in actions for slander may be traced partly to confusion of thought consequent upon mixing up three separate questions which ought to have been kept entirely distinct. In this way a rule of evidence has been converted into one of substantive law. The first question is — How may malice be proved? The answer is—By circumstances extrinsic or intrinsic, or by the defender's admission. The second question is—What shall happen if a pursuer does not give fair notice of the case which he intends to prove? The answer is, that he must not be allowed to prove facts of which he improperly failed to give his adversary fair notice, and that if in such a case he does not adduce his adversary as a witness and obtain from him some evidence of malice the case should be withdrawn from the jury. The third question is—What constitutes a relevant averment of malice? The answer is that in nine cases out of ten a general averment of malice is perfectly intelligible and sufficient. The context shows that what is meant is that the accusation was made by the defender recklessly and without caring whether it was true or false, or without any belief in its truth or even knowing its falsehood. In all such cases the law presumes that the words were uttered from a bad motive of some kind and no further specification is needed unless the pursuer chooses to allege a particular motive and desires to be allowed to lead evidence on this point. In exceptional cases more specification would be necessary, *e.g.*, if the pursuer was prepared to admit that the defender believed the slander to be true, but maintained that he uttered it with the object of effecting some purpose different from the purpose for which alone the privilege exists. In such a case the Court must be told the defender's alleged motive in order that they may decide whether it was or was not a legitimate one—in other words, whether there is or is not a relevant averment that the defender abused his privilege.

The decisions and dicta in this branch of the law are exceedingly numerous, and it is not always easy to understand or to reconcile them. I have already referred to the case of *Farquhar*, decided in the year 1890 by the Second Division, and to the case of *Macdonald*, decided in the year 1901 by the First Division. In the case of *Currie* v. *Weir*, (1900) 2 F. 522, the present Lord Justice-Clerk reverted to the law as it stood prior to *Farquhar's* case, and stated that a general averment of malice was quite relevant. He described actions against public officials as exceptional. Lord Trayner was of the same opinion. He had previously stated his disapproval of *Farquhar's* case in *Reid* v. *Moore*, (1893) 20 R. 718. In the case of *Buchanan* v. *The Corporation of Glasgow*, (1905) 7 F. 1001, Lord M'Laren said that he had doubted whether the Court had not gone too far in the case of *Macdonald* in extending a special privilege to persons in authority so as to make it necessary in any action of damages against them to aver special facts and circumstances inferring malice. He does not appear to have noticed that *Macdonald's* case was one between a master and a former servant, whereas the case before him might be assimilated to an action against a public official, and was so regarded by the Lord President. I have already referred to the case of *Campbell* v. *Cochrane* for another purpose. It was treated as a case of judicial slander, but it is valuable because the opinion of the Lord President (Dunedin) is founded on that of his predecessor in *Beaton's* case, from which I infer that he also regarded actions for judicial slander and actions against public officers as wholly special and exceptional.

Actions of damages for judicial slander stand in a position by themselves. No one can doubt that a Supreme Court has inherent power to lay down the conditions upon which alone it will tolerate any interference with the freedom of speech of persons litigating before it, and no one can doubt that the Court of Session has exercised its power in this matter in a way which commends itself to the good sense of the community.

LORD HUNTER—Looking to the nature of the pursuer's averments I do not think that this case can be satisfactorily disposed of without inquiry. I have not, however, found it necessary to consider the question raised by Lord Skerrington as to whether or not a bare averment of malice would have been sufficient to entitle the pursuer to proof. I express no opinion upon that point. I concur in the course that your Lordship proposes.

LORD JOHNSTON and LORD MACKENZIE were absent.

The Court recalled the interlocutor of the Lord Ordinary and allowed the issues.

Counsel for the Pursuer and Reclaimer—Cooper, K.C—Paton. Agents—Maxwell, Gill, & Pringle, W.S.

Counsel for the Defender and Respondent—The Solicitor-General (Morison, K.C.)—D. P. Fleming. Agents—Duncan Smith & Maclaren, S.S.C.

Friday, February 6.

FIRST DIVISION.

(Before Seven Judges.)

[Exchequer Cause.

J. & M. CRAIG (KILMARNOCK) LIMITED *v.* INLAND REVENUE.

Revenue—Income Tax—Profits—Purchase of Business and Assets—Allocation for Bookkeeping Purposes — Valuation — Income Tax Act 1853 (16 *and* 17 *Vict. cap.* 34), *sec.* 2, *Sched. D.*

A company, formed to acquire as a going concern the business of a manufacturing company then in liquidation, purchased the concern, including the lands, leases, plant, and stock-in-trade, for (1) a sum of £25,000, and (2) an obligation to relieve the liquidator of cer-

tain contingent claims. The purchasers thereafter allocated these assets for book-keeping purposes, apportioning £19,375 to all the assets other than the stock-in-trade, leaving £5625 as the assumed value of the latter. At the same time they had the stock-in-trade separately valued on the basis of ordinary stock-taking, which brought out a sum of £12,798, 1s. 4d., and carried the difference between the assumed and real values, viz., £7173, 1s. 4d. (afterwards altered to £6635, 8s. 10d. in respect of errors in pricing), to a stock suspense account. At the end of the financial year a balance-sheet was made up, in which the sum of £6635, 8s. 10d. was entered as "reserve fund." In assessing the company to income tax the Commissioners held that the commencing value of the stock was to be taken as £5625, and that accordingly the difference between that sum and the balance at the close of the financial year was profits.

