HIGH COURT OF JUSTICE—27TH AND 28TH MARCH AND 3RD APRIL, 1950

COURT OF APPEAL—29TH AND 30TH JUNE AND 14TH JULY, 1950

HOUSE OF LORDS—11TH AND 12TH FEBRUARY AND 26TH MARCH, 1952

(1) Reynolds and Gibson

v.

Crompton (H.M. Inspector of Taxes)(1)

(2) Reynolds and Gibson

v.

Commissioners of Inland Revenue

Income Tax, Schedule D, and Profits Tax—Profits of trade—Debt taken over at reduced valuation on change of partnership and subsequently recovered in full—Whether profit assessable.

In September, 1938, *a debt of* £174,600 *due to the Appellant firm (as then constituted) was valued in the firm's books at* £124,600, *the balance of* £50,000 *having been transferred to a bad debt reserve account and allowed by deductions in computing profits for Income Tax purposes in previous years. On the retirement of one of the partners, the proviso in Sub-section* (1) *of Section* 32, *Finance Act,* 1926, *was invoked, with the result that the firm was treated for Income Tax purposes as though a new business had been set up with effect from* 1*st October,* 1938. *In fixing the consideration payable by the new firm to the old, the debt was valued at its book figure of* £124,600. *By* 30*th September,* 1945, *the firm had recovered* £84,114 13*s.* 10*d. of the debt, and had written down the bad debt reserve by re-transferring to profit and loss account sums totalling* £40,000 *out of the* £50,000 *previously set aside. A further change in the partnership took place on* 30*th September,* 1945, *but the proviso in Sub-section* (1) *of Section* 32, *Finance Act,* 1926 *was not invoked and the firm was therefore treated as one continuing partnership. On* 24*th December,* 1946, *the balance of the debt,* £90,485 6*s.* 2*d., was paid in full.*

The firm was assessed to Income Tax and to Profits Tax on the footing that £50,000, *the amount for which deductions had been allowed in past years, should be included in the firm's profits for taxation purposes for the year ended* 30*th September,* 1947. *The firm appealed, contending that neither it nor the firm as constituted before the change on* 30*th September,* 1945, *carried on the trade of dealing in debts, and that the sums recovered were not receipts of the trade carried on by the firm before and after that change. The Special Commissioners dismissed the appeals and confirmed the assessments. The firm demanded Cases.*

Held *that the* £50,000 *was not a taxable profit of the new trade set up on* 1*st October,* 1938.

Decision in Henry Hall, Ltd. *v.* Barron, 30 T.C. 45 *over-ruled.*

(1) Reported 94 S.J. 352; 94 S.J. 566; [1950] 2 All E.R. 502; [1952] 1 All E.R. 888; [1952] 1 T.L.R. 922.

CASES

(1) Reynolds and Gibson

v.

Crompton (H.M. Inspector of Taxes)

CASE

Stated under the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 29th March, 1949 Reynolds and Gibson (hereinafter called " the Appellant firm ") appealed against an assessment to Income Tax made upon it for the year ended 5th April, 1949, under the provisions of Case I, Schedule D of the Income Tax Act, 1918.

1. The Appellant firm, a partnership as from time to time differently constituted, has carried on the business of cotton brokers in Liverpool for many years.

2. From 1st October, 1928 to 30th September, 1948 the following table sets out the names of the members of the Appellant firm in which, from time to time, various changes occurred, and are referred to in the table set out below as firm no. 1, no. 2, no. 3, and no. 4 respectively. On the formation of each new firm the assets and liabilities of its predecessor were valued for the purpose of fixing the amount of the consideration to be paid by the new firm to the old and were taken over at the figure so fixed. The assessment appealed against was made upon firm no. 4 which is the Appellant in this case.

Schedule of Partners of Reynolds and Gibson

1st Oct., 1928 to 30th Sept., 1933 (5 years)	1st Oct., 1933 to 30th Sept., 1938 (5 years)	1st Oct., 1938 to 30th Sept., 1941 (3 years) subsequently extended to 30th Sept., 1944—3 years—further year at will, *i.e.*, 30th Sept., 1945	1st Oct., 1945 to 30th Sept., 1948 (3 years)
Firm No. 1	*Firm No.* 2	*Firm No.* 3	*Firm No.* 4
Sir John Shute	Sir John Shute	Sir John Shute	(7)Sir John Shute
E. B. Orme	(2)E. B. Orme	(5)F. R. Verdon	
F. R. Verdon	F. R. Verdon	(4)F. Reynolds	Sir John F. R. Reynolds, Bt.
W. J. Walmsley	(3)W. J. Walmsley	Sir John F. R. Reynolds, Bt.	
F. Reynolds	F. Reynolds	(6)A. Lightbound	F. L. Orme
John F. R. Reynolds	Sir John F. R. Reynolds	F. L. Orme	E. R. Orme
A. Lightbound	A. Lightbound	E. R. Orme	
(1)F. L. Orme	F. L. Orme		

(1) F. L. Orme admitted 1st Oct., 1932.
(2) E. B. Orme died 1937.
(3) W. J. Walmsley retired on the 30th Sept., 1938.
(4) F. Reynolds retired early 1939.
(5) F. R. Verdon retired 30th Sept., 1945.
(6) A. Lightbound retired 30th Sept., 1945.
(7) Sir John Shute died 13th Sept., 1948.

3. The sole question raised by this appeal is whether a sum of £50,000, being the amount of a bad debt reserve, in respect of a debt fully recovered in December, 1946, by firm no. 4 is rightly included in the said assessment by reason of the matters hereinafter set out.

4. About the year 1920 the Appellant firm, as then constituted, in the course of its business supplied cotton to Combined Egyptian Mills, Ltd. (hereinafter referred to as " Combined "). In 1930 a debt, for cotton so supplied, of £200,000 was owing to the Appellant firm, as then constituted, by Combined. The question arose as to how far this debt was good and how far it should be treated as doubtful. In the year ended 30th September, 1930 the Appellant firm, as then constituted, made a reserve of £37,500 against the said debt and in the year to 30th September, 1932 a further reserve of £12,500 making £50,000 in all. The said sums of £37,500 and £12,500 were allowed as deductions in computing its profits and gains for the purposes of Income Tax for the appropriate years of assessment, i.e. 1931-32 and 1933-34.

5. In respect of this debt it was agreed that the Appellant firm as then constituted should draw, and Combined should accept, three-month bills of exchange. The Appellant firm as then constituted took collateral security in the form of a mortgage and the debt was reduced from time to time as the bills were met. In subsequent years it was considered that the said reserve was too drastic and the value of the debt was estimated to be greater than was originally thought to be the case. The said reserve of £50,000 was consequently reduced, the amount of the reductions being recredited to the profit and loss accounts.

6. The following table sets out the amount of bills of exchange drawn by the Appellant firm as from time to time constituted and accepted by Combined, the said reserve created and subsequently reduced, the amount of the bills honoured by Combined and the amounts of the reserve as reduced credited to the profit and loss accounts of the Appellant firm as then constituted from the year ended 30th September, 1938 to 30th September, 1946.

	Bills met	Bills Receivable	Re-credited to profit and loss account	Provision (To reserve account)
	£ s. d.	£ s. d.	£	£
Year ending 30.9.1938 ...		174,600 0 0		50,000
" " 30.9.1939 ...	10,000 0 0	164,600 0 0		50,000
" " 30.9.1940 ...	14,600 0 0	150,000 0 0		50,000
" " 30.9.1941 ...	15,000 0 0	135,000 0 0		50,000
" " 30.9.1942 ...	12,000 0 0	123,000 0 0	10,000	40,000
" " 30.9.1943 ...	11,000 0 0	112,000 0 0	15,000	25,000
" " 30.9.1944 ...	21,514 13 10	90,485 6 2	10,000	15,000
" " 30.9.1945 ...		90,485 6 2	5,000	10,000
" " 30.9.1946 ...		90,485 6 2		10,000
24.12.1946	90,485 6 2		10,000	

This table shows that firm no. 3, having been formed on 1st October, 1938, acquired a debt, owing by Combined, from firm no. 2 of £174,600 against which a reserve of £50,000 had been created. The said debt was thus valued at £124,000 at that time. In the years ended 30th September, 1939, 1940, 1941, 1942, 1943 and 1944 firm no. 3 received sums totalling £84,114 13*s.* 10*d.* from Combined in respect of the said debt of £174,600. In the years ended 30th September 1942, 1943, 1944 and 1945 firm no. 3

wrote back sums totalling £40,000 from the reserve to its profit and loss accounts. On 24th December, 1946 Combined discharged the balance of the said debt of £174,600 by paying to firm no. 4, which was formed on 1st October, 1945, a sum of £90,485 6*s.* 2*d.*

7. Neither firm no. 3 nor firm no. 4 traded in book debts.

8. On the formation of firm no. 3 the proviso to Sub-section (1) of Section 32 of the Finance Act, 1926, was invoked by the partners of firms no. 2 and no. 3. As a consequence firm no. 3 fell to be treated for Income Tax purposes as if a new trade had been set up by it. The said proviso was not invoked on the formation of firm no. 4 which fell to be treated for Income Tax purposes under the provisions of Sub-section (1) of the said Section as between firm no. 3 and itself.

