

NO. 1470—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—5TH MAY,
1949

COURT OF APPEAL—14TH, 15TH AND 30TH NOVEMBER, 1949

HOUSE OF LORDS—12TH, 13TH AND 14TH MARCH AND 28TH JUNE, 1951

Ryan⁽¹⁾ (H.M. Inspector of Taxes) v. Asia Mill, Ltd.

Income Tax, Schedule D — Purchases of stocks of cotton from Cotton Controller — Provision for adjusting payments to be made in event of subsequent change in price of cotton — Sum paid to Controller under this arrangement — Whether part of cost of stock-in-trade.

The Company was one of a number of firms of cotton manufacturers which agreed, at the request of the Cotton Controller, to operate a new system in purchasing from him their supplies of raw cotton. Under this system, the manufacturers were to purchase not merely sufficient cotton to meet existing orders for yarn, but as large stocks as they could store. It was provided that in the event of a rise or fall in the price of cotton after such purchases had been made, the Controller should receive from, or make to, the manufacturer a payment of an amount calculated on the quantity of cotton held or ordered by the manufacturer at the date of the price variation, above or below the quantity he required to meet existing contracts for yarn. Under these arrangements, following an increase in price, the Company paid a sum of £55,087 7s. 4d. to the Controller and was assessed to Income Tax on the basis that for the purpose of computing its profits its stock-in-trade at the end of the year in question should be valued at cost and that in arriving at the cost the appropriate proportion of the £55,087 7s. 4d. should be included.

On appeal to the Special Commissioners, the Company contended that the cost of the cotton must be ascertained solely by reference to the invoice prices paid for it, and that the payment to the Cotton Controller, being an amount calculated by reference to the Company's position at the time of the price variation, did not represent an addition to the actual cost of the cotton purchased. The Commissioners allowed the appeal.

Held, that the decision of the Commissioners was correct.

CASE

Stated under 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⁾ Mr. H. R. Heather was the Inspector of Taxes in whose name the case came before the Special Commissioners. Mr. Heather died before the case was heard in the King's Bench Division and was succeeded by Mr. J. Ryan.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 1st July, 1947, Asia Mill, Ltd. (hereinafter called "the Respondent Company") appealed against an assessment to Income Tax in the sum of £22,000 less an allowance of £3,070 for wear and tear and £456 exceptional depreciation for the year ended 5th April, 1946, made upon it under the provisions of Case I, Schedule D of the Income Tax Act, 1918.

2. The Respondent Company carries on the business of cotton spinners. For the purpose of computing its profits for the purposes of Income Tax for the year 1945-46 the basis year was the Respondent Company's accounting year ended 13th January, 1945.

3. Pursuant to arrangements made in August, 1942, between cotton spinners and the Cotton Controller (an official of the Ministry of Supply) the Respondent Company, during the said year ended 13th January, 1945, paid a sum of £55,087 as hereinafter appearing to the Cotton Controller. It was common ground between the parties to this appeal that this sum of £55,087 constituted a proper deduction in computing the profits of the Respondent Company for the said year. It was also common ground that in computing such profits the value of the Respondent Company's stock-in-trade in hand at 13th January, 1945, was required to be included at a figure representing its true cost to the Respondent Company, and that no question of market value arose.

4. The question in dispute was whether in ascertaining the cost of such stock-in-trade the said sum of £55,087 or any part of it should be included.

5. Since April, 1941, transactions in raw cotton and cotton yarn have been subject to regulations made by the Cotton Controller from whom alone all raw cotton had to be bought. The Cotton Controller fixed day-to-day prices for the purchase of raw cotton and the margins to be added in ascertaining the selling prices of yarn. From April, 1941, to September, 1941, cotton was bought from the Controller without any cover system, but from September, 1941, till ⁽¹⁾ August, 1942, spinners were given "cover notes" entitling them to purchase raw cotton at the ruling prices, for the fulfilment of approved yarn orders, to the extent of 12 weeks' production.

In August, 1942, new arrangements designed to simplify procedure and to secure the dispersal of cotton stocks were directed by the Cotton Controller. Under these new arrangements spinners were urged to assist the Controller by purchasing cotton to the fullest extent of their storage space, irrespective of their yarn orders in hand, and in the event of a rise or fall in the general price level of raw cotton they were to make payments to or receive payments from the Controller according to whether their respective positions were "long" or "short" at the time of the variation of the general price level.

A spinner's position is "long" where he has purchased a weight of cotton in excess of the weight of yarn he has contracted to sell; and "short" when he has contracted to sell a weight of yarn in excess of the cotton he has in stock or has contracted to purchase.

6. The arrangements briefly described in the foregoing paragraph of this Case are set out in detail in a letter addressed by the Cotton Controller to the Respondent Company on 24th August, 1942, and in the form of undertaking and explanatory notes enclosed with that letter. The said

(1) As amended by an agreed statement.

form of undertaking was duly signed on behalf of the Respondent Company and was returned to the Cotton Controller.

A bundle comprising the said letter of 24th August, 1942, the enclosures therewith and a letter from the Cotton Controller dated 21st September, 1942, is annexed hereto marked "A" and forms part of this Case⁽¹⁾.

7. With effect from 1st February, 1943, all raw cotton prices were reduced by 1*d.* per pound. As the Respondent Company's position at 30th January, 1943, was "long" the Respondent Company received from the Cotton Controller a payment amounting (after minor adjustments) to £10,233 19*s.* 4*d.*

8. With effect from 17th April, 1944, the prices of all types of raw cotton were increased by 4½*d.* per pound.⁽²⁾ As the Respondent Company's position at 15th April, 1944, was "long" to the extent of 2,937,993 pounds an amount of £55,087 7*s.* 4*d.* became due from the Respondent Company to the Cotton Controller, representing 4½*d.* per pound on this "long" position. This amount of £55,087 7*s.* 4*d.* was duly paid by the Respondent Company.

9. Particulars of the calculations leading to the payments mentioned in the last two foregoing paragraphs are set out in various letters comprised in the bundle annexed hereto marked "B" and forming part of this Case⁽¹⁾.

10. A statement setting out particulars of the Respondent Company's cotton stocks in hand at 13th January, 1945, is annexed hereto marked "C" and forms part of this Case⁽¹⁾. The figures of price shown in this statement represent the actual prices paid on the purchase of the several lots specified therein and do not embody any adjustments in respect of the sums received from and paid to the Cotton Controller in 1943 and 1944 respectively. Certain of the stocks shown in the said statement—that is to say all lots bearing an invoice date earlier than April, 1941, were purchased otherwise than from the Cotton Controller.

11. All cotton purchases by the Respondent Company from the Cotton Controller were effected by contracts made in accordance with one or other of the forms of contract and advice note annexed hereto marked "D" and forming part of this Case⁽¹⁾.

12. A copy of the Respondent Company's accounts for the year ended 13th January, 1945, is annexed hereto, marked "E", and forms part of this Case⁽¹⁾. The sum of £55,087 paid to the Cotton Controller as above stated is included in the debit item "Cotton and Charges—£164,197 13*s.* 7*d.*" In these accounts the value of the Respondent Company's stock-in-trade at 13th January, 1945, appears at the figure of £191,312 13*s.* 2*d.* In arriving at this figure the Respondent Company added 4½*d.* per pound to the invoice prices of all stocks of raw cotton bought prior to 17th April, 1944.⁽²⁾

13. Mr. F. W. Gower, a chartered accountant and the principal advisory accountant to the Board of Inland Revenue, gave evidence that in his opinion, from an accountancy point of view, the accounts as presented were correct. In our opinion, as appears from our decision, the fundamental question is purely one of law depending on the proper construction of the documents.

(1) Not included in the present print.

(2) As amended by an agreed statement.

14. It was contended on behalf of the Respondent Company:
- (1) that as all stocks of cotton held by the Respondent Company at 13th January, 1945, had been purchased by the Respondent Company outright at fixed prices under contracts in which no provision was made for price adjustments in the event of subsequent variations in the general level of cotton prices the cost of such stocks must be ascertained by reference solely to the invoice prices paid;
 - (2) that the said sum of £55,087 was a sum calculated (in accordance with the arrangements above described) by reference to the Respondent Company's cover position at the time of the general price increase and did not represent an addition to the actual cost of the cotton purchased; and
 - (3) that accordingly no part of the said sum of £55,087 was required to be treated for Income Tax purposes as a part of the cost of the cotton stocks of the Respondent Company in hand at 13th January, 1945.
15. It was contended on behalf of the Inspector of Taxes:
- (a) that the payment of £55,087 7s. 4d. was made by the Company to the Controller in respect of 2,937,993 pounds of cotton actually in stock or on order at 15th April, 1944, at the rate of 4½*d.* per pound;
 - (b) that 2,546,518 pounds of cotton remained in stock at 13th January 1945,⁽¹⁾ in respect of which 4½*d.* per pound in addition to the invoice price had been paid by the Company to the Controller;
 - (c) that the true cost to the Company of the said 2,546,518 pounds of cotton in stock at 13th January, 1945,⁽¹⁾ was the invoice price plus the 4½*d.* per pound;
 - (d) that the true cost as defined in the preceding paragraph of the said 2,546,518 pounds of cotton should be included in arriving at the profits of the Company for Income Tax purposes for the year 1945-46.
16. We, the Commissioners, gave our decision as follows:—

The payment of £55,087 which the Respondent Company was called upon to make under the terms of the said agreement with the Cotton Controller was, in our opinion, a payment pursuant to a commercial contract calculated by reference to the cover position and could not be said to be part of the price of the cotton. We hold that the cost to the Respondent Company of the stock of cotton was the invoice price and the sum of £55,087 did not enter into the matter. The cotton was purchased out and out and no provision existed for adjustment of the price. The appeal succeeds and we reduced the assessment to £10,031.

