COURT OF SESSION (FIRST DIVISION)—
1ST AND 2ND MAY, 1962

HOUSE OF LORDS—14TH AND 15TH JANUARY, 1963

Commissioners of Inland Revenue

v.

Luke[1]

Income Tax, Schedule E—Benefit in kind—Director in occupation of company's house—Expenditure by company on repairs and upkeep in excess of rent—Income Tax Act, 1952 (15 & 16 *Geo.* VI & 1 *Eliz.* II, *c.* 10), *Sections* 161 *and* 162.

The Respondent was the managing director of a public company. At the company's suggestion he bought for his own occupation a large house in which he entertained foreign customers. Later he sold the house to the company at arm's length and continued to occupy it as tenant at a rent equal to the gross annual value for the purposes of Income Tax (Schedule A). Under the tenancy agreement the company was responsible for repairs to the fabric and for the fences and boundary walls. The Respondent was tenant of the house from 1st October, 1955, *to 15th May*, 1957, *and in this period the company spent* £950 *on repairs, owner's rates, insurance and feu duties. The excess of the company's expenditure over the amount paid by the Respondent in rent was included as a benefit chargeable under Part* VI, *Chapter* II, *Income Tax Act*, 1952, *in assessments to Income Tax made upon him for the years* 1955–56 *to* 1957–58 *inclusive.*

On appeal against these assessments the General Commissioners found that the amounts were not liable to tax.

The Court of Session held that the Respondent was assessable to tax in respect of the sums in question.

The House of Lords (Lord Jenkins dissenting) restored the decision of the General Commissioners on the grounds (i) (per *Lords Dilhorne, L.C., Guest and Pearce*) *that expenditure on repairs (being of a kind which would normally fall on an owner and not on a tenant) and improvements was incurred by the company in the acquisition or production of an asset which remained its own property, and was therefore by reason of Section* 162(1) *not liable to tax;* (ii) (per *Lord Dilhorne, L.C.*) *that expenditure by the company on owner's rates, insurance and feu duty was not made in or in connection with the provision of living accommodation for the Respondent; and* (iii) (per *Lords Reid and Pearce; Lords Dilhorne, L.C., and Guest dissenting*) *that none of the payments in question, if made to the Respondent, would have been sums "paid in respect of expenses" within the meaning of Section* 160(1).

CASE

Stated for the opinion of the Court of Session, as the Court of Exchequer in Scotland, under the Income Tax Act, 1952, Section 64.

At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of the Lower Ward of the County of Lanark,

[1] Reported (C.S.) 1962 S.C. 218; 1962 S.L.T. 253; (H.L.) [1963] 2 W.L.R. 559; 107 S.J. 174; [1963] 1 All E.R. 655; 234 L.T.Jo. 164; 1963 S.L.T. 129.

held at 50, St. Vincent Crescent, Glasgow, C.3., on 17th April, 1961, Mr. William Edgell Luke, resident for all relevant periods at "Deaseholm", Troon, Ayrshire (hereinafter called "the Respondent") and holding office as managing director of the Linen Thread Co., Ltd., of 95, Bothwell Street, Glasgow, C.2. (hereinafter called "the company"), appealed against assessments to Income Tax made on him under Schedule E of the Income Tax Act, 1952, in respect of emoluments from that office for the following years in the amounts shown:

1955–56 (year ended 5th April, 1956) £288
1956–57 (year ended 5th April, 1957) £383
1957–58 (year ended 5th April, 1958) £32

The assessments were in each case shown as being in respect of "benefits in kind", and related to the expenditure incurred by the company in those years on the upkeep and repairs of a dwellinghouse owned by the company and occupied by the Respondent as tenant. The amounts of the assessments were not in dispute.

The only matter on which the Commissioners who heard the appeal were asked to adjudicate was whether the said expenditure incurred by the company was or was not assessable to Income Tax on the Respondent as part of the emoluments of his office.

I. The following facts were admitted or proved:

(1) The Respondent is managing director of the Linen Thread Co., Ltd., a very large public company then having its head office in Glasgow, and for the years involved the Respondent resided in the dwellinghouse "Deaseholm", Troon, Ayrshire.

(2) The company had desired that the Respondent should reside in Ayrshire, and had suggested that "Deaseholm" might be a suitable residence. In November, 1951, the Respondent purchased that house and had taken up residence there. He had regarded the house as attractive and had purchased it of his own free choice.

(3) The purchase price of the house was £10,000, and the Respondent spent about £4,000 on initial repairs and on upkeep in the next three years.

(4) The house was of substantial size, containing 4 sitting rooms, 7 bedrooms, 4 bathrooms and a play room as well as the usual offices.

(5) The house was used to a great extent for entertaining the foreign customers of the company.

(6) By 1954 the Respondent found that the house was too big and expensive to keep up and that he could not afford it. He had advertised the house for sale. The chairman of the company had seen the advertisement, but desired that the Respondent should continue to live there for the company's benefit. To this end it was proposed by the company that it should purchase the house and let it to the Respondent, who would continue to reside there as tenant. The Respondent stated that this proposal was spontaneous and unsolicited.

(7) The company purchased the house from the Respondent for £12,000 with entry at 11th November, 1954, and by minute of agreement it was let by the company to the Respondent at a rental of £148 per annum, which was the gross annual value. Under the agreement the Respondent was responsible for all occupier's rates and charges, for all internal repairs and decorations, and for all upkeep and maintenance of the grounds and garden. The company was responsible for all repairs to the fabric of the house and other buildings, and for the fences and boundary walls.

(8) The sale of the house was entirely a matter of the Respondent's own

choice. The transfer from himself to the company was at arm's length, as was also the tenancy agreement, and after a survey had been carried out by the professional surveyor usually employed by the company in its acquisition of heritable properties.

(9) By 1957 the Respondent found that the house was still too big for him. His son had left home and his daughter was at boarding school, and he himself was abroad on business for considerable periods. His wife also found it too large to manage. He gave up the tenancy at 15th May, 1957, and acquired another residence, with about half the accommodation, in the South of England, because his company's policy of diversification made it necessary for him to spend more time in the South.

(10) After the Respondent had moved out of the house "Deaseholm", it was sold by the company for £11,500.

(11) During the period of the Respondent's tenancy of "Deaseholm", the company as owner, and in terms of the tenancy agreement, incurred the following expenditure in respect of the house:

(*a*) Year ended 30th September, 1956

	£	£
Rates (owner's)		68
Insurance		10
Repairs:		
New hothouse boiler	66	
Repairs to greenhouse wall	3	
Renewal of fireplace (2)	41	
Laying new water main and renewing plumbing in "Deaseholm" and chauffeur's house	489	599
Feu duty (exceeds annual value)		47
		724

(*b*) Year ended 30th September, 1957 (period to 15th May, 1957)

	£	£
Rates		91
Insurance		9
Repairs:		
Chimney (less covered by insurance)	7	
Repairs to fences and felling trees	83	
Repairs to roof (less covered by insurance)	5	95
Feu duty (exceeds annual value)—8/12ths of £47		31
		226

(12) The excess of the expenditure over the rent paid by the Respondent to the company in terms of the agreement was, therefore, as follows:

	Year ended 30th September, 1956	Year ended 30th September, 1957 (period to 15th May, 1957)
	£	£
Expenditure as above	724	226
Rent	148	(8 months) 99
Excess	576	127

(13) The assessment under Schedule A for the house was on a gross annual value of £148, reduced for the purposes of collection to £26.

(14) The computation of the sums assessed, based upon the preceding figures in paragraph (12), is as follows:

		£	£
1955–56	6/12 of £576		288
1956–57	6/12 of £576	288	
	6/8 of £127	95	383
1957–58	2/8 of £127		32
			703

II. Mr. A. G. McBain, chartered accountant, contended on behalf of the Respondent, *inter alia.*

(1) That there was no "benefit" to the Respondent from the expenditure by the company within the terms of Section 161 of the Income Tax Act, 1952.

(2) That the tenancy agreement was at arm's length, that there was no dispute as to the adequacy of the rent under Section 162 of the Income Tax Act, 1952, and no question of any hidden benefit by under-charge of rent.

(3) That the expenditure on repairs did no more than keep the house in a habitable condition and related wholly to expenditure properly borne by the owner.

(4) That the state of the house would be taken into account by the skilled surveyor employed by the company in making his valuation, and any necessary repairs subsequent to ownership by the company must be taken as the normal incidence of ownership.

(5) That the repairs concerned contained no element of improvement, and that, if anyone received any benefit from the repairs expenditure, it must have been the owners, in order that they might protect a capital asset and not for the purpose of conferring any benefit on the tenant.

(6) That (*a*) the major item of repairs (renewal of water main and plumbing) cost £489 and that this was completed in 1956, and Mr. Luke gave up the tenancy on 15th May, 1957; and (*b*) a repair of this nature was only likely to arise at very long intervals.

(7) That the occupation of the house by the Respondent was regarded by the directors of the company as advantageous to the company for entertainment purposes.

(8) That the agreement was the same as it would have been for any other tenant and the case would not have arisen under any other owner.

(9) That the assessments for all three years should be discharged.

