HIGH COURT OF JUSTICE (CHANCERY DIVISION)—
18TH, 19TH, 20TH AND 26TH JULY, 1961

COURT OF APPEAL—19TH AND 20TH JUNE, 1962

HOUSE OF LORDS—
24TH, 25TH AND 26TH JUNE, AND 24TH JULY, 1963

Brogan (H.M. Inspector of Taxes)

v.

Stafford Coal & Iron Co., Ltd.(1)

Commissioners of Inland Revenue

v.

Stafford Coal & Iron Co., Ltd.

Income Tax, Schedule D, and Profits Tax—Liquidation of mutual insurance company—Whether sums received by member trading receipts.

The Respondent Company, which carried on a mixed trade of operating collieries and brickworks, had been a member of a mutual insurance company, M Ltd., formed by a number of colliery proprietors in North Staffordshire with the object of insuring themselves against liability in respect of workmen's injuries. Following the nationalisation of the collieries, M Ltd. was put into liquidation, and its surplus funds distributed among its members, of whom the Respondent Company received as its share £52,059 *in* 1953 *and* £6,049 *in* 1954. *Assessments to Income Tax under Case* I *of Schedule D for the years* 1954–55 *and* 1955–56 *and to Profits Tax for the chargeable accounting periods ended* 31*st December,* 1953 *and* 1954 *were made on the Respondent Company on the footing that these sums were trading receipts.*

On appeal to the Special Commissioners the Company contended that the sums received were not revenue receipts arising in the course of its trade and that no taxable profit could be made from mutual insurance. For the Crown it was contended that the sums were refunds in respect of premiums paid and were revenue receipts. The Special Commissioners allowed the Company's appeals.

Held, *that the sums in question were received on capital account.*

CASES

Brogan (H.M. Inspector of Taxes) v. *Stafford Coal & Iron Co., Ltd.*

CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

(1) Reported (C.A.) [1962] 1 W.L.R. 1195; 106 S.J. 530; [1962] 3 All E.R. 410; 233 L.T.Jo. 503; (H.L.) [1963] 1 W.L.R. 905; 107 S.J. 809; [1963] 3 All E.R. 277; 234 L.T.Jo. 496.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 8th and 9th October, 1959, the Stafford Coal & Iron Co., Ltd. (hereinafter called " the Stafford Company "), appealed against the following assessments to Income Tax made upon it under Case I of Schedule D:

1954–55—in the sum of £81,031, less £5,334 agreed capital allowances and £23,448 agreed losses.

1955–56—in the sum of £38,586, less £2,870 agreed capital allowances.

At the same time an appeal was heard relating to the Profits Tax assessments on the Stafford Company; a separate Case has been demanded and stated upon these Profits Tax assessments.

2. The question for determination was whether or not two sums of £52,059 and £6,049 paid to the Stafford Company by virtue of its membership of the North Staffordshire Collieries Mutual Indemnity, Ltd. (hereinafter called " the mutual company "), upon the liquidation of the mutual company, were properly to be treated as forming part of the trading receipts of the Stafford Company in computing its taxable profits.

3. Evidence was given at the hearing of this appeal by Mr. Eric Prichard Southall, A.C.A., who has been employed by Messrs. Price, Waterhouse and Co., the Stafford Company's auditors, continuously since March, 1921, and who has personally dealt with the Stafford Company's accounts since 1944; and by Mr. Frederick William Gower, F.C.A., a Senior Advisory Accountant to the Board of Inland Revenue. The facts found by us are set out in paragraph 4 below.

4. (*a*) The Stafford Company, whose present registered office is situated at Federation House, Stoke-on-Trent, was incorporated on 10th September, 1873. A copy of its memorandum of association is attached hereto, marked " A " and forms part of this Case[1].

(*b*) For many years prior to the nationalisation of the coalmining industry on 1st January, 1947, the Stafford Company carried on a mixed trade, including the operation of several collieries in the Stoke-on-Trent area and of a brickworks situated on the site of one of the collieries. Since the nationalisation of the collieries it has continued to operate the brickworks, and has done so on property the freehold of which was acquired by the National Coal Board but which was leased to the Company for a period of 21 years from 1st January, 1947. It has been agreed that, for taxation purposes, the various activities of the Stafford Company together constituted one indivisible trade the identity of which was not destroyed by the nationalisation of the collieries.

(*c*) In common with a number of other colliery proprietors in the North Staffordshire area, the Stafford Company was a subscriber to the memorandum of the mutual company. The mutual company, which was a company limited by guarantee and having no share capital, was incorporated on 22nd May, 1934. It was formed to act as insurer of its members, on the mutual principle, against liabilities under the Workmen's Compensation Acts, the Employers' Liability Act or any similar Act, or at common law, resulting from injuries to workmen employed in the collieries or other undertakings of the members. (Under the Workmen's Compensation (Coal Mines) Act, 1934, insurance against workmen's compensation risks was made compulsory so far as colliery undertakings were concerned.) At 1st January, 1947, the

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[1] Not included in the present print.

mutual company had 17 members, one of which was the Stafford Company. Clause 5 of the mutual company's memorandum of association is as follows :

> " 5. Every Member of the Company undertakes to contribute to the assets of the Company, in the event of its being wound up whilst he is a Member, or within one year after he ceases to be a Member, for payment of the debts and liabilities of the Company contracted before he ceases to be a Member, and of the costs, charges and expenses of winding up, and for adjustment of the right of the contributories among themselves, such amount as may be required, not exceeding £10."

Copies of the mutual company's memorandum and articles of association, and special resolutions amending the articles, are attached hereto, marked " B ", and form part of this Case[1].

(*d*) Apart from income from its invested funds, the income of the mutual company consisted throughout of premiums paid by the members, and expressed as a percentage of wages paid by them. Such premiums were allowed as deductions in arriving at the profits of the member companies for the purpose of assessment to taxation, but from 1944–45, following the decision in *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue,* 27 T.C. 331, the mutual company was not assessed to taxation on any surplus resulting from such premiums. It had previously been regarded as assessable under Case I of Schedule D, although its accounts had shown losses for several years past.

(*e*) The premiums paid by the Stafford Company in respect of the four and a half years preceding 1st January, 1947, were as follows :

Date Paid	*Particulars*	£	*s.*	*d.*
1943				
29th June.	Premiums for September quarter, 1943 ...	5,131	3	5
29th September.	do December do 1943 ...	5,064	3	5
1944				
5th January.	do March do 1944 ...	6,999	8	1
21st March.	do June do 1944 ...	7,263	1	10
27th June.	do September do 1944 ...	14,404	14	2
1st October.	do December do 1944 ...	15,229	5	5
30th December.	do March do 1945 ...	8,759	4	6
1945				
29th March.	do June do 1945 ...	11,572	10	9
29th June.	do September do 1945 ...	10,947	6	7
1st August.	Special premium re deficiency	7,360	1	10
2nd October.	do	7,360	1	10
2nd October.	Premiums for December quarter, 1945 ...	8,129	10	10
4th October.	Special premiums re deficiency	7,360	1	10
30th October.	do	7,360	1	10
3rd December.	do	7,360	1	10
31st December.	do	7,360	1	9
1946				
2nd January.	Premiums for March quarter, 1946 ...	9,999	12	6
2nd April.	do June do 1946 ...	11,204	10	3
2nd July.	do September do 1946 ...	10,025	13	10
30th September.	do December do 1946 ...	9,447	11	11
1947				
15th January.	Premium adjustment, September quarter, 1946	350	5	1
5th March.	Premium adjustments, December quarter, 1946	1,384	18	10

[1] Not included in the present print.

No figures are available for the half year to 30th June, 1943. No premiums were called for in respect of periods after 31st December, 1946.

(*f*) In addition to the ordinary annual premiums, a special payment was made to the mutual company in the following circumstances. In 1944 a firm of actuaries was asked to examine the reserves available to cover outstanding cases as at 31st December, 1943, and their preliminary report indicated a considerable under-provision in the figures on which the mutual company was working. This was confirmed by a further report by the actuaries on the position as at 31st December, 1944. The directors of the mutual company, faced with this position, had no option but to demand an additional premium to meet the deficit without delay and, by a resolution dated 14th May, 1945, an additional levy was demanded which, in the case of the Stafford Company, amounted to approximately £44,000. The total amount of this levy was £552,410 5*s*. 11*d*.

(*g*) Following the nationalisation of the collieries, the activities of the mutual company (which it continued to carry on temporarily as agent for the National Coal Board) were transferred to the National Coal Board, and negotiations took place between the mutual company and the National Coal Board for the ascertainment of the liabilities which had vested in the Board under the Coal Industry Nationalisation Act, 1946. These negotiations were completed in 1953, and the mutual company was then put into voluntary liquidation. The extraordinary meeting of the mutual company, under which that company was put into liquidation, took place on 21st October, 1953 ; a copy of the resolutions passed at this meeting is attached hereto, marked " C ", and forms part of this Case(1). The funds available in the liquidation enabled a first distribution of £700,000 to be made to the contributories of the mutual company, and this distribution was in fact made in December, 1953, the amount received by the Stafford Company being £52,059. A copy of the standard form of letter addressed by the liquidator to the contributories is attached hereto, marked " D ", and forms part of this Case(1).

(*h*) As appears from the mutual company's balance sheet at 21st October, 1953 (a copy of which is attached hereto, marked " E ", and forms part of this Case(1)), the surplus of funds arose largely because the amount available to meet outstanding claims at that date (£1,168,133 8*s*.) substantially exceeded the valuation agreed for the purposes of transfer to the National Coal Board of liability to meet those claims. The said amount of £1,168,133 8*s*. was made up of the sum of £1,126,897 11*s*. 8*d*., which was the amount held available, in consequence of the actuaries' advice referred to in paragraph 4(*f*) hereof, at the cessation of the mutual company's activities on 31st December, 1946, to which had been added the small surplus arising on revenue account each year from 1947 onwards.

(*i*) In 1954 a further and final distribution to contributories was made by the liquidator of the mutual company, of £82,180, of which the Stafford Company's share was £6,049. A copy of the standard form of letter addressed to the contributories by the liquidator is attached hereto, marked " F ", and forms part of this Case(1) ; and a copy of the liquidator's final account is attached hereto, marked " G ", and forms part of this Case(1).

(*j*) The sums of £52,059 and £6,049 referred to above were not included as revenue receipts in the Stafford Company's profit and loss accounts for 1953 and 1954. The said sums, less provision for possible taxation, were

(1) Not included in the present print.

put to capital reserve in the balance sheets as at 31st December, 1953 and 1954. Copies of the Stafford Company's balance sheets for the two years ending 31st December, 1953 and 1954, and a copy of its profit and loss account for the year ending 31st December, 1953, are attached hereto, marked "H", and form part of this Case(1).

(*k*) The sums received from the liquidator of the mutual company were put to capital reserve in the Stafford Company's accounts in the same manner as some other items relating to the clearing-up on nationalisation of the coal industry. This procedure was followed after discussion between the Stafford Company's auditors and the directors.