The Appellant immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the

⁽¹⁾ As amended by an agreed statement.

High Court pursuant to the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

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

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

14th April, 1948.

The case came before Croom-Johnson, J., in the King's Bench Division on 5th May, 1949, when judgment was given in favour of the Crown, with costs.

The Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, K.C., and Mr. R. E. Borneman for the Company.

Croom-Johnson, J.—In my judgment, the Special Commissioners in this case have misdirected themselves. They have confused two things: the question as to the purchase price of certain cotton, which this is not, with the question of the value of certain stock, which this is, it being agreed between the two sides at the hearing before the Special Commissioners that the value of the stock was required to be included at a figure representing its true cost to the Company.

Apparently, before August, 1942, the Cotton Controller, who was the person in whom all stocks of cotton in this country were then vested, had made it a condition of the acceptance of orders from cotton manufacturers that cotton manufacturers should apply for supplies, sending in documents which were called yarn orders, so as to show through the yarn orders and by means of cover notes how much cotton the manufacturers either had in their warehouses or could see would come forward within the period, I suppose, of the application, so as to enable them to say "Against yarn orders that we have in hand we shall need such and such." That was the system.

For, I have no doubt, a very good and sufficient reason the Cotton Controller decided in August, 1942, that that should no longer be the system and in order to make it easier for spinners or manufacturers to obtain their supplies the system of cover notes was given up and manufacturers were invited, and indeed encouraged, to send in orders for as much as their storage space would enable them to take delivery of. But of course the effect of this, as a matter of business, on the manufacturer might be very serious. If he accepted the invitation of the Controller and ordered a whole lot of stuff, not on a twelve-week basis, but as much as his warehouses or storage space would accommodate, inasmuch as the Controller was the one person who could fix the price it might be very hard indeed on the manufacturer if, when he had stocked his warehouses to the full, the Controller suddenly put on a very much reduced price which presumably would have the effect of making the yarn price lower and might have the consequence that a particular spinner or manufacturer who was going to stock his warehouses to the full at what had been the enhanced price, would find himself at a very great disadvantage as against competitors who had not done that which he had done.

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Accordingly, in order as it seems to me to meet that very difficulty, by a letter of the 24th August, 1942, sent, I assume, to the trade generally, the Controller indicated that spinners would no longer have to send in the forms which theretofore had been sent in, and (as what he calls a main purpose of the provision) so as to enable spinners to buy cotton suitable to their needs as it became available, without controlling it or peddling it out in accordance with what the Controller thought was the position, the Controller offered that if he found it necessary to raise prices in future — by that I mean, as I think he meant, a general rise, not particular qualities or particular kinds of material — or lower the general price level of raw cotton, he would pay the difference to the spinner if the new price was against the spinner, and if the new price was not against the spinner the spinner was to pay to the Controller. There was no obligation that I can see, no particular obligation, on the people to whom this invitation was directed to accept this scheme, but if they did accept it it is quite obvious that it would have effect for so long as new orders continued to be sent in by the spinners under the revised scheme and under the revised directions.

The Company in this case proceeded to accept. They knew quite well — they must have known from a quite explicit letter sent by the Cotton Controller — that they would have the obligation of making certain returns dealing with their amount of stock in hand or coming forward and that they would have to make returns showing the Controller what the situation was; but of course it was also obvious — at least I should have thought sufficiently obvious from a business point of view — that if there was going to be some sort of arrangement for adjusting ups and downs in the prices fixed by the Controller, some ready method of assessing the amount must be made. No doubt, as Mr. Talbot has rightly pointed out, the Controller could have said, "If the price goes up we will adjust the contract price". Of course they could have said it, but it would have been a very complicated business, as it seems to me, because there would have to be enquiries as to how much of a particular order had been used up, how much of it had been delivered, and all the rest of it. Therefore a scheme was propounded by the Controller, a pure scheme of convenience, in order to assess how much the allowance should be and over what it should be. What was suggested in effect was that under this cover system, which is not a new system in the industry by any means, the adjustment should be done by a series of calculations made in accordance with what the cover position proved to be.

I do not find it necessary to go into any more detail about it. The parties perfectly well understood it. Everybody, I think, in this industry must have been perfectly well able to understand what the cover system was, and that is how it worked. But the effect of the arrangement to which, as I have said already, the Company assented and agreed as a matter of contract, was two-fold. The calculations were to be made upon stock in hand at particular periods under the scheme, plus stock coming forward. Therefore it was essentially an adjustment with regard to stock, including in that word the stock which had not been delivered but was coming for delivery under forward contracts.

The other thing which I think is plain from the arrangement is this, that all subsequent orders, which could only be sent to the Controller — nobody else could supply but the Controller — must, I think, as a matter

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of law, be deemed to have been sent and to have been accepted by the Controller as subject to that arrangement. It is just as much a part, not of any individual contract but of all the general orders that were sent forward from that time on as any other of the general arrangements, including the general conditions which are endorsed upon the particular forms which were used for acceptance of orders.

Once that is stated it seems to me that it is impossible to say that the sums of money paid or received by the Company are not to be taken into account in trying to find out what the real cost, not of deliveries under particular contracts but of stock generally, is at any particular time. I should have thought that that was a tolerably plain proposition with a tolerably plain result. When the Special Commissioners come to assess the profits and gains which have to be charged under Case I of Schedule D, which is the particular assessment here, in computing the amount of profits or gains to be charged, they of course must deduct disbursements and expenses but only those expenses or disbursements being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation. That is Rule 3 which is applicable to Cases I and II. Whereas the parties have already agreed that the sum of money which the Company had to pay to the Controller is deductible generally in assessing the profits and gains, I do not know to what head other than the head to which it relates, namely, stock-in-trade, it can properly be referred.

Of course it must be borne in mind, as again Mr. Talbot has pointed out to me, that the stock-in-trade at any particular time is not necessarily stock-in-trade received by the spinner under orders given after the letter of the 24th August, 1942. Whatever stock-in-trade was there is to be calculated; some of it was, to some small extent, bought in the first few months of the war in 1939, but that does not seem to me to make any difference. What is to be valued for the purposes of the accounts is the stock-in-trade. This method achieved by the Controller is a method of assessing rightly what the cost to the Company of that stock-in-trade was and, by virtue of the system of applying something analogous to the cover notes, that is exactly what was being done.

I cannot think that there is any difficulty about it except this one: I should have thought that generally speaking the question as to what was the value of stock-in-trade was a question of fact for the Commissioners. I should interfere not at all with any finding by the Commissioners which was a finding of fact; but assuming that this is a question of fact and not, as the Commissioners seem to have directed themselves, a question of law, the question of fact being what is the value, I can only interfere if I am of opinion that in arriving at their conclusion the Commissioners had misdirected themselves.

I do not see any real difficulty, when one looks at their stated reasons, in deciding that problem, because in paragraph 16 they say this: "The payment of £55,087 which the Respondent Company was called upon to make under the terms of the said agreement with the Cotton Controller was, in our opinion, a payment pursuant to a commercial contract calculated by reference to the cover position". That is neither here nor there. Then the Commissioners go on to say, "and could not be said to be part of the price of the cotton." Whoever said it was? That is not the problem which they have to deal with. It is not the question which they have to solve. It is not the price of the cotton. It is the value of

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the cotton measured, as the parties have agreed, by the actual cost of it to the Respondents. Then the Special Commissioners go on to say: "We hold that the cost to the Respondent Company of the stock of cotton was the invoice price". That again, I think, is a misdirection. It may be that the invoice price of a stock-in-trade in certain circumstances may be the acid, the final and the conclusive test, but to say that that is the only test, which is what the Commissioners apparently have held in this case, is, in my judgment, to go wrong. They say: "The sum of £55,087 did not enter into the matter." They go on, as another reason: "The cotton was purchased out and out" — a good deal of stock-in-trade is purchased out and out — "and no provision existed for adjustment of the price." It may be, but it is a method which I think must be taken into account in looking to see what is the value of the stock, what is the cost to the Respondent Company of the stock.

