HIGH COURT OF HOUSE OF LORDS

Lowry (Inspector of Taxes)

v.

Consolidated African Selection Trust Ltd.

LORD CHANCELLOR (VISCOUNT CALDECOTE), VISCOUNT MAUGHAM, LORD RUSSELL OF KILLOWEN, LORD WRIGHT, LORD ROMER.

MAY 8, 1940

Sir Terence J. O'Connor, K.C. and **Reginald P. Hills** *for the Appellant.* **J. Millard Tucker, K.C.** and **Terence Donovan** *for the Respondent.*

JUDGMENT

Viscount Caldecote (Lord Chancellor). — This appeal from a judgment of the Court of Appeal, which was delivered by Sir Wilfrid Greene, M.R., allowing an appeal from Macnaghten, J., raises a difficult question concerning the computation of the profits of trade carried on by a limited company. The respondent company, which carried on the business of searching for and winning diamonds, was incorporated on October 11, 1924, under the Companies Acts, 1908 to 1917, with a nominal capital of one million shares of 5s. each. By a special resolution passed at an extraordinary general meeting of the company on December 6, 1933, the capital of the company was increased by the creation of a number of preference shares and also of 400,000 new ordinary share of 5s. each, out of which 10,000 shares were to be reserved for issue to employees of the company at such time or times and upon such terms and conditions as the directors should determine. Six months later the directors passed a resolution authorising the chairman and vice-chairman of the company to allot and issue on such terms and conditions as they should determine up to a total of 6,000 ordinary shares to employees under the special resolution of December 6, 1933. Accordingly a letter was written on June 15, 1934, to certain members of the staff of the company in the following terms : "The directors desire to show their appreciation of special services you have rendered to the company by giving you an opportunity to acquire a share interest in the company on favourable terms. If you will kindly fill up and return to the secretary the enclosed from of application for —— shares together with a remittance for £——being payment in full at par namely 5s. per share, you will in due course receive an allotment."

2. In response to this invitation applications were made for the whole of the 6,000 shares so offered and payment was made in full. On July 2, 1934, allotments were made and certificates issued to the applicants. On that day the market price of the ordinary shares was 23/16 to 21/4, making a middle market price of £2 3s. 9d It was, therefore, calculated that if the new shares had been issued in the open market, a premium at the rate of £1 18s. 9d. would have been received amounting to a total of £ 11,625, this amount representing the difference between the middle price of the shares in the open market and the sum paid on allotment. The respondents claim to deduct this sum in computing their profits for income-tax purposes.

3. One other fact appearing from the special case must be stated. The employees of the company resident in England who received these shares were assessed to income-tax under Schedule E on the premium value of the shares, on the footing that they were paid this amount as remuneration for their services. The assessment was justified as the Master of the Rolls pointed out in his judgment by the law as declared in the case of *Weight* v. *Salmon* [1935] 19 TAX Cas. 174 ; 153 L.T. 55. It was there decided in your Lordships' House that the profit which the taxpayer in that case was in a position to make by going on the market and selling shares allotted to him on payment of less than the market price was an immediate profit in the nature of money's worth received by him. The employees of the respondent company have in the same way been treated as receiving money's worth, to the extent of the premium value of the shares and have been assessed accordingly. Whether the directors intended that this should be the result of their offer of shares to their employees on the terms contained in the letter of June 15, 1934, may be open to some doubt. It is at least as likely, if attention is paid to the terms of the letter, that the directors really intended to give their employees a chance of acquiring a share interest in the company at a favourable price so that they might have what is sometimes called a "stake" in the company with the success of which their own interests were so closely connected. If the wish of the company had been that their employees should be remunerated by receiving shares which could be turned into cash, the simple course of making a direct payment of an equivalent amount of cash would have produced precisely that same result. The payments could no doubt have been made out of the ordinary resources of this prosperous company. If some special provision of funds to meet the payments were required, shares to the necessary amount could have been issued on the open market at the full price obtainable. This course would have allowed the company without question to treat the payments as trading expenses, and to deduct them from its gross receipts in making up its trading account. The company chose to take another course which did not involve any expenditure of its money, or realisation of any of its assets. It was perfectly entitled to take that course, even though the result might have been to divert into the pockets of its employees the equivalent of the cash profit, which it might otherwise have obtained. In fact, the company did not obtain the cash profit. It is none the less said on its. behalf that it is entitled to make up its trading account as if it had expended a sum of money equivalent to the premium value of the shares in the remuneration of its employees.

4. I find no guidance from the fact that the employees have had to pay income-tax on the premium value of their shares. The assessment on the employees was on the ground that holding an office or employment of profit they received a profit therefrom; the right to include a deduction of the amount in question in the trading account of the company for the purposes of Schedule D must be justified by a finding that the company incurred a trading -expense. The question, therefore, which has to be decided is whether, by reason of the fact that the company did not make use of the opportunity of issuing shares, at a premium, the company can be said to have incurred a trading expense to the amount of the premium.

5. It is to be observed that the learned counsel for : the respondents was insistent at the outset of his argument in disclaiming any intention to base his case upon the contention that the profit on the shares was forgone and could therefore be deducted as an expense. The foundation for such an argument is to be found, if at all, in some observations by Lord Sumner in his speech in the case of *Usher's Wiltshire Brewery, Ltd.* v. *Bruce* [1914] 84 L J K B at p. 435; [1915] AC at p. 469. Those observations, which were cited at length by the Master of the Rolls, were as follows : "A trader who utilises, for the purposes of his trade, something belonging to him, be it chattel or real property, which he could otherwise let for money, seems to me to put himself to an expense for the purposes of his trade. Equally he does so if he hires or rents for that purpose property belonging to another. The amount of his expense is *prima facie* what he could have got for it by letting it in the one case, and what he pays for it when hiring it in the other. Where he gets something back for it, while employing it in his trade, by receiving rent or hire for it in connection with that trade, the true amount of his expense can only be arrived at by giving credit for such receipt. In principle, therefore, I think that in the present case rent forgone, either by letting houses, which the brewers own, to tied tenants at a low rent instead of to free tenants at a full rack-rent in the open market, or by letting houses in the same way, which they hire and then re-let at a loss, is money expended within the first rule applying to both of the first two cases of Schedule D." In view of the disclaimer by the respondents' counsel of any intention of basing his case on the argument that a "profit was forgone" in the present case, it is unnecessary to say more about the propositions contained in the passage I have quoted from Lord Sumner's speech than that they may require very careful examination if they are relied on as having the authority of your Lordships' House. The Master of the Rolls, however, did not refer to these observations for the purpose of supporting the argument which counsel for the company was at pains to disclaim. On the contrary, the Mister of the Rolls expressly rejected the argument, I agree with him so far as I understand the argument, but in any case the word "forgone" as used by Lord Sumner was no more than an apt word to describe the result of a simple arithmetical calculation, namely, the deduction of amounts of the rent received by the brewery company from amounts of the annual value or of the rent paid by the brewery company in respect of premises used by the brewery company in selling its liquor. It is clear that any attempt to build upon the use of the expression "rent forgone" any such argument as was, apparently without justification, fathered by the Grown on the respondents counsel must fail.

6. It is said, however, that the decision in *Usher's* Case (*supra*) , supported and explained as it is by the case of *Hoare & Co.* v. *Collyer* [1932] 101 LJKB 274; [1932] AC 407*,* was based upon a broad principle which is applicable to the present case-The argument is that the company parted with money's worth in. issuing the shares at par to the employees, or, to use the words of the Master of the Rolls, the company " has remunerated its employee to its own financial prejudice by giving to its employee the power which it had itself, of obtaining a monetary sum in respect of those shares". This view of the facts is said to warrant the conclusion on the authority of *Usher's* Case (*supra*) that the respondents are entitled to make the deduction in question. It is therefore necessary to examine *Usher's* Case (*supra*) to see whether it really is an authority for this proposition.

7. The facts of *Usher's* Case (*supra*) are familiar. The brewery company owned or rented houses in order to provide places in which the company's liquor could be sold. So far as the freehold houses were concerned, the annual value for the proposes of Schedule A was treated as an expense incurred by the company. In the case of the leaseholds, the rent paid which as Lord Loreburn pointed out was not other than the proper annual value, was an obvious item of expense. Both freeholds and leaseholds were let as tied houses at rents less than that annual value, and the difference was claimed by the brewery company to be a permissible deduction. What is, now Rule 3 of the rules applicable to Cases I and II of Schedule D with its prohibition of certain deductions had on those facts to be considered. Lord Parker (84 LJKB, at p. 430; [1915] A.C., at p. 460) called attention to the three points decided on the construction of the rule in the case of *Russell* v. *Town and County Bank* [1888] 58 LJ PC 8; 13 App. Cas. 418*:* First, that the annual value or rent of premises used wholly for the purposes of the trade is a proper deduction in ascertaining the balance of profits and gains. Secondly, that the effect of the prohibition now contained in Rule 3 (*c*) could not be extended by implication to cover a 'deduction which would, otherwise be a proper deduction, and thirdly, that what is now Rule 3 (*a*) does not preclude a deduction for the annual value of premises used wholly for the purposes of the trade, though the annual value is not money upended in the ordinary sense of the word. Applying that construction your Lordships' House decided that the deduction claimed was properly made in ascertaining the balance of profits and gains :

8. The brewery company was treated in the case both of its freehold and of its leasehold premises as incurring an outlay. The deduction of the outlay, once it had been decided to have been incurred, was no more than an application of the elementary principle stated by Lord Herschell in the case of *Gresham Life Assurance Society* v. *Styles* [1892] 62 LJQB at p. 47; [1892] AC at p. 321 *:* " Profits are ascertained by setting against the income earned the cost of earning it" With the greatest respect to the Court of Appeal I am unable to find any principal laid down in *Usher's Case* [1914] 84 LJKB 417; [1915] AC 433 which can be applied to the facts of the present case, even assuming that the view of those facts taken by the Master of the Rolls was the one which commended itself to me.

