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House of Lords — 30th November, 1st and 2nd December, 1948,
and 20th January, 1949

**Commissioners of Inland Revenue *v.* Trustees of
Joseph Reid (Deceased) (1)**

Income Tax, Schedule D, Case V—*Capital or income—Dividend on shares of foreign company paid out of capital profits.*

The Respondent Trustees held shares in a South African trading company. The company sold certain warehouses and office premises, which it occupied for the purposes of its trade, at a profit out of which it declared and paid a dividend of 20 per cent. "payable from capital profits". The dividend was received by the Trustees without deduction of Income Tax, and the dividend on shares held for liferenters of the trust was credited by the Trustees to the revenue accounts of the liferenters.

On an appeal to the Special Commissioners against an assessment to Income Tax under Case V *of Schedule D in respect of the dividend, the Trustees contended that the dividend, having been paid out of profits of a capital nature, was not assessable to Income Tax. The Special Commissioners upheld the Trustees' contention, and discharged the assessment.*

Held, *that the dividend received by the Trustees was income arising from foreign possessions assessable to tax under Case* V *of Schedule D.*

Case

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at Edinburgh on 28th March, 1946, for the purpose of hearing appeals, the Trustees of Joseph Reid, deceased (hereinafter called "the Trustees" or "the Respondents") appealed against an assessment to Income Tax made upon them for the year 1943-44 in the sum of £6,866 under Schedule D of the Income Tax Act, 1918, the said sum being described as income from possessions out of the United Kingdom.

1. The following facts were admitted or proved:—

(1) The Trustees were appointed and act under trust disposition and settlement of the deceased Joseph Reid, iron merchant, Glasgow, who died on 7th October, 1909.

(2) The sum of £6,866 in respect of which the aforesaid assessment was raised, was received by the Trustees on 14th December, 1943, from Reid Bros. (South Africa), Ltd. (hereinafter called "the company"), a company incorporated and registered in South Africa, in which the Trustees hold 3,433 shares of £10 each (fully paid). The remittance was

(1) Reported (C.S.) 1947 S.C. 700; (H.L.) [1949] L.J.R. 701.

received without deduction of Income Tax by the hands of James M. Reid, 90 Mitchell Street, Glasgow, as paying agent in the United Kingdom for the company.

(3) The said sum of £6,866 is part of a distribution made by the directors of the company among the shareholders at the rate of £2 per share out of profits realised from the sale of capital assets, to wit, four properties in Johannesburg which belonged to the company and were occupied by it as warehouse and office premises as after-mentioned.

(4) The company was incorporated and registered in the Union of South Africa in 1918 for the purpose of acquiring and carrying on the business of Reid Bros. (Johannesburg), Ltd., a company incorporated under the Companies Acts and registered in the United Kingdom, whose registered office was situated in Glasgow. The earlier company had been formed in the year 1896 for the purpose of acquiring and carrying on the business of Reid Bros., importers of mining materials and machinery, Johannesburg.

(5) The business which has been carried on by these successive concerns is chiefly that of mine furnishers, dealing principally in the supply of equipment and appliances for mining operations. Dealing also takes place in other iron and steel goods. A print of the memorandum and articles of association of the company is annexed, and forms part of this Case [1]. The authorised capital is £100,000 divided into 10,000 ordinary shares of £10 each, of which 7,802 ordinary shares have been issued, and are fully paid. The company is not authorised under its memorandum of association to trade in the buying and selling of property in land.

(6) The properties taken over when the company was formed in 1918 at a price of £33,761 4*s*. 4*d*. consisted of the following stands (the word "stand" meaning a plot or parcel of land for building and being commonly used to include the buildings as well as the site), viz:—six stands in Johannesburg Township, two in the City and Suburban Township, one in Marshalls Township, five in Denver Township and three in Geduld Township.

(7) From time to time stands were sold and new stands were acquired—as set out below—in order to meet the requirements of the company's business:—

1928. The two City and Suburban stands were sold for £3,500.

1929. The Marshalls stand was sold for £23,000.

1935. The five Denver stands were sold for £2,250.

1939. Three stands were purchased for £5,685 in Village Deep Township.

1941. One further adjoining stand in Village Deep Township was purchased for £3,352.

(8) In March, 1943, four of the six original Johannesburg stands were sold for £30,025, and produced the profits distributed in 1943 in connection with which the question at issue in this appeal arises (see paragraphs (2) and (3) above).

The circumstances in which the sale took place are as follows. The two Johannesburg stands which were retained had from 1918 onwards been occupied by the company as its offices and stores. The four which were sold were occupied as warehouse and office premises. In 1928 and 1929 the Johannesburg buildings were adapted and enlarged to take over

(1) Not included in the present print.

storage and office facilities previously existing at the City and Suburban stands and the Marshall stands. By 1939 the said buildings had become out of date and unsuitable for the company's business, and it was foreseen that removal to other premises would become necessary. These considerations led to the aforementioned purchases of Village Deep stands in 1939 and 1941. Subsequently, however, an opportunity occurred of acquiring a site in Selby Township situated nearer the business area, but also in the direction of the mines. As this ground was considered much more suitable for the company's purpose, it was decided to buy the Selby ground and dispose of the Village Deep stands. It was intended to erect suitable office and store premises on the Selby ground when war-time restrictions should be relaxed. With this intention in view the aforementioned sale of four Johannesburg stands took place in March, 1943, on conditions which entitle the company to continue in occupation until permission is granted by the authorities for erection of the new business premises on the Selby ground. The purchase of the Selby ground was delayed by war conditions but was completed in May, 1944.

The two remaining Johannesburg stands, in which the present office premises are situated, are also for sale by the company, subject to similar terms of continued occupation. Of the four Village Deep stands, two have been sold for £5,000 and it is intended to dispose of the remaining two as opportunity occurs.

Apart from the Selby ground and from the Johannesburg and Village Deep stands which still remain to be sold, the company now owns only the three Geduld stands mentioned in paragraph (6). These stands were acquired, and have continued to be unbuilt on, mining activities not having developed in the locality.

(9) When the City and Suburban, Marshalls and Denver properties were sold as aforesaid in 1928, 1929 and 1935 respectively, the whole of the sale prices were credited to the company's property account. When the two Village Deep stands and four Johannesburg stands were sold in 1943, estimated amounts of profit on the sales, viz., £2,500 and £17,451 19*s*. 10*d*. respectively, were transferred to profit and loss acount, from which the latter sum was transferred to a property suspense account. In the opinion of the directors the value of the properties still held is in excess of the balance shown in the property account.