In these circumstances, in my judgment, the question of law which arises for my determination is, on the basis that this is a question of fact: have the Commissioners misdirected themselves about the matter? If they have, that is sufficient to enable this Court to exercise jurisdiction and to set aside or interfere with or deal with the suppositious question of fact that they have called a question of law. There it is. I think it is quite a plain point.

I desire to add one other thing about this particular case. The Commissioners have been persuaded to annex to this Case a whole heap of documents showing the transactions which lie behind this quite simple problem. Sometimes it is convenient to have an important document annexed to a Case, but I hope that what has been done in this case, by annexing correspondence and invoices and all sorts of documents which have not a great deal to do with the case on any view, will not be pursued in later cases where the subject has expressed dissatisfaction and asks for the assistance of the Court.

The appeal will be allowed. What is the consequence, Mr. Solicitor?

The Solicitor-General.—I would ask your Lordship to say the appeal will be allowed with costs. Would your Lordship direct that the appeal go back to the Special Commissioners to adjust the figures in accordance with your Lordship's determination?

Croom-Johnson, J.—I think that is right. It may be that there are other adjustments to make, and I am not pronouncing about any of those.

The Solicitor-General.—There is one which I think must be made; that is, in April the "long" position, as your Lordship knows, was broadly speaking 2,900,000 pounds; on January 1st, it was broadly speaking 2,500,000 pounds, and the 4½*d.* would only be applicable to the 2,500,000, so that the figure would need to be adjusted. If your Lordship would formally make the Order, it may probably be the case that the solicitors on both sides will agree a figure.

Croom-Johnson, J.—The Commissioners will deal with the point you raise, I have no doubt. I do not think I need say anything about it. I shall simply allow the appeal and remit the case to the Commissioners to deal with the matters which came up for their determination in pursuance of my judgment.

The Solicitor-General.—If your Lordship pleases. With costs?

Croom-Johnson, J.—And the Respondents must pay the costs of the appeal.

The Company having appealed against the above decision the case came before the Court of Appeal (Tucker, Singleton and Jenkins, L.J.J.) on 14th and 15th November, 1949, and judgment was reserved. On 30th November, 1949, judgment was given unanimously in favour of the Crown, with costs.

Mr. F. Heyworth Talbot, K.C., and Mr. R. E. Borneman appeared as Counsel for the Company, and the Solicitor-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

Tucker, L.J.—This is an appeal from a decision of Croom-Johnson, J., whereby he allowed the appeal of the Crown from a decision of the Special Commissioners reducing an assessment to Income Tax for the year ending 5th April, 1946, made upon the Appellant Company, Asia Mill, Ltd., under Case I of Schedule D of the Income Tax Act, 1918. The question involved in the appeal is whether, in assessing its profits for the Company's accounting year ended 13th January, 1945, its stock-in-trade as at that date should be valued at a figure which includes a sum of £55,087 paid by the Company to the Cotton Controller during that year, or whether this sum should be excluded. It is common ground that the £55,087 constituted a proper item on the expenditure side of the Company's trading account for the relevant period. It is also common ground that the stock-in-trade required to be valued at a figure representing its true cost to the Company and not at market value.

The Appellant Company carry on business as cotton spinners and the stock in question consisted of cotton. After April, 1941, raw cotton could only be bought from the Cotton Controller and its purchase and the sale of cotton yarn was subject to regulations. From September, 1941, to August, 1942, spinners were given "cover notes" by the Controller entitling them to make purchases for fulfilment of approved yarn orders to the extent of 12 weeks' production. In August, 1942, new arrangements were made and it is on the effect of these new arrangements that the decision in the present case turns. The Case finds that they were designed to simplify procedure and secure the dispersal of stocks. The scheme is set out in a letter from the Controller dated 24th August, 1942, which is annexed to the Case. There is no finding in the Case that spinners who did not enter the scheme were precluded from obtaining further supplies of cotton and in the absence of any such finding the Appellant Company, who accepted the scheme, must be regarded as having voluntarily contracted with the Controller with regard to the terms on which they would do business with him.

The effect of the scheme, so far as material, was shortly as follows. Spinners were urged to assist the Controller by purchasing cotton to the fullest extent of their storage capacity irrespective of their yarn orders in hand. In the event of a rise or fall in the price of raw cotton they were to make returns showing the weight of cotton held or agreed to be purchased and the weight of yarn contracted to be sold. According as the position so shown was "long" or "short", and depending on whether the price had risen or fallen, the spinner would make payments to or receive payments from the Controller. As from 1st February, 1943, raw cotton prices were reduced by 1*d.* per pound. As the Company's position was then "long" it received a payment of £10,233 odd from the Controller. As from 17th April, 1944, the price was increased by 4½*d.* per pound, and as at that time its position was "long" it had to pay to the Controller the sum of £55,087 which is now in issue.

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It is common ground that for present purposes "cost" is not synonymous with "price", but that other items of expenditure such, for instance, as freight or warehouse charges or insurance, must in certain cases be added to the price. Croom-Johnson, J., thought that the Special Commissioners, in deciding to exclude this sum of £55,087, had confused "cost" with "price". There is some ground for this view in the language used in paragraph 16 of the Case where the Commissioners say: "The payment . . . was, in our opinion, a payment pursuant to a commercial contract calculated by reference to the cover position and could not be said to be part of the price of the cotton." Reading the Case as a whole I find some doubt whether this criticism is justified. However this may be, the question remains whether the Special Commissioners came to a correct determination as to the true effect of the agreement.

The question has to be decided on business accountancy principles. It is to be observed in passing that the Company's own accountants, in preparing the balance sheet, included this sum as part of the cost of the stock-in-trade, and that the Inland Revenue accountant, who gave evidence before the Special Commissioners, stated that in his opinion the accounts as presented were correct from an accountancy point of view. No evidence to the contrary is referred to in the Case. I agree however with the Special Commissioners that the question turns upon the proper construction of the agreement. I would only observe that I cannot find anywhere what was the construction put upon the agreement by these accountants which has been found by implication to have been erroneous.

I think the Solicitor-General was right when he said that over-emphasis on such phrases as the Company's "cover position" might tend to obscure the real question, which is simply what was the effect of the particular arrangement which the parties in fact entered into, as distinct from the reasons which may have actuated them in so doing. At 13th January, 1945, according to a document marked "C" and annexed to the Case, the Company held stocks totalling just over three million pounds in weight. An analysis shows that of these just under two million were invoiced to the Company before 17th April, 1944, and just over one million subsequently. What was the effect of the agreement of 24th August, 1942, on these stocks? To obtain the one million purchased since 17th April, 1944, the Company had to pay not only an increase of $4\frac{1}{2}d.$ per pound on the price previously ruling but also $4\frac{1}{2}d.$ per pound on their "long" position as at that date. To this expenditure they were bound by contract as one of the conditions under which, so long as the agreement remained in force, they obtained their supplies. It seems to me that this necessary expenditure is one which is properly attributable to the cost of the stock held at the end of the year and that it is quite immaterial that some of this stock may have been bought in the open market before cotton control was imposed.

I agree with the reasoning of the learned Judge in arriving at his decision that the Special Commissioners had come to an erroneous determination. In my opinion this appeal fails.

Singleton, L.J.—Cotton was controlled from an early stage of the war: it could only be acquired through or from the Cotton Controller, and there were many difficulties. By August, 1942, the Controller was carrying large stocks of cotton and he was anxious to secure their dispersal as far as possible. A scheme was initiated and it is shown in the letter of 24th August, 1942, and in the documents which accompanied that letter. The

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purpose of the scheme was two-fold: (1) to bring about dispersal of the stocks of cotton held by the Controller, and (2) to enable spinners to buy cotton suitable to their purposes as it became available and with the fewest possible formalities. Spinners were encouraged to buy cotton to the full extent of their storage space. It was recognised that if they did so they might be unduly affected by a change in price and accordingly the scheme contained provisions whereby spinners could cover themselves against any risk of this kind. They were asked to make a weekly statement showing to what extent they were "long" or "short"; and if the price of cotton was raised, one who was "long" would pay the Controller the amount of the increase in price on the quantity by which he was "long", while if he was "short" he would be paid by the Controller on the quantity he was "short", provided that it could be shown that he had been unable to buy cotton. There was a similar arrangement—the other way round—in the event of there being a reduction by the Controller in the price of cotton. There was no compulsion on anyone to come into the scheme, but it is to be supposed that most spinners did so, for thereafter the control was worked on this basis. If there had been difficulties a stronger form of control could have been put into operation.