(*l*) Mr. Gower and Mr. Southall disagreed about the best accountancy method of treating the sums in question. Mr. Gower was of the opinion that the sums in question were refunds relating to premiums charged in the profit and loss accounts of the Stafford Company in previous years, and that these refunds should appear in the trading account to offset the overcharges in previous years. It would be very difficult to discover, where a mutual company was involved, whether there had been any overcharges until the liquidation of the mutual company ; and, when that event had happened, there would be great difficulty in determining for which year any overcharge had arisen. These refunds were not in themselves profits of the Stafford Company's brickworks, but were reductions of expenditure previously incurred in the course of the Company's trade. It would have been correct to include the refunds as receipts of the Stafford Company's brickworks business because, in the making of bricks, wages had to be paid and employees insured. A suitable note should be made in the accounts, because it was unusual to receive back such large amounts. The refunds would be available for distribution by way of dividends. Whether the refunds should eventually be carried to reserve or distributed by way of dividend would be a matter for the decision of the directors.

Mr. Southall did not consider that the sums in question were refunds of premiums overcharged in previous years ; he thought they represented "a mopping-up operation" relating to previous years. To an accountant, the sums in question, being a distribution in a liquidation, should be regarded as a capital receipt. The sums in question could have been used to pay dividends since, in appropriate circumstances, dividends can be paid out of a realised capital surplus. It was material, in deciding what was the proper accountancy method of treating such large sums, to consider what the Stafford Company was doing at the time of receipt. The Stafford Company was then running a brickworks, and he did not think these sums should be brought into the profit and loss account of that business. He would have felt he was failing to comply with the provisions of the Companies Act if they had been included as receipts in the Stafford Company's profit and loss account without drawing attention to their nature by adequate notes. He was of the opinion that the accounts drawn up on the basis set out in paragraph 4(*j*) above had been drawn up on a proper basis and gave a true and fair picture of the position. If, however, the directors had wanted such a sum to be shown in the profit and loss account, it could have been put (taking the profit and loss account for the year ending 31st December, 1953, as an example) immediately below the figure of £13,054, "balance for the year after charging taxation". It would not be wrong, but would be undesirable, to put it immediately below the figure of £16,021, "profit for the year after charging taxation". In either case, there should be a label fully describing the nature of the payment.

(1) Not included in the present print.

5. Having to make a choice between these conflicting accountancy views, we preferred the view of Mr. Southall. We consider that the method of dealing with the sums in question which was adopted by the Stafford Company, and which is set out in paragraph 4(*j*) above, correctly ascertains the full profits for Income Tax purposes for the years of assessment under appeal (see *Patrick* v. *Broadstone Mills, Ltd.*, 35 T.C. 44, *per* Birkett, L.J., at page 71).

6. The following cases were referred to:

Styles v. *New York Life Insurance Co.*, 2 T.C. 460.

Commissioners of Inland Revenue v. *Burrell*, 9 T.C. 27.

Jones v. *South-West Lancashire Coal Owners' Association, Ltd.*, 11 T.C. 790.

Thomas v. *Richard Evans & Co., Ltd.*, 11 T.C. 790.

Glenboig Union Fireclay Co., Ltd. v. *Commissioners of Inland Revenue*, 12 T.C. 427.

Commissioners of Inland Revenue v. *Cornish Mutual Assurance Co., Ltd.*, 12 T.C. 841.

Seaham Harbour Dock Co. v. *Crook*, 16 T.C. 333.

British Mexican Petroleum Co., Ltd. v. *Jackson*, 16 T.C. 570.

Odhams Press, Ltd. v. *Cook*, 23 T.C. 233.

Absalom v. *Talbot*, 26 T.C. 166.

Bristow v. *William Dickinson & Co., Ltd.*, 27 T.C. 157.

Faulconbridge v. *National Employers' Mutual General Insurance Association, Ltd.*, 33 T.C. 103.

Sharkey v. *Wernher*, 36 T.C. 275.

7. It was contended on behalf of the Stafford Company, the Respondent in this Case:

(*a*) that the Company's trade was to sell coal and bricks, and that receipts on the liquidation of the mutual company were not revenue receipts arising in the course of its trade in the years in which they were received;

(*b*) that the payments received were not receipts for the purpose of computing profits assessable under Case I of Schedule D, because they arose from a mutual fund and no profit could be made from mutual insurance;

(*c*) that the appeal should be allowed in principle, and that the figures of the assessments should be left for agreement between the parties.

8. It was contended on behalf of H.M. Inspector of Taxes, the Appellant in this Case:

(*a*) that the sums paid by the mutual company to the Stafford Company were receipts on revenue and not on capital account, and should be included in the trading accounts of the Stafford Company in the years of receipt;

(*b*) that, while the mutual company was admittedly a mutual insurance company, the decided cases on the taxation of mutual companies were of no assistance to the Stafford Company. The sums in question were returns of premiums previously allowed as deductions in computing the Stafford Company's profits for assessment under Case I of Schedule D, and such returns should be included as trading receipts in computing such profits;

(*c*) that the assessments should be confirmed.

9. We, the Commissioners who heard the appeal, gave the following decision in writing on 27th November, 1959:

In our opinion, this case is covered by authority.

The principal object of the North Staffordshire Collieries Mutual Indemnity, Ltd. (" the mutual company "), is to indemnify its members " upon the mutual principle ", and it is, we think, " a genuine mutual concern ".

In the cases of *Styles* v. *New York Life Insurance Co.* (2 T.C. 460), *Jones* v. *South-West Lancashire Coal Owners' Association, Ltd.* (11 T.C. 790) and *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.* (33 T.C. 103), the Courts were considering the taxability of the various associations involved.

In *Styles* v. *New York Life Insurance Co.*, Lord Herschell says (2 T.C., at page 481):

> " I think the Attorney-General was correct in thinking it immaterial that the persons thus associated had been incorporated, and that a legal entity had been created distinct from the members of which it was composed."

In the same case Lord Macnaghten says, at page 484:

> " The fact, therefore, that the insured, who are also the insurers, carry on their business through the medium of a company was properly treated as immaterial."

In *Jones* v. *South-West Lancashire Coal Owners' Association, Ltd.*, Lord Cave, L.C., quotes the above-mentioned passages from the speeches of Lord Herschell and Lord Macnaghten in the *New York Life* case, and goes on (11 T.C., at page 839):

> " It appears to me that the reasoning which commended itself to those distinguished jurists in the *New York Life* case, applicable as it is to genuine mutual concerns and to no others, applies to the present case, and disposes of the contention under discussion."

In *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.*, Upjohn, J. (33 T.C. at page 125), quotes a passage from Lord Normand's opinion in *English & Scottish Joint Co-operative Wholesale Society, Ltd.* v. *Commissioner of Agricultural Income Tax, Assam* ([1948] A.C. 405, at page 419). Lord Normand had been dealing with the speeches of Lord Watson and Lord Herschell in the *New York Life* case, and he says:

> " From these quotations it appears that the exemption was based on (1) the identity of the contributors to the fund and the recipients from the fund, (2) the treatment of the company, though incorporated, as a mere entity for the convenience of the members and policy-holders, in other words, as an instrument obedient to their mandate, and (3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

In the next paragraph, Upjohn, J., says:

> " The authorities show that the only essential conditions are that any surplus must ultimately come back to the contributors in meal or in malt on a winding-up or otherwise."

In the first complete paragraph of page 125 of 33 T.C., Upjohn, J., says:

> " . . . whereas it follows, in my judgment, that it matters not that the class has been diminished by persons going out of the scheme or that others may come in in their place in the future."

Our interpretation of these authorities as they apply to the facts of the present case is that:

(1) The Stafford Company was a member of a genuine mutual concern, since any surplus in the hands of the mutual company must ultimately

have come back to the contributors : it is immaterial that the membership may not always have been the same, and it is immaterial that the members were traders.

(2) Any surplus in the hands of the mutual company was not a profit assessable to Income Tax on the mutual company.

(3) It is immaterial that the associated members were incorporated as the mutual company ; it was a mere entity for the convenience of its members.

(4) Since the mutual company could not make a profit assessable to Income Tax, and since its existence was immaterial, any surplus returned to its members was not a profit assessable to Income Tax in the hands of its members. Such a return would have been merely the return to members of the surplus of a fund which had always belonged to them.

(5) The payments received by the Stafford Company were not receipts of its trade to be included in a computation of its Case I profits.

It follows from these views that we do not accept that to include these payments in arriving at a balance of profits or gains would be correctly to ascertain the full profits for Income Tax purposes for the years of assessment in question (*Patrick* v. *Broadstone Mills, Ltd.*, 35 T.C. 44, *per* Birkett, L.J., at the bottom of page 71). Accordingly, we hold that both the Income Tax and the Profits Tax appeals succeed in principle, and we leave the figures to be agreed between the parties.

Figures having been agreed between the parties on 12th February, 1960, we determined the assessments in the following figures:

1954–55 : assessment reduced to £28,972, less agreed capital allowances £5,334, agreed losses £23,448.

1955–56 : assessment reduced to £32,537, less agreed capital allowances £2,870.

10. The Appellant immediately after the determination of the appeal declared to us his 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, 1952, Section 64, which Case we have stated and do sign accordingly.

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

H. G. Watson
R. W. Quayle
Commissioners for the Special Purposes of the Income Tax Acts.

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

1st February, 1961.

Commissioners of Inland Revenue v. *Stafford Coal & Iron Co., Ltd.*

CASE

Stated under the Finance Act, 1937, Fifth Schedule, Part II, Paragraph 4, and the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 8th and 9th October, 1959, the Stafford Coal & Iron Co., Ltd. (hereinafter called "the Stafford Company"), appealed against the following assessments to Profits Tax:

For the chargeable accounting period beginning 1st January, 1953, and ending 31st December, 1953, in the sum of £2,107 3*s*. 6*d*. (tax).

For the chargeable accounting period beginning 1st January, 1954, and ending 31st December, 1954, in the sum of £1,016 17*s*. (tax).

This appeal was heard at the same time as an appeal by the Stafford Company in respect of Schedule D assessments for the years 1954–55 and 1955–56 upon identical facts and with the same arguments, in respect of which we have stated a Case entitled *Brogan* (*H.M. Inspector of Taxes*) v. *Stafford Coal & Iron Co., Ltd.* The facts found in that Case, and the documents forming part thereof, may be regarded as forming part of this Case.

2. We, the Commissioners who heard the appeal, gave the following decision in writing on 27th November, 1959:

In our opinion, this case is covered by authority.

The principal object of the North Staffordshire Collieries Mutual Indemnity, Ltd. ("the mutual company"), is to indemnify its members "upon the mutual principle", and it is, we think, "a genuine mutual concern".

In the cases of *Styles* v. *New York Life Insurance Co.* (2 T.C. 460), *Jones* v. *South-West Lancashire Coal Owners' Association, Ltd.* (11 T.C. 790) and *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.* (33 T.C. 103), the Courts were considering the taxability of the various associations involved.

In *Styles* v. *New York Life Insurance Co.*, Lord Herschell says (2 T.C., at page 481):

> "I think the Attorney-General was correct in thinking it immaterial that the persons thus associated had been incorporated, and that a legal entity had been created distinct from the members of which it was composed."

In the same case Lord Macnaghten says, at page 484:

> "The fact, therefore, that the insured, who are also the insurers, carry on their business through the medium of a company was properly treated as immaterial."

In *Jones* v. *South-West Lancashire Coal Owners' Association, Ltd.*, Lord Cave, L.C., quotes the above-mentioned passages from the speeches of Lord Herschell and Lord Macnaghten in the *New York Life* case, and goes on (11 T.C., at page 839):

> "It appears to me that the reasoning which commended itself to those distinguished jurists in the *New York Life* case, applicable as it is to genuine mutual concerns and to no others, applies to the present case, and disposes of the contention under discussion."