9. It was contended on behalf of the Appellant firm (firm no. 4) ;

(1) that neither the Appellant firm nor firm no. 3 carried on the trade of dealing in debts and accordingly the sums received by those firms from Combined were not receipts or profits of the trades carried on by them respectively ;

(2) that the debt of Combined was never part of the circulating capital of firm no. 3 but was part of the fixed assets of that firm acquired by it on its being constituted ;

(3) that the said debt was likewise never part of the circulating capital of the Appellant firm which continued to carry on the trade of firm no. 3 from which the Appellant firm, upon its constitution, acquired the said debt ;

(4) alternatively, the said debt was part of the fixed capital assets of the Appellant firm so acquired by it upon its constitution ;

(5) the said debt was at no time a book debt of firm no. 3 or of the Appellant firm.

10. It was contended on behalf of the Respondent ;

(1) that the receipt by firm no. 3 and firm no. 4 of money owing by Combined Egyptian Mills was not the realisation of capital assets ;

(2) that the receipt of the money owing was a part of the ordinary business dealing of firm no. 3 and firm no. 4 ;

(3) that as no notice under the proviso to Sub-section (1), Section 32 of the Finance Act, 1926, had been given by firm no. 3 and firm no. 4 the businesses carried on by them must, for Income Tax purposes, be regarded as one continuous business carried on since 1st October, 1938 ;

(4) that the sum of £50,000, the difference between the sum for which the Combined Egyptian Mills debt had been taken over and the amount eventually realised, was properly brought into account in computing the amount of the assessment on firm no. 4.

11. We, the Commissioners, gave our decision as follows.

In September, 1938, firm no. 3 took over from firm no. 2, for £124,600, the debt of £174,600 due from Combined Egyptian Mills. Eventually the full sum of £174,600 was realised, £84,114 13*s.* 10*d.* being received by firm no. 3 and £90,485 6*s.* 2*d.* by firm no. 4.

For Income Tax purposes firm no. 3 fell to be treated as having set up a new trade, and we accept that it did not trade in book debts. Nevertheless, in the hands of firms nos. 1 and 2 the debt in question was in no sense a capital asset, but simply an ordinary trading debt, and on the facts of this case we are unable to see that when it was taken over by firms nos. 3 and 4 successively its "quality" was changed from revenue to capital, as contended on behalf of the Appellant firm. In our opinion it remained a debt on revenue account, collectible in the ordinary course of trade and its collection was incidental to the trade.

If the full £174,600 had been received by firm no. 3, we should have felt no doubt that its profit of £50,000 over the amount which it had paid for the debt would have been a profit on revenue account. But the final £90,485 6*s*. 2*d*. was received by firm no. 4 (the present Appellant firm) and the Crown admits that if all the members of firms nos. 3 and 4 had given the requisite notice under the proviso to Sub-section (1), Section 32 of the Finance Act, 1926, firm no. 4 would fall to be treated as having set up a new trade, with the result that its profit on realisation would have been only £10,000 (being the excess of the amount received over the amount at which it took over the debt from firm no. 3).

It is admitted, however, that no such notice was given, and we accept the contention of the Crown that in these circumstances for Income Tax purposes this change of partnership must be ignored, with the result that the above profit of £50,000 must be brought into the Income Tax assessment of firm no. 4. The appeal therefore fails.

The figure having been agreed between the parties, we confirmed the assessment.

12. The Appellant firm immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

R. Coke
F. N. D. Preston } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94-99, High Holborn,
London, W.C.1.

25th November, 1949.

(2) Reynolds and Gibson

v.

Commissioners of Inland Revenue

This Case related to an assessment to Profits Tax for the chargeable accounting period ended 31st December, 1946.

The facts and the contentions of the parties and the decision of the Commissioners were similar to those in the first case.

The cases came before Roxburgh, J., in the High Court on 27th and 28th March, 1950, when judgment was reserved. On 3rd April, 1950, judgment was given in favour of the Crown, with costs.

Mr. Cyril King, K.C., and Mr. J. H. Bowe appeared as Counsel for the taxpayers and Mr. Frederick Grant, K.C., and Mr. Reginald P. Hills for the Crown.

Roxburgh, J.—About the year 1930 a partnership firm of cotton brokers (hereinafter called Reynolds and Gibson no. 1) were creditors of Combined Egyptian Mills, Ltd. for £200,000 for cotton supplied to them. There was a change in the firm in 1933, and thereafter Reynolds and Gibson no. 2 carried on the business until there was a further change in the firm on 1st October, 1938. Upon the formation of firm no. 3 the proviso to Sub-section (1), Section 32, of the Finance Act, 1926, was invoked with the result that firm no. 3 fell to be treated for Income Tax purposes as if a new trade had been set up. On 1st October, 1938, the debt had been reduced to £174,600, and firm no. 3 took it over at a valuation, namely, £124,600. Firm no. 3 got in a further part of the debt and then there was a further change in the firm, but as the proviso to Sub-section (1), Section 32, was not invoked on that occasion, this last change can be disregarded. Firm no. 4 completed the recovery of the debt, and accordingly, as firm no. 3 purchased the debt for £124,600, firms 3 and 4 between them ultimately realised a profit of £50,000 on the collection of the debt. I am not quite sure what the findings of fact by the Special Commissioners which I will now set out really amounted to, but neither party wishes me to ask them for further elucidation.

Paragraph 7 of the Case states: "Neither firm no. 3 nor firm no. 4 "traded in book debts." Paragraph 11 of the Case states: "For Income "Tax purposes firm no. 3 fell to be treated as having set up a new trade, "and we accept that it did not trade in book debts. Nevertheless, in the "hands of firms nos. 1 and 2 the debt in question was in no sense a "capital asset, but simply an ordinary trading debt, and on the facts of "this case we are unable to see that when it was taken over by firms nos. "3 and 4, successively, its 'quality' was changed from revenue to capital, "as contended on behalf of the Appellant firm. In our opinion it remained "a debt on revenue account, collectible in the ordinary course of trade "and its collection was incidental to the trade."

I understand this to be a finding that although firms nos. 3 and 4 did not trade in book debts generally it was a part of their trade to acquire and collect this particular book debt. Is this finding of fact one which justifies

(Roxburgh, J.)

treating the £50,000 as profits of the trade for Income Tax purposes? I do not share the view of the Special Commissioners that when the debt had been purchased by firm no. 3 it remained a debt on revenue account. It seems to me that it clearly became a capital asset, purchased out of capital. But the question remains whether it was fixed or circulating capital. As Romer, L.J., pointed out in *Golden Horse Shoe (New), Ltd.* v. *Thurgood*, 18 T.C. 280, at page 300: "The profits or losses in a "year of trading cannot be ascertained unless a comparison be made of "the circulating capital as it existed at the beginning of the year with the "circulating capital as it exists at the end of the year. It is, indeed, by "causing the floating capital to change in value that a loss or profit is "made."

Between assets which clearly constitute fixed and circulating capital respectively there is a debatable territory, and in that territory the decision is one of fact, and may be one of degree. I think that the findings of the Special Commissioners, as I understand them, are equivalent to a finding that the profit in question arose from the utilisation of circulating capital in the trade and was accordingly profit liable to taxation and was not a realised accretion to a fixed capital asset. Mr. King submitted that the finding in paragraph 7 of the Case was conclusive against this view, but that submission is inconsistent with the decision of Croom-Johnson, J., in *Harry Hall, Ltd.* v. *Barron*, 30 T.C. 451, who upheld a determination of the Special Commissioners that the profits on realisation of purchased book debts were taxable although the company was not a dealer in book debts, holding that the question was essentially one of fact. As he pointed out, the book debts had a particular characteristic. They had arisen in the conduct of a business of the same nature. That also applies here. It was a book debt in a cotton broker's business. It would certainly seem to me difficult to regard this particular book debt as fixed capital and in my judgment the determination of the Special Commissioners cannot be successfully impeached.

Mr. Reginald Hills.—In both cases the appeals will be dismissed with costs?

Roxburgh, J.—Yes. That is right, I suppose.

Mr. Hills.—The other case was a Profits Tax case which follows on this.

Roxburgh, J.—Very well.

An appeal having been entered against the above decision, the cases came before the Court of Appeal (Sir Raymond Evershed, M.R., and Singleton and Jenkins, L.JJ.) on 29th and 30th June, 1950, when judgment was reserved. On 14th July, 1950, judgment was given against the Crown, with costs.

Mr. Cyril King, K.C., and Mr. J. H. Bowe appeared as Counsel for the taxpayers and Mr. Frederick Grant, K.C. and Mr. Reginald P. Hills for the Crown.

Singleton, L.J.—The judgment of the Master of the Rolls will be read by Jenkins, L.J.