Asia Mill, Ltd. joined in the scheme and signed the form required. They assisted the Controller by buying and storing a large quantity of cotton so that their position was generally "long". As from 1st February, 1943, there was a reduction of 1d. a pound in the price of raw cotton "in order to offset the increases in spinning, doubling and weaving margins, and so to prevent a rise in the cost of living index". In consequence of this fall in price the Company, being "long", received from the Controller a payment amounting to more than £10,000. As from 17th April, 1944, the price of raw cotton was increased by 4½d. a pound and this meant that under the scheme the Company had to pay to the Controller the sum of £55,000 odd, and they did so. Everyone agrees that this sum of £55,000 is an allowable deduction in the Company's accounts. It was properly included on the debit side of the trading account for the year ending 13th January, 1945, and was part of the item, £164,197 13s. 7d., shown against cotton and charges. The question which arises in this appeal is the figure at which stock-in-trade on the other side of the account should be taken. In the original account it appeared as £191,312 13s. 2d., and that figure was arrived at by adding to the invoice price of cotton in stock the sum of £55,000 already mentioned. In the submission of the Crown that is the proper figure but the claim of the Company is that it ought to be reduced by omitting the figure of £55,000 on the ground that that amount did not form part of the cost of the cotton.

I ought to say that the increase in the price of raw cotton, or the payment of £55,000, made no difference in the financial position of the Company (except as to bank and interest charges), for increases in the prices which could be charged on yarn contracts were made by the Minister of Supply which fully compensated spinners.

The Special Commissioners were of opinion that the payment of £55,000 was a payment pursuant to a commercial contract calculated by reference to the cover position and could not be said to be part of the price of the cotton. They held that the cost to the Company of the stock of cotton was the invoice price and that the sum of £55,000 did not enter into the matter. Their view was that the cotton was purchased out and out and

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that there was no provision for adjustment of the price. They reduced the assessment.

It is right to point out that contracts for the sale of cotton were made on behalf of the Cotton Controller (Ministry of Supply) and that there is nothing on the face of them to show that there might be a change in price or any adjustment whatever. Croom-Johnson, J., reversed the finding of the Commissioners, holding that they had misdirected themselves.

Before this Court the submission of Mr. Heyworth Talbot for the Company was that though the £55,000 was a proper debit item in order to arrive at the company's trading profit it was no part of the cost of the cotton to them. He submitted that the only question was: what was the cost to the Company of the raw cotton on hand on 13th January, 1945? Normally, he said, that would be the invoice price, but there might be items such as carriage which should be added to the invoice price. The £55,000 was arrived at, he argued, by reference to the cover position, and it had no reference to the cost of stock. Indeed, it was clear that some of the stock on hand was bought before there was any control, and about one-eighth of the stock of cotton on 13th January, 1945, was bought before the agreement which followed upon the letter of 24th August, 1942.

The principles governing a question of this kind were stated by the Lord President (Lord Clyde) in *Whimster's* case, 12 T.C. 813, at page 823.

It was common ground that the cost of the raw cotton on hand was less than its value, so cost was that which had to be considered from the point of view of the profit and loss, or trading account. Hence the question to be determined is: what was the cost to the Company of the stock-in-trade?; or, to put it in another form: ought the figure of £55,000, or any part of it, to be included in that item? In the circumstances of this case that is not purely a question of fact, as cost must be in most cases. It really falls to be decided according to the true effect of the agreement of August, 1942. My understanding of the position is that as to future purchases of raw cotton the price should be stated on the invoice, and that price should be paid, but in certain events (which events happened) a further sum might have to be paid to the Controller in respect of that cotton. A further sum was paid. The further sum so paid on the cotton was in the nature of an increase in the price of cotton purchased from the Controller: in other words the cost of that cotton to the Company included the invoice price and the additional sum paid—and that by reason of the agreement between the parties made in August, 1942.

So much seems to me to be clear. The further point is as to cotton in stock before the date of the agreement and which remained in stock at the date of the increase in price, so that 4½d. a pound was paid on it to the Controller. This, as I have said, was about one-eighth of the stock. From the point of view of good accountancy I do not think that it is necessary or desirable to draw a distinction between the two cases. Once the spinner entered into the August, 1942, agreement with the Controller, he had agreed that he would pay, in the event of an increase in price if he was "long", so much a pound on all the raw cotton in respect of which he was "long" irrespective of whether the cotton was bought before or after the agreement and from whomsoever it was bought. I agree with the submission of the Solicitor-General that a payment made in those circumstances was a payment made in respect of that cotton, and it was referable only to that cot-

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ton: it was something which on ordinary principles of accounting would be treated as part of the cost of the cotton to the spinner. I think this becomes the clearer when one remembers that correspondingly there was an increase allowed by the Minister on yarn contracts. This does not help on the construction of the agreement but it does go to support the evidence as to accountancy practice. The auditors of the Company had originally included the whole of the £55,000 in the stock-in-trade figure. Mr. Gower, the principal advisory accountant to the Board of Inland Revenue, gave evidence that, in his opinion, from an accountancy point of view the accounts as presented were correct. There was no evidence to the contrary. In my view, this uncontradicted evidence ought to have been accepted unless there was something to show that it was wrong. However I agree with the Commissioners that the question really depends on the documents. On the true construction of the agreement between the Controller and the Company, and on principles of good accountancy the £55,000 became as from the date of payment part of the cost to the company of the cotton, and it falls to be included in the trading account as such.

I agree that the appeal should be dismissed.

Jenkins, L.J.—This is an appeal by Asia Mill, Ltd. from a judgment of Croom-Johnson, J., dated 5th May, 1949, allowing an appeal by the Crown from a determination of the Special Commissioners in favour of the present Appellants on a question affecting their assessment to Income Tax for the year of assessment 1945-46, such assessment being based on the Appellants' profits for their accounting year ended on 13th January, 1945.

The Appellants are cotton spinners, and the sole question in the appeal relates to the value which should be placed on the Appellants' stock of raw cotton on hand on 13th January, 1945, for the purpose of computing their profits for the accounting year ended on that date.

It is common ground that the principle to be applied is as stated by the Lord President in *Whimster & Co. v. Commissioners of Inland Revenue*, 12 T.C. 813, at page 823, where he said: "In computing the balance of profits and gains for the purposes of Income Tax, or for the purposes of Excess Profits Duty, two general and fundamental commonplaces have always to be kept in mind. In the first place, the profits of any particular year or accounting period must be taken to consist of the difference between the receipts from the trade or business *during such year or accounting period* and the expenditure laid out to earn *those receipts*. In the second place, the account of profit and loss to be made up for the purpose of *ascertaining that difference* must be framed consistently with the ordinary principles of commercial accounting, so far as applicable, and in conformity with the rules of the Income Tax Act, or of that Act as modified by the provisions and schedules of the Acts regulating Excess Profits Duty, as the case may be. For example, the ordinary principles of commercial accounting require that in the profit and loss account of a merchant's or manufacturer's business the values of the stock-in-trade at the beginning and at the end of the period covered by the account should be entered at cost or market price, whichever is the lower; although there is nothing about this in the taxing statutes."

It is also common ground that in the present case the stock should be valued at cost, not market value. The question thus resolving itself simply into a dispute as to the cost of the stock, one would have expected it to be

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essentially a question of fact for the Commissioners. There is however an underlying question of law, which arises out of an agreement made between the Appellants and the Cotton Controller under a scheme set on foot by the latter in August, 1942, which, with a view to simplifying the control procedure (into the details of which as operated before August, 1942, I need not enter) and encouraging cotton spinners to purchase cotton to the full extent of their storage space, provided in effect for the elimination of profits and losses due to alterations in the controlled price of cotton, as compared with the prices charged for yarn in pending contracts, by the payment of "differences" to the Controller by cotton spinners who would otherwise have gained by a given alteration in the price of cotton, and by the Controller to cotton spinners who would otherwise have lost by such alteration. The payment to or by the Controller which would be necessary to counteract the effect of an increase or reduction in the price of cotton on the position of any individual cotton spinner obviously depended not simply on the total amount of cotton which the spinner had in stock or on order at the date of the alteration in the price of cotton, but on the difference between that amount and the amount of cotton required to fulfil pending contracts for yarn based on the price of cotton as it previously stood. Thus a spinner whose stock of cotton in stock or on order exactly balanced the amount required to fulfil pending contracts for yarn would be unaffected by an alteration in the price of cotton because his existing stock would be wholly applied in meeting, and exactly suffice to satisfy, his contracts for yarn based on the old price of cotton, and stock subsequently acquired at the new price would be applied in meeting contracts for yarn at prices fixed so as to allow the appropriate margin over the new price of cotton, whether greater or less than it had formerly been. On the other hand a spinner who at the date of any alteration in the price was "long" in cotton (i.e., whose stock in hand or on order exceeded the amount required to fulfil pending contracts for yarn) would gain if the price was increased (since he could apply his surplus stock purchased at the old and lower price in filling new contracts for yarn at prices based on the new and higher price) but would lose if the price was reduced (since he would then be left with a surplus stock purchased at the old and higher price which, when converted into yarn, would have to be sold at prices based on the new and lower price). The effect of any alteration in price on the position of a spinner who at the date of the alteration in price was "short" in cotton (i.e., whose stock in hand or on order was less than the amount required to fulfil pending contracts for yarn) would be precisely the reverse. The "short" spinner would gain by any reduction in price (because he could to the extent of his deficiency in stock satisfy contracts for yarn at prices based on the old and higher price by means of purchases of cotton at the new and lower price) but would lose by any increase in price (because he would then have to make up his deficiency in stock by purchases at the new and higher price for the purpose of fulfilling contracts for yarn based on the old and lower price).

