HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—
18TH MARCH, AND 18TH AND 19TH JUNE, 1946

COURT OF APPEAL — 17TH AND 18TH JULY, 1947

HOUSE OF LORDS — 29TH AND 30TH NOVEMBER, 1948, AND
20TH JANUARY, 1949

COMMISSIONERS OF INLAND REVENUE v. TOOTAL BROADHURST LEE CO., LTD. [1]

Excess Profits Tax—Patent royalties—Whether "income from invest-"ments"—Finance (No. 2) Act, 1939 (2 & 3 *Geo.* VI, *c.* 109), *Seventh Schedule, Part* I, *Paragraph* 6.

The Respondent Company manufactured and merchanted textile goods, using in the course of manufacture patents relating to processes mostly developed in its own research department. The Company granted non-exclusive licences of a number of such patents to other manufacturers and to finishers and received royalties therefrom. The royalties with which the case was concerned were received in respect of three groups of patents. The first group related to a finishing process developed in the Company's research department and employed by a subsidiary and by licensee finishers by whom cloth produced by the Company was treated. Licences provided for minimum prices and for reduced prices in the case of work done for the Company. The facts in relation to the second group, which was concerned with another process, were similar, except that the patent rights, subject to existing licences, were bought by the Company. In the case of the third group, which was concerned with certain mechanical devices, the Company and the inventor, a person connected with the Company, had transferred their entire interest in return for a royalty. The royalties received in the material period in respect of the first two groups amounted to about £100,000, *and those in respect of the third group to about* £150.

The Company was assessed to Excess Profits Tax for the chargeable accounting period ended 30*th June,* 1940, *on the footing that all the royalties fell to be included in the computation of profits. On appeal against this assessment the Company contended that the royalties were income from investments within the meaning of Paragraph* 6 *of Part* I *of the Seventh Schedule to the Finance* (*No.* 2) *Act,* 1939, *and should be excluded in computing profits for the purposes of the tax. The Special Commissioners accepted the Company's contention, and allowed the appeal.*

Held, *that the Company had been correctly assessed on the basis that none of the royalties in question was income from investments.*

CASE

Stated under the Finance (No. 2) Act, 1939, Section 21 (2), and the Finance Act, 1937, Fifth Schedule, Part II, and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

(1) Reported (C.A.) [1947] 2 All E.R. 409; (H.L.) [1949] 1 All E.R. 261.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 15th December, 1942, Tootal Broadhurst Lee Co., Ltd. (hereinafter called "the Company") appealed against an assessment to Excess Profits Tax for the chargeable accounting period beginning 1st July, 1939, and ending 30th June, 1940, in the sum of £116,000.

2. The question at issue was whether certain patent royalties should be excluded in computing the Company's profits as being income from investments within the meaning of the Finance (No. 2) Act, 1939, Seventh Schedule, Part I, Paragraph 6.

3. The Company carries on trade as manufacturers and merchants of cotton, linen, woollen and other goods. In the course of manufacture the Company (together with its subsidiaries) uses patents covering inventions and processes which have been mostly developed in its own research department, which has been in operation for 20 years. The staff of this research department is permanent and is employed largely for the purpose of perfecting old processes and devising new.

The Company has from time to time granted non-exclusive licences of a number of such patents to other manufacturers and finishers both in the United Kingdom and abroad at a royalty. Royalties from such licences were received by the Company in the standard period and in the chargeable accounting period in question.

4. The royalties the subject of this appeal were received in respect of three groups of patents:—

(*a*) *Crease-resisting process.* This process was developed by the Company's research department, and is patented in many countries abroad. The Company itself does not employ this process, but the cloth it produces is treated either by a subsidiary of its own or by licensee finishers.

A specimen of the licences granted is annexed hereto, marked "A", and forms part of this Case (1).

(*b*) *Process to prevent felting in woollen goods.* In 1939 the Company bought the patent rights in respect of this process from the original patentees, taking over the benefit and burden of existing licences. The Company has since granted further licences, and the process is also used in the manufacture of its own goods.

A specimen of the licences granted is annexed hereto, marked "B", and forms part of this Case (1).

(*c*) *Controlling devices on stentering machines.* These devices govern the transit of cloth on conveyor belts on drying machines. They were invented by a person connected with the Company; a joint application by the Company and this person was made almost simultaneously with an application by another company (hereinafter called "the assignees") which had produced a somewhat similar device. By an agreement made on 12th March, 1940, the Company and the person connected with it transferred their interest to the assignees in return for a royalty, and the assignees took out a consolidated patent under the two applications.

The royalties received under this agreement in the year in question amounted to about £150; the royalties received under (*a*) and (*b*) of this paragraph in the year in question amounted to about £100,000.

The agreement made 12th March, 1940, is annexed hereto, marked "C", and forms part of this Case (1).

(1) Not included in the present print.

5. None of the licences granted as referred to in paragraph 4 above is exclusive, nor for the whole term of the patent. The Company owns patents other than those mentioned in paragraph 4 hereof, but no licences have been granted in respect of them.

The negotiation of the licences gives the Company a fairly substantial amount of trouble and expense but once a licence is granted little is involved except collecting the royalty.

6. It was contended on behalf of the Company that the said royalties were income received from investments within the meaning of the said Paragraph 6 (1) and should be excluded in computing its profits for the purposes of Excess Profits Tax.

7. It was contended on behalf of the Commissioners of Inland Revenue:—

(1) That patents are not "investments" within the meaning of Paragraph 6 of Part I of the Seventh Schedule, Finance (No. 2) Act, 1939.

(2) Alternatively, that the word "investments" in the said Paragraph did not include patents not acquired by purchase.

(3) That a company can only "invest" in outside securities, and not in assets forming an integral part of its own business.

(4) That in any event, the patents in question having been acquired and exercised in connection with the Company's trade or business, they were not "investments" within the meaning of the said Paragraph.

(5) That therefore the patent royalties in question should be included in arriving at the amount of profits of the Company's trade or business chargeable to Excess Profits Tax.

8. We, the Commissioners who heard the appeal, having considered the evidence and arguments submitted to us, were of opinion that patents which had been exploited by licensing them out at a royalty fell within the term "investments", and allowed the appeal. Figures being agreed we reduced the assessment to £61,746.

9. Immediately upon our determination of the appeal the representative of the Crown expressed to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance (No. 2) Act, 1939, Section 21 (2), and the Finance Act, 1937, Fifth Schedule, Part II, and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

H. H. C. GRAHAM,
MARK GRANT-STURGIS, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C. 1.

24th August, 1944.

The case came before the King's Bench Division (Macnaghten, J.) on 18th March, 1946. On 15th April, 1946, it was ordered that the case be remitted to the Special Commissioners for them to determine whether the

wording of certain statements contained in the Case Stated was in accordance with the evidence adduced before and accepted by them, and if not, to report what alterations were necessary in order to bring the Case into accord with that evidence.

The following report was duly furnished by the Commissioners.

REPORT

We, the undersigned Special Commissioners, who heard the appeal and stated the Case in the above matter, pursuant to the Order of the Court entered the 15th April, 1946, report as follows:—

(*a*) We have referred to our minute of the appeal from which it appears that Counsel for the Company in his opening of the case stated that the processing patents and inventions referred to in paragraph 4 (*b*) of the Case were used by the Company itself. Mr. T. A. Fairclough, a director of the Company in charge of the research department, whose evidence we accepted, confirmed Counsel's opening of the facts of the case. In cross-examination he stated that the processes were not actually used in his Company but a subsidiary company existed for treating such goods under the various processes. We accordingly determine that the wording of paragraph 4 (*b*) is in accordance with the evidence adduced and accepted by us.

(*b*) According to the said minute Mr. Fairclough also stated that the Company never parted absolutely with its patent rights, that is, it never granted an exclusive licence. We accordingly determine that the wording in paragraph 5 that "none of the licences granted as "referred to in paragraph 4 above is exclusive" is in accordance with the evidence adduced and accepted by us.

(*c*) We have no note to show whether the statement in the same paragraph 5 that "none of the licences granted as referred to in paragraph "4 above is . . . for the whole term of the patent" is or is not in accordance with the evidence adduced before us, and we have no personal recollection which enables us to say whether the said statement is correct or incorrect.