III. Mr. G. W. Yule, H.M. Inspector of Taxes, contended on behalf of the Crown, *inter alia.*

(1) That the company, for the years under consideration, had expended the sum of £950 on or in respect of the house which the company had acquired from the Respondent in order to provide him with accommodation therein; that the company had during the same period recovered from the Respondent only £247 as rent; and that the difference between these two sums, namely, the sum of £703, fell to be regarded as part of the emoluments of the Respondent, assessable to Income Tax for the years under consideration pursuant to the provisions of Sections 160 and 161 of the Income Tax Act, 1952.

(2) That the assessments for the three years in question were properly made and should be confirmed.

IV. No reference was made by either side to any decided cases.

V. We, the Commissioners who heard the appeal, after due consideration of the facts and arguments submitted to us were of the opinion that the sums involved were not liable to tax. Accordingly, we discharged the assessments for each of the years 1955–56, 1956–57 and 1957–58.

VI. Immediately after our so determining the appeal dissatisfaction with our decision as being erroneous on a point of law was expressed to us on behalf of the Crown, and we were duly required, pursuant to the provisions of Section 64 of the Income Tax Act, 1952, to state and sign a Case for the opinion of the Court of Session as the Court of Exchequer in Scotland, which Case we have stated and signed accordingly.

VII. The question of law for the opinion of the Court is whether we were correct in deciding that the expenditure incurred by the company on the upkeep and repairs of the house occupied by the Respondent, in excess of the rent paid by him as tenant of the company, was not assessable under Section 161 of the Income Tax Act, 1952, as part of his emoluments.

R. A. Ure
Wm. Yeaman
W. Lambert F. Shaw
William Robieson
} General Commissioners of Income Tax for the Lower Ward of Lanarkshire.

10th November, 1961.

The case came before the First Division of the Court of Session (the Lord President (Clyde) and Lords Carmont and Guthrie) on 1st and 2nd May, 1962, when judgment was given in favour of the Crown.

The Solicitor-General for Scotland (Mr. D. C. Anderson, Q.C.) and Mr. A. J. Mackenzie Stuart appeared as Counsel for the Crown, and Mr. J. P. H. Mackay for the taxpayer.

The Lord President (Clyde).—The question in this case relates to certain of the expenses incurred by a company in connection with a house let by the company to its managing director. He has been assessed to Income Tax upon these sums on the ground that these expenses fall to be treated

> "as if the expense had been incurred by the director . . . and the amount thereof . . . refunded to him by the body corporate by means of a payment in respect of expenses"

within the meaning of Section 161(1) of the Income Tax Act, 1952. On an appeal to the General Commissioners they discharged the assessments in question, and the Crown have appealed against this determination by the Commissioners. The question of law for our opinion is whether the Commissioners were correct

(The Lord President (Clyde))

in deciding that the expenditure incurred by the company on the upkeep and repair of the house occupied by the Respondent, in excess of the rent paid by him as tenant of the company, was not assessable under Section 161 of the Income Tax Act, 1952, as part of his emoluments.

The company is the Linen Thread Co., Ltd., and the present Respondent was at the material time the managing director thereof. The company had desired that the Respondent should reside in Ayrshire, and had suggested that a certain house in Troon would be a suitable residence for him. He decided to buy the house and lived there using it among other things for entertaining the foreign customers of the company. In 1954, as the house was larger than he desired, he decided to sell. But by arrangement with his company, he sold the house to the company, which let it to him. The purchase price and the rent were fixed at arm's length after an independent surveyor had been consulted. The Respondent occupied the house for some two-and-a-half years thereafter till he left it to reside in England. During the period of his tenancy there the company expended considerable sums on repair and upkeep, in excess of the rent received from him. This excess is the basis of the assessments in issue in this case. The company's expenditure, apart from owner's rates and insurance, according to the findings in the Case, consisted in what the Commissioners described as "repairs". It involved not only repairs to walls, chimneys, roof and fences, but also the supply of a new hothouse boiler and of a fireplace and the laying of a new water main, coupled with the renewing of the plumbing in the mansion house and the chauffeur's cottage.

The first question is whether the expenditure in question falls within the type of expenditure envisaged in the opening words of Section 161 (1). These words are very wide. They include expense incurred by the company

> "in or in connection with the provision, for any [director], of living or other accommodation . . . or of other benefits or facilities of whatsoever nature".

It appears to me clear that the expenses in question fall within the ambit of these words. Indeed, they all seem to me to be expenses incurred by the company in or in connection with the provision for the Respondent of living or other accommodation. If not, they clearly fall within the category of "other facilities of whatsoever nature". I am, therefore, not in favour of the Respondent on this aspect of the case.

Two further arguments were put forward by the Respondent, however, for excluding his liability for tax in respect of these expenses. In the first place, it was contended that not all expenses in connection with the provision by the company of a director's living or other accommodation was assessable in terms of Section 161 (1), but only so much of it "as is not made good to the body corporate by the director". In the present case, the bargain under which the Respondent became the tenant was fixed at arm's length and the rent adjusted on that basis. Any expenditure, therefore, so it was contended, which the landlords made on the subjects must be deemed to have been made good to them by the tenant, since the rent was fixed as a fair rent in the light of the landlord's probable liability for repairs or renewals. I am, however, unable to give so fanciful a meaning to the words "made good". This phrase relates, in my view, primarily to money payments made by the director to the company, and not to cases where the company has incurred expense in respect of which he has made no specific contribution in money or in kind. The expenditure on which the present assessments are based falls within this latter category in so far as not met by his rent payments. This argument for the Respondent is, therefore, in my view erroneous.

(The Lord President (Clyde))

The other argument put forward for the Respondent was based upon the provisions of Section 162(1) of the Act. That Sub-section provides that:

> "Any expense incurred by a body corporate in the acquisition or production of an asset which remains its own property shall be left out of account for the purposes of the last preceding section."

The contention was that the expenses in question were incurred in the acquisition or production of an asset within the meaning of this Sub-section. In my view, however, the contention is unsound. Section 162(1) relates to capital outlays on acquiring, for instance, a dwellinghouse, not outlays such as those in question here, which are essentially payments for improvements or repair of an already existing capital asset. Expenditure on repairs or upkeep always involves an element of replacement or renewal, but that is not in itself enough to bring such repairs within the scope of Section 162(1).

On the whole matter, therefore, in my opinion the General Commissioners were in error in deciding as they did, and the question put to us should be answered in the negative.

Lord Carmont.—I am of the same opinion, and have nothing to add.

Lord Guthrie.—I am also in general agreement with what your Lordship has said, and I only add some observations out of respect for the able argument put forward by Mr. Mackay, for the Respondent.

The question stated in the Case is whether certain sums of money were assessable as part of the emoluments of the Respondent under Section 161(1) of the Income Tax Act, 1952; and accordingly the answer is to be found in the terms used in that Sub-section, which are to be read, however, as the Sub-section bears, subject to the following provisions of Chapter II of Part VI of the Act. The Sub-section provides that certain expenses incurred by a company are to be treated, for the purposes of the assessment of a director under Schedule E, as expenses incurred by the director and refunded to him by the company. The relevant conditions of the accountability of the director for such expenses as laid down in the Sub-section are, first, that the expenditure has been incurred by the company; second, that it is expense in or in connection with the provision by the company of living or other accommodation for the director; and third, that he is accountable to the extent to which the expense has not been made good by him to the company.

The main argument for the Respondent was that the third of these conditions had not been fulfilled, because the director had made good to the company the expense incurred in the provision of living or other accommodation. It was said that the director had paid a fair rent for the house, and that the expenditure by the company on the house was the counterpart of the payment of rent—the fulfilment of a landlord's obligation to maintain the house in a state to command that rent. Although in one year the expenditure greatly exceeded the rent paid, in another year there might be no expenditure, and therefore, it was submitted, the only reasonable way of looking at the situation was to regard a fair rent as making good, one year with another, the company's expenditure on the provision of accommodation. In my opinion that argument is unsound. The Sub-section does not provide that there shall be no accountability on the part of the director for such expenditure where the accommodation has been let to him at a fair rent. Even if a reasonable consideration is paid by the director for the accommodation, the expenditure incurred by the company in the provision of that accommodation may be far in excess of the rent; and, in terms of the Sub-section, it has to be brought into account because it is expense incurred in connection with the provision of accommodation.

(Lord Guthrie)

Secondly, it was submitted that the director was not accountable for the expense incurred by the company in so far as that expense related to improvements and not to current repairs. Again, I cannot accept this submission. If the house has been improved for the accommodation of the director, then the expense incurred in making that improvement is just as much in connection with the provision of the accommodation as expense on current repairs. The argument was supported by reference to Section 162(1) of the Act, which provides that:

> "Any expense incurred by a body corporate in the acquisition or production of an asset which remains its own property shall be left out of account for the purposes of [Section 161]."

It was submitted that in this case the provision of a new hothouse boiler, new fireplaces and a new water main represented expense incurred by the company in the acquisition of assets. Now, without attempting to define the word "asset" as used in Section 162(1), I am of opinion that the word does not cover these things, which are merely fitments inserted in or affixed to the dwellinghouse provided by the company, and which have no utility except as fitments in the dwellinghouse.

Then it was argued for the Respondent that in any event only a portion of the expense incurred should be taken into account in connection with the Respondent's liability under Schedule E. Reference was made to Section 161(6), which provides that:

> "Any reference in this section to expense incurred in or in connection with any matter includes a reference to a proper proportion of any expense incurred partly in or in connection with that matter."