(10) The sum of £17,451 19*s*. 10*d*. transferred to property suspense account represented the profit made on the sale of the four Johannesburg stands. From that sum the dividend now in question amounting to £15,604, representing a 20 per cent. dividend, was declared by the board of the company on 23rd October, 1943, leaving a balance of £1,847 19*s*. 10*d*. in the suspense account. The company has not been assessed to Income Tax in respect of the said profit. The minute of the directors states that "it was resolved that a dividend of 20 per cent. be declared payable from "capital profits realised on the sale of properties during the past financial "year." At the same meeting of the board a dividend of 15 per cent. from trading profits was recommended. The minute of the directors states that "it was further resolved that the Board recommend that a dividend "of 15 per cent. payable from the Company's trading profits for the year "ended 30th June 1943 be declared." This dividend was declared accordingly at the annual general meeting of shareholders on 14th December, 1943. This dividend, so far as paid to shareholders in the United Kingdom, was paid under deduction of United Kingdom Income Tax, which was accounted for by the paying agent, the said James M. Reid.

(11) The report of the directors to be submitted at the annual general meeting of shareholders on 14th December, 1943, contained the following statement:—

"*Properties.* During the year four of the Johannesburg stands were "sold for a total of £30,750. After deducting agent's commission amount- "ing to £725 incurred on the sale of three of these stands, the net result "was a capital profit of £17,451 19*s.* 10*d.* In the accounts this surplus "has been transferred to a Property Suspense Account and out of this "profit your Directors have, since the close of the financial year, declared "a capital distribution of 20 per cent. payable to shareholders registered "on the 23rd October 1943. The properties which were sold will continue "to be occupied by the Company in terms of the conditions of sale. "Negotiations are proceeding for the purchase by the Company of a "property in Selby Township, where it is proposed to transfer the business "in due course. Your Directors are of the opinion that there should be "no difficulty in disposing of the two remaining Johannesburg stands and "the Village Deep Township stands advantageously."

(12) The 3,433 shares of the Trustees in the company are held by them as follows:—858 shares are appropriated to the account of each of the three daughters of the said Joseph Reid and the remaining 859 shares to the account of his son Arthur E. Reid. In the case of the daughters the shares are held for their respective liferents, the fee being payable to their respective lawful heirs, and in the case of Arthur E. Reid the Trustees are exercising the discretionary power given to them by the trust disposition and settlement by holding his share of his father's estate and applying only part of the income for his behoof in so far as necessary from time to time to supplement the income from his own personal funds which are under the charge of a *curator bonis,* the fee and any accumulations of surplus revenue going to his lawful heirs.

(13) The dividends from trading profits on the said shares held for the three daughters have always been paid to them and the dividend of £2 per share now in question has been treated by the Trustees in their account of charge and discharge for the year to 7th October, 1944, as revenue of the daughters. The accounts show on the charge side under the heading "Additions to Revenue" for each daughter a credit as follows:—

> "Payment on 858 shares at £2 per share from capital profits realised £1,716."

In the individual revenue accounts of each daughter in the said account the said sum of £1,716 is shewn as having been placed on deposit receipt.

2. It was contended on behalf of the Respondents:—

(1) that the sum of £6,866, in respect of which they had been assessed to Income Tax, was a dividend paid out of profits from the realisation of capital assets of the company in South Africa;

(2) that profits made by a company from the realisation of capital assets were profits of a capital nature, and were not "annual profits or "gains", within the charging Rules of Schedule D;

(3) that, for this reason and this reason alone, profits from such a source made by a company in the United Kingdom were not assessable to Income Tax under the relevant Cases I or VI of Schedule D;

(4) that, equally for the same reason, dividends paid out of profits from such a source made by a company not in the United Kingdom were not assessable to Income Tax under Case V of Schedule D;

(5) that, consequently, the assessment under appeal was wrong in law, and should be discharged.

Reference was made to the following Cases:—

Scottish Provident Institution v. *Allan* (1901), 3 F. 874 (C.S.), 4 T.C. 409; (1903) 5 F. 10 (H.L.), 4 T.C. 591.

Pool v. *Guardian Investment Trust Co., Ltd.*, [1922] 1 K.B. 347; 8 T.C. 167.

Gimson v. *Commissioners of Inland Revenue*, [1930] 2 K.B. 246; 15 T.C. 595.

Neumann v. *Commissioners of Inland Revenue*, [1934] A.C. 215; 18 T.C. 332.

Kneen v. *Martin*, [1935] 1 K.B. 499; 19 T.C. 33.

3. It was contended on behalf of the Crown:—

(1) that although profits from the realisation of a capital asset of a company chargeable to Income Tax on its trading profits under Case I of Schedule D of the Income Tax Act, 1918, are not "annual profits or "gains" assessable to Income Tax under that Schedule, any payment thereout to shareholders, except by way of an authorised reduction of capital, is a distribution of profits;

(2) that such distribution has the quality of income and for that reason falls to be paid to a liferenter as income where, as in the present case, shares, in respect of which the distribution is made, are held for persons in liferent and there is no direction in the trust instrument to treat the distribution otherwise:—

In re *Bates*; *Mountain* v. *Bates*, [1928] Ch. 682;

Hill v. *Permanent Trust Company of New South Wales, Ltd*, [1930] A.C. 720;

Forgie's Trustees v. *Forgie*, 1941 S.C. 188;

(3) that where the quality of a receipt has been determined for one purpose it bears the same quality for other purposes including Income Tax:—

Commissioners of Inland Revenue v. *John Blott*, [1921] 2 A.C. 171; 8 T.C. 101;

(4) that although a shareholder in a British company is not chargeable to Income Tax by direct assessment in respect of his dividends but is only liable to suffer, by deduction under General Rule 20, a share of the Income Tax charged upon the company, by contrast income from possessions out of the United Kingdom is chargeable upon the recipient thereof by direct assessment;

Canadian Eagle Oil Co., Ltd. v. *The King*, [1946] A.C. 119; 27 T.C. 205;

(5) that the £6,866, which is the subject of the assessment appealed against, being a dividend from a foreign or colonial company (Miscellaneous Rule 7 of Schedule D) was income from a foreign possession and was consequently correctly charged to Income Tax under Case V of Schedule D on the full amount thereof.

4. We, the Commissioners who heard the appeal, held, on the arguments addressed to us, and on the authorities cited that the dividend of £6,866 paid by the company to the Trustees out of profits from the realisation of capital assets was of the same capital nature as the source from which it was paid, and did not constitute "annual profits or gains" in the Trustees' hands, so as to fall within the charge to Income Tax under Schedule D. We therefore discharged the assessment.

