HIGH COURT OF JUSTICE (CHANCERY DIVISION)—
3RD AND 4TH DECEMBER 1964

COURT OF APPEAL—12TH, 13TH AND 14TH MAY AND 7TH JULY 1965

HOUSE OF LORDS—28TH, 29TH AND 30TH JUNE
AND 4TH AND 26TH JULY 1966

Finsbury Securities Ltd. *v.* Bishop (H.M. Inspector of Taxes)[1]

Income tax, Schedule D—Loss in trade—Dealer in shares—Dividend-stripping—Forward-stripping—Whether shares acquired as stock-in-trade—Income Tax Act 1952 (15 & 16 *Geo.* 6 & 1 *Eliz.* 2, *c.* 10), *s.* 341.

The Appellant Company carried on the trade of dealing in shares and securities. During the years 1958, 1959 *and* 1960 *it entered into a number of transactions in shares for the purpose of dividend-stripping. The transactions fell into two distinct categories. A typical transaction of the first category involved the acquisition by the Company of specially created preference shares in a manufacturing company. They carried, in addition to the normal right to a fixed dividend, a special right to dividends for five years which were to absorb the whole of the profits available for distribution after payment of the fixed dividend, provided that the total did not exceed a certain figure. The purchase price was to be determined by reference to the amount of the net dividends received and the amount of the income tax repayment obtained by the Appellant Company. A typical transaction of the second category involved the purchase by the Company of the whole of the share capital of an estate development company. The sale agreement provided that the development company would distribute the whole of its net profits for the following year and that if any of its assets then remained unsold the vendors of the shares would purchase those assets at cost or market value, whichever was the greater. The purchase price for the shares was to be determined by reference to the amounts of the development company's profits and of any income tax repayment.*

The Appellant Company claimed adjustment of its tax liability for the year 1959–60 *under s.* 341, *Income Tax Act* 1952, *on the basis that it had sustained losses in its trade in respect of the above transactions. On appeal, the Crown contended* (1) *that the shares in question were capital assets and not stock-in-trade, and* (2) *that, if they were stock-in-trade, the dividends received must be taken into account in determining whether there was a loss, and if this were done no loss was shown. The Special Commissioners rejected the Crown's first contention but accepted the second and disallowed the claim.*

In view of the decision of the House of Lords in F.S. Securities Ltd. *v.* Commissioners of Inland Revenue 41 T.C. 666; [1964] 1 W.L.R. 742, *the Crown did not pursue its second contention in the High Court.*

Held, *that the transactions were not "an adventure or concern in the nature of trade" within s.* 526, *Income Tax Act* 1952, *and the shares were not stock-in-trade.* J.P. Harrison (Watford) Ltd. *v.* Griffiths 40 T.C. 281; [1963] A.C.1; *distinguished.*

[1] Reported (Ch.D.) [1965] 1 W.L.R. 358; 108 S.J. 1031; [1965] 1 All E.R. 530; (C.A.) [1965] 1 W.L.R. 1206; 109 S.J. 576; [1965] 3 All E.R. 337; (H.L.) [1966] 1 W.L.R. 1402; 110 S.J. 636; [1966] 3 All E.R. 105.

CASE

Stated under the Finance Act 1953, s. 15(4) and the Income Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At meetings of the Commissioners for the Special Purposes of the Income Tax Acts held on 26th, 27th and 28th March 1962, Finsbury Securities Ltd. (hereinafter called "the Company") claimed under s. 341 of the Income Tax Act 1952 an adjustment of its liability to tax for the year 1959–60 by reference to a loss alleged to have been incurred in that year, the Inspector of Taxes having objected to the claim.

2. The Company was incorporated in May 1956 to carry on the trade of dealing in shares and securities, and it has always carried on this trade, its profits therefrom being assessable under Case I of Schedule D.

3. The questions for our determination were: (1) whether certain "forward-stripping" transactions in shares were transactions in the course of the Company's trade (the nature of a forward-stripping transaction will appear later), and whether the shares in question were part of the Company's stock-in-trade; (2) whether taxed dividends received by the Company should be included in the computation to be made under s. 341(3) of the Income Tax Act 1952.

4. The Case I profits of a dealer in shares have for many years been computed on the basis of excluding the gross amount of dividends received from which tax has been deducted. Although this is to anticipate the remainder of this Case, we think it may be of assistance to show how the Company's loss claim is computed, on the basis that the shares referred to later were its stock-in-trade. There is annexed hereto, marked "A", and forming part of this Case[1], a copy of the Company's accounts for the year ended 31st March 1960. There is annexed hereto, marked "B", and forming part of this Case[1], a copy of the Company's income tax computation for the year 1959–60. The gross dividends are brought into the trading and profit and loss account, but are deducted in the income tax computation, and this computation consequently shows a loss.

5. Mr. Leslie Lavy (hereinafter referred to as "Mr. Lavy") gave evidence before us on behalf of the Company. He was responsible for the formation of the Company, and was at all material times the director in control of its activities, carrying on during the same period practice as a chartered accountant. The only other director was a Mr. Lever, and the Company's shares were held by these two, either beneficially or as trustees of their respective family settlements.

6. During the year 1958–59 Mr. Lavy was approached by one or two persons who had interests in companies and were anxious to know whether there was some method of avoiding tax on the companies' profits. Mr. Lavy was at first lukewarm to these approaches, but he came to the conclusion that forward-stripping transactions might achieve this object and provide a profit for the Company. The result was that during the years 1958, 1959 and 1960 the Company entered into 15 of these transactions. All of the transactions were designed to produce some profit for the Company apart from any tax repayment that might become due.

[1]Not included in the present print.

A 7. We were invited to consider the Company's transactions in the shares of a company called I. Warshaw & Sons Ltd. ("Warshaw"), as typical of a forward-stripping operation. This was the first of such operations entered into by the Company. The Warshaw shareholders approached Mr. Lavy; though not clients of his, they were well known to him socially and he had done a lot of business with them. Warshaw is a good example of one batch
B of transactions, except that it has certain features which do not occur in any other case: these are referred to in para. 9(5) below. There is another batch of transactions, of which an example will be given later; and there are, of course, minor variations throughout.

8. The companies of which Warshaw may be taken as an example are: L. Greenberg Ltd.; M. F. Lampert & Co. Ltd.; Superior Sewing Machines
C Ltd.; Alfred Kasmir Ltd.; J. Berry & Sons Ltd.; Bullroyd Properties Ltd.; Allenrim Developments Ltd.; M. A. Morris Ltd.; Reggie & Co. Ltd.; Smartwear Ltd.; Carol Freedman Ltd.

The Company received no dividends in the year to 31st March 1960 from Allenrim Developments Ltd., Reggie & Co. Ltd. or Carol Freedman Ltd., and only a half-year's fixed interest dividend from Superior Sewing
D Machines Ltd.; consequently there was no decrease in the value of the shares in these companies as at that date (see para. 9(4) below). The transactions in the shares of these four companies do not, therefore, affect the loss computation for that year, but they do form part of the general picture.

9. (1) Warshaw was incorporated on 1st April 1957 to acquire and take over as a going concern the business of brassfounders and ironmongers. Its
E original capital was £10,000 in £1 shares, of which 2,004 were issued by 29th December 1958.

(2) On 29th December 1958 Warshaw passed two special resolutions and an ordinary resolution. Copies of these three resolutions are annexed hereto, marked "C", and form part of this Case(1). Put shortly, the special resolutions provide for the increase of Warshaw's capital to £10,100 by the
F creation of 100 6 per cent. preferred shares with the normal rights attached to fixed interest preference shares, but also with the special right to dividends, for the next five years, absorbing the whole of the profits available for distribution, after payment of the fixed preference dividend, provided that the total amount of these dividends did not exceed £60,000. The ordinary resolution provided for the capitalisation of £100, to be applied in paying up in full these
G new preferred shares.

(3) On the same day, 29th December 1958, the holders of these preferred shares agreed to sell them to the Company. A copy of the sale agreement is annexed hereto, marked "D", and forms part of this Case(1). The purchase price was £60,100, but clause 3 provides for adjustments of this price. If the total of the five years' dividends turned out to be less than £60,000 there was
H to be an adjustment in respect of the difference: but there was to be added to the purchase price 50 per cent. of the amount (if any) of the repayment obtained by the Company in respect of the tax deducted from the dividends received by it. Clause 2(*a*) provides for completion immediately, together with the payment of £20,100; under clause 2(*b*) the balance was to be paid not later than 31st December 1960.

(4) £100 would be the residual value of the Warshaw preferred shares
I at the end of the five years, and year by year their value would be diminished

(1)Not included in the present print.

by reason of the distribution of all the available profits. On the assumption that the Warshaw preferred shares were stock-in-trade of the Company and that taxed dividends should be excluded from the s. 341 computation, the Company, having received dividends from which tax had been deducted but which had been excluded from the computation of its Case I profits, would receive repayment of the tax and retain half of this repayment.

(5) The peculiar features in the Warshaw transaction are as follows:

(*a*) Warshaw is the only case in which, up to the time of the hearings before us, the Company had sold the shares it bought. (The Company was considering selling the shares in J. Berry & Sons Ltd.)

(*b*) Warshaw was a family company. The vendors of its preferred shares were anxious to achieve an amalgamation with a company called North Eastern Timber Importers Ltd. ("North Eastern"), and they considered that it would facilitate this amalgamation if the special right attached to Warshaw's preferred shares was abolished.

(*c*) At the request of the vendors of Warshaw's preferred shares, the Company agreed to the passing of a special resolution by Warshaw, the effect of which was to abolish the special right attached to its preferred shares and to leave them with the normal rights attaching to preference shares. The special resolution was passed on 30th November 1961, and a copy of it, marked "E", is annexed hereto and forms part of this Case[1]. No formal step was taken to rescind the sale agreement dated 29th December 1958.

(*d*) Immediately after the passing of this special resolution the Company sold its Warshaw preferred shares for £100, either direct to North Eastern, or to the original Warshaw holders, who then sold them to North Eastern. At the date of sale the total amount that had been paid by the Company for the Warshaw preferred shares was still only £20,452, and no more than this was ever paid.

(*e*) There is no minute in the Company's books relating to this transaction.

(*f*) Although at the date of Warshaw's special resolution abolishing the special right attached to its preferred shares the Company's agreement with Warshaw still had some time to run, the Company neither asked for nor received any consideration for agreeing to the passing of the special resolution.

10. A company called Mantern Properties Ltd. ("Mantern") is typical of the second batch of transactions, the companies being Mantern and two companies called Sunbridge Estate Co. Ltd. and Wyndare Trading Co. Ltd., respectively. Mantern went into voluntary liquidation on 20th April 1961.

11. Mantern carried on the business of estate development. It had acquired a 99-year building lease of land at St. John's Wood and had entered into an agreement with contractors to build 14 houses on this land. By clause 1(*a*) of an agreement dated 20th February 1959, the Company bought all Mantern's issued 100 £1 shares for the "basic price" of £100, and by clause 1(*b*) the Company was to pay "such further sum if any as is equal to 85 per cent." of Mantern's net profits, calculated in accordance with the provisions of the third schedule to the agreement. By clause 6(*a*) the vendors of Mantern's shares covenanted that, if any of its assets remained unsold by 1st March 1960, they would themselves purchase or procure the purchase of these assets at the cost to Mantern or their value, whichever was the greater. A supplemental agreement of the same date (20th February 1959) recites that the

[1]Not included in the present print.

Company had agreed with the vendors of the Mantern shares to procure that Mantern should make a distribution by way of dividend of the whole of Mantern's net profits up to 31st March 1960, and further, to make claims against the Revenue in respect of one or both of (*a*) relief for income tax by way of set-off, repayment or otherwise, and (*b*) reduction of the Company's liability to income tax in respect of (i) the above mentioned dividend, and (ii) the loss (if any) sustained by the Company in the purchase and in any realisation or revaluation of the Mantern shares. The supplemental agreement then goes on to provide for payment of the dividend by Mantern.

There are annexed hereto, marked "F" and "G" respectively, and forming part of this Case(1), copies of the agreement of 20th February 1959 and of the supplemental agreement of the same date.

12. There is annexed hereto, marked "H", and forming part of this Case(1), an analysis of all the transactions involved in this case. Amongst other things, it shows how the purchased shares were treated in the Company's accounts for the year ended 31st March 1959, for which year a loss claim under s. 341 had been allowed by the Revenue.

13. There is annexed hereto, marked "I", and forming part of this Case(1), a document showing in all cases, except that of Superior Sewing Machines Ltd., which is now in liquidation:

column A—purchase price as per contract;
column B—initial payments provided and made;
column C—net dividends received to 31st March 1961;
column D—total purchase price to be paid if no further dividends were received;
column E—excess of column C over column D.

