HIGH COURT OF JUSTICE (CHANCERY DIVISION)—1ST, 2ND, 3RD, 25TH AND 26TH JULY 1974

COURT OF APPEAL—24TH, 25TH, 28TH, 29TH AND 30TH APRIL AND 27TH JUNE 1975

HOUSE OF LORDS—3RD, 4TH, 5TH, 6TH AND 10TH MAY AND 7TH JULY 1976

Commissioners of Inland Revenue *v.* Church Commissioners for England[1]

Income tax—Capital or income—Rentcharges—Payable for 10 *years—Paid as consideration for sale of capital assets—Whether containing a capital element—Whether wholly payable under deduction of tax—Income Tax Act* 1952 (15 & 16 *Geo.* 6 & 1 *Eliz.* 2, *c.* 10), *s.* 177.

Practice—Appeal from High Court to House of Lords—Leapfrogging—Decision on application of the Income Tax Acts—Whether mainly relating to construction of an enactment—Administration of Justice Act 1969 (*c.* 58), *s.* 12.

Judicial precedent—Decision of Court of Appeal on point held by House of Lords to be irrelevant—Not a binding authority.

The Respondents were a charity. By an agreement dated 5th January 1960 they sold to a property investment company (or in one case to a subsidiary thereof) their freehold or leasehold interest in seven properties, which were already let by them to the company (or its subsidiary) for terms with between 60 and 990 years to run, in consideration of rentcharges reserved for ten years. In the negotiations leading up to that agreement there was no legally enforceable agreement between the parties for the purchase of any of the properties for a lump sum. The rentcharges totalled £96,000 per annum; the aggregate rents payable for the properties by the group before the transaction were £62,500 per annum; three of the properties were burdened with head rents totalling £22,000 per annum. Evidence extrinsic to the agreement showed that the Respondents calculated that the rentcharges would have a market value of about £720,000 based on 18 years' purchase, and that of the £96,000 per annum £40,000 would be available as expendable income and £56,000 would be annually invested to produce an income of 5½ per cent. per annum and at the end of the ten years a sum which would provide an income of £40,000 per annum in perpetuity. The rentcharges were paid under deduction of income tax on the footing that s. 177, Income Tax Act 1952, applied.

The question whether the rentcharges were an allowable deduction in arriving at the purchasers' liability to profits tax was litigated in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* [2] 45 T.C. 495. Cross J. held at first instance, that they fell to be dissected into income and capital elements; the Court of Appeal held that they were allowable in full, on the ground that rentcharges were *prima facie* completely payments of income and fell within the direct terms of s. 177, which was the relevant section; the House of Lords held that, irrespective of whether s. 177 applied, the rentcharges were not allowable deductions on the income tax principles applicable for

[1] Reported (Ch.D.) [1975] 1 W.L.R. 251; [1974] 3 All E.R. 529; [1974] S.T.C. 441; 118 S.J. 883; (C.A.) [1975] 1 W.L.R. 1383; [1975] 3 All E.R. 614; [1975] S.T.C. 546; 119 S.J. 681; (H.L.) [1977] A.C. 329; [1976] 3 W.L.R. 214; [1976] 2 All E.R. 1037; [1976] S.T.C. 339; 120 S.J. 505. [2] [1969] 1 W.L.R. 604.

profits tax purposes (viz., the principles of computation of profits under Case I of Schedule D), because they were the cost of acquiring capital assets, viz., the reversions of the properties.

The Commissioners of Inland Revenue refused repayment for the years 1959–60 to 1963–64 of the whole of the sums deducted on account of income tax from the rentcharges on the ground that they consisted partly of capital sums which were not payable under deduction of tax, like the annuities in *Scoble* v. *Secretary of State for India* 4 T.C. 618 and *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112. On appeal, the Special Commissioners held (*a*) that, even if s. 177, Income Tax Act 1952, was applicable to rentcharges only to the extent that they were payments of an income nature, the rentcharges in question were entirely of an income nature and not partially instalments of a capital sum; (*b*) that since the preliminary negotiations for the sale did not create any legally enforceable contract, and therefore, did not bring into being a price or lump sum capital obligation, the extrinsic evidence of the calculation of the amount of the rentcharges was inadmissible.

The Chancery Division held (1) that, since it was open to the parties to a contract to agree *inter se* to treat income payments as capital or conversely, in a revenue case extrinsic evidence, such as that ruled out by the Special Commissioners, must always be admissible to show the true character in law of the transaction; (2) that where periodical payments had been held to be wholly or partly capital receipts they were made in discharge of a capital obligation, whether pre-existing or created by the transaction under which they were made, and in the present case there was nothing to indicate that any part of the rentcharges was of a capital nature.

Immediately after judgment was given the Crown applied (subject to further consideration and to the Respondents' consenting) for a certificate for leave to appeal direct to the House of Lords under s. 12, Administration of Justice Act 1969, on the ground that the decision involved a point of law of general public importance relating mainly to the construction of an enactment (viz., s. 177, Income Tax Act 1952) and the other requirements of s. 12 were satisfied. The Crown conceded that the alternative condition that the Judge was bound by the decision of a higher tribunal did not apply.

The Chancery Division held (1) that although only four days of the sittings remained the application ought to be decided before the Long Vacation; (2) that the application would not be granted, because the decision did not relate mainly to the construction of the word "rentcharge" in s. 177 but to whether what were admittedly rentcharges contained a capital element to be dissected out of them, and the Crown's concession that the alternative condition did not apply had been rightly made; alternatively, that if the decision did fall within the relevant conditions the application would be refused in the exercise of the Judge's discretion as not falling within the spirit thereof.

The Court of Appeal held that the extrinsic evidence, whether admissible or not, did not assist in determining the quality of the instalments of rentcharge; the true legal nature of the bargain was that the Church Commissioners sold their reversions for ten annual payments of £96,000 amounting to £960,000 and not for a principal sum of a lesser amount payable by ten instalments of principal and interest.

Held, in the House of Lords, (1) that the rentcharge payments were wholly of an income nature and contained no capital element having regard both to the true construction of the agreement dated 5th January 1960 and also the preceding negotiations; there could be no "dissection" of the payments into capital and

income elements since there was no agreed purchase price; the bargain was always thought of in income terms and was concluded in income terms; (2) that in revenue cases extrinsic evidence is admissible if it tends to show the true character of a transaction.

Dicta of Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79, at page 98, of Sir Wilfrid Greene M.R. in *Sothern-Smith* v. *Clancy* 24 T.C. 1, at pages 6–8; [1941] 1 K.B. 276, at pages 282–5, and of Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (1948) 30 T.C. 11, at page 16, applied on point (1); *Scoble* v. *Secretary of State for India* 4 T.C. 618; [1903] A.C. 299, *Perrin* v. *Dickson* 14 T.C. 608; [1930] 1 K.B. 107, *Goole Corporation* v. *Aire & Calder Navigation Trustees* [1942] 2 All E.R. 276 and *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112; [1962] Ch. 861 distinguished on point (1).

Per Lord Wilberforce (Lord Salmon concurring): Except in particular cases where a different rule is stated, all payments which fall within the charging words are *prima facie* taxable as income notwithstanding that, as a matter of accountancy or prudence or trust administration, some part ought to be treated as capital.

CASE

Stated under the Taxes Management Act 1970, s. 56, 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 19th and 20th March 1973 the Church Commissioners for England (hereinafter called "the Church Commissioners") appealed against the refusal by the Commissioners of Inland Revenue of claims to relief under s. 447 of the Income Tax Act 1952 for the years 1959–60 to 1963–64 inclusive.

2. Shortly stated, the question for our decision was whether in respect of the years of assessment 1959–60 to 1963–64 inclusive income tax was properly deductible under s. 177 of the Income Tax Act 1952 or otherwise from certain payments of rentcharge made by Land Securities Investment Trust Ltd. (hereinafter called "Land Securities") and by Associated London Properties Ltd. (hereinafter called "Associated") to the Church Commissioners and is repayable to the Church Commissioners, who are a charity, under the provisions of s. 447(1)(*a*) of the Income Tax Act 1952.

The transaction giving rise to this question is referred to in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.*(1) 45 T.C. 495.

3. The following documents were admitted before us:

(1) A copy of an agreement made on 5th January 1960 between the Church Commissioners and Land Securities and Associated.

(2) A bundle of copies of deeds comprising deeds of transfer reserving a rentcharge between the Church Commissioners and Land Securities, a deed of transfer reserving a rentcharge between the Church Commissioners and Associated and a deed creating a rentcharge executed by Land Securities.

(3) A copy of the accounts of the Church Commissioners for the year ended 31st March 1960.

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(1) [1969] 1 W.L.R. 604.

Documents 1 and 3 are attached as exhibits to and form part of this Case(1). Document 2, in which the terms of the transfers referred to in clause 9 of document 1 are set out in full, is, to save expense, not attached to this Case.

4. The following facts were admitted between the parties:

(A) The Church Commissioners are, and were at all material times, a charity.

(B) Land Securities is a large public company carrying on business as a property investment trust company. During the period to which these appeals relate Associated was a wholly-owned subsidiary of Land Securities.

(C) The Church Commissioners owned certain freehold and leasehold properties which were let or underlet to Land Securities (or, in the case of one property, to Associated) on long leases. By an agreement dated 5th January 1960 the Church Commissioners agreed to sell to Land Securities their freehold or leasehold interests (or, in the case of the property let to Associated, to sell to Associated) subject to the leases and underleases to Land Securities and Associated in consideration of rentcharges. Particulars of the properties, the leases to Land Securities or to Associated and the rentcharges are set out in a schedule to this agreement, but for convenience brief particulars are set out below:

Property	*Particulars of lease or underlease to the company*	*Rentcharge* £
No. 1 Freehold	993 years from 1953 at £5,000	12,000
No. 2 Freehold	150 years from 1948 at £2,000	4,800
No. 3 Freehold	150 years from 1947 at £2,000	4,800
No. 4 Underlease 71 years from 1949 at £7,500 per annum	whole term less 3 days at £17,500	23,450
No. 5 Leasehold 99 years from 1935 at £5,000 per annum	whole term less 3 days at £7,000	4,700
No. 6 Leasehold 99 years from 1934 at £9,500	whole term less 3 days at £20,000	24,650
No. 7 Freehold	999 years at £9,000 (this was the lease to Associated)	21,600

The agreement of 5th January 1960 provided that the transfer of the properties should be in a form agreed, and the transfers were duly made on 25th March 1960. These provided that the rentcharge received in each case was a yearly rentcharge for the period of ten years from 1st April 1959 charged on and issuing out of the property transferred.

(D) Land Securities and Associated deducted income tax at the standard rate on paying the rentcharges, on the footing that s. 177 of the Income Tax Act 1952 entitled them to do so.

5. Pages 12 to 15 of document 3 (exhibit 2 to this Case) contain the income and expenditure account of the Church Commissioners for the year ended 31st March 1960. Included in the "Gross rental income £5,241,503" on page 13

(1) Not included in the present print.

are the rentcharges received from Land Securities and Associated. On page 14 there is an item of expenditure "Amortisation of certain depreciating assets (see Note 1) £254,644". Note 1 is to be found on page 19 of exhibit 2 and reads:

> "1. Amortisation of certain depreciating assets. The Commissioners are amortising by sinking fund over the appropriate number of years all their leasehold property and rentcharges for a fixed term . . ."

The debit of £254,644 included the appropriate amount relating to the rentcharges received from Land Securities and Associated.