9. I come back to the facts of this case, and I ask whether the issue of the these shares in the manner adopted involved the respondent in any "disbursements or expenses wholly and exclusively laid out or expended for the purposes of" its trade. Its capital was intact after the issue of the shares; not a penny was in fact disbursed or expended. Its trading receipts were not diminished, nor do I think it is right view of the facts to say that the respondent gave away money's worth to its own pecuniary detriment. The company was entitled to issue its shares at par. It did so, and the company never received, and never elected to receive, anything more than the par value of the shares. Quite apart from any desire to let the employees have a share interest in the company, the directors might have had very good reasons for deciding not to issue shares to the company's employees at a price which could only. Only be justified by an expectation of very high dividends over a long period of time.

10. I am fortified in this view by the opinion of Lord Davey in the case of *Hilder* v. *Dexter* [1902] 71 L J Ch. at p. 784; [1902] AC at p. 480 In that case the appellants had subscribed to shares in company with an option to take further shares at par. The shares rose to a premium and the appellants desired to take them up. Lord Davey's speech contains the following passage "

The argument seems to be that the company, by engaging to allot shares at par to the shareholder at a future date, is applying or using its shares in such a manner as to give him a possible benefit at the expense of the company in this sense, that it forgoes the chance of issuing them at a premium. With regard to the latter point, it may or may not be at the expense of the company. I am not aware of any law which obliges a company to-issue its shares above par because they are saleable at a premkam-in the market. It depends on the circumstances of each case whether it will be prudent or even possible to do so. and it is a question for the directors to decide."

11. I should very much regret it, if the law was not what, in the light of Lord Davey's opinion, I conceive it to be If in the circumstances of this case the company must be held to have suffered a financial detriment, or in .other words to have incurred an expense, solely by reason of the fact that it did not issue its shares at a premium, very far-reaching results might follow in many cases in which for one reason or another an opportunity of securing some financial advantage is not used, That, however, does not in any way affect or alter the view I take of this case on the facts. The-plain fact as it appears to me is that the cost to the company of earning its trading receipts was not increased by the issue of these shares at less than their full market value. In my view this appeal should be allowed and I move accordingly.

Viscount Maugham stated the material facts and continued :- What we have in effect to consider is whether, since the company has not in fact received any part of the sum of £ 11,625, the premiums which the company might have got and expanded, but never did get or expend, can be treated as an expense or deduction laid out or expended in some artificial but legitimate sense for the purpose of the trade of the company. This is a rather difficult proposition establish in the affirmative. We are invited to consider something which did not take place; and it is to be remembered that in *Blott* v. *Inland Revenue Commissioners* [1921] 90 L J K B 1028 ; [1921] 2 A C 171 this House declined, to be influenced by the argument that the case before it was the same as if the shareholders had received the bonus and paid it back : to the company to be retained as capital. The simple answer was that they never received it at all (90 L.J.K.B., at pp. 1034, 1037,. 1040 : [1921] 2 A.C, at pp. 184, 194 and 200).

13. The same answer might, I think, be given here. The hypothetical view of the facts is not here the true one. The plain object of the company, as the resolution and the letter of June 15, 1934, show, was to give to the employees in question "an opportunity to acquire a share, interest in the company on favourable terms ". The-directors were making use of their powers to enable this to be done. The terms were favourable in order to make sure that the offer would be accepted.) The advantage to a 'trading company or a "business firm of an arrangement as the result of which employees get a stake in the concern is on 3 which has been dilated upon for the past hundred years. It is a false view of the transaction to regard it merely as a present of money or money's worth. The company, it is true, parts with a right, since shares once issued cannot (except in cases of forfeiture) be issued again; but the nature of this right' must now be considered.

14. In my opinion this appeal largely turns on the nature of the right of a company to issue its shares at any price and on any conditions it thinks fit provided that it does so in good faith for the benefit of the company and does not issue them at a discount (See *Hilder* v. *Dexter* [1902] 71 L J Ch. 781; [1902] AC 474). Upon an issue of shares the assets of the company are increased by the amounts obtained from the subscribers. These amounts are obviously not profits or gains of. the trade, and they are not liable to be brought into the accounts for income-tax. It may be said that these amounts are of the nature of capital, but I prefer for the present purpose to say that beyond all doubt they are not profits and gains arising or accruing from a trade, for that goes directly to the question which arises under Schedule D. What I have said is equally true whether the shares are allotted at par or at a premium. The sum of £11,625 which in this case the company might hypothetically have received for premiums was not an item in its profits and gains. In the ordinary course such a sum would be carried to a reserve account in the balance sheet : but carrying it to some account in the profit and loss account would not have affected the matter. It would not be an item of profit of the trade. Indeed the issue of shares by a limited company is not a trading transaction at all. The corporate entity becomes *pro tanto* larger; but the receipts of the trade on the one hand and the amount of the costs and expenditure necessary for earning these receipts on the other remain unaltered; and it is the difference between these two sums which is taxable under Schedule D. It is well settled that profits and gains must be ascertained on ordinary commercial principles, all this fact must not be forgotten—*Gresham Life Assurance Society* v. *Styles* [1892] 62 LJQB at pp. 44. 47 ; [1892] AC at pp, 316, 321 ; *Usher's Wiltshire Brewery* v. *Bruce* [1914] 84 LJKB at pp. 429 ; [1915] AC at p. 458.

15. There is one other fact importance of which must be borne in mind. It is that the company was not discharging a debt or liability to the employees when it issued the 6,000 shares to them at par. The word "remuneration" has been more than once mentioned in this case as if it described the advantages which the employees were obtaining by the issue, and I think it has led to some confusion. If money or money's worth in any form, whether from capital or income, is given to an employee in discharge of an ordinary trading obligation or debt due to him incurred in the course of the trade and is accepted as such, I am quite ready to accept the view that the amount of the debt or liability so discharged will find its way into the profit and loss account on ordinary commercial principles and will *pro tanto* reduce the profits for the year for income-tax purposes. A man's salary with his consent can be paid in meal or malt as well as in money, and that salary is one of the items of expenditure which go to reduce the amount of the profits and gains. If in this case the employees were paying the par value of the shares and also releasing to the company some amounts of salary due to them the case would be very different from what it is. All we really have before us is that the company has chosen to issue 6,000 shares at par to the employees and that they have received the benefit of that issue. There is really nothing more. The employees have given up nothing. The company has not lost or parted with any asset. It has a fewer number of shares remaining for issue ; but of course, it can create as may more as it pleases. There is here, in my opinion, no transaction of trade at all, nor an item of any kind that ought to be carried to either side of the profit and loss account. If the company, apart from the issue of the 6,000 shares, made a profit of half a million in the year in question, I am myself wholly unable to understand how it can be said that that profit has been reduced to the extent of a farthing (much less £ 11,625) by reason of the fact that the company has 6,000 fewer shares to issue to the public. The company cannot, even if it would, deal in its own shares, and the latter do not partake in any sense of the nature of

stock-in-trade. The issue of shares by a company, whether at par or over, does not affect the profits or gains of the company for the purposes of income-tax.

16. If there were no authorities to be considered, and if the Court of Appeal had not expressed a different view from mine, I should have been tempted to leave the matter there; for in its essence I think it is only necessary in this case to ascertain the profits and. gains on ordinary commercial principles; But out of respect to the : Court of Appeal I must now deal, I fear at some length, with some at least of the matters and the cases which have, as I think, led them to a wrong conclusion.

17. I think it is clear that the premiums obtained on an issue of shares are not items of. receipt in the account of profits and gains-It must then be asked, what is the event which is alleged in this case to entitle the respondents to treat the amount of these premiums as a disbursement or expense wholly and exclusively laid out or expended for the purposes of the trade.(rule 3 of the Rules applicable to Cases I and II) ? The contentions of the taxpayer are set out in para. 13 of the case stated. It is said in effect that the amount of the premiums is "an amount forgone" by the taxpayer because the shares were issued at less than their market value to the employees as "remuneration" for their services, or, alternatively, that if the company had issued the shares in the open market it could have utilised "the premiums" for the purpose of paying "the aforesaid remuneration" and could then have debited the amount for the purpose of computing its profits for income-tax purposes. There are, I think, quite distinct reasons. To the first I think the short answer is that an "amount forgone" is not (with one special exception) deductible, and that there is no principle under which such a sum can be treated as a disbursement or expense of the trade. To the second the reply is that you must look at the events which have happened, not those which never happened, and that there is nothing to show that the premiums in question will ever be obtained by anyone either in the year of assessment or in any subsequent year.

