HIGH COURT OF JUSTICE (CHANCERY DIVISION)—
11TH AND 12TH MARCH AND 8TH AND 15TH MAY 1964

COURT OF APPEAL—10TH, 11TH AND 12TH MAY AND 2ND JUNE 1965

HOUSE OF LORDS—11TH, 12TH, 13TH AND 17TH OCTOBER AND
8TH DECEMBER 1966

Commissioners of Inland Revenue *v.* G. B. Bates[1]
Commissioners of Inland Revenue *v.* E. Bates

A *Surtax—Settlement—Capital sums paid to settlor—Whether paid by "body corporate connected with the settlement"—Meaning of "relevant year of assessment"—Income Tax Act* 1952 (15 & 16 *Geo.* 6 & 1 *Eliz.* 2, *c.* 10), *ss.* 408 *and* 411(4).

The Respondent in the first case was a director of a company to which at all material times s. 245, *Income Tax Act* 1952, *applied, but in respect of which no* B *direction was given under that section. In* 1948 *and* 1950 *he had settled shares in the company on trusts for the benefit of his children. No income arose from the shares before* 1953–54. *The income for the years* 1953–54, 1954–55 *and* 1955–56 *was* £3,610, £3,158 *and* £3,201 *respectively, all of which was accumulated. In April of each of the years* 1950 *to* 1954 *the company paid sums in the region of* £8,000 *to* £10,000 *to the Respondent or, when his current account at his bank was* C *overdrawn, to his bank for his credit; in particular, it paid him* £9,100 *on* 5*th April* 1954. *These sums were debited to the Respondent's current account with the company, which in consequence until June* 1954 *was overdrawn each year, for most of the company's accounting year to* 31*st March, to the approximate extent of the sum debited in the preceding April, but was brought into credit each year by a cheque from the Respondent shortly before* 31*st March.*

D *The Respondent was assessed to surtax for the years* 1953–54 *to* 1955–56 *on the footing that the sums paid to him as aforesaid by the company in* 1953–54 *were capital sums paid by a body corporate connected with the settlements and under s.* 408, *Income Tax Act* 1952, *the grossed-up equivalent fell to be treated as his income to the extent of the undistributed income of the settlements. On appeal, it was contended for the Respondent* (a) *that, since a direction under* E *s.* 245 *had neither been given nor precluded by the distribution of the whole of its income, the company was not a body corporate connected with the settlements as defined in s.* 411(4), *Income Tax Act* 1952; (b) *that the sums paid by the company were not "capital sums" within the meaning of s.* 408, *Income Tax Act* 1952; (c) *that "relevant year" in s.* 408(2)(*a*) *was, but "relevant year of assessment" in s.* 408(1) *was not, to be construed by reference to s.* 408(7), *so that,* F *after deducting under s.* 408(2)(*a*) *the capital sum paid to the Respondent on* 4*th April* 1952, *there was within the meaning of s.* 408 *no "income available up to the end of"* 1953–54, 1954–55 *or* 1955–56. *The Special Commissioners accepted the Respondent's first contention.*

---

(1) Reported (C.A.) [1965] 1 W.L.R. 1133; 109 S.J. 517; [1965] 3 All E.R. 64; (H.L.) [1968] A.C. 483; [1967] 2 W.L.R. 60; 111 S.J. 56; [1967] 1 All E.R. 84.

In the other case the facts, the contentions and the findings of the Commissioners were similar to those in the first case. A

In the Court of Appeal and the House of Lords it was further contended for the Crown that the sum paid to the Respondent on 4th April 1952 *could not be taken into account because the company was not shown to have been a body corporate connected with the settlement in* 1951–52.

Held, *in the House of Lords,* (1) *that, since but for the distribution made out of the company's income for* 1953–54 *some of that income could have been apportioned to the trustees of the settlements, the company was a body corporate connected with the settlements for that year;* (2) *that the payment of* £9,100 *was a "capital sum" within s.* 408; (3) *that the company was not shown to have been a body corporate connected with the settlement in* 1951–52. B

Held, *in the Court of Appeal, and by Lords Reid and Morris in the House of Lords, that "relevant year of assessment" in s.* 408(1) *was to be construed by reference to s.* 408(7). C

CASES

(1) *Commissioners of Inland Revenue* v. *G. B. Bates*

CASE

Stated under the Income Tax Act 1952, ss. 229(4) and 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice. D

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 23rd January 1962 and thence adjourned to 24th January 1962 Geoffrey Booth Bates (hereinafter called "the Respondent") appealed against the undermentioned assessments to surtax. E

Year of assessment	*Amount of assessment*
	£
1953–54 (additional)	3,607
1954–55 (additional)	3,165
1955–56 (additional)	2,709

The assessments purported to be laid under the provisions of Part XVIII, Income Tax Act 1952, and in particular s. 408 thereof. The grounds of the appeal were that, in computing for surtax purposes the total income from all sources of the Respondent for the periods relevant to the assessments under appeal, certain sums paid to or into the account of the Respondent with the National Provincial Bank Ltd., Bradford (hereinafter referred to as "the bank"), by Thomas Ambler & Sons Ltd. (hereinafter referred to as "the company"), as hereinafter appeareth, have been included contrary to the provisions of the Income Tax Acts. F G

2. Evidence was given at the hearing of the appeal by the Respondent and Ernest Bates, his brother (hereinafter referred to as "Mr. Ernest Bates"), and the following documents were produced and admitted or proved:

(i) memorandum and articles of association of the company; H

(ii) deed of settlement made 7th August 1948 between the Respondent and William Herbert Mosley Isle, Mary Bates and the Respondent (hereinafter referred to as "the principal deed"); and a further deed of settlement made 4th October 1948 between the same parties (hereinafter referred to as "the further deed") endorsed thereon;

(iii) deed of settlement made 10th November 1950 between the same parties (hereinafter referred to as "the supplemental deed");

(iv) accounts of the company for the period 12th April 1948 to 31st March 1956;

(v) copy of the ledger account of the Respondent in the books of the company;

(vi) cheque dated 6th April 1950 drawn by the company in favour of the bank for £17,190 6*s*. 7*d*.;

(vii) cheque dated 28th April 1951 drawn by the company in favour of the bank for £15,600;

(viii) cheque dated 4th April 1952 drawn by the company on the bank in favour of the Respondent for £10,158 6*s*. 11*d*.;

(ix) cheque dated 8th April 1953 drawn by the company on the bank in favour of the bank for the credit of the account of the Respondent for £10,100;

(x) cheque dated 5th April 1954 drawn by the company on the bank in favour of the Respondent for £9,100;

(xi) letter dated 16th January 1962 from the manager of the bank to Messrs. Claridge Turner & Co. (hereinafter referred to as "the auditors");

(xii) a schedule giving particulars of settlements made by the Respondent and Mr. Ernest Bates;

(xiii) letter dated 14th September 1959 from the Special Commissioners of Income Tax to the auditors;

(xiv) a schedule showing alternative calculations of income available to the Respondent.

Apart from the copy of the ledger account of the Respondent in the books of the company (no. (v) above[1]), the above documents are not attached to and do not form part of this Case, except to the extent that they are hereinafter incorporated.

3. We found the following facts admitted or proved on the evidence adduced at the hearing of the appeal.

(1) At all times material to this appeal the Respondent was a director of the company, which was incorporated on 2nd April 1948, having as its objects, *inter alia,*

"(*a*) To acquire and take over as a going concern the business of Worsted Spinners now carried on at East Ardsley, near Wakefield in the County of York, under the style or firm of Thomas Ambler & Sons, and all or any of the assets and liabilities of the proprietors of that business in connection therewith."

Under clause 5 of the memorandum of association of the company the share capital was £300,000, divided into 600,000 ordinary shares of 5*s*. each and 150,000 preference shares of £1 each.

(2) On 7th August 1948 the Respondent executed the principal deed in favour of his children, which recited, *inter alia,* as follows:

"Whereas:

(1) The said Geoffrey Booth Bates (hereinafter called "the Settlor") is desirous of making such provision as hereinafter appears for the benefit of his three daughters Hazel Bates Joan Margaret Bates and Elaine Mary Bates now aged 15 years 12 years and 10 years respectively

(2) With a view to the Settlement intended to be hereby created the Settlor on the 11th day of June 1948 caused to be allotted to and registered in the joint names of the Trustees 60,000 Ordinary Shares of 5/– each fully

---

[1] Not included in the present print.

paid Numbered 392,001 to 452,000 inclusive of and in the Capital of Thomas Ambler & Sons Limited of Ardsley Mills East Ardsley near Wakefield in the said County of York Worsted Spinners and Manufacturers (for the purchase of which said Shares the Settlor had on that day paid to the said Company in cash the sum of £15,000) to the intent that the same shall be held upon the Trusts and with and Subject to the powers and provisions hereinafter declared and contained

(3) The Settlor intends that this Settlement shall be absolutely irrevocable in all circumstances"

and provided, *inter alia,* as follows:

"Witnesseth as follows:

1. The Trustees shall and will stand possessed of the said investment so registered in their joint names as aforesaid Upon Trust that they may either allow the said investment to remain so long as the Trustees shall think fit or may at the discretion of the Trustees sell the same or any part thereof and shall at the like discretion invest all monies produced thereby in or upon any investments hereby authorised with power at such discretion as aforesaid to vary or transpose any investments for or into others of any nature hereby authorised

2. The Trustees shall hold the said investment registered in their joint names as aforesaid and the investments for the time being representing the same (hereinafter called 'the Trust Fund') and the income thereof from the said 11th day of June 1948 Upon The Following Trusts namely:

(*a*) As to one equal third part or share of the Trust Fund to accumulate the income therefrom by way of compound interest by investing the same and the resulting income thereof in any of the investments hereby authorised as an accretion to and augmentation of the same and to pay the said one equal third part or share with the accretions thereto as aforesaid unto the said Hazel Bates if and when she shall attain the age of 26 years

(*b*) As to another one equal third part or share of the Trust Fund to accumulate the income therefrom by way of compound interest by investing the same and the resulting income thereof as aforesaid as an accretion to and augmentation of the same and to pay the same one equal third part or share with the accretions thereto as aforesaid unto the said Joan Margaret Bates if and when she shall attain the age of 26 years

(*c*) As to the remaining one equal third part or share of the Trust Fund to accumulate the income therefrom by way of compound interest by investing the same and the resulting income thereof as aforesaid as an accretion to and augmentation of the same and to pay the same one equal third part or share with the accretions thereto as aforesaid unto the said Elaine Mary Bates if and when she shall attain the age of 26 years

3. If any of the Trusts hereinbefore declared shall fail then subject to the trusts and provisions hereinbefore contained the Trustees shall stand possessed of the share of the Trust Fund as to which such failure occurs together with the accretions thereto as aforesaid Upon Trust to add the same to the share or shares of the Trust Fund as to which such failure shall not have occurred and if more than one equally and so that such addition or additions shall be held upon the same Trusts in all respects as the share or shares in the Trust Fund to which they shall be added and as one fund in each case Provided However that if any of them the said Hazel Bates Joan Margaret Bates and Elaine Mary Bates shall die under the age of 26 years leaving child or children then her share of the Trust Fund both original and accrued with all accretions thereto as aforesaid shall be held

In Trust for all or any her children or child who being male shall attain the age of 21 years or being female shall attain that age or marry under that age and if more than one in equal shares

4. If all the Trusts hereinbefore declared shall fail the Trustees shall stand possessed of the Trust Fund and the accretions thereto as aforesaid In Trust for the Settlor absolutely".

(3) On 4th October 1948 the Respondent executed the further deed in favour of his three children, which recited, *inter alia*, as follows:

"Whereas:

(1) The Settlor is desirous of making further provision for the benefit of his three daughters named in the Settlement

(2) Accordingly on the 7th day of October 1948 the Settlor caused to be allotted to and registered in the joint names of the Trustees 16,000 further Ordinary Shares of 5/– each fully paid Numbered 492,001 to 508,000 inclusive of and in the Capital of Thomas Ambler & Sons Limited (for the purchase of which said Shares the Settlor on that day paid to the said Company in cash the sum of £4,000) to the intent that the same should be held Upon the Trusts and with and subject to the powers and provisions of the Settlement"

and provided, *inter alia,* as follows:

"that the Trustees shall and will stand possessed of the said investment of 16,000 Ordinary Shares of 5/– each in Thomas Ambler & Sons Limited Upon The Trusts declared by and Subject in all respects to the declarations and provisions contained in and with the benefit of the powers conferred by the Settlement as if the said investment of 16,000 Shares had been originally included in and formed part of the investment included in the Settlement and so as to form one Fund therewith".

(4) On 10th November 1950 the Respondent executed the supplemental deed in favour of his three children, which recited, *inter alia*, as follows:

"Whereas:

(1) In addition to the provisions made by the Settlor in the above-mentioned Settlements the Settlor is desirous of making further provision for the benefit of his three daughters named or referred to in the said Settlements

(2) Accordingly on or about the 9th day of November 1950 the Settlor caused to be paid to the Trustees a sum of £3,125 0. 0. for the purpose of the purchase by them from John Hobson Bates of 10,000 fully paid Ordinary Shares of 5/– each numbered 1 to 10,000 inclusive of and in the Capital of Thomas Ambler & Sons Limited to the intent that the said investment should be held by the Trustees upon the trusts and with and subject to the powers and provisions hereinafter mentioned or referred to

(3) On or about the said 9th day of November 1950 the Trustees purchased the above Shares from the said John Hobson Bates which were duly transferred on or about that date into their names ad valorem stamp duty having been duly paid on such transfer"

and provided, *inter alia,* as follows:

"that the Trustees shall and will stand possessed of the said further investment of 10,000 ordinary Shares of 5/– each in Thomas Ambler & Sons Limited Upon The Trusts declared by and Subject in all respects to the declarations and provisions contained in and with the benefit of the powers conferred by the Principal Settlement as if the said investment of the said

10,000 Shares had been originally included in and formed part of the investment included in the Principal Settlement and so as to form one Fund therewith". A

(5) The company paid no ordinary dividends for the period from the date of its incorporation to 31st March 1952. Thereafter the following dividends were paid: for the year to 31st March 1953, 10 per cent.; for the year to 31st March 1954, 10 per cent.; for the year to 31st March 1955, 14 per cent.; for the year to 31st March 1956, 14 per cent. The following additional dividends were paid with the agreement of the Special Commissioners: in respect of the year to 31st March 1953, 6·6 per cent.; in respect of the year to 31st March 1954, 4 per cent. These dividends were duly paid to the trustees of the aforementioned settlements made by the Respondent. B

(6) As from the incorporation of the company, the Respondent had a current account with the company, a copy of which is attached to and forms part of this Case (exhibit A)([1]). Until in or about June 1954 the Respondent's current account was overdrawn for most of the year. He was a person of substance, however, and could at any time have paid off his indebtedness to the company without embarrassment. The state of his account was principally due to large items debited at the commencement of each accounting period of the company to his current account, in respect of cheques paid to the Respondent or to the bank by the company, for the credit of the Respondent's current account with the bank, which was overdrawn on each such occasion. The actual balances of the Respondent's current account were: C D

		£	s.	d.
6.4.50	Dr.	8,289	2	4
27.4.51	Dr.	11,406	19	2
4.4.52	Dr.	10,315	16	5
8.4.53	Dr.	9,957	7	2
5.4.54	Dr.	9,032	5	8

E

Details of the cheques drawn by the company were as follows:

Date	*Payee*	*Amount* £	*s.*	*d.*	*Account credited by the bank*	£	*s.*	*d.*
6.4.50	The bank	17,190	6	7	G. B. Bates	8,286	4	8
					E. Bates	8,904	1	11
28.4.51	The bank	15,600	0	0	G. B. Bates	8,000	0	0
					E. Bates	7,600	0	0
4.4.52	Mr. G. B. Bates	10,158	6	11	G. B. Bates	10,158	6	11
8.4.53	The bank credit account G. B. Bates, Esq.	10,100	0	0	G. B. Bates	10,100	0	0
5.4.54	Mr. G. B. Bates	9,100	0	0	G. B. Bates	9,100	0	0

F G

During each accounting period the Respondent's current account with the company was credited, *inter alia,* with his salary and dividends received, and at the end of each accounting period of the company with a substantial cheque drawn by the Respondent on the bank, the effect of which was to place the Respondent's current account with the company in credit on the date to which the accounts of the company were made up each year, i.e., 31st March. H

(7) On or about 14th September 1959 the assessing Special Commissioners of Income Tax wrote to the auditors (so far as material to this Case) as I

([1]) Not included in the present print.

follows:

"I am directed by the Special Commissioners to refer to their letter of the 29th May 1959" [should be 1958] "and to say that the application of Section 408, Income Tax Act 1952, has now been considered in the light of the information furnished and the decision in the case of *Potts' Executors* v. *C.I.R.* 32 T.C. 211. The Commissioners' computation of the amounts to be assessed and carried forward is shown in the enclosed statement. In computing the total capital sum loaned the amounts selected from the ledger accounts are those paid to the Settlors at a time when their accounts were already in debit or were thereby put into debit, in the latter case to the extent of the resulting debit balance only.