Sir Raymond Evershed, M.R. (*read by Jenkins, L.J.*)—In this appeal both my brethren (whose judgments I have had the advantage of reading) have arrived at a clear conclusion in favour of the Appellant. I have felt for myself impressed by the force of Mr. Grant's argument that the question whether the item in suit, the debt—Mr. Cyril King was reluctant to call it a " book debt "—due from Combined Egyptian Mills, Ltd., was in the hands of the Appellants or their immediate predecessors, called firm no. 3, a capital or revenue item, was one of fact ; that the Special Commissioners had found the facts in favour of the Crown ; and that there was some evidence to support that finding. The Case Stated is, in its exposition of the character of the Appellant's business as cotton brokers, of the way in which this particular debt was dealt with and of the business relations (if any) between firms no. 3 and no. 4 on the one hand and the debtor company on the other, undoubtedly meagre. But having regard to the matters set out in paragraph 6 of the Case there is (as it seemed to me) much to be said for the view that by the second sub-paragraph of paragraph 11 the Special Commissioners intended to find as a fact that the debt in question was treated for all practical or business purposes as a revenue item, and retained the revenue character which, admittedly, it had originally possessed in the hands of firms nos. 1 and 2. And if this were right, then I cannot see that the terms of paragraph 7 of the Case produced any inconsistency.

But both my brethren clearly think that the relevant part of paragraph 11 cannot, in its context, be regarded as a finding of fact but constitutes rather an expression of opinion based on the matters previously set forth. If this is the right view then I agree that the Case and the conclusions of the Special Commissioners appear to do less than justice to the effect of the advantage taken upon the formation of firm no. 3 of the proviso to Rule 11 (1) of the Rules applicable to Cases I and II of Schedule D to the Income Tax Act, 1918. In all the circumstances I am not prepared to dissent from the view of my brethren that the appeal should be allowed.

Singleton, L.J.—The Appellant firm has carried on the business of cotton brokers in Liverpool for many years. The appeal is against an assessment to Income Tax made upon it for the year ended 5th April, 1949, under Case I, Schedule D of the Income Tax Act, 1918. Roxburgh, J., upheld the decision of the Special Commissioners confirming the assessment, and the firm appeals to this Court. Under Case I Income Tax is chargeable in respect of the annual profits or gains arising or accruing to the firm in respect of their trade. Thus it must be shown that the assessment is based upon profits arising from the business of cotton brokers or accruing to the firm in respect of it. It is not enough to show merely that there was a profit of some kind : it must be a profit accruing to the firm in the course of its trade.

Some 30 years ago, the firm of Reynolds and Gibson, as then constituted, supplied cotton to Combined Egyptian Mills, Ltd., and as a result, the latter incurred a debt to the former of £200,000. There have been various changes in the firm since that date and they are shown in paragraph 2 of the Case. The firm which supplied the cotton was firm no. 1 therein mentioned (or a firm which was in existence before firm no. 1) and the firm upon which the assessment is made is firm no. 4. The debt was regarded

(Singleton, L.J.)

as doubtful to some extent, and during the existence of firm no. 1 sums amounting to £50,000 were reserved against it, and these amounts were allowed as deductions in computing the profits or gains of firm no. 1 in the relevant years. In later years, during the time of firm no. 3, it was considered that the value of the debt was greater than had been thought and amounts aggregating £40,000 were re-credited to the profit and loss accounts as shown in paragraph 6 of the Case. Firm no. 1 had taken securities from the company in respect of the debt and the company made payments as shown in paragraph 6. When firm no. 3 was formed on 1st October, 1938, the proviso to Rule 11 (1) under Cases I and II of Schedule D was invoked by all those who were engaged in the business both immediately before and immediately after the change, so that firm no. 3 fell to be treated for Income Tax purposes as though a new trade had been set up or commenced. Firm no. 3 acquired the debt owing by Combined Egyptian Mills, Ltd. It was then £174,600, but as I have said already it had been written down in the books by £50,000 so that it was of the book value of £124,600 (paragraph 6 of the Case). The Appellant firm, firm no. 4, was formed on 1st April, 1945 ; no notice to bring into operation the proviso to Rule 11 (1) was given. At the time of formation of firm no. 4 £90,485 6*s.* 2*d.* of the original indebtedness of Combined Egyptian Mills, Ltd. was still outstanding.

There is nothing in the Case to show the figure at which it was taken over by firm no. 4 from firm no. 3, though the £40,000 I have mentioned had already been credited in the profit and loss account of firm no. 3. The amount was paid off by Combined Egyptian Mills, Ltd. on 24th December, 1946. The contention of the Respondent, the Inspector of Taxes, is that the sum so paid results in a profit to the firm of £50,000, and that that sum must be brought into account in order to arrive at the profits or gains of firm no. 4 in respect of the year of assessment ended 5th April, 1949. The difficulty in the case is created by the paucity of the facts found and stated. Roxburgh, J., referred to this and appears to have thought that there was need for further elucidation, but neither party wished the case to go back. Speaking for myself, I do not think that the Court ought to be asked to give judgment on the meagre statement of facts contained in this Case.

The original debt had arisen from sales of cotton by firm no. 1 many years ago and they had taken securities to cover it. There is nothing whatever to show that business relationship continued (apart from payments on account of the debt from time to time). Nor is there anything to show whether this kind of transaction is usual when one firm takes over the business of another firm engaged in cotton-broking. It may well be an important element in preserving good-will on a change of firm such as took place in 1933, in 1938 and in 1945, but there is no suggestion of that kind in the Case. All that we are told is that the assets and liabilities were valued on each occasion for the purpose of fixing the amount of consideration to be paid by the new firm. There may well have been other book debts ; only this one is mentioned in the Case.

The Appellant firm relies strongly on the finding in paragraph 7 that neither firm no. 3 nor firm no. 4 traded in book debts, and undoubtedly this is of importance in view of the necessity of its being shown that the profit arose from trade or business carried on by the firm. The Respondent places reliance on paragraph 11, and Counsel submitted that that paragraph amounted to a finding of fact that the balance of the debt remained a debt

on revenue account. I do not regard paragraph 11 as a finding of fact. The Commissioners had already stated their findings of fact, and paragraph 11 should be read as containing the conclusions at which the Commissioners arrived on the facts set out earlier in the Case. In any event I agree with the view of Roxburgh, J., that whatever the position had been earlier, as from the time the debt was acquired by firm no. 3 it became a capital asset purchased out of capital. Yet I find myself unable to agree with the learned Judge that the findings of the Special Commissioners are equivalent to a finding that the profit in question arose from the utilisation of circulating capital in the trade. Circulating capital is normally something used by a trading concern for the purpose of buying goods in which it trades in the hope of making a profit. I do not see that this debt in the hands of firm no. 3 or of firm no. 4 can be described as circulating capital in any sense. It was a debt and, so far as we know, an isolated case of a debt taken over, and there is nothing to show that it had any connection with the trade or business of firm no. 3 or of firm no. 4—unless that can be assumed from the fact that the indebtedness arose from sales of cotton by a predecessor firm, and I cannot think it is right to make such an assumption. In *Golden Horse Shoe (New), Ltd.* v. *Thurgood,* 18 T.C. 280, Romer, L.J., dealing with the difference between fixed capital and circulating capital, said (at page 300): "Unfortunately, however, it is not always easy to determine whether a "particular asset belongs to the one category or the other. It depends in no "way upon what may be the nature of the asset in fact or in law. Land "may in certain circumstances be circulating capital. A chattel or a chose "in action may be fixed capital. The determining factor must be the nature "of the trade in which the asset is employed." Herein lies the importance of the finding that neither firm no. 3 nor firm no. 4 traded in book debts, coupled with the absence of any finding that any business relationship continued or that the debt had anything to do with the business of firm no. 3 or of firm no. 4. It is true to say that firm no. 4 collected the balance of the debt and included it in the books of the firm; it is that fact, I take it, which leads the Commissioners to say that it remained "collectible in the "ordinary course of trade and its collection was incidental to the trade." I am not quite sure what that means and I do not think that it carries one much further.

In *Leeming* v. *Jones,* 15 T.C. 333, Lord Buckmaster said at (page 357): "This brings the argument back to the original position. Can the profits "made in this case be described as income? Were the Respondent a company "promoter or were his business associated with purchase and sale of estates, "wholly different considerations would apply, but this is negatived: the "transaction in this case stands isolated and alone. It is to my mind, in the "circumstances, purely an affair of capital." For some reason which I do not profess to understand both parties wish to have a decision on this case as it stands. Having regard to the isolated nature of the transaction, to the finding that neither firm no. 3 nor firm no. 4 dealt in book debts, to the application of the proviso to Rule 11 (1) in 1938, and to the lack of anything to show that the debt was in any way connected with the trade or business of either firm no. 3 or firm no. 4, I am not prepared to say that the sum of £50,000 falls to be dealt with as part of the profits or gains from the trade or business of the Appellant firm. Such part of the profit as was made by either firm accrued not by reason of its trade or by reason of its carrying on the business of cotton brokers, but because of the acquisition of a debt.

