NO. 1325—COURT OF SESION (FIRST DIVISION)—21ST AND 22ND MARCH, 1944

HOUSE OF LORDS—7TH AND 10TH MAY AND 30TH JULY, 1945

COMMISSIONERS OF INLAND REVENUE v. COOK[1]

Income Tax—Repayment claim—Annuity under will " payable free of all " deductions including Income Tax "—Annuitant required to pay over to trustees any tax recovered by her—Amount of annuitant's income under will for purposes of repayment claim by her.

The Respondent was entitled under the will of her aunt who died in 1937 *to an annuity at the rate of* £100 *per annum payable " free of all deductions " including Income Tax and Government duty ". The annuity was paid wholly out of income which had been brought into charge to Income Tax. The annuity was the Respondent's sole income and she received repayment of Income Tax for the years prior to* 1939–40 *on the basis that she was entitled to* £100 *grossed at the standard rate. She claimed repayment of Income Tax for the year* 1939–40 *on a similar basis, but the Inspector of Taxes, having discovered that she had been required to pay over to the trustees the amount of tax repaid for the previous years, objected to the claim, contending* (inter alia) *that her annuity was not an annuity of such a sum as after deduction of Income Tax left* £100, *but an annuity of* £100 *plus the tax* (*if any*) *liable to be ultimately borne by her in respect thereof, and that, as she was not liable to Income Tax* (*her income being under the exemption limit of* £125), *her annuity for the purposes of the repayment claim was* £100 *and no more.*

On appeal the General Commissioners held, by a majority, that she was entitled to repayment on the basis that her income was £100 *grossed at the standard rate.*

Held, *that the decision of the majority of the General Commissioners was correct.*

CASE

At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Edinburgh held at Edinburgh on 4th November, 1940, Miss Minnie Cook (hereinafter called " the Respondent ") appealed against an objection made by the Inspector of Taxes to a claim made by the Respondent for repayment of Income Tax for the year ended 5th April, 1940.

I. The following facts were admitted as proved :—

(1) Mrs. Margaret Jessie Cook or Penny or Forrest died on 24th September, 1937. By the third purpose of her trust disposition and settlement she directed her trustees " out of the free annual income derived from the heritable subjects " which shall belong to me at the time of my death to pay to my nephew Harold " Hope Cook presently a patient at New Saughton Hall, Polton, Midlothian, " an annuity or yearly sum at the rate of one hundred and fifty pounds per " annum for the remainder of his life after my decease and to my niece Miss " Minnie Cook, residing at Seven Annandale Street, Edinburgh, an annuity or " yearly sum at the rate of one hundred pounds per annum for the remainder " of her life after my decease both of which annuities shall be payable at two " terms in the year Whitsunday and Martinmas beginning at the first of these

[1] Reported (C.S.) 1944 S.C. 286 : (H.L.) [1946] A.C.1 ; 1945 S.C. (H.L.) 52.

"terms after my death with the proportion for the period from my death to "that term and so forth thereafter at the said two terms: declaring that the "said annuities (one) shall be purely alimentary and not capable of anticipation "or subject to the debts or deeds of the said Harold Hope Cook and Miss "Minnie Cook or liable to the diligence of their respective creditors and (two) "shall be payable free of all deductions including Income Tax and Government "duty".

(2) At each term of Whitsunday and Martinmas since the death of the testatrix the trustees acting under her trust disposition and settlement paid to the Respondent the sum of £50 in respect of the said annuity for the half year preceding. When making the payments the trustees gave to the Respondent a certificate in the form hereinafter referred to. The annuity was paid wholly out of income that had already been brought into charge to tax. Included in the sum brought into charge was a gross sum of £153 16*s*. 11*d*., of which £100 was paid to the annuitant and £53 16*s*. 11*d*., being Income Tax on the said gross sum at the full standard rate in force during the year ended 5th April, 1940, namely 7*s*. in the £, was accounted for to the Inland Revenue.

(3) The Respondent, who had no income other than the said annuity, from time to time lodged with the Inspector of Taxes claims for the repayment of the Income Tax shewn by the said certificates to have been deducted and retained by the trustees on payment of the annuities.

(4) For all years prior to the year ended 5th April, 1940, repayment of Income Tax was given in accordance with the claims.

(5) On 2nd January, 1940, the Respondent lodged with the Inspector of Taxes a claim for the repayment of Income Tax for the year to 5th April, 1940. That claim shewed the Respondent's total income from all sources as follows :—

"*Source of income.*	*Amount of income before deduction of tax.*	*Amount of Income Tax deducted.*
"Annuity of £100 per annum free of "tax from Mrs. M. J. Forrest's Trust.	£153 16 11	£53 16 11"

The repayment claim form shewed that there were no charges on the Respondent's income and repayment of £47 11*s*. 4*d*. of tax was claimed. The said sum was made up as follows :—

(*a*) a personal allowance of tax at the full standard rate of 7*s*. on £100	£35 0 0
(*b*) an allowance of two-thirds of tax at the standard rate on £53 16*s*. 11*d*.	12 11 4
	£47 11 4

(6) The amounts of the Respondent's income and of the tax claimed to have been deducted therefrom as appearing in the said repayment claim were vouched by a certificate granted by the solicitors for the said Mrs. Forrest's trust in the following terms :—

"Income Tax
"(Beneficiary of Trust)

"I hereby certify that Miss Minnie Cook of 41 Colinton Mains Grove, "Oxgangs, Edinburgh, is a beneficiary of the Trust known as Mrs. M. J. Forrest's "Trust to the extent of £100 and that the following particulars are correct.

" Information regarding this trust has been or will be furnished to H.M. " Inspector of Taxes, 1st Edinburgh District.

" Signature of Trustee (or auth- " orised agent for the Trust) } Cooper & Brodie.

" Address—40 Castle Street, " Edinburgh.

" Date—3rd January, 1940.

" Income for the year ended 5th April, 1940.

" *Gross amount on which* " *tax has been suffered* " *by the beneficiary.*	*Amount of Income Tax suffered thereon by the beneficiary.*	*Amount of the net payment actually made to or for the benefit of the beneficiary.*
" £153 16 11	£53 16 11	£100 "

(7) On enquiry the Inspector of Taxes was informed during the year ended 5th April, 1940, by the said solicitors that the Income Tax repaid to the Respondent in former years in respect of the said annuity had been handed over by her to the said solicitors on behalf of the trust, so that the Respondent was left with only £100 each year as income.

(8) The Inspector of Taxes intimated to the Respondent's solicitors (who are also the solicitors to the trustees) on 20th March, 1940, that, if her right under the will was to £100 net (i.e., after deduction of Income Tax), she should have been allowed to retain the Income Tax repaid to her, but as the trustees had required her to pay over to them the tax recovered by her this indicated that they accepted the principle that her right under the will was only to £100 in cash after the Income Tax liability had been met, and that, in a case of this type where the annuitant was not liable to tax, the annuity was not increased by the free of tax provision and that repayment was only due on £100.

(9) The said solicitors would not accept this restricted repayment, but insisted on repayment on the basis that the Respondent's income for the year in question was £153 16*s*. 11*d*.

II. It was contended on behalf of the Respondent, *inter alia* :—

1. That the Respondent was in terms of the said trust disposition and settlement entitled to an annuity of £100 free of all deductions including Income Tax, and that the trustees were bound in the year in question, in order to make payment of the said annuity and to satisfy the liability to Income Tax, to retain in their hands a gross sum of £153 16*s*. 11*d*. and to account to the Inland Revenue for tax thereon at the standard rate.

2. That the amount of tax actually accounted for to the Inland Revenue by the trustees in respect of the income required to satisfy the annuity was in excess of the amount of tax due by the Respondent and that such excess should be repaid.

3. That the Respondent was entitled to claim repayment of Income Tax on the basis of a gross income of £153 16*s*. 11*d*.

4. That the Respondent is the only person entitled under the Income Tax Acts to claim repayment of the Income Tax which the said annuity has borne in the hands of the trustees.

5. That the Commissioners of Inland Revenue have no concern with how the sum repaid to the Respondent by way of relief from Income Tax is applied in a question between her and the trustees, and in any event the Respondent was bound to pay to the trustees the amount of tax recovered by her.

6. That in any event there is no distinction for revenue purposes between an annuity payable "free of all deductions including Income Tax" and an annuity of such sum as after deduction of Income Tax will be equal to an annuity of a stated amount.

III. It was contended on behalf of the Crown, *inter alia* :—

(1) That the Respondent's annuity was not an annuity of such a sum as after deduction of Income Tax left £100, but an annuity of £100 plus the tax (if any) liable to be ultimately borne by her in respect thereof, and that this view was confirmed by the action of the parties.

(2) That, as the Respondent's income was under the exemption limit of £125, she was not liable to Income Tax and the annuity was accordingly £100 and no more.

(3) That the payment of £100 was either a payment in full without deduction of Income Tax, in which case the Respondent was not entitled to any repayment, or it was a payment of £100 under deduction of Income Tax under Rule 19 of the General Rules applicable to all Schedules of the Income Tax Act, 1918, accompanied by a temporary advance of a sum equal to the tax so deducted until such time as the Income Tax deducted should be repaid ; and

(4) that repayment of Income Tax was not due on any sum in excess of £100.

IV. After consideration we, by a majority, allowed the appeal.

James F. Fairweather, W. S., gave an opinion (in which Sheriff Charles H. Brown, K.C., concurred) as follows :—

" The will in question bequeaths to the Appellant an alimentary annuity of " £100 ' free from all deductions including Income Tax.'

" The Appellant maintains that the tax payable in respect of the annuity " should be grossed so as to entitle her to make a claim for repayment of tax. " The Revenue contend that the words are merely an indemnity protecting an " annuitant against being called upon to pay tax and that the tax paid does not " fall to be grossed.

" The first impression created on reading the clause is that in the words of " an English Judge (Peterson, J., in In re *Crawshay*, [1915] W.N. 412) the " testator meant to say ' I direct that the annuitant is to get payment of the " ' specified sum without deduction even of Income Tax,' but an impression " gathered from the words alone requires to be tested by consideration of all " other relevant factors, and in this case there are, in my view, such factors.

" When a bequest without deduction of legacy duty or free of legacy duty " is given it is recognised that this is a bequest of an additional sum equal to the " legacy duty. In *Kinloch's Trustees*, 7 R., at page 599, Lord Gifford says, " ' It is precisely the same with the Income Tax.' In *Hunter's Trustees* v. " *Mitchell*, 1930 S.C., at page 982, Lord Sands says : ' When under a will an " ' annuity is payable free of income tax the amount of the tax is taken to be " ' an additional gift, and is included in the income of the annuitant when, for " ' revenue purposes, a return of total income is necessary. Further, the " ' income from this source is not the annuity plus the tax upon it, but the " ' amount of the annuity plus such sum that, when the tax is levied upon the " ' total amount, the net amount left will be the amount of the annuity.'

" When a testator bequeaths an annuity and directs that the Income Tax " payable in respect of it shall not be paid by the annuitant, he obviously " visualises that the tax must come out of another part of his estate. That " benefit is as much an expression of the testator's bounty towards the annuitant

"as the specified sum. If a dividend be declared free of Income Tax what is "given is not only the dividend but the additional benefit represented by the "freedom from tax.

"In deciding the case of In re *Pettit*, [1922] 2 Ch. 765, Romer, J., stated that "he could see no ground for repaying tax to a person who had not paid and "withholding it from the residuary legatees who had paid. In a later case, "*Lord Michelham's Trustees* v. *Commissioners of Inland Revenue*, 15 T.C., at "page 751, the same Judge (then Romer, L.J.) stated: 'Where a testator by "'his will purports to give an annuity free of Income Tax, the will necessarily "'must be read as conferring on the annuitant such an annuity as, after "'deduction of tax therefrom, shall leave the clear sum mentioned by the "'testator.' If that be so, there seems no ground for the suggestion that the "residuary legatees are being unfairly treated if the annuitant is held entitled "to repayment of tax. The payment of tax no doubt lessens the benefit to the "residuary legatees, but so does the specified amount of the annuity, and the "one is as much a gift by the testator as the other.