Formal notices of assessment will be issued in due course as follows:

G. B. Bates

	£
1953–54 ..	3,607
1954–55 ..	3,165
1955–56 ..	2,709

	1953–54 £ *s.* *d.*		1954–55 £ *s.* *d.*		1955–56 £ *s.* *d.*
9.4.53	10,100 0 0	14.5.54	2 0 0	7.8.55	7 10 0
1.10.53 – 15.1.54	13 0 0	3.2.55	3 0 0	15.11.55	4 0 0
1.4.54 (Balance Dr.)	68 5 10				
3.4.54	9,100 0 0				
	19,281 5 10		5 0 0		11 10 0
Add I/Tax at 9*s.*	15,775 8 10	(9*s.*)	4 1 10	(8*s.* 6*d.*)	8 10 0
Total "capital sums" loaned	35,056 14 8		9 1 10		20 0 0
		B/fwd.	31,449 11 7		28,293 17 8
			31,458 13 5		28,313 17 8
Undistributed settlement income	3,607 3 1		3,164 15 9		2,708 18 5
Carried forward	31,449 11 7		28,293 17 8		25,604 19 3"

(8) The income received by the trustees of the Respondent's children's settlements was as follows:

Settlor: G. B. Bates

Date	*Trustees*	*Beneficiaries*	*Property*	1953–54	1954–55	1955–56
1948						
Aug. 7	W. H. M. Isle Mary Bates G. B. Bates	Hazel, Joan and Elaine Bates, children of the settlor, who each achieve vested interest on reaching 26 years of age	60,000 ordinary shares of 5*s.* each in Thomas Ambler & Sons Ltd.	£3,610	£3,158	£3,201
Oct. 4	do.	do.	16,000 do.			
1950						
Nov. 10	do.	do.	10,000 do.			

(9) At all times material to this appeal the company was a company to which the provisions of s. 245, Income Tax Act 1952, applied but no direction had been made by the Commissioners to the company under the provisions of the said s. 245.

4. It was contended on behalf of the Respondent: A

(i) that the company was not a body corporate connected with the aforementioned settlements made by the Respondent in favour of his children within the meaning of ss. 408 and 411(4), Income Tax Act 1952;

(ii) that the aforesaid sums paid to the Respondent or to the bank hereinbefore referred to were intended to be repaid and were not "capital sums" within the meaning of s. 408, Income Tax Act 1952; B

(iii) that the cheques paid by the company to the bank and credited to the Respondent's current account therewith were not sums paid directly or indirectly to the Respondent (the settlor) within the meaning of the said s. 408, Income Tax Act 1952;

(iv) that in any event there was no "income available", computed in manner provided by s. 408(2), "up to the end of" any of the years of assessment C to which the appeal related; and accordingly,

(v) that the appeal should be allowed and the assessments be discharged.

5. It was contended on behalf of the Commissioners of Inland Revenue:

(i) that the company was a body corporate connected with the aforementioned settlements made by the Respondent in favour of his children within the meaning of ss. 408 and 411(4), Income Tax Act 1952; D

(ii) that the aforesaid sums paid to the Respondent or to the bank hereinbefore referred to were "capital sums" within the meaning of s. 408, Income Tax Act 1952;

(iii) that the cheques paid by the company to the bank and credited to the Respondent's current account with the bank were sums paid directly or indirectly to the Respondent (the settlor) within the meaning of the said s. 408, E Income Tax Act 1952;

(iv) that the Respondent was assessable in the amounts of the assessments under appeal by virtue of the provisions of s. 408, Income Tax Act 1952, these being in the years under appeal "income available" within the meaning of the section;

(v) that the appeal should be dismissed and the assessments confirmed. F

6. We, the Commissioners who heard the appeal, gave our decision as follows:

(1) This is an appeal by Geoffrey B. Bates (hereinafter referred to as "the Appellant") against the undermentioned additional assessments to surtax:

1953–54	..	£3,607
1954–55	..	£3,165 G
1955–56	..	£2,709

The assessments purport to be laid under the provisions of Part XVIII of the Income Tax Act 1952, and in particular under s. 408 thereof, and relate to certain sums paid to or into the account of the Appellant with the National Provincial Bank Ltd. by Thomas Ambler & Sons Ltd. (hereinafter referred to as "the company"), and applied in reduction of the Appellant's overdraft with H that bank. The Appellant was the settlor of two settlements in favour of his children, and under the provisions of s. 408, Income Tax Act 1952, any sums paid to him as settlor in any relevant year of assessment by a company connected with the settlement in that year fall to be treated as his income to the extent specified in that section. The principal ground of the Appellant's objection to such assessments is that the company by whom the said payments were made I

A was not a body corporate connected with the settlement of which he was the settlor within the meaning of ss. 408(3) and 411(4), Income Tax Act 1952. Both parties to the appeal agreed that if the Appellant's main contention is correct the assessments must be discharged. We therefore deal with this contention first.

(2) The definition of a body corporate connected with the settlement for
B the purposes of s. 408, Income Tax Act 1952, is to be found in s. 411, Income Tax Act 1952, the relevant portion of the section being subs. (4)(*b*), which provides as follows:

> ". . . could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United
C Kingdom, if the body corporate had been incorporated in the United Kingdom."

The question for determination is, therefore, whether on a true construction of s. 411(4)(*b*) the company falls within its provisions.

(3) It was contended on behalf of the Appellant that the words "the income" in s. 411(4)(*b*) relate to the whole income of the company; that the
D company is a trading company; that the income of the company could not, therefore, have been apportioned under the provisions of Part IX of the Income Tax Act 1952 without the issue by the Special Commissioners of a direction under s. 245, Income Tax Act 1952; and that since no such direction has been made by the Special Commissioners of Income Tax, no part of the income of the company could have been apportioned; and that therefore the company
E does not fall within the definition contained in the said s. 411(4)(*b*). Or, to put it in another way, that the provisions of the said s. 411(4)(*b*), Income Tax Act 1952, could relate only to an investment company within the meaning of s. 262, Income Tax Act 1952, or to a company in respect of which a direction has been made by the Special Commissioners of Income Tax under s. 245, Income Tax Act 1952.

F (4) It was contended on behalf of the Crown that s. 411(4)(*b*) is an exact re-enactment of the provisions of s. 41(4)(*e*)(ii), Finance Act 1938, and that the Income Tax Act 1952 was a consolidating Act and not an amending Act so far as related to that section; that the construction of the said s. 411(4)(*b*) is dependent upon the provisions of the Income Tax Acts as they existed at the time the said s. 41(4)(*e*)(ii) was passed, without regard to subsequent fiscal legislation;
G that s. 262, Income Tax Act 1952, is a re-enactment of s. 14, Finance Act 1939 (which introduced the compulsory apportionment of the income of investment companies to which s. 245, Income Tax Act 1952, applies), and thus could not have been within the purview of s. 41, Finance Act 1938; and, therefore, in construing s. 411(4)(*b*) an investment company within the meaning of s. 262, Income Tax Act 1952, cannot be included; and that if the said s. 411(4)(*b*) is to
H have any meaning it must be taken to relate to all companies in respect of which a direction under s. 245, Income Tax Act 1952, might have been made; and that this included the company.

(5) In our opinion this reasoning is fallacious. Income tax and surtax is an annual tax, and in our view the taxpayer is obliged to compute his liability having regard to the Income Tax Acts as they stand as a whole in the year of assessment
I in question, and the provisions of previous Finance Acts must be taken to be extended or modified by subsequent enactments up to and including the year of assessment in order to achieve certainty of liability, without which there can be no liability. In our opinion we must construe s. 411(4)(*b*), Income Tax Act 1952, as it stands in relation to the income tax as a whole in the years of assess-

ment with which we are concerned. Assuming the correctness of this view, in our opinion the expression "the income" in s. 411(4)(*b*), read in conjunction with s. 411(4)(*a*), means the actual income of the company from all sources within the meaning of s. 245, Income Tax Act 1952. The company was a trading company subject to the provisions of s. 245, Income Tax Act 1952, and such income, to the extent that it was not already distributed to members, could only be apportionable under Part IX, Income Tax Act 1952, if a direction to that effect had been made by the Special Commissioners under section 245. No such direction either as to the whole or part of the income of the company has been made for any of the years in question. From this it follows, we think, that "the income" of the company could not have been apportioned so as to bring the company within the definition contained in s. 411(4)(*b*), Income Tax Act 1952.

(6) In our opinion, therefore, the main contention of the Appellant is correct, and the appeal succeeds in principle. We therefore find it unnecessary to deal with the Appellant's further contentions, and we adjourn the appeal for the agreement between parties of the amounts of the assessments on the basis of our decision in principle set forth above.

7. On 30th April 1962, the parties having agreed upon the amounts of the assessments on the basis of our decision in principle set forth above, we determined the appeal by discharging the said assessments.

8. Immediately after the determination of the appeal dissatisfaction therewith as being erroneous in point of law was expressed to us on behalf of the Commissioners of Inland Revenue, and in due course we were required to state a Case for the opinion of the High Court of Justice pursuant to the Income Tax Act 1952, ss. 229(4) and 64, which Case we have stated and do sign accordingly.

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

N. F. Rowe
H. G. Watson
} Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94–99 High Holborn,
London, W.C.1.
9th April 1963.

---

(2) *Commissioners of Inland Revenue* v. *E. Bates*

This Case related to the appeal of E. Bates against assessments to surtax for the years 1953–54, 1954–55 and 1955–56. The facts, the contentions of the parties and the Commissioners' decision were similar to those in the foregoing case.

The cases came before Plowman J. in the Chancery Division on 11th and 12th March and 8th May 1964, when judgment was reserved. On 15th May 1964 judgment was given against the Crown, with costs.

A *B. L. Bathurst Q.C., E. Blanshard Stamp* and *J. Raymond Phillips* for the Crown.

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

Plowman J.—The judgment I am about to deliver relates to the first case, *Commissioners of Inland Revenue* v. *G. B. Bates*. This is an appeal by the Crown from a decision of the Special Commissioners discharging certain
B assessments to surtax made on the Respondent in respect of the years 1953–54, 1954–55 and 1955–56. He had been assessed on the basis that certain sums paid to him or into his account with the National Provincial Bank, Bradford, by a company called Thomas Ambler & Sons Ltd. (to which I will refer as "the company") fell to be treated as part of his income for surtax purposes by virtue of s. 408 of the Income Tax Act 1952.

C The relevant facts are these. On 7th August 1948 the Respondent executed a settlement of 60,000 5*s*. ordinary shares in the company upon trust for the benefit of his three infant daughters. Briefly, one-third of the income was to be accumulated for each daughter until she attained the age of 26, when one-third of the capital and the accumulations of her share of income were to be paid to her. On 4th October 1948 the Respondent added a further 16,000 5*s*. ordinary
D shares of the company to the settlement, and on 10th November 1950 a further 10,000, making 86,000 in all. The company had been incorporated on 2nd April 1948, with a share capital of £300,000 divided into 600,000 ordinary shares of 5*s*. each and 150,000 preference shares of £1 each. At all material times the Respondent was a director.

It is common ground, first, that the company is one to which s. 245 of the
E Act applies, and, secondly, that it is not one to which s. 262 applies: that is to say, it is not an investment company. Its dividend history is set out in para. 3(5) of the Case Stated, as follows:

> "The company paid no ordinary dividends for the period from the date of its incorporation to 31st March 1952. Thereafter the following dividends were paid: For the year to 31st March 1953, 10 per cent.; for the
F year to 31st March 1954, 10 per cent.; for the year to 31st March 1955, 14 per cent.; for the year to 31st March 1956, 14 per cent. The following additional dividends were paid with the agreement of the Special Commissioners: In respect of the year to 31st March 1953, 6·6 per cent.; in respect of the year to 31st March 1954, 4 per cent. These dividends were duly paid to the trustees of the aforementioned settlements made by the
G Respondent."

The dividends paid to the trustees have been accumulated as directed by the settlement.

The ground on which the Revenue sought to assess the Respondent to surtax in respect of the sums paid by the company to him or into his bank account was that, by virtue of s. 408(3) of the Act, those sums are to be treated
H as having been paid to him by the trustees of the settlement and that as such they fall to be treated as his income by virtue of s. 408(1). For the moment it is unnecessary to detail the sums in question, and I now refer to so much of s. 408 as is relevant to this appeal:

> "(1) Any capital sum paid directly or indirectly in any relevant year of assessment by the trustees of a settlement to which this section applies
I to the settlor shall—(*a*) to the extent to which the amount of that sum falls within the amount of income available up to the end of that year, be

(Plowman J.)

treated for all the purposes of this Act as the income of the settlor for that year; (*b*) to the extent to which the amount of that sum exceeds the amount of income available up to the end of that year but falls within the amount of the income available up to the end of the next following year, be treated for the purposes aforesaid as the income of the settlor for the next following year, and so on. (2) For the purposes of subsection (1) of this section, the amount of income available up to the end of any year shall, in relation to any capital sum paid as aforesaid, be taken to be the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less—(*a*) the amount of any other capital sums paid to the settlor in any relevant year before that sum was paid". I need not read (*b*), (*c*) or (*d*). Then, "(*e*) an amount equal to tax at standard rate on—(i) the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less (ii) the aggregate amount of the income and sums referred to in paragraphs (*b*), (*c*) and (*d*) of this subsection. (3) For the purpose of this section, any capital sum paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year. (4) Where the whole or any part of any sum is treated by virtue of this section as income of the settlor for any year, it shall be treated as income of such an amount as, after deduction of tax at the standard rate for that year, would be equal to that sum or that part thereof." Then I can omit subss. (5) and (6) and go on to subs. (7): "This section applies to any settlement wherever made, and whether made before or after the passing of this Act, and in this section—'capital sum' means—(i) any sum paid by way of loan or repayment of a loan; and (ii) any other sum paid otherwise than as income, being a sum which is not paid for full consideration in money or money's worth, but does not include any sum which could not have become payable to the settlor except in one of the events specified in the proviso to subsection (2) of section four hundred and five of this Act; and 'relevant year' means any year of assessment after the year 1937–38; and references to sums paid to the settlor include references to sums paid to the wife or husband of the settlor."

Then I turn to s. 411(4), which says this:

"For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or (*b*) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom."

The crucial question is whether, as the Crown submits, the company is a company connected with the settlement. If it is not, it is common ground that this appeal must fail. It is also common ground that s. 411(4) must be construed as being capable of applying both to investment companies and also to surtax companies which are not investment companies. In both cases the income of the

company is liable to apportionment, but there are important differences, as appears from a comparison of ss. 245 and 262. Section 245 is as follows:

> "With a view to preventing the avoidance of the payment of surtax through the withholding from distribution of income of a company which would otherwise be distributed, it is hereby enacted that where it appears to the Special Commissioners that any company to which this section applies has not, within a reasonable time after the end of any year or other period for which accounts have been made up, distributed to its members, in such manner as to render the amount distributed liable to be included in the statements to be made by the members of the company of their total income for the purposes of surtax, a reasonable part of its actual income from all sources for the said year or other period, the Commissioners may, by notice in writing to the company, direct that, for purposes of assessment to surtax, the said income of the company shall, for the year or other period specified in the notice, be deemed to be the income of the members, and the amount thereof shall be apportioned among the members."

