
COURT OF APPEAL—4TH, 5TH AND 6TH FEBRUARY, 1963

HOUSE OF LORDS—2ND, 3RD AND 4TH MARCH,
AND 8TH APRIL, 1964

Musker (H.M. Inspector of Taxes)

v.

English Electric Co., Ltd.⁽¹⁾

Commissioners of Inland Revenue

v.

English Electric Co., Ltd.

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

The Respondent Company, in the course of carrying on its trade of engineering manufacturers, acquired a fund of specialised information and technique in engineering processes. It had not been its practice to turn this information and technique to account by imparting it to others. In 1949, however, at the request of the Admiralty, the Company entered into an agreement to design and develop a marine turbine and to license its manufacture by a limited number of companies in the United Kingdom, Australia and Canada. Later, in 1950 and 1952, the Company, at the request of the Ministry of Supply, entered into agreements with the Government of Australia and an American aircraft manufacturing corporation, respectively, under which it licensed them to manufacture the Canberra bomber which it had designed and developed. All three agreements provided, inter alia, for the imparting of “manufacturing technique” to the licensees and in consideration of this the Company received specified lump sum payments.

The profits of the Company’s trade were assessed to Income Tax under Case I of Schedule D for the years 1951–52 and 1952–53, and to Profits Tax for the chargeable accounting period 1st January, 1950, to 31st December, 1950, on the footing that these payments should be included as trading receipts. On appeal to the Special Commissioners, the Company contended that the sums were of a capital nature. The Special Commissioners allowed the appeals.

Held, that the sums in question were of an income nature.

Jeffrey v. Rolls-Royce, Ltd., 40 T.C. 443, applied.

CASES

(1) *Musker (H.M. Inspector of Taxes) v. English Electric Co., Ltd.*

CASE

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

(¹) Reported (Ch.D.) 106 S.J. 511; (C.A.) 107 S.J. 135.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 29th February and 1st, 2nd and 3rd March, 1960, English Electric Co., Ltd. (hereinafter called "the Company"), appealed against assessments to Income Tax under Schedule D in respect of profits as engineering manufacturers for the year 1951-52 in the sum of £3,100,000 and for the year 1952-53 in the sum of £3,420,000. The ground of appeal was that in computing the profits of the Company for those years there were included certain lump sums received under agreements with the Admiralty, the Government of Australia and the Glenn L. Martin Co. of America, which lump sums the Company contended were of a capital nature.

2. Over 70 Exhibits were put in and examined at the hearing before us. A list of those Exhibits is attached as an appendix to this Case⁽¹⁾. Each Exhibit, in whole or such part as was considered to be relevant, was read to us or in the case of photographs and models was examined by us. In so far as they are not attached to this Case all the items mentioned in the list are available for the use of the High Court if desired.

Oral evidence was given before us by the following persons:

Mr. Percy Horsfall, who has been a director of the Company since 1930;

Mr. George Alexander Riddell, who became chief accountant of the Company in 1947 and was subsequently appointed controller of the Company and all its subsidiaries;

Mr. William Marshall Hurton, who joined a predecessor company as an engineering student in 1912, who was employed by the Company when it was formed in 1918, and who is now a director of the group manufacturing development of the Company and its subsidiaries;

Mr. Ronald Frederick Charles Acford, who is an Associate Member of the Institution of Mechanical Engineers and an Associate Member of the Institution of Production Engineers, and who joined the Company in 1936 and is now the head of a development and process department concerned, in particular, with steam turbines;

Mr. John Brian Sell, who is a Graduate Member of the Institution of Mechanical Engineers and of the Institution of Production Engineers, and who joined the Company in 1943 and has, since 1947, been concerned as a draughtsman with plant and process development work relating to steam turbines;

Mr. Horace Instone, who is an Associate Member of the Institution of Production Engineers, and who joined the Company in 1933 as a jig and tool draughtsman and, since 1943, has been concerned with and is now the head of a development and process department dealing in particular with aircraft manufacturing;

Mr. James Gillibrand, who joined the Company in 1919 and from 1945 onwards was concerned with the designing of aircraft and later was appointed liaison officer between the Company and the Australian Government and between the Company and the Glenn L. Martin Co. of America;

Mr. Leonard Bentley Shuffrey, who is a Fellow of the Chartered Institute of Patent Agents and has been manager of the patent department of the Company since 1945.

From the documents and oral evidence given before us the facts given in paragraphs 3 to 14 of this Case were admitted or proved.

(¹) Not included in the present print.

3. The Company was incorporated on 14th December, 1918. The objects clause of the Company's memorandum states, in clause 3:

“(A) To purchase or otherwise acquire, lease, underwrite, subscribe for, and deal in real and personal property of all kinds, . . . (B) To carry on the business of electrical, mechanical, hydraulic and general engineers and contractors, . . . (H) To purchase or by other means acquire and protect, prolong and renew, whether in the United Kingdom or elsewhere, any patents, patent rights, . . . (L) To develop and turn to account any property or assets of or in which the Company is interested.”;

and in the final sentence at the end of clause 3:

“And it is hereby declared that the objects specified in each paragraph of this clause shall be in no wise restricted by reference to or inference from the terms of any other paragraph . . .”.

It was accepted by the parties that the Company had power, if it so desired, to purchase or sell secret information.

4. The Company's authorised capital in 1950 was £8,000,000, and the issued capital was nearly £7,000,000. In each of the three calendar years 1950, 1951 and 1952 there was added to the Company's capital reserve account a sum of money described as “sales of manufacturing technique”. The sums so added were, for the year 1950, £263,833; for the year 1951, £255,118; and for the year 1952, £177,468. The said sums were received by the Company from separate sources, namely, the Commonwealth of Australia, the Glenn L. Martin Co. of the State of Maryland, U.S.A., and the Admiralty. The two first named desired to manufacture aircraft; the third named desired the Company to provide information necessary for the manufacture by other firms of marine turbines. The following paragraphs 5 and 6 give certain facts concerning the Company's historical background and its trading policy before and during the three relevant years. Details of the agreements which gave rise to the sales of manufacturing technique are given in paragraphs 7, 8, 10 and 11 of this Case.

5. On its formation in 1918 the Company took over the businesses of a number of old-established companies; those businesses became branches of the Company. The businesses of four of the predecessor companies commenced between 80 and 90 years ago. At the Preston works railway carriages, tram cars and buses were manufactured prior to the 1914–18 war. At the Bradford works 150 aircraft had been built prior to 1918. Steam turbines for land use had been manufactured at Rugby since 1904, and diesel engines from 1906. After the formation of the Company, ranges of products were extended and additional works were opened.

6. The Company's trade is that of a manufacturer. Its policy is, and always has been, to manufacture and sell its manufactured products. The Company has always guarded very jealously its manufacturing processes and designs, and at all times treated them as trade secrets. The Company has never at any time developed manufacturing technique with a view to selling it. On a few occasions the Company has licensed other persons to use some device, whether patented or otherwise, but such occasions have been rare and the Company has only given such licence when pressed very hard to do it.

7. The Company has never manufactured *marine* turbines, but because of its outstanding reputation as a manufacturer of *land* turbines it was requested in 1949 by the Admiralty to design, develop and produce prototypes for marine turbines known as Y.100, Daring Class turbines and Y.E.A.D.I. The prototypes were in each case produced and paid for separately. The Company did not wish to manufacture marine turbines but it deemed it desirable to assist the Admiralty; and it therefore entered into discussions with Admiralty representatives on the understanding that if it produced a prototype which proved successful

in its tests the Company would not itself manufacture marine turbines but it would be asked by the Admiralty to license marine turbine manufacturers in the United Kingdom and, if possible, in the Commonwealth, to manufacture to the Company's designs. Contracts were entered into, the terms of one of which (relating to the Y.100) are contained in a letter dated 31st August, 1949, from the Admiralty (Contract Department) to the Company. The letter reads as follows:

" C.P. Br. 8B/9135/49.

SECRET.

Gentlemen,

*Y.100. Turbine Design for A/S Frigates.
Messrs. Yarrow's Contract. C.P.62979/48 dated
9th March, 1949*

With reference to Sir George Nelson's letter of 25th August addressed to Mr. Coxwell, and to previous correspondence I have to confirm the following terms for:—
(a) The preparation of a design for, and the manufacture of a prototype of Frigate Steam Turbine of the type known as Y.100. (b) The provision of the necessary data and other information for the manufacture of Turbines to such a design and the granting of licences for the use thereof by other manufacturers to Admiralty instructions.

2. The Admiralty will order at least one set of machinery of Y.100 design for manufacture at the English Electric Company's works and the price to be paid for such prototype shall include *inter alia* the cost of all designers' and draughtsmen's work and material expended in stressing out and detailing the Y.100 turbine design, the production of the working drawings, and the cost of the preparation of necessary jigs, tools, etc., required for production.

3. In consideration of the following lump sum payments the English Electric Company agree to provide manufacturing technique, engineering data and other information necessary for the manufacture by other firms of Steam Turbines to the English Electric Company's design of the type known as Y.100.

(a) In U.K.—£40,000 for manufacture by other firms up to a maximum of six.

(b) In Canada—£25,000 for manufacture by not more than two firms.

(c) In Australia—£25,000 for manufacture by not more than two firms.

The payments under (a), (b) and (c) will be made after decision by the individual countries concerned to order Turbines to this design from one or more firms other than the English Electric Company, but such payment shall be made to you before manufacture is commenced. If the Admiralty desire to extend the manufacture to any firms in addition to the numbers stated in (a), (b) and (c) above, or should the question arise of manufacture in countries other than the U.K., Canada and Australia, the question of additional payments will be considered with a view to a fair settlement being mutually agreed in the circumstances prevailing at the time.

4. In consideration of the granting by the English Electric Company of licences for the manufacture, sale and use of Steam Turbines to the said design by other manufacturers, a payment of 2½ per cent. of the selling price of all sets of turbines and condensers (but not gearing) manufactured to Y.100 design by firms other than yourselves (in U.K., Canada and Australia) will be made to your company. When a total of 50 shafts has been reached by firms other than yourselves, the question of the rate of payment will be reviewed with a view to a fair settlement being mutually agreed in the circumstances prevailing at the time.

5. The Admiralty will also reimburse to the English Electric Company any sums which the Company may be required to pay by way of *ad valorem* royalty to the Westinghouse Electric International Company under the terms of the E.E.C. agreement with that Company dated 11th May, 1945, which agreement, unless renewed, terminates on the 1st September, 1955. It is noted that you will afford facilities for the inspection of this agreement as evidence of your liability under this head and it would be appreciated if the agreement could be forwarded for this purpose. It is understood that payments to Westinghouse do not arise in respect of turbines manufactured in Canada or Australia.

6. The English Electric Company will provide adequate facilities at their works for one or more Liaison Officers or Engineers of the manufacturer (up to a maximum of three at any one time) to receive advice and instruction on the manufacture of the

above design of turbine. The manufacturer will pay all expenses incurred by such visits. If required by the manufacturer the English Electric Company will give assistance to the manufacturer by sending a reasonable number of personnel to advise and assist at the manufacturer's Works at Company cost plus 10 per cent.

7. It is an essential condition that an undertaking will be given by all manufacturers to whom the English Electric Company provide the manufacturing technique, engineering data and other information (under the terms of paragraph 3 hereof) that they will not use such manufacturing technique, engineering data and other information for the purpose of entering into the land turbine field, except on the basis of a reasonable payment to the English Electric Company.

8. This arrangement is limited and relates solely to the above designs of Frigate Steam Turbine and any modification or variations which do not constitute a new design.

9. With regard to manufacture in Canada it is noted that the English Electric Company of Canada (which you do not control) is a wholly owned subsidiary of Messrs. John Inglis & Co. Ltd., and has the exclusive right to manufacture to your turbine designs under a general agreement with you. It is also noted that you will open negotiations with them with a view to the terms outlined herein applying for Canadian manufacture.

10. The English Electric Company will indemnify the Admiralty and any other participating Commonwealth country against claims by other parties in respect of turbines constructed under this Agreement on account of alleged infringement of patents or registered designs owned by them.

11. Please acknowledge receipt of this letter and confirm your agreement to its terms.

I am, Gentlemen,

Your obedient Servant,

(Signed) BERNARD POOL.

DIRECTOR OF NAVY CONTRACTS

The English Electric Co. Ltd."

8. The Company was paid by the Admiralty for the prototype of the Y.100 in accordance with the terms of paragraph 2 of the letter of 31st August, 1949. There was no dispute, so far as taxation was concerned, relating to the payment so received by the Company. What was in dispute in the appeal before us was the assessability of the lump sum payments under paragraph 3 of the letter of 31st August, 1949. On 2nd February, 1951, the Company entered into a supplementary contract with the Admiralty for the granting of licences extending the number of firms undertaking the manufacture of Y.100 turbines in the United Kingdom from six to nine. It was agreed by the parties that for the purposes of this appeal there was no distinction to be drawn between the 1949 and the 1951 contracts. It was also agreed by the parties that for the purposes of this appeal the respective contracts relating to Daring Class turbines and Y.E.A.D.I., while admittedly involving the disclosure of manufacturing technique substantially different from that disclosed under the Y.100 contract (although derived from a common parent) should be treated as being on the same basis as the Y.100.

