excluding from them persons who do not fall within that class.

LORD SANDS—I concur in the course proposed. Two questions have been canvassed in argument, the determination of which is unnecessary for the disposal of the case—in the first place, the question whether the Tramways Company would satisfy their obligation under section 75 if they provided ample accommodation for everybody and charged workmen only the halfpenny rate without setting aside special cars for them; and in the second place, whether if they had set aside special cars and found on any occasion that there was ample accommodation without any inconvenience to the workmen who desired to travel, they might admit other passengers and charge them the full rate. On both these questions I desire to reserve my opinion.

The Court pronounced this interlocutor—

"Sustain the appeal: Recal the interlocutor of the Sheriff-Substitute dated 19th December 1922: Find and declare (1) that the defender was not on 5th October 1922 one of the classes of persons referred to in section 75 of the Hamilton, Motherwell, and Wishaw Tramway Act 1900, and (2) that he was not at that date entitled to travel on cars set aside in terms of said section for artisans, mechanics, daily labourers, clerks, and shop assistants: Find it unnecessary to dispose of the other conclusions of the action, and decern."

Counsel for the Pursuers and Appellants—Wark, K.C.—King Murray. Agents—Patrick & James, S.S.C.

Counsel for the Defender and Respondent—Mitchell, K.C.—Gibson. Agents—Balfour & Manson, S.S.C.

Saturday, November 17.

FIRST DIVISION.

[Exchequer Cause.

LAW SHIPPING COMPANY, LIMITED v. INLAND REVENUE.

Revenue—Excess Profits Duty—Purchase of Ship—Determination of Purchasers' Profits—Deductions—Repairs Attributable to Employment before Purchase—Finance (No. 2) Act 1915 (5 *and* 6 *Geo. V, cap.* 89), *sec.* 40 (1) *and* (3), *and Fourth Schedule, Part I, par.* 3—*Finance Act* 1916 (6 *and* 7 *Geo. V, cap.* 24), *sec.* 47 (*d*)—*Income Tax Act* 1918 (8 *and* 9 *Geo. V, cap.* 40), *First Schedule, Schedule D, Rules Applicable to Cases i and ii, No.* 3 (*a*) *and* (*f*).

A company purchased a ship which was ready to sail with freight booked. At the time of the purchase the four-yearly Lloyd's survey of the ship for the purpose of ascertaining and having executed the repairs necessary to keep her in thorough sea-going condition was overdue, and special exemption was obtained for the purpose of the voyage then in contemplation. When the ship returned from the voyage the survey was made, with the result that the purchasers had to incur considerable expenditure for repairs. *Held*, *quoad* the computation of the purchasers' profits for assessment to excess profits duty, (1) that the expenditure so far as attributable to the employment of the ship by the purchasers' predecessors was of the nature of a capital outlay, and did not fall to be deducted from the purchasers' profits, and (2) that the expenditure so far as attributable to the employment of the ship by the purchasers fell to be deducted, and expenditure apportioned accordingly.

The Finance (No. 2) Act 1915 (5 and 6 Geo. V, cap. 89) enacts—Section 40—*Determination of Profits and Pre-war Standard.*—"(1) The profits arising from any trade or business to which this part of this Act applies shall be separately determined for the purpose of this part of this Act, but shall be so determined on the same principles as the profits and gains of the trade or business are or would be determined for the purpose of income tax, subject to the modifications set out in the First Part of the Fourth Schedule to this Act and to any other provisions of this Act. . . . . (3) Where it appears to the Commissioners of Inland Revenue, on the application of a taxpayer in any particular case, that any provisions of the Fourth Schedule to this Act should be modified in his case owing to a change in the constitution of a partnership, or to the postponement or suspension as a consequence of the present war of renewals or repairs, . . . or to any other special circumstances specified in regulations made by the Treasury, those Commissioners shall have power to allow such modifications of any of the provisions of that schedule as they think necessary in order to meet the particular case. . . ." Fourth Schedule, Part I.—*Computation of Profits.*—Par. 3—"Deductions for wear and tear, or for any expenditure of a capital nature for renewals, or for the development of the trade or business or otherwise in respect of the trade or business, shall not be allowed except such as may be allowed under the Income Tax Acts, and if allowed shall be only of such amount as appears to the Commissioners of Inland Revenue to be reasonably and properly attributable to the year or accounting period."