Section 262(1) is as follows:

> "Subject to the provisions of this section with respect to companies with estate or trading income, the whole of the actual income from all sources, for every year of assessment, of every investment company to which section two hundred and forty-five of this Act applies shall, however much or however little thereof has been distributed to its members, be deemed for the purposes of assessment to surtax to be the income of the members of the company, and accordingly the Special Commissioners shall give a direction under the said section two hundred and forty-five in respect of each year of assessment in relation to every such company without considering whether or not the company has distributed a reasonable part of its income."

It will thus be seen that in the case of an investment company a direction is automatic, while in the case of a surtax company which is not an investment company a direction is discretionary. In neither case, however, can there be an apportionment without a prior direction. No direction has ever been made in the present case, and it follows that s. 411(4)(*a*) cannot apply. The focal point of the argument has been s. 411(4)(*b*), and what it means, and, indeed, whether it means anything. Since the matter first came before me last March I have made many attempts to make sense of s. 411(4), and at every attempt fresh difficulties seem to arise. The words down to the reference to Chapter III of Part IX of the Act are sufficiently clear: where there has been an actual apportionment of income to the trustees of a settlement, whether under s. 245 or under s. 262, the company is deemed to be connected with the settlement. Paragraph (*a*) then continues "or could have been so apportioned if the body corporate had been incorporated in the United Kingdom". This provision reflects the fact that a foreign company is excluded from the definition of a company for the purposes of Chapter III of Part IX (see s. 255(1)). But what do the words "could have been so apportioned" mean? Is it sufficient that the foreign company is of the genus surtax company or investment company, the question of what distribution of income it has in fact made being irrelevant? Or, if the foreign company is not an investment company, must the factual situation be such that it has appeared to the Special Commissioners that it has not distributed a reasonable part of its income? The word "could", rather than "would", seems inappropriate to a foreign investment company, but appropriate in a case where a direction is discretionary. These questions are not without

(Plowman J.)

relevance, notwithstanding that in the present case the company is not a foreign company and no direction has been made, because a similar reference to foreign companies is included in s. 411(4)(*b*), and unless one can understand the meaning and purpose of the reference to foreign companies in one paragraph, it seems to me to be impossible to understand them in the other.

I turn then to s. 411(4)(*b*). It is clearly dealing with cases where there has not in fact been any apportionment, but that of itself solves little or nothing, because so too is para. (*a*) where foreign companies are concerned. A host of new questions now arises. For example, do the words "if the income of the body corporate for that year or period had not been distributed to the members thereof" relate to a factual situation or a hypothetical situation? Do they mean "but for the fact that the income was distributed"? Or can they be interpreted as if they were in parentheses and meant "assuming the income not to have been distributed", irrespective of the question whether there was in fact a distribution or not? And what is meant by the words "the income"? Does it mean the whole of the income? If so, what is the *rationale* of limiting the paragraph to a case where the whole of the income has been distributed, but the whole less sixpence has not? If it does not mean the whole of the income, does it mean a part of it, and if so what part? Can it mean the "reasonable part" referred to in s. 245? What is the significance of the word "could" with which the paragraph opens? And why was it considered necessary to repeat the reference to a foreign company?

Again, on one view of the construction of the paragraph which was submitted to me, would it not have been enough for s. 411(4) to have said in effect "For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement if the company is a company to which s. 245 applies and the trustees thereof are members of the company"? Is it possible to give the subsection a reasonable construction which will fit both the case of the s. 245 company, where a direction is discretionary, and the case of the s. 262 company, where the direction is automatic?

I confess that I have found these difficulties almost insuperable, but there seem to me to be three possible means to a solution. The first is to say, with the Special Commissioners, that, as there can be no apportionment without a direction, and as in this case there has been no direction, the income could not have been apportioned. The second is to follow what seemed to my untutored eye when I first read s. 411(4)(*b*), and still seems to me, to be its literal meaning, and to say that it is dealing with a case where the whole of the income for the year has in fact been distributed to the members, and that this is not that case. The third is to adopt the words of Lord Normand in *Ayrshire Employers Mutual Insurance Association Ltd.* v. *Commissioners of Inland Revenue*[1] 27 T.C. 331, at page 344:

> "I seem in the end to be driven to that last refuge of judicial hesitation when confronted with a difficulty of interpretation, the doctrine that no tax can be imposed on the subject without words in an Act of Parliament clearly showing an intention to lay a burden on him."

I have little confidence in the soundness of the first and second solutions, but any of the three must result in the dismissal of this appeal. Mr. Heyworth Talbot submitted that, even if he were wrong on the question I have been discussing, the Respondent is still entitled to succeed in this appeal on the ground that there was no "income available" (computed in manner provided by

(1) 1946 S.C.(H.L.) 1.

A s. 408(2)) up to the end of any of the years of assessment to which this appeal relates. In the event, this question does not strictly arise, but since it was argued, and in case the matter should go further, I will briefly state my opinion upon it.

The additional facts which are relevant to this question are as follows. On 9th April 1953 the company drew a cheque for £10,100 in favour of the National Provincial Bank Ltd. for the credit of the Respondent's account, B which was duly credited with that amount. On 3rd April 1954 the company paid to the Respondent by cheque drawn in his favour a sum of £9,100, which was credited to his same account. At the date of each of these payments the Respondent's bank account was overdrawn to the approximate amount of the payment. Both the payments were made in the tax year 1953–54. It is common ground, first, that so far as this Court is concerned those sums must be taken to be C "capital sums"; secondly, that, though it is not conceded by the Respondent that the earlier sum was paid to him either directly or indirectly, this point makes no practical difference to the result. The bone of contention is a capital sum, agreed to be the sum of £8,586, which was paid to the Respondent by the company on 4th April 1952 by a cheque for a larger sum drawn in his favour and credited to his bank account. Mr. Heyworth Talbot submits that, by virtue D of s. 408(2)(*a*), the Respondent is entitled to deduct this sum from the aggregate amount of income in making the appropriate calculations. The result of this deduction would be that the income available would be nil. Mr. Bathurst, for the Crown, disputes the Respondent's right to make the deduction on the ground that in the year of its payment, 1951–52, the company was not a company connected with the settlement, for the reason that in that year it made no E distribution of income to its members, other than payment of a dividend on its preference shares.

I do not propose to traverse this ground again; I merely express the view that, if (contrary to my opinion) the company was a company connected with the settlement in the year 1953–54, when it paid a dividend on its ordinary shares, it was no less connected with the settlement in the year 1951–52, when it paid F none. Mr. Bathurst then says that, even if that is right, it simply means that one goes back in time in order to find the first relevant year, and therefore starts with 1951–52, when the £8,586 was paid. If one does this, Mr. Bathurst says, the result, after making the necessary calculations, is exactly the same. It is, I think, accepted by Mr. Talbot that Mr. Bathurst is right in saying that the result of going back in this way would be the same, but Mr. Talbot disputes the right of G the Crown to make the earlier start which it proposes.

It seems to me that this issue turns on the meaning of the words "in any relevant year of assessment" in the opening sentence of s. 408. If those words can be interpreted as including the year 1951–52, Mr. Bathurst's argument may be right; if, on the other hand, the earliest year to which they refer, as applied to the facts of this case, is the year 1953–54, his argument must, in my opinion, H be wrong. Mr. Bathurst supports his argument by reference to the definition of the expression "relevant year" in s. 408(7) as "any year of assessment after the year 1937–38", but I am unable to take the view that the definition of the expression "relevant year" (which occurs on a number of occasions in s. 408) has any application to the expression "any relevant year of assessment". So to apply it would make nonsense, as s. 408(1) would then read "any capital sum I paid directly or indirectly in any year of assessment of assessment".

I am unable, therefore, to accept Mr. Bathurst's argument on this point. In my opinion the first relevant year of assessment is the year 1953–54, that

(Plowman J.)

year being the first of the years in respect of which the assessments now under appeal were made. In the result I dismiss the appeal. A

Allen—The appeal is dismissed with costs, my Lord?

Plowman J.—That follows, Mr. Bathurst, I take it?

Bathurst Q.C.—Yes, and the other case is the same.

Plowman J.—And in the other case, the *E. Bates* case, it is common ground that the appeal must also be dismissed. B

The Crown having appealed against the above decision, the cases came before the Court of Appeal (Lord Denning M.R. and Russell and Davies L.JJ.) on 10th, 11th and 12th May 1965, when judgment was reserved. On 2nd June 1965 judgment was given unanimously in favour of the Crown, with costs.

B. L. Bathurst Q.C., J. Raymond Phillips and *J. P. Warner* for the Crown.

F. Heyworth Talbot Q.C., H. Major Allen Q.C. and *B. Pinson* for the taxpayers. C

Lord Denning M.R.—Two brothers, Mr. Geoffrey Bates and Mr. Ernest Bates, have considerable interests in a family business of worsted spinners at East Ardsley near Wakefield. The business is owned by a private company called Thomas Ambler & Sons Ltd., of which the brothers are directors and own many of the shares. The company has less than five members and is a surtax company. D

In 1948 each of the brothers had three young children and each decided to make a settlement for their benefit. On 7th August 1948 Mr. Geoffrey Bates made a settlement of 60,000 ordinary shares in the company for his three daughters. On the same day Mr. Ernest Bates made a settlement of 40,000 ordinary shares for his son and two daughters. Each added further shares in the next two years. The income from the settlement was in each case to be accumulated by the trustees for the benefit of each child until he or she attained the age of 22. It is plain that these settlements were effected so as to avoid tax. It is quite a legitimate operation. Parents are entitled to effect settlements by which income is accumulated for their children until they reach the age of 22 years: and the income so accumulated does not attract tax. But parents must be careful to see that it is accumulated, and not draw on the funds themselves. If the trustees pay a capital sum to the parents, it is to be treated as part of the parents' income. So also if a "body corporate connected with the settlement" pays a capital sum to the parents, it is to be treated as part of the parents' income. The question in this case is whether Thomas Ambler & Sons Ltd. was a "body corporate connected with the settlement" and whether it did pay a capital sum to the parents: and if so, to what extent it should be regarded as the income of the parents. E F G

The relevant facts are these. Each of the brothers had a current account with the company. The company credited each brother in this account with sums due to him, such as his director's salary and dividends on shares. It paid

A out of the account his tax and life insurance and so forth. But in addition the company allowed each brother to overdraw this account very considerably. Neither brother needed the money, because each was a person of substance. But nevertheless, from 1950 onwards, shortly after 5th April in each year, each brother overdrew a sum in the region of £8,000 to £10,000; and then, shortly before 5th April in the next year, each brother paid off the overdraft by paying B into the company a corresponding amount. The net result was that each brother had the use of £8,000 to £10,000 for most of the year free of interest, and nothing appeared in the company's annual accounts relating to it. (The accounts were made up to 31st March each year.) The overdrawings were made in one of two ways. In the years 1950, 1951 and 1953 the company paid a cheque to the bank and directed the bank to credit the proceeds to the account of Mr. Geoffrey C or Mr. Ernest Bates, as the case might be. In the years 1952 and 1954 the company paid a cheque for £10,000 or thereabouts direct to each brother. In every case the overdraft was discharged towards the end of each year by each brother paying his cheque to the company.

The company paid no dividends up till the end of March 1952: but it paid (with the agreement of the Special Commissioners) 16·6 per cent. for the D year to 31st March 1953 and 14 per cent. for the year to 31st March 1954; and 14 per cent. for the next two years. By getting the agreement of the Special Commissioners, it meant that the company distributed a reasonable part of its income and would not be made subject to a surtax direction and apportionment.

Now the Crown claim that, by these overdrawings, each brother is caught by the provisions of ss. 404 to 411 of the Income Tax Act 1952. These pro- E visions apply, not only to a capital sum paid by the trustees of the settlement to the parents, but also to a capital sum paid to them by "any body corporate connected with the settlement": see s. 408(3). And the first question we have to consider is whether the company here, Thomas Ambler & Sons Ltd., was a "body corporate connected with the settlement". This needs a close consideration of s. 411(4) of the 1952 Act, which runs as follows:

F

> "For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III or Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United G Kingdom; or (*b*) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom."

The reference to "Chapter III of Part IX" is a reference to the well-known H provisions about surtax companies in ss. 245 to 263 of the Act, that is, private companies under the control of not more than five persons. If such a company (being a trading company and not an investment company) does not distribute a reasonable part of its income to its members, the Commissioners, under s. 245, can issue a direction saying that the income shall be deemed to be the income of the members, and upon such direction being given the amount of the income I has to be apportioned among the members. Apportionment follows automatically on a direction. If the company is an investment company the Commissioners, under s. 262, are bound to give a direction, no matter how much or

(Lord Denning M.R.)

how little of the income has been distributed. In an investment company, therefore, an apportionment has to be made in every case.

Now, reverting back to s. 411(4)(*a*) and (*b*), these points seem to me to be clear. (1) Section 411(4)(*a*) applies to every United Kingdom *trading company* on which the Commissioners have made a direction on the ground that the company has not distributed a *reasonable* part of its income, for then apportionment must follow. It also applies to every United Kingdom *investment company;* for then apportionment is automatic. (2) Section 411(4)(*b*) is the difficult pro-provision, so difficult indeed that Plowman J. seems to have found it impossible to give it any intelligible meaning. I do not think we should do this except in extremity. For myself I find the best way of interpreting the set of words in para. (*b*) is to take a simple example on the lines of one suggested by Mr. Bathurst. Suppose my wife says to me, "The red tablecloth could have been used for the party if the ink had not been spilled on it." This means that some ink has actually *in fact* been spilled on the cloth; and that, *by reason of that fact,* the tablecloth cannot be used for the party; and that, *but for that fact*, the tablecloth *could have been so used.* It does not mean that *the whole* of the ink in the bottle has been spilled on the cloth. It only means that *some* of it has been spilled, indeed, so much of it as to prevent the tablecloth being used. So here para. (*b*) envisages a case where some of the income has actually *in fact* been distributed to the members; and that, *by reason of that fact,* the income cannot be apportioned to the trustees or a beneficiary under the settlement; and that, *but for that fact,* the income *could have been so apportioned.*

Mr. Heyworth Talbot in his ingenious argument said that the words should be read quite differently. He too took an example as a hypothesis. Suppose, he said, a company has a total income of £50,000 and reserves of £500,000. It distributes the whole of the £50,000 to the members. You then have to ask yourself under s. 411(4)(*b*), Could any of the income have been apportioned to the trustees or a beneficiary if the whole £50,000 had not been distributed? The answer is, of course, Yes. But Mr. Talbot said that if the company distributed something less than £50,000, say £49,000, the case would be different. Then you could never, he said, ask that question because that question only applies when the whole £50,000 has been distributed. I cannot accept this argument at all. It would mean that s. 411(4)(*b*) only applies in a case where the company has distributed *the whole* of its income to its members, and not when it has distributed nine-tenths of it, indeed, far more than a reasonable part of it.

It is worth mentioning also foreign companies. In order to see whether a foreign company is within s. 411(4)(*a*) you look to see if it has distributed a reasonable part of its income. If it has *not* done so, its income could have been apportioned under s. 245 if it had been a United Kingdom company: and so the company is within para. (*a*). In order to see whether a foreign company comes within s. 411(4)(*b*) you look to see if it *has already* distributed its income or a reasonable part thereof. If it has done so, then its income could have been apportioned if it had not done so: and so it is within para. (*b*). So each branch has a meaning in regard to foreign companies. Whereas Mr. Talbot was forced to say that, on his construction, para. (*b*) has no meaning in regard to foreign companies.

I hold, therefore, that Mr. Bathurst's construction is correct. I apply the test I have stated and I ask myself these three questions: First, has the company distributed some of its income to its members? Answer, Yes. It did so for the

A years ending 31st March 1953, 1954, 1955 and 1956. Second, does that distribution prevent an apportionment being made? Answer, Yes, because the distribution was so high in each year that the Commissioners did not give a direction. Indeed, the Commissioners agreed the amount of the dividend, and thus franked the company from an apportionment for those years. Third, but for that distribution, could the income have been apportioned for those years? B Answer, Yes. It follows, therefore, that the company comes within the definition in s. 411(4)(*b*). It is a body corporate connected with the settlement for the years 1953, 1954, 1955 and 1956.