(Singleton, L.J.)

The position would have been the same had firm no. 3 acquired at a low figure a debenture which was ultimately paid in full.

In my view the appeal should be allowed.

Jenkins, L.J.—This is an appeal from a judgment of Roxburgh, J., dated 3rd April, 1950, dismissing an appeal by the Appellant firm of Reynolds and Gibson from a determination of the Special Commissioners to the effect that the assessment to Income Tax under Case I of Schedule D made on the Appellant firm for the year ended 5th April, 1949, should be confirmed.

The assessment under appeal was made in respect of the profits of the trade of cotton brokers carried on by the Appellant firm in Liverpool from 1st October, 1945, onwards in succession to a series of firms of the same name, three of which, covering the period from 1st October, 1928, to 30th September, 1945, are specifically mentioned in the Case, and conveniently referred to in chronological order as firms nos. 1, 2 and 3 respectively, the Appellant firm being distinguished from its three immediate predecessors as firm no. 4.

Firm no. 1 (which succeeded a yet earlier firm of Reynolds and Gibson) operated from 1st October, 1928 to 30th September, 1933; firm no. 2 from 1st October, 1933 to 30th September, 1938; and firm no. 3 from 1st October, 1938 to 30th September, 1945, when it was succeeded by the Appellant firm no. 4. As will appear below, the only significant change for the present purpose is the succession of firm no. 3 to firm no. 2 on 1st October, 1938. The method of effecting the succession on each occasion is thus described in the Case: "On the formation of each new firm the "assets and liabilities of its predecessor were valued for the purpose of "fixing the amount of the consideration to be paid by the new firm to the "old and were taken over at the figure so fixed."

The question in the appeal is in effect whether a sum of £50,000, representing the difference between the value (namely, £124,600) at which firm no. 3 took over a certain debt from firm no. 2 and the full amount (namely, £174,600) of the debt as ultimately recovered from the debtor by firms nos. 3 and 4, was rightly included in the assessment under appeal as a profit of firm no. 4's trade as cotton brokers.

The debt in question was the balance of a larger sum which had become due from a company called Combined Egyptian Mills, Ltd. (to which I will refer as "the debtor company") in respect of cotton supplied to the debtor company in or about the year 1920 by the firm of Reynolds and Gibson as then constituted. In 1930, the amount of the debt was £200,000, and firm no. 1, having doubts as to its recoverability, made reserves against it in the years ended 30th September, 1930, and 30th September, 1932, of £37,500 and £12,500 respectively, making £50,000 in all. These reserves were duly allowed as deductions for Income Tax purposes in the appropriate years.

At a date not specified in the Case, but clearly before 1st October, 1938, arrangements were made between firm no. 1 or firm no. 2 and the debtor company under which the debt was to be discharged over a period by means of three-month bills drawn by the firm and accepted by the debtor company, and the debtor company gave collateral security in the form of a mortgage. Under this arrangement the amount of the debt had by 1st October, 1938, (that is to say, the date of firm no. 3's succession to firm no. 2) been reduced to £174,600, but the reserve against it still stood

at £50,000. Thus in effect firm no. 3 in taking over the assets and liabilities of firm no. 2 on its succession to that firm paid for this particular asset a sum less by £50,000 than its face value (that is to say, £174,600 less £50,000, which equals £124,600).

In the years ended 30th September, 1939, 1940, 1941, 1942, 1943, and 1944, firm no. 3 received from the debtor company in reduction of the debt sums totalling £84,114 13*s.* 10*d.*, and in the years ended 30th September, 1942, 1943, 1944, and 1945, firm no. 3 re-credited to profit and loss account from the reserve sums totalling £40,000. The position at the date of firm no. 4's succession to firm no. 3 (that is to say, 1st October, 1945) therefore was that the debt stood at £90,485 6*s.* 2*d.*, with a reserve against it of £10,000, and, in taking over the assets and liabilities of firm no. 3, firm no. 4 thus in effect paid for this particular asset £10,000 less than its face value (that is to say, £90,485 6*s.* 2*d.* less £10,000, which equals £80,485 6*s.* 2*d.*). On 24th December, 1946, the debtor company discharged the balance of the debt in full by payment to firm no. 4 of the sum of £90,485 6*s.* 2*d.*

The debt of £174,600 having thus been paid in full, its acquisition by firm no. 3 from firm no. 2 at the price of only £124,600 resulted in the end in a profit of £50,000 of which, as appears above, £40,000 was received by firm no. 3 and £10,000 by firm no. 4.

The question is whether, in the circumstances I have stated, this profit of £50,000 was for Income Tax purposes a profit of the trade of cotton brokers carried on by firm no. 4, so as to attract tax under Case I of Schedule D.

In the consideration of this question the succession of firm no. 4 to firm no. 3 must admittedly be ignored, as on the occasion of that succession recourse was not had to the proviso to paragraph (1) of the new Rule 11 of the Rules applicable to Cases I and II of Schedule D, introduced by Section 32 of the Finance Act, 1926, and consequently for Income Tax purposes firms nos. 3 and 4 fall to be treated as one and the same firm, with the result that if the £50,000 is taxable at all, the whole amount is rightly assessed on firm no. 4 notwithstanding that £40,000 of it was in fact received by firm no. 3. But it is important to observe that the proviso to paragraph (1) of Rule 11 was invoked on the succession of firm no. 3 to firm no. 2 and consequently that the liability or otherwise of the £50,000 to tax as a profit of the trade of firm no. 4 must be judged on the assumption that on 1st October, 1938, firm no. 3 set up a new trade as cotton brokers and for that purpose purchased the assets and undertook the liabilities of the previously existing firm no. 2.

I should perhaps read paragraph (1) of Rule 11, which is in these terms: " If at any time after the fifth day of April, nineteen hundred and " twenty-eight, a change occurs in a partnership of persons engaged in any " trade, profession or vocation, by reason of retirement or death, or the " dissolution of the partnership as to one or more of the partners, or the " admission of a new partner, in such circumstances that one or more of " the persons who until that time were engaged in the trade, profession or " vocation continued to be engaged therein, or a person who until that " time was engaged in any trade, profession or vocation on his own account " continues to be engaged in it, but as a partner in a partnership, the tax " payable by the person or persons who carry on the trade, profession or

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" vocation after that time shall, notwithstanding the change, be computed " according to the profits or gains of the trade, profession or vocation " during the period prescribed by the Income Tax Acts: Provided that, " where all the persons who were engaged in the trade, profession or " vocation both immediately before and immediately after the change, " require, by notice signed by all of them or, in the case of a deceased " person, by his legal representatives, and sent to the surveyor within " twelve months after the change took place, that the tax payable for all " years of assessment shall be computed as if the trade, profession or vocation " had been discontinued at the date of the change, and a new trade, " profession or vocation had been then set up or commenced, and that " the tax so computed for any years shall be charged on and paid by such " of them as would have been charged if such discontinuance and setting " up or commencement had actually taken place, the tax shall be computed, " charged, collected and paid accordingly."

The Special Commissioners, after narrating the facts to which I have already referred, recorded (in paragraph 7 of the Case) a finding that " Neither firm no. 3 nor firm no. 4 traded in book debts." Then, after summarising the contentions of the parties, they expressed their decision in paragraph 11 of the Case in the following terms: " We, the Commissioners, " gave our decisions as follows. In September, 1938, firm no. 3 took " over from firm no. 2, for £124,600, the debt of £174,600 due from " Combined Egyptian Mills. Eventually the full sum of £174,600 was " realised, £84,114 13*s.* 10*d.* being received by firm no. 3 and " £90,485 6*s.* 2*d.* by firm no. 4. For Income Tax purposes firm no. 3 fell " to be treated as having set up a new trade, and we accept that it did " not trade in book debts. Nevertheless, in the hands of firms nos. 1 " and 2 the debt in question was in no sense a capital asset, but simply " an ordinary trading debt, and, on the facts of this case, we are unable " to see that when it was taken over by firms nos. 3 and 4 successively " its 'quality' was changed from revenue to capital, as contended on " behalf of the Appellant firm. In our opinion it remained a debt on " revenue account, collectible in the ordinary course of trade and its " collection was incidental to the trade. If the full £174,600 had been " received by firm no. 3, we should have felt no doubt that its profit of " £50,000 over the amount which it had paid for the debt would have " been a profit on revenue account. But the final £90,485 6*s.* 2*d.* was " received by firm no. 4 (the present Appellant firm) and the Crown " admits that if all the members of firms nos. 3 and 4 had given the " requisite notice under the proviso to Sub-section (1), Section 32 of the " Finance Act, 1926, firm no. 4 would fall to be treated as having set up " a new trade, with the result that its profit on realisation would have " been only £10,000 (being the excess of the amount received over the " amount at which it took over the debt from firm no. 3). It is admitted, " however, that no such notice was given, and we accept the contention " of the Crown that in these circumstances, for Income Tax purposes this " change of partnership must be ignored, with the result that the above " profit of £50,000 must be brought into the Income Tax assessment of " firm no. 4. The appeal therefore fails."