The Finance Act 1916 (6 and 7 Geo. V, cap. 24) enacts—Section 47—*Computation of Excess Profits Duty in Case of Sale of Ships.*—"Where any ship has been sold since the fourth day of August Nineteen hundred and fourteen, in such circumstances that the profits of the sale are not the profits of a trade or business, the following special provisions shall, if the Commissioners of Inland Revenue so require, be applied in the computation of the liability to excess profits duty in respect of the profits arising from the use of the ship—(*a*) The pre-war standard of profits of the purchaser as respects the ship shall, where the standard of the trade

or business of the vendor is a profits standard, be calculated by reference to the profits arising from the use of the ship during the pre-war trade years, and shall be ascertained in accordance with the provisions of the principal Act, but calculated, where necessary, as if the use of the ship were a separate business. . . . . . . (*d*) Nothing in sub-section (three) of section forty of the principal Act, or in paragraph three of Part I of the Fourth Schedule to the principal Act, shall operate so as to enable the purchaser of the ship to obtain any greater relief than could have been obtained by the vendor if the ship had not been sold other than relief in connection with expenditure by the purchaser on improvements or repairs."

The Income Tax Act 1918 (8 and 9 Geo. V, cap. 40) enacts—First Schedule, Schedule D, Rules applicable to Cases i and ii, No. 3.—"In computing the amount of the profits or gains to be charged no sum shall be deducted in respect of (*a*) any disbursements or expenses, not being money wholly and exclusively laid out or expended for the purposes of the trade, profession, employment, or vocation. . . . . . (*f*) Any capital withdrawn from, or any sum employed or intended to be employed as capital in such trade, profession, employment, or vocation."

The Law Shipping Company, Limited, *appellants*, being dissatisfied with a determination of the Commissioners for the Special Purposes of the Income Tax Acts at Glasgow in an appeal against an assessment to excess profits duty made upon them for the accounting period of one year ended 31st December 1920 in the sum of £10,762 appealed by way of Stated Case, in which the Commissioners of Inland Revenue were *respondents*.