The second question is whether each of these sums of £8,000 to £10,000 (which the company paid to the brothers each year, or to their bankers) was a "capital sum" paid to the settlor. The Crown say each sum was so paid because C it was a sum "paid by way of loan", and paid "directly or indirectly" by the body corporate "to the settlor". The brothers said that at any rate the sums paid to the bankers did not come within that description: and that they were on the same footing as the subscriptions to charities and the payments to the Revenue in *Potts' Executors* v. *Commissioners of Inland Revenue*(1) [1951] A.C. 443. I do not think they were. In my opinion, a payment to a bank for the D credit of the settlor is on the same footing as a cheque made payable to the settlor. It is an order on the bank to make payment to him. These sums of £8,000 to £10,000 were all plainly sums paid by way of loan to the settlor within s. 408 of the Act.

The third question is as to the extent to which each brother is chargeable with tax on these capital sums. He is not chargeable on the whole £8,000 to E £10,000 each year, but only to the extent of the income available under the settlement each year. Section 408 says that on each capital sum received in any year he is chargeable to the extent of the "income available" under the settlement for the year in question. Now in 1953–54 Mr. Geoffrey Bates received a capital sum of £9,100. The aggregate income received by the trustees under the settlement was gross £3,610 and net £1,986. You would have thought, F therefore, that he was chargeable on that income. But here is the point. Section 408(2)(*a*) says that in calculating the income available for any year you are to deduct "the amount of any other capital sums paid to the settlor in any relevant year *before* that sum was paid". Mr. Heyworth Talbot says that you are to deduct therefrom the capital sum of £8,586 paid to the settlor on 4th April 1952. If you deduct that sum, nothing is payable for 1953–54. Nor for 1954–55. Nor G for 1955–56. Mr. Heyworth Talbot agrees that this is an absurd result, which can never have been intended by Parliament. But he says that it is the consequence of the words used.

I think the answer to this contention is to be found in the definition of "relevant year" in s. 408(7). It means "any year of assessment after 1937–38". The calculation should start from the year 1937–38 (if the settlement was then H in being), or, if the settlement commenced afterwards, then the calculation should start from the beginning of the settlement. Then on the one hand you take the capital sums paid each year to the settlor and on the other hand you take the income available to the trustees of the settlement each year. You start from the beginning, and each year you add up the totals. The settlor is chargeable up to the total of the capital sums received in all the years from the I beginning, but he is not chargeable on any more than the total of the income

(1) 32 T.C. 211.

(Lord Denning M.R.)

available in all the years from the beginning. You should calculate the totals each year and charge him accordingly at the end of each year.

The only impediment in the way of this construction is the words "relevant year of assessment" in the second line of s. 408(1). I think that the words "relevant year" refer to any year of assessment after 1937–38: and that the additional words "of assessment" refer only to the financial year from 6th April in one year to 5th April in the next. It does not cut down the words "relevant year". This is the only construction which makes sense of the enactment. Alternatively, I would regard the words "of assessment" as being meaningless, or as leading to an absurd result.

Mr. Heyworth Talbot recognised that his contentions in this case rendered paragraphs meaningless or ridiculous. If we gave them his interpretation, it would make nonsense of the Statute. But he exhorted us to take heart from the decision of the House of Lords in *Ayrshire Employers Mutual Insurance Association Ltd.* v. *Commissioners of Inland Revenue*[1] 27 T.C. 331, where the Legislature "plainly missed fire". So here we should give the words their literal interpretation heedless of what Parliament intended. I cannot think this is right. It would reduce the interpretation of Statutes to a mere exercise in semantics. Whereas the object, as I have always understood it, is to ascertain the intention of the Legislature. This intention must be discovered, of course, from the words they have used. For the words are the vehicle by which the meaning is conveyed. But the words must be sensibly interpreted. We do not sit here to make nonsense of them.

I decline to accept Mr. Heyworth Talbot's invitation. I would allow the appeal.

I will ask Russell L.J. to give his judgment next.

Russell L.J.—The first question for decision in the case of Mr. Geoffrey Bates is the meaning to be given to the language of s. 411(4) of the Income Tax Act 1952 in order to see whether in the present case the company was a body corporate connected with the settlement in the year of assessment 1953–54, in which the sum of £9,100 was paid on 3rd April 1954, being a sum which it is common ground before this Court was a capital sum within s. 408. Only if that is established could that payment made by the company to the settlor be treated under s. 408(3) as a payment made by the trustees of the settlement for the purposes of the rest of s. 408.

Section 411(4) lays down the criteria of relevant connection between body corporate and settlement and does so by reference to the provisions of Chapter III of Part IX of the Act, to which attention should first be directed. Under s. 245, in the case of a United Kingdom company of which the control is in few hands, if it appears to the Commissioners that it has not distributed to its members a reasonable part of its actual income for a period from all sources so as to render the distribution liable to be included in the income of the members for surtax purposes, the Commissioners may direct that the whole of the income of the company shall for those purposes be deemed to be the income of the members, and if there be such direction the whole of the income *shall* be apportioned among the members in accordance with their respective interests. It should be noted that a company which makes no distribution at all does not necessarily fail to distribute a reasonable part of its income. Relevant investment companies are specially treated: irrespective of the facts of dis-

(1) 1946 S.C.(H.L.) 1.

A tribution the income of the company is deemed to be for surtax purposes the income of its members, and a direction is compulsory and an apportionment must follow. This distinction was first introduced in 1939, and did not exist in 1938, when the equivalent of s. 411(4) was enacted in (so far as now relevant) its present form.

The company in the present case is a trading company. In respect of B the relevant year it made distributions satisfactory to the Commissioners: no direction was given under s. 245, and consequently there was no apportionment among members, who included the trustees of the relevant settlement as ordinary shareholders.

I turn now to s. 411(4), which is in the following terms:

"For the purposes of this Chapter, a body corporate shall be deemed C to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment— (*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or (*b*) could have been so apportioned if the income of the body D corporate for that year or period had not been distributed to the members".

A good deal of discussion took place before the Special Commissioners on the history of this subsection, with particular reference to investment companies, but I do not myself perceive its relevance. Prior to their special treatment both paragraphs were applicable to investment companies, as they now are to trading companies. Since their special treatment, which necessarily involves E direction and apportionment, para. (*a*) embraces all relevant investment companies, whether United Kingdom or foreign, and reference to para. (*b*) is unnecessary: in that sense para. (*b*) ceased to be relevant to investment companies in 1939.

The argument for the taxpayer was based upon the submission that "the income" in s. 411(4)(*b*) means and can only mean the *whole* income of the F body corporate for the year or period in question, the contrast being with "any of" the same subject matter earlier in the subsection. It was submitted that para. (*b*) stated a hypothetical assumption that the whole income had not been distributed, in the sense that some part however small had not been distributed. This construction limits the operation of para. (*b*) to those cases in which the Commissioners could properly have come to the conclusion that any G distribution short of 100 per cent. by as little as sixpence warranted a direction under s. 245: and it was rightly said that there is no evidence that this was such a case. But it cannot be thought, and could not have been thought, that there ever could be such a case. The notion that it could ever appear to the Commissioners that a company which failed to distribute only the last sixpence of its income had failed to distribute a reasonable part of its income and merited a H direction involves an opinion of the Commissioners so contemptuous that I decline to attribute it to the Legislature.

The Crown, on the other hand, contend that s. 411(4)(*b*) is not stating a hypothetical assumption as to income distribution, but refers to distribution which had actually happened: that the proper way of reading the paragraph is "could have been . . . but for the fact that income had been distributed to the I members", and that it extends the cases of relevant connection between body corporate and settlement to those cases in which direction and apportionment has been *prevented* by distribution. Thus, it was said, in the case of United

(Russell L.J.)

Kingdom trading companies the necessary connecting link is found under s. 411(4)(*a*) by direction and consequent apportionment where there has been inadequate distribution: and under s. 411(4)(*b*) in cases where there would have been a direction and consequent apportionment but for the distribution. This, it is said, in the context of such connection makes sense: there is no sense in a connection which depends on anything else than the nature of the company in which the settlement trustees are members. Suppose, it is said, that is the true view, does it fit sensibly with both paras. (*a*) and (*b*)? It fits with para. (*a*) in connection with United Kingdom trading companies. It fits with the idea that in the case of foreign trading companies para. (*a*) covers the case of those which have not distributed enough, and para. (*b*) covers those which have distributed enough. I consider that the proper construction of s. 411(4)(*b*) and the actual meaning of its phraseology is that it speaks of cases in which apportionment could have been made but for the facts of actual distribution.

It is, however, then said for the taxpayer: there is the phrase "the income"; there is the word "the"; it must refer to the whole income of the company. Paragraph (*b*) therefore deals only with a case in which the whole income has in fact been distributed, and that was not the present case in the relevant period, so that connection with the settlement is not established. This contention admittedly allots to para. (*b*) a highly selective and limited role for which no logical basis can exist. Why on earth should the Legislature select only those cases of non-apportionment where actual 100 per cent. distribution has prevented it, for the purpose of defining a company connected with the settlement? Take the United Kingdom trading company in a case where 60 per cent. is a reasonable distribution. It distributes only 59 per cent., and an actual apportionment under s. 411(4)(*a*) establishes the relevant connection with the settlement. It distributes 60 per cent. to 99 per cent., and it comes within neither para. (*a*) nor para. (*b*). It distributes 100 per cent., and the connection is established under para. (*b*). Similar effects would follow in the case of foreign trading companies: the 59 per cent. distributor would be connected by force of para. (*a*); the 100 per cent. distributor would be connected by force of para. (*b*); the 60 to 99 per cent. distributor would not be connected with the settlement. Admittedly there is neither rhyme nor reason in such a scheme. But, says the taxpayer, in a taxing Statute we must take the language as it comes, and if the language results in a defective scheme it is not for us to remedy the semantic errors of the Legislature, more particularly in an enactment such as this, where the net is cast so wide that the innocent are enmeshed, as in *Commissioners of Inland Revenue* v. *De Vigier*[1]. In this connection reference was made to authority. The case of *Ayrshire Employers Mutual Insurance Association Ltd.* v. *Commissioners of Inland Revenue* 27 T.C. 331 was referred to as one in which the use of inept language stultified what might have been considered to be the purpose of the enactment; though in that case it seems to me that the language selected could by no possible means be modified by reference to context. Attention was drawn to the strict approach to the construction of this legislation adopted by the House of Lords in *Potts' Executors* v. *Commissioners of Inland Revenue*[2] [1951] A.C. 443.

For the Crown it is argued that "the income" must be construed in its context—the context being what could have been done but for the fact of its distribution. Though "the income" would seem in another context to mean the whole income, the context of the absence of its distribution must, in relation

(1) 42 T.C. 24; [1964] 1 W.L.R. 1073. (2) 32 T.C. 211.

A to Chapter III of Part IX, limit the phrase to such of the income as would prohibit apportionment under that Chapter. It was argued that a man overhearing the remark: "The balloon could have stayed airborne but for the fact that the gas escaped", would not understand the speaker necessarily to describe a case of *total* gas escape: he would understand it to include a case in which the gas escaped to an extent sufficient to require descent. The analogy is perhaps
B imperfect: total escape of gas from a balloon suggests a burst envelope, a dramatic episode of which the remark overheard would be an outstanding understatement.

Nevertheless, I do not find myself able to construe "the income" in the context of the whole of this subsection as referring only to the whole income. If the draftsman had intended the eccentric scheme already described he could
C not but refer in terms to "the whole income". To treat the paragraph as referring only to the whole income is in my judgment to attach undue weight to the word "the". The relevant distribution of the income of the company is that but for which a relevant apportionment could have been made, and I do not consider that reference to distribution of "the income" as distinct from "income" is an inept phrase for the purpose. I am fortified in this view by
D s. 408(1). That provides that any capital sum paid in any relevant year of assessment to the settlor by the trustees "shall . . . be treated for all the purposes of this Act as *the income* of the settlor for that year". Plainly this does not mean "the whole income", but simply "income": otherwise this would afford a convenient method by which a rich man could reduce his income for tax purposes to an inconsiderable sum.

E If that be the right construction of s. 411(4)(*b*), I have no doubt from the actual dividend history of the company in respect of the year 1953–54 that without it the Commissioners would have made a direction and apportionment in respect of that year, and accordingly the company was a connected company in that year, and the £9,100 is to be treated as a capital sum paid by the trustees of the settlement to the settlor in that year.

F I am bound to say that I find it hard to follow both the arguments before the Special Commissioners as set out in paras. 3 and 4 of the Case Stated and their conclusion as set out in para. 5. They are much concerned with the position of investment companies, which I do not find relevant: and they seem to suggest that unless there has been an actual direction it cannot be said that there could have been an apportionment. But the subsection takes direc-
G tion, so to speak, in its stride, relying, as I see it, on the fact that apportionment is mandatory once a direction is made: it refers to the event of apportionment rather than direction because it is the link with the settlement trustees as members that is essential.

Plowman J. found some difficulty in construing s. 411(4)(*a*) in relation to foreign companies. I do not see any problem: if a trading company, its
H inclusion depends upon failure to distribute a reasonable part of its income—a circumstance which would have led, had it been a United Kingdom company, to direction and apportionment: if an investment company, it is included whatever its distribution: whichever they are, they are put in the same position as the United Kingdom companies in para. (*a*) which are "apportioned". I do not find the use of "could" instead of "would" a stumbling block. Coming
I to s. 411(4)(*b*), he posed a number of problems or questions, and then concluded that there were only three possible solutions, any one of which would decide the case in favour of the taxpayer. The first was to say that absence of actual

(Russell L.J.)

direction was conclusive, since without it apportionment could not be made: I have already dealt with that suggestion, which would stultify all reference to foreign companies. The second was to construe para. (*b*) as limited to a case where in fact the whole income had been distributed. The third was (in effect) to say that the Statute failed to make anything sufficiently clear to impose a tax. He did not plump for any of these, though he indicated a view in favour of the second. For the reasons I have given, I do not agree with that view; I think that there is a fourth possible solution, and the correct one, which decides that point in favour of the Crown.

This, however, is by no means the end of the case. The conclusion that the company was connected with the settlement when in 1953–54 it paid to the settlor the capital sum of £9,100 leads only into another maze. In the fiscal year 1953–54 the trustees received £3,610 gross income for accumulation: in 1954–55, £3,158: in 1955–56, £3,201. The company on 4th April 1952 paid to the settlor another sum of £8,586 which would comply with the definition of a capital sum under the section. What is the operation of s. 408 in those circumstances? Subsection (1) requires a relevant capital sum paid "in any relevant year of assessment" to the settlor to be treated for tax purposes as the income of the settlor for that year, but only to the extent to which the amount of that sum falls within the amount of "income available up to the end of that year". Attribution of the capital sum to the settlor's taxable income is thus limited by reference to the income of which he had deprived himself by the settlement in a manner which (by accumulation) made it the income of nobody for surtax. Subsection (1)(*b*) then, so to speak, carries forward the *balance* of the capital sum as taxable income of the settlor for the next year of assessment, but again with a ceiling on the amount of that balance, which ceiling is ascertainable by reference to the amount of "income available up to the end of the next following year . . . and so on". Now we move into a definition of income available, under subs. (2). That provides that

> "the amount of income available up to the end of any year shall . . . be taken to be the aggregate amount of [undistributed] income arising under the settlement in that year and any previous relevant year":

but from this must be deducted

> "(*a*) the amount of any *other* capital sums paid to the settlor in any relevant year before that sum was paid".

"That sum" is the capital sum in relation to which the exercise is undertaken of calculating the amount of income available up to the end of any year. (There is also to be deducted an amount equal to tax at the standard rate on the aggregate amount of (undistributed) income arising under the settlement in that year and any previous relevant year: this brings the available income down to a net figure, but subs. (4) contains provision for grossing up so much of any capital sum paid to the settlor as is to be treated as his income to such a sum as after deduction, etc., etc.)

At first sight it would seem that the carry-forward system would work as follows. In respect of 1953–54 the available income was £3,610 less tax £1,624, equals £1,986: this grossed up for tax would form part of the settlor's income for 1953–54: the balance of the £9,100 after deducting £1,986, viz. £7,114, would carry forward. In respect of 1954–55 the net available income was £3,158 less tax £1,421, equals £1,737, to be grossed up for tax to form part of the settlor's income for *that* year: the carry-forward balance is now reduced to £7,114 less £1,737, equals £5,377. In respect of 1955–56 the available income is £3,201 less tax £1,360, equals £1,841, to be grossed up for tax to form part of

A the settlor's income for *that* year: at the end of the operation the carry-forward balance is reduced to £5,377 less £1,841, equals £3,536.