"So far as I know, there is no provision in the Income Tax Acts for residuary "legatees in such circumstances, or for trustees acting on their behalf entitling "them to reclaim tax. The privilege is conferred by the Acts on the annuitant, "who alone is entitled to make the claim. This is consistent with the view "that the provision in regard to tax forms part of the bequest, and I cannot "see on what legal ground a benefit conferred by the Acts on one person can be "transferred without the consent of that person to another. See *Richmond's* "*Trustees*, 1935 S.C. 585, at page 594. Yet according to In re *Pettit* and "In re *Kingcome*(1) not only may the annuitant be deprived of all benefit but "is compelled to claim for the benefit of others, and the amount to be "repaid is determined by taking into account extraneous facts, so that the "benefit a residuary legatee obtains depends upon the wealth or poverty and the "personal circumstances of the annuitant. If the annuitant be wealthy the "residuary legatee gets less than if the annuitant be poor. If the annuitant be "a foreigner no sum can be recovered for the benefit of the residuary legatees. "If the annuitant be a married woman the amount of the annuity must be "included in her husband's Income Tax return and, to be consistent with "In re *Pettit*, presumably he would have to share with the trustees paying the "annuity, his reliefs and allowances. That such results should be possible "confirms me in the view that it is the annuitant alone who is entitled to "recover such repayment as may be allowable.

"The distinction made by the Revenue between an annuity payable free of "tax and an annuity of such sum as after deduction of tax will leave the net "sums, seems to me to be a strained construction. The intention of the "testators in both cases appears to me identical, the latter method of expression "merely being better draftsmanship.

"At the hearing the representative of the Revenue stated that the point "to be decided was open. It is this which has led me to express my views.

"In my opinion the appeal should be sustained."

James Watt, LL.D., W.S., gave his opinion as follows:—

This is a claim arising in respect of the Income Tax year 1939–40. In that year the standard rate of tax was 7*s*. in the £, also anyone whose income did not exceed £100 was wholly exempt from Income Tax, and if tax had been paid by the claimant or by anyone who had paid the tax, the tax paid could be recovered. Now the will gives the claimant an annuity or yearly sum at the rate of £100 per annum, and that is to be payable free of all deductions, including Income Tax.

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(1) [1936] Ch. 566.

The claimant argues that the annuity can be treated as an annuity of £100 after tax at the standard rate has been deducted—hence the figure of £153 16*s*. 11*d*. But it appears that it has been the practice that whatever has been recovered has been handed over to the trustees and treated as trust income to be otherwise disposed of under the will. If, however, the £153 16*s*. 11*d*. is to be treated as the income of the claimant, it seems obvious that her obligation to indemnify the trustees cannot extend to paying the trustees the whole of what is recovered, for the income, so far as in excess of £100, would be her property and subject only to a reduced rate of Income Tax—and the balance would be her own.

I cannot so read the will. The intention is that the claimant is to have £100—in her hands—to spend free of all liability for Income Tax. She has been paid the £100 in full. As that is her total income, she is not liable to pay any tax, while on the other hand, if the trustees under this claim receive in cash £35—being 7*s*. in the £ which, but for the claim against deduction of tax they would have been entitled to deduct—they are indemnified against what they have lost by not having been able to deduct tax. It may well be that other claimants on the income will be entitled to this £53 16*s*. 11*d*., being the excess of trust income and be entitled to recover tax, but that must be the subject of claim by others—the claimant here cannot make any claim which leaves in her hands more than the £100 a year.

It may be that the clause as to tax in this year gives no relief at all—but the aim of the clause was not to give the claimant a relief from tax—it was to ensure her an annual sum from which there should be no deduction for tax—and recent increases in taxation are now benefiting her. Indeed, under the same clause of the will an annuity of £150 a year is given to her brother, and he in this same year of assessment must have benefited accordingly.

V. Immediately after the determination of the appeal the Inspector of Taxes declared his dissatisfaction therewith as being erroneous in law, and having requested us to state and sign a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland, this Case is stated and signed accordingly.

VI. The question of law for the opinion of the Court is whether the decision of the majority of the Commissioners is right.

J. F. FAIRWEATHER,
JAMES WATT, } Commissioners.

J. I. BALFOUR MELVILLE, Clerk to the Commissioners.

Edinburgh, 16th November, 1943.

The case came before the First Division of the Court of Session (the Lord President and Lords Fleming, Moncrieff and Carmont) on 21st and 22nd March, 1944, and on the latter date judgment was given unanimously against the Crown, with expenses.

The Solicitor-General (Sir T. D. King Murray, K.C.) and Mr. J. F. Gordon Thomson appeared as Counsel for the Crown, and Mr. J. F. Strachan, K.C., and Mr. J. A. Crawford for the Respondent.

I.—INTERLOCUTOR

Edinburgh, 23rd March, 1944. The Lords having considered the Stated Case on Appeal and having heard Counsel for the parties, Answer the Question of Law in the Case submitted for the opinion of the Court in the Affirmative and affirm the decision of the majority of the Commissioners; Dismiss the appeal and Decern; Find the Respondent entitled to the expenses, as between Solicitor and Client, of the Stated Case on Appeal and remit the Account thereof, when lodged, to the Auditor to tax and to report.

(*Signed*) W. G. NORMAND, I.P.D.

II.—OPINIONS

The Lord President (Normand).—This is an appeal by the Commissioners of Inland Revenue against a determination of the General Commissioners allowing a claim by the Respondent for repayment of Income Tax for the year ended 5th April, 1940. The Respondent is entitled under the will of her aunt to an annuity at the rate of £100 per annum, payable at Whitsunday and Martinmas, after the death of her aunt, which annuity was declared to be payable "free of all deductions including Income Tax and Government "duty". At each term of Whitsunday and Martinmas since the death of the testatrix the trustees have paid the sum of £50 to the Respondent in respect of the annuity, and when making payments the trustees have given to the Respondent a certificate, to which I shall presently refer. The annuity was paid wholly out of income that had already been brought into charge to tax; and included in the sum brought into charge was a gross sum of £153 16*s*. 11*d*. of which £100 was paid to the annuitant and £53 16*s*. 11*d*., being the Income Tax on the gross sum at the full standard rate in force during the year ended 5th April, 1940, namely, 7*s*. in the £, was accounted for to the Inland Revenue. The Respondent had no income beyond the annuity, and in the year ended 5th April, 1940, the figure at which exemption from payment of Income Tax was fixed was £125. For some years the Respondent made claims for repayment of Income Tax on the basis that her income from the trust had been such sum as after deduction of Income Tax at the standard rate left the sum of £100. On 2nd January, 1940, the Respondent lodged with the Inspector of Taxes a claim for repayment of Income Tax for the year ended 5th April, 1940, as had been done in previous years. That claim showed the Respondent's total income as £153 16*s*. 11*d*. and the amount of Income Tax deducted £53 16*s*. 11*d*., being the annuity received under her aunt's will. The repayment claim form showed that there were no charges on the Respondent's income, and repayment of £47 11*s*. 4*d*. of tax was claimed, made up as follows:—A personal allowance of tax at the full standard rate of 7*s*. on £100, amounting to £35; an allowance of two-thirds of tax at the standard rate on £53 16*s*. 11*d*. amounting to £12 11*s*. 4*d*. The amounts of the Respondent's income and of the tax claimed to have been deducted therefrom as appearing in the repayment claim were vouched by a certificate granted by the solicitors for the trust, and bearing that the Respondent was a beneficiary to the extent of £100; that the particulars of gross income and of the amount of tax stated in the reclaim were correct, and also that the amount of the net payment actually made to the Respondent was £100. It appears that, when dealing with this reclaim for the year ended 5th April, 1940, the Inspector of Taxes made certain inquiries, and discovered that the amounts which had been repaid by the Revenue to the Respondent under similar reclaims in previous years had been handed over by the Respondent to the

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trust, so that the Respondent was left with only £100 in each year as her income. Having ascertained that, the Inspector intimated to the Respondent's solicitors that she was not entitled to make any reclaim.

When the case came before the General Commissioners, the contentions put forward on behalf of the Crown were that the annuity was not an annuity of such a sum as after deduction of Income Tax left £100, but an annuity of £100 plus the tax (if any) to which the Respondent was ultimately liable after a final adjustment of her right to reclaim overpayment of tax; that, as the Respondent's income was under the exemption limit of £125, she was not liable to any Income Tax, and that the annuity to which she was entitled was accordingly £100 and no more; that the payment of £100 was, accordingly, either a payment in full without deduction of Income Tax, in which case the Respondent was not entitled to any repayment, or it was a payment of £100 under deduction of Income Tax under Rule 19 of the General Rules applicable to all Schedules of the Income Tax Act, 1918, accompanied by a temporary advance of a sum equal to the tax so deducted until such time as the Income Tax deducted should be repaid, and that repayment of Income Tax was not due on any sum in excess of £100. As explained to us, the theory of these contentions may be more correctly restated alternatively as follows. Either the Respondent, being entitled to an annuity of £100 plus Income Tax, if any, due by her in respect thereof, and being exempted from all liability to Income Tax, is not entitled to any repayment; or the proper method of dealing with her annuity and Income Tax, so far as the trustees were concerned, was that they should have tendered to her two sums amounting together to £65 per annum, in equal parts at Whitsunday and Martinmas, and a certificate showing that £35 had been paid by way of Income Tax in respect of the annuity so as to enable the Respondent to recover £35.

The decision was given in favour of the Respondent's whole claim by a majority of two of the three Commissioners. In my opinion the majority arrived at a right conclusion. I propose to deal with the case by setting forth what I conceive to be the duties of the trustees in relation to the payment of Income Tax and to the payment of the annuity, and the rights of the Respondent in relation to any overpayment of tax which occurred as the result of the performance of their duties by the trustees.

(1) I think that the first duty which lay upon the trustees, who were not embarrassed by an insufficiency of funds, was to obey the express instructions of the will and to pay directly to the Respondent £50 at Whitsunday and £50 at Martinmas, £100 per annum in all. It would have been contrary to the terms of the will, and a breach of trust, if they had paid only £65 and had accompanied that payment with a certificate that £35 had been paid by way of tax. Moreover, I think that such a proceeding would have been contrary to the provisions of the Income Tax Acts, and that it would have been without legal warrant. That disposes of one of the alternative contentions of the Crown before the Commissioners, although that alternative was not the one supported before us by the Counsel for the Inland Revenue.

(2) The trustees are assessed for, and they must pay, the Income Tax in respect of the annuity, but the Income Tax is tax upon the Respondent's income so far as derived from funds held by the trustees.

(3) Since the income is an annuity free of Income Tax, its amount for the purposes of the Income Tax law and for the assessment must be ascertained by grossing it, i.e., by finding such a sum as after payment of the Income Tax on it suffices to pay the annuity and no more.

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(4) In this calculation for the purpose of grossing the income, Income Tax must be taken at the standard rate of tax. This rate may in fact be different from the rate of tax which will finally be borne by the Respondent's income in accordance with the provisions of the Income Tax Acts. But the trustees cannot calculate the actual rate which will apply to the Respondent's income, for they have no means of knowing the circumstances that determine it. Moreover, they are not charged with a duty of assessing for themselves the Income Tax to be paid ultimately by the Respondent's income, but only of following out the provisions of the Act and, particularly, Rules 19 and 21 of the General Rules applicable to all Schedules. That, I think, disposes of the other alternative tabled by the Crown in the proceedings before the General Commissioners, that the trustees should ascertain for themselves what is the tax ultimately payable by the annuitant, and that they should, I presume, present her with a certificate showing that the actual amount due by her in respect thereof (in this case, nil) had been paid by them to the Inland Revenue. There is no warrant for that in the Income Tax law.

(5) Having grossed the income the trustees are bound to pay the tax on the income so grossed to the Inland Revenue, and they are then in a position to hand over the balance of the gross income (which is the exact amount of the tax-free annuity) to the annuitant. In the present case he Income Tax had already been paid, because the whole fund available for the payment of the annuity had suffered tax by deduction at source. But, if the funds in the hands of the trustees had not suffered tax by deduction at source, the provisions of Rule 21 would have applied, and they would have been bound to deduct and retain from the payment to the Respondent the appropriate tax at the standard rate and hand it over to the Inland Revenue.