9. During the 1939-45 war the Company manufactured Hampden and Halifax bombers and, later, de Havilland Vampire fighters. Those particular types of aircraft were, on Government orders, manufactured by the Company to other persons' designs. Soon after the end of the war, the Ministry of Supply urged the Company to set up its own design teams and to design and make its own planes. In particular the Ministry requested the Company to design a twin-engined bomber for the Royal Air Force. The Company's design team made certain proposals to the Ministry and, those proposals having been approved, the Company was entrusted with the work of design, development and manufacture of a twin-engined bomber. The Company was reimbursed to the extent of a percentage of its actual expenditure on the work every month. The Company's first prototype bore the identification B3/45 but hereafter it is

referred to by the name eventually given to it—"The Canberra bomber". The Company manufactured and delivered Canberra bombers to the Royal Air Force up to April, 1950.

10. At the request of the Ministry of Supply the Company entered into an agreement with the Commonwealth of Australia on 12th April, 1950. A copy of that agreement is attached to this Case, marked Exhibit 12⁽¹⁾. In view of their importance in considering this appeal the first eleven paragraphs of the said agreement are now reproduced. The sums mentioned in paragraph 8(i) and 8(iii) of the agreement were admittedly taxable. What was in dispute was the assessability of the sum of £200,000 mentioned in paragraph 8(ii) of the agreement. The agreement (up to the end of paragraph 11) reads as follows:

"THIS AGREEMENT is made the Twelfth day of April One thousand nine hundred and fifty BETWEEN THE ENGLISH ELECTRIC COMPANY LIMITED whose registered office is at Queens House Kingsway London W.C.2. (hereinafter referred to as 'the Company' which expression shall where the context so admits include its successors and assigns) of the one part and the COMMONWEALTH OF AUSTRALIA (hereinafter referred to as 'the Commonwealth') of the other part

WHEREAS the Company is a designer and manufacturer and has extensive experience of the production of aircraft

AND WHEREAS the Company has developed a bomber aircraft in accordance with the specification detailed in the First Schedule to this Agreement and the Commonwealth is desirous of manufacturing the said Aircraft in the territory hereinafter defined

NOW IT IS HEREBY AGREED between the parties hereto as follows:

1. IN this Agreement the following expressions shall bear the meanings set out in this Clause
 - (a) 'THE TERRITORY' shall mean Australia and the territories and possessions administered by the Commonwealth at the date of this Agreement
 - (b) 'THE AIRCRAFT' shall mean the bomber aircraft designed in accordance with the specification set out in the First Schedule to this Agreement and any variants based on that design and spare parts therefor.
2. THE COMPANY HEREBY AGREES:
 - (i) TO provide in Australia the designs and drawings of the Aircraft and designs and drawings of the Jigs and Tools specified in the Second Schedule hereto together with any other designs and drawings not mentioned in the said Second Schedule and which may be necessary to enable the Commonwealth to manufacture assemble test operate and service the Aircraft in accordance with the Company's designs;
 - (ii) TO provide in Australia particulars of the manufacturing technique engineering data and other information specified in the Third Schedule hereto together with such other information as the Company now possesses and which will enable the Commonwealth to manufacture assemble test operate and service the Aircraft in accordance with the methods and processes used by the Company; and
 - (iii) TO notify the Commonwealth of any improvements or modifications in design or in processes and methods of manufacture devised by the Company during the term of this Agreement and relating to the Aircraft subject where necessary to the prior consent of His Majesty's Government in the United Kingdom and to provide the Commonwealth in Australia in so far as it is permitted by His Majesty's Government in the United Kingdom so to do with full information relating to such improvements and modifications.
3. THIS Agreement relates solely to the manufacture and use of the Aircraft by or on behalf of the Commonwealth in the territory for the use of the Commonwealth and the COMMONWEALTH HEREBY UNDERTAKES that the Aircraft manufactured under the terms of this Agreement will not be supplied to others without the prior consent of the Company at terms to be agreed.
4. THE COMMONWEALTH UNDERTAKES to make known to the Company any improvements or modifications in design or process of manufacture devised by or on behalf of the Commonwealth during the term of this Agreement and relating to the Aircraft and the Company shall have the right on request and without charge by the Commonwealth to make use of such improvements or modifications outside the territory and whether patented or otherwise.

(¹) Not included in the present print.

5. AT the request of the Commonwealth the Company will send to Australia one or more* than four at any one time of its competent engineers or employees as may be necessary for the successful implementation of this Agreement to give advice and assistance in the manufacture assembly use and testing of the aircraft. The Commonwealth shall reimburse to the Company the reasonable cost to the Company of the visits of the said engineers or employees who will continue to be employed by or on behalf of the Company. [*The words 'but not more' were omitted in error in the original agreement.]
6. THE Commonwealth may send to the Company's Works from time to time one or more liaison officers and engineers employed by or on behalf of the Commonwealth to receive advice and instruction on the manufacture assembly testing operation and servicing of the Aircraft and the Company will provide all reasonable facilities for such visits. The Commonwealth will pay all expenses incurred on such visits including the cost of clerical assistance cables and trunk telephone calls and the remuneration and living allowances of the visiting personnel who will continue to be employed by or on behalf of the Commonwealth.
7. TO assist the Commonwealth in the production of the Aircraft the Company will on request and on terms to be agreed in each case supply so far as is reasonably possible Jigs Tools and parts of Aircraft and on request will assist the Commonwealth to procure the supply of raw materials and other equipment.
8. THE COMMONWEALTH HEREBY AGREES TO PAY to the Company:
 - (i) THE sum of THIRTEEN THOUSAND POUNDS (£13,000) per annum for the use by the Commonwealth during the term of the Agreement of the designs and drawings of the Aircraft and of the designs and drawings of the Jigs and Tools to be used in connection with its production and which the Company undertakes to supply in Clause 2(i) hereof. The first of such annual payments shall be made on the First day of March One thousand nine hundred and fifty one and subsequent payments shall be made regularly on each First day of March thereafter during the continuance of the Agreement.
 - (ii) THE sum of TWO HUNDRED THOUSAND POUNDS (£200,000) on the date of the commencement of this Agreement for the supply to the Commonwealth in accordance with Clause 2(ii) hereof of the manufacturing technique engineering data and other information now in the possession of the Company and which will enable the Commonwealth forthwith to manufacture the aircraft but exclusive of the designs and drawings referred to in paragraph (i) of this Clause.
 - (iii) THE sum of FOUR THOUSAND POUNDS (£4,000) per annum in consideration of the undertaking by the Company in Clause 2(iii) hereof to supply the Commonwealth with information relating to modifications and improvements of the Aircraft and of the manufacturing processes and methods used by the Company such annual sums to be deemed to cover the cost thereof to the Company and to be payable simultaneously with the payments provided for in paragraph (i) of this Clause.
9. ALL moneys payable by the Commonwealth to the Company under this Agreement shall be paid to the Company in London in United Kingdom sterling.
10. IN the event of the Commonwealth for the purposes of this Agreement making use of any inventions covered by current Australian Letters Patent or of any design registered in Australia as a result of technical information and assistance supplied by the Company in pursuance of this Agreement the terms and conditions of such use (including payment of Royalties) shall be settled in accordance with the National Security (Industrial Property) Regulations or such other law of the Commonwealth as may for the time being be in force in relation to the use by the Commonwealth of inventions and designs provided that any Royalties paid to the Company under the said Regulations or other law of the Commonwealth as the case may be shall be deducted from the moneys payable to the Company under Clause 8(i) hereof.
11. THE COMMONWEALTH HEREBY UNDERTAKES that all drawings data and technical information supplied by the Company shall be treated as confidential and shall not be disclosed to others except as may be necessary for the manufacture assembly and servicing of the Aircraft by the Commonwealth or by any person firm or corporation on behalf of the Commonwealth."

11. Early in 1951, the United States Air Force decided that production of the Canberra bomber was essential in the development of United States' air power. The United States sent a mission to the United Kingdom, headed by General K. B. Wolfe, including representatives of an American aircraft

manufacturing corporation called the Glenn L. Martin Co., of Maryland U.S.A. By arrangement with the Ministry of Supply the mission entered into negotiations with the Company (English Electric Co., Ltd.). The whole of the Company's output of Canberra bombers in the United Kingdom, up to that time, was taken by the Royal Air Force but the United States mission did not wish to purchase bombers from the Company; what the mission desired was to manufacture the bombers in the United States. On 16th April, 1952, the Company entered into an agreement with the Glenn L. Martin Co. A copy of that agreement is attached to this Case, marked Exhibit 13⁽¹⁾. In view of their importance in considering this appeal the first twelve paragraphs of the said agreement are now reproduced. The sums mentioned in paragraph 12(b) of the agreement were admittedly taxable. What was in dispute was the assessability of the sum of \$1,500,000 (£536,379 is the sterling equivalent) mentioned in paragraph 12(a) of the agreement.

"AN AGREEMENT made the 16th day of April One thousand nine hundred and fifty two by and between THE ENGLISH ELECTRIC COMPANY LIMITED a limited liability company with registered office at Queens House Kingsway London W.C.2. England by HENRY GEORGE NELSON its Deputy Managing Director (hereinafter called 'ENGLISH ELECTRIC') and THE GLENN L. MARTIN COMPANY a corporation duly organized under the laws of the State of Maryland U.S.A. having a principal place of business at Middle River Maryland by CHESTER CHARLES PEARSON its President (hereinafter called 'MARTIN').

WITNESSETH:

WHEREAS ENGLISH ELECTRIC has designed lofted and engineered for production a jet airplane known as the CANBERRA and represents that it has full engineering design and technical data for said airplane as well as complete tool design manufacturing and manufacturing technical data know-how processes and procedures for the production of said airplane

AND WHEREAS MARTIN desirous of acquiring complete design information drawings lofts technical data etcetera to enable it to manufacture assemble test operate and service the said jet airplane in accordance with the ENGLISH ELECTRIC's design for the Government of the United States of America entered into an Agreement with English Electric executed on the Third day of April One thousand nine hundred and fifty one whereby ENGLISH ELECTRIC and MARTIN agreed the terms and conditions applicable to the manufacture of said jet airplane by MARTIN to the design of ENGLISH ELECTRIC

AND WHEREAS by an Agreement dated the First day of May One thousand nine hundred and fifty one between ENGLISH ELECTRIC and MARTIN the terms and conditions of the said Agreement of 3rd April 1951 were modified

AND WHEREAS ENGLISH ELECTRIC and MARTIN now desire to incorporate in one document the terms and conditions of the said Agreement of 3rd April 1951 as modified by the said Agreement of 1st May 1951 and correct some inconsistencies in the Agreement occasioned by the amendments.

NOW THEREFORE IT IS MUTUALLY AGREED as follows:

1. THIS Agreement supersedes and shall be deemed to cancel the terms and conditions of the said Agreements of 3rd April 1951 and 1st May 1951 AND IT IS HEREBY AGREED by ENGLISH ELECTRIC and MARTIN that the entire terms and conditions applicable to the manufacture of the said jet airplane by MARTIN are hereinafter contained.
2. IN this Agreement the following expressions shall bear the meanings set out in this clause.
 - (a) ' TERRITORY ' shall mean the United States of America and the territories and possessions administered by the United States of America at the date of this Agreement;
 - (b) ' AIRCRAFT ' shall mean the aircraft designed by ENGLISH ELECTRIC known as the CANBERRA and any variants thereof manufactured by MARTIN or any sub-licensees of MARTIN to specifications furnished to MARTIN by ENGLISH ELECTRIC or to ENGLISH ELECTRIC's specifications or specifications based thereon furnished by MARTIN to said sub-licensees;
 - (c) ' BOUGHT OUT ARTICLES ' are those articles manufactured and sold to ENGLISH ELECTRIC by other manufacturers which are not manufactured to the designs of ENGLISH ELECTRIC;

⁽¹⁾ Not included in the present print.