Note 8 on page 20 of exhibit 2 reads:

> "8. Land, buildings and other property. The land, buildings and other property are included [in the balance sheet as at 31st March 1960] at valuation as at 1st April, 1957, with subsequent additions at cost. Profits or losses on sales have been transferred to capital reserve.
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> . . . . .
>
> A number of freehold and leasehold properties with a total book value of £1,335,300 were sold during the year, the consideration being in the form of rentcharges for a fixed term secured on the properties concerned. The capital value of these rentcharges, being £1,639,000, is included in the total of leasehold property acquired or built during the year. £1,335,300 is included in the total book value of property sold. The profit of £303,700 on these sales has been transferred to capital reserve."

Included in the freehold and leasehold properties so referred to were those sold to Land Securities and Associated, and included in the rentcharges so referred to were those paid by these two companies in respect of the properties sold to them.

6. It was common ground between the parties to the appeal that in the negotiations leading up to the agreement of 5th January 1960 there was no legally enforceable agreement between Land Securities or Associated and the Church Commissioners for the purchase of any of the properties for a lump sum.

7. In the course of the hearing of the appeal a question arose whether we should admit in evidence a bundle of documents comprising copies of correspondence, file notes and inter-office memoranda relating to the negotiations which took place between the Church Commissioners and Land Securities prior to the agreement of 5th January 1960 (exhibit 1) and oral evidence from the Secretary to the Church Commissioners.

For the reasons given in para. (2) of our decision (*see* para. 11 of this Case) we decided not to admit this evidence, and accordingly no part of it is attached hereto as being found by us to be admissible and so to form part of this Case. We did, however, think it right *de bene esse* to receive the bundle of documents and hear the Secretary's testimony, and we have thought it proper to attach to this Case as an addendum, firstly, the excluded bundle of documents(1) and, secondly, our findings of fact in relation to the Secretary's evidence, so that if we are held to have been wrong in refusing to admit this evidence the documents and our findings will be available to the High Court without the trouble and expense of the remission of the Case to us.

(1) Not included in the present print.

A 8. It was contended on behalf of the Church Commissioners that:

(*a*) the rentcharges paid to them by Land Securities and Associated were wholly within the scope of s. 177 of the Income Tax Act 1952;

(*b*) the views expressed on this point by the Court of Appeal in *Commissioners of Inland Reveune* v. *Land Securities Investment Trust Ltd.*(1) were right and should be followed;

B (*c*) the provisions of s. 177 would still apply even if (which is denied) the rentcharges could be regarded as containing a capital element; and

(*d*) their claim to repayment under s. 477(1)(*a*) of the Income Tax Act 1952 of all the income tax deducted in paying the rentcharges should be allowed.

9. It was contended on behalf of the Commissioners of Inland Revenue
C that:

(*a*) a rentcharge may be wholly income or wholly capital or partly income and partly capital in nature;

(*b*) s. 177 does not convert into income the capital element, if any, in a rentcharge, but charges to income tax rentcharges so far as they are of an income nature;

D (*c*) the question whether and to what extent a rentcharge is of a capital nature has to be determined by consideration of the circumstances in which it was created;

(*d*) the transaction by the Church Commissioners was one whereby they intended to keep their capital undiminished, but to deal with certain land (with a value of £720,000 and a yield of about £40,000 a year) by substituting for
E it a cash sum of £720,000 that would yield income of about £40,000 or more; the method used to effect the transaction was sale in return for ten-year rentcharges; the rentcharges were to produce £96,000 a year, of which £40,000 would replace the income of the land during the ten years and £56,000 would (accumulated at compound interest over the ten years) replace the capital value of the land;

F (*e*) the correct and only reasonable conclusion is that in the hands of the Church Commissioners these rentcharges were part income and part capital;

(*f*) had the conveyances creating the rentcharges distinguished expressly the capital and income elements they would have recorded the true nature of the transaction and have complied with the requirements of the Settled Land Act 1925, ss. 29 and 39(2); and

G (*g*) *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* is not a binding authority in this appeal.

10. The following authorities were referred to at the hearing before us: *Scoble* v. *Secretary of State for India* 4 T.C. 618; [1903] A.C. 299; *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79; *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29; [1938] 2 K.B. 482;
H *Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153; *B. G. Utting & Co. Ltd.* v. *Hughes* 23 T.C. 174; [1940] A.C. 463; *Sothern-Smith* v. *Clancy* 24 T.C. 1; [1941] 1 K.B. 276; *Lomax* v. *Peter Dixon & Son Ltd.* 25 T.C. 353; [1943] K.B. 671; *Smethurst* v. *Davy* (1957) 37 T.C. 593; *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112; [1962] Ch. 861; *Commissioners of Inland*

(1) 45 T.C. 495.

Revenue v. *Land Securities Investment Trust Ltd.* 45 T.C. 495; [1969] 1 W.L.R. 604; *Ralli Estates Ltd.* v. *Commissioner of Income Tax* [1961] 1 W.L.R. 329. A

11. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 1st May 1973, as follows:

(1)(*a*) The question for determination is whether in respect of the years of assessment 1959–60 to 1963–64 inclusive income tax was properly deductible under s. 177, Income Tax Act 1952, or otherwise from certain payments of B rentcharge made by Land Securities or by Associated to the Church Commissioners and is repayable to the Church Commissioners, who are a charity, under the provisions of s. 447(1)(*a*), Income Tax Act 1952. No point was taken before us regarding the application of the rentcharges to charitable purposes only. The transaction giving rise to this question is referred to in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* 45 T.C. 495. C

(*b*) In the course of the hearing of the appeal a subsidiary question arose for determination, namely, whether we should admit in evidence a bundle of documents comprising copies of correspondence, file notes and inter-office memoranda relating to the negotiations between the Church Commissioners and Land Securities prior to the agreement of 5th January 1960, and oral evidence given *de bene esse* by the Secretary to the Church Commissioners. D The Crown sought to have admitted this bundle as well as the Secretary's evidence, but the Church Commissioners objected on the grounds of their irrelevancy.

(2) We think, on reviewing the subsidiary question, that the bundle of documents and Mr. Ryle's testimony should not be admitted in evidence. In interpreting the agreement of 5th January 1960 it is, we think, on authority, E incumbent on us to ascertain "the precise character of the transaction" and to determine "the terms of the contract as properly interpreted in the light of all admissible extrinsic evidence". It is, however, admittedly the case that the preliminary negotiations leading up to that agreement did not create any legally enforceable contract and therefore did not bring into being a price or lump sum capital obligation, and, this being so, we hold that the bundle of F documents embodying those negotiations and the Secretary's oral testimony do not constitute admissible extrinsic evidence.

We hold that in the circumstances there is no pre-existing legal position which is relevant to the interpretation of the agreement of 5th January 1960. If no binding obligation to sell for a lump sum was created prior to that agreement, it seems to us irrelevant in interpreting that agreement to know that in G the prior negotiations either party to the agreement for its own purpose calculated the capital value of the payments by way of rentcharges.

(3) On the substantive issue before us we note that Lord Donovan observed in the course of his opinion in the House of Lords in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* 45 T.C. 495, at page 515I:

> "For my part, I am content to assume, without expressly deciding, H that these rentcharges are income in the Church Commissioners' hands and are in their entirety liable to deduction of tax at source under s. 177."

But, while the House of Lords refrained from expressly deciding this matter, the members of the Court of Appeal were clearly of opinion, as we read their judgments, that the rentcharges in the present case fell plainly within the term of s. 177. This being so, the question for us resolves itself, in our view, into I whether arguments advanced to us and references to statutory provisions made to us, neither of which were put to the Court of Appeal, ought to lead us to a different conclusion. We think not.

Even if s. 177 is applicable to rentcharges only to the extent that they are "payments of an income nature", we hold that the disputed rentcharges are entirely of an income nature and not partially instalments of a capital sum. It is common ground that in the negotiations leading up to the agreement of 5th January 1960 there was no legally enforceable agreement between the parties for the purchase of any of the properties for a lump sum, and we cannot construe that agreement as providing in its terms wholly or in part for the payment of rentcharges of a capital nature. We do not regard the provisions of the Victorian Statutes or those of the Settled Land Act 1925 to which we were referred as leading us to the conclusion that the rentcharges in dispute were partially of a capital nature. Granted that rentcharges may be wholly or partially of a capital nature, the question whether they are so depends on the precise character of the transaction which creates them, interpreted in its relevant context. In the present case we see nothing in the further arguments addressed to us to lead us to depart from what we understand to be the conclusion reached by the Court of Appeal in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.*(1) that the disputed rentcharges were wholly within the ambit of s. 177. All rentcharges have, it seems to us, a capital value, which is arithmetically ascertainable once the period for which they are payable and the appropriate rate of interest have been determined. Accepting that the Church Commissioners were aware of the capital value, so ascertained, of the rentcharges which they agreed to accept in exchange for their various properties, this, in our view, still leaves in issue whether those properties were disposed of for rentcharges wholly within the scope of s. 177. We think they were, and we allow the appeal in principle.

12. The representative of the Commissioners of Inland Revenue immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law, and on 24th May 1973 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s. 56, which Case I have stated and do sign accordingly, Mr. G. R. East C.M.G., the Special Commissioner with whom I heard and determined the appeal, having since retired from the public service.

The questions of law for the opinion of the Court are:

(*a*) whether we were wrong to exclude certain evidence;

(*b*) if so, whether on all the evidence our substantive decision was wrong in law; and

(*c*) if not, whether our substantive decision was still wrong in law.

W. E. Bradley { Commissioner for the Special Purposes of the Income Tax Acts

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25th February 1974.

Addendum to the Case Stated in the matter of Commissioners of Inland Revenue and The Church Commissioners for England.

Part I

The bundle of documents comprising copies of correspondence, file notes and inter-office memoranda relating to the negotiations which took place

(1) 45 T.C. 495.

between the Church Commissioners and Land Securities prior to the agreement of 5th January 1960 (exhibit 1 to the Case Stated) referred to in para. 7 of the Case Stated is attached and forms Part I of this addendum(1).

Part II

As a result of the evidence of both Mr. K. S. Ryle, C.B.E., M.C., the Secretary to the Church Commissioners, and the documents comprising Part I, we find the following facts proved or admitted:

(*a*) In or about the year 1956 the Church Commissioners decided that they would sell all their leasehold properties where the leases had more than 50 years to run. Certain of these properties were offered to Mr. Harold Samuel, who was then chairman of Land Securities. Mr. Samuel was not prepared to buy.

(*b*) Later Mr. Samuel said he was prepared to purchase the properties in exchange for rentcharges. He would on no account buy them for a lump sum.

(*c*) After considering Mr. Samuel's proposition the Church Commissioners were not averse to it provided that the projected rentcharges were sufficient in amount not only to maintain the Commissioners' income but also to provide a sinking fund which, suitably invested, would at the end of the period of the rentcharges leave the Commissioners with a sum which, properly invested, would at least maintain their income.

(*d*) The document in Part I headed "Freehold and Long Leasehold Interests owned by the Commissioners and let to Harold Samuel on long leases" was prepared by Mr. Ryle for submission to the then Secretary to the Church Commissioners to show the considerations involved in the proposed sale and the importance of the factor of the appropriate rate of interest in evaluating any proposal.

(*e*) The memorandum in Part I headed "Church Estates Commissioners: Monday 26th October 1959" was prepared by Mr. Ryle and submitted to the members of the Estates and Finance Committee of the Church Commissioners so that those members could weigh up the merits of the proposal to sell properties in exchange for rentcharges totalling £96,000 and payable for a period of ten years.

(*f*) On 26th October 1959, after considering Mr. Ryle's memorandum, the committee approved the proposal. This is recorded in the document headed "Minute of Estates and Finance Committee 26th October 1959".