The Controller's scheme thus involved the payment of "differences" as follows:—(a) in the event of an increase in price, the payment to him by spinners who were "long" and by him to spinners who were "short", of sums calculated by multiplying the increase in price per pound of cotton by the number of pounds by which their respective stocks of cotton in hand or on order exceeded or fell short of the amounts required to fulfil their res-

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pective pending contracts for yarn; and (b) in the event of a reduction in price, the payment to him by spinners who were "short" and by him to spinners who were "long", of sums similarly calculated with reference to the reduction in the price per pound of cotton. The result achieved by this system of "difference" payments in a controlled market, in which the Controller was the sole supplier of cotton, would be to provide spinners with "cover" against adverse alterations in price substantially corresponding to the "cover" with which, in the days of the free market, they had been accustomed to provide themselves by means of calculated dealings in cotton futures.

The details of the scheme are to be found in a circular letter from the Controller to cotton spinners dated 24th August, 1942, and a form of undertaking enclosed in that letter which cotton spinners were invited to sign and return (copies of which are included in Exhibit "A" to the Case Stated) but do not call for further elaboration here. The Appellants duly signed and returned the form of undertaking and by so doing concluded an agreement with the Controller, under which they were bound to pay and entitled to receive to or from the Controller the appropriate differences calculated as above described whenever the price of cotton was increased or reduced.

There was some discussion before us as to whether the scheme was voluntary, so that cotton spinners could refuse to sign the undertaking while continuing to be supplied with cotton by the Controller, or compulsory in the sense that signature of the undertaking was required by the Controller as a condition of his continuing to supply them with cotton. So far as appears from the Case Stated there was no evidence about this one way or the other, though Mr. Heyworth Talbot for the Appellants informed us on instructions that spinners who elected not to sign the undertaking were not debarred from purchasing further supplies of cotton from the Controller. There is nothing in the terms of the documents to indicate that the scheme was compulsory in the sense I have indicated. In these circumstances I think the proper course for the purposes of this appeal must be to assume that it was voluntary. The fact remains however that so far as those spinners who did sign the undertaking were concerned—and in this case so far as the Appellants were concerned—the agreement with the Controller thus constituted formed part of the conditions on which the Controller thereafter supplied them with cotton. This is not to say that such agreement had the effect of altering retrospectively the actual purchase price of the Appellants' stock of cotton already in hand or on order at the date of a given price alteration. They bought their cotton outright at fixed prices under contracts which made no provision for price adjustments in the event of subsequent variations in the price of cotton. Moreover, the calculation of differences was to take into account the whole of the Appellants' stock of cotton, including not only cotton bought from the Controller after the signing of the undertaking, but also cotton bought from him before that date, and even cotton which had not been bought from him at all, but from ordinary commercial vendors in the days prior to control. But the agreement did mean that from the time of signing the undertaking the Appellants were doing business with the Controller on terms that in the event of the price of cotton being altered they were in effect to pay a levy to the Controller or receive a subsidy from the Controller (as the event might require) calculated by reference to their surplus or deficiency of stocks, as compared with pending contracts, in such a way as to place them (if "long") in the same

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position as if the portion of their stocks corresponding to the surplus had in fact been bought at prices greater or less than the actual cost of such stocks by the amount of the increase or reduction (as the case might be) in the price of cotton, and (if "short") in the same position as if the additional stocks required to make up the deficiency were actually going to be purchased at the price at which they would have been obtainable immediately before the increase or reduction in the price of cotton came into operation.

As from 1st February, 1943, the price of raw cotton was reduced by 1d. a pound, and the Appellants, being "long", received from the Controller a "difference" payment amounting (after minor adjustments) to £10,233 19s. 4d. There appears to be no evidence as to the way in which this payment was dealt with in the Appellants' accounts. As from 17th April, 1944, the prices of raw cotton of all types were increased by 4½d. a pound and the Appellants again being "long" they made a "difference" payment to the Controller of £55,087 7s. 4d.

In the Appellants' accounts for the year ended 13th January, 1945, this sum of £55,087 7s. 4d. is included on the payments side of the trading account in the item "Cotton & Charges, £164,197 13s. 7d.", and on the receipts side in the item "Stock-in-Trade £191,312 13s. 2d.", and the same figure for stock-in-trade appears on the assets side of the balance sheet. These accounts were duly certified as correct by the Company's auditors, and they show that at all events in the view of the chartered accountants concerned, it was proper to treat the difference payment in question as offset by a corresponding increase in the value of the stock. But for the purposes of their assessment to Income Tax for the year of assessment 1945-46 the Appellants claimed that the figure assigned to the item "Stock-in-trade" in their audited accounts should be reduced by £55,087 7s. 4d. on the ground that the proper basis of valuation was cost, not market value, and that the "difference" payment in question formed no part of the cost of their stock. The assessment having been made on the footing that the figure adopted in the audited accounts was the right one, the Appellants appealed to the Special Commissioners, who allowed their appeal. The only accountancy evidence before the Commissioners was that of Mr. F. W. Gower, chartered accountant and principal advisory accountant to the Board of Inland Revenue, who gave evidence to the effect that, in his opinion, from an accountancy point of view the accounts as presented (that is to say, the Appellants' audited accounts to which I have just referred) were correct. The Special Commissioners disregarded this evidence, being of opinion that "the fundamental question was purely one of law depending "on the proper construction of the documents" and expressed their decision in the following terms:—"The payment of £55,087 which the Respondent Company was called upon to make under the terms of the said agreement with the Cotton Controller was, in our opinion, a payment pursuant to a commercial contract calculated by reference to the cover position and could not be said to be part of the price of the cotton. We hold that the cost to the Respondent Company of the stock of cotton was the invoice price and the sum of £55,087 did not enter into the matter. The cotton was purchased out and out and no provision existed for adjustment of the price. The Appeal succeeds and we reduced the assessment "to £10,031."

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The learned Judge reversed this decision and in my opinion he came to a right conclusion in holding, as he did, that the £55,087 7s. 4d. formed part of the true cost to the Appellants of their stocks of cotton.

The contrary view was forcibly argued before us by Mr. Heyworth Talbot for the Appellants. He contended (in effect): (i) that the cost of stock is the total amount the trader has to pay in order to get it, i.e., contract price plus incidental expenses such as carriage and insurance where borne by the purchaser; (ii) that all the Appellants had to do in order to get their stock was to pay the fixed contract price for it, when it became theirs outright; (iii) that the Appellants' stock included cotton bought in pre-control days from vendors other than the Controller, and also cotton bought from the Controller before the commencement of the scheme, the cost (i.e., price) of which could not be affected by a subsequent agreement with the Controller of the kind here in question; (iv) that the "difference" payments were not calculated by reference to any particular purchases or by reference to the entirety of the stocks on hand but simply by reference to the spinners' "cover" position (i.e., the extent to which they were "long" or "short") at the date of the price change; (v) that the "difference" payments were made or received simply by reference to the spinners' prospects of deriving a special profit or sustaining a special loss from the price change by reason of their cover position at the date of the price change; (vi) that accordingly, the "difference" payment of £55,087 7s. 4d. made by the Appellants did not constitute an addition to the cost of their stocks, but was simply in the nature of an adjustment of their profits by elimination of the extra profit, or, so to speak, the windfall, attributable to the price change.

I think these contentions place too narrow a meaning on the term "cost" for the present purposes. In my view, the cost with which we are here concerned is not merely the contract price and incidental expenses paid for the stock in order to get it, but must also take into account any payments the Appellants became liable to make or entitled to receive which had the effect of adding to or reducing the total outlay attributable to their stock as a whole, whether referable to particular items of stock, or to a balance of stock in excess of the amount of stock required to fulfil pending contracts for yarn on a given date, or to the purchases of stock required to make up the existing stock to the amount necessary to meet such pending contracts. Thus to my mind the "difference" payment of £55,087 7s. 4d. made by the Appellants was in the relevant sense an addition to the cost of the stock, since it had to be paid under the agreement with the Controller, and it was a payment which did add to the total outlay attributable to the Appellants' stock as a whole, though calculated not by reference to the entire amount of their stock or to any specific item in it, but by reference to the balance of their stock in excess of the amount required to fulfil pending contracts for yarn on a given date. It is, so far as I can see, immaterial that under the agreement with the Controller the "difference" payment only had to be made because the Appellants were "long" when the price was raised. It was nevertheless a payment which, when made, added to the effective cost of the stock.

