

COURT OF APPEAL—24TH, 25TH AND 26TH APRIL, 1961

HOUSE OF LORDS—
7TH, 8TH AND 12TH FEBRUARY, AND 1ST MARCH, 1962

(1) **Jeffrey (H.M. Inspector of Taxes)**

v.

Rolls-Royce, Ltd. (1)

(2) **Commissioners of Inland Revenue**

v.

Rolls-Royce, Ltd. (2)

(3) **Commissioners of Inland Revenue**

v.

Rolls-Royce, Ltd. (3)

(4) **Commissioners of Inland Revenue**

v.

Rolls-Royce, Ltd. (4)

Income Tax, Schedule D, Excess Profits Tax, Excess Profits Levy and Profits Tax—Sales of technical “know-how”—Whether receipts capital or income.

The Respondent Company, during the manufacture of aero engines, had engaged in metallurgical research and the development of engineering techniques and acquired a fund of technical knowledge commonly called “know-how”. During the period 1946 to 1953 it entered into a number of agreements with foreign governments and companies under which it agreed to supply information necessary to construct certain engines which it had developed and to license the other party to manufacture these engines. For example, by an agreement with the Republic of China the Company undertook to license the Chinese to manufacture a Rolls-Royce jet aero engine and to supply the necessary information and drawings; to advise them from time to time as to improvements and modifications in manufacture and design; to instruct Chinese personnel in their works and to release one or two members of their own staff to assist in China with the manufacture of the engine in

(1) Reported (Ch.D.) [1960] 1 W.L.R. 720; 104 S.J. 566; [1960] 2 All E.R. 640; 230 L.T.Jo. 11; (C.A.) [1961] 1 W.L.R. 897; 105 S.J. 404; [1961] 2 All E.R. 469; 231 L.T.Jo. 278; (H.L.) [1962] 1 W.L.R. 425; 106 S.J. 261; [1962] 1 All E.R. 801; 233 L.T.Jo. 178.

(2) Excess Profits Tax.

(3) Excess Profits Levy.

(4) Profits Tax.

consideration of the payment of "a capital sum of fifty thousand pounds" plus royalties. Agreements in similar terms were entered into with the governments of Argentina, Belgium and Australia and companies in France, the United States of America and Italy. Some of these agreements provided for payment of an annual technical liaison fee in addition to the capital sum.

The profits of the Company's trade were assessed to Income Tax under Case I of Schedule D for the years 1948-49 to 1954-55 inclusive and to Excess Profits Tax, Excess Profits Levy and Profits Tax for the relevant chargeable accounting periods on the footing that the sums received under the agreements should be included as trading receipts. On appeal to the Special Commissioners, the Company contended that the sums received related to the sale of a capital asset and were not trading receipts. The Crown contended that the sums received under the agreements were normal receipts of a revenue nature of the trade or business carried on by the Company. The Special Commissioners allowed the Company's appeal.

Held, that the sums in question were receipts on revenue account of the Company's trade and fell to be included in the computation of its profits or gains.

Evans Medical Supplies, Ltd. v. Moriarty, 37 T.C. 540, distinguished.

CASES

(1) *Jeffrey (H.M. Inspector of Taxes) v. Rolls-Royce, Ltd.*

CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 18th June, 1956, and thence adjourned to 19th, 20th, 21st and 22nd June, 1956, and 29th January, 1958, Rolls-Royce, Ltd. (hereinafter called "the Respondent"), appealed against assessments to Income Tax made under Schedule D as follows:

1948-49	Manufacturers of motor cars and aero engines	£1,300,000
1949-50	do do do	£1,200,000
1950-51	do do do	£1,800,000
1951-52	do do do	£1,500,000
1952-53	do do do	£2,300,000
1953-54	do do do	£2,500,000
1954-55	do do do	£4,800,000

The grounds of the appeal were that, in computing the profits or gains of the Respondent for the period relative to the assessments under appeal, lump sums paid to and received by the Respondent by virtue of certain licensing agreements as hereinafter appear had been included contrary to law, such lump sum payments being of a capital nature.

2. Evidence was given by James Denning Pearson (hereinafter called "Mr. Pearson"), a director of the Respondent and managing director of the Respondent's aero engine division; William Tait Gill (hereinafter called "Mr. Gill"), a director of the Respondent; and James Walter Jeffrey, H.M. Inspector of Taxes for Derby 3rd District. The following documents were produced and admitted or proved at the hearing of the appeal:

- (i) A bundle comprising notices of assessments made on the Respondent under Schedule D for the years 1948-49 to 1954-55 inclusive.
- (ii) A chronological list of agreements entered into by the Respondent.
- (iii) A comparative list of countries covered by licensing agreements and ordinary sales of the Respondent.

- (iv) Two bundles comprising the agreements listed in document (ii) above.
- (v) An abstract of the agreements comprised in document (iv).
- (vi) A statement in writing entitled "Brief History of Rolls-Royce Limited".
- (vii) A schedule showing the total turnover of the Respondent on engine sales and receipts from licence agreements for the years 1946 to 1955 inclusive.
- (viii) A bundle comprising statements of accounts and directors' reports for the years ended 31st December, 1946, to 31st December, 1954, inclusive.
- (ix) A copy of a schedule entitled "Annexure R.-R."
- (x) A schedule showing a calculation of notional sales of the Respondent's aero engines based on receipts from licence agreements.
- (xi) A copy of the memorandum and articles of association of the Respondent.

Such of the above documents as are not attached to and do not form part of this Case are available for the use of the High Court if required.

3. (1) The Respondent was incorporated in 1906 with an authorized capital of £200,000 divided into shares of £1 each. The share capital was increased subsequently, and on 16th October, 1947, amounted to £2,500,000 divided into 2,355,000 ordinary shares of £1 each and 145,000 workers' shares of £1 each. On 24th July, 1951, the share capital of the Respondent was again increased to £4,000,000 divided into 3,855,000 ordinary shares of £1 each and 145,000 workers' shares of £1 each. The object for which the Respondent was established was, *inter alia*:

"3(1) To manufacture, sell, or let on hire, or in any manner dispose of or turn to account, motor vehicles for use on land or water or in the air, and any parts of or accessories to the same, and internal combustion engines for stationary use, and to carry on all or any businesses directly or indirectly relating to or connected with any object or thing which the Company is authorised to manufacture.

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(5) To carry on any other business, whether manufacturing or otherwise, which may seem to the Company capable of being conveniently carried on in connection with any of the above objects, or calculated, directly or indirectly, to advance any of the above objects, or add to the value of any of the Company's property or rights.

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(8) To purchase, acquire, or apply for letters patent, or patent rights, which the Company may deem it advisable to hold in connection with its business, and to sell or otherwise deal with such patents, or patent rights, and grant licences in respect thereof."

(2) The business of the Respondent in its early years was confined to the manufacture and sale of motor cars. During the first world war, the Respondent began to manufacture aircraft engines; and with the development of the aircraft industry the manufacture of aircraft engines became the larger and more important part of the Respondent's business.

(3) For the purposes of its business as a manufacturer of motor cars and aircraft engines the Respondent has throughout its life been engaged in metallurgical research and in the discovery and development of engineering techniques and secret processes. As a result, it acquired in the course of the years a fund of technical knowledge (commonly called "know-how"), of which only a comparatively small part was capable of forming the subject-matter of patent rights.

(4) In the years immediately following the first world war, the aero engine side of the Respondent's business existed, without government support, on the proceeds of contracts for overhauls and supply of spare parts of obsolete types of engines. In 1925, in the absence of government support, the Respondent embarked on the private venture of producing a new aircraft engine, and it designed the "Kestrel", deriving directly from its wartime engines, but with a different construction of cylinders. The Respondent made use of its "know-how", particularly in the field of lightness and strength of materials, which it had by now acquired. The "Kestrel" engine was very successful, and orders were received from the United Kingdom Government and from a number of foreign governments. This led to an engine of increased power called the "Buzzard", which in turn was the foundation of other engines and led directly to the design of the "Merlin", the first test type being produced in 1934. In order to continue the development of the "Merlin" engine, including testing in flight, the Respondent acquired its own aircraft and aerodrome; and in 1935 and 1936 this engine was used in various aircraft, including the prototype "Hurricane", the prototype "Spitfire" and the prototype Fairey "Battle". In the years immediately preceding the second world war a great strain was put on the Respondent owing to the rearmament of the United Kingdom. In order to cope with the demand, the Respondent rented from the Government a factory at Crewe and undertook the management of a government shadow factory at Glasgow. After the war ended the Respondent leased from the Government parts of both of these factories, and has thenceforward carried on aero engine production at Glasgow and the manufacture of motor cars at Crewe.

During the immediate pre-war period the Respondent embarked on the task of designing "power eggs". Troubles were often experienced due to faulty installation of an engine in an aircraft, and, in order to ensure that the best use was made of its engines, the Respondent designed a unit known as a "power egg" which included the engine and all the attendant apparatus serving the engine or operating therefrom. This development was of great importance.

(5) Just before the commencement of the second world war the Respondent at the instance of the United Kingdom Government, entered into negotiations with the French Government to enable it to make "Merline" engines. This was the first occasion on which the Respondent had granted a licence in respect of its engines. This new departure arose out of the exigencies of the time, when there was a necessity to establish the French forces as strongly as possible.

(6) Other engines which were produced during the second world war were the "Vulture", the "Peregrine" and the "Griffin". During the second world war the Respondent was called upon to double its production and was required to teach the Ford Motor Co., Ltd., how to make the "Merlin" engine; and a number of employees of that company lived in Derby, where a little model factory was created where they were taught to manufacture "Merlin" engines through each stage of its production until they were able to go back and set up production in the Ford factory in Manchester. When the United Kingdom Government wanted alternative sources of supply overseas, the Respondent was required to hand over all the drawings and technical information to the Packard company of America, from which the United Kingdom Government bought "Merlin" engines. When the United States of America came into the second world war it decided to use "Merlin" engines for one or two of its machines, and the Packard company of America also manufactured the machines for the American Government. In respect of this manufacture a modest award was made to the Respondent after the war. The "Merlin" engine was

enormously improved during the war, particularly to make it suitable for operation at greater heights, not only for fighters but also for bombers, and give it an extra turn of speed which was used, for example, in the "Mosquito" night fighter. All this information was made freely available to others who were making the engine for war purposes.

(7) The Respondent had already been studying the question of producing a jet or internal combustion turbine engine since 1937-38, when it had engaged a Dr. Griffith and had set up a design staff under him to study the problem and produce such an engine. At the same time the development of this type of engine had been started by Sir Frank Whittle in conjunction with the Rover Co., Ltd. The Respondent was also engaged in producing tank engines as a modification of the "Merlin" aircraft engine, and had produced a number of very successful engines. The Rover company were also engaged on tank engines, and an arrangement was made whereby the Respondent took over the jet engine work from the Rover company and the Rover company took over the tank engine from the Respondent. The Respondent was in a position immediately to go ahead with the development of the Whittle engine, for which it had already made a number of parts. In due course there were developed the "Derwent", the "Nene" and the "Tay", all centrifugal engines, and the "Dart", a propeller turbine engine now used, for example, in the "Viscount" airliners. Then it became necessary, in order to get higher compression ratios, to use an axial engine. Development went back to Dr. Griffith's original work in part, and there were produced the "Avon" and the "Conway" engines.

(8) All this successful development of aircraft engines derived from the Respondent's fund of "know-how" relating to their manufacture, which was of the greatest value to the Respondent. By contrast, the Respondent set very little store by its patent rights, which it took out to prevent other persons copying processes long known to the Respondent and interfering with the Respondent's manufacture by themselves taking up patents relating thereto.

(9) After the conclusion of the second world war, overtures were made to the Respondent by representatives of the Chinese Nationalist Government, who sought the grant of a licence for the manufacture of Rolls-Royce aero engines in China. At first the directors of the Respondent were unwilling to grant such a licence, but eventually the request was supported by the then British Government, and on 13th February, 1946, the Respondent entered into an agreement with the Government of the Republic of China (hereinafter referred to as "the China agreement") acting by the Commission on Aeronautical Affairs of the Republic of China, which recited:

"Whereas Rolls-Royce are designers of aircraft engines (hereinafter defined in the schedule attached) and have agreed to licence the Commission to manufacture the same and to supply the drawings and information necessary therefor to the extent hereinafter stated upon the terms and conditions hereinafter provided",

and provided, *inter alia*, as follows:

"1. Selection of Type: On or before June 30, 1946, the Commission shall select and designate the desired type of jet engine and notify Rolls-Royce of such selection, whereupon such engine so selected shall be the basic type of engine referred to in this agreement. In the event that the Commission shall not give such notice of its selection of the desired type engine within the time above provided, or in the event Rolls-Royce is prohibited by the British Government from supplying said desired type of engine, then this agreement shall remain in full force and effect with respect to Derwent Series V engine or the Nene engine. The Derwent Series V engine is defined as a simple jet propulsion engine comprising centrifugal compressor with combustion chambers, single stage turbine, and generally as per brochure attached to the contract, subject to improvements and modifications between the date of signing the contract and the 30th June, 1946. The Nene engine is defined as a jet propulsion engine comprising centrifugal compressor combustion chambers, single stage turbine and generally as per brochure attached to the

contract, with an estimated test bed thrust 4,500 lbs. and subject to modifications and improvements between the signing of the contract and the 30th June, 1946.

2. Rolls-Royce will supply the Commission with the complete drawings and manufacturing and engineering data and information adequate and reasonably necessary to enable the Commission to manufacture said engine referred to in Clause One above. These engines will be the type numbered as set out in the schedule hereto which are the latest mark of the type referred to, of which the British Government has allowed particulars to be given at this date. Improvements of the engine defined in Clause One will be supplied to the Commission as they are released by the British Government and shall be included and governed by this numbered Clause and Clause Ten.

The manufacturing data and information shall include three sets of designs, which comprise two sets of blue prints and one set of either tracings, or in some form of black and white, so that they can be copied, together with copies of process schedules, material schedules, jig, tool and fixture drawings and full manufacturing details and instructions. These drawings, data, information and instructions shall include the items listed in the following and shall all be supplied within ninety days from June 30, 1946. . . .

3. The Commission shall pay Rolls-Royce the following consideration for the rights granted hereunder:—

A capital sum of fifty thousand pounds sterling to be paid as follows:

- (i) On the signing of the contract, Twenty Thousand Pounds Sterling.
- (ii) On June 30, 1946, Twenty Thousand Pounds Sterling.
- (iii) On the complete delivery of drawings, data, and information referred to in Clause Two, Ten Thousand Pounds Sterling.

4. It shall be a condition precedent to the supply of the drawings and information provided for in the preceding Clause that all sums due to be paid hereunder on or before the date when such drawings or information are to be supplied shall have first been paid.

5. The Drawings will be supplied in triplicate, one set in the form of Van Dyke cloth and two in blue prints. If any further copies are requested by the Commission, the Commission will pay for the same at fair and reasonable prices.

6. In Addition to the capital sum above-mentioned in Clause Three, the Commission will pay to Rolls-Royce the following royalties:

(A) Two hundred and fifty pounds sterling per engine for the first two hundred engines specified in Clause One produced in China, one hundred pounds per engine for the next five hundred engines. Seventy-five pounds per engine for the next five hundred engines and thereafter fifty pounds per engine. An engine shall be deemed to have been produced in China and to require the payment of royalty therefor if any part of it has been produced in China by use of the said manufacturing information and/or drawings. In the case of engines which may be in part manufactured in China and in part made up of parts purchased from Rolls-Royce, the royalty shall be reduced by a sum which bears the same proportion to the appropriate royalty for the complete engines as the amount paid to Rolls-Royce for the parts at Works bears to the total price of complete engine current at the time of payment.

Engines and spares purchased from Rolls-Royce are to be taken into account as material on which royalties have been paid for the purpose of arriving at annual minimum royalties due.

(B) The Commission shall also pay on all spare parts manufactured by them for the engine referred to in Clause One, a royalty of Five per cent. based on Rolls-Royce commercial selling price for the parts manufactured, details of which will be supplied on request at the appropriate date. Provided always that when the Commission shall have paid royalty upon Two Hundred Thousand pounds worth of spare parts the royalty shall thereafter be Two and a Half per cent.

7. The minimum royalty payable by the Commission under Clauses Six (A) and Six (B) during the existence of the Contract shall be as follows:

For the first year	Nil.	(The first year being from June 30, 1946 to the 29th June, 1947.)
For the second year	£5,000 sterling.	
For the third year	£10,000 sterling.	
For the fourth year	£15,000 sterling.	
For the fifth year	£20,000 sterling.	

If in any year the royalty payable in accordance with the provisions of the contract shall be less than the minimum royalty prescribed for that year, the Commission shall pay to Rolls-Royce within one month following the end of that year, such additional sum as may be necessary to make up the royalty payable to the amount of the minimum royalty. Annual minimum royalties if paid on engines and spares not manufactured during the particular period are to be credited to periods when royalties due on engines and spares manufactured exceed the yearly minimum.

10. Rolls-Royce will fully advise the Commission from time to time as to improvements and modifications in the manufacture and design of the engine referred to in Clause One, the subject of this Licence as and when the British Government permit Rolls-Royce so to do, provided always that this obligation shall be suspended if the royalties in any year are in arrears, but shall be revived when the royalty payments have been made up to the annual minimums referred to in the contract.

11. The Engines made in whole or in part under this Licence by the use of the said drawings, data and information shall only be used:—

- (1) in aircraft owned by the Government of China and operated in China or from aerodromes in China as the home aerodrome of the aircraft or,
- (2) in transport aircraft owned and operated by Chinese-owned civil transport authorities or private firms or corporations licensed to operate in China by the Chinese Government and operated in China or from aerodromes in China as the home aerodrome of the aircraft.
- (3) The contract shall not authorise the Commission directly or indirectly to sell the licensed Rolls-Royce engines or spare parts for export from conceded territory to any place outside the conceded territory.

The Commission shall prevent and prohibit the use or disposition of the engines or parts except as authorised for the agreement.

12. The Commission shall not use in engines other than engines referred to in Clause One any parts manufactured from the drawings to be supplied hereunder.

13. All Drawings and information supplied hereunder shall be kept secret by the Commission who shall not disclose the same or any part thereof to any other person or corporation, but this Clause shall not prevent such disclosure as is necessary to enable the engines to be manufactured by the Commission, or to enable them to be installed or repaired.

14. Rolls-Royce will receive into their Works or Plants personnel appointed by the Commission with a view to instructing them in the construction of the engines referred to in Clause One upon the following terms:—

- (1) The number to be received by Rolls-Royce at any one time shall be reasonable. It is agreed that the following is reasonable: During the first three years, not more than fifty trainees, thereafter not more than ten in training at any one time. Any increase over the number stated above shall be subjected to prior agreement between the Commission and Rolls-Royce.
- (2) Rolls-Royce may distribute these personnel at such of their Factories and Works as they may determine provided that each of such personnel is given thereby opportunities for acquiring the knowledge of that part of the construction of the engines for which they have been sent.
- (4) The Commission shall reimburse to Rolls-Royce on demand all actual damages due directly to the said employment of the said personnel.
- (5) All salaries and expenses of the said personnel shall be borne by the Commission.

16. Rolls-Royce will if requested by the Commission temporarily release one or more competent members of their staff to enable them to enter into agreements with the Commission to assist in China in connection with the manufacture of the engines referred to in Clause One and will endeavour to persuade such persons to enter into contracts with the Commission for this purpose if the terms of the proposed contracts are approved by Rolls-Royce. The Commission will duly comply with the terms of the said contracts when entered into and save harmless Rolls-Royce from all claims arising out of such employment of such personnel.

20. All obligations of Rolls-Royce hereunder shall cease at the expiration of five years from the date hereof; provided that at the end of the first five years, the Commission has the right to extend this Contract for another period of five years if desired. During these two periods of five years each if the Commission exercise the option to acquire additional licence for any newer type of Rolls-Royce Engine the obligations of both parties will then be defined; but any royalty paid on the newer engine manufactured by the Commission shall be counted together with the royalty on the type of engine referred to in Clause One being manufactured, in determining the minimum royalty referred to in Clause Seven.

21. As from the date when the obligations of the Commission cease hereunder as aforesaid, the Commission shall be entitled to continue to construct the said type of engine without Rolls-Royce being paid royalty, but the right to use patents referred to in Clause Twenty-Two, the property of Rolls-Royce and/or those of the property of the British Ministry of Production and Power Jets Research and Development Limited will be subject to the Commission obtaining their prior approval and agreement in writing so to do, but the obligations of the Commission under Clause Eleven shall not terminate and shall continue to apply to engines built both under this Licence before or after such date and the Commission shall not at any time hereafter disclose the drawings and information supplied hereunder other than as permitted hereunder.