(*g*) The properties sold by the Church Commissioners were thought by them to have a market value of approximately £720,000 based on 18 years' purchase.

The Church Commissioners considered Mr. Samuel's proposal on the footing that, of the rentcharges totalling £96,000, £40,000 would be available as expendable income and £56,000 would be annually invested, it was expected, to produce an income of 5½ per cent. per annum and, at the end of ten years, a sum which would provide an income of £40,000 in perpetuity.

(*h*) All the assets of the Church Commissioners other than those required to be specifically invested (see para. (*i*) below) are available to meet any of the obligations of the Commissioners, including, for example, the specific obligations referred to in Note 3 on page 19 of exhibit 3 "Trust funds and other commitments". The properties sold under the agreement of 5th January 1960 (exhibit 1) were partly affected by the obligations referred to in the said Note 3 and partly affected by the general obligations of the Church Commissioners.

(1) Not included in the present print.

(*i*) Under the provisions of s. 10 of the Church Commissioners Measure 1947 the Church Commissioners hold in one fund all the assets and the income therefrom except funds governed by a trust deed which are required to be separately invested. The funds so specifically invested are shown at the bottom of the balance sheet on pages 16 and 17 of exhibit 2. All the assets other than those so specifically invested were available to cover all the obligations of the Church Commissioners other than those under the trust deeds relating to the specifically invested funds.

(*j*) The Church Commissioners are an exempt charity, and so do not have to get the consent of the Charity Commissioners to dispose of their properties. The Church Commissioners have by Statute all the powers of a freeholder in relation to property owned by them.

The case came before Megarry J. in the Chancery Division on 1st, 2nd and 3rd July 1974, when judgment was reserved. On 25th July 1974 judgment was given against the Crown, with costs.

D. C. Potter Q.C. and *D. K. Rattee* for the Crown.

Michael Nolan Q.C. and *S. J. L. Oliver* for the Church Commissioners.

The following cases were cited in argument in addition to those referred to in the judgment:—*Attorney-General* v. *London County Council (No.* 1) 4 T.C. 265; [1901] A.C. 26; *Woods* v. *Wise* [1955] 2 Q.B. 29; *B. G. Utting & Co. Ltd.* v. *Hughes* 23 T.C. 174; [1940] A.C. 463; *Coltness Iron Co.* v. *Black* (1881) 1 T.C. 287; 6 App. Cas. 315.

Megarry J.—This is an appeal by the Crown from a decision of the Special Commissioners. It relates to a sale in 1960 by a charity, the Church Commissioners for England, to a property investment company, Land Securities Investment Trust Ltd. I shall call the former "the Church Commissioners" and the latter "the company". By a written contract dated 5th January 1960 the Church Commissioners sold their reversions on certain leaseholds owned by the company, which yielded rents totalling £62,500 a year for terms varying from 60 years to over 990 years. Some of the reversions were freehold and some leasehold and, after paying rents of £22,000 a year in respect of the leasehold reversions, the net rent received by the Church Commissioners was £40,500, a figure which in this transaction seems to have been rounded down to £40,000. The consideration for the sale was the reservation by the Church Commissioners of certain rentcharges for ten years charged on the properties sold, amounting in all to £96,000 a year. The forms of transfer containing the reservations of the rentcharges were attached to the contract, and the transfers were to be made in those forms without any alterations. One of the leaseholds was vested in a wholly-owned subsidiary of the company, and this subsidiary was joined as a party to the contract. No point arises on this, and I shall treat all the reversions as having been sold to the company.

One end of this transaction has already made its way from the Special Commissioners to the House of Lords, and now the other end is making its first leap. In *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.*(1) 45 T.C. 495 the House of Lords unanimously reversed the decision of the Court of Appeal and held—I put it shortly—that, in computing the

(1) [1969] 1 W.L.R. 604.

(Megarry, J.)

company's profits for the purposes of profits tax, the rentcharges could not, on the ordinary principles of commercial accounting, be set against the income of the company's trade or business, since they were the price of purchasing capital assets, namely, the reversions. The case now before me relates, not to the effect of paying the rentcharges on the company's profits, but to the right of the Church Commissioners, as a charity, to recover the income tax deducted by the company in paying the rentcharges. The years of assessment in question are 1959–60 to 1963–64 inclusive, and the relevant statutory provisions are the Income Tax Act 1952, ss. 177 and 447(1)(*a*), the former relating to the deduction of tax and the latter to the right of recovery. The Special Commissioners held that these statutory provisions applied, and that the Commissioners of Inland Revenue had wrongly refused relief to the Church Commissioners under them. The question for me is whether this decision was right.

Section 447(1)(*a*) provides, so far as relevant, that:

> "Exemption shall be granted—(*a*) from tax chargeable . . . by virtue of section one hundred and seventy-seven . . . of this Act, under Schedule D, in respect of the rents and profits of any lands, tenements, hereditaments or heritages . . . vested in trustees for charitable purposes, so far as the same are applied to charitable purposes only."

No question on this arises: it is accepted that any tax properly deducted is recoverable by the Church Commissioners. The provision round which the argument has centred is s. 177. This runs as follows:

> "(1) This section applies to the following payments, that is to say—(*a*) rents under long leases; and (*b*) any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land, not being rent under a short lease or an annuity within the meaning of the Tithe Acts, 1936 and 1951. (2) Any payment to which this section applies shall, so far as it does not fall under any other Case of Schedule D, be charged with tax under Case VI of Schedule D and be subject to deduction of tax under Chapter I of this Part of this Act as if it were a royalty or other sum paid in respect of the user of a patent."

I need not read subs. (3), which provides for Scotland.

In its most basic form, the argument of Mr. Nolan, who appeared for the Church Commissioners, is simplicity itself: 177(2) admittedly subjects to deduction of tax "any payment to which this section applies"; s. 177(1)(*b*) provides that the section applies to "any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service," and so on; the payments in question are rentcharges within this provision; therefore they are subject to deduction of tax. The answer of Mr. Potter, appearing for the Crown, is more complex. It is that in the hands of the Church Commissioners these particular rentcharges were in their nature partly income and partly capital, and that it was only the income element that was subject to deduction of tax. Relying to some extent on the decision of the Court of Appeal in the *Land Securities* case[1], and a sentence of Lord Donovan in the House of Lords in that case, in a speech in which the other Law Lords concurred, the Special Commissioners held that, even if s. 177 applied to rentcharges only to the extent that they were payments of an income nature, the disputed rentcharges were entirely of an income nature and were not partly instalments of a capital sum. There was also a subsidiary question, namely,

(1) 45 T.C. 495.

whether various documents, together with some oral evidence, which all related to the negotiations and other events during the period prior to the execution of the contract, were admissible in evidence in order to help resolve the main issue. The Special Commissioners held that they were not admissible, and the Crown challenges this decision.

The essence of Mr. Potter's argument is that the price paid by the company to the Church Commissioners for the capital assets that the company acquired was, as could be discovered from what appeared on the face of the documents, the sum of £960,000, to be paid over ten years by ten equal payments of £96,000 each year. True, the figure of £960,000 does not appear as such in the contract or the transfers, but the individual rentcharges are set out in a table which is scheduled to the contract and also in the individual forms of transfer annexed to the contract and mentioned in clause 9 of it. If the amounts of these individual rentcharges are added up they come to £96,000, and if this sum is multiplied by ten, the period over which the rentcharges are to be paid as set out in the forms of transfer, the result is £960,000. The value of the sum of £960,000 which is payable in this deferred way was, of course, substantially less than £960,000 payable forthwith and, if the disputed extrinsic evidence is admissible, the correspondence between the parties as well as internal Church Commissioners' documents show that the sum of £720,000 was treated as being the then present value of the annual sums of £96,000 payable for ten years. Subtract £720,000 from £960,000, said Mr. Potter, and £240,000 emerges as the income element included in the £960,000; and this income element alone was subject to deduction of tax.

Mr. Nolan would not have this. Even if (contrary to his main contention) the payments were to be dissected, the Crown's calculations were wrong in failing to distinguish between, on the one hand, capital, and, on the other hand, income which was to be accumulated. Certain calculations of the Church Commissioners in the disputed evidence showed that the Church Commissioners intended to divide each payment of £96,000 into £40,000 to be used as income and £56,000 to be accumulated. In this way the Church Commissioners would continue their existing income from the properties that they were selling and would build up a fund which would produce an equivalent income when the ten years were up. On that footing, the income element in the £960,000 was not £240,000 but £400,000. Mr. Potter's rejoinder was that the question whether the right amount was £240,000, £400,000 or any other sum could be determined by remitting the matter to the Special Commissioners with a direction to perform the appropriate feats of dissection and valuation, each side to have liberty to adduce evidence on the point, whether by actuaries or otherwise. The important point was to establish the principle that the ten payments of £96,000 should be dissected in this way.

At the outset I should make it clear that there has been no suggestion whatever of any impropriety on the part of anyone. It was no part of the Crown's case that there was any "sham", or any dressing up of one transaction so as to make it appear to be another, or of any attaching of any false labels that described a transaction as being one thing in an attempt to prevent it from being recognised as another. The dispute was, first, as to the law, and second, as to the true nature of the wholly genuine transaction that actually was effected. I may also say that I was told that, although the questions of capital and income are of general significance, the particular application of them to the deduction of tax from rentcharges was now mainly a problem of the past, in that the

(Megarry J.)

Finance Act 1963 had abolished the deduction of tax from rentcharges, and had replaced it by a process of direct assessment: see ss. 15 and 73 and Sch. 13.

A wealth of authority was put before me. In the *Land Securities* case[1] at first instance Cross J. referred to his own judgment in *Vestey* v. *Commissioners of Inland Revenue*[2] 40 T.C. 112, in which he had had a somewhat analogous question. In that case he discussed at some length the conflicting authorities, and in particular whether the relevant parts of statements of the law made by Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79, at page 98, and by Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (1946) 30 T.C. 11, at page 16, were reconcilable with the decision of the House of Lords in *Scoble* v. *Secretary of State for India*[3] 4 T.C. 618. His conclusion was that they were not. Applying that view, he reached the conclusion in the *Land Securities* case that the Special Commissioners had been wrong in holding the payments under the rentcharges to be entirely of an income nature, and held that, purely for income tax purposes, they should be dissected into income and capital; and he remitted the case to the Special Commissioners for this purpose. The Court of Appeal allowed an appeal against this decision, and restored the decision of the Special Commissioners. Both the *Scoble* case and the *Vestey* case were distinguished. Danckwerts L.J. said, at page 511, that the payments were "payments in the form of rentcharges, which *prima facie* at any rate, are completely payments of income and fall within the direct terms of s. 177." Salmon L.J., at page 513, said that "Rent and rentcharges *prima facie* are income"; and Fenton Atkinson L.J. agreed, though he had been inclined simply to say that the rentcharges were genuine rentcharges within s. 177, and that sufficed. On the footing that rentcharges are *prima facie* income, it was held that there was nothing to rebut that *prima facie* view, and in particular there was no agreement for any capital sum. From a commercial point of view larger rents for a ten-year period had been substituted for smaller rents for longer but varying periods.

In the House of Lords all members of the House concurred in Lord Donovan's speech. He held that the question decided by the Court of Appeal in no way concluded the true question, which was, not the nature of the rentcharges as receipts in the hands of the Church Commissioners, but their nature as disbursements by the company. Lord Donovan said[4] that he was "content to assume, without expressly deciding, that these rentcharges are income in the Church Commissioners' hands and are in their entirety liable to deduction of tax at source under s. 177." However, what had to be decided was whether, in computing profits tax and applying the ordinary principles of commercial accounting, the rentcharges were proper items to debit against the incomings of the company's trade. To this question the answer was No, for the rentcharges amounted to the cost to the company of acquiring capital assets, namely, the reversions. In short, it seems that the true question for decision in that case was never dealt with in the Court of Appeal, and that the point decided by the Court of Appeal was one which, though not truly arising in that case, does arise in the present case.