As I have already indicated, the correctness of this decision is not challenged so far as the effect of paragraph (1) of Rule 11 is concerned. In other words, it is admitted that if and so far as the £50,000 constituted a profit of the trade of firm no. 3 or firm no. 4 at all, firm no. 4 is

assessable to tax on the whole amount notwithstanding that the great part of it was in fact received by firm no. 3. The contest is directed solely to the question whether it was a profit of their trade at all.

It was argued before us on the part of the Crown that the Special Commissioners' decision of this question adversely to the Appellant firm no. 4 involved a finding of fact which ought not to be disturbed. I do not think this is so. Apart from the somewhat meagre narrative summarised above and the finding in paragraph 7 of the Case that neither firm no. 3 nor firm no. 4 traded in book debts, the only findings bearing on the character of the debt in question appear in the second paragraph of the decision, and are to the following effect: (1) that in the hands of firms nos. 1 and 2 the debt in question was in no sense a capital asset but simply an ordinary trading debt ; (2) that on the facts of the case the Special Commissioners were unable to see that when it was taken over by firms nos. 3 and 4 successively its " quality " was changed from revenue to capital ; and (3) that in their opinion it remained a debt on revenue account collectible in the ordinary course of trade and its collection was incidental to the trade.

I cannot regard these as findings of fact concluding the matter against the Appellant firm no. 4. That the debt in question was in origin an ordinary trading debt is not open to doubt. But the question is not whether it was a trading debt in the hands of the firm to which it originally became due or in the hands of firms nos. 1 and 2, but whether, on the assumption that it preserved its original character as a trading debt down to the date of the succession of firm no. 3 to firm no. 2, and was at that date a trading debt owing to the latter, it then became a trading debt owing to firm no. 3 notwithstanding that firm no. 3, by virtue of the proviso to paragraph (1) to Rule 11, is to be considered as having set up a new trade as opposed to merely continuing the trade of its predecessor. The Special Commissioners do not seem to me to have addressed themselves adequately to this question. They draw no distinction between the succession of firm no. 3 to firm no. 2 (to which the proviso to paragraph (1) of Rule 11 applied) and the succession of firm no. 4 to firm no. 3 (to which that proviso did not apply), but content themselves by saying that on the facts of the case they are unable to see that when the debt was taken over by firms nos. 3 and 4 successively its " quality " was changed from revenue to capital. Now if firm no. 3 is to be considered as having set up a new trade, the trading operations by which the right to receive the debt in question was originally earned are *ex hypothesi* not to be regarded as operations of the trade carried on by firm no. 3, since they were wholly completed and done with long before firm no. 3's trade was ever set up. Therefore if the debt in question became a trading debt of firm no. 3 it can only have done so because its acquisition by firm no. 3 as part of the assets of firm no. 2 amounted to an operation of firm no. 3's new trade. But, as found by the Special Commissioners, the new trade set up by firm no. 3 did not include dealing in book debts. It was simply the trade of cotton brokers. It follows that the acquisition of the debt in question was not *per se* an operation of the new trade set up by firm no. 3. The question therefore is whether on the facts of the case its acquisition was an operation of firm no. 3's new trade although such trade was simply that of cotton brokers, and not dealers in book debts. On the facts as found by the Special Commissioners I see no warrant for so holding. Their statement of the opinion that the debt in question " remained " a debt on revenue account, collectible in the ordinary course of trade and

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" its collection was incidental to the trade " appears to me to carry the matter no further. The question as I understand it is whether the acquisition of the debt was an operation in the course of firm no. 3's trade. If the answer to that question is " yes ", then *prima facie* any profit resulting from such acquisition would be a profit of firm no. 3's trade and taxable accordingly. If the answer is " no ", then *prima facie* any such profit would be simply the appreciation of an asset acquired otherwise than in the course of such trade, and accordingly not part of the profits of such trade or taxable in that character. There seems no doubt that the debt in question was in fact treated in the books of firm no. 3 in the same way as a debt arising in the course of its own trade would have been treated, and I am prepared to assume it was similarly dealt with for the purposes of collection (if that is what the Special Commissioners mean by " collectible " in the ordinary course of trade ") and also that its collection was carried out in conjunction with the ordinary trading operations of firm no. 3 (if that is what the Special Commissioners mean by saying " its collection was " incidental to the trade "). But these circumstances cannot suffice to convert it into an asset acquired by firm no. 3 in the course of its trade if in fact it was not so acquired.

The learned Judge expressed doubts which I fully share as to the effect of the Special Commissioners' findings of fact, but added that neither party wished him to ask them for further elucidation. A similar reluctance was shown on both sides when it was suggested in this Court that the case might with advantage be remitted in the Special Commissioners for further facts to be found.

After referring to the statement of the Special Commissioners' decision in paragraph 11 of the Case, the learned Judge continued [1]: " I under- " stand this to be a finding that although firms nos. 3 and 4 did not trade " in book debts generally it was part of their trade to acquire and collect " this particular book debt. Is this finding of fact one which justifies treat- " ing the £50,000 as profits of the trade for Income Tax purposes? I do " not share the view of the Special Commissioners that when the debt had " been purchased by firm no. 3 it remained a debt on revenue account. It " seems to me that it clearly became a capital asset, purchased out of " capital. But the question remains whether it was fixed or circulating " capital. As Romer, L.J., pointed out in *Golden Horse Shoe (New), Ltd.*, v. " *Thurgood*, 18 T.C. 280, at page 300: 'The profits or losses in a year " ' of trading cannot be ascertained unless a comparison be made of the " ' circulating capital as it existed at the beginning of the year with the " ' circulating capital as it exists at the end of the year. It is, indeed, by " ' causing the floating capital to change in value that a loss or profit is " ' made.' Between assets which clearly constitute fixed and circulating " capital respectively there is a debatable territory, and in that territory " the decision is one of fact, and may be one of degree. I think that the " findings of the Special Commissioners, as I understand them, are equivalent " to a finding that the profit in question arose from the utilisation of " circulating capital in the trade, and was accordingly profit liable to taxation " and was not a realised accretion to a fixed capital asset. Mr. King " submitted that the finding in paragraph 7 of the Case was conclusive " against this view, but that submission is inconsistent with the decision of " Croom-Johnson, J., in *Harry Hall, Ltd.* v. *Barron*, 30 T.C., 451, who upheld " a determination of the Special Commissioners that the profits on realisation

[1] Page 294 *ante*.

" of purchased book debts were taxable although the company was not a " dealer in book debts, holding that the question was essentially one of fact. " As he pointed out, the book debts had a particular characteristic. They " had arisen in the conduct of a business of the same nature. That also " applies here. It was a book debt in a cotton broker's business. It would " certainly seem to me difficult to regard this particular book debt as fixed " capital and in my judgment the determination of the Special Commissioners " cannot be successfully impeached."

The learned Judge thus arrived at what may perhaps be described as a rationalisation of the Special Commissioners' findings which enabled him to uphold their decision.

But for my part I do not think the importation into the case of the somewhat debatable distinction between fixed and circulating capital really contributes anything to the solution of the question in issue. After all, if I understand the cases correctly, " circulating capital " is simply an expression used to denote capital expended in the course of the trade with a view to disposal at a profit of the assets produced or acquired by means of such expenditure, and represented at different stages of its career by cash, assets into which the cash has been converted, and debts owing from customers to whom those assets have been sold. It follows that to describe the sum of £124,600 expended by firm no. 3 in the present case on the acquisition of the debt of £174,600 owing to firm no. 2 as circulating capital is really to beg the question, since the £124,600 was circulating capital employed in firm no. 3's trade if but not unless the acquisition of the debt was an operation of firm no. 3's trade.

The question therefore still remains to be answered : Was the purchase of the debt in question a purchase in the course of the new trade which firm no. 3 is treated as having set up, with the result that the profit of £50,000 accruing through the ultimate payment of the debt in full was a profit of that trade? For this purpose, firm no. 3 must be regarded as a complete stranger to firm no. 2, purchasing the assets and undertaking the liabilities of firm no. 2 with a view to setting up a new business of the same kind on its own account.

The mere fact that a given asset was included in the totality of the assets so acquired clearly could not of itself make its acquisition an operation in the course of the new trade set up by firm no. 3 so as to turn any appreciation in the value of that particular asset into a profit of such trade. For instance (the trade being that of cotton brokers) appreciation in the value of such assets as premises, office furniture, or investments acquired from firm no. 2 would clearly not answer that description. The result must therefore depend on the nature of the asset. If it was an asset of the kind dealt in in the course of the particular trade, or in other words if it was in the nature of stock-in-trade, its purchase would clearly amount to a trading operation, and any resulting profit would be a profit of the trade. If it was an asset which could only be turned to account by the exercise of the trade (for example, an uncompleted contract for the supply of goods of the kind dealt in in the trade) the same result would, I apprehend, ensue. But if it was an asset neither of the kind dealt in in the trade nor such that it could only be turned to account by the exercise of the trade I cannot for my part see on what ground its purchase could be regarded as in itself constituting an operation of the trade.