Held that the Commissioners were in error in taking as the basis of their assessment the assumed and not the real value of the stock-in-trade, and that accordingly the sum of £6635 was not assessable for income tax.

J. & M. Craig (Kilmarnock), Limited, *appellants*, appealed by Stated Case against a determination of the Special Commissioners for Income Tax, confirming (under deductions) certain assessments for the years ending 5th April 1908, 1909, and 1910, made upon them by the Commissioners for the district, under section 2, Schedule D, of the Income Tax Act 1853 (16 and 17 Vict. cap. 34), in respect of trade profits.

The Case set forth that the following *facts* were admitted or proved:—"(1) The appellants are a limited company, formed in 1907 to acquire as a going concern a portion of the assets and business of J. & M. Craig, Limited, coalmasters and fireclay manufacturers (in liquidation), viz., the Kilmarnock land and works, consisting of the lands of Hillhead, the Hillhead Brick-works, Longpark Pottery, colliery plant and machinery, mineral leases, fixed and moveable machinery, plant, fittings and fixtures, stock-in-trade, moulds, tools, &c., together with the goodwill of the Kilmarnock business, but excluding the book-debts. (2) The business and assets referred to were exposed in one lot for public sale on 16th August 1907, and were bought on that date on behalf of the appellants at the reduced upset price of £25,000. The purchasers were bound under the conditions of sale to relieve the liquidator of the rent for the unexpired portion of the leases of the minerals, and to settle the claims for damage due to the proprietor of the minerals at the termination of the lease, as well as the outstanding claims for annual surface damages due to the agricultural tenants. The amount of the damages due to the proprietor is indefinite, as it cannot be ascertained until the end of the lease, but was estimated by the proprietor at the date of the liquidation at £1800. The outstanding claims of the tenants have since been settled for £446. (3) The last valuation of the stock-in-trade at the Kilmarnock branch was made by the liquidator twelve months prior to the date of its sale to the appellants, and the lump purchase price, £25,000, was not apportioned by him in any way among the various assets, nor was there any valuation made at or immediately prior to the sale to the appellants, showing the relative values of the subjects acquired, or how the purchase price fell to be apportioned between them. (4) The appellants directly after their acquisition of the concern allocated for bookkeeping purposes the purchase price, £25,000, between the various assets as shown in statement 'Opening entries, in the books of J. & M. Craig (Kilmarnock), Limited, at 17th August 1907, viz.—

Fol. in Statement.				
4	Hillhead Brick-works—Buildings A/c	£2500 0 0		
8	Hillhead Colliery Buildings and Land A/c	7600 0 0		
12	Hillhead Brick-works—Plant A/c	2380 0 0		
16	Hillhead Colliery—Plant A/c	1750 0 0		
28	Hillhead Brick-works—Office Furniture A/c	45 0 0		
40	Longpark Pottery—Buildings A/c	2700 0 0		
44	Longpark Pottery—Plant A/c	2390 0 0		
52	Longpark Pottery—Office Furniture A/c	10 0 0		
				£19,375 0 0
20	Hillhead Brick-works Stock A/c	1500 0 0		
24	Hillhead Colliery—Stock A/c	180 0 0		
48	Longpark Pottery—Stock A/c	3464 0 8		
60	Edinburgh Branch Stock and Plant A/c (value of plant stated to be nominal)	480 19 4		
				5,625 0 0
	Total purchase price			£25,000 0 0

(5) The appellants at the same time caused a valuation to be made of the stock-in-trade included in the said purchase price—£25,000—and found the value of the same, on the basis of ordinary stock-taking, to be £12,798, 1s. 4d. . . . The lands included in the purchase were also valued on behalf of proposed lenders, the value fixed by the valuation being £7000. (6) When the appellants came to open their books and to allocate the purchase price among the various assets they entered the stock at the aforesaid value—£12,798, 1s. 4d.—and the land at the amount of the valuation—£7000. As no valuation had been made of the buildings, plant, machinery, and other assets, they entered these at a proportionate figure corresponding to their value as standing in the books of the old company, J. & M. Craig, Limited (in liquidation), in comparison with the price paid. That is to say, the whole assets purchased by the appellants originally stood in the books of J. & M. Craig, Limited (in liquidation), at approximately £75,000, and were purchased for £25,000—hence the assets, the value of which had not been ascertained, were entered at approximately one-third of this value as standing in the books of J. & M. Craig, Limited (in liquidation). As the appellants were unable to put a definite figure on the mineral damages, they did not add any definite sum to the purchase price on this

account. They deducted from the value of the stock as taken—£12,798, 1s. 4d.—the amount—£5625—remaining after deducting the value of the land and buildings on the basis mentioned above from the purchase price of £25,000, and carried the amount—£7173, 1s. 4d.—to an account which they called a 'stock suspense a/c.' This account was intended to include the liability for mineral damages. (7) At the close of the appellants' financial year on 11th November 1908 a balance-sheet was made up on the foregoing lines, the 'stock suspense a/c' being called therein 'reserve fund.' Such balance-sheet was duly audited and presented to the shareholders as provided in No. 107 of the articles of association. The figures from which the total of the 'stock suspense a/c' is arrived at are shown in the statement thus:—