(6) The trustees are entitled to a receipt from the annuitant for the grossed annuity when they pay the tax-free annuity to her. It is in accordance with custom and practice to hand over to the annuitant a certificate showing the amount of the grossed income, the amount of the Income Tax paid on it, and the amount of the tax-free annuity actually paid. The payment of the tax is made by the trustees in satisfaction of the Respondent's liability to the Inland Revenue, and is therefore treated as payment to her *pro tanto* of her income. Her income from the trust is accordingly the grossed income.

(7) The Respondent may have in any year the right to claim repayment in whole or in part of Income Tax paid in respect of the annuity, because she is exempt from Income Tax or because she is entitled to abatements or allowances. In making her reclaim she must state the whole income received by her and must, accordingly, state the grossed income.

(8) The trustees have no right to make a reclaim of this sort in their own name. It is the annuitant who must claim since it is a right personal to her. Where she has a right to reclaim tax and receives a repayment of tax from the Inland Revenue as having been overpaid on her behalf, other questions may arise. For example, must she account to the trustees for what she has recovered? That is a question which has given rise to a number of reported cases, most of which are referred to in *Rowan's Trustees,* 1940 S.C.30. I do not propose to discuss that type of question, because it deals with rights as between the trust and the annuitant in what the annuitant recovers, and not with the annuitant's right to recover from the Crown. But in one of the reported cases the procedure to be followed by the trustees is described, and I shall refer to that case in a moment. It is agreed, however, in the present case, that the annuitant was bound to account to the trustees for whatever

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she recovered from the Inland Revenue, and it is possible—I express no opinion—that other questions may yet be raised which would involve parties who are not represented at the Bar today.

That describes what is, in my opinion, the procedure to be followed by the trustees and by the beneficiary. It is in exact accordance with what was done, and proposed to be done, in the present case if we now affirm the decision of the majority of the Commissioners, and if the claim made by the Respondent for repayment is allowed. I have said that in one of the cases dealing with the rights as between beneficiary and trustees after such a repayment has been made, the Court has made observations about the procedure to be followed. The case is In re *Pettit,* [1922] 2 Ch. 765, where, at page 769 and the following pages, Romer, J., (as he then was) states the procedure to be followed in less detail but, I respectfully think, to the same effect as the procedure which I have described. In *Hunter's Trustees* v. *Mitchell,* 1930 S.C. 978, which was a different case because the question to be decided was whether the annuity was a tax-free annuity or not, Lord Sands, at pages 982 and 983, dealt with the procedure and he approved of what had been said by the learned Judge in In re *Pettit*. I find myself in agreement with all Lord Sands said in his opinion about the duty of the trustees and the rights of the tax-free annuitant in relation to the Inland Revenue. I find also in *Baird's Trustees,* 1933 S.C. 553, at page 560, observations of Lord Murray—it is true in a dissenting opinion but for this particular purpose it does not matter—with which I agree.

That is sufficient for the disposal of the case. I do not propose to enter into ulterior questions some of which were discussed at the Bar. They do not arise. I therefore suggest to your Lordships that we should answer the question of law in the affirmative.

Lord Fleming.—I am of the same opinion and have little to add. The Solicitor-General said, I think quite correctly, that in the final analysis the decision of this case depends upon the view which is taken of the total or gross income of the Respondent. The first constituent of the Respondent's income is the annuity of £100 which the trustees were directed under the will to pay to her by half-yearly instalments. But the trustees were also directed to pay that annuity " free of all deductions including Income Tax ", and, accordingly, any liability which the trustees incurred, or any payment which they made in order to free the annuity of £100 from tax, was just an addition to the gift of the £100 and became in law part of her income. The will directed that the annuity should be paid out of income derived from heritable subjects; and it is stated in the Case that the annuity was paid wholly out of income that had already been brought into charge, and that included in the sum so brought into charge was a gross sum of £153 16*s*. 11*d*., of which £100 was paid to the annuitant and £53 16*s*. 11*d*., being Income Tax on the said gross sum at the full standard rate, was accounted for to the Inland Revenue. What was done was in accordance not only with the terms of the will, but also with the provisions of the Revenue statutes. The trustees had thus to disburse £153 16*s*. 11*d*. in order to pay the legacy to which the Respondent was entitled, and it is immaterial whether that disbursement was made directly to the Inland Revenue or indirectly through the medium of deduction. It seems to me to follow that, for the purposes of Income Tax, and in particular for the purposes of the Respondent claiming any repayment of tax, her gross income must be taken to be £153 16*s*. 11*d*. I am accordingly of the opinion that the claim on her behalf for repayment of tax was framed on the proper lines, and that the decision of the Commissioners was correct.

(Lord Fleming.)

The trustees are not parties to this case, and I reserve my opinion upon the question of whether there will be liability to pay tax on any sums which they may recover from the Respondent.

Lord Moncrieff.—I agree with both your Lordships. As it appears to me, the fallacy which underlies the contentions on behalf of the Crown results from the old familiar failure to recognise that when trustees, whether by deduction or otherwise, make payment of Income Tax upon income which falls to be passed over to a beneficiary, the income subsequently paid by them to the beneficiary includes not only the direct cash payment to himself, but also the instalment of Income Tax which had already been paid on his behalf. It would almost seem as if it could not too often be repeated that Income Tax is part of the income of the person who suffers the deduction of tax. It is that part of his income which the Revenue is, under statute, entitled to enjoy, or it may be regarded when prepaid on his behalf as a payment to a creditor who has a right against himself as also against all others to exact that payment out of his income. In this case, seeing that the trustees made payment to the beneficiary, as they were bound to do, of an exact sum of £100 per annum out of a trust income which had already been charged to tax, they thus exactly fulfilled the direction of the truster to make payment to her of £100 tax free and this by making payment to her—for no other way was open—of an actual income of £153 16*s*. 11*d*. and not of a bare sum of £100. Her income, whether or not she was entitled to exemption from tax, was thus (as falling to be assessed and returned for claims of repayment of tax, albeit subject to subsequent adjustment between herself and the trustees) an income of £153 16*s*. 11*d*., and not an income of merely £100. Had her income been merely £100 there could not have been, by deduction or otherwise, a payment by the trustees to the Revenue of £53 16*s*. 11*d*. on her behalf, together with a payment to herself of a net sum of £100. In these circumstances, the claim for repayment of tax could only properly be presented as a claim for repayment of the tax which had been charged upon the greater and not upon the smaller of these two sums; and that claim was entirely proper although, in view of her personal right of exemption from tax, a separate question for after determination arose to be solved, not between herself and the Revenue, but between herself and the trustees who had made the payment of Income Tax which she had been instrumental in getting repaid.

This closed chapter of assessment, payment and repayment of tax upon the Respondent's annuity of £100, does not, in my opinion, fall to be reopened because, in a question with the trustees, it afterwards became the duty of the Respondent upon recovering repayment of tax as having been overpaid, to communicate the amount repaid to the trustees who had antecedently paid tax on her behalf. It is, however, because of that obligation in favour of third parties, and for no other reason, that the Revenue claims to refuse to accept the statement of the Respondent's income at the sum of £153 16*s*. 11*d*., and refuses to make repayment of the tax which is appropriate as measured upon that sum. We were informed that it is Revenue practice to accept the larger sum as measuring the right of repayment in cases in which, under the authority of the decision in the case of In re *Jones,* [1933] Ch. 842, the beneficiary not only receives from the trustees the larger sum by way of income but, in view of the particular provisions of the trust deed, retains the tax when repaid for her own behoof. On the other hand when, under the authority of the case of In re *Pettit,* [1922] 2 Ch. 765, and the related cases, the sum falls upon repayment to be communicated to the trustees, we were informed it is the practice of the Revenue to refuse to measure the claim for repayment upon the income which the beneficiary had in fact received. If this be indeed the

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practice, I can only say that, in my opinion, it is a practice which is entirely without warrant and which should now be reformed.

It was argued by learned Counsel for the Revenue that, upon any such view of the rights of parties, strange anomalies might result as affecting the distribution of income by trustees in cases in which certain of the beneficiaries should have rights of exemption from tax. As testing this argument a case was figured in which the total income of the trust was assumed to be the exact sum of £1,000. It was said that under the present rate of tax the first duty of the trustees would be to pay £500 of that £1,000 to the Revenue. If, as in this case, the beneficiaries were on the one hand an annuitant for £100 and on the other hand the residuary legatee, the trustees would then have a duty of paying £100 of the free £500 to the annuitant and £400 to the residuary legatee. The annuitant being *ex hypothesi* entitled to recover tax upon the said sum of £100 and bound to communicate the tax repaid to the trustees, the result of the transaction would be that her receipt of an annuity of £100 from the trust would not have diminished by a halfpenny the sum payable to the residuary legatee, as this would again become £500. Any such anomaly as so suggested seems to me once again to result from the old fallacy of failing to observe that the income paid to the annuitant from the trust is not £100 but is £200, and that the income paid to the residuary legatee is £800 and not £400. The payment to the Revenue is not a payment to a third party. It is payment *quoad* £400 of an instalment of Income Tax as payable by the residuary legatee, and *quoad* £100 of an instalment of Income Tax payable by the annuitant. The true result of the distribution thus will be that, the trustees having paid £200 to the annuitant and having received £100 back in respect of a repayment of tax which the annuitant cannot retain, the annuitant draws, as she is entitled to draw, only £100 from the trust and leaves £900 in place of £800 to be distributed between the residuary legatee and the Inland Revenue. The result, instead of being anomalous, seems to me to be entirely in order. The trust income by a series of cross entries is diminished in favour of the annuitant by the exact sum of £100 net, to which she is entitled under the trust, while £900 of the £1,000 remains available for payment to the residuary legatee. This income will fall in ordinary course to be paid to him under such adjustment with the Revenue as the repayment of tax may require, but any such question of adjustment of his Income Tax is without interest for the Respondent, and does not fall within the compass of this appeal. There is nothing anomalous in the fact that residue should derive benefit from the personal exemption from tax of an annuitant whose annuity is to be paid tax free.

Lord Carmont.—I also agree with your Lordship.

The Crown having appealed against the decision in the Court of Session, the case came before the House of Lords (Viscount Maugham and Lords Thankerton, Russell of Killowen, Porter and Simonds) on 7th and 10th May, 1945, when judgment was reserved. On 30th July, 1945, judgment was given against the Crown, with costs (Lords Russell of Killowen and Simonds dissenting), confirming the decision of the Court below.

The Attorney-General (Sir Donald Somervell, K.C.), the Lord Advocate (Mr. J. S. C. Reid, K.C.), Mr. Reginald P. Hills and Mr. J. F. Gordon Thomson appeared as Counsel for the Crown, and Mr. J. F. Strachan, K.C., and Mr. J. A. Crawford for the Respondent.

JUDGMENT

Viscount Maugham (read by Lord Thankerton).—My Lords, this appeal arises out of a claim by the Respondent for repayment of Income Tax for the year ended 5th April, 1940. The Inspector of Taxes objected to the claim made by the Respondent. The Respondent appealed to the Commissioners for the General Purposes of the Income Tax for the Division of Edinburgh against the said objection, and the General Commissioners by a majority allowed the appeal. The Commissioners of Inland Revenue appealed to the Court of Session as the Court of Exchequer in Scotland against the determination of the General Commissioners allowing the Respondent's claim, and their Lordships of the First Division unanimously dismissed the appeal.

The facts are fully stated in the Case for the opinion of the Court of Session, and it is not necessary to repeat them at length. I may perhaps summarise them by saying that the Respondent is entitled under the will of her aunt, Mrs. Margaret Jessie Cook, who died on 24th September, 1937, to an annuity at the rate of £100 per annum, payable at Whitsunday and Martinmas, after the death of her aunt, which annuity was declared to be payable "free of all deductions including Income Tax and Government "duty". Accordingly, at each term of Whitsunday and Martinmas since the death of the testatrix the trustees have paid the sum of £50 to the Respondent in respect of the annuity, and when making payments the trustees have given to the Respondent a certificate, which is set out in the Case. She had during these years no other income. The annuity was paid wholly out of income that had already been brought into charge to tax, and included in the sum brought into charge for the year in question was a gross sum of £153 16*s*. 11*d*., of which £100 was paid to the annuitant and £53 16*s*. 11*d*., being Income Tax on the gross sum at the standard rate in force (7*s*. in the £), was accounted for to the Inland Revenue. The Respondent, as it turned out, had no income beyond the annuity for the year ended 5th April, 1940, and the figure at which exemption from payment of Income Tax was fixed was £125.