14. In all cases, except that of Bullroyd Properties Ltd., the initial payments provided for in the agreements for sale were made as provided; in the case of Bullroyd Properties Ltd. £9,826 5*s*. was paid instead of £10,000. The Company had to borrow money from a bank to make these initial payments, and the bank only agreed to lend the money on condition that by arrangement with the vendors of the shares these payments when made to the vendors should be held by the bank by way of charge pending the reduction of the Company's overdraft.

15. The bank was not willing to lend the Company money to enable it to make the various further payments under the sale agreements. In each case the vendors agreed verbally with the Company that these further payments should be made as and when dividends from the vendors' companies enabled the Company to make them. No special approach was made to each vendor by Mr. Lavy, as he met the various vendors very frequently and the matter of further payments then came up for discussion. At 31st March 1961 a further payment of £342 had been made in the case of Warshaw and no further payments had been made in the cases of L. Greenberg Ltd., M. F. Lampert and Co. Ltd., Alfred Kasmir Ltd., M. A. Morris Ltd., Reggie & Co. Ltd., Smartwear Ltd. and Carol Freedman Ltd. Some further payments had been made in the remaining cases of J. Berry & Sons Ltd., Bullroyd Properties Ltd., Allenrim Developments Ltd. and Mantern. No agreement for postponement of further payments was made, nor was any contemplated, by the Company before 30th March 1960.

(1) Not included in the present print.

16. Up to the time of the hearing before us it had been for many years the practice of the Revenue, in computing an assessment under Case I of Schedule D on the profits of a financial concern which deals in shares, to make a deduction for dividends taxed at source which are received on shares held as part of the concern's trading stock. This practice existed both before and after 1937. Prior to 6th April 1937 it was the practice of the Revenue not to make any deduction for such dividends in determining whether the concern had made a loss for which relief could be claimed under s. 34 of the Income Tax Act 1918. Consequent upon the passing of s. 13 of the Finance Act 1937, the Revenue changed its practice as regards losses, and in determining whether a loss had been made for which relief could be claimed under s. 34 of the Income Tax Act 1918 or s. 341 of the Income Tax Act 1952 a deduction was made for dividends taxed at source. This practice continued from 1937 until revised contentions were put forward by the Revenue in the claim now under consideration.

17. It was contended on behalf of the Appellant (the Company):

(1) that the shares in question were bought for the purpose of making a profit out of them;

(2) that the transactions in these shares were transactions in the course of the Company's trade of dealing in shares;

(3) that these shares were stock-in-trade of the Company's trade;

(4) that any loss resulting from the transactions in these shares was a loss within the meaning of s. 341 of the Income Tax Act 1952.

18. It was contended on behalf of H.M. Inspector of Taxes:

(1) that the shares in question were bought for the purposes of holding them and receiving dividends from them;

(2) that these shares were capital assets of the Company, and were not stock-in-trade of its trade of dealing in shares;

(3) that taxed dividends received by the Company must be included in the computation to be made under s. 341(3) of the Income Tax Act 1952, with the result that the computation made on this basis does not disclose any loss.

19. The following cases were cited to us: *California Copper Syndicate* v. *Harris* (1904) 5 T.C. 159; *Commissioners of Inland Revenue* v. *Livingston* 11 T.C. 538; 1927 S.C. 251; *John Smith & Son* v. *Moore* 12 T.C. 266; [1921] 2 A.C. 13; *Gloucester Railway Carriage and Wagon Co. Ltd.* v. *Commissioners of Inland Revenue* 12 T.C. 720; [1925] A.C. 469; *Patrick* v. *Broadstone Mills Ltd.* 35 T.C. 44; [1954] 1 W.L.R. 158; *Cenlon Finance Co. Ltd.* v. *Ellwood* 40 T.C. 176; [1962] A.C. 782; *J. P. Harrison (Watford) Ltd.* v. *Griffiths* 40 T.C. 281; [1963] A.C.1.

20. We, the Commissioners who heard the appeal, reserved our decision, and gave it in writing on 12th July 1962, as follows:

The Crown's first contention was put in various ways: at the relevant time no trade was being carried on by the Appellant Company of which the shares in question were trading assets; they were acquired to hold, and were part of the fixed, and not part of the circulating, capital in the Appellant Company; they were acquired with a view to the dividends being received on them, and not with a view to their being turned over in the way of trade. We find that the shares were acquired with the object of making a profit out of them, a profit by the recovery of income tax. On this finding the question is whether the forward-stripping transactions which took place in the present

A case are so different in their nature from the stripping transaction in *J. P. Harrison (Watford) Ltd.* v. *Griffiths*(1) that that case does not apply. In our view the fact that in the present case the dividends of which use was to be made for the purpose of the loss claim were to accrue over a period of years, whereas in *Harrison* v. *Griffiths* the dividend was paid immediately out of profits available for that purpose, is not sufficient to enable us to distinguish that B case from the present one, and we reject the Crown's first contention.

It was contended on behalf of the Appellant Company, as an alternative, that the words in s. 341(3) of the Income Tax Act 1952:

> "For the purposes of this section, the amount of a loss sustained in a trade shall be computed in like manner as the profits or gains arising or accruing from the trade are computed under the provisions of this Act C applicable to Case I of Schedule D"

require a reference to long-established practice governing such a computation, and mean "as these profits have been computed as a matter of well-established practice". We reject this contention. We think that the words of the subsection mean that these profits are to be computed as the Act provides, and have no reference to a practice which may or may not have been right.

D The Crown's second contention has caused us great difficulty; it was that a computation made as s. 341(3) provides will show no loss, since for the purposes of such a computation taxed dividends received by a person carrying on the trade of dealing in shares ought to be included. We reject this contention. The contention is based on several passages from the judgments and speeches in *Cenlon Finance Co. Ltd.* v. *Ellwood*(2) and *J. P. Harrison (Watford) Ltd.* v. E *Griffiths*. Several of these passages appear to have been considered pronouncements, but in our view they nevertheless remain *obiter*, for in neither case was the issue the construction of s. 341 and the proper method of computing a loss for the purposes of that section; nor, as far as we can discover, were any of the statutory provisions to which we are about to refer mentioned by any of the Courts. Moreover, Donovan L.J. says in the *Cenlon* case(3) that F those appeals do not raise the problem of the proper treatment of dividends taxed at source received by a company dealing in stocks and shares by way of trade. The statutory provisions which lead us to reject this contention are:

(1) proviso (*a*) to s. 13 of the Finance Act 1937 and r. 15(2) of the Rules applicable to Cases I and II of Schedule D of the Income Tax Act 1918: the implication from these two provisions seems clearly to be that in computing G losses the only case in which taxed dividends are to be included is the case of the life assurance fund of an assurance company;

(2) s. 428 of the Income Tax Act 1952, with its reference to ss. 342 and 341, carries the same implication;

(3) s. 342(4) of the Income Tax Act 1952: the words

> " . . . any interest or dividends on investments arising in that year, H being interest or dividends which would fall to be taken into account as trading receipts in computing the profits or gains of the trade for the purpose of assessment under that Case but for the fact that they have been subjected to tax under other provisions of this Act . . . "

seem clearly to mean that it is only when the conditions of the subsection are satisfied that taxed dividends are to be included;

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(1)40 T.C. 281. (2)40 T.C. 176. (3)*Ibid.*, at p.198.

(4) s. 18(3) of the Finance Act 1954: again the implication seems clear that it is only when the conditions of the subsection are satisfied that taxed dividends are to be included. A

With considerable hesitation, in view of the opinions expressed by the Courts and the House of Lords, we have come to the conclusion that we must hold that the effect of these statutory provisions is that taxed dividends must be excluded from a computation for the purposes of s. 341, and that we are not compelled to follow what we think are *obiter dicta* in the authorities. B

The claim succeeds. We hold that the Appellant Company sustained a loss in the year 1959–60, within the meaning of s. 341, and we leave the amount of the claim to be agreed.

21. On 30th July 1963, after figures had been agreed between the parties but before we had issued our final determination of the claim, we heard an application at the instance of H.M. Inspector of Taxes that we should reconsider that part of our decision in principle which dealt with the question whether or not taxed dividends should be included in the computation to be made under s. 341(3) of the Income Tax Act 1952. C

22. It was contended on behalf of H.M. Inspector of Taxes that:

(1) there was now direct authority, in the decisions of the High Court and the Court of Appeal in *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue*[1] [1963] 1 W.L.R. 173 and 1223 on the above-mentioned question, showing that our decision in principle was wrong; D

(2) in view of this direct authority, we ought to exercise our discretion to reconsider a decision in principle only;

(3) if we decided to reconsider that decision, we ought to give our final determination on the basis of the law as the direct authority showed that it now was. E

23. It was contended on behalf of the Appellant (the Company) that:

(1) the decisions of the High Court and the Court of Appeal in *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue* [1963] 1 W.L.R. 173 and 1223 were not direct authority on the above-mentioned questions; F

(2) if they were, it was very undesirable that we should reconsider a decision which we had given in principle merely because there had been decisions of the Courts subsequent to our decision in principle.

24. The following cases were cited to us: In re *Harrison* [1955] Ch. 260; *Cenlon Finance Co. Ltd.* v. *Ellwood* 40 T.C. 176; *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue* [1963] 1 W.L.R. 173 (Ch.D.); 1223 (C.A.). G

25. We reserved our decision on this application, and gave it in writing on 16th August 1963 as follows.

This application is that we should reconsider that part of our decision dated 12th July 1962 which deals with the question whether or not taxed dividends should be included in the computation to be made under s. 341(3) of the Income Tax Act 1952 in the case of a company whose business it is to deal in shares. The grounds of the application are that since our decision there has appeared in *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue* direct authority on that question; and, if that is so, that we should exercise our discretion to reconsider our decision and should give our final determination of the s. 341 claim before us on the basis of the law as it now is. It is common H

(1)41 T.C. 666.

ground that, if the *F. S. Securities* case[1] is direct authority on this case and if we decide to reconsider our decision, then taxed dividends must be included in the computation to be made under the above-mentioned subsection, with the result that there will be no loss, and the claim under subs. (1) of the section will fail.

We have come to the conclusion that the *F. S. Securities* case is direct authority on this question. It is true that that case is not dealing with s. 341, but in our view the Courts could not have reached the conclusion they did without deciding, not by way of *obiter*, that taxed dividends must enter into the Case I computation of the profits of a share-dealing company. In the *F. S. Securities* case[2] Donovan L.J., referring to the case of *Cenlon Finance Co. Ltd.* v. *Ellwood* 40 T.C. 176, says:

> "During the argument of the case in this Court it was said for the company that dividends taxed at source were not brought into the computation of profit made by a dealer in stocks and shares, so why should a dividend not so taxed be brought in? Deduction or non-deduction of tax was, it was argued, an immaterial consideration. The answer given was that dividends taxed at source ought to be brought into such a computation. Strictly speaking, of course, this was *obiter*, but it would have been unsatisfactory not to deal with the point thus raised. In the House of Lords, Viscount Simonds and Lord Denning expressed the same view: and accordingly even if, on reflection, I thought I had been mistaken in what I myself said in this Court, I would certainly defer to their view. But I see no reason to depart from what I said."

Donovan L.J. is referring to what he said in the *Cenlon* case, 40 T.C., at page 198:

> "These appeals do not raise the problem of the proper treatment of dividends taxed at source received by a company dealing in stocks and shares by way of trade, but in the course of the argument the question has naturally been looked at. These also, in my view, would fall to be included in a computation of profits taxable under Case I of Schedule D, with an adjustment of the tax bill which allows for that suffered at source."

In view of this passage there is in our opinion no room for the suggestion that in the above-cited passage from his judgment in the *F. S. Securities* case he is referring to something which would come into the computation of trading profits but would be excluded for the purposes of an assessment under Case I. We think, therefore, that what Donovan L.J., said in the *F. S. Securities* case is direct authority for the proposition that taxed dividends fall to be included in the Case I computation of the profits of a share-dealing company; and it is common ground that, if they do, they fall to be included in the computation to be made under s. 341(3).

If we are right, we think that in the present case we ought to reconsider that part of our decision in principle which deals with this question, and to give our final determination on the basis of what we think the law now is. It is that there is no loss in the year 1959–60, and the claim fails.

26. The Appellant Company immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and required us to state a Case for the opinion of the High Court pursuant to the Finance Act 1953, s. 15(4), and the Income Tax Act 1952, s. 64, which Case we have stated and do sign accordingly. The questions of law for the opinion of the High Court are:

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(1)41 T.C. 666. (2)*Ibid.*, at p.683.

(1) whether *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue*[1] [1963] 1 W.L.R. 173 and 1223 is direct authority on the question whether taxed dividends must be included in the computation to be made under s. 341(3) of the Income Tax Act 1952; A

(2) if it is, whether we were wrong in law to reconsider our decision in principle on this question;

(3) if it is, whether we were wrong in law in determining that the Appellant Company's claim fails; B

(4) whether we were wrong in law in holding that the shares referred to in paras. 7, 8 and 10 of this Case were part of the Company's stock-in-trade.