Fol. 20 Hillhead Brick works — Stock Suspense A/c		£1811 8 6
Fol. 24 Hillhead Colliery—Stock Suspense A/c		113 9 7
Fol. 48 Longpark Pottery—Stock Suspense A/c		4927 10 4
Fol. 60 Edinburgh Stock and Plant Suspense A/c		320 12 11
		£7173 1 4
Deduct—Error in pricing old clay bings	£499 0 0	
Error in pricing stock of catalogues	38 12 6	537 12 6
Total,		£6635 8 10

being the amount shown in balance-sheet as at 11th November 1908 under the head —'Excess of valuation of stock at 17th August 1907 over proportion of purchase price applicable thereto.' (8) The business of the appellants having been set up within the period of three years referred to in sec. 100, First Case, First Rule, Schedule D, of 5 and 6 Vict. cap. 35, their first accounts, viz., from 17th August 1907 (date of their purchase of the concern) to 11th November 1908, form the basis of the assessments for each of the three years to which their present appeal relates, subject to any application to the District Commissioners by whom the assessments were made—for adjustment of liability for the years subsequent to 1907-8, ended 5th April 1908—under the provisions of sec. 24 (2) of the Finance Act 1907. In the assessments under appeal the appellants' profits for the aforesaid period, 17th August 1907 to 11th November 1908—viz., one year and eighty-seven days—viz., £8546, 8s. 11d., were calculated on the assumption that the commencing value of the stock as at 17th August 1907 must be taken as £5625, the apportioned value as in the statement referred to in paragraph 4. . . *Year* 1907-8, *ended 5th April* 1908. The proportion of the foregoing profit, £8546, 8s. 11d., for the period 17th August 1907 to 5th April 1908, viz., 232 days=£4386, as assessed.—*Year* 1908-9, *ended 5th April* 1909. The proportion of the profit, £8546, 8s. 11d., for one year=£6901, as assessed.—*Year* 1909-10, *ended 5th April* 1910. The proportion of the profit, £8546, 8s. 11d., for one year=£6901, as assessed."

The company *contended*—"(1) That the assessments in dispute should have been based on the appellants' trading and profit and loss accounts for the period 17th August 1907 to 11th November 1908, as prepared for their own purposes, and that the value of the stocks in hand at the beginning of the period as entered in such accounts should be accepted as representing the true value of such stocks, viz., £12,798, 1s. 4d. . . . (4) That the manner in which the so-called profits—£8546, 8s. 11d.—on which the assessments were based—were arrived at is not correct; that the real value of the stock in hand was ascertained by the appellants at the time they acquired it; that it was also ascertained in the same manner at the close of the period covered by their first account, and that the difference between the two stocks is the correct amount to be carried to the profit and loss account. (5) That the appellants were entitled to apportion the total purchase price among the various assets in any proportion they pleased so long as they did so fairly. In the present case they purchased the whole concern at its market price. The only item of which they could ascertain the separate market value was the stock, and having ascertained the value of this they were entitled to assume that they purchased the remainder of the assets at the difference between the value of the stock and the total purchase price. The appellants' method of preparing the accounts should have no effect on the merits of the case. The figures in the balance-sheet were entirely arbitrary and in a sense fictitious, inasmuch as the only item of which the value had actually been ascertained was the stock. The value put upon the latter must be assumed to represent approximately the sum which would have been realised for it had it been sold as a separate item by the liquidator of the old company and the sum which it would have cost the company to replace it by manufacture. It did not include any surplus stock, but was the ordinary stock carried by the concern as its working stock. The amount may fluctuate temporarily, but is approximately the same from year to year. The appellants admitted that no part (if there was any) of the stock in hand at the end of the period covered by the profit and loss accounts could have been earmarked as forming part of the original stock purchased from the liquidator of the old company, and that it is possible that the bulk at any rate of the closing stock may consist of goods the full cost of the manufacture of which has been debited in the profit and loss accounts, though it may also have included a portion of the stock purchased from the liquidator. (6) That the so-called reserve fund—£6635, 8s. 10d.—was merely a book entry, and did not represent an appropriation from profits, and the appellants tendered a fresh balance-sheet as at 11th November 1908, in which the stock was shown at its ascertained value, the land at the valuation which had been made and the remainder of the purchase price, with the addition of a sum of £1800 estimated mineral damages due

to the proprietors at the termination of the lease, distributed over the buildings, machinery, and other assets. By this rearrangement of the figures the item 'reserve fund' in the first balance-sheet wholly disappears. . . ."

The Surveyor of Taxes, *inter alia*, *contended*—"(1) That any profits made by the appellants on the sale of the stock purchased from the liquidator of the old company were profits realised in the ordinary course of trade, and hence were properly included in the assessments to income tax, Schedule D. He further contended that the proportion—£5625—of the total purchase price—£25,000—allocated by the appellants to stock in the opening entries in their books on the assumption apparently that the whole business and assets were purchased at one-third of the value that such business and assets stood in the books of the old company, must be regarded as fairly representing the actual cost to the appellants of such stock, and hence that their profit and loss accounts should commence with such approximate cost—£5625—and not, as contended by the appellants, with the valuation—£12,798, 1s. 4d.—made on the basis of ordinary stock-taking. . . . (2) That if the contentions of the appellants as to the proper manner of treating the stock purchased were correct, a firm purchasing by tender stocks of bankrupt drapers, &c., at, say, 33 per cent. below cost price, and selling off the same at a substantial profit, could nevertheless by opening their profit and loss accounts with the value of such stocks as ascertained on the usual basis of stock-taking, show little or no profit assessable to income tax, Schedule D."