- (d) ' EMBODIMENT LOAN ARTICLES ' shall mean those articles presently or in the future furnished by the Ministry of Supply for incorporation in the manufacture of the AIRCRAFT.
3. ENGLISH ELECTRIC agrees:
- (a) To furnish to MARTIN in the TERRITORY a set of all designs drawings and loft templates of the AIRCRAFT and all designs and drawings of jigs tools and the relevant operation sheets necessary to enable MARTIN to manufacture assemble test operate and service the AIRCRAFT in accordance with ENGLISH ELECTRIC's design;
- (b) To furnish to MARTIN in the TERRITORY particulars of the manufacturing technique including tool process sheets materials and process specifications and engineering data including stress and static test data of such parts as are involved in any modifications introduced by MARTIN and flight test data from the first flight of the Canberra aircraft Mark II and all such other information as will enable MARTIN to manufacture assemble test operate and service the AIRCRAFT in accordance with the methods and processes used by ENGLISH ELECTRIC;
- (c) To furnish to MARTIN in the TERRITORY particulars of the design manufacture and technique of maintenance ground handling and service equipment for the AIRCRAFT;
- (d) To notify MARTIN promptly of any improvements or modifications in design or in processes and methods of manufacture devised by ENGLISH ELECTRIC during the term of this Agreement and relating to the AIRCRAFT subject where necessary to the prior consent of Her Majesty's Government in the United Kingdom and to provide promptly to MARTIN in the TERRITORY insofar as it is permitted by Her Majesty's Government in the United Kingdom so to do with complete information relating to such improvements and modification; PROVIDED that nothing contained in this Agreement shall be construed as giving to MARTIN under this or any other Clause any rights in respect of BOUGHT OUT ARTICLES or EMBODIMENT LOAN ARTICLES. All such rights are however granted in respect of the following two proprietary articles namely the English Electric main undercarriage and the English Electric electrically operated actuators insofar as such rights are necessary in connection with the manufacture of the AIRCRAFT.
4. THIS Agreement relates solely to the manufacture use and sale of the AIRCRAFT and the requisite spare parts thereof by MARTIN or any sub-licensees of MARTIN in the TERRITORY to the Government of the United States of America for the use and disposition according to law by said Government of the United States of America for any governmental purpose and MARTIN undertakes that the AIRCRAFT manufactured under the terms of this Agreement will not be supplied by MARTIN or any sub-licensees of MARTIN to other than the Government of the United States of America without the prior written consent of ENGLISH ELECTRIC on terms to be agreed.
5. MARTIN undertakes to make known to ENGLISH ELECTRIC subject where necessary to the prior consent of the Government of the United States of America any improvements or modifications in the design or manufacture devised by MARTIN or any sub-licensees of MARTIN during the term of this Agreement and relating to the AIRCRAFT and ENGLISH ELECTRIC shall have the right on request and without charge by MARTIN or any sub-licensees of MARTIN to make non-exclusive use of such improvements or modifications outside the TERRITORY and whether patented or otherwise in the production of the AIRCRAFT. Nothing in this Clause shall be construed as granting rights in and to developments and/or inventions made prior to the effective date of this Agreement or the effective date of any sub-licences granted by MARTIN hereunder. For use of such developments and/or inventions made prior to the effective date of this agreement or the effective date of any sub-licences granted by MARTIN hereunder ENGLISH ELECTRIC will secure the prior written consent of MARTIN on terms to be agreed.
6. ENGLISH ELECTRIC will promptly upon execution of this Agreement send to the factory of MARTIN two engineers one from its Engineering Division and one from its Manufacturing Division. ENGLISH ELECTRIC will maintain said two engineers at its own expense at the factory of MARTIN for such time as is necessary to enable MARTIN to acquire knowledge necessary to manufacture the AIRCRAFT. If at any time during the terms of this Agreement it is agreed between the parties that engineers or employees of ENGLISH ELECTRIC other than the two referred to above are required to be sent to the TERRITORY for the successful implementation of this Agreement the same shall be so sent and the cost of their salaries transportation living and other expenses shall be borne by

MARTIN as from time to time agreed between the parties. In each case the engineers or employees referred to above shall remain the employees of ENGLISH ELECTRIC and while at the factory of MARTIN shall observe all rules and regulations of MARTIN including security regulations.

7. MARTIN may send to ENGLISH ELECTRIC's factory from time to time one or more but not more than fifteen engineers in addition to supervisory and liaison staff employed by MARTIN to receive advice and instructions on the manufacture assembly testing operation and servicing of the AIRCRAFT and ENGLISH ELECTRIC will provide all reasonable facilities for such visits. PROVIDED ALWAYS that the said number of fifteen engineers may with the consent of ENGLISH ELECTRIC be temporarily increased if MARTIN advise ENGLISH ELECTRIC of its requirements. MARTIN will pay all expenses incurred on such visits including the cost of clerical assistance cables and trunk telephone costs and the remuneration and living allowance of the visiting personnel who will continue to be employed by MARTIN. The visiting personnel of MARTIN will observe all rules and regulations of ENGLISH ELECTRIC including security regulations.
8. TO assist MARTIN in the production of the AIRCRAFT ENGLISH ELECTRIC will upon request and on terms to be agreed in each case supply so far as is reasonably possible parts of the AIRCRAFT up to a maximum of seven sets of aircraft parts and upon request will assist MARTIN in the United Kingdom to procure raw materials bought-out material and other equipment. Any request for parts raw materials bought-out material or equipment under this Clause will be by MARTIN's purchase order.

In lieu of any warranty condition or liability implied by law and notwithstanding the terms of Clause 15 hereof IT IS AGREED that ENGLISH ELECTRIC's liability in respect of any defect in or failure of aircraft parts supplied by ENGLISH ELECTRIC in accordance with this Clause or for any loss injury or damage attributable thereto is limited to making good by replacement or repair defects which under proper use appear therein and arise solely from faulty design materials or workmanship within a period of twelve months after the said aircraft parts shall have been first despatched at the termination of which period all liability on ENGLISH ELECTRIC's part ceases. In the case of aircraft parts not of ENGLISH ELECTRIC manufacture MARTIN is entitled only to such benefits as ENGLISH ELECTRIC may receive under any guarantee given to ENGLISH ELECTRIC in respect thereof.

9. ENGLISH ELECTRIC will use its best efforts to assist MARTIN in obtaining such information regarding manufacturing rights as may be required for the AIRCRAFT relating to processes not performed and parts not made in ENGLISH ELECTRIC's factories and further will use its best efforts to secure the co-operation of the Ministry of Supply in this matter. ENGLISH ELECTRIC will use its best efforts in the United Kingdom through the Ministry of Supply to assist MARTIN in developing sources of materials.
10. ENGLISH ELECTRIC grants to MARTIN all rights which it is free to grant necessary for the implementation of this Agreement. ENGLISH ELECTRIC upon the request of MARTIN in writing agrees to extend this grant for uses other than in the production of the AIRCRAFT on terms and at a royalty rate no less favourable than other licences in the TERRITORY and in any event at a rate not to exceed Five per cent (5%) of the selling price or fair market value of the article.
11. ENGLISH ELECTRIC authorises MARTIN to grant sub-licences under this Agreement in the TERRITORY if a request and a direction of the Government of the United States of America to that effect is made to MARTIN and MARTIN notifies ENGLISH ELECTRIC in writing. Any sub-licences so granted by MARTIN shall be subject to and consistent with the terms and conditions of this Agreement. MARTIN shall be responsible for the provision to its sub-licensees of all information necessary to enable the said sub-licensees to manufacture assemble test operate and service the said AIRCRAFT and likewise MARTIN shall be responsible for the instruction of the personnel of its sub-licensees. Except for the granting of sub-licences by MARTIN at the request and direction of the Government of the United States of America, the licence and rights granted by this Agreement in the AIRCRAFT to MARTIN by ENGLISH ELECTRIC shall be exclusive in the TERRITORY.
12. MARTIN will pay to ENGLISH ELECTRIC:
 - (a) A capital payment of One million five hundred thousand Dollars and No Cents (\$1,500,000.00) free of United States of America Federal and State Taxes in consideration of the supply to MARTIN of the manufacturing technique engineering data and other information now in the possession of ENGLISH ELECTRIC

necessary for the manufacture of the AIRCRAFT. MARTIN will make the said payment as follows:—

(1) Five hundred thousand Dollars and No Cents (\$500,000.00) upon approval by the Government of the United States of America of this Agreement receipt of which sum is hereby acknowledged.

(2) An additional Five hundred thousand Dollars and No Cents (\$500,000.00) when ENGLISH ELECTRIC has delivered to MARTIN all of the initial drawings and data required to be delivered under the terms of this agreement receipt of which sum is hereby acknowledged.

(3) The remaining Five hundred thousand Dollars and No Cents (\$500,000.00) upon the execution by MARTIN and approval by the Government of the United States of America of all other licence agreements between MARTIN and any other persons or corporations deemed necessary by MARTIN to complete the necessary licence rights required by MARTIN to produce the AIRCRAFT receipt of which sum is hereby acknowledged.

In the event that the Government of the United States of America shall terminate the order for the AIRCRAFT as a result of which it is apparent that the manufacture of said AIRCRAFT will not take place or will be deferred the balance outstanding of the initial payment shall be paid forthwith by MARTIN to ENGLISH ELECTRIC and upon reinstatement of the order for the AIRCRAFT by the Government of the United States of America with MARTIN or a sub-licensee of MARTIN the agreement shall be reinstated upon the same terms and conditions. If said payment shall not have been made under the first paragraph of this sub-section 12(a)(3) then when MARTIN shall have commenced the final assembly in the manufacture of the first production aircraft MARTIN shall be deemed to have acquired all other licence rights from persons or corporations other than ENGLISH ELECTRIC necessary to enable MARTIN to produce the AIRCRAFT.

(b)(1) Throughout the term of this Agreement within thirty (30) days of the last day of June and last day of December of each year payments in respect of the AIRCRAFT manufactured by MARTIN and any sub-licensees of MARTIN at the rates set out in the following schedule in consideration of all rights necessary for the implementation of this Agreement other than those specified in paragraph (a) of this clause:

<i>Quantity of aircraft manufactured by MARTIN and any sub-licensees of MARTIN</i>			<i>Payments due per Aircraft</i>	
<i>In respect of aircraft numbers</i>	<i>1 to</i>	<i>100</i>	<i>At the rate of \$11,500</i>	<i>per Aircraft</i>
"	101 to	150	" \$8,500	"
"	151 to	200	" \$7,800	"
"	201 to	250	" \$7,450	"
"	251 to	300.	" \$7,200	"
"	301 to	350	" \$6,975	"
"	351 to	400	" \$6,800	"
"	401 to	450	" \$6,650	"
"	451 to	500	" \$6,500	"
"	501 to	550	" \$6,400	"
"	551 to	600	" \$6,300	"
"	601 to	650	" \$6,225	"
"	651 to	700	" \$6,150	"
"	701 to	750	" \$6,075	"
"	751 to	800	" \$6,000	"
"	801 to	850	" \$5,925	"
"	851 to	900	" \$5,875	"
"	901 to	950	" \$5,825	"
"	951 to	1,000	" \$5,775	"
"	1,001 and	onwards	" \$3,500	"

(2) All payments set out in (1) above shall be made free of any deductions for United States of America Federal and State Taxes.

(c) All payments to be made under the terms of this Agreement by MARTIN to ENGLISH ELECTRIC shall be made in United States Dollars and paid to an account in New York to be specified by ENGLISH ELECTRIC."

12. In considering the scope of the manufacturing technique which the Company sold under the relevant agreements we were greatly assisted by the Company's officials (listed in paragraph 2 of this Case) who gave oral evidence before us at considerable length and helped us to examine numerous photographs, drawings and models. Most of that evidence was unchallenged by the Crown. The following is a statement of further facts found by us and regarded by us as relevant. We deal first with the Company's manufacturing technique relating to the marine turbines. The Company's first land turbine (steam), made in 1904, was 1,000 kilowatts. By 1950 its turbines were approximately 60,000 kilowatts. The development of the turbine resulted from much higher pressures and temperatures which necessitated entirely new materials and an entirely new technique in dealing with those materials. Many of the Company's methods concerning turbines were the result of experience gained in other branches of its business, e.g. gun work at its Coventry ordnance works. A turbine blade, marked Exhibit 17 was taken as an agreed example of manufacturing technique. There was 27 separate operations in the manufacture of the turbine blade.

We deal now with the Canberra bomber. Although at the time the Company entered into the agreements with the Australian Government and the Glenn Martin Co., the whole of the Company's output of Canberra bombers was taken by the Ministry of Supply the Company hoped to sell Canberras to other persons and it has in fact sold several Canberras of its own manufacture to various governments of the world in recent years. It has made those sales direct to those governments but it obtained the permission of the Ministry of Supply to make the sales. There were about 32,000 items in the Canberra, excluding rivets, nuts, bolts and engines. As regards drawings there were several for each item: there were, for example, seven sheets of drawings of one item—the coaming tube. A coaming tube, part of which is marked Exhibit 22(c), was taken as an agreed example of manufacturing technique. The manufacturing technique relating to the turbine blade and to the coaming tube was capable of being patented. In neither of these cases was the manufacturing technique patented because the policy of the Company was not to patent things which were known only as processes or where certain adaptations to a basic machine inside the Company's works were made by the Company's engineers and the processes for adaptations would not be apparent to a customer. Such patents as were taken out and related to component parts of the turbines and the Canberra bomber were small in number and trivial in value.

Both as regards the turbines and the Canberras the disclosure of manufacturing technique was made by means of handing over a large number of documents and by oral disclosure at lectures and demonstrations and liaison visits both by the Company's officials visiting the licensees' works and visits by officials of the licensees to the Company's works. An example of documentary disclosure of manufacturing technique relating to turbines is shown in brochures marked Exhibit 21(a) and 21(g) and relating to Canberras in the document marked Exhibit 22. There was very strict regulation as to the number of persons allowed to see the Company's techniques.

