income Tax on its profits. There was, as yet, no Income Tax upon dividends in Rhodesia, but the taxation of dividends had been discussed there and this matter had to be considered in deciding whether debentures should be issued by the company as part consideration for the share of the business it acquired as aforesaid.

(*l*) The avoidance of British taxation was considered but it was not the main purpose of the formation of the company.

12. It was contended on behalf of the Appellant that:—

(*a*) No income became " payable " to the company within the meaning of Section 18, Finance Act, 1936, in consequence of the transfer of assets to the company under the said agreement for sale dated 20th March, 1933.

(*b*) The company was carrying on business in partnership with Mr. Mack, and earned its income.

(*c*) The transfer of assets effected by the agreement of 20th March, 1933, was effected mainly for some purpose other than the purpose of avoiding liability to taxation.

(*d*) The said transfer was a bona fide commercial transaction and not designed for the purpose of avoiding liability to taxation.

(*e*) A transfer of assets situate outside the United Kingdom does not fall within Section 18 of the Finance Act, 1936.

13. It was contended on behalf of the Crown that:—

(*a*) The transfer of assets effected by the agreement of 20th March, 1933, was a transfer of assets to a person resident out of the United Kingdom by individuals resident in the United Kingdom, and falls within the provisions of Section 18 of the Finance Act, 1936.

(*b*) By virtue of the said transfer, income became payable to the company.

(*c*) By reason of the said transfer, Mrs. Johnson, the Appellant's wife, Mrs. Mayo and Mrs. Gwen Latilla Campbell had power to enjoy the income of the company.

(*d*) The said transfer was not effected mainly for a purpose other than the purpose of avoiding taxation.

(*e*) The said transfer was not a bona fide commercial transaction and was designed for the purpose of avoiding liability to taxation.

(*f*) The assessments were correct in principle and should be upheld.

14. Having considered the arguments and evidence adduced before us; we held that the transfer of assets effected by the agreement of 20th March, 1933, was a transfer of assets within the terms of Section 18, Finance Act, 1936, and that by reason of the said transfer income became payable to the company.

We further held that the said transfer for shares and non-interest bearing debentures was effected mainly for the purpose of avoiding British taxation and was not a bona fide commercial transaction.

We, therefore, confirmed the assessments in principle and at a later date adjusted the said assessments to figures agreed between the parties.

15. The Appellant immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1927, Section 42 (7), Income Tax Act, 1918, Section 149, and the Finance Act, 1936, Section 18, which Case we have stated and do sign accordingly.

N. ANDERSON,
F. ENGLAND, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.
21st January, 1941.

The case came before Lawrence, J., in the King's Bench Division on 28th and 29th April, 1941, and on the latter date judgment was given in favour of the Crown, with costs.

Mr. J. Millard Tucker, K.C., and Mr. Terence Donovan appeared as Counsel for the Appellant, and the Attorney-General (Sir Donald Somervell, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lawrence, J.—The questions in this case are, first, whether in the circumstances there has been a transfer of assets " by virtue or in consequence " whereof . . . income becomes payable to persons resident or domiciled out " of the United Kingdom ", and, secondly, whether there was evidence upon which the Special Commissioners were entitled to come to the conclusion that they were not satisfied that the transfer in question was " effected mainly for " some purpose other than the purpose of avoiding liability to taxation."

The facts are set out in the Case, and are substantially as follows. Some twenty-five years ago the Appellant's wife, a Mrs. Johnson, and a Mr. Mack