The ceasing of the obligations of either party shall not prejudice any claim by either party against the other in respect of anything done, suffered, or omitted prior to the ceasing of the said obligations or any claim by Rolls-Royce on account of any breach by the Commission of any obligation as aforesaid.

22. In so far as the engine referred to in Clause One may be covered by Patents or the drawing and manufacturing information by designs or copyright the property of Rolls-Royce, and in so far as any improvements or modifications hereafter communicated by Rolls-Royce to the Commission hereafter are so covered Rolls-Royce hereby grants to the Commission licence and authority under the said patents, designs and copyrights to the intent that the Commission may manufacture the said engines in China. Rolls-Royce agrees to give the Commission the benefit for the purposes of this Agreement or any non-exclusive licence Rolls-Royce may have granted to them under Chinese Patents owned by the British Ministry of Aircraft Production or by Messrs. Power Jets Research and Development Limited, as are necessary to enable the Commission to manufacture the said engine the subject of the agreement. . . .

23. If within five years from the signature of this contract Rolls-Royce puts in series production a new type of Gas Turbine aircraft engine and the British Government has authorised the manufacture of the engine in the conceded Territory Rolls-Royce will not licence anyone to manufacture the engine in the conceded territory without first giving the Commission an option to acquire a licence to do so. To give effect to this undertaking Rolls-Royce shall in regard to each engine at the appropriate time notify the Commission of the terms upon which Rolls-Royce are then prepared to grant to the Commission a licence to manufacture that engine, if the Commission shall within three months of such communication notify Rolls-Royce in writing that they desire to exercise option and shall at the same time pay a capital sum stated in such notification by Rolls-Royce the said licence shall be carried into effect.

The obligations in this Clause are to bind Rolls-Royce only if at the time when such a notification would be given by them the Commission shall have dealt with and punctually complied with all their obligations under this contract.

Rolls-Royce agree that the capital payment required by them under this Clause in connection with each new engine shall not be less favourable than the capital sum demanded by them from other manufacturers for a similar licence.

The Commission agree to incorporate or attach a plate to the engines manufactured under the Licence Agreement to the effect that they are manufactured to Rolls-Royce Limited designs, and will also insert Patent Numbers if requested so to do."

Despite the wording of clause 22, the Respondent never owned any Chinese patents. The lump sum payments provided for in the China agreement were duly paid. A copy of the said China agreement is attached to and forms part of this Case (Exhibit "A")⁽¹⁾.

(10) The general policy of the French Government over a long period

(1) Not included in the present print.

was to rely on aero engines built in France to meet its military requirements, so that the only means whereby Rolls-Royce engines could be made available for use in French military aircraft was by manufacture in France under licence. At the end of the second world war the French aero engine industry was substantially depleted and the French Government was short of sterling exchange to purchase equipment. The Société Hispano Suiza (a company incorporated in France and hereinafter called "Hispano Suiza"), which was one of the companies which had been to the forefront of engine design and development in their own right before the war, approached the Respondent with regard to the grant of a licence to manufacture Rolls-Royce engines. On 13th August, 1946, the Respondent entered into an agreement (hereinafter called "the first Hispano Suiza agreement") with Hispano Suiza with regard to the Respondent's gas turbine engine known as the "Nene". The first Hispano Suiza agreement, which was in similar form to the China agreement, recited:

[The Stated Case then set out certain passages from the agreement.]

The said agreement was limited to France and French colonies. The lump sums and royalty payments provided for in the first Hispano Suiza agreement were duly paid. A copy of the said first Hispano Suiza agreement is attached to and forms part of this Case (Exhibit "B")⁽¹⁾.

(11) On 13th August, 1950, the Respondent entered into a further agreement (hereinafter called "the second Hispano Suiza agreement") with Hispano Suiza, amending the first Hispano Suiza agreement, which recited:

[The Stated Case then set out certain passages from the agreement, including clause 16.]

"16. This Agreement shall endure for a period of six (6) years from the date of signing but the Licensee shall have the right to extend this Agreement for a further period if so desired at conditions to be mutually agreed upon by giving notice to the Company not less than six months prior to the date upon which the Agreement would otherwise expire."

A copy of the said second Hispano Suiza agreement is attached to and forms part of this Case (Exhibit "C")⁽¹⁾.

(12) The option contained in clause 16 of the second Hispano Suiza agreement was not exercised, but on 20th February, 1953, the Respondent entered into a new agreement (hereinafter called "the third Hispano Suiza agreement") with Hispano Suiza, in very similar terms to the second Hispano Suiza agreement, with regard to a new type of engine known as the "Avon" which provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

During the period material to this appeal, however, only the first sum of £50,000 provided for in clause 6 of the said agreement was paid to the Respondent by Hispano Suiza, and no further steps were taken either by the Respondent or Hispano Suiza to implement the third Hispano Suiza agreement. A copy of the said third Hispano Suiza agreement is attached to and forms part of this Case (Exhibit "D")⁽¹⁾.

(13) The United States Government would not purchase Rolls-Royce aero engines for military purposes from the Respondent, and the Respondent saw no prospect of selling aero engines as such on a long-term basis in that country. The Respondent was, however, desirous of getting a foothold in the United States. A Mr. Philip B. Taylor of New York, U.S.A. (hereinafter referred to as "Mr. Taylor"), who was an engineer, was aware of this, and he approached the Respondent because he wished to interest an American firm in obtaining a licence from the Respondent to manufacture Rolls-Royce aero engines in America. The directors of the Respondent knew Mr. Taylor's back-

⁽¹⁾ Not included in the present print.

ground and knew that he had been associated with the Wright Aeronautical Corporation, one of the leading aero engine manufacturers in the United States of America, but that he had severed his connections with that corporation. On 19th September, 1946, the Respondent entered into an agreement (hereinafter called "the Taylor agreement") with Mr. Taylor which provided, *inter alia*, as follows:

"1. Subject to the terms and conditions hereinafter contained, and for the period hereinafter defined, the Company hereby grants to Mr. Taylor the sole and exclusive right to sell within the United States of America and its territories and possessions as at the date of this Agreement (hereinafter referred to as "the said territory") Rolls-Royce Turbine Engines of the types known as "the Nene" and "the Derwent" for use in aircraft, and all spare parts and accessories manufactured by the Company for such engines (which engines, spare parts and accessories shall hereinafter be referred to as "the said Turbine Engines and parts") and the Company hereby agrees to sell to Mr. Taylor, when orders are placed by him, such Turbine Engines and parts and accessories.

2. This Agreement shall, save as hereinafter provided, endure for a period of two years from the date hereof, and thereafter be subject to the right of either party to give to the other notice in writing of their intention to terminate the Agreement at the expiry of a period of six months from the date of such notice. Provided always however that in the event of the option provided in Clause 18 hereof not having been exercised the Company shall be entitled to terminate the said Agreement without prior notice at the end of one year from the date hereof in the event of their not having received from Mr. Taylor or by his introduction orders for ten such Turbine Engines including the orders for four such Turbine Engines referred to in Clause 3 hereof and shall further be entitled to similarly terminate the said Agreement at the end of the second year if by that time they have not received orders over the two year period for fifty such Turbine Engines. All such orders to comply with the Company's normal terms for business must be accompanied by a deposit payment of 10 per centum of the agreed price and the opening of an unqualified credit in London for the balance payment against presentation of shipping documents.

3. Mr. Taylor has already procured that an order shall be placed with the Company for four such Turbine Engines at current quotations *f.a.s.* an English port and has made in respect thereof a deposit payment of approximately 10 per centum of the purchase price.

4. (i) Mr. Taylor shall at his own expense use his best endeavours to further by all available means the sale of the said Turbine Engines and parts within the said territory, and to this end the Company hereby undertakes to refer to him all enquiries which may be received by them concerning the said Turbine Engines and parts arising in the said territory.

5. Save as hereinafter appears, the Company shall not at any time during the currency of this Agreement grant to any other person, firm, or corporation any right to sell the said Turbine Aircraft Engines and parts within the said territory in derogation of the rights conferred on Mr. Taylor by this Agreement.

7. (1). Subject to the provisions of Clause 10 hereof and to Mr. Taylor observing and fulfilling the terms and conditions herein contained, the Company will allow him in respect of the said Turbine Engines sold within the said territory, other than those sold or supplied to the American Government by virtue of arrangements made between that Government and the British Government discount

8. The price to be paid by Mr. Taylor to the Company for each of the said Turbine Engines or parts purchased hereunder shall not exceed that quoted by the Company to any other purchaser or prospective purchaser in the said territory for similar material under similar conditions of sale, less the amount of any discount herein provided for.

9. Subject to any contract between the Company and Mr. Taylor containing special provisions, the Company will not be liable for any failure to deliver, or any delay in delivery, nor Mr. Taylor for any failure to receive, or delay in receiving, the said Turbine Engines and parts sold pursuant to this Agreement, when such

failure or delay is caused by revolution, war, acts of enemies of state, strikes or other labour disturbances, prohibition of export, acts of God, orders or acts of any Government or Governmental authority, or other causes of a like kind beyond the control of the party whose performance is interfered with.

11. Mr. Taylor shall not represent himself as agent of the Company nor do any act or thing which might result in other parties believing that he had authority to contract on behalf of the Company and nothing herein contained shall give him authority to act in any way or make any statement or representation on behalf of the Company or to give any undertaking guarantee warranty or indemnity on its behalf with reference to any of the said Turbine Engines or parts or otherwise.

13. This agreement is personal to Mr. Taylor and it shall not be lawful for him to sell or assign his rights thereunder or any benefits arising therefrom except that he may assign any moneys due or to become due under this Agreement and except that the Company will not unreasonably withhold consent to the assignment by him of his rights hereunder to a corporation formed and incorporated by him for the purpose of carrying out the terms and conditions of this Agreement or to an existing corporation provided that Mr. Taylor satisfies the Company that such corporation possesses adequate financial resources and technical direction adequate to carry out and attain the object of this Agreement, bearing in mind the option given by this Agreement to permit of manufacture in the said territory.

18. During the currency of this Agreement the Company shall, if called upon by Mr. Taylor so to do, and subject to the consent of the British Government, grant to him the rights and licences subject to the general terms and conditions all as set forth in the schedule hereto.

22. In the event of this Agreement being assigned by Mr. Taylor in accordance with the provisions of Clause 13 hereof then the name of the assignee shall be read in place of the name of Mr. Taylor throughout this Agreement where the context so permits."

The general terms and conditions under which the manufacturing licence referred to in clause 18 of the Taylor agreement were to be concluded were contained in a schedule to the said Taylor agreement and were substantially similar to the general terms and conditions incorporated in the Hispano Suiza agreements and other agreements hereinbefore referred to. They provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the schedule.]

A copy of the said Taylor agreement and schedule is attached to and forms part of this Case (Exhibit "E") (1).

(14) On 13th November, 1946, Mr. Taylor entered into an agreement (hereinafter referred to as "the Taylor Turbine agreement") with the Taylor Turbine Corporation of Delaware, U.S.A. (hereinafter referred to as "Taylor Turbine") and the Respondent, whereby he assigned the whole of his interest in the Taylor agreement, hereinbefore referred to, to Taylor Turbine, and the Respondent consented to the assignment.

(15) On 30th December, 1947, the Respondent entered into an agreement (hereinafter referred to as "the first United Aircraft agreement") with the United Aircraft Corporation, Connecticut, U.S.A. (hereinafter referred to as "United Aircraft"), which recited, *inter alia*:

"Whereas, Rolls-Royce entered into an agreement dated September 19, 1946 with Philip B. Taylor of New York City whereby Rolls-Royce granted to said Taylor the exclusive right to sell within the United States of America Rolls-Royce Turbine Engines of the types known as the Nene and Derwent, together with an option to acquire certain manufacturing rights and licences referred to in Clause 18 thereof, for a more particular description of the terms of which reference shall be had to said agreement; and

Whereas, said Taylor by an agreement dated November 13, 1946, assigned

(1) Not included in the present print.

and transferred to Taylor Turbine Corporation, a Delaware corporation having an office in the City of New York, all of his rights under said agreement of September 19, 1946; and

Whereas, said Taylor Turbine Corporation by an agreement dated November 28, 1947, a copy of which is attached hereto and marked Annex 1, assigned and transferred to United with the consent of Rolls-Royce all of its rights under said agreement of September 19, 1946; and

Whereas, United has elected to exercise the option referred to in Clause 18 of said agreement of September 19, 1946, and the parties hereto desire to set forth herein the terms and conditions comprising said manufacturing rights and licenses, as set forth in said agreement of September 19, 1946 and as now amended, amplified and modified".

and provided, *inter alia*, as follows :

[The Stated Case then set out certain passages from the agreement.]

A copy of the said first United Aircraft agreement is attached to and forms part of this Case (Exhibit "F") (1).

(16) On 16th August, 1950, the Respondent entered into a second agreement (hereinafter called "the second United Aircraft agreement") with United Aircraft amending the first United Aircraft agreement, which recited :

"Whereas, the parties hereto entered into a Manufacturing Agreement, dated the 30th day of December, one thousand nine hundred and forty-seven, whereby Rolls-Royce granted to United certain rights and licenses relating to gas turbine engines, to which Manufacturing Agreement reference shall be had for a description of the terms thereof; and

Whereas, the parties hereto now desire to amend said Manufacturing Agreement in order to provide for the granting of sub-licenses by United under certain conditions, to clarify and modify certain provisions therein with respect to the payment of royalties and the disclosure of data and to make certain other revisions therein".

and provided, *inter alia*, as follows :

[The Stated Case then set out certain passages from the agreement.]

A copy of the said second United Aircraft agreement is attached to and forms part of this Case (Exhibit "G") (1).

(17) On 15th December, 1951, the Respondent entered into a third agreement (hereinafter referred to as "the third United Aircraft agreement") with United Aircraft with the object of amending further the first United Aircraft agreement. The said third United Aircraft agreement recited, *inter alia*, as follows :

"Whereas, the license granted in said Manufacturing Agreement, as amended, extended to a license to make, use and sell for installation in aircraft Licensed Engines and Parts embodying or manufactured according to certain inventions described and claimed in certain patents and applications, the property of Power Jets (R. & D.) Limited, all as set forth in said Manufacturing Agreement, and more particularly in Exhibit B thereto; and

Whereas, Power Jets (R. & D.) Limited has recently concluded a fully-paid-up license agreement with the United States of America, effective June 1, 1951, pursuant to Article 6 of which it is agreed that no further royalties shall be paid by any manufacturer within the United States, either directly or indirectly to Power Jets (R. & D.) Limited by reason of the incorporation in, or use in connection with, any articles, equipment or materials manufactured for the United States Government, of any inventions disclosed by United States patents or applications for United States patents, owned by said Power Jets (R. & D.) Limited, and filed on or before December 31, 1951 or resulting from any application completed in the United Kingdom on or before December 31, 1952".

(1) Not included in the present print.

and provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

A copy of the said third United Aircraft agreement is attached to and forms part of this Case (Exhibit "H") (1).

(18) In or about 1947 the Government of the Argentine approached the Respondent with an enquiry for a number of Rolls-Royce aero engines, and the Respondent dispatched a representative to the Argentine to pursue the negotiations. Upon arrival in that country the Respondent's representative found that the Argentine Government would not buy Rolls-Royce aero engines as a single transaction, but were intent on the policy of employing German and Italian technicians, who had taken up residence in the Argentine, to establish an aircraft engine and aeroplane industry in the Argentine which had not existed theretofore. The directors of the Respondent were conscious of the fact that it was in the national interest to acquire foreign exchange at that time. They had little confidence, however, in the ability of the Argentine Government to manufacture aircraft engines. They were also impressed by the consideration that any German and Italian technicians who had acquired knowledge of the Respondent's technical processes would be in a position, on their return to their native countries, to take the advantage, to the Respondent's detriment, of any "know-how" they had acquired. For these reasons the directors were not prepared to sell any of the Respondent's "know-how" to the Argentine Government unless for a substantial lump sum. On 18th July, 1947, the Respondent entered into an agreement (hereinafter referred to as "the Argentine agreement") with the Government of the Argentine, which provided, *inter alia*, as follows:

"Clause 1 — The Company grants to The Government the exclusive licence to manufacture within the territory and possessions of the Argentine Nation as at the date of this Agreement, gas turbine engines and spare parts of the type designated Derwent V, designed wholly or in part by The Company for installation in aircraft.

.

Clause 3 — It is perfectly understood that The Government has the non-exclusive right to sell to any South-American government aircraft equipped with engines of the type manufactured under the conditions of the present contract and also sell spare parts which will ensure the servicing of the engines installed in the said aircraft.

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Clause 5 — The Company shall supply to The Government after the enforcement of this contract commences and subject to the clauses hereinafter stipulated complete drawings, manufacturing processes and all manufacturing and engineering data and information which are adequate and necessary to enable The Government to manufacture, assemble, test, operate and service without any difficulty the said turbine engines and spare parts, including all information on testing installations, as specified in Appendix I.

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Clause 7 — The Company undertakes to supply to The Government, 104 (one hundred and four) Derwent V engines, in various stages of manufacture and assembly, in accordance with the details specified in Appendix II of the present contract, and the raw material for the manufacture of another 100 (one hundred) engines of the same type plus 50% (fifty per cent) in excess of the quantities to meet normal wastage in manufacture.

Clause 8 — The value of the raw material and turbine engines to be supplied by The Company as specified in the preceding Clause shall not exceed the total sum of £1,000,000 (one million pounds sterling).

Clause 9 — The Company shall furnish to The Government within 60 (sixty) days from the date on which the enforcement of this contract commences, a complete list, with prices, of the jigs and fixtures necessary for the manufacture of the Derwent V gas turbine engine at the rate of four engines per week. The Government having the option of purchasing the whole or part of those supplies.

(1) Not included in the present print.

The value of these supplies shall not exceed the sum of £777,000 (seven hundred and seventy-seven thousand pounds sterling).

Clause 10 — Likewise The Company undertakes to supply to The Government the machinery and special tools which the latter should order suitable for the manufacture of the gas turbine engines to which the present contract refers, up to the sum of £740,370 (seven hundred and forty thousand three hundred and seventy pounds sterling). This sum of money solely covers the supplies detailed in Appendix III which shall be quoted for when and as The Government requires.

Clause 12 — The Company undertakes to communicate to The Government without charge, periodically and without delay, during the validity of the licence covered by the present contract the approved improvements or modifications in the manufacture and design of the said turbine engines and spare parts and The Government in turn undertakes to communicate without delay similar information to The Company relative to any improvement effected by The Government to the said turbine engines and spare parts while the licence of this contract is in force.

Clause 14 — In regard to the manufacture of the turbine blades The Company undertakes to give detailed instructions to The Government as to the use of the process denominated "Lost Wax Process" as soon as the British Government permits The Company to divulge the necessary information. These instructions shall be furnished without additional charge to The Government. The Company undertakes to sell to The Government the foundry equipment for the production of castings used in the Derwent V engine if The Government desires to purchase same after consultation with the technical mission of The Company. . . .

Clause 15 — The Company shall at the request of The Government receive into their workshops, laboratories and technical offices fifteen persons representing the latter, with the object of instructing them in the manufacture and construction of the said turbine engines and spare parts. The Government shall pay the salary and any other remuneration for living and travelling expenses of such personnel who shall continue to be the employees of The Government. The Company shall have the power to request The Government to withdraw from their premises any member of The Government's personnel, without depriving the latter of the right to replace him.

Clause 17 — The Company shall place at The Government's disposal, when requested, the necessary British technical personnel to advise the latter on the manufacture and servicing of the turbine engines and spare parts.

Clause 19 — For the licence and other services established in this contract, to be allowed by The Company, excepting that which is stipulated in Clauses 7, 8, 9 and 10, The Government shall pay, as sole remuneration, the sum of £500,000 (five hundred thousand pounds sterling), in the following manner:

£250,000 (two hundred and fifty thousand pounds sterling) within thirty days of having obtained the approval of the present contract by the Executive Power of the Nation. £125,000 (one hundred and twenty-five thousand pounds sterling) within ninety days of the date on which the enforcement of this contract commences, always providing that The Company has delivered 50% (fifty per cent) of the documentation specified in Appendix I and that same has been received satisfactorily by The Government. The Company shall advise The Government when delivery of the 50% (fifty per cent) of the documentation has been effected. £125,000 (one hundred and twenty-five thousand pounds sterling) within one hundred and eighty days from the date on which enforcement of this contract commences, always providing that The Company has delivered the complete documentation referred to in Appendix I, received satisfactorily by The Government, and has complied with the exigencies of the present contract relative to the licence covered by the same.