13. There is a vast difference between "design" and "manufacturing technique". One of the witnesses (Mr. Riddell) was asked to explain to us the situation when the Company granted a licence of the design type and then to explain the situation when a licence of the manufacturing technique was granted. His evidence on these matters, which we accepted as facts, was as follows:

"This was a problem [the imparting of knowledge about manufacturing technique] that was quite new to us and it worried us a great deal. In the past we did not seek licensees but anyone who approached us normally did not approach us in relation to a product, nor did they approach us in relation to manufacturing technique. They were

usually other manufacturers who fancied some device of ours and would like the right to make to that design, which of course would be something that would be of greater or lesser value according to the length of time it would run before it was superseded by something else. Where we felt it was a matter of policy to grant such a licence we would not object to it because we would feel that anyone who wanted to do that was to some extent admitting he was not carrying out the necessary research and development that we were carrying out and we were that much ahead of him in the game, and we ought to continue to be that much ahead of him in the future. It would not have worried us very greatly to let him have the right to use the design provided he was not a major competitor. In the case of manufacturing technique and the introduction of this proposal that we should throw all our work techniques open to a manufacturer, we felt that we were, as it were, at one step—to use a topical term—up-dating the whole of his background knowledge of works methods, and we were putting him in a position equal to ourselves in making to anybody's design. For that reason we felt that we were imparting something which we had never imparted before and which was inherently at the basis of any goodwill value that our organisation might have."

By way of amplification the witness said (and we find this as a fact):

"We felt it [the knowledge of the Company's manufacturing technique] was something we could never take away from him. On the marine steam turbine, of course, as you will have seen from the agreements, we were more concerned to put a restriction in on going into the land steam turbine field but we had no doubt in our own minds he was permanently better off in his own business."

14. In the preceding paragraphs of this Case we have stated a number of facts concerning the Company's manufacturing technique but we have not said what "manufacturing technique" is. Mr. Riddell's evidence, recited in paragraph 13, speaks of up-dating the background knowledge of a competitor and putting him in a position equal to the Company in making to anybody's design. None of the witnesses gave us a short, complete definition. It is certain that it is something distinct from the blue-print or design. The best description we are able to give from the oral evidence is to say—and we find this as a fact—that here was a Company that had been a pioneer in many fields of manufacture and it had accumulated in hundreds of ways knowledge of methods or processes. The possession by a would-be manufacturer of blue-prints of, for example, the thousands of component parts of the Canberra bomber was not enough; given time the would-be manufacturer might be able to produce the components without the aid of any information other than the blue-prints—but what the would-be manufacturer wanted was the knowledge how to make each component accurately, quickly and efficiently, how to adapt standard machine tools for particular purposes, how to stretch or bend materials to particular shapes, how to assemble the components accurately, quickly and efficiently into a complete and efficient article. That is what is meant by the words "manufacturing technique".

15. It was contended on behalf of the Company that the appeal should be allowed.

16. It was contended on behalf of H.M. Inspector of Taxes that the appeal should be rejected.

17. We, the Commissioners who heard the appeal, took time to consider our decision, which we gave in writing on 10th March, 1960, as follows:

Having carefully considered the evidence and the arguments advanced we reject the Crown's contention that the sums in dispute were receipts of an income character arising to the Company in respect of its existing business or an extension of its existing business. On the facts of this case and having regard to the decision of the House of Lords in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, we think the true view in the present case is that the said sums were capital receipts. It was conceded by the Crown that there could be no question

of apportionment between capital and income so far as the Canberra airframes were concerned but it was contended (as an alternative) as regards the marine steam turbines that we should apportion the sums between capital and income and that for the purpose of such apportionment we should hold the element of "secret process" to be capital and the remainder to be income received in respect of services rendered. Basing ourselves on the documents and on the oral evidence of the many witnesses who appeared before us we find as a fact that no part of the said sums in dispute was paid to the Company for the provision of services as such. The whole sum received in each case is, we hold, capital, and is indivisible.

The appeals succeed.

We leave figures to be agreed.

18. In due course it was reported to us that figures were agreed between the parties and on 22nd September, 1960, we determined the appeal by amending the assessments to the following figures:

1951-52, £3,114,750 (less agreed capital allowances £664,179).

1952-53, £3,485,674 (less agreed capital allowances £889,455).

19. H.M. Inspector of Taxes, the Appellant, immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

20. The question for the opinion of the High Court is whether our decision, in paragraph 17 of this Case, was correct in law.

F. Gilbert

B. Todd-Jones

} Commissioners for the
Special Purposes of the
Income Tax Acts.

Turnstile House,
94-99, High Holborn,
London, W.C.1.
2nd August, 1961.

(2) *Commissioners of Inland Revenue v. English Electric Co., Ltd.*

This Case related to an assessment to Profits Tax for the chargeable accounting period 1st January, 1950, to 31st December, 1950.

The facts, contentions of the parties and the decision of the Commissioners were the same as those in the Income Tax Case.

The case came before Pennycuik, J., in the Chancery Division on 31st May and 1st June, 1962, when judgment was reserved. On 5th June, 1962, judgment was given in favour of the Crown, with costs.

Mr. Roy Borneman, Q.C., and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. N. Bucher, Q.C., and Mr. Neil Elles for the Company.

Pennycuik, J.—This is an appeal by the Crown against a decision of the Special Commissioners whereby they allowed an appeal by English Electric Co., Ltd., to which I shall refer as “the Company”, against assessments under Case I, Schedule D, in respect of the profits of its trade for the years 1951–52 and 1952–53. The question at issue is whether, in the computation of its profits, there should be brought into account certain sums received by the Company under agreements with the Admiralty, the Commonwealth of Australia and the Glenn Martin Co. of the United States of America respectively.

The Company carries on the trade of engineering manufacturers, and manufactures, amongst other products, land turbines (but not marine turbines) and aircraft. In the course of its trade the Company has accumulated a quantity of specialised information and technique in engineering processes of the kind which is sometimes compendiously described as “know-how”. It has not been the Company’s practice to turn this information and technique to account by imparting it to others.

In 1949 the Admiralty desired to have marine turbines manufactured by other manufacturers to a prototype made by the Company and entered into an agreement with the Company contained in a letter dated 31st August, 1949. Under this agreement the Company undertook, in consideration of certain payments described as lump sum payments, to provide manufacturing technique, engineering data and other information necessary for the manufacture by other firms of steam turbines to the Company’s design. In 1950, at the request of the Ministry of Supply, the Company made an agreement with the Commonwealth of Australia in order to enable the Commonwealth to have Canberra bombers manufactured in Australia. Under this agreement the Company agreed to provide in Australia particulars of manufacturing technique, engineering data and other specified information, and also certain other facilities. The consideration was expressed severally as certain annual sums in respect of the use of designs and drawings and information, and a single payment described as a lump sum for the supply of manufacturing technique, engineering data and other information. In 1952 the Company, again at the request of the Ministry of Supply, made an agreement in broadly similar terms, *mutatis mutandis*, with the Glenn Martin Co. to enable that company to manufacture Canberra bombers in the U.S.A. I will read parts of the Case Stated in full at a later stage.

Assessments were made on the Company for the years 1951–52 and 1952–53 in amounts including the sums described as lump sums under the three agreements, and the Company appealed against these assessments. The appeals were heard at the end of February, 1960, i.e., after the decision of the House of Lords in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, in 1957, but before the decisions of the successive Courts in *Jeffrey v. Rolls-Royce, Ltd.*⁽¹⁾, [1960] 1 W.L.R. 720, [1961] 1 W.L.R. 897 (Court of Appeal) and [1962] 1 W.L.R. 425 (House of Lords). On 10th March, 1960, the Special Commissioners gave their decision to the effect that on the facts of the case, and having regard to the decision in the *Evans Medical Supplies* case, the sums in question were capital receipts. The appeal before me is from that decision.

In the *Evans Medical Supplies* case, the facts, as summarised in the head-note, were as follows:

“The Appellant Company, which manufactured pharmaceutical products and had a world-wide trade, carried on business in Burma through an agency. In 1953 the Burmese Government wished itself to establish an industry there for the production of pharmaceutical and other products, and the Company secured a contract, dated 20th October, 1953, from the Burmese Government to assist in setting up this industry. The Company undertook to disclose secret processes to the Burmese Government and to provide other information in consideration of the payment of a capital sum of

(¹) 40 T.C. 443.

(Pennycuik, J.)

£100,000'. The Company also undertook to provide certain services and to manage the proposed factory in return for an annual fee, which was admitted to be subject to tax. No similar agreement had been entered into by the Company with any other foreign Government or any other party."

In that case the disclosure of secret processes and provision of information, in return for which the company received the sum of £100,000, was part of an agreement whereby the company, for practical purposes, gave up altogether its own existing trade in Burma. On these facts, as more fully set out in the Case Stated, the House of Lords, by a majority, held that the sum of £100,000 represented consideration for the sale of a capital asset and was a capital receipt in the hands of the company.

In the *Rolls-Royce* case⁽¹⁾ the facts, as summarised in the headnote to the case in the House of Lords⁽²⁾, were as follows:

"A company for the purpose of its business as a manufacturer of motor-cars and aircraft engines, had, since its formation in 1906, been engaged in metallurgical research and the discovery and development of engineering techniques and secret processes. As a result it acquired in the course of the years a fund of technical knowledge, or 'know-how', of which only a comparatively small part was capable of forming the subject-matter of patent rights. For some years the company, as a general rule, used its 'know-how' only in its own trade, but during the period 1946 to 1953, as a result of overtures made by certain foreign governments and companies, the company entered into a number of agreements whereby, in consideration of lump sum payments and royalties, it undertook to supply the foreign government or company with technical knowledge, plans, a licence and facilities for the interchange of staff to enable them to manufacture specified types of aircraft engines. The agreements were for periods of from five to ten years with provision for giving full information regarding improvements and the like during that time, and with options to renew on terms."

On those facts, again as more fully set out in the Case Stated, the Special Commissioners and this Court upheld the Company's contention, these decisions being based on a mistaken view as to the scope of the principle laid down by the House of Lords in the *Evans Medical Supplies* case⁽³⁾. The Court of Appeal reversed the decision of this Court, and the House of Lords affirmed the decision of the Court of Appeal. Each of the judgments in the Court of Appeal and the speeches in the House of Lords is to the same broad effect, and, whilst all throw valuable light on one or other aspect of the issue, it will be sufficient for my purpose to read extracts from two only of the speeches in the House of Lords.

Lord Reid said ([1962] 1 W.L.R., at page 428 (4)):

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

Then, at page 429 (5):

"I cannot accept the contention that by each of these agreements the appellants sold a part of that capital asset and received a price for it. There is nothing in the case to indicate that that capital asset was in any way diminished by carrying out these agreements. The whole of their knowledge and experience remained available to the appellants for manufacturing and further research and development, and there is nothing to show that its value was in any way diminished. They had not even given up a market which had been open to them. They could not sell their engines in these countries whether they made these agreements or not. If they had not made these agreements they would have got nothing from these countries; by making them they were able to exploit their capital asset by receiving large sums for its use there. In essence what they did was to teach the 'licensees' how to make use of the 'licences' which they granted."

⁽¹⁾ 40 T.C. 443.

⁽²⁾ [1962] 1 W.L.R. 425.

⁽³⁾ 37 T.C. 540.

⁽⁴⁾ 40 T.C., at p. 491.

⁽⁵⁾ *Ibid.*, at p. 492.

(Pennycuik, J.)

Lord Radcliffe said, at pages 430-1 (1):

"... I think that the issue of this appeal depends upon a right appreciation of just two matters. One is the nature of this asset of the appellants which is conveniently comprehended in the word 'know-how': the other is the nature of the considerations given by them in exchange for the payment of the sums of money which are the subject of this dispute. First, as to 'know-how'. I see no objection to describing this as an asset. It is intangible: but then so is goodwill. It would be difficult to identify with any precision the sources of the expenditure which has gradually created it and, patents apart, I would not have thought of it as a natural balance-sheet item. But it is a reality when associated with production and development such as that of Rolls-Royce, and a large part, though not the whole of it, finds its material record in all those lists, drawings and manufacturing and engineering data that are specified in the various licence agreements. It is fundamental to the appellants' case that we should categorise this asset as being part of their fixed capital. Indeed, their argument proceeds from the premise that it is fixed capital. That, I think, is to start from too assured a base. An asset of this kind is, I am afraid that I must use the phrase, *sui generis*. It is not easily compared with factory or office buildings, warehouses, plant and machinery or such independent legal rights as patents, copyright or trade marks, or even with goodwill. 'Know-how' is an ambience that pervades a highly specialised production organisation and, although I think it correct to describe it as fixed capital so long as the manufacturer retains it for his own productive purposes and expresses its value in his products, one must realise that in so describing it one is proceeding by an analogy which can easily break down owing to the inherent differences that separate 'know-how' from the more straightforward elements of fixed capital. For instance, it would be wrong to confuse the physical records with the 'know-how' itself, which is the valuable asset: for, if you put them on a duplicator and produce one hundred copies, you have certainly not multiplied your asset in proportion. Again, as the facts of the present appeal show, 'know-how' has the peculiar quality that it can be communicated to or shared with others outside the manufacturer's own business, without in any sense destroying its value to him. It becomes, if you like, diluted, and its value to him may be affected, though, in my view, it begs the question to say that that value is necessarily reduced because the asset is used for outside instruction. These considerations lead me to say that, although 'know-how' is properly described as fixed capital by way of analogy, it is the kind of intangible entity that can very easily change its category according to the use to which its owner himself decides to put it. I am not sure that it is too much to say that it is his use of it that determines the category. It is not like a single physical entity which must be employed for production or else broken up: it is more like a fluid in store which can be pumped down several channels. I do not therefore think that this appeal can be decided by the simple set of propositions: "'know-how' is an item of fixed capital. A lump sum received by a trader on a sale of such an item should not go to his income account. It makes no difference that the item is disposed of, by several separate transactions divided from each other by time intervals."