Ignoring for the moment the sum of £8,586 already mentioned, this does not seem to suit exactly the language of the section. According to that language the balance of the £9,100 after the section has operated in respect of 1953–54—viz., £7,114—is to be treated for 1954–55 as the settlor's income up to a figure
B of the net income of the settlement for both 1953–54 and 1954–55: for "the income available up to the end of the next following year" is the aggregate of the income for that year and for any previous relevant year, and relevant year is defined by the section as any year of assessment after 1937–38: thus it would appear that for 1954–55 the sum of £1,986 plus £1,737, equals £3,723 (to be grossed up), is to be part of the settlor's income, leaving a carry-forward figure
C of £3,391. Such a system would result in capital payments being attributed to the settlor as his income to an extent far greater than the undistributed income of the settlement. This construction, though canvassed before us, was not contended for by the Crown. This construction would mean that, though the relevant capital payment may be £9,100 and the total net undistributed income of the settlement so far has been only £5,564, nevertheless the whole £9,100
D (grossed up for tax) is to be treated as the settlor's income.

This would indeed be a remarkable enactment, wholly inconsistent with any view that the purpose is to attribute to a settlor for tax purposes the equivalent of what would be but for the settlement his income, and wholly inconsistent with the provisions of s. 408(2)(*b*), (*c*) and (*d*), which are obviously aimed at avoiding overall taxability (if the experts will forgive the phrase) of the settlor
E beyond his relinquishment of income.

But how would this conclusion be avoided? (Again I stress that this question is on the assumption that the earlier payment of £8,586 never happened.) If this question were for present decision, I would strain to avoid it. A taxpayer would say that the conclusion was monstrous. He would be right. It means that a settlor can indirectly be taxed twice or even more often in respect
F of the same income. But how is the conclusion to be avoided? In my opinion it is to be avoided by a view of the general scheme to be observed in s. 408(1), and by taking s. 408(2) to be merely an attempt to state a method of calculation to carry out the scheme. The scheme is that undistributed income of the settlement shall be regarded as income of the settlor if he receives not the actual income but an equivalent amount in the form of capital, but not more than
G that. Therefore implicitly there must be set against the total of available income since 1937–38 so much as has already been "used" for the purpose of attributing the capital payment to the settlor as his income. The result is that which would appear at first sight to be the intention of the provisions. This was indeed the basis upon which the additional assessments appealed from were made, which in respect of each year were based on the net settlement income for that year
H only.

I come now to the taxpayer's argument. This is that s. 408(2)(*a*) requires deduction, in calculating the available income, of "the amount of any other capital sums paid to the settlor in any relevant year" before the £9,100 was paid: that in a year since 1937–38 a capital sum of £8,586 was paid by the company to the settlor, and that therefore it must be deducted in calculating
I the available income, which as a result in each year was nil.

The first answer of the Crown is that this payment of £8,586 in 1951–52 was not the equivalent of a capital payment by the trustees because in that year

the company was not connected with the settlement, or is not shown to have been. No ordinary dividends were paid in respect of that year by the company: we were told, and it was accepted, that some preference dividends were paid, but the amount is not known: there was no direction or apportionment in respect of that year: is it to be concluded that but for the preference dividends there could have been a direction and apportionment in respect of that year? I do not think so. The inference from the dividend history in the year 1953–54, that in that year the company was a connected company by force of s. 411(4)(*b*), is I think clear: but I do not see how the inference can be drawn, from such exiguous information as is available about 1951–52, that the payment of some dividend on preference shares prevented a direction and apportionment. It is to be observed that para. (*b*) does not apply if there has been no distribution of income at all: and I do not think it can be said that it must apply in every case where there has been some distribution of income.

Alternatively, suppose that the company was in 1951–52 a connected company. The result would seem to me to be the same, but for present purposes s. 408(1) would operate on the sum of £8,586 and not on the £9,100. There was no income available up to the end of the year 1951–52 in which it was paid, so that under s. 408(1)(*b*) the whole was carried forward to 1952–53. There being still no income available up to the end of 1952–53, the whole was again carried forward to 1953–54 by force of the words in s. 408(1) "and so on". We are then in the three years in which there was income of the settlement: and of course the £9,100 cannot be deducted from the income available because it was not paid before the £8,586. If and when, however, the £8,586 should become exhausted, income available to be covered by the £9,100 would be ascertained only after deducting the previous capital payment of £8,586.

For the taxpayer it was argued that it is not correct to say that £8,586 can be thus substituted for £9,100 because, though it was paid "in any relevant year" for the purposes of s. 408(2)(*a*)—"relevant year" meaning by definition in s. 408(7) "any year of assessment after the year 1937–38"—it was not paid in "any relevant year of assessment" under s. 408(1), the first relevant year of assessment *in this case* being 1953–54. "Year of assessment" is defined by s. 526 as the year for which the tax was granted by any Act. I am not able to accept this argument for the taxpayer. It seems to me to involve the proposition that the carry-forward system under s. 408(1) does not operate if there is no income of the settlement for the year in which the capital payment is made, or that it can only operate in such case if there has been a nil additional assessment in respect of that year.

Accordingly in my judgment the appeal should be allowed and the additional assessments upheld.

The decision in the case of Mr. Ernest Bates follows the decision in this case.

Davies L.J.—I agree with the conclusions reached by my Lords, and I cannot usefully add anything to the reasons stated by them.

Lord Denning M.R.—Mr. Bathurst, the appeals will be allowed. Is it that the assessments are upheld or remitted?

Bathurst Q.C.—Would your Lordships remit so that the assessments can be adjusted in accordance with your Lordships' judgments? Apparently there are some small adjustments to be made.

Lord Denning M.R.—If there are adjustments to be made, it has been drawn to my attention that it might be useful perhaps to have a new procedure about the form of Order. In *Trustees of Tollemache Settled Estates* v. *Coughtrie*[1] [1960] 2 W.L.R. 825, at the end of the judgment, on page 835, Lord Evershed M.R. did not like the form of Order where it was simply remitted for the assessment to be adjusted in accordance with the judgment of the Court. He indicated that the Order ought to be self-contained. But I think it would be sufficient, if the case is to be remitted for the Commissioners to adjust the assessments, to say "in accordance with the judgment of the Court, a transcript whereof has been filed with the Order". If those words are added, it will not be necessary to put in any detail. It will simply be "in accordance with the judgment of the Court, a transcript whereof is filed with the Order".

Bathurst Q.C.—I understand from my instructing solicitor that that goes back to what the old practice was. I think perhaps I ought to state that so far as I know I never argued the point, and I do not think my learned Junior did, that these sums were cumulative.

Russell L.J.—I thought you did. I know you were not trying to press it but I thought you did at some stage in your argument.

Bathurst Q.C.—I was not conscious of doing it. I thought it was something Mr. Heyworth Talbot tried to put on me and I did not want it. I thought it right to state that.

Russell L.J.—I thought you did.

Bathurst Q.C.—The Crown definitely did not want that argument. It is right that I should state that.

Lord Denning M.R.—They did not want a ludicrous result. I had not myself understood you to put it.

Bathurst Q.C.—I did not think I had but I apologise if I appeared to. The appeal will be allowed with costs?

Lord Denning M.R.—Yes, in the ordinary way the appeal will be allowed with costs here and below.

Allen Q.C.—Your Lordships may have anticipated the application which I have to make.

Lord Denning M.R.—You cannot resist the Order as to costs?

Allen Q.C.—No.

Lord Denning M.R.—And the form of Order which I have indicated you are quite happy with?

Allen Q.C.—Yes.

Lord Denning M.R.—In future cases in remitting for adjustment, the form of Order will be "in accordance with the judgment of the Court, transcript whereof has been filed with the Order".

Allen Q.C.—My application is the usual one in these cases, for leave to go to the House of Lords. There has been a judicial difference of opinion in the sense that your Lordships are reversing Plowman J. The case is one which raises, if I may say so, difficult questions of construction.

Lord Denning M.R.—Difficult questions, but is it of much general application?

([1]) 39 T.C. 454, at p. 468; [1960] Ch. 475.

Allen Q.C.—I would have thought there must be a considerable number of cases on s. 408 to which this point may be relevant. I think I am bound to say in all fairness, if the Finance Bill at present before Parliament goes through in its present form, we shall have a different definition to put before your Lordships.

Lord Denning M.R.—We shall have the same old trouble over again!

Allen Q.C.—It does look a little simpler at first reading, but I hope I shall not be held to that in any future case. I have only read it a couple of times.

Lord Denning M.R.—You never know what lawyers can do with a definition!

Russell L.J.—I would be content myself to give the taxpayer every possible chance to get out of this section if he can.

Allen Q.C.—That is one aspect. It does bear hardly on some people. It has not been avoidance in this case. It was appreciated by the House of Lords in *Potts'* case([1]) that this can, if I may say so, have the most monstrous results. It catches the innocent along with the guilty. I think it would be fair to say that the man who has the prudence to take advice beforehand can avoid the operation of the section. It is only the man who carries on in a perfectly straightforward fashion who finds himself enmeshed in its toils and is faced with these desperate problems of interpretation which have been before your Lordships. I am bound to make the application.

Lord Denning M.R.—Have you anything to say about it, Mr. Bathurst?

Bathurst Q.C.—The Crown is entirely in your Lordships' hands in this matter.

Lord Denning M.R.—We will give leave.

Allen Q.C.—If your Lordship pleases.

Russell L.J.—Mr. Bathurst, I will add a sentence to my judgment, as I apparently misunderstood you.

Bathurst Q.C.—It may have been my fault, my Lord, but I thought it right to mention it. I was not instructed to do it and I am sorry if I gave that impression.

Mr. G. B. Bates having appealed against the above decision, the case came before the House of Lords (Lords Reid, Morris of Borth-y-Gest, Guest, Upjohn and Wilberforce) on 11th, 12th, 13th and 17th October 1966, when judgment was reserved. On 8th December 1966 judgment was given unanimously in favour of the Crown, with costs.

([2])*F. Heyworth Talbot Q.C.*, *H. Major Allen Q.C.* and *Barry Pinson* for the Appellant. The questions at issue depend on the construction and effect of ss. 408 and 411 of the Income Tax Act 1952. It will be observed that in s. 408 the subject charged is a capital sum and not income measured with reference to a capital sum.

([1]) 32 T.C. 211.

([2]) Argument reported by J. A. Griffiths, Esq., Barrister-at-law.

A The Appellant's contentions are: (1) the company was not a body corporate connected with the settlement within the meaning of the definition in s. 411(4); (2) the overdrawings were not loans or not otherwise within the definition of "capital sum" contained in s. 408(7); (3) the calculations on which the surtax claims are based have not been made in accordance with the requirements of the relevant sections, and if they had been correctly made the result would have B shown that no tax was payable.

First, some general observations. If the owner of a motor car were to give a cheque for £100 to his local garage and were to tell the proprietor to debit his account for petrol and repairs and to inform him when the £100 was exhausted, and said that he would then give the garage another cheque for the same amount, no one surely will suggest that the cheque given to the garage pro- C prietor was by way of loan. It is pertinent to compare the facts in *Potts' Executors* v. *Commissioners of Inland Revenue*[1] with those in the present case. There is no difference between the payment made by the company there to the creditor of Potts, namely, the Inland Revenue, and the payment made by the company to the creditor of the Appellant, namely, the National Provincial Bank, since at all material times the Appellant had an overdraft with the bank. It is for the D Special Commissioners to determine on the evidence before them whether what took place was an ordinary transaction apart from one between bank and customer on current account or whether it was a payment by way of loan. Section 408 should be construed strictly in view of the hardship to taxpayers which would otherwise result.

As to the three submissions, (1) If it be supposed that the Legislature in E framing the definition had intended to include all surtax companies, close companies, in which a trustee or settlement beneficiary has shares then this could have been accomplished by providing: "For the purposes of this chapter, a body corporate shall be deemed to be connected with a settlement if the company is a company to which section 245 applies and the trustees thereof are members of the company." To succeed here the Crown must read the F words "a reasonable part of the income" into s. 411(4)(*b*). If s. 411(4) were meant to have universal application to all close companies which had income there would be no necessity for the dichotomy created by paras. (*a*) and (*b*) of the subsection. Two classes of case come within s. 411(4): (*a*) those where there has been a direction and apportionment; (*b*) those where there could have been a direction and apportionment if there had not been a 100 per cent. distribution G of income. "The income" in this subsection means "the whole income". The use of the definite article imports the adjective "whole". The expression "the income" is to be contrasted with the single word "income", which would connote part of the income. Paragraph 15 of Sch. 18 to the Finance Act 1965 shows how simply s. 411(4) of the Income Tax Act 1952 could have been drafted to accord with the Crown's contention.

H It is to be observed that the subject matter of a direction and apportionment under s. 245 is *always* the total income of the company, that is, the actual income from all sources. See also ss. 246 to 257, inclusive, and ss. 261 and 262. The above provisions show that what is being dealt with is the income of the company, that is the whole income. A part of the income only comes into consideration when the Special Commissioners are making a direction. It is I emphasised that s. 411(4) must be strictly construed, and that "the income" does not mean a part of the income.

(2) If the words of the definition of "capital sum" in s. 408(7) are read

(1) 32 T.C. 211; [1951] A.C. 443.

without points of punctuation, then the same conclusion can be reached as that of Lord Oaksey in *Potts' Executors*(1), that "it refers only to sums paid by way of loan which are not paid for full consideration in money or money's worth". The expression "being a sum which is not paid for full consideration in money or money's worth" is apt to apply to both branches of the definition in s. 408(1). The Crown's contention leads to gross injustice; the courts will not adopt a construction which leads to injustice unless the language of the enactment in question constrains the court to adopt the plain meaning of the words used. Where the customer is overdrawn to the extent of £x and a cheque is drawn in favour of the bank in that sum to discharge that overdraft, the bank will appropriate it in discharge of the sum owed to it.

(3) For the purposes of s. 408(1) there was a capital sum paid in the financial year 1953–54. To ascertain the income available it is necessary to refer to s. 408(2). The underlying intent of s. 408 was to tax "loans" which were never in fact intended to be repaid.

The definition of "relevant year" in s. 408(7) is to be ignored in construing the phrase "relevant year of assessment" at the beginning of s. 408(1), for otherwise the opening words of s. 408(1) would read: "Any capital sum paid directly or indirectly in any relevant year of assessment . . . of assessment", which is meaningless. It is necessary first to see when a capital sum was paid in order to ascertain if it was in a relevant year of assessment.

Section 408(2) leads to absurdity on any construction of the section. To make the section operate fairly it would be necessary to rewrite it, but that is not within the province of the House. Accordingly, the section must be construed strictly. The observations of Lord Simonds in *Ayrshire Employers Mutual Insurance Association Ltd.* v. *Commissioners of Inland Revenue*(2) that

> "the language of the Section fails to achieve its apparent purpose, and I must decline to insert words or phrases which might succeed where the draftsman failed"

should be applied here.

On the true construction of s. 408 the sum paid to the Appellant in the year 1951–52 was not paid in a relevant year of assessment, and therefore it falls within the phrase "any other capital sum" in s. 408(2)(*b*). Accordingly, the sum paid in 1951–52 is deductible under para. (*b*), and there was no "income available" in any of the years to which this appeal relates.

[Reference was also made to *Commissioners of Inland Revenue* v. *De Vigier*(3).]

H. Major Allen Q.C. following. It is pertinent to observe that there may be circumstances in which it is reasonable for a company to make no distribution of income at all: see *Thomas Fattorini (Lancashire) Ltd.* v. *Commissioners of Inland Revenue*(4). In ss. 249 and 253 "the income" means the whole income of the company for the purposes of a surtax direction. This is a pointer to the meaning of the words "the income" in s. 411(4).

B. L. Bathurst Q.C. (*Viscount Bledisloe*), *J. Raymond Phillips* and *J. P. Warner* for the Crown. Three issues have been formulated. As to (2), it was said that the sums in question were not capital sums within s. 408(7); the Appellant had a running account with the company and the sums received by him were not loans.

[Lord Reid intimated that their Lordships did not wish to hear further argument on this question.]