The Case stated—"1. The following *facts* were admitted or proved:—(1) On the 2nd December 1919 the company purchased for £97,000 the steamship 'Duns Law,' which was lying with freight booked and loaded at Newcastle-on-Tyne ready for sailing to Port Said. The ship returned from this voyage in May 1920 and was then put through a Lloyd's survey, which resulted in an expenditure of £59,474, of which it is agreed that £7916 was for capital expenditure and the balance, £51,558, was for repairs. After such repairs had been executed she started upon her second voyage in the service of the company some time in August 1920. (2) The 'Duns Law,' originally named the 'Irismere,' was built at Sunderland in the year 1906. It is customary for a ship to be submitted to a Lloyd's survey at intervals of every four years with one year of grace, so, however, that not more than one such year of grace is allowed in the life of the ship. The object of the survey is to ascertain and have executed such repairs as are necessary to keep the ship in a thorough sea-going condition. (3) The 'Duns Law' was so subjected to a survey in 1910, and in 1914 underwent the Special Periodical Survey No. 2 of the Bureau Veritas in Calcutta. The certificate was granted in September 1914. The annual boiler survey was carried out in September 1915. At the time when the ship was purchased by the company her periodical survey was overdue, but exemption from such survey had been obtained for the purpose of the voyage which was then in contemplation. (4) For the purposes of this case it is not disputed that if the former owner of the vessel had in consequence of a Lloyd's survey executed during his ownership the repairs which cost in the present case the sum of £51,558 he would have been allowed to deduct the said sum in a question of income tax. (5) It is also agreed that for income tax purposes the company cannot, by reason of the principles applied in the case of *Watson Brothers* v. *Lothian* ((1902) 4 F. 795, 4 T.C. 441), be regarded as continuing to carry on or succeeding to any business previously carried on by the previous owner of the ship. (6) For excess profits duty purposes the pre-war standards of profits both of the company and of the vendor of the 'Duns Law' were profits standards. The assessment appealed against was accordingly, under the Finance Act 1916, section 47, made by calculating the pre-war profits of the company by reference to the profits arising from the use of the ship during the pre-war trade years, but the sum of £51,558 above referred to was not allowed as a deduction in the making of such assessment. 2. It was contended on behalf of the company that the said sum of £51,558 was an admissible deduction for income tax purposes, and should also be allowed for excess profits duty. The company founded on Rule 3, Part I, of the 4th Schedule to the Finance (No. 2) Act 1915, section 47 (*d*) of the Finance Act 1916, and Rule 3 (*a*) of Cases i and ii, Schedule D of the Income Tax Act 1918. 3. On behalf of the Commissioners of Inland Revenue it was contended—(1) That the sum of £51,558 was not expenditure wholly and exclusively incurred by the company for the purpose of earning its profits within the meaning of Rule 3 (*a*) of Cases i and ii of Schedule D of the Income Tax Act 1918. (2) That the said sum was a sum employed as capital in the business of the company within the meaning of Rule 3 (*f*) of Cases i and ii Schedule D of the Income Tax Act 1918. (3) That for purposes of excess profits duty this expenditure was not reasonably and properly attributable to the Accounting Period 1920, within the meaning of Rule 3, Part I of the 4th Schedule to the Finance (No. 2) Act 1915. 4. After consideration we gave our decision as follows:—'We have considered carefully the arguments submitted to us in this case, and we have decided that we can only allow the proportion of the cost of Lloyd's survey of the s.s. "Duns Law" which is applicable to the period during which the company was the owner of the ship. The balance of the expenditure must be treated in our opinion as capital, and wear and tear will be admissible upon it at the usual rate. In expressing this opinion the Special Commissioners must not be held to be deciding any question under the last twelve words of Rule 3 of Part I of Schedule IV of the Finance (No. 2) Act 1915. Before deciding what

proportion of the expenditure is admissible under this decision the Special Commissioners desire to know if the company wish to submit any further evidence in the matter.' 5. The Inspector of Taxes on behalf of the Commissioners of Inland Revenue informed us that they were prepared to allow £10,000 out of the total expenditure of £51,558 to be treated as expenditure on repairs applicable to the period during which the company was the owner of the ship, but the company after correspondence, although we gave an opportunity of supplying further evidence as to how much of the repairs was applicable to the period in question, did not produce any further evidence. In these circumstances we decided upon the evidence before us to allow a deduction of £12,000, and we amended the assessment appealed against to £3561, and determined the appeal accordingly."

The *question of law* for the opinion of the Court was — "Whether the company is entitled to deduction of all or any part of the said sum of £51,558?"

Argued for the appellants—The whole expenditure of £51,558 fell to be deducted in ascertaining the appellants' profits for the year in which it was made. It was strictly an expenditure due to wear and tear and was necessary to keep the ship in her class. Such a payment was properly a charge on revenue for the particular year and could not be treated as a capital outlay. The fact that under Lloyd's rules such a payment fell to be made only once in four years and was ascertainable only at the end of each period could not alter its character as a charge on revenue; nor did it entitle the respondents to apportion the expense as representing repairs spread over a number of years. If the expenditure was a revenue charge then it could make no difference who paid it. In assessment for income tax the expenditure would fall to be deducted and should therefore be deducted in the case of excess profit duty.