18. The first point seems to be founded on an expression used by Lord Sumner in the case of *Usher's Wiltshire Brewery* v. *Bruce* [1914] 84 L J K B 417; [1915] A C 433. The material question—material for our consideration—in that case was whether a brewery company which had, wholly and exclusively for the purposes of its trade, acquired licenced houses which they let to tied tenants at rents substantially lower than their full letting values, was entitled to deduct as expenses incurred in earning its profits the difference between the Schedule A assessments and the rents paid by the tenants. Lord Sumner (84 L.J.K.B., at p. 435; [1915] A.C., at p. 469) observed : [His Lordship read the passage already set out in the judgment of the Lord Chancellor]. With all respect to the memory of a great Judge, I cannot help saying that the reference to "chattels" in the first sentence must be due to a slip, and moreover I do not think the sentence in its wide form can possibly be supported. None of the other speeches gave any countenance to it, and it was certainly not necessary for the decision of the appeal. ' The second sentence contains the words "rent forgone", but I think the words in their context mean only rent which might have been but was not actually received. The decision, so far as it concerned the point as to a deduction for rents, was in truth governed by the previous decision of this House in *Russell* v. *Town and County Bank* [1853] 53 L.J.P.C. 8 ; 13 App. Cas. 418. I am spared the duty of stating the results of that case because Lord Parker (84 L.J.K.B., at p. 430 ; [1915] A.C., at p. 460) stated with his usual lucidity and acuteness the three points on the construction of the rule applicable to Cases I and II which were decided in *Russell* v. *Town and County Bank* [1853] 53 L.J.P.C. 8 ; 13 App. Cas. 418. The third point decided was that " the first part of the rule 3 (*a*) which prohibits deductions for disbursement and expenses, not being money wholly and exclusively expended for the purpose of the trade, does not preclude a deduction for the annual value of premises used wholly for the purposes of the trade, *though such annual value is not money ex pended in the ordinary sense of the word"* (the italics are mine.) The main reason for this decision, surprising as it is at first sight, is to be found in Lord Herschell's speech in *Russell* v. *Town and County Bank* [1883] 58 L.J.P.C. at P. 10 ; 13 App. Cas. at p. 425. It depends on the particular provisions of the Income Tax Acts. "It is quite true," Lord Herschell said, "that, strictly speaking, the annual value where the premises are owned and not rented is not money laid out or expended for the purposes of the trade; but it is admitted and must, I think, have been, admitted, that in either the one way or the other that deduction is to be made, because inasmuch as it is clear that even in the case of a dwelling-house a part of which is used for purposes wholly unconnected with the trade, the annual value of the portion which in used for the purposes of the trade is to be deducted", (that is, under rule 3 (*c*), "it is evident that it can never be contended that in the case of premises used not for the purpose of a dwelling at all but exclusively for trade purposes, the annual value is not to be deducted". This reason is, I think, decisive ; but it seems to me to be beyond doubt that there is no ground for extending this artificial and unusual construction of the rule to anything beyond the annual value of premises exclusively used for business purposes, and that *Usher's Case* (*supra*) has no application in the present appeal. The ground of the decision, as Lord Herschell's speech in the earlier case clearly showed, is limited to premises used exclusively for the purposes of the business. I do not understand how the reasoning of those cases can throw any light upon the present case, and I am unable to agree with the Master of the Rolls that *Usher's Case* (*supra*) is laying down some broad, though undefined, principle which may extend to all sorts of cases in which the taxpayer has "forgone" a profit. Where are we to stop? If a company chooses to make a sale of goods at cost price to a subsidiary company, is the former to be allowed to make a deduction of the difference between market value and cost price in its profit and loss account on the ground that it is profit forgone ? I do not believe anyone would so contend; but for myself I am unable to think of any concrete example of a "profit forgone" in relation to goods and chattels or services rendered which would stand the test of justifying the deduction on ordinary business principles.

19. If we turn to the second point it is to be observed that it is only in an exceptional case that either the Crown or the subject is entitled to claim on the basis of a transaction which has not taken place. There are no doubt cases where, for example, a payment in, cash is deemed to be the result of an accord and satisfaction. You need not pass cheques backwards and forwards across a table. But we have nothing of that kind here. The company was issuing the shares at par without any juggling with cheques; it was a plain straightforward offer and acceptance of shares at par followed by an allotment. It is said by the Master of the Rolls that the company has remunerated its employees to its own financial prejudice by giving to them the money's worth of the premiums on the shares allotted to them. I would prefer to say "has made a present to its employees".

The words "to its own financial prejudice" do not, I think, advance the argument, for all they mean is that certain shares have been issued at par while they might have been issued at a higher price. How does that lead us to the conclusion that (moneys have been "laid out or expended" for the purposes of the trade? For myself I do not think the premiums which might have been obtained are "money's worth" in the sense in which those words are generally used, that is, as an equivalent for cash paid by the company; and in my opinion that view is supported by the case I must next refer to. But whether or not that is so, I repeat that in this case the sum of £11,625 which the company never obtained was not in any sense laid out or expended for the purposes of the trade.

20. I think this House in the case of *Hilder* v. *Dexter* [1902] 71 LJ Ch. 781 [1902] AC 474 decided *by* necessary inference that although a premium obtained by a company on an allotment of its shares is obviously money belonging to it and is *prima facie* part of the capital of the company, nevertheless the advantage which an allottee of shares at less than the market value of the shares obtains is not either money or money's worth belonging to the company, nor is it part of the capital of the company. That was a decision on Section 8 (2) of the Companies Act, 1900. Lord Halsbury took the responsibility for its drafting (71 L. J. Ch., at p. 783; [1902] AC, at p. 477); but I cannot say that the section is an example of lucidity, and it is necessary to study the case with some care to discover precisely what was being : decided. The first sub-section of Section 8 states the condition under which a company might pay a commission to a person in consideration of his agreeing to subscribe for shares. It required disclosure and provided a limit of the amount. The second sub-section, stated shortly, runs thus : "Save as aforesaid, no company shall apply any of its shares or capital money either directly or indirectly in payment of any commission….whether the shares or money be so applied by being added to the purchase-money of any property acquired by the company or to the contract price of any work to be executed for the company, or the money be paid out of : the nominal purchase-money or contract price or otherwise." The section therefore prohibits the payment of such a commission out of shares of the company or money coming from the allotment of shares in the company and out of any money belonging to the company with, however, the possible exception of the earned profits of the company. Lord Davey's speech, concurred in by Lord Halsbury and Lord Robertson, shows this quite clearly, though he does not mention the possible exception I have referred to. He points out that the words "apply any of its shares or capital money" include money derived from the issue of shares (71 L.J. Ch., at p. 784; [1902] A.C., at p. 480). A little lower down the same page he observes that the company in the case before the House was not indeed "parting—with any moneys belonging to it (the company)". He then had to deal with the words "directly or indirectly". The argument was that this prevented the company from "applying or using its shares in such a manner as to give" the person promising to subscribe for shares "a possible benefit at the expense of the company in this sense, that it forgoes the chance of issuing them at a premium". Here we come across precisely what is said in this case. Lord Davey, however, deals with the point by saying that there is no law " which compels a company to issue its shares above par because they are saleable at a premium In the market", and that "the benefit to the shareholder from being able to sell his shares at a premium is not obtained by him at the expense of the company's capital". If this House had regarded the transaction as one in which the company was giving "money's worth" in the sense of an equivalent for cash in consideration of the promise to subscribe for shares the decision would have been the other way. The words "directly or indirectly" would have been in point.

21. On the other hand there is no doubt at all that a man who gets a share standing in the market at £2 3s. 9d. for the sum of 5s. is himself getting an advantage of considerable value. The point of *Hilder* v. *Dexter* [1902] 71 LJ Ch. 781; [1902] AC 474 for the present purpose is that he is not getting it in any true sense at the expense of the company, though no doubt the company has forgone the chance of making a profit, which as I have pointed out above, would usually be treated as capital.

22. The decision of this House in *Weight* v. *Salmon* [1935] 153 LT 55; 19 Tax Cas. 174; 51 TLR 333 is also invoked by the respondents. It was there held that director could properly by assessed on the premium value of shares in their company for which they had been given the privilege of subscribing. Since the allottee at par of shares standing at a premium is plainly getting an advantage capable of being turned into money, it is easy to arrive at the conclusion, if Schedule E applies to him, that the market value of the shares less the amount he pays is within the wide words of rule 1 of that Schedule : " Salaries, fees wages, perquisites or profits whatsoever." I can see no difficulty in that case; but I have a difficulty in appreciating its application to the one before us. It depended on the language of the rules applicable to Schedule E, while the problem which arises under Schedule D seems to me to be a very different one, since it concerns profits of a trade and is subject to a large number of prohibitions as to the deductions which alone are premissible and on other statutory rules of some complexity.

23. It is, of course, clear that if a company owing, say, £500 to an employee for his contractual salary agrees to deliver to him so many tons of coal or any other marketable commodity in discharge of the-£500, the company would then be entitled to deduct the £500 as an expense. I only mention this for the purpose of remarking once more that it is not the present case. A number of other questions have been raised as regards the giving of coal and other commodities to employees. I do not wholly agree with what the Court of Appeal has said in relation to those matters; but I do not think they arise on the present appeal, and for my part I think it will be wiser not to express an opinion on them.

24. In conclusion I return to the view which I expressed earlier its this judgment, A company, generally speaking, can issue its share's at any price it likes not being less than par. This is not a trading, transaction, and does not in any way affect its gains and profits, under Schedule D. In the present instance the shares were issued at par to certain employees in order to give them an interest in the company, but not in payment of any sum contractually due to' them. In these circumstances the respondents have, failed to establish that any sum has thus been expended or laid out, for the purpose of the trade of the company.