On 2nd January, 1940, the Respondent lodged with the Inspector of Taxes a claim for the repayment of Income Tax for the year to 5th April, 1940. That claim showed the Respondent's total income from all sources as follows:—

"*Source of income.*	*Amount of income before deduction of tax.*	*Amount of Income Tax deducted.*
"Annuity of £100 per annum "free of tax from Mrs. M. J. "Forrest's Trust.	£153 16 11	£53 16 11"

The repayment claim form showed that there were no charges on the Respondent's income and repayment of £47 11*s*. 4*d*. of tax was claimed. That sum was made up as follows:—

(*a*) a personal allowance of tax at the full standard rate of 7*s*. on £100 ...	£35 0 0
(*b*) an allowance of two-thirds of tax at the standard rate on £53 16*s*. 11*d*.	12 11 4
	£47 11 4

These allowances had nowhere been taken into account. It is this claim by the Respondent which was objected to by the Inland Revenue and which forms the only subject of the appeal before your Lordships. It is to be

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noted that the trustees of the will are not parties and that questions as between them and the Respondent are not directly before the Court. It is, however, the fact that for the years prior to the year ended 5th April, 1940, repayment of Income Tax was allowed in accordance with the claims of the Respondent.

On 2nd January, 1940, when the Respondent lodged her claim for repayment for the year ending 5th April, 1940, the Inspector of Taxes learned that the Respondent in fact handed over the returned tax to the trustees, and accordingly retained for her own use only the net sum of £100. He refused to allow her claim for £47 11*s*. 4*d*.

My Lords, it is not surprising that the Inland Revenue authorities have found it difficult to state the precise grounds on which they rely in contesting the Respondent's claim. Abandoning the arguments they put forward before the Commissioners, the two main contentions which they supported (as amended) in the Court of Session are thus stated by the learned President: " Either the Respondent, being entitled to an annuity of £100 plus Income " Tax, if any, due by her in respect thereof, and being exempted from all " liability to Income Tax, is not entitled to any repayment; or the proper " method of dealing with her annuity and Income Tax, so far as the trustees " were concerned, was that they should have tendered to her two sums " amounting together to £65 per annum, in equal parts at Whitsunday and " Martinmas, and a certificate showing that £35 had been paid by way of " Income Tax in respect of the annuity so as to enable the Respondent to " recover £35.(1)"

The Appellants, however, have now made an *ex gratia* offer to repay, not the sum of £47 11*s*. 4*d*., but the sum of £35. They submitted in their case that some confusion had been introduced into the appeal by this offer, and I am tempted to agree with this view. Their explanation of the offer is as follows. The Appellants are prepared to make this *ex gratia* payment because, the whole of the trust income having borne tax, the total available for distribution among the beneficiaries was diminished thereby. If the trustees had followed the procedure laid down in General Rule 19 of the Income Tax Act, 1918, they would have paid the Respondent not £100 in cash but £65 in cash, and given her a certificate of deduction of tax for £35. This latter sum she could have recovered from the Appellants, and she would then have had £100 in her hands. The trustees did not follow this procedure, but the Appellants are prepared to treat the case as one in which that procedure had been followed and to repay her £35 on the assumption that she would hand it over to the trustees to replace the excess of £35 formerly paid by them to her. This, it will be noted, implicitly reasserts the proposition that the Income Tax Acts make it illegal to pay an annuitant the amount of the annuity payable free from Income Tax at the dates specified in the will, which, in my opinion, would be an unhappy conclusion. I will explain later why I think it is incorrect.

I cannot deal with the above contentions of the Inland Revenue in better language than that used by the Lord President. He said(1): " I think " that the first duty which lay upon the trustees, who were not embarrassed " by an insufficiency of funds, was to obey the express instructions of the " will and to pay directly to the Respondent £50 at Whitsunday and £50 at " Martinmas, £100 per annum in all. It would have been contrary to the " terms of the will, and a breach of trust, if they had paid only £65 and had

(1) *Ante*, at p. 496.

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"accompanied that payment with a certificate that £35 had been paid by "way of tax. Moreover, I think that such a proceeding would have been "contrary to the provisions of the Income Tax Acts, and that it would have "been without legal warrant. That disposes of one of the alternative con-"tentions of the Crown before the Commissioners, although that alternative "was not the one supported before us by the Counsel for the Inland "Revenue." I will give reasons for agreeing with this view. In the form of the *ex gratia* offer the alternative in question seems still to be supported; but for the reason given by the Lord President the course suggested in the offer seems to me inadmissible.

The first alternative, however, has been further amended and is now framed in these terms: (1) The Appellants contend that the total of the Respondent's annuity for the year in question was £100; that the additional benefit under the trust disposition and settlement to receive that annuity free of all deductions, including Income Tax, did not have any pecuniary value in that her total income was below the exemption limit of £125 fixed by the Finance Act, 1935, Section 19 (1); and that, as she admitted she intended to pass on the recovered tax to the trustees to be used for other trust purposes, that tax could not properly be treated as an addition to her annuity of £100. (2) If the Respondent's income for the year in question was £100, the Appellants maintain (i) that she cannot claim any repayment at all, or (ii) that in any event she can only claim repayment of tax at the standard rate on the sum of £100.

When the appeal came before your Lordships, the Lord Advocate, on behalf of the Inland Revenue, made a fresh and final offer or statement which took Mr. Strachan, who appeared for the Respondent, by surprise. As I understood the Lord Advocate he said that the Inland Revenue were prepared to admit a claim by the residuary legatees under the will for a return of the difference between £53 16*s*. 11*d*. and the sum of £35 which had been offered to the Respondent. The effect, as I understand it, would be, if both offers were accepted, that the Inland Revenue would gain nothing at the end of the day except perhaps some small amounts for interest. I think, whatever view your Lordships may take of these tempting offers, we are left in our judicial capacity with the task of deciding the legal rights of the subject in a case depending on a number of rather obscure Sections and Rules of the Income Tax Acts. One thing, however, is in my opinion clear, and that is that the duty of the trustees was to comply with the directions contained in the will according to their true interpretation, unless indeed there was some illegality involved in them.

My Lords, the first thing, then, to determine in this case is the true construction of the clause in the will. In the interests of brevity I shall confine myself to the Respondent's annuity. It is described as an annuity at the rate of £100 per annum for her life, payable in two terms in the year, Whitsunday and Martinmas; it is to be alimentary and not capable of anticipation, and is to be payable "free from all deductions including Income "Tax and Government duty". Gifts by will of annuities free from Income Tax have been common both in Scotland and England for many years, and have given rise to a large number of reported decisions. At an early stage there was a little hesitation in dealing with them, for it was and is apparent that a named annual sum cannot literally be given free from Income Tax, since the annuitant must normally pay Income Tax on his or her income, and what is sometimes called a benevolent construction had to be applied if the plain intention of the will was to be carried out. That intention could

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be achieved by the simple means of holding that the testator must have intended to give, in addition to the fixed annuity, such a sum as would enable the trustees in each year to discharge the Income Tax on the total amount of the fixed annuity and the additional sum, and to pay the balance, which in the normal case would be the exact amount of the stated annuity, to the annuitant. Unless there is something special in the language of the will, which prevented that construction being adopted, that became the recognised construction in cases of gifts of annuities of fixed amounts free of Income Tax both in England and Scotland. In the case of *Hunter's Trustees* v. *Mitchell,* 1930 S.C. 978, at page 982, Lord Sands observed as follows: " When under a will an annuity is payable free of income tax, " the amount of the tax is taken to be an additional gift, and is included in the " income of the annuitant when, for revenue purposes, a return of total " income is necessary. Further, the income from this source is not the " annuity plus the tax upon it, but the amount of the annuity plus such " sum that, when the tax is levied upon the total amount, the net amount " left will be the amount of the annuity."

This is a perfectly correct statement of what has long been the settled rule of construction in a case which presents no special features capable of leading to the conclusion that the application of the rule would involve a departure from the true intention of the testator. The rule, where it is properly applied, is, in my opinion, a fair and just one. It carries out the intention of the testator. It has been applied in very numerous cases, and it is far too late to challenge it today. It is clear that it applies in the present case. I will only add that under the rule what is treated as being given to the annuitant is given, to use the language of that eminent Judge the late Lord Fleming, in two annual constituents. The one is the annuity of £100, the other is " just an addition to the gift of £100 "—to enable the trustees to comply with the direction to pay that annuity free from Income Tax—and it " became in law part of her income.[1]"

No difficulty usually arose in early days, when Income Tax was at a very low rate, in applying the rule, for questions as to abatement, exemption and so forth seem to have been easily settled, and Super-tax with all its problems had not been invented. Without going into details as regards these matters, it is easy to see that they make it impossible to ascertain at the beginning of any year what further income an annuitant may receive during that year and what abatements and deductions he might become entitled to. For instance, he may earn or lose other income. He may marry. A child may be born to him, or may die. All these events may happen during the year. Nor have trustees either a duty or a right to make inquiries on these matters. The Legislature had anticipated these possibilities and had provided by Rule 19 (1) of the All Schedules Rules, as amended by the Finance Act, 1927, Section 39 amongst other things, that no assessment should be made upon an annuitant under a deed or will, but that the person liable to make such payment (for example, the trustees) should be entitled on making such payment to deduct or retain thereout a sum representing the amount of the tax on the annuity at the standard rate for the year in which the annuity payable became due.

In the present case the standard rate, 7*s*. in the £, on £153 16*s*. 11*d*. is equal to £53 16*s*. 11*d*., and the trustees had therefore to disburse the sum of £153 16*s*. 11*d*. in order to be able to pay £53 16*s*. 11*d*. to the Inland

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(1) *Ante*, at p. 498.

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Revenue as representing the tax at the standard rate on £153 16*s*. 11*d*., and to be entitled and liable to pay the annuity to which the Respondent was entitled.

It is, I think, immaterial whether the disbursement of £53 16*s*. 11*d*. was made directly or indirectly by previous deduction to the Inland Revenue. To make the position clear, it may be desirable to point out that the amount of the annual benefits given on the true construction of the will to the annuitant was £100 plus the sum which might ultimately prove to be payable by her for Income Tax for that year so as to leave £100 for her personal behoof. In other words, the annuity given to her was an amount equal to £100 plus an amount, say £*x*, varying from year to year and liable to exemptions and abatements. The £*x* is none the less a constituent of her income because it may vary from year to year and (if payable) has to be paid in discharge of her Income Tax. The fact that the value of £*x* is unascertainable until after the end of the year, when the deductions for abatements and exemptions, if any, will be ascertained, does not occasion any practical difficulty. The trustees have only to follow the provision of Rule 19 of the All Schedules Rules, the effect of which I have already mentioned. They had, therefore, to make a provisional calculation on the basis of the standard rate for the year in question on £100 plus £*x*, so that £*x* is equal to the tax at that rate on £100 plus £*x*. A simple equation may be necessary. In the year in question £*x* was found to be £53 16*s*. 11*d*. and £153 16*s*. 11*d*. was, therefore, the ascertained total annual benefit of the Respondent on the basis of tax at 7*s*. in the £. The £53 16*s*. 11*d*. was paid to the Inland Revenue under the Rule, but with a probable or possible right to a claim for exemption or abatement at the end of the year. The sum was exigible by the Revenue, not because the tax which would become due by the Respondent for Income Tax for the year in question on £100 was or would necessarily be £53 16*s*. 11*d*., but because it was the arbitrary or hypothetical amount fixed by the Rule 19 and chargeable against the trustees by the terms of that Rule on the total sum of £153 16*s*. 11*d*.

My Lords, I think it is clear that the sum of £53 16*s*. 11*d*. was an amount of Income Tax deducted for and on behalf of the Respondent as being a sum representing (at 7*s*. in the £) the amount of the tax on both the constituents of her annuity. She it is who makes and who alone could make the claim I have mentioned for the return of tax, £35 for a personal allowance of tax on £100, and £12 11*s*. 4*d*. for an allowance of two-thirds of tax on £53 16*s*. 11*d*., both at 7*s*. in the £. The total is £47 11*s*. 4*d*. The sum of £53 16*s*. 11*d*. was deducted at the source and it must be dealt with as if it had been paid by the Respondent herself. She contends that the amount of the excess over her true liability for the year was £47 11*s*. 4*d*. It may be noted that there is a plausible argument for the Respondent as the result of which her claim might have been for the total sum of £53 16*s*. 11*d*., but your Lordships are only concerned with a claim for the smaller sum of £47 11*s*. 4*d*., and that is all I propose to deal with.