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Applying these principles to the present case, I find that firm no. 3 purchased from firm no. 2 amongst other assets a debt, the right to receive which had been fully earned many years ago by trading operations long since completed. Nothing whatever in the way of the relevant trade remained to be done in order to recover the amount, and it was in due course recovered by firms nos. 3 and 4 simply by virtue of the former's purchase of the right to receive it. It is true that the trading operations by which the debt had originally been earned were of the same kind as those upon which firm no. 3 was proposing to embark. But this seems to me to be beside the point. It was simply a right to receive £174,600 and it mattered not on what account that right had arisen. Precisely the same profit would have arisen to any purchaser of the debt whether a cotton broker or not. Its value in no way depended on firm no. 3 carrying on the business of cotton brokers or any other business. The transaction as I see it was simply the purchase of an asset which subsequently appreciated in value by a firm whose trade did not include the purchase of or dealing in assets of that character.

I ask myself whether in the converse event of firm no. 3 having purchased from firm no. 2 a similar debt which ultimately realised £50,000 less than the price paid for it the deficiency would have constituted a loss sustained in the course of the new trade set up by firm no. 3, and find difficulty in seeing how the answer to that question could fail to be in the negative.

If this view is right, the following passage from the judgment of Lord Young in *Assets Company, Limited* v. *Forbes,* 3 T.C. 542, at page 549, seems to me to be closely in point: " Is it to be said that they were making " a trade of buying and selling doubtful debts? There is nothing to indi- " cate that in the least. The proposition that where anybody who purchases " a doubtful debt and makes more than he paid for it—one purchase, he " not being a trader in that kind of thing—that that is income, is, I think, " a proposition which cannot be sustained. Now, I think, we have nothing " upon the face of this case to show that in a trade of buying and selling " there was income or gain made by this Company upon which the assess- " ment is made."

I would refer also to the opening passage in the judgment of Rowlatt, J., in *Rees Roturbo Development Syndicate, Ltd.* v. *Ducker,* 13 T.C. 366, at page 378, where he said: " This is one of those cases which raise great " difficulty in applying a principle which in itself is perfectly clear. It has " been said before in this Court, and in more important Courts, and it is " perfectly clear, that where profit accrues from the sale of property a ques- " tion arises whether that forms the basis of liability to Income Tax. Now " Income Tax is not attracted by the mere circumstance that there is a " profit; because the profit may be a mere accretion of the value of the " article, and the profit may not accrue in the course of any trade at all. " On the other hand the circumstances that the profit is due to an accretion " in the value of the article does not negative the application of Income " Tax, because the accretion of value to the article may have been the very " thing that a trade within Case I was established to secure. In that case " you have a trade which is going to be in articles with a view to securing " the accretion of value to those articles, and the accretion of value does not " negative the incidence of Income Tax."

The present case as I see it is one in which *quoad* firms nos. 3 and 4 the profit did not, in the words of Rowlatt, J., " accrue in the course of any " trade at all."

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As to the case of *Harry Hall, Ltd.* v. *Barron*, 30 T.C. 451, in which Croom-Johnson, J., treated the question whether a profit realised by the collection of book debts purchased from one tailoring concern by another was a trading profit in the hands of the purchaser as a question of fact which had been concluded in favour of the Crown by the findings of the Special Commissioners, I need only say that whether that case was rightly decided or not there were facts found by the Special Commissioners which have no counterpart here.

On the facts as found in the present case I am of opinion, for the reasons I have endeavoured to state, that the Special Commissioners and the learned Judge came to a wrong conclusion and that the appeal should be allowed.

Mr. King.—Did I understand, my Lord, that the judgments your Lordships have given are primarily in the Income Tax appeal?

Singleton, L.J.—That was the only one argued. The other, we were told, would follow.

Mr. King.—So it would follow in your Lordships opinion that both appeals would be allowed with costs?

Singleton, L.J.—Both appeals allowed with costs—costs in this Court and below.

Mr. Rowland.—I am instructed to apply for leave to appeal to the House of Lords in this case. There has been a conflict of judicial opinion.

Singleton, L.J.—Have you anything to say about that, Mr. King?

Mr. King.—I must leave it to your Lordships. I would only venture most respectfully to submit that, if my friend is given leave, the Order as to costs should not be disturbed.

Singleton, L.J.—Is there any ground for such an Order in the circumstances of this case? We are differing from the view of the learned Judge below, and there is a considerable sum of money involved.

Mr. King.—I cannot resist my friend's application, but I thought your Lordship would just bear in mind that after a struggle I have succeeded, and I want to keep the Order as to costs.

Singleton, L.J.—You may have leave to appeal to the House of Lords.

Mr. Rowland.—I am much obliged.

The Crown having appealed against the above decision, the case came before the House of Lords (Lords Normand, Morton of Henryton, Reid, Tucker and Cohen) on 11th and 12th February, 1952, when judgment was reserved. On 26th March, 1952, judgment was given unanimously against the Crown, with costs.

Mr. Cyril King, Q.C., and Mr. R. Borneman appeared as Counsel for the taxpayers and Mr. Frederick Grant, Q.C., and Sir Reginald Hills for the Crown.

Lord Normand.—My Lords, this is an appeal from orders of the Court of Appeal allowing appeals by the Respondent from Orders of Roxburgh, J. whereby two appeals by the Respondent upon Cases separately stated by the Commissioners for the Special Purposes of the Income Tax Acts were dismissed.

The Respondent is a partnership trading under the firm name of Reynolds and Gibson and the appeal relates to two separate assessments made upon the partnership, (*a*) for the year ended 5th April, 1949, in respect of Income Tax under the provisions of Case I, Schedule D, of the Income Tax Act, 1918, and (*b*) for the chargeable accounting period ended 31st December, 1946, in respect of Profits Tax, under the provisions of the Finance Act, 1937, as amended by the Finance Acts, 1942 and 1946. The appeals in respect of both of these assessments were heard before the Special Commissioners on the same date and have since been heard together in the High Court and the Court of Appeal. At the hearing before the Special Commissioners it was agreed by the parties that the question at issue was the same in both appeals, and it is stated by the Special Commissioners in the Case stated by them in relation to the Profits Tax appeal that the questions at issue, the facts, and the contentions of the parties are identical with those in the Income Tax appeal. The sole question raised in each of the appeals is whether a sum of £50,000 falls to be included in each of the assessments.

For the complete statement of the facts I refer to the Stated Case, and to the judgment of Jenkins, L.J., who has narrated them and elucidated them by valuable explanations and comments. I therefore content myself with a short summary.

Four successive firms have for a long time carried on business as cotton brokers in Liverpool, all of them under the name "Reynolds and Gibson". The Respondent is the fourth of these firms. On the formation of each new firm the assets and liabilities of its predecessor were valued for the purpose of fixing the amount of the consideration to be paid by the new firm to the old and were taken over at the figure so fixed. On the formation of firm no. 3 on 1st October, 1938, the proviso to Subsection (1) of Section 32 of the Finance Act, 1926, the terms of which I shall recite later, was invoked by the partners of firms nos. 2 and 3. The proviso was not invoked on the formation of no. 2 firm nor on the formation of no. 4 firm. As a consequence no. 3 firm fell to be treated for Income Tax purposes as if a new trade had been set up by it, but firms nos. 1 and 2 fell to be treated for the purpose of Income Tax as one firm carrying on the same trade, and so also firms nos. 3 and 4 fell to be treated as one firm carrying on the same trade. About the year 1920 no. 1 firm, in the course of its business, supplied cotton to Combined Egyptian Mills, Ltd., and in 1930 a debt of £200,000 for cotton so supplied was owing to no. 1 firm. When firm no. 3 was formed this debt had been reduced to £174,600 against which a reserve of £50,000 had been created. The debt was thus valued at £124,600 at that time and that was the consideration paid by no. 3 firm for the right to collect the debt and retain the sums collected. Between 1st October, 1938, and 24th December, 1946, the whole sum of £174,600 was repaid and the whole debt extinguished partly by repayments to no. 3 firm and partly by a final payment to no. 4 firm. There is an important finding, paragraph 7, by the Special Commissioners that "neither "firm no. 3 nor firm no. 4 traded in book debts". After stating the facts the Special Commissioners in the Stated Case set out the contentions of parties

and proceed to give their decision in a separate paragraph, number 11, which it will be well to quote:

"We, the Commissioners, gave our decision as follows.

"In September, 1938, firm no. 3 took over from firm no. 2 for "£124,600, the debt of £174,600 due from Combined Egyptian Mills. "Eventually the full sum of £174,600 was realised, £84,114 13*s.* 10*d.* "being received by firm no. 3 and £90,485 6*s.* 2*d.* by firm no. 4.