25. It follows, in my opinion, that the appeal should be allowed.

Lord Russell of Killowen. — The respondents in this case claim that in computing the profits of their trade assessable to income-tax, there should be deducted a sum which they have not disbursed, and in respect of which they have incurred no liability.

27. I will not recount all the facts, they have already been stated. I must, however, call attention to one important matter. The claim is made upon the footing that the sum in question represents remuneration paid by the respondents to their servants, but the transaction as evidenced by the documents does not, I think, warrant this terminology. The sum in truth represents the premium on certain shares which the respondents might have issued to the public at a price above par, but which they elected to offer to their servants at par, in order to induce them to become shareholders' and therefore, servants directly interested in the welfare of the company. That is an accurate description of the transaction. The hope and intention were that the servants should keep the shares. No doubt the servants had it in their power to sell and obtain a premium from their purchasers. No doubt too they, or such of them a were liable to income-tax, would be taxable on the benefit which accrued to them from the allotment at par. These, however, are considerations irrelevant to the question which we have to determine, namely, whether the respondents are entitled to deduct as a trade expense a sum equivalent to the premium at which the respondents might, had they so chosen, have issued the shares.

28. The Court of Appeal answered this question in the affirmative, but in my opinion the deduction is not permissible. I have considered with care the judgment delivered by the Master of the Rolls. It rests, I think, on two foundations : one, that the respondents transferred money's worth from themselves to their employees : the other, that upon the authority of *Usher's Case* (*supra*) the premium which the respondents elected not to obtain was a "profit forgone" which they were entitled to enter on the expenses side of their trading account in ascertaining their trading profits. It is true that the Master of the Rolls emphatically disclaims any assertion of the general proposition that money forgone is money expended, but the exact limits within which the proposition may apply are not very clearly marked.

29. There is no difficulty about the cases, indicated in the course of the judgment, in which a servant is remunerated in kind. The value of the "kind" must be deducted in ascertaining the profits of the trade, subject however to this, that if the " kind " is part of the trader's stock-in-trade further entries must be made in the account if it is desired to ascertain the profit made by the realisation of all the stock-in-trade realised ; for the "kind" which is applied at its value in remunerating the servant is stock-in-trade realised just as much as if sold at that value to a customer. The value of the "kind" should, I think, be included in the receipts as representing a realisation at the value at which it discharges *pro tanto* the servant's salary, and the expenses should include, in addition to the cost of the whole stock-in-trade, an item representing the whole amount of that salary. I am throughout assuming that the cost is lower than the market value. But transactions such as that do not represent what in fact happened in this case. Here the respondents in my opinion parted with nothing; they transferred no asset of theirs to the servants. The power of a limited company to issue and allot shares is not an asset of the company ; it is only a power to increase its issued capital and, it may be, the number of the corporators. It is not bound to issue its shares for more than their nominal value. The words of Lord Davey in *Hilder* v. *Dexter* [1902] 71 L J Ch. at p. 784 ; [1902] AC at p. 480 may be quoted : "... the argument seems to be that the company, by engaging to allot shares at par to the shareholder at a future date, is applying or using its shares in such a manner as to give him a possible benefit at the expense of the company in this sense, that it forgoes the chance of issuing them at a premium. With regard to the latter point, it may or may not be at the expense of the company. I am not aware of any law which obliges a company to issue its shares above par because they are saleable at a premium in the market. It depends on the circumstances of each case whether it will be prudent or even possible to do so, and it is a question for the directors to decide. But the point which, in my opinion, is alone material for the present purpose is that the benefit to the shareholder from being able to sell his shares at a premium is not obtained by him at the expense of the company's capital." I am of opinion that the first basis of the judgment of the Court of Appeal fails because the respondents transferred neither money nor money's worth to their servants; they merely elected not to obtain more than the nominal value of the shares in order to induce the servants to become shareholders in the company. I cannot hold (apart from compelling authority) that such action by the respondents is, or may be treated as, a disbursement or an expense; or that the premium which the servants could, if they wish, obtain from purchasers of their shares, is or may be treated as money laid out or expended by the respondents for the purposes of the respondents' trade.

30. It is, however, said that compelling authority does exist in the decision of your Lordships' House in the case of *Usher's Wiltshire Brewery, Ltd.* v. *Bruce* [1914] 84 LJKB 417; [1915] A C 433 : and I now proceed to consider this question.

31. The matters there in debate which are relevant to the present case were two—namely, (*i*) the freehold tied houses which the brewery let to tenants at rents lower than the Schedule A assessment, and (*ii*) the leasehold tied houses which the brewery sub-let to tenants at rents lower than the rents paid by the brewery to the freeholders. It was held that the brewery could, in ascertaining its profits, charge as an expense (in the first case) the difference between the rents paid by the tenants and the Schedule A assessment, and (in the second case) the difference between the rents paid by the tenants and the rents paid by the brewery. In other words, the receipts side of the account included the smaller sums of rent received by the brewery while the expenditure side included the larger sums representing (*a*) the annual value of the freeholds and (*b*) the rents paid by the brewery. Three things may here be noted—namely (1) so far as concerns the leaseholds the position seems; to present no abnormal features, it is a plain case of entering actual income and actual outgoings; (2) the great difficulty arose as to the freeholds in regard to which no actual disbursement or expense was made or incurred by the brewery, which could be described as money laid out or expended for the purposes of the trade; and (3)-it was never suggested that anything beyond the Schedule A assessment (that is, the amount of a potential rackrent) could be charged as an expense. It is in regard to the decision concerning the annual value of the freeholds that I propose to consider the case.

32. This House decided that the annual value could properly be entered as an expense, or (to put it in other words) that the difference between the larger amount of the brewery's assessment under Schedule A and the smaller amount of the rent received from the tied tenant was deductible in ascertaining the brewery's profits for the purposes of income-tax.

33. It is important to see how this result was achieved because it is upon the authority of *Usher's Case* (*supra*) that the Court of Appeal has relied. Just as in *Usher's Case* (*supra*) "rent forgone" was held to be money wholly and exclusively expended

by the brewers for the purpose of the trade, so it is said the premium here forgone by the respondents is money wholly or exclusively expended by them for a similar purpose. Such, as I read the judgment, is the view expressed.

34. *Usher's Case* (*supra*) when examined, will prove to be founded, and I think entirely founded, on the earlier 'decision of the House in *Russell* v. *Town and County Bank* [1888] 58 L J P C 8; 13 App. Cas 418. Lord Parker of Waddington, in *Usher's Case* (*supra*), said in terms that it was covered by that decision. The question there was whether, in ascertaining the profits of a bank, the annual value of the whole of bank premises was deductible including that part of them in which the bank manager resided. The difficulty of treating the annual value as a disbursement or expense or as money laid out or expended for the purpose of the trade was fully appreciated, but the difficulty was overcome, and it was treated as a permissible deduction, by reason of the fact that the provision of the 1842 Act (which corresponds with the present rule 3 (*c*) of the Rules applicable to Cases I and II of Schedule D) showed that in appropriate circumstances annual value might be deducted. Lord Herschell made this clear when he said (58 L.J.P.C, at p. 10 ; 13 App. Cas., at p. 425) : [His Lordship read the passage set out in Viscount Maugham's judgment.]

35. Having thus laid the foundation of the right to deduct the annual value of premises wholly used for bank purposes, Lord Herschell then held that the fact of the bank manager residing in part made no difference, because that part too was used for the purposes of the bank's business, and further that the premises in question were not a dwelling-house within the special statutory provision in that behalf. As I read the decision the right to deduct the annual value of land used for the purposes of trade, whether as a necessary element in arriving at the balance of profits and gains of the trade or as included under a broad construction of disbursements and expenses, is based upon and justified by the existence of the express provision now represented by rule 3 (*c*).

36. Both cases are decisions dealing with the ownership by the trading company of land in which rule 3 (*c*) or its predecessor came into consideration as a reason for allowing the annual value to be treated as a permissible deduction. Neither is an authority extending beyond that, and in my opinion *Usher's Case* (*supra*), founded as it is on Russell v. *Town and County Bank* [1888] 58 L J P C 8; 13 App. Cas 418 does not justify the deduction which is claimed by the respondents. It is true that the language used by Lord Sumner, and quoted by the Master of the Rolls, is far-reaching and extends even to chattles; indeed if taken literally it would lead to some startling results. The other members of this House who took part in the debate use no such wide language and I, for one, am not prepared to extend the decision so as to cover the wholly different facts of the present case. Both these decisions relate to the annual value of land, to which peculiar considerations are applicable, and I am unable to see how the reasoning in either of these two decisions of your Lordships' House can be applied to a case like the present, in which the claim is to deduct a sum which never came into existence because the respondents, in order to achieve a desired result, elected to issue some shares at their nominal value.

37. As a last argument, it was urged that apart from *Usher's Case* (*supra*), and the rules, the deduction was permissible on general commercial principles. I do not agree. If the respondents had issued the shares at a premium, no trace of the transaction would appear in the profit and loss account. I find difficulty in understanding how on any principle, commercial or otherwise, you may, by electing not to get a sum, become entitled to charge as an expense in your profit and loss account the amount of the sum which, if you had got it, could not have been included therein as a receipt.