Argued for the respondents—The expenditure was in effect part of the capital value of the ship to the purchasers. If it had been made by the vendors when the survey was due it would have formed a proper deduction from their profits. But what was a proper deduction from the vendors' profits could not be deducted from the profits of the purchasers. The latter were in the position of starting a new business with a ship, part of the cost of which was the expenditure for the repairs which were known to be necessary at the time of purchase and were taken into consideration in fixing the price. The expenditure was therefore a capital outlay and did not fall to be deducted from the purchasers' profits — *Highland Railway Company* v. *Special Commissioners of Income Tax* 1889, 16 R. 950, *per* Lord President at p. 953, 26 S.L.R. 657; *Ounsworth* v. *Vickers*, [1915] 3 K.B. 267, *per* Rowlatt, J., at p. 274; *City of London Contract Corporation* v. *Styles*, 1887, 2 Tax Cases 239, *per* Lord Esher at p. 244.

At advising—

LORD PRESIDENT (CLYDE)—In December 1919 the appellants bought for £97,000 a ship built in 1906, which at the time of the purchase was ready to sail with freight booked. The periodical survey of the ship was then considerably overdue; indeed, for the purposes of the voyage about to commence, exemption from survey had had to be obtained. When the ship returned from the voyage she underwent survey, and the purchasers had to expend a sum of £51,558 on repairs (in addition to certain further expenditure of an admittedly capital character).

The assessment appealed against is for excess profits duty and is made in terms of section 47 of the Finance Act 1916 (6 and 7 Geo V, cap. 24) which specially deals with the case of ships changing hands by purchase. Accordingly the *pre-war profits* are calculated by reference to the profits arising from the use of the ship by the purchasers' predecessors during the pre-war trade years. On the other hand the purchasers' profits during the accounting period are calculated under section 40 of the Finance Act (No. 2) 1915 (5 and 6 Geo. V, cap. 89) on the same principle as those upon which the profits and gains of their own business would be determined for the purposes of income tax, subject to the modifications contained in Part I of the Fourth Schedule to the Act. By paragraph 3 of Part I it is enacted—"Deductions for wear and tear, or for any expenditure of a capital nature for renewals, or for the development of the trade or business, or otherwise in respect of the trade or business, shall not be allowed except such as may be allowed under the Income Tax Acts. . . ." The whole question in the case is as to the admissibility of the above-mentioned repair account of £51,558 as a deduction in the determination of the purchasers' profits; and it will be seen from the foregoing narrative that that question really turns on the Income Tax Act 1918 (8 and 9 Geo. V, cap. 40) and particularly on Rule 3 of Cases i and ii of Schedule D of that Act.

The expense laid out in keeping a ship which is employed in trade in proper repair is certainly an expense necessary for the purposes of the trade. It is made for the purpose of earning the profits of the trade. Repairs may be executed as the occasion for them occurs; or if they are such as brook delay they may be postponed to a convenient season; but in either case they truly constitute a constantly recurring incident of that continuous employment of the ship which makes them necessary. They are therefore an admissible deduction in computing profits, and as is admitted in the case, if the ship had not been sold the purchasers' predecessors would have been entitled to deduct the whole of the £51,558 in returning their profits for income tax. Accumulated arrears for repairs are, in short, none the less repairs necessary to earn profits although they have been allowed to accumulate.

In the present case, however, the accumulation of repairs (represented by the expen-

diture of £51,558 required to overtake them) was an accumulation which extended partly over a period during which the ship was employed, not in the purchasers' trade, but in that of the purchasers' predecessors. And the question relates to the computation of the *purchasers' profits only*.

The purchasers started their trade with a ship already in need of extensive repairs. The need was not so clamant as to make it impossible to employ her (as she stood at the time of the purchase) in the voyage she was then about to commence. So much is clear from the fact that she was allowed exemption from survey for the purposes of that voyage. But while some portion of the repairs executed after her return was no doubt attributable to her employment in the purchasers' trade between the date of their purchase and the return of the ship—and while such portion was therefore necessary to the earning of profits by them in that and subsequent voyages—it seems plain that a large portion of them was attributable solely to her employment by the purchasers' predecessors in whose profits the purchasers had no interest whatever. The admissibility of deduction of the latter portion thus appears to be negatived by the terms of Rule 3 (*a*) of Cases i and ii.