On 12th December 1913 the First Division appointed the case to be heard before Seven Judges.

Argued for appellants—The price paid for the stock was not £25,000 but £25,000 plus an unascertained liability. That being so, the value of the stock—even taking the appellants' books as conclusive against them—was not £5625—the figure taken by the assessor—but that sum plus £7173, 1s. 4d., the amount of the suspense account, *i.e.*, £12,798, 1s. 4d. *Esto* that the sum of £6635, 8s. 10d., *i.e.*, the sum of £7173, 1s. 4d., less £537, 12s. 6d. (errors in pricing stock, &c.), was described in the appellants' balance-sheet of November 1908 as a "reserve fund," being "excess of valuation of stock at 17th August 1907 over proportion of purchase price applicable thereto," that was merely an erroneous description which the Court would disregard. It should have been headed "suspense account." The unascertained liability referred to above might exhaust it all. The actual cost of the stock was irrelevant; the question was, what was its real value at the commencement of the trading year—*Tebrau Rubber Syndicate, Limited* v. *Farmer*, 1910 S.C. 906, 47 S.L.R. 816, and authorities there cited.

Argued for respondent—The determination of the Commissioners was right. The stock cost £5625, and the difference between that now and the value at the time of the stocktaking was the profit earned by the company. As to the meaning of "profits" reference was made to Dowell's Income Tax Laws (7th ed.), 274 *et seq.*; *Coltness Iron Company* v. *Inland Revenue*, January 7, 1881, 8 R. 351, 18 S.L.R. 221, *aff.* April 7, 1881, 8 R. (H.L.) 67, 18 S.L.R. 466; *City of London Contract Corporation* v. *Styles* (1887), 2 Tax Cases 239, *per* Esher, M.R., at p. 244; *Russell* v. *Town and County Bank* (1888), L.R., 13 A.C. 418, *per* Lord Herschell at p. 424. The appellants had treated the sum of £6635, 8s. 10d.—the sum in question—as profits, and that being so the question was one of fact and not of law—*Blyth's Trustees* v. *Milne*, June 23, 1905, 7 F. 799, *per* Lord Kinnear at p. 809, 42 S.L.R. 676. Further, the Commissioners had found as a fact that this was profit, and the Court, on a case stated, would only consider whether there was evidence to justify such a finding—*American Thread Company* v. *Joyce* (1913), 108 L.T. 353.

At advising—

LORD PRESIDENT—The seeming obscurity which surrounds the controversy in this case vanishes upon a reasonable scrutiny of the figures. The question we have to decide is, what are the trading profits assessable to income tax of a limited company for the period from 17th August 1907 to the 11th November 1908. The Special Commissioners of Income Tax, holding that the value of the stock-in-trade at the commencement of the period is £5625, have determined that the amount of profits for the period is £8546; the appellants, on the other hand, holding that the value of the stock-in-trade at the commencement of the period was £12,798, contend that the net profits assessable to income tax are £2011. The difference between these two figures—the £5625 and the £12,798—after making an adjustment which is immaterial to the question at issue, amounts to £6635. That sum appears in the balance-sheet of the appellants for the year as at 11th November 1908, and reappears in the balance-sheet as at 11th November 1909 under the denomination "reserve fund." To determine the quality and the composition of that sum of £6635 is to solve the problem. The Commissioners say that, like many, indeed most, reserve funds, the £6635 consists of tied-up profits. The appellants on the other hand maintain that it is a sum set apart before the earning of profits actually began in order to meet certain contingent claims. In my judgment the contention of the appellants is correct, and the amount of their profits for the period in question is not £8546 but £2001. To see how that conclusion is reached, it is necessary to trace the genesis of the £6635.

The appellants' company was formed in the year 1907 to take over certain departments of a larger concern then in liquidation. They purchased from the liquidator a miscellaneous assortment of assets, consisting, *inter alia*, of stock-in-trade. Now the consideration for all these assets was, first, a round sum of £25,000 in cash, and second, an engagement to release the liquidator of certain claims under mineral leases due to the landlord at the expiry of the

lease and to the agricultural tenants at once. The appellants set aside the £6635 in order to meet these contingent claims. The claim of the agricultural tenants has now emerged and has been settled, and, with the assent of the Inland Revenue, £446 has been deducted from the £6635 in order to pay the agricultural tenants' claims. That leaves the sum of £6189 at the credit of this reserve fund, and there it remains to meet the claims of the landlord which are at present undetermined but will emerge at the expiry of the lease. Of all the assets purchased from the liquidator the market value of one alone was susceptible of definite ascertainment. It is agreed that for the stock-in-trade there was always a considerable demand, and that its true market value at any given time was susceptible of ascertainment. The appellants straightway proceeded to ascertain the value of their stock-in-trade, and, valuing it on the basis of ordinary stocktaking, they reached the figure of £12,798. With that sum they commenced the trading period, as their trading and the profit and loss accounts disclose. But before they commenced to earn profits at all they set aside £6635 value out of the £12,798 in order to meet the contingent claims to which I have referred. If £12,798 is the true value of the stock-in-trade at the commencement of the period, taken on an ordinary stocktaking basis, and if the appellants are entitled to set aside, before trading commenced, a certain proportion of that £12,798 to meet the claims which will yet emerge against the company, then it is not denied that the determination of the Commissioners cannot be sustained. But the Commissioners say that this is an inadmissible process, and that the true figure at which the stock-in-trade must be taken at the commencement of the period is £5625 and not £12,798. If it is to be taken at £5625, it is conceded that the profits for the period amount, as the Commissioners have determined, to £8546.