As might be expected, there was some discussion of the status in this case of that decision of the Court of Appeal. It is plainly relevant, even if it is not of binding authority. Mr. Potter and Mr. Nolan not surprisingly differed in the weight that they would attach to it; and Mr. Potter, who was concerned to

(1) 45 T.C. 495. (2) [1962] Ch. 861. (3) [1903] A.C. 299.
(4) 45 T.C. 495, at p. 515.

A diminish its authority, stressed that, although it related to the self-same transaction as is now before me, I had had the advantage of listening to authorities and contentions that had not been put before the Court of Appeal; and if these had been considered by the Court of Appeal the Court might well have reached a different decision. Mr. Potter also stressed the fact that, in applying income tax principles, the House had held that the payments by the company were finite
B payments made for a capital asset and thus were of a capital nature, and so on this footing they should accordingly not be treated as wholly income receipts in the hands of the Church Commissioners. One difficulty in this argument is that it proves too much, in that it leads to the conclusion that the rentcharges are entirely capital. Another difficulty is the assumption, already quoted, that the House was prepared to make, and another is the truism that one man's income
C expenditure may be another man's capital receipt, and *vice versa*. Throughout the argument one had to remember that, contrary to the usual state of affairs, it was the Crown that was seeking to demonstrate that part of each payment was capital, and it was the subject that was trying to show that it was entirely income.

Most of the cases discussed before me were cases on annuities. However,
D s. 177(1) uses the terms "annuity" and "rentcharge" *simpliciter* in close juxtaposition, and nobody suggested that the cases on annuities were irrelevant when considering rentcharges or that the characteristics of rentcharges which did not affect annuities, such as the remedies for enforcing them, made any difference. The cases fall into two main categories. First, there are the cases where annual or other periodical payments were held to be entirely capital in nature or entirely
E income in nature; and, second, there are those where such payments were dissected into constituent capital and income elements. It is primarily on the latter category that Mr. Potter relies. There are five cases in the first category, the first four relating to capital and the fifth to income.

In *Commissioners of Inland Revenue* v. *Ramsay* 20 T.C. 79, a dental practice had been sold for a "primary price" of £15,000, though the agreement
F provided for this sum to be paid by means of £5,000 down and annual payments for ten years equal to 25 per cent. of the net profits for each year. The agreement also provided that, if the aggregate of the yearly payments was greater or less than the balance of the primary price, then that primary price was to be correspondingly increased or diminished. The Court of Appeal held that the annual sums were entirely capital: they were the means of paying the £15,000,
G which, as Lord Wright M.R. said, at page 98, was "a figure which permeates the whole of the contract". As he said at page 92, "the instalments are not annuities in the proper sense of the term, but are merely the method and the manner and the form in which a lump sum is paid". At page 100 Greene L.J. said that it was quite clear that the primary obligation was the obligation to pay a sum of £15,000, which was the immediate obligation. The passage in the judgment of
H Romer L.J. which in the *Vestey* case(1) Cross J. considered not to be reconcilable with the *Scoble* case(2) is at page 98. I shall not set it out in full, but, briefly, it points out that a man who wishes to sell property in return for sums of £500 a year for 20 years may do so either by selling his property for an annuity of £500 a year for 20 years or for a price of £10,000 payable by equal annual instalments of £500 a year for 20 years. If he chooses the latter method the
I sums of £500 are not liable to income tax, and cannot be made liable to income tax by asserting that in substance the transaction is the same as if the property

(1) 40 T.C. 112, at pp. 122–3. (2) 4 T.C. 618.

(Megarry J.)

had been sold for an annuity. I may add that the passage in the judgment of Lord Greene M.R. in the *Wesleyan and General* case(1) which Cross J. regarded in the same way is in substance almost identical.

The second case in this group is *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.*(2) 22 T.C. 29. There under a written agreement a company acquired the sole licence for ten years to manufacture and sell within British territories certain aeroplane engines made by a French company. The agreement provided for the payment of a sum of £25,000, payable as to £15,000 on signing the agreement and two further sums of £5,000 respectively payable six and twelve months thereafter. It also provided for a royalty of £2,500 a year for ten years. The question arose under the then rule 21 of the General Rules applicable to all Schedules of the Income Tax Act 1918, and the Court of Appeal held that the first three payments were capital but that the ten annual payments of £2,500 were royalties or other sums paid in respect of the user of a patent under the Rule. Sir Wilfrid Greene M.R. referred, at pages 40–1, to some correspondence between the parties prior to the contract which showed that they probably had it in mind to create a lump sum liability for £50,000 and then make it payable by instalments. But he pointed out that these documents "are not documents which resulted in the creation of a lump sum liability of £50,000 at all", and that the agreement showed on its face that, if the parties had had that intention, they had changed their minds. Again there is the emphasis on whether or not there ever existed an obligation to pay an identifiable lump sum.

In *Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153 a taxpayer who wished to secure the completion of a multi-volume literary work had entered into a covenant to pay a publishing company £33,000 by means of an existing guarantee of £5,000 and five future annual payments of £5,600, with the last payment due in December 1931. In March 1930, when £13,310 still remained to be paid under the covenant, the taxpayer entered into a new covenant whereunder he was to pay the company seven annual sums of decreasing amounts which, after deducting income tax at the standard rate, would amount to £15,800 in all. The new covenant did not mention the old covenant, but the company exchanged the later deed for the earlier. The Court of Appeal held that the Court must have regard to the pre-existing legal position resulting from the two deeds and the exchange of one for the other. What the taxpayer had done, it was held, was to get rid of his existing obligation to pay the remainder of the capital sum of £28,000 (that is, the £33,000 less the guarantee of £5,000) by paying certain annual instalments: in the words of Sir Wilfrid Greene M.R., at page 169, he was "liquidating a capital obligation of his own". The Master of the Rolls said this:

> "It was suggested, on behalf of the Crown, that, provided there was present a mere intention to provide a sum expressed as a capital sum, and the covenant was a covenant to pay annual sums, that mere intention would be sufficient to bring the case within the rule to which I have referred. That is an argument which I must not be taken to be accepting for one moment. It seems to me that the cases to which we have been referred, and indeed the principle of the thing, must depend upon there being a real existing capital sum, not necessarily pre-existing but existing in the sense that it represents some kind of capital obligation. If you had a case where a man merely made up his mind that he would like a covenantee to have a

(1) 30 T.C. 11, at p. 16. (2) [1938] 2 K.B. 482.

certain sum of money more than he had at present and then effectuated that intention by entering into a covenant to make annual payments, the sum which he thought of, which would in no real sense be a sum at all, would be no more than the motive for entering into the covenant to make the annual payments. On the other hand, if there is a real liability to pay a capital sum, either pre-existing or then assumed, that capital sum has a real existence, and, if the method adopted of paying it is a payment by instalments, the character of those instalments is settled by the nature of the capital sum to which they are related. If there is no pre-existing capital sum, but the covenant is to pay a capital sum by instalments, the same result will follow."

Next in this group of cases there is *Lomax* v. *Peter Dixon & Son Ltd.*(1) 25 T.C. 353. There an English company which manufactured newsprint secured the formation of a Finnish company so as to obtain a source of wood-pulp. The English company lent over £300,000 to the Finnish company, and under a subsequent agreement the Finnish company provided for the repayment of the loan by a series of notes for £500 which were issued at a discount of 6 per cent. and were repayable over a period. The notes carried interest at 1 per cent. over the lowest discount rate of the Bank of Finland. If the Finnish company's profits permitted it, each note was to be repaid at a premium of 20 per cent. over par; and some notes were in fact repaid in this way. The question was whether such discounts and premiums were income or capital; and the Court of Appeal held that each was capital. I do not think that the case helps on the present point as much as some of the others do.

The last case in this group, *Sothern-Smith* v. *Clancy*(2) 24 T.C. 1, was a case in which the whole of a life annuity which had been purchased for a capital sum was held to be income. The contract provided that in any event the total payments would equal the capital sum; if the annuitant died before this had occurred the payments would be made to his nominee or the personal representative of the annuitant or his nominee. Despite the presence of the capital sum as a means of measuring the minimum period for which the annuity would be paid, the Court of Appeal held that the annuity was entirely income. The capital sum paid for the annuity had gone, for it ceased to exist as soon as it was paid; there was no debt or anything analogous to a debt; and all that had happened was that the annuitant had bought an income. The case is important, I think, as demonstrating that, even if a capital sum appears on the face of a contract, and has an operative effect as a means of calculating the length of time for which in certain events the payments will be made, it will not have the effect of making into capital any or all of what are income payments. Of course, there the annuity was an annuity for life and not for a fixed term; but I do not think that this destroys the point. I may add that by the Finance Act 1956, s. 27, the Legislature provided for the dissection of purchased life annuities into capital and income elements for tax purposes, thus producing the position that Sir Wilfrid Greene M.R., at page 7, thought "would be simple and perhaps not unjust".

I turn to the second category of cases, those in which it has been held that the payments in question should be dissected into capital and income. The first is *Scoble's* case(3). There the East India Company had power under a contract to give notice to a railway company of its intention to purchase the

(1) [1943] K.B. 671. (2) [1941] 1 K.B. 276. (3) 4 T.C. 618.

(Megarry J.)

railway for the full value of the shares in the railway company. The East India Company had a further option to pay the railway company an annuity for 99 years in place of the gross purchase price, the annuity to be determined according to a specified average rate of interest. As successor to the East India Company, the Secretary of State for India exercised both options, but then, in order to test the matter, refused to make part of certain half-yearly payments, claiming to deduct income tax; and the railway company then sued the Secretary of State. The House of Lords, affirming the Court of Appeal, held that the payments had to be apportioned between capital and income, and that no tax was payable on so much of each payment as represented repayment of the principal of the existing debt. The real question was not whether any part of each payment represented interest, but whether, as the Crown contended, the whole of each payment was liable to tax as an annuity, with none of it as capital. Again much weight was put on the existence of the existing lump sum debt. The fact that each payment contained an element of interest does not seem to have been in issue: see 4 T.C., at page 625.

I pause at this point: for this, of course, is the case which in the *Vestey* case(1) Cross J. regarded as being inconsistent with the statements by Romer L.J. in the *Ramsay* case(2) and by Lord Greene M.R. in the *Wesleyan and General* case(3). I need hardly say that this is difficult and controversial territory, and I say what I do with great diffidence. Nevertheless, I am bound to say that I find some difficulty in seeing the inconsistency. If V contracts to convey property to P, he may do so either in consideration of a fixed lump sum, payable by instalments spread over *x* years, or in consideration of annual sums payable for *x* years: and at least *prima facie* the payments in the former case are capital and in the latter case are income. That is the essence of what both Romer L.J. and Lord Greene M.R. said. But there are other possibilities. Thus, if V sells the property for a fixed lump sum, the contract may give P the option of paying this sum by making a series of payments which, as appears from the contract, have the true nature of consisting partly of capital and partly of income; and in this event for tax purposes the capital portions will be treated as capital and the income portions as income. That, as it seems to me, is the *Scoble* case(4). As Stirling L.J. said in the Court of Appeal, at page 621:

> " . . . if we look at the real nature of the transaction here, these so-called annuities are simply annual payments of equal amount, being instalments of a debt, and are made up partly of principal, partly of interest calculated at a particular rate. On the face of the contract, therefore, it appears that each annual instalment contains principal money and a portion of interest which can be readily ascertained by a competent actuary."