If the Appellants' directors had been asked "What was the cost to your company of the stock on your books on the 13th January, 1945?", I do not think they would have given a true answer to that question by merely stating the total of the contract prices paid for the stock, and not

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adding that by reason of the agreement with the Controller, and an increase made in the price of cotton at a time when the Appellants were "long" the Appellants had also had to pay in respect of the stock a difference of £55,087 7s. 4d., which became due to the Controller under the terms of the agreement as representing the amount of the increase in price per pound of cotton multiplied by the number of pounds by which their stock exceeded the amount required to fulfil pending contracts for yarn at the date of the price change. Conversely, I think a "difference" payment received by a spinner who was "long" at the date of a reduction in price would properly be treated as a reduction in the cost of his stock. The point is perhaps most clearly brought out in the case of a spinner who was "short" at the date of a price change. If the price was reduced the "difference" payment he had to make would quite clearly constitute an addition to the cost to him of the stock required to make up his deficit; while if the price was increased the "difference" payment he received would quite clearly constitute a reduction in the cost to him of the stock so required. The agreement with the Controller can, I think, be fairly described as providing for the adjustment up or down of the effective cost to spinners of their stocks of cotton (or of any cotton needed to make up their stocks to the amount required to fulfil pending orders) to the extent necessary to offset the profits or losses they would otherwise have gained or suffered through changes in the price of cotton. To put the particular case in another way, the increase of 4½d. a pound in the price of cotton increased the value of the Appellants' stock by £55,087 7s. 4d. This, however, was not a gratuitous increment, because under their agreement with the Controller the Appellants, contemporaneously with the increase in value, became liable to pay for it pound by pound by making to the Controller a "difference" payment of like amount. I think an increase in the value of stock which under an agreement such as this gives rise to an obligation to pay out a like amount can properly be described as an addition to the cost of the stock. To put the case for the Crown at its lowest, I find nothing in the construction or effect of the documents to make it wrong as a matter of law to treat this "difference" payment as an addition to the cost of the stock. That being so, the question is one which falls to be determined by reference to "the ordinary principles of commercial accounting". (*Whimster & Co. v. Commissioners of Inland Revenue*⁽¹⁾). The only evidence before the Commissioners as to the way in which the "difference" payment should be dealt with according to those principles was that of Mr. Gower, whose opinion must be taken to have been shared by the Appellants' auditors when they certified the accounts as correct. Accordingly, even if the point should be regarded as a debatable one from the accountancy point of view, I do not think the Special Commissioners' conclusion was justified on the evidence before them.

For these reasons, I agree that the appeal fails and should be dismissed.

Mr. Hills.—The appeal will be dismissed with costs?

Tucker, L.J.—Yes.

Mr. Heyworth Talbot.—I am instructed to ask for leave to appeal to the House of Lords in this case, if the Appellant Company be so advised, after considering your Lordship's judgments.

(The Court conferred.)

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

Mr. Hills.—It is the custom of my clients in these cases to leave the matter to the Court.

Tucker, L.J.—Yes, Mr. Talbot.

Mr. Heyworth Talbot.—If your Lordship pleases.

The Company having appealed against the above decision, the case came before the House of Lords (Lords Porter, Normand, Oaksey, Reid and Radcliffe) on 12th, 13th and 14th March, 1951, and judgment was reserved. On 28th June, 1951, judgment was given against the Crown, with costs.

Mr. F. Heyworth Talbot, K.C., and Mr. R. E. Borneman appeared as Counsel for the Company, and the Attorney-General (Sir Frank Soskice, K.C.) and Mr. Reginald P. Hills for the Crown.

Lord Porter.—My Lords, I would willingly spare your Lordships from a recital of the facts of this case, more particularly as they are set out in the Case stated by the Commissioners for the Special Purposes of the Income Tax Acts, but I fear that the views which I hereafter express would be incomprehensible without some introductory statement of the matters at stake.

The appeal is from a judgment of the Court of Appeal affirming a judgment of the Judge in charge of the Revenue Paper, who had allowed an appeal from a Case stated by the Commissioners for the Special Purposes of the Income Tax Acts. The matter to be determined is the sum at which the Company's stock-in-trade in hand on 13th January, 1945, is to be valued for Income Tax purposes.

The Appellant Company carries on the business of cotton spinners. For the purpose of computing its profits for Income Tax for the year 1945-46, the basic year was the Appellant Company's accounting year ended 13th January, 1945, and during that year they paid a sum of £55,087 to the Cotton Controller. It was common ground between the parties to this appeal that this sum of £55,087 constituted a proper deduction in computing the profits of the Appellant Company for the year. It was also common ground that in computing such profits the value of the Appellant Company's stock-in-trade in hand at 13th January, 1945, was, in accordance with the principle enunciated in *Whimster & Co. v. Commissioners of Inland Revenue*, 1926 S.C. 20 at page 25 (1), required to be included at a figure representing its true cost to the Appellant Company. No question of market value arose inasmuch as its cost was less than its market value. The question in dispute was whether in ascertaining the cost of such stock-in-trade this sum of £55,087 or any part of it should be included.

After April, 1941, transactions in raw cotton and cotton yarn were subject to regulations made by the Cotton Controller from whom alone all raw cotton had to be bought. The Cotton Controller fixed day-to-day prices for the purchase of raw cotton and the margins to be added in ascertaining the selling prices of yarn. From April, 1941, to September, 1941, cotton was bought from the Controller without any cover system, but from September, 1941, till August, 1942, spinners were given "cover notes"

(1) 12 T.C. 813, at p. 823.

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entitling them to purchase raw cotton at the ruling prices, for the fulfilment of approved yarn orders, to the extent of 12 weeks' production.

In August, 1942, new arrangements designed to simplify procedure and to secure the dispersal of cotton stocks were directed by the Cotton Controller. Under these new arrangements spinners were urged to assist the Controller by purchasing cotton to the fullest extent of their storage space, irrespective of their yarn orders in hand, and in the event of a rise or fall in the general price level of raw cotton they were to make payments to or receive payments from the Controller according to whether their respective positions were "long" or "short" at the time of the variation of the general price level. A spinner's position is "long" where he has purchased a weight of cotton in excess of the weight of yarn he has contracted to sell; and "short" when he has contracted to sell a weight of yarn in excess of the cotton he has in stock or has contracted to purchase. The arrangements described above are set out in a letter addressed by the Cotton Controller to the Appellant Company on 24th August, 1942, and in a form of undertaking and explanatory notes enclosed with that letter. That form of undertaking was duly signed on behalf of the Appellant Company and returned to the Cotton Controller, with the result that the Appellants became participants in the scheme.

With effect from the 1st February, 1943, all raw cotton prices were reduced by 1d. per pound. As the Appellant Company's position at 30th January, 1943, was "long", the Appellant Company received from the Cotton Controller a payment amounting (after minor adjustments) to £10,233 19s. 4d.

With effect from 17th April, 1944, the prices of all types of raw cotton were increased by 4½d. per pound. As the Appellant Company's position at 15th April, 1944, was "long" to the extent of 2,937,933 pounds, an amount of £55,087 7s. 4d. became due from the Appellant Company to the Cotton Controller, representing 4½d. per pound on this "long" position. This amount of £55,087 7s. 4d. was duly paid by the Appellant Company.

All cotton held in stock by the Appellants on 13th January, 1945, whether obtained from the Cotton Controller or from other suppliers and whether purchased before control or during the varying methods adopted as a means of control, was purchased through brokers on ordinary trade terms and was bought outright at the price ruling on the date of purchase. In the terms of purchase there was no provision for rebate or increase by reference to any future change of circumstances. Obviously, such portion of the stock as had been held on 15th April, 1944, but had been sold before 13th January, 1945, formed no part of the stock to be brought into computation on the latter date. It had been sold and any profit made upon it formed part of the profits of the business. It is the cost to be attributed to that which remained in stock on 13th January, 1945, which is in dispute.

The Crown say that its cost must be increased by 4½d. a pound weight beyond the price paid for it, whereas the Appellants say that the exaction of the sum of £55,087 has no bearing on the cost of the stock.

It is admitted that in making up their accounts for the year to 13th January, 1945, the sum of £55,087 is included in a debit item of £164,197 13s. 7d. and that the value of the stock on the credit side is augmented by an amount representing an increase in value of 4½d. a pound on the cost of such portion as remained on that date. The accuracy of

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the accounts so presented was said in evidence by the principal advisory accountant to the Board of Inland Revenue to be correct from an accountancy point of view.

In these circumstances it was contended on behalf of the Appellant Company:

"(1) that as all stocks of cotton held by the Company at 13th January, 1945, had been purchased by the Company outright at fixed prices under contracts in which no provision was made for price adjustments in the event of subsequent variations in the general level of cotton prices, the cost of such stocks must be ascertained by reference solely to the invoice prices paid;

"(2) that the sum of £55,087 was a sum calculated (in accordance with the arrangements above described) by reference to the Company's cover position at the time of the general price increase, and did not represent an addition to the actual cost of the cotton purchased; and

"(3) that accordingly no part of the said sum of £55,087 was required to be treated for Income Tax purposes as a part of the cost of the cotton stocks of the Company in hand at 13th January, 1945."