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acquired in partnership in third shares a gold mine in South Africa called the Golden Valley Mine, for which they paid £10,000 on the liquidation of the Golden Valley Mines Co., Ltd. At a later date the Appellant's wife gave one-third of her one-third interest in the mine to each of her two daughters, Mrs. Mayo and Miss Latilla (who is now Mrs. Campbell). The mine was worked on behalf of the partnership until 1933. In 1933 Colonel Johnson, the husband of Mrs. Johnson, who had up to that time been resident in Rhodesia where the mine was, had to come back to this country, and it was then considered desirable that the arrangements should be altered, and that there should be somebody in Rhodesia besides Mr. Mack who should look after the interests of the Appellant's wife and Mrs. Johnson. Accordingly, the transfer in question was made by an agreement dated 20th March, 1933, whereby the Appellant's wife, Mrs. Johnson, Mrs. Mayo and Mrs. Campbell transferred their interests in the mine to a company called Latjohn Trust, Ltd., which had been formed for the purpose of entering into this agreement. The consideration which the transferors received for the transfer was 10,000 £1 ordinary shares and £250,000 of non-interest bearing debentures. No dividend has ever been declared upon the ordinary shares, but non-interest bearing debentures have been redeemed in the years in question. In 1935 £24,000 worth of non-interest bearing debentures were redeemed, in 1936 £22,500 worth, and in 1937 £20,000 worth. In addition to the proof of these facts an accountant was called and he gave evidence as to the reasons why this arrangement had been made.

The Special Commissioners decided that there had been a transfer of assets by virtue or in consequence whereof income became payable to Latjohn Trust, Ltd.—persons resident or domiciled out of the United Kingdom—and that it was for the purpose of avoidance by the Appellant, who was ordinarily resident in the United Kingdom, of his liability to Income Tax, and they held that the Appellant had not satisfied them that the transfer was effected mainly for some purpose other than the purpose of avoiding liability to taxation within the meaning of the proviso to Sub-section (1) of Section 18 of the Finance Act, 1936.

From this decision the Appellant appeals, and Mr. Tucker, on his behalf, argues that under the transfer, which he admits took place, income did not become payable to Latjohn Trust, Ltd., within the meaning of Section 18. He admits also that the Appellant had power, through his wife, to enjoy the income within the meaning of Section 18, but he contends that the income did not become payable, within the meaning of that Section, to Latjohn Trust, Ltd. He relies principally upon the case of *Trustees of Psalms and Hymns* v. *Whitwell*, 3 T.C. 7, where it was held that trading profits which were made by the trustees in question were not yearly interest or other annual payments within the meaning of Section 105 of the Income Tax Act, 1842, and the case of *Rex* v. *Special Commissioners of Income Tax* (Ex parte *Shaftesbury Homes and Arethusa Training Ship*), 8 T.C. 367, where a testator had bequeathed to trustees a business, the profits of which were by his will to be paid to a charitable institution, the Shaftesbury Homes, and it was there held that the payment of such profits to the Shaftesbury Homes was an annual payment under Section 105, on the ground that the Shaftesbury Homes did not make the profits themselves but had them paid to them by the trustees, and that, therefore, the case was distinguishable from the case of *Trustees of Psalms and Hymns*.

Mr. Tucker's argument is that trade profits made by a person cannot be said to be " income payable " to him, nor can trade profits made by a partnership be said to be " income payable " to one of the partners. He says

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that, if the Finance Act of 1936 had intended to strike at trade profits, the words used would have been " income arising to persons resident or domiciled " out of the United Kingdom ", and he says that the words " income becomes " payable to persons resident out of the United Kingdom " are totally inapplicable to trade profits which are made by such persons.

Upon the other point he contended that the Commissioners could not reasonably have come to the conclusion that they were not satisfied that the transfer was effected mainly for some purpose other than the purpose of avoiding liability to taxation. He also said that the words in which they expressed their decision upon this point, namely: " We further held that the " said transfer for shares and non-interest bearing debentures was effected " mainly for the purpose of avoiding British taxation and was not a bona fide " commercial transaction ", indicated some error of law.

I will deal with the second point first. In my opinion there was evidence upon which the Commissioners might come to the conclusion to which they came, and there is nothing in the words which they used to indicate that they were in any legal error.