The House of Lords certainly did not dissent from this view. Lord Shand, at page 625, said:

> "It is not disputed that the payments to be made, and which are actually being made, under the contract"—and I pause to emphasise those last three words—"embrace capital and interest amounting, as they do, to the precise amount of capital and interest at the rate of £2 17*s.* per cent. stipulated for in the contract between the parties,"—and again I pause to emphasise those words—"though it is called an annuity."

Lord Davey, at page 626, after emphasising that the gross sum under the contract was "the foundation of the whole thing", said that "the amount of the

(1) 40 T.C. 112, at pp. 122–3. (2) 20 T.C. 79. (3) 30 T.C. 11. (4) 4 T.C. 618.

annual payment is to be ascertained, by the application to that gross sum of interest which is also ascertained under Clause 26 of the contract." Lord Lindley, at page 626, said that the annuity was

> "nothing more than the payment by equal instalments of the purchase money for the Railway with interest at the rate of £2 17*s.* per cent. The annual instalments are not all profits or gains, but are in fact partly payments of principal moneys and partly only profits in the shape of interest."

In a word, the *Scoble* case(1) does not seem to me to provide any warrant for saying that, where the true agreement between the parties is for the payment of a capital sum by periodical payments, or is for the payment of a series of income payments, these payments are to be dissected into capital and income. All that it seems to me to say on the point is that, if the true agreement is for a capital sum to be paid by a series of payments which are to be part capital and part income, for tax purposes the payments are to be dissected into their constituent elements.

The next case in this second category is *Perrin* v. *Dickson*(2) 14 T.C. 608. There the taxpayer took out a policy of assurance under which he was to pay premiums for six years and the assurance company was to pay what was called an "annuity" for seven subsequent years if the taxpayer's son so long lived: the purpose was to provide for the son's school fees. The policy provided that if the son died the taxpayer would get back the premiums that he had paid without interest, subject to deducting any amount that he had received by way of annuity. Though nothing to that effect appeared on the face of the policy, the annuity had been calculated so that if the son lived the amount paid by way of annuity would equal the premiums paid together with 3 per cent. compound interest. The son lived, and so the taxpayer received the full annuity. The Crown claimed income tax on the whole of each payment as being payments of an annuity within Schedule D, but Rowlatt J. held that the case was not one of an annuity in the sense that the taxpayer had parted with his money and had received instead an annuity. The principal sum paid to the assurance company had never been parted with; for in certain events it was to be repaid without interest and in other events (which had occurred) it was to be repaid with interest. Accordingly, income tax was payable only on the interest element in the annuity: page 615. The Court of Appeal affirmed this decision. At pages 619 and 622 Lord Hanworth M.R. said that it mattered not whether what was to be paid was or was not called an annuity, and that no dressing of the transaction could alter its character. The facts must be examined "to ascertain the nature and business meaning of the contract made". At page 627 Lawrence L.J. said that he had felt "considerable difficulty" in making up his mind whether the form of the contract precluded the Court from giving effect to what he considered to be the true nature of the bargain. He said that the amount of the annuity which was in fact paid "was calculated by agreement between the parties so as to return to the Respondent the premiums which he had paid with 3 per cent. compound interest". Slesser L.J. said, at page 628, that "though in description the payment is an annuity, in reality the money" paid to the taxpayer "was the repayment of [the taxpayer's] own capital". It seems to me that what the Court did was to say that the policy had failed to set out the full and true nature of the bargain between the parties. That bargain was for the repayment of capital either with or without interest, depending on the event. When the

(1) 4 T.C. 618. (2) [1930] 1 K.B. 107.

(Megarry J.)

event showed that the payments were part capital and part income, the Court gave effect to that bargain and said that it was the income element alone which must be dissected out of each payment and subjected to tax. I can see nothing to support any view that if the true bargain had been for payments that were wholly income or wholly capital the Court would nevertheless have dissected them into the income and capital elements that could have been agreed but had not been.

The *Perrin* case(1) must, I think, be read in the light of what was said about it in the *Sothern-Smith* case(2) at pages 7–8, 11 and 13. Sir Wilfrid Greene M.R. said that he found the reasoning in the *Perrin* case difficult to follow. He rejected the view that the nature of any financial calculations involved in ascertaining the amount of an ordinary annuity for a term of years could stamp any part of the payment as being capital and not income. Clauson L.J. was troubled by the absence of any contractual right for the taxpayer in the *Perrin* case to recover any premiums that he had paid if he had failed to keep up the payments, as distinct from the mere practice of the assurance company, established by the evidence, to make such repayments. Goddard L.J. said that in the *Perrin* case the Court had held that the true nature of the transaction was the accumulation by the taxpayer of a fund to be returned to him either at compound interest or without interest, and that the payments were in no sense an annuity. At least it seems plain that, whatever criticisms there may be of the process of ascertaining what was the true bargain between the parties, the decision was based upon that true bargain having provided for the making of payments which, in the events which occurred, contained an element of interest: and what was taxable was that contractual element. I do not read the case as deciding that the payments must be dissected in search of an income element even if the true bargain did not provide for any such element to be paid.

Then there is *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276, the case which in some way goes the furthest. There, a local authority proposed to take over certain private roads owned by some landowners. The local authority, however, required certain repairs to the roads to be carried out first, and after some negotiations a written agreement was made whereunder the local authority undertook to do the repairs and relieve the landowners from future liability for them in return for an agreement by the landowners to pay the local authority 20 yearly sums of £600. The cost of doing the work was in fact estimated at £8,550, but it actually came to rather more, as the local authority wished some of the roads to be brought up to a condition above the average. This, however, did not appear in the written agreement, which, conditionally upon loan sanction from the Ministry of Health being obtained, simply provided for the local authority to do the work and relieve the landowners from liability, and for the landowners to pay the yearly sums. After making the first three payments in full, the landowners then began to deduct income tax on the whole of each payment; and Stable J. held that tax could be deducted only on such part of each payment as represented interest.

I say that the case seems to go further than the others for two reasons. First, the £8,550 did not appear in the contract either directly or in a calculable form, and it never existed as a matter of obligation: it was no more than an estimate of the cost to the local authority. Yet Stable J. held that what the parties "had in mind" was that the local authority should spend this sum and be reimbursed it by the landowners by means of the 20 annual payments; and

(1) 14 T.C. 608. (2) 24 T.C. 1.

A he said that the case was one in which there was "a pre-existing capital sum": pages 278–9. The Court, I may say, granted a declaration in quite general terms, stating that income tax could be deducted on so much of each instalment as represented interest, without saying how this was to be ascertained, or whether, and if so how, it related to the £8,550. Perhaps this was worked out under the liberty to apply that was given. Yet, although it may be said that the B £8,550 never existed as a matter of obligation, the landowners were in fact under a pre-existing obligation to bring the roads up to the requisite standard, so that if the £8,550 was regarded as a mere quantification of that liability it is no great step for those concerned to regard the landowners as being under a pre-existing obligation for a capital sum. Looked at in that way, I do not think that the *Goole* case(1) falls gravely out of line with the other cases on this C point.

Second, the case seems to go far because it is not easy to see how the true character of the bargain could be said to be that payments would be made which were to consist partly of income and partly of capital. What the parties have in mind may well be one thing, and what they actually agree may be another. However, at page 278, referring, I think, to the contractual obligation to make D the payments of £600 a year, Stable J. did say:

> "I hold that this obligation, so far as it represented the repayment of the expenditure on repair, was a capital payment and not subject to income tax, but that so far as it was a payment of interest on that sum, it must be paid subject to deduction of tax."

It seems, therefore, that the learned Judge was addressing his mind at that point E to matters of obligation, and thus to the true bargain between the parties, and not merely to matters of contemplation. If so, this accords in principle with the general run of the cases, even though there may be some difficulty in perceiving the ground on which, on the materials available, this was held to constitute the true bargain. I may add that the only cases cited were the *Ramsay* case(2) and the *Mallaby-Deeley* case(3), so that the Judge did not have all the F assistance that I have had.

Finally, there is the *Vestey* case(4), which I have already discussed to some extent. There the owner of some shares entered into a written contract to sell them to the trustees of a family settlement for £5,500,000, to be paid "without interest by 125 yearly instalments of £44,000". If the purchaser defaulted for 90 days in paying any instalment, all the remaining instalments were to become G immediately payable with 4 per cent. interest. The shares were worth about £2,000,000 at the time of sale. Extrinsic evidence showed that prior to the sale the trustees had been advised that the shares were worth this sum, and that if, as was proposed, they were to be sold in consideration of annual payments for a long period such as 125 years, a 2 per cent. rate of interest should, on certain assumptions, be taken, thereby yielding a payment of £44,278 a year for 125 H years, which could be rounded down to £44,000. Cross J. upheld the decision of the Special Commissioners that these payments should be dissected into an income element and a capital element.

In addition to discussing the points that I have already mentioned, Cross J. considered at some length a decision which is cited in many of these cases, *Foley* v. *Fletcher* (1858) 3 H. & N. 769. There the Court of Exchequer held

(1) [1942] 2 All E.R. 276. (2) 20 T.C. 79. (3) 23 T.C. 153. (4) 40 T.C. 112.

(Megarry J.)

that, on a sale of land for £99,000 payable by equal half-yearly instalments over 30 years, the purchasers were not entitled as against the vendors to deduct income tax from any of the payments. After weighing the various authorities, Cross J. reached the conclusion that none bound him to decide that the payments in the case before him were wholly capital or wholly income, but that the purchase price clearly contained an interest element. Accordingly he held that the Special Commissioners had been right in dissecting the payments. I may add that the Special Commissioners had taken the view that the terms of the contract were not conclusive because it was well settled that the label that the parties chose to attach to their payments was not conclusive of their character: see at page 115. It may indeed be that the *Vestey* case(1) should be regarded as a "label" case.

I have already discussed certain points in the *Vestey* case, and in particular the view that was taken in it about the *Scoble* case(2). In the *Land Securities* case(3) Cross J. applied his own decision in the *Vestey* case, but the Court of Appeal reversed his decision and held that the *Vestey* case was distinguishable. Furthermore, the House of Lords agreed with the Court of Appeal in holding that the *Scoble* case and the *Vestey* case were not really in point: see 45 T.C., at page 517. Of course in the present case there is not, and never has been, any agreement to sell property for a capital sum to be paid by instalments: the whole basis of the agreement throughout was for a sale of the property in consideration of rentcharges payable for ten years.

Running through the cases there seems to me to be a clear recognition of the importance in this field of the existence of some capital obligation. Such an obligation may have arisen under some pre-existing debt which is to be discharged, or it may be brought into being by the very transaction in question: but whichever it is, the Courts are slow to recognise any arrangements for paying the debt by means of a succession of payments as constituting anything except an arrangement for discharging a capital obligation by making capital payments. He who is obliged to pay a capital sum will readily be taken to have performed his obligation, whatever the manner of payment. In the phrase of Rowlatt J. in the *Perrin* case 14 T.C. 608, at page 615, "If the principal sum has gone and been converted into something else, there is an annuity; but if you are liquidating a principal sum it is not an annuity."