5. The Appellants immediately after the determination of the appeal declared to us their dissatisfaction therewith as being erroneous in point of law and having duly required 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.

6. The question of law for the opinion of the Court is whether the dividend of £6,866 paid as aforesaid falls within the charging Rules of Schedule D of the Income Tax Act, 1918, so as to be assessable under Case V of Schedule D.

G. R. HAMILTON, } Commissioners for the Special Purposes
N. ANDERSON, } of the Income Tax Acts.

Turnstile House,
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London, W.C. 1.

24th September, 1946.

The case came before the First Division of the Court of Session (the Lord President and Lords Carmont and Russell) on 11th and 15th July, 1947, when judgment was reserved. On 21st July, 1947, judgment was given unanimously against the Crown, with expenses.

The Solicitor-General for Scotland (Mr. John Wheatley, K.C.) and Mr. H. A. Shewan appeared as Counsel for the Crown, and Mr. L. Hill Watson, K.C., and Mr. C. J. D. Shaw for the Respondent Trustees.

I.—INTERLOCUTOR

Edinburgh 21st July, 1947. The Lords having considered the Case, answer the Question of Law in the negative, affirm the determination of the Special Commissioners and Decern: Find the Respondents entitled to expenses and remit the Account thereof, when lodged, to the Auditor of Court to tax and to report.

(*Signed*) T. M. COOPER, I.P.D.

II.—OPINIONS

The Lord President (Cooper).—This case relates to an assessment to Income Tax made under Case V of Schedule D upon the recipients of a sum of £6,866 remitted to them by a South African company in which they hold 3,433 shares of the nominal value of £10 each. The Special Commissioners have discharged the assessment upon the ground that the £6,866, having been paid out of profits from the realisation of capital assets, was of the same capital nature as the source from which it was paid. The Inland Revenue now appeals.

It is found as a fact that the foreign company sold certain warehouses and office premises at a profit of some £17,000, out of which they declared

and paid a dividend of 20 per cent. "payable from capital profits". At the same time they declared and paid a dividend of 15 per cent. "payable "from the Company's trading profits". It is with the former that this case is concerned.

We are not called upon to enquire whether this 20 per cent. distribution, in the form in which it was made, was as a matter of company law a lawful one. The company is registered in the Transvaal, and even assuming the local law to be the same as our own, we have not the necessary material to determine whether there has been compliance with the rules to be derived from such cases as *Lubbock* v. *British Bank of South America,* [1892] 2 Ch. 198; *Foster* v. *New Trinidad Lake Asphalt Co., Ltd.,* [1901] 1 Ch. 208, and *Cross* v. *Imperial Continental Gas Association,* [1923] 2 Ch. 553, as to the conditions on which a realised capital profit may be distributed as dividend. This matter, in light of the facts found proved, is irrelevant for our present purposes, for whatever the proper method of effecting this transfer from the company to its shareholders—whether by a reduction of capital, or an ordinary dividend distribution, or in any other way—the transfer was in fact made, and it was in fact made out of capital profits. Its quality as capital in the hands of the recipients did not depend upon anything done or left undone by the company in making the distribution, but upon the essential nature of the payment and the source from which the money came. In describing the dividend as "payable from capital "profits", the company were not merely affixing a label to a payment of ambiguous quality, but were recording a fact which the Special Commissioners have since confirmed.

To justify an assessment under Case V the remittance must be *income* of the recipient arising from a foreign possession. The short answer of the Respondents, accepted by the Special Commissioners after investigating the facts, is that this sum is not the income of anyone, and never was. I agree. No doubt the Respondents still hold the same 3,433 shares as they held before this distribution; but part of the fixed assets in which the company's capital had been sunk has disappeared as a result of the sale, and to the extent of £2 in each share—the Respondents have *in substance* received in cash a return of part of their capital. Valued on an assets basis the shares must be less valuable now than they were before the sale by (approximately) the amount of this 20 per cent. distribution, and if the company went into liquidation tomorrow the shareholders would recover so much less.

Upon this view I find it unnecessary to follow Counsel into the contentious regions explored in argument. None of these side issues has any necessary bearing on the single question before us, and that question, as formulated in the Case, I would answer in the negative, dismissing the appeal.

Lord Carmont.—I concur.

Lord Russell.—I concur.

The Crown having appealed against the decision in the Court of Session, the case came before the House of Lords (Lords Simonds, Normand, Morton of Henryton, MacDermott and Reid) on 30th November and 1st and 2nd December, 1948, when judgment was reserved. On 20th January, 1949, judgment was given unanimously in favour of the Crown, reversing the decision of the Court below.

The Solicitor-General for Scotland (Mr. D. H. Johnston, K.C.), Mr. Terence Donovan, K.C., Mr. J. H. Stamp, Mr. Reginald P. Hills and Mr. H. A. Shewan appeared as Counsel for the Crown, and Mr. J. Millard Tucker, K.C., and Mr. C. J. D. Shaw for the Respondent Trustees.

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, this appeal is brought against an Interlocutor pronounced by the First Division of the Court of Session as the Court of Exchequer in Scotland upon a Case Stated under Section 149 of the Income Tax Act, 1918. The Case was stated upon a requisition by the Appellants who were aggrieved by a determination of the Commissioners for the Special Purposes of the Income Tax Acts discharging an assessment upon the Respondents in a sum of £6,866 in circumstances which I shall shortly narrate. That determination was upheld in the Court of Session. Hence the appeal to this House.

The facts are fully set out in the Case, and I think it necessary to state only so much as will make the opinion that I have formed intelligible. The Respondents are the trustees of the will of Joseph Reid, an iron merchant of Glasgow, who died in the year 1909. The assets of the trust include 3,433 shares of £10 each in a South African company, Reid Bros. (South Africa), Ltd., which had in the year 1918 been incorporated in the Transvaal under the Companies Act, 1909 (Act No. 31 of 1909). The objects for which it was established were to purchase and carry on the business of Reid Bros. (Johannesburg), Ltd., which had been incorporated under the Companies (Consolidation) Act of 1908 with its registered office in Scotland, and to carry on the business of iron and steel merchants and kindred businesses which did not include the buying and selling of land.

The shares in question are held by the trustees as to one-quarter for each of the three daughters of the truster for their respective liferents, the fee being payable to their respective heirs, and as to the remaining quarter upon discretionary trusts for behoof of a son of the truster.