The argument was that in the present case the expense of providing a hothouse boiler, fireplaces and a new water main could not be attributed solely to the provision of accommodation for the Respondent, because he had given up the tenancy soon after these improvements were made, and therefore the benefit of these improvements must be ascribed partly to the owners and to his successors in the tenancy. In these circumstances, it was submitted that there ought to be an apportionment of the expense based on the proportion between any temporary benefit derived by the Respondent and the benefits which should be ascribed to these other parties. In my opinion, it does not matter that the benefit of the expenditure incurred by the company has endured beyond the termination of the tenancy of the director. The improvements were wholly made to the property provided by the company as accommodation for the Respondent. The continuance of the benefit beyond the period of his tenancy does not destroy, either in whole or in part, the connection between the expense and the provision of accommodation for the Respondent. If the expenditure had been incurred partly on that property and partly on another property not used for his accommodation, there would have been room for apportionment.

The other argument for the Respondent related to insurance premiums which were paid by the company after its acquisition of the house from the Respondent, and to owner's rates and feu duty. It was said that these payments were not made in connection with the provision of accommodation for the Respondent, but were payments which were borne by the company purely in its capacity as owner of the property. Again, I am of opinion that this argument is negatived by the terms of Section 161(1). The company acquired the ownership to provide accommodation for the director, and accordingly

(Lord Guthrie)

incurred the liabilities of ownership for that purpose. Therefore, these expenses were in connection with the provision of accommodation for the Respondent.

In these circumstances I agree with your Lordships that the question should be answered in the negative, as proposed.

The taxpayer having appealed against the above decision, the case came before the House of Lords (Lord Dilhorne, L.C., and Lords Reid, Jenkins, Guest and Pearce) on 14th and 15th January, 1963, when judgment was reserved. On 20th February, 1963, judgment was given against the Crown, with costs (Lord Jenkins dissenting).

Sir John Senter, Q.C., and Mr. J. P. H. Mackay appeared as Counsel for the taxpayer, and the Solicitor-General for Scotland (Mr. D. C. Anderson, Q.C.), Mr. Alan Orr and Mr. A. J. Mackenzie Stuart for the Crown.

Lord Dilhorne, L.C.—My Lords, the Appellant, Mr. William Edgell Luke, was at all material times the managing director of the Linen Thread Co., Ltd., whose headquarters were in Glasgow. The company had wanted him to live in Ayrshire, and in November, 1951, he bought the house, "Deaseholm", at Troon, of his own free choice, for £10,000. In addition to this sum he spent about £4,000 on initial repairs and on upkeep in the next three years. In 1954 the Appellant advertised the house for sale as he had found it too big and expensive to keep up. The chairman of the company saw the advertisement, but still wanted the Appellant to live there for the company's benefit, and it was accordingly proposed that the company should purchase the house and let it to the Appellant. This proposal, which the Appellant stated was spontaneous and unsolicited, was acted upon, and the company bought the house for £12,000 and let it to the Appellant at a rent of £148 per year, which was the gross annual value.

Under the tenancy agreement the Appellant was responsible for all occupier's rates and charges, for all internal repairs and decorations, and for all upkeep and maintenance of the grounds and garden; and the company was responsible for all repairs to the fabric of the house and other buildings, and for the fences and boundary walls. There does not appear to be anything unusual in the tenancy agreement, and it was found as a fact by the General Commissioners that the transfer of the house from the Appellant to the company was at arm's length, as was also the tenancy agreement, after a survey had been carried out by a professional surveyor usually employed by the company in its acquisition of heritable properties.

On 15th May, 1957, the Appellant gave up the tenancy. During the period of his occupation as tenant the company "as owners and in terms of the tenancy agreement", so the Case states, incurred expenditure on the following items in relation to the house:

	£	£
Rates	159	
Insurance	19	
	—	178
Feu duty		78
Repairs:		
New hothouse boiler	66	
To greenhouse wall	3	
Renewal of fireplace (2)	41	

Laying new water main and renewing plumbing in "Deaseholm" and chauffeur's cottage	489	
To chimney (less covered by insurance)	7	
To fences and felling trees..	83	
To roof (less covered by insurance)	5	
	—	694
		£950

The total expenditure on repairs amounted to £694, and on the rates (owner's), insurance and feu duty amounted to £256.

The Case does not distinguish between expenditure incurred by the company as owner and that incurred under the terms of the tenancy agreement. As owner the company would, I understand, be liable for owner's rates and feu duty, and it would seem unlikely that the amount spent by it on insurance, namely £19, was required to be spent under the terms of the tenancy agreement. It was not disputed that the expenditure on repairs incurred by the company was expenditure the company was obliged to make under the terms of that agreement. The Crown contended that the excess of this expenditure over the rent paid is, by virtue of Sections 160 and 161 of the Income Tax Act, 1952, to be treated as taxable income in the hands of the Appellant, and they accordingly assessed him to Income Tax under Schedule E in respect of emoluments from his office of managing director in the following terms:

1955–56	£288
1956–57	£383
1957–58	£32

The Appellant appealed to the General Commissioners, who discharged the assessments as they were of the opinion that the sums involved were not liable to tax. The Crown then appealed to the Court of Session, who reversed the Commissioners' finding, and now the Appellant before your Lordships seeks to restore the finding of the Commissioners.

The simple facts of this case necessitate a close examination of Chapter II of Part VI of the Income Tax Act, 1952. That Chapter is headed "Expenses Allowances to Directors and Others" and contains provisions first enacted in 1948. The material part of the first Section in this Chapter, Section 160, reads as follows:

> "160.—(1) Subject to the provisions of this Chapter, any sum paid in respect of expenses by a body corporate to any of its directors or to any person employed by it in an employment to which this Chapter applies shall, if not otherwise chargeable to income tax as income of that director or employee, be treated for the purposes of paragraph 1 of the Ninth Schedule to this Act as a perquisite of the office or employment of that director or employee and included in the emoluments thereof assessable to income tax accordingly: Provided that nothing in this subsection shall prevent a claim for a deduction being made under paragraph 7 of the said Ninth Schedule in respect of any money expended wholly, exclusively and necessarily in performing the duties of the office or employment."

The effect and object of this provision is clear. It was to prevent evasion of liability to tax by the payment of expenses to directors of bodies corporate and other persons employed to whom the Chapter applies. Save and in so far as deductions might be made in respect of moneys expended wholly, exclusively and necessarily in performing the duties of the office or employment, the amount paid as expenses was to be included in the emoluments of the office or employment and so made subject to tax.

(Lord Dilhorne, L.C.)

It would not have sufficed to prevent evasion of liabilities to tax merely to have dealt with expenses. Section 161 was, as the marginal note to that Section indicates, directed to benefits in kind. Section 161(1) reads as follows:

> "Subject to the following provisions of this Chapter, where a body corporate incurs expense in or in connection with the provision, for any of its directors or for any person employed by it in an employment to which this Chapter applies, of living or other accommodation, of entertainment, of domestic or other services or of other benefits or facilities of whatsoever nature, and, apart from this section, the expense would not be chargeable to income tax as income of the director or employee, paragraphs 1 and 7 of the Ninth Schedule to this Act, and section twenty-seven of this Act, shall have effect in relation to so much of the said expense as is not made good to the body corporate by the director or employee as if the expense had been incurred by the director or employee and the amount thereof had been refunded to him by the body corporate by means of a payment in respect of expenses."

As the Lord President (Clyde) observed in the course of his judgment in the Court of Session(1), the opening words of this Sub-section are very wide, and the Crown contend that the expenditure in question incurred by the company was in or in connection with the provision of living accommodation, and so that that expenditure less the sum "made good" by the payment of rent is subject to tax.

The first question that falls for consideration is whether the sum which was spent by the company in discharge of owner's rates, feu duty and for insurance can properly be regarded as expended in the provision of living accommodation for the Appellant or in connection therewith. In my opinion it cannot properly be so regarded. As owner of the property "Deaseholm", the company had to pay owner's rates and feu duty, and it was to its interest to see that the property was insured. The Solicitor-General, in the course of his clear and interesting argument, contended that, as the purpose of the sale by the Appellant to the company and of the letting to the Appellant was to relieve the Appellant of expenditure in relation to the property which he was unable to afford, any expenditure incurred by the company in relation to "Deaseholm" was to be regarded as expenditure for living accommodation for him. He maintained that it was less expensive to rent than to own and that consequently any expense incurred by the owner of the property, which is a body corporate, in relation to premises let to a director was in or in connection with the provision of living accommodation for him. In this case there is a finding of fact that during the period in question the house was used to a great extent for entertaining foreign customers and that the chairman of the company wanted the Appellant to continue to live at "Deaseholm" for the company's benefit.

While I recognise that the Appellant was not prepared to continue to meet the expense that fell on him as owner of the premises, I am unable to conclude that the expenditure incurred by the company in relation to owner's rates, feu duty and insurance is to be regarded as expenditure in or in connection with provision of living accommodation for him. He was paying a full rent while undertaking the normal tenant's obligations, and the company was securing that, while he continued to live near their headquarters in Glasgow for the company's foreign visitors. Nor can I reach the conclusion that any letting by a company to a director at a full rent with the normal obligations of a tenant is to be regarded as subjecting the tenant to tax in respect of such outgoings as fall upon the company as owner of the property. On the other hand, the expense of repairs to a property so let cannot, in my opinion, be regarded otherwise than as expense incurred in or in connection with the provision of living accommodation, and

(1) *See* page 635, *ante*.