Then, lower down page 431 (2):

"If one analyses the various things that the appellants are to do in return for the money they are to get they all come down to forms of instruction and advice. By clause 2 they are to supply 'complete drawings and manufacturing and engineering data and information adequate and reasonably necessary to enable the commission to manufacture' the particular Rolls-Royce engine selected. No doubt the things to be supplied are tangible objects, but then so are textbooks, formulae or recipes. They are teaching at long range."

Then, at page 432 (3):

"The 'capital' sum is what is now in question. I do not think it possible to attach any significance to the qualifying adjective. If we did, revenue appeals on this particular issue would soon settle themselves."

Then, at the bottom of the page (3):

"I have not been able to see why these 'capital' receipts should not be brought into account in the assessment of the appellants' trading profits. It seems to me that, so long as they kept their 'know-how' to themselves, they used it for the manufacture of their own engines, and its value was expressed in the successful sales which they achieved

(1) 40 T.C., at pp. 492-3.

(2) *Ibid*, at p. 494.

(3) *Ibid*.

(Pennycuik, J.)

of those products. I daresay that they would have preferred, ideally, to reserve their 'know-how' solely for the purposes of their own manufacture."

I leave out the next sentence.

"However that may be, it is clear that they saw that, having the 'know-how' they could derive profit from the manufacture of their engines, even by others, in parts of the world where they either could not or would not sell or manufacture them themselves, provided only that they equipped those others with the requisite expertise. So they turned the 'know-how' to account by undertaking for reward to impart it to the others in order to bring about this alternative form of manufacture."

Finally, near the bottom of page 433 (1):

"What weighed with the majority judgments in that case"

—that is, the *Evans Medical Supplies* case (2)—

"was that the company had sold to the Burmese Government a secret process upon which the success of the business in Burma had to depend and it had, in effect, disposed altogether of its Burmese trade. To do that was to dispose finally of part of its fixed capital and moneys received in return were not trading receipts."

It was held, then, in the *Rolls-Royce* case(3), that what is called "know-how" in the hands of a manufacturer is an asset of such character that it may be communicated for value to another, on the one hand in such manner that it loses its value to the trader—in which case the consideration is capital—or on the other hand in such manner that it retains its value to the trader—in which case the consideration must be brought into account in the computation of income profit. I hope that is not an undue simplification of the decision for the purpose of the present case. The *Evans Medical Supplies* case was an instance of the former, the *Rolls-Royce* case an instance of the latter, type. Each case must depend on its own particular facts. Obviously there may be an intermediate belt between the two extremes of complete loss of value and complete retention of value, and such cases may, I think, sometimes involve apportionment irrespective of contractual provisions.

I return now to read in detail the relevant passages of the Case Stated here. Paragraph 1 gives particulars of the assessments and the grounds of appeal. Paragraph 2 describes the Exhibits and gives the names and qualifications of the witnesses who gave oral evidence. Paragraph 3 sets out the incorporation and objects of the Company. Paragraph 4:

"The Company's authorised capital in 1950 was £8,000,000, and the issued capital was nearly £7,000,000. In each of the three calendar years 1950, 1951 and 1952 there was added to the Company's capital reserve account a sum of money described as 'sales of manufacturing technique'. The sums so added were: for the year 1950, £263,833; for the year 1951, £255,118; and for the year 1952, £177,468. The said sums were received by the Company from separate sources, namely, the Commonwealth of Australia, the Glenn L. Martin Co. of the State of Maryland, U.S.A., and the Admiralty. The two first named desired to manufacture aircraft; the third named desired the Company to provide information necessary for the manufacture by other firms of marine turbines. The following paragraphs 5 and 6 give certain facts concerning the Company's historical background and its trading policy before and during the three relevant years. Details of the agreements which gave rise to the sales of manufacturing technique are given in paragraphs 7, 8, 10 and 11 of this Case.

5. On its formation in 1918 the Company took over the businesses of a number of old-established companies; those businesses became branches of the Company."

Then follow particulars, and at the end of the paragraph there is this:

"After the formation of the Company, ranges of products were extended and additional works were opened.

(1) 40 T.C., at p. 495.

(2) 37 T.C. 540.

(3) [1962] 1 W.L.R. 425; 40 T.C. 443.

(Pennycuik, J.)

6. The Company's trade is that of a manufacturer. Its policy is, and always has been, to manufacture and sell its manufactured products. The Company has always guarded very jealously its manufacturing processes and designs, and at all times treated them as trade secrets. The Company has never at any time developed manufacturing technique with a view to selling it. On a few occasions the Company has licensed other persons to use some device, whether patented or otherwise, but such occasions have been rare and the Company has only given such licence when pressed very hard to do it.

7. The Company has never manufactured *marine* turbines, but because of its outstanding reputation as a manufacturer of *land* turbines it was, in 1949, requested by the Admiralty to design, develop and produce prototypes for marine turbines known as Y.100, Daring Class turbines and Y.E.A.D.1. The prototypes were in each case produced and paid for separately. The Company did not wish to manufacture marine turbines, but it deemed it desirable to assist the Admiralty; and it therefore entered into discussions with Admiralty representatives on the understanding that, if it produced a prototype which proved successful in its tests, the Company would not itself manufacture marine turbines but it would be asked by the Admiralty to license marine turbine manufacturers in the United Kingdom and, if possible, in the Commonwealth, to manufacture to the Company's designs. Contracts were entered into, the terms of one of which (relating to the Y.100) are contained in a letter dated 31st August, 1949, from the Admiralty (Contract Department) to the Company. The letter reads as follows: ". . . With reference to Sir George Nelson's letter of 25th August addressed to Mr. Coxwell, and to previous correspondence I have to confirm the following terms for:— (a) The preparation of a design for, and the manufacture of a prototype of Frigate Steam Turbine of the type known as Y.100. (b) The provision of the necessary data and other information for the manufacture of turbines to such a design and the granting of licences for the use thereof by other manufacturers to Admiralty instructions. 2. The Admiralty will order at least one set of machinery of Y.100 design for manufacture at the English Electric Company's works and the price to be paid for such prototype shall include *inter alia* the cost of all designers' and draughtsmen's work and material expended in stressing out and detailing the Y.100 turbine design, the production of the working drawings, and the cost of the preparation of necessary jigs, tools, etc., required for production. 3. In consideration of the following lump sum payments the English Electric Company agree to provide manufacturing technique, engineering data and other information necessary for the manufacture by other firms of steam turbines to the English Electric Company's design of the type known as Y.100. (a) In U.K.—£40,000 for manufacture by other firms up to a maximum of six. (b) In Canada—£25,000 for manufacture by not more than two firms. (c) In Australia—£25,000 for manufacture by not more than two firms.'"

The paragraph goes on to provide for the mode of payment and extension in the number of firms. Paragraph 4 of the letter provides for a payment of 2½ per cent. of the selling price in consideration of the grant of licences, and paragraph 5 for reimbursement to the Company of certain sums which the Company may have to pay to the Westinghouse Co.:

" 6. The English Electric Company will provide adequate facilities at their works for one or more Liaison Officers or Engineers of the manufacturer (up to a maximum of three at any one time) to receive advice and instruction on the manufacture of the above design of turbine. The manufacturer will pay all expenses incurred by such visits. If required by the manufacturer the English Electric Company will give assistance to the manufacturer by sending a reasonable number of personnel to advise and assist at the manufacturer's Works at Company cost plus 10 per cent. 7. It is an essential condition that an undertaking will be given by all manufacturers to whom the English Electric Company provide the manufacturing technique, engineering data and other information (under the terms of paragraph 3 hereof) that they will not use such manufacturing technique, engineering data and other information for the purpose of entering into the land turbine field, except on the basis of a reasonable payment to the English Electric Company. 8. This arrangement is limited and relates solely to the above designs of Frigate Steam Turbine and any modification or variations which do not constitute a new design."

I go back now to the Case Stated, paragraph 8:

" The Company was paid by the Admiralty for the prototype of the Y.100 in accordance with the terms of paragraph 2 of the letter of 31st August, 1949. There was no dispute, so far as taxation was concerned, relating to the payment so received by the Company. What was in dispute in the appeal before us was the assessability of the lump sum payments under paragraph 3 of the letter of 31st August, 1949."

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The remainder of that paragraph deals with a supplementary contract.

" 9. During the 1939-45 war the Company manufactured Hampden and Halifax bombers and, later, de Havilland Vampire fighters. Those particular types of aircraft were, on Government orders, manufactured by the Company to other persons' designs. Soon after the end of the war, the Ministry of Supply urged the Company to set up its own design teams and to design and make its own planes. In particular, the Ministry requested the Company to design a twin-engined bomber for the Royal Air Force. The Company's design team made certain proposals to the Ministry and, those proposals having been approved, the Company was entrusted with the work of design, development and manufacture of a twin-engined bomber. The Company was reimbursed to the extent of a percentage of its actual expenditure on the work every month. The Company's first prototype bore the identification B3/45, but hereafter it is referred to by the name eventually given to it—the Canberra bomber. The Company manufactured and delivered Canberra bombers to the Royal Air Force up to April, 1950.

10. At the request of the Ministry of Supply, the Company entered into an agreement with the Commonwealth of Australia on 12th April, 1950. . . . In view of their importance in considering this appeal, the first eleven clauses of the said agreement are now reproduced. The sums mentioned in clause 8(i) and (iii) of the agreement were admittedly taxable. What was in dispute was the assessability of the sum of £200,000 mentioned in clause 8(ii) of the agreement."

The agreement reads as follows (the parties are the Company and the Commonwealth of Australia):

" Whereas the Company is a designer and manufacturer and has extensive experience of the production of aircraft And Whereas the Company has developed a bomber aircraft in accordance with the specification detailed in the First Schedule to this Agreement and the Commonwealth is desirous of manufacturing the said aircraft in the territory hereinafter defined "

Clause 1 consists of definitions. Clause 2:

" The Company Hereby Agrees: (i) To provide in Australia the designs and drawings of the Aircraft and designs and drawings of the Jigs and Tools specified in the Second Schedule hereto together with any other designs and drawings not mentioned in the said Second Schedule and which may be necessary to enable the Commonwealth to manufacture assemble test operate and service the Aircraft in accordance with the Company's designs; (ii) To provide in Australia particulars of the manufacturing technique engineering data and other information specified in the Third Schedule hereto together with such other information as the Company now possesses and which will enable the Commonwealth to manufacture assemble test operate and service the Aircraft in accordance with the methods and processes used by the Company; and (iii) To notify the Commonwealth of any improvements or modifications in design or in processes and methods of manufacture devised by the Company during the term of this Agreement and relating to the Aircraft subject where necessary to the prior consent of His Majesty's Government in the United Kingdom and to provide the Commonwealth in Australia in so far as it is permitted by His Majesty's Government in the United Kingdom so to do with full information relating to such improvements and modifications. 3. This Agreement relates solely to the manufacture and use of the Aircraft by or on behalf of the Commonwealth in the territory for the use of the Commonwealth and the Commonwealth Hereby Undertakes that the Aircraft manufactured under the terms of this Agreement will not be supplied to others without the prior consent of the Company at terms to be agreed."

Clause 4 is a provision whereby the Commonwealth is to make known to the Company any improvements or modifications; under clause 5 the Company is to send engineers to Australia; under clause 6 the Commonwealth may send liaison officers to the Company's works; and under clause 7 the Company is to supply jigs, tools and parts.

" 8. The Commonwealth Hereby Agrees To Pay to the Company: (i) The sum of Thirteen Thousand Pounds (£13,000) per annum for the use by the Commonwealth during the term of the Agreement of the designs and drawings of the Aircraft and of the designs and drawings of the Jigs and Tools to be used in connection with its production and which the Company undertakes to supply in Clause 2(i) hereof. . . . (ii) The sum of Two Hundred Thousand Pounds (£200,000) on the date of the commencement of

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this Agreement for the supply to the Commonwealth in accordance with Clause 2(ii) hereof of the manufacturing technique engineering data and other information now in the possession of the Company and which will enable the Commonwealth forthwith to manufacture the aircraft but exclusive of the designs and drawings referred to in paragraph (i) of this Clause. (iii) The sum of Four Thousand Pounds (£4,000) per annum in consideration of the undertaking by the Company in Clause 2(iii) hereof to supply the Commonwealth with information relating to modifications and improvements of the Aircraft and of the manufacturing processes and methods used by the Company. . . ”.