On 23rd October, 1943, the board of directors of the company recommended a payment of a dividend of 15 per cent. from the trading profits of the company for the year ended 30th June, 1943. This dividend was declared accordingly at the annual general meeting of the company on 14th December, 1943, and, so far as it was paid to shareholders in the United Kingdom (including the Respondents), it was subjected to deduction of United Kingdom Income Tax in the hands of the paying agent of the company, one James M. Reid. On the same 23rd October, 1943, the board of directors also resolved that a dividend of 20 per cent. be declared from capital profits realised on the sale of properties during the past financial year. This dividend also was duly declared and paid. No deduction of Income Tax was made in the hands of the paying agent or otherwise. The sum of £6,866 now in question represents this dividend of 20 per cent. upon the 3,433 shares held by the Respondents. I am content

(Lord Simonds.)

to state thus shortly the facts which are set out in great detail in the Case because I do not understand it to be denied by the Crown that the dividend of 20 per cent. was in fact paid out of what are conveniently called " capital " profits ", that is to say, profits which were derived from a sale of capital assets at an enhanced value, and would not, if the company were being assessed to tax under Case I of Schedule D, be included in the computation of its trading profits.

It is in these circumstances that the question arises whether the Court of Session, affirming the Special Commissioners, has rightly held that tax is not exigible.

The claim of the Appellants is founded on Case V of Schedule D. They say that this sum of £6,866 is " income arising from possessions out " of the United Kingdom ", that the shares in a South African company are possessions out of the United Kingdom, and that the sum in question is income arising from those shares. They say that there is no *tertium quid*. This sum is either capital or income. How can it be capital if the shares remain intact, so many shares of £10 each in the capital of the company? There is a way of distributing a dividend while leaving the capital intact, and there is a way of returning part of the capital: it is the former course that has here been taken. This then, they say, is income. When Lord Macnaghten reminded this House in an oft-quoted phrase that Income Tax is a tax upon income, he did not mean that that only was income which fell within Case I of Schedule D, but he intended a wider and more popular test, a test which is here satisfied by the fact that the sum has been without question treated not as capital but as income of the trust, and that this treatment has legal sanction in relevant decisions of high authority, see, for example, *R. A. Hill* v. *Permanent Trustee Company of New South Wales, Ltd.*, [1930] A.C. 720; In re *Bates,* [1928] Ch. 682; Re *Doughty,* [1947] 1 All E.R. 207; *Forgie's Trustees* v. *Forgie,* 1941 S.C. 188.

My Lords, this is the short and simple case made by the Appellants and I see no answer to it. The learned Lord President (Cooper) accepted an answer which he thus stated(1): " The short answer of the Respondents, " accepted by the Special Commissioners after investigating the facts, is " that this sum is not the income of anyone, and never was. I agree." My Lords, I must say, with great respect, that I think that this conclusion can only be reached by ignoring that what may be regarded as capital in the hands of the payer may yet be income in the hands of the payee. It is begging the question to say that this sum is not income in the hands of the shareholders; by every practical test it has proved to be income.

I will assume that the money out of which the dividend was paid was capital in the hands of the company for the purpose at any rate of ascertaining its taxable profits. I think that the Commissioners were entitled to find that as a fact; but it was not the fact, and they were not entitled to find as a fact, that the dividend in the hands of a recipient shareholder was not his income.

But, it was urged, this will create a strange anomaly. If this was an English company carrying on its trade in the United Kingdom and the same series of events occurred—an appreciation of capital assets, a realisation of those assets and a distribution by way of dividend of so-called capital profits—no Income Tax would be exigible in respect of them in the

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(1) Page 437 *ante*.

(Lord Simonds.)

hands of the company or of its shareholders. My Lords, let it be so. I think it should not be necessary to repeat what has so often been said in this House, that the position of a company resident in the United Kingdom (I will call it an English company) and its shareholders is wholly different from that of a foreign company and its shareholders who, being resident here, are taxable in respect of income from their foreign possessions. The most striking difference, which itself cuts at the root of any argument based upon a disparity of treatment, is that a shareholder in an English company is not, but a shareholder in a foreign company is, directly assessable to tax in respect of the dividends that he receives. The consequences that flow from this are far-reaching. They led at one time to what was known as the rule in *Gilbertson* v. *Fergusson* (1) now happily laid at rest. They still produce this anomaly, that, while a shareholder in an English company is not assessable to tax because the company (though not his agent) has "notionally" paid it for him or because his dividend has been "franked" by payment by the company (both expressions are used), yet the shareholder in a foreign company must pay tax upon the whole of his dividend under Case V, whether or not that dividend has been paid out of profits which themselves had already borne tax in the hands of the company—see *Canadian Eagle Oil Co., Ltd.* v. *The King* (2), [1946] A.C. 119. So too—and it is really another facet of the same proposition—while under Rule 20 of the General Rules an English company may, if it thinks fit, deduct tax from the dividend that it pays, that Rule has no application to the case of a foreign company whether or not it has in fact paid tax on some part of the profits out of which the dividend is paid. It is not, I think, going too far to say that for the determination of the question, whether under Case V the dividend payable upon the shares of a foreign company is taxable income, it is irrelevant and, more than that, misleading to look to the analogy of an English company. And here, too, I would remind your Lordships of the observation of Lord Phillimore in *Bradbury* v. *English Sewing Cotton Co., Ltd.* (3), [1923] A.C. 744, at page 770, that, in regard to the income arising from foreign possessions, "The officers of "the Crown do not know and do not care what is the character of the "sources from which the money comes." I must not be taken as suggesting any inaccuracy or insufficiency in the information which has in this case been furnished by the South African company, but it is obvious that, as a general rule, the Inland Revenue authorities cannot have the same facilities for investigating the affairs of a foreign company and checking its statement that a dividend is paid out of "capital profits". They must work upon a broader basis, and I cannot imagine a safer or better one, where the question is as to income arising from a foreign possession, than to ask whether the corpus of the asset remains intact in the hands of the taxpayer. That question can, in the case of the shares here in question, only be answered in the affirmative. The shares the Respondents held before the distribution of dividend they still hold intact. The dividend they received was income arising out of those shares. I therefore move that this appeal be allowed and the Interlocutor of the Court of Session be reversed in so far as it affirmed the determination of the Special Commissioners and answered in the negative the question of law raised by the Case. So far as it related to expenses the Interlocutor will remain undisturbed, and by an arrangement properly made by the Appellants they will

(1) T.C. 501. (2) 27 T.C. 205. (3) 8 T.C. 481, at p. 519.

(Lord Simonds.)

pay the costs of the Respondents of the appeal to this House, such costs to be taxed as between party and party.