H. H. C. GRAHAM,
MARK GRANT-STURGIS, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C. 1.

20th May, 1946.

The case again came before the King's Bench Division (Atkinson, J.) on 18th June, 1946, when judgment was reserved. On 19th June, 1946, judgment was given in favour of the Crown as regards the royalties in the first and second groups and against the Crown as regards the royalties in the third group.

The Solicitor-General (Sir Frank Soskice, K.C.), and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. J. Millard Tucker, K.C., and Mr. Terence Donovan, K.C., for the Company.

JUDGMENT

Atkinson, J.—This Case stated by the Special Commissioners raises the question whether certain royalties received under licences with regard to a number of patents are income from investments. It will be remembered that Paragraph 6 of Part I of the Seventh Schedule to the Finance (No. 2) Act, 1939, provides: "(1) Income received from investments shall "be included in the profits in the cases and to the extent provided in sub-"paragraph (2) of this paragraph and not otherwise. (2) In the case of "the business of a building society, or of a banking business, assurance "business or business consisting wholly or mainly in the dealing in or "holding of investments, the profits shall include all income received from "investments, being income to which the persons carrying on the business "are beneficially entitled." In this case the Commissioners have taken the view that all the royalties were income from investments; and the Crown appeals.

The facts can be quite simply stated. Messrs. Tootal Broadhurst Lee Co., Ltd. are a very well-known company carrying on business in Manchester. They are manufacturers and merchants of cotton, linen, wool and other things, so the Case states; and it is to be observed that they are not finishers or bleachers; they merely manufacture the cloth, and I imagine that very few manufacturers also carry on the trade of finishing, but at any rate they are merely manufacturers of the cloth, and when it is made and finished they merchant it.

In the course of manufacture the Company uses patents covering inventions and processes which have been mostly developed in its own research department, which has been in operation for 20 years; and the Case states that "The staff of this research is permanent and is employed "largely for the purpose of perfecting old processes and devising new." A big concern manufacturing cloth in the way they do want new finishes if they can find them, and it is quite common for them to have their own research department in the hope that some new and attractive finish can be discovered and can be applied to their cloth and make it more saleable. Then the Case states: "The Company has from time to time granted "non-exclusive licences of a number of such patents to other manufacturers "and finishers both in the United Kingdom and abroad at a royalty." The question is: What is the position of these royalties?

The Commissioners divide the royalties which they are considering into three groups of patents. The first is described as the crease-resisting group. They state that this process was developed in the research department and is patented abroad; the Company itself does not employ the process—because, of course, they do not finish—but the cloth it produces is treated either by a subsidiary company of its own or by licensed finishers; and a specimen of the licence, marked "A", forms part of the Case.

The second group relates to patents to prevent felting, that is to say, shrinking, in woollen goods. The only difference between this class and the crease-resisting patents is that these patent rights were bought by the Company from the original patentees, taking over the benefits and burdens of any existing licences, and they have since granted further licences, and the process is also used by a subsidiary of Tootal Broadhurst in the manufacture of its own goods. "B", annexed to the Case, is an example of such licence.

Then (*c*), the third class, relates to controlling devices on stentering machines. That is a totally different class from the other two. It is a

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mechanical device which is affixed to certain machinery. The Company, of course, are not machinists—they do not make machines; and the facts were that (it may be by accident, I do not know) some person—it does not say in their employ, but some person connected with the Company—invented this mechanical device, but somebody else also invented it or thought of it at the same time, and there was a joint application by the Company and this person, whoever it was, and they assigned their rights to a third party on terms that they received royalties. That agreement of 12th March, 1940, is also exhibited.

The patents in the first two groups apparently produce a very large royalty—the Case states £100,000 in one year—and this mechanical device, which was rather a trifling affair, produced in the same year merely £150.

There is no doubt that a patent can be an investment. A patent may produce income certainly in two different ways. The owner of the patent may manufacture or use the subject-matter of the patent for the purpose of earning money, or he may merely permit others to use the subject-matter of the patent for reward, usually in the form of royalties. Obviously he may also make money in both ways.

I suggest that three propositions can more or less safely be laid down, based upon, if I may say so, a most illuminating judgment of Lord Greene, M.R., in *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.*, [1946] 1 All E.R. 58; 29 T.C. 155. If a patent is manufactured or used by the owner for the purpose of earning money, the patent is not an investment and the money earned by its manufacture or user is not income from an investment. Secondly, if the owner merely permits by licence others to use it, deriving no business benefit from the patent other than the receipt of royalties, it may fairly be said to be an investment, and the royalties may be fairly said to be income from an investment. Thirdly, if the owner of the patent earns money in both ways, the patent is not an investment for the purpose of this Paragraph. The royalties in such a case are merely one of the ways in which the patent is being exploited. If he wants the benefit of that Paragraph, the owner must elect to treat the patent merely as a royalty-producing investment.

The Master of the Rolls gave two examples. The example he gave of a case where the patent may properly be said to be an investment was a very extreme one. He illustrated the case of a barrister owning a patent and making no use of it himself but merely licensing it to other people and enjoying the income so received. He said that the barrister would then be merely passive; he would be the passive recipient of income from that particular piece of property (1). But the Master of the Rolls did not suggest that only in such an extreme case as that could a patent be deemed to be an investment. The Paragraph would not be required to exclude such a case, because no business would be carried on. I was referred to the case of *Commissioners of Inland Revenue* v. *Gas Lighting Improvement Co., Ltd.*, 12 T.C. 503, where that point was emphasised, that the corresponding Excess Profits Duty provision must be deemed to have some meaning when applied to a business which is being in fact carried on. On page 524 Lord Sterndale, M.R., deals with the point, and it is again emphasised by Lord Cave, L.C., on page 534, by Lord Finlay on page 539 and by Lord Sumner on page 543.

(1) 29 T.C., at pp. 162-3.

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Bearing that in mind I think that my second proposition is applicable if a man, carrying on a business, acquires a patent which might be of value in his business either by his making the subject-matter or by using the subject-matter, but nevertheless elects not to make or use it but merely to treat it as a royalty-producing patent. It seems to me that the principle there is just the same as in the case of the barrister in that the particular owner is merely a passive recipient of income from that particular piece of property.

The Master of the Rolls emphasises the importance of ascertaining the facts and determining how the patent is being used. Following his suggestion or advice, I will examine first the crease-resisting patent. This was a patent for a process which is a finishing process. As I have said, Messrs. Tootal Broadhurst are not finishers; they manufacture the cloth. Apparently they own a subsidiary company which does finish; they also license other finishers to use it. The specimen licence which has been put in shows how the licensees are tied down to minimum prices. They are not to charge other people less than certain prices, and Tootal Broadhurst are to get a 20 per cent. reduction from those minimum prices for any work done for them: in other words they take very good care to secure that their competitors will not come in on the same advantageous terms as they do themselves.

It seems to me perfectly plain that the process was being used in and for their business. When they wanted their cloth finished in this way, instead of doing it themselves they sent it to others to finish for them, receiving back the cloth and then selling it at probably enhanced prices. I should think it is very likely that they would find it difficult to get finishers to instal the necessary apparatus for the new finish merely to deal with their own goods. The finishers probably could not make it pay. If a licence were granted permitting the finishers to apply it to other manufacturers' goods, the process would be cheapened, and incidentally they would draw revenue from the royalties; but it seems to me that, so long as the subject-matter of the patent is being applied in their business on their cloth, it is immaterial whether they are employing their own employees or whether they are paying somebody else to do it for them. It is something being used in the business and it cannot, in my view, be described as a mere investment.

To my mind the same result follows with regard to the second group. There is no real difference. There, instead of being lucky enough to discover the process in their own department, the Company purchased the patent from somebody else; but, having purchased it, they have not purchased it as an investment, they have purchased it for use in their own business, not for using it by their own hands but for use on the cloth which they manufacture. Whether it is the same subsidiary or another subsidiary is wholly immaterial, but some subsidiary of their own, as well as licensees, used the process on cloth of their manufacture. The main purpose of that purchase obviously was for use in their business, if not by people in their own employ, by others whom they paid to use it. The receipt of royalties was an incident, though a remunerative incident, and in my judgment it is quite impossible to say that the mere fact that they received royalties turned what was a business use into an investment.