In *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.*, Upjohn, J. (33 T.C., at page 125) quotes a passage from

Lord Normand's opinion in *English & Scottish Joint Co-operative Wholesale Society, Ltd.* v. *Commissioner of Agricultural Income Tax, Assam* ([1948] A.C. 405, at page 419). Lord Normand had been dealing with the speeches of Lord Watson and Lord Herschell in the *New York Life* case, and he says:

> "From these quotations it appears that the exemption was based on (1) the identity of the contributors to the fund and the recipients from the fund, (2) the treatment of the company, though incorporated, as a mere entity for the convenience of the members and policy-holders, in other words, as an instrument obedient to their mandate, and (3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

In the next paragraph, Upjohn, J., says:

> "The authorities show that the only essential conditions are that any surplus must ultimately come back to the contributors in meal or in malt on a winding-up or otherwise."

In the first complete paragraph of page 125 of 33 T.C., Upjohn, J., says:

> ". . . whereas it follows, in my judgment, that it matters not that the class has been diminished by persons going out of the scheme or that others may come in in their place in the future."

Our interpretation of these authorities as they apply to the facts of the present case is that:

(1) The Stafford Company was a member of a genuine mutual concern, since any surplus in the hands of the mutual company must ultimately have come back to the contributors: it is immaterial that the membership may not always have been the same, and it is immaterial that the members were traders.

(2) Any surplus in the hands of the mutual company was not a profit assessable to Income Tax on the mutual company.

(3) It is immaterial that the associated members were incorporated as the mutual company; it was a mere entity for the convenience of its members.

(4) Since the mutual company could not make a profit assessable to Income Tax, and since its existence was immaterial, any surplus returned to its members was not a profit assessable to Income Tax in the hands of its members. Such a return would have been merely the return to members of the surplus of a fund which had always belonged to them.

(5) The payments received by the Stafford Company were not receipts of its trade to be included in a computation of its Case I profits.

It follows from these views that we do not accept that to include these payments in arriving at a balance of profits or gains would be correctly to ascertain the full profits for Income Tax purposes for the years of assessment in question (*Patrick* v. *Broadstone Mills, Ltd.*, 35 T.C. 44, *per* Birkett, L.J., at the bottom of page 71). Accordingly, we hold that both the Income Tax and the Profits Tax appeals succeed in principle, and we leave the figures to be agreed between the parties.

Agreement of the figures on the basis of our decision in principle was in due course reported to us and on 12th February, 1960, we determined the appeal as follows:

Chargeable accounting period 1st January, 1953, to 31st December, 1953, assessment reduced to £805 14*s*. (tax).

Chargeable accounting period 1st January, 1954, to 31st December, 1954, assessment reduced to £865 12*s*. 6*d*. (tax).

3. The Crown immediately after the determination of the appeal declared to us 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 Finance Act, 1937, Fifth Schedule, Part II, Paragraph 4, and the Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

4. The question of law for the opinion of the High Court is whether, on the facts found by us, there was evidence upon which we could properly arrive at our decision and whether, on the facts so found, our decision was correct in law.

H. G. Wats
R. W. Quayle
Commissioners for the Special Purposes of the Income Tax Acts.
the of the Income Tax Acts.

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

1st February, 1961.

The cases came before Plowman, J., in the Chancery Division on 18th, 19th and 20th July, 1961, when judgment was reserved. On 26th July, 1961, judgment was given against the Crown, with costs.

Mr. W. A. Bagnall, Q.C., Mr. E. B. Stamp and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. N. Bucher, Q.C., and Mr. Philip Shelbourne for the Company.

Plowman, J.—The question in the first case, *Brogan* v. *Stafford Coal & Iron Co., Ltd.*, is whether two assessments to Income Tax made on the Respondent Company (which I will call " the Coal Company ") under Case I of Schedule D for the years 1954–55 and 1955–56 were correctly made. This depends upon the question whether two sums, amounting in the aggregate to some £58,000, which the Coal Company received in 1953 and 1954 from the liquidation of the North Staffordshire Collieries Mutual Indemnity, Ltd. (which I will call " Mutual ") on the winding-up of Mutual ought, as the Crown contend, to be treated as part of the trading receipts of the Coal Company in computing its taxable profits under Case I of Schedule D.

The circumstances in which these sums were received were as follows. The Coal Company was incorporated as long ago as 1873. Before the nationalisation of the coalmining industry on 1st January, 1947, it carried on a mixed trade of operating collieries and brickworks. With effect from 1st January, 1947, it ceased to operate collieries, but continued to operate its brickworks. For taxation purposes, however, the various activities of the Coal Company constituted a single trade, which the nationalisation of the collieries did not destroy.

Mutual was incorporated in 1934. It was formed by a number of colliery proprietors in North Staffordshire with the object of acting as insurer of its members, on the mutual principle, against liability under the Workmen's Compensation Acts, Employers' Liability Act or any similar Act, or

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at common law, resulting from injuries to the members' workmen. The Coal Company was one of eleven subscribers to its memorandum of association, and was at all material times a member. Mutual was a company limited by guarantee without a share capital. Its articles of association included the following provisions. Article 3 provided :

> " No person shall be capable of becoming a Member unless he is an employer of labour and is about to be insured with the Company against his employers' liability risks ".

Article 4 provided that membership of the company should entitle the member to certain benefits thereinafter specified. Articles 5 and 6 dealt with the question of application for membership, and provided that anybody who wanted to become a member must apply to Mutual in writing requesting admission and that the application must contain an undertaking by the applicant that, in consideration of his admission, he would

> " perform and observe all the obligations for the time being imposed on him by the regulations of the Company ".

Then, article 9 provided that the directors, on accepting any application for membership, should specify in their acceptance the premiums and contributions which the member was required to make. It provided that the applicant should forthwith pay all premiums and contributions, and that upon payment his name should be entered in the register of members. Then, a series of articles beginning with article 23 contained provisions as to the insurance premiums payable, and it is sufficient to say that the premiums were to be based on a percentage of the amount of the wages paid by the member. Then, article 33 contained provisions for creating a reserve fund out of surplus income. Article 130, which dealt with winding-up, provided that if the company should be wound up the surplus assets should be divided amongst the members and such past members as should be then existing *pro rata* to the total amount of premiums paid in respect of the last five financial years of the company preceding 1st January, 1947. That is provided by the article, not in its original form, but as subsequently amended. Apart from income of its invested funds, the income of Mutual consisted of premiums paid by its members. In accordance with well-established principles which are not in issue, the members were allowed the premiums paid by them as deductions in arriving at their trading profits, but Mutual was not assessed to tax on the excess of its receipts over its expenses.

Following the nationalisation of the collieries, the functions of Mutual were transferred to the National Coal Board, and its liabilities were taken over at a figure which was considerably less than the moneys which Mutual had in hand. On 21st October, 1953, a special resolution for the voluntary winding-up of Mutual was passed, and a liquidator was appointed. The funds available in the liquidation for distribution among members was in excess of £700,000, of which the share of the Coal Company was the £58,000 I have already mentioned. The way in which the Coal Company dealt with these receipts was to put them to " capital reserve " in the relevant balance sheets, whereas the Crown say that they ought to have been brought into their profit and loss account as revenue receipts. That is the contest.

Mr. Bagnall, on behalf of the Crown, submits that, when the Coal Company entered into a contract with Mutual as a condition of becoming a member and assumed obligations and became entitled to rights under that contract in accordance with the articles of association of Mutual, it was carrying out a function of its trade of operating collieries and brickworks. It was for that reason, says Mr. Bagnall, that the premiums were deductible

as expenses. Therefore, submits Mr. Bagnall, it follows that receipts by the Coal Company from Mutual (whether as a going concern or in liquidation), being moneys received pursuant to the same contract, are part and parcel of the carrying on of the same trade, and so are trading receipts to be brought into the Coal Company's trading account and so increase its profit. Mr. Bagnall submits the general principle in these terms : all trading receipts of a trading company which are the contractual counterparts of revenue payments fall to be treated as revenue receipts unless it can be shown that there are exceptional circumstances requiring them to be treated in some other manner. One asks oneself : what are exceptional circumstances? Is the nationalisation of the coal industry an exceptional circumstance? Is the liquidation of Mutual an exceptional circumstance? And, if so, are they relevant exceptional circumstances? I doubt, however, whether the test suggested by Mr. Bagnall is valid as a general principle. For example, if a trading company insures its warehouse and the goods in it against loss by fire, the whole of the premium would, *prima facie,* be allowed as a revenue expense. Suppose, then, that the warehouse and its contents are reduced to ashes. In that event, on the suggested test, it would seem that the whole of the insurance moneys ought to be treated as a trading receipt, for the fact that the event contemplated has happened can hardly be said to be an exceptional circumstance. And yet it is, I think, clear that, while the insurance moneys will no doubt fall to be treated as a trading receipt so far as the goods are concerned, they will be a receipt on capital account so far as the warehouse is concerned.

In my judgment, the question whether the receipts with which I am concerned were receipts of a capital nature or receipts on revenue account has to be judged on the facts of the case with such assistance as authority affords, rather than by an appeal to any general principle of the kind suggested. The crucial fact, in my judgment, is the fact that the sums in question were distributions by a liquidator in a winding-up. They represented not a return of premiums, but the Coal Company's share of the joint stock of Mutual. It was held by the Court of Appeal in *Commissioners of Inland Revenue* v. *Burrell,* 9 T.C. 27, that money so distributed, even to the extent that it represented undistributed profits, was not income but capital in the hands of a shareholder. Mr. Bagnall points out that that is a different matter from the question whether such a distribution is a trading receipt in the hands of a trader, and so it is ; but when Mr. Bagnall goes on to submit that the Coal Company did not receive the money *qua* shareholder alone, but as a party to a contract of indemnity insurance, I think the facts are against him.

I refer first to Exhibit "D" to the Case Stated, which is a letter dated 11th December, 1953, from the liquidator of Mutual to the members, in which the following passage occurs :

> "Sufficient funds are available to enable a first distribution of £700,000 to be made, which amount is divisible among Members *pro rata* to the total amount of premiums paid by them respectively in respect of the last five financial years of the Company preceding 1st January, 1947, and your share of such distribution amounts to £[blank]. It is proposed to make the distribution on 16th December, 1953, to Members appearing on the Register of Members of the Company on that date. To obtain this payment you should:—1. Complete and sign the enclosed Form of Instructions, and forward it to the above address as soon as possible. 2. Send at the same time your Certificate of Membership for marking in respect of this distribution."

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Then, attached, is the form of instructions referred to, which is headed:

> " First Liquidation Distribution to Members ",

and which opens with the words:

> " We, being a Member of The North Staffordshire Collieries Mutual Indemnity Limited, hereby authorise and request you to pay the First Liquidation Distribution payable in respect of our membership in the Company ".

In the liquidator's statement of account in the liquidation of Mutual there appears on the credit side the item:

> " Returns to Contributories (no Share Capital)—First Distribution, £700,000; Second and Final Distribution, £82,180 ".

In those circumstances, I conclude that the Coal Company received these payments as a member of Mutual, and in no other capacity.

It is true that what may be capital in the hands of a payer is not necessarily capital in the hands of the receiver; but in *Burrell's* case, Atkin, L.J., after referring to the fact that a liquidator might earn profits while carrying on the business with a view to a beneficial realisation, said this, at page 43[1]:

> " But the shareholder will not receive them as profits, for they are but an accretion to the assets, and if they become surplus assets, it is in that form that the shareholder will receive them."