It is obvious that a ship on which repairs have been allowed to accumulate is a less valuable capital asset with which to start business than a ship which has been regularly kept in repair. And it is a fair inference that the sellers would have demanded and obtained a higher price than they actually did, but for the immediate necessity of repairs to which the ship was subject when they put her in the market. The additional gains they had made by postponing repairs were thus counterbalanced by the diminished value of the ship on realisation; but it is not relevant to the question of the extent of the purchasers' assessability to income tax on their own profits that the Revenue may have gained by the inflation of the profits of their predecessors consequent on the postponement of repairs which, if regularly made, would have diminished them.

Again, when the purchasers started trade with the ship the capital they required was not limited to the price paid to acquire her, but included the cost of the arrears of repairs which their predecessors had allowed to accumulate; because while their own trading with her would, in ordinary course, provide a revenue out of which the repairs incidental to such trading would be met, it would be unreasonable and abnormal, in any commercial sense, to saddle such trading with the burden of arrears of repairs incidental to the trading of their predecessors from which the purchasers derived no benefit. If the purchasers had "succeeded to the trade" of their predecessors within the meaning of Rule II of Cases i and ii of Schedule D, the case would have been otherwise; but this view of the purchasers' relation to the sellers is excluded by the case of *Watson Brothers* v. *Inland Revenue* ((1902) 4 F. 795, 4 T.C. 441) mentioned in the case.

The Commissioners have allowed deduction of £12,000 (out of the £51,558) as being in their view of the facts applicable to the period during which the purchasers were owners of the ship, and to the extent of the £12,000 thus allowed I think the company is entitled to deduction but not to the extent of the whole £51,558.

LORD SKERRINGTON—In or about May 1920 the appellants expended the sum of £59,474 upon work which they caused to be executed on a ship the "Duns Law" purchased by them six months previously. All this work was necessary in order to bring the ship up to the standard required by a Lloyd's survey. It is agreed that £7916 of this sum was for capital expenditure, but that the balance of £51,588 was for work of the nature of repairs, and in respect of which the seller would have been allowed a deduction for income tax purposes if he had caused these repairs to be executed before he sold the ship. The appellants, not unnaturally in the circumstances, claim that this sum of £51,588 is an admissible deduction from the profits of their business for income tax purposes. A difficulty arises, however, from the fact that although they bought the "Duns Law" they did not acquire or succeed to the business carried on by her former owner prior to the sale. In these circumstances the Special Commissioners refused the deduction claimed by the appellants except to the extent of £12,000, which they determined, upon the evidence before them, to be the cost of the repairs applicable to the period during which the appellants were the owners of the ship. Admittedly at the time when the appellants bought the ship her periodical survey was overdue.

The validity of the appellants' claim for a deduction of the whole sum of £51,588 seems to me to depend, primarily, upon a question of fact which as already explained has been decided by the Special Commissioners, viz., that only £12,000 out of the sum of £51,588 is applicable to the period of the appellants' ownership. Did the Special Commissioners fall into any error in law when they disallowed the appellants' claim to deduct the balance of £39,588? I do not think so. For the purpose of starting a new business the appellants bought a ship which was out of repair to the extent of £39,588. They made good this defect at the first convenient opportunity. The cost of these repairs was in my opinion just as much a capital expenditure from the point of view of the appellants' business as it would have been if the work had been executed by the seller before the sale and the cost had been added by him to the price of the ship. There is no reason why expenditure which would have formed a proper deduction for income tax purposes if incurred by the owner of one business should not be regarded as a capital expenditure if incurred by the owner of a different business. The determination of the Special Commissioners ought in my opinion to be affirmed.