I think the third group is quite different. I think that is a very good example of my second proposition. Here the subject-matter of the patent was mechanical; it was a mechanical device, a controlling device. It is

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described in one recital as an improvement in machines. Messrs. Tootal Broadhurst are not machinists; they do not manufacture machines, and it is no part of their business to make these devices or to get other people to make them and then sell them to the Company. There is no finding that the devices were to be made for fixing on to their own machinery or that they would be of any use when fixed to their own machines. I do not know enough to say anything about that. I know that stentering machines are used in finishing and bleaching, but I do not know whether they are of any use to a mere manufacturer. That is immaterial. The Case does not find that these devices were or would be of any use in their own manufacturing business, or that they would benefit in any way by the assignment other than by the receipt of royalties. Therefore it seems to me that the Commissioners were there well entitled to take the view that the royalties received under the agreement of 12th March, 1940, were income from an investment. The distinction seems to me to be that, whereas the other patents with which the Case deals were wanted for their own business, here there is no finding that they were of any business use at all to them, and *qua* their rights with regard to that invention they were mere passive receivers of income.

Therefore, in my judgment, the appeal ought to be allowed with regard to the first two groups and dismissed as to this comparatively small matter, the controlling devices dealt with in what the Commissioners call the third group. What do you say as to costs, Mr. Hills?

Mr. Hills.—My learned friend Mr. Tucker quite frankly said that the third device was a very insignificant matter. The real fight is on the first two.

Atkinson, J.—You have substantially succeeded. Mr. Donovan, what do you say about this?

Mr. Donovan.—That is true so far as money is concerned, but the argument on the third point was just as substantial as the argument on the other two.

Atkinson, J.—What had been in my mind was to say three-quarters of the taxed costs.

Mr. Donovan.—I should agree with that.

Mr. Hills.—If your Lordship pleases. I take it that the case will have to go back to the Commissioners to adjust the assessment in accordance with the judgment. That is the usual Order.

Atkinson, J.—Very well.

Both sides having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Tucker, Somervell and Evershed, L.JJ.) on 17th and 18th July, 1947, and on the latter date judgment was given unanimously dismissing the Company's appeal and allowing the Crown's cross-appeal, with costs.

Mr. J. Millard Tucker, K.C., and Mr. Terence Donovan, K.C., appeared as Counsel for the Company and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Tucker, L.J.—I will ask Somervell, L.J., to deliver the first judgment in this case.

Somervell, L.J.—This is an appeal from a judgment of Atkinson, J., and the question arises in relation to Excess Profits Tax. It is unnecessary to set out the main structure of that tax, as this case turns on the application of a few words in a Paragraph in the Seventh Schedule to the Finance (No. 2) Act, 1939. The case is concerned with sums received in respect of (I will use neutral words) patent rights, and the question is whether those sums are income received from investments within the meaning of Paragraph 6. Paragraph 6, Sub-paragraph (1), of Part I of the Seventh Schedule to the Act reads as follows: "Income received from investments shall be "included in the profits in the cases and to the extent provided in sub-"paragraph (2) of this paragraph and not otherwise." The taxpayer in this case does not come within Sub-paragraph (2), so, if the income is income received from investments, it is not to be included in the computations which give rise to the assessment which is under appeal.

The Solicitor-General emphasised, and rightly emphasised, that in this Act, for example in Sub-section (4) of Section 12, which is the main charging Section in respect of Excess Profits Tax, you find the phrase "investments or other property". He also pointed out that that phrase is to be found in the earlier Act, the 1937 Finance Act, which dealt with National Defence Contribution, and he submitted, therefore, that where you find the expression "investments" without the expression "or other "property", that is an indication that it is to be given a narrower construction and you are not to bring within it income simply because it could be described and might naturally fall under the description "income from "property".

I think the simplest way is to read the relevant paragraphs, which are quite short, from the Case. The taxpayer, Tootal Broadhurst Lee Co., Ltd., appealed against an assessment to Excess Profits Tax for the chargeable accounting period 1st July, 1939, to 30th June, 1940. I need not read paragraph 2. Paragraph 3 is: "The Company carries on trade as "manufacturers and merchants of cotton, linen, woollen and other goods. "In the course of manufacture the Company (together with its subsidiaries) "uses patents covering inventions and processes which have been mostly "developed in its own research department, which has been in operation "for 20 years. The staff of this research department is permanent and is "employed largely for the purpose of perfecting old processes and devising "new. The Company has from time to time granted non-exclusive licences "of a number of such patents to other manufacturers and finishers both "in the United Kingdom and abroad at a royalty. Royalties from such "licences were received by the Company in the standard period and in the "chargeable accounting period in question." "4. The royalties the "subject of this appeal were received in respect of three groups of "patents—(*a*) Crease-resisting process. This process was developed by "the Company's research department, and is patented in many countries "abroad. The Company itself does not employ this process, but the cloth "it produces is treated either by a subsidiary of its own or by licensee "finishers. A specimen of the licences granted is annexed hereto, marked "'A', and forms part of this Case. (*b*) Process to prevent felting in "woollen goods. In 1939 the Company bought the patent rights in respect "of this process from the original patentees, taking over the benefit and

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"burden of existing licences. The Company has since granted further "licences, and the process is also used in the manufacture of its own goods. "A specimen of the licences granted is annexed hereto, marked 'B', and "forms part of this Case. (*c*) Controlling devices on stentering machines. "These devices govern the transit of cloth on conveyor belts on drying "machines. They were invented by a person connected with the Company; "a joint application by the Company and this person was made almost simul-"taneously with an application by another company (hereinafter called 'the "'assignees') which had produced a somewhat similar device. By an "agreement made on 12th March, 1940, the Company and the person "connected with it transferred their interest to the assignees in return for "a royalty, and the assignees took out a consolidated patent under the "two applications." Then it gives the amounts received, which do not matter; and then it is said in the next paragraph that none of the licences granted is exclusive, nor for the whole term of the patent. I am not sure whether that is right about the agreement, but I propose to look at the agreement of 12th March later. Then: "The negotiation of the licences "gives the Company a fairly substantial amount of trouble and expense "but once a licence is granted little is involved except collecting the "royalty."

The Commissioners on that found: "We . . . having considered the "evidence and arguments submitted to us, were of opinion that patents "which had been exploited by licensing them out at a royalty fell within "the term 'investments', and allowed the appeal." Then the Crown expressed dissatisfaction.

Pausing there, a question was raised, but not very strenuously, that that might be regarded as a finding on a question of fact. At the time when the Commissioners dealt with this matter, certain cases—in particular, a certain case in this Court, to which I shall refer later—had not been decided, but I think myself it is clear from the form of the finding that they were laying down a principle of law which, as it seems to me, is inconsistent with what was said by this Court in a later case and therefore the matter is open for argument on both sides.

At some stage before the Case came before the Court the taxpayer complained that that Case contained inaccuracies, which had crept in, he said, in accordance with what we were told is the usual practice of a Case being sent for correction first to the successful side, then to the unsuccessful side, and then the Commissioners get it back. They do not necessarily adopt, of course, but consider any suggestions for amendment that have been made. It was agreed between the parties, for example, that the specimen licences which had been exhibited to the original Case were not the normal form of licences, and the proper form was, by agreement, substituted. Then the matter went back, and I do not think it is necessary to read the questions because the points are clear from what the Commissioners said. They stated this. "(*a*) We have referred to our minute "of the appeal from which it appears that Counsel for the Company in "his opening of the case stated that the processing patents and inventions "referred to in paragraph 4 (*b*) of the Case were used by the Company "itself. Mr. T. A. Fairclough, a director of the Company in charge of "the research department, whose evidence we accepted, confirmed Counsel's "opening of the facts of the case. In cross-examination he stated that "the processes were not actually used in his Company but a subsidiary

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"company existed for treating such goods under the various processes. "We accordingly determine that the wording of paragraph (4) (*b*) is in "accordance with the evidence adduced and accepted by us. (*b*) According "to the said minute Mr. Fairclough also stated that the Company never "parted absolutely with its patent rights, that is, it never granted an "exclusive licence. We accordingly determine that the wording in para-"graph 5 that 'none of the licences granted as referred to in paragraph 4 "'above is exclusive' is in accordance with the evidence adduced and "accepted by us. (*c*) We have no note to show whether the statement in "the same paragraph 5 that 'none of the licences granted as referred to "'in paragraph 4 is . . . for the whole term of the patent' is or is not "in accordance with the evidence adduced before us and we have no "personal recollection which enables us to say whether the said statement "is correct or incorrect."