My Lords, I am of opinion, for the reasons above stated, that the Inland Revenue must fail in their contention as to the true construction of the gift to the Respondent contained in the will. They must also fail in the contention that no Income Tax was paid by or on behalf of the Respondent and that, therefore, she cannot under Section 9 of the Income Tax Act, 1918 (as amended), claim any repayment. With regard to this contention I take the same view as my noble and learned friend Lord Thankerton takes in his judgment, which I have had the advantage of reading, and I could

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not improve upon his language. There remains, however, an argument not, I think, advanced in the Court of Session, based on the circumstance that the Respondent does not intend to retain under the will more in any year than the net sum which the will intended her to have, and that she accordingly proposes to hand over to the trustees the sum of £47 11*s*. 4*d*. if and when she recovers it under her claim.

It is not in dispute by the Inland Revenue that payment at the source is merely the machinery by which Income Tax is collected, and the rights of the parties are not thereby altered. In my opinion the same proposition is true in regard to the deduction by trustees of Income Tax under Rule 19 at the standard rate for the year in which an annuity, such as we are now discussing, becomes due. That sum merely represents the amount of the tax at what in many cases is only an arbitrary figure. The Rule clearly is not designed to affect or diminish the rights of the poorest class of taxpayers to abatement or exemption. Nor, I think, do Counsel for the Inland Revenue now contend for such a result.

Looking at the matter broadly, I have been unable to see how the Inland Revenue are concerned with the fact that the Respondent does not intend to retain for her own benefit the amount of her claim. They could scarcely have so contended if that claim had been assigned together with the fixed amount of the annuity (if assignable) to a third party. It is plain that the Respondent is the right person to make the claim under Section 29 of the Income Tax Act, 1918; it is, I repeat, a personal claim, but I can see nothing in the Section to prevent her from handing over the amount received to a third party.

It is true that according to the well-known decision of Lord Romer (as Romer, J.) in the similar case of In re *Pettit,* [1922] 2 Ch. 765, she will be bound to hand over the amount of any sum recovered by her from the Inland Revenue to the trustees for the ultimate benefit of the residuary legatees. The Inland Revenue had there allowed the claim for abatement which they here seek to question, and they have till recently continued that practice. That case has been often followed. To mention only some of them, it was approved by the English Court of Appeal in In re *Maclennan,* [1939] Ch. 750; by Lord Sands and Lord Fleming in *Hunter's Trustees* v. *Mitchell,* 1930 S.C. 978, at pages 983, 989; and by the Lord President (Normand) in the case of *Rowan's Trustees,* 1940 S.C. 30, at page 42. It seems to me to be a complete fallacy to say that the annual benefit given by the will is, accordingly, the fixed sum of £100 described as " the annuity "; for if that were true she would have to submit to a deduction of 7*s*. in the £ on that sum for her supposed Income Tax and would only receive £65 in the year, with a right in certain events to reclaim £35 at a later date. Those, as pointed out above, are not her rights under the will. The curious thing is that it does not seem to matter to the Inland Revenue whether the Respondent hands over the £47 11*s*. 4*d*. to the trustees because of her ideas of honesty and fair dealing, or because of the principle of construction laid down in In re *Pettit*. In either case she will not retain the sum in question. I am unable to detect any logical ground on which the Inland Revenue can refuse to allow her claim to recover what is proved to be an overpayment on her behalf of Income Tax for the year ending 5th April, 1940. As I see it the argument is based on the view that, because of the nature of the gift and of events in the year in question, the Respondent has only been given an annuity of £100; but this is incorrect. She was given, as I have endeavoured to explain, the chance of receiving and retaining *subject to Income Tax* the

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sum of £153 16*s.* 11*d.* Whatever income accrued to her, she would be left with £100 net payable to her by the trustees in accordance with the will.

I should add that the provisions of Section 25 of the Finance Act, 1941, seem to indicate that the procedure adopted by the trustees in the present case is precisely that contemplated by Parliament in normal cases of payment by trustees of stated annual sums of income free from tax.

The case of In re *Jones,* [1933] Ch. 842, has been referred to. There the bequest was given as " such an annuity as after deducting therefrom income " tax at the current rate for the time being would amount to the clear yearly " sum of £350." Eve, J., distinguishing the case of In re *Pettit*(1), held that the annuitant was entitled to such sum as after deduction of tax thereon at the standard rate would leave £350, and was not bound to pay over to the trustees the tax recovered by her. Taking his view that " current rate " meant the same thing as " standard rate ", it is not difficult to see that the gift in In re *Pettit* was a very different one. The decision does not affect the present case.

It must be noted that the trustees could not themselves apply for a deduction or abatement, and the argument that the Respondent could not do so either seems to me logically to lead to the result that in such a case the Inland Revenue become entitled (apart from *ex gratia* concessions) to receive and retain considerably more than the Income Tax really due from the annuity given tax free and the persons entitled as residuary legatees. The Lord Advocate seems to shrink from this view. So do I; but my conclusion is no more than that the old practice in force for some years before and after the decision of In re *Pettit* was a legal and a correct practice and that the Inland Revenue have no concern with the question as to how the sum repaid to the Respondent by way of deduction or abatement is applied.

My Lords, I agree with the unanimous decision of the First Division and with the reasons given by their Lordships, and I move that the appeal should be dismissed with costs.

Lord Thankerton.—My Lords, this appeal arises out of a claim by the Respondent for repayment of Income Tax for the year ended 5th April, 1940.

The question relates to the provisions made in favour of the Respondent by the trust disposition and settlement of her aunt, Mrs. Margaret Jessie Forrest, who died on 24th September, 1937. By the third purpose of her said will, the testatrix directed her trustees " out of the free annual income " derived from the heritable subjects which shall belong to me at the time " of my death to pay to my nephew Harold Hope Cook presently a patient " at New Saughton Hall, Polton, Midlothian, an annuity or yearly sum " at the rate of one hundred and fifty pounds per annum for the remainder " of his life after my decease and to my niece Miss Minnie Cook, residing " at Seven Annandale Street, Edinburgh, an annuity or yearly sum at the " rate of one hundred pounds per annum for the remainder of her life " after my decease both of which annuities shall be payable at two terms " in the year Whitsunday and Martinmas beginning at the first of these " terms after my death with the proportion for the period from my death to " that term and so forth thereafter at the said two terms: declaring that the " said annuities (one) shall be purely alimentary and not capable of anticipa- " tion or subject to the debts or deeds of the said Harold Hope Cook and " Miss Minnie Cook or liable to the diligence of their respective creditors " and (two) shall be payable free of all deductions including Income Tax and " Government duty ".

(1) [1922] 2 Ch. 765.

(Lord Thankerton.)

Since the death of the testatrix, her trustees have paid to the Respondent £50 half-yearly, and, when making such payment, gave to the Respondent each year a certificate appropriate to the standard rate of tax current at the time, in a form similar to the certificate granted for the year here in question, which was in the following terms:—

" I hereby certify that Miss Minnie Cook of 41 Colinton Mains Grove, " Oxgangs, Edinburgh, is a beneficiary of the Trust known as Mrs. M. J. " Forrest's Trust to the extent of £100 and that the following particulars " are correct.

" Information regarding this trust has been or will be furnished to " H.M. Inspector of Taxes, 1st Edinburgh District.

" Signature of Trustee (or " authorised agent for the " Trust) } Cooper & Brodie. Address— 40 Castle Street, Edinburgh.

" Date—3rd January, 1940.

" Income for the year ended 5th April, 1940.

" Gross amount on which " tax has been suffered by " the beneficiary.	*Amount of Income Tax suffered thereon by the beneficiary.*	*Amount of the net payment actually made to or for the benefit of the beneficiary.*
" £153 16 11	£53 16 11	£100 "

Prior to the year here in question the Respondent had made claims for repayment of the Income Tax shown by the certificates to have been deducted and retained by the trustees, and she received payment in accordance with these claims, and she handed the amount of the repayment to the trustees.

It should be made clear that the payments by the trustees to the Respondent were made wholly out of income of the trust which had already been brought into charge to tax, and that in each of these years, including that ending 5th April, 1940, the Respondent had no other source of income outside the provisions of her aunt's will. In the year ending 5th April, 1940, the standard rate of tax was 7*s*. in the £.

On 2nd January, 1940, the Respondent lodged with the Inspector of Taxes a claim for the repayment of Income Tax for the year to 5th April, 1940, in which her total income from all sources was stated as follows:—

" Source of income.	*Amount of income before deduction of tax.*	*Amount of Income Tax deducted.*
" Annuity of £100 per annum " free of tax from Mrs. M. J. " Forrest's Trust.	£153 16 11	£53 16 11 "

The repayment claim form showed that there were no charges on the Respondent's income, and repayment of £47 11*s*. 4*d*. of tax was claimed. The said sum was made up as follows:—

(*a*) a personal allowance of tax at the full standard rate of 7s. on £100 ...	£35 0 0
(*b*) an allowance of two-thirds of tax at the standard rate on £53 16*s*. 11*d*.	12 11 4
	£47 11 4

Along with the claim the Respondent lodged the certificate already referred to.

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The Inspector of Taxes objected to the Respondent's claim. The Respondent appealed to the General Commissioners, who by a majority allowed the appeal, and, at the request of the present Appellants, stated a Case for the opinion of the Court of Session under Section 149 of the Income Tax Act, 1918, in which the question of law was stated to be whether the decision of the majority of the Commissioners was right. The case was heard by the First Division of the Court of Session, who unanimously answered the question in the affirmative and affirmed the decision of the majority of the Commissioners. The Crown now appeal against that decision.

The first question arises on construction of the direction in the will for payment to the Respondent out of the free annual income of the heritage held by the trustees of " an annuity or yearly sum at the rate of one " hundred pounds per annum . . . payable free of all deductions including " Income Tax and Government duty ". I do not think that the alimentary restrictions imposed on the annuity affect the decision. We are here concerned with Income Tax only; no question of Sur-tax arises. In my opinion the meaning of such a bequest is clearly established in the law of Scotland, and I have no reason to think that the law of England is different. It is well expressed by Lord Sands in *Hunter's Trustees* v. *Mitchell,* 1930 S.C. 978, at page 982. Lord Sands says: " Income tax is a tax upon the income of " the person who enjoys the income. In whatever manner it may be col- " lected, its ultimate incidence is upon the income of this person. So rigid " is this principle that, when under a will an annuity is payable free of " income tax, the amount of the tax is taken to be an additional gift, and " is included in the income of the annuitant when, for revenue purposes, a " return of total income is necessary. Further, the income from this source " is not the annuity plus the tax upon it, but the amount of the annuity " plus such sum that, when the tax is levied upon the total amount, the " net amount left will be the amount of the annuity." In other words, the duty of the trustees is to provide by means of the additional gift a sum to meet the annuitant's liability for Income Tax and leave her £100 annuity in her hands unaffected by tax. It is well to remember that, in the case of a taxpayer's source of income which is subjected to deduction at the source either under Rule 19 or Rule 21 of the General Rules applicable to all Schedules of the Income Tax Act, 1918, there are usually two stages in the taxpayer's liability to Income Tax, namely, first, the taxpayer has to suffer deduction at the source at the standard rate, which is provisional and subject to adjustment at the second stage, when the taxpayer claims and obtains relief by repayment under Section 29 of the Act. Now, the duty of the trustees in a case such as the present is to provide for the liability of the annuitant to tax under the first stage, and it is difficult to see why they are not to get the benefit of the later adjustment to which the provisional discharge of the taxpayer's liability is subject. The additional gift in such a case, either in whole—as in the present case—or in part, serves to meet a temporary tax liability, and, when the tax liability is ultimately ascertained, its service is terminated, and it should be *pro tanto* returned to the trust estate. This case is in marked contrast to the bequest of such an annuity as after deducting Income Tax at the current rate (which was held to mean the standard rate) for the time being would amount to the clear yearly sum of £350—In re *Jones,* [1933] Ch. 842. Such a deduction is not affected by the ultimate tax liability of the annuitant, as ascertained under the second stage.