(Lord Dilhorne, L.C.)

so in my view that expense will be subject to tax unless taken out of Section 161(1) by a subsequent provision.

Before I leave this Sub-section I must add that I do not find the latter part of it any assistance in determining the scope of the opening words. The phrase

> "apart from this section, the expense would not be chargeable to income tax as income of the director or employee"

seems to me to have been inserted to avoid any possibility of duplication of liability to tax. The words:

> "paragraphs 1 and 7 of the Ninth Schedule . . . shall have effect in relation to so much of the said expense as is not made good to the body corporate by the director or employee as if the expense had been incurred by the director or employee and the amount thereof had been refunded to him by the body corporate by means of a payment in respect of expenses"

seem to me, apart from the reference to expense "made good", to be a mere machinery provision in no way limiting or throwing a light upon the scope of the first part of the Sub-section. Expenses which come within the scope of the Sub-section are to be treated as if they had been incurred by the director and as if they had been refunded to him as a payment in respect of expenses. Such payments are made subject to tax by virtue of Section 160 unless, of course, the director can show that they were wholly, exclusively and necessarily incurred in performing the duties of his office.

Sub-sections (2) to (5) of Section 161 are provisions exempting from the scope of Section 161(1) certain categories of expenditure which would otherwise be included.

Section 162(1) reads as follows:

> "Any expense incurred by a body corporate in the acquisition or production of an asset which remains its own property shall be left out of account for the purposes of the last preceding section."

Section 162(1) thus takes out of the scope of Section 161(1) all expense incurred in the acquisition or production of an asset, provided that the asset remains the property of the body corporate, no matter to what extent the acquisition or production of it may enure to the benefit of a director or other employee to whom Chapter II applies. "Asset" and "production of an asset" are not defined, and I do not propose to attempt a definition.

Section 162(3) deals with a case where the body corporate is assessed under Schedule A in respect of premises occupied by a director or other employee. Then, if the body corporate pays no rent or a rent less than the amount of the assessment as reduced for the purposes of collection, Section 161 is to have effect as if the body corporate paid a rent equal to the amount of the assessment so reduced. If the body corporate paid a higher rent than that, then by virtue of Section 161(1) the amount of the higher rent falls to be treated as part of the director's or employee's income.

Section 162(4) has a wider application; it extends to all assets which belong to the body corporate (except premises in respect of which the company is assessed under Schedule A) used in the making of such provision as is caught by Section 161(1). The Sub-section then provides, in relation to such assets, that

> "the body corporate shall be deemed for the purposes of the last preceding section to incur (in addition to any other expense incurred by it in connection with the asset, not being expense to which subsection (1) of this section applies) annual expense in connection therewith of an amount equal to the annual value of the use of the asset".

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The effect of this provision is to secure that there shall be added to the director's or employee's taxable income an amount equal to the annual value of the assets so used, whether the asset be a motor car, premises in respect of which the body corporate is not assessed under Schedule A, or an asset of any other description. The proviso to this Sub-section provides that, if any sum is payable by way of rent or hire in respect of the assets by the body corporate, the Sub-section is not to apply if the sum paid is greater than or equal to the annual value of its use, and if the rent or hire is less than the annual value the amount paid for rent or hire is to be disregarded.

Sub-sections (3) and (4) thus provide for minimum sums to be treated as part of the director's or employee's taxable income.

It is, I think, odd that the effect of Section 162(3) and 162(4) in relation to premises is to make the extent of the liability of the director under these Sub-sections depend upon whether or not the body corporate is assessed under Schedule A. If the company was so assessed in respect of "Deaseholm", the amount to be treated as added to the Appellant's income would be £26. As the company was not so assessed, by virtue of Section 162(4) £148 is to be deemed to be added to his income.

The words in brackets in Section 162(4) do not appear in Section 162(3), but despite their absence it is, I think, clear that in a case to which Section 162(3) applies any other expense which comes within Section 161(1) and not within Section 162(1) is to be treated as added to the director's taxable income as well as a sum equal to the Schedule A assessment so reduced.

These words in brackets were not in my opinion intended to add, and do no add, to what is contained in Section 161(1). They make it clear that the amount to be treated as forming part of the taxable income is not limited to an amount equal to the annual value of the use of the asset. It follows that, unless the amounts spent by the company on repairs are to be regarded as coming within Section 162(1), the Appellant is liable to be taxed on an amount equivalent to the annual value and also on the expenditure on repairs. Many instances can be given of the manifest unfairness of this. I will content myself with one. If the roof of the house had been blown off in a gale and the repair effected in one financial year, the Appellant would have been liable to pay tax for that year on the annual value and on the entire cost of putting on a new roof. The more expensive the repair the greater is the amount to be notionally added to his income. It must be borne in mind that it is to the interest of the owner of the premises that repairs of the character for which a landlord is normally responsible should be carried out so that the value of the premises may be maintained, and, also, while the effect of the expenditure may last for several years, the whole cost has on this interpretation to be regarded as taxable income of the year in which it was spent.

I cannot believe that it was the intention of Parliament that these provisions should have this effect. As I have said, the object of this Chapter appears to have been to prevent avoidance of tax liability by the payment of expenses allowances and, as a corollary to that, to bring into tax the value of benefits in kind. I cannot believe that it was the intention of Parliament to treat the cost of carrying out repairs, for which a landlord is normally responsible and the carrying out of which is to both his and the tenant's advantage, as a benefit in kind to the tenant. But unless such expenditure can be regarded as incurred in the acquisition or production of an asset, that, in my opinion, is the effect of these provisions. The expenditure of £66 on a new hothouse boiler was, in my view, expense incurred in the acquisition of an asset which remains the property of the company, and so comes within Section 162(1).

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I do not think that the laying of a new water main and renewing plumbing (£489) can be regarded as the acquisition of an asset. The cost of doing this work and the cost of doing the other repairs in question in this case can, in my view, only be excluded if it is to be regarded as expense in the production of an asset. I think, having regard to the context, that this phrase should not be narrowly interpreted. As I have pointed out, if it is to be understood to exclude the cost of repairs of the character executed in this case, the result will be manifestly unjust. I do not think that one is constrained to consider each item of expenditure separately and say whether or not that particular item of expenditure produced an asset which remained the property of the company. I think one is entitled to look at the position before the repairs are executed and to contrast it with that after their execution. Before they were executed, the company owned premises with a defective water main, defective plumbing, a defective chimney, defective fireplaces and a defective roof. After their execution, it owned premises of a very different character. The creation of premises of such a different character can, I think, legitimately be regarded as constituting the production of an asset.

For these reasons, in my view the Commissioners were right in holding that the sums involved in this case were not liable to tax. The case would, I think, be different if the company had executed repairs the cost of which is normally borne by a tenant; then it might well be said that the tenant had received a benefit in kind.

I would only add that I agree with the views expressed by my noble and learned friend Lord Reid, with regard to the attempt by the Crown to mitigate the injustice to the Appellant, if their contention be right, by two concessions neither of which in my view can be justified under Section 162(4).

I would allow the appeal.

Lord Reid.—My Lords, the Appellant in this case is the managing director of the Linen Thread Co., Ltd. (which I shall call "the company"). Prior to May, 1957, he resided at "Deaseholm", Troon. From 11th November, 1954, until that date, the company owned that house, and the Appellant occupied it as its tenant. This appeal relates to three assessments to Income Tax made on the Appellant under Schedule E in respect of his emoluments as managing director. These assessments were for the years 1955–56, 1956–57 and 1957–58 and were for sums amounting in all to £703. The assessments were in each case shown as being in respect of "benefits in kind", and related to the expenditure incurred by the company in those years on the upkeep and repair of "Deaseholm". The General Commissioners held that these sums were not liable to tax and discharged the assessments. The Crown required a Case to be stated, the question of law being whether the Commissioners were correct in deciding that these sums were not assessable under Section 161 of the Income Tax Act, 1952. By Interlocutor of 2nd May, 1962, the First Division of the Court of Session answered that question in the negative and allowed the Crown's appeal. The taxpayer now appeals to this House against that Interlocutor.

I can summarise the relevant facts set out in the Case Stated. The company was a large company which, during the relevant years, had its head office in Glasgow. In 1951 the Appellant purchased "Deaseholm", which was a substantial house with four sitting-rooms and seven bedrooms, and spent a considerable sum on repairs. In 1954 he advertised it for sale, finding it too big and expensive. The chairman of the company thought it would be for the benefit of the company that the Appellant should continue to reside there and proposed that the company should buy the house from him and let it to him as its tenant. Accordingly, the company bought the house for £12,000, a sum which was not sufficient to

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cover the price which the Appellant had paid for the house and the sums which he had spent on it, and then let it to him from 11th November, 1954, at a rent of £148, which was the gross annual value. It is found as a fact that the sale of the house was entirely a matter of the Appellant's own choice. The transfer from himself to the company was at arm's length, as was also the tenancy agreement, and after a survey had been carried out by the professional surveyor usually employed by the company in its acquisition of heritable properties. In May, 1957, the Appellant gave up the tenancy and moved to England because the company's policy required him to spend more time there.