I shall have later to refer to the learned Judge's judgment, but it is sufficient at the moment to say that the learned Judge reversed the finding of the Commissioners in respect of the sums covered by paragraph 4 (*a*) and 4 (*b*), and he held that they were not income from investments. He held in respect of the sums received under paragraph 4 (*c*) that they were income from investments. The taxpayer appeals from the decision in respect of 4 (*a*) and (*b*), and the Crown cross-appeals in respect of the decision under (*c*).

This general subject-matter came before this Court in a case called *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.* (1), [1946] 1 All E.R. 58. That case was concerned with royalties received in respect of patent rights. The company was a British company, and the matter came in the first instance before Macnaghten, J. Macnaghten, J., decided that the royalties were not income received from investments, following a principle he had laid down in an earlier decision, *Commissioners of Inland Revenue* v. *Rolls-Royce, Ltd.* (2), [1944] 2 All E.R. 340, a principle that in order to have an investment there must have been a laying out of money in order to acquire it, and, applying that test, the royalties were not in that case income received from investments.

When that case came before this Court the decision of Macnaghten, J., was affirmed, but the general principle which he had laid down was dissented from. After reciting what I have already stated about the learned Judge's decision, Lord Greene, M.R., said this (3): "Speaking for myself "I am always disinclined to accept any general definition or test for the "purpose of solving this type of question. The question whether or not "a particular piece of income is income received from an investment must, "in my view, be decided on the facts of the case. The facts must be "ascertained and then the question has to be answered. For the Court to "find itself fettered by some apparently comprehensive attempt at a "definition directed to the solution of the problem in relation to one type "of property, I cannot help thinking is unfortunate."

Later in the judgment—and this is important on the general question of construction — he said, referring to a certain argument (4): "It is "contrary to what one may call the popular conception of the word "'investment', which is not a word of art but has to be interpreted in a

(1) 29 T.C. 155. (2) 29 T.C. 137. (3) 29 T.C., at p. 161. (4) *Ibid.*, at p. 163.

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"popular sense"; and MacKinnon, L.J., in the same case said (1): "I "think that the word 'investments' in the relevant Sections of the statute "is not a word capable of legal definition. Like so many words in modern "legislation, it is a word of current vernacular."

The Master of the Rolls' judgment, therefore, must be read as not laying down any general principle, but as dealing with the facts of the case before him, and I fully accept that point which Mr. Tucker rightly emphasised. What the Master of the Rolls said is this, and this is a passage which I think should be read (2): "To my mind it is obvious "that a patent in the hands of a manufacturer is quite a different type of "property, both in the business and in the practical sense, from a patent "in the hands of somebody who is a mere passive owner of the monopoly "right. For instance, a member of the Bar, who was fortunate enough "to have bequeathed to him a patent, or who had purchased a patent, the "validity of which had been established by the Court, might continue, "without any active participation in manufacturing himself, merely to "exploit that monopoly by granting licences. He would then be merely "passive; he would be the passive recipient of income from that particular "piece of property. In such a case it might very well be, and I strongly "suspect it would be, held, if members of the Bar were subject to Excess "Profits Tax, that the income from that patent could properly be described "as income from an investment. But directly the patent is held by a "manufacturer of the patented article, it seems to me that the situation is "entirely changed. When you have a manufacturer who is exploiting his "monopoly right not merely by excluding all competitors but by letting "one competitor in on terms, to say that the profits so derived are profits "from an investment seems to me to be a misuse of language. It is "contrary to what one may call the popular conception of the word "'investment', which is not a word of art but has to be interpreted in a "popular sense. The contrast, I venture to think, is brought out exactly "in the two examples I have put. One is that of a private individual, not "concerned with manufacture at all, but merely holding a patent, as he "might hold a copyright in a book, and simply drawing the income from the "royalties payable under the copyright. He would merely be a passive "person, drawing the income which flows from that particular chose in "action. That is one example. The other example is the manufacturer "who can, if he likes, at any moment exploit his monopoly in a number "of different ways, either by manufacturing himself, or by vending himself, "or by allowing somebody else to manufacture and vend, or manufacture "but not vend, or to vend but not manufacture. The mere granting of "such licences does not seem to me to take the income out of the category "of income of the business."

By that last phrase the Master of the Rolls clearly meant profits of the business as distinct from income from investments. As Mr. Tucker pointed out, and quite rightly emphasised, in dealing with this Paragraph the words do not cover income from investments except income which is income of the business. You would not need a special Paragraph in the Schedule to exclude from the computation income from investments which had nothing whatever to do with the business. It may be difficult to imagine such a case in the case of a company, but certainly in the case of an individual or partnership it is very easy to imagine income from

(1) 29 T.C., at p. 165. (2) *Ibid.*, at pp. 162-3.

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investments which would not have anything to do with the business in question at all. The passage I have cited seems to me to give the guidance which we have got to apply in this case.

This case is not covered in one sense by the decision in the *Desoutter* case (1), because there were two differences on which Mr. Tucker relied. In the first place, in the *Desoutter* case the taxpayer was manufacturing, as I understand it, the articles covered by the patent, and that is not so in this case. There was a further point which Mr. Tucker took, in that he said in the licensing agreements in that case there were provisions which went beyond the ordinary licence provisions and dealt with the supply of drawings of drills and tools and so on, and therefore were provisions which may, as he suggested, have led the Court to take the income in that case out of the character of income from investments, whereas if those provisions had not been there they might have decided differently. Those undoubtedly are differences, but they do not seem to me to be differences which lead—and I am dealing at the moment with the first two categories of income under 4 (*a*) and (*b*)—to a different conclusion.

Now, with regard to 4 (*a*) and (*b*), the learned Judge, after referring to this case, said this (2): "it seems to me that, so long as the subject-matter "of the patent is being applied in their business on their cloth, it is "immaterial whether they are employing their own employees or whether "they are paying somebody else to do it for them. It is something being "used in the business and it cannot, in my view, be described as a mere "investment." I agree with that. It seems to me a correct application of "the general principles as they are to be found in the earlier case, and I "have nothing that I wish to add to it.

That disposes of the matter so far as 4 (*a*) and 4 (*b*) are concerned, and I now turn to paragraph 4 (*c*) of the Case. These particular sums had a somewhat unusual origin, and were not quite like the ordinary licences such as were granted and dealt with under paragraph 4 (*a*) and (*b*). What apparently happened, according to the recitals in the agreement, was that the Company and a Mr. Laurie, who is said in the Case to have been connected with the Company, applied for letters patent for the invention as described in the Case. The other parties to the agreement, John Daglish & Sons, had also made an application for letters patent in respect of a similar invention—at least, one assumes it is similar—and there were, therefore, as it were, rival claims in respect of an invention. The parties came together and effected a compromise, or effected a settlement, and the taxpayer in this case and Mr. Laurie sold and assigned to the other party, who are called the assignees, all their right, title and interest whatsoever of and in the patent application which they had put forward. They did that in return for an undertaking by the assignees to pay royalties, and there were various other provisions. The assignees undertook to use their best endeavours to work the said invention on a commercial scale in the United Kingdom of Great Britain and Northern Ireland. The Company had the option to require the assignees to grant licences to any party or parties whom the Company may from time to time nominate for this purpose if the gross amount due under the agreement should be less than £100 in any one year.

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(1) 29 T.C. 155. (2) Page 358 *ante*.

(Somervell, L.J.)

I am bound to say, speaking for myself, that it would never have occurred to me to call that an investment—I am not quite sure what the investment is—but our attention was drawn to some observations made by Rowlatt, J., in the case of *Commissioners of Inland Revenue* v. *Sangster* (1), [1920] 1 K.B. 587. That case was dealing with quite a different point, but it was concerned with a man who had made a number of inventions and had licensed them to, I think, two companies, of each of which he was managing director, and under those licences he got royalties. Rowlatt, J., said this, at page 594 (2): "There is therefore a very great difficulty in "treating this royalty income as anything other than income of an invest-"ment which had been called into being by his past efforts"; and he later said, at page 597 (3): "It seems to me that carrying on a business "involves, in a case like this, the disposal of the article which is produced "as opposed to retaining it as a valuable thing in itself which can be "treated as an investment, just as anything bought with the money "obtained for it if it had been sold could be treated as an investment."