(Lord Thankerton.)

That being the proper construction of the bequest, the next question is as to how the bequest works out in a question with the Revenue. This may well be exemplified in this case by an assumption that there was no statutory machinery for collection at the source. The annuitant would then be directly assessed on her total income, and there can be no doubt that her total income would be found to be £100, and she would be exempt from any liability to tax, with the result that the additional gift would become unnecessary in the particular year.

But there was in this case statutory provision for deduction at the source, and, as the trust income had already been brought into charge, Rule 19 of the General Rules applicable to Schedules A, B, C, D and E, as amended by the Finance Act, 1927, Section 39 (1), ensured deduction at the source, and entitled the trustees, on making payment of the annuity or other annual payment, " to deduct and retain thereout a sum representing the amount " of the tax thereon " at the standard rate for the year in which the annuity payable became due. " The person to whom such payment is made shall " allow such deduction upon the receipt of the residue of the same, and the " person making such deduction shall be acquitted and discharged of so " much money as is represented by the deduction, as if that sum had been " actually paid." The standard rate of tax in the year to 5th April, 1940, was 7*s*. in the £, and the Crown maintains that the duty of the trustees under this Rule, if they made the deduction, was to pay the Respondent £65 in cash, and to give her a certificate of deduction of tax showing that £35 had been paid as Income Tax, and that the Respondent was bound to accept payment in that form. I agree with the learned Judges of the First Division in their rejection of this contention, and their reasons for so doing.

In the first place I am of opinion that the trustees, in order to carry out the provisions of the will, were bound to exercise the right conferred by the Rule and make the deduction. Secondly, it is established beyond doubt that the provisions for deduction at the source are nothing more, under the Income Tax Acts, than the machinery by which the Revenue collects the tax from the person ultimately liable to pay. The authorities are referred to by Lord Fleming in *Richmond's Trustees* v. *Richmond*, 1935 S.C. 585, at page 596. I may say that I prefer Lord Fleming's dissenting opinion, as to the right of the trustees to share in the repayments obtained by the annuitant, to the opinions of the majority. Further, it must be remembered that any sum payable under the additional bequest forms part of the total income of the annuitant and is thus subject to tax.

Under Rule 19 the trustees had no choice but had to apply the standard rate to the £100 annuity, and this necessarily involved a calculation of what sum paid under the additional bequest would cover tax at the standard rate on that amount as well as the £100. No one disputes that £153 16*s*. 11*d*. formed a correct calculation on this basis. The trustees had no call, under this Rule, even if they otherwise had a right, to ask the Respondent to provide them with particulars as to what her total income was, or as to what personal allowances she might be entitled. But the deduction did involve a payment by the trustees, on her behalf, out of the additional bequest which beneficially belonged to her, of £53 16*s*. 11*d*., being in discharge of the Respondent's personal liability for tax. Romer, J., in In re *Pettit*, [1922] 2 Ch. 765, at pages 769–70, in relation to a tax free annuity of £1,000, puts the matter so clearly as to the stage which I have reached

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that I venture to quote a passage, namely: " It would, however, be im-
" possible for the trustees to ascertain what rate of tax was ultimately payable
" in respect of the annuitant's income, and in any case they would, under
" the provisions of the Income Tax Acts, be bound, in the first instance,
" to treat that income as liable to the ordinary rate. In the year 1918–19,
" for instance, when the ordinary rate of income tax was 6*s*. in the £ the
" trustees would have had in the first instance to set aside £1,428 11*s*. 5*d*.
" and to pay £428 11*s*. 5*d*. to the revenue and the balance to the annuitant.
" But this sum might in the end prove to be too little or too much. If the
" annuitant were liable to pay super tax it would be too little and the
" proper proportion of her super tax referable to her annuity would, when
" ascertained, have to be paid to her by the trustees and would so go to
" reduce the income payable to the residuary legatees. It might on the
" other hand turn out that the circumstances of the annuitant were such
" that she was not liable in respect of her income to the full rate of income
" tax, that, in my opinion, being the true effect of the provisions for relief
" and abatement contained in the relevant taxing Acts. In that case the
" sum so set aside and the £428 11*s*. 5*d*. paid in the first instance to the
" revenue would be too much, and if, in consequence of this, the annuitant
" is repaid the excess by the Special Commissioners, I cannot understand
" on what ground it can be suggested that such excess should be retained
" by the annuitant who has not paid it, and not be handed back to the
" residuary legatees who have. If the annuitant were to retain the excess
" she would in the end have received out of the estate more than 20*s*. in the
" £ on the £1,000 given to her by the will." This passage was approved
by Lord Sands in *Hunter's Trustees* v. *Mitchell*, 1930 S.C., at page 983.

The Crown were not parties in that case, and they take exception to it only in so far as the language of Romer, J., may be held to be inconsistent with a contention which they have submitted for the first time in this House, and which depends on the proper construction of Section 29 of the Income Tax Act, 1918 (as amended by Section 32 and the Third Schedule to the Finance Act, 1920), which provides: " (1) If it is proved to the satisfaction
" of the general commissioners that any person whose claim for allowance
" or deduction or relief has been allowed, has paid any tax, by deduction
" or otherwise, the general commissioners may, in the form prescribed,
" certify the facts proved before them to the special commissioners. (2) The
" certificate of the general commissioners shall state the particulars of the
" different sources of income in respect of which tax has been paid, the
" relief to which the claimant is entitled, the amount repayable in respect
" thereof, and the name and place of the abode of the claimant. (3) On
" receipt of the certificate, the special commissioners shall issue an order
" for repayment." The contention of the Crown is that the claim for repayment is personal to the claimant, and that the words, " has paid any
" tax, by deduction or otherwise ", import that no claim is valid except on the footing that on receipt of the repayment it belongs to the claimant who is entitled to keep it; that, in the present case, it is the trustees who are out of pocket, and that the claimant would be bound to account to the trustees for any repayment recovered by her, and that, accordingly, the Respondent's claim for repayment does not fall within the purview of the Section.

My Lords, in my opinion this contention is untenable, both as regards the narrow construction sought to be put on the Section and the proper view of the facts in the present case. The words " paid by deduction " must

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refer to payment at the source by someone other than the claimant, but someone who thereby has paid the claimant's tax on the claimant's behalf; and that it constitutes payment by the claimant of her tax appears to me to be made clear by the closing words of Sub-rule (1) of Rule 19: "and "the person making such deduction shall be acquitted and discharged of "so much money as is represented by the deduction, as if that sum had "been actually paid." As I have already stated, on the basis of Rule 19 the amount of the additional bequest was £53 16*s*. 11*d*., which belonged to the Respondent, and that amount was applied on her behalf by the trustees in payment of £53 16*s*. 11*d*. of tax. As it turns out now, that calculation was in error as regards the liability of the Respondent to Income Tax to the amount of £53 16*s*. 11*d*., which the Respondent has paid by deduction within the meaning of Section 29, and it does not seem to me to be any concern of the Crown whether the Respondent is to account to the trustees for it or not.

Finally, I am unable to see any reason for any reduction of the £53 16*s*. 11*d*. to £47 11*s*. 4*d*. The amount overpaid was £53 16*s*. 11*d*. in respect of the Respondent's personal liability to Income Tax. So far as she is concerned the Crown have no possible ground for claiming any tax out of the £53 16*s*. 11*d*. Whether after its return to the trustees and its distribution to, say, the residuary legatees, it is liable to any tax, is not *hujus loci*. Whether the Respondent can amend her claim so as to claim the £53 16*s*. 11*d*. is not for this House to decide; we can only deal with the claim as presented to us in the Stated Case, and, in that view, I am of opinion that the appeal should be dismissed, and that the decision of the First Division should be affirmed. In accordance with the arrangement mentioned by the Lord Advocate, the Respondent will be entitled to her costs of the appeal as between solicitor and client.

Lord Russell of Killowen.—My Lords, this appeal raises a question to which I find it difficult to give an answer which satisfies me in every particular. The difficulty arises from the impossibility of making the provisions of the will fit into the provisions of the Income Tax Act, 1918, but the problem must be approached, in my opinion, from the point of view that the trustees of the will do in each year strictly carry out the trusts imposed upon them by the testator.

At the outset my personal difficulty is increased by the fact that, unaided by authority, I would have imagined that the testator meant Miss Cook to receive an annuity of £100 per annum, and that residue was to bear the burden of and recoup her the amount of any tax which she might have to pay in respect of an annuity of £100. It has, however, been settled by authority (too late, it is said, for challenge) that the true meaning of such a provision is such that it bequeaths an annuity not of £100 but of such a sum as after deduction of tax will produce in each year that net sum of £100. In other words it is not a bequest of an annuity of £*x*, the tax on which has to be borne by residue, but a bequest of an annuity of £*y*, the tax on which is treated as borne by the annuitant by deduction, although in truth the burden of paying the annual sum of £*x* tax free to the annuitant falls upon residue. The amount of the annuity given may, therefore, vary from year to year according as the amount of tax payable by the annuitant increases or diminishes; and such an increase or diminution may be caused by one or other of several factors, as, for instance, an alteration in the standard rate of tax, or an alteration in the annuitant's rights (by personal

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or other allowances) to exemption from tax. For, be it observed, the freedom from tax in the case of such a gift as the present is not, as in the very special case of In re *Jones*, [1933] Ch. 842, freedom from tax at the standard rate as a fixed deduction for the purpose of ascertaining the amount of the net annual payment, but freedom from the tax which would otherwise be payable by the particular annuitant.

What are the facts relevant to the particular year here in question?—for the only matter for our determination is whether Miss Cook is entitled to recover repayment of tax for the year ending 5th April, 1940. The facts are as follows. (1) The trustees out of the income of the estate, which had already borne tax by deduction, paid to Miss Cook, at the times specified in the will, two sums of £50 each; (2) they made no deduction in respect of tax under Rule 19 of the General Rules because the terms of the will prohibited any such deduction; (3) the two sums of £50 constituted the sole income of Miss Cook; and (4) she was, therefore, not liable to pay Income Tax at all.

Those are the facts of this case, and on a consideration of them I am unable to see how any overpayment of tax has taken place or how any claim by the annuitant to repayment can arise. She has received exactly what the will gave her, namely, £100, and has paid no tax. The residue has suffered the reduction of the estate's taxed income contemplated by the will and caused by the direction to pay the £100. The Revenue has received all the tax to which it is entitled.

My Lords, I am painfully conscious that the solution which I have indicated commends itself to none of your Lordships, but, notwithstanding the uneasiness to which that fact gives rise, I prefer it to a solution which causes the trustees to depart from the directions given to them by the testatrix, and to a solution which is based on a twofold fiction, namely, that the income of Miss Minnie Cook during the year in question was £153 16*s*. 11*d*., and that the trustees had disbursed a sum of £153 16*s*. 11*d*. out of which they paid to the Revenue Income Tax at the standard rate.

I would allow the appeal.

Lord Porter.—My Lords, in this case I have had an opportunity of reading the opinions of Lord Maugham and Lord Thankerton, and agree that the judgment of the First Division of the Court of Session should be affirmed.

I should not trouble your Lordships with my own views were it not that the provisions of the various Finance Acts applicable are neither clear nor coherent, and in a matter where some violence to language must take place whatever view be taken, I think it desirable to state shortly the reasons why I have arrived at the conclusion stated. I need not repeat the facts and may, therefore, express my reasoning at once.