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

Turnstile House,
94–99 High Holborn,
London, W.C.1.
11th June 1964.

D

The case came before Buckley J. in the Chancery Division on 3rd and 4th December 1964, when judgment was given against the Crown, with costs.

F. Heyworth Talbot Q.C. and *H. Major Allen* for the Company.

The Solicitor-General (*Sir Dingle Foot Q.C.*), *Roy Borneman Q.C.*, *J. Raymond Phillips* and *J. P. Warner* for the Crown.

The following cases were cited in argument in addition to those referred to in the judgment: *John Smith & Son* v. *Moore* 12 T.C. 266; [1921] 2 A.C. 13; *Van den Berghs Ltd.* v. *Clark* 19 T.C. 390; [1934] A.C. 431; *Commissioners of Inland Revenue* v. *Livingston* 11 T.C. 538; 1927 S.C. 251. E

Buckley J.—This is an appeal by way of Case Stated from a decision of the Special Commissioners of Income Tax in respect of a claim under s. 341 of the Income Tax Act 1952 made by the Appellant Company, Finsbury Securities Ltd., for an adjustment to its liability to tax for the year 1959–60 by reference to a loss alleged to have been incurred in that year. The Appellant Company was incorporated in May 1956 to carry on the trade of dealing in shares and securities, and it has always carried on that trade. The loss in respect of which the claim is made is one which arose as the result of various transactions which are described in the Case as "forward-stripping" transactions, the nature of which I shall have to explain, but they are transactions for stripping companies of profits, as the result of which the share capital of those companies became very greatly depreciated in value and consequently the loss which is relied upon for the purposes of the claim arose. F G

During the years 1958, 1959 and 1960 the Company entered into fifteen separate and distinct transactions of this nature. They were of two kinds, and the Commissioners, in the Case Stated, have selected examples of each kind. H

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(1)41 T.C. 666.

A The first example relates to a company called I. Warshaw & Sons Ltd., a company engaged in carrying on the business of brassfounders and ironmongers, with an issued and paid-up share capital of £5,000. On 29th December 1958 Warshaw increased its capital by creating 100 new 6 per cent. preferred shares. Those shares carried, as regards dividend, an ordinary conventional right to a 6 per cent. cumulative preferential dividend, and a further right to dividend to B which I shall refer in a minute. As regards capital, they conferred upon the holders the right to preferential repayment of capital in a winding-up, together with payment of arrears of a fixed cumulative preferential dividend. Apart from the special right to which I am about to refer, they were perfectly straightforward and ordinary 6 per cent. cumulative preference shares.

The special right attached to this class of shares was this:

C "... the right, pro rata to their [i.e. the shareholders'] respective holdings, to the payment in respect of each of the financial years of the Company ending on 31st December in the years 1959 to 1963 both inclusive of a net dividend (after deduction of income tax) of such an aggregate amount as is equal to the profits of the Company arising in such financial year (to be determined in the manner set out in paragraphs 4 D and 5 of the Third Schedule to the Finance (No. 2) Act 1955) or the accumulated profits of the Company available for dividend (whichever shall be the less) after deduction of the net amount of the said fixed cumulative preferential dividend in respect of such financial year Provided Always:—(*a*) that the total amounts paid by way of dividends under the provisions of paragraph (ii) above"—that is the paragraph conferring the E special right—"in respect of the said five financial years shall not exceed £60,000 after deduction of income tax, and (*b*) that no dividends shall be declared or paid on any other class of shares in the capital of the Company until 1st January 1965 or until the date on which the total amount paid by way of dividends under the provisions of paragraph (ii) above reaches £60,000 after deduction of income tax, whichever shall be the earlier."

F Then there are provisions as to when the dividends under the special rights are to be paid, which I do not think I need read.

On the same day, 29th December 1958, the holders to whom the 100 6 per cent. preferred shares had been allotted by Warshaw agreed to sell them to the Appellant Company. By that agreement the vendors agreed to sell the shares to the Appellant Company at the price of £60,100 subject to adjustment G as thereinafter provided. Of the price of £60,100, £20,100 was to be paid forthwith, and the balance of £40,000 was to be paid to the vendors or their nominees not later than 31st December 1960. The agreement contained the following clause for adjusting the purchase price:

"The said purchase price shall be subsequently adjusted:—(*a*) in the event of the aggregate dividends (other than cumulative dividends) paid H on the said Shares on or before 31st December, 1964 (after deduction of tax) amounting to less than £60,000 by the deduction from the said purchase price of a sum equal to the difference between the amount of the said aggregate dividends and £60,000 and (*b*) by the addition to the said purchase price of 50 per cent. of the amount (if any) which the Purchasers shall by reason of losses suffered by them on their purchase holding and I sale or other dealing in the said Shares become entitled to claim and of which they shall receive repayment (or relief against income tax otherwise

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payable on other profits) in respect of any part of the income tax deducted from any such dividends (other than cumulative dividends)". A

The adjustment under paragraph (*a*) of that clause was to take place not later than 31st December 1964, and any adjustment under paragraph (*b*) was to be made not later than 31st December 1966. So under the terms of that agreement the purchase price was in the end to be the equivalent of the sum of three things: the actual amount of the net profits for the five years (not exceeding £60,000) after satisfying the fixed cumulative preferential dividend; the sum of £100, being the amount of the capital paid up on the shares; and one half of the tax recovered by the Appellant Company. B

Now, it so happened that after a short time those interested in Warshaw, the vendors of the shares to the Appellant Company, wished to rearrange their business and wanted to procure a sale of Warshaw to some other purchaser— C I think as part of an amalgamation or reconstruction, or something of that nature. The Warshaw transaction was *de facto* abandoned by the Company, the shares were disposed of in the way that the vendors to the Appellant Company desired, and the whole scheme for stripping the company of its profits over the period indicated in the agreement fell by the wayside after it had been in operation for only about one year. That is an exceptional characteristic of D that one particular transaction out of the 15 transactions upon which the Company embarked, and is not, I think, material to anything that I have to consider, for it was not part of the way in which it was contemplated by the parties that these transactions would be carried out at the time the Warshaw agreement was first entered into.

The other sample transaction which is selected by the Commissioners E relates to a company called Mantern Properties Ltd., and that was a company that was carrying on a business of estate development. It owned a 99-year building lease of some land in St. John's Wood, and it had entered into an agreement with contractors to build 14 houses on the land. By an agreement of 20th February 1959 the shareholders in Mantern agreed to sell, and the Appellant Company agreed to buy, all the 100 issued £1 shares in the company F for the sum of £100 and such further sum, if any (referred to in the agreement as "the further sum"), as should be equal to 85 per cent. of the net profits of Mantern, calculated in accordance with certain provisions set out in the third schedule to the agreement, earned up to 31st March 1960. The schedule provided the following method of calculating the net profits of the company under the agreement: "the net profits of the Company" were, for that purpose, G to be

"taken to consist of the aggregate profits less losses (including capital profits or losses) of the Company before deducting Income Tax therefrom but after deducting therefrom the Profits Tax or any other taxes assessable by reference to the income or the profits of the Company attributable to such income or profits and all other revenue charges and expenses of the H business".

It is further provided in the schedule:

"The said net profits calculated as aforesaid shall be certified as soon as practicable after" 31st March 1960 by the Company's auditors.

The agreement contained this clause:

"6(*a*) The Vendors hereby jointly and severally covenant with the I Purchaser that if any of the assets owned by the Company at the date

A hereof or any of the properties which the Company is entitled to sell by virtue of the Building Agreement remain unsold or unrealised by the First day of March [1960] the Vendors will purchase or procure the purchase of such unsold or unrealised assets at the cost of such assets to the Company or the value thereof at the said date whichever shall be the greater (to be determined in default of agreement by an independent B Chartered Surveyor to be nominated by the President for the time being of the Royal Institute of Chartered Surveyors) and will forthwith pay or procure payment of the purchase price thereof to the Company. (*b*) The Purchaser agrees to procure the Company to sell and convey or transfer or procure the conveyance and transfer to the Vendors or as they shall direct of all of the said assets which the Vendors have agreed to purchase C as aforesaid on payment of the purchase price thereof".

There is also a clause which provides that the directors of Mantern shall continue to serve as directors, and that the Appellant Company shall procure Mantern to retain the services of those directors until a date which is called "the interim payment date".

There were twelve transactions which followed the Warshaw pattern more D or less closely, and three transactions which followed the Mantern pattern. In the case of Mantern, there was a supplemental agreement (and I presume also in the case of the other companies which followed the same pattern as Mantern), and by the supplemental agreement the Appellant Company covenanted to procure that Mantern should make a distribution by way of dividend of the whole of its net profit up to 31st March 1960 not earlier than E 14 days after the issue of the certificate referred to in the principal agreement, to the extent that the necessary funds were available; and that, if the certificate proved that the company had made a net profit, then they, the Appellant Company, would pay to the vendors, on the fourteenth day after the date of the certificate, on account of the further sum mentioned in the principal agreement, such an amount as should be equal to the net profit after deducting income F tax at the standard rate. The Appellant Company further undertook to pay to the vendors the balance due in respect of the further sum when, but not unless, the Appellant Company should obtain the benefit of a reduction in its income tax in respect of the dividend and the loss, if any, sustained by it in the purchase and in any realisation or revaluation of the Mantern shares. The effect of that transaction appears to be that the Appellant Company G became the sole shareholder of Mantern with complete control over the company, but subject to its contractual obligations under the agreements that I have mentioned, which included an obligation to distribute all the profits of the company down to the date mentioned and to pay a purchase price for the shares related to the profits of the company in the way provided by the agreement.

The Company was not itself in a position to finance these transactions from H its own resources, and it had to borrow the initial payments which fell to be made to the vendors from its bankers on some unusual terms, which will be found stated in para. 14 of the Case. The bank, however, was not prepared to lend the Company money to enable it to make the various further payments under the agreements, and in each case the vendors agreed verbally with the Company that these further payments should be made as and when dividends I from the vendors' companies enabled the Company to make them.

In these circumstances, the crucial question is whether the shares acquired

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by the Appellant Company were shares which were acquired by them as the result of trading transactions carried out in the course of the Company's trade as a dealer in shares, so that the shares so acquired constituted part of the Company's stock-in-trade, or whether they were shares acquired in circumstances making it plain, upon the true view of the facts, that they were not acquired in the course of the Company's trade, but were acquired outside the scope of that trade. If they were acquired outside the scope of that trade, it may be that they should be regarded as being in the nature of investments; or it may possibly be the case, I suppose, that these transactions could be regarded as some other kind of activity of the Company. The question to which I have to address my mind is whether, upon the true view of the facts, these shares were acquired by the Company in the course of its trade as a dealer in shares.

When the matter came before the Commissioners, the case was put forward on two grounds. The Crown resisted the claim of the Appellant Company, first, upon the ground that, upon the true view of the facts, the shares did not become stock-in-trade of the Company's trade of dealing in shares; and secondly, on the ground that, if they did so, then, in computing the profit or loss of that trade for the purposes of Case I of Schedule D, the dividends received on the shares should be treated as receipts of that trade and brought into account in ascertaining the profits and gains of that trade for the purpose of Case I, which would result in no loss being established.

Now, the Commissioners rejected the first of those contentions, and they did so on the ground that the case was not distinguishable from *J. P. Harrison (Watford) Ltd.* v. *Griffiths*[1]. What they say in their reasons, which they delivered in writing, is this:

> "The Crown's first contention was put in various ways: at the relevant time no trade was being carried on by the Appellant Company of which the shares in question were trading assets; they were acquired to hold and were part of the fixed, and not part of the circulating, capital in the Appellant Company; they were acquired with a view to the dividends being received on them and not with a view to their being turned over in the way of trade. We find that the shares were acquired with the object of making a profit out of them, a profit by the recovery of income tax."

Now, as I understand that finding, it is a finding that the shares in question were not acquired as investments but were acquired in the course of the trade of the Company, that being a necessary incident to their being able to recover tax. They then go on to say:

> "On this finding the question is whether the forward-stripping transactions which took place in the present case are so different in their nature from the stripping transaction in *J. P. Harrison (Watford) Ltd.* v. *Griffiths* that that case does not apply. In our view the fact that in the present case the dividends of which use was to be made for the purpose of the loss claim were to accrue over a period of years, whereas in *Harrison* v. *Griffiths* the dividend was paid immediately out of profits available for that purpose, is not sufficient to enable us to distinguish that case from the present one, and we reject the Crown's first contention."

They then went on to consider the second contention, and they rejected that upon the ground that, in accordance with the long-established practice in the

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(1)40 T.C. 281; [1963] A.C.I.