It is quite unnecessary, I think, to go into what was the issue in that case. The importance of it to my mind is this: We have to consider what is the ordinary popular or business sense of the word "investment", and one does find Rowlatt, J., a Judge (if I may say so) of the greatest possible experience in this class of case, using the word "investment" as a word that occurred to him as reasonably appropriate in respect of royalty income being received by an inventor. He was not, of course, deciding that royalty income was an investment within this Paragraph, still less was he deciding or in any way dealing with the problem which we have in respect of the particular agreements before us, but I do attach importance to the language he used.

Now the learned Judge, in dealing with this part of the case, after referring to the *Desoutter* case (4), laid down three propositions which he thought could be "more or less safely laid down" in the light of that case. His second was this, he said (5): "If the owner merely permits by licence "others to use it, deriving no business benefit from the patent other than "the receipt of royalties, it may fairly be said to be an investment, and "the royalties may be fairly said to be income from an investment." For the reasons which I shall state shortly it is unnecessary, I think, in this case to decide whether that as a general principle is right. I do not think it can be derived from what was said in the *Desoutter* case, and I think there is a good deal in the argument which was put forward by the Crown, that it may go too far and might cover cases in which it would not be right to say that the income was income from investments. Deciding as he did on this third point, he was, I think, applying that principle. He said (6): "I think the third group is quite different. I think that is a very good "example of my second proposition. Here the subject-matter of the patent "was mechanical", and so on. He says: "Messrs. Tootal Broadhurst "are not machinists; they do not manufacture machines, and it is no part "of their business to make these devices or to get other people to make "them and then sell them to the Company. There is no finding that the "devices were to be made for fixing on to their own machinery or that "they would be of any use when fixed to their own machines." Then he says: "I know that stentering machines are used in finishing and bleaching.

(1) 12 T.C. 208. (2) *Ibid.*, at p. 214. (3) *Ibid.*, at p. 217.
(4) 29 T.C. 155. (5) Page 357 *ante*. (6) Pages 358-9 *ante*.

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"but I do not know whether they are of any use to a mere manufacturer. "That is immaterial. The Case does not find that these devices were or "would be of any use in their own manufacturing business, or that they "would benefit in any way by the assignment other than by the receipt of "royalties. Therefore it seems to me that the Commissioners were there "well entitled to take the view that the royalties received under the agree- "ment of 12th March, 1940, were income from an investment. The dis- "tinction seems to me to be that, whereas in the other patents with "which the Case deals they were wanted for their own business, here there "is no finding that they were of any business use at all to them, and *qua* "their rights with regard to that invention they were mere passive receivers "of income."

On that matter I differ from the learned Judge, but in a sense on a very narrow ground, because I think from what is stated in the Case, this being a patent taken out or patent rights which a manufacturer thought he had and which were dealt with under the agreement in the way in which I have stated, it obviously related to textile machinery, and he was a textile manufacturer. The Case says: "These devices govern the transit "of cloth on conveyor belts on drying machines", and, as it seems to me, you have not got to draw too fine distinctions in this matter. I think what the Master of the Rolls said indicated that. Where you find that a manufacturer is getting money in respect of patent rights which are related to the business which he is carrying on, it seems to me, at any rate *prima facie*, income from them is not income from investments and falls under the principle which the learned Judge applied to the income from 4 (*a*) and 4 (*b*).

That is sufficient, in my view, to dispose of this case. For those reasons I think that the appeal fails on 4 (*a*) and (*b*) and should be allowed on 4 (c).

Tucker, L.J.—I agree. I only desire to say a word or two as we are differing from the learned Judge on 4 (*c*), which concerns the cross-appeal. As I read the learned Judge's judgment, he comes to the conclusion to support the finding of the Commissioners because of the absence of any finding that they—that is to say, these devices—were of any business use at all to the Company. That, I think, put shortly, is the ground of his decision. He is taking the view that in order that income received from a patent—and I am not here drawing any distinction between a patent and the agreement which gave rise to the receipt of these moneys—should cease to be an investment income, it is necessary to have a finding that the patent was of business use to the company concerned, and in so saying he is applying what he thought was some principle laid down by the Master of the Rolls in the *Desoutter* case (1). I do not think any such principle can be extracted from that case. It has already been pointed out by Somervell, L.J., that the Master of the Rolls was there dealing with the case of a patent in the hands of the manufacturer, and he was pointing out how different that case is from the case of a patent in the hands of such a person as a member of the Bar. All he says is (2): "To my mind "it is obvious that a patent in the hands of a manufacturer is quite a "different type of property, both in the business and in the practical sense, "from a patent in the hands of somebody who is a mere passive owner "of the monopoly right." Now, although for the purpose of explaining

(1) 29 T.C. 155. (2) *Ibid.*, at p. 162.

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the nature of a patent he instances the holding of a patent by a member of the Bar, and says that in his view that would be an investment, I cannot find in the course of his judgment that he indicates any view as to the position of a manufacturer who holds a patent which is not proved to be actually used or of direct beneficial benefit to the manufacturer in connection with the goods which he manufactures.

In my view the learned Judge has taken too narrow a view of the problem before him in deciding that under 4 (*c*) these sums which were receivable under this agreement had the character of income from investment merely because of the absence of an express finding that they were of use to the Company in their business. As Somervell, L.J., has pointed out, they were devices which governed the transit of cloth on conveyor belts on drying machines. Keeping closely to the Case, and not placing reliance upon Atkinson, J.'s statement that he knew that stentering machines are used in finishing and bleaching, and having no knowledge myself of those matters, it is obvious that these machines are used in a process of drying. I am entitled to assume that until the cloth is dry the process has not been completed.

Now the Company in this case was a company that carried on business as manufacturers and merchants of cotton, linen, woollen and other goods, and when I find that they are receiving money under an agreement, which for this purpose I will assume gives them an interest in a patent, connected with devices governing the transit of cloth on conveyor belts on drying machines, I come to the conclusion that *prima facie* that would not be described by a business man as an investment; and I leave entirely open for consideration, if and when it does arise, in what circumstances, if any, where a manufacturer owns a patent and receives royalties in respect thereof, such income might be income from an investment.

Evershed, L.J.—I also agree. Upon the cross-appeal I only venture to add this, that as I read it, and as has been pointed out, the learned Judge based his conclusions upon the view that the third class, the subject-matter of the cross-appeal, was an instance of a business owner of a patent, which was unrelated to the business he was carrying on, turning it into a source of revenue by merely, as he says, " passively " licensing it to others in return for an income in the form of royalties. As has been pointed out by my brethren, it seems to me, on the facts as set out in the Case, it is going too far to say that the subject-matter of this particular patent relating to textile machinery was unrelated to the business of Tootals, who are cotton manufacturers. For my part I also agree with what has been said by Somervell, L.J. It seems to me in this case that, in applying the words of the Act and the Schedule, " income received from investments ", to the £150 here in question, it is really not possible to say that there is an investment from which £150 is received. In this case, for reasons which have been explained, the Company, together with a Mr. Laurie, disposed altogether of the patent in return for a number of rights which they obtained under a contract. Those contractual rights included the contractual right to receive sums described as royalties, but, in my judgment, applying the test laid down by MacKinnon, L.J., that the word " invest- " ment " must be given a business sense according to current vernacular (1), it is impossible to say that the sums received are received from an investment in that sense.

(1) Commissioners of Inland Revenue *v.* Desoutter Bros., Ltd., 29 T.C. 155, at p. 165.

(Evershed, L.J.)

For these reasons I agree that the appeal should be dismissed and the cross-appeal succeed.

The Solicitor-General.—Will your Lordships then say that the appeal should be dismissed with costs and the cross-appeal should be allowed with costs?

Tucker, L.J.—Yes.

The Solicitor-General.—If your Lordships please.

Mr Tucker.—Would your Lordships allow me to make an application now for leave to appeal in this case to the House of Lords?

Tucker, L.J.—Did the Court give leave to appeal in the *Desoutter* case? (1)

Mr. Tucker.—No, not the *Desoutter* case, in the *Broadway* case (2).