Now the appellants say that the £5625 is, to use their own language, an entirely arbitrary figure and in a sense fictitious, and that, if we can realise its origin, that will become apparent. It arises thus—the appellants found it necessary for bookkeeping purposes to allocate, not the whole consideration which they paid for the assets to which I have referred, but the cash price which they paid, to these various assets. Now they could not—no man could—tell what was the exact price which was paid for each one of these assets, and the way they set to work was this—they took one-third of the value of these assets as they stood in the books of the selling company, and they assigned that to each item in their own books. That absorbed £19,375 of the £25,000, leaving over £5625, which they straightway proceeded to allocate to the stock-in-trade.

Now it is apparent that the £5625 thus reached does not represent the true value of the stock-in-trade, nor indeed does it represent the price which they paid for the stock-in-trade to the selling company. If this be so, then plainly the trading period to which I have referred cannot commence with a stock-in-trade of £5625, and if not there is only one alternative offered. If we take the £12,798, therefore, as the appropriate value of the stock-in-trade at the commencement of the trading period, ascertained, as I have described, on an ordinary stock-taking basis, it follows inevitably that the profits of the appellants for that period were £2011.

Thus far all appears to me to be plain sailing. My difficulty only arises when I come to formulate the question of law which we have to decide. There is no help to be found in the case. Mr Clyde shared my difficulty in some measure, and the Solicitor-General pressed home the point, arguing with great force that this is a pure question of fact upon which the Commissioners were not only the best but the only judges. Now if I thought it was necessary to our decision of this case to balance conflicting estimates of value or price, or to weigh conflicting valuations of property, I should decline to disturb the determination at which the Commissioners have arrived. But after much consideration I have come to the conclusion that the correct question of law submitted to us is this—is there in this case legal evidence adequate to support the determination of the Commissioners that the profits of this company for the period in question were £8546 and not £2011, or otherwise is there in this case legal evidence to warrant the conclusion that £5625 represents either the true market value for stocktaking purposes or even the proportion of the cost price paid for the stock-in-trade?

Without hesitation, for the reasons I have given, I would answer both questions in the negative, and if your Lordships agree with me then the conclusion we must arrive at is this, that this appeal be sustained, that the determination of the Commissioners be recalled, and that we remit to them to fix the profits at which this company is to be assessed, having in view the judgment we now pronounce.

LORD DUNDAS—I agree with your Lordship in the chair, and I have nothing to add.

LORD JOHNSTON—I also concur in the conclusion at which your Lordship has arrived. But I may say that I have never, as your Lordship has, had any difficulty about there being a question for this Court to determine, Notwithstanding that it is said that you can prove anything by figures, it is true that figures themselves are facts, or represent facts. Probably they are the only things that do represent facts. But the method of arriving at the result deducible from figures regarded as facts, and, in particular, the method on which the accounts of a statutory company—and I regard a registered company as a statutory company from this point of view—are to be kept is one of principle and so of law. And it has throughout seemed to me that unquestionably this case raised the question of the principle upon which registered companies under certain circumstances are required to keep their accounts. I further think that the

case is not by any means an exceptional one, and that it is therefore a case of more general interest than was supposed. There must be many cases nowadays—looking to the great multiplication of public companies—in which a company is constituted for the purpose of doing exactly what this company has done, viz., taking over the assets of a previous firm or company and carrying on its business. I have therefore had no doubt about the competency of the case before us. I pass then to the case as stated.

Though only registered in November the appellants seem to have taken over the business as from 17th August 1907, and they were at once obliged to make opening entries in their books so that these might be kept in form suitable to the conduct of their business as a limited company. The preliminary question is, what was their business out of which they were to make their profit or loss, and the answer is easy and clear. It was primarily the manufacture and sale of fire-clay goods. But they also, as a necessary adjunct or concomitant of their business, had to deal in—that is, to buy and sell—certain goods not manufactured by them, and they had to dispose of surplus coal, as they could not use up the whole coal wrought under their mineral lease in their manufacturing operations. It cannot be said that, buying as they did a going business and its assets, real and personal, it was particularly easy to adjust these opening entries in such way as to exhibit intelligible and accurate results to shareholders, to provide for contingent liabilities undertaken, and at the same time to give on the face of their accounts sufficient and correct information to the Inland Revenue for income-tax purposes. The difficulty arose from the fact that a slump sum had been paid for the whole assets as a *unum quid*, and that these assets (including such goodwill as there was of the old business) were of different descriptions. They consisted of land, leases, works, and plant. These were of the nature of fixed capital assets. But they included also stocks of goods and raw material. These were of the nature of floating assets. They have on the whole taken, I think, a very reasonable and proper course, and are not to be penalised for so doing. In the circumstances, as was to be expected, the total assets of the whole company were acquired at a price very much below their book value, as standing in the books of the old company, and even very probably below the *cumulo* valuation which would have been put by a valuer *separatim* on the different items. But in such transactions there is a large element of risk in taking over the assets of a bankrupt business, and there is no reason to think that the gross price, coupled with the incidental and contingent obligations undertaken, was not a fair consideration for the gross assets, taking the broad and the long of it. The appellants in the opening entries, made an endeavour to put a capital value on each of the assets taken over by them. But it is a book entry value merely, and as regards the separate items entirely empirical. Notwithstanding, the Inland Revenue have seized upon these figures, and the figures which consequently enter the first balance-sheet of the appellants as at 11th November 1908, in order to assess the appellants for income tax, as if they were not empirical but real. I am not surprised that the Inland Revenue officials at first sight should have taken advantage of these figures, but I think that a little consideration would have shown that they could not really be made the basis of assessment. The course they have taken is, I think, at once condemned by the statement of the Commissioners in the 4th head of the case, viz., "The appellants directly after their acquisition of the concern allocated for bookkeeping purposes the purchase price." Figures adopted for bookkeeping purposes can be no true guide to the ascertainment of profit and loss. Hence it will not be surprising if the profit which the Inland Revenue have deduced is found to be not a real but a fictitious profit.