38. I am of opinion, for the reasons which I have endeavoured to indicate, that this appeal should succeed.

Lord Wright - - stated the preliminary facts and continued : But for the divergence of opinion which has emerged, I should have been clear in my mind that the £11,625 claimed as a deduction was properly so claimed. If the respondent company had arranged with certain of their employees to satisfy their salary or part of it to the aggregate extent of £ 11,625 by the allotment of these shares at 5s. instead of charging the market price, I do not see how it could be contested that the £11,625 was deductible as a trade expense. It would *pro tanto* wipe off trade debits for wages just as much as if it had been utilised to discharge any other indebtedness. Each employee by the allotment of the fully paid shares would be paid what was due to him to the extent of the difference between 5s. a share and the market value. He in truth receives a share or chose in action worth £2 3s. 9 d. ; though he has to pay 5s. for each share (because the company cannot issue the shares at less than par) that is really a deduction from the gross value which he receives, so that he is only paid, in the hypothesis immagined, £1 18s. 9d. in respect of each share. I shall not express the position as being that he obtains the power to realise a profit of £1 18s. 9. What he gets is the share and all the rights which it involves. He may realise it and turn it into cash, or keep it as an investment for income or appreciation. The payment of 5s. a share does not make the position in essence different from what it would be if the salary were being paid by a transfer of shares in a subsidiary company which were held by the respondents and which they could transfer without any payment at all. The only difference is that in such a case the full market value of the shares, and not the market value less 5s. a share, could be reckoned as the sum paid.

40. I cannot see any distinction between the case supposed where the shares are used to discharge a pre-existing debt for salary and where they are utilised to pay a bonus or extra remuneration. No doubt in the former case the value attributable to the share is expressly liquidated on the footing of the amount of the debt. In the case of the bonus remuneration the amount of the bonus is only determined by ascertaining what is the value to the employee of the share which he receives, which in the present case is the market value less 5s. a share. But I see no difference. In fact, the recipient is taxed on precisely this basis, as in respect of profits of his office. This practice, which was followed in the present case, has the authority of this House in *Weight* v. *Salmon,* [1935] 153 L T 55 ; 19 ; TAX Cas. 174 ; 51 T L R 333 where directors who had been allotted at par by way of remuneration fully paid shares which stood at a premium in the market, were taxed on the difference between the market value and the par value. The question from the point of view of the recipient who is taxed under Schedule E is obviously different from that of the company on its. profits under Schedule D. But it is at least clear that the recipient does obtain a profit. In my opinion this profit so obtained was in the facts found at the expense of the respondents (if I may use the word in its ordinary business sense) and even though in other cases, as Lord Davey points out in *Hilder* v *Dexter* [1902] 71 L J Ch. at p. B

784; [1902] A C at p, 480, the benefit which the recipient obtains may or may not be at the expense of the company in the sense that it forgoes the chance of issuing them at a premium. Lord Davey says ; [His Lordship read the passage in Lord Davey's judgment already quoted and set out in the judgment of the Lord Chancellor]. In the present case any question of this nature is disposed of by the findings in the special case which states that the) directors could have issued the shares in the open market at a premium, but offered them at par to the employees solely in the interests of the respondent trade.

41. The respondents have parted with an asset at one-tenth of its-value in order to further the interests of the company. The case States at what price they could have sold the shares in the market. Most people would say that they gave them away, treating the 5s. a share as merely a nutigation of what would otherwise be a free transfer, or the difference between the 5s. a share and its market value may be regarded, to borrow Lord Atkin's phrase from *Weight's Case,* (*supra*) as a notional sum paid in order to remunerate the employees or as a sacrifice made to promote the company's trading. However it is put, the benefit which the employees receive by having the shares at 5s. a share is at least in the facts of this case correlated with the corresponding expense incurred by the respondent company when they allotted the shares on these terms. It may be that this would be clearer if the difference were being used to pay a debt as for definitely stipulated wages. But I can see no difference in principle. No doubt in that event as a matter of book-keeping the debt would appear on one side and the difference in value on the other said. But similarly, here the extra remuneration paid should appear on one side and the difference in value on the other side of the account. It has been notionally received on capital account, and is being utilised on revenue account, just as would have been the case if it had been used to pay an ordinary debit. It is true that unissued shares are not an asset in any sense of the company. What value they have only comes when and by the fact that they are issued, just as a deed has no value or indeed existence until it is signed, sealed and delivered, or a negotiable instrument until it is issued. Unissued share capital was described by Lord Davey in *Hilder* v. *Dexter* [1902] 71 LI Ch. at p. 784; [1902] A C at p. 480 as potential capital. The power to issue further capital is only a potentiality. But the fact of issue makes. it actual capital, and creates the fasciculus of rights and liabilities between the company and the shareholder which flow from the, share when issued. If the share stands at a premium, the directors *prima facie* owe a duty to the company to obtain for it the full value which they are able to get It is true that it is within their-powers under the Companies Acts to issue it at par even in such case, but their duty to the company is not to do so unless for good reason. Normally they would transfer the difference between the market value and the par value to a premium reserve or similar capital account. But they could justify issuing the share at par on the ground the that difference has been utilised to secure a benefit to the company, as here by paying the extra remuneration to the employees and it may be also by giving them an interest in the company. In my opinion when the directors did so the company was incurring an expense on revenue account deductible; as such under Schedule D in order to assess the balance of profits and gains. This is so none the less because the premium, if acquired, would not have been a trading profit but a receipt on capital account.

42. I think there is authority in this House which in principle precisely covers this conclusion. I refer in particular to *Usher's Wiltshire Brewery, Ltd.* v. *Bruce,* [1914] 84 LJKB 417; [1915] AC 433 where it was held that a trading company which had transferred an interest of value at less than its full value, in order to advance its trade, was entitled in estimating the balance of its profits and gains to claim to deduct the difference between the full value and the amount which it thus received, as being an expense necessarily earned for the purpose of earning the profits. The trade in question was that 6f a brewery company. In the ordinary course of that trade the company was-either owner or lessee of licensed houses which it let to "tied" tenants, who, in consideration of the tie, paid a rent less than the full annual value. It was the difference between the rents and the full annual values which the company was held to be entitled to deduct as an expense of the trade under the Rules applicable to-Cases I and II of Schedule D. Lord Loreburn shortly summed up the position (84 L. J. K. B., at p. 423 ; [1915] A.C. at p. 446) : "On ordinary principles of commercial trading such loss arising, from letting tied houses at reduced rents is obviously a sound commercial outlay." In the same way, in the present case the loss involved in allotting the shares at less than their market value for the purposes found by Commissioners is a sound commercial outlay which the respondent company are entitled to bring into account. Lord Atkinson states (84 L. J. K. B., at p. 426; [19151 A.C., at p. 451) : "This is only another way of saying that the appellants let their tied houses at low rent solely and exclusively; for the purpose of promoting their trade and enhancing the profits of It". Later on (84 L. J. K. B., at p. 429; [1915] A.C., at, p. 457) he compares what would have been the position if the brewery-company instead of putting in a tenant into the tied house had put in a manager. In the latter case, on the authority of *Russell* v. *Town and Country Bank,* [1888] 58 L J P C 8 ; 13 App. Cas. 418 the full annual value of the house would have been deductible. "But"; Lord Atkinson proceeds 'the balance of the profits and gains of the brewer's trade would, according to the methods of practical business men, be ascertained in the same way in both cases, that is, by deducting from the receipts what it cost to earn them. Part of the cost to the brewer is, in the Manager's case, his salary, and possibly a discount on profits. In the case of the tenant it is the difference between the annual value of his, the brewer's, freehold house and the rent he receives for it, and in his leasehold house the difference between the rent he receives for it and the rent he pays for it, if that be equal to the full annual value under Schedule A. For the purposes of striking; the balance of profits and gains the two cases are in principle undistinguishable". I draw special attention to these last words as showing conclusively that nothing turned on any feature peculiar to landed interests in Schedule A. Earlier in his speech (84 L. J. K. B., at p. 426; [1915] A.C., at p. 452) Lord Atkinson said : "If he" [the trader] "abstains from letting his premises and devotes them to the purposes of his trade, he must be taken to have dedicated to that trade a sum equivalent to the annual sum which he might have obtained in the shape of rent if he had let them to an untied tenant." It is true that in that case the trade was different and the subject-matter was different, but the difference between the brewer's trade and the diamond merchant's, and between the letting of houses and the allotting of shares must not be allowed to veil what in my opinion is the identity in principle. The undervalue deliberately incurred was a dedication of all equivalent sum to the purposes of the trade. Lord Parker speaks to the same effect. He points out that the brewers were claiming to deduct the difference between the Schedule A assessment and the rent they received or the difference between the rent they paid and the rent they received, the former applying when they are freeholders and the latter when they are leaseholders. He said (84 L. J. K. B., at p. 432; [1915] A. G, at p. 463) : "In other words they claim the Schedule A assessment value or the rent they pay as a deduction, giving credit on the other side of the

account for the rent paid by the tenants of the tied houses." He held that they were right in their contention, because it was a. deduction not precluded by the first rule applicable to Cases I and II, and necessary to ascertain the balance of the profits and gains in any true sense of that expression. But he added that "the right to make the deduction, however, must of course carry with it the obligations to give credit for the rents received from the tenants of the tied house." I think, notwithstanding certain objections which I shall consider later, that this decision does in principle precisely apply to the case now in question. The brewers were letting their houses at an undervalue in order to promote their trade. They were held entitled to a deduction of the true value, subject to allowance for the rent which they actually received. Here the respondents are parting with their shares at an undervalue for the purposes of their trade. They are accordingly, it seems to follow, entitled to a deduction of the market value of these shares, subject to an allowance for the par value which they actually receive. The sacrifice in *Usher's Case* (*supra*) was of the rents, in the present case of the market value of the shares, less in either case the credits-The fact that Schedule A applies to property in land does not, in my opinion, affect the position, save that the annual value under Schedule A takes the place of market value. Lord Sumner puts this principle very clearly (84 L. J. K. B. at p. 435; [1915] A. C, at p. 469) : [His Lordship read the passage already set out in the judgment of the Lord Chancellor.]