With regard to payments for the supplies to which Clauses 7, 8, 9 and 10 refer, these will be effected in the following manner:—

30% (thirty per cent) on placing the order and the remaining 70% (seventy per cent) against presentation of shipping documents through a Bank in England, nominated by The Company, acceptance certificates signed by the representatives of The Government and invoices in triplicate duly approved.

Clause 42 — With the prior consent of the British Government, The Company during the currency of the present contract, shall inform The Government, not

later than when the information is divulged to other licencees of The Company, about the same types of gas turbine engines developed by The Company distinct from the Derwent V for installation in aircraft and to that effect if The Government notifies The Company in writing within sixty days of the dispatch to The Government of such information that it desires to obtain a further licence or licencees relating to the new types referred to, The Company shall concede to The Government such licence or licencees upon payment of the remuneration which shall be mutually agreed upon.

These further licencees shall be entirely subject to the general terms of the present contract.

Clause 43 — Even though the gas turbine engine and spare parts of the type designated Derwent V, to which Clause 1 refers, may be covered by patents or are constructed by manufacturing designs and processes owned exclusively by The Company, the latter grants The Government licence and authority for manufacturing the same in the Argentine Republic under the patents, drawings and manufacturing information which The Company enjoys at present.

The Company agrees to give to The Government for the purpose of this contract the benefit of any non-exclusive licence which has been granted to The Company under Argentine patents owned by the British Ministry of Supply or by Messrs. Power Jets Research and Development Limited as is necessary for The Government to manufacture the engines subject of this contract.

This Clause absolutely does not refer to what is specified in Clause 13, headings (b) and (c).

Clause 44 — This contract shall endure for ten years from the date on which the order is issued to execute it, but The Government shall have the right to extend the duration period stipulated, for a further period of 5 (five) years, if so desired, always providing that the corresponding notice is given to The Company six months prior to the expiry date. This notice is to be considered as the basis for further negotiations in respect of the extension of the present licence."

The lump sums and other payments provided for in the said Argentine agreement were duly paid. A copy of the said Argentine agreement is attached to and forms part of this Case (Exhibit "I") (1).

(19) On 15th October, 1947, the Respondent entered into an agreement (hereinafter referred to as "the Fiat agreement") with Societa Per Azioni Fiat of Turin, Italy (hereinafter referred to as "Fiat") which provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

A copy of the said Fiat agreement is attached to and forms part of this Case (Exhibit "J") (1).

It was common ground that receipts under this agreement were of a revenue character.

(20) In or about 1948 one British designed aeroplane, the "Meteor", was chosen as the fighter aircraft for Belgium and Holland. As a matter of policy the Respondent kept the Belgian Government fully informed on the development of its Rolls-Royce aero engines, and the Belgian Government wished to install Rolls-Royce aero engines in the aircraft that it intended to purchase for the Belgian air force. The national requirements of the Benelux group of countries at that time were such that the Belgian Government wished to establish a source of supply for their aircraft engines in Belgium, the aeroplane itself being made in Holland. Accordingly, the Belgian Government approached the Respondent with a view to obtaining a licence to manufacture Rolls-Royce aero engines, and on 12th November, 1948, the Respondent entered into an agreement (hereinafter referred to as "the first Belgian agreement") with the Belgian Government which provided, *inter alia*:

[The Stated Case then set out certain passages from the agreement, including clause 13.]

"13. Subject to the consent of the British Government being first obtained, the

(1) Not included in the present print.

Company will, during the currency of this Agreement, inform the Licensee not later than the time when the information is divulged to other Licensees of the Company, actual or prospective, of further developments by the Company of Gas Turbine Engines for installation in aircraft, that is engine or engines of new design, and thereupon if the Licensee notifies the Company in writing within sixty days of the despatch to him of such information that he desires to take out a further license or licenses in respect of such further developments, the Company will grant him such license or licenses upon payment of further capital sums and royalties on a scale which shall be determined and subject to such other conditions as shall be deemed appropriate, having regard to the nature of the further developments which are the subject of the license. Such further license or licenses shall be subject to the general terms of this Agreement so far as these may be applicable to the conditions then existing."

A copy of the said first Belgian agreement is attached to and forms part of this Case (Exhibit "K") (1).

(21) Certain practical difficulties arose in the administration of the said first Belgian agreement because one party to the agreement was the Belgian Government, whose representatives had to be consulted too frequently in connection with matters arising thereunder. On 31st December, 1952, the Respondent entered into an agreement (hereinafter referred to as "the second Belgian agreement") with Fabrique Nationale d'Armes de Guerre, Belgium (hereinafter referred to as "Fabrique Nationale"), which was very similar in terms to the first Belgian agreement but related principally to the gas turbine engine known as the "Avon Mark 108". The said second Belgian agreement, however, was not carried into effect by the parties — although the sum of £25,000, being the first instalment of the capital sum of £100,000 payable under clause 6(i), was in fact received by the Respondent — and was superseded and cancelled by a subsequent agreement as hereinafter appeareth. A copy of the second Belgian agreement is attached to and forms part of this Case (Exhibit "L") (1).

(22) At some time subsequent to the making of the second Belgian agreement, Fabrique Nationale represented to the Respondent that the taxation position of Fabrique Nationale in Belgium was such that it was desirable to split the provisions of the second Belgian agreement as between licences and technical liaison, and on 5th August, 1953, the Respondent entered into a further agreement (hereinafter referred to as "the third Belgian agreement") with Fabrique Nationale which provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

A copy of the said third Belgian agreement is attached to and forms part of this Case (Exhibit "M") (1).

(23) On 12th August, 1953, the Respondent entered into a further agreement (hereinafter called "the fourth Belgian agreement") with Fabrique Nationale, in very similar terms to the first and second Belgian agreements. The said fourth Belgian agreement related to the "Avon Mark 110" engine, but the consideration provided for in clause 4 thereof consisted of a royalty payment only.

A copy of the said fourth Belgian agreement is attached to and forms part of this Case (Exhibit "N") (1).

(24) In or about 1949 it was doubtful, for political reasons, if the Respondent could sell the Rolls-Royce engines for military aircraft in Australia. But the Respondent was approached by representatives of the Commonwealth of Australia, and on 29th April, 1949, the Respondent entered into an agreement (hereinafter referred to as "the first Australian agreement") with the Commonwealth of Australia (hereinafter referred to as "Australia") which provided, *inter alia*, as follows:

(1) Not included in the present print.

[The Stated Case then set out certain passages from the agreement.]

A copy of the said agreement is attached to and forms part of this Case (Exhibit "O")⁽¹⁾.

This agreement was subsequently extended for a further period of three years ending 31st October, 1956⁽²⁾, the technical liaison fee being fixed at £500 per annum for this period.

(25) On 6th July, 1950, the Respondent entered into a further agreement (hereinafter referred to as "the second Australian agreement") with Australia, which recited as follows:

"Whereas the Company manufactures Engines as hereinafter defined and in connection therewith is in possession of secret knowledge and processes and technical and manufacturing information and is in a position (subject to the consent of His Majesty's Government in the United Kingdom) to supply all such designs drawings technical assistance and the like as is essential and desirable for the purpose of manufacturing the said Engines

And Whereas the Commonwealth is desirous of procuring the manufacture of such Engines within the Commonwealth of Australia and the territories administered by the Commonwealth and for that purpose . . . the Company to make the disclosures and give the assistance hereinafter agreed to be given by the Company which the Company has agreed to do for the considerations hereinafter appearing and on the terms and subject to the conditions of this Agreement".

and provided, *inter alia*:

[The Stated Case then set out certain passages from the agreement, including clause 12.]

"12. Subject to the consent of His Majesty's Government in the United Kingdom being first obtained the Company will during the currency of this Agreement inform the Commonwealth not later than the time when the information is divulged to licensees of the Company actual or prospective of further developments by the Company of Gas Turbine Engines for installation in aircraft and thereupon if the Commonwealth notifies the Company in writing within Sixty (60) days of the despatch to it of such information that the Commonwealth desires the Company's technical assistance in respect of such further development the Company will afford it such technical assistance upon payment of further capital sums and technical liaison fees on a scale which shall be determined and subject to such other conditions as shall be deemed appropriate having regard to the nature of the further developments. Nothing contained in this Clause shall be construed as affecting in any way the Company's obligation under Clause 4(iii) hereof to communicate to the Commonwealth any improvements or modifications in the manufacture or design of the said Turbine Engines and Parts."

A copy of the said second Australian agreement is attached to and forms part of this Case (Exhibit "P")⁽¹⁾.

It was within the knowledge of the directors of the Respondent when this agreement was entered into that other companies, both in the United States and the United Kingdom, were desirous of securing this contract.

(26) On 24th April, 1951, the Respondent entered into a further agreement (hereinafter referred to as "the third Australian agreement") with Australia, which recited:

"Whereas during the period of five years which commenced on the First day of January One thousand nine hundred and forty five and ended on the Thirty first day of December One thousand nine hundred and forty nine there subsisted between the Company and the Commonwealth an arrangement under which the Company kept the Commonwealth supplied with designs drawings and other technical information and assistance to enable the Commonwealth to manufacture, test, repair, overhaul and service 108 Merlin Mark 102 aircraft engines as designed, manufactured, modified and improved by the Company and also to enable the Commonwealth to test, repair, overhaul and service other types of Merlin aircraft engines used by the Commonwealth.

⁽¹⁾ Not included in the present print. ⁽²⁾ The agreement was originally intended to cover a period of five years from 1st November, 1948.

And whereas the parties are desirous of renewing the said arrangement for a further period of five years upon the terms and conditions hereinafter appearing", and provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

A copy of the said third Australian agreement is attached to and forms part of this Case (Exhibit "Q")⁽¹⁾.

It was common ground that all receipts under the first and third Australian agreements were of a revenue character.

(27) In or about 1952 it was doubtful, for political reasons, whether the Respondent could sell Rolls-Royce aero engines in Sweden for military aircraft, but the Respondent was approached by representatives of the Royal Swedish Air Board with a view to their obtaining a licence to manufacture the Respondent's Rolls-Royce aero engines in Sweden. On 13th November, 1952, the Respondent entered into an agreement (hereinafter referred to as "the Swedish agreement") with the Royal Swedish Air Board (hereinafter referred to as "Swedish Air") which provided, *inter alia*, as follows:

[The Stated Case then set out certain passages from the agreement.]

A copy of the said Swedish agreement is attached to and forms part of this Case (Exhibit "R")⁽¹⁾.

It was within the knowledge of the directors of the Respondent when this agreement was entered into that at least one other English company and an American company were competing for the contract.

(28) The Respondent maintained continuous contact with the American armed forces and was continuously presenting to them the merits of its Rolls-Royce aero engines. In or about 1953 the Westinghouse Electric Corporation of Pennsylvania, U.S.A., and Westinghouse Electric International Co. of Delaware, U.S.A. (hereinafter jointly referred to as "Westinghouse"), which were engaged in the business of developing and manufacturing aero engines for the United States armed forces, approached the Respondent with a view to obtaining technical assistance to enable it to recover the ground which it had lost to its United States competitors, who had at that time outstripped it in engine design. The directors of the Respondent were of the opinion at that time that the big market in America was in military aero engines, and they decided that an association with Westinghouse was a way of getting the name of Rolls-Royce accepted in America. Furthermore, United Aircraft were continuing to make centrifugal engines but had indicated that Pratt & Whitney did not intend to take up the option to take the later types of engines provided for in the third United Aircraft agreement hereinbefore referred to. On 14th July, 1953, the Respondent entered into an agreement (hereinafter referred to as "the Westinghouse Agreement") with Westinghouse, which recited, *inter alia*, as follows:

"Whereas, Westinghouse is anxious that technical knowledge, information and experience in the manufacture of certain aircraft power plants at present possessed by R.R. may be immediately imparted to it as provided in this Agreement; and

Whereas, R.R. and Westinghouse both wish to enter into an agreement whereby their future technical knowledge and information in the manufacture of certain aircraft power plants may be mutually exchanged and whereby either party may manufacture and sell certain aircraft power plants originated by the other, as provided in this Agreement"

and provided, *inter alia*, as follows:

"Clause 2. Except as provided for in Clause 3, this Agreement and the licenses

(1) Not included in the present print.

herein granted shall relate to aircraft power plants and parts thereof of any and all types

Clause 4. (a) Subject to the provisions of Clause 3, and insofar as R.R. has the right to do so, R.R. agrees to make immediately available to Westinghouse at R.R.'s development and engineering laboratories, test cells, flight test facilities, offices and shops in England, the technical knowledge and information already in its possession, (including for example, and not by way of limitation, technical data, designs, calculation and design sheets, performance data, and material and process specifications, material cards, construction drawings, test data, and designs and specifications relating to manufacturing equipment, tools, dies, jigs and fixtures).

(b) Subject to the provisions of Clause 3, and insofar as either party has the right to do so, the parties hereto agree during the first eight (8) years of this Agreement to exchange freely technical, development, design, patent, testing, operational, manufacturing and application information (all of which information, together with the technical knowledge and information referred to in Clause 4 (a), is herein referred to as 'Information') relating to aircraft power plants, which is available in the records of the respective parties and, to assist in accomplishing the foregoing, each party shall have access to the development and engineering laboratories, test cells, flight test facilities, offices and shops of the other party during normal working hours

Clause 7. (1) Subject to the provisions of Clause 3, R.R. hereby grants to Westinghouse under any and all Patents of R.R. and under the Information of R.R. from time to time furnished to Westinghouse pursuant to this Agreement:

- (a) A license to manufacture or have manufactured for it aircraft power plants and parts therefor in the U.S.A. (the term U.S.A. in this Agreement being understood to mean the United States of America, Alaska, Hawaii, Puerto Rico, Guam, the Virgin Islands and the Panama Canal Zone). During the first eight (8) years of this Agreement, R.R. agrees to grant no additional licenses to manufacture aircraft power plants of the types covered by this Agreement in the U.S.A. except that, during the entire life of this Agreement, R.R. reserves a non-transferable right to manufacture aircraft power plants and parts therefor in the U.S.A.
- (b) With respect to aircraft power plants originated by R.R. and primarily of its design:
- (1) The right to grant non-exclusive sub-licenses to third parties to manufacture such aircraft power plants and parts therefor in the U.S.A. when so requested by an agency of the United States Government.
 - (2) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties sub-licensed under Clause 7 (b) (1), to sell such aircraft power plants and parts therefor manufactured by Westinghouse or its sub-licensees for installation in any aircraft manufactured in the U.S.A.
- (c) With respect to aircraft power plants originated by Westinghouse and primarily of its design:
- (1) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties, to manufacture such aircraft power plants and parts therefor in all countries of the world except Great Britain (the term Great Britain in this Agreement being understood to mean England, Scotland, Wales, Northern Ireland, the Channel Islands and the Isle of Man).
 - (2) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties sub-licensed under Clause 7 (1) (c) (1), to sell such aircraft power plants and parts therefor in all countries of the world except Great Britain.
 - (3) A non-exclusive license to sell such aircraft power plants and parts therefor in Great Britain for installation in aircraft manufactured in Great Britain by or to the order of and for the use of any person, firm, corporation or Government Agency whose principal office is in the U.S.A.
- (d) A non-exclusive license to Westinghouse, its sub-licensees, and its and their vendees, to use licensed aircraft power plants and parts therefor in all countries of the world.

(2) Subject to the provisions of Clause 3 and to prior commitments contained in the aforesaid Agreement between Westinghouse and D. Napier & Son Limited, dated May 29, 1953, and the aforesaid Agreements between Westinghouse and Armstrong-Siddeley Motors Limited, made September 22, 1948, and February 6, 1950, Westinghouse hereby grants to R.R. under any and all Patents of Westinghouse and under the Information of Westinghouse from time to time furnished to R.R. pursuant to this Agreement:

- (a) A license to manufacture or have manufactured for it aircraft power plants and parts therefor in Great Britain. During the first eight (8) years of this Agreement, Westinghouse agrees to grant no additional licenses to manufacture aircraft power plants of the types covered by this Agreement in Great Britain except that, during the entire life of this Agreement, Westinghouse reserves a non-transferable right to manufacture aircraft power plants and parts therefor in Great Britain.
- (b) With respect to aircraft power plants originated by Westinghouse and primarily of its design:
 - (1) The right to grant non-exclusive sub-licenses to third parties to manufacture such aircraft power plants and parts therefor in Great Britain when so requested by an agency of the British Government.
 - (2) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties sub-licensed under Clause 7 (2) (b) (1), to sell such aircraft power plants and parts therefor manufactured by R.R. or its sub-licensees for installation in any aircraft manufactured in Great Britain.
- (c) With respect to aircraft power plants originated by R.R. and primarily of its design:
 - (1) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties, to manufacture such aircraft power plants and parts therefor in all countries of the world except the U.S.A.
 - (2) A non-exclusive license, together with the right to grant non-exclusive sub-licenses to third parties sub-licensed under Clause 7 (2) (c) (1), to sell such aircraft power plants and parts therefor in all countries of the world except the U.S.A.
 - (3) A non-exclusive license to sell such aircraft power plants and parts therefor in the U.S.A. for installation in aircraft manufactured in the U.S.A. by or to the order of and for the use of any person, firm, corporation or Government Agency whose principal office is in Great Britain.
 - (4) The right to grant to each respective third party licensee enumerated in Addendum I of this Agreement a non-exclusive sub-license, for the duration of the respective license agreements as specified in said Addendum, to sell (but not to make) in the U.S.A. for installation in aircraft manufactured in the U.S.A. by or to the order of and for the use of any person, firm, corporation or Government Agency whose principal office is in the home country of such third party licensee, the particular types of aircraft power plants and parts therefor as to which such third party licensee in any agreement enumerated in Addendum I is licensed, or has an option for a license, on the date of this Agreement to sell in the U.S.A.
- (d) A non-exclusive license to R.R., its sub-licensees, and its and their vendees, to use licensed aircraft power plants and parts therefor in all countries of the world.

Clause 8. Upon termination of this Agreement as provided in Clause 21 the licenses granted by each party to the other under Patents shall continue on a non-exclusive basis thereafter for the lives of the Patents respectively, and the licenses under Information granted by each party to the other shall continue forever

Clause 9. As consideration for making available and the transfer to Westinghouse of the technical knowledge and information which R.R. already possesses as provided in Clause 4 (a), Westinghouse shall pay to R.R. in U.S. dollars the sum equivalent to one million pounds Sterling (£1,000,000), which sum shall be payable as follows: A number of U.S. dollars equivalent to two hundred and fifty thousand pounds Sterling (£250,000) prior to July 12, 1953 and the remaining payment of U.S. dollars equivalent to seven hundred and fifty thousand pounds Sterling (£750,000) during the month of January, 1954, which latter payment in U.S. dollars shall be determined by the Bank of England rate of exchange prevailing on January 4, 1954.

Clause 10. (a) In consideration of the continuing provision of Information by R.R. to Westinghouse, and of the licenses granted by R.R. to Westinghouse, the Information to be furnished and the licenses granted by Westinghouse to R.R. hereunder shall be free of royalty or other payment, except as provided in Clause 15 (b), and Westinghouse shall pay to R.R. in U.S. dollars, a royalty of two-and-a-half per cent (2½%) of the net selling price of each complete aircraft power plant and parts of aircraft power plants, except as hereinafter provided, sold by it or its sub-licensees, provided that, if and when the aggregate of the royalties paid by Westinghouse, for itself and its sub-licensees, exclusive of any other payment made by Westinghouse under this Agreement except any payment that may be made under Clause 11, have amounted to five million U.S. dollars (\$5,000,000), the royalty payable by Westinghouse, for itself and its sub-licensees, under this Clause 10 shall thereafter be two per cent (2%) and provided, further, that, if and when the aggregate of the royalties paid by Westinghouse, for itself and its sub-licensees, exclusive of any other payment made by Westinghouse under this Agreement except any payment that may be made under Clause 11, have amounted to ten million U.S. dollars (\$10,000,000), including the aforesaid five million U.S. dollars (\$5,000,000), the royalty payable by Westinghouse and its sub-licensees under this Clause 10 shall thereafter be one-and-a-half per cent (1½%)

Clause 11. In the event the aggregate royalties paid hereunder to R.R. under Clause 10 for the calendar year of 1955, or for any succeeding calendar year prior to January 1, 1961, shall not amount to five hundred and sixty thousand U.S. dollars (\$560,000) Westinghouse agrees to make up the deficiency within three (3) months after the end of each calendar year for which such a deficiency may occur.

Clause 14. (a) During the first eight (8) years of this Agreement, each party may assign a reasonable number of resident engineers to be located at the plant of the other party, each party to defray the salary, travelling and living expenses of its own engineers.