During the period of the tenancy the company paid owner's rates amounting to £159, feu duty amounting to £78, insurance of the fabric amounting to £19, and also paid for several repairs and renewals of which the most important are: laying new water mains and renewing plumbing, £489; new hothouse boiler, £66; and renewal of fireplace, £41. Subject to a point which I shall mention later, the sums assessed as benefits in kind are calculated by adding together all the above items (and certain others) and deducting the sums paid by the Appellant as rent. There is a finding of fact that all these items of expenditure were incurred by the company "as owner, and in terms of the tenancy agreement". But the argument for the Crown is that that finding is irrelevant.

It is not disputed that the lease to the Appellant was a genuine transaction, that the rent was a full commercial or market rent, that owner's rates and feu duty are owner's burdens with which a tenant has in law no concern, or that the repairs were necessary repairs which, under the lease, the company as owner was bound to carry out and pay for. It is not suggested that these repairs were done in an extravagant way or included any element of improvement. Yet it is said that the law requires us to regard the whole cost of each of these items as a benefit in kind to the tenant in the year in which it was carried out, and requires us to disregard the facts that the rent was the agreed counterpart of the landlord's obligation to keep the house in tenantable repair and that the benefit to the landlord of these repairs would endure far beyond the end of the tenancy. Indeed, the argument for the Crown goes as far as this: if extensive dry rot were discovered during the tenancy and it cost the landlord £5,000 to deal with it, the whole of that £5,000 would be a benefit in kind to the tenant for the particular year when the money was spent, so that, although the tenant gets no more than he had bargained and paid for—a habitable house—but had suffered great inconvenience, his income for that year must be held to be inflated for tax purposes by £5,000. Now I must turn to the relevant Sections of the Income Tax Act, 1952, to see whether they do require us to reach that wholly unreasonable result.

The Consolidating Act of 1952 includes, in Part VI, Chapter II, a number of Sections which were first enacted in 1948. The heading of the Chapter is: "Expenses Allowances to Directors and Others". Before this legislation the position was that, under what is now Rule 1 of the Rules applicable to Schedule E in the Ninth Schedule, tax was chargeable in respect of all salaries, fees, wages, perquisites or profits whatsoever for the year of assessment. Those are wide words, but it is common knowledge that it was thought in many quarters that in spite of this provision the growing practice of expense accounts and the like was enabling a number of business men to escape from their fair share of taxation. This was the mischief which was obviously intended to be curbed by these new provisions.

The Sections which it is necessary to consider in this case are:

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"160.—(1) Subject to the provisions of this Chapter, any sum paid in respect of expenses by a body corporate to any of its directors or to any person employed by it in an employment to which this Chapter applies shall, if not otherwise chargeable to income tax as income of that director or employee, be treated for the purposes of paragraph 1 of the Ninth Schedule to this Act as a perquisite of the office or employment of that director or employee and included in the emoluments thereof assessable to income tax accordingly: Provided that nothing in this subsection shall prevent a claim for a deduction being made under paragraph 7 of the said Ninth Schedule in respect of any money expended wholly, exclusively and necessarily in performing the duties of the office or employment."

"161.—(1) Subject to the following provisions of this Chapter, where a body corporate incurs expense in or in connection with the provision, for any of its directors or for any person employed by it in an employment to which this Chapter applies, of living or other accommodation, of entertainment, of domestic or other services or of other benefits or facilities of whatsoever nature, and, apart from this section, the expense would not be chargeable to income tax as income of the director or employee, paragraphs 1 and 7 of the Ninth Schedule to this Act, and section twenty-seven of this Act, shall have effect in relation to so much of the said expense as is not made good to the body corporate by the director or employee as if the expense had been incurred by the director or employee and the amount thereof had been refunded to him by the body corporate by means of a payment in respect of expenses . . . .(6) Any reference in this section to expense incurred in or in connection with any matter includes a reference to a proper proportion of any expense incurred partly in or in connection with that matter."

"162.—(1) Any expense incurred by a body corporate in the acquisition or production of an asset which remains its own property shall be left out of account for the purposes of the last preceding section. . . . (3) Where a body corporate is assessable under Schedule A in respect of any premises the whole or any part of which is made available by it as living or other accommodation for any of its directors or employees, and either the body corporate pays no rent in respect of the premises or the annual amount of the rent paid by it is less than the amount of the assessment on the premises as reduced for the purposes of collection, the provisions of the last preceding section shall have effect as if the body corporate paid in respect of the premises an annual rent equal to the amount of the assessment as so reduced. (4) Where an asset which continues to belong to the body corporate is used wholly or partly in the making of any such provision as is mentioned in subsection (1) of the last preceding section, and the asset is not premises in respect of which the body corporate is assessable under Schedule A, the body corporate shall be deemed for the purposes of the last preceding section to incur (in addition to any other expense incurred by it in connection with the asset, not being expense to which subsection (1) of this section applies) annual expense in connection therewith of an amount equal to the annual value of the use of the asset: Provided that where any sum by way of rent or hire is payable by the body corporate in respect of the asset—(*a*) if the annual amount of the rent or hire is equal to or greater than the annual value of the use of the asset, this subsection shall not apply; and (*b*) if the annual amount of the rent or hire is less than the annual value of the use of the asset, the rent or hire shall be left out of account for the purposes of the last preceding section."

Section 160 deals with sums paid by the company to the director. Section 161 deals with sums paid by the company to other persons. It appears to me obvious that Section 161 cannot have been intended to bring in sums paid for things which are of no benefit at all to the director. I infer that not only from the apparent purpose of the whole Chapter but also from internal evidence. The specified purposes: living accommodation, entertainment and domestic and other services, are typical benefits. The Section then refers to "other benefits or facilities", making it clear that benefits alone are in contemplation. Then the Section proceeds, "apart from this section, the expense would not be chargeable to income tax as income of the director". No doubt it is a long time since Lord Macnaghten said(1) that Income Tax is a tax on income, and there are now a few cases where Income Tax is expressly made payable in respect of moneys which are not in any sense income of the taxpayer. But one is entitled to expect that any such exception will be enacted in clear terms. The words which I have quoted

(1) 3 T.C. 158, at p.171.

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strongly suggest to me that the intention was to bring within the scope of the Section sums which can be regarded as representing income in a broad or popular sense but which were not caught by the earlier provisions. And, thirdly, the reference at the end of Section 161(1) to "a payment in respect of expenses" clearly links Section 161 to Section 160, and it surely could not be suggested that the words in Section 160 "any sum paid in respect of expenses" could be held to apply to a sum, paid to a director to enable him to pay expenses incurred by the company, which conferred no benefit of any kind on the director.

But Section 161(1) is drafted in such a way that if its words are applied literally with their ordinary meanings they would include all the items with which this case is concerned. If a company provides a house for its director—or for anyone else—it not only provides the house when the director's tenancy begins but in any ordinary sense it continues to provide the house throughout the tenancy. And in any ordinary sense its expense in connection with the provision of the house will include all expense which it has to incur in order to continue to provide the house, that is, all expense which it has to incur as owner during the tenancy. To read the word "provision" as limited to the provision of the house when the director enters into occupation would in many cases defeat the obvious intention of the Section. For instance, if a company takes a lease of a house and then permits the director to live in the house, such a limitation would exclude the rent paid by the company from the scope of the Section, although living in a house for which the company pays the rent is an obvious benefit.

How, then, are we to resolve the difficulty? To apply the words literally is to defeat the obvious intention of the legislation and to produce a wholly unreasonable result. To achieve the obvious intention and produce a reasonable result, we must do some violence to the words. This is not a new problem, though our standard of drafting is such that it rarely emerges. The general principle is well settled. It is only where the words are absolutely incapable of a construction which will accord with the apparent intention of the provision and will avoid a wholly unreasonable result that the words of the enactment must prevail.

There appear to me to be three provisions which are susceptible of interpretation in such a way as to remove the difficulty in whole or in part. The first is Section 162(1) which excludes expense incurred "in the acquisition or production of an asset". If the words "acquisition" and "production" are read in their ordinary sense it would not help, but so to read them would produce an unreasonable result. Suppose a case where a company buys for £10,000 a house in good repair to be let to a director; then the whole of that expense is clearly excluded by Section 162(1). But suppose the company buys for £5,000 a house so dilapidated that it has to spend another £5,000 on repairs; then, according to the Crown's argument, the sum spent on repairs is caught by Section 161(1), so that this sum must be treated as a benefit in kind to the director. That absurd result could only be avoided by reading "expense incurred . . . in the acquisition or production of an asset" as wide enough to include not only purchase price but cost of repair to make the purchased house habitable. And if these words are wide enough to include repairs immediately after purchase, why should they not also be wide enough to include repairs which become necessary later? No doubt it can be said that if that had been the intention it would have been obvious that the words should be "acquisition, production, improvement or repair". And it may well be that to make this Sub-section wide enough to cover all improvements or repairs would exclude in some cases expense which is truly a benefit in kind. I find it difficult to read "production of an asset" as covering all repairs to an asset, and almost equally difficult to read them as covering some repairs but not others. But this is a case of any port in a storm, and I would not dissent from an interpreta-

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tion which excludes by this means those items in the present case which concern renewals and repairs. But I do not see how this line of escape can afford a remedy as regards feu duty and owner's rates.