Tucker, L.J.—And the *Broadway* case is going to the House of Lords?

Mr. Tucker.—I understand that the Crown have now decided not to go to the House of Lords.

Tucker, L.J.—I thought you told us that in the *Desoutter* case the leave had been given.

Mr. Tucker.—No, I did not mention *Desoutter*. I do not know what the position was with regard to *Desoutter*.

Tucker, L.J.—What was the position, Mr. Solicitor?

The Solicitor-General.—I am told the appeal in the *Broadway* case is not going to the House of Lords. Leave was refused, I am told, in the *Desoutter* case.

Tucker, L.J.—No, Mr. Tucker, we do not feel that we can give you leave.

Mr. Tucker.—Your Lordship had not heard entirely what I wanted to say, but I know your Lordship will. In the first place, of course, this is not an insignificant application from the point of view of money. In the first year alone there is £100,000 tax involved, and there are five more years to come. Secondly, the question as to the true construction of this word "investments" and how wide a meaning has to be given to it is one which affects both sides, both the Crown and the taxpayer. Thirdly, as your Lordships realise, we are not the only persons who are concerned in a matter of this sort. There must be any number of big businesses in this country where patents are owned in connection with their business, and in respect of which they may be used in the business and also licences granted outside. For those substantial (I hope) commercial reasons I press your Lordships to allow us to have leave to go to the House of Lords.

Tucker, L.J.—What do you say, Mr. Solicitor?

The Solicitor-General.—I am entirely in your Lordships' hands about that. The only brief comment I would make would be that so far as the major amount, the £100,000, is concerned, there has been no difference whatsoever of judicial opinion, but I say no more than that.

Somervell, L.J.—I only wondered whether you might like to get a decision of the House of Lords.

The Solicitor-General.—I would sooner leave it entirely to your Lordships to decide.

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(1) 29 T.C. 155. (2) Commissioners of Inland Revenue *v.* Broadway Car Co. (Wimbledon), Ltd.. 29 T.C. 214.

(The Court conferred.)

Tucker, L.J.—No, Mr. Tucker.

Mr. Tucker.—If your Lordship pleases.

On the petition of the Company leave to appeal against the decision in the Court of Appeal was granted by the Appeal Committee of the House of Lords.

The case came before the House of Lords (Lords Simonds, Normand, Morton of Henryton, MacDermott and Reid) on 29th and 30th November, 1948, and on the latter date judgment was reserved. On 20th January, 1949, judgment was given unanimously in favour of the Crown, with costs, affirming the decision of the Court below.

Mr. J. Millard Tucker, K.C., Mr. Terence Donovan, K.C., and Mr. L. C. Graham-Dixon appeared as Counsel for the Company, and Mr. Cyril L. King, K.C., and Mr. Reginald P. Hills for the Crown.

Consideration of report from the Appellate Committee

Lord Simonds.—My Lords, I beg to move that the report from the Appellate Committee be now considered.

Question put:

That the report from the Appellate Committee be now considered.

The Contents have it.

Lord Simonds.—My Lords, the question raised in this appeal relates to an assessment to Excess Profits Tax made upon the Appellants for the chargeable accounting period ending on 30th June, 1940, in respect of the profits of their trade or business. Shortly stated, it is whether, in the computation of those profits, certain sums received in respect of so-called patent rights belonging to the Appellants, or in which they were interested, ought to be included. If, as the Appellants contend, such sums were income from investments within the meaning of Paragraph 6 of Part I of the Seventh Schedule to the Finance (No. 2) Act, 1939, then they ought not to be included.

Excess Profits Tax was first imposed by Part III of the Finance (No. 2) Act, 1939, and was imposed in respect of a certain excess of the profits arising from a trade or business over the standard profits, as therein defined. It is in this context that your Lordships have to consider the meaning of the words "income received from investments". It is convenient to set out, or state the effect of, the relevant Sections of the Act that I have mentioned.

By Section 12 (2) of the Act the trades and businesses to which the tax applies are all trades or businesses of any description carried on in the United Kingdom, or carried on, whether personally or through an agent, by persons ordinarily resident in the United Kingdom. Sub-section (4) of Section 12 of the Act is as follows: "Where the functions of a company "or society incorporated by or under any enactment consist wholly or "mainly in the holding of investments or other property, the holding of "the investments or property shall be deemed for the purpose of this "section to be a business carried on by the company or society."

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By Section 14 of the Act it is provided that the profits from a trade or business shall be computed on Income Tax principles as adapted in accordance with the provisions of Part I of the Seventh Schedule to the Act. Part I of the Seventh Schedule to the Act is headed "Adaptations of Income "Tax principles as to computation of profits", and it is provided in Paragraph 6 (1) and (2) thereof as follows: "6.—(1) Income received "from investments shall be included in the profits in the cases and to the "extent provided in sub-paragraph (2) of this paragraph and not otherwise. (2) In the case of the business of a building society, or of a "banking business, assurance business or business consisting wholly or "mainly in the dealing in or holding of investments, the profits shall "include all income received from investments, being income to which the "persons carrying on the business are beneficially entitled." The Appellants do not carry on any of the businesses mentioned in Paragraph 6 (2).

The facts, so far as they are material, are succinctly set out in three paragraphs of the Case stated by the Commissioners. They are thus stated:—

"3. The Company carries on trade as manufacturers and merchants "of cotton, linen, woollen and other goods. In the course of manufacture "the Company (together with its subsidiaries) uses patents covering in"ventions and processes which have been mostly developed in its own "research department, which has been in operation for 20 years. The staff "of this research department is permanent and is employed largely for the "purpose of perfecting old processes and devising new. The Company has "from time to time granted non-exclusive licences of a number of such "patents to other manufacturers and finishers both in the United Kingdom "and abroad at a royalty. Royalties from such licences were received "by the Company in the standard period and in the chargeable accounting "period in question."

"4. The royalties the subject of this appeal were received in respect "of three groups of patents:—(*a*) Crease-resisting process. This process "was developed by the Company's research department, and is patented "in many countries abroad. The Company itself does not employ this "process, but the cloth it produces is treated either by a subsidiary "of its own or by licensee finishers. A specimen of the licences "granted is annexed hereto, marked 'A', and forms part of this Case. (*b*) "Process to prevent felting in woollen goods. In 1939 the Company "bought the patent rights in respect of this process from the original "patentees, taking over the benefit and burden of existing licences. The "Company has since granted further licences, and the process is also used "in the manufacture of its own goods. A specimen of the licences granted "is annexed hereto, marked 'B', and forms part of this Case. (*c*) Control"ling devices on stentering machines. These devices govern the transit of "cloth on conveyor belts on drying machines. They were invented by a "person connected with the Company; a joint application by the Company "and this person was made almost simultaneously with an application by "another company (hereinafter called 'the assignees') which had pro"duced a somewhat similar device. By an agreement made on 12th "March, 1940, the Company and the person connected with it transferred "their interest to the assignees in return for a royalty, and the assignees "took out a consolidated patent under the two applications. The royalties "received under this agreement in the year in question amounted to about

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"£150; the royalties received under (*a*) and (*b*) of this paragraph in the "year in question amounted to about £100,000. The agreement made 12th "March, 1940, is annexed hereto, marked 'C', and forms part of this "Case."

"5. None of the licences granted as referred to in paragraph 4 above "is exclusive, nor for the whole term of the patent. The Company owns "patents other than those mentioned in paragraph 4 hereof, but no "licences have been granted in respect of them. The negotiation of the "licences gives the Company a fairly substantial amount of trouble and "expense but, once a licence is granted, little is involved except collecting "the royalty."

Upon the form of the licences and the agreement of 12th March, 1940, I will make some observations at a later stage. For the licences originally annexed to the Case others were afterwards substituted, but nothing turns on this.

Upon these facts the Commissioners expressed the opinion that "patents which had been exploited by licensing them out at a royalty fell "within the term 'investments'", and that the sums in question should therefore be excluded from the assessment.

From this determination the Respondents appealed by way of Case Stated to the High Court and, after some interlocutory proceedings to which I need not refer, Atkinson, J., decided that the patents in groups (*a*) and (*b*) were not, but that the patents in group (*c*) were, investments. There was an appeal and cross-appeal from his decision, and the Court of Appeal unanimously held that none of the patents were investments and, accordingly, that the whole of the sums in question must be included in the computation of profits for the purpose of assessment.