A computation of profits and loss of a trade, the dividends ought to be excluded from such a computation. The matter was then left in abeyance for figures to be agreed between the parties, but before the determination of the Commissioners was made final a case called *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue*(1) came before the Court of Appeal, and as the result of the Court of Appeal's decision in that case the Crown sought reconsideration by the B Commissioners of their decision on the Crown's second contention. The matter was reconsidered, and the Commissioners reversed their decision on that part of the case. However, subsequently, *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue* went to the House of Lords, who reversed the decision of the Court of Appeal, and there is now no dispute between the parties before me as to the second ground of the Commissioners' decision. The only issue now C is whether these shares were or were not bought in circumstances which justify the view that they were bought as part of the stock-in-trade of the Company as a dealer in shares.

The Commissioners, before reconsidering the matter, as I have already mentioned, in the light of the Court of Appeal's decision in *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue*, held that the claim of the Company D succeeded and that the Company had sustained a loss in the year 1959–60 within the meaning of s. 341; that is to say, the Commissioners found as a fact that the loss was one which was sustained by the Appellant Company in the course of its trade as a dealer in shares. That is a finding of fact, but a finding of fact reached by inference from the primary findings of fact to be found in the Case Stated; and, as I conceive my position, I have only to consider, E and can only consider, whether that conclusion at which the Commissioners arrived was one at which they could reasonably arrive upon the primary findings of fact. It is not for me to say whether I myself would have reached that conclusion. I have to consider whether in the Case Stated there are facts found upon which the Commissioners could reasonably reach the conclusion which they did reach.

F Now, having regard to the somewhat peculiar history of this case, the Appellant has really fulfilled the role of respondent and the Crown has really fulfilled the role of appellant; and the submissions which have been put forward on behalf of the Crown by the Solicitor-General and Mr. Borneman are, shortly, these. It is said that there is no ground here for holding that the shares which the Appellant Company acquired under these fifteen transactions were stock-G in-trade because the transactions were so different from the normal sort of transactions entered into by a dealer in stocks and shares, and the course of dealing that the parties had in contemplation was so unlike that normally existing between a dealer in stocks and shares and those with whom he deals, that the facts in this case negative the view that these transactions were transactions entered into in the course of trade as a dealer. It is said that the nature of the transactions H is much more consistent with the view that the Company was acquiring these shares as an investment, with a view to obtaining profit from holding them—holding them, it may be, for only a short time, but holding them for long enough to drain the company concerned of its profits, leaving the Appellant Company with nothing but what has been called in the course of the argument (to borrow some language from Lord Simonds in another case) an eviscerated company. I With regard to *J. P. Harrison (Watford) Ltd.* v. *Griffiths*(2), referred to by the

(1)41 T.C. 666; [1963] 1W.L.R. 1223 (C.A.); [1964] 1W.L.R. 742 (H.L.).

(2)40 T.C. 281.

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Commissioners, it is said that this case is distinguishable on its facts from that case, and I shall have to say something about that later.

On the other hand, it is said for the Appellant Company that this was a company which, as is found in the Case, was engaged in dealing in shares; that, although these transactions may be in some respects unlike ordinary dealings entered into by a dealer in shares, they nevertheless are transactions of a kind which can reasonably be regarded as dealings in shares, and therefore as an appropriate part of the activities of such a business; and that, although it may be that the Appellant Company, when it acquired the various parcels of shares, contemplated retaining them during the periods over which the several agreements worked themselves out, such an intention is by no means a conclusive indication that the subject matter of such agreements is not stock-in-trade of a dealer in shares. It was emphasised on behalf of the Crown that one of the exceptional characteristics of this case was that the price which the Appellant Company was to pay was not determined at the date of the sale, and could not be determined until the shares had been held for a considerable period, sometimes up to five or six years. Mr. Heyworth Talbot, for the Appellant Company, says that that also is not a characteristic which is inherently incapable of being regarded as consistent with the transactions being dealings in shares, although such an arrangement may be unusual in dealings in shares; and he says it is an arrangement of a kind which would not be so unusual in other fields—such, for instance, as dealings in land of a speculative nature, where, he suggests, it would not be unusual for a purchaser to buy property upon terms that he will pay a certain price and share with the vendor what profit he might make on a resale.

As I said earlier, I think what I must do is to consider whether on the facts found in the Case there is material upon which the Commissioners could reach the conclusion that they did. Before doing that, I think that perhaps it would be right that I should make some reference to *J. P. Harrison (Watford) Ltd.* v. *Griffiths* 40 T.C. 281; [1963] A.C. 1. This was a case which related to a simple share-stripping transaction; that is to say, a case in which a dealer in shares acquired the share capital in a company which was, as has been said, pregnant with profits, and, having acquired those shares, stripped the company of its profits. The value of the shares consequently declined, and so the company claimed to be entitled to take that reduction in value into account in arriving at its profits and gains or its losses in the course of its trade for the relevant period. Lord Simonds, [1963] A.C., at page 11 ([1]), states that the Commissioners must be assumed to have reached their determination on the basis of two facts: firstly, that the transaction in question was an isolated one in the year of assessment—and Lord Simonds says that that contention, if not actually abandoned, was one which he considered to be quite unsustainable—and, secondly, that the shares were purchased with a view to obtaining a dividend against which the company could claim to set off its losses. He goes on to deal with that second ground, and says that the argument for the Crown rested on the proposition that trading involves doing something with the object of profit, which was not the object of the transaction in question; and Lord Simonds says that, attractively though that argument had been presented, it did not convince him. I now read:

"Here was a company whose object it was to deal in shares. It entered

([1])40 T.C. 281, at p. 293.

into a commercial transaction which, though it might be given an invidious name, contained no element of impropriety, much less of illegality. I can find nothing that enables me to say that it is not a trading transaction and echo the question asked by the majority in the Court of Appeal: 'If it is not trade, what is it?' No doubt, many observations that have been made alio intuitu will be found to the effect that trade is carried on with a view to a profit. But this proposition is not universally true, nor can it be tested merely by ascertaining the difference between the purchase price (or, it may be, the manufacturing cost) of an article and the selling price of that article. For a dealer may seek his profit, if a profit is essential, otherwise than by an enhanced price upon a resale, as by a declaration of dividend, a repayment upon a reduction of capital or upon a liquidation of the company whose shares he has bought."

Lord Morris of Borth-y-Gest, at page 23([1]), said:

"The company bought the shares, received a dividend and then sold the shares. These facts seem to me to point firmly to the conclusion that the transaction was entered into as a part of a trade of dealing in shares or was an adventure in the nature of trade. The inherent nature of the transaction suggests a trading operation."

Then he goes on to say that a trading operation does not lose that character merely because it is entered into for some fiscal advantage. At page 26([2]), Lord Guest said, at the foot of the page:

"The test is an objective one. The question to be asked is not quo animo was the transaction entered into but what in fact was done by the company", and he cites certain cases. "In my opinion one has to look at the transaction by itself irrespective of the object, irrespective of the fiscal consequences, and ask the question in Lord President Clyde's words in *Livingston*([3]): 'whether the operations involved in it are of the same kind, and carried on in the same way, as those which are characteristic of ordinary trading in the line of business in which the venture was made.' The company had power to deal in shares, they bought shares, they received a dividend on these shares, they sold the shares. This was just the ordinary commercial transaction of a dealer in shares."

Now it is said on behalf of the Crown in the present case that that case is distinguishable on its facts from the present case, as indeed it is, but distinguishable in this particular respect: that there the shares had been bought and had been sold, and the House of Lords treated the transaction as being one which had all the incidents of an ordinary dealing in shares, and was concerned only with the question whether the fact that the company there had chosen to embark upon that dealing because it would obtain a fiscal advantage was a circumstance which would deprive the dealing of its character of being a dealing in the course of trade. It is, I think, true that in that case it was easier to say that the transaction there under consideration had all the characteristics of a dealing in shares, but it seems to me that that case does decide that, where a share dealer has bought shares with the object of making a profit by stripping a company—and he may, to use Lord Simonds's words, have had in mind making his profit in a number of ways: by an enhanced price, by a declaration of dividend, by a repayment upon a reduction of capital or by liquidating the company; all of which ways, as Lord Simonds thought, would be appropriate ways for a dealer

([1])40 T.C. 281, at p. 301. ([2]) *Ibid.*, at p. 304. ([3])11 T.C. 538, at p. 542; 1927 s.c. 251.

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in shares to obtain his profit in the course of his dealings—that is at least capable of being regarded as a trading transaction. It may be that whether it is proper to be regarded in a particular case as a trading transaction may depend upon surrounding circumstances, but it must be authority for the view that, where a share dealer buys shares with such objects as those, the transaction is one capable of being regarded as a trading transaction.

Now in the present case there were these circumstances found by the Commissioners. First of all, the Company was engaged in carrying on a trade of dealing in shares. That was the nature of the Company's business. The memorandum and articles of the Company are not annexed to the Case, and I do not know precisely what its objects were, but the Company was incorporated to carry on that type of business. They found that the active director of the Company, who was responsible for the Company's entering into these transactions, came to the conclusion that the transactions might prove profitable to the Company; and they found that all the transactions were designed to produce some profit to the Company, apart from any tax repayment that might become due. In support of that finding, a table is exhibited to the Case which purports to show that, as at 31st March 1961, if no further profits were earned by the various companies and no further dividends were received by the Appellant Company from the companies whose shares it had acquired in these various transactions, there would be some profit on every one of the fifteen transactions. I say "every one": it is not in fact every one, but in the great majority of them. In many of those the amount of profit shown on the table is very small—of the order of £3 to £7; in some it is more substantial. But these figures, of course, are prepared upon the basis that all these transactions were going to cease to be profitable after 31st March 1961. It seems to me that that schedule does support the view that, if the transactions went through in the way in which it was expected that they would, they would be calculated to provide some profit for the Company, even though a small one, apart from tax repayments. At any rate, they would not be transactions which would incur losses for the Company, apart from tax advantages.

These, therefore, were what can properly be described as commercial transactions. They were not colourable transactions: nor were they transactions such as those which were considered in two cases to which I was referred by the Solicitor-General, *Petrotim Securities Ltd.* v. *Ayres*[1] 41 T.C. 389 and *Ridge Securities Ltd.* v. *Commissioners of Inland Revenue*[2] [1964] 1 W.L.R. 478, where sales at a great undervalue, or transactions of which such sales formed part, were held to be not truly commercial transactions at all, and therefore not to form part of a trade. The transactions in the present case were genuine transactions. There was nothing sham about them, and they were transactions of a truly commercial character. It is certainly true that they were not transactions of a kind that one would expect a dealer in shares to enter into day by day in the ordinary course of his business, but I see no reason why a dealer in shares should be confined to dealing in what one might call the ordinary course, or why he should not be entitled, as part of his business, if he considers that it will be to his advantage, to enter into transactions of an unusual nature and involving unusual terms. Such transactions, it seems to me, can still be properly regarded as part of his business if they are truly trading transactions, if they are transactions relating to dealing in shares.

(1) [1964] 1 W.L.R. 190. (2) To be printed later in Tax Cases.

A The argument that these were transactions which involved the Company holding the shares in question for a period of time is one which, as it seems to me, looks at the motive of the parties in entering into the transactions rather than at the nature of the transactions themselves; and, bearing in mind what was said by Lord Guest in *Griffiths* v. *Harrison*, [1963] A.C., at page 26([1]), about the test being an objective one, I think that one must look at the nature of the trans-
B action and not at the circumstances which the parties had in contemplation at the time the transaction was entered into. It may well be that the Appellant Company expected to retain these shares for the whole of the periods covered by the agreements, and that business considerations would normally have induced them to do so; but there is nothing in these agreements which would have precluded the Company from selling any of these shares, with, of course, whatever
C special rights had been attached to them, at any time if they had found it necessary for the purposes of their business, or if their financial position had become such that it was absolutely essential for them to raise liquid cash. It may well be that they would never have considered selling any of these shares during the currency of one of the agreement periods unless exceptional circumstances arose, but there is nothing in the agreements to make it impossible for the Com-
D pany to deal with the shares in that way—and, indeed, in the Warshaw agreement, clause 3(*b*), which I read, there is a reference to "sale or other dealing" by the Appellant Company in the subject matter of that agreement.

It seems to me that it would be impossible for me, in these circumstances, to say that the conclusion at which the Commissioners arrived was one which it was impossible for them reasonably to reach, and unless I can say that I do
E not think I can interfere with their determination. Consequently, in my judgment this appeal succeeds.

Heyworth Talbot Q.C.—If your Lordship pleases. The appeal is allowed with costs?

Buckley J.—Yes. I think that must be so, Mr. Solicitor, must it not?

The Solicitor-General—Yes, my Lord.

F **Buckley J.**—Very well.

Talbot Q.C.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came before the Court of Appeal (Lord Denning M.R. and Davies and Russell L. JJ.) on 12th, 13th and 14th May 1965, when judgment was reserved. On 7th July
G 1965 judgment was given against the Crown, with costs (Lord Denning M.R. dissenting).

The Solicitor-General (*Sir Dingle Foot Q.C.*), *Roy Borneman Q.C.*, *J. Raymond Phillips* and *J. P. Warner* for the Crown.