LORD CULLEN—I am of the same opinion. The appellants purchased a ship in order to

begin and carry on a business with it. If the ship had been a new ship but not completed so as to make it adequate for use, and if the appellants had laid out on it the money required to complete it, there would, I take it, have been no doubt that the money so laid out would have been properly treated as capital expenditure. The ship actually bought by the appellants was not a new ship, but it was not complete and adequate for use in their intended business, inasmuch as a large amount of money had to be laid out on necessary repairs. I am unable to see any good ground in principle for differentiating, *quoad* the present question, the money so laid out by the appellants on necessary repairs from the figured expenditure on completion in the case of the new ship, and I am of opinion that it has been properly treated by the Commissioners as capital expenditure. It is in substance the equivalent of an addition to the price. If the ship had not been in need of the repairs in question when bought, the appellants would presumably have had to pay a correspondingly larger price.

In relation to the present question I am unable to see that it is relevant for consideration that the ship, before the appellants bought it in order to start their business, had been employed by the vendors in a business of their own with which the appellants have no connection, or that if the vendors had made the repairs in the normal course of their business they might or would have been right in treating their expenditure thereon as expenditure out of income in their accounts. There has been no continuity between the two businesses.

Little was sought to be made by the appellants' counsel of the fact that the ship *de facto* traded for six months or so before the repairs were executed. She did so by special licence, and it was by virtue of that licence alone that the immediate execution of the repairs after the purchase was temporarily avoided. It is not disputed that such part of the sum of £51,558 mentioned in the case as represents repairs incurred after the purchase should be deducted.

Lord Sands—In this case it appears that in December 1919 the appellants purchased for the sum of £97,000 a vessel which at that time must be held, according to the finding of the Commissioners, to have stood in need of repairs to the amount of, in round figures, £40,000 in order to retain her class. These repairs were executed in the course of the following summer. The appellants now claim to deduct this sum from the profits of the year as being necessary outlay chargeable against the income of the year. I have come to the conclusion, though not with complete satisfaction, that the appellants are not entitled to make this deduction, and that the £40,000 must be treated as a capital outlay. I base this conclusion upon two grounds—(1) The case of the *Highland Railway Company* v. *Special Commissioners of Income Tax* (16 R. 950) appears to me in point and the reasoning of the Lord President to be applicable. Repairs necessary at the time of purchase to render the subject of purchase serviceable fall to be added to the initial cost as a capital charge. (2) Upon ordinary business principles this outlay appears to me to be properly a capital charge. A prospectus of a company formed to purchase this ship would in ordinary course have shown the purchase price and the repairs immediately required as part of the initial capital outlay. It may be that the appellants' company did not raise capital to meet these charges but paid them out of future income. But, as pointed out by the Lord President in the *Highland Railway Company* case, such considerations are not conclusive. The question is not from what source the charges were actually defrayed, but whether according to accounting principles they ought to be charged to capital or to income.

I have stated that I do not reach this conclusion with complete satisfaction. That is owing to the admissions made by counsel for the Inland Revenue at the bar. I understood it to be conceded that if the purchase had been made before the survey was due, then according to the practice of the Inland Revenue the whole might have been deducted from income although the defective condition rendering repairs necessary had developed before the date of purchase. This may be a rule of convenience or a benignant concession, but it does not appear to me to accord with the principle for which the Inland Revenue here contend. I confess I do not quite appreciate the crucial importance which in this regard is attached to the quadrennial survey being due. No doubt it is likely that at this time some repairs will be required. But on the other hand there may be urgent necessity for extensive and costly repairs although no survey is due. When, however, a case such as the present is brought before the Court the decision must be consistent with law, however inconsistent the result may be with working practice in cognate cases.

The Court answered the question of law to the effect that the company was entitled to a deduction of £12,000, but not to a deduction of the whole £51,558.

Counsel for the Appellants — Dean of Faculty (Sandeman, K.C.) — Normand. Agents—J. & J. Ross, W.S.

Counsel for the Respondents—Lord Advocate (Hon. W. Watson, K.C.) — Skelton. Agent—Stair A. Gillon, Solicitor of Inland Revenue.