(b) During the first eight (8) years of this Agreement each party may, from time to time, request of the other party the services, for periods to be estimated in such requests, of not more than two (2) engineers to be located at the plant of the requesting party and shall pay to the other party, as complete reimbursement for the services of each such engineer, including reasonable travel time between the plants of the parties, at the rate of fourteen thousand U.S. dollars (\$14,000) per annum.

(c) During the first eight (8) years of this Agreement, each party will permit a reasonable number of engineers of the other party to visit its plants and offices in reference to Information to which it may be entitled under this Agreement.

Clause 21. This Agreement shall terminate March 1, 1963, subject to the provisions of Clause 8."

A copy of the said Westinghouse agreement is attached to and forms part of this Case (Exhibit "S") (1).

(29) For reasons of security, the Respondent was normally only permitted by the United Kingdom Government to grant a licence in respect of an aero engine which was already well established in production. The aero engines so licensed were current models, though new and more advanced types of engine were being developed all the time.

(30) The Respondent had never refused to grant a licence to a foreign government or manufacturer on the ground that to do so and to communicate the necessary "know-how" would prejudice its interests. It had, however, always sought to restrict as far as possible the field in which the licensee could apply the information so obtained. Possession of the Respondent's "know-how" enabled a licensee to get into production far earlier than would otherwise have been possible. It was important from the point of view of the Respondent's reputation that each licensee should have all the "know-how" it or he required to be able to manufacture engines to the Respondent's traditionally high standards.

(1) Not included in the present print.

(31) In the case of articles produced by the Respondent under contracts with the United Kingdom Government during the period 1946 to 1954, special terms were incorporated in such contracts relating to the sale and grant of licences by the Respondent other than to the United Kingdom Government in the form of a schedule entitled "Annexure R-R". The said Annexure R-R provided, *inter alia*, as follows:

"1. The design of the articles produced by the contractor in accordance with this contract shall be deemed to be the property of the contractor subject to any rights held by other parties.

4. Where it can be shown that the whole or major part of the cost of the development of the articles sold has been borne by the United Kingdom Government the Contractor will pay to the Minister 5% of the sale price thereof.

6. In the event of the contractor granting a licence (for articles where the United Kingdom Government has borne development costs as defined in paragraph 4) to a third party to manufacture articles, he shall pay to the Minister one third of any sums received by way of royalties or licence fees. In the calculation of the sums payable to the Minister under this paragraph the contractor shall be entitled to deduct from the gross amounts received any sums which he is under agreement to pay to any other party other than a subsidiary or associated company concerning the grant of rights in patents or licences."

(32) The following table shows the Respondent's turnover of engine sales and repairs, and the net amounts received from the afore-mentioned licence agreements, for the years 1946 to 1955 inclusive:

	<i>Total turnover on engine sales and repairs</i>	<i>Receipts from licence agreements</i>	
		<i>Lump sums</i>	<i>Royalties</i>
	£	£	£
1946	16,220,000	60,001	—
1947	19,225,000	60,000	2,070
1948	19,398,000	133,001	4,491
1949	23,469,000	119,334	59,114
1950	23,781,000	48,667	154,001
1951	30,083,000	—	195,657
1952	46,825,000	61,667	277,973
1953	53,519,000	232,401	449,347
1954	63,177,000	500,000	764,937
1955	61,437,000	—	547,487

Under the terms of the afore-mentioned Annexure R-R incorporated in agreements between the Respondent and the United Kingdom Government, one-third of the sums derived under the afore-mentioned licence agreements, both lump sums and royalties, was paid to the United Kingdom Government.

(33) The chairman's statement dated 4th July, 1947, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1946, contains, *inter alia*, the following references:

"A reduction in the aero turnover was only to be expected. We are, however, still receiving valuable orders and contracts from government departments, and the works have been kept extremely busy throughout the year. In addition to this domestic business, every effort has been made to increase our export trade. An expert force has been actively employed travelling throughout the world, following up existing enquiries and originating new proposals. These efforts have been crowned with considerable success and we have built up a sound foreign trade which is steadily expanding.

A considerable demand has arisen for licences to manufacture various models of our engines. This is all to the good as it reflects the appreciation of the merits of what we make, but it likewise calls for extensive initial education and continuing contact with the licensee to keep him abreast of developments.

Our extensive study and experience of gas turbine engines had placed us in a favourable position in this new field, but, as soon as it became apparent what part this new form of propulsion was to play in the future, others were not slow to take up the construction of engines of this class.

There are many competent and experienced engine builders now in this field and the prospects of this Company largely depend on keeping well ahead of its competitors.

An enormous amount of development work has been done in the year under review both in solving problems and improving manufacturing technique of existing types of engines, and in creating new models capable of more power and greater efficiency.

In considering the future prospects of the Company, it is wise to be very guarded. So much depends on circumstances over which we have no control. Our order position in both spheres of the Company's activities is satisfactory and shows expansion in some desirable directions.

The condition of our research and development is sound and continues to show commendable enterprise. Numerous interesting and valuable projects are in hand and we continue to look a long way ahead."

(34) The chairman's statement dated 29th June, 1948, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1947, contains, *inter alia*, the following references:

"In spite of this, the Company has had a successful year. The excellent design and quality of the Company's motor cars have enhanced our reputation both at home and abroad, and the demand for the product has been most satisfactory. Every effort has been made to increase our overseas business and, in the face of import restrictions imposed by many Foreign Governments, considerable success has been attained.

Development, particularly in respect of those features peculiar to export business, is being constantly pursued and there is no reason to doubt that it will create an increased enquiry for our cars.

The year has seen a very large expansion in overseas business. A network of commercial representation throughout the world has been built up and Rolls-Royce technicians, well qualified to deal with the special problems of particular countries, pay regular visits to the users and prospective users of our engines.

Recognition of the Company's position in the development of the gas turbine is shown by the negotiation of manufacturing licences in the U.S.A., South America and Australia.

Lastly, Battles of Britain may vary—Hurricanes and Spitfires have gone down in history. The battle now is being fought in the field of export, and your Company knows no reason to feel ashamed of its contribution which, during the last year, amounted to five million pounds."

(35) The chairman's statement dated 22nd June, 1949, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1948, contains, *inter alia*, the following references:

"I have referred to the considerable expansion which has taken place in the export sales of the Aero Division. In this field it gives me particular pleasure to refer to the good relations which are being built up with those who are operating our products and also with those to whom we have granted manufacturing licences. In particular I would refer to our American friends, Pratt & Whitney Aircraft, with whom we have been working closely on a programme of development work shared between our two companies.

The Belgian Government is now amongst those who have acquired manufacturing rights, while other governments are interested in extending existing arrangements. You will no doubt have read in the press that since the end of the financial year under review we have invested some £50,000 in the Commonwealth Aircraft Corporation Proprietary Limited, Australia—a token of our confidence in the future technical development of that country.

Whatever the future may hold, however, your Board is steadily pursuing the policy of ever improving the technical excellence of the Company's products."

(36) The chairman's statement dated 26th June, 1950, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1949, contains, *inter alia*, the following references:

"The Aero Division has experienced a further increase in activity, the outstanding feature of which has been the volume of business in overseas markets.

The complex nature of the new family of engines of which the Avon is the forerunner places a high premium on fundamental research and design facilities, and it continues to be your Company's policy to foster and strengthen these particular activities in parallel with the subsequent development work which follows the prototype stage. The rate of technical development has, until recently, presented problems to the production departments, but the last year has seen substantial progress in this field also. There is still scope for further ingenuity if the production costs of the engines of the future are to stand comparison with those of the established piston engines.

Last year I referred to our collaboration with Messrs. Pratt & Whitney, and I am glad to say that this has continued most satisfactorily. The engines which Pratt & Whitney have developed from Rolls-Royce designs are already giving a good account of themselves in the Grumman "Panther" operated by the U.S. Navy.

Nearer home, we continue to make a practical contribution to Western Union resources and Belgium and France have both made progress in the local manufacture of our engines.

Your Managing Director, Mr. E. W. Hives, has recently returned from an extended tour through the Middle East to Australia, where your Company has now established a very happy relationship with Commonwealth Aircraft Corporation, who have been nominated by the Australian Government to manufacture certain of our products under licence. The small investment which we made in this Company a year ago is already showing a satisfactory return.

During the year we have dealt with requests from many countries for advice and assistance in the establishment and use of their own engineering resources, and we believe that in these various conversations we have established considerable goodwill for the future."

(37) The chairman's statement dated 29th June, 1951, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1950, contains, *inter alia*, the following references:

"The major expansion plan for aero engines in this country is based on the Rolls-Royce "Avon". The Ministry of Supply is arranging to place direct contracts with the Bristol Aeroplane Company Limited, D. Napier & Son Limited, and possibly with the Standard Motor Company Limited, to manufacture these engines. On our side, we are handing over unreservedly not only our designs but also our manufacturing technique and experience for the use of the nation. We have very friendly relations with all of these companies whereby we pool our manufacturing knowledge.

In addition to the increased demands for our products in this country, expansion is also planned in countries where engines are built under licence. In the U.S.A. it has been announced that the Chrysler Corporation will work with Pratt & Whitney to manufacture the J.48, which is a licensed engine. Increased demands are also being made on our licensees in Australia, Belgium and France.

It should be appreciated that in dealing with licensees the flow of information is by no means one way. In the case of Pratt & Whitney we have benefited by the original work which they have carried out and passed on to us. Engines of their manufacture have given excellent service in the U.S.A.A.F. in Korea.

This Division, therefore, goes forward with no lack of orders or potential orders. It cannot, however, be emphasised too strongly that this is a position which has only been achieved and can only be maintained by constant effort on the part of those responsible for design and development, and by the most rigid adherence to the standards of engineering which are part of the Company's tradition.

It is unfortunate that political considerations have prevented us from adding to the number of countries in which our products have become established. We have, however, actively maintained the technical service to existing customers and

we are ready, when circumstances permit, to follow up with our later products.

The form of the Profit and Loss Account shows only one slight change from last year, in that the revenue from royalties is shown as a separate item. This step has been taken in view of the increased revenue from this source which may be expected to accrue during the currency of the present licence arrangements."

(38) The chairman's statement dated 26th June, 1952, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1951, contains, *inter alia*, the following references:

"We have this year obtained, against American competition, an order for a very considerable number of Nene engines for training aircraft to be built in Canada. This order probably represents the largest single dollar order ever secured by the British Aircraft Industry. One of the conditions attached to this order was that we should establish facilities in Canada which would be capable in an emergency of manufacturing Nene engines and spares, and to this end we are in the process of establishing a factory near Montreal for the assembly and — with the help of existing Canadian facilities — the manufacture of Nene engines.

Our existing arrangements in Australia have continued to operate satisfactorily. The Australian Government continue to manufacture components for Merlin engines in their own factory; Commonwealth Aircraft Corporation are in production on the Nene engine and are well under way towards producing Avon engines.

Merlin engines have continued to give a good account of themselves in civil operation, and we have built up experience which will be of great value to us as our commitments increase with the operation of the Dart/Viscount and the Avon/Comet. We fully realize the obligations to stand behind these engines and provide service and spares on a world-wide basis. In this, the factory which we are building in Canada will, of course, play its part. We are now considering how we shall meet similar obligations in Australia.

Our licensees, Pratt & Whitney in America, the Hispano Suiza Company in France, and the F.N. Company in Belgium, are all now in quantity production, and we may expect a further increase in royalty receipts from these sources. Our relations with our licensees continue to be most friendly, and we look forward to a continuing association with them.

It is as well to remember that the unique reputation which your Company has built up and held for so many years, with widely varying products, is not due to any monopoly in inventions. It is the result of the unequalled skill and experience of your executive officers; to the profound knowledge and enthusiasm of the staff, and eventually to the pride and loyalty of all the Rolls-Royce workers. To them go our grateful thanks."

(39) The chairman's statement dated 18th June, 1953, attached to the statement of accounts and directors' report of the Respondent for the year ended 31st December, 1952, contains, *inter alia*, the following references:

"A part of our obligation is, that we must design and manufacture the best engines, and that it must also be possible to have them manufactured in other factories in case of emergency.

In connection with the NATO off-shore purchases by the U.S.A., your Company is fortunate in that the aircraft that have been chosen for manufacture, both in this country and on the Continent, are fitted with our engines. Our licensees in France and Belgium will receive direct contracts for our engines.

During the year the Swedish Government has taken a licence to manufacture the Avon engine. This engine has been chosen to power the latest fighter designed and manufactured in Sweden.

In the U.S.A., engines built by our licensees, Pratt & Whitney Aircraft, are going into service in the U.S.A. Air Corps. In France, the new Mystère fighter is fitted with a Rolls-Royce engine manufactured by our licensees, Hispano Suiza, Paris.

We have continued to study the needs of all export markets which are open to us and particularly the European and American Continents. The introduction of the Continental Bentley has been welcomed by many Bentley owners of long standing, both at home and abroad.

Our products — aero engines, motor cars and oil engines — are in use in most countries throughout the world. . . .

The Commonwealth Aircraft Company at Melbourne are producing Rolls-Royce engines, both the Nene and the Avon, under licence from us.

The demand which your Company is experiencing for its products both Military and Civil, at home and overseas, can only be attributed to the emphasis which has always been placed on the importance of design and development and the equal importance of moving forward in clearly defined steps, each step being based on sound knowledge and experience. It is worth recording that this policy is recognised by the official historians of the last war. In his chapters on British War Production, Professor Postan writes:—

‘By comparison with the vast resources of the American design departments, those of British firms were diminutive. Rolls-Royce was probably alone among the British airframe and aero engine firms in possessing organisation for design and development of a size comparable to the American.’

It cannot be repeated too often that the future of our business depends upon the continuation of this policy. It is not merely the size of the organisation which will achieve results, but it is the quality of the engineers. It is our constant endeavour to select and train people in the art of sound thinking so that with the use of modern equipment we may continue to develop products which will maintain the standard expected of any article bearing the name of Rolls-Royce.”

(40) The chairman’s statement dated 9th June, 1954, attached to the statement of accounts and directors’ report of the Respondent for the year ended 31st December, 1953, contains, *inter alia*, the following references:

“It is also satisfactory to record a further increase in our revenue from royalties; almost all of this comes from our foreign licensees.

The demands which have been made on the company’s financial resources in order to sustain this steadily expanding business are clearly demonstrated by the figures in the consolidated balance sheet. Debtors and stocks together show an increase of nearly £5 million. Nearly £1½ million has been spent on fixed assets during the year, and there were outstanding commitments at the end of the year of more than £1 million. This figure, of course, only refers to firm contracts and does not include the many schemes involving capital expenditure which must of necessity be carried through in the near future.

Our capital reserves have again been increased by sums received from the sale of licences. The tax position in relation to these receipts is the subject of negotiation with the Inland Revenue, but as it may be some time before we know the outcome, it has been deemed prudent to make provision for a possible tax liability.

The steadily increasing demand for the company’s products both at home and abroad, particularly in the aero engine field, calls for a corresponding increase in working capital. . . .

Most of our foreign licensees have been very active, and the increasing volume of their production is reflected in the substantial increase in royalties which we have received. We have negotiated new licence agreements with some of our existing licensees to permit the manufacture of current types of engine, and in addition we have entered into an agreement with the Westinghouse Electric Corporation of America. This agreement should lead to a long-term collaboration which will be of mutual benefit. Pratt & Whitney continue to be our licensees in America for our centrifugal-type jet engines which are still being produced in quite large numbers.

We have made steady progress with our many research and development projects. Much of our effort has been directed to the development of reheat systems as a source of additional power for fighter aircraft. The development of the Conway engine for operation over long distances has gone on steadily, and this engine is scheduled for installation in the four-engined Vickers-Armstrongs aircraft, the V. 1000, which is a military transport. All of this work, and the work on new projects which must be tackled to keep pace with changing military requirements, goes on in parallel with the task of improving the performance and

mechanical reliability of the existing types of engine on which our fighting services have to depend today. While we accept that our first duty is to provide the best possible equipment for our own defence forces, we are equally conscious of our national responsibility to exploit our technical knowledge and skill to the full extent that it can be made available for civil and foreign military requirements. The substantial export business to which I have already referred results from the energetic pursuit of this policy, and not only does it bring in much needed foreign currency, but it also enables the United Kingdom government to recover at least a contribution towards the substantial development expenditure which it has to invest in defence projects.

It is interesting to record that our products are in use in 39 countries. This situation has only been achieved by most energetic attention to the requirements to both customers and prospective customers—a task which involves much travelling by directors and senior officials of the Company. During 1953 some eighty visits were paid to thirty-four different countries in fulfilment of this policy.”

(41) The chairman’s statement dated 10th June, 1955, attached to the statement of accounts and directors’ report of the Respondent for the year ended 31st December, 1954, contains, *inter alia*, the following references:

“Our licensees also continued to be active, and there has been a substantial increase in the royalties which we have received from them.

Our total personnel employed in the United Kingdom showed little change, and is still in excess of 35,000. The competition for engineering personnel, both for production and development functions, continues to be severe, and has emphasised the importance of the schemes for recruitment and training to which we have always given considerable attention.

On the commercial side the production of Nene engines for the Royal Canadian Air Force has continued and will be concluded during 1955. A number of these engines have been produced at our Canadian factory in Montreal at the request of the Canadian Government in order to establish a source of production in Canada. The supply of production engines and parts to our licensees, particularly in Australia, Belgium and Sweden has been substantial and illustrates the export business which accrues from licences.

Apart from production, we are pleased to be able to report that we have delivered prototype engines for fitting to substantial numbers of Royal Air Force and naval aircraft, as well as for prototype aircraft in America, France, Sweden, Holland and Italy. It is on the success of these aircraft that our future production depends.

Our long-term policy initiated at the end of the war of cultivating the civil market is now bearing fruit in the Dart, which is the only propellor turbine in civil air line operation in the world. In the Viscount aircraft, which has already been ordered by seventeen different air lines, by foreign governments and by private companies for executive use, it has accumulated over 300,000 engine-hours flown in scheduled service and this figure is increasing at the rate of over 20,000 hours a month. It is particularly gratifying that it has been possible to follow up last year’s sale of Viscounts to Canada with a sale to America.”

4. It was contended on behalf of the Respondent:

- (i) that the trade carried on by the Respondent was correctly described in the Income Tax assessment under appeal as that of “manufacturers of motor cars and aero engines”, and that the sale of “know-how” formed no part of the Respondent’s trade;
- (ii) that the metallurgical engineering research upon which the Respondent had throughout its life been engaged was at all times directed exclusively to the more efficient production of motor cars and aero engines and not at all to the earning of profits by selling or licensing the results of that research;
- (iii) that the lump sums paid to the Respondent under the provisions of the licence agreements hereinbefore referred to related to the sale by the Respondent to the licensees of a capital asset referred to

- throughout the case as "know-how", and accordingly such sums fell to be excluded from the computation of the profits and gains of the Respondent for the periods relative to the assessments under appeal;
- (iv) that a multiplicity of sales of portions of a fixed capital asset could not of itself convert that asset, or any part of it, into a revenue or trading asset;
- (v) that in any event the assessments, being estimated amounts, should be amended in accordance with the accounts of the Respondent's trade or business for the periods relative thereto;
- (vi) that the appeal should be allowed.

5. It was contended on behalf of the Crown:

- (i) that the whole of the sums received by the Respondent under the licence agreements hereinbefore referred to were normal receipts of a revenue nature of the trade or business carried on by the Respondent and accordingly fell to be included in computing the profits or gains of the Respondent for the periods relative to the assessments under appeal;
- (ii) that the said assessments, being in estimated amounts, should be amended in accordance with the accounts of the Respondent for the periods relative thereto;
- (iii) that the appeal should be dismissed.

6. We, the Commissioners who heard the appeal, gave our decision in writing on 24th October, 1956, to both parties in the following terms:

"1. This is an appeal by Rolls-Royce, Ltd., against the following assessments to Income Tax made under Case I of Schedule D.

<i>Year</i>	<i>Amount of assessment</i>
1948-49	£1,300,000
1949-50	£1,200,000
1950-51	£1,800,000
1951-52	£1,500,000
1952-53	£2,300,000
1953-54	£2,500,000
1954-55	£4,800,000

The grounds of the appeal are that in computing the profits or gains of the Appellant [Rolls-Royce] for the periods relative to the assessments under appeal, lump sums paid to and received by the Appellant by virtue of certain licensing agreements (conveniently listed in [Exhibit 'T']⁽¹⁾) have been included contrary to law, such lump sum payments being of a capital nature.

2. The Appellant also appeals against assessments to Excess Profits Tax, Excess Profits Levy and Profits Tax as follows:

<i>Chargeable Accounting Period</i>	<i>Gross Amount of Assessment</i>	<i>Duty Assessed</i>
<i>Assessment to Excess Profits Tax</i>		
12 months ended 31st December, 1945	£ 66,667	£ 66,667
<i>Assessments to Excess Profits Levy</i>		
12 months ended 31st December, 1952	£ 800,000	£240,000
12 " " " " 1953	£2,000,000	£600,000
<i>Assessments to Profits Tax</i>		
12 months ended 31st December, 1947	£1,155,000	£150,000
12 " " " " 1948	£1,000,000	£134,500

(1) Not included in the present print.