(1) 32 T.C. 211, 232. (2) 27 T.C. 331, 348; 1946 S.C. (H.L.) 1.
(3) 42 T.C. 24; [1964] 1 W.L.R. 1073. (4) 24 T.C. 328; [1942] A.C. 643.

(1) Section 411(4)(*b*) of the Income Tax Act 1952 applies, because the income could have been apportioned if there had not been a distribution. Paragraph (*b*) envisages a case where some of the income has actually in fact been distributed to members of the company; and that, by reason of that fact, the income cannot be apportioned to the trustees or a beneficiary under the settlement and that, but for that fact, the income could have been so apportioned. Here, there was a distribution of income of the company to its members for the years ending 31st March 1953, 1954, 1955 and 1956. That distribution prevented an apportionment because the distribution was so high in each year that the Special Commissioners did not give a direction. Thirdly, but for that distribution the income could have been apportioned for those years. It follows that the company comes within the definition in s. 411(4)(*b*).

According to the Appellant s. 411(4)(*b*) only applies to a trading company which distributes every penny of its income. The House will resile from placing such a construction on this provision. There cannot be a trading company in the whole of the United Kingdom which distributes *all* its income. This contention results from construing "the income" as meaning "the whole income". The judgments of Lord Denning M.R. and Russell L.J. are adopted on this question.

(3) It is first necessary to discover what was "the amount of the income available up to the end of" the "year" as defined in s. 408(2). The Court of Appeal were right in rejecting the Appellant's contention on this question. The company has not been shown to be a "body corporate connected with the settlement" in any year earlier than 1953–54. Further, the construction sought to be placed on the phrase "any relevant year of assessment" in s. 408(1) is erroneous. The definition of the words "relevant year" in s. 408(7), which is not qualified by any such words as "unless the context otherwise requires", must be applicable to those words where they are found in s. 408(1). True, this makes the opening words of s. 408(1) read "Any capital sum paid directly or indirectly in any year of assessment after the year 1937–38 of assessment . . ." but the only conclusion that can be drawn from this is that the additional and meaningless words "of assessment" were left in by inadvertence and should be ignored as mere surplusage. Alternatively, the phrase "any relevant year of assessment" should be construed as meaning any year of assessment in which circumstances exist which may attract the operation of the section, and, in particular, any year of assessment in which there is in existence a settlement to which the section applies. The argument put forward to the effect that the phrase should be construed as meaning any year in which an assessment is made under s. 408 is misconceived because there is no such thing as an assessment under s. 408. The effect of the section is merely to treat the amounts to which it applies as being for all purposes of the Act the income of the "settlor". The construction of "relevant year" given by Lord Denning M.R. is adopted.

The principle enunciated by Lord Simonds in the *Ayrshire* case([1]) is not applicable here. Where there is an ambiguity the Court will construe the section so as to lead to a reasonable scheme of taxation. Section 411(4)(*b*) does lead to a reasonable result if "income" is there construed as a reasonable part of the income. Reliance is placed on the observations of Lord Reid in *Luke* v. *Commissioners of Inland Revenue*([2]).

> "The general principle is well settled. It is only where the words are absolutely incapable of a construction which will accord with the apparent intention of the provision and will avoid a wholly unreasonable result, that the words of the enactment must prevail."

([1]) 27 T.C. 331. ([2]) 40 T.C. 630, 646; [1963] A.C. 557.

Finally, the parties are agreed that there are four possible ways of deciding this appeal.

(i) The House may take the view that the construction of s. 411(4)(*b*) contended for by the Appellant is correct, namely, that the words "the income" in subs. (4)(*b*) mean the whole of the actual income from all sources of the body corporate for the relevant period. It is agreed that, in that event, the appeal will succeed on the first question, and that accordingly no remission to the Special Commissioners will be necessary.

(ii) The second possibility is that the House decides that the construction of subs. (4)(*b*) contended for by the Crown is correct, namely, that the test posed by the subsection is factual, and that the relevant question is whether the distributions that were in fact made by the body corporate for the relevant period were such as to prevent the making of a direction and apportionment for that period. It is agreed that, in that event, having regard to the figures disclosed by the accounts, the company cannot be regarded as a body corporate connected with the settlement for the year of assessment 1951–52, and that accordingly no remission to the Special Commissioners is necessary.

(iii) The third possibility is that the House adopts a view of the construction of subs. (4)(*b*) which is not now contended for by either party but which was canvassed in the Court of Appeal, namely, that the subsection poses a hypothetical test, which disregards any distribution actually made. On this view the question is: would the trustees of, or a beneficiary under, the settlement have been among the persons to whom income could be apportioned, assuming that a reasonable part of the income of the company had not been distributed to the members thereof? It is agreed that if this view is adopted no remission will be necessary, because the answer to the question must be in the affirmative.

(iv) The fourth possibility is that the House adopts another view of the construction of subs. (4)(*b*) which is not now contended for by either party, but which was canvassed before Plowman J., namely, that the subsection poses the question whether a direction and apportionment could properly have been made if no income had been distributed (in other words whether the circumstances are similar to those in the *Fattorini* case(1)). It is agreed that if this view is adopted a remission will be necessary unless the House accepts the construction of the words "relevant year of assessment" in s. 408(1) contended for by the Crown. It is agreed that the remission to the Special Commissioners would be to find whether, assuming the company had made no distribution of income for the accounting year ended 31st March 1952, a direction under s. 245 could properly have been made, and to state all facts on which such finding is based.

[Reference was also made to s. 526 of the Income Tax Act 1952 and *Potts' Executors* v. *Commissioners of Inland Revenue*(2).]

J. Raymond Phillips following. Section 411 of the Income Tax Act 1952 shows a coherent scheme. It is aimed at (i) a loan, (ii) the repayment of a loan. The Legislature had in mind the case where a company is interposed between the settlor and the trustees of the settlement. That is the reason for the enactment of s. 408(3).

The section is aimed at the following devices. (i) A loan: the settlor transfers property to a company in consideration of the allotment of shares which he renounces in favour of the trustees of an accumulation settlement; the property of the company is income-producing property and it makes use of it by making loans in addition to paying dividends. (ii) The repayment device: a settlor forms a company and settles the shares thereof on the trusts of an accumulation settlement; he lends the company a substantial sum which the

(1) 24 T.C. 328. (2) 32 T.C. 211.

company uses to buy some income-producing assets and uses it to pay the settlor. If it be assumed that these are the kinds of problem which the Legislature intended to combat, the construction of s. 411 contended for by the Crown leads to a reasonable solution.

There are three situations which may arise in practice relating to a direction and apportionment: (i) an actual apportionment to trustees: s. 411(4)(*a*); (ii) a distribution but for which there would have been such an apportionment: this is caught by s. 411(4)(*b*); (iii) no apportionment and no distribution.

There are therefore three cases which have been omitted by the Legislature: (i) where the Special Commissioners have made an error in failing to make a direction and apportionment; (ii) the situation which arose in the *Fattorini* case(1); (iii) if the Crown are correct in their construction of subs. (4)(*b*), that it postulates a case where there has been a distribution and that distribution has prevented an apportionment, there could be a case where there is a small distribution: this is *a fortiori* the *Fattorini* case. It is not unreasonable that these three cases should have been omitted from the purview of the section.

As to the language of s. 411(4)(*b*), ". . . if the income of the body corporate . . . had not been distributed to the members thereof", this clearly implies that there has been a distribution. It does not in any way qualify or add anything.

It is to be noted that in s. 262 where the Legislature intends to refer to the whole income it is so expressed. It is conceded that s. 262 first appeared in the Finance Act 1939, whilst ss. 408 and 411 first appeared in the Finance Act 1938.

[Reference was also made to *Commissioners of Inland Revenue* v. *Sneath*(2) and *Caffoor* v. *Commissioner of Income Tax, Colombo*(3).]

F. Heyworth Talbot Q.C. in reply. The words "relevant year of assessment" in s. 408 mean a year of assessment relevant for the purposes of making an assessment under s. 408. For no purpose relevant to s. 411 can any distinction be drawn between the status or circumstances of the company in 1953–54 and 1951–52. The company was equally connected with the settlement in both these years. The Crown can only circumvent the position by drawing a fine gloss on s. 411(4)(*a*) and (*b*).

The words "the income" in their natural use mean "the whole income". True, this has surprising consequences, but this is *nihil ad rem* if the language of the enactment is clear.

The general principle in construing a taxing Statute is that the subject should not be taxed unless there is plain language to that effect: *National Provident Institution* v. *Brown*(4), *per* Lord Sumner; *Smidth* v. *Greenwood*(5).

Their Lordships took time for consideration.

Lord Reid—My Lords, this is an appeal against additional assessments to surtax for the years 1953–54, 1954–55 and 1955–56, laid under Part XVIII of the Income Tax Act 1952, and in particular under s. 408 thereof. The Appellant was a director and shareholder of a company, T. Ambler & Sons Ltd., to which the provisions of Chapter III of Part IX applied. In 1948 he made an irrevocable settlement in favour of his children in which accumulation of the trust income was directed, and he conveyed to the trustees of the settlement some of his shares in that company. It was his practice to have a current account with that com-

(1) 24 T.C. 328. (2) 17 T.C. 149, 167–8; [1932] 2 K.B. 362. (3) [1961] A.C. 584, 598–9.
(4) 8 T.C. 57, 97; [1921] 2 A.C. 222. (5) 8 T.C. 193, 206; [1922] 1 A.C. 417.

(Lord Reid)

pany. From time to time sums accruing to him were paid in and sums owing by him were paid by the company and debited to this account. There was generally a considerable balance owing by him, but at the end of each financial year of the company he paid to them enough to meet this balance, thereby creating a large overdraft from his bank, and at the beginning of the next year the company paid out enough to cover that overdraft from his bank. In April of 1950, 1951 and 1953 this was done by the company paying a sum direct to the bank, but in 1952 and 1954 it was done by the company drawing cheques in favour of the Appellant, which he paid into his account with the bank. We are particularly concerned with a payment of £9,100 made by the company to the Appellant on 5th April 1954. I have no doubt that this was a sum paid by way of loan within the meaning of s. 408(7).

The case against the Appellant is that s. 408 requires that the sum of £9,100 shall be treated as the income of the Appellant to the extent therein provided. The section requires that any loan to the settlor by "any body corporate connected with the settlement" shall be treated as having been paid by the trustees of the settlement, and the definition in s. 411(4) of "body corporate connected with the settlement" is so wide that in my opinion it must be held to include this company, although there was in fact no connection whatever between the company and the settlement beyond the fact that the settlement trustees held some shares of the company, and the Appellant had no intention of gaining any tax advantage and in fact gained none by taking this loan from the company.

This startling proposition makes it necessary to examine these statutory provisions with some care. They are as follows:

> "408.—(1) Any capital sum paid directly or indirectly in any relevant year of assessment by the trustees of a settlement to which this section applies to the settlor shall—(*a*) to the extent to which the amount of that sum falls within the amount of income available up to the end of that year, be treated for all the purposes of this Act as the income of the settlor for that year; (*b*) to the extent to which the amount of that sum exceeds the amount of income available up to the end of that year but falls within the amount of the income available up to the end of the next following year, be treated for the purposes aforesaid as the income of the settlor for the next following year, and so on. (2) For the purposes of subsection (1) of this section, the amount of income available up to the end of any year shall, in relation to any capital sum paid as aforesaid, be taken to be the aggregate amount of income arising under the settlement in that year and any previous relevant year which has not been distributed, less—(*a*) the amount of any other capital sums paid to the settlor in any relevant year before that sum was paid; and (*b*) so much of any income arising under the settlement in that year and any previous relevant year which has not been distributed as is shown to consist of income which has been treated as income of the settlor by virtue of section four hundred and four of this Act; and (*c*) any income arising under the settlement in that year and any previous relevant year which has been treated as the income of the settlor by virtue of section four hundred and five of this Act; and (*d*) any sums paid by virtue or in consequence of the settlement, to the extent that they are not allowable, by virtue of the last preceding section, as deductions in computing the settlor's income for that year or any previous relevant year; and (*e*) an amount equal to tax at the standard rate on—(i) the aggregate amount of income arising under

A the settlement in that year and any previous relevant year which has not been distributed, less (ii) the aggregate amount of the income and sums referred to in paragraphs (*b*), (*c*) and (*d*) of this subsection. (3) For the purpose of this section, any capital sum paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year. B (4) Where the whole or any part of any sum is treated by virtue of this section as income of the settlor for any year, it shall be treated as income of such an amount as, after deduction of tax at the standard rate for that year, would be equal to that sum or that part thereof. (5) Tax chargeable at the standard rate by virtue of this section shall be charged under Case VI of Schedule D. (6) In computing the liability to income tax of a settlor C chargeable by virtue of this section, the same deduction and reliefs shall be allowed as would have been allowed if the amount treated as his income by virtue of this section had been received by him as income. (7) This section applies to any settlement wherever made, and whether made before or after the passing of this Act, and in this section—'capital sum' means—(i) any sum paid by way of loan or repayment of a loan; and (ii) any other D sum paid otherwise than as income, being a sum which is not paid for full consideration in money or money's worth, but does not include any sum which could not have become payable to the settlor except in one of the events specified in the proviso to subsection (2) of section four hundred and five of this Act; and 'relevant year' means any year of assessment after the year 1937–38; and references to sums paid to the settlor include refer- E ences to sums paid to the wife or husband of the settlor."

"411 . . . (4) For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been F so apportioned if the body corporate had been incorporated in the United Kingdom; or (*b*) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom."

G These provisions were first enacted in 1938. The mischief against which they were directed appears to have been that some taxpayers, intending to avoid paying surtax, transferred to trustees of settlements shares in companies controlled by them: then they borrowed money from the trustees, who used the dividends on these shares to make the loans. In that way the settlors got possession of the income from the shares which they had settled in the form of capital H payments which did not attract surtax. And if the trustees were complacent the settlors might never repay these "loans". The reason why some companies were brought in appears to have been that some settlors had devised rather more elaborate schemes. A settlor might form a company, controlled by him, to which he transferred assets yielding income. He would then put the whole, or the greater part, of the shares of that company in the settlement, and then he I would cause that company to lend to him the whole or a part of its income, thereby diminishing the dividends which would otherwise have gone to the settlement trustees. He would not repay these loans during his lifetime, and in

(Lord Reid)

that way he would receive and enjoy the income of the assets which he had transferred to the company without being liable to pay surtax in respect of it.

Of course it was necessary to stop that kind of tax evasion, and of course it was necessary to try to anticipate and forestall more complicated variations of this plan. But this was an early example of legislation directed against tax evasion, and experience has shown that in at least one respect it is too narrow—see *Potts' Executors* v. *Commissioners of Inland Revenue*(1) [1951] A.C. 443, to which I shall return—and in other respects it is too wide. Its provisions suffer from two glaring defects. In the first place, they impose heavy liabilities in respect of many kinds of ordinary and innocent transactions which no laymen and indeed few lawyers not familiar with this section would ever imagine could be caught in this way—in short, they are a trap. And secondly, they are framed in such a way that their plain meaning in many cases leads to a result which Russell L.J. has rightly called monstrous. Normally when we construe a Statute we are attempting to discover the intention of Parliament from the words used in the Act; but here it is obvious, and indeed admitted, that Parliament could never have intended some of the results which are inescapable if certain of the provisions of the section are not to be disregarded. But we cannot apply a statutory provision in one way in cases where it creates injustice and in a different way in cases where it serves to defeat attempts to evade tax.

The first and main question in this case involves the construction of s. 411(4). I have tried to explain why it was necessary to bring in companies controlled by settlors and used in aiding schemes for tax evasion, and this subsection is intended to do that. The fact that it is so widely drawn as to be a trap for the innocent does not in my judgment entitle a Court to attribute to any of its provisions a strained or unnatural meaning so as to make it impotent in those cases where tax evasion is attempted. It applies to companies subject to surtax directions, which would be followed by apportionment of the whole income for the year where that is directed. There is no difficulty about para. (*a*). If for any year there has been apportionment of any part of the company's income to the settlement trustees (or a beneficiary) the subsection applies. The difficulty is in para. (*b*). This requires that there could have been such an apportionment "if the income" of the company "had not been distributed to the members". There can be apportionment if, and only if, the Special Commissioners are of opinion that a reasonable part of the company's income has not been distributed. So it appears to me that the natural meaning of the words I have quoted is: if a reasonable part of the income had not been distributed. We are to look at the year retrospectively: if there was no apportionment, we are to enquire whether there could have been apportionment, and there could have been apportionment in that case but in no other. If that is right, it is not disputed that, if a reasonable part of the company's income had not been distributed in the year when the loan of £9,100 was made, there could have been apportionment. In fact, a reasonable part must have been held to have been distributed and no apportionment was made of that year's income, but that is immaterial.