Lord Normand.—My Lords, an assessment under Schedule D, Case V, of the Income Tax Act, 1918, in the sum of £6,866 for the year 1943-44 was made on the Respondents, who appealed to the Special Commissioners. They discharged the assessment and their determination was affirmed by the First Division of the Court of Session, from whose Interlocutor this appeal is now taken.

The facts stated in the Case can be briefly summarized. The Respondents are Scottish testamentary trustees, who hold as part of the trust estate 3,433 shares of £10 each of Reid Bros. (South Africa), Ltd., a company incorporated and carrying on business in South Africa as dealers in and suppliers of equipment and appliances for mining. The company is not authorized by its memorandum of association to trade in the buying and selling of property in land. In 1943 the company owned certain stands or parcels of land with buildings which were used as stores and offices. The buildings were, however, out of date and unsuitable for the company's business, and it was intended to erect suitable store and office premises elsewhere. In March, 1943, therefore, these stands were sold on conditions which entitled the company to remain in occupation pending the erection of the new premises. The estimated profit on the sale was £17,451 19*s.* 10*d.*, and this sum was transferred first to profit and loss account, and thence to a property suspense account. The value of the properties still held by the company is, in the opinion of the directors, greater than the balance shown in the property account. On 23rd October, 1943, the board passed a resolution which is thus worded in the minute of the directors: "It was resolved that a dividend of 20 per cent. be declared "payable from capital profits realised on the sale of properties during "the past financial year." This dividend of 20 per cent., amounting to £15,604, was in fact paid out of the sum of £17,451 19*s.* 10*d.* representing the profit on the sale of the properties, and the £6,866 in which the Respondents were assessed is their part of the dividend.

My Lords, the argument for the Crown was based on the words of Schedule D, Case V, and sought no aid from other provisions of the Income Tax Act. There are two parts of Schedule D to be considered. The first is the charging Section which provides that tax under the Schedule shall be charged in respect of (*a*) the annual profits or gains arising or accruing (i) to any person in the United Kingdom from any kind of property whatever, whether situated in the United Kingdom or elsewhere. The rest of the Section is not material. The second Section deals with the several Cases under which the tax shall be charged. The tax under Case V is: "Tax in respect of income arising from possessions out of the United "Kingdom". It is therefore necessary before tax can be charged under Schedule D, Case V, to show that there is a profit in the nature of income arising from possessions out of the United Kingdom.

The Special Commissioners and the First Division agreed in holding that the dividend in this case is not income. The Special Commissioners' finding is that it is of the same capital nature as the source from which it was paid. The Lord President, delivering the judgment of the First Division, held that it was not the income of anyone and never was. He said[1]: "No doubt the Respondents still hold the same 3,433 shares as

(1) Page 437 *ante*.

(Lord Normand.)

"they held before this distribution; but part of the fixed assets in which "the company's capital had been sunk has disappeared as a result of the "sale, and to the extent of £2 in each share—the Respondents have *in* "*substance* received in cash a return of part of their capital." I respectfully think that in this passage there may lurk some ambiguity about what are the possessions out of the United Kingdom from which the dividend arises, but it seems to me beyond dispute that the "possessions" are the shares and that it is incorrect, both in law and in substance, though I would prefer to draw no such distinction, to treat the shareholder as possessing the capital assets of the company. The Lord President also attached importance to the diminution in the value of the company's assets, and, therefore, of the shares in a winding up, caused by the withdrawal of the sum required to pay the dividend. But, with respect, the same result must follow the withdrawal of money in order to pay a dividend the source of which is ordinary trading profits.

There are, in my opinion, valid reasons for treating the dividend as taxable income in the Respondents' hands. The payment was quite properly described as a dividend, and a dividend is at least *prima facie* income of the recipient. In law capital cannot be returned to shareholders by a mere money distribution whether called a dividend or by some other name, and there was in this instance no return of capital. The shares of the company remained after the distribution intact and precisely as they were before it. The payment wears on the face of it, therefore, the appearance of an income receipt in the hands of the shareholders. It is not irrelevant to consider how similar dividends have been dealt with in a question between liferenter and fiar or tenant for life and remainderman. It has been held that, according to the law of England, a payment received by way of dividend out of the proceeds of a sale of the company's assets *prima facie* goes to the tenant for life as income of the trust estate. In In re *Bates,* [1928] Ch. 682, the sum distributed represented profits on the sale of steam trawlers previously owned and operated by the company. Eve, J., at page 687, held that it was a fund which the company "could treat as "available for dividend and could distribute as profits, or having regard to "its power to increase capital could apply to that purpose by, for example, "increasing the capital, declaring a bonus and at the same time allotting to "each shareholder shares in the capital of the company paid up to an "amount equivalent to his proportion of the bonus so declared. Unless "and until the fund was in fact capitalised it retained its characteristics of "a distributable profit". In *Hill* v. *Permanent Trustee Company of New South Wales, Ltd.,* [1930] A.C. 720, Lord Russell of Killowen, delivering the opinion of the Privy Council, expounded the law in a series of propositions of which it is enough here to cite the following (page 731): "(2) "A limited company not in liquidation can make no payment by way of "return of capital to its shareholders except as a step in an authorised "reduction of capital. Any other payment made by it by means of which "it parts with moneys to its shareholders must and can only be made by "way of dividing profits. Whether the payment is called 'dividend' or "'bonus,' or any other name, it still must remain a payment on division of "profits. (3) Moneys so paid to a shareholder will (if he be a trustee) "prima facie belong to the person beneficially entitled to the income of the "trust estate. If such moneys or any part thereof are to be treated as "part of the corpus of the trust estate there must be some provision in "the trust deed which brings about that result. No statement by the

(Lord Normand.)

"company or its officers that moneys which are being paid away to share-"holders out of profits are capital, or are to be treated as capital, can "have any effect upon the rights of the beneficiaries under a trust instru-"ment which comprises shares in the company." These two cases were followed in the later case of In re *Doughty,* [1947] Ch. 263. These cases do not turn on any principle which is not common to the law of England and the law of Scotland (*Forgie's Trustees* v. *Forgie,* 1941 S.C. 188), and they are, I think, entirely congruous with the principle applied by Lord President Kinross in *Ross's Trustees* v. *Nicoll,* 1902 5 F. 146. The question there was whether the duplicands of feu duty payable to trustees who held the superiority of certain lands, together with the several feu duties and casualties payable to the superior, fell to be paid to the liferentrix entitled to the free income of the estate. The Lord President said: "The question "asked is whether these duplicands of feu-duty form part the income of "the trust-estate, and I am of opinion that they do. They do not come out "of capital, and they leave the capital of the estate untouched." This is no more than an application of the civil law conception of *Ususfructus* as a *jus alienis rebus utendi fruendi salva rerum substantia* which still plays its part in our law of liferent and fee. Your Lordships are not in this appeal concerned to construe the terms of the trust deed, and I therefore express no opinion whether the dividend under consideration was properly treated as the revenue of the liferentrices, but these authorities show that a distribution of money to shareholders out of profits realised by the sale of the company's assets without any alteration of the share capital is normally a payment of the nature of income.