F. Heyworth Talbot Q.C., *H. Major Allen Q.C.* and *Peter Rees* for the Company.

([1])40 T.C. 281, at p. 304.

The following cases were cited in argument in addition to those referred to in the judgment: *Petrotim Securities Ltd.* v. *Ayres* 41 T.C. 389; [1964] 1 W.L.R. 190; *Ridge Securities Ltd.* v. *Commissioners of Inland Revenue* [1964] 1 W.L.R. 479; *Commissioners of Inland Revenue* v. *Livingston* 11 T.C. 538; 1927 S.C. 251; *Orchard Parks Ltd.* v. *Pogson* (1964) 43 T.C. 442; *Gloucester Railway Carriage & Wagon Co. Ltd.* v. *Commissioners of Inland Revenue* 12 T.C. 720; [1925] A.C. 469; *Cenlon Finance Co. Ltd.* v. *Ellwood* 40 T.C. 176; [1962] A.C. 782.

Lord Denning M.R.—This is yet another case about dividend-stripping, but of a new kind. It is *forward-stripping* as distinct from *backward-stripping*. We had to consider backward-stripping in *Griffiths* v. *J. P. Harrison (Watford), Ltd.*(1) [1963] A.C.1, at pages 17–19, and in *Argosam Finance Co. Ltd.* v. *Oxby*(2) [1964] 3 W.L.R. 774, at pages 778–9. The essence of *backward-stripping* is that a dealer in shares buys shares in a company which *has accumulated large profits* and has paid tax on those profits. It is in a position to declare a dividend after deduction of tax. The price is high because of the dividend soon to be distributed. The dealer pays the price and receives the dividend. In consequence the value of the shares falls at once by a large amount. He resells (or holds till the end of the year). The dealer then makes out his accounts for income tax purposes. These accounts omit all reference to the dividend received. (This practice is sanctioned by law: see *F. S. Securities Ltd.* v. *Commissioners of Inland Revenue*(3) [1964] 1 W.L.R. 742.) The accounts show simply the shares bought at a high price, and resold (or revalued) at a low price. So they show a large loss on the purchase and sale of the shares. The dealer claims tax repayment on this loss, and succeeds. He gets back into his own hands all the tax which the company paid. It is all sheer gain to him. No tax on it. No surtax. The only loser is the Revenue, or rather the other taxpayers.

Now in *forward-stripping* the dealer buys shares in a company which *hopes to make in the future* large profits out of which it will be asked to declare a dividend after deduction of tax. The dealer agrees to pay a lump sum price to cover the anticipated amount of dividends in the next few years. It may be five years, three years, or only one year. He keeps the shares and receives the dividends each year as they are declared. The value of the shares drops each year as and when the dividends are received. Then each year he makes out his accounts for income tax purposes. These omit all reference to the dividends received. So the accounts show a loss each year as the shares are revalued. The dealer claims tax repayment on this loss. Can he succeed? I should add that, if the dividends should not reach the anticipated figure, the original price is reduced to meet the deficiency. So the dealer in the long run only pays the amount of the dividends. The price equals the amount of the dividends received. But he gets the whole of the tax repayment (if permitted) free of any tax at all.

It is plain that in all these dividend-stripping cases the so-called "loss" sustained by the dealer is an artificial loss. He sustains no loss in fact on his outlay because he gets it all back in dividends. But there is a strange rule of income tax law which enables him in his accounts to ignore the dividends he receives. He takes advantage of this rule so as to show a fictitious loss. All he does is to make artificial book entries: and this enables him to claim hard cash

(1) 40 T.C. 281, at pp. 297–8. (2) 42 T.C. 86, at pp. 101–3; [1965] Ch. 390. (3) 41 T.C. 666.

(Lord Denning M.R.)

A from the Revenue. Thousands and thousands of pounds of it. He says it is all part of his trade. If so, it is a most discreditable part. I feel, for my part, that the Courts should do nothing to encourage it. Encourage it they do if they allow this palpable device to succeed. Repayment should only be permitted if there is genuine loss in a genuine trading transaction. It should not be permitted when it is a device to outwit the Revenue.

B In the present case the dealer carried out 15 *forward-stripping* transactions. They are described in the report in the Court below, [1965] 1 W.L.R. 358, and I need not repeat them again. The whole question in point of law is whether the loss sustained on these transactions by the dealer is a "loss in any trade" within s. 341 of the Income Tax Act 1952. If these transactions were trading transactions in the way of his trade, he is entitled to recover the tax. Otherwise not.
C The Commissioners have found that the shares were part of the dealer's stock-in-trade—in other words, that these transactions were trading transactions—with the result that the dealer is entitled to recover the tax. So has Buckley J. The Crown appeal to this Court.

The first question is whether we can go behind the finding of the Commissioners. I think we can, for the reason that they have misdirected themselves.
D They gave their reasons. They said in their written decision on 12th July 1962:

> "We find that the shares were acquired with the object of making a profit out of them, a profit by the recovery of income tax. On this finding, the question is",

they say, whether the case can be distinguished from *Harrison* v. *Griffiths*[1]: and they held it was not distinguishable.

E It is plain from that reasoning that the Commissioners had regard to the profit motive. They thought that these transactions by the dealer had as their object the making of profit, and were *therefore* transactions in the way of the dealer's trade. And the profit they had in mind was a profit *by the recovery of income tax*. They say so. They adopted the words of Upjohn L.J. in the Court of Appeal in *Harrison* v. *Griffiths*[2] and treated them as applicable to the
F present case. Now the House of Lords, as I understand them, rejected that element. They held it was immaterial. It was not permissible to have regard to *the profit made by the recovery of income tax*. Such a profit is not a profit by way of trade. It is only the fiscal result of the transaction and that must be ignored.

> "It appears to me to be wholly immaterial", said Viscount Simonds[3], ". . . what may be the fiscal result, or the ulterior fiscal object, of the
G transaction".

And Lord Guest said that[4]:

> "one has to look at the transaction by itself irrespective of the object, irrespective of the fiscal consequences".

In looking to the fiscal object, therefore, the Commissioners misdirected them-
H selves. This misdirection is such that the Court can review that determination: see *Edwards* v. *Bairstow*[5] [1956] A.C. 14, at pages 29 and 36; and determine the matter itself: see *British Insulated and Helsby Cables Ltd.* v. *Atherton*[6] [1926] A.C. 205, at page 212.

([1])40 T.C. 281. ([2])*Ibid.*, at p. 290 ([3])*Ibid.*, at p. 294.
([4])*Ibid.*, at p. 304. ([5])36 T.C. 207, at pp. 224 and 229. ([6])10 T.C. 155, at p. 191.

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Buckley J. rightly rejected the fiscal object, but he found another profit motive. He seems to have found that the objective was a trading profit. He relied particularly on the statement in the Case that

> "all of the transactions were designed to produce some profit for the Company, apart from any tax repayment that might become due",

and a table exhibited to the Case. I am afraid I cannot go with Buckley J. on this point. The statement in the Case was, I think, a mere recital of what Mr. Lavy (one of the dividend-strippers) had said, and not an acceptance of it by the Commissioners. It is only necessary to look at the figures in the table: In one case a gross profit of £2 15*s.* 2*d.*, in another £4 5*s.* 0*d.*, and so forth. Those trifling sums were not the object of the exercise. The object was obviously to get tax repayments. Indeed the Commissioners, in their written decision, so said: "a profit by the recovery of income tax."

It appears to me, therefore, that both the Commissioners and Buckley J. proceeded on the wrong lines. All that *Griffiths* v. *Harrison*[1] decided was that, if a transaction was truly an adventure in the way of trade, it did not cease to be so simply because the ulterior object was a fiscal benefit. But the question remains in every case, was the transaction truly a transaction in the way of trade? In *Griffiths* v. *Harrison* the House held that the transaction there (of backward-stripping) was an adventure in the nature of trade because it had all the characteristics of a trade. As Lord Guest put it[2]:

> "The Company had power to deal in shares, it bought shares, it received a dividend on these shares, it sold the shares. This was just the ordinary commercial transaction of a dealer in shares."

Here we have a transaction of a different kind. These transactions of forward-stripping do not wear the ordinary characteristics of a trade. The dealers here on the forward-stripping did not buy the shares in order to resell them. They bought them to keep. They did not buy at any fixed price. They bought at a price dependent on future dividends. They bought the shares rather as a man buys a coalmine or a gravel pit. They bought the shares as an income-producing asset at a price dependent on the income produced by that asset. They acquired the shares as fixed capital, not circulating capital. Lord Haldane described the difference in *John Smith & Son* v. *Moore*[3] [1921] 2 A.C. 13, at page 19:

> "Adam Smith described fixed capital as what an owner turns to profit by keeping it in his own possession, circulating capital as what he makes profit of by parting with it and letting it change masters."

In *Griffiths* v. *Harrison* the shares in Claiborne were circulating capital. Here the shares are fixed capital.

In *Griffiths* v. *Harrison* the majority of the House felt it useful to ask the test question, "if it is not a trade, what is it?" I still have misgivings about the utility of that question. But accepting it as relevant, there was no answer to it in *Griffiths* v. *Harrison* except the one I there gave. It is dividend-stripping and nothing else. That was held to be insufficient. But in this case there is an answer to it. It is this. The shares were an investment in the nature of capital, and not an adventure in the nature of trade. That disposes of the test question.

In my judgment, therefore, these transactions in forward-stripping were not transactions in the way of trade. They were no part of the ordinary trade

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(1)40 T.C. 281. (2)*Ibid.*, at p. 304. (3)12 T.C. 266, at p. 282.

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A of a dealer in shares. They were dividend-stripping transactions and nothing else. I would therefore allow the appeal and hold that the Commissioners were wrong in holding that the shares were part of the Company's stock-in-trade.

Davies L.J.—In the course of his judgment in this case Buckley J. said(1):

". . . the crucial question is whether the shares acquired by the Appellant Company were shares which were acquired by them as the result of trading
B transactions carried out in the course of the Company's trade as a dealer in shares, so that the shares so acquired constituted part of the Company's stock-in-trade, or whether they were shares acquired in circumstances making it plain, upon the true view of the facts, that they were not acquired in the course of the Company's trade, but were acquired outside the scope of that trade. If they were acquired outside the scope of that trade, it may
C be that they should be regarded as being in the nature of investments; or it may possibly be the case, I suppose, that these transactions could be regarded as some other kind of activity of the Company. The question to which I have to address my mind is whether, upon the true view of the facts, these shares were acquired by the Company in the course of its trade as a dealer in shares."

D No one could quarrel with that statement of the question for decision. And later in his judgment the learned Judge—again, in my opinion, correctly—said(2):

". . . the Commissioners found as a fact that the loss was one which was sustained by the Appellant Company in the course of its trade as a dealer in shares. That is a finding of fact, but a finding of fact reached by inference
E from the primary findings of fact to be found in the Case Stated; and, as I conceive my position, I have only to consider, and can only consider, whether that conclusion at which the Commissioners arrived was one at which they could reasonably arrive upon the primary findings of fact. It is not for me to say whether I myself would have reached that conclusion. I have to consider whether in the Case Stated there are facts found upon
F which the Commissioners could reasonably reach the conclusion which they did reach."

There is no doubt that in para. 3(1) of the Case Stated the Commissioners correctly stated the question for their decision, namely:

"whether certain 'forward-stripping' transactions in shares were transactions in the course of the Company's trade . . . and whether the shares
G in question were part of the Company's stock-in-trade".

Paragraph 17 of the Case Stated reads as follows:

"It was contended on behalf of the Appellant: (1) that the shares in question were bought for the purpose of making a profit out of them; (2) that the transactions in these shares were transactions in the course of the Company's trade of dealing in shares; (3) that these shares were stock-in-
H trade of the Company's trade; and (4) that any loss resulting from the transaction in these shares was a loss within the meaning of s. 341 of the Income Tax Act 1952."

And in para. 18 the contentions for the Crown are stated as follows:

"(1) that the shares in question were bought for the purposes of holding

(1) *See* pages 603–4 *ante*. (2) *See* page 605 *ante*.

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> them and receiving dividends from them; (2) that these shares were capital assets of the Company, and were not stock-in-trade of its trade of dealing in shares".

So there can be no doubt that the Commissioners had before them and put to themselves fairly and squarely the proper question for decision. And having decided the question in favour of the taxpayer, they pose the question in the Case Stated (para. 26(4)) for the opinion of the Court as follows:

> "Whether we were wrong in law in holding that the shares . . . were part of the Company's stock-in-trade."