On the first point it appears to me that it is one thing to say that trade profits are not yearly interest or other annual payments under Section 105 of the Act of 1842, and it is quite another thing, when an Act to prevent tax evasion refers expressly to income which, by virtue of transfer of assets, becomes payable to A but remains capable of enjoyment by B, to say that it was intended to exclude all income from trade profits. One finds in the Statute of 1936 the word " assets " used in the widest sense—they produce income. To whom then does the income become payable? Mr. Tucker says that it becomes payable to no one, although in fact it is received by Latjohn Trust, Ltd. abroad and paid over to the Appellant's wife in this country. I am unable to accept that argument, and it appears to me that the cases to which he has referred are distinguishable because they were decided upon different words in a different context, and were decisions upon the construction of an exemption clause in an Income Tax Act which exempted yearly interest or other annual payments, which words had been used in other parts of the Act in contradistinction to trade profits. It is, therefore, easy to understand why the Courts held that the exemption was inapplicable to trade profits which had been distinguished from yearly interest and other annual payments in other parts of the Statute. The Act of 1936 is dealing with quite a different topic. It is expressly for the purpose of preventing the avoidance of tax by individuals ordinarily resident in the United Kingdom. In a sense, it contrasts income which becomes payable to one person although the power to enjoy it remains with someone else. The words are, in my opinion, amply wide enough to cover the facts of the present case. I am, therefore, of opinion that the decision of the Special Commissioners was correct on both points, and the appeal will be 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 Greene, M.R., and Clauson and du Parcq, L.JJ.) on 11th and 12th November, 1941, when judgment was reserved. On 16th December, 1941, judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. Terence Donovan appeared as Counsel for the Appellant, and the Attorney-General (Sir Donald Somervell, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Greene, M.R.—The judgment which I am about to read is the judgment of the Court.

The questions raised by this appeal are short and the answers to them do not, in our judgment, admit of doubt. They arise in the following circumstances. On 20th March, 1933, by an agreement of that date, four ladies, the Appellant's wife, Mrs. Latilla, and her two daughters and a Mrs. Jane Johnson, being all at that time resident in the United Kingdom, sold to a company called Latjohn Trust, Ltd. their shares in a mining partnership having the firm name of John Mack and Company. The shares in question were two one-third shares of which one was owned by Mrs. Johnson, and the other by Mrs. Latilla and her two daughters in equal thirds. The remaining one-third share in the partnership belonged to a Mr. John Mack who lived in Rhodesia, where the mine owned by the partnership was situated. Latjohn Trust, Ltd. was a limited company incorporated under the laws of Southern Rhodesia where it was admittedly resident during the period with which this appeal is concerned. The incorporation took place on the same day as the sale agreement. The consideration to which the four ladies were entitled under the agreement consisted of shares and non-interest bearing debentures in the company in each case of the nominal value of £1, the Appellant's wife receiving 1,667 shares and 41,667 debentures. The sale was to take effect as from 1st April, 1932.

Latjohn Trust, Ltd. proceeded to carry on business in partnership with Mr. Mack who had consented to the sale. The terms of the partnership as it existed between Mr. Mack and the four ladies and later between Mr. Mack and the company are not stated. The accounts show the sums receivable by the company in the various years in respect of its two-thirds share of the profits of John Mack and Company. The company has never declared a dividend, but has applied its profits in redeeming debentures. It has been the practice of the four ladies to borrow money from the company in anticipation of the redemption of debentures which they held.

Until the Finance Act, 1936, came into force, Mrs. Latilla, as the result of these transactions, was able to obtain for herself a share of the profits which the company derived from the partnership business without incurring for herself or her husband any liability to British Income Tax. She, or rather her husband as the person assessable in respect of her income, now claims that the provisions of that Act have not altered the position. The Crown, on the other hand, claims that by reason of Section 18 of the Finance Act, 1936, Income Tax and Sur-tax are payable by Mr. Latilla in respect of income of the company which Mrs. Latilla admittedly has power to enjoy within the meaning of Sub-section (3) of that Section. The details of the assessments which have given rise to the controversy need not be stated.

The Special Commissioners found that the transfer of the shares in the partnership to the company was effected mainly for the purpose of avoiding British taxation, and was not a bona fide commercial transaction. This finding goes farther than is required by the proviso to Sub-section (1) of Section 18, in force at the relevant times, which threw the burden of proof on the taxpayer. Nevertheless, an attempt was made, not very vigorously, to attack it on some ground which we must confess remains obscure to us. There was ample evidence to support the finding which is quite unassailable and we therefore say no more about it.