My Lords, I entertain no doubt that the decision of the Court of Appeal, which was founded on and followed an earlier decision of the same Court, *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.*(1), [1946] 1 All E.R. 58, was correct.

I do not propose to attempt an exhaustive definition of the word "investments". It is a word of which the meaning may vary according to its context. I hesitate to say, as was said by MacKinnon, L.J., in the *Desoutter* case(2), that it is to be construed as "a word of current verna-"cular". It is, for instance, a popular use of the word to say that a good education is a good investment. Here the meaning is limited by the context, and the context is one in which a distinction has to be made between the income of investments and the other profits of a trade or business. This does not mean that, if the assets (to use a neutral word) as to which the question arises would necessarily be described as investments in any context, they can be anything but investments for the purpose of Paragraph 6. This was long since determined in *Commissioners of Inland Revenue* v. *Gas Lighting Improvement Co., Ltd.*(3), [1923] A.C. 723, a case decided upon the strictly comparable language of Rule 8 of Part I of the Fourth Schedule to the Finance (No. 2) Act, 1915, which was much pressed upon this House. There the question was whether certain shares, which were admittedly investments, were investments within the Rule, the then appellant company contending for an implied qualification to the effect that to be within the Rule the investment must be made outside the operations for which the business of the company was constituted. But, as Viscount Cave, L.C., said, at page 730(4), there was nothing in the Act

(1) 29 T.C. 155. (2) *Ibid.*, at p.165. (3) 12 T.C. 503. (4) *Ibid.*, at p.535.

(Lord Simonds.)

which compelled or admitted of such a limitation of the meaning of the word. Your Lordships will, I think, get no assistance from this case, and I mention it only because, first and last, learned Counsel for the Appellants asserted its relevance.

The problem, my Lords, is a different one, not whether these assets, being investments, are within the Paragraph, but whether they are investments at all, and, as I have already said, that is a word whose scope will depend on its context.

It appears to me that the problem may be solved in this way. I would take a schedule of the assets of the trading company concerned and, omitting assets such as stocks and shares to which in view of the decision in the *Gas Lighting Improvement Co.* (1) case the title of investments can in no circumstances be denied, would ask of each other asset: "Is this an asset which the company has acquired and holds for the purpose of earning profits in, or otherwise for the promotion of, its particular trade or business?" There might be borderline cases in which the answer would be uncertain, but I do not doubt that in the vast majority of cases the answer would be clear cut. If it was in the affirmative, the asset would not be an investment within the Paragraph. It is possible, as was pointed out in the *Desoutter* case (2) by Lord Greene, M.R., that a particular kind of asset might in the hands of one trader be, and in the hands of another not be, an investment, though a less likely form of investment for any trader to make than a patent cannot readily be imagined.

Applying this test to the facts of the present appeal I cannot believe that any business man (who may be regarded as the touchstone in such a case) would describe the patent rights here in question as investments of the Appellants or the payments received by them under the licences or agreement as income of their investments. On the contrary the elaborate character of the so-called licences, which are designed to further the commercial interests of the Appellants and are directly related to their own particular trade, indicates clearly enough that these are assets of a kind which a trader carrying on such a business as that of the Appellants might be expected to own, but are assets such as no company carrying on a different trade would be likely to acquire. The agreement of March, 1940, need not be particularly examined. It serves to emphasise the distinction that I have made. It is not from such a source as this that a trader would seek to derive an income, unless it was an integral part of, or at least closely associated with, the trade he carried on.

I should finally say a word about the cases that were cited to this House. I need say no more about the *Gas Lighting Improvement Co., Ltd.* case. I have, I hope, given full weight to it in the opinion that I have formed.

In *Commissioners of Inland Revenue* v. *Rolls-Royce, Ltd. (No. 2)*(3), [1944] 2 All E.R. 340, Macnaghten, J., decided that income derived from the patent licences there in question was not income from an investment. He partly, at least, founded his decision on the view that, before there can be anything properly called an investment, money must be laid out to acquire it or bring it into existence. This test, though it was not accepted by Lord Greene, M.R., in the *Desoutter* case, may, I think, have an element of considerable value. It is not decisive, but it would at least be easier to

(1) 12 T.C. 503. (2) 29 T.C. 155. (3) 29 T.C. 137.

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describe an asset as an investment if it had been purchased out of funds not needed for the immediate purposes of the business.

In *Desoutter's* case (1), to which I have more than once referred, the facts were similar to those in the present case, and it was held that the royalties derived from certain patents were not income from investments. The judgment of the learned Master of the Rolls in that case, which has been followed and applied in the Courts below in the present case, is in effect now under review. I shrink, as he did, from attempting to lay down any general rule. The question is, as he pointed out, largely one of fact in each case. If for the purpose of drawing the right inference of fact I have suggested a certain test, I do not seek to depart from or to qualify what he said.

Finally reference was made to *Commissioners of Inland Revenue* v. *Broadway Car Co. (Wimbledon) Ltd.* (2), [1946] 2 All E.R. 609. There the Court held that, applying the principle of *Desoutter's* case, it was impossible to say that the Commissioners had erred in law in concluding that the transaction there in question had resulted in an investment. I am content without further investigation to accept the case as correctly decided on that ground.

In the result, my Lords, I am satisfied that the decision of the Court of Appeal was correct and move that the appeal be dismissed with costs.

Lord Normand.—My Lords, the question in this appeal is whether income described as royalties received by the Appellant Company under three separate agreements relating to patent rights and admittedly part of the Appellant's business profits is also income from an investment within the meaning of the Seventh Schedule, Part I, Paragraph 6, of the Finance (No. 2) Act, 1939.

The meaning of investment is not its meaning in the vernacular of the man in the street but in the vernacular of the business man. It is a form of income-yielding property which the business man looking at the total assets of the company would single out as an investment. It certainly does not include all the property of the company, and I am unable to accede to Mr. Tucker's proposition that every item of the company's property is an investment, and that while the company uses those items itself the profit it derives from them is a profit of trade, but if it hands one of them over to others to use in return for a periodic payment it begins to receive an income from an investment. The business man would not limit income from investments to income from the kinds of securities which are quoted on the Stock Exchange, and he would, I think, regard as income from investment a profitable rent from a sub-lease of office premises, or the like, surplus to the company's requirements (*Commissioners of Inland Revenue* v. *Broadway Car Co. (Wimbledon), Ltd.*, [1946] 2 All E.R. 609). But he would regard income from assets in which a company might reasonably have invested its cash reserves, in order to have them ready to hand if it needed to employ them in its business, as the typical income from an investment. In *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.*, [1946] 1 All E.R. 58, the Master of the Rolls gave as a possible example of an income from an investment the royalties passively received by a barrister who exploited a patent inherited or

(1) 29 T.C. 155. (2) 29 T.C. 214.

(Lord Normand.)

acquired by him by granting licences. I think that a business man would find no difficulty in taking the same view. In these cases the investment is made when the lease or licence is granted, and it seems to me the preferable view that it is the lease or the licence which is the investment. It is conceivable that an ordinary trading company as well as an individual might enjoy an income from investments in the form of royalties under patent licences, but it would be a rare occurrence, and a company claiming to be in the enjoyment of such an income must satisfy the Income Tax Commissioners, or the Court on appeal, that it is not merely a profit of the business and that it is truly of the nature of an income from investment.

The Appellant Company carries on trade as manufacturers and merchants of cotton, linen, woollen and other goods. It has for 20 years maintained a research department for the purpose of perfecting old processes and devising new processes used in its business or for finishing the products. It grants from time to time non-exclusive licences to other manufacturers and finishers. Exhibit "A" is an example of an agreement granting a licence to use a patented process developed in the Company's research department. The process is used in finishing. The Company itself does not finish its own goods, which are in fact finished by the other parties to the agreement, who are taken bound to treat the materials of third parties at not less than minimum prices prescribed by the Appellant Company; not to sell or allow to be sold materials treated by the process at less than minimum prices fixed by the Appellant Company; to keep accounts and to allow the Appellant Company's accountants to inspect their books, accounts, receipts and other documents; to mark as prescribed by the Appellant Company all materials sold or treated under the licences, and in other respects to conduct their business of finishing goods under the licence in a manner advantageous to the business of the Appellant Company. I am of opinion that no business man would classify the royalties received under this agreement as anything but the profits accruing from the Company's business of manufacturing, finishing and marketing treated goods.