Clause 9 is concerned with the mode of payment, and clause 10 with Australian letters patent and other matters; and clause 11:

“ The Commonwealth Hereby Undertakes that all drawings data and technical information supplied by the Company shall be treated as confidential and shall not be disclosed to others except as may be necessary for the manufacture assembly and servicing of the Aircraft by the Commonwealth or by any person firm or corporation on behalf of the Commonwealth.”

Going back to the Case Stated, paragraph 11:

“ Early in 1951, the United States Air Force decided that production of the Canberra bomber was essential in the development of United States’ air power. The United States sent a mission to the United Kingdom, headed by General K. B. Wolfe, including representatives of an American aircraft manufacturing corporation called the Glenn L. Martin Co. of Maryland, U.S.A. By arrangement with the Ministry of Supply, the mission entered into negotiations with the Company (English Electric Co., Ltd.). The whole of the Company’s output of Canberra bombers in the United Kingdom, up to that time, was taken by the Royal Air Force, but the United States mission did not wish to purchase bombers from the Company; what the mission desired was to manufacture the bombers in the United States. On 16th April, 1952, the Company entered into an agreement with the Glenn L. Martin Co. . . . In view of their importance in considering this appeal, the first twelve clauses of the said agreement are now reproduced. The sums mentioned in clause 12(b) of the agreement were admittedly taxable. What was in dispute was the assessability of the sum of \$1,500,000 (£536,379 is the sterling equivalent) mentioned in clause 12(a) of the agreement.”

The agreement sets out the parties, namely, the Company and the Glenn Martin Co. The recital begins:

“ Whereas English Electric has designed and engineered for production a jet airplane known as the Canberra and represents that it has full engineering design and technical data for said airplane as well as complete tool design manufacturing and manufacturing technical data know-how processes and procedures for the production of said airplane And Whereas Martin desirous of acquiring complete design information drawings lofts technical data etcetera to enable it to manufacture assemble test operate and service the said jet airplane in accordance with the English Electric’s design for the Government of the United States of America entered into an Agreement. . . ”.

Then it recites a modified agreement, and finally:

“ And Whereas English Electric and Martin now desire to incorporate in one document the terms and conditions of the said Agreement of 3rd April 1951 as modified by the said Agreement of 1st May 1951 and correct some inconsistencies in the Agreement occasioned by the amendments.”

Clause 1 supersedes the previous agreement, clause 2 gives definitions; and clause 3:

“ English Electric agrees: (a) To furnish to Martin in the Territory a set of all designs drawings and loft templates of the Aircraft and all designs and drawings of jigs tools and the relevant operation sheets necessary to enable Martin to manufacture assemble test operate and service the Aircraft in accordance with English Electric’s design; (b) To furnish to Martin in the Territory particulars of the manufacturing technique including tool process sheets materials and process specifications and engineering data including stress and static test data of such parts as are involved in any modifications introduced by Martin and flight test data from the first flight of the Canberra aircraft Mark II and all such other information as will enable Martin to

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manufacture assemble test operate and service the Aircraft in accordance with the methods and processes used by English Electric; (c) To furnish to Martin in the Territory particulars of the design manufacture and technique of maintenance ground handling and service equipment for the Aircraft; (d) To notify Martin promptly of any improvements or modifications in design or in processes and methods of manufacture devised by English Electric during the term of this Agreement and relating to the Aircraft. . . ”.

That is subject to Government consent.

“ 4. This Agreement relates solely to the manufacture use and sale of the Aircraft and the requisite spare parts thereof by Martin or any sub-licensees of Martin in the Territory to the Government of the United States of America for the use and disposition according to law by said Government of the United States of America for any governmental purpose and Martin undertakes that the Aircraft manufactured under the terms of this Agreement will not be supplied by Martin or any sub-licensees of Martin to other than the Government of the United States of America without the prior written consent of English Electric on terms to be agreed.”

Under clause 5 Martin is to make known to the Company modifications or improvements, under clause 6 the Company is to send engineers to Martin's factory, under clause 7 Martin may send engineers to the Company's factory and under clause 8 the Company is to supply parts. Then I need not read clauses 9, 10 and 11.

“ 12. Martin will pay to English Electric: (a) A capital payment of One million five hundred thousand Dollars and No Cents (\$1,500,000.00) free of United States of America Federal and State Taxes in consideration of the supply to Martin of the manufacturing technique engineering data and other information now in the possession of English Electric necessary for the manufacture of the Aircraft.”

Then it provides for the payment of that sum by specified instalments.

“(b) (1) Throughout the term of this Agreement within thirty (30) days of the last day of June and last day of December of each year payments in respect of the Aircraft manufactured by Martin and any sub-licensees of Martin at the rates set out in the following schedule in consideration of all rights necessary for the implementation of this Agreement other than those specified in paragraph (a) of this clause.”

There follow particulars of the quantity of aircraft and payments per aircraft.

Returning again to the Case Stated, paragraph 12:

“ In considering the scope of the manufacturing technique which the Company sold under the relevant agreements, we were greatly assisted by the Company's officials . . . who gave oral evidence before us at considerable length and helped us to examine numerous photographs, drawings and models. Most of that evidence was unchallenged by the Crown. The following is a statement of further facts found by us and regarded by us as relevant. We deal first with the Company's manufacturing technique relating to the marine turbines. The Company's first land turbine (steam), made in 1904, was 1,000 kilowatts. By 1950 its turbines were approximately 60,000 kilowatts. The development of the turbine resulted from much higher pressures and temperatures, which necessitated entirely new materials and an entirely new technique in dealing with those materials. Many of the Company's methods concerning turbines were the result of experience gained in other branches of its business—e.g., gun work at its Coventry ordnance works. A turbine blade, marked Exhibit 17, was taken as an agreed example of manufacturing technique. There were 27 separate operations in the manufacture of the turbine blade. We deal now with the Canberra bomber. Although, at the time the Company entered into the agreements with the Australian Government and the Glenn Martin Co., the whole of the Company's output of Canberra bombers was taken by the Ministry of Supply, the Company hoped to sell Canberras to other persons; and it has in fact sold several Canberras of its own manufacture to various governments of the world in recent years. It has made those sales direct to those governments, but it obtained the permission of the Ministry of Supply to make the sales. There were about 32,000 items in the Canberra, excluding rivets, nuts, bolts and engines. As regards drawings, there were several for each item: there were, for example, seven sheets of drawings of one item—the coaming tube. A coaming tube, part of which is marked Exhibit 22(c), was taken as an agreed example of manufacturing technique. The manu-

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facturing technique relating to the turbine blade and to the coaming tube was capable of being patented. In neither of these cases was the manufacturing technique patented because the policy of the Company was not to patent things which were known only as processes or where certain adaptations to a basic machine inside the Company's works were made by the Company's engineers and the processes for adaptations would not be apparent to a customer. Such patents as were taken out and related to component parts of the turbines and the Canberra bomber were small in number and trivial in value. Both as regards the turbines and the Canberras the disclosure of manufacturing technique was made by means of handing over a large number of documents, and by oral disclosure at lectures and demonstrations and liaison visits, both by the Company's officials visiting the licensees' works and visits by officials of the licensees to the Company's works. An example of documentary disclosure of manufacturing technique relating to turbines is shown in brochures marked Exhibits 21(a) and 21(g), and relating to Canberras in the document marked Exhibit 22. There was very strict regulation as to the number of persons allowed to see the Company's techniques.

13. There is a vast difference between 'design' and 'manufacturing technique'. One of the witnesses (Mr. Riddell) was asked to explain to us the situation when the Company granted a licence of the design type, and then to explain the situation when a licence of the manufacturing technique was granted. His evidence on these matters, which we accepted as facts, was as follows: 'This was a problem [the imparting of knowledge about manufacturing technique] that was quite new to us, and it worried us a great deal. In the past we did not seek licensees, but anyone who approached us normally did not approach us in relation to a product, nor did they approach us in relation to manufacturing technique. They were usually other manufacturers who fancied some device of ours and would like the right to make to that design, which, of course, would be something that would be of greater or lesser value according to the length of time it would run before it was superseded by something else. Where we felt it was a matter of policy to grant such a licence we would not object to it, because we would feel that anyone who wanted to do that was to some extent admitting he was not carrying out the necessary research and development that we were carrying out and we were that much ahead of him in the game, and we ought to continue to be that much ahead of him in the future. It would not have worried us very greatly to let him have the right to use the design, provided he was not a major competitor. In the case of manufacturing technique and the introduction of this proposal that we should throw all our work techniques open to a manufacturer, we felt that we were, as it were, at one step—to use a topical term—up-dating the whole of his background knowledge of works methods, and we were putting him in a position equal to ourselves in making to anybody's design. For that reason, we felt that we were imparting something which we had never imparted before and which was inherently at the basis of any goodwill value that our organisation might have.' By way of amplification, the witness said (and we find this as a fact): 'We felt it [the knowledge of the Company's manufacturing technique] was something we could never take away from him. On the marine steam turbine, of course, as you will have seen from the agreements, we were more concerned to put a restriction in on going into the land steam turbine field, but we had no doubt in our own minds he was permanently better off in his own business.'

14. In the preceding paragraphs of this Case we have stated a number of facts concerning the Company's manufacturing technique, but we have not said what 'manufacturing technique' is. Mr. Riddell's evidence, recited in paragraph 13, speaks of up-dating the background knowledge of a competitor and putting him in a position equal to the Company in making to anybody's design. None of the witnesses gave us a short, complete definition. It is certain that it is something distinct from the blue-print or design. The best description we are able to give from the oral evidence is to say—and we find this as a fact—that here was a Company that had been a pioneer in many fields of manufacture, and it had accumulated in hundreds of ways knowledge of methods or processes. The possession by a would-be manufacturer of blue-prints of, for example, the thousands of component parts of the Canberra bomber was not enough; given time, the would-be manufacturer might be able to produce the components without the aid of any information other than the blue-prints—but what the would-be manufacturer wanted was the knowledge how to make each component accurately, quickly and efficiently, how to adapt standard machine tools for particular purposes, how to stretch or bend materials to particular shapes, how to assemble the components accurately, quickly and efficiently into a complete and efficient article. That is what is meant by the words 'manufacturing technique'.

15. It was contended on behalf of the Company that the appeal should be allowed.

16. It was contended on behalf of H.M. Inspector of Taxes that the appeal should be rejected.

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17. We, the Commissioners who heard the appeal, took time to consider our decision, which we gave in writing on 10th March, 1960, as follows: Having carefully considered the evidence and the arguments advanced, we reject the Crown's contention that the sums in dispute were receipts of an income character arising to the Company in respect of its existing business or an extension of its existing business. On the facts of this case, and having regard to the decision of the House of Lords in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, we think the true view in the present case is that the said sums were capital receipts. It was conceded by the Crown that there could be no question of apportionment between capital and income so far as the Canberra airframes were concerned, but it was contended (as an alternative) as regards the marine steam turbines that we should apportion the sums between capital and income, and that for the purpose of such apportionment we should hold the element of 'secret process' to be capital and the remainder to be income received in respect of services rendered. Basing ourselves on the documents and on the oral evidence of the many witnesses who appeared before us, we find as a fact that no part of the said sums in dispute was paid to the Company for the provision of services as such. The whole sum received in each case is, we hold, capital and is indivisible."

Paragraph 18 relates to figures, and in paragraph 19 the Inspector of Taxes expresses dissatisfaction.

" 20. The question for the opinion of the High Court is whether our decision, in paragraph 17 of this Case, was correct in law."

It is common ground that the question before this Court, namely, whether these receipts are of a capital or income nature, is one of law. In my judgment, the proper conclusion in law is that these receipts are of an income nature and, as such, must be brought into account in the computation of the Company's profits. The Company has never manufactured marine turbines. Before the 1950 and 1951 agreements the whole of the Company's output of Canberra bombers was taken by the Ministry of Supply, and the Company has recently sold some Canberras to various governments. Apart from the matters dealt with in the Case there is no evidence as to the Company's activities either in Australia or in the U.S.A. Under the three agreements the Company communicated its information and manufacturing techniques, not to rival manufacturers, but to a British Government Department, the Commonwealth of Australia and the company nominated by a foreign government respectively, in each case with restrictions upon communication to other parties. There is no evidence that the Company's trade has in any way contracted as a result of the agreements. Upon those facts it seems to me that the proper conclusion is that by the agreements the Company has turned its information and technique to account without diminishing their value to the Company, and that this asset remains intact in the possession of the Company for future employment in its own manufacturing trade and also, if the Company thinks fit, by way of communication to others.

I must now refer shortly to certain contentions advanced by Mr. Bucher on behalf of the Company, though not in his precise words, which I have sought to tabulate later: (1) Under the agreements the Company undertakes severally (a) to impart information to, or, in his words, to teach, the other party; and (b) to supply manufacturing technique and information to the other party. The former obligation, Mr. Bucher contends, results in consideration of an income character under the principle laid down in the *Rolls-Royce* case⁽¹⁾, but not the latter obligation. I can find nothing in the *Rolls-Royce* case which justifies this distinction. The *ratio decidendi* in the *Rolls-Royce* case is equally applicable to the latter obligation, it seems to me, provided of course that its performance does not result in the destruction of the value of the technique and information in the hands of the Company. (2) In the Canberra agreements there is an express

(¹) 40 T.C. 443.