The substantial argument presented on behalf of the Appellant was concerned with the words " income becomes payable " in the preamble to Section 18. It is not disputed that, if those words are apt to describe the share of partnership profits received by the company, the operative part of the Section applies to the case and the assessments, as agreed, are valid

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assessments. It is, accordingly, unnecessary to refer to the complicated provisions of the operative part of the Section. The preamble explains the purpose of the legislation, namely, to prevent " the avoiding by individuals " ordinarily resident in the United Kingdom of liability to income tax by " means of transfers of assets by virtue or in consequence whereof, either " alone or in conjunction with associated operations, income becomes payable " to persons resident or domiciled out of the United Kingdom ". It is notorious that previously to the passing of this legislation individuals who were minded to enjoy their income without bearing the appropriate burden of British taxation were able to do so by transferring assets productive of income to a non-resident person or company by whom the income was retained abroad so as not to incur taxation here. The money representing the income was then by means of one or other of several well-known expedients transferred to this country as capital. The device used in the present case of transferring money by repayment of debentures was a favourite one, and it was effective for its purpose. These ingenious schemes the Legislature set out to defeat in Section 18 of the Finance Act, 1936, and the question which arises in the present appeal is whether or not the transaction now under consideration falls outside its scope.

As we have said, the answer depends on the true construction of three words in the preamble. It was argued by Mr. Tucker on behalf of the Appellant that the operative provision of Sub-section (1) of Section 18 is confined to cases where the transfer of assets which has taken place is of the description mentioned in the preamble, namely, a transfer of assets " by virtue " or in consequence whereof, either alone or in conjunction with associated " operations, income becomes payable to persons resident or domiciled out " of the United Kingdom ". With this argument we agree, since the words " any such transfer " in Sub-section (1) clearly refer to a transfer of the description mentioned in the preamble. Mr. Tucker then argued that the transfer in the present case, although it was a transfer of assets within the comprehensive definition contained in Sub-section (5), was not a transfer of that description since no income became " payable " to the company. He pointed out quite correctly that the assets transferred in the present case were shares in a partnership together with the interests of the transferors in the mining property itself, and that the income derived by the company was derived through the activities of the partnership in exploiting the mine. He contended that the words were not apt to describe income derived by a person's own exertions since income so earned is his own and cannot be said to be " payable " to him. In the special case of a partnership he referred to the limitations which existed at Common Law upon the right of partners to sue one another and he claimed that the share of partnership profits to which the company became entitled could not be described as income which became " payable " to the company. We disagree with all these contentions in their application to the facts of the present case and we need not discuss their wider implications.

The share of the profits of the partnership to which the company is entitled is that share which comes to it in accordance with the terms of the partnership. The company is entitled to call upon its partner to do whatever may be necessary, for example, by signing a cheque on the banking account of the partnership to enable the company to obtain its share. In the partnership accounts the company's undrawn share of profits would appear as a debt owing to the company. If the profits were under the control of the other partner, the company could, by appropriate proceedings, compel him to pay over its share. If this is not income " payable " to the company, we do not

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know what it is. With regard to the argument that it was not the transfer of assets which produced the income but the activities of the partners, we agree with the argument submitted by the Attorney-General that those activities are " associated operations " within the definition of that phrase in Sub-section (2). By that Sub-section, so far as is relevant, an associated operation means, in relation to any transfer, " an operation of any kind " effected by any person in relation to any of the assets transferred ", words of the widest import which, in our judgment, clearly cover the operation of turning the assets to account.

Although the figures are agreed, we must refer to a suggestion made by the Attorney-General in the course of his argument to the effect that the Crown in such a case as the present was entitled to go behind the accounts as agreed between the partners and examine the accounts of the partnership itself in order to ascertain what, in the view of the Crown, the profits of the partnership were. In our opinion this would not be legitimate. The " income " payable " to a partner is his share of the partnership profits which the partners in accordance with the partnership agreement determine to divide. He cannot demand more. It is right to say that the Attorney-General finally accepted the position that in the present case the Crown was bound to accept the actual amounts received by the company as being the correct basis for the assessments.