Later on he added:

> " . . . I think that for the shareholder profits have ceased to be profits, and have become irrevocably merged in the total sum of assets and should not be treated for taxation as part of his annual profits or gains."

It is true, as I have said, that Atkin, L.J., was not then considering whether a distribution of surplus assets in the liquidation of a company could ever be a trading receipt in the hands of a member who was a trader, and I conceive that in some circumstances—for example, where the business of the member was to deal in stocks and shares—it might. But I see no reason in this case why the distributions with which I am concerned should be treated for taxation as part of the Coal Company's annual profits or gains, and the effect of bringing the distribution into the Coal Company's trading account would be just that, because it would increase the profit by an equivalent amount.

While, therefore, I agree with Mr. Bagnall that the *Burrell* case is not an authority which directly governs the present case, it seems to me that the reasoning which led to the conclusion that the distribution with which the Court of Appeal was concerned was not the taxable income of the shareholders points here to the conclusion that the distributions with which I am concerned were receipts on capital account in the hands of the Coal Company.

Mr. Bucher, on behalf of the Coal Company, urged two other reasons in support of the Coal Company's case. First, he submitted that the receipts in question could not be receipts for the purpose of computing the Coal Company's profits because they came from a mutual indemnity company, and you cannot make a taxable profit out of mutual insurance. For this proposition he relied on a line of cases, of which the latest is *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.*, 33 T.C. 103. Those cases, however, were concerned with the liability to tax of the insurance companies in question, and it is not with the question of the liability of Mutual to tax that I am concerned. I do not, therefore,

(1) 9 T.C.

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regard those cases as authority for saying that a surplus received by a trader from a mutual company can in no circumstances be a revenue receipt. The question still remains whether in any particular case it is a revenue receipt. Secondly, echoing what was said by Lord Macmillan in the House of Lords in *Van den Berghs, Ltd.* v. *Clark,* 19 T.C. 390, Mr. Bucher submitted that the Coal Company's membership of Mutual was part of the fixed capital framework of the Coal Company and, being a transaction entered into on capital account, it followed that what the Coal Company received in the liquidation of Mutual on the termination of that membership was received on capital account. On the view which I take of this case it is unnecessary for me to decide how far, on analysis, this is really a different point from what I may call the *Burrell* point and, if and so far as it is, what its implications may be. I prefer to rest my decision on the ground which I have endeavoured to state—namely, that a sum received by a member from a liquidator in a winding-up, whatever its source may be, is *prima facie* received on capital account, and that the circumstances in this case do not lead to any different conclusion. The Coal Company, as I have said, put these sums to " capital reserve " in the balance sheets as at 31st December, 1953, and 31st December, 1954, and the Special Commissioners considered that that method of dealing with them correctly ascertained the full profits for Income Tax purposes for the years of assessment under appeal. I accept that conclusion, and therefore dismiss the present appeal.

It follows that the appeal in *Commissioners of Inland Revenue* v. *Stafford Coal & Iron Co., Ltd.,* which relates to Profits Tax liability arising out of the same distribution by the liquidator of Mutual, must also be dismissed.

Mr. Philip Shelbourne.—Will your Lordship say that both appeals will be dismissed with costs?

Plowman, J.—That is the only Order necessary, is it, Mr. Shelbourne?

Mr. Shelbourne.—I think so, yes, my Lord.

Mr. W. A. Bagnall.—My Lord, that must follow.

Plowman, J.—Very well.

The Crown having appealed against the above decision, the cases came before the Court of Appeal (Lord Denning, M.R., and Donovan and Pearson, L.JJ.) on 19th and 20th June, 1962, when judgment was given in favour of the Crown, with costs (Pearson, L.J., dissenting).

Mr. W. A. Bagnall, Q.C., Mr. E. B. Stamp and Mr. Alan Orr appeared as Counsel for the Crown, and Mr. F. N. Bucher, Q.C., and Mr. R. Buchanan-Dunlop for the Company.

Lord Denning, M.R.—The question in this case is whether two sums, one of £52,059 received by the Company in December, 1953, and another of £6,049 received by it in September, 1954, were trading receipts or were capital receipts. The facts are simple. Since 1873 the Stafford Coal & Iron Co., Ltd., has been carrying on the trade of a colliery and brickfield. In 1934 an Act of Parliament was passed (the Workmen's Compensation (Coal Mines) Act, 1934) which made it compulsory for the owners of coal mines

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to insure themselves against their liability to their workmen under the Workmen's Compensation Acts. Accordingly, in 1934 this Company joined with a number of other companies in the North Staffordshire coalfield in a mutual insurance scheme. They formed a mutual insurance company limited by guarantee called the North Staffordshire Collieries Mutual Indemnity, Ltd. Each company paid its premium to the mutual company, and in return the mutual company met the liabilities of the companies to the workmen if the workmen were injured or killed. Premiums were paid for many years, and the liabilities were met by the mutual company accordingly. In 1944 a firm of actuaries reported that there was a considerable under-provision for contingent liabilities. In consequence, the mutual company demanded a special premium to meet the deficit without delay. The Stafford Company itself paid £44,000 on this additional levy. Thereafter, premiums were paid at the rate of some £40,000 a year until the end of December, 1946, when the collieries were nationalised. The Stafford Company was allowed to deduct these premiums in arriving at its profits for the purpose of its assessment for taxation.

This mutual insurance scheme had an especial benefit attached to it. Not only were the member companies entitled to deduct the premiums from their own tax assessment, but also the mutual company itself did not have to pay tax on any profits it made. I say "profits"; but in point of law a mutual company of this kind does not make any profits, it makes only a surplus. Theoretically, the premiums ought to be so estimated that they are just sufficient to meet the liabilities of the members. But in point of fact the estimate turns out usually to be made on a conservative basis, so that the members contribute more than is needed to meet the liabilities. These surpluses build up year by year into a vast reserve. But it has been held by decisions of the House of Lords that the surpluses are not profits and are not taxable in the hands of the mutual company. It was so decided in *New York Life Insurance Co.* v. *Styles*(1) (1889), 14 A.C. 381, *Commissioners of Inland Revenue* v. *Ayrshire Employers Mutual Insurance*(2), 1946 S.C. (H.L.) 1, 62 T.L.R. 317, *Faulconbridge* v. *National Employers Mutual Association* (1952), 33 T.C. 103. So, in this present case, this mutual company, the North Staffordshire mutual company, was not taxed on its surpluses, and built up its reserve fund of over £1,000,000.

In January, 1947, under the Coal Industries Nationalisation Act, 1946, the coal industry was nationalised. The National Coal Board took over the colliery portion of the Stafford Company, but left it in possession of the brickfield. But it is agreed that it is to be treated as one continuing business throughout. The Coal Board took over the assets and the liabilities of the colliery side as from 1st January, 1947. Then a question arose as to the liabilities which the Stafford Company had already incurred towards its own men who had been injured by accident or disease before the Coal Board took over. The mutual company had, of course, funds in hand, derived from premiums, to meet these liabilities. Negotiations took place for the transfer of these liabilities from the Stafford Company to the Coal Board, and also for the transfer from the mutual company of funds to meet them. It was found that, owing to its vast surplus reserve, the mutual company had much more than enough to meet the liabilities of its members to their workmen. It had £1,168,133 8*s*. available to meet the liabilities of all its members, but the amount needed was only £475,901 2*s*. 3*d*. It paid the Coal Board the

(1) 2 T.C. 460. (2) 27 T.C. 331.

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£475,901 2*s*. 3*d*., and that left it with a surplus of some £700,000 available for distribution amongst the member companies. So long as the mutual company continued to do business, this surplus remained in its hands. But on a winding-up it was to be distributed amongst its member companies, for under the winding-up provisions of the mutual company it was provided, by article 130:

> "If the Company shall be wound up:—(*a*) The surplus assets shall be divided amongst the Members and such past Members as shall be then existing, *pro rata* to the total amount of premiums paid in respect of the last five financial years of the Company, preceding [1st January, 1947]".

On 21st October, 1953, the mutual company was wound up voluntarily and the surplus assets were divided amongst the members. The share which this Company, the Stafford Coal & Iron Co., Ltd., got was the two sums which I have mentioned—£52,059 and £6,049. They were moneys distributed in the course of the winding-up as a result of article 130; and the question is whether those two sums, surplus, so distributed, are trading receipts or capital receipts.

In this case, the Special Commissioners seem to have thought that because the surpluses were not profits in the hands of the mutual company they were not profits in the hands of the Stafford Coal & Iron Co., Ltd., and therefore were not taxable. I am afraid they were wrong in so holding. Although these were not profits in the hands of the mutual company, nevertheless it does not follow at all that they were not trading receipts in the hands of the Company which received them. The nature of a payment in the hands of a payer may be very different from what it is in the hands of a receiver. A man may make a payment out of capital which is a trading receipt in the hands of the receiver—see *Cenlon Finance Co., Ltd.* v. *Ellwood*(1), [1962] 2 W.L.R. 871.

Then the matter came before the learned Judge. He said that these were moneys paid in a liquidation and, that being so, it was just the same as if they were moneys paid by an ordinary company (not a mutual company but an ordinary company) to its shareholders in a liquidation. He thought the reasoning in *Commissioners of Inland Revenue* v. *Burrell,* 9 T.C. 27, pointed to that conclusion. In that case it was held that, when moneys are paid out to shareholders in a liquidation, it is property of a company being distributed amongst its shareholders and is to be regarded as a capital receipt. Following that reasoning, the Judge held that

> "a sum received by a member from a liquidator in a winding-up, whatever its source may be, is *prima facie* received on capital account, and the circumstances in this case do not lead to any different conclusion.(2)"

I cannot for myself regard this as in any way like the liquidation of an ordinary company. The law regards mutual insurance companies as being in an entirely different position. When the premiums are paid, there are two elements which enter into the calculation: one of them is, so to speak, a true provision to meet the current risk; the other is, by design or accident, an over-provision which builds up a reserve. In a perfect world the only amount that ought to be deducted for tax purposes is the true provision to meet the current risk, and not the over-provision to build up a reserve. But things do not work in this way. No actuary can assess the true provision to meet current liabilities. He must make an estimate. It is usually a conservative estimate, but that can make no difference to the tax position. So, in point of practice, the whole premium paid is treated as an expenditure

(1) 40 T.C. 176. (2) *See* page 319, *ante*.

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which is deductible in the course of the company's business for the purposes of its trade: it was so held by this Court in *Thomas* v. *Richard Evans & Co., Ltd.,* 11 T.C. 790, and has not been contested today. Indeed, the practice of this Company always has been to claim a deduction for the whole of the premiums it has paid in all its years of business, and it has been allowed those payments as deductions in all the years it has been carrying on business. But it turns out that this is an over-provision: that more has been paid than has been necessary to meet the liabilities. Such is the case with all these mutual insurance companies. A great reserve is built up. No doubt the surplus is invested and earns interest, but nevertheless it remains throughout a reserve which has to come back eventually (it may sometimes be at the end of a year, it may be at the end of three years, or it may be, as in this case, on a winding-up) to the original contributors because they over-provided what was needed.