The argument for the Appellant was that "the income" must mean the whole income, and that to hold that it means a reasonable part of the income or that part which in fact was distributed involves writing in words which are not there. But in my view "the income" must take its meaning from the context. The expression is capable of meaning "the whole income", or "income" without the article "the", or "part of the income", or such part of the income

(1) 32 T.C. 211.

A as the context indicates to be relevant. And to give the words the meaning "the whole income" would make nonsense of the paragraph. It would only apply if the whole of the company's actual income from all sources had in fact been distributed, but not if only 90 per cent. had been distributed. The Appellant admits that that would be so unreasonable that no one could possibly have intended that to be the test. It may not be easy to see why para. (*b*) is there at B all, but we are not entitled either to disregard it or to attribute an absurd meaning to it if it is susceptible of a reasonable meaning, as I think it is. I should add that I get no assistance either way from the references in paras. (*a*) and (*b*) to bodies corporate not incorporated in the United Kingdom. So I hold that for the relevant year the company must by reason of s. 411(4) be deemed to be connected with the settlement made by the Appellant.

C I now turn to s. 408, under which the assessments have been made. By subs. (3) a loan to the settlor by a company connected with the settlement in the year in which it was made must be treated as having been made by the trustees of the settlement in that year. So the £9,100 must be treated as having been paid by the trustees to the Appellant on the last day of the year 1953–54, although in fact they did not have such a sum available. Then subs. (1) provides that such D a payment—to an extent which I shall deal with later—shall be treated for all the purposes of the Income Tax Act as the income of the settlor for that year. That clearly means that he must pay both income tax and surtax on it. But this is only an assessment to surtax. Counsel for the Crown admitted that it had been the practice not to demand income tax in these cases because that would be wholly unjust and involve double taxation: but they were unable to suggest E any construction of the words of the section which could justify this.

The next point is the extent to which the loan is to be regarded as the settlor's income in any year. Subsection (1)(*a*) deals with the first year, 1953–54. For that year the assessment is £3,607: that can be reconciled with the words of the Act. But for the next year the assessment of £3,165 has been arrived at by a method which bears no relation to the method prescribed by the Act. That is admitted, F and again the reason is given that to follow the prescribed method would lead to injustice and double taxation. The draftsman has chosen such a complicated method that he has obviously failed to realise the absurd results to which it leads in all but the simplest cases—and, I think, in almost every case where the trust income has to be accumulated; so the Inland Revenue have taken it on themselves to disregard the Statute and substitute a method which they think G fair and, if I understood Counsel rightly, in accord with the spirit of the Act. I can, I hope, explain the difference in this way. Suppose loans of £20,000 are made by the connected company in year 1, which is the first in which the trustees receive income. That, after making the calculations in subs. (2)(*b*) and (*e*), is £3,000. That £3,000 is added to the settlor's income for year 1. It is the calculation directed for year 2 which gives rise to the absurdity. Suppose the H trust income in year 2 to be £2,000, then the "income available" up to the end of year 2 is the sum of the incomes of years 1 and 2, i.e. £5,000, because there was a direction to accumulate. And if in year 3 there is a trust income of £3,000 the "income available" at the end of that year is the sum of the incomes for years 1, 2 and 3, i.e. £8,000. In year 2 £5,000 will be treated as the income of the settlor and in year 3 £8,000 will be treated as his income, so, although the trust I income for the three years was only £8,000 in all, the settlor's income for these years will be regarded as increased by £3,000 plus £5,000 plus £8,000, i.e. £16,000, or double the whole trust income. It is not surprising that Russell L.J. called this "monstrous" and that the Inland Revenue refuse to apply subs. (2)

(Lord Reid)

as it stands and have devised a scheme which appears to avoid this particular injustice. But the fact that the Inland Revenue have chosen to assess for a smaller sum that the terms of the section would appear to justify does not entitle us to hold that the assessment is bad.

Then the Appellant argued that he is entitled to a statutory deduction which has not been taken into account. Section 408(2)(*a*) requires that, before ascertaining the "income available" for treatment as the income of the settlor in any year, there must be deducted the amount of any other capital sum, i.e. loan, paid to the settlor in any "relevant year" before the year in which this loan of £9,100 was paid to him. By definition in s. 408(7), "relevant year" simply means any financial year after 1937–38. And a loan of £8,586 was paid by the company to the Appellant in an earlier year, 1951–52. The answer of the Crown is twofold. First, they say that in 1951–52 this company was not a company connected with the settlement. I do not think that the facts found in the Stated Case enable us to determine that matter, and, although this was raised in argument, neither party asked for a remit to enable further facts to be stated. So I pass to the Crown's second answer. They say that if this sum had to be brought in under s. 408(2)(*a*) it would also have to be brought in under s. 408(1), so that the Appellant in the end would be no better off. This the Appellant denies. It is pointed out that, whereas s. 408(2)(*a*) refers to a sum paid "in any relevant year", s. 408(1) refers to a sum paid "in any relevant year of assessment". It was argued that although 1951–52 was a "relevant year" it was not "a relevant year of assessment", because on the facts there could have been no assessment under this section in that year. It is of course an elementary principle of drafting that different expressions should not be used in different places in the same section to express the same meaning. So there is a presumption that these two expressions do not mean the same thing. But that is only a presumption, and if it is applied in this case it leads to an absurd result. So I am forced to the conclusion that this difference of phraseology is only another example of the thoroughly bad draftsmanship of this section. I must therefore decide this point against the Appellant.

Before I conclude I must again draw attention to the very unsatisfactory state in which the law has been allowed to remain since the decision by this House in 1950 of *Potts'* case([1]). In that case the question was whether sums paid by a company connected with the settlement to creditors of the settlor to discharge his debts fell within the scope of this section. It was argued by the Crown that a decision against them "would make it so easy to circumvent the Act as to render it useless for its object". And Lord Normand said, [1951] A.C. 443, at page 459([2]):

> "Courts of law are not concerned with extrinsic circumstances, such as that the provisions of s. 40 [now s. 408] as I have construed them are of little value because they may easily be evaded by those who have the will to evade them; or that persons who contract genuine loans or receive repayment of genuine loans without any purpose of evasion and without in fact evading any liability to tax are as likely to be taxed under s. 40 as persons who contrive elaborate schemes of pretended loans for the purpose of evasion."

But when the case was decided against the Crown nothing was done to amend the section. In the present case it appears that in five different years payments

([1]) 32 T.C. 211. ([2]) *Ibid.*, at p. 231.

were made by the company for the purpose of discharging the Appellant's debt to his bank. In three cases these payments were made direct to the bank, and *Potts' case*[1] shows that they were not caught by s. 408. But it so happened that in the other two years the payments were made by cheques drawn in favour of the Appellant and not in favour of the bank. It is this fortuitous circumstance alone that has brought the Appellant within the scope of s. 408 and imposed on him tax liability for several thousands of pounds. This case may well afford ammunition to that body of opinion which holds that redrafting of the Income Tax Act ought to be taken out of the hands of those at present responsible.

With regret I must move that this appeal be dismissed.

Lord Morris of Borth-y-Gest—My Lords, during the fiscal year 1953–54 a cheque for £9,100 payable to Mr. G. B. Bates was drawn by Thomas Ambler & Sons Ltd. It was recorded in a ledger account kept by that company. That ledger account contained entries of sums paid either to or on the instructions of Mr. G. B. Bates and also contained entries of sums received or held by the company for the credit of Mr. G. B. Bates. When the cheque for £9,100 was received by Mr. G. B. Bates the account showed that no money was owed to him or was held for him by the company. There was a balance owing to the company. I think that it must follow that the sum of £9,100 was a loan by the company to Mr. G. B. Bates. It was none the less a loan because of the existence of a number of transactions as shown in the account. The substance of the matter was that during a year the company paid some sums for Mr. Bates or paid sums to him and that at the close of a year Mr. Bates, who was a man of substance, paid to the company the balance of what was owing to them. The payment of £9,100 was nothing less than a loan. It was a "capital sum" within the meaning of s. 408. It was paid directly to Mr. G. B. Bates. He was the settlor of certain settlements in favour of his children. They were settlements to which s. 408 applied (see s. 408(7)). The capital sum was paid in a "relevant year of assessment" (see s. 408(1)), for I read that phrase to refer to any year of assessment after the year 1937–38. If the capital sum was paid to Mr. G. B. Bates in 1953–54 by any body corporate connected with the settlement in the year 1953–54, then it must be treated as having been paid by the trustees of the settlement in 1953–54 (see s. 408(3)). The sum of £9,100 was paid by Thomas Ambler & Sons Ltd. If that company was in 1953–54 a body corporate connected with the settlement, then the £9,100 must be treated as having been paid by the trustees of the settlement in 1953–54. If so treated, then, to the extent to which the £9,100 falls "within the amount of income available" up to the end of 1953–54, it must be treated for all the purposes of the Income Tax Act 1952 as the income of Mr. G. B. Bates for 1953–54.

Before considering the "amount of income available" up to the end of 1953–54, it is necessary to decide whether Thomas Ambler & Sons Ltd. was in 1953–54 a body corporate connected with the settlements. It must be deemed to be such if (see s. 411(4)(*b*)) the income of the company could have been apportioned to the trustees of the settlement (or to a beneficiary under the settlement) under Chapter III of Part IX of the Income Tax Act 1952 if the income of the company for 1953–54 had not been distributed to the members of the company. This, I think, requires that it should first be assumed that in the year 1953–54 the company had not distributed its income, and that the question should then be asked whether in that eventuality there could have been a direction which would have the result that an apportionment of the actual income from all sources of the company would have been made by the Special Com-

(1) 32 T.C. 211.

(Lord Morris of Borth-y-Gest)

missioners in accordance with the respective interests of the members. In the Case Stated it is recorded that for the year to 31st March 1954 the company paid a dividend of 10 per cent., and that in respect of that year a further additional dividend of 4 per cent. was paid with the agreement of the Special Commissioners. Those dividends were paid to the trustees of the settlements in respect of the shares they held. From the facts as found I think it follows that the income of the company for the year 1953–54 could have been apportioned if the income for that year had not been distributed to the members. The result is that the company was deemed to be connected with the settlement in the year of assessment 1953–54. The capital sum of £9,100 paid to Mr. G. B. Bates in that year must be treated as having been paid by the trustees of the settlement. It must, therefore (see s. 408(1)(*a*)), be treated as the income of the settlor for the year 1953–54 to the extent to which it was within the amount of income available up to the end of that year.

The amount of such income available is to be calculated in accordance with s. 408(2). First, a figure must be ascertained of the aggregate amount of income arising under the settlement in the particular year and any previous year of assessment after 1937–38 which had not been distributed. Certain deductions are to be made, and thereafter there is to be a grossing up. In the years with which we are concerned the income arising under the settlement remained undistributed. From the aggregate of the amount of such income one of the deductions that falls to be made is of the amount of any "other capital sums" paid to the settlor in any relevant year before the capital sum which is being treated as the income of the settlor was paid. On 4th April 1952 the Appellant received a loan from the company of £8,586. Should that sum be deducted in making the calculation under s. 408(2)? If it should, the result would be that the "income available" would be nil. The loan would only be a capital sum within the calculation if it was paid by a body corporate connected with the settlement in the year in which the sum was paid by way of loan. The inquiry becomes, therefore, whether in the year of assessment 1951–52 the income of the company could have been apportioned under Chapter III of Part IX of the Act if the income of the company for that year had not been distributed to the members. In the year 1951–52 some preference dividends were paid, but the company paid no ordinary dividends. If the question is posed, whether (on the assumption that in 1951–52 the company had not distributed its income) the income for that year could have been apportioned under Chapter III of Part IX of the Act, there are indications that the answer would be in the negative, though it may be that the available information does not suffice to give a positive answer without a remission. If the Crown's contention is correct, that the test posed by subs. (4)(*b*) is factual, and that the relevant question is whether the distributions that were in fact made by the body corporate for the relevant period were such as to prevent the making of a direction and apportionment for that period, then it is agreed that in that event, having regard to the figures disclosed by the accounts, the company cannot be regarded as a body corporate connected with the settlement for the year of assessment 1951–52. I would prefer the Crown's contention to that of the Appellant, and in all the circumstances I do not consider that a remission is necessary. I do not think that it is shown that the sum of £8,586 was paid by a body corporate connected with the settlement in the year in which it was paid. We are not concerned with precise figures, but on the views which I have expressed I see no escape from the conclusion that in the year 1953–54 the Appellant was assessable in the manner contended for by the Crown. By an application of s. 408(1)(*b*), and on the facts and figures as

A found, I think it follows that the Appellant was also assessable for the two later years.

I would add my concurrence with the view that it is a matter of regret that the statutory provisions now under consideration have been allowed to remain in an unsatisfactory state.

I would dismiss the appeal.

B **Lord Guest**—My Lords, the controversy between the taxpayer and the Crown centred on ss. 408 and 411 of the Income Tax Act 1952. The first question is whether the company which made the loans to the Appellant is a "body corporate connected with the settlement" within the meaning of s. 411(4)(*a*) of the Act. This subsection reads:

> "(4) For the purposes of this Chapter, a body corporate shall be deemed
> C to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assessment—(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or (*b*) could have been so apportioned if the income of the
> D body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the United Kingdom, if the body corporate had been incorporated in the United Kingdom."

The meaning of this subsection is obscure, but after mature consideration I have come to the view that the construction contended for by the Crown is correct.
E The Appellant's construction involved reading before the word "income", where it appears in para. (*b*), "the whole of the". This would mean that the first limb of the subsection would only operate if the whole of the income had not been distributed to the members, but not so if a portion, however small, had been distributed. This would lead to such a nonsensical result that I decline to accept it. The Crown's contention is that the test posed by the section is factual,
F and that the relevant question is whether the distributions which in fact were made were such as to prevent an apportionment under the relevant section of the Income Tax Act. If this is the proper test, the company is a body corporate connected with the settlement for the years 1953–54, 1954–55 and 1955–56. The rationale of this construction appears to be that subs. (4)(*a*) deals with the company where an actual apportionment has been made and the income has
G thereby become the income of the members. Subsection (4)(*b*) provides for the case where, but for the distribution, there would have been an apportionment; in other words, where the distribution which has in fact been made has prevented an apportionment and the income has also gone to the members.

This construction of the section has an important bearing on the question of the amount of the income available under s. 408(2), but I will pass for the
H moment to the question whether the loans in question were capital sums within the meaning of s. 408(7), which is in the following terms:

> ". . . 'capital sum' means—(i) any sum paid by way of loan or repayment of a loan; and (ii) any other sum paid otherwise than as income, being a sum which is not paid for full consideration in money or money's worth".

It was argued for the Appellant that the expression "being a sum which is not
I paid for full consideration in money or money's worth" qualified, not only the opening words of para. (ii), but also the whole of para. (i), so that the section

(Lord Guest)

would read "any sum paid by way of loan or repayment of a loan, being a sum which is not paid for full consideration in money or money's worth". In my view, this is not a tenable construction and it involves a contradiction in terms. A loan is made in respect of an obligation to repay and could not by its very sense be "for full consideration in money or money's worth". An obligation to repay is not "money or money's worth". Next, it was suggested that these sums were not loans, but were payments passing in the course of a running account between the company and the Appellant. Even if they were, the sums were, in my opinion, none the less loans. I pose the rhetorical question—"If those sums were not loans, what were they?" I accordingly reach the conclusion that the payments made by the company to the Appellants were capital sums within the meaning of s. 408(7) and therefore caught by s. 408(1).

The last point concerns the contention for the Appellant that in calculating the "income available" in s. 408(2) a deduction fell to be made under subs. (2)(*a*) of £8,586, being the net sum paid to the Appellant by the company in 1951–52. Parties are agreed that, assuming the Crown's construction of s. 411(4) is sound, which I think it is, the company was not during that period "a body corporate connected with the settlement", within the meaning of s. 411(4). The deduction is accordingly not admissible.