The appeal is dismissed with costs.

Mr. Tucker.—May I ask your Lordships for leave to appeal in this case? There is a considerable sum of money involved, although your Lordships have not got the exact figures before you, and, of course, as far as I know, this position will go on from year to year.

Lord Greene, M.R.—Mr. Stamp, we have considered this possibility of such an application being made and, subject to anything you may say, we take the view that it is one which should be granted.

Mr. Stamp.—My Lord, I respectfully submit to that view of the case, seeing that the amount at stake is sufficient to justify an appeal. Your Lordship sometimes puts the Crown on terms, but I think that only applies where the case in itself on its own basis is not sufficient to justify an appeal. An appeal is only justified because it is a test case.

Lord Greene, M.R.—Where the establishment of a principle is of great importance to the Crown but of no importance whatever to the taxpayer?

Mr. Stamp.—Yes.

Lord Greene, M.R.—Very well, Mr. Tucker, you may take leave.

Mr. Tucker.—If your Lordship pleases.

An appeal having been entered against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Simon, L.C., and Lords Atkin, Thankerton, Russell of Killowen and Porter) on 8th, 9th and 10th December, 1942, when judgment was reserved. On 11th February, 1943, judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., and Mr. Terence Donovan appeared as Counsel for the Appellant, and the Attorney-General (Sir Donald Somervell, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Viscount Simon, L.C.—My Lords, of recent years much ingenuity has been expended in certain quarters in attempting to devise methods of disposition of income by which those who were prepared to adopt them might enjoy the benefits of residence in this country while receiving the equivalent of such income, without sharing in the appropriate burden of British taxation. Judicial dicta may be cited which point out that, however elaborate and artificial such methods may be, those who adopt them are " entitled " to do so. There is, of course, no doubt that they are within their legal rights, but that is no reason why their efforts, or those of the professional gentlemen who assist them in the matter, should be regarded as a commendable exercise of ingenuity or as a discharge of the duties of good citizenship. On the contrary, one result of such methods, if they succeed, is, of course, to increase *pro tanto* the load of tax on the shoulders of the great body of good citizens who do not desire, or do not know how, to adopt these manœuvres. Another consequence is that the Legislature has made amendments to our Income Tax code which aim at nullifying the effectiveness of such schemes.

The question in the present appeal is whether Section 18 of the Finance Act, 1936, has the result of checkmating the design of avoiding Income Tax and Sur-tax which was the main purpose of certain highly artificial dispositions made in 1933. The Appellant contended before the Special Commissioners, before Lawrence, J., and before the Court of Appeal, that the avoidance of British taxation was not the main purpose of these arrangements. He failed in this contention at each stage. One of the reasons adduced in his printed Case to this House is that the scheme adopted in 1933 " was a " bona fide commercial operation not designed for the purpose of such " avoidance ". If this were true the scheme would have come within the exemption provided, as the law then stood, for operations not effected for the main purpose of avoiding liability to taxation, and the Appellant would escape tax. Counsel for the Appellant prudently decided to drop the contention. The contrary finding adopted by the Special Commissioners and affirmed by both Courts below, is, as the Master of the Rolls says, " quite " unassailable ".

Nevertheless, if the Crown is unable to bring the scheme of 1933 within the range covered by Section 18 of the Finance Act, 1936, the Appellant must succeed. The issue turns on a comparison of the particular arrangements now before us and of the language of the Section.