Now when that over-provision comes back, it seems to me clear that it is a trading receipt, a receipt in the nature of trade, and not a capital receipt at all. An adjustment has to be made, somewhat similar to the adjustments which have to be made in the case of bad debts. If too much provision has been made in the first instance for a bad debt and later on the bad debt is recovered—it turns out to be a good debt, and the money is received—then that money comes in as a trading receipt. So also, it seems to me, when an over-provision was made in this case—as it was year after year by reason of too much being paid in premiums—and in consequence a big reserve was built up, when it comes back it is a trading receipt in the same way. I would point out that if this were not so, if this were not to be regarded as a trading receipt, it would be a remarkably easy way whereby companies could build up capital assets to a tremendous extent at the expense of taxable income. All they would have to do is to form a mutual company, pay premiums to it and deduct them from their taxable income, and then in due course wind up the mutual company and distribute the reserves to themselves. I do not think the law permits this to be done free of tax. It seems to me that when the over-provision comes back—whether it is at the end of the first year, every three years, or whenever it is—it is a trading receipt and is taxable accordingly.

I would allow the appeal.

Donovan, L.J.—I agree. If a trader finds that a revenue disbursement which he has made for the purpose of his trade is excessive, and he recovers the excess, his accounts must obviously reflect that position. If such disbursement and recovery happen in the one trading year, the trading account will show both or will contain a debit for the net outlay only. If the disbursement is in year one and the recovery in a later year, say year six, then according to the circumstances it may be right to re-open and correct the accounts in year one or, on the other hand, to credit the receipt of the excess in the accounts of year six. Thus, if the original disbursement were excessive because of some error at the time or some imperfect appreciation of the current relevant facts, the former method might be preferable. If the recovery is due to some new fact supervening in year six, the latter might be the better course. The trader's Income Tax bill, either way, will normally need to be revised in consequence, though special circumstances may preclude this—for example, the forgiveness of the trading debt by the creditor, such as occurred in *British Mexican Petroleum Co., Ltd.* v. *Jackson,* 16 T.C. 570.

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In the present case, the business effect of what has happened is that trading disbursements—to wit, insurance premiums—made by the Respondent Company in years prior to 1947 have turned out, for reasons connected with the nationalisation of the coal industry, to be excessive; and the Company recovered sums equivalent to the excess in 1953 and 1954 according to the formula prescribed in the articles of association of the mutual company. The Respondent Company duly credited these sums in its books; but, though the trading accounts were debited with the original disbursements in the years when they were made, nevertheless the 1953 and 1954 trading accounts have not been credited with the recoveries of the excess. The balance sheets as at the end of each of those years, 1953 and 1954, simply show the recoveries as credited to the Company's capital reserves. How the Company chooses to treat these sums in its books is, within limits, its own affair; but when the Revenue is computing the full amount of the Company's profits or gains for tax purposes this treatment necessarily comes under review. Here, the Crown's contention, hitherto unsuccessful, is that the recoveries should properly be treated as trading receipts on revenue account and so affect the balance of profits susceptible to tax. The Company replies that it would be wrong so to treat these sums, and the reasons are to be found in the special circumstances of the case. They are these: the premiums were paid to, and the recoveries received from, a mutual insurance company of which it was a member, so that the recoveries were of money which all along was the property of the Respondent Company. Alternatively, the receipts are capital receipts.

The mutual insurance company in question was a company having its own separate corporate identity; and, when the premiums were originally paid to it, those moneys became its own property. There is admittedly no question of agency or trusteeship in the case. Year by year the Respondent Company claimed *vis-à-vis* the Revenue that the premiums were a "disbursement", which they could not be except on the basis that they had been paid away to some other person; and the claims were allowed. The present contention of the Respondent Company involves that all this was wrong and that the Company never really parted with any money at all; and the claim is rested on the circumstance that for some purposes the incorporation of a mutual insurance company to effect the insurance of its members is disregarded for tax purposes—for example, its trading profits are regarded as immune from tax: see *Styles* v. *New York Life Insurance Co.*[1] and other cases, and in particular Lord Radcliffe in *Sharkey* v. *Wernher,* 36 T.C. 275, at page 303. But for other purposes the separate identity of the mutual company is recognised: for example, the members can debit as disbursements in their trading accounts for Income Tax purposes the premiums paid to it, as my Lord has said: see *Thomas* v. *Richard Evans & Co., Ltd.,* 11 T.C. 790. The position is curious and from time to time produces difficulties, and I suppose will go on doing so; but there it is. However, in the present case I think the separate identity of the mutual company ought not, for present purposes, to be disregarded. It was given full effect when the premiums were allowed as a trading expense. We were pressed with the contention that this is quite irrevelant when considering the taxability or otherwise of what has now been received, and I fully subscribe to the view that one cannot simply say: "Well, they were allowed the deductions, therefore they ought to pay on the recoveries". But when one is asked, for the benefit of the Respondent Company, to ignore the separate identity of the

(1) 2 T.C. 460

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mutual company, I think it is relevant to remember that, again for its own benefit, the Respondent Company impliedly represented to the Revenue that this separate identity existed when it was a question of deducting the premiums as expenses—and these were very substantial. I do not think it ought now to be allowed successfully to urge the opposite, when it transpires that the premium payments were excessive, and to do so in contradiction of the true legal position. In my view, the fact should be recognised that when the Respondent Company received the sums now in question they became the Company's moneys on receipt and not before.

Then, were they trading receipts on revenue account or not? The negative answer for which the Company contends is based, as I understand it, on two considerations: first, the sums were received in the liquidation of the mutual company; second, they are sums received out of the dismantling of a capital asset. As regards the liquidation, it is of course true that in the normal case the contributory will receive capital and not income: see *Burrell's* case[1]. The proposition is not universally true. For example, a finance company dealing in stocks and shares may have to treat as a receipt on revenue account moneys which come to it in the liquidation of a company in which it was a member. The present case, also, is one where, in my opinion, the liquidation is not decisive of the character of the receipt. The mutual company did not carry on some additional, independent business of its own which yielded profits undistributed before the liquidation, which profits—conformably with the decision in *Burrell's* case—would not be income in the hands of a contributory receiving them in a liquidation. The mutual company had nothing except the premiums—or, I suppose, the produce of the premiums while invested—and what was distributed in the liquidation was the money representing these premiums to the extent that they were no longer required. I agree, of course, that the moneys were not distributed as excess of premiums *eo nomine*, but what I have said seems to me to be the business truth of the matter; and, taking that view, I cannot treat the fact that a liquidation supervened as being conclusive against the present claim of the Crown.

Another way of putting the Company's contention is to say that it received these moneys simply in its character of a member of the mutual company, and not as a trader: but these two capacities were interlocked. The Company was a member because it was trading and wished to insure, and it could not become a member except by insuring. Therefore, there is in this case no clear-cut dichotomy, as there is in most cases, between a shareholder's capacity as such and his capacity as an independent trader.

The argument that the sums received are capital because they come from the dismantling of a capital asset is rested on an analogy drawn from the decision in *Van den Berghs, Ltd.* v. *Clark*, 19 T.C. 390. There, an elaborate agreement regulating the business activities of two competing concerns was abrogated and Van den Berghs received some £400,000 as compensation, which was held to be a capital receipt. So here, it is argued, the arrangement for mutual insurance represented likewise a capital structure, and when it is put an end to any receipts flowing from its termination should be regarded as capital. I respectfully doubt the soundness of the analogy. The Respondent Company did not receive compensation for the surrender of some asset, as did Van den Berghs: it received money in 1953 and 1954 because it had overpaid money in years prior to 1947, though the fact was

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[1] 9 T.C. 27.

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not, and could not then be, known in those prior years. If these receipts had come in while the mutual company's business was still going on, no-one would have suggested that they were capital receipts. The fact that they do come in because the mutual company is no longer going to carry on business does not make it right to say, at least in my opinion, that some capital asset is being given up and the moneys are the proceeds of that asset or a *quid pro quo* for its destruction. They remain, I think, moneys representing excess revenue disbursements of previous years, which excess is now being recouped.

The question still remains, of course: Are they trading receipts on revenue account for the years 1953 and 1954? I think they are, for these reasons. The Company is carrying on the same business as it carried on in the years when the premiums were paid, albeit one department of that business has now been discontinued. The contract under which the premiums were paid (contained in the articles of association of the mutual company) was a contract entered into in the normal course of trading. Thus, the premiums were allowed as a trading expense. By virtue of the same contract, the Respondent Company gets back moneys representing the excess of what it has paid. The whole transaction, from its beginning to its end, is in my opinion a transaction on trading account, and there is no warrant for treating the recoveries as anything else but revenue.

In the circumstances, though differing, with regret, from the Special Commissioners and from the learned Judge, I also think that the appeal should be allowed.

Pearson, L.J.—I have the misfortune to take a different view in this case. I must express it with all due deference for that reason, but it is right to state it shortly. It is in agreement with the conclusion of the learned Judge in this case. Let me say in advance that I am not at all disagreeing with the proposition that the mutual company had a separate corporate identity and that separate corporate identity should not be disregarded. I do not accept the argument, therefore, advanced on the part of the Respondent, to the effect that the moneys received and held by the mutual company remained throughout the moneys of the companies which may be called the subscribing companies.

The reason why I accept the Respondent's argument on a different point is this. The Respondent Company and the other trading companies which joined together in combination to form the mutual company were carrying on business: they were employing workmen and they had, as a matter of commercial prudence, the obligation to insure against liability for accidents to their workmen ; and in order to provide the necessary insurance for an indefinite period, which might well have lasted as long as the constituent companies lasted, they made their mutual insurance arrangements. There was a scheme of mutual insurance, for which purpose they set up the insurance company called, in this case, the mutual company. The Respondent became a member of the mutual company, and by virtue of its membership it had a participation in the scheme ; and it had certain continuing rights and obligations. It may be it was not bound to continue its membership, but so long as it elected to do so it had certain rights and certain obligations. Its obligations, if it wished to continue, were to pay the annual premiums and to pay also any supplemental premiums which might be considered by the mutual company to be required for setting up a sufficient reserve. That was its

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principal obligation. On the other hand, it had various rights. The important one, of course, was—so long as it paid its premiums and continued its membership—to be indemnified in respect of accident liability. It also had the right to take part in the direction of the mutual company's affairs ; and it also had the right, which might become very valuable, to participate in a distribution of any surplus of assets over liabilities which the mutual company might be found to have on a winding-up.

Now, it is reasonably clear that this was an arrangement which was intended to be of indefinite duration, which might well last as long as the constituent companies lasted and continued to trade. It might have endured for 20, 50 or even, at the extreme, 100 years ; and the participation of each company in the scheme was, in my judgment, an asset of a capital nature. It is quite true that at the beginning it would be worth very little, almost nothing: but when premiums had been paid, when the scheme was under way, there might be a substantial advantage merely in the participation in this scheme of mutual insurance as contrasted with insuring in the ordinary way with an independent, outside company. But, also, it would be reasonably expected that the mutual company would wish to build up some reserve against its contingent future liabilities. I would not, with respect, accept the statement that the mutual company was making an over-provision and that the premiums contained an element of over-provision, because the mutual company would be reasonably entitled and expected to make some provision for building up a reserve to cover its contingent liabilities. It seems in this case, on the facts, that there was a large requirement of a supplemental premium in the year 1945, which may have given rise very largely to the extremely large sum which was found to be surplus on the eventual winding-up of the mutual company. But the position seems to me to be that, although the main function of the mutual company was, of course, to provide annual indemnity against annual liabilities in return for annual premiums, there was also a more permanent character. It was building up its reserve, as it would be expected to do, and under its articles—and I refer to article 36—it was expected to invest its reserve fund ; so that the sums subscribed as premiums by the constituent companies would become invested and they would lose their original character as premiums and would become, I suppose, stocks and shares as investments.