43. If the "expense" of letting houses at an undervalue for purposes of the trade is a deductible expense under Schedule D, I cannot see why in principle the expense of alloting shares at an undervalue for purposes of the trade should not equally be deductible under Schedule D.

44. But it was objected that *Usher's Case,* (*supra*) like Russell's *Case* (*supra*) which, to a certain extent, it followed, related to rent and that the principle enunciated in these cases was not general, but was limited to deductions in respect of rent. It was sought to maintain this proposition by reference to the Rules applicable to Cases I and II of Schedule D. The contention was that this House decided the two cases referred to not on any general principle but on the specific terms of the Rules which relate to rent or annual value. In the Acts before 1918 these Rules were for practical purposes identical with what is now to be found in rule 3 (*c*) and in rule 5, and I shall accordingly refer to the modern Rules. Rule 3 (*c*) deals with the rent or annual value of a dwelling-house and prohibits any deduction in that respect except for such part as is used for the purposes of the trade of profession, etc., of the person claiming the deduction. Rule 5 provides that the computation of the tax shall be exclusive of the profits and gains arising from (or since 1927 of the annual value of) lands, tenements and so forth occupied for the purpose of the trade or profession, etc., of the person being assessed, and separately assessed under Schedule A. I may note in passing that in *Usher's Case* (*supra*) the tied tenant, not the brewers, were occupiers of the premises. After a careful study of the rule and of these two authorities I can find nothing to justify putting this limited interpretation on the principles laid down. I do not wish to repeat all that was said on this point by Lord Herschell in *Russell's Case* (*supra*) or by the various Lords, especially Lord Parker in *Ushers Case* (*supra*). The Rules do certainly present a curious example of draftsmanship. The governing principle, however, is that the assessment is to be on the balance of the profit and gains. Rule 1 provides that the tax shall be charged without any deduction other than is by the Act allowed. Rule 3 (*a*) is the most general in its terms. "No sum shall be deducted in respect of any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment or vocation". One major question debated both in *Russell's Case* (*supra*) and *Usher's Case* (*supra*) was whether there could be a deductible expense when there was no outlay in money, but merely the sacrifice or surrender of something of value wholly for the purpose of the trade. This was true of the rent of the manager's residence in *Russell's Case* (*supra*) where the whole rent was forgone, and of the rent in *Usher's Case* (*supra*) where only a part was forgone. The decision was in both cases that the money value of the rent forgone was deductible, and that in *Usher's Case* (*supra*) the partial payment made no difference, save that the amount deductible had to be reduced *pro tanto.* Lord Herschell in *Russell's Case* (*supra*), after examining the rules, thus concludes : "The annual value" [of the premises occupied by the bank manager] "is, therefore, to be deducted somehow. It is to be deducted either by taking it as an element before arriving at the balance of profits and gains, or as included is a very broad construction of the provision relating to disbursements and expenses". Lord Herschell means in that phrase that there is a disbursement or expense within the rule though not in a literal sense, since money has not been expended. In *Usher's Case* (*supra*),' Lord-Parker arrives at a similar conclusion. He deals with the prohibition against any deduction for the rent or value of a dwelling-house; except such part as is used for the trade, and points out that the; rule refers only to a dwelling-house Occupied by the person to be assessed. He summed up the position thus (84 L.J.K.B., at p. 430; [1915] A.C., at p. 460) : "In other words, the effect of the prohibition cannot be extended by implication to cover a deduction for rent or annual value which would otherwise be a proper deduction in ascertaining the balance of profits and gains". He states his general view of the law on this point (84 L.J.K.B. at p. 429; [1915] A.C, at p. 458) : "The better view, however, appears to be that, where a deduction is proper and necessary to be made in order to ascertain the balance of profits and gains, it ought to be allowed,, notwithstanding anything in the first rule or in Section 159" [of the Act of 1842] "provided there is no prohibition against such an, allowance in any of the subsequent rules applicable to the case". In my opinion Lord Parker is clearly deciding the case on general principles, not on any particular feature attaching to rent or annual value. Lord Sumner expressed this view quite specifically in the passage I have quoted. Lord Loreburn's reference to "sound commercial outlay" again put the principle. So also did Lord Atkinson in the passage I have quoted. The particular analogy he draws between the manager's salary and the reduced amount of rent shows that he was enunciating a general principle.

45. In *Hoare & Co.* v. *Collyer,* [1932] 101 L.J.K.B. 274 ; [1932] A.C. 407 the principle in *Usher's Case* (*supra*) was considered by this House, the issue being whether the loss by brewers on the lettings of some tied houses could be set off against the profit on others. This House decided against such aggregation of gains and losses. But all their Lordships summed up the effect of *Usher's Case* (*supra*) in substantially the same terms. I shall quote the language of Lord Atkin (101 L.J.K.B., at p. 278 ; [1932] A.C., at p. 416) : "Whether the expense allowed in *Usher's Case* (*supra*) is based upon deduction of the Schedule A valuation as on premises used in the brewers' business, mitigated by the sum received from the tied tenant, or whether it is regarded as a notional sum paid for the advantage of the tie, it is allowed as an expense incident to the particular house in

respect of which it is incurred. It in no way differs from expenses for repairs or compensation levy or insurance : premiums on particular houses such as are also authorised by the same decision". Lord Tomlin (101 L.J.K.B., at p. 279; [1932] A.C., at p. 419) said : "In *Usher's Wiltshire Brewery Ltd.* v. ' *Bruce,'* where tied houses of a brewery company were held by the tenants at rents below the Schedule A valuation, your Lordships' House, as I understand the case, treated the difference between the rent and the valuation in the case of each house as rent forgone, or money spent exclusively for the purpose of earning profits, and held that expense to be one which could be deducted for the purpose of ascertaining profits and gains under Schedule D". The other Lords who took part in the appeal spoke to the same effect. It is difficult to see what Schedule A has to do with this kind of question, except as fixing the limit of annual value. Schedule A deals with the assessment of the charge on the landholder. The deductions now being considered are deductions under Schedule D in respect not of land owning but of a trade or business. The two schedules are disparate and distinct.

46. One other case I must refer to, that of *Weight* v. *Salmon* [1935] 153 L.T. 55 ; 19 Tax Cas. 174 ; 51 T.L.R. 333. I regard that case as the counterpart of the present though it is not a direct authority because the question there turned on the different language of Schedule E. It dealt with the position of the recipient, not the payer. The Company there had allotted shares to its directors at par which was considerably below their market value.

47. As the allotment was found to be by way of extra remuneration for their services, it was held that the directors (or at least the director who was concerned in the case) were taxable in respect of the value of that remuneration under rule 1 of Schedule E. Lord Atkin, in whose speech the other Lords concurred, said that the difference between the price paid and the value of the shares was an immediate profit in the nature of money's worth, and put as an analogy a case where a director of a colliery company himself engaged in the coal trade was given the privilege of buying coals at one-third of their market price. That would clearly be a profit or perquisite of the office. But as the Master of the Rolls observed in the judgment appealed from it would be a startling inconsistency to say that the director was to be taxed because he was receiving by way of remuneration money's worth at the expense of the company, and yet that the company which was incurring the expense for purposes of its trade to remunerate the directors was not entitled to deduct that expense in ascertaining the balance of its profits and gains, whether the matter is dealt with as an expense under the specific Rules applicable to Cases I and II under Schedule D, a course which would be justified by the opinions expressed in *Usher's Case,* (*supra*) or alternatively under the general right to deduct expenses according to the ordinary principle of commercial trading.

48. It is true that in certain cases an employee who has received a benefit from his employment may not be assessable in regard to the value of it. Thus in *Tennant* v. *Smith* [1892] 61 L.J.P. C. 11; [1892] A.C 150, H.L.(Sc) a bank manager or agent, who was in the same position as the manager or agent in *Russell's Case* (*supra*) was held not to be assessable in respect of the privilege of free residence, in particular because he was not free to dispose of that advantage or turn it into cash. "Schedule E", said Lord Macnaghten (61 LJ.P.G, at p. 17 *;* [1892] A.C., at p. 163) "extends only to money payment or payments convertible into money", or in Lord Watson's words (61 L.J.P.C., at p. 15 ; [1892] A.C., at p. 159), "Money or that which can be turned into pecuniary account". The decision of this House in *Weight's Case'* clearly involves that the acquisition by the recipient of the shares involved a benefit convertible into money, that is to the extent of the difference between the par value and the market value. It seems to follow that an equal sacrifice expressible in terms of money must have been suffered by the respondents. To that extent *Weight's Case* (*supra*) directly supports the respondents' case.