The Inland Revenue are not entitled as matter of course to hold the company to entries made in their books for purely *bookkeeping purposes*, and these entries may in many cases be wholly disregarded, and that for two reasons—The first a general reason, viz., that the Revenue cannot have it both ways; they cannot accept entries in a company's books when they find them to be to the advantage of the fisc, and discard them when they are to its disadvantage. They invariably set aside, and rightly so, entries which would favour a company, but which do not give the real results of their business. And I do not think that they can be allowed to hold a company to entries which favour the Revenue but equally do not show the real results of the business. The second, a special reason, that the Revenue authorities cannot be allowed to pick and choose their figures, taking those that suit them and rejecting others. Of this the statement at the bottom of page 4 of the case is an excellent example and extremely misleading. For whereas State A appended to the case is itself a collection of entries found in as many as twelve different folios of the company's ledger, the said statement at the bottom of page 4 of the case, on which the contention of the Revenue is mainly founded, is itself not a fair representation of State A but eliminates essential entries.

The true initial consideration which must, I think, guide those concerned in arriving at the profits of the appellant's company for assessment to income-tax is this—The company's capital account must be distinguished from its trading account. It is essential that the capital account be so stated that according to the principles which regulate joint-stock company management, the true position of the company may be disclosed and its capital be kept as a matter of accounting intact. But it is equally essential that the company's trading accounts and profit and loss accounts be kept on such a basis and in such a form as to show true and real results. The appellants did not buy the assets of the old company to turn them over *en bloc* and make their profit on the transaction as if they were an

assets company or a dealer in bankrupt businesses—they bought them to carry on the manufacturing and mercantile business of the old company, for which these assets were adapted. Looking at the position from this point of view, a large part of the assets were, as I have said, of the nature of fixed capital assets. These for the purposes of the company's bookkeeping might call for capital values being put on them, but values which, less or more, would in no way affect the result of the company's business as a profit-earning concern. Such items were the lands and leases, the works, and the plant. But there were other assets of a different kind, viz.—the floating assets, consisting of the stocks of material to be worked up and of the manufactured articles to be sold. With these the appellants' company had to commence business, and it was on the turnover of these, and their replacement by further material and further manufactured articles, that the company was to make its profit or loss. If the appellants' company were not to show fictitious results and delude their shareholders, it was necessary that they should begin their business operations on a true and not a fictitious valuation of these assets. They could never reach correct figures for these assets if they simply took, as the Inland Revenue maintain that they did take, and irrevocably take, the gross price paid, and having attributed empirical values to the fixed or capital assets simply attribute the balance, whatever it might be, less or more, to the working stock in their trading and profit and loss accounts. I think that the appellants took the proper course, and re-valued the working stock on a basis of stocktaking, with the result that whereas on the empirical division of the £25,000 the sum left for the working stock was £5625, the re-valuation made on stocktaking basis was £12,798. And with this latter sum distributed over its different departments the company commenced its trading accounts.

I do not for one moment say that this revaluation is one which must be accepted by the Department without examination. I think that the Inland Revenue were entitled to have its fairness and accuracy tested, and, if necessary, corrected. But their counsel intimated that if the determination of the Commissioners of Inland Revenue were found to be wrong, they accepted the figure of £12,798 as a fair valuation for the purpose for which, and at the date as at which, it was made.

On the principle of the thing, the course taken by the company was the right course to adopt, and unless this course had been adopted proper trading and profit and loss accounts such as are found in Appendix B could not have been prepared. Were the values based on an empirical apportionment of the gross price of £25,000 taken, the profit deduced would be a manifestly fictitious profit. To the principle of these trading and profit and loss accounts I can see no objection whatever, and from them, after making due allowances, I think that the appellants' assessable income can easily be ascertained. It may neither be the trading profit shown of £2410, 14s. 3d., nor the balance on profit and loss carried to the balance sheet of £675, 0s. 3d. But it can be ascertained by the methods which the Inland Revenue adopt in dealing with similar accounts.