"For Income Tax purposes firm no. 3 fell to be treated as having "set up a new trade, and we accept that it did not trade in book debts. "Nevertheless, in the hands of firms nos. 1 and 2 the debt in question "was in no sense a capital asset, but simply an ordinary trading debt, "and, on the facts of this case, we are unable to see that when it was "taken over by firms nos. 3 and 4, successively, its 'quality' was "changed from revenue to capital, as contended on behalf of the "Appellant firm. In our opinion it remained a debt on revenue "account, collectible in the ordinary course of trade and its collection "was incidental to the trade.

"If the full £174,600 had been received by firm no. 3, we should "have felt no doubt that its profit of £50,000 over the amount which "it had paid for the debt would have been a profit on revenue "account. But the final £90,485 6*s.* 2*d.* was received by firm no. 4 "(the present Appellant firm) and the Crown admits that if all the "members of firms nos. 3 and 4 had given the requisite notice under "the proviso to Sub-section (1), Section 32 of the Finance Act, 1926, "firm no. 4 would fall to be treated as having set up a new trade, "with the result that its profit on realisation would have been only "£10,000 (being the excess of the amount received over the amount "at which it took over the debt from firm no. 3).

"It is admitted, however, that no such notice was given, and we "accept the contention of the Crown that, in these circumstances, for "Income Tax purposes this change of partnership must be ignored, with "the result that the above profit of £50,000 must be brought into the "Income Tax assessment of firm no. 4."

At this stage it is convenient to turn to the statutory provisions dealing with successions to trades and businesses. By Section 32 of the Finance Act, 1926, an amendment was made to the Income Tax provisions dealing with successions to trades and businesses in relation to the computation of profits. Previously the general position was that under Rule 11 of the Rules of Cases I and II of Schedule D in the Income Tax Act, 1918 (subject to exceptions not material) upon a succession taking place in the ownership of a business the business was treated for the purpose of the computation of profits as a continuing business and as though there had been no change in ownership. Section 32 of the Finance Act, 1926, repealed the old Rule 11 and replaced it by a new Rule 11 of which Sub-rule (1) dealt with changes in ownership due to changes in partnerships or the creation of a partnership. By Sub-rule (2) all successions other than those dealt with in Sub-rule (1) are directed to have effect for the purpose of computing profits as though upon the change in ownership a business had ceased and a new business had been set up. Sub-rule (1) of the new Rule 11 so enacted in Section 32 of the Finance Act, 1926, and the proviso thereto are as follows:

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"11.—(1) If at any time after the fifth day of April, nineteen hundred "and twenty-eight, a change occurs in a partnership of persons engaged "in any trade, profession or vocation, by reason of retirement or death, "or the dissolution of the partnership as to one or more of the partners, "or the admission of a new partner, in such circumstances that one "or more of the persons who until that time were engaged in the "trade, profession or vocation continue to be engaged therein, or "a person who until that time was engaged in any trade, profession "or vocation on his own account continues to be engaged in it, but "as a partner in a partnership, the tax payable by the person or per- "sons who carry on the trade, profession or vocation after that time "shall, notwithstanding the change, be computed according to the profits "or gains of the trade, profession or vocation during the period pre- "scribed by the Income Tax Acts:

"Provided that, where all the persons who were engaged in the trade, "profession or vocation both immediately before and immediately after "the change require, by notice signed by all of them or, in the case "of a deceased person, by his legal representatives, and sent to the "surveyor within [twelve] months after the change took place, that "the tax payable for all years of assessment shall be computed as if "the trade, profession or vocation had been discontinued at the date "of the change, and a new trade, profession or vocation had been "then set up or commenced, and that the tax so computed for any "year shall be charged on and paid by such of them as would have "been charged if such discontinuance and setting up or commencement "had actually taken place, the tax shall be computed, charged, "collected and paid accordingly."

"Twelve" was substituted for "three" in the above proviso by Section 15 of the Finance Act, 1930.

In the High Court, Roxburgh, J., in his judgment dismissing the appeal, expressed some doubt about what the Special Commissioners' findings of fact included, but he came to the conclusion that paragraph 7 of the findings together with the findings in paragraph 11 amounted to a finding of fact that although firms nos. 3 and 4 did not trade in book debts generally, it was a part of their trade to acquire and collect this particular book debt of £174,600. He did not, however, share the view of the Special Commissioners that when the debt had been acquired by firm no. 3 it remained a debt on revenue account. He held that it was a capital asset purchased out of capital but that it was circulating capital. He also said that to hold that it was a fixed capital asset would be inconsistent with *Harry Hall, Ltd.* v. *Barron,* 30 T.C. 451. In the Court of Appeal Sir Raymond Evershed, M.R. said that he was impressed with the argument for the Crown that it was a question of fact whether the debt was a capital or a revenue item in the hands of firms nos. 3 and 4, and that there was much to be said for the view that the Special Commissioners had intended to find that the debt was treated as a revenue item and retained its original revenue character. But he deferred to the views of the other members of the Court and did not dissent. Singleton, L.J. and Jenkins, L.J. both agreed that there was no finding of fact concluding the case in favour of the Crown; that the debt in the hands of firms nos. 3 and 4 was not part of their circulating capital and that it was not acquired for or employed in the trade carried on by them. Jenkins, L.J. was further of opinion that the Special Commissioners had failed to address themselves adequately to

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the question whether a debt that had been a trading debt owed to firm no. 1 or firm no. 2 became a trading debt owing to firm no. 3 notwithstanding that firm no. 3 by virtue of the invocation of the proviso above cited was to be considered as having set up a new trade as opposed to merely continuing the trade of its predecessor. He said that the true question was whether the acquisition of the debt was an operation in the course of firm no. 3's trade; and he held that it was not.

My Lords, I agree that unless the acquisition of the debt was in course of the business carried on by firm no. 3, the profit which arose on the full discharge of the debt cannot be regarded as a profit of the business carried on by firms nos. 3 and 4. The Crown's argument was that the Special Commissioners had by a finding of fact, not open to review, concluded that the acquisition of the debt was a transaction within the scope of the business carried on by firm no. 3. We have therefore to consider paragraph 7 of the Case and along with it paragraph 11 or the relevant part of it. Paragraph 7 is unqualified in its terms: "Neither firm no. 3 "nor firm no. 4 traded in book debts." I think that it means that trading in book debts was never part of the business of either firm. If the Special Commissioners meant to say only that the two firms were not financial firms though they did on this occasion trade in this particular debt, I can see no reason why they should not have said so in plain language in this paragraph. Instead, they use language which on the face of it seems to exclude any trading in book debts from the business of the firms. From paragraph 7 I go on to paragraph 11, and I can discover no finding in it that firms nos. 3 or 4 entered into an isolated transaction of the nature of trade in acquiring the debt. What the Special Commissioners say is that in the hands of firms nos. 1 and 2 the debt in question was in no sense a capital asset but simply an ordinary trading debt, and that on the facts they were unable to see that when it was taken over by firms nos. 3 and 4 successively its "quality" was changed from revenue to capital. This is not a finding that firms nos. 3 and 4 embarked *pro hac vice* upon a business of trading in book debts. The finding in paragraph 11 is, in my view, a finding in law that this trade debt when it was acquired by firms nos. 3 and 4 did not alter its quality from revenue to capital "on the facts of "this case". The Special Commissioners do not specify the facts on which they relied. One salient fact is that all the partners of firms nos. 2 and 3 had given notice in terms of the proviso, with the legal consequence that the trade carried on by firms nos. 1 and 2 must be taken to have been discontinued and a new trade by firm no. 3 to have been set up when firm no. 3 succeeded to firm no. 2; another salient fact is that the debt had been incurred in trading operations completed at least eight years before the new trade of firm no. 3 began. Then not less important is the absence of any finding that the debt was acquired in order to further in any way the trade of cotton broking about to be begun by firm no. 3. The acquisition of the debt was in no way a transaction within the scope of the cotton broking business carried on by firm no. 3 but a transaction precedent to the commencement of that business. The collection of the debt by firms nos. 3 and 4 was likewise not a transaction in the course of their cotton broking. To say, as the Commissioners did, that it was incidental to the trade is merely a consequence of the previous finding in law that the debt retained its "quality" as a trading debt; if a debt is a trading debt of a firm its collection is necessarily an incident of that firm's trade. The finding in law ignores the consequences which result from giving notice in terms of the proviso, and is therefore erroneous. The right which no. 3

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firm acquired was a right to receive a sum of money from the debtor of its predecessor and the origin of the debt represented by that sum became immaterial as soon as the right to collect it passed to a firm which was about to commence a new trade. So, too, the collection of the sum from the debtor was the exercise of the right which firms nos. 3 and 4 had acquired by expending a part of their capital on the purchase of a non-trading debt and it was in no way an exercise of the trade of cotton brokers. If firm no. 3 had ceased to carry on business as cotton brokers it would still have collected the debt precisely as it did collect it and, as was said by Jenkins, L.J., precisely the same profit could have arisen to any purchasers of the debt whether a cotton broker or not. No exertions of trading were employed in the collection and the profit was not a profit of the business carried on by firms nos. 3 and 4 as cotton brokers ; and, I repeat for the sake of completeness, these firms did not carry on a trade in book debts. The fact that entries were made in the books of these firms recording reductions of the reserve made against the debt and the receipt of sums in payment does not affect the matter. These entries are not inconsistent with the acquisition of the debt as an asset outside the scope of the trade carried on by the firms.