The second possible way of getting over the difficulty is by interpretation of the words "made good" in Section 161(1). The natural interpretation of this provision seems to me to be that you add up all the expense caught by Section 161(1) and then deduct from the total all sums paid by the director to the company in connection with the provision of living accommodation or other benefit. And that is what the Revenue have done. They have deducted the rent from the expense which they say is caught by Section 161(1), and based the assessments on the balance. But it is, I think, possible to say that where you have, as in this case, a lease at a full commercial rent or rack rent, the rent must be regarded as full consideration for all expense which the lease obliges the landlord to incur, and therefore payment of the rent makes good to the landlord all such expense. I do not much like that argument, but again I would be prepared to accept it as a way out, and it would be sufficient to decide this case in favour of the Appellant because it has been found as a fact, and it is not disputed, that all the items on which these assessments are based were incurred by the company "in terms of the tenancy agreement".

I prefer the third possible way out of the difficulty. The purpose of the last three lines of Section 161(1)—from the words "as if" to the end—is obscure. This provision seems to me quite unnecessary unless it was intended to qualify in some way the earlier part of the Sub-section. It had already been provided in the Sub-section that Paragraphs 1 and 7 of the Ninth Schedule shall have effect in relation to expense to which the Sub-section applies, and I would think that sufficient to make this expense chargeable to tax without invoking Section 160 at all. It was suggested in argument that the purpose was to bring in the proviso to Section 160(1), but that proviso merely brings in Paragraph 7 of the Ninth Schedule, and that has already been done in Section 161(1) by the earlier express reference to that Paragraph. I find it difficult to see why this tortuous drafting of the last part of Section 161(1) should have been thought necessary for this purpose. It appears to me that an equally good explanation of this final provision in Section 161(1) is that the draftsman may have realised, if only vaguely, that injustice might be done if the very wide words of Section 161(1) stood alone and unqualified, and he may therefore have sought to qualify their application by this reference to Section 160—for it was not denied in argument that this is a reference back to Section 160(1).

What the end of Section 161(1) requires us to do is to suppose the perfectly possible case that the Appellant had himself arranged and paid for the repairs and had, for convenience, himself paid the feu duty and owner's rates, and had then sought and obtained a refund from his company. But not every refund is caught by this provision. The refund must be "by means of a payment in respect of expenses". So if the refund which we are directed to suppose in this case would not have been "a payment in respect of expenses", the items of the refund would not be chargeable to tax. I would agree that that would be a rather improbable explanation if the drafting of the rest of this Chapter was above reproach, but what I have said already shows the contrary and this will be emphasised when I come to Section 162(4).

So the question is whether the supposed refund would have been a "sum paid in respect of expenses" within the meaning of Section 160(1). Expenses are not defined in the Act. But it is surely unarguable that these words could apply to a sum paid to a director to enable him to pay expenses incurred by the com-

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pany for some purpose which conferred no benefit on him. Of course, there may be borderline cases, but if the expense incurred by the company conferred on the director no benefit at all—no advantage beyond what he has under his pre-existing legal rights—I cannot think that handing to the director the sum necessary to meet the bills could possibly come within Section 160(1). And that is this case. By the expenditure with which this case is concerned the Appellant got absolutely no benefit or advantage to which he was not already entitled under his lease, and the lease was admittedly a genuine contract entered into at arm's length.

If it is right that, in order to avoid imputing to Parliament an intention to produce an unreasonable result, we are entitled and indeed bound to discard the ordinary meaning of any provision and adopt some other possible meaning which will avoid that result, then what I am looking for in examining the obscure provision at the end of Section 161(1) is not its ordinary meaning (if it has one) but some possible meaning which will produce a reasonable result. I think that the interpretation which I have given is a possible interpretation and does produce a reasonable result, and therefore I adopt it. The explanation of the end part of Section 161(1) which I have offered has this advantage. It keeps Sections 160 and 161 in line, and obviously they ought to be kept in line because the only real difference between them is that Section 160 applies to money paid to the director to enable him to buy benefits and Section 161 applies to benefits procured for him and paid for by the company.

If this explanation is adopted it covers the present case and this appeal must be allowed. It is not necessary to go on to consider Section 162(4) because Section 162 deals with valuation of benefits, and if there is no benefit there is nothing to value. But I propose to examine this Sub-section because it makes even more obvious the unreasonable consequences which would follow from holding that Section 161(1) applies to this case. Section 162(3) applies where the company is assessable under Schedule A in respect of premises made available to a director as living accommodation. The person assessable under Schedule A is the occupier. So Section 162(3) only applies where the company remains the occupier and the director is only a licensee: it does not apply where there is a lease. Section 162 (4) applies to any asset used in providing any benefit to which Section 161(1) applies, provided that the asset is not premises in respect of which the company is assessable under Schedule A. This rather odd form of drafting means that the Sub-section applies both to heritage let or sub-let to a director and to movables such as a motor car which the director is permitted to use whether by way of hire or licence. It has been suggested that the primary purpose of the Sub-section is to deal with movables, and I think that the difficulties which I am going to explain may have arisen from the draftsman having movables in mind and failing to give adequate consideration to the application of the Sub-section to heritage which has been let to the director.

If I take the present case, or any case where a house is let to a director, I find that the clear purpose of the Sub-section is to add something to the expense already caught by Section 161(1) (and not excluded by Section 162(1)). What has to be added is "an amount equal to the annual value of the use of the asset". That must mean the use by the director; and where the director pays a rent, the value to him of the use of the house can hardly be much less than the rent or he would not pay it. So we are directed to add together the rent and all the landlord's expenses caught by Section 161(1), and then Section 161(1) permits the deduction of what is "made good" by the director, which, as I have said, can only be the rent if the ordinary meaning of the words is taken. The result is that the rent cancels out and we are left, in every case where a house is let at a market rent,

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with the position that the whole of the landlord's expenses—owner's burdens and repairs—is to be charged as a benefit in kind although the director is already paying in rent a full annual return for the house which he occupies.

This result is so absurd and capricious that even the Inland Revenue shy at enforcing it. In the present case, each assessment is about £100 less than would be required by the literal meaning of these provisions because the Revenue have tried to mitigate their injustice by two concessions which cannot be justified, in my view, on any reading of Section 162(4). In the first place they have treated the feu duty as rent within the meaning of the proviso to Section 162(4), although a feu duty is not a rent. The proviso only applies where the company pays rent or hire for the house, but this company is the owner of the house. And in the second place the Revenue have treated "the annual value of the use of the house" as the same as the Schedule A value as reduced for the purposes of collection which is referred to in Section 162(3). But that must be wrong. This latter value takes account of the authorised reduction for repairs, and in practice the Schedule A value so reduced may bear little relation to the actual value of the use of the house.

I cannot find any secondary meaning of the words in Section 162(4) which would avoid these consequences. So the provisions of this Sub-section increase the unreasonable consequences which are inevitable if the provisions of this Chapter are read in their ordinary sense and are not held to be qualified by the last part of Section 161(1). I cannot recollect ever having seen statutory provisions which lead to a more unreasonable result if read literally. I cannot believe that this can have been the intention either of Parliament or of the draftsman or of those who advise Parliament and instruct the draftsman. So the case for adopting a secondary meaning, if that is possible, is overwhelming.

Finally, I must notice the case of *Doyle* v. *Davison*, 40 T.C. 140, which appears to be the only reported case dealing with this matter. There a private company bought a house for occupation by its managing director. The house was let to him by oral agreement, there being no express agreement about paying for repairs. Considerable sums were expended by the company on repairs, alterations and additions. An additional assessment was made on the director, which included only a part of this expenditure. It may be that the remainder was regarded as excluded by Section 162(1). The assessment was discharged by the Special Commissioners, but on appeal was allowed by McVeigh, J. He said[1]:

> "Expenditure on premises is always a source of fruitful argument as to whether it represents improvement or repair, but, provided it is reasonable tenant's repair, it seems to me to be taxable."

If that amounts to a finding that there was no obligation on the company to do these repairs and that under the lease responsibility for them rested on the tenant, then the decision was plainly right because by carrying out and paying for the repairs the company clearly conferred a benefit on the director by doing and paying for something which benefited him and which the lease did not oblige them to do. The construction of Section 162(4) did not arise, and the learned Judge's observations about it were *obiter*, because in Northern Ireland the landlord, and not the tenant, is assessable under Schedule A, and therefore the case fell within Section 162(3).

On the whole matter I am clearly of opinion that this appeal should be allowed.

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[1] *See* page 145, *ante*.

Lord Jenkins.—My Lords, this case concerns the liability (if any) to Income Tax, Schedule E, of the present Appellant, Mr. William E. Luke, in respect of "benefits in kind" within the meaning of the Income Tax legislation, claimed by the Commissioners of Inland Revenue to have been received by him during his tenure of the office of managing director of the Linen Thread Co., Ltd. Three assessments were made under Schedule E on Mr. Luke in respect of emoluments from his office in the nature of "benefits in kind", namely:

For the year ended 5th April, 1956—£288
" " " " 5th April, 1957—£383
" " " " 5th April, 1958— £32.

The "benefits in kind" related to the expenditure incurred by the company during the years in question on the upkeep and repairs of a dwellinghouse owned by the company and occupied by Mr. Luke.