9 months ended 30th September, 1949	£1,500,000	£175,875
3 " 31st December, 1949	£ 500,000	£ 61,500
12 " " " 1950	£2,000,000	£269,000
12 " " " 1951	£2,000,000	£384,000
12 " " " 1952	£2,500,000	£182,500
12 " " " 1953	£2,500,000	£202,500

The grounds of these appeals are similar, *mutatis mutandis*, to the grounds of appeal against the Income Tax assessments.

3. The case for the Appellant is that at all material times it carried on the trade of manufacturers of motor cars and aero engines, being properly so described in the notices of assessment relative to the appeal. In the course of its business it had acquired a vast store of knowledge and secret information relating to its secret processes of manufacture, referred to throughout the case as 'know-how', which represented a fixed capital asset of the Appellant's trade, but it had never been any part of the policy of the Appellant to make inventions and discover secret processes with a view to the earning of profits by realising its rights in those inventions and processes. On 13th February, 1946, the Appellant entered into an agreement with the Government of China (hereinafter called 'the China agreement') whereby, *inter alia*, the latter was licensed to manufacture for itself certain of the Appellant's aero engines. As a separate part of this agreement, the Appellant undertook, *inter alia*, to make available to the Government of China its 'know-how' relating to the particular aero engines covered by the agreement, in consequence of which it was confidently expected that the time which must necessarily elapse before production by the Government of China became effective would be considerably reduced and the resulting product of higher quality than might otherwise have been the case. Provision was also made for the transfer of patents if necessary, though in fact the Appellant had no Chinese patents. The consideration for the agreement took the form of a lump sum and royalties on the engines that were made abroad. The Appellant concedes that sums received by way of royalties under the agreement are taxable income in its hands, so also are any sums received for the sale of patent rights properly so-called by reason of the express provisions of the Finance Act, 1945, though it is generally agreed by both parties that only a very small value could be placed upon these patents. It was, however, contended for the Appellant that the lump sum paid and received under the China agreement, apart from a small amount attributable as aforesaid to patent rights, represented a capital receipt in respect of 'know-how' which did not fall to be included in the profits or gains of the Appellant for the periods relative to the assessments under appeal. In support of this contention, reliance was largely placed upon two cases cited to us, viz., *Handley Page v. Butterworth*, 19 T.C. 328; and *Evans Medical Supplies, Ltd. v. Moriarty*, [1956] 2 All E.R. 706; 37 T.C. 540.

4. It is further contended for the Appellant that if the subject-matter with which we are concerned, i.e., 'know-how', is initially a fixed capital asset, then mere multiplicity of transactions in it does not convert it into a revenue or trading asset in the absence of other facts which suggest that there has been a conversion or that some new trade has been set up. It is said that there has been no such change of circumstances affecting the Appellant's 'know-how' and therefore, with regard to the remainder of the agreements entered into by the Appellant for, generally speaking, licensing the manufacture of aero engines and the provision of 'know-how' in connection therewith, the lump sums, by whatever name they are called, paid to and received by the Appellant thereunder were also receipts of a capital nature.

5. The case for the Crown can be summarised as follows:

(1) It is not contended that a new trade was set up by the Appellant between the years 1946 and 1954 which consisted of dealing in patents and secret processes; but it is said that it had become a part of the normal trade or business of the Appellant, in order fully to exploit the commercial possibilities of aero engines of its design in circumstances where it would otherwise be unable to sell them, to enter into agreements for the production of its engines by other persons under licence on payment of a lump sum or technical liaison fee and/or a royalty per engine manufactured.

(2) That, in order to permit the manufacture of engines so licensed to commence at the earliest possible moment and to earn the maximum amount in royalties, it was the normal practice of the Appellant to furnish the licensee on payment with the technical knowledge and information required to manufacture such engines, i.e., the 'know-how'.

(3) It was also part of the normal trade or business of the Appellant, in association with the Ministry of Supply, to exploit commercially and to the best advantage technical knowledge and manufacturing information acquired by the Appellant in the process of research into the design and production of aero engines, incorporating that technical knowledge and information, for reward.

(4) That, on the facts of the case, it was also part of the normal trade or business of the Appellant, particularly when licensing the manufacture of one of the Appellant's engines, to agree with the licensee to a mutual exchange of information obtained in the course of manufacturing the licensed engine; thus, the lump sums received by the Appellant under the various agreements which are the subject-matter of this appeal were received by the Appellant in the normal course of its trade or business and not merely for parting with a capital asset.

(5) The agreements provide for the licensee to make engines and for the transfer to the licensee of technical knowledge and information to enable him to do so; but they also provide for the licensee to receive certain other benefits and advantages, e.g., some of his personnel to be trained by the Appellant, the Appellant's engineers to assist in setting up the production in the country of the licensee, the Appellant to act as agent in the purchase of raw materials and equipment for the job, the grant of an option for future engines: any part of the lump sums attributable to such services cannot be transfers of capital.

(6) Further, in so far as the lump sum payments were received by the Appellant in respect of the transfer of technical information or of manufacturing knowledge, they did not arise from sales of property but from the provision of a service.

(7) When the whole of the transactions are looked at as a whole, each agreement is seen to be merely a trading convention between the Appellant and the licensee; and the payments, whatever form they take, are profits arising from the trade or business between the Appellant and the licensee, which was to be regulated by that convention.

6. Upon consideration of the evidence adduced and the arguments addressed to us on behalf of the parties, we are of the opinion that the case for the Appellant succeeds and the appeal must be allowed. We adjourn the appeal for the agreement of figures based on this our decision in principle, on the footing that (1) all lump sums, however described, received by the Appellant under the aforesaid agreements fall to be treated as capital receipts not forming part of the profits or gains of the Appellant for the periods relative to the assessments under appeal; and (2) the value of the patent rights included in the lump sums so received by the Appellant, being very small and wholly

indeterminate, no amounts are to be deducted from such lump sums in respect thereof.

7. With regard to the appeals against the Excess Profits Tax, Excess Profits Levy and Profits Tax assessments, no separate evidence having been adduced nor additional argument addressed to us, our decision must follow that given above in the case of the Income Tax appeal. All these appeals are therefore allowed in principle and adjourned for agreement of figures between the parties."

On 29th January, 1958, figures having been agreed between the parties on the basis of our decision in principle, we determined the appeals as follows:

1948-49 assessment reduced to	£988,075	(agreed capital allowances £255,935)
1949-50	"	" £1,067,473
1950-51	"	" £1,687,858
1951-52 assessment increased to	£1,527,991	" £240,103
1952-53	"	" £546,574
1953-54	"	" £673,688
1954-55 assessment reduced to	£4,557,115	" £845,421
		" £532,859
		" £655,073

7. Immediately after the determination of the appeal dissatisfaction therewith as being erroneous in point of law was expressed to us on behalf of the Crown, and in due course we were required to state a Case for the opinion of the High Court of Justice pursuant to the Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

8. The question of law for the opinion of the High Court of Justice is whether, on the facts found by us as hereinbefore set forth, there was evidence upon which we could properly arrive at our decision, and whether, on the facts so found, our determination of the appeal was correct in law.

N. F. Rowe	} Commissioners for the Special Purposes of the Income Tax Acts.
R. W. Quayle	

Turnstile House,
94-99, High Holborn,
London, W.C.1.
15th May, 1959.

(2) *Commissioners of Inland Revenue v. Rolls-Royce, Ltd.*

(3) *Commissioners of Inland Revenue v. Rolls-Royce, Ltd.*

(4) *Commissioners of Inland Revenue v. Rolls-Royce, Ltd.*

These cases related respectively to assessments to Excess Profits Tax for the chargeable accounting period ending 31st December, 1945, Excess Profits Levy for the chargeable accounting periods ending 31st December, 1952, and 31st December, 1953, and Profits Tax for the chargeable accounting periods ending 31st December, 1947, 31st December, 1948, 30th September, 1949, 31st December, 1949, 31st December, 1950, 31st December, 1951, 31st December, 1952, and 31st December, 1953.

The facts, the contentions of the parties and the decisions of the Commissioners were the same as in the first case.

The cases came before Pennycuik, J., in the Chancery Division on 24th, 25th, 26th and 27th May, 1960, when judgment was given against the Crown, with costs.

Mr. Roy Borneman, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. C. N. Beattie for the Company.

Pennycuik, J.—This is an appeal by the Crown against a decision of the Special Commissioners upon appeals by Rolls-Royce, Ltd., from assessments under Case I of Schedule D for the years 1948–49 to 1954–55 inclusive. The ground of appeal was that in computing the profits of the Company for those years there were included certain payments under a number of agreements with foreign governments or companies which the Company contended were of a capital nature. The Special Commissioners allowed the appeals and adjusted the assessments accordingly.

The facts as found by the Special Commissioners may be summarised as follows. The Company was incorporated in 1906 and has ever since carried on the trade of manufacturing and selling motor cars. During the first war the Company began to manufacture aircraft engines, and the manufacture and sale of aircraft engines has become the larger part of the Company's trade. For the purposes of its trade the Company has been engaged in metallurgical research and in the discovery and development of engineering techniques and secret processes, and in the result has acquired a fund of technical knowledge of which only a comparatively small part is capable of forming the subject-matter of patent rights. This technical knowledge is commonly called "know-how", and it will be observed that the Commissioners use the expression "know-how" as covering secret processes. With one or two exceptions due to the exigencies of the period immediately before 1939, and to the second war itself, the Company did not, until after 1945, turn its "know-how" to account, except in its own manufacturing trade. During the period from 1946 to 1953, however, being the period to which the assessments under appeal relate, the Company entered into a number of agreements with foreign governments and companies, the basic provision of which was that in consideration of a lump sum payment the Company undertook to supply the other party with drawings and information necessary to enable that party to manufacture specified types of aircraft engines. The Company did not initiate proposals for these agreements, which generally appear to have arisen from the policy of foreign governments that aircraft engines should be manufactured in their own territories.

Agreements of this character were made between the Company and governments or companies in China, France, the Argentine, the United States of America, Belgium, Australia and Sweden. All of those agreements, in addition to one or two others not directly material, are summarised in the Case Stated. Each of the agreements contained a number of other provisions beyond the basic provision indicated above and they are by no means identical in their terms. In one agreement—for example, that with Australia—the Company received, in addition to the lump sum, an annual payment described as a "technical liaison fee". Neither party, however, has contended that for the present purposes any distinction falls to be made between payments in one or other of the agreements, and it would not, therefore, be useful for me to refer to all the agreements in detail. I will confine myself to reading certain of the provisions of the first agreement set out in the Case Stated, namely, that dated 13th February, 1946, with the Republic of China. That agreement (see paragraph 3 (9) of the Case Stated⁽¹⁾) contains a recital in the following terms:

(1) See pages 447–50, *ante*.

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"Whereas Rolls-Royce are designers of aircraft engines (hereinafter defined in the schedule attached) and have agreed to license the Commission to manufacture the same and to supply the drawings and information necessary therefor to the extent hereinafter stated upon the terms and conditions hereinafter provided",

and provided, *inter alia*, as follows :

"1. Selection of Type"

—and then there is a provision under which the Commission is to

"select and designate the desired type of jet engine and notify Rolls-Royce of such selection . . . 2. Rolls-Royce will supply the Commission with the complete drawings and manufacturing and engineering data and information adequate and reasonably necessary to enable the Commission to manufacture said engine referred to in Clause One above. These engines will be the type numbered as set out in the schedule hereto which are the latest mark of the type referred to, of which the British Government has allowed particulars to be given at this date. Improvements of the engine defined in Clause One will be supplied to the Commission as they are released by the British Government and shall be included and governed by this numbered Clause and Clause Ten."

Then follow provisions as to what the manufacturing data and information shall include. Then clause 3 :

"The Commission shall pay Rolls-Royce the following consideration for the rights granted hereunder:—A capital sum of fifty thousand pounds sterling to be paid as follows: (i) On the signing of the contract, Twenty Thousand Pounds Sterling. (ii) On June 30, 1946, Twenty Thousand Pounds Sterling. (iii) On the complete delivery of drawings, data, and information referred to in Clause Two, Ten Thousand Pounds Sterling."

There follow a number of provisions, all of which are important in the construction of the agreement as a whole, but which it is not necessary to read in full in this judgment. Clause 5 provides for the form of drawings; clause 6 for royalties; clause 7 for the minimum royalty; and clause 10 is in these terms :

"Rolls-Royce will fully advise the Commission from time to time as to improvements and modifications in the manufacture and design of the engine referred to in Clause One, the subject of this Licence as and when the British Government permit Rolls-Royce so to do, provided always that this obligation shall be suspended if the royalties in any year are in arrears, but shall be revived when the royalty payments have been made up to the annual minimums referred to in the contract."

Then clause 11 provides, in effect, that engines are only to be used in Chinese owned or operated aircraft. Clause 12 :

"The Commission shall not use in engines other than engines referred to in Clause One any parts manufactured from the drawings to be supplied hereunder."

Clause 13 provides :

"All Drawings and information supplied hereunder shall be kept secret by the Commission who shall not disclose the same or any part thereof to any other person or corporation, but this Clause shall not prevent such disclosure as is necessary to enable the engines to be manufactured by the Commission, or to enable them to be installed or repaired."

Clause 14 provides in some detail that Rolls-Royce

"will receive into their Works or Plants personnel appointed by the Commission with a view to instructing them in the construction of the engines . . .".

Clause 20 provides :

"All obligations of Rolls-Royce hereunder shall cease at the expiration of five years from the date hereof; provided that at the end of the first five years, the Commission has the right to extend this Contract for another period of five years if desired. During these two periods of five years each if the Commission exercise the option to acquire additional licence for any newer type of Rolls-Royce Engine the obligations of both parties will then be defined; but any royalty paid

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on the newer engine manufactured by the Commission shall be counted together with the royalty on the type of engine referred to in Clause One being manufactured”

Clause 21 :

“As from the date when the obligations of the Commission cease hereunder as aforesaid, the Commission shall be entitled to continue to construct the said type of engine without Rolls-Royce being paid royalty”

and there follow certain provisions as to patents. Clause 22 is concerned with patents. Clause 23 :

“If within five years from the signature of this contract Rolls-Royce puts in series production a new type of Gas Turbine aircraft engine and the British Government has authorised the manufacture of the engine in the conceded Territory Rolls-Royce will not license anyone to manufacture the engine in the conceded territory without first giving the Commission an option to acquire a licence to do so.”

As I have said, the other agreements for the most part contain the same basic provisions, but the terms of them are widely different in certain respects. The question which has arisen on this appeal is whether the lump sums payable under clause 3 of the Chinese agreement and the similar lump sums payable under the other agreements represent trade receipts of the Company and as such must be brought into account in the computation of its profits.

The contentions of the parties before the Commissioners are set out in the Case Stated as follows⁽¹⁾ :

“4. It was contended on behalf of the Respondent: (i) that the trade carried on by the Respondent was correctly described in the Income Tax assessment under appeal as that of ‘manufacturers of motor cars and aero engines’, and that the sale of ‘know-how’ formed no part of the Respondent’s trade; (ii) that the metallurgical engineering research upon which the Respondent had throughout its life been engaged was at all times directed exclusively to the more efficient production of motor cars and aero engines and not at all to the earning of profits by selling or licensing the results of that research; (iii) that the lump sums paid to the Respondent under the provisions of the licence agreements hereinbefore referred to related to the sale by the Respondent to the licensees of a capital asset referred to throughout the case as ‘know-how’, and accordingly such sums fell to be excluded from the computation of the profits and gains of the Respondent for the periods relative to the assessments under appeal; (iv) that a multiplicity of sales of portions of a fixed capital asset could not of itself convert that asset, or any part of it, into a revenue or trading asset”.

“5. It was contended on behalf of the Crown: (i) that the whole of the sums received by the Respondent under the licence agreements hereinbefore referred to were normal receipts of a revenue nature of the trade or business carried on by the Respondent and accordingly fell to be included in computing the profits or gains of the Respondent for the periods relative to the assessments under appeal”.

Then the Commissioners gave their decision in writing on 24th October, 1956, in the following terms. After setting out the particulars of the assessments, they say⁽²⁾ :

“1 The grounds of the appeal are that, in computing the profits or gains of the Appellant [Rolls-Royce] for the periods relative to the assessments under appeal, lump sums paid to and received by the Appellant by virtue of certain licensing agreements . . . have been included contrary to law, such lump sum payments being of a capital nature 3. The case for the Appellant is that at all material times it carried on the trade of manufacturers of motor cars and aero engines, being properly so described in the notices of assessment relative to the appeal. In the course of its business it had acquired a vast store of knowledge and secret information relating to its secret processes of manufacture, referred to throughout the case as ‘know-how’, which represented a fixed capital asset of the Appellant’s trade, but it had never been any part of the policy of the Appellant

(1) See pages 469–70 *ante*. (2) See pages 470–72 *ante*.

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to make inventions and discover secret processes with a view to the earning of profits by realising its rights in those inventions and processes. On 13th February, 1946, the Appellant entered into an agreement with the Government of China (hereinafter called 'the China agreement') whereby, *inter alia*, the latter was licensed to manufacture for itself certain of the Appellant's aero engines. As a separate part of this agreement, the Appellant undertook, *inter alia*, to make available to the Government of China its 'know-how' relating to the particular aero engines covered by the agreement, in consequence of which it was confidently expected that the time which must necessarily elapse before production by the Government of China became effective would be considerably reduced and the resulting product of higher quality than might otherwise have been the case. Provision was also made for the transfer of patents if necessary, though in fact the Appellant had no Chinese patents. The consideration for the agreement took the form of a lump sum and royalties on the engines that were made abroad. The Appellant concedes that sums received by way of royalties under the agreement are taxable income in its hands, so also are any sums received for the sale of patent rights properly so-called by reason of the express provisions of the Finance Act, 1945, though it is generally agreed by both parties that only a very small value could be placed upon these patents. It was, however, contended for the Appellant that the lump sum paid and received under the China agreement, apart from a small amount attributable as aforesaid to patent rights, represented a capital receipt in respect of 'know-how' which did not fall to be included in the profits or gains of the Appellant for the periods relative to the assessments under appeal. In support of this contention, reliance was largely placed upon two cases cited to us, *viz.*, *Handley Page v. Butterworth*, 19 T.C. 328; and *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540."

At that stage the *Evans Medical Supplies* case had been heard before Upjohn, J., but had not reached the Court of Appeal.

"4. It is further contended for the Appellant that if the subject-matter with which we are concerned, i.e., 'know-how', is initially a fixed capital asset, then mere multiplicity of transactions in it does not convert it into a revenue or trading asset in the absence of other facts which suggest that there has been a conversion or that some new trade has been set up. It is said that there has been no such change of circumstances affecting the Appellant's 'know-how' and therefore, with regard to the remainder of the agreements entered into by the Appellant for, generally speaking, licensing the manufacture of aero engines and the provision of 'know-how' in connection therewith, the lump sums, by whatever name they are called, paid to and received by the Appellant thereunder were also receipts of a capital nature. 5. The case for the Crown can be summarised as follows: (1) It is not contended that a new trade was set up by the Appellant between the years 1946 and 1954 which consisted of dealing in patents and secret processes; but it is said that it had become a part of the normal trade or business of the Appellant, in order fully to exploit the commercial possibilities of aero engines of its design in circumstances where it would otherwise be unable to sell them, to enter into agreements for the production of its engines by other persons under licence on payment of a lump sum or technical liaison fee and/or a royalty per engine manufactured. (2) That, in order to permit the manufacture of engines so licensed to commence at the earliest possible moment and to earn the maximum amount in royalties, it was the normal practice of the Appellant to furnish the licensee on payment with the technical knowledge and information required to manufacture such engines, i.e., the 'know-how'. (3) It was also part of the normal trade or business of the Appellant, in association with the Ministry of Supply, to exploit commercially and to the best advantage technical knowledge and manufacturing information acquired by the Appellant in the process of research into the design and production of aero engines, incorporating that technical knowledge and information for reward. (4) That, on the facts of the case, it was also part of the normal trade or business of the Appellant, particularly when licensing the manufacture of one of the Appellant's engines, to agree with the licensee to a mutual exchange of information obtained in the course of manufacturing the licensed engine; thus, the lump sums received by the Appellant under the various agreements which are the subject-matter of this appeal were received by the Appellant in the normal course of its trade or business and not merely for parting with a capital asset. (5) The agreements provide for the licensee to make engines and for the transfer to the licensee of technical knowledge and information to enable him to do so; but they also provide for the licensee to receive certain

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other benefits and advantages, e.g., some of his personnel to be trained by the Appellant, the Appellant's engineers to assist in setting up the production in the country of the licensee, the Appellant to act as agent in the purchase of raw materials and equipment for the job, the grant of an option for future engines: any part of the lump sums attributable to such services cannot be transfers of capital. (6) Further, in so far as the lump sum payments were received by the Appellant in respect of the transfer of technical information or of manufacturing knowledge, they did not arise from sales of property but from the provision of a service. (7) When the whole of the transactions are looked at as a whole, each agreement is seen to be merely a trading convention between the Appellant and the licensee; and the payments, whatever form they take, are profits arising from the trade or business between the Appellant and the licensee, which was to be regulated by that convention. 6. Upon consideration of the evidence adduced and the arguments addressed to us on behalf of the parties, we are of the opinion that the case for the Appellant succeeds and the appeal must be allowed."