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apportionment of the consideration between the instruction on the one hand and the supply of manufacturing technique and information on the other hand. This apportionment, however, cannot help the Company if the consideration for the supply of the technique and information is itself properly to be regarded as of an income character. (3) The manufacturing technique and information is, in Mr. Bucher's words, a patentable, durable and basic asset. There is no doubt that the Company has acquired a vast quantity of technique and information, though it may be a matter for argument whether the epithet "durable" is appropriate to this technique and information which, from its nature, changes over the years. Be that as it may, I do not think that the qualities attributed by Mr. Bucher to this asset are inconsistent with the exploitation of the asset by communication in such manner that its value to the Company is retained rather than destroyed by communication. (4) As found in paragraph 13 of the Case Stated, one witness said:

"In the case of manufacturing technique and the introduction of this proposal that we should throw all our work techniques open to a manufacturer, we felt that we were, as it were, at one step . . . up-dating the whole of his background knowledge of works methods, and we were putting him in a position equal to ourselves in making to anybody's design."

So it is said that the consideration for such a communication must be of a capital nature. There would be force in this contention if the other party were a rival manufacturer, and one can imagine circumstances in which such communication would represent something in the nature of pooling capital assets; but this is not the case here, where the other parties are governments or their nominees to whom the communication is made for a purpose but not in competition with the existing activities of the Company's own trade. (5) It is said that this is an isolated transaction. I am not clear whether an element of repetition is required in this connection. In so far as such element is required, the three agreements together seem to me sufficiently to provide it. (6) The communication of manufacturing technique and information is in any event a separate trade from the trade of manufacturers to which the assessment relates. This contention, I think, is conclusively rejected by a number of statements in the speeches in the House of Lords in the *Rolls-Royce* case⁽¹⁾; see *per* Lord Reid at page 430 and Lord Radcliffe at page 433.

Mr. Borneman, for the Crown, has stressed the similarities, which are indeed striking, between the facts in the present case and the facts in the *Rolls-Royce* case. Mr. Bucher has pointed out the differences. I have to apply to the facts in this case the principle laid down in the *Rolls-Royce* case, and whilst comparisons in detail are helpful in argument, I do not think I should pursue them further now. For the reasons I have sought to give I allow this appeal.

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This case raises an issue identical in every respect with regard to Profits Tax, and I equally allow the appeal in this case.

Mr. Roy Borneman.—Will you allow costs, my Lord?

Mr. F. N. Bucher.—I think that follows.

Pennycuick, J.—Yes.

Mr. Borneman.—Can I assume in both cases that it is for the Special Commissioners to adjust the assessments, both for Income Tax and Profits Tax?

Pennycuick, J.—Yes.

⁽¹⁾ [1962] 1 W.L.R.; 40 T.C., at pp. 492 and 495.

The Company having appealed against the above decision, the case came before the Court of Appeal (Lord Denning, M.R., and Danckwerts and Russell, L.J.J.) on 4th, 5th and 6th February, 1963, when judgment was given in favour of the Crown, with costs.

Mr. F. N. Bucher, Q.C., and Mr. Neil Elles appeared as Counsel for the Company, and Mr. Roy Borneman, Q.C., and Mr. Alan Orr for the Crown.

Lord Denning, M.R.—This case raises a question as to the tax, if any, payable on sums which English Electric Co., Ltd. received for sales of manufacturing technique or, in the modern phrase, “know-how”. The sum received for the year 1950 was £263,833; for the year 1951, £255,118; and for the year 1952, £177,468. Those sums were received from three main contracts: one with the Admiralty in England, another with the Commonwealth of Australia, and the third with the Glenn L. Martin Co. of the United States of America.

The Company or its predecessors has over many years developed peculiar skills in manufacturing its products. It has kept those skills closely in its own hands, so far as it can. Its policy is, and always has been, to manufacture and sell its manufactured products. It has kept its manufacturing technique confidential and secret for its own use; and, although quite a number of the Company’s techniques might have been patented, it has not sought to patent them but has preferred to keep them confidential for its own use.

So far as the Admiralty contract was concerned, the position was that the English Electric Co. had an outstanding reputation as manufacturer of land turbines. In 1949 the Admiralty requested the Company to design, develop and produce a prototype for marine turbines. The Company was not requested actually itself to manufacture marine turbines; it was asked to license manufacturers in the United Kingdom and the Commonwealth. By a letter of 31st August, 1949, a contract was made by the Company with the Admiralty under which the Company agreed to provide manufacturing technique to the licensees in return for lump sum payments, namely: in the United Kingdom £40,000 for manufacture by other firms up to a maximum of six; in Canada £25,000 for manufacture by not more than two firms; in Australia £25,000 for manufacture by not more than two firms. Those are the sums of which the assessability is in dispute.

So far as the Australian contract was concerned, the position was that after the war the Ministry of Supply requested the Company to design a twin-engined bomber for the Royal Air Force. The Company did so, and produced the Canberra bomber and delivered it to the Royal Air Force. The Ministry then asked the Company to tell the Commonwealth of Australia how to make Canberra bombers. The Commonwealth wanted to make them in Australia. Accordingly, on 12th April, 1950, the Company made an agreement with the Commonwealth of Australia whereby it agreed to provide in Australia (i) designs and drawings of the Canberra bomber, for which the Company was to be paid £13,000 per annum; (ii) manufacturing technique specified in a schedule, for which the Company was to be paid £200,000; (iii) information relating to modifications and improvements, for which the Company was to be paid £4,000 per annum. It is admitted that the sums of £13,000 per annum and £4,000 per annum are assessable to tax. The sum in dispute is the lump sum of £200,000 for manufacturing technique. Is that a capital receipt or a revenue receipt?

So far as the American contract is concerned, the position was that early in 1951 the United States Air Force decided that the Canberra bomber was essential to the development of United States air power. A mission under

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General Wolfe came to the United Kingdom. They did not wish to purchase bombers from the Company; the mission desired to manufacture bombers in the United States. On 16th April, 1952, the Company entered into an agreement with the Glenn L. Martin Co. of the United States of America whereby the English Electric Co. agreed to provide the American company with (a) manufacturing technique, for a "capital payment" of \$1,500,000; (b) all rights necessary for the implementation of the agreement, at the rate of \$11,500 per aircraft for the first 100 aircraft and so forth. It is admitted that these latter sums per aircraft are assessable to tax. The sum in dispute is the lump sum of \$1,500,000 for manufacturing technique. Is it a capital receipt or a revenue receipt? It is admitted that the description in the agreement of it as a "capital payment" does not affect this question.

The Commissioners rejected the Crown's contention that the sums in dispute were receipts of an income character. They had before them only *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540. The Commissioners said there was a vast difference between "design" and "manufacturing technique". So far as design is concerned, the Company had granted licences to use designs and it did not worry the Company greatly to let anyone else have the right to use the design provided he was not a major competitor. But manufacturing technique was different. The Commissioners held that this was a capital asset and the money received for the sale of it was a capital receipt. The Commissioners accepted the Company's evidence on the matter, which was as follows:

"In the case of manufacturing technique and the introduction of this proposal that we should throw all our work techniques open to a manufacturer, we felt that we were, as it were, at one step—to use a topical term—up-dating the whole of his background knowledge of works methods, and we were putting him in a position equal to ourselves in making to anybody's design. For that reason, we felt that we were imparting something which we had never imparted before and which was inherently at the basis of any goodwill value that our organisation might have."

The Commissioners went on to give their description of what they considered manufacturing technique to consist of:

"[We find as a fact] that here was a Company that had been a pioneer in many fields of manufacture, and it had accumulated in hundreds of ways knowledge of methods or processes. The possession by a would-be manufacturer of blue-prints of, for example, the thousands of component parts of the Canberra bomber was not enough; given time, the would-be manufacturer might be able to produce the components without the aid of any information other than the blue-prints—but what the would-be manufacturer wanted was the knowledge how to make each component accurately, quickly and efficiently, how to adapt standard machine tools for particular purposes, how to stretch or bend materials to particular shapes, how to assemble the components accurately, quickly and efficiently into a complete and efficient article. That is what is meant by the words 'manufacturing technique'."

Now it seems to me that this is a typical case of "know-how". "Manufacturing technique" is just "know-how". "Know-how" is an intangible asset, just as intangible as goodwill and just as worthy of recognition. It is a revenue-producing asset, just as goodwill is. "Know-how" can be put to use so as to produce revenue in two ways. The manufacturer can use it himself to make things for sale and make profit in that way; or he can teach it to others, so that they can make their own things, in which case he gets paid for the knowledge and information which he imparts to them. His fees and rewards are then revenue in his hands. I assume, of course, that the manufacturer, although teaching it to others, still retains the knowledge himself and intends to go on using it himself and making things from it. So long as he does this, he retains his capital asset himself and is only using it to produce revenue.

(Lord Denning, M.R.)

But "know-how" can be used to produce a capital receipt. It can be sold outright and bring in a capital fund. This happens when a trader or manufacturer sells his goodwill or "know-how" outright to a purchaser, withdraws from the business himself, and agrees not to use the "know-how" or goodwill to the prejudice of the purchaser. The purchase price he receives is then capital in his hands. As Lord Radcliffe said in *Rolls-Royce, Ltd. v. Jeffrey*, [1962] 1 W.L.R. 425, at page 431⁽¹⁾, "know-how" is rather like "a fluid in store which can be pumped down several channels". It can be pumped down one channel for use in his own manufacturing shops, and down another channel for the use of his customers who wish to manufacture themselves. But so long as he retains his capital store of fluid (which is for ever being filled anew with accretions of knowledge at one end whilst being pumped out at the other), it remains a capital asset in his hands which produces revenue from all the various channels into which it is pumped.

It seems to me that this case is governed by the *Rolls-Royce* case. No doubt in this case, as in that, the Company would rather have kept the "know-how" to itself; and itself alone made use of it. It was reluctant to impart it to others or allow them to make use of it. It only did so because it was requested by the Government so to do. Nevertheless it meant that the Company got in money which it would not otherwise have done. If it had not made these agreements, it would not have got anything out of the manufacture of marine turbines (for it was not in that line of business); and it would not have got anything by manufacturing Canberra bombers for Australia or the U.S.A. (for it would never have got a direct order for them). By making these agreements the Company was able to exploit its capital asset, its "know-how", by receiving large sums from its licensees for the use of it. Yet it retained its asset itself and it remained in its own hands as its own capital asset. In essence, all the Company did was to teach others how to use it and licensed them to use it elsewhere. That is not parting with a capital asset. It is making use of it by licensing others in return for payment. The receipts were, I think, revenue receipts.

Mr. Bucher suggested several distinctions between this case and the *Rolls-Royce* case, but none of them commended themselves to my mind. The "know-how" here was, he said, acquired over many years and was of a permanent character, not fleeting. But so it was in the *Rolls-Royce* case. True, the "know-how" in this case was found to be largely capable of being patented, whereas in the *Rolls-Royce* case only a little was so capable. But I do not see how that makes any difference. In either case it was not patented. True also that there was more of a deliberate policy in the *Rolls-Royce* disposal of "know-how" than in the present case. But nevertheless it was disposed of in just the same sort of way. This was not an isolated transaction, any more than *Rolls-Royce*. I can find no valid distinction between this and the *Rolls-Royce* case, and I hold that we are bound by that authority to hold that the receipts in this case were trading receipts. Mr. Bucher did suggest that this was not part of the trade of the English Electric Co. as manufacturers but a new business of trading in "know-how". But I think the *Rolls-Royce* case is an answer to this also. It was merely another method of deriving profit from their technical knowledge, experience and ability.

Mr. Bucher tried hard to bring this case within the *Evans Medical Supplies* case⁽²⁾, [1958] 1 W.L.R.666. As I was a party to the decision in that case I may perhaps be permitted to say that I regard it as a very special case decided on its own very peculiar circumstances.

⁽¹⁾ 40 T.C. 443, at p. 493.

⁽²⁾ 37 T.C. 540.

(Lord Denning, M.R.)

I find myself in agreement with the judgment of Pennycuik, J. I think we are bound by the *Rolls-Royce* case⁽¹⁾ to dismiss these appeals.

Danckwerts, L.J.—I have felt very great doubt whether the circumstances of the present case are really covered by the decision of the House of Lords in the *Rolls-Royce* case. I can see great force in the arguments Mr. Bucher put forward in regard to certain differences which undoubtedly do exist, but I find it very troublesome to decide whether those differences are sufficient to take this case out of the effect of the decision of the House of Lords in the *Rolls-Royce* case. The other two members of the Court take the view that it is covered by that case, and on the whole I am not prepared to dissent from the view which they take.