The discharge of a capital obligation must, I think, be contrasted with other transactions with a capital aspect. Thus I do not think that the purchase of a capital asset falls within the same category as the discharge of a capital obligation. If a capital obligation is discharged it ceases to exist, and the Courts appear to have found it easy to treat the means of discharging the obligation as bearing the same capital nature as the obligation that they discharge. But if a capital asset is acquired there is merely the exchange of one form of property for another; and there is no reason why capital should not be exchanged for income or *vice versa*. No doubt, as Mr. Potter contended, from the creditor's point of view a debt that is owed to him is as much of an asset as his land or his shares are: but the nature of the transaction is quite different, and it is the nature of the transaction that matters. Payments in discharge of a debt readily take the nature of the debt they discharge, whereas a capital asset may be purchased in exchange for a capital payment, or income payments, or a mixture of capital and income, or some other consideration. After some hesitation, Mr. Potter finally accepted that he could not contend that a rentcharge in perpetuity or for

(1) 40 T.C. 112. (2) 4 T.C. 618. (3) 45 T.C. 495.

life was of a capital nature merely because it was given in consideration of the purchase of a capital asset, though he contended that the capital asset played an important part in determining that the payments were of a capital nature. Yet I can see little or no reason why the nature of what is transferred should colour the nature of what is being paid. At most, the fact that a capital asset is being acquired can be said to be a factor to be taken into account.

Again, I think that the mere existence of a capital sum of money in the minds of either or both of the parties must be contrasted with the actual existence of a capital obligation. As a matter of valuation, all capital can be expressed in terms of income and all income can be expressed in terms of capital. An annuity or rentcharge, whether in perpetuity, for an uncertain period such as life or for a fixed term of years, may readily have its capital equivalent ascertained by valuers and others: yet such capital equivalents, though useful on either side as a means of appraising the effect of a proposed transaction, and perhaps as an aid to bargaining, remain mere units of calculation so long as they form no part of the bargain that is struck, and never represent any true obligation, existing or past. The comments of Sir Wilfrid Greene M.R. in the *Sothern-Smith* case[1] to which I have already referred seem to me to be in point.

For somewhat similar reasons, I cannot attach any great weight to the question whether, without there being any obligation to pay a capital sum, such a sum appears in some way on the face of the transaction or can by due diligence be detected in it. I cannot see why the bare inoperative mention of a capital sum should affect the nature of what is being paid under the contractual obligation. Mr. Potter contended that in the present case the transaction itself did mention a lump sum, at least by implication, in that one had only to add together the annual rentcharges and multiply by ten (their duration in years) in order to discover that the transaction was for an expressed lump sum of £960,000. On this footing almost any transaction could be regarded as being for a lump sum; the argument is one that might cost the Crown dear in a multitude of other cases. Further, Mr. Potter accepted that if annual payments were to be made for an uncertain period, such as life, they might well be income in their nature; but he drew a sharp distinction between these and annual payments for a fixed period of years, which he said were capital in nature. Yet each may be reduced to a capital equivalent, and I cannot see why their nature should depend on whether that reduction can be achieved by simple arithmetic or whether it involves the additional complication of actuarial expectations of life.

I am also unable to see the relevance of what the recipient of a sum of money intends to do with it. Money that is income when received does not become capital because the recipient has decided, or later decides, to use it for some capital purpose, as by purchasing a capital asset; nor does money that was capital when received become income by reason of a decision of the recipient to spend or apply it as income. What matters is the character of the payment when made, and not the intention of the recipient, which in any case may be indefinite or fluctuating. In short, for this purpose I would distinguish between capital of obligation, which normally is of great significance, and capital of acquisition, or of calculation, or of intention, all of which will normally have little significance, if any.

(1) 24 .TC. 1, at pp. 7–8, 11 and 13.

(Megarry J.)

Turning from the cases, I must refer briefly to certain statutory provisions that were discussed in argument. Mr. Potter contended that the Improvement of Land Act 1864, ss. 49 to 51, and the Settled Land Act 1925, ss. 39 and 84, showed that rentcharges for fixed terms could be wholly or partly capital in nature. On the other hand, Mr. Nolan relied on the Income Tax Act 1842, s. 60, Schedule A, No. IV, rules 9 and 10, and the Income Tax Act 1853, s. 42, and contended that the provisions of the latter showed that for the purpose of income tax the assumption was that, apart from transactions to which such provisions applied, a rentcharge was wholly income. I do not think that either these or certain other statutory provisions that were mentioned are of any great cogency on what arises for decision in this case. In so complex a subject as this there are bound to be inconsistencies and loose ends of one kind or another, and I would hesitate to put any great weight on assumptions and inferences drawn from enactments made with other objects in mind.

Before considering any further the substantive law established by the authorities, I propose to turn to the question of evidence: for in determining the nature of the payments I must decide what is admissible for the purpose. As a matter of principle, I cannot see on what ground it would be right on tax questions to exclude all evidence of negotiations between the parties or other matters extrinsic to the documents that create the contractual obligation. In determining what is the true meaning of the contract between the parties no doubt many such matters may be inadmissible. But although the true construction of the bonds which bind the parties to each other is a factor, and a very important factor, in determining their liability to tax, it cannot be decisive. The parties are at liberty to make whatever bargain they please within the law. I see no reason why they should not, as a matter of contract, bind themselves to each other to treat a capital payment as if it were income or an income payment as if it were capital. But they have no power to alter the law or to bind the Revenue authorities. If they strike a bargain for making a payment of an income nature within the taxing Acts and also agree that the obligation to make this payment is to be imposed by a written contract which not only binds them to treat the payment as being a capital payment but also does all that skilled drafting can do to give it a capital nature, then I do not think the parties can point to the resulting product of pluperfect draftsmanship and say to the Inspector of Taxes: "That is conclusive: you can look no further in determining the tax liability of either of us." For the purposes of taxation the question is always what is the true nature of the payment, paying due respect to the contractual obligations of the parties, on their true construction, but not according them conclusive effect.

Looked at as a whole, the authorities seem to me to support this view. I have already mentioned a few instances in passing, and I do not propose to discuss these or any others in detail. I think it will be enough if I give a sufficiency of references. First, I must say that it is plain that extrinsic evidence cannot be looked at for the purpose of treating a transaction of one legal character as if it were a transaction of another legal character, thereby bringing into operation the discredited doctrine of substance as against form. Such evidence is admissible, not for that purpose but in order to discover what is the true character in law of the transaction in question: see the *Mallaby-Deeley* case 23 T.C. 153, at page 167, *per* Sir Wilfrid Greene M.R. Subject to that, it seems to me that support for the admissibility of extrinsic evidence is to be found in the *Mallaby-Deeley* case at pages 166–7, the *Perrin* case 14 T.C. 608, at pages 622 and 627 (with which the *Sothern-Smith* case 24 T.C. 1, at page 7,

A should be contrasted), the *British Salmson* case 22 T.C. 29, at pages 40 and 43, the *Lomax* case 25 T.C. 353, at page 363, the *Goole* case [1942] 2 All E.R. 276, at page 278, and the *Vestey* case 40 T.C. 112, at page 123. In the *Lomax* case, at page 363, Lord Greene M.R., I may say, put the matter succinctly when he said:

> "Evidence *dehors* the contract must always be admissible in order to explain what the contract itself usually disregards, namely, the quality
B which ought to be attributed to the sum in question."

References to the question being one of "the proper construction to be placed upon the documents by which the transaction is carried out" (as in the *Ramsay* case 20 T.C. 79, at page 98, *per* Romer L.J.) cannot, I think, be said to indicate any different rule by suggesting that the only question is one of construction and that therefore extrinsic evidence is admissible only to the limited extent
C permissible in the construction of documents. The construction of any document is of course an important factor, and in some cases it may be conclusive; but for fiscal purposes evidence of other matters may be admissible, and, indeed, important.

I turn then to the extrinsic evidence in this case. The Special Commissioners held that it should be excluded on the ground that it was admittedly
D the case that the preliminary negotiations leading up to the formal contract had not created "any legally enforceable contract and therefore did not bring into being a price or lump sum capital obligation". This seems to me to be too strict a view. If the whole of the negotiations for a sale are on the basis of, say, the price being a lump sum payment which finally becomes settled at £100,000, and then at the last moment the transaction is cast into the form of the payment
E of a rent charge of £10,000 a year for a fixed term of years, I doubt whether it would be right in a fiscal case to exclude all evidence of the negotiations merely because they had never amounted to a legally enforceable contract. A bargain struck "subject to contract" creates no legally enforceable contract, yet I cannot think that it would be right to exclude all evidence of such a bargain in arriving for fiscal purposes at what is the true nature of the contract subsequently made.

F The excluded extrinsic evidence in this case consists of certain correspondence, internal memoranda and communications of the Church Commissioners, and the findings of fact made by the Special Commissioners as a result of considering these documents and the oral evidence of Mr. K. S. Ryle, the Secretary of the Church Commissioners. These findings show that in 1956 the Church Commissioners offered to sell the properties in question to the
G company, but the company was not prepared to buy. Later the chairman of the company said that "he was prepared to purchase the properties in exchange for rentcharges. He would on no account buy them for a lump sum". The Church Commissioners then considered various aspects of this proposal, and came to favour it if the rentcharges were large enough to maintain the existing income of the Church Commissioners from the properties and also to provide
H a sinking fund which, when the rentcharges ended, would then at least suffice to maintain that income. In the course of considering the proposal various capital values of the properties were assumed by officers of the Church Commissioners, and also various interest rates, these being important, of course, in relation to building up the sinking fund and to the yield to be obtained from it. Thus, one calculation showed that, if a 6 per cent. basis was adopted, the total
I rentcharge would be £90,000 a year and the equivalent capital value was £666,666, whereas on a 5 per cent. basis the figures were £103,000 a year and £800,000, and on a 4½ per cent. basis £112,000 a year and £888,888. These

(Megarry J.)

percentages could, as a matter of valuation, also be expressed in the form of a number of years' purchase, and in the end the deal settled down to being on an 18 years' purchase basis, which is the equivalent of an interest rate of 5·55 per cent., yielding rentcharges of £96,000 a year and an equivalent capital value of about £720,000. These figures did not remain within the four walls of the Church Commissioners but appeared in correspondence with the company. There was also a tabular statement which set out in separate columns for each property various details of the rents, the "purchase price", the "rentcharge" and so on; and a copy of this was sent to the company. There were other matters too. Nevertheless, I cannot see anything in the evidence which indicates that references to capital sums were ever to anything except capital of calculation or intention, as distinct from capital of obligation. From first to last, the whole basis of the transaction was one of selling the reversions in return for rentcharges for ten years, and there never was any obligation, even inchoate, to pay any capital sum.

I may now attempt to summarise the position. First, the starting point is the ascertainment of the true character in law of the actual transaction, and not of some other transaction that might have been effected but was not. Second, to do that involves construing the documents; but the true construction of the documents, though important, is not always conclusive. In respect of the Revenue authorities extrinsic evidence is admissible if it tends to show the true character of the transaction. Third, the consideration given for an asset may, on the true character of the transaction, be wholly capital, wholly income or partly one and partly the other: and any consideration in the last category (though not consideration in the other two categories) must be dissected for tax purposes. Fourth, in determining the nature of any consideration the true nature of the bargain is of high importance. Subject to any overriding considerations, if the true bargain is to discharge a capital obligation (whether pre-existing or new) by instalments, those instalments will be either capital or else a mixture of capital and interest, depending on whether or not there is any express or implied obligation to pay interest: but if the only obligation is to pay periodical sums and there is no capital obligation, the payments will normally be income. Fifth, the nature of the payments will normally not be affected by the existence of any capital of acquisition, of calculation or of intention; and similarly as to the corresponding income equivalents. If during the negotiations any such equivalents came into existence, expressing capital in terms of income or *vice versa*, they will normally have no effect, unless, of course, they play such a part in the transaction as to affect its true nature, or demonstrate that the transaction is a sham or is using false labels. Sixth, if the true character of the transaction is that payments consisting partly of income and partly of capital are to be made, then they must be dissected in order to discover how much falls under each head. But payments will not be dissected if according to the true character of the transaction they are wholly income or wholly capital, even if the transaction might have been carried out in some different way which would have yielded mixed payments of this kind. Putting the matter even more shortly, I would attempt to summarise the matter by saying: Look at the contract and any evidence that is admissible to discover what the true bargain between the parties actually is. Then look at what is to be paid in accordance with that bargain. If it is all capital or all income, leave it alone: if it is partly one and partly the other, dissect it. Ignore any other bargain that the parties might have made but did not.