It will be observed that the Commissioners' decision consists of a summary of the opposing contentions and that their own conclusion is contained in a single sentence. It falls to me to decide whether this conclusion is right.

I think it is clear that, while due weight should be given to the view of the Commissioners, this is eminently the type of finding which is open to review by the Court, see *Commissioners of Inland Revenue v. Rustproof Metal Window Co., Ltd.*, 29 T.C. 243, per Lord Greene, M.R., at page 266, where he says:

"It was argued by Counsel on behalf of the Crown that the decision of the Special Commissioners upon a question of this kind ought not to be disturbed unless it could be said that they had misdirected themselves in law. This, I think, is to put the matter too high. Great weight should no doubt be given to their view, but the Courts have on many occasions acted on the principle that the decision of Commissioners on the question whether a receipt is of a capital or an income nature is open to review, and I propose so to treat it in this case. It is a question which is to be answered upon a consideration of all the relevant facts."

The character of technical knowledge as an asset of a trader has been considered by the House of Lords in the recent case of *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540. I will read the headnote in that case:

"Income Tax, Schedule D—Disclosure of secret processes and provision of other information in consideration of lump sum payment—Whether sum received capital or income. The Appellant Company, which manufactured pharmaceutical products and had a world-wide trade, carried on business in Burma through an agency. In 1953 the Burmese Government wished itself to establish an industry there for the production of pharmaceutical and other products, and the Company secured a contract, dated 20th October, 1953, from the Burmese Government to assist in setting up this industry. The Company undertook to disclose secret processes to the Burmese Government and to provide other information in consideration of the payment of a 'capital sum of £100,000.' The Company also undertook to provide certain services and to manage the proposed factory in return for an annual fee, which was admitted to be subject to tax. No similar agreement had been entered into by the Company with any other foreign Government or any other party. The profits of the Company's trade as wholesale druggists were assessed to Income Tax under Case I of Schedule D for the year 1954-55 on the footing that the sum of £100,000 should be included as a trading receipt. On appeal to the Special Commissioners the Company contended that the sum of £100,000 was a capital sum received either for the sale of fixed capital or for the granting to the Burmese Government of an exclusive licence, and that in any event it did not arise in the course of a trade. The Crown contended, *inter alia*, that on a true construction of the agreement the sum in question was, like the annual fee admitted to be subject to tax, received by the Company for providing services in the cause of a trade. The Special Commissioners held that the agreement should be read as a whole as one for the provision of services, and that the sum of £100,000 had been properly included in computing the Company's profits for Income Tax purposes. The Chancery Division held that the sum in question was a capital payment. The Court of Appeal held unanimously (1) that there was evidence to support the Special Commissioners' finding that the sum of £100,000 arose to the Company as a receipt of its trade; but (2) that the sum

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in question, to the extent that it was attributable to the disclosure of secret processes, was a capital receipt. The Court ordered the case to be remitted to the Commissioners to determine the part so attributable. The House of Lords, dismissing the Crown's appeal and allowing the Company's cross-appeal, restored the Order of the Chancery Division. Lords Simonds, Tucker and Denning held that, the Case having been stated by the Commissioners and the appeal argued throughout on the footing that the sum of £100,000 was indivisible, it was not open to the Court of Appeal to direct apportionment between consideration for the disclosure of secret processes and consideration for other matters. Lords Simonds and Tucker were of opinion that the Company had parted with a capital asset for a purchase price. Lord Denning considered that there was nothing wrong in the Commissioners' finding that the amount in question was a payment for services, but that it was not received in the course of the Company's existing trade of wholesale druggists, etc., and therefore could not be brought into the assessment of the Company's existing trade for 1954-55. Lord Morton of Henryton, dissenting as to the cross-appeal, agreed with the judgments in the Court of Appeal. Lord Keith of Avonholm, dissenting, was of opinion that there was ample evidence that the Company was trading in 'know-how' and that it was no more than a legitimate extension of their existing trade."

It will be seen that in that case the consideration given by the company for the lump sum payment included alike the disclosure of secret processes and the provision of other information. Certainly three members of the House of Lords, Lord Simonds, Lord Morton of Henryton and Lord Tucker, in common with the Court of Appeal, and Upjohn, J., in the Chancery Division, held that secret processes should be regarded as capital assets of the appellant company. In the present case, too, the technical knowledge possessed by the Company, and described by the Special Commissioners as "know-how", comprised secret processes; and it is evident from the nature of the trade that such processes must be of great importance in it. There can thus be no doubt that the "know-how" possessed by the Company represented at any rate in great part a capital asset.

Mr. Borneman has pointed to certain apparent differences between the views expressed by the respective members of the House of Lords in the *Evans Medical* case⁽¹⁾ as to the precise ambit of the capital asset there in question, i.e., as to whether it should be regarded as confined to secret processes or comprising also knowledge outside of those processes. It might be necessary to explore this point further in the case where the secret processes were relatively unimportant or where there must be an apportioning of consideration. But I do not think it is of practical importance here.

Once it is accepted that a trader possesses a capital asset in the nature of technical knowledge, or know-how, it must be open to him to exploit it either by using it himself in the process of his own trade or by communicating it to others, and in the latter case the taxable character of the consideration received by him must depend upon the particular circumstances. It may be possible for the trader to a limited extent to retain the asset intact and to exploit it by rendering services to others in the way of imparting information or rendering assistance to them. This was the view which Lord Keith took upon the facts in the *Evans Medical* case. But again, as pointed out in that case, it is in the nature of this particular asset to lose its value upon communication, and in a normal case communication of the asset is likely to represent the disposition of part of the asset itself. I refer on this point to two statements in the speech of Lord Simonds. At the foot of page 578, he says:

"It was no doubt the corollary of their view"
—that is, the Commissioners' view—

(1) 37 T.C. 540.

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"that the agreement was one for the provision of services that the Commissioners should say that in any event the Company had not 'sold or assigned any property' to the Government. Here again they fell into an error which vitiates their determination. For it is manifest that a secret process, whether in composition or methods of storing and packing, is something which can be disposed of for value and that by imparting the secret to another its owner does something which could not fairly be described as 'rendering a service'. I would not think that authority is needed for so obvious a proposition, but it may be found in *Handley Page v. Butterworth*, 19 T.C. 328."

At the foot of page 579 he says:

"A contention was put forward on behalf of the Crown that, even if the divulging of a secret process to the whole world could be regarded as parting with a capital asset, the same could not be said of divulging it to one other. This does not make sense. The whole value of the secret might conceivably not be lost at once to the original owner, but that its value must be greatly diminished is obvious: in the present case it is doubtful whether within a measurable time it will have any value at all, at any rate so far as the Burmese market is concerned. I adopt, with respect, the apt words of Lord Fleming in *Trustees of Earl Haig v. Commissioners of Inland Revenue*, 22 T.C. 725, at page 735: '... the transaction here in question was not merely a use of the subject *salva rei substantia* but necessarily involved the realisation of a considerable part of its capital value.'"

In my judgment this was the nature of the transactions effected by the various agreements in the present case. In each case the company, having a capital asset consisting of technical knowledge, or "know-how", communicated that asset to another party, with the natural consequence that at least as regards the territory of that party the asset must lose the whole or the greater part of its value. This seems to me to represent a disposition of part of the capital asset itself. It follows that the lump sum consideration paid in each case, being the price of a capital asset, represents the receipt of capital in the hands of the company and ought not to be brought into account in the computation of its revenue.

Mr. Borneman contended that, even if the knowledge is to be treated as a capital asset, its communication should be treated, on the facts of this case, as in the nature of services rendered by the Company. For the reasons given above, I do not think this is a proper view of this transaction. Mr. Borneman pointed out that in this case, unlike the *Evans Medical* case⁽¹⁾, there is no evidence that at the date of the agreements the Company was trading in the territories affected. But I do not think the transaction was any less a disposition of part of a capital asset by reason of the fact that the Company had not previously exploited this asset by way of manufacture in the particular territories.

Mr. Borneman further pointed out that in the *Evans Medical* case there was a single transaction, whereas in this case there were a number of transactions. This circumstance again seems to me to be irrelevant. A trader, having capital assets, may dispose of those assets by a single transaction or by a number of transactions and in either case the price received would be a receipt of capital.

Mr. Borneman's principal contention, however, was that the trade of the Company during the material years was, in his own words, "that of exploiting the commercial possibilities of the aero engine and its design", and that the Company carried on this trade in two ways; namely, one, by the manufacture and sale of engines, and two, by teaching others how to manufacture engines. I find nothing in the Case Stated which justifies the view that the Company has ever carried on any trade other than that of manufacturing and selling motor cars and aircraft engines. The trade imputed to the Company

(1) 37 T.C. 540.

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by this contention appears to me to be something of a travesty of the facts. But, in any event, I do not see how this description of the trade advances the argument, since it does no more than raise—in a slightly different form—the question whether in communicating information the Company is parting with a capital asset or rendering a service. Perhaps conscious of this difficulty, Mr. Borneman said that the Company should include “know-how” in its accounts as its circulating capital, but this seems to me to postulate a different trade altogether, namely, that of a dealer in “know-how”; and indeed Mr. Borneman, as an alternative, contended that the Company carried on such a trade. No assessment on the footing of this trade has been made on the Company, and Mr. Borneman expressly disclaimed the view that the Company carried on more than one trade.

Mr. Borneman during his argument placed great reliance on a sentence of Bankes, L.J., in the case of *British Dyestuffs Corporation (Blackley), Ltd. v. Commissioners of Inland Revenue*, 12 T.C. 586, at page 596, where he says this:

“The real question is, looking at this matter, is the transaction in substance a parting by the Company with part of its property for a purchase price, or it is a method of trading by which it acquires this particular sum of money as part of the profits and gains of that trade? For that purpose one has to look at the nature and substance of the transaction and the Agreement as a whole.”

For the reasons given above, I think this should be answered in accordance with the first alternative.

The agreements here differ in an important respect from that in the *Evans Medical* case⁽¹⁾ in that there the agreement was divided into parts and the lump sum in question was allocated exclusively to the consideration specified in part 1 of the agreement. Here there is no such division or allocation. Neither party at any stage in the proceedings has, however, contended that on this or any other ground the lump sum should be apportioned so as to represent in part a capital and in part a revenue receipt. In view of the decision of the House of Lords as to apportionment in the *Evans Medical* case, it is clear I should not be entitled to make any such apportionment even if I were otherwise minded to do so.

For the reasons I have endeavoured to express above, I have come to the conclusion that the decision of the Commissioners was right, and I accordingly dismiss the appeal.

The parties agree that the three other appeals entitled *Commissioners of Inland Revenue v. Rolls-Royce, Ltd.*, raise identical points upon assessments to Excess Profits Tax, Profits Tax and Excess Profits Levy respectively as the first case, and no separate argument has been addressed to me upon them. I accordingly dismiss these appeals.

Mr. F. Heyworth Talbot.—All four appeals are dismissed with costs?

Pennycuik, J.—That must necessarily follow.

Mr. Roy Borneman.—I cannot resist that.

The Crown having appealed against the above decision, the cases came before the Court of Appeal (Pearce, Upjohn and Donovan, L.JJ.) on 24th, 25th and 26th April, 1961, when judgment was given unanimously in favour of the Crown, with costs.

(1) 37 T.C. 540

Mr. Roy Borneman, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. C. N. Beattie for the Company.

Pearce, L.J.—The facts are fully and clearly set out in the Case Stated.

In February, 1946, Rolls-Royce, Ltd., entered into an agreement with China, the first or prototype manufacturing agreement (1). It did so at the wish of the British Government in order that Rolls-Royce engines might be manufactured in China. By that agreement the Company was to supply complete drawings and manufacturing and engineering data and information necessary to enable engines of the Derwent type to be manufactured by the Chinese, and to provide full information from time to time with regard to improvements and modifications of its manufacture and design. The Company also agreed to receive into its works trainees from China and to release competent members of its own staff to undertake employment by the Chinese. The agreement was to last for five years, with an option to the Chinese to extend it for a further five years. There were provisions for the substitution of a different type of engine. The Chinese had to pay a specified royalty on engines and parts of engines manufactured by them. In addition they had to pay a capital sum of £50,000 as consideration for the rights granted thereunder. Thus the £50,000 covered all the benefits received by the agreement—the provision of technical knowledge, or plans, of a licence, and of the facilities for interchange of staff. It was not allocated to any particular benefit. Probably the major part of that sum was intended to be in respect of the transfer of technical knowledge. Nevertheless, the agreement is one undivided whole and the £50,000 is consideration for all the benefits obtained thereunder.

The words "a capital sum" do not decide the matter, being "a mere label attached . . . with an eye, no doubt, to tax considerations" (*per* Lord Greene, M.R., in *Rustproof Metal Window Co. Ltd. v. Commissioners of Inland Revenue*, 29 T.C. 243, at page 271). It is conceded by the Crown that, if on one occasion only the Company had merely sold its technical knowledge for a lump sum, it would be selling a capital asset and the receipt of that sum would be a capital receipt. In *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, at page 552, Upjohn, J., expressed it clearly thus:

"The Company was, in fact, parting for ever with its secret information in its methods of preparation, packing and preservation to the Burmese Government; that may not in law amount to an assignment of all its rights in Burma, for the Company in legal theory, though hardly in practical Burmese politics, remained at liberty to use the processes itself in Burma. Of course, it also remained at liberty to carry on its business of wholesale druggists there by selling its products made in this country, in Burma, through its usual agents. But it was parting for ever with part of a valuable asset, and was doing so to enable an entirely new and competing industry to be set up there. That industry, established by the skill and 'know-how' of the Company, could embark on an export trade which could compete with the Company's own products in other countries. In that sense the Company was dissipating its asset, and it must be remembered that a secret process once communicated to another is in jeopardy; if it gets into the wrong hands, the grantor has no protection. Even if it be a necessary ingredient to support a capital payment to show some dissipation of a capital asset (which, in my judgment, it is not), that element seems to me to be present here."

See also *per* Romer, L.J., in *Handley Page v. Butterworth*, 19 T.C. 328, at page 359, and *per* Lord Simon in *Nethersole v. Withers*, 28 T.C. 501, at page 518. The case of *Evans Medical Supplies, Ltd. v. Moriarty* went to the House of Lords and caused much diversity of view (37 T.C., at page 573). For that reason, and because in that case there was only one agreement

(1) See pages 447–50 *ante*.

(Pearce, L.J.)

under consideration—and that was in a form different from those which we are here considering—it does not provide great help in the present case.

The China agreement does not stand alone. A few months later the Company entered into a French manufacturing agreement in terms materially similar, which provided for a capital sum of £50,000. That was followed by a French variation agreement in 1950, and a further French agreement in 1953 providing for a capital sum of £100,000. Similar agreements were made in 1947 in respect of the United States (capital sum £50,000), with two subsequent ancillary agreements. In 1947 an agreement was made with the Argentine, but for special reasons, instead of receiving a capital sum for the provision of technical knowledge and other benefits, the Company received payment of £1,000,000 as the price of engines in various stages of manufacture. In 1948 the Company made an agreement with Belgium similar to the Chinese prototype, and under that a capital sum of £50,000 was payable. In 1950 the Company made a similar agreement with Australia, in respect of which lump sums amounting to £120,000 were payable. In 1952 a similar agreement was made with Sweden, under which a capital sum of £100,000 was payable. Some of these agreements provided for the payment of a large or small technical liaison fee which is admittedly taxable.

In 1953 the Company made an agreement⁽¹⁾ with the Westinghouse Electric Corporation and the Westinghouse Electric International Co., in respect of the United States. This agreement is more complicated and differs somewhat from the prototype of manufacturing agreement. But one clause in it provides that

“As consideration for making available and the transfer to Westinghouse of the technical knowledge and information which R.R. already possesses as provided in Clause 4 (a), Westinghouse shall pay to R.R. in U.S. dollars the sum equivalent to one million pounds Sterling”,

payable by instalments.

In respect of all these lump sums the Company, under an agreement with the British Government, paid one-third to them, in acknowledgment, no doubt, of the fact that the research which led to the knowledge for which those sums were paid was partially defrayed by the Government and that without the Government's consent it could not be disseminated.

Against that background the Crown argue that these oft-repeated sales of growing technical knowledge constitute receipts of the Company's trade. It is not argued that they constitute a separate trade, but that they are a development of its general trade in the manufacture and sale of engines. The Company contends that, if one looks at the China agreement alone, the sum of £50,000 represents the sale price of technical knowledge including secret processes. The Company had never before sold such knowledge; it had only sold motor cars and aeroplane engines. Therefore, it is urged, it was selling part of its fixed assets. The mere repetition of such a transaction, however frequent, did not, without more, change the nature of the transaction nor the nature of the Company's trade, and the so-called capital sums received under the various agreements were in truth capital sums. The Special Commissioners rightly, it is argued, found as a fact that the transactions subsequent to the China agreement continued to be sales of a capital asset, and that the sums so received were capital and not trading receipts. Further, the Company contends that this Court cannot in any event properly disturb that finding of fact.

(1) See pages 460-63 ante.

(Pearce, L.J.)

The Special Commissioners, after finding the various facts set out in the Case, expressed their conclusion on the issue before them as follows (1):

"Upon consideration of the evidence adduced and the arguments addressed to us on behalf of the parties, we are of the opinion that the case for the Appellant succeeds and the appeal must be allowed."

One has, therefore, to refer to the Case for the Appellant to ascertain precisely what the Special Commissioners found on the crucial issue. The material parts of that Case are as follows (2):

"In the course of its business [the Company] had acquired a vast store of knowledge and secret information relating to its secret processes of manufacture, referred to throughout the case as "know-how", which represented a fixed capital asset of [the Company's] trade, but it had never been any part of the policy of [the Company] to make inventions and discover secret processes with a view to the earning of profits by realising its rights in those inventions and processes."

The Chinese agreement is then described. The Case continues:

"It was, however, contended for [the Company] that the lump sum paid and received under the China agreement, apart from a small amount attributable as aforesaid to patent rights, represented a capital receipt in respect of "know-how" which did not fall to be included in the profits or gains of [the Company] It is further contended for [the Company] that if the subject-matter with which we are concerned, i.e., "know-how", is initially a fixed capital asset, then mere multiplicity of transactions in it does not convert it into a revenue or trading asset in the absence of other facts which suggest that there has been a conversion or that some new trade has been set up. It is said that there has been no such change of circumstances affecting [the Company's] "know-how" and therefore, with regard to the remainder of the agreements entered into by [the Company] for, generally speaking, licensing the manufacture of aero engines and the provision of "know-how" in connection therewith, the lump sums, by whatever name they are called, paid to and received by [the Company] thereunder were also receipts of a capital nature."

With all respect to the Special Commissioners, I think that there are certain aspects of the matter to which they did not give any, or adequate, weight.

It is beside the point to consider the China agreement as if it stood alone. It did not stand alone. It has to be considered in the light of surrounding circumstances. Subsequent events may, and in my judgment do, throw light on it.

Almost all the territory to which these agreements applied was found to be territory which the Company could not reasonably hope to penetrate by any other methods (see, as to France, paragraph 3 (10) of the Case (3); the United States, paragraph 3 (13) (4); Argentine, paragraph 3 (18) (5); Belgium, paragraph 3 (20) (6); Australia, paragraph 3 (24) (7); Sweden, paragraph 3 (27) (8); and see also, as to the United States, paragraph 3 (28) (9)).

"[The Company] had never refused to grant a licence to a foreign government or manufacturer on the ground that to do so and to communicate the necessary 'know-how' would prejudice its interests. . . . Possession of [the Company's] 'know-how' enabled a licensee to get into production far earlier than would otherwise have been possible. It was important from the point of view of [the Company's] reputation that each licensee should have all the 'know-how' it or he required to be able to manufacture engines to [the Company's] traditionally high standards"

(paragraph 3 (30) (10)).