My Lords, no assistance is to be obtained by the Crown from the contention that the debt was not a fixed asset but part of the circulating capital of firms nos. 3 and 4. Such a contention merely clouds the simple issue whether the acquisition and collection of the debt were within the scope of the trade carried on by the two firms so that the surplus collected over the price paid for the right to collect was a fruit or profit of that trade. I agree with Jenkins, L.J., on this point, and indeed I most respectfully agree with his whole judgment which unanswerably develops the reasons for the conclusion that the profit of £50,000 is an accretion of value analogous to the profit made by the sale of a fixed asset and not a profit accruing in the course of any trade at all.

I cannot distinguish *Harry Hall, Ltd.* v. *Barron*, 30 T.C. 451, from the present case. It is true that in that case there were express findings that the appellant company acquired from the old company more than one trading debt arising from business completed by it, whereas here we are told only of one such debt. But there was a finding in *Harry Hall, Ltd.* that the appellant company's business was not that of a dealer in book debts, just as there is here. The reasoning which excludes from the computation of trading profits for the purposes of taxation one book debt acquired by a new company which does not deal in book debts will equally apply where several or many such debts are so acquired. I therefore think that the decision in *Harry Hall, Ltd.* rests on the same mistake of law as the decision of the Special Commissioners in this case and that it should be disapproved so that it may not hereafter appear as a case which may be distinguished from the present case and become a source of future error.

I would dismiss both appeals with costs.

Lord Morton of Henryton.—My Lords, I have had the advantage of reading in print the opinion which has just been delivered by my noble and learned friend on the Woolsack. I agree so entirely with his reasoning and his conclusions that I find it unnecessary to add any observations of my own.

I agree that both appeals should be dismissed with costs.

Lord Reid.—My Lords, on 30th September, 1938, one partner of the firm of Reynolds and Gibson retired and a new partner was taken into partnership. On the occasion of this change a notice was given in terms of the proviso to the new Rule 11 (1) of the Rules applicable to Cases I and II of Schedule D which had been substituted for the old Rule by Section 32 of the Finance Act, 1926. It is common ground that by reason of this notice the new firm must be treated as if it had commenced a new business on 1st October, 1938. There had been previous changes in the firm and there were also subsequent changes but these are immaterial in this case because the statutory notice was not given in respect of these changes. The Case refers to firms nos. 1, 2, 3 and 4. The change in respect of which the notice was given was the change from firm no. 2 to firm no. 3, and I shall refer to firms nos. 1 and 2 as the old firm and to firms nos. 3 and 4 as the new firm.

In 1938 Combined Egyptian Mills owed to the old firm a debt of £174,600: about 1920 the old firm had sold cotton to this company for a sum of £200,000 and of that sum £174,600 was still owing in 1938. This debt had been treated by the old firm as a bad debt to the extent of £50,000, and when the new firm took over the old firm's assets at a valuation this debt was valued at £124,600 and was assigned to the new firm for that price. In 1946 the debt was paid in full to the new firm who thus made a profit of £50,000. The question is whether that profit is assessable to Income Tax under Case I of Schedule D.

The Rule applicable to Case I provides that tax shall be computed on the full amount of the balance of the profits or gains of the Respondents' trade. The trade of the new firm, like that of the old, was that of cotton brokers. There is a finding in the Case that the new firm did not trade in book debts and there is no suggestion that they conducted any other trade than that of cotton brokers. So if the profit of £50,000 is taxable under Case I it can only be because it was a profit earned by the new firm in carrying on that trade. Accordingly the task of the Special Commissioners was to determine whether the scope of the trade of cotton brokers as carried on by the new firm was wide enough to include the acquisition, holding and collection of this debt. But unfortunately the Commissioners did not address themselves directly to that question. The case of *Harry Hall, Ltd.* v. *Barron*, 30 T.C. 451, had been decided shortly before this case was heard by the Commissioners and they appear to have had that case in mind in reaching their decision.

I find it very difficult to discover the precise meaning of the crucial findings in the Case stated by the Commissioners and to determine to what extent they are findings of fact and to what extent findings of law. I do not think that I should here examine these findings again in detail, but giving them the best consideration I can, I have come to the conclusion that the Commissioners misdirected themselves in two respects. In the first place they appear to have attached decisive importance to the nature of the debt in the hands of the old firm; and secondly, they appear to have thought it sufficient that the collection of the debt by the new firm was incidental to the trade of the new firm without deciding whether the acquisition and collection of the debt by the new firm were or were not in themselves trading operations or part of the trade of the new firm.

The Commissioners truly state that the debt was a trading debt in the hands of the old firm: it arose from a sale of cotton by them in the course of their ordinary business and if it had been paid to them the

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money received would have been the fruit of their trading. But on being assigned to the new firm or to anyone else it could not remain a trading debt in that sense: the money could not then be the fruit of any trading in cotton by the assignee. It could only be a trading debt in the hands of the assignee if the acquisition of the debt by him was a trading operation on his part. I think that the Commissioners assumed that a trading debt in the hands of one cotton broker would remain a trading debt in the hands of a successor in the business unless something more than the assignment had happened to change its character: and this was a natural assumption on their part in view of the decision in *Harry Hall, Ltd.* v. *Barron*(1). But I agree with your Lordships in thinking that this decision must be over-ruled.

I venture to think that some unnecessary difficulty has been introduced into this case by the Respondents' original contention that the debt was part of the fixed assets of the new firm and was never part of its circulating capital. If circulating capital means no more than capital expended in the course of a firm's trade or capital represented by a trading asset, then to enquire whether this debt or the money spent to acquire it was circulating capital or fixed capital is only to enquire in a circuitous way whether the acquisition of this debt by the new firm was a trading operation or not. But if the term circulating capital is used in any other sense, then to enquire whether this debt or the money spent to acquire it was circulating capital or not is likely to be misleading because it may divert attention from the real issue. In the same way I doubt whether it is helpful to put the question whether the debt was a capital or a revenue asset. If by a revenue asset is meant something of which the proceeds on realisation must be treated as a trading receipt (anything else being a capital asset) then one comes back to the same question whether the acquisition and realisation of the asset are or are not trading operations. But if the terms capital asset and revenue asset are used in any other sense, again the use of these terms may be misleading.

If, as I think, the Commissioners never decided the vital question in this case, then one must examine the facts which have been found to see whether there is any evidence on which the Commissioners could now decide in favour of the Appellant. If there is, the case must be sent back to them, but if there is not, there is no reason to send the case back. If, on the other hand, I am wrong in my interpretation of the Commissioners' findings and they did decide the right question in favour of the Appellant, then the question is whether there is anything in the case to support this decision. So on either view one must examine the facts found in the Case.

The Commissioners have found that the new firm did not trade in book debts. If one gives to this finding its natural meaning it is fatal to the Appellant's case, because the debt with which this case is concerned was a book debt and the Respondents can only be liable to Income Tax if their dealings with it were trading operations. But reading this finding with the findings in paragraph 11 of the Case I doubt whether the Commissioners intended this finding to apply to debts which the new firm took over from the old firm. The new firm took over all the old firm's assets. The Case does not disclose whether those assets included any other trading debts but it is probable that there were others and, for the purpose of this argument, I am willing to assume that there were. But this debt was in

(1) 30 T.C. 451.

a special position: it had been outstanding for a long time and special arrangements had been made with regard to it. Even if there were other book debts I do not think that the mere fact that they were taken over and collected would assist the Appellant's argument. The real question is whether there is anything in the Case to indicate that the new firm's dealings with this debt could properly be regarded as a trading operation. The Case does not state that the new firm did anything more than take over the old firm's rights, receive payments to account and become parties to bills of exchange for the balances outstanding from time to time and finally receive payment of the full sum due. This was no more than any other assignee of the old firm's rights would have done. It had nothing to do with buying or selling cotton, and if that is all that the new firm did I do not see how it had any connection with the business of a cotton broker. I do not think that it is at all impossible that a new firm should take over and deal with an old firm's book debts as a trading operation, but in order to establish that I think that something more would have to be proved than the mere fact that they took over the debts and received the sums due and in this case there is really nothing more than that. I therefore agree that this appeal must be dismissed.

Lord Tucker.—My Lords, I concur.

Lord Cohen.—My Lords, I also concur.

Questions Put:

Crompton (*Inspector of Taxes*)

v.

Reynolds and Gibson

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

Commissioners of Inland Revenue

v.

Reynolds and Gibson

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Lightbounds, Jones & Co.; Solicitor of Inland Revenue.]

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