What has led to the disagreement between the company and the Inland Revenue is the necessity of reconciling the capital account and the trading and revenue accounts as parts of one whole system of accounts in the company's balance sheet. £25,000 had been paid for the gross assets. Of this £19,375 had been attributed, for bookkeeping purposes only, to real estate. There was left £5625 (I am taking the figures without making certain minor corrections which were found necessary) as the apparent amount of capital attributable to the stock. But the real value of the stock was found to be £12,798, 1s. 4d. How was the difference to be dealt with? It amounted to £7173, 1s. 4d. It was correctly, I think, placed to suspense account, and held against the future and contingent liabilities undertaken by the company. And if it is not required for these it will still remain as a book entry on suspense account against which may be written depreciation of assets or losses of the company. Unfortunately the directors dropped the term "suspense" and adopted the equivocal term "reserve." But this made no real difference. One thing is certain — that the Revenue's contention that it represented "an appropriation from profits" is entirely without foundation. The fallacy which underlies the position maintained for the Department is, I think, illustrated by the analogy suggested by them at the foot of page 13 of the case. This company is not in the position of a firm purchasing by tender stocks of bankrupt drapers, &c., at, say 33 per cent below cost price, selling them of at a profit, and trying to avoid income-tax by revaluing them and entering them in their books on the basis of ordinary stocktaking. Such a firm would be engaged, as I believe some are, in the business of buying and selling off bankrupt stocks and making its profit on the turnover. A manufacturing firm which acquires a going manufacturing business, and with it its current stock, not merely to turn over the stock, but to do so as a mere incident in carrying on the manufacturing business and continuing to market its products, stands in a wholly different position. It is the erroneous application to the latter class of business of considerations which apply only to the former which has, I think, led to the erroneous conclusion at which the Commissioners have arrived.

I think, therefore, that the judgment of the Special Commissioners was wrong, but that the parties should be left to readjust figures, which I have no doubt that they can do much better than the Court The judgment can then be based on these figures. If they cannot agree they may come back to the Court.

LORD SALVESEN—The facts in this case, so far as material, are very simple. The

appellants were formed in 1907 to acquire as a going concern part of the assets and business of a previous company of coalmasters and fireclay manufacturers. This company had gone into liquidation, and certain assets, consisting of mineral leases, brick-works, a colliery, and a pottery, with their plant and stock-in-trade, were exposed in one lot for public sale. They were bought by the appellants at a slump price of £25,000. This sum, however, did not represent the full purchase consideration, because the appellants were taken bound under the conditions of sale to relieve the liquidator of the rent for the unexpired portion of the mineral leases, to settle the claims for damages due to the proprietor of the minerals at the termination of the leases, as well as the outstanding claims for annual surface damages due to the agricultural tenants. The amount of the damages due to the proprietor is stated in the case to be indefinite, as it cannot be ascertained until the end of the leases; and whether the leases are valuable, as no doubt they were assumed to be, depends upon whether the minerals can be worked to profit.

After their acquisition of these assets the appellants allocated them for bookkeeping purposes. They apportioned £19,375 to all the assets other than the stock-in-trade, leaving £5625 as the assumed value of the latter. At the same time they had the stock-in-trade separately valued on the basis of ordinary stocktaking, and this valuation brought out a sum of £12,798, 1s. 4d. With the various sums contained in this valuation applicable to the separate branches of their business, they opened the trading accounts from which their profit and loss accounts are made up.

The first trading account commences with the date of the incorporation of the company and ends on the 11th November 1908, at which date the books were then and annually thereafter closed. This period covers a year and eighty-five days; and for income tax purposes the result falls to be apportioned over two periods, namely, from 17th August 1907 to 5th April 1908, and from 5th April 1908 to 5th April 1909. The trading accounts show a balance amounting to some £2400 gross, or £675 net profits, the exact amount not being material. To this sum the Commissioners have added substantially the difference between the value of the stock at £12,798 and the sum of £5625, which for their own purposes the appellants allocated against the stock out of the cash purchase price of £25,000. The question is whether this sum falls to be treated as profits and is assessable for income tax.

Counsel for the Inland Revenue maintained that the sum of £5625 must be treated as the purchase price of the stock-in-trade as fixed by the appellants themselves, and ought to enter the trading accounts in the same way as any goods which they purchased for their business in the ordinary course of trade fell to be entered at the invoice prices paid. They said that the appellants were not entitled to go back on the apportionment which they had deliberately made, and which they did not even now seek to have altered or corrected; that accordingly their trading accounts ought to have commenced (treating them for simplicity as one), not with the figure of £12,798 as the value of the stock-in-trade, but with the figure of £5625. If this were so, of course the trading accounts would show a larger profit, to the extent claimed, in the first period of the company's trading.

In my opinion the claim of the Inland Revenue is neither in accordance with the books of the company nor with the truth and reality of the matter. The difference between the two sums already referred to was not in fact treated as profits. In the first balance-sheet £675, 0s. 3d. was stated as the net balance on profit and loss account. The excess of valuation of the stock was put to reserve fund in order to meet the unascertained liabilities, which were part of the consideration. Until these were run off it would have been improper to treat this sum to any extent as profit, yet if the respondent is right in his contention the directors might have divided the whole sum as dividend among the shareholders, for he treats it as a fund accumulated out of the profits of the year. I cannot imagine any more improper act for the directors to have done than to have followed the respondent's lead in this matter. It may turn out that the amount is wholly insufficient to meet the liabilities in question. It was, moreover, not a sum which in any way depended on the results of the year's trading. The precise difference was ascertained at the time that the account opened. How, therefore, it can be represented as profits of the period down to 11th November 1908 I fail to see. Had the appellants chosen to apportion the £25,000, which was the cash purchase price, to the stock-in-trade to the extent of £12,798 as representing the value of the stock-in-trade and allocated the remainder to the other assets the present question could never have arisen. They could have had a similar and possibly a larger reserve fund by having a valuation made of the heritable properties, for it may be assumed that the total assets must in the appellants' view have had a greater value than the cash purchase price they paid, otherwise they would not have undertaken the liabilities with regard to the mineral leases and claims by surface proprietor and tenants. The mere fact that the appellants had estimated the total value of the assets which they acquired at a higher figure than the cash purchase price would have been no ground for treating the difference as part of the profits earned, and that even if the appreciation had not merely been assumed but was capable of accurate ascertainment by the end of the year and there had been no indefinite liabilities to set against it. An appreciation of capital value is not the subject of taxation under the Income Tax Acts, although if it is actual it may be reflected in the profits of succeeding years.