An appeal by Mr. Luke to the General Commissioners against the disputed assessments was allowed by them by a determination dated 17th April, 1961; but on appeal by the Commissioners of Inland Revenue by way of Case Stated to the First Division of the Court of Session, that Court by an Interlocutor pronounced on 2nd May, 1962, reversed the decision of the General Commissioners, and the present appeal ensued.

The relevant statutory provisions and the facts to which they are applicable in the present case are fully set out in the Case Stated by the General Commissioners, the judgments pronounced by the Court of Session and the respective cases of the parties in the appeal to your Lordships' House, and I will so far as practicable avoid repeating them at length. Briefly as to the house "Deaseholm", Troon, Ayrshire: Mr. Luke bought and took possession of this house in November, 1951, the company having desired that Mr. Luke should reside in Ayrshire and having suggested that this house might be suitable. For his part, Mr. Luke had regarded the house as attractive and had purchased it of his own free choice. The house cost £10,000, and Mr. Luke spent about £4,000 on initial repairs and on upkeep in the next three years. By 1954 Mr. Luke found the house too big and expensive to keep up. On the other hand, the company wanted Mr. Luke to go on living there for the company's benefit. In these circumstances the company purchased the house from Mr. Luke for £12,000 with entry at 11th November, 1954, and by minute of agreement it was let by the company to Mr. Luke at a rental of £148 per annum, which was the gross annual value. Under the agreement Mr. Luke was responsible for all occupier's rates and charges, for all internal repairs and decorations, and for all upkeep and maintenance of the grounds and garden. The company was responsible for all repairs to the fabric of the house and other buildings, and for the fences and boundary walls. By 1957 Mr. Luke found the house to be still too big for him and too large to manage, and at 15th May, 1957, he gave up the tenancy. After Mr. Luke had moved out of "Deaseholm" it was sold by the company for £11,500. During the period of Mr. Luke's tenancy, the company, as owner and in terms of the tenancy agreement, incurred expenditure in respect of the house as set out in the Case Stated; and such expenditure exceeded the rent of £148 by £576 for the year to 30th September, 1956, and by £127 for the period to 15th May, 1957, when Mr. Luke left the house. It will be seen that the company's expenditure on the house included such substantial matters as a new hothouse boiler (£66), renewal of fireplace (£41), laying a new water main and renewing plumbing (£489), and repairs to fences and felling trees.

As to the statutory provisions applicable to these facts, those mainly in point (to which so far as possible I will restrict my citation) will be found grouped in Chapter II of the Act, under the heading "Expenses Allowances to Directors and Others". The first Section in the Chapter is Section 160, which by Sub-

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section (1), to put it very shortly, provides that any sum paid in respect of expenses to a director or employee of a company shall (save as therein mentioned) be treated for the purposes of Paragraph 2 of the Ninth Schedule as a perquisite and assessable to Income Tax accordingly. It will be noted that Section 160(1) refers to "any sum" paid in respect of expenses, which would not ordinarily include payments in kind. This omission is put right by Section 161(1) which must be read in full:

> "Subject to the following provisions of this Chapter, where a body corporate incurs expense in or in connection with the provision, for any of its directors or for any person employed by it in an employment to which this Chapter applies, of living or other accommodation, of entertainment, of domestic or other services or of other benefits or facilities of whatsoever nature, and, apart from this section, the expense would not be chargeable to income tax as income of the director or employee, paragraphs 1 and 7 of the Ninth Schedule to this Act, and section twenty-seven of this Act, shall have effect in relation to so much of the said expense as is not made good to the body corporate by the director or employee as if the expense had been incurred by the director or employee and the amount thereof had been refunded to him by the body corporate by means of a payment in respect of expenses."

Reference was also made to Section 162 (particular importance being attached to Sub-section (4) of that Section).

In these circumstances the position in regard to the three disputed assessments would, *prima facie*, appear to have been as contended for by H.M. Inspector of Taxes before the General Commissioners and included in the Case Stated by them in these terms:

> "Mr. G. W. Yule, H.M. Inspector of Taxes, contended on behalf of the Crown, *inter alia:* (1) That the company, for the years under consideration, had expended the sum of £950 on or in respect of the house which the company had acquired from the Respondent [the taxpayer] in order to provide him with accommodation therein; that the company had during the same period recovered from the Respondent only £247 as rent; and that the difference between these two sums, namely, the sum of £703, fell to be regarded as part of the emoluments of the Respondent, assessable to Income Tax for the years under consideration pursuant to the provisions of Sections 160 and 161 of the Income Tax Act, 1952. (2) That the assessments for the three years in question were properly made and should be confirmed."

This deceptively simple statement has been the subject of much discussion. I will not by any means attempt to raise all the arguments used or touched upon. One point was to the effect that Section 161(1) was not applicable to a case where the body corporate was landlord and the director tenant of premises in respect of which the former had incurred expenses. The short answer to this appears to be that the Act does not so provide. Moreover, if the landlord and tenant relationship excluded Section 161, evasion of that Section would be made only too easy. It was also put that Section 161(1) is only concerned to apply to benefits of an "income" character (in so far as not "made good") and not to expenses of a capital character. I see no justification for this and am content to accept what is said about the words "made good" by the Lord President (Clyde) in his opinion regarding this part of the case[1].

It is said to be unfair to inflict the liability to tax in cases in which the expenditure incurred is of relatively small value as compared with the enjoyment by the director of the thing acquired, and reference is made to the water main and plumbing in the present case which, it would seem, must have comprised some considerable unexpended value. But surely it must be for the parties to agree the terms of the tenancy, and it is not suggested that they were in any sense over-reached.

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(1) *See* page 635, *ante*.

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Then it is suggested that it is anomalous that a body corporate should be able to foist on a director some unwanted repair, improvement or amenity. Here one can only say that it is to be hoped that the two of them conduct their affairs in a reasonably businesslike manner, which would exclude extravagancies such as this.

As to Section 162(1), I cannot see how it can be regarded as covering the transaction here under review; and if it cannot do so, then it can only be regarded as without significance for the present purpose.

I need not elaborate further on the various respects in which the statutory provisions relevant to this case have been criticised. It may be that a case is made for amending legislation, but that does not concern your Lordships; and in the meantime I find myself unable to agree that the disputed assessments are invalid.

I am substantially in accord with the views of the Court of Session, and would dismiss this appeal.

Lord Guest.—My Lords, the Appellant is the managing director of the Linen Thread Co., Ltd., which at the relevant date had its head office in Glasgow. At the suggestion of the company, the Appellant in November, 1951, purchased a house, "Deaseholm", in Troon, Ayrshire. The Appellant paid £10,000 for the house and spent about £4,000 on initial repairs and on upkeep during the next three years. In 1954, as the house was too big for him, the Appellant wished to sell it. The company proposed to purchase the house and let it to the Appellant, who would continue to reside there as tenant, as the chairman of the company was anxious that he should live there for the company's benefit. The purchase price of the house was £12,000, and it was let to the Appellant by the company in November, 1954, at a rent of £148, which was the gross annual value. Under the agreement, the Appellant was responsible for all occupier's rates and charges, for all internal repairs and decorations and for all upkeep and maintenance of the grounds and garden. The company was responsible for all repairs to the fabric of the house and other buildings, and for the fences and boundary walls. The Appellant, for various reasons, gave up the tenancy on 15th May, 1957, and the house was subsequently sold by the company for £11,500. It has been found as a fact by the Commissioners that the transfer from the Appellant to the company and the tenancy agreement were at arm's length, from which it may be assumed that the rent of £148 was the fair annual value for the house.

During the Appellant's occupancy of the house the company as owner, in terms of the tenancy agreement, incurred expenditure in respect of the house. The details are given in the Stated Case. They comprise owner's rates, insurance, repairs and feu duty. Included among the repairs in addition to minor repairs are sums of £66 for a new hothouse boiler, £41 for renewal of a fireplace, £489 for laying a new water main and renewing the plumbing in "Deaseholm" and the chauffeur's house. The excess of expenditure over the rent paid by the Appellant for the year ended 30th September, 1956, was £576, and for the period to 15th May, 1957, £127. Assessments were made on the Appellant under Schedule E of the Income Tax Act, 1952, in respect of emoluments from his office for the financial years 1955–1958 to the total amount of £703, allocated between the financial years. The Commissioners held that the sums involved were not liable to tax and they discharged the assessments. Upon appeal the First Division of the Court of Session reversed their determination.

Section 161(1) of the Income Tax Act is in the following terms:

> "161.—(1) Subject to the following provisions of this Chapter, where a body corporate incurs expense in or in connection with the provision, for any of its directors or for any person employed by it in an employment to which this Chapter applies, of

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> living or other accommodation, of entertainment, of domestic or other services or of other benefits or facilities of whatsoever nature, and, apart from this section, the expense would not be chargeable to income tax as income of the director or employee, paragraphs 1 and 7 of the Ninth Schedule to this Act, and section twenty-seven of this Act, shall have effect in relation to so much of the said expense as is not made good to the body corporate by the director or employee as if the expense had been incurred by the director or employee and the amount thereof had been refunded to him by the body corporate by means of a payment in respect of expenses."