If I apply these principles and the law that I have attempted to discern in the cases, the true nature of the transaction in this case appears to me as being a

A conveyance of capital assets in return for the grant of rentcharges. I can see nothing either in the transaction itself or in the extrinsic evidence which provides any real indication that any part of those rentcharges is of a capital nature. In my judgment, a capital nature is not conferred on any part of these rentcharges either by the capital nature of the assets acquired or by the fixed period for which the rentcharges were to be paid or by the calculations that expressed the B capital equivalents for the rentcharges or by anything else, either individually or collectively.

I do not say that all rentcharges are inevitably of a wholly income nature; it is not necessary to say this. Mr. Potter contended that there was no magic in the word "rentcharge" in s. 177 and that the section did nothing to convert capital into income but only charged rentcharges to income tax so far as they C were of an income nature. He also said that the word "rentcharge" stood neutral on whether the payments were in their nature income or capital or a mixture of the two. I do not need to decide any of these things, though I may say that I would respectfully prefer the view taken by the Court of Appeal in the *Land Securities* case(1) that rentcharges are at least *prima facie* entirely of an income nature. However that may be, I decide none of it. What I do decide D is that in my judgment there is nothing in the circumstances of this case to give any part of these rentcharges a capital nature. In a sentence, the case is one in which the Church Commissioners sold their capital assets in return for an income. I think that the rentcharges are wholly of an income nature in the hands of the Church Commissioners, and that the Church Commissioners are accordingly entitled to recover the income tax deducted by the company in E making the payments. Even if in some respects I have erred in my perilous task of attempting a summary of the law (and perhaps I may add that of course no judicial summary is ever intended to be construed as if it were an Act of Parliament), I still find it difficult to perceive any capital element in the rentcharges to which the Church Commissioners are entitled.

As I have indicated, I do not think that the Special Commissioners ought to F have excluded the extrinsic evidence; but I do not consider that this evidence, when admitted, alters the conclusion which the Special Commissioners reached. I therefore dismiss the appeal, and answer Yes to question (*a*) in the Case Stated, and No to question (*b*); and if question (*c*) had arisen, I would have answered No.

Nolan Q.C.—Would your Lordship say that the appeal is dismissed with G costs?

Rattee—My Lord, I cannot resist that.

Megarry J.—Yes.

Nolan Q.C.—I am much obliged, my Lord.

Rattee—My Lord, may I mention one thing?

Megarry J.—Yes.

H **Rattee**—It is this. As your Lordship will appreciate, the Crown will want to consider, of course, whether to take the matter any further.

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(1) 45 T.C. 495.

Megarry J.—On the footing that as one side of the transaction has already gone to the House of Lords justice demands that the other side should go to the House of Lords as well? A

Rattee—I would not put it as high as that, my Lord. One point to which consideration is being given by the Crown is whether, in the event of their deciding to take the matter further, an application should be made to your Lordship under s. 12 of the Administration of Justice Act 1969. B

Megarry J.—Is that the "leapfrog" procedure?

Rattee—Yes, my Lord. I am not in a position to make any effective application at this stage. Apart from anything else, I understand from my learned friends appearing for the Church Commissioners that they wish to have time to consider your Lordship's judgment before deciding whether or not to consent to such an application—and, of course, they have to consent. C

Megarry J.—Everybody has got to consent.

Rattee—Yes. On the other hand, the application has to be made to your Lordship within 14 days of your Lordship's decision. It is not at all clear to those instructing me, nor to my learned friends, whether those 14 days run through the vacation, or whether they do not.

Megarry J.—Why not? It is for pleadings that time does not run in the vacation, is it not? D

Rattee—No, my Lord. We do not have very long before the end of this term, in which the application can be made. In those circumstances, I am wondering whether your Lordship would think there is any objection to dealing with the matter on the basis that the Crown makes an application for a certificate under that section; your Lordship is not in a position to determine that application at this stage because your Lordship is not in a position to know whether my learned friends consent; and so, on that basis, my application might be adjourned. E

Megarry J.—You simply want your application for a certificate to be adjourned. Is that it?

Rattee—That is it, my Lord: adjourned with liberty for me to apply to restore it if the circumstances appear to justify it. F

Megarry J.—Let us look at the provisions.

Rattee—Certainly, my Lord. It is in Part 2 of the White Book, para. 3607 on page 1026. It is s. 12 of the Administration of Justice Act 1969, which is the section which deals with the conditions under which a certificate may be granted. That says: G

> "(1) Where on the application of any of the parties to any proceedings to which this section applies the judge is satisfied—(*a*) that the relevant conditions are fulfilled in relation to his decision in those proceedings, and (*b*) that a sufficient case for an appeal to the House of Lords under this Part of this Act has been made out to justify an application for leave to bring such an appeal, and (*c*) that all the parties to the proceedings consent to the grant of a certificate under this section, the judge, subject to the following provisions of this Part of this Act, may grant a certificate to that effect. (2) This section applies to any civil proceedings in the High Court which are either—(*a*) proceedings before a single judge of the High H

A Court . . . or (*c*) proceedings before a Divisional Court. (3) Subject to any Order in Council made under the following provisions of this section, for the purposes of this section the relevant conditions, in relation to a decision of the judge in any proceedings, are that a point of law of general public importance is involved in that decision and that that point of law either—(*a*) relates wholly or mainly to the construction of an enactment B or of a statutory instrument, and has been fully argued in the proceedings and fully considered in the judgment of the judge in the proceedings, or (*b*) . . . the judge is bound by a decision of the Court of Appeal or of the House of Lords in previous proceedings . . ."

I do not think para. (*b*) applies.

"(4) Any application for a certificate under this section shall be made C to the judge immediately after he gives judgment in the proceedings: Provided that the judge may in any particular case entertain any such application made at any later time before the end of the period of fourteen days beginning with the date on which that judgment is given or such other period as may be prescribed by rules of court. (5) No appeal shall lie against the grant or refusal of a certificate under this section."

D So, my Lord, the position is that under subs. (4) the application has to be made within a period of 14 days, that being, so far as I can discover, the period now prescribed by the Rules of Court.

Megarry J.—You start with this, that this is a period of 14 days laid down by an Act of Parliament, not by the Rules; so I would have thought that there was some difficulty in saying that time does not run during the Vacation.

E **Rattee**—With respect, I think that is right. Of course, the whole point may not arise in reality, in that the other side may not consent to the application; and I concede that when we have had an opportunity to consider your Lordship's judgment the Crown may decide either not to appeal or not to apply for a certificate under this section. On that basis, I am put in some difficulty, and on that basis I ask whether your Lordship might not consider dealing with it on the F basis that I now make an application under this section which cannot effectively be dealt with.

Megarry J.—Pause there for one moment. There are only two things which stand in the way of an immediate decision: first of all, you are not certain whether you want a certificate, and you have got to take a decision on that; secondly, Mr. Nolan does not at the moment know whether he is prepared to G consent to the grant of a certificate. Now, if we can deal with the whole of the matter now except for the two outstanding points and then adjourn the matter for those two outstanding points to be dealt with, I having intimated that subject to those outstanding points the certificate can be granted, then could not the matter be dealt with in that way, probably before the end of this term; or is there some difficulty in that?

H **Rattee**—I do not know, my Lord. I do not know what my learned friend thinks about the time that it is going to take his clients to decide. I do not know what their attitude is going to be. Perhaps your Lordship should hear that first.

(After further discussion)

Megarry J.—Your strongest point, perhaps, is the decision of the Court of Appeal in the *Land Securities* case(1), where the judgment of all three members almost revolved around the word "rentcharge".

Rattee—Indeed, my Lord; and they decided it very largely upon the bare construction of s. 177. I submit that it is a question of law at issue which does depend, I do not say wholly but mainly, on the construction of s. 177.

Megarry J.—Of course, granting a certificate is discretionary, it is not?

Rattee—Indeed, my Lord.

Megarry J.—" . . .the judge . . . may grant a certificate". One of the matters to be considered, I should have thought, was whether it is the sort of case where I think the House of Lords ought to have the assistance that is provided by a decision in the Court of Appeal before the matter is taken to them.

Rattee—Yes. They have already had it, my Lord; so, really, if the Court of Appeal were to do it, then the House of Lords may have two different decisions of the Court of Appeal.

Megarry J.—And you are almost certainly bound to get a completely different Court of Appeal if it goes to the Court of Appeal. The only circumstance under which you could conceivably have the same Court of Appeal is if Lord Salmon came and sat as a member of the Court of Appeal; but the other two Lord Justices have both retired.

Rattee—Yes. On the question of discretion otherwise, my submission to your Lordship is that it is clearly in the interest of everybody to save costs if we can. The House of Lords has already got the opinion of a Court of Appeal on the question, though perhaps given in the wrong circumstances; and in my submission the extra costs involved in going through the Court of Appeal in those circumstances—a different Court of Appeal—are really not justified. I do not think I can add to it, my Lord. Those are my submissions.

Megarry J.—Yes. I think I should like to think a little about this. I can quite plainly say that this is obviously not a hopeless application, and therefore there would be some point in coming back again if the thing is to be pursued. But with s. 12 in front of me I should like, I think, to glance through my notes of the judgment again, having in mind what I did not have in mind before, of course, and that is the requirements of s. 12. In effect, therefore, what I am saying is that I adjourn this application generally. It is basically being adjourned for you to consider whether you wish to pursue it and for Mr. Nolan to consider whether he agrees; but it is plainly not a hopeless application, and it may well be that I shall be able to grant a certificate. I am not saying, of course, that I will: merely that it is worth while your coming back if you want to pursue it.

Rattee—I am most grateful, my Lord. On that basis, I do not know whether your Lordship wants me to come back before the end of this term or whether it might be more convenient to come back on the adjourned application next term? To some extent, of course, that depends on your Lordship's convenience.

(1) 45 T.C. 495.

Megarry J.—I should have thought that this is something that really ought to be dealt with by the end of this term. Plainly the general trend of subs. (4) is "Let this be dealt with as speedily as possible". Today is Thursday.

Rattee—Yes; and there is Friday, Monday, Tuesday and Wednesday.

Megarry J.—That should be long enough.

Rattee—I entirely accept that, my Lord.

Megarry J.—It will simply be on the footing that I shall not expect any further argument from either side. I merely wish to be told whether you wish a certificate to be granted and whether Mr. Nolan consents. If in fact Mr. Nolan does not consent, then there is no need to come back. An intimation through the usual channels that the application is being abandoned because Mr. Nolan does not consent will put an end to it all. If it is in issue because Mr. Nolan does consent and you wish to have a certificate, then it will come back; and I do not think there will be any difficulty, through the usual channels, in fitting it in whenever is most convenient to you both, because it should not take very long.

Rattee—I am much obliged, my Lord.

Megarry J.—Would that be suitable, Mr. Nolan?

Nolan Q.C.—Perfectly, my Lord.