But then the Respondents say that, though the dividend may be of the nature of income, it is not taxable income. They say justly that a profit derived from the sale of a capital asset would neither have been taxed in the hands of the company if it had been registered in the United Kingdom, nor have been taxed by deduction when the dividend was paid. The company would not have been taxed on this profit, for it would not have been reckoned part of the profits and gains of the company's business under the rules by which the profits and gains of the company would have been computed if it had been a British company. The shareholder would not have suffered any deduction because the dividend was not paid out of profits and gains brought into charge. The argument for the Respondents then attempted an elaborate analogy between the taxation of the British company and its shareholders and the taxation of a foreign company and its shareholders. It assumed an overriding principle of taxation consistently applied both to British and to foreign companies and their respective members.

The Income Tax Act is an unpromising field for the argument from analogy, and it has been said in authoritative expositions of the law in this House that there is no analogy between the provisions for taxing the profits of British companies and the provisions for taxing the profits of foreign companies, and no overriding principle common to both.

In *Commissioners of Inland Revenue* v. *Cull,* [1940] A.C. 51, Lord Atkin, at page 56([1]) states the law applicable to British companies thus: "It is now clearly established that in the case of a limited company the "company itself is chargeable to tax on its profits, and that it pays tax "in discharge of its own liability and not as agents for its shareholders.

([1]) 22 T.C. 603, at p. 636.

(Lord Normand.)

"The latter are not chargeable with income tax on dividends, and they are "not assessed in respect of them." The position of the British company and its shareholders in relation to Income Tax is special (*Neumann* v. *Commissioners of Inland Revenue,* [1934] A.C. 215, Lord Tomlin, at page 222; 18 T.C. 332, at page 358), and hinges on the deduction at the current standard rate of Income Tax from dividends before payment, now authorised by Rule 20 of the General Rules, a Rule which does not apply to foreign companies (*Canadian Eagle Oil Co., Ltd.* v. *The King,* [1946] A.C. 119, Viscount Simon, at page 134, Lord Thankerton, at page 141; 27 T.C. 205, at pages 244-5; 250). "So far as income tax at the standard "rate is concerned, dividends received by the shareholders of a (sc., British) "company are regarded as franked by the payment by the company of "income tax on its profits or gains" (*Commissioners of Inland Revenue* v. *Cull,* [1940] A.C. 51, Lord Macmillan, at page 64 (1)). The position of foreign companies and their shareholders resident in the United Kingdom is entirely different. The foreign company is beyond the jurisdiction and is not assessable and cannot be taxed; the British shareholder is directly assessable and is taxed on the full amount of the dividend received by him (Rule 1 of the Rules applicable to Case V). In *Canadian Eagle Oil Co., Ltd.* v. *The King,* [1946] A.C. 119, Viscount Simon said, at page 133(2): "The provision of the Income Tax Act, 1918, by which deduction at "the source is authorised in the case of dividends in respect of shares in "companies resident in the United Kingdom, stands in sharp contrast to the "rules which relate to dividends of foreign companies." Lord Macmillan in the same case pointed out, at page 149(3), that there was a fundamental distinction drawn in the Income Tax code between income arising from sources in this country and income arising from sources outside the United Kingdom, and observed that "The topic" (viz., the position of a foreign company and of its shareholders) "has been darkened rather "than illuminated by a false analogy which it has been sought to draw "with the case of the taxation of the income of United Kingdom com-"panies and their shareholders." Lord Simonds said, at page 158(4): "The shareholder in an English company is not taxed upon his dividend, "but he goes untaxed because on the true construction of the Income "Tax Act no tax is imposed on his dividend. He does not escape tax "because some overriding principle says that he shall not be taxed . . . "But in the case of the foreign company's dividend the Act imposes tax "in unambiguous terms. It is impossible to escape it by reference to "some overriding principle." In *Barnes* v. *Hely-Hutchinson,* [1940] A.C. 81, a case dealing with the liability to tax of a British shareholder in a foreign company, Lord Wright said, at page 92(5): "I do not think for "several reasons that the analogy of dividends of an English company "applies, and I see no sufficient ground in a case like the present for "relieving the respondent from what is expressed to be his liability under "Case V." These citations may suffice, though it would be easy to add to their number, to show that the argument from analogy has no validity.

The liability to tax of a British shareholder of a foreign company depends, therefore, on the proper construction of Schedule D, Case V, which is not affected by the provisions for exemptions or abatements, or for the assessment of Sur-tax. For the reasons which I have already

(1) 22 T.C., at p. 642. (2) 27 T.C., at p. 244. (3) *Ibid.,* at p. 256.
(4) *Ibid.,* at p. 262. (5) 22 T.C. 655, at p. 675.

(Lord Normand.)

given, my conclusion is that the Respondents are liable under Schedule D, Case V, and I would allow the appeal.

Lord Morton of Henryton.—My Lords, the facts giving rise to this appeal are fully set out in the Case stated by the Special Commissioners. These facts, and the question which arises, may be summarised as follows.

The Respondents hold, as trustees of the trust disposition and settlement of Joseph Reid, deceased, 3,433 shares of £10 each, fully paid, in Reid Bros. (South Africa), Ltd., a company incorporated and registered in South Africa, hereafter referred to as "the company".

During the year in question the Respondents received two dividends in respect of these shares. One was a dividend of 15 per cent. declared as "payable from the Company's trading profits for the year ended 30th "June 1943." The other was a dividend of 20 per cent., or £2 a share, and the Special Commissioners found as a fact that this latter dividend was paid "out of profits realised from the sale of capital assets, to wit, four "properties in Johannesburg which belonged to the company, and were "occupied by it as warehouse and office premises". That sale took place in March, 1943. It is not disputed that the former dividend is chargeable to Income Tax in the United Kingdom and the tax thereon has already been paid. It is contended by the Appellants that the latter dividend also is chargeable to Income Tax in the United Kingdom as being "income arising from possessions out of the United Kingdom" within Case V of Schedule D of the Income Tax Act, 1918. This contention is disputed by the Respondents, who were successful before the Special Commissioners and in the First Division of the Court of Session.