The agreements are for periods of five or even ten years and envisage the continuance of the arrangement after the expiry of the contract periods. There are provisions for the substitution of more modern engines on payment of a further

(1) See page 472 ante. (2) See page 471 ante. (3) See page 450 ante. (4) See page 451 ante. (5) See page 455 ante. (6) See page 457 ante. (7) See page 458 ante. (8) See page 460 ante. (9) See page 460 ante. (10) See page 463 ante.

(Pearce, L.J.)

sum (see, for instance, the schedule to the United States agreement (clause 14), paragraph 3 (13) of the Case, Argentine (clause 42), paragraph 3 (18) ⁽¹⁾; Belgium (clause 13), paragraph 3 (20) ⁽²⁾; Australia (clause 12), paragraph 3 (25) ⁽³⁾).

These facts create a strong impression that, in territories where the Company could not hope to sell its engines, it was pursuing a wise policy of allowing local manufacture from which it would receive the benefits of advertisement, lump sums and royalties. This was not in substitution for its policy of selling its own engines in territories where it could do so, but a collateral and supplementary method of trading in territories where it could not do so. When one regards the chairman's annual statements that strong impression is confirmed. In July, 1947, after the China, first French and first United States agreement, the chairman said (paragraph 3 (33) of the case ⁽⁴⁾):

"A considerable demand has arisen for licences to manufacture various models of our engines. That is all to the good as it reflects the appreciation of the merits of what we make, but it likewise calls for extensive initial education and continuing contact with the licensee to keep him abreast of developments."

In June, 1949 (paragraph 3 (35) ⁽⁵⁾), he said:

"The Belgian Government is now amongst those who have acquired manufacturing rights, while other governments are interested in extending existing arrangements."

In 1952 (paragraph 3 (38) ⁽⁶⁾), he said:

"Our licensees, Pratt & Whitney in America, the Hispano Suiza Company in France, and the F.N. Company in Belgium, are all now in quantity production, and we may expect a further increase in royalty receipts from these sources. Our relations with our licensees continue to be most friendly, and we look forward to a continuing association with them."

Finally, in July, 1954, he said (paragraph 3 (40) ⁽⁷⁾):

"It is also satisfactory to record a further increase in our revenue from royalties; almost all of this comes from our foreign licensees . . . Most of our foreign licensees have been very active, and the increasing volume of their production is reflected in the substantial increase in royalties which we have received. We have negotiated new licence agreements with some of our existing licensees to permit the manufacture of current types of engine".

He made further remarks as to the duty of the Company to develop such a policy and concluded:

"not only does it bring in much needed foreign currency, but it also enables the United Kingdom government to recover at least a contribution towards the substantial development expenditure which it has to invest in defence projects."

No doubt that is a reference to the one-third which the British Government received on all lump sums received.

Thus it is clear that the policy of issuing licences for royalties was deliberate and continuous, and that the dissemination of technical knowledge to the licensees was a desirable, or even an essential, part of the issue of licences. In each case there was no allocation of the lump sum to the disclosure of technical knowledge. That knowledge was but one of the benefits conferred by the agreements. The training of staff and interchange of employees was also of great importance. Can it be said that the mere fact that the imparting of technical knowledge was one of the considerations, and probably a major one, for the payment of the lump sums takes them out of the category of trading receipts, when the rest of the agreement is devoted to producing trading receipts?

(1) See page 456 ante. (2) See page 457 ante. (3) See page 459 ante. (4) See page 464 ante. (5) See page 465 ante. (6) See page 467 ante. (7) See page 468 ante.

(Pearce, L.J.)

The knowledge sold in this case is not some secret of permanent value sold by an owner who is transferring or terminating his business. Such a sale would clearly be the sale of a fixed asset. The knowledge sold in this case is in the main the transient by-product of advancing engineering science. It accrues automatically from the Company's business of manufacture, and in a comparatively short time it is superseded and loses its value. It is ever growing, ever changing. It is the kind of knowledge which can easily merge its character of a fixed asset into that of a trading asset. The secret knowledge is the more transient since it becomes more quickly obsolete. That which is not secret is the valuable practical experience of years, but such knowledge partakes less of the nature of a fixed asset. It consists in the power to communicate the knowledge possessed by a well trained, efficient and experienced staff. It could find no place in any balance sheet. So far as part of the lump sums are paid in respect of the imparting of knowledge, they are sums regularly received as an ingredient in the Company's policy of making manufacturing agreements to secure royalty revenue. To such agreements the disclosing of technical knowledge is a necessary adjunct, but it is a means rather than an end. None of these considerations is conclusive in itself, but they have cumulative weight. With all respect to the learned Judge, who took a contrary view, I feel compelled to the conclusion that the receipt of the sums in question is part of the annual profit or gain accruing from the Company's trade.

I venture to think that the Commissioners arrived at their conclusion by omitting all or many of the considerations to which I have referred. There is nothing to show that they had them in mind. Even if they did, the well-known observations of Viscount Simonds and Lord Radcliffe in *Edwards v. Bairstow*, 36 T.C. 207, at pages 224, 229 and 231, apply. We should, in my judgment, hold that the only reasonable conclusion on the facts found is that the sums in question are trading receipts on revenue account. I would accordingly answer "No" to the question asked in the Case Stated and allow the appeals.

Upjohn, L.J.—I agree with the judgment that has just been delivered, and only add a few words of my own as I delivered the judgment at first instance in the case of *Evans Medical Supplies, Ltd. v. Moriarty* (1), which has been much debated before us. In that case, as in this, the question is, whether the lump sum of £100,000 in the *Evans Medical* case and the several lump sums in this case fall within the charge to Income Tax under Case I of Schedule D; that is, whether this is a revenue receipt which should be brought into account in ascertaining the annual profits or gains arising or accruing from any trade whether carried on in the United Kingdom or elsewhere.

The answer to that question necessarily depends almost entirely upon the circumstances of each case and the nature of the contract or contracts under which the lump sum or sums arise. Decisions on one set of facts form no sure guide to an entirely different set of facts. Apart from the fact that in each case the subject-matter of the transaction was in part a disposition of "know-how", the two cases bear but little resemblance to one another. There is, indeed, much difference even in the nature of the "know-how" in the two cases. In the *Evans Medical* case, the "know-how" was the knowledge which would make large-scale manufacture of medical products possible in Burma. It consisted, not in secret medical compositions but in secret methods of preparation of known products and in methods of storing and packaging, particu-

(1) 37 T.C. 540.

(Upjohn, L.J.)

larly in hot climates. It was, so to speak, a basic necessity for the introduction of a successful pharmaceutical factory in Burma, and that very same "know-how" would be applied in manufacture probably for a long time. My Lord has pointed out the quite different transient and changing character of the "know-how" dealt with by the Company. It is more nearly akin to a trading asset. However, the fundamental difference between the two cases rests, of course, in the manner in which the Company has dealt with the disposal of its knowledge and experience in the manufacture of aero engines. In the *Evans Medical* case (1) the transaction was isolated and special. In this case the only reasonable inference to be drawn from the evidence, and this is in complete contrast to the *Evans Medical* case, is that, as a deliberate matter of policy, the Company has embarked upon a course of licensing others to manufacture its engines in countries where it was difficult or impossible to export engines of its own manufacture. Finally, it is to be observed that the contract in the *Evans Medical* case was quite different from the several contracts in this case. In the earlier case, despite much conflict of judicial opinion, it was ultimately decided that the sum of £100,000 was paid for the promises in part I of the agreement and that the respondents were parting with a capital asset for that sum of money. In this case it is not possible to reach such a conclusion. The lump sums were paid not only to secure "know-how", but other benefits. Upon a proper interpretation of the agreements it is not permissible to make an allocation to "know-how", as in the *Evans Medical* case, or to draw the conclusion that the Company was in substance selling a capital asset for a lump sum. That case does not really assist in the determination of this case.

In my judgment, on the facts of this case only one conclusion is reasonable, namely, that these lump sums were received as revenue receipts in the ordinary course of the Company's trading. I would allow these appeals.

Donovan, L.J.—The argument for the Company is that here was a fixed capital asset. It has been sold. True, it was sold in the course of the Company's trade, but the proceeds were capital and not income. The Special Commissioners have so found, and their conclusion being one of fact, with evidence to support it, ought not to be disturbed.

The expression "fixed capital asset" is a convenient one to describe such things as buildings, machinery, licences and so on which a trader uses to produce the things he sells. But it may be misleading when applied to knowledge, skill and experience. For example, factory premises, new this year, are not likely to become obsolete next, and replaced by yet another factory which in turn may suffer a like fate. But this may be true of engineering skill and knowledge in the field of aero engines. The process of research and new discovery is unending. Again, to speak of a fund of "know-how" possessed by the Company as one of its fixed capital assets is not an exact description of the situation. The Company is served by its staff, and it is in the brains and hands of its staff that knowledge, skill and experience reside. What the Company can do is to make these things available to some third party if it so decides: and it is the ability to do this which is really the Company's asset. Moreover, when the Company does this it does not part with the knowledge so communicated, as it would part with factory premises if sold. It simply shares its knowledge with others.

If these distinctions be borne in mind it does not matter a great deal by what name knowledge, skill and experience be called. They are clearly part of the capital equipment of a company such as the Respondent, in much the same way as the same attributes are the capital equipment of an individual

(1) 37 T.C. 540.

(Donovan, L.J.)

craftsman. They can be exploited in two ways. By their employment, articles can be produced and sold. Alternatively or in addition, the knowledge, skill and experience can be imparted to others for reward. The great artist with his pupils is a familiar example. Similarly with a company such as the Respondent. It can and does use its great experience, and the knowledge and skill which comes of it, to make and sell aero engines. In addition it imparts these things to others for reward. Admittedly, it does this in the course of its trade, and the sole question here is whether that part of the reward consisting of a lump sum is a receipt which should be included in the revenue account when computing the Company's taxable profits, or whether, on the other hand, the receipt should properly be credited to some capital account.

Now that one can pass in review some seven years of the Company's activities, I entertain no doubt that these lump sums are trading revenue. I reach this conclusion having regard to the systematic and repeated exploitation of the Company's knowledge, skill and experience in this way; to the clear indications, afforded by the option clauses in the various agreements, that this is a long-term policy of the Company; and to the circumstance that, in certain countries, this was the only sure way in which the Company could exploit these attributes. I think the case is quite different from *Evans Medical Supplies, Ltd. v. Moriarty* (1). I differ from the learned Judge and from the Special Commissioners with regret, but I find myself unable to say that the Commissioners' finding was reasonably open on the facts. I should reach the same conclusion even if the large expenditure on research and experiment undertaken by the Company, which contributes so much to its knowledge and skill, had not been allowed as a revenue expense when computing chargeable profits. The Court was informed, however, that it has.

I agree that these appeals should be allowed.

Mr. Roy Borneman.—Would your Lordships allow the appeals with costs here and below? In modern practice your Lordships make a declaration with regard to the matter, and I would respectfully submit the declaration might be in this form: Your Lordships declare that the lump sums referred to in paragraph 1 of the Case Stated were receipts on revenue account of the Respondent's trade and fall to be included in the computation of the Respondent's profits and gains; that your Lordships remit the case to the Commissioners to adjust the assessments in accordance with your Lordships' declaration; and your Lordships make similar Orders with regard to the other three cases, the Excess Profits Tax case, the Excess Profits Levy case and the Profits Tax case.

Pearce, L.J.—Mr. Borneman, when I was dealing, I think in some other list, with these Cases Stated, I was told that you started, in these cases, by answering the question "Yes" or "No" in the Case Stated, and that that was recently an agreed form.

Mr. Borneman.—That would be just as convenient. This is the form in which it has been done frequently recently. If your Lordships adopted the other course, it would be paragraph 8 of the Case Stated:

"The question of law for the opinion of the High Court of Justice is whether, on the facts found by us as hereinbefore set forth, there was evidence upon which we could properly arrive at our decision, and whether, on the facts so found, our determination of the appeal was correct in law."

The answer to that would be "No", would it not, if that is the form?

Upjohn, L.J.—I am not sure that I like that.

(1) 37 T.C. 540.

Pearce, L.J.—No, we will not put it in.

Upjohn, L.J.—“. . . whether there was evidence upon which they could find” is not quite the formula which is applied.

Pearce, L.J.—So be it. I had raised that point. We will leave that matter out, then. I see no objection to what you suggested to me.

Upjohn, L.J.—Would you read that again?

Mr. Borneman.—“. . . declare that the lump sums referred to in paragraph 1 of the Case Stated were receipts on revenue account of the Respondent's trade and fall to be included in the computation of the Respondent's profits and gains”.

Pearce, L.J.—Let us hear what Mr. Heyworth Talbot says.

Mr. F. Heyworth Talbot.—I have had the advantage of reading this before your Lordships came into Court in anticipation of the effect of your Lordships' judgment. I considered that with my learned friend, and I quite agree that that is a proper form and will give effect to your Lordships' judgment.

Donovan, L.J.—Who started all this? In the old days one simply said “Appeal allowed”.

Mr. Heyworth Talbot.—It was started by your Lordships' Court, I think about twelve months ago.

Pearce, L.J.—I was told by somebody that we had to start off answering the question. I rather resisted it, but was told there was some reason for it. I am glad, now, nobody is trying to make me do it.

Mr. Heyworth Talbot.—I think the Master of the Rolls felt there would be some difficulties in some cases if there was a mere order to remit to the Commissioners to give effect to the judgment.

Donovan, L.J.—I do not know who said that. I do not remember it.

Mr. Heyworth Talbot.—I do not either.

Mr. Borneman.—It was in the case of *Trustees of the Tollemache Settled Estates v. Coughtrie* (1) that the Master of the Rolls directed it.

Pearce, L.J.—All I wish to do is, if there is any prescribed procedure, to follow it.

Mr. Heyworth Talbot.—Perhaps this Order might be made *de bene esse*. It cannot do any harm.

Pearce, L.J.—Yes, certainly.

Mr. Heyworth Talbot.—It falls to me to ask your Lordships for leave to appeal to the House of Lords.

Pearce, L.J.—If you are both agreed on that form of Order, as far as I am concerned that is good enough for me. Now, Mr. Heyworth Talbot, you have an application to make?

Mr. Heyworth Talbot.—I am so sorry; I was anticipating. I was venturing to ask your Lordships for leave to appeal to the House of Lords in this case if my clients should desire, having considered the effect of the judgment.

Pearce, L.J.—Yes.

Mr. Heyworth Talbot.—If your Lordship pleases.

Pearce, L.J.—We make an Order as to costs. That includes all the costs.

Mr. Borneman.—I asked your Lordship first to allow the appeals with costs here and below.

Pearce, L.J.—Yes.

(1) 39 T.C. 454

The Company having appealed against the above decision, the cases came before the House of Lords (Viscount Simonds and Lords Reid, Radcliffe, Morris of Borth-y-Gest and Guest) on 7th, 8th and 12th February, 1962, when judgment was reserved. On 1st March, 1962, judgment was given unanimously in favour of the Crown.

Mr. F. Heyworth Talbot, Q.C., and Mr. C. N. Beattie appeared as Counsel for the Company, and Mr. Roy Borneman, Q.C., and Mr. Alan Orr for the Crown.

Viscount Simonds.—My Lords, I am of opinion that these appeals must be dismissed, and am so fully in agreement with the judgment of Pearce, L.J., in the Court of Appeal that I need say very little.

It is common ground between the parties that the Court, while paying proper regard (as to which, see *Edwards v. Bairstow*⁽¹⁾, [1956] A.C. 14) to the facts found by the Commissioners and to the inferences drawn by them from those facts, must ultimately determine as a question of law alike whether receipts by the taxpayer are capital or income for purposes of Income Tax and whether expenses incurred by him are for the same purposes to be treated as incurred on income or capital account.

In the present case, the Company over a number of years received under agreements—which were sometimes called licence agreements and sometimes convention agreements—various sums of money, and amongst them substantial sums which were described as capital sums. It was urged on its behalf that these sums were the consideration that it received for the sale of a fixed capital asset and that therefore they could not be regarded as income for tax purposes.

My Lords, it appears to me to beg the question to refer to that which the Company sold as a fixed capital asset. I will not analyse the several agreements made by the Company, first with the Chinese Government and afterwards with other foreign governments and companies. It may be said compendiously, in the words of Pearce, L.J.⁽²⁾, that what the Chinese Government received and the Company gave were technical knowledge, plans, a licence and facilities for the interchange of staff. An important and valuable part of the consideration was, I think, the undertaking by the Company to communicate, so far as it was permitted to do so, future improvements and developments. Can these things be regarded as a fixed capital asset and the communication of them as the disposal of that asset? I do not think so. It appears to me (and I venture once again to quote the apt words of the learned Lord Justice⁽³⁾) that the only proper conclusion is that

“in territories where the Company could not hope to sell its engines, it was pursuing a wise policy of allowing local manufacture from which it would receive the benefits of advertisement, lump sums and royalties.”

This it did, not by parting with its assets but by using or trading in them in the only, or at least the most advantageous, way that was open to it.

I must add a word on the case of *Evans Medical Supplies, Ltd. v. Moriarty*⁽⁴⁾, [1958] 1 W.L.R. 66, since I was a party to the majority decision in this House. In the Court of Appeal in the present case, Upjohn, L.J., who had given the first decision in that case, pointed out the clear difference between the two cases⁽⁵⁾. The facts in the earlier case were complicated, but the inference was there drawn that the capital sum in question was paid for the communication of secret processes to the Burmese Government with

(1) 36 T.C. 207. (2) See page 482 ante. (3) See page 485 ante. (4) 37 T.C. 540. (5) See pages 486-7 ante.

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a resulting total loss to the company of its Burmese trade. I applied in that case, and would apply here too, the test laid down by Bankes, L.J., in *British Dyestuffs Corporation (Blackley), Ltd. v. Commissioners of Inland Revenue*, 12 T.C. 586, at page 596:

"looking at this matter, is the transaction in substance a parting by the Company with part of its property for a purchase price, or is it a method of trading by which it acquires this particular sum of money as part of the profits and gains of that trade?"

In the circumstances of that case, regard in particular being had to the fact that the transaction was an isolated one of its kind, the conclusion was inevitable that the so-called capital sum was a receipt of a capital nature. The analogy of secret processes to patents was drawn to enforce this conclusion. The decision did not establish, or purport to establish, a principle that whenever, and however often, a company communicates what is called "know-how" to a third party and receives what is called a lump sum for it, that sum is for tax purposes a capital receipt. The circumstances may lead, as in my opinion they lead in the present case, to the opposite conclusion.

I would dismiss these appeals.

Lord Reid.—My Lords, in 1946 the Company had an immense fund of technical knowledge and experience with regard to the design and manufacture of aircraft engines. Certain countries were unwilling to buy engines from it, but wished to manufacture similar engines themselves. Between 1946 and 1953 agreements to grant "licences" were made in respect of Nationalist China, France, the United States, Belgium, Sweden, the Argentine and Australia. Generally, the Company supplied a very large number of drawings and much other information, and undertook to teach technicians from these countries and to send some of their own employees to supervise operations there. The payments made to the Company under these agreements included lump sums and royalties. The question in this case is whether these sums were trading receipts. If they were, the assessments appealed against are correct. If they were not, the Company admits that the royalties are taxable under Schedule D, Case III, but maintains that the lump sums are not taxable.

The Company's case is that its fund of knowledge and experience, mostly embodied in documents and drawings, and colloquially known as "know-how", was a capital asset; and that these agreements were in essence sales of parts of it, so that the lump sums were capital receipts. I do not find it necessary to decide whether that fund was a capital asset: I shall assume that it was.

The Special Commissioners have made no specific findings of fact in the Case Stated with regard to the matters in dispute. They simply set out certain admitted facts, the relevant parts of the agreements, excerpts from annual reports by the chairman of the Company, and the contentions of the parties; and then they say that, upon consideration of the evidence and arguments, they are of opinion that the case for the Company succeeds. They adjourned the appeals for the agreement of figures on the footing that all lump sums fall to be treated as capital receipts. It was argued that, in reaching this decision, the Commissioners must have made certain inferences of fact favourable to the Company, and that we must now deal with the case as if those inferences had been expressly stated: being inferences of fact, they would now not be subject to review unless they were unreasonable or there was no evidence to support them. I am not prepared to proceed in that way. If inferences of fact had been stated, they might or might not have been

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binding. But as none have been stated I must draw my own conclusions from the facts and documents set out in the Case. Both parties agreed that the final question whether these lump sums were capital or income is a question of law to be determined on a consideration of the whole facts.