I would dismiss the appeal.

Lord Upjohn—My Lords, the Appellant was a substantial holder of shares in a private company called Thomas Ambler & Sons Ltd., of which at all material times he was a director. It was a trading company to which Chapter III of Part IX of the Income Tax Act 1952 is applicable, that is to say, it was what is commonly called a "surtax company". The most important section of that Chapter is s. 245. In 1948 the Appellant made a settlement of 60,000 of his shares in the company upon trusts under which, for the relevant years of assessment, the trustees were bound to accumulate the income. The company's financial year began on 1st April, and on 5th April 1954 it made a substantial payment of £9,100 to the Appellant. The Crown seek to tax this sum as income of the Appellant for surtax purposes spread over a number of years, the relevant years of assessment being 1953–54, 1954–55 and 1955–56. They do so in reliance upon certain legislative provisions originally enacted in 1938, and now to be found in ss. 408 to 411 of the Income Tax Act 1952.

Section 408 provided that in certain circumstances (satisfied here) any capital sum paid by trustees of a settlement to the settlor should be treated as income of the settlor to the extent (putting it very briefly) of the available income of the settlement. But realising that the ingenious might devise schemes whereby payments might be made to them by a company rather than by trustees, s. 408(3) provided that:

> "any capital sum paid to the settlor in any year of assessment by any body corporate connected with the settlement in that year shall be treated as having been paid by the trustees of the settlement in that year."

The first and most important question, therefore, is whether the company, having made this payment, is a body corporate connected with the settlement. That depends on s. 411(4) of the Act, which defines a body corporate connected with a settlement. The draftsman of the Act realised that the companies aimed at would in all probability be surtax companies, so he expressly defined a connected company by reference to Chapter III of Part IX of the Act. Now, s. 245 empowered the Special Commissioners to apportion the income of a

A surtax company among its members where it appeared to them that the company had not distributed to its members a reasonable part of its income for its financial year, and s. 411(4) must be read in the light of that provision. Paragraph (*a*) is clear enough: a company is a connected company if any of its income has been apportioned to the trustees of the settlement under s. 245 for that year. Paragraph (*b*) provides that a company is a connected company if any of its income

B

> "could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof".

The whole difficulty of construction of this paragraph, to my mind, is caused by the use of the words "the income". If the phraseology employed had been "could have been so apportioned, if a reasonable part of the income of the body corporate had not been distributed to the members thereof", I would think there

C could be no possible doubt about the construction of the section. It would be reflecting s. 245, and dealing with the purely factual case where there could have been an apportionment but for the fact that the body corporate had distributed sufficient of its income to prevent an apportionment. I cannot myself think that the draftsman of this section was dealing in any way with a hypothetical case but was dealing with a purely factual case.

D The Appellant, however, seizing upon the phrase "the income", has argued that the natural meaning of "the income" is the whole income, and therefore if the company distributes, not 100 per cent. of its income, but only 99 per cent., it escapes from the consequences of para. (*b*). All of your Lordships and the Court of Appeal have reached the conclusion that such a construction must lead to such a ludicrous result that Parliament cannot have intended it. I

E entirely agree. For my part, I am not satisfied that the natural meaning of the words "the income" is necessarily the whole income. It must entirely depend upon the context in which that phrase is found. Again, for my part, I have no difficulty, as para. (*b*) is obviously echoing s. 245, in thinking that the section should be read so as to make a company a connected company if it has prevented an apportionment which could otherwise have been directed by a reasonable

F body of Special Commissioners by reason of the fact that it has distributed a reasonable part of its actual income to its members. Apparently the draftsman of the subsection deliberately excluded from the definition of a connected company those companies which made no, or only a very small, distribution to their members but justified this on the grounds of commercial prudence, so as to prevent the Special Commissioners from saying that a reasonable part

G of the income had not been distributed, and those fortunate companies whose accounts had escaped the vigilance of the Special Commissioners, who failed to make an apportionment. The law was altered to include all surtax companies in 1965.

Accordingly, as it is admitted that the company in the relevant year did distribute a reasonable part of its income in order to prevent an apportionment

H (by a perfectly proper arrangement with the Commissioners), it follows that for that year the company was deemed to be connected with the settlement. Accordingly, if proved to be payment of a capital sum, the payment of £9,100 paid by the company to the Appellant must be treated as having been paid by the trustees of the settlement in that year.

The definition of a "capital sum" includes (by s. 408(7)(i)) "any sum paid

I by way of loan or repayment of a loan". It is perfectly clear that this sum was so paid as a loan: that was the practice of Mr. Bates and his brother. Shortly

(Lord Upjohn)

after the commencement of each financial year of the company they caused to be paid to themselves substantial sums, which they repaid just before the end of that financial year. The particular cheque of £9,100 was dated 5th April 1954, and was made payable to Mr. Bates. It was plainly a payment to him, for he could dispose of the cheque and its proceeds in any way he pleased; the case of *Potts' Executors* v. *Commissioners of Inland Revenue*[1] [1951] A.C. 443, where payments were made not directly to the settlor but to his creditors, is plainly distinguishable.

The final question that arises is whether a sum of £8,586 paid by the company to the Appellant in the year 1951–52 is a proper deduction for the purposes of s. 408(2)(*a*). The Appellant would have been on strong ground, in my view, in saying that sum could be so deducted, apart from the fact that it seems to be common ground that in 1951–52 the company was not a connected company because neither subs. (4)(*a*) nor subs. (4)(*b*) of s. 411 applied to it. Accordingly a payment made by the company to the Appellant in that year cannot be treated as having been paid by the trustees of the settlement in that earlier year; it follows that subs. (2)(*a*) has no application and accordingly the sum is not deductible.

My Lords, I only desire to refer briefly to a more general aspect of this matter. First, the monstrous result of this series of sections, which has been so clearly set out by Lord Reid in his speech; putting it very shortly, if a large capital sum was paid and that had to be spread over income of the settlement for, say, five years, it would follow that the income available in the settlement in the first year would be taken into account five times and would be taxed five times over; income available in the second year taxed four times over and so on. Such a result cannot of course have been intended: but that seems to be the perfectly plain result of the provisions of s. 408(2). It is regrettable, especially having regard to the decision in *Potts' Executors*, now 16 years ago, that it has not been thought fit to amend this section. Instead, the Commissioners of Inland Revenue, realising the monstrous result of giving effect to the true construction of the section, have in fact worked out what they consider to be an equitable way of operating it which seems to them to result in a fair system of taxation. I am quite unable to understand upon what principle they can properly do so, and like Lord Reid I hope this matter may receive some consideration in the proper place.

For these reasons I would dismiss the appeal.

Lord Wilberforce—My Lords, the Appellant has been additionally assessed to surtax in respect of three sums of £3,610, £3,158 and £3,201 for the years 1953–54, 1954–55 and 1955–56. These assessments were made under s. 408 of the Income Tax Act 1952 upon the basis that the Appellant received capital sums from a body corporate connected with an accumulation settlement made for the benefit of his children on 7th August 1948. He appeals against the assessment on three grounds: (1) that the company from which he received payments was not a body corporate connected with the settlement in the relevant years; (2) that such payments as were made to him by the company were not capital sums within the meaning of s. 408(7); (3) that in any event on a correct computation of the figures his liability under the section is nil.

(1) *The body corporate.* The company in question was a trading company named Thomas Ambler & Sons Ltd., incorporated on 2nd April 1948. It had

(1) 32 T.C. 211.

A a preference and ordinary share capital of equal nominal amounts. The trustees of the settlement held ordinary shares in it and the Appellant was a director. It paid no ordinary dividends from its incorporation down to 31st March 1952, but for the accounting years ending on 31st March 1953, 1954, 1955 and 1956 ordinary dividends were paid of amounts accepted by the Special Commissioners as sufficient to avoid a surtax direction under s. 245 of the Income Tax Act 1952.

B In relation to these facts it is necessary to consider the definition of a body corporate connected with a settlement provided in s. 411(4) of the Act. It is as follows:

> "(4) For the purposes of this Chapter, a body corporate shall be deemed to be connected with a settlement in any year of assessment if any of the income thereof for any year or period ending in that year of assess-
> C ment—(*a*) has been apportioned to the trustees of or a beneficiary under the settlement under Chapter III of Part IX of this Act, or could have been so apportioned if the body corporate had been incorporated in the United Kingdom; or (*b*) could have been so apportioned if the income of the body corporate for that year or period had not been distributed to the members thereof and, in the case of a body corporate incorporated outside the
> D United Kingdom, if the body corporate had been incorporated in the United Kingdom."

Since no apportionment was made in any of the three years para. (*a*) does not apply: if at all, the case comes under para. (*b*).

In order to see what the subsection may mean, it is necessary to have in mind the main provisions of s. 245 of the Act, found in Chapter III of Part IX.
E These must be considered as they stood at the time of the Finance Act 1938, from which ss. 408 and 411 were derived, and therefore without certain special provisions later added with regard to investment companies: s. 14 of the Finance Act 1939; s. 262 of the Income Tax Act 1952. They provided that, if it appeared to the Special Commissioners that a company had not distributed to its members, in such a way as to make the amount distributed liable to be
F returned for surtax, a reasonable part of its actual income for the year, they might direct that "the said income of the company" should be deemed to be the income of the members and the amount thereof should be apportioned among the members. There were a number of elaborate provisions of a consequential character, but I need not refer to them here.

The significant points to notice about this legislation are (i) that it is for
G the Special Commissioners to determine, in the light of all they know about the company's business and its requirements, whether in any year a reasonable part of its income has been distributed, (ii) that if they so decide that a direction is appropriate, the direction must extend to the whole income of the company. But the section does not say or suggest that, in order to avoid a direction, *the whole* of the company's income must be *distributed*, but only what the Com-
H missioners decide to be, in the circumstances, a reasonable part. There may be circumstances in which it is reasonable to make no distribution at all: see *Thomas Fattorini (Lancashire) Ltd.* v. *Commissioners of Inland Revenue*[1] 24 T.C. 328.

Returning to s. 411(4), the Appellant's main contention was that the words "if the income of the body corporate for that year or period had not been
I distributed" mean "if *the whole* income" etc. If this were right, the subsection

---

(1) [1942] A.C. 643.

(Lord Wilberforce)

would not apply to the company here because, in each relevant year, an apportionment was avoided by a distribution of less than the whole of its income. But though there is much that is doubtful about the subsection, I am clear that it cannot mean that. In the first place, a test dependent on a total distribution is inconsistent with the statutory scheme, which (as it stood in 1938) depended upon a reasonable distribution: it could only fit the case—exceptional if existent at all—where a reasonable distribution was a total distribution. Secondly, as was well pointed out in the Court of Appeal, this interpretation would introduce a distinction between cases of 100 per cent. distribution, which would be within the section, and those of (say) 90 per cent., which would not. There would be no reasonable logic either in the inclusion of one case or the exclusion of the other. Like the Court of Appeal, therefore, I would not accept this meaning if there is any reasonable alternative.

In the search for another interpretation the first clue is, I think, provided by the references, equally in the body of s. 411(4), in para. (*a*) and in para. (*b*), to the actual year of assessment. These suggest that the test to be applied is to some extent a factual test, related to the position in the year in question, not one wholly hypothetical, related to the nature or structure of the company irrespective of what it does. But one is not entitled to look solely at the actual facts, because some hypothesis is certainly introduced by the words "if the income", etc.: the difficulty is to see what this hypothesis is. That which was put forward by the Crown can be reflected in the following paraphrase: "The income could have been so apportioned but for the fact that the income of the body corporate, which was actually distributed, was distributed". This presupposes that a distribution was made in the relevant year and that it is possible to say that it was this distribution that prevented an apportionment being made. This interpretation has the attraction of a clear and direct application to the facts of this case, for in the relevant years it was shown that discussion took place with the Special Commissioners as to the amount of the distribution with the result that no apportionment was made. It was no doubt mainly this that made it acceptable to the Court of Appeal.

For myself, while I find this meaning clearly preferable to that suggested by the taxpayer, I am not wholly satisfied with it. I am unable to discern, and Counsel for the Crown was unable to suggest, any convincing reason of taxation policy why the test of connectedness for this purpose should be based upon the making of such a distribution as in fact has prevented an apportionment being made. One could think, on the contrary, that the policy of the section would require that a taxpayer who obtains loans or other capital payments from a company which makes an insufficient distribution should be liable to a surtax assessment, and this whether or not an apportionment of income has actually been made. The interpretation which I would prefer is not, perhaps, very different, but it would take a different hypothesis as the starting point. It would take as the test of connectedness that the income could have been so apportioned on the assumption that the income of the body corporate which was in fact distributed was not distributed. In other words, I would read the section as directing one to disregard any distribution made, to assume that it was not made, and then to ask whether, by Commissioners acting reasonably in the light of all the relevant facts about the company, an apportionment could have been made. This seems to produce an intelligible fiscal scheme. Taken together with para. (*a*) it brings within the subsection all (qualified) companies, whether in the relevant year they have abstained from distribution or made any distribution, with the sole exception of a company as to which no body of Commissioners

A could (which I take to mean "could reasonably") have directed an apportionment in the absence of any distribution at all. Such cases are not uncommon and are typified by the company whose affairs were considered in the case of *Fattorini*(1), and very probably by the company in this case in some years prior to 1953. Not to tax a settlor in respect of loans made by such a company seems reasonable enough, because no surtax has been escaped: to tax all other cases B seems, if not fair, at least logical. There is no doubt that, if this is the test, it was satisfied by the company in each of the three years 1953–54 to 1955–56, so that the Crown's argument succeeds on this point.

(2) *The capital sums.* The facts as to these are set out in para. 3(6) of the Case Stated. There can be no dispute, in my opinion, that in 1953–54 the Appellant received a loan or loans from the company amounting to £9,100 which rank C as "capital sums" within the meaning of s. 408(7). It may well be in fact that he received other sums of a similar character, but this one sum is enough to justify the assessments and it is unnecessary to reach any conclusion as to any additional amounts.

(3) *The computation.* The Appellant's contention is that, even assuming points (1) and (2) against him, the assessments made are not justified on the D figures. His argument can be simply identified (though fully to explain it would require some detailed arithmetic) by saying that he claims that, against the figures of assessment in 1953–54, he is entitled to subtract a sum of £8,586 which represents a net capital sum (viz. a loan) paid to him in the previous year, 1952–53. That such a payment was made is proved. The provision under which this deduction is claimed is s. 408(2)(*a*), which refers to "any other capital sums E paid to the settlor in any relevant year before that sum was paid". To qualify as a deduction the capital sum in question must be paid to him either by the trustees of the settlement or (and this is the claim here) by a body corporate connected with the settlement.

The Crown's first answer to this is that in 1952–53 the company which made the payment (Thomas Ambler & Sons Ltd.) was not such a body corporate, F or at least that the Appellant has not shown that it was. The facts, so far as proved, are that, although profits were made in that year, the only distribution made was of a dividend on the company's preference share capital, and it may safely be inferred that the Special Commissioners, who considered the company's affairs in the next following year, thought that this was a reasonable distribution to have made. On the Crown's interpretation of s. 411(4)(*b*), it is G agreed by both sides that the company was not a connected body corporate in that year, and although no finding has been made which would cover the alternative interpretation which I would prefer, it seems unlikely that any different result would follow, and no remission for such a finding to be made was requested on the Appellant's behalf.

The conclusion must, therefore, be that the Appellant does not succeed in H the initial step of showing that the sum for which deduction is claimed was paid by a body corporate connected with the settlement. Consequently this third contention fails *in limine*, and it is unnecessary to deal with some difficult points as to the meaning of "any relevant year of assessment" in s. 408(1) and "any relevant year" in s. 408(2), or with certain computation anomalies which would arise in recalculating the assessments. I must, however, state my opinion that I it seems clear that there are in several respects grave defects in s. 408(2), particularly with regard to the aggregation of income, which are over-ripe for correction.

(1) 24 T.C. 328.

(Lord Wilberforce)

The Crown has very fairly not taken advantage of these deficiencies, which might indeed lead to exorbitant surtax claims, but, in matters of taxation, administrative moderation, though not to be discouraged, is, except in the short term, no real substitute for legislative clarity and precision. A

I would dismiss the appeal.

Questions put:

That the Order appealed from be reversed. B

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Blundel, Baker & Co.]