Exhibit "B" is another agreement. It is used when licences are granted by the Appellant Company to use a patent purchased by it from the original patentees. The patented invention is for a process to prevent felting in woollen goods, and this process is used by the Company in the manufacture of its own goods. The material clauses in this agreement resemble those in "A" to which I have made reference, and no distinction between the two can be drawn. Both are trade agreements entered into as a means of promoting the Appellant Company's business and increasing trade profits; neither is an investment.

Exhibit "C" deals with devices which control the transit of cloth on conveyor belts on drying machines. These devices were invented by Mr. Laurie who is connected with the Appellant Company. There had been a joint application for a patent by him and the Appellant Company and, almost simultaneously, an application by another company which had produced a similar invention. The parties came to a compromise agreement, embodied in exhibit "C", by which the Appellant Company and Mr. Laurie assigned their rights in their application to the other company in return for royalties. I am unable to find in this compromise arrangement anything that a business man would describe as an investment. I think that it also was a means of promoting the trade and increasing the busi-

(Lord Normand.)

ness profits of the Appellant Company, or, to put it no higher, that the Appellant Company has failed to show that it was more than that.

I am therefore for dismissing the appeal.

Lord Morton of Henryton.—My Lords, the royalties to which this appeal relates admittedly form part of the profits arising from the business of the Appellant Company within Section 12 (1) of the Finance (No. 2) Act, 1939, and the question to be decided is whether or not these royalties are "income received from investments" within Paragraph 6 of Part I of the Seventh Schedule to the Act. If they are, they must be excluded from the computation of the Appellant Company's profits for the purposes of Excess Profits Tax.

I agree with the views expressed by Lord Greene, M.R., in *Commissioners of Inland Revenue* v. *Desoutter Bros., Ltd.*(1), [1946] 1 All E.R. 58, that the word "investment" in this context is not a word of art, and that the question whether or not a particular piece of income is income received from an investment must be decided on the facts of each case. I think that the question must be approached from the standpoint of an intelligent man of business, and, in my view, such a man, being informed of the facts set out in paragraphs 3, 4(*a*) and 5 of the Stated Case, and being shown the agreement which is exhibit "A", would not think that the royalties received under that agreement were aptly described as income received from an investment. I think he would rightly say that the royalties were income received from a commercial agreement conferring advantages on each of the parties to it and entered into as a part of the Company's business. By that agreement the Company grants to the finishers a non-exclusive licence, in a specified territory, to make, use and sell certain materials manufactured or treated under the patents therein mentioned, at such factory or factories of the finishers as shall from time to time be nominated by the finishers to the Company and not elsewhere, for the period commencing on 1st August, 1937, and terminable at any time by 6 months' previous notice in writing given by either party to the other. Clause 5 provides for the payment of royalties by the finishers to the Company, and other clauses provide for various commercial advantages to the Company and for a substantial measure of control to be exercised by the Company over the business of the finishers.

It is contended on behalf of the Appellant Company, first, that the royalties payable under the agreement are income received "from" the patents therein mentioned; secondly, that these patents are an "investment" within Paragraph 6 of Part I of the Seventh Schedule. As to the first contention I think it can more accurately be said that the royalties are income received "from" the agreement "A", but I shall assume for the moment that the Appellant Company is right on this point. Making this assumption, I cannot regard the patents described in paragraph 4(*a*) of the Stated Case, used as they were being used at the relevant time, as being an "investment" within Paragraph 6. I need not further elaborate my reasons for this view as they are in substance the same as the reasons about to be expressed by my noble and learned friend Lord MacDermott.

As to the process mentioned in paragraph 4(*b*) of the Stated Case, I do not overlook the fact that the patent rights in respect of this process were bought by the Company, whereas the process mentioned in paragraph

(1) 29 T.C. 155, at p. 161.

(Lord Morton of Henryton.)

4(*a*) was developed by the Company's own research department, but I do not think that this fact is sufficient to distinguish, for Excess Profits Tax purposes, the royalties payable under the exhibit "B" from the royalties payable under the exhibit "A".

The royalties payable under the agreement of 12th March, 1940, mentioned in paragraph 4(*c*) of the Stated Case are, in my view, still further removed from being income received from an investment, and I agree with the comment of Somervell, L.J., "I am not quite sure what the "investment is"(1). However, I need not pursue this matter, as Counsel for the Appellant felt himself unable to press his argument under this head.

I would dismiss the appeal.

Lord MacDermott.—My Lords, I agree that this appeal should be dismissed and only wish to add a brief statement of the reasoning which has led me to that conclusion.

The income here in question arose under a series of agreements made by the Appellants in the course of carrying on their business, whereby the Appellants used their rights as proprietors of several patents or (in the case of the agreement of 12th March, 1940) their claim to become such proprietors, for the purpose of obtaining certain advantages, pecuniary and otherwise, in the way of their trade.

My Lords, I do not think any business man would describe the income so obtained as "income received from investments". He would be bound to admit that the purpose of the agreements was a trade purpose. But I do not think he would look on this alone as conclusive against so describing the income, and in that, I apprehend, he would be right, having regard to the decision of this House in *Commissioners of Inland Revenue* v. *Gas Lighting Improvement Co., Ltd.* (2), [1923] A.C. 723. He would, no doubt, find difficulty in giving a precise definition of "investments" as the word is used in the relevant enactment. But I think he would be prepared to go the length of saying something like this: "If, in the course of carrying on my business, I make active use of a business asset—be it my factory building, a piece of machinery, a patent or my working capital—that asset is not an investment. Whatever else a business investment may have to be, it is an asset for the time being held intentionally aloof from the active work of the business. It is none the less an asset of the business and may have great business value: for instance, it may enable me to survive bad times and take advantage of good, or it may help me to control supplies or competition. And if it produces income that is income of the business. But I do not earn that income by my business efforts. The part I play there is essentially passive. I cannot, of course, afford to neglect my investment; I may have to preserve it and, on occasion, to change its form. But normally I just hold it and receive whatever it brings in."

The question then arises whether that view of the matter accords with the use of the word "investments" in Paragraph 6 of Part I of the Seventh Schedule of the Finance (No. 2) Act, 1939. In my opinion it does. The term as there employed obviously relates to investments of the trade or business, for the income therefrom will be part of the profits unless excluded under Section 14 and Paragraph 6. But it does not necessarily

(1) Page 365 *ante*. (2) 12 T.C. 503.

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extend to all the assets of the trade or business. Section 12(4), it may be observed, speaks of "investments or other property", a phrase which is studiously avoided in Paragraph 6. And, apart from this, such an extended meaning would undermine the whole purpose of Part III of the Act. It is plain, therefore, that "investments" refers to some assets and not to others. The statute, however, does not lay down any method of segregation for its purposes and, in the absence of such provision, the proper test must, in my opinion, be related to the limited sphere of trade or business with which the Act is here dealing and founded, accordingly, upon the meaning of the word for the man engaged in trade or business rather than for the man in the street. Beyond this broad consideration the language of the enactment affords little help, but I think the special inclusion of "holding" companies and societies by Section 12(4), and the expression "income *received* from investments" in Paragraph 6(1), go to support the distinction which, as it seems to me, a business man would draw.

Having arrived at this conclusion it becomes unnecessary to attempt a definition of "investments" or to consider whether particular forms of property, such as patents, are capable of being brought within the term. On the facts of the present case it is enough to say that the income in question cannot be income from investments for the purposes of the statute because it arose from a series of commercial agreements exploiting certain proprietary rights or claims, which were entered into by the Appellants *in the active prosecution of their trade or business.* The rights concerned played their part, so to speak, in the arena and not from the grand-stand.

For these reasons I am of opinion that the appeal fails and that the income must be included in the computation of profits.

Lord Reid.—My Lords, I concur with your Lordships.

Lord Simonds.—My Lords, I beg to move that the report from the Appellate Committee be agreed to.

Questions put:

That the report from the Appellate Committee be agreed to.

The Contents have it.

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors: Ellis, Piers & Co., for Slater, Heelis, Sandbach, Marriott, Smiths & Irvine, Manchester; Solicitor of Inland Revenue].

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