Russell, L.J.—I agree that these appeals fail. In my view the case is well covered by the *Rolls-Royce* case, and I hope it will not be thought disrespectful of Mr. Bucher's arguments if at this hour I content myself with saying that, having listened attentively to the suggested differences between that case and the present case, it does not appear to me that all the differences suggested even exist as differences; nor does it appear to me that those differences which do exist are in truth relevant distinctions.

Mr. Roy Borneman.—Would your Lordship say the appeals are dismissed with costs?

Lord Denning, M.R.—Yes.

Mr. F. N. Bucher.—I think this is the proper moment at which I should make an application. However much one may feel the force of what has fallen from your Lordships, might I have leave to appeal, if my clients are so advised, to the House of Lords?

Lord Denning, M.R.—There is a lot of money involved.

Mr. Bucher.—There is a lot of money involved in the case and there are, in spite of what your Lordships have said, the two cases of the House of Lords which appear to be on different sides of the line. I respectfully submit it is a proper case in which to grant leave to appeal.

Lord Denning, M.R.—Have you anything to say, Mr. Borneman?

Mr. Borneman.—As your Lordship knows, it is not the practice of the Crown to offer any observations.

Lord Denning, M.R.—You may have your leave.

Mr. Bucher.—If your Lordship pleases.

The Company having appealed against the above decision, the case came before the House of Lords (Viscount Radcliffe, and Lords Reid, Guest, Upjohn and Donovan) on 2nd, 3rd and 4th March, 1964, when judgment was reserved. On 8th April, 1964, judgment was given unanimously in favour of the Crown, with costs.

Mr. F. N. Bucher, Q.C., and Mr. Neil Elles appeared as Counsel for the Company, and Mr. Roy Borneman, Q.C., Mr. Alan Orr, Q.C., and Mr. J. Raymond Phillips for the Crown.

House of Lords—8th April, 1964

Lord Reid.—My Lords, I have read the opinion of my noble and learned friend, Lord Donovan, and I agree with it. I would therefore dismiss this appeal.

⁽¹⁾ 40 T.C. 443.

Viscount Radcliffe.—My Lords, I am afraid that I regard this case as fully covered by the principle of our recent decision in *Rolls-Royce, Ltd., v. Jeffrey*⁽¹⁾, [1962] 1 W.L.R. 425, and, having said on that occasion all that I can about the proper tax treatment of these so-called “sales of know-how”, I cannot usefully enlarge upon what I said there.

In my opinion, there are two considerations which govern cases of this kind and which go a long way towards destroying the force of the analogies by which the Appellant’s argument seeks to prove that the transactions under review were sales of fixed assets, and that receipts arising from them ought to be treated as receipts on capital account. One is that in reality no sale takes place. The Appellant had after the transaction what it had before it. There is no property right in “know-how” that can be transferred, even in the limited sense that there is a legally protected property interest in a secret process. Special knowledge or skill can indeed ripen into a form of property in the fields of commerce and industry, as in copyright, trademarks and designs and patents, and where such property is parted with for money what is received can be, but will not necessarily be, a receipt on capital account. But imparting “know-how” for reward is not like this, any more than a teacher sells his knowledge or skill to his pupil. Admittedly the Appellant was not in the same position after each transaction as before it. It had “up-dated the background knowledge” of a possible competitor, to use the graphic phrase of one of its witnesses. Conceivably, by so doing it had affected for the worse its trading potential in some fields and in some respects, but the significance of that is almost unavoidably theoretical at the time when the transaction has to be judged, and the consequences are far too speculative to allow the imparting of “know-how” to be treated for that reason as the disposal of a “capital” asset analogous with the sale of all or part of an undertaking.

The other point is that “know-how”, though very naturally looked upon as part of the capital equipment of a trade, is a fixed asset only by analogy and, as it were, by metaphor. The nature of receipts from it depends essentially, I think, upon the transaction out of which they arise and the context in which they are received. Where, as in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540, “know-how” is imparted as one element of a comprehensive arrangement by virtue of which a trader effectively gives up his business in a particular area, the moneys paid for the “know-how”, whether or not independently quantified, may properly rank as capital receipts. But the *Rolls-Royce* case provides a different context, in which the imparting is no more than a service, of however special a kind, attendant upon an activity that arises out of the Appellant’s trading.

The Appellant has put before us certain distinctions between its case and the *Rolls-Royce* case, which distinctions, it claims, serve to bring it within the *Evans Medical* principle and outside the *Rolls-Royce* principle. I can only say that, having done my best to weigh them, I do not think that they amount to any relevant difference where principle is concerned.

I would dismiss the appeal.

Lord Guest.—My Lords, I concur.

Lord Upjohn.—My Lords, in my opinion this case is completely covered by your Lordships’ decision in *Rolls-Royce, Ltd. v. Jeffrey*, [1962] 1 W.L.R. 425, and therefore I would dismiss this appeal.

Lord Donovan.—My Lords, the Respondent Inspector of Taxes has included in the assessments to Income Tax made upon the Appellant in respect of its trading profits for the years of assessment 1951–52 and 1952–53, lump

(1) 40 T.C. 443.

(Lord Donovan)

sums received by the Appellant from the Admiralty, the Government of Australia, and the Glenn L. Martin Co. of America, respectively.

The lump sums received from these sources totalled £263,833 in the year 1950, £255,118 in 1951 and £177,468 in 1952. The Appellant objects to the inclusion of these receipts in its taxable profits on the ground that they are capital receipts.

The consideration for which these sums were received is expressed in the several written agreements which govern the matter as follows. In the case of the agreement with the Admiralty:

“ In consideration of the following lump sum payments the English Electric Company agree to provide manufacturing technique, engineering data and other information necessary for the manufacture by other firms of Steam Turbines to the English Electric Company’s design. . . . ”

(certain lump sums are then set out). In the case of the agreement with the Commonwealth of Australia:

“ The Commonwealth Hereby Agrees To Pay to the Company ”

(i.e., the Appellant)

“ . . . The sum of two hundred thousand pounds . . . for the supply to the Commonwealth . . . of the manufacturing technique engineering data and other information now in the possession of the Company and which will enable the Commonwealth forthwith to manufacture the aircraft . . . ”

(i.e., the Canberra bomber). In the case of the agreement with the Glenn L. Martin Co. of America:

“ Martin will pay to English Electric . . . a capital payment of One million five hundred thousand Dollars . . . in consideration of the supply to Martin of the manufacturing technique engineering data and other information now in the possession of English Electric necessary for the manufacture of the Aircraft . . . ”

(i.e., the Canberra bomber).

The Special Commissioners allowed the Company’s appeal against the inclusion of these lump sums in computing the Company’s trading profits. Pennycuik, J., on appeal by the Crown reversed this decision, and his judgment was upheld in the Court of Appeal (Lord Denning, M.R., Danckwerts and Russell, L.J.J.) though Danckwerts, L.J., expressed some doubts in the matter. The Special Commissioners’ determination was given before the decision of this House in *Rolls-Royce, Ltd. v. Jeffrey*⁽¹⁾, [1962] 1 W.L.R. 425. In reversing the Special Commissioners, Pennycuik, J., and the Court of Appeal held that the present case was covered by your Lordships’ decision in the *Rolls-Royce* case. The argument of the Appellant is that that case is distinguishable.

Counsel for the Appellant specified the following distinctions. The Appellant received its lump sums in return for imparting basic manufacturing technique of a relatively permanent kind, whereas Rolls-Royce received its lump sums partly for designs which were transient. All the Appellant’s manufacturing technique was capable of being patented and was therefore identifiable property, whereas only a small part of Rolls-Royce “ know-how ” was capable of being patented. In the Appellant’s case “ know-how ” was parted with reluctantly under Government pressure. Rolls-Royce, however, embarked on the selling of “ know-how ” deliberately, although it also began such sales under similar pressure. The Appellant’s lump sum receipts were for “ know-how ” and nothing else. In the *Rolls-Royce* case the lump sums were received not only

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(Lord Donovan)

for "know-how" but for the service of teaching as well. In the Appellant's case there was evidence that by parting with some of its "know-how" it suffered a loss in the value of that asset. In the *Rolls-Royce* case⁽¹⁾ there was no such evidence. And, finally, that the imparting of manufacturing technique jeopardised the Appellant's world market in the products concerned. There was no such element in the *Rolls-Royce* case.

Assuming all these distinctions to exist, I am of opinion that they are distinctions without a difference. Fundamentally, the present case raises the same problem as was considered in the *Rolls-Royce* case; and I believe this truth to have become obscured by mere nomenclature. If a manufacturer carrying on a continuing business were to say to a rival: "I know how to make a particular product efficiently and economically; it will take you a long time and cost you much money to find out for yourself. Pay me £x and I will teach you"; then it would be clear that he was proposing to teach for reward. The £x when he received it, being remuneration for this service, would not be capital but income, unless there were some exceptional circumstance pointing the other way—always a necessary qualification to make in this field. In the present case the transaction is not so simply described. The manufacturer's knowledge becomes an asset called "know-how". The teaching becomes "a sale" of a part of that asset. The reward for the teaching becomes "the price" of what is "sold". And so the transaction becomes the sale of part of an asset for a price, and thus the foundation is laid for the argument that the price is a capital receipt.

I do not criticise this line of approach. For the industrialist at any rate it is a natural way of regarding the transaction; he, understandably, will look upon his fund of accumulated knowledge as being a vital part of his capital equipment. Yet what the Appellant has done is essentially no different from what the manufacturer did whose case I have taken as an example. It has taught for reward, as *Rolls-Royce* taught for reward: and just as that reward was held to be trading income in the hands of *Rolls-Royce, Ltd.*, so also must the reward accruing to the Appellant. There is here no exceptional circumstance which gives that reward the character of capital.

That is really sufficient for the determination of this appeal, but I should perhaps say something about the decision in *Evans Medical Supplies, Ltd. v. Moriarty*, 37 T.C. 540. That case occasioned much difference of judicial opinion, and it is not easy to define the ground upon which the taxpayer eventually succeeded. Two of the five noble and learned Lords who considered the case thought that the £100,000 received by the company was capital; two thought that it was income; Lord Morton of Henryton thought it comprised both capital and income and that an apportionment was required. It was his view, however, that such part of the £100,000 as was consideration for the imparting of a secret process would in the circumstances of the case be a capital receipt. The company's appeal succeeded because, while only Viscount Simonds and Lord Tucker considered that the £100,000 should be treated as a capital receipt in its entirety, and the appeal be allowed accordingly, Lord Denning took the view that the appeal should be allowed on the ground that the sum was an income receipt but of a different trade from that forming the subject matter of the assessments.

But if, bearing in mind Lord Morton of Henryton's view, the true *ratio* of the decision be that the consideration received for imparting the secret process was capital, it does not follow that this conclusion must be reached in all cases. There may well be instances where, although the taxpayer concerned is not engaged in a trade of dealing in such processes, nevertheless that

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which he receives as consideration for imparting such a process is income in his hands. *Rolls-Royce, Ltd. v. Jeffrey*⁽¹⁾ is one such case. What distinguishes *Evans Medical Supplies, Ltd. v. Moriarty*⁽²⁾ in this respect is, I think, the circumstances of the transaction, which was, in effect, the disposal by degrees of the company's branch business in Burma. Where a business is sold, or relinquished by degrees, and part of the consideration is a lump sum for the disclosure of secret processes which will enable the purchaser of the business to carry it on, it may well be that the lump sum should be regarded simply as part of the entire consideration for the sale, and thus as capital. Such a case would indeed be the converse of *Royal Insurance Co. v. Watson*⁽³⁾, [1897] A.C.1. There the Royal Insurance Co. bought the business of the Queen Insurance Co. on terms *inter alia* that it was to take the manager of the Queen company into its employment at a salary of £4,000 per annum, but with power later to commute it. The manager was duly taken into the service of the Royal Insurance Co., but later on the company commuted his salary for some £59,000. It claimed this sum as a deduction from its profits for Income Tax purposes as being an income outgoing. But your Lordships' House, while deliberately refraining from saying that such a deduction could not in different circumstances be claimed, held that it was all part of the consideration for the purchase and sale of the Queen company's business, and was therefore a capital outgoing.

One final matter should be mentioned. Counsel for the Appellant submitted that if the lump sums in the present case were income of a trade they were income of a new and distinct trade, that is, of exploiting manufacturing and engineering technique. The advantage of this contention, if it succeeded, would presumably be that the sums will escape taxation since the time limit for making new assessments has expired. There is, however, no indication in the Case Stated of any such contention being advanced before the Special Commissioners, though your Lordships are informed that the point was in fact taken. But the substance of the Appellant's case was that the disputed sums were capital and this contention succeeded. There are no materials in the case which, in my opinion, would warrant the remission of the case to the Commissioners for this opposite contention (which might well require fresh evidence) to be further explored.

I also think that the Income Tax appeal must be dismissed. The same result must follow in the appeal concerning Profits Tax.

Lord Reid.—My Lords, I beg to move that the Report of the Appellate Committee be agreed to.

Questions Put:

That the Report of the Appellate Committee be agreed to.

The Contents have it.

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Linklaters & Paines.]

⁽¹⁾ 40 T.C. 443.

⁽²⁾ 37 T.C. 540.

⁽³⁾ 3 T.C. 500.