Then, secondly, it would be open to a member to transfer his interests in the mutual company to an incoming member. Article 42 provides that

> "Any Member may, with the consent of the Directors . . . and on such terms as they shall from time to time determine, transfer his interest in the Company to any person or persons acquiring his business and becoming a Member of the Company."

Now that might have an important effect financially, because under article 130 there is this provision:

> "If the Company shall be wound up:—(*a*) The surplus assets shall be divided amongst the Members and such past Members as shall be then existing, *pro rata* to the total amount of premiums paid in respect of the last five financial years of the Company, preceding the date of winding up, or during the existence of the Company whichever period shall be the shorter. For this purpose any premiums paid by the predecessor in business of the Member or past Member, to whom such predecessor's interest in the Company shall have been transferred under Article 42, shall be treated as having been paid by such Member or past Member."

The effect of that is that the transferor company, transferring its whole business including its participation in respect of the scheme, will be able to transfer to the transferee company a right which may be of very considerable value,

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as in this case—credit for the past five years premiums already paid by the transferor. Therefore, the constituent company's participation in membership of the mutual company is a thing of value. It is property of considerable value, property which can be transferred; and it is, in my judgment, right to describe that interest of a constituent company in the mutual company as an asset of a capital nature. When the winding-up occurs, the constituent companies on the one hand lose their interests which they had in the mutual company; and in return for parting with that interest they obtain their appropriate proportions of the distributed surplus. It seems to me that that is a receipt of a capital nature and is not properly to be regarded as a trading receipt.

On that ground, I myself would dismiss the appeal; but, in view of the different opinion of my Lords, the appeal will be allowed.

Mr. W. A. Bagnall.—Will your Lordships then allow the appeal with costs?

Lord Denning, M.R.—Yes.

Mr. Bagnall.—The Special Commissioners, on the hearing before them, having formed the view which they did, simply reduced the assessments appealed against by the two amounts—the £50,000 odd in the one year and the £6,000 odd in the other year. It may well be that my learned friend would now agree that the effect of your Lordships' decision would be simply to restore the original assessments.

Mr. F. N. Bucher.—I think so.

Mr. Bagnall.—If that were so, there would be no necessity, so far as this appeal goes, to refer the matter back to the Special Commissioners.

Lord Denning, M.R.—That is so, Mr. Bucher?

Mr. Bucher.—I would have thought so, my Lord.

Mr. Bagnall.—Then, your Lordship will remember that there is the Profits Tax appeal. The result of your Lordships' decision in the Income Tax appeal will mean that the Profits Tax appeal will also be allowed?

Lord Denning, M.R.—With costs.

Mr. Bagnall.—I am told that I ought to have said "costs here and below" in both cases, my Lord.

Lord Denning, M.R.—Yes.

Mr. Bagnall.—So far as the Profits Tax appeal goes, I understand it will be necessary to refer that back to the Special Commissioners for the figures to be agreed. . . . My Lord, I am now told that it would be possible for the original assessments to be restored there, again. The same process operates as on the Income Tax appeal.

Lord Denning, M.R.—Mr. Bucher, I do not know whether that is so.

Mr. Bucher.—I am not instructed about this, but it would seem to me that logically it would be so.

Lord Denning, M.R.—Perhaps enquiries could be made. If it is so, then we need not refer them back and the assessments will be amended accordingly.

Mr. Bagnall.—Your Lordships would restore, in each case, the original assessments, but if any difficulty arose they could be referred back?

Lord Denning, M.R.—Yes. Then, subject to anything Mr. Bucher says, the appeals will be allowed with costs here and below and the original assessments will be restored, subject to any question arising. If any question does arise, they will be referred back.

Mr. Bagnall.—If your Lordship pleases.

Mr. Bucher.—My Lord, in view of the considerable difference of judicial opinion, may I ask that my clients may have leave to appeal to the House of Lords if so advised?

Lord Denning, M.R.—Yes, you shall have leave.

Mr. Bucher.—If your Lordship pleases.

The Company having appealed against the above decision, the cases came before the House of Lords (Lords Reid, Evershed, Jenkins, Hodson and Devlin) on 24th, 25th and 26th June, 1963, when judgment was reserved. On 24th July, 1963, judgment was given against the Crown, with costs (Lord Devlin dissenting).

Mr. F. N. Bucher, Q.C., and Mr. R. Buchanan-Dunlop appeared as Counsel for the Company, and Mr. W. A. Bagnall, Q.C., Mr. Alan Orr, Q.C., Mr. E. B. Stamp and Mr. J. Raymond Phillips for the Crown.

Lord Reid.—My Lords, prior to 1947 the Appellant Company carried on a colliery undertaking and a brickworks ; after the nationalisation of the coal industry it continued to carry on these brickworks. It is found as a fact that it has carried on a single business throughout, so that any revenue payments which came to it after 1947 in respect of its colliery undertaking must enter into the computation of the profits of the continuing business.

This case is concerned with sums amounting to some £58,000 received by the Appellant on the liquidation of the North Staffordshire Collieries Mutual Indemnity, Ltd. This was a company limited by guarantee, of which a number of colliery companies were members, and with which those companies insured against accident claims. The mutual company ceased to carry on business after nationalisation of the collieries. It had a large reserve fund, so that, after the National Coal Board had taken over all its liabilities at an agreed valuation, it had surplus assets, when put into voluntary liquidation in 1953, of over £700,000. The mutual company insured only its own members and its only source of income was premiums paid by the members. So this surplus arose entirely from the fact that, as it turned out, members had been paying more in premiums than was required to meet claims. By reason of the decision of the Court of Appeal in *Thomas* v. *Richard Evans & Co., Ltd.* (1927), 11 T.C. 790, the members, including the Appellant, were entitled to and did bring in all these premiums to their profit and loss accounts as trading expenses in each year for Income Tax purposes. So the Crown reasonably contend that the sums received by the Appellant in the liquidation should be treated as a return of excess premiums and therefore as trading receipts. On the other hand, the Appellant relies on the rule that distributions in a liquidation are capital whatever may have been the source of the assets distributed. The Special Commissioners and Plowman, J., decided in favour of the Appellant, but that decision was reversed by the Court of Appeal.

(Lord Reid)

The Crown do not question the general rule that distribution to members of the assets of a company in liquidation must be treated as capital. But they say that the liquidation of a mutual insurance company differs from an ordinary liquidation. The articles of association of a company are a contract between the company and its members (see Section 20 of the Companies Act, 1948), and in this case they were the only contract between the mutual company and the Appellant. They authorised the directors of the mutual company to assess the amounts of premiums and required the members to pay the premiums so assessed, and they bound the company to settle all claims by employees of members against them in respect of accidents. They authorised the accumulation of a reserve fund and provided the method of distribution of surplus assets if the company should be wound up. The Crown say that the articles of association were primarily a commercial contract, so that all sums either paid or received by the Appellant by reason of this contract are trading expenses or trading receipts and must therefore be brought into computation for Income Tax purposes.

I do not think that that is a full or accurate statement of the position. The company was an independent legal entity and its assets were its property and in no sense the property of the members. It is quite true that by reason of the decision in *New York Life Insurance Company* v. *Styles,* 14 A.C. 381; 2 T.C. 460, a mutual insurance company does not make profits so as to be assessable to Income Tax, and, despite an abortive attempt to alter the law by the Finance Act, 1933, the law as settled in *Styles's* case remains: see *Ayrshire Employers Mutual Insurance Association, Ltd.* v. *Commissioners of Inland Revenue,* 27 T.C. 331. But that does not affect the independent position of the company. So Section 302 of the Companies Act applied on its being voluntary wound up. That Section provides that .

> "the property of a company . . . shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company."

In the present case the articles do " otherwise provide ". Article 130 provides for distribution in proportion to the amounts of premiums paid during the five years before the company ceased to carry on business. But the articles of any kind of company can " otherwise provide ". And Section 20 of the Companies Act makes the articles of every company a contract between it and its members. So if the argument for the Crown is sound it must, I think, lead to the conclusion that wherever the articles " otherwise provide " the distribution of the company's assets in liquidation is in fulfilment of the contract contained in the articles and is not subject to the ordinary rule that the assets when distributed are capital. There is certainly no authority for drawing such a distinction between cases where the articles expressly provide how the assets are to be distributed and cases where they do not, and I do not think that it would be right to introduce any such distinction.

In my view the Crown's argument neglects the fact that membership of any company implies a great deal more than that each member has a contract with the company contained in the articles. Indeed, this is a very peculiar kind of contract if it is considered in isolation, because it can be altered without the consent of the member if the other members pass the necessary resolution. I can find no sufficient reason to exclude this case from the general rule that what is distributed in a liquidation is capital whatever may have been its source. One may think that that rule leads to an unreasonable result in this case, but there is nothing unusual in that. One may think it equally unreasonable that accumulated profits distributed in a liquidation

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should escape Surtax. But the rule is firmly established, and if it is to be altered that must be done by legislation. In my opinion the consequence is that this appeal must be allowed and the judgment of Plowman, J., restored.

Lord Evershed.—My Lords, in the year 1934 the Appellant Company together with nine other companies and one partnership firm, all carrying on the business of colliery proprietors and coal mining in North Staffordshire, formed the North Staffordshire Collieries Mutual Indemnity, Ltd. (hereinafter called " the mutual company "). As its name implies, the purpose of the formation of the mutual company and its business were to provide out of its resources derived from its members complete cover for any liability that any member might incur in respect of claims by any of its workmen or servants under the Workmens' Compensation Act and other like Statutes or under common law. In fact the Workmen's Compensation (Coal Mines) Act, 1934, made such insurance compulsory for colliery companies.

The mutual company was incorporated as a company limited by guarantee under the Companies Act, 1929. There was no share capital, but each member undertook as a term of his membership to contribute up to a certain sum as required upon the mutual company's liquidation. The principal object of the mutual company, as stated in clause 3 of its memorandum of association, was to " indemnify upon the mutual principle " its members against claims by their workmen or servants as above stated. Its other objects were subsidiary to its main object and they included that of investing any moneys not for the time being required for the general purposes of the company. Under the mutual company's articles of association its affairs were managed by a board of directors with a managing director appointed by themselves. The original directors were appointed in writing by a majority of the subscribers to the memorandum of association, being thereafter subject to retirement by rotation, and directors were afterwards elected by general meetings of the company. It was the duty of the directors from time to time to fix the amounts of the premiums payable by its members, the amount of such premiums being in each case related to the total of the member's wage bill. Membership was confined to companies or persons carrying on the business of coal mining. By article 38 a member was entitled to withdraw from membership, provided that all premiums due from such member up to the date of his withdrawal had been paid. By article 42 a member might transfer his interest in the mutual company, on such terms as the directors might determine, to some other company or person or persons who might acquire the transferor's coal mining business and become a member of the mutual company. The only other article to which I need refer is article 130, which provided that upon the liquidation of the mutual company

> " The surplus assets shall be divided amongst the Members and such past Members as shall be then existing, *pro rata* to the total amount of premiums paid in respect of the last five financial years of the Company, preceding the date of winding-up ".