It was contended on behalf of the Inspector of Taxes:

"(a) that the payment of £55,087 7s. 4d. was made by the Company to the Controller in respect of 2,937,993 pounds of cotton actually in stock or on order at 15th April, 1944, at the rate of 4½d. per pound;

"(b) that 2,546,518 pounds of cotton remained in stock at 13th January, 1945, in respect of which 4½d. per pound in addition to the invoice price had been paid by the Company to the Controller;

"(c) that the true cost to the Company of the said 2,546,518 pounds of cotton . . . was the invoice price plus the 4½d. per pound;" and that this cost "should be included in arriving at the profits of the Company for Income Tax purposes for the year 1945-46."

Upon these facts and arguments the Commissioners gave their decision in the following terms:

"The payment of £55,087 which the Respondent"—now the Appellant—"Company was called upon to make under the terms of the said agreement with the Cotton Controller was, in our opinion, a payment pursuant to a commercial contract calculated by reference to the cover position and could not be said to be part of the price of the cotton. We hold that the cost to the Respondent"—now the Appellant—"Company of the stock of cotton was the invoice price and the sum of £55,087 did not enter into the matter. The cotton was purchased out and out and no provision existed for adjustment of the price. The appeal succeeds and we reduced the assessment to £10,031."

The learned Judge in charge of the Revenue List and the Court of Appeal reversed this finding and held that a proper proportion of the additional £55,087 was part of the cost of the stock and that the value of the stock-in-trade on 13th January, 1945, must be increased accordingly.

Croom-Johnson, J., thought that the Commissioners had confused cost and price. I cannot find any indication that they have done so. Rather

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I think they have held that this sum was part of the expense of carrying on the business and not part of the cost of its stock.

Tucker, L.J., doubted whether this criticism by the learned Judge was justified but was to some extent influenced by the evidence of the Revenue accountant. His main reason however for the view he held was that the Appellants would have obtained no further supplies of cotton after 17th April, 1944, unless they had come in under the new scheme, that apparently they had obtained about 2,000,000 pounds before that date and about 1,000,000 after and that as they would not have obtained the additional one million unless they had agreed to pay the additional 4½*d.* a pound on all their "long" stock, the additional sum so paid was rightly to be regarded as part of the price given for each pound.

My Lords, to my mind the payment is not an increase in the cost of the cotton. It is a global payment in respect of a holding of cotton in excess of that required to fulfil the Appellants' contracts. The simplest illustration which can be given of the truth of this statement is to consider the case of cotton bought before control came into existence. That cotton together with the rest formed a pool which under the arrangement with the Controller acts as a measure by means of which the payment to be made to him is calculated, but it is not part of the cost. The cost was ascertained long before; indeed the pre-control cotton must have been valued and its worth incorporated in a number of the previous yearly accounts. Does, then, its cost per pound vary from year to year or, indeed, between the times at which the Controller fixes or refixes the price at which future sales may be made?

The Court of Appeal have sought to get over the difficulty by regarding the payment as being a condition upon which future supplies are granted. I see no reason for making this assumption but even if it were true it provides, indeed, a consideration for the payment, but that circumstance does not seem to furnish a reason for holding that the payment for a right to receive further supplies of cotton is rightly to be regarded as increasing the cost of that already supplied.

The assumption, I presume, is that spinners must be regarded as contracting with the Controller to pay a given sum down per pound of cotton but with a reservation that that sum shall be increased or reduced in case an alteration is made in the selling price. Such an agreement is no doubt possible but it is quite inconsistent with the procedure followed, since no such implication can be made in respect of cotton bought and paid for out and out before cotton was controlled at all or even in the case of cotton supplied under the earlier system of control and it forms no part of the terms contained in the Controller's letter.

Nor do I think that any guidance can be obtained from the Revenue accountant's evidence. The arrangement was a peculiar and exceptional one and no general accountancy practice can be called in aid. Moreover what may be prudent accountancy for a company is not necessarily the correct method of ascertaining the proper assessment for Income Tax. The Company may desire to ascertain the value of the stock in hand, whereas for Income Tax purposes they are entitled to take not market value but the cost.

Jenkins, L.J., if I understand him rightly, thought that a payment in respect of yarn held "long" could be rightly described as an addition to its cost though it added to the cost of the stock as a whole and was not

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attributable to any particular item and though it was not paid in accordance with the stock held but according to whether the Appellants' position happened to be "long" or "short" at the time of the change of price.

To take the view that the payment did not constitute an addition to the cost but was in the nature of an adjustment of profit by eliminating the extra profit attributable to the price change was, in his opinion, to place too narrow an interpretation on the meaning of the term "cost". He says ⁽¹⁾: "to my mind the 'difference' payment of £55,087 7s. 4d. made by the Appellants was in the relevant sense an addition to the cost of the stock, since it had to be paid under the agreement with the Controller, and it was a payment which did add to the total outlay attributable to the Appellants' stock as a whole, though calculated not by reference to the entire amount of their stock or to any specific item in it, but by reference to the balance of their stock in excess of the amount required to fulfil pending contracts for yarn on a given date. It is, so far as I can see, immaterial that under the agreement with the Controller the 'difference' payment only had to be made because the Appellants were 'long' when the price was raised. It was nevertheless a payment which, when made, added to the effective cost of the stock."

Speaking for myself I think the attribution of the sum paid as forming part of the cost of the cotton held on 13th January, 1945, is to extend unduly the meaning of the word "cost". The additional sum paid is undoubtedly part of the expense incurred by the Appellants in carrying on their business but it is not in my opinion part of the cost of their stock. On the contrary, I prefer the description of the transaction given by the Commissioners.

I would allow the appeal with costs and restore the decision of the Commissioners.

Lord Normand.—My Lords, I have had the advantage of reading the Opinion of my noble friend Lord Radcliffe, in which I concur.

Lord Oaksey.—My Lords, I agree. I have also had the advantage of reading in print the Opinion of my noble friend Lord Reid, and I agree with it.

Lord Reid.—My Lords, it is common ground in this case that in determining the Appellants' profits for Income Tax purposes for their accounting year 13th January, 1944, to 13th January, 1945, there must be brought into account their stock-in-trade at 13th January, 1945, valued at cost or market value, whichever is the lower. On any view the cost was lower than the market value; so the question in the case is; what was the cost of the stock-in-trade at that date? That stock consisted of over three million pounds weight of raw cotton bought at various times between 1939 and 1945 and the total price paid for it was £147,268. The Appellants contend that this is the sum which should be taken into account. The Respondent maintains that there should be added to this sum a further sum of £44,045 to arrive at the true cost of the stock.

The facts have been stated by the Special Commissioners and are not in dispute. Before April, 1941, there was a free market in cotton; thereafter cotton had to be bought from the Cotton Controller, who fixed the price from time to time. In August, 1942, the Controller instituted new arrangements to simplify procedure and to induce manufacturers to buy

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and store as much cotton as possible so as to disperse stocks and minimise risks of loss from enemy action. There was no compulsion to accept these arrangements but they were agreed to by the Appellants and apparently by most other manufacturers.

The new arrangement was set out in the Cotton Controller's letter of 24th August, 1942. Spinners were requested to make a weekly statement showing to what extent they were "long" or "short". A spinner was "long" if the amount of cotton which he had in his possession or had bought but not yet received was more than enough to fulfil his existing contracts to supply yarn; he was "short" if that amount of cotton was not enough for that purpose. The letter stated: "If at any time it is decided to raise or lower the general price level of raw cotton, spinners will be paid differences by the Control or will pay differences to the Control in accordance with the arrangements set out in the enclosed 'Undertaking' in regard to arrangements for Raw Cotton cover' which should be signed and returned to us as soon as possible." There was then a limitation of the circumstances in which the Controller would pay differences in respect of "short" positions, and it was made clear that payments of differences were not to be made on every adjustment in the prices of individual types of cotton but only in the event of a general change in the price level. The amount to be paid in any case was to be arrived at by multiplying the extent of the "long" or "short" position in pounds weight of raw cotton by an amount in pence per pound determined by the Minister as representing the general change in the Cotton Control's selling price. In the event of a general price increase a spinner whose position was "long" was to pay the amount of the "difference" to the Controller and a spinner whose position was "short" was, subject to the limitation referred to, to receive the amount of the "difference", and conversely in the event of a general price reduction.

In February, 1943, prices were reduced by one penny per pound and the Appellants, being then "long", received £10,233 from the Controller. On 17th April, 1944, prices were increased by 4½d. per pound and the Appellants, being then "long" to the extent of 2,937,993 pounds, paid to the Controller £55,087.