The arrangements, so far as relevant, can be summarised as follows. There existed in Rhodesia a partnership firm called John Mack and Company which owned and worked an enterprise known as the Golden Valley Mine. Mr. Mack, who lived in Rhodesia, owned a one-third share. Four ladies, namely, the Appellant's wife, her two daughters, and Mrs. Jane Johnson, owned the rest. On 20th March, 1933, by an agreement of that date, these four ladies, being all at that time resident in the United Kingdom, sold as from 1st April, 1932, their shares in the partnership to a limited company formed for the purpose and registered on the same date under the laws of Southern Rhodesia. The company was named the Latjohn Trust, Ltd. The consideration was £260,000, satisfied by the issue to the sellers of 10,000 £1 shares, and 250,000 debentures of £1 each. The debentures carried no interest, and there was no provision as to period of redemption. It is manifest that they were brought into existence merely in order that their redemption might serve as a means, from time to time, of transferring part of the profit of the mine to these ladies in the form of capital. The Appellant's wife was entitled to one-sixth of the consideration, that is, 1,667 shares and 41,667 debentures.

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Latjohn Trust, Ltd. proceeded to carry on business in partnership with Mr. Mack, and the accounts show the sums receivable by the company in the various years in respect of its two-thirds share of the profits of John Mack and Company. Latjohn Trust, Ltd. has never declared a dividend, but has applied its profits in redeeming debentures. It has been the practice of the four ladies to borrow money from the company in anticipation of the redemption of debentures which they held.

Until the Finance Act, 1936, came into force, Mrs. Latilla, as the result of these arrangements, was able to obtain for herself a share in the profits which the Latjohn Trust, Ltd. derived from the partnership business, without incurring for herself or for her husband, the Appellant, any liability to British Income Tax. Admittedly, by receiving sums in redemption of her debentures, she has " power to enjoy " income of the Latjohn Trust, Ltd. (see Sub-section (3) of Section 18 of the Finance Act, 1936). The decisive question is whether the right by virtue of which she has this power to enjoy has been acquired by means of the sort of transfer to which Section 18 applies.

Section 18 begins as follows:— " For the purpose of preventing the " avoiding by individuals ordinarily resident in the United Kingdom of " liability to income tax by means of transfers of assets by virtue or in " consequence whereof, either alone or in conjunction with associated " operations, income becomes payable to persons resident or domiciled out " of the United Kingdom, it is hereby enacted as follows:— (1) Where such " an individual has by means of any such transfer, either alone or in con- " junction with associated operations, acquired any rights by virtue of which " he has, within the meaning of this section, power to enjoy, whether " forthwith or in the future, any income of a person resident or domiciled " out of the United Kingdom which, if it were income of that individual " received by him in the United Kingdom, would be chargeable to income " tax by deduction or otherwise, that income shall, whether it would or would " not have been chargeable to income tax apart from the provisions of this " section, be deemed to be income of that individual for all the purposes " of the Income Tax Acts ".

The Appellant correctly argues that " any such transfer " in Sub-section (1) means any " transfer of assets by virtue or in consequence whereof, " either alone or in conjunction with associated operations, income becomes " payable " to the company. He then contends—and this is the pinch of the case—that trade profits made by a partnership cannot be said to be income a share of which " becomes payable " to one of the partners. One partner, it is said, is not a creditor of the partnership: the share of partnership profits to which the Latjohn Trust Company became entitled could not, in this view, be described as income which " became payable " to the company.

The answer to this argument is to be found in the powerful judgment of Lawrence, J.. and again in a passage from the judgment of the Master of the Rolls which I would respectfully adopt as expressing with the greatest clearness and precision the true view of the application of Section 18 to the facts of this case. Speaking for the Court of Appeal, Lord Greene declared his disagreement with the Appellant's arguments and continued: " The share " of the profits of the partnership to which the company is entitled is that " share which comes to it in accordance with the terms of the partnership. " The company is entitled to call upon its partner to do whatever may be " necessary, for example, by signing a cheque on the banking account of " the partnership to enable the company to obtain its share. In the partner- " ship accounts the company's undrawn share of profits would appear as " a debt owing to the company. If the profits were under the control of the

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" other partner, the company could, by appropriate proceedings, compel him " to pay over its share. If this is not income ' payable ' to the company, " we do not know what it is. With regard to the argument that it was not " the transfer of assets which produced the income but the activities of the " partners, we agree with the argument submitted by the Attorney-General " that those activities are ' associated operations ' within the definition of " that phrase in Sub-section (2). By that Sub-section, so far as is relevant, " an associated operation means, in relation to any transfer, ' an operation " ' of any kind effected by any person in relation to any of the assets " ' transferred ', words of the widest import which, in our judgment, clearly " cover the operation of turning the assets to account."(1) These words of the Master of the Rolls completely justify the conclusion that the Appellant's attempt to avoid British Income Tax and Sur-tax by these artificial arrangements has been frustrated by the Act of 1936.