I agree with Buckley J. that this is not a question of law but a question of fact, albeit a difficult one. There was, as I think, evidence to support the Commissioners' finding, and consequently the Court could not in the ordinary way interfere and substitute its own view of the facts. But my Lords take the view that the Commissioners misdirected themselves and that therefore the question is open for the decision of the Court. This view is founded on the written reasons given by the Commissioners for their decision on 12th July 1962 (nearly two years before the Case Stated). In those reasons, after a fuller statement of the contentions for the Crown, they say:

> "We find that the shares were acquired with the object of making a profit out of them, a profit by the recovery of income tax. On this finding the question is whether the forward-stripping transactions which took place in the present case are so different in their nature from the stripping transaction in *J. P. Harrison (Watford) Ltd.* v. *Griffiths* 40 T.C. 281 that that case does not apply. In our view the fact that in the present case the dividends of which use was to be made for the purpose of the loss claim were to accrue over a period of years, whereas in *Harrison* v. *Griffiths* the dividend was paid immediately out of profits available for that purpose, is not sufficient to enable us to distinguish that case from the present one".

Now, of course, the Commissioners were in error in thinking that the fact that the transactions were designed to make a fiscal profit was a valid pointer to the conclusion that the transactions were trading transactions. The decision of the House of Lords in *Griffiths* v. *Harrison* is clear authority to the contrary. That case decides that the fiscal object is to be ignored and that what must be looked at is the nature of the transactions in themselves. Indeed, it might be said that in the *Harrison* case the transaction was held to be a trading transaction despite its fiscal object; that case certainly did not decide that the transaction was a trading one by reason of its fiscal object.

So to that extent I agree that the Commissioners misunderstood *Griffiths* v. *Harrison* and misdirected themselves. But, as I think, there is great force in the argument that in the last sentence of their reasons quoted above they returned to a proper consideration of the question before them. What, as it seems to me, they are saying is that, if a dealer in shares buys shares in circumstances which would *prima facie* point to the transaction being a trading one, the fact that the ultimate object of the transaction will not be attained until after the expiration of a period of years does not affect the real nature of the transaction. If a poulterer buys a goose and sells it after it has laid one golden egg, that is presumably a trading transaction: *Griffiths* v. *Harrison*. Is it less a trading transaction if he postpones the sale until after more eggs have been laid? In *Griffiths* v. *Harrison* the dealer bought shares, received a dividend and then

A resold. Here the dealer bought shares which, as I understand the facts, he could have sold at any time, though he in fact intended to hold them for a specified period. It seems to me that the argument for the Crown in this case does what Lord Guest in the *Harrison* case([1]) said should not be done, namely, to rely on the intent of the party instead of upon the nature of the transaction. It might be added that, since the presence of a fiscal motive or object is established to
B be irrelevant, it would hardly seem legitimate to rely on the fact that the shares must or were intended to be retained for a period in order fully to attain the fiscal object.

In my judgment, therefore, the misdirection did not vitiate the Commissioners' finding, and there was evidence here upon which they could reach the finding which they did reach. To this I would merely add that, if the matter
C is open for fresh consideration by this Court, I agree with the judgment and reasoning of Russell L.J., which I have had the opportunity of reading. I also agree with the judgment and reasoning of Buckley J., save in the respect next mentioned.

There was some discussion in the course of the argument on the question whether the dealers intended to make or did make any profit other than the
D fiscal one. Buckley J. attached importance to this. He took the view that the Commissioners made a finding that the transactions were designed to produce a profit for the Company over and above any tax repayment, and he was of the opinion that the table attached to the Case showed that some such profits, though small, had in fact accrued.

It is by no means certain that the Commissioners did make such a finding.
E The Master of the Rolls has said that he thinks that they did not, and that the last three lines of para. 6 of the Case Stated are a mere recital of the evidence of Mr. Lavy. I myself should incline to the other view and consider that the Commissioners were impliedly accepting the evidence. But the matter is, in my judgment, of little or no importance to the decision of this case. For the Commissioners make no reference to this point in their reasons, and the profits
F shown in the table are so small as to be insignificant.

It is difficult to refrain from one other reflection. If, owing to some unforeseen circumstances, the dealers in the present case had made a profit instead of a loss, it is not easy to imagine that—quite apart from the effect of recent legislation—the Crown would not claim, and rightly claim, that such a profit was a trading profit.

G In my judgment, the appeal should be dismissed.

Russell L.J.—There are certain matters in the Case Stated to which particular attention should be directed. Paragraph 2 states that the Company was incorporated in May 1956 to carry on the trade of dealing in shares and securities and has always carried on that trade. Paragraph 3 states the questions for determination:

H "whether [the] . . . transactions were transactions in the course of the Company's trade . . . and whether the shares in question were part of the Company's stock-in-trade".

Paragraph 4 refers to the manner in which the loss claim is computed "on the basis that the shares . . . were its stock-in-trade." Paragraph 5 starts by stating that Mr. Lavy gave evidence on behalf of the Company: that paragraph and

([1])40 T.C. 281, at pp. 303–4.

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para. 6 appear to recite the effect of part of his evidence in terms that suggest to me that that part was accepted as fact : para. 6 included the phrase :

> "All of the transactions were designed to produce some profit for the Company apart from any tax repayment that might become due."

Paragraphs 17 and 18 recited the rival contentions : for the Company, that the shares were bought for the purpose of making a profit out of them; that the transactions were transactions in the course of the Company's trade of share-dealing; that the shares were stock-in-trade; for the Crown, that the shares were bought for the purpose of holding and receiving dividends from them; that they were capital assets and not stock-in-trade of the Company's trade.

In their written decision on 12th July 1962 the Commissioners again adverted to the Crown's contention, which they put as follows (together described as "the first contention"): that no trade was being carried on of which the shares were trading assets; that the shares were acquired to hold and were part of the fixed and not part of the circulating capital of the Company; that they were acquired with a view to the dividends being received and not with a view to their being turned over in the way of trade. They then found that they were acquired with the object of making a profit out of them by the recovery of income tax. They posed the question "on this finding" whether the transactions were so different in their nature from that in *Griffiths* v. *Harrison*[1] that that case did not apply. They concluded that the fact that the dividends looked to were to accrue over a period of years, as distinct from a once-for-all dividend of already existing available profits, was insufficient to distinguish the case from *Griffiths* v. *Harrison*. They then rejected the Crown's "first contention." Further, when, nearly two years later, they signed the Case Stated, they posed the question as being whether they were wrong in law in holding that the shares "were part of the Company's stock-in-trade". For the Company it is said that all this amounts to a finding by the Commissioners that these purchases of shares were trading transactions, the shares being acquired as part of the Company's stock-in-trade, and that it is not open to this Court to differ from that conclusion unless satisfied that some other was the only reasonable conclusion on the facts.

I am not satisfied that the test of the ability to interfere with the finding of the Commissioners is applicable in the present case. My reason is that it seems to me that the true basis of the Commissioners' decision is that they were unable to discern from such differences of fact as existed any relevant distinction between *Griffiths* v. *Harrison* and the present case, and so were bound by that decision to conclude that here were trading transactions and here was stock-in-trade. This, in my view, leaves this Court free to form its own opinion on the question whether a relevant distinction should be discerned. I do not, however, myself construe the Commissioners' finding as showing that they thought that *Griffiths* v. *Harrison* decided that, where there was acquisition with the object of making a profit by the recovery of income tax, that object *conferred* the character of trading on the transaction.

In *Griffiths* v. *Harrison* the company had been a mercantile trading company which had ceased trading as such. It had, as a result of such trading, accumulated a loss which would be available under s. 341. In October 1953 the company added to its objects those of a dealer or trader in stocks and shares. On 4th December 1953 it bought for £16,900 all the £1,000 issued share capital

(1) 40 T.C. 281.

A of company B, having borrowed £15,900 for that purpose. Company B was not carrying on business but had in its coffers substantial liquid assets representing accumulated profits available for distribution as dividend. The purchase was on blank transfers, the company not being registered as shareholders. On 26th January 1954 company B declared a gross dividend yielding, after deduction of £13,000 income tax, the net sum of £15,900, with which the company repaid B the borrowed money; at the same time the company resolved to sell the shares for £1,000 to Company C. This sale was not actually effected until June 1954, outside the relevant fiscal year, and the shares would have appeared in the directly relevant accounts of the company at the depleted figure of £1,000. It was not disputed that the company's accumulated *mercantile* trading loss was available to support a claim to repayment of part of the £13,000 tax deducted. C The question was whether the difference of £15,900 between the purchase price of £16,900 and the residual value of £1,000 also qualified as a trading loss thus available. It was on those facts that the House of Lords decided that the only reasonable conclusion was that the character of the transaction was that of trading in the shares, and that the character of the transaction was not altered by the object or intention that inspired it: the question in effect being not "*Quo* D *animo?*" but "*Quid actum est?*"

What are the facts in the present case? We are concerned with a number of transactions entered into by a company which had in other respects never been other than one which carried on the trade of a dealer in stocks and shares. The Special Commissioners selected the Warshaw company transactions as typical of the greater number of the 15 transactions now in question. The E issued capital of Warshaw was 5,000 £1 shares. On 29th December 1958 Warshaw created 100 6 per cent. preferred shares of £1 each, with normal cumulative preference share rights and with special rights for each of the next five years to be paid a dividend net after deduction of income tax equal to the amount of the profits (as defined) of Warshaw for the year (less the cumulative preference dividend), up to a total maximum of £60,000 net dividend; no dividend was F to be paid which would interfere with those rights. Various voting rights were attached to the preference shares by which the holders would be able to ensure their effective entitlement to those special dividend rights. These preference shares were allotted, by a capitalisation of profits, to the ordinary shareholders *pro rata* as fully paid. On the same day the Company agreed to buy the preference shares from the shareholders for £60,100 subject to adjustment of the G purchase price. £20,100 was to be paid at once against renounced letters of allotment; the balance was to be paid not later than 31st December 1960. Thus far the Company was in effect buying for £60,000 the future divisible profits of Warshaw over five years up to a maximum of £60,000 in net dividends, the purchase price to be paid in two years. The agreement further provided for the future adjustment of the purchase price in two ways: first, if the net dividends H in respect of the 5 years did not reach £60,000, the shortfall was to be deducted from the purchase price; second, half the amount which the Company should be able to reclaim from the tax deducted from the dividends on the ground of loss sustained in the transaction was to be added to the purchase price. Taking the matter thus far, and ignoring the more usual aspects of the shares as cumulative preference shares, it is plain that the Company was looking for its profit I out of the whole transaction to its ability to reclaim tax deducted from the special dividends by reliance upon the difference between the price it paid and the residual value of the shares when their special dividend rights came to an

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end after five years. The shareholders in Warshaw were looking for a tax-free benefit by selling the preference shares for a capital sum which would incorporate a 50 per cent. cut of the Company's tax reclaim.

Pausing there for a moment, it is to be noted that, whereas in *Griffiths* v. *Harrison*[1] the transaction involved, so to speak, the purchase of a silo complete with its existing contents of known value, this transaction involved the purchase of the ability to crop grass over a future period of up to five years for a price basically dependent upon the future worth of the crop. To complete the analogy, in *Griffiths* v. *Harrison* the purchaser would be left with the value of the silage container, and in the present case with the value of the cropping utensil included in the bargain.

The other point to be noted in the Warshaw type of case is that in each year the value of the preference shares would be written down by an amount which would be conditioned by the amount of special dividend paid and the maximum dividend expectations over the whole period. But it is to be realised that sale is not necessary to establish a trading loss.

In the Warshaw type group of cases the Company was not able out of its liquid resources to make the initial payment, but had to borrow from a bank. The bank, moreover, insisted that the vendors should leave the payments with the bank to secure the resultant overdraft. Moreover, the vendors informally agreed that the obligation to make further payments (due before the end of the five years subject to possible downward adjustment if the dividends should not come up to expectations) should be conditioned by actual dividend receipts by the Company. In the event the substance of the matter was that the vendors should receive the purchase price as and when the Company received its net dividends, the purchase price being whatever should be the amount of the net dividends, plus 50 per cent. of any tax reclaim available to the Company.

Though Warshaw is typical of the larger group of these transactions, it is special in that the scheme was never carried through. The Crown draw attention to the fact as tending to colour the character of these transactions. The shareholders of this family company, people known personally to the proprietors of Finsbury Securities Ltd., wished to resile from the arrangement so as to facilitate another arrangement involving amalgamation with a quite different company. Finsbury made no demur, and without requiring any *quid pro quo* obligingly agreed to cancellation of the special rights attached to the preferred shares and turned them over to this third company for £100. The whole bargain was cancelled without further formality. I do not think that this throws any light on the character of the transaction or of other transactions. I consider that it might have been relevant if it were suggested that the transactions were not genuine, or sham; but it is not so suggested.

The other and smaller group of transactions is typified by the case of Mantern Properties Ltd. The issued share capital of Mantern was 100 £1 ordinary shares, held by three people. It carried on the business of estate development. It was party to a building agreement out of which it hoped to make profits. Finsbury, by agreement dated 20th February 1959, bought the shares in Mantern for a basic price of £100 plus an addition of 85 per cent. of the net profits of Mantern before deducting income tax earned up to 31st March 1960. The additional sum was to be paid 14 days after the net profits

(1) 40 T.C. 281.