49. It was, however, contended that though the employee may profit, the company is at no expense and is not out of pocket when it issues shares at par, by way of remuneration or for a special purpose in the interest of its business, because the company is involved in no expense since to allot shares at par, instead of at their market value, costs the company nothing. It is true that the directors would not be breaking any provision of the Companies Acts if they allotted shares at par instead of realising their market value. They might do so for some legitimate reason', for instance, to give a bonus to the extent of the price difference s to shareholders, or to remunerate employees, or to discharge a debt of any; kind. Otherwise the shareholders might complain that by so issuing shares at less than the market value the directors were wasting the assets of the company, if they were not getting something in return or had no good reason for so doing or at least did not *bona fide* think they had. It is, however, said that shares are not an asset of the company, I agree, as I have already observed, that : unissued shares are not an asset of the company. But in Lord Davey's useful phrase in *Hilder* v. *Dexter,* [1902] 71 LJ Ch. 781; [1902] A C 474 they are potential capital. The company which has the right to issue them has a-right which it can turn into money, and the amount' of money which it can derive from the issue depends on the market. The question is not what shares cost the company, but what they were worth' to the company in the sense that it was open to the company to derive the full market value, either by selling on the market or by, allotting at an undervalue as fully paid shares for some special consideration or object in the company's interest. No one, I imagine, would deny that if the company had been possessed of bonus, shares in a subsidiary company which had cost them nothing, the value to them of these shares was their market value, and that if the company used these shares to pay a debt or satisfy an obligation, in the course of the company's trading, their value could be deducted in ascertaining the balance of profits and gains. I see no difference in principle between that case and the present.

Hilder case (*supra*) in my opinion either does not throw any light on the question whether in this case the company has incurred an expense or, perhaps more accurately, supports my view, for the reason which I stated in citing it above. The sole question there-was whether an allotment of shares at par fell, on the facts of the case, within Section 8 (2) of the Companies Act, 1900, which prohibited a company from applying either directly or 'indirectly any of its "shares or capital money" to the payment of commissions and similar matters, save as provided in the Act A shareholder who had taken up shares did so in the terms of an agreement that he should have the option at a later date of taking up a certain number of shares at par. He exercised the option when the market price was above par. The company fulfilled its contract and it was held that the section was not contravened. Lord Davey (71 L.J. Ch., at p. 784; [1902] A.C., at p. 480) construed the words "share or capital money" as meaning " its capital, either in the form of shares before issue, when they may be described as potential capital, or in the form of money derived from the issue of its shares". He concluded, "the point which, in my opinion, is alone material for the

present purpose is that the benefit to the shareholder from being able to sell his shares at a premium is not obtained by him at the expense of the company's capital", This in my opinion is merely a decision on the particular words of the Act and affords no guidance in this appeal. Indeed, it seems clear that in the events which happened the capital was not being reduced nor had there been any outlay of money, capital or otherwise, by the company nor any application of shares or capital money to the payment of commissions and sot forth. The company was simply fulfilling its contract. The words of the Act are narrow.

50. I must not be taken to say that a profit forgone is in every case the same as an outgoing or expense, or that money's worth is always to be deemed to be the same as money. But I think that in the facts of the present case and for purposes of determining the deductions permissible for the respondents under Schedule D, both propositions may be asserted.

51. For all these reasons, which in substance are the same as those stated by the Master of the Rolls in the Court of Appeal, I think that the decision of the court of Appeal was right. I regret that I find myself unable to agree with those of your Lordships who are of a different opinion.

Lord Romer, after stating the facts, said :- It has been laid down on more than one occasion by this House that in order to ascertain whether, in computing the profits of a trade for the purposes of Schedule D, Case I, of the Income Tax Act, a particular deduction is permissible, the profits 'must be ascertained on ordinary commercial principles by setting against the income earned what it has cost to earn it, provided always that, as regards each particular item of cost, its deduction is not expressly prohibited by the terms of the Act and Rules. It becomes necessary, therefore to inquire in the present case whether, in ascertaining the profits of its trade on ordinary commercial principles, it would be permissible to deduct the sum in question as forming part of the cost of earning the company's income. It must, of course, be conceded that the sum never formed part of the assets of the company. It was nevertheless, a sum that could have been made an asset had the directors decided to issue the 6,000 shares to the public at the market price. The company, therefore, had the power of acquiring; such a sum. I have never consciously committed, and I trust that I may never commit, the great sin in a lawyer's eyes of confusing; property with power. If a man has a general power of appointment over a sum of money, the- sum does not strictly speaking form part of his assets. Should he release the power voluntarily, his assets will be in no way diminished. He will not have parted with a farthing. But he will nevertheless be the poorer for having; released the power. So too in the case of a company whose shares-stand at a premium in the market. The directors may, if they think fit, and if they act in good faith, issue the shares at par. In such a case they in effect voluntarily release the power of the company to acquire the premium. The company parts with none of its money, but it is nevertheless the poorer for the release. For not only does the company give up by the release the opportunity of adding to its assets a sum in cash, it also gives up the opportunity of utilising the possession of the power for the purpose of adding directly to its stock-in-trade, or for the purpose of preventing a diminution of its existing assets. Where a company issues its shares at a premium, the premium is a receipt on capital account. It is not a trading profit and it is not chargeable with income-tax-It can, nevertheless, be distributed as dividend among the shareholders, or spent in purchasing stock or machinery, or in any other way that the company thinks fit. But the company may equally well utilise its power of realising the premium by purchasing (say) stock-in-trade, or by discharging a liability without any cash passing through its hands at all. If a company, for example, whose £ 1 shares stand at 10 per cent, premium in the market buys goods of the value of £110 by the issue of 100 fully paid shares to the vendor, the cost price of the goods to the company is £110. If it then sells the goods for £ 130, its trading profit from the transaction (apart from working charges which can be disregarded) will be £ 20 and not £30. It will have made a total profit on the transaction of £ 30, but £10 of this, representing the premium, will be entered as a receipt on capital account. The £ 20 alone will be taxable.

53. A company, too, in the like circumstances, may discharge an existing trading liability of £100 by the issue to its creditor of 1,000 shares for a payment of £1,000. It will not have parted with the £ 100, but it will have utilised the power of realising the £100 premium by preventing its assets being depleted by that amount. The £100 will accordingly be deducted from the trading account, *pro tanto* diminishing the taxable trading profit, and a similar amount must be credited in the books as a receipt on capital amount. It is to be observed in both these cases that, if the, premium could be treated as a trading and taxable receipt' there would be no necessity to resort to this method of bookkeeping. In the first instance, the cost of the goods could be entered as being £100 only, and in the second instance nothing would be deducted in respect of the debt and nothing' in either case would be credited in respect of the premium. It is "the fact that the premium is not a trading and taxable receipt that renders this "short circuiting" " impossible.

54. Applying these considerations to the present case, it is obvious that the directors have utilised the possession of the power of realising a premium "of £ 118s. 9d. on each of the 6,000 shares for the purpose of inducing their employees to subscribe at par for those 'shares and so become members of the company. It is found that this was done solely in the interests of the company's trade, which means that it was done solely for the purpose of enabling the' company to earn its income. In these circumstances. I should; but for the fact that some of your Lordships, are of the contrary opinion, have thought it plain that in ascertaining the trading profits of the company on commercial principles the deduction now sought to be made was permissible as part of the cost of earning the company's income, a like sum being, of course, credited to its capital account.

55. It may be convenient at this stage to say something about a passage in the judgment of the Master of the Rolls in the present case that has been the subject of much misunderstanding. The passage in question is as follows (108 L.J.K.B., at p. 376), [1939] 7 I.T.R. at p. 446" "If an employer having two receptacles, one containing cash and the other containing goods, chooses to remunerate his employee by giving him goods out of the goods receptacle instead of cash out of the cash receptacle, the expenditure that he makes is the value of those goods, not their purchase price or anything else but their value, and that is the amount which he is entitled to deduct for income-tax purposes." It seems to have been thought that the Master of the Rolls was here suggesting that, for the purpose of ascertaining the profits of the employer's business made by the purchase and sale of such goods, the cost of the goods to the employer was to be treated as their sale value. The Master of the Rolls of course said nothing so absurd. If an employer having brought 100 tons of coal at 20s. per ton and having incurred

no other expense than £10 10s. paid in cash to his clerk for salary, sells the coal for 30s. per ton the profit of his trade is £39 10s. If, however, instead of paying, the clerk in cash, he pays him by handing over to him seven tons of coal worth 30s. a ton, and sells the remaining ninety three tons, at 30s. per ton, the result to the trader will obviously be the same as in the first case. But the amount that he will enter in his accounts in respect of the salary of his clerk will depend upon the way in which he chooses to keep his books. He may, if he likes, treat the .seven tons as haying been sold to the clerk at 30s. a ton, In. that case he will deduct £10 10s the value of the seven tons; as an expense in respect of the clerk's salary. In this case, however, the sum that would have been realised had the seven tons been sold at 30s. would have to ,be treated as a trading receipt. The employer could therefore, and no doubt would, "short circuit" the account by crediting himself with nothing in respect of the seven tons and debiting nothing is respect of the salary.. I have taken this example as it was one that, the Solicitor General placed before your Lordships for the purpose of, showing that, in such a case as last supposed, no deduction could be made in respect of the clerk's salary. But the Solicitor-General was assuming , that the employer "short-circuted" the account. No further deduction could be made in that case in respect of the salary, for it would have already been deducted in account. The Master of the Rolls on the other hand, was obviously assuming that the employer used, the longer, and perhaps more accurate, way of keeping his accounts. In that case the value of the seven tons of coal would properly be deducted as an expense, for the employer would have credited himself with that value as a trade receipt. The Master of the Rolls no doubt thought it was unnecessary to say so. And so it was.