In the view I have taken this case falls to be decided upon its own special facts, and does not afford any basis for laying down principles of general application. Had the sole subject of the purchase been the stock-in-trade at a price of £5625, and had a profit

been realised of £7000 in the course of a single year by its disposal, a case would have arisen very much more favourable to the respondent. This is how he proposes to treat the transaction, although it is plain from its nature that the seller would not have sold the stock separately from the less realisable heritable subjects with all their contingent liabilities. As the case stands, however, it is impossible to affirm that the sum placed to the reserve fund by the appellants at the very commencement of their existence represents actual profits of the first period of their trading. I am accordingly of opinion that the Commissioners were wrong in allowing this figure to enter the account for income tax purposes; and that this so-called reserve fund, which was virtually a suspense account to meet non-ascertained liabilities, is not assessable for income tax.

LORD MACKENZIE—I concur.

LORD GUTHRIE—I am of the same opinion. The argument of the Inland Revenue was based on two assumptions—First, that of the £25,000 paid by the appellants in 1907 for the acquisition of the business of coal-masters and fireclay manufacturers at Kilmarnock previously carried on under the same name, £5625 was the true proportion paid by the appellants for the stock taken over by them; and second, that there was no consideration for their acquisition other than the £25,000, disregarding in particular the liability for mineral damages of substantial although indefinite extent undertaken by them. The appellants have shown both these assumptions to be unfounded, but it would not necessarily have followed that the appellants' valuation of £12,798 must be accepted. The Commissioners, however, do not dispute that if the figure of £5625 relied on by them is rejected as empirical, the proper sum to be taken as the value of the stock is £12,798, the sum arrived at by a valuation the fairness of which is not challenged.

In my opinion the appellants are entitled to prevail on the merits of the question, there being no reasonable ground on which the finding of the Commissioners can be supported. I also think that the argument based on the appellants' books is unfounded. The course taken by the appellants in splitting up the £12,798 under stock account and stock suspense account was not only justifiable, it was the proper course in the circumstances. It does not follow either that £5000 was a correct proportion to take of the £25,000, or that £7173 (corrected to £6635) was a correct valuation of the liabilities undertaken in addition to payment of the sum of £25,000. Mr Clyde, as I understood, admitted that questions may arise between the appellants and the Inland Revenue if it ultimately turns out that the amount of the unascertained liability for mineral damages does not exhaust the suspense account fund. But no such questions arise under the case presented for our decision.

LORD SKERRINGTON—I concur.

The Court pronounced this interlocutor—

"The Lords . . . in conformity with the opinions of the whole Seven Judges, sustain the appeal, reverse the determination of the Commissioners, and remit to them to fix the profits on which the appellant company is to be assessed according to the principle laid down in said opinions, and decern."

Counsel for Appellants—Clyde, K.C.—Hunter. Agents—Laing & Motherwell, W.S.

Counsel for Respondent—Sol.-Gen. Morison, K.C.—R. C. Henderson. Agent—Sir Philip J. Hamilton Grierson, Solicitor of Inland Revenue.

Friday, February 20.

SECOND DIVISION.

[Lord Skerrington, Ordinary.

D. & J. NICOL *v.* DUNDEE HARBOUR TRUSTEES.

Title to Sue—Trust—Ultra vires—Statutory Harbour Trust including Steam Ferries—Illegal Use of Ferry Boat—Action by Rival Trader—Action by Ratepayer.

A statutory harbour trust, part of whose undertaking consisted in running ferry steamers, and which had power to meet any loss on its ferry traffic by means of increased dues on, *inter alia*, shipowners using the harbour, employed one of its ferry steamers occasionally for excursion traffic outwith the limits of its statutory area. In an action of interdict at the instance of a firm of shipowners, part of whose business consisted in running excursion steamers from the harbour, and who averred that their business was injured by the competition of the harbour trust, *held* (1) (*diss.* Lord Dewar) that as rival traders averring patrimonial loss the complainers had a title to sue, and (2) (*diss.* Lord Dewar and *rev.* judgment of Lord Skerrington, Ordinary) that as ratepayers paying harbour dues the complainers had also a title to sue.

Opinions (*per* Lords Salvesen and Guthrie) that the Lord Advocate would have no title to sue such an action.

Corporation—Ultra vires—Trust—Harbour Trust Authorised to Run Ferry Steamers within Certain Limits—Hire of Ferry Steamer for Excursion Traffic beyond Limits—Dundee Harbour and Tay Ferries Consolidation Act 1911 (1 *and* 2 *Geo. V, cap. lxxx*).

A statutory harbour trust, having power under its incorporating Act to charge certain rates per day under the heading of "ferries rates" for the hire of its steamboats, hired out one of these steamboats for occasional excursion traffic beyond the ferry limits. *Held* (*diss.* Lord Dewar) that such use was *ultra vires*.