A were ascertained by certificate. This agreement would, of course, enable Finsbury to procure a declaration by Mantern of a dividend out of its profits from the development contract. Contemporaneously Finsbury and the Mantern shareholders entered into an agreement whereby Finsbury was to procure that Mantern would declare a dividend of its whole net profit up to 31st March 1960, to claim repayment of tax deducted therefrom on the grounds of resultant B loss, to pay the vendors the amount of the net dividend received, and to pay the rest of the purchase price as and when it made a successful loss reclaim. This supplementary agreement was in effect a qualification of the absolute obligation as to purchase price. If the fiscal scheme did not work, the vendors would get in purchase price for their shares no more than the net dividend made possible by the profits on the current contract of Mantern, and Finsbury would C show no profit. If the fiscal scheme worked, Finsbury would make a profit thereby, and the Mantern shareholders would participate in the success by extra purchase price. I should have mentioned that under the original agreement the vendors of the shares obliged themselves to buy any assets of Mantern remaining at 31st March 1960 at their cost (or greater) value.

The broad effect of the Mantern type of transaction was, therefore, that D there was a company which had one asset which in the course of continuing its active business it expected to turn into a profit in about a year, and Finsbury was buying the shares in that company in order to take that profit in the form of a dividend, leaving at the end a more or less nominal value in the shares, showing a trading loss which would enable a reclaim of tax on the dividend.

I remark as a general proposition that the phrase in para. 6 of the Case E Stated,

> "All of the transactions were designed to produce some profit for Finsbury apart from any tax repayment that might become due",

cannot, if a finding of fact, be correct. Take the Warshaw type of case, where the minimum purchase price was the net dividend receipts. The correct finding was that in para. 20, that the shares were acquired

F > "with the object of making a profit out of them, a profit by the recovery of income tax."

Buckley J. concerned himself with the question, and placed some reliance on a table produced as showing that some profit (however small) might be hoped for by Finsbury even if no tax reclaim could succeed. As I say, I cannot see how this can be so when the purchase price is not less than the net dividend G receivable.

This summary of the transactions exposes, I hope, sufficiently the differences between them and the transaction in *Griffiths* v. *Harrison*[1]. The views of the majority in that case may I think be summarised in this way. The facts showed all the characteristics of a trade or deal in the shares: they were bought, a dividend was received, they were sold. (The opinions did not notice as relevant H the fact that they were not actually sold in the relevant year.) A dealer in shares may buy shares and look to a profit in many ways other than by capital appreciation. The character of that which was done was not affected by the fact that the profit hoped for was to be obtained by the eccentric operation of our fiscal system, under which the dividend to be received was excluded from the receipt

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([1]) 40 T.C. 281.

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side of the trading account. What element of trade did the transaction lack? What was it if not trading? So the fact that in that case the essence of the transaction was a purchase of shares, followed by realisation of and substantial destruction of their value through the machinery of distribution of profits—what has been called evisceration—did not deprive it of its character of a dealing or trading transaction.

It is argued for the Crown that the differences are such as deny to the transactions in the present case the character of trading or dealing transactions, and show that the shares were more akin to investments acquired than to stock-in-trade. In *Griffiths* v. *Harrison*[1] there was no answer available to the question "If not trading, what is it?" Here the answer is that it is investment, or more akin to investment than to trade. Retention or holding of the shares for a longer or shorter period was an *essential* part of the transaction. The transactions were not characteristic of dealings in shares as stock-in-trade. A trader ordinarily knows the cost of his purchase from the outset. The transactions were more akin to investment in the purchase of a coal mine or gravel pit with a limited extraction potential. The fact that in the Mantern type of case the asset would be exhausted in a short time did not make the shares part of circulating capital or stock-in-trade. In that connection, reference was made to *John Smith & Son* v. *Moore* 12 T.C. 266. In that case the taxpayer, under an option given by his father's will, acquired a coal merchant's business; no figure was paid for goodwill; £30,000 was paid for existing profitable supply contracts expiring in December 1915, the father having died in March 1915: it was held that this sum was not a trading expenditure for purposes of excess profits tax: it was fixed, not circulating, capital of the coal merchant's business.

For the taxpayer it was pointed out that it was more usual for a person who was admittedly a dealer in shares to experience great difficulty in establishing that shares disposed of by him were *not* acquired in the course of his trade. It is quite common for a dealer in shares to hold them for a period. It is quite a common feature of trading transactions for the price to depend upon future events such as the profitability of the asset: indeed, such a feature is more to be expected in a trading transaction than in an investment. A process involving evisceration over a relatively short period does not look very like investment. In these transactions, as in *Griffiths* v. *Harrison*, the method of turning the asset acquired into money was evisceration by dividend. The fact that retention for a period was an essential part of the transaction was not inconsistent with the character of a trading transaction, and did not make it more akin to investment than to trading. The case of *John Smith & Son* v. *Moore* gave no guidance, for the trade in question was that of a dealer in coal, not a dealer in contracts for the supply of coal. In summary, these shares were acquired by the Company because they had qualities attractive to a dealer in shares—that in a short time their value would be realised and the cash outlay returned by a particular process: the purpose of the acquisition from the outset was realisation of the value, and the true character of the transaction was a purchase for realisation of the value, which is trading; the fact that profit was hoped for only by a fiscal sidewind was irrelevant.

I have found these arguments nicely balanced, and I have not found it easy to decide on which side to come down. I have, however, finally concluded that these are properly to be regarded as trading transactions. The fact that

(1) 40 T.C. 281.

A they have many features not commonly found in transactions by a trader in stocks and shares cannot be conclusive: it was so in *Griffiths* v. *Harrison*(1), and here, as there, the uncommon features were imposed by the particular way in which the company proposed to make a profit by realisation of the value of an asset acquired. I apprehend that a dealer in stocks and shares who acquired a holding in shares the value of which would be returned to him by the company
B over a period of a few years, and which would show a profit on the acquisition price, would be unable to deny that he had made a trading profit; and I find this comparison more helpful than that of a gravel pit or coalmine purchased in order to work it and sell the product at a profit.

Accordingly, I conclude that the appeal should be dismissed.

Allen Q.C.—Your Lordships will dismiss the appeal with costs?

C **Lord Denning M.R.**—That must follow, I think, Mr. Borneman.

Borneman Q.C.—Indeed; I cannot resist that. Might I make an application to your Lordships which perhaps your Lordships may have anticipated? I would ask that the Crown may have leave to appeal to the House of Lords if, after consideration of your Lordships' judgments, they may be so advised.

Russell L.J.—I expected it, though I did not anticipate it.

D **Borneman Q.C.**—Now your Lordship has both.

(The Court conferred.)

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

Borneman Q.C.—If your Lordship pleases.

E The Crown having appealed against the above decision, the case came before the House of Lords (Lords Reid, Morris of Borth-y-Gest, Pearce, Upjohn and Pearson) on 28th, 29th and 30th June and 4th July 1966, when judgment was reserved. On 26th July 1966 judgment was given unanimously in favour of the Crown, with costs.

The Solicitor-General (*Sir Dingle Foot Q.C.*), *Roy Borneman Q.C.*, *J. Raymond Phillips* and *J. P. Warner* for the Crown.

F *F. Heyworth Talbot Q.C.*, *H. Major Allen Q.C.* and *Peter Rees* for the Company.

The following cases were cited in argument in addition to those referred to in the speech:—*Commissioners of Inland Revenue* v. *Hyndland Investment Co. Ltd.* (1929) 14 T.C. 694; *Petrotim Securities Ltd.* v. *Ayres* 41 T.C. 389; [1964] 1 W.L.R. 190; *Ridge Securities Ltd.* v. *Commissioners of Inland Revenue* [1964]
G 1 W.L.R. 479; *Commissioners of Inland Revenue* v. *Livingston* (1926) 11 T.C. 538; *Edwards* v. *Bairstow* 36 T.C. 207; [1956] A.C. 14; *John Smith & Son* v. *Moore* 12 T.C. 266; [1921] 2 A.C. 13; *Jeffrey* v. *Rolls-Royce Ltd.* 40 T.C. 443; [1962] 1 W.L.R. 425; *Johns* v. *Wirsal Securities Ltd.* 43 T.C. 629; [1966] 1 W.L.R. 462; *Ammonia Soda Co. Ltd.* v. *Chamberlain* [1918] 1 Ch. 266; *Gloucester Railway Carriage & Wagon Co. Ltd.* v. *Commissioners of Inland Revenue* 12 T.C. 720;

(1)40 T.C. 281.

[1925] A.C. 469; *Regent Oil Co. Ltd.* v. *Strick* 43 T.C. 1; [1965] 3 W.L.R. 636; *Smith Barry* v. *Cordy* (1946) 28 T.C. 250.

Lord Reid—My Lords, for the reasons given by my noble and learned friend Lord Morris of Borth-y-Gest, I would allow this appeal.

Lord Morris of Borth-y-Gest—My Lords, the question which arises in this case concerns the nature of a number of transactions entered into by Finsbury Securities Ltd., whom I will refer to as "the Company". The Company claimed an adjustment of its liability to tax for the year 1959–60. The claim was made under s. 341 of the Income Tax Act 1952. The Company asserted that it had sustained a loss in its "trade" and was entitled to have an adjustment of its tax liability by reference to such loss. In the Act (see s. 526) the word "trade" is interpreted to include "every trade, manufacture, adventure or concern in the nature of trade". The claim was considered by the Commissioners for the Special Purposes of the Income Tax Acts, who stated a Case for the opinion of the High Court.

The Company was incorporated in May 1956 to carry on the trade of dealing in shares and securities. After its incorporation it carried on that trade. Its profits from that trade have been assessable under Case I of Schedule D. The director in control of its activities was a Mr. Lavy. He had been responsible for the formation of the Company. There was only one other director, a Mr. Lever. The Company's shares were held by these two either beneficially or as trustees of their respective family settlements.

The Case Stated records with stark clarity the events which led to the transactions whose nature is under consideration. Mr. Lavy had some acquaintances who were well known to him socially. They were shareholders in certain companies. They were anxious to avoid tax on the companies' profits. So they approached Mr. Lavy. They wanted to know whether there was some method whereby they could achieve their aim. Mr. Lavy was at first lukewarm to these approaches, but he came to the conclusion that forward-stripping transactions might achieve this object and provide a profit for the Company.

So it came about that during the years 1958, 1959 and 1960 the Company entered into 15 sets of transactions. In the Case Stated one set or batch of transactions (relating to a company called I. Warshaw & Sons Ltd.) was said to be an example of eleven other similar sets of transactions: copies of the relevant documents forming the set of transactions were annexed to the Case. All further relevant facts are fully stated in the Case. The transactions relating to twelve different companies were, therefore, in all important respects similar. One other set of transactions (which related to a company called Mantern Properties Ltd.) was said to be an example of two other similar sets of transactions: copies of the relevant documents forming this set of transactions are annexed to the Case and the facts are set out. Such differences as there are between the arrangements in the one group of transactions and the arrangements in the other group do not denote any difference between the essential nature of the transactions in the one group as compared to the other.

The question to be decided is whether the transactions should be regarded as trading transactions of a kind undertaken by a dealer in shares and securities. This, in my view, is a question of law. The facts are found. Indeed, they were

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A not at any time in dispute. The documents and agreements which are annexed to the Case Stated are typical of those not actually annexed. On the Case Stated it is for the Court to consider the documents and the agreements and the established facts and then to decide as to their legal nature and effect.

I do not propose to repeat or to refer fully to the contents of the Case Stated, but, in order to express my view, it is necessary to describe briefly the B tax-avoiding scheme which was evolved in response to the request of those who sought such avoidance. The arrangements concerning the company I. Warshaw & Sons Ltd. may be taken as illustrative. That company (Warshaw) was incorporated on 1st April 1957 to acquire and take over as a going concern a business of brassfounders and ironmongers. It had a capital of £10,000 in £1 ordinary shares, of which 5,000 were issued by 29th December 1958. These C shares were owned as to one half by Mr. Gerald Warshaw and as to the other half by Mr. Edward Simon Warshaw. On 29th December 1958 Warshaw passed two special resolutions and an ordinary resolution. The effect of these may be summarised as follows. The capital of the company was increased to £10,100 by the creation of 100 6 per cent. preferred shares. A sum of £100 standing to the credit of Warshaw's profit and loss account was capitalised and set free for D distribution among the holders of the 5,000 issued and fully paid ordinary shares and was to be applied in paying up in full the 100 unissued 6 per cent. preferred shares. The result was that each Mr. Warshaw became the owner of 50 preferred shares of £1 each. The preferred shares had the normal rights attached to fixed interest preference shares, but in addition they had certain special rights to dividends. Shortly stated, these special rights entitled holders E of the shares to have dividends paid to them for the next five years which absorbed the whole of the profits available for distribution (after payment of the fixed preference dividend). There was a proviso, however, that the total amount of the dividends in respect of the five years should not exceed £60,000 after deduction of income tax. In each of the five years, therefore, the preferred shares had a special right to be paid a dividend (net after deduction of income F tax) equal to the amount of the profits (as defined) of Warshaw for the year (less the preference dividend). No dividend was to be paid which would interfere with this special right.