By an amendment, the last six words I have quoted were struck out and there was substituted therefor (for reasons which will later become apparent) the phrase " prior to the 1st January, 1947 ". It follows from the article which I have last recited that a past member who had ceased to carry on the business of coal mining but whose business had not been transferred to another member would be entitled to a share in the distribution of the surplus assets on a winding-up if such winding-up occurred within five years of the member's withdrawal from membership—or (as the article has been altered) within five years before 1st January, 1947. It follows, of course, by virtue of what

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is now Section 10 of the Companies Act, 1948, that the terms of any of the mutual company's articles, including article 130, could have been at any time altered by special resolution of its members—a right out of which, by the terms of the Section, the company could not have contracted.

When the so-called nationalisation of the coal mines in this country took effect on 1st January, 1947, all the coal mining businesses of the members of the mutual company came to an end. On the same date the National Coal Board took over the liabilities of the mutual company so that its business, too, then came to an end. It took, in fact, some time to ascertain the exact amount of the mutual company's liabilities on 1st January, 1947 ; but when this was done it became apparent that the assets of the mutual company exceeded by over £700,000 the amount of its liabilities under the mutual insurance obligations and otherwise on 1st January, 1947. In 1953 the mutual company went into voluntary liquidation and the amount of its surplus assets (which then, of course, consisted in part of interest earned on the investments of its funds) became distributable among its members and past members within the terms of article 130. The amount to which the Appellant Company became then entitled was a total sum of £58,108. I should here state that the Appellant Company had, prior to January, 1947, carried on both coal mining activities and also a brickworks, and its activities as regards the brickworks have continued since the beginning of 1947 until the present time. It has for the purposes of this case been conceded on the Appellant Company's behalf that its activities prior to 1st January, 1947, constituted a single business and that that business has since 1st January, 1947, continued up till the present time.

In the circumstances which I have stated, the question involved in the present proceedings is whether the sum of £58,108 which I have mentioned was a trading receipt in the Appellant Company's hands and accordingly should be taken into account for Income Tax purposes ; or whether, on the other hand, it was a capital sum and as such not liable to be reckoned for tax purposes. Before the Special Commissioners and in the Court of first instance the question was decided in the Appellant Company's favour, but the Court of Appeal by a majority (Lord Denning, M.R., and Donovan, L.J. ; Pearson, L.J., dissenting) reversed Plowman J.'s decision and concluded that the sum of £58,108 must, in the Appellant Company's hands, be treated as a trading receipt.

The argument of the Appellant Company, as presented by Mr. Bucher, was before your Lordships put upon two grounds, namely, (1) that, since the surplus assets of the mutual company were, in the hands of its liquidator, capital assets, the share of such assets which the Appellant Company received did not lose its capital character when received by the Appellant Company ; and (2) that in any event what the Appellant Company received represented part of its " fixed capital framework " within the language used by Lord Macmillan in *Van den Berghs, Ltd.* v. *Clark,* 19 T.C. 390, at page 429. Your Lordships were informed by Mr. Bucher that in the Courts below he had presented a further argument based on the special nature of the mutual company's business and the relationship between the Appellant Company and the mutual company ; but before your Lordships Mr. Bucher resiled from advancing this further argument—not the least because it was upon its basis that the majority of the Court of Appeal had decided adversely to him. Indeed, it was upon the nature of the mutual company's business and the Appellant Company's

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relation to the mutual company that Mr. Bagnall founded his argument on the part of the Crown. As formulated by him, Mr. Bagnall's argument was that the relationship between the Appellant Company and the mutual company was contractual and was moreover derived from the single contract between the Appellant Company, the other members of the mutual company and the mutual company itself to be found in the mutual company's articles of association: see Section 20 of the Companies Act, 1948. Under that single and indivisible contract, said Mr. Bagnall, the Appellant Company had one principal liability, namely, that of paying the premiums, and two principal benefits, namely, (1) that of having all its liabilities by way of compensation or damages to its workmen or servants paid by the mutual company, and (2) upon the mutual company's liquidation that of receiving (under the terms of article 130 as it stood and stands) a share of the mutual company's surplus assets proportionate to the premiums which it had paid. In the circumstances, the surplus assets at any point of time of the mutual company (including any investment of such surplus) represented (according to the Crown's argument) and were in truth nothing other than the surplus not called upon for the time being of the premiums paid; so that when upon a liquidation such surplus assets came to be distributed the sums received by the Appellant Company represented and were in truth (notwithstanding any effect of any investment by the mutual company) nothing other than a return of what had proved in the event to be an overpayment of premiums. It is not in doubt for the purposes of the present case that the premiums in fact paid from time to time by the Appellant Company were properly allowed as trade expenses for Income Tax purposes, and also it was not in doubt, following certain cases (including cases before your Lordships' House), the latest of which is that of *Faulconbridge* v. *National Employers' Mutual General Insurance Association, Ltd.* (1952), 33 T.C. 103, that the nature of the mutual company's business was such that the excess in any year of the premiums received over any expenditure in meeting claims could not be regarded as trading profits liable to Income Tax. It was therefore said (and this point appealed particularly to the majority of the Court of Appeal) that as a matter of fairness and common sense the share of the surplus assets received by the Appellant Company (being in truth, as the Crown contended, a return of overpayments of premiums) should be taken into account for tax purposes in the recipient's hands; and Mr. Bagnall further observed that, if before the liquidation of the mutual company that company had in fact distributed any surplus assets among its members, any member's share in such distribution would inevitably in his or its hands have been a trade receipt.

As regards this last point, I am content to assume, without deciding, that Mr. Bagnall was right. Though a distribution in specie of the mutual company's property is comprehended within clause 3 of that company's memorandum, there is in fact no clause in the articles of association providing for such distribution, though I do not, of course, at all doubt that the members could by appropriate means have provided for such a distribution—whether or not (and this is not without significance) past members would have been entitled to participate therein.

My Lords, I have been unable to accept that part of Mr. Bucher's argument founded on Lord Macmillan's *dictum* in the *Van den Bergh* case[1]. In that case the company in question had made very elaborate arrangements

(1) 19 T.C. 390.

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with a Dutch company which had the effect of regulating and restricting the scope and other highly important aspects of the business which the English company was carrying on in consideration of certain payments from time to time made by the Dutch company. Eventually the arrangement was by mutual consent cancelled and the Van den Bergh company was then paid some £400,000 as compensation for such cancellation. It was in those circumstances that this House concluded that the sum so received was a capital sum in the recipient's hands and Lord Macmillan used the formula above mentioned. In my opinion, it is impossible to say that the present case can be determined by applying similar considerations. The Appellant Company's relationship with the mutual company was concerned with the Appellant Company's obligations under Statute and common law to any workmen or servants who might be injured in the course of its employment. Any company carrying on a factory business or conducting a commercial undertaking has to pay regard to its possible liabilities to workers or servants injured in the course of their employment and to take appropriate steps to meet any such liability. I cannot regard the steps so taken by the Appellant Company (in the present case the relationship of the Appellant Company with the mutual company) as sensibly a special or distinguishing characteristic of its business or as part of its "fixed capital framework", as I understand that phrase in light of the *Van den Bergh* case[1], and I therefore reject this part of Mr. Bucher's argument. On the other hand, I have, with all respect to the majority of the Court of Appeal, felt compelled to the conclusion that the £58,108 received by the Appellant Company from the liquidator of the mutual company did not lose its capital character when received by the Appellant Company and cannot properly be regarded as a trading receipt.

It cannot now be in doubt that surplus assets in the hands of the liquidator of a limited liability company—whether limited by share capital or by guarantee—are in his hands capital. Such a conclusion was laid down by the Court of Appeal in *Commissioners of Inland Revenue* v. *Burrell* (1924), 9 T.C. 27 (see especially per Atkin, L.J., at pages 41 *et seq*), and it has never since been questioned. The terms of Section 302 of the Companies Act, 1948, are entirely consistent with this view, for they speak of the "property of the company" being distributed as therein stated. I agree that the fact that the surplus assets of a company upon its winding-up are capital in the hands of the liquidator is not conclusive upon the question whether the respective shares of them handed out to the members are likewise in their respective hands capital also. But *prima facie* beyond doubt they are. Some business may consist of dealing with capital assets: for example a company whose business is that of buying and selling real property or stocks and shares. In the case of such a company, no doubt the capital share of the surplus assets in a liquidation would be no less a trading receipt than the proceeds of sale of any other of the assets it had acquired for the purposes of its business. But, in my opinion, it is not possible to say that the exception I have indicated is applicable to this case. True it is that the right of the Appellant Company to a share in the liquidation is one derived from contract; but that is true of the right of any member of a limited company so to participate in surplus assets upon a liquidation: see Section 20 of the Companies Act, 1948. For my part I cannot find in the contract here in question or in the articles anything of so special a character as to take the case out of the ordinary rule. If the mutual company had been limited by shares instead of by guarantee it would, in my judgment,

(1) 19 T.C. 390.

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have been exceedingly difficult to say that what a shareholder *qua* member received upon liquidation was other than his share of the surplus assets in the liquidator's hands; and in my judgment the result is no different because the company is limited by guarantee. The truth is, as I see it, that there is a vital distinction in kind between the right of a member of the mutual company to have one of its claims paid and its right to share in the surplus assets in the winding-up of the mutual company. The latter right is, in my judgment, derived from the member's position as a member of a distinct corporation (namely, the mutual company) and that membership to my mind is essentially a capital or proprietary asset.

Like Pearson, L.J., I also attach no little significance to article 42 of the articles of association; for the terms of that article seem to me clearly to show that what the member is entitled to do is to dispose of its interest as a member and to do so on such terms as the directors decide. It is, of course, possible that the directors might decide in favour of the consideration being paid by annual sums; but *prima facie* what is being done upon a member's exercising his rights under article 42 is to dispose of his interest *qua* member, that is to say, to dispose of his proprietary interest in the mutual company.

It so happened that on 1st January, 1947, the assets of the mutual company exceeded considerably its liabilities. At other points of time the excess might have been very different, and there might have been times on which the assets would have shown, upon a proper accounting, a deficiency. Indeed, it is the fact that in the year 1944 reports made by actuaries employed for the purpose by the mutual company showed that on 31st December, 1943, the assets in that company's hands fell short by over £500,000 of the amount regarded as requisite and appropriate to cover probable or estimated liabilities; and, as a result, all the members were called upon to pay and paid during 1944 additional premiums. As Pearson, L.J., pointed out in his judgment, had it not been for the nationalisation of the coal mines the mutual company might have continued in business for very many years and during such a period there would inevitably have been considerable variation in the relationship of the company's assets to its probable or estimated liabilities. As we are all unhappily aware, there may occur an explosion or other serious disaster in a coal mine, which might give rise to very large claims on the part of the member concerned. It seems, therefore, to me that the value of the member's interest or right in the mutual company's surplus assets upon a winding-up must depend upon the chances of the date on which the mutual company ceased business and the winding-up took place. The same would indeed be true of the value of the interests of the members of any limited company carrying on business, though no doubt the chances might be greater where the business carried on was that of insurance of the kind here involved.