I cannot accept the contention that by each of these agreements the Company sold a part of that capital asset and received a price for it. There is nothing in the Case to indicate that that capital asset was in any way diminished by carrying out these agreements. The whole of its knowledge and experience remained available to the Company for manufacturing and further research and development, and there is nothing to show that its value was in any way diminished. The Company had not even given up a market which had been open to it. It could not sell its engines in these countries whether it made these agreements or not. If it had not made these agreements, it would have got nothing from these countries; by making them it was able to exploit its capital asset by receiving large sums for its use there. In essence, what it did was to teach the "licensees" how to make use of the "licences" which it granted. The Company founds on the decision of this House in *Evans Medical Supplies, Ltd. v. Moriarty* (1957), 37 T.C. 540. In that case it was held that the company parted with a capital asset and received for it a capital sum. For one thing, it lost its Burmese market. And, further, it was said to be obvious that the capital value of the secret processes must have been greatly diminished by their disclosure to the Burmese Government. Every case of this kind must be decided on its own facts; and, at least in these two respects, that case was very different from the present case. There is also the difference that in that case there was a single transaction, whereas in the present case there was a series of similar transactions. That in itself might not count for much, but it is, I think, important that these transactions arose out of deliberate policy. Even in the first agreement there was, in clause 23, a provision that certain further payments should not be less favourable than the sums demanded from other manufacturers for a similar licence.

I have, therefore, no doubt that these lump sums were not capital receipts and that the Commissioners' decision was wrong in law. But the Company says that nevertheless these receipts did not come to it as receipts of its trade of manufacturing and selling aircraft engines and motor cars, and for that reason should not enter the computation of the profits of that trade. I cannot agree. It is for each trader to determine the scope of his own trade. No doubt a trader can carry on two separate trades simultaneously. But the facts of this case clearly indicate that this course of granting "licences" was merely an extension of its existing trade devised to meet the difficulty that it could not sell its engines in the countries of the "licensees". It was merely another method of deriving profit from the use of its technical knowledge, experience and ability. The Company sought to rely on the fact that in the assessments appealed against its trade is described as "manufacturers of motor cars and aero engines", but I see no reason why there should have to be set out a full description of the taxpayer's trade, and this abbreviated description in no way misled the Company.

I agree that these appeals must be dismissed.

Lord Radcliffe.—My Lords, I think that the issue of these appeals depends upon a right appreciation of just two matters. One is the nature of this asset of the Company, which is conveniently comprehended in the word "know-how"; the other is the nature of the considerations given by it in exchange for the payment of the sums of money which are the subject of this dispute.

(Lord Radcliffe)

First, as to "know-how". I see no objection to describing this as an asset. It is intangible: but then, so is goodwill. It would be difficult to identify with any precision the sources of the expenditure which has gradually created it, and, patents apart, I would not have thought of it as a natural balance-sheet item. But it is a reality when associated with production and development such as that of Rolls-Royce, and a large part, though not the whole of it, finds its material record in all those lists, drawings and manufacturing and engineering data that are specified in the various licence agreements.

It is fundamental to the Company's case that we should categorise this asset as being part of its fixed capital. Indeed, its argument proceeds from the premise that it is fixed capital. This, I think, is to start from too assured a base. An asset of this kind is—I am afraid that I must use the phrase—*sui generis*. It is not easily compared with factory or office buildings, warehouses, plant and machinery, or such independent legal rights as patents, copyright or trade marks, or even with goodwill. "Know-how" is an ambience that pervades a highly specialised production organisation, and, although I think it correct to describe it as fixed capital so long as the manufacturer retains it for his own productive purposes and expresses its value in his products, one must realise that in so describing it one is proceeding by an analogy which can easily break down owing to the inherent differences that separate "know-how" from the more straightforward elements of fixed capital. For instance, it would be wrong to confuse the physical records with the "know-how" itself, which is the valuable asset; for, if you put them on a duplicator and produce one hundred copies, you have certainly not multiplied your asset in proportion. Again, as the facts of the present appeal show, "know-how" has the peculiar quality that it can be communicated to or shared with others outside the manufacturer's own business without in any sense destroying its value to him. It becomes, if you like, diluted, and its value to him may be affected; though in my view it begs the question to say that that value is necessarily reduced because the asset is used for outside instruction. These considerations lead me to say that, although "know-how" is properly described as fixed capital by way of analogy, it is the kind of intangible entity that can very easily change its category according to the use to which its owner himself decides to put it. I am not sure that it is too much to say that it is his use of it that determines the category. It is not like a single physical entity which must be employed for production or else broken up: it is more like a fluid in store which can be pumped down several channels. I do not, therefore, think that this appeal can be decided by the simple set of propositions. "Know-how" is an item of fixed capital. A lump sum received by a trader on a sale of such an item should not go to his income account. It makes no difference that the item is disposed of by several separate transactions divided from each other by time intervals.

Now as to the licence agreements. I will take the agreement with the Chinese National Government⁽¹⁾ as typical, since the essential features of all are the same. To begin with, it is not well described as a licence. Putting aside the actual patents, which are found by the Case Stated to have been such as to have very little store set by them in this context (in fact, there were no Chinese patents), there is really no licensing done at all. Whatever else the lump or capital sums payable under the agreement are paid for, it is not for a licence in the ordinary sense: it is for the making available, the imparting, of the "know-how", both as recorded in the drawings and other data

(1) See pages 447-50 *ante*.

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and as conveyed by direct instruction, advice and information. If one analyses the various things that the Company is to do in return for the money it is to get, they all come down to forms of instruction and advice. By clause 2 it is to supply

“complete drawings and manufacturing and engineering data and information adequate and reasonably necessary to enable the Commission to manufacture”

the particular Rolls-Royce engine selected. No doubt the things to be supplied are tangible objects; but then, so are text-books, formulae or recipes. The Company is teaching at long range. There are supplementary obligations. By clause 10 the Company is to give the commission advice as to further improvements and modifications in the engine's manufacture and design, so far as it lawfully can. Again, clause 14 binds it to receive and instruct in its works persons nominated by the commission, with a view to rendering them capable of constructing the engine; and, under clause 16, the Company undertakes to release one or more competent members of its staff for temporary secondment to help in construction work in China. Finally, clause 23 grants to the commission an option, in effect, to acquire the “know-how” on any future type of gas-turbine aircraft engine, provided that acceptable terms are offered to them by the Company. The money which the Company gets in return under the agreement consists of a “capital” sum, payable by instalments, and recurring sums described as royalties. They are only royalties in the sense that the measure of these recurrent payments is taken to be so many pounds sterling per engine manufactured in China and a fixed percentage on the commercial selling price of all spare parts so manufactured.

The “capital” sum is what is now in question. I do not think it possible to attach any significance to the qualifying adjective. If we did, Revenue appeals on this particular issue would soon settle themselves. Presumably it did not matter to the commission how the sum was described: on the other hand, it certainly did not bind the Company, when it had received the money, to apply it in any particular way in its accounts or otherwise. I think that one has to be on one's guard, in cases of this kind, against supposing that such adjectives as “capital” or “lump” contribute anything to the solution of the issue. “Capital” here seems to refer merely to the fact that the monies are to be paid outright against complete delivery of the drawings and other documents, regardless of whether any production followed or not. A “lump” sum is merely a non-recurring payment of money, but the adjective does not afford a good guide to the decision whether there is taxable income or not. A man keeping a tobacco shop who sells a packet of cigarettes receives a lump sum as the purchase price of his property, and I suppose that we should add that his trading stock is part of his capital; but no one would doubt that, just the same, the money he gets should find its way into his accounts for the purpose of ascertaining his trading profit. I have not been able to see why these “capital” receipts should not be brought into account in the assessment of the Company's trading profits. It seems to me that, so long as it kept its “know-how” to itself, it used it for the manufacture of its own engines, and its value was expressed in the successful sales which it achieved of those products. I daresay that the Company would have preferred, ideally, to reserve its “know-how” solely for the purposes of its own manufacture. I am not sure of that, when I read some of the chairman's speeches at the annual meetings. However that may be, it is clear that it saw that, having the “know-how”, it could derive profit from the manufacture of its engines, even by others, in parts of the world where it either could not or would not

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sell or manufacture them itself, provided only that it equipped those others with the requisite expertise. So it turned the "know-how" to account by undertaking, for reward, to impart it to the others in order to bring about this alternative form of manufacture.

My Lords, in my opinion monies so obtained arise from the Company's trade as manufacturers of motor cars and aero engines. I appreciate its point that such monies are not derived from its own operations of manufacture and therefore, if assessable at all, must be attributable to a new and separate trade consisting of the exploitation of "know-how" for reward. But this, with all respect, is a verbalism, and I think that the Crown were right in saying that the Company's new way of exploiting "know-how" was no more than a development of its direct manufacturing trade and did not rank, or need to rank, as a separate business. In my view, that expresses the reality of the matter since, as manufacturers, the Company was interested to promote the production of its engines for reward to itself; and it was a question of trading policy by which method it secured this result, by manufacturing and selling on its own or by selling to others the essential secrets of manufacture.

The argument before us naturally turned largely on the applicability, or the reverse, of the decision of this House in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, and I have no doubt that the conclusions of the Special Commissioners and of Pennycuik, J., were largely determined by the belief that the present case was governed by the earlier decision. I wish that the endless complexities of commercial and industrial life did not so often throw up combinations of factors which, while appearing to have close resemblance to each other, turn out on final analysis to have some significant divergence. I can only say that the circumstances that we have here do not present themselves to me as having the same essential features as those that distinguished *Evans Medical Supplies*. What weighed with the majority judgments in that case was that the company had sold to the Burmese Government a secret process upon which the success of its business in Burma had to depend and it had, in effect, disposed altogether of its Burmese trade. To do that was to dispose finally of part of its fixed capital, and monies received in return were not trading receipts. The case was regarded as being an equivalent to *Handley Page v. Butterworth*, 19 T.C. 328, in which the owner of a secret process had destroyed his property by making it available to the world. I do not read the agreements that we have here as amounting to a disposal of something that was fixed capital in that sense, if only because the information made available is only that bearing upon the production of a single type of engine.

I would dismiss these appeals.

Lord Morris of Borth-y-Gest.—My Lords, the decision in this case turns upon what is the correct legal result which should follow from the facts which are recorded in the Case Stated. The Special Commissioners were of the opinion that the "case" for the Company succeeded. Shortly stated, that "case" was that the lump sum payments which were received under the various agreements did not fall to be included in the profits or gains of the Company for the reason that such lump sum payments represented capital receipts. The Company claimed that in the course of its business it had acquired a vast store of knowledge and secret information relating to its secret processes of manufacture, all of which (compendiously labelled as "know-how") represented a fixed capital asset of its trade: it claimed that the lump sum payments were capital receipts in respect of such fixed capital assets. The Crown,

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on the other hand, while not suggesting that the Company had set up a new trade consisting of dealing in patents and secret processes, submitted that it had become a part of the normal trade or business of the Company to enter into agreements for the production of its engines by other persons under licence on payment of lump sums (and royalties and other payments), and that such lump sum payments were not capital receipts but were trading receipts. My Lords, the facts having been found, it was open to an appellate Court to say that the view that the lump sum payments were of a capital nature rather than of an income nature was erroneous in law (see, for example, *Bean v. Doncaster Amalgamated Collieries, Ltd.*, 27 T.C. 296, and *Commissioners of Inland Revenue v. Rustproof Metal Window Co., Ltd.*, 29 T.C. 243). It is manifest that the circumstance that, in the agreements which it made, the Company itself employed the phrase "a capital sum" cannot determine the nature of the receipt.

The business of the Company in the early years after its incorporation in 1906 had been confined to the manufacture and sale of motor cars. During the first world war it began to manufacture aircraft engines, and with the development of the aircraft industry, the manufacture of aircraft engines became the larger and more important part of its business. The Company had continuously been engaged in metallurgical research and in the development of engineering techniques and secret processes, and as a result acquired a fund of technical knowledge, of which only a comparatively small part was capable of forming the subject-matter of patent rights. The successful development of successive types of aircraft engines all derived from the Company's fund of knowledge and experience.

The Company was assessed as "manufacturers of motor cars and aero engines". It manufactured, and it also sold, motor cars and aero engines. But types and designs of aero engines do not remain static. New engines will be designed, and the newer designs will supplant the older ones. New knowledge will create new skill, which in turn will generate further skill. With recognition of this, it was open to the Company to conduct its business as manufacturers in the way that it decided was most expedient and advantageous. There were some parts of the world in which, for one reason or another, it either could not or did not sell products made by itself to its own designs and by the use in England of its knowledge and experience. In respect of such territories it would seem, therefore, that its current designs (with their transient novelty and superiority) could yield it no advantage. It would seem natural, therefore, that in reference to such territories the Company should as manufacturers use its knowledge, designs and skill in the best available way. As it could not in those territories sell that which it had itself manufactured, it could do the next best thing, which was to permit governments or others, upon payment of sums of money, to manufacture within such territories; and, in order to enable that to be done, to give all the necessary assistance by making documents available and by giving instruction. That is, in effect, what it did. Whatever description is given to that which in this case has been denoted by the words "know-how", the course of activity embarked upon by the Company was to put its current "know-how" to the most advantageous available use while it had its maximum current value. The Company acted in the way in which it considered that it could best carry on its trade as manufacturers. This may have involved a development of the method in which it had previously traded, but the fact that many successive licensing agreements were made suggests to my mind that, of set

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policy, the Company decided that its methods of trading as manufacturers should include that development. I cannot regard the licensing agreements as involving sales of successive portions of a fixed capital asset. So to regard the licensing agreements seems to me to be quite unreal. The Company did not part with, or get rid of, its "know-how". The remarks made in the chairman's reports point to the conclusion that it had become a recognised part of the Company's trading activities as manufacturers to obtain trading receipts by entering into licensing agreements: in that way, profits would be derived from the use of the manufacturing knowledge and experience that the Company had acquired and which was constantly being added to and kept up to date. The Company considered that the demand for licences to manufacture reflected appreciation of the merits of what it manufactured. Furthermore, the licensing agreements contained provisions under which the Company would divulge information to the other party if it had made developments affecting the type of engine which was the subject of an agreement: as a result, the other party would be enabled to enter into a further licensing agreement which would cover the development. Thus, under the China agreement⁽¹⁾, which was made on 13th February, 1946, it was provided that the commission (acting for the Chinese Government) was to

"select and designate the desired type of jet engine and notify Rolls-Royce of such selection, whereupon such engine so selected shall be the basic type of engine referred to in this agreement";

there was a provision in regard to advising the commission as to improvements and modifications in the manufacture and design of the engine referred to; there was also a provision that if within five years Rolls-Royce put in series production a new type of gas turbine aircraft engine, then (subject to a condition) Rolls-Royce would not license anyone to manufacture the engine in the conceded territory without first giving the commission an option, upon payment of a further "capital sum", to acquire a licence to do so.

The various circumstances to which I have referred distinguish the present case on its facts from *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540. In that case there was not the feature of the repetition of licensing which exists in the present case and, as Upjohn, L.J., pointed out, there was an isolated transaction which resulted in the imparting of certain knowledge of methods of preparation of products and of storing and packaging them in hot climates, which knowledge would probably be applied in manufacture for a long time. The imparting of the knowledge would be to the detriment of the company's position and prospects in Burma. In the present case it is possible to survey the activities of the Company over the period of years following the time of the China agreement. Such a survey seems to me to show that the Company decided as a matter of trading policy that, in regard to certain territories, it would adopt the method of permitting local manufacture upon the terms of the various agreements that were entered into and, in order to enable this to be done and so that its name and reputation should not suffer, that it would give all necessary assistance to ensure that the engines would be satisfactorily manufactured.

For the reasons which I have indicated, I feel impelled to the view that the sums which are in question, and which the Company received under the terms of the agreements, were trading receipts on revenue account.

I would dismiss these appeals.

(1) See pages 447-50 ante.

Lord Guest (read by Lord Morris of Borth-y-Gest).—My Lords, the Special Commissioners have held that the lump sums received by the Company under the agreements referred to fell to be treated as capital receipts not forming part of its profits or gains. Pennycuik, J., affirmed their determination and dismissed the Crown's appeals. The Court of Appeal reversed his decision, and held that the lump sums were trading receipts and fell to be included in the profits or gains of the Company for Income Tax purposes. In my opinion they were right in so holding.

The question whether any particular receipt is capital or income in the hands of the trader is a question of law to be determined upon a consideration of all the relevant facts. The decision of the Commissioners is therefore open to review by the Court. This question has been treated by the Courts as a question of law in a number of cases, of which *Commissioners of Inland Revenue v. Rustproof Metal Windows Co., Ltd.*, 29 T.C. 243 (Lord Greene, M.R., at page 266); *Van den Berghs, Ltd. v. Clark*, 19 T.C. 390; *Bean v. Doncaster Amalgamated Collieries, Ltd.*, 27 T.C. 296; and *Davies v. The Shell Company of China, Ltd.*, 32 T.C. 133, are only examples.

The Company's argument in favour of the sums being capital receipts was based upon bringing the case within the ratio of the decision in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, which, it was said, established that the proceeds of the sale of "know-how" was a capital receipt. Unless the Company's case can be brought within that ratio, I can see no ground upon which the Commissioners' determination can be supported. However, I regard *Evans Medical Supplies* as a very special case decided upon its own particular facts. The processes which the company undertook to disclose to the Burmese Government in return for £100,000 were secret processes in relation to the preparation, storage and packing of pharmaceutical products which they manufactured. The disclosure of these secrets, never disclosed to anyone before, involved the gradual cessation of the company's own wholesale trading activities in Burma. The company parted with an asset which was the source, or one of the sources, of its profits. No similar agreement had been entered into by the company with any other foreign government or party. The ratio of the speech of Viscount Simonds⁽¹⁾, who held that the £100,000 was a capital receipt, was that the process was a secret process and that the transaction "necessarily involved the realization of a considerable part of its capital value", quoting from Lord Fleming's judgment in *Trustees of Earl Haig v. Commissioners of Inland Revenue*, 22 T.C. 725, at page 735. It was a "once for all" sale. My Lords, the circumstances of the present case are very different. The case is said, like *Evans Medical Supplies*, to involve the sale of "know-how". There is no mystique attaching to this word. In fact, what the Company did was to hand over in terms of the agreements the complete drawing and manufacturing and engineering data necessary to enable the other contracting parties to manufacture the aero engines in question. There were also provisions for the exchange of technical personnel. In addition to the lump sum payments, the other parties to the agreements were to pay to the Company royalties in respect of each engine and all spare parts manufactured by them. Whether this can properly be described as a sale of "know-how", what the Company had done over a long period of years was to acquire a specialised knowledge of the methods of manufacture of aero engines. This knowledge it employed in the manufacture, for sale by itself, of aero engines; and, in countries to which the export of aero engines was not possible, it employed its knowledge

(1) 37 T.C., at p. 579.

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by obtaining lump sums under these licensing agreements. Similar agreements have been made with seven countries, and in fact 19 agreements in all have been concluded. These were not, of course, in relation to the same aero engine, as new types were constantly being developed. It was suggested that mere multiplicity of transactions could not convert what was otherwise a capital receipt into trading profit, and that the matter must be looked at when the very first agreement was made by the Company. This would, in my view, be a totally unrealistic approach. The fact that the Company was able, over the years, to continue to dispose so advantageously to itself, by means of these licensing agreements, of its "know-how" shows, to my mind, quite clearly that it was not realising a considerable part of the capital value of the "know-how" but that a substantial portion of the "know-how" remained and was not dissipated by the disclosure of any secret process. It remained for disposal to the other numerous parties to the agreements.

It is not doubtful that if the Crown had made a case that the Company entered upon a new trade of dealing in "know-how", it might have been assessed on the lump sums paid under the agreements. The Crown, however, expressly disclaimed any intention of alleging a new trade. The question is, therefore, whether the licensing fees can be included as profits of the Company as incidental to the manufacture of aero engines. I have given my reasons for distinguishing this case from *Evans Medical Supplies* ⁽¹⁾. If the licensing fees are not capital receipts on the basis of the decision in *Evans Medical Supplies*, I do not see any other conclusion than that they are trading receipts. The matter can be expressed in different ways. I prefer to base my conclusion upon the view that the licensing agreements were a development of the general trade carried on by the Company. The royalties are admittedly included among the Company's profits of the trade as manufacturers of aero engines. These could not have been earned so easily without the licensing, which enabled the foreign governments to manufacture the aero engines. It was an integral trading activity and the licensing agreements were incidental to the manufacture of aero engines.

I would dismiss the appeals.

Questions put:

That the Orders appealed from be reversed.

The Not Contents have it.

That the Orders appealed from be affirmed and the appeals dismissed with costs.

The Contents have it.

[Solicitors:— Solicitor of Inland Revenue; Claremont Haynes & Co.]

(1) 30 T.C. 540.