On the same date as the resolutions to which I have referred the two Mr. Warshaws agreed to sell the newly created shares which they had newly acquired. They agreed to sell the shares to the Company. The price was to be £60,100. G That sum was to be paid as to £20,100 at once (i.e., on 29th December 1958), and as to the balance of £40,000 not later than 31st December 1960. There was, however, a provision that the purchase price could be adjusted. It might become more or it might become less. If the total of the five years' net dividends did not amount to £60,000 then the purchase price of the shares was to be reduced to the figure of that total. The price was, however, in certain circumstances to be H increased. If the Company made a loss, and if it was able as a result to claim a repayment in respect of the tax deducted from the dividend on the preferred shares (other than the cumulative dividends), then the Company was to pay to the vendors (i.e., the two Mr. Warshaws) one-half of what the Company so recovered.

It becomes clear how it was hoped that this tax-avoiding scheme would I work. The £100 preferred shares in Warshaw were to be sold for £60,100. During the period of five years after purchase the purchasers (the Company)

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were to receive as net dividends the whole of Warshaw's profits after deduction of tax subject to a maximum figure of £60,000 net. It is apparent that year by year the value of the preferred shares would diminish by reason of the distribution of the available profits. At the end of the period of five years the residual value of the Warshaw preferred shares would merely be the value of the 100 shares carrying a preferential dividend of 6 per cent. If the shares as held by the Company could be regarded as the stock-in-trade of a share-dealing company, then it would be claimed that the annual and progressive decline in value had resulted year by year in a trading loss. During the five years the Company would have received net (or taxed) dividends. If the receipts of these taxed dividends could be excluded from the computation of the Company's trading loss for the purposes of s. 341 then there could be a claim for repayment of tax on the amount of the loss. It was half of any such repayment as was attributable to the tax deducted from the dividends received from Warshaw (other than the cumulative preference dividends) that, under the scheme, would have to be added to the purchase price of the shares and be paid to the two Mr. Warshaws.

It is interesting to note how the two Mr. Warshaws would be placed and also how the Company would be placed if the scheme could work. In the five-year period the two Mr. Warshaws would receive or be entitled to receive in one way or another and at one time or another all the net profits of the Warshaw company. If the scheme worked they would additionally receive one-half of the tax deducted from the dividends. So far as the Company was concerned, apart from paying £100 for the preferred shares they would have to pay the vendors of the shares no more than the net amount that they received from Warshaw. If they recovered tax attributable to the tax deducted from the gross dividends received from Warshaw they would have to pay half of it to the vendors but could retain the other half. Apart from the division of the amount of any tax that the Revenue might have to repay or to lose, and apart from any expenses involved in the making and the operating of these singular arrangements, it seems clear that the vendors (the two Mr. Warshaws) did not stand to lose and that the Company did not stand to gain.

It will have been seen that in the case of the Warshaw shares, for which the price was £60,100, an amount of £20,100 had to be paid on the making of the agreement (29th December 1958), and the balance of £40,000 had to be paid long before the end of the five-year period: the balance had to be paid not later than 31st December 1960. Certain special arrangements had to be made with a bank both in regard to this transaction and in regard to other comparable transactions. The Company had to borrow money from a bank to make the initial payments. But the bank only agreed to lend the money on condition that by arrangement with the vendors of the shares the payments when made to the vendors should be held by the bank by way of charge pending the reduction of the overdraft of the Company. As regards the various further payments under the various sale agreements, the bank was not willing to lend money to the Company to enable it to make the payments. What was done, therefore, was that in each case the vendors agreed orally with the Company that the further payments should be made as and when the Company received dividends from the various companies whose shares were being sold by vendors.

I do not find it necessary to refer more elaborately to the scheme of the arrangements. In the Mantern case the result would be that the division of the spoil, or in other words the tax to be recovered if ingenuity triumphed, would

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A not be on a fifty-fifty basis but would be in other proportions.

My Lords, the various arrangements are not to be regarded as sham transactions. They were as real as they were elaborate. But I cannot think that there is room for doubt that they were no more than devices which were planned and contrived to effect the avowed purpose of tax avoidance. The Company used their organisation and their resource so that shareholders in Warshaw B and in other companies involved should not wholly be deprived of money that had to be paid in tax. The scheme was one whereby the Revenue would be denied certain sums of money. Such sums could be made to find their way to the pockets of the shareholders in the various companies less such proportion as was the payment for the skilful services rendered. That was the reality of the matter. My Lords, the question that arises is whether the arrangements under considera- C tion are to be regarded as within the trade of share dealing. I should be sorry if any processes of reasoning, or any authority, required me to denigrate share dealing by associating these arrangements with those which are ordinarily to be classed or normally to be found within such description.

When the matter was before the Commissioners the Crown resisted the claim of the Company on two grounds. It is only the first of these that is now D in issue. The Crown contended that the shares were acquired to hold and with a view to the receipt of dividends, with the result that the shares were capital or fixed assets and were not stock-in-trade or trading assets or circulating capital. The finding of the Commissioners was expressed in the words:

> "We find that the shares were acquired with the object of making a profit out of them, a profit by the recovery of income tax."

E On that finding they considered that the case was not distinguishable from *Griffiths* v. *J. P. Harrison (Watford) Ltd.*[1] [1963] A.C.1. They therefore held against the Crown on the first ground. Before returning to this issue it is necessary to recite that the claim was, secondly, resisted by the Crown on the ground that on a proper computation the Company did not show a loss, since taxed dividends received by a person carrying on the trade of dealing in shares ought F to be included. The Commissioners rejected that contention. However, before they had issued their final determination of the claim they were invited to reconsider their decision on the second ground in view of the judgment of the Court of Appeal in *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue*[2] [1963] 1 W.L.R. 1223. Following that judgment they decided that the Company had not suffered a loss in the year 1959–60 and that its claim to an adjustment of G its liability to tax should fail. The Company required them to state a Case. That they did on 11th June 1964.

The judgment of the Court of Appeal in *F.S. Securities Ltd.* v. *Commissioners of Inland Revenue* was subsequently reversed in this House[3]. When, therefore, the matter came before Buckley J. the decision of the Commissioners adverse to the Company could only be supported if the view of the Commis- H sioners on the first ground was overruled. Buckley J. held that it was not possible for him to say that the Commissioners could not reasonably reach their conclusion on the first ground. Consequently he allowed the appeal. On appeal to the Court of Appeal the majority (Davies and Russell L.JJ.), though for differing reasons, upheld the decision of Buckley J. Lord Denning M.R. dissented. He held that the Company had acquired the shares as an income-

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(1) 40 T.C. 281. (2) 41 T.C. 666. (3) [1965] A.C. 631.

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producing asset at a price dependent on the income produced by that asset, and that they had acquired the shares as fixed capital and not circulating capital. A

Before proceeding to consider further the main question which now arises it is necessary to mention two matters. The first relates to the preferred shares in Warshaw. Though the transaction in relation to those shares was said to be illustrative of other transactions concerning the shares in other companies, it so happened that the Warshaw transaction was never completed. The preferred B shares acquired by the Company were in fact sold by the Company. So the scheme which brought the shares into existence was never carried through. What happened was that the two Mr. Warshaws found that it would suit them if an amalgamation took place between Warshaw and some other company. So the two Mr. Warshaws asked that the arrangement with the Company should be terminated. They found that the Company was willing to oblige C them. The Company neither sought nor received any recompense or consideration for being so willing. The special rights of the preferred shares were cancelled (in November 1961) and the Company (being then practically financially all square so far as the transaction had then gone) agreed to sell the preferred shares either to some other company or to the original holders for £100. Though this development seems somewhat strange, I share the view expressed by Russell D L.J. that, when carefully considered, it does not provide any material that assists in the determination of the main issue that arises.

The second matter relates to a sentence which is contained in para. 6 of the Case Stated. Having recited that during the years 1958, 1959 and 1960 the Company entered into 15 broadly comparable transactions, it was set out that :

> "All of the transactions were designed to produce some profit for the E Company apart from any tax repayment that might become due."

This was not, I think, a finding of fact : but as a description of the transactions it does not seem to be warranted. The transactions are recorded in the various agreements, and it would seem to be clear that the purchase price of the acquired shares was to be no less than the net dividend receivable. I need not refer further to this matter because it was stated by learned Counsel for the Company that F no reliance at all was placed upon any suggestion that profit for the Company was to be found other than by reference to any repayment of tax.

I turn, therefore, to the question whether the various transactions can be held to be within the trade of dealing in shares. I have earlier quoted the words of the Commissioners in recording their finding that the Company acquired the shares with the object of making a profit out of them by the recovery of G income tax. The Commissioners proceeded to consider whether what they called the "forward-stripping" transactions, which were a feature of the arrangements now under review, were so different in their nature from the arrangements in *J. P. Harrison (Watford) Ltd.* v. *Griffiths*[1] that that case did not apply. They decided that they could not distinguish that case from the present one. H

My Lords, I take a different view. In my opinion, the arrangements now under review are essentially different from those which gave rise to the *Harrison* case. In that case there was a purchase of the shares in a company called Bendit Ltd. (afterwards called Claiborne Ltd.). The vendors of the shares had no interest in the shares thereafter. They had no prospect of receiving any benefit

(1) 40 T.C. 281.

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A from any tax recovery. After the Harrison company owned the shares in Claiborne Ltd. there was a declaration of dividend on the shares. After that the shares were sold. It was my view in that case that the transaction was demonstrably a share-dealing transaction. Shares were bought; a dividend on them was received; later the shares were sold. There may be occasions when it is helpful to consider the object of a transaction when deciding as to its nature. B In the *Harrison* case([1]) my view was that there could be no room for doubt as to the real and genuine nature of the transaction. The fact that the reason why it was entered into was that the provisions of the revenue law gave good ground for thinking that welcome fiscal benefit could follow did not in any way change the character of the transaction. It was not capable of being made better or worse or being altered or made different by the circumstance that the motive C that inspired it was plain for all to see. In that case the vendors of the shares had no further concern once they had sold. The essence of the arrangements now being reviewed was that the future interests of the vendors were being safeguarded. Under the devised scheme they were to have all the benefits that would have resulted from their shareholdings had there been no scheme. In addition, they were to be saved from the full extent of the exactions which taxation D imposes. Here also the scheme involved a factor which was entirely absent in the *Harrison* case. In that case the purchasers could have done what they wished with the shares. Here, on the other hand, it seems to me that it was of the essence of the scheme that the Company should continue to hold the shares during the periods covered by the particular sets of transactions. It is clear and not seriously disputed that the Company could not have sold the preferred shares during the E currency of the agreement without committing a basic breach of it. The Company had to retain the shares so that year by year there would be diminutions in the value of the shares and so that year by year there could be the receipts of dividends from profits to be earned in the future, so that year by year the planned tax recovery could proceed for the mutual benefit of the Company and the vendors.

F A consideration of the transactions now under review leads me to the opinion that they were in no way characteristic of nor did they possess the ordinary features of the trade of share dealing. The various shares which were acquired ought not to be regarded as having become part of the stock-in-trade of the Company. They were not acquired for the purpose of dealing with them. In no ordinary sense were they current assets. For the purposes of carrying G out the scheme which was devised the shares were to be and had to be retained. The arguments before your Lordships depended mainly upon the submission by the Crown that the shares were acquired for a period of five years as part of the capital structure of the Company, from which an income would be earned, and, on the other hand, upon the submission of the Company that they were acquired as part of their stock-in-trade.

H In my opinion neither argument is correct. For the reasons I have already given this transaction on its particular facts was not, within the definition of s. 526, "an adventure or concern in the nature of trade" at all. It was a wholly artificial device remote from trade to secure a tax advantage.

The question of law raised by the Case Stated was expressed as being whether the Commissioners were wrong in law in holding that the shares were I part of the stock-in-trade of the Company. For the reasons which I have

([1]) 40 T.C. 281.

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expressed I consider that the Commissioners were wrong in so holding. I would allow the appeal. A

Lord Pearce—My Lords, I concur.

Lord Upjohn—My Lords, I concur.

Lord Pearson—My Lords, I concur.

Questions put: B

That the Order complained of be reversed, and that the fourth question of law in the Case Stated be answered by declaring that the Special Commissioners were wrong in law in holding that the shares referred to in paras. 7, 8 and 10 of the Case Stated were part of the Company's stock-in-trade.

The Contents have it. C

That the Respondents do pay to the Appellant his costs here and below.

The Contents have it.

[Solicitors:—Slaughter & May; Solicitor of Inland Revenue.]