This is not a case requiring an examination of previous authority, but I may add that, in my opinion, the two decisions cited by the Appellant on the meaning of " annual payment " in Section 105 of the Income Tax Act, 1842 (*Trustees of Psalms and Hymns* v. *Whitwell*, 3 T.C. 7, and *Rex* v. *Special Commissioners of Income Tax* (Ex parte *Shaftesbury Homes and Arethusa Training Ship*), 8 T.C. 367), have no bearing here. A recent decision of this House in *Commissioners for General Purposes* v. *Gibbs*, [1942] A.C. 402; 24 T.C. 221, goes to show that the technical view of the nature of partnership in English law cannot always be taken in applying the law of Income Tax.

I move that the appeal be dismissed with costs.

My Lords, I am authorised by my noble and learned friends **Lord Atkin** and **Lord Russell of Killowen** to say that they concur in the opinion which I have delivered.

Lord Thankerton.—My Lords, I concur.

Lord Porter.—My Lords, the conclusion which your Lordships have to reach in this case depends upon the construction and effect of Section 18 of the Finance Act of 1936.

That Section, and the facts upon which its provisions must operate in the circumstances under consideration, have already been set out and it is unnecessary to repeat them. The Section contains a proviso exempting cases where the subject shows to the satisfaction of the Special Commissioners that the transfer dealt with was effected for some purpose other than avoiding liability to taxation. This proviso was amended in 1938 (Finance Act, 1938, Section 28 (2)) so as to have a stricter application, but whether the earlier or later provisions be applicable, the Commissioners have found (and it is now conceded that we are bound by their finding) that in the present instance they are not so satisfied.

The main argument, however, presented to your Lordships was centred upon the words " payable to ". It was said that those words necessitated the existence of a payer and a payee, and that income could not become " payable " out of partnership funds to a company which was a member of the partnership. A partner, it was contended, was already the owner, amongst other things, of his share of the partnership profits and could no more pay himself out of those profits than an individual could pay himself out of the profits of his own business.

No doubt, it is true to say that an individual cannot pay himself, if " pay " be used in its strict sense. But no question of an individual's ability to do so arises here. The only question is whether income can be said to be payable

(1) *See* page 115 *ante*.

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to a partner out of the partnership assets. I think it can. " Payable " is not a term of art, and though a partner cannot sue the partnership or the partners individually in order to recover partnership assets, yet, as the Master of the Rolls points out, he has at his disposal means whereby he can ensure that his share reaches his hands. In such circumstances it seems to me that the word " payable " is appropriately used and accurately conveys the process by which the income finds its way into the pocket of the individual. It would, I think, not inaccurately be described as having been paid to him out of the partnership funds.

The Appellant, however, sought to support his argument by the suggestion that, though Cases I and II of Schedule D have provided appropriate machinery for calculating what the profit of a business is, no such machinery exists in the case of Section 18 of the Act of 1936. He maintained that this omission showed that moneys earned by the personal carrying on of a business abroad, whether alone or in partnership, were not intended to be subject to tax under this Section. No doubt, this is a matter for consideration, but it is an element only and not a very important one. I can see no reason why a proper estimate cannot be made where the case requires it.

As the Lord Chancellor has already observed, the principles laid down in the cases quoted to your Lordships, reported in 3 T.C.7 and 8 T.C. 367, are not applicable here. They deal with different wording, and in those instances no partnership existed. Whatever may be the true view in the circumstances which existed in them, they do not touch the case where money is receivable by a partner out of partnership property.

I agree that the appeal should be dismissed.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Birkbeck, Julius, Edwards & Co.; Solicitor of Inland Revenue.]