56. Having arrived at the conclusion that the deductions in the present case would on commercial principles be permissible as part of the cost of earning the company's income, I must now inquire whether such a deduction is expressly prohibited by the Income-tax Act and Rules. I can deal with this matter quite shortly. The only rule that by any possibility can be regarded as prohibiting the deduction is rule 3(*a*) of the Rules applicable to Cases I and II of Schedule D. But if the sum now in question is to be regarded as a disbursement or expense at all, it can only be done by treating the company by a stretch of the imagination as having received the sum and passed it on to the employees. In that case, however, the sum must be treated as money, and, as it would have been wholly and exclusively laid out or expended for the purposes of the trade, the deduction is not prohibited. I should therefore have arrived at the conclusion that the deduction in question is permissible, even if there were no authority to be found in the books to lend support to that conclusion. There are, however, at least two decisions of your Lordships' House which appear to me to be direct authorities-in favour of the view that I have endeavoured to express. They are *Russell* v. *Town and County Bank* [1888] 58 LJPC 8; 13 App. Cas. 418 and *Usher's Wiltshire Brewery, Ltd.* v. *Bruce* [1914] 84 L J K B 417; [1915] AC 433. The facts in the first of these two cases, decided under the Income-tax Act, 1842, were as follows. A company carrying on the business of banking were the owners of the premises upon which the business was carried on, and those premises contained certain accommodation occupied as a dwelling-house by the manager of the bank. The company claimed to deduct, in estimating the balance of their profits and gains tinder Schedule D, the entire annual value of the bank premises, including the portion so occupied by the manager. The Crown, on the other hand contended that the portion of the premises occupied for that purpose ought to be dealt with separately from the part used for the actual carrying on of the business and that no deduction ought to be allowed in respect of the annual value of the portion occupied by the manager as a dwelling-house. The point at issue, therefore, was, in effect, whether the deduction of this last mentioned annual value was not forbidden by what at that time corresponded to the present rule 3 (*c*), it being admitted by the Crown that the annual value—that is, the rent which the company might have received for the bank premises proper had they let the premises to a tenant — was a proper deduction. This admission was held by Lord Herschell to have been rightly made. He said this (58 L.J.P.C, at p. 10; 13 App. Cas., at p. 425) : "Now it is not disputed that the annual value of premises exclusively used for business purposes is properly to be deducted in arriving at the balance of profits and gains. I am, of course, speaking for the moment of premises which are not used in any way as a place of dwelling, but are exclusively business premises. But there may be a question where the right to make that deduction is to be found. I am myself disposed to think that it is allowed because it is an essential element to be taken into account in ascertaining the amount of the balance of profits. If not it can only be included by a very broad extension of the terms actually used, as being a disbursement or expense which is money wholly and exclusively laid out or expended for the purposes of the trade." He then referred to the exception contained in the predecessor of rule 3(*c*) which was substantially the same as the exception contained in rule 3(*c*) but, as I read his judgment, merely as being confirmatory of the conclusion he had reached without that exception. If he had thought that the exception was itself an enactment impliedly justifying the deduction he would have said so, and would not have given other reasons for arriving at his conclusion which seems to be based on quite general principles. The annual value of the part occupied by the manager was also allowed as a deduction, it being held that the part so occupied was not a dwelling-house within the rule. Lord Fitzgerald also based his decision on general principles relating to the ascertainment of profits, and made no reference at all to the rule relating to dwelling-houses. He said this (58 L.J.P.C., at p. 12 ; 13 App. Cas., at p. 429) : " 'Profits' I read on authority to be the whole of the incomings of a concern after deducting the whole of the expenses of earning them—that is that what is gained by the trade. The whole expenses of earning : them must mean, according to the Schedule, the whole expenses incurred for the purposes of the business and nothing else. But I come, upon the statement of facts, to the conclusion that the whole premises were used for the purposes of the business of the bank and the annual value of them forms a proper deduction in estimating the balance of profits That balance of profits is to be ascertained after deducting the whole of the necessary expenses save those which by negative provisions are excepted in the statute." Lord Macnaghten said (58 L.J.P.G., at p. 12 ; 13 App. Cas., at p. 430) that the deduction was "properly and necessarily made in estimating the profits and gains of the bank which were chargeable with duty," and that there was nothing in the rules applicable to Cases I and II under Schedule D prohibiting the deduction. He did not think that the house was a dwelling-house within the meaning of the rules. I would call attention to the word "necessarily" used by Lord Macnaghten.

57. I regard this case as a clear authority for the proposition that in computing the profits of a trade for income-tax purposes a sum may be deducted as part of the cost of earning the receipts which has never in fact been paid or expended, but is something the receipt of which has been forgone for the purpose of the trade. In the particular case the company refrained

from letting their premises, and so earning a profit, solely in the interests of their business. It was,, therefore, proper and necessary on ordinary commercial principles to deduct from their receipts this profit that they might have made as part of the cost of earning such receipts; and there was nothing in the Act to render such deduction illegal.

58. *Usher's Case* (*supra*) is, as I read it, another authority for the same proposition. The facts of that case are so familiar to your Lordships that I will not weary you with reciting them. It is sufficient to recall that the brewery company sought to deduct (amongst other things) the difference between the annual value in the case of freehold and the rent they paid in respect of leasehold houses on the one hand, and the rent received from their tied tenants on the other. Your Lordships are also familiar with the reasons given by this House for deciding that the actual cash disbursements made by the company in connection with the tied houses were allowable deductions upon ordinary commercial principles and not prohibited by the Income-tax Acts then in force. But the important thing to be noticed for the present purpose is that none of their Lordships who were parties to the decision drew any distinction between the freehold and leasehold properties, that is to say, between the rents paid for the leaseholds and the annual values of the freeholds. Both the annual values in the case of the freeholds and the rents paid in the case of the leaseholds were treated as forming part of the cost of the brewery business and for precisely the same reason, namely, that both the rents paid for the leasehold properties and the rents that would have been received for the freeholds had they been let, instead of being used for the business, formed part of the costs incurred in earning the receipts of the business, and that the deduction of them was not prohibited by the Act. Lord Loreburn, referring to both classes of property together, said (84 L.J.K.B., at p. 423; [1915] A.C., at p. 446) : "On ordinary principles of commercial trading such loss arising from letting tied houses at reduced rents is obviously a sound commercial outlay." Lord Atkinson, in holding that it was immaterial whether a manager or a tied tenant was put into occupation of the houses, said (84 L. J .K. B., at p. 429; [1915] A.C., at p. 457) : [His Lordship read the passage set out in Lord Wright's judgment.] Lord Parker said (84 L.J.K.B., at p. 432; [1915] A.C., at p. 464) : The appellants claim to deduct, in the one case, the difference between the Schedule A assessment and the rent they receive, and in the other case the difference between the rent they pay and the rent they receive. In other words, they claim the Schedule A assessment value or the rent they pay as a deduction, giving credit on the other side of the account for the rent paid by the tenants of the tied houses. I am of opinion that they are also right in this contention." Lord Sumner dealt even more particularly with this absence of difference, for the purposes of estimating the costs of a business, between sums actually spent and sums that might have been received but were forgone for the purposes of the business. " Next as to the rent", he said (84 L.J.K.B., at p. 435; [1915] A.C., at p. 469), " a trader who utilises, for the purposes of his trade, something, belonging to him, be it chattel or real property, which he could otherwise let for money, seems to me to put himself to an expense; for the purposes of his trade. Equally he does so if he hires 6r rents, for that purpose property belonging to another." These observations exactly apply to the present case, if, as I have endeavoured to show in an earlier part of this judgment, there can be no difference in principle between utilising property and utilising a power for the purposes of a business.

59. It is plain from the passage that I have just cited from Lord Sumners's judgment that, in deciding in favour of the deduction o£ the annual values of the freeholds, he was not relying in the least upon any consideration peculiar to land or houses, or upon any implication that was to be drawn from the rule now represented by rule 3 (*c*), Nor did the other noble Lords. It appears, more over, that neither Lord Atkinson nor Lord Parker, who were the only ones who referred to *Russell's Case,* (*supra*) regarded that case as. depending upon any such consideration. Lord Atkinson said that the decision in that case was obviously right and just, because if the trader abstains from letting his premises and devotes them to the purposes of his trade, he must be taken to have dedicated to that trade a sum equivalent to the annual sum which he might have obtained in the shape of rent if he had let them to an untied tenant. Lord Parker enumerated three points which he said had been decided in Russell's Case (*supra*). Of these I need only mention the second, because that one alone dealt with the prohibition of deductions in respect of the annual value on rent of dwelling-houses. He said this (84 L.J.K.B., at p. 430; [1915] A.C., at p. 460); "Secondly, it decides that the rule refers only to a dwelling-house or domestic offices, or part of a dwelling-house or domestic offices, occupied by the person to be assessed; so that the fact that a bank manager resides in part of the bank premises does not bring that part of the premises within the prohibition or prevent the whole premises from being considered as used for the proposes of the trade." Observe what follows : " In other words, the effect of the prohibition cannot be extended by implication to cover a deduction for rent or annual value which would otherwise be a proper deduction in ascertaining the balance of profits and gains." It is not that the rule permits the deduction by implication of the annual value or rent of a house that is' not a dwelling-house. The point is that the rule does not prohibit that deduction, which is a proper one to be made on commercial principles.

60. For these reasons I would dismiss this appeal.