Like Lord Maugham, I think that the first question is to determine the meaning of the will. I do not think that any of your Lordships have any doubt as to this: the trustees are under an obligation to pay the annuitant £50 at Whitsunday and £50 at Martinmas in each year, and the right to payment is to accrue on the first appointed date immediately following the death of the testatrix, subject to a reduction in the first payment so that it shall bear the same proportion to £50 as the period between the death and the date of the first payment bears to the full half-year. Whatever recovery

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of tax she may or may not obtain later, at that moment the annuitant is entitled to the named sum given by the will. No question of a broken period arises in the present case, so that the named sum is on each date £50 and for the year £100. The trustees are not entitled—and indeed it has not been maintained that they are—to pay a reduced sum, leaving the annuitant to make up the testator's bounty by claiming repayment of relief from the Income Tax authorities. In order to fulfil their obligations the trustees are entitled under Rule 19 of the General Rules, or obliged under Rule 21, to deduct tax at the current rate from such a sum as will leave £100 net. The gross sum so arrived at is £153 16*s*. 11*d*., so that £53 16*s*. 11*d*. has to be paid to meet an immediate liability for tax, though that sum may ultimately be found not to be due by the annuitant in whole or in part. In these circumstances the question arises whether she can claim repayment from the Income Tax authorities of any sum and, if she can, what that sum should be.

Four suggestions have been mooted as to what this sum should be.

(1) It was originally said by the Crown that the claim was one personal to an annuitant in the sense that her claim was confined to any diminution of income which she suffered by reason of the deduction of tax: that in the present case, as the annuity was tax free, no loss of income had occurred, and therefore no claim for repayment was possible. It is true that the Appellants tempered the harshness of this contention by offering an *ex gratia* payment of £35, but they maintained that strictly no repayment was exigible.

My Lords, such a result would not, I imagine, commend itself to any tribunal as a fair solution of the difficulty, but, in a matter which is purely a question of statutory enactment, one must look at the provisions of the various Finance Acts which deal with the matter in order to ascertain if the argument is sound.

The right to repayment is now dealt with in Sections 9, 10 and 16 of the Income Tax Act, 1918, read with Sections 40 and 41 of the Finance Act, 1927, which contains certain modifications of the Act of 1918, but does not affect the question at issue. Sections 9, 10 and 16 of the Act of 1918 so far as material read as follows: " 9. An individual who claims and proves, " in the manner prescribed by this Act, that his total income . . . does not " exceed the amounts in the six sections next following, shall be entitled " to such relief as is mentioned in those sections. 10. Where the income " does not exceed one hundred and thirty pounds " (at the material date £125) " the claimant shall be entitled to exemption from income tax . . . " 16. Except as otherwise provided, any exemption, abatement or relief " under the preceding provisions of this Part of this Act shall be given either " by discharge or reduction of the assessment, or by repayment of the excess " which has been paid. . . . "

I see nothing in these provisions, or indeed in any of the provisions for relief or repayment of Income Tax, which would prohibit a subject from claiming repayment of tax paid in respect of the income to which he is entitled, though the sum repaid may on receipt be payable to some other person. Indeed, the provisions of Section 25 (4) of the Finance Act, 1941, seem to show a recognition, at a later date it is true, that a claim for repayment may be made on behalf of a person other than the claimant, and ultimately the Crown was prepared to acknowledge a right in the claimant to receive a sum which, though less than that which the annuitant put forward, would enure to the benefit of the trust. It would, in my view,

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be unfortunate if a concession, even to this extent, was not justified, since otherwise the Revenue could retain tax in respect of a sum which normally would be free of tax.

(2) The main argument on behalf of the Commissioners, however, was that the annuitant's gross income was £100 and her net income, therefore, £65. The necessity which the trustees were under of providing two sums of £50 at stated dates, both long before a return of tax could be claimed, much less recovered, they explained by contending that the trustees must be taken to have advanced the amount of this tax at the date of each payment, and to be entitled to recover it from the annuitant as repayment of a loan when she recovered it from the tax authorities. This, to my mind, is a more attractive argument than that originally advanced, but I do not think it accords with the facts.

In the numerous cases in which the question has been raised as to the right of trustees to recover from a *cestui que trust* a sum which he in his turn has recovered from the Revenue authorities, such an argument has never been put forward. It is true that in none of those cases was the Crown interested, but it would have been an effective argument on behalf of trustees seeking to recover if it had been sound. The fact is that the £100 is paid under the provisions of the will and without regard to whether the lady has the right to or will recover anything from the Crown. There is no loan in fact of the whole or any part of the tax chargeable on the sum paid, nor do I see any necessity for an implication that a loan has been advanced.

(3) and (4) The actual claim lodged with the Inspector of Taxes alleged that the annuitant's gross income was £153 16*s*.11*d*. and her net income, therefore, £100, but she claimed relief only to the extent of £47 11*s*. 4*d*., which was the correct figure if her gross income was really £153 16*s*. 11*d*.

I do not, however, accept this view; the distinction between gross and net seems to me to have no application to a case where income is given free of tax. Her income is £100, but in providing that sum the trustees may take into account tax deducted at the source and must take into account untaxed income which comes into their hands and out of which the annuity is to be paid. In order to meet their obligations and to pay the £100, they therefore required in the existing circumstances a sum of £153 16*s*. 11*d*., of which £53 16*s*. 11*d*. had already been deducted in tax. In handing over the £100 they were passing on the exact sum which they themselves had received, but one in respect of which the tax had already been deducted.

Even if the trustees had received untaxed income and deducted tax, as they must have done under Rule 21, theirs would have been the hand which paid the tax, but they would have paid it not for themselves but for her, and it appears to me to make no difference whether the tax is deducted at the source or withheld by the trustees. In each case £53 16*s*. 11*d*. must be paid to the Revenue authorities in order that the lady may receive her annuity at the dates demanded by the will.

It was her tax, paid to enable her to receive the £100 at the appropriate time. The form of certificate given by the trustees appears to me to represent the true state of affairs: the gross amount on which tax has been suffered by the beneficiary is £153 16*s*. 11*d*.; the amount of Income Tax suffered thereon by the beneficiary is £53 16*s*. 11*d*.; the amount of net payment actually made to or for the benefit of the beneficiary is £100. If, then, the amount of tax suffered by the beneficiary is £53 16*s*. 11*d*., and she

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owes no tax, I see no reason why she should not recover the whole sum. The alternative suggestion, that the repayment of £47 11*s*. 4*d*. only can be recovered, depends upon the truth of the suggestion that the annuitant's gross income is £153 16*s*. 11*d*. That, in my view, is not so. Her income is £100, and the terms "gross" or "net" are not expressions appropriate to that income. It is true that, in order that she may receive £100 at the proper time, tax to the amount of £53 16*s*. 11*d*. has to be set aside. That sum is, as I think, paid on her behalf and is, therefore, recoverable by her. But it is not hers to keep; it must be handed over to the trustees. In the present case, however, it is immaterial whether the sum to be recovered is £53 16*s*. 11*d*. or £47 11*s*. 4*d*. At least the lesser sum can be claimed, and no more is sought.

I agree that the appeal should be dismissed.

Lord Simonds.—My Lords, this appeal raises a question of real difficulty. It is an appeal against the Interlocutor pronounced by the First Division of the Court of Session as the Court of Exchequer in Scotland in a Case stated under Section 149 of the Income Tax Act, 1918. The facts can be shortly stated.

Mrs. Margaret Jessie Forrest, who died on 24th September, 1937, by the third purpose of her trust disposition and settlement directed her trustees out of the free annual income derived from the heritable subjects which should belong to her at the time of her death (*inter alia*) to pay to her niece Miss Minnie Cook an annuity or yearly sum at the annual rate of £100 per annum for the remainder of her life, such annuity to be payable at two terms in the year, Whitsunday and Martinmas, beginning at the first of these terms after her death with the proportion for the period from her death to that term and so forth thereafter at the said two terms, and the testatrix declared that the said annuity should be purely alimentary and not capable of anticipation or subject to the debts or deeds of the annuitant or liable to the diligence of her creditors, and should be payable free of all deductions, including Income Tax and Government duty.

The terms of this bequest are of a deceptive simplicity: the gift of an annuity free of Income Tax does not, upon the face of it, suggest any question of difficulty in regard either to interpretation or to the rights, *inter se,* of the Revenue, the annuitant and the residuary legatees. Yet your Lordships have, upon one point at least, been left in no doubt, namely, that such a bequest in fact raises questions of which there is no easy solution.

The controversy with which your Lordships are immediately concerned is between the Crown and the annuitant, and arises out of an objection made by the Inspector of Taxes to a claim made by the annuitant for repayment of Income Tax for the year ended 5th April, 1940.

At each term of Whitsunday and Martinmas after the death of the testatrix the trustees, acting under her trust disposition and settlement, paid to the annuitant the sum of £50 in respect of the annuity for the preceding half-year. These sums were paid wholly out of income that had already been brought into charge to tax, that is to say, at the then prevailing rate of tax every £100 in the hands of the trustees represented a gross sum of £153 16*s*. 11*d*. from which tax amounting to £53 16*s*. 11*d*. had been deducted. The trustees by their solicitor accordingly gave to the annuitant a certificate whereby it was certified that she was "a beneficiary of the

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"Trust known as Mrs. M. J. Forrest's Trust to the extent of £100 and that "the following particulars are correct." The particulars purported to show in respect of the annuitant's income for the year ended 5th April, 1940, (1) that the gross amount on which tax had been suffered by the beneficiary was £153 16*s*. 11*d*., (2) that the amount of Income Tax suffered thereon by the beneficiary was £53 16*s*. 11*d*., and (3) that the amount of the net payment actually made to or for the benefit of the beneficiary was £100.

Upon the footing of this certificate the annuitant, who had no other income than her annuity, lodged her claim for repayment of Income Tax for the year to 5th April, 1940. She claimed, (1) that the source of her income was "Annuity of £100 per annum free of tax from Mrs. M. J. Forrest's "Trust", (2) that the amount of income before deduction of tax was £153 16*s*. 11*d*., and (3) that the amount of Income Tax deducted was £53 16*s*. 11*d*.; and claimed repayment of £47 11*s*. 4*d*., made up of (*a*) a personal allowance of tax at the full standard rate of 7*s*. on £100 = £35, and (*b*) an allowance of two-thirds of tax at the standard rate on £53 16*s*. 11*d*. = £12 11*s*. 4*d*.

It appeared that the annuitant was prepared and intended, if she was repaid this sum of £47 11*s*. 4*d*., to hand it over to the trustees for behoof of whom it might concern. She recognised that her right was to get £100, and no more, from the bounty of the testatrix. This course she had followed in previous years in which her claim for repayment had been allowed.

The Inspector of Taxes objected to the claim. He was prepared to concede as a matter of grace, if not of right, the repayment of £35, that is, 7*s*. in the £ upon £100, upon the footing that the trustees might, if they had thought fit, have paid to the annuitant £65 and given her a certificate of deduction of tax amounting to £35, upon which she could have obtained repayment. This the annuitant would not accept, and so the matter came before the Commissioners for the General Purposes of the Income Tax for the Division of Edinburgh upon an appeal by the annuitant against the objection made by the Inspector of Taxes to her claim for repayment of tax. The Commissioners by a majority allowed her appeal, and at the request of the Inspector of Taxes stated a Case for the opinion of the Court of Session, in which the question of law for the opinion of the Court was expressed to be, whether the decision of the majority of the Commissioners was right. The Court of Session has unanimously held that the decision was right, that is to say, that the claim for repayment of £47 11*s*. 4*d*. was valid. Hence the appeal to this House.

My Lords, I think that the first stage in the consideration of this question must be to interpret the will of the testatrix. Shorn of the incidental provisions in regard to mode of payment, what is meant by an annuity of £100 free of Income Tax? It can mean one of two things, either (*a*) an annuity of such a sum as after deduction of tax at the standard rate for the time being in force will leave £100, or (*b*) an annuity of such a sum as after all necessary adjustments in respect of the allowances and reliefs personal to the annuitant have been made will leave her with £100, no more and no less. Between these two meanings a choice must be made, and I do not think that the choice is assisted or should be guided by the fact that the testatrix has given directions in regard to payment which are more easily reconcilable with the one result or the other. The substance of the bequest lies in the words, "an annuity or yearly sum at the rate of £100 per "annum . . . free of all deductions including Income Tax", and,

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giving these words the best consideration that I can, I am clearly of opinion that they import no more than that the annuitant, be her circumstances what they may, is to receive £100, no more and no less: that is the sum that is to remain in her pocket after tax has been provided for. If she is a payer of Sur-tax, then there must be provision for Sur-tax: if she is below the level of taxation there will be neither Sur-tax nor Income Tax. This would be very plain if the assessment to tax was made directly upon her. The question would be, What is her income?—the answer, £100: the next question, What tax is payable by her?—and the answer, None. No one can fail to be aware of the complications that are introduced by the machinery of tax collection. But they do not, in my opinion, lead to a conclusion which is so manifestly incorrect as the statement that an annuity of £100 free of Income Tax is the same thing as an annuity of such an amount as after deduction of tax at the standard rate will leave £100. I say " mani-" festly incorrect ", for in the present case it leads, and necessarily leads, to the further statement by the annuitant that her income is £153 16*s*. 11*d*. I see no justification for such a statement. It is indisputable as a mathematical proposition that £153 16*s*. 11*d*. is the sum which after deduction of tax at 7*s*. will produce £100: it is, therefore, true that every £100 of tax-paid income in the hands of the trustees represents a gross income of £153 16*s*. 11*d*. But it does not follow that the annuitant's income is £153 16*s*. 11*d*. We know that if her income is £100 she pays no tax. Why, then, should an income of £100 free of tax in her case be stated to be £153 16*s*. 11*d*.?