If these payments had been really adjustments of price then of course they would have to come in to the cost of the stock. But it has not been maintained that they were and clearly they were not. In the first place the stock in 1945 included cotton which had been bought in the old free market and not from the Controller; it could not be maintained that the price of that cotton was altered by the making of these payments. And secondly there was nothing either in the agreement of 1942 or in the subsequent sales by the Controller to the Appellants which indicated that the price in any of these sales was to be subject to later adjustment. The Solicitor-General's argument was that these were payments which, though not part of the price, "had the effect of adding to or reducing the total outlay attributable to their stock as a whole": I quote from a passage ⁽¹⁾ in the judgment of Jenkins, L.J., which the Solicitor-General maintained correctly set out the principle to be applied. I cannot agree that every payment or receipt which has that effect must come in to the cost of the stock. If a trader keeps perishable stock for a considerable time he may have to incur large expense in keeping it in proper condition—expense which he would

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not have incurred if he had not been carrying the stock. In such a case it could be said that when the trader comes to use the stock it has cost him not only its price but also all that he has spent on keeping it but would not have had to spend if he had not had it in his possession. And in the same way when the trader is making up his accounts he could determine how much it has already cost him to acquire and keep in condition the stock then in his possession. But I do not think that it was seriously argued that such expense incurred after the stock has been acquired and delivered to the trader must go to swell the cost of the stock for Income Tax purposes. And if such expense is not to come in then it seems to me that the principle as stated by Jenkins, L.J., must be too wide. No other principle was suggested in argument and I have searched in vain for any which would cover the circumstances of this case but exclude other expenditure incurred in consequence of a trader having stock in his possession.

The Solicitor-General made something of the fact that the same event that required the payment to the Controller also increased the value of the stock which the Appellants then held. The rise in price of $4\frac{1}{2}d.$ per pound for raw cotton and the consequent rise in the price of yarn meant that thereafter the Appellants could sell yarn made from the old cheap cotton at the new higher prices. That may be true but, if it is true, what has increased is not the cost but the value of the cotton which the Appellants then held, and in this case we are not concerned with value but only with cost.

Then it was said that the Appellants' obligation to make the payment to the Controller "formed part of the conditions on which the Controller there-
"after supplied them with cotton" (again I quote from the judgment of Jenkins, L.J. (1)). I do not think that it did, but even if it did it would not produce the result for which the Respondent has contended. I cannot see how that view could lead to any other result than that the payment must be attributed as an additional cost to the cotton bought after it was made; if the payment did not alter retrospectively the price of the cotton which the Appellants had already got from the Controller I do not see how it could effect the cost of that cotton. But the case for the Respondent is based on the view that the whole of the payment must be attributed to cotton which the Appellants already had before the price rose. They do not seek to bring into the cost of the stock at 13th January, 1945, the whole of the £55,087, but only £44,045, and the reason for that is that part of the stock at 17th April, 1944, to which they attribute the payment had been sold before 13th January, 1945. The Respondent's contention as set out in the Case stated by the Special Commissioners is "that the payment
"of £55,087 7s. 4d. was made by the Company to the Controller in respect
"of 2,937,993 pounds of cotton actually in stock or on order at 15th April, 1944, at the rate of $4\frac{1}{2}d.$ per pound". There are also other difficulties in the way of the Respondent but I need not refer to them.

Then the Solicitor-General fell back on quite a different argument which ought logically to have come first. As I understood it the argument was that what properly comes in to the "cost" of a stock for Income Tax purposes is not a question of law but a question of accountancy practice, that the Special Commissioners had evidence about this, and that as the evidence was all one way they were not entitled to disregard it, and this House must accept it as decisive in this case. The case of *Green v.*

(1) Page 289 ante.

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J. Gliksten & Son, Ltd., 14 T.C. 364, was cited in support of this argument. I do not think that it supports this argument at all. That case ultimately came before this House, but I do not find that any of the learned Judges or noble and learned Lords who took part in that case held that they were precluded from dealing with the question at issue by reason of the fact that accountancy evidence had been given before the Commissioners. But I need not pursue that matter further because I do not find any conclusive evidence set out in the Case Stated. The Respondent maintains that the manner in which the Appellants in fact made out their accounts is correct for Income Tax purposes. The Appellants deny this, and the Case states: "13. Mr. F. W. Gower, a chartered accountant and the principal advisory accountant to the Board of Inland Revenue, gave evidence that in his opinion, from an accountancy point of view, the accounts as presented "were correct." That is all: it is not said whether Mr. Gower regarded the £44,045 as a part of the price of the cotton or what construction of the agreement of August, 1942, he thought was correct. The construction of that document must be a matter of law and if Mr. Gower based his evidence on a wrong construction of the document, as he may well have done, then his evidence cannot be conclusive.

On the whole matter I am of opinion that no good reason has been shewn for disturbing the decision of the Special Commissioners, and I am therefore of opinion that this appeal should be allowed.

Lord Radcliffe.—My Lords, I think that the truth of this case is that the Special Commissioners' decision ought never to have been interfered with. Various things have been said against that decision. It is said that they confused "cost" with "price" and so misled themselves. This is the criticism that commended itself to the learned Judge in the Revenue Court. I can see no ground at all for that criticism, which seems to be based on the argument that anyone who holds that in this case the cost of the stock was the invoice price must be incapable of distinguishing between the two conceptions. Then it is said that the Commissioners failed to appreciate the full legal significance of the 1942 agreement with the Cotton Controller. That is, I think, the substance of the criticism made by the Court of Appeal. But there again I can see no ground for such a criticism in anything that the Commissioners have said or decided. One may describe at length the circumstances in which the agreement was made or its general results as part of the Controller's scheme: but after everything has been said it remains the fact that monies paid under it were not paid as part of the consideration for acquiring stock but as a contribution to the Controller's pool which he operated on the basis of "cover positions". That fact does not necessarily prevent such a payment being treated as an element of cost, but I cannot see why any misapprehension of the legal significance of the agreement should be said to have caused the Commissioners to decide against treating the payment in that way.

Is there then some legal meaning of the word "cost" with which the Commissioners' decision is inconsistent? I do not know that "cost" has any precise meaning in law. It is I think useful to recall the form in which this question arises. We are not here dealing with the word "cost" in an Act of Parliament or a document *inter partes*: if we were it would be for the law to say what its meaning was in that context. Here we are dealing with the application of "the principle of commercial accounting . . . that "in the profit and loss account of a merchant's or manufacturer's business "the values of the stock-in-trade at the beginning and the end of the

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“period covered by the account should be entered at cost or market price, “whichever is the lower.” The Commissioners have answered the question by saying that no part of the monies paid to the Controller in respect of the “cover position” forms part of the cost of the stock-in-trade within the meaning of this principle. My own view accords with theirs, but anyway I cannot see what is at fault in their view. It is said that they had no right to come to that opinion, having regard to the evidence that was given before them by Mr. Gower, the principal advisory accountant to the Board of Inland Revenue. This seems to be the third head of criticism; it was much pressed in argument before your Lordships and it evidently weighed with the Court of Appeal. But, my Lords, it seems to me too slender for its purpose.

What we know is that the Company wrote up the value of its stock-in-trade as at 13th January, 1945, by adding 4½d. per pound to the invoice price of all lots bought before 15th April, 1944. We do not know on what principle this was done. It may be that the Company’s officials did not analyse it very carefully themselves, but if a conclusion had to be reached on the point I should myself agree with the argument of the Solicitor-General that it was regarded as an addition to the cost of those lots. But then this question is not to be determined by what the Company entered in its accounts but by what it ought to be treated as having entered. Mr. Gower gave evidence that in his opinion what they did was correct “from an accountancy point of view”. That is an opinion entitled to respect but it cannot take over from the Commissioners their duty of deciding the case. It is not as if it were evidence that by a settled principle of commercial accounting or the established general practice of accountants payments such as these arising under an agreement such as this are treated as part of the cost of stock-in-trade. If there were such evidence, uncontradicted, it might well have been the Commissioners’ duty to act on it, for if the law guides itself by the principle of accountancy as to cost or market price, whichever be the lower, it must I think guide itself also by any of its principles which determine how cost is made up. But Mr. Gower’s evidence did not, and I should suppose, could not, amount to anything like this: could not, because these payments depended upon the special provisions of a special agreement and are of a nature, accordingly, that could hardly fall under any general rule or within any general category. I think therefore that the Commissioners were quite right in thinking that what they had to do was to find out what the effect of the agreement was and then to come to their own decision upon the matter.

Questions Put:

That the Order appealed from be reversed.

The Contents have it.

That the judgments of the Court of Appeal and of Croom-Johnson, J., be set aside, and that the decision of the Commissioners for the Special Purposes of the Income Tax Acts be restored.

The Contents have it.

That the Respondent do pay to the Appellants their costs here and below.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Whitfield, Byrne & Dean for J. Arnold Brierley & Robinson, Oldham.]