Was this sum of £6,866 received by the Respondents on 14th December, 1943, income arising from a possession out of the United Kingdom within Case V? If the Respondents had owned the four properties in Johannesburg, which were sold in March, 1943, and if their agents in South Africa had remitted part of the proceeds of sale to the Respondents, there would be no doubt that these moneys would form part of the capital of the trust and would not come within Case V. In that event the Respondents would merely have transformed one form of capital, the four properties, into another form of capital, cash, which would have to be invested as part of the trust capital. The Respondents did not, however, own these four properties. They were owned by a different entity, namely, the company. The trustees owned the 3,433 shares, and the "possession" from which the sum of £6,866 "arose" was the shares.

This sum must be either income arising from that possession or part of the capital of that possession. Despite the ingenious argument of Counsel for the Respondents, I am clearly of opinion that it cannot be part of the capital of that possession. No part of that possession has been sold; no part of the capital paid up on that possession has been returned. Before the payment was made the Respondents held 3,433 shares of £10 each fully paid in the company; after the payment was made their holding was exactly the same. All that happened was that certain cash belonging to the company, and representing part of the profit realised by the sale of a capital asset belonging to the company, was paid away as a dividend. Your Lordships are not concerned to consider whether the company could or could not have given its shareholders the benefit of this profit in a form which would have been capital

(Lord Morton of Henryton.)

in the hands of the Respondents. The directors, having this sum in their hands representing a profit which they were at liberty to distribute, very naturally decided to utilise it in paying a dividend.

For the reasons which I have briefly stated, I must reject the contention that this dividend came to the Respondents as part of the capital of the " possession ". It follows, I think, inevitably that the dividend is income arising from the " possession ". *Prima facie* a dividend paid on shares is income. It has been held that, even if a distribution by way of dividend has been made out of profits arising from some dealing with the company's capital assets, the distribution is income, as between the persons beneficially interested in capital and income respectively (see In re *Bates,* [1928] Ch. 682; *Hill* v. *Permanent Trustee Company of New South Wales, Ltd.,* [1930] A.C. 720; In re *Doughty,* [1947] Ch. 263). None of these cases is binding on your Lordship's House, but I see no reason to differ from any of them. These cases are not decisions as to the incidence of Income Tax, and, of course, the destination of sums paid to the trustees of a will must depend upon the language used by the testator. The decisions are, however, helpful as showing that the word " income ", when used in its ordinary sense, includes a dividend paid out of a profit of the kind that is sometimes called " a capital profit ".

My Lords, I see no good reason for giving to the words " income " arising from possessions out of the United Kingdom " some special meaning which would exclude from their scope the dividend now in question. This dividend is, I think, income according to the ordinary use of the word; it is part of the income of the trust estate in the hands of the Respondents, and in holding it to be income within the meaning of this taxing provision, your Lordships would in no way be disregarding the fact that income, and not capital, is the proper subject of taxation under an Income Tax Act.

Counsel for the Respondents sought to base an argument, by analogy, on the position which would have arisen if the company had been incorporated in the United Kingdom, had sold capital assets in the United Kingdom and had paid this dividend out of a profit arising from such sale. In my view this argument only leads to confusion for reasons which have already been fully stated.

I regret to find myself unable to accept the reasoning of the learned Lord President, with which the other two Judges of the First Division agreed. Accepting the finding of the Special Commissioners that the sum in question was paid out of profits realised from the sale by the company of capital assets, I would agree that this sum while it remained in the hands of the company was not income of the company, but I must respectfully part company with the Lord President when he says " this " sum is not the income of *anyone*, and never was ".(1) The italics are mine. For the reasons I have already stated, I think that it became income of the Respondents when it was paid to them. The tree owned by the trustees, whereof this sum was the fruit, was their holding of 3,433 shares, and they have treated that fruit, rightly in my view, as belonging beneficially to the persons entitled to the income of the trust estate. If the sum in question were not the income of anyone, it surely could not rightly be so treated.

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(1) Page 437 *ante*.

(Lord Morton of Henryton.)

I would allow the appeal and answer in the affirmative the question of law set out in paragraph 6 of the Case Stated.

Lord MacDermott.—My Lords, had Reid Bros. (South Africa), Ltd. been a British company, the Respondents would not have been called upon to pay the tax now in dispute. They would have been shielded by the taxation of the company in respect of its profits, and, in assessing that taxation, the Crown, recognising the basic principle that Income Tax is not a tax upon capital, would have ignored that part of the profits arising from the realisation of the appreciated capital assets, such realisation, as was conceded, not being in the way of trade. The result, on this hypothesis of a British company, would therefore have been that the tax claimed by the Crown in these proceedings would not have been sought of anyone, company, trustees or beneficiaries. It is of importance to note, however, that this deliverance would not have flowed merely from the distinction observed between capital and income according to what I shall call the "true income" rule. It would also have been due to the state of the law in this country which, by a merciful if somewhat anomalous dispensation, disregards in this connection the juristic personality of the incorporated company and, in effect, treats its taxation as the taxation of its members. This principle, which finds reflection in the definition of "Body of persons" in Section 237 of the Act of 1918, I shall call the "representative" rule for lack of a better description. It has its limitations but these are not now material.

A return to the situation as it exists finds the Respondents claiming that they are not assessable to tax on the dividend of 20 per cent. "payable", as the relevant resolution has it, "from capital profits realised "on the sale of properties during the past financial year." They rely upon the true income rule, and they are entitled to do so because it is a fundamental and pervading principle. They also call in aid the representative rule, but this they are not entitled to do, for no assessment has or could have been made on the South African company and no theory based on the collective taxation of a number of persons is therefore available.

The field of enquiry is thus considerably narrowed. The peculiarities of the law relating to the taxation of "bodies of persons" in this jurisdiction and the authorities bearing upon that and cognate subjects may, therefore, be put to one side leaving, as the matter for determination, the question whether this "capital profits" dividend is subject to charge, as the Crown claims, under Case V of Schedule D which provides for "tax in respect of income arising from possessions out of the United "Kingdom".

Now Case V does not, of course, extend the scope of the Schedule as delineated by Rule 1 thereof, and what I have called the true income rule remains applicable. It is also clear that "possessions" in Case V must here refer to the shares held by the Respondents in the company. That was conceded, and properly so, for in the absence of any evidence to the contrary it must be assumed that this company, which is incorporated and registered in South Africa, has the general characteristics of a British company incorporated under the Companies Acts and, accordingly, that the proprietary interest of its members is limited to their shareholding and does not include, at all events while the company is a going concern and its capital structure remains unaltered, "any right to any

(Lord MacDermott.)