In coming to this conclusion I do not in any way dissent from the proposition of law stated by Lord Sands in *Hunter's Trustees* v. *Mitchell*, 1930 S.C. 978, at page 982: " Income tax is a tax upon the income of the " person who enjoys the income. In whatever manner it may be collected, " its ultimate incidence is upon the income of this person. So rigid is this " principle that, when under a will an annuity is payable free of income tax, " the amount of the tax is taken to be an additional gift, and is included in " the income of the annuitant when, for revenue purposes, a return of total " income is necessary." This has been accepted in England as in Scotland as an accurate statement of the law: see also *North British Railway Company* v. *Scott*, 1923 S.C. (H.L.) 27; 8 T.C. 332. But it leaves entirely open the question what upon the true interpretation of a particular will is the amount of the tax which is the subject of the additional bequest. It may be either the hypothetical standard rate of tax or the actual tax which the particular beneficiary has to bear, and the actual tax may be by virtue of allowance and relief less than the standard rate, or by virtue of the addition of Sur-tax may be something more than the standard rate.

It is, I think, upon this point that the issue really turns. The Lord President (from whose opinion I very reluctantly differ) says that " for the " purpose of grossing the income, Income Tax must be taken at the standard " rate of tax.[1]" If it were so, I should find his conclusions difficult to resist. But holding as I do that the meaning and effect of the will is that the annuitant is to have her annuity free of the tax which she, her total income being what it is, would pay in respect of it, not free of the tax which she would have to pay if her total income was something quite different, I cannot accept the view that for the purpose of grossing the income the tax must be taken at the standard rate. Here I find myself in complete agreement with the judgment of Romer, J., in In re *Pettit*,

(1) *Ante*, at p. 497.

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[1922] 2 Ch. 765, as expounded by Lord Greene, M.R., in In re *Maclennan,* [1939] Ch. 750, at page 758: " He treats the direction in the will " (i.e., a direction to pay an annuity free of Income Tax) " as a direction to the " trustees to ascertain what is the gross sum which will give the net annuity " specified, a clear sum of £1,000. He points out that in calculating that " gross sum it would lead to an inaccurate result if the trustees merely " calculated it by reference to the deduction which it was permissible for " them to make without reference to the recoveries which the annuitant " might obtain. He says that the true calculation which the trustees ought " to make is to ascertain a sum which, after taking not merely the initial " deduction but also the matter of relief into account, will produce the net " sum specified. If I may say so with respect, that reasoning appears to " me to be as satisfying as any reasoning can be." It may further be observed that, as was pointed out by Evershed, J., in In re *Tatham,* [1945] Ch. 34, at page 38, Romer, J., was not deterred from coming to this conclusion by the fact that the testator had directed that the annuity should be paid in equal quarterly payments.

This, then, my Lords, upon the true construction of the will, is the measure of the bounty of the testatrix. Somehow, in conformity with the provisions of the law of Income Tax, she is to receive £100, no more and no less. But it is at this point that the difficulty arises. In In re *Hooper,* [1944] Ch. 171, at page 172, Uthwatt, J., justly observes: " Testators frequently " provide that an annuity of an amount specified by them is to be free " of income tax or is to be paid without deduction of income tax. These " words do not fit in at all comfortably with the provisions of the Income " Tax Acts, for it is beyond the competence of testators to free an annuity " from income tax. The income tax withheld on payment of an instalment " of an annuity is not a deduction from the annuity; and, where part of " the annuity is not payable out of profits and gains brought into charge, " the withholding of the income tax appropriate to that part is obligatory " on the payer." The learned Judge proceeds to point out that the intention disclosed by such phrases, or phrases of similar import disclosing an intention to relieve the annuitant of the burden of Income Tax, is nevertheless carried out by an appropriate increase in the amount specified for the annuity, the increase being such as to enable the annuitant to receive the specified amount after the tax incident to the increased annuity in the hands of the annuitant has been satisfied in manner required by the Act. The question, then, is how the intention of the testatrix is to be carried out. How are the trustees to provide the beneficiary (*a*) with an annuity of £100, and (*b*) with such further sum as will leave her that sum after her liability to tax has been satisfied? And, further, how are they to do this conformably with Rule 19 or Rule 21 (as the case may be) of the General Rules applicable to Schedules A, B, C, D and E of the Income Tax Act? My Lords, it appears to me to be quite clear that this result is satisfactorily achieved, so far as the substance of the gift is concerned, by paying to the annuitant £65 in cash and giving to her a certificate which enables her to recover £35 from the Revenue. But it is said that the form of the gift is in this way disregarded, for the testatrix has prescribed payment at two terms in the year, and presumably in two equal parts. What then? Is the substance of the gift to be disregarded in order that form may be observed? The testatrix has made a bequest which is in form irreconcilable with the statutory machinery for the collection of tax. I see no reason why, in order to observe form, the fiction should be adopted that her income is £153 16*s*. 11*d*., or, in other words, that the bequest to her is of an annuity of that amount.

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I am led to the same conclusion by a consideration of the provision for repayment of tax contained in Section 29 of the Income Tax Act, 1918 (as amended by Section 32 and the Third Schedule to the Finance Act, 1920). That Section provides: " (1) If it is proved to the satisfaction of the general " commissioners that any person whose claim for allowance or deduction " or relief has been allowed, has paid any tax, by deduction or otherwise, " the general commissioners may, in the form prescribed, certify the facts " proved before them to the special commissioners. (2) The certificate of " the general commissioners shall state the particulars of the different sources " of income in respect of which tax has been paid, the relief to which the " claimant is entitled, the amount repayable in respect thereof, and the " name and place of abode of the claimant. (3) On receipt of the certificate, " the special commissioners shall issue an order for repayment."

This Section appears to me to look at nothing but the position of the individual taxpayer. What is his total income? From what sources is it derived? Upon that basis to what allowance or relief is he entitled? These questions and the answers that must be given to them are not consistent with the solution of the present case, by which admittedly the repaid tax is not to be retained by the claimant. I must respectfully dissent from the proposition which has found favour with the Court of Session, that this is a matter irrelevant to the issue. On the contrary, the question being what is the income of the annuitant for the purpose of determining the allowances and reliefs to which she is entitled, I think it very germane to ask whether the sums that are repaid to her belong to her in her own right. And, if I find that they belong not to her but to another, then I take leave to doubt the major premiss, namely, the amount of her income upon which her claim to repayment was based. So here the annuitant claims relief and repayment upon the basis of a total income of £153 16*s*. 11*d*. But, having obtained repayment of £47 odd, she hands that sum over to the trustees and she does so for no other reason than that, since her total income is not £153 16*s*. 11*d*., she is not entitled to retain it. But if her total income is not £153 16*s*. 11*d*. (a conclusion to which on the construction of the will I had already come) she is not entitled to relief and repayment upon the footing that it is.

My Lords, I was much impressed by other considerations advanced by the learned Lord Advocate. It is, I think, material to ask what is the character of this £47 of repaid tax when it has reached the hands of the trustees. In the hands of the annuitant it is a sum which has been repaid to her upon the footing that it was a tax paid by her by deduction or otherwise. In the hands of the trustees how is it to be regarded? As part of the trust income, presumably. But I do not know whether it is income upon which tax has been paid or is income which is still liable to tax under some Case of some Schedule. It is not conclusive that such an apparently insoluble problem arises, but my doubts about the correctness of the decision under appeal are strengthened.

Yet another difficulty presses on me. I do not understand why only £47 11*s*. 4*d*., not £53 16*s*. 11*d*., is repayable upon the basis of the Respondent's argument. If her total income was in fact £153 16*s*. 11*d*., then she would be entitled to £47 11*s*. 4*d*. and no more. But I do not understand that it is contended at the Bar that her total income was in fact £153 16*s*. 11*d*. On the contrary the argument is that, as the Crown has received £53 16*s*. 11*d*. by way of tax in respect of every £100 of income left in the hands of the trustees, therefore it has received £53 16*s*. 11*d*. in

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respect of the £100 paid by the trustees to the annuitant. If so, since *ex hypothesi* the annuitant pays no tax, the whole of the £53 16*s*. 11*d*. should be repaid. But it is sufficiently obvious that no such claim could validly be made either by the annuitant or by anyone else under Section 29 of the Income Tax Act, 1918. Again I am forced to doubt the soundness of the foundation of the claim.

The Respondent relied in this House (though the point appears not to have been raised in the Court of Session) upon Section 25 of the Finance Act, 1941, which, it is said, shows that the procedure adopted by the trustees in this case is the procedure which Parliament contemplated for every case of payment of a stated sum free of Income Tax. I am unable to accept this argument. It is as tenable a view that this Section is dealing only with the case where the annuitant does in fact bear tax at the standard rate. If the Section does cover the case of the Respondent's annuity and she is entitled to an annuity only of £68 19*s*. 3*d*. free of tax, I must admit that for my part I do not see what advantage she derives from it. I do not think that this Section absolves your Lordships from the duty of construing the will and reconciling its provisions, so far as they can be reconciled, with the machinery of the Income Tax law.

It has been urged in favour of the claim that the trustees have no means of finding out what the position of the annuitant is in regard to reliefs and allowances; that they cannot compel her to tell them, and, therefore, that they can do no other than pay her the full nominal amount of the annuity. From this proposition too I must dissent. As I see it the trustees can only perform their duty properly, that is, provide an annuity of £100 free of tax, if they know what is the tax that the annuitant has to pay, and they are, accordingly, entitled to obtain from her all necessary information and to satisfy themselves that it is correct. If the annuitant was a payer of Sur-tax, she would have to give the trustees all the information about her income which would enable them to provide her with an annuity free of tax. I see no reason why she should not do so, whatever may be the measure of the freedom which she claims.

Finally, I must recur to the contention that, if the solution that I favour is adopted, the mode of payment prescribed by the testatrix is ignored. If this is the necessary result, I do not shrink from it. It is, to my mind, preferable to saying that a bequest of an annuity of £100 free of tax to an annuitant who, if she had £100 of income and no more, would pay no tax, is equivalent to a bequest of an annuity of £153 16*s*. 11*d*. upon which she ultimately pays tax of £6 5*s*. 7*d*., and, recovering £47 11*s*. 4*d*. by way of personal relief and allowance, hands that sum over to another. But I would not finally express an opinion that it is the necessary result. It may well be that it would be proper in the administration of this trust, in order to give effect to the testamentary intentions, for the trustees to make the necessary advances by means of equal half-yearly payments subject to the necessary accounting when the annuitant had recovered the tax paid in respect of £100, that is, in the year under review the sum of £35. I do not venture, particularly as this is a case arising under the law of Scotland, to express any view upon this without hearing argument on the part of the annuitant and the residuary legatees.

I would allow this appeal and answer the question of law stated for the opinion of the Court by saying that the decision of the majority of the Commissioners was not right.

Questions put:

That the Interlocutor appealed from be reversed.

The Not Contents have it.

That the Interlocutor appealed from be affirmed and that the appeal be dismissed with costs, such costs to be taxed as between solicitor and client in accordance with the arrangement mentioned by the Lord Advocate.

The Contents have it.

[Agents:—Solicitor of Inland Revenue, England, for Solicitor of Inland Revenue, Scotland; Beveridge & Co., for Cooper & Brodie, W.S., Edinburgh.]