My Lords, it follows, in my opinion, from what I have said that there is in the present case no ground for making an exception to the general rule that the surplus assets of a company, whether limited by shares or guarantee, after providing for all liabilities, are divisible among its members as capital. With all respect to those who take a different view, I cannot find in article 130 of the mutual company's articles of association any ground for arriving at a different conclusion. True it is that by that article, as it now in its amended form stands, the surplus assets are expressed to be divisible among its members on 1st January, 1947, and certain (only) of its past

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members in proportion to the premiums respectively paid by them. That, indeed, may well be thought to constitute a fair division—analogous in the case of a company limited by shares to division among its members in proportion to the share capital subscribed by them. I cannot, for my part, derive from article 130 a right *ex contractu* for the mutual company's members to recoupment of premiums (as such) shown to have been overpaid. It is a matter of common form with a limited company that its articles should contain a clause for the distribution of its surplus assets upon a winding-up, and article 130 is such a clause. I have noted, moreover, already that its terms might, like the terms of any other of its articles, have been altered at any time by the requisite majority of its members upon a special resolution. The truth is, in my opinion, that the assets from time to time in the possession of the mutual company represented (subject to its liabilities) the property of that company as a *persona ficta* wholly distinct from its members, and that article 130 provided for the distribution among the members of the surplus (capital) assets of the mutual company upon its liquidation.

It was the view of Lord Denning, M.R., that if the Appellant Company was entitled to succeed a way would be shown whereby "companies could build up capital assets to a tremendous extent at the expense of taxable income". If such were in truth the result, no doubt Parliament would deal effectively with it, as it has done in regard to other matters relating to taxation. But in my opinion such a result does not at all follow. The Appellant Company was allowed to treat its payments to the mutual company as proper trade expenses because they did in fact and in truth represent premiums paid in respect of its (compulsory) insurance liabilities. If, as the learned Master of the Rolls supposed, a mutual insurance company were established as a means to secure the building up of large capital assets, I cannot think that the annual payments would be allowed as trading expenses because they were called insurance premiums, or at least would not be allowed to the extent that in truth and in fact they were not properly so required. But, however that may be, the answer to the present case, in my view, rests upon this: that the mutual company was established as a distinct business corporation, and the rights of its members to share in the surplus assets of the mutual company upon its liquidation were proprietary rights in the nature of capital; and were not the less so because, by virtue of Section 20 of the Companies Act, the articles of the mutual company, including article 130, formed part of the contract under the mutual company's memorandum and articles of association by which, subject to the terms of the Companies Act (including Section 10 already mentioned), the members were all bound.

I would therefore allow the appeal and restore the Order made by Plowman, J.

Lord Jenkins (read by Lord Hodson).—My Lords, I agree with my noble and learned friends Lord Reid and Lord Evershed that this appeal should be allowed, and find little I can usefully add to what they have said in support of that conclusion in the opinions they have just delivered.

In the course of the hearing in your Lordships' House there was some discussion as to the combined effect of Section 302 of the Companies Act, 1948, and article 130 of the articles of association of the mutual company. Section 302 of the Act provides as follows:

(Lord Jenkins)

> "302. Subject to the provisions of this Act as to preferential payments, the property of a company shall, on its winding up, be applied in satisfaction of its liabilities pari passu, and, subject to such application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company."

Article 130 of the articles of association of the mutual company provides, *inter alia,* as follows:

> "If the Company shall be wound up:—(*a*) The surplus assets shall be divided amongst the Members and such past Members as shall be then existing, *pro rata* to the total amount of premiums paid in respect of the last five financial years of the Company, preceding [1st January 1947]".

It will thus be seen that article 130 makes express provision for the mode of distribution of the surplus assets of the mutual company in a winding-up, which takes the place of the simple distribution "among the members according to their rights and interests in the company". I can find nothing in Section 302 or in article 130 which to my mind in the least advances the claim that the subject matter of the distributions of assets made in the winding-up of the mutual company was income rather than capital. What is the "property" which Section 302 requires to be applied in satisfaction of the mutual company's liabilities, and subject thereto to be distributed amongst its members? To my mind it can be nothing more nor less than the entirety of the assets of the mutual company, which (subject to the satisfaction of liabilities) must be distributed amongst the members of the mutual company in the way indicated by article 130 and constitute in their hands a capital, as distinct from a revenue, receipt.

An argument was raised, which perhaps I did not fully understand, to the effect that the members of the mutual company should be regarded as having severally entered into contracts of insurance with the mutual company, each such contract being embodied in the articles of association of the mutual company as well as the distinct and separate contract of membership. This ingenious theory would produce—so it is said—the result that the funds accumulated by the mutual company could—and should—be distributed under the contract of insurance contained in the articles of association of the mutual company, the distributions falling to be treated simply as payments under the contract of insurance with the mutual company and not payments capitalised by reason of the liquidation. With respect to all who may think otherwise, I cannot accept this. It seems to me impossible to suppose that a draftsman setting about the task of drafting articles of association such as those now proposed, containing separate contracts of membership and of insurance, would not have been more explicit.

This aspect of the case appears to me to be well dealt with in the judgment of Plowman, J., in 40 A.T.C. 279, at pages 285–6([1]):

> "In my judgment, the question whether the receipts with which I am concerned were receipts of a capital nature or receipts on revenue account has to be judged on the facts of the case with such assistance as authority affords, rather than by an appeal to any general principle of the kind suggested. The crucial fact, in my judgment, is the fact that the sums in question were distributions by a liquidator in a winding up. They represented not a return of premiums, but the coal company's share of the joint stock of Mutual. It was held by the Court of Appeal in *Commissioners of Inland Revenue* v. *Burrell*([2]) that money so distributed, even to the extent that it represented undistributed profits, was not income but capital in the hands of a shareholder. Mr. Bagnall points out that that is a different matter from the question whether such a distribution is a trading receipt in the hands of a trader, and so it is; but when Mr. Bagnall

([1]) *See* page 317, *ante*. ([2]) 9 T.C. 27.

(Lord Jenkins)

goes on to submit that the coal company did not receive the money *qua* shareholder alone, but as a party to a contract of indemnity insurance, I think the facts are against him. I refer first to Exhibit 'D' to the case stated, which is a letter dated December 11th, 1953, from the liquidator of Mutual to the members, in which the following passage occurs: 'Sufficient funds are available to enable a first distribution of £700,000 to be made, which amount is divisible among members *pro rata* to the total amount of premiums paid by them respectively in respect of the last five financial years of the company preceding January 1st, 1947, and your share of such distribution amounts to [blank]. It is proposed to make the distribution on December 16th, 1953, to members appearing on the register of members of the company on that date. To obtain this payment you should: (1) Complete and sign the enclosed form of instructions, and forward it to the above address as soon as possible: (2) send at the same time your certificate of membership for marking in respect of this distribution.' Then, attached, is the form of instructions referred to, which is headed: 'First Liquidation Distribution to Members', and which opens with the words: 'We, being a member of The North Staffordshire Collieries Mutual Indemnity Ltd., hereby authorize and request you to pay the first liquidation distribution payable in respect of our membership in the company', and so on. In the liquidator's statement of account in the liquidation of Mutual, there appears on the credit side the item: 'Returns to contributories (no share capital)—first distribution, £700,000; second and final distribution, £82,180'. In those circumstances, I conclude that the coal company received these payments as a member of Mutual, and in no other capacity."

I would add that the new plan, under which the articles of association would contain separate and distinct contracts of membership and of insurance, might give rise to difficulty under Section 21(1) of the Companies Act, 1948, which reads as follows:

"(1) In the case of a company limited by guarantee and not having a share capital, and registered on or after the first day of January, nineteen hundred and one, every provision in the memorandum or articles or in any resolution of the company purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member shall be void."

Applying this to what is proposed in the present case, one might, I suppose, suggest that the insurance contract (contained, be it remembered, in the articles of association of the mutual company) purported to give the beneficiary under that contract a right to participate in the divisible profits of the company not as a member of the company but simply as a party to the insurance contract.

Towards the end of his judgment (page 286 of 40 A.T.C.), Plowman, J., said this[1]:

"On the view which I take of this case it is unnecessary for me to decide how far, on analysis, this is really a different point from what I may call the *Burrell*[2] point, and, if and so far as it is, what its implications may be. I prefer to rest my decision on the ground which I have endeavoured to state, namely, that a sum received by a member from a liquidator in a winding up, whatever its source may be, is prima facie received on capital account, and that the circumstances in this case do not lead to any different conclusion."

That passage accords closely with the opinion of Lord Reid[3]:

"I can find no sufficient reason to exclude this case from the general rule that what is distributed in a liquidation is capital whatever may have been its source."

To these two pronouncements I add my own respectful concurrence and hold with my noble and learned friends Lords Reid and Evershed that this appeal must be allowed and the judgment of Plowman, J., restored.

Lord Hodson.—My Lords, the conclusion of the majority of the Court of Appeal is well summarised in the penultimate paragraph of the judgment of Donovan, L.J., in the following passage[4]:

(1) *See* page 319, *ante*. (2) 9 T.C. 27. (3) *See* page 329, *ante*.
(4) *See* page 325, *ante*.

(Lord Hodson)

> "The Company is carrying on the same business as it carried on in the years when the premiums were paid, albeit one department of that business has now been discontinued. The contract under which the premiums were paid (contained in the articles of association of the mutual company) was a contract entered into in the normal course of trading. Thus, the premiums were allowed as a trading expense. By virtue of the same contract, the Respondent Company gets back moneys representing the excess of what it has paid. The whole transaction, from its beginning to its end, is in my opinion a transaction on trading account, and there is no warrant for treating the recoveries as anything else but revenue."

At the conclusion of the argument I was of the same opinion, but I have since had the opportunity of reading the opinions prepared by my noble and learned friends Lords Reid, Evershed and Jenkins. I have been persuaded to the view that one cannot legitimately, by having regard to the special character of the mutual company, a company limited by guarantee which does not make profits so as to be assessable to Income Tax, treat it differently from other companies on a winding-up.

Section 302 of the Companies Act, 1948, provides that

> "the property of a company shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company."

The articles of the mutual company do otherwise provide: see article 130, to which reference has been already made. This does not, however, lead to the conclusion that the article must be construed, not only as a contract between the members and the company providing, *inter alia,* for distribution of assets as capital on liquidation, but as part of a trading contract between the members and the company involving the return of the surplus premiums which should be taxable in the hands of the Colliery Company just as the premiums when paid were allowed as a deduction from profits.

I agree, therefore, that the appeal be allowed.

Lord Devlin.—My Lords, with deference I disagree with your Lordships and agree with the majority in the Court of Appeal.

The heart of the matter, to my mind, is the effect to be given to article 130. It is common ground that the articles of association contain not only the conditions of membership but also the contract of insurance between the members or assured and the mutual company. Some articles, such as 9 and 49, under which premiums are paid, and article 15, under which the indemnity is granted, belong purely to the contract. Others are concerned only with membership. In my opinion, article 130 should be regarded as forming part of the contract of insurance. The surplus assets consist of the reserve fund which is formed out of part of the premiums (see article 23(*c*)) ; and its divisibility in proportion to premiums paid shows that it is in the nature of a return and not of a distribution of profits, which indeed the company is assumed for tax purposes not to make.

The position is exactly expressed in the passage from Donovan, L.J.'s judgment which my noble and learned friend Lord Hodson has cited.

Questions put :

That the Orders appealed from be reversed and that the Orders of Plowman, J., be restored.

The Contents have it.

That the Respondents do pay to the Appellant its costs here and in the Court of Appeal.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue ; Wedlake, Letts & Birds, for Kent, Jones & Done, Alsager.]