"item of property owned by the company" (see *Macaura* v. *Northern Assurance Co., Ltd.*, [1925] A.C. 619, per Lord Buckmaster, at page 626). This dividend, then, was income arising from the Respondents' shareholding, and the question accordingly reduces itself to this: Is it permissible, in order to determine the liability of the dividend to tax in the hands of the Respondent shareholders, to look beyond the immediate source, the shareholding, and to examine the make-up of the profits out of which the dividend has been declared? In my opinion the answer must be in the negative. Apart from the difficulties of ascertaining in the United Kingdom the facts relating to the internal management of a foreign company, the process of exploring payments beyond their immediate source, if once admitted for this purpose, would have no end. The matter, however, does not rest merely on considerations of convenience or expediency. The Respondents and the company are distinct entities and must be so regarded; but if the answer to the question now under discussion were in the affirmative, the words of Case V, "income arising "from possessions", would have to be read as relating to the possessions of the person charged or, at his option, to the possessions of someone else instead, and that is a construction for which I am unable to find any justification either in principle or authority.

If I am right in this, it means that the application of the true income rule has to be determined by reference to the dividend and the shareholding alone. But here the shareholding, which was the only relevant capital in the Respondents' hands, rested as it was, and the dividend cannot, therefore, be said to have contained an element of capital. No doubt the shares abated in market value after the payment of the dividend, but they nevertheless remained intact. The ripe tree loses weight and worth when it sheds its fruit, but the fruit remains fruit and no more, unless in its fall it has taken part of the tree with it.

For these reasons I am of opinion that the dividend in question fell within Case V and is subject to tax. I would therefore allow the appeal.

Lord Reid.—My Lords, I think that the decision of this case depends on the question whether a dividend from a foreign company which comes to a shareholder in this country must in all cases be held to be received by him as income within the meaning of the Income Tax Acts. In this case the Respondents held more than one-third of the shares in a company incorporated and registered in the Union of South Africa. That company does not trade in land. It held a considerable amount of land in or near Johannesburg and sold a part of this land which it did not need. A sum of over £17,000 was estimated as profit on this sale and the greater part of this sum was distributed as a dividend. This dividend was declared by minute of the directors to be "payable from capital "profits realised on the sale of properties during the past financial year." It is not disputed that if this had been a British company, no Income Tax would have been payable by the company in respect of such profits. The phrase "capital profits" is not an accurate description of such profits, but it is a convenient short name for them and I shall use it as such.

The main argument for the Respondents depended on a comparison with the position which arises when a British company distributes capital profits as dividend. In that case there is no liability on the shareholders to pay Income Tax, either at the standard rate or in the form of Sur-tax,

(Lord Reid.)

on such a dividend. But the reason for that is not that what the shareholder receives is capital. It is that a shareholder is never directly assessable in respect of any dividend paid by a British company and that the Sur-tax provisions in the Income Tax Acts do not impose any liability to pay Sur-tax in respect of dividends paid by a British company out of profits which were not of a kind which is taxable in the hands of the company. It has frequently been pointed out that the Income Tax Acts treat payments by foreign companies quite differently from payments by British companies. I need only refer in this matter to *Canadian Eagle Oil Co., Ltd.* v. *The King*(1), [1946] A.C. 119. I think that little or no assistance towards the decision of the present case can be got from statutory provisions or authorities dealing with similar dividends paid by British companies.

The assessment in the present case was made under Case V of Schedule D in respect of income from possessions out of the United Kingdom. I do not think that there can be any doubt that the Respondents' shares in the South African company were possessions out of the United Kingdom, or that the dividend in question arose from those shares. The only question is: Was that dividend received by the Respondents as income within the meaning of Schedule D?

The question whether a capital dividend is capital or income in the hands of the shareholder who receives it may arise in trust administration. If a truster, without giving any special directions to his trustees, merely directs them to hold a fund including certain shares for one beneficiary in liferent and for another in fee, does a capital dividend from those shares go to the liferenter or must it be retained as part of the capital of the trust fund? It has been held in England that it goes to the tenant for life (In re *Doughty,* [1947] Ch. 263), and Scottish authority points to the same result (*Forgie's Trustees* v. *Forgie,* 1941 S.C. 188). In some cases the dividing line between capital and income is not the same for the purposes of Income Tax as for trust administration, but I see no reason why that should be so in this case. If a dividend ought to be regarded as income as between liferenter and fiar, I think that points to its being income within the meaning of the Income Tax Act, but it is not conclusive.

The crucial question in this case must, therefore, be decided with little direct assistance from authority. The contention for the Inland Revenue has the merit of extreme simplicity, if that be a merit in questions of Income Tax. It is that the dividend cannot be capital because the Respondents' foreign possessions, the shares, remain intact and, therefore, the dividend must be income. It is admitted that if the money had been paid by way of reduction of the share capital, that would not have been income; the shares would not have remained the same. It is also admitted that if the surplus profits had been used to create bonus shares, or even it may be bonus debentures, there would have been no receipt of income; new capital assets would have been created. But it is said that, so long as the capital asset abroad remains the same, anything received by the shareholder in this country must be income subject to assessment under Case V of Schedule D. This may seem a technical argument which neglects the real fact that the capital value of the Respondents' foreign asset has been reduced by the making

(1) 27 T.C. 205.

(Lord Reid.)

of the payment. But a company can, and often does, reduce considerably the market value of its shares by paying a dividend out of accumulated trading profits, and there can be no doubt that such a dividend would fall within Case V, if it came from a foreign company. There are many ways in which a company can deal with its profits. If it adopts certain methods the result is the creation of new capital assets. If it adopts other methods the result is the receipt of income by its shareholders. In either case it is immaterial whether the profits were trading profits or capital profits. It is true that, owing to the special provisions of the Income Tax Acts which distribute liability for Income Tax (including Sur-tax) between a British company and its shareholders, a dividend paid by a British company out of its capital profits is not taxable. But there are no provisions applicable to a foreign company which bring about this result.

I can find no satisfactory alternative to the view that, if a foreign company chooses to distribute its surplus profits as dividend, the nature and origin of those profits do not and cannot be made to affect the quality of the receipt by the shareholder for the purpose of Income Tax.

I therefore agree that this appeal should be allowed.

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 Interlocutor appealed from be reversed, except in regard to expenses, and that the question of law be answered in the affirmative.

The Contents have it.

That the Appellants do pay the Respondents their costs in this House.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue (England), for Solicitor of Inland Revenue (Scotland); Ince, Roscoe, Wilson & Briggs, for Simpson & Marwick, W.S., Edinburgh, and Borland, King & Stewart, Glasgow.]