Section 160(1) provides as follows:

> "160.—(1) Subject to the provisions of this Chapter, any sum paid in respect of expenses by a body corporate to any of its directors or to any person employed by it in an employment to which this Chapter applies shall, if not otherwise chargeable to income tax as income of that director or employee, be treated for the purposes of paragraph 1 of the Ninth Schedule to this Act as a perquisite of the office or employment of that director or employee and included in the emoluments thereof assessable to income tax accordingly: Provided that nothing in this subsection shall prevent a claim for a deduction being made under paragraph 7 of the said Ninth Schedule in respect of any money expended wholly, exclusively and necessarily in performing the duties of the office or employment."

The Crown contended that all the expenditure by the company on "Deaseholm" during the Appellant's occupancy, so far as not made good by the Appellant, fell to be treated as a perquisite of his employment and included in his emoluments for Income Tax purposes. In addition to the expenditure by the company on the house, the Revenue were entitled, under Section 162(4) of the 1952 Act, to charge the annual value of the use of the asset, which as the rent was a fair rent would not have been less than the rent. The Revenue, however, by a purported concession made under the proviso to Section 162(4) in regarding the feu duty as the rent or hire of the house, charged only the feu duty, and made no addition in respect of the annual value of the use of the house. This was, in my opinion, based upon an entirely mistaken view of Section 162(4). The result of the contentions of the Crown on Section 162(1) and a proper interpretation of Section 162(1) would be that there fell to be added as a perquisite to the Appellant's income the annual value of the house plus all the other landlord's charges, under deduction only of the rent as having been made good. The manifest absurdity of these contentions can be shown by taking a few examples. During the director's occupancy the house develops dry rot, which has to be made good at a cost far exceeding the cost of the house, and the director is saddled with the whole cost of making good the damage as a perquisite and an addition to his income. The house is almost completely gutted by fire: the whole cost of restoration would be a perquisite of his office. The central heating plant, which is outworn and useless, is renewed: in this case the director is saddled not only with the cost of installing a new central heating plant under Section 161(1) but also with the annual value of the house as improved by the new installation under Section 162(4). I cannot believe that this can have been the intention of Parliament in framing this legislation. The sums which are to be added to the director's income under Section 161(1) are to be treated as a perquisite of his employment. It can never have been intended that, taking the last illustration as an example, the director was to be charged as a perquisite twice over, once for the improvement and again for the improved value of the house. But this, the Solicitor-General was compelled to concede, was the result of a strict reading of Section 162(4), unless it could be modified as involving double taxation.

I therefore approach this legislation from the point of view that, if possible on a fair construction of the Section, some mitigation must be found to the extreme results of the contentions for the Crown. I am, however, compelled, although most unwillingly, to agree that the expenditure charged in this case qualifies for inclusion as a perquisite under Section 161(1). The very wide words

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of Section 161(1) are apt to include all expenditure in or in connection with the provision of living accommodation. Unless the *ejusdem generis* rule could be applied to control the width of the generality of the opening words to benefits to the director—and it was not suggested that this rule could apply—I see no escape from the conclusion that all the company's expenditure, whether in terms of the tenancy agreement or additional to it, falls to be included. It was suggested that by reason of the concluding words of Section 161(1), "by means of a payment in respect of expenses", the expenditure must be expenditure which would have been incurred by the director—in other words, tenant's expenditure —and did not include expenditure properly applicable to the company as landlord's expenditure. I cannot agree. Section 161(1) invokes the not unfamiliar method of a fiction. The expenditure under Section 161(1) is to be treated as sums paid in respect of expenses to a director under Section 160(1) and thus becomes a perquisite. Nor am I impressed by the argument that as the rent was a fair rent the company's expenditure has been "made good" by the payment of that rent and the counter obligations undertaken by the tenant. The interpretation which I put on this part of Section 161(1) is that in each year one side of the account shows the expenditure by the company and the other side any payment by way of rent or any other payment by the director to the company, and the balance is to be treated as expenses paid to the director.

So far I am in agreement with the opinions of the Lord President (Clyde) and Lord Guthrie. But it is when I turn to Section 162(1) that I am unable to follow their reasoning. Section 162(1) provides as follows:

> "162.—(1) Any expense incurred by a body corporate in the acquisition or production of an asset which remains its own property shall be left out of account for the purposes of the last preceding section."

In this connection the Lord President (Clyde) says(1):

> "Section 162(1) relates to capital outlays on acquiring, for instance, a dwellinghouse, not outlays such as those in question here, which are essentially payments for improvements or repair of an already existing capital asset. Expenditure on repairs or upkeep always involves an element of replacement or renewal, but that is not in itself enough to bring such repairs within the scope of Section 162(1)."

And Lord Guthrie says(2):

> "Now, without attempting to define the word 'asset' as used in Section 162(1), I am of opinion that the word does not cover these things, which are merely fitments inserted in or affixed to the dwellinghouse provided by the company, and which have no utility except as fitments in the dwellinghouse."

The Solicitor-General found himself unable to support Lord Guthrie's view and conceded that a new electrical installation or a new central heating plant would be assets covered by Section 162(1). In making this concession he was, in my opinion, right. The Lord President, in limiting the Section to capital outlays on acquiring the dwellinghouse, has not considered the alternative in Section 162(1), "the production of an asset", and has, in my view, placed an unduly narrow construction on the Section.

As I have already said, the Solicitor-General conceded that the installation of an electric supply, or of central heating, or of a system of water supply, none of which had pre-existed, was the production of an asset albeit the systems were incorporated in the fabric of the house. For the purposes of this Section, I

(1) *See* page 636, *ante*. (2) *See* page 637, *ante*.

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cannot see the distinction between a new installation which had not been there before and a renewal of an existing but defective installation. Both are assets, or at any rate the improvement has made the house more valuable as an asset, and therefore can be said to constitute an addition to the asset. What is essential in qualifying the installation for exemption under Section 162(1) is that it should remain the property of the company. In my opinion, where the expenditure has resulted in the replacement or renewal of an existing asset that is none the less the production of an asset within the meaning of Section 162(1). It may be a question of fact in any given circumstances whether any particular renewal involves the production of an asset. The Commissioners did not apply their minds to this question, as they decided that the whole expenditure in excess of the rent was not assessable. Upon the information contained in the Stated Case, my opinion is that the expenditure on the new hothouse boiler, £66; the renewal of two fireplaces, £41; the laying of a new water main and renewing the plumbing, £489, involved production of assets and falls to be excluded under Section 162(1). This would leave as expenditure: owner's rates, insurance, minor repairs and feu duty, which total £128; but against this figure would have to be set the rent of £148, so that for the year to 31st September, 1956, no perquisite would fall to be added to the Appellant's income.

I have had more difficulty with the year to 15th May, 1957. Having in view my interpretation of Section 161(1), I regard all the expenditure for that year covered by this Section. There would, upon this reading of the Section, be a balance of £127 which would fall to be added as a perquisite to the Appellant's emoluments. But as the majority of your Lordships take the view that all the assessments should be discharged, I do not dissent. The amount involved is in any case small.

I would allow the appeal.

Lord Pearce.—My Lords, I agree with the opinion of my noble and learned friend Lord Reid, but I feel less difficulty in accepting the wider construction of the words in Section 162(1) and I would adopt that construction in addition to the construction which he puts on Section 161.

The benefit in kind for which the director is here sought to be charged is "the provision of living accommodation". *Prima facie*, one would expect the intention of Sub-sections (1) and (4) of Section 162 to be that where the body corporate retains the ownership of the asset—in this case the house or the "living accommodation"—the expenses that go to acquiring or producing the "living accommodation" shall not be charged against the director as a benefit in kind, but the annual value of it, enhanced, of course, as it will be by any renewals or repairs, shall be charged against him. That would be a fair and sensible intention. But the Crown contend that such an intention cannot be drawn from the words, since the words "the acquisition or production of an asset" can only refer to the original purchase (or building) of the house, and, therefore, improvements, renewals or repairs cannot be included.

In the context, however, I think that the wide words "production of an asset" are capable of the broader construction which is necessary to give sense to the provisions of the Section. Any money spent which enhances the value of the "living accommodation" goes to produce an asset. If a man possesses a derelict house, the cost of putting it into repair may be said to be expense that produces an asset; the resulting asset is a house in good repair. Two sets of expenses have gone to its production, the original purchase and the subsequent repair; neither by itself produced the asset.

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If the contention of the Crown were adopted the taxpayer would be charged twice over for the same benefit, with the additional injustice that he would be charged, as if on an income perquisite, on a cost that may well have a largely capital element—for example, the cost of extensive renewals necessitated by dry rot or of installing a new water system which will have 20 or 30 years of life in it. One can imagine frivolous expenditure that could be described as having no asset-producing character, but the renewal of a hothouse boiler, a fireplace and a water main could certainly not be so described.

For the reasons given by my noble and learned friend Lord Reid, I would allow the appeal.

Questions put:

That the Interlocutor appealed from be recalled and that the determination of the General Commissioners be restored.

The Contents have it.

That the Respondents do pay to the Appellant his costs here and in the Court of Session.

The Contents have it.

[Solicitors:— Solicitor of Inland Revenue (England) for Solicitor of Inland Revenue (Scotland); Travers Smith, Braithwaite & Co., for Shepherd & Wedderburn, W. S. (Edinburgh).]