26th July 1974

Megarry J.—Yesterday, at the conclusion of my judgment in this case, Mr. Rattee applied on behalf of the Crown for a certificate under the Administration of Justice Act 1969, s. 12, relating to what is commonly called the "leapfrog" procedure, so as to make it possible for the Crown to seek leave from the House of Lords to appeal directly to that House. There was some discussion on procedure, as Mr. Rattee lacked firm instructions to appeal, and Mr. Nolan needed time to consider whether to give the consent to the grant of the certificate that s. 12(1)(*c*) makes requisite. In the end, in view of the approach of the Long Vacation and the importance of making prompt application that appears from s. 12(4), it was decided that the convenient course was for Mr. Rattee to make his application forthwith, and then for it to be stood over for a few days while the parties considered their positions. This was done; and having heard what was said on each side, I intimated that before ruling I wished to look through my judgment in the light of the submissions that had been made. After adjourning the application I considered it in relation to my judgment, and then directed the case to be restored to the list for this morning, for I had reached a conclusion that made it unnecessary for the parties to consider matters any further, namely, that no certificate should be granted.

As far as I am aware, there is no reported case which considers the general operation of the section, and so I think that I ought to state my reasons for refusing a certificate. Section 12(1) lays down three requirements for the grant of a certificate. They are (*a*) that the "relevant conditions" are fulfilled; (*b*) that a sufficient case for an appeal to the House of Lords has been made out to justify an application to that House for leave to bring such an appeal; and (*c*) that all parties consent to the grant of the certificate. Of these requirements I have already mentioned the last. The second requirement is, I think, fully

(Megarry J.)

satisfied: the amount involved is large, and the law is both complex and arguable. The first requirement carries one to s. 12(3), which defines the "relevant conditions". A

The first of the relevant conditions is that "a point of law of general public importance is involved" in the decision. This condition is, I think, plainly satisfied. True, the deduction of income tax from rentcharges has now gone, but the tests for determining whether and to what extent for tax purposes rentcharges are of a capital nature or an income nature are clearly of general public importance. The second condition is whether under s. 12(3)(*a*) the point of law "relates wholly or mainly to the construction of an enactment or of a statutory instrument"; Mr. Rattee rightly disclaimed reliance on the alternative in s. 12(3)(*b*), which relates to the point of law being one on which the Judge is bound by a decision of the Court of Appeal or House of Lords. It is this second condition that raises the difficulty, and I shall return to it in a moment. The third condition is that the point of law "has been fully argued in the proceedings and fully considered in the judgment of the judge in the proceedings". I have no hesitation in saying that in the three days of argument the point was fully argued, and I do not understand that counsel, who endured with fortitude a judgment that took some 90 minutes to read, dissent from the view that the point was fully considered in the judgment. Subject to the consent of the Church Commissioners, all the requirements of the section are thus satisfied if the second of the "relevant conditions" is fulfilled. The question is whether it is. B C D

Mr. Rattee did not rely on the word "wholly", but he did contend that the point of law "relates . . . mainly to the construction of an enactment", namely, the Income Tax Act 1952, s. 177. In a sense all questions of income tax sooner or later come back to some enactment, to the extent that if no enactment is in point, there is no tax. Here, however, the statutory material is slender. In essence, there is little more than the one word "rentcharge" in s. 177(1)(*b*). Nobody has contended that the rentcharges reserved by the Church Commissioners in this case lacked the quality of being rentcharges. The real question has been as to the nature of what are admittedly rentcharges: are they wholly of an income nature, as I have held, or do they house a capital element which can and will be dissected out of them and be excluded from the payments from which, under the section, tax is to be deducted? On that footing I find it difficult to see how it can be said that the point of law "relates . . . mainly to the construction of an enactment". The construction of the contract and the transfers, in their context and in the light of the extrinsic evidence, and the ascertainment of the true nature of the bargain between the parties, cannot in any real sense of the words be said to be the construction of an enactment. Very little of the argument and very little of my judgment turned on the meaning of the word "rentcharge" in s. 177. The judgment of the Court of Appeal in the *Land Securities* case[1] seems to be the high water mark of the contention that the point is one on the construction of an enactment; but when the judgments are read the whole emphasis of them is away from a construction of the meaning of s. 177 and towards the nature of the rentcharges that had been created. It follows that in my judgment the second of the "relevant conditions" is not fulfilled, and that even if the Church Commissioners consent I cannot grant a certificate under s. 12. E F G H

I would add this. I think that where the requirements of the section are satisfied, it is nevertheless within the judicial discretion of the Judge whether or I

(1) 45 T.C. 495.

not to grant the certificate: for s. 12(1) provides that where the requirements are satisfied the Judge "may" grant the certificate, and I can see no grounds for saying that this is one of the limited class of cases in which "may" in effect means "must". In the normal course of events of an appeal, the House of Lords has before it the judgments both at first instance and in the Court of Appeal, and I can well imagine cases where on an application for a certificate the Judge might consider it desirable that the members of the House of Lords should, in addition to having his own judgment before them, have the benefit of the decision and judgments of the Court of Appeal. This is especially so in cases where there have been disputed questions of fact, for then the case will have been argued before the facts have been found. Each side must argue before the Judge on the different bases of whatever facts the Judge may by possibility find, and so they may not be prepared with the full range of authorities and arguments which are appropriate to the facts as ultimately found. In such cases the judgments in the Court of Appeal, given after the case has been argued on ascertained facts, can be expected to be of especial assistance to the House. This consideration, however, is less apposite to Revenue cases, where in the normal course the arguments and authorities put before the Judge are based on the facts found by the Commissioners. Nevertheless, there may be other circumstances in which, even in Revenue cases, the Judge may think it desirable that the case should not reach the House of Lords unless it has first gone to the Court of Appeal. One such instance I think, is where the Judge considers that, although the case is within the letter of s. 12, he does not consider that it falls within the spirit. In the present case, even if I am wrong in holding that the case fails to satisfy the second of the relevant conditions, I feel little doubt that it fails to fall within the spirit of that condition. Accordingly, I would in any event have refused to grant the certificate. The application accordingly fails.

Rattee—I am much obliged, my Lord.

The Crown having appealed against the decision given on 25th July 1974, the case came before the Court of Appeal (Russell and Stamp L.JJ. and Sir John Pennycuick) on 24th, 25th, 28th, 29th and 30th April 1975, when judgment was reserved. On 27th June 1975 judgment was given unanimously against the Crown, with costs.

Donald Potter Q.C. and *D. K. Rattee* for the Crown.

Michael Nolan Q.C. and *Stephen Oliver* for the Church Commissioners.

The following cases were cited in argument in addition to those referred to in the judgment:—*Lomax* v. *Peter Dixon & Son Ltd.* 25 T.C. 353; [1934] K.B. 671; *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29; [1938] 2 K.B. 482; *Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153; *B. G. Utting & Co. Ltd.* v. *Hughes* 23 T.C. 174; [1940] A.C. 463.

Russell L.J.—Stamp L.J. will deliver the judgment of the Court.

Stamp L.J.—This litigation arises out of an agreement made on 5th January 1960 between the Church Commissioners for England of the first part, Land Securities Investment Trust Ltd. of the second part, and Associated London Properties Ltd. of the third part.

(Stamp L.J.)

The Church Commissioners owned a number of certain freehold and leasehold properties which were subject to long leases, none of which was due to expire earlier than the year 2033, at rents amounting in the aggregate to some £40,000 per annum. Land Securities or, in the case of one property its wholly-owned subsidiary, Associated London Properties Ltd., were the lessees or underlessees of the properties holding as tenants of the Church Commissioners.

By the agreement, the Church Commissioners agreed to sell and Land Securities and Associated London Properties agreed to purchase the reversions. Associated London Properties were joined as a party to the contract because one of the leases was vested in that company, but we will do as did Megarry J. in the Court below and treat all the reversions as having been sold to Land Securities. Clause 4 of the agreement provided: "The considerations for the transfers shall be the respective rentcharges described in Column Five of the Schedule and the covenants on the part of the respective purchasers for the payment of the said rentcharges."

The rentcharges set out in the schedule were of varying amounts payable in respect of the several properties and amounted in the aggregate to £96,000 required to be payable for ten years. The agreement provided that the transfers of the respective freehold and leasehold properties (the titles to which were all registered) should be in the forms attached to it without any alteration. The forms attached were all, so far as material, in similar terms and we will read the operative part of one of them. It runs:

> "1. In consideration of the rentcharge hereinafter reserved and the covenant by Land Securities hereinafter contained the Commissioners being seised in fee simple hereby transfer to Land Securities (and so that the same covenants shall be implied therein as if the Commissioners had been and had been expressed to convey or transfer as beneficial owners) the land comprised in the title above referred to reserving out of the premises to the Commissioners a yearly rentcharge of £12,000 for the period of ten years from the 1st day of April 1959 charged on and issuing out of the property hereby transferred and to be paid without any deductions except for property or income tax by equal yearly payments on the 31st day of March in every year the first payment of £12,000 for and in respect of the full year commencing on the 1st day of April 1959 to be made on the 31st day of March 1960 and the last payment to be made on the 31st day of March 1969. 2. Land Securities hereby covenant with the Commissioners that Land Securities will at all times hereafter during the continuance of the term thereof pay the said yearly rentcharge (including the said sum of £12,000 for and in respect of the said full year commencing on the 1st day of April 1959) at the times hereinbefore appointed for payment thereof. 3. For the removal of doubt it is hereby declared that in the event of the exercise in any manner whatsoever by the Commissioners of their powers or any of them under Section 121(4) of the Law of Property Act 1925 the surplus of all moneys received by or under or by virtue of or arising in consequence of the exercise of the said powers or any of them after satisfaction of all sums to which the Commissioners may be entitled as rentcharge-owners hereunder shall in all circumstances be held in trust for and payable to Land Securities. 4. It is hereby further declared that the rights of the Commissioners under Section 121(4) of the Law of Property Act 1925 shall continue in being for so long as any part of the rentcharge herein reserved remains unpaid notwithstanding the expiration of the period of ten years hereinbefore mentioned."

A There then followed covenants by Land Securities on which nothing turns.

It will simplify the matter to consider it as though the Commissioners had disposed of the reversion to a single long lease at a rent of £40,000 per annum in consideration of a rentcharge of £96,000 payable annually for ten years supported by a covenant by Land Securities for its payment.

In the years of assessment 1959–60 to 1963–64 inclusive, Land Securities in
B making payments of the rentcharge deducted income tax under s. 177 of the Income Tax Act 1952. The question on this appeal is whether, and if so to what extent, the income tax was properly deductible. To the extent that it was properly deducted the Church Commissioners as a charity are entitled, by the effect of s. 447(1)(*a*) of the 1952 Act, to recover it from the Commissioners of Inland Revenue.

C The Commissioners of Inland Revenue refused the Church Commissioners relief under s. 447. The Church Commissioners appealed to the Special Commissioners who allowed the appeal. The Crown appealed by way of Case Stated and on 25th July 1974 Megarry J. gave judgment dismissing the appeal. From that judgment the Crown appeals.

Before the Special Commissioners evidence was adduced, and admitted
D *de bene esse*, regarding the course of the negotiations leading to the making of the agreement and the basis on which the Church Commissioners concluded that the bargain would be commercially satisfactory to them. The Special Commissioners, whose decision in this regard was affirmed by Megarry J., took the view that the evidence was inadmissible. Let us say at once that, whether admissible or not, the evidence appears to us not to assist in the determination
E of the question. We will deal with this later in our judgment.

The instalments of rentcharge payable pursuant to the agreement of 5th January 1960 have already been the subject of litigation between Land Securities and the Commissioners of Inland Revenue. In that litigation as well in this Court(1)([1968] 1 W.L.R. 1446) as in the Chancery Division([1968] 1 W.L.R. 423) the question at issue was dealt with as a question whether the instalments
F were payments of income falling within s. 177 of the Income Tax Act 1952. This Court (Danckwerts, Salmon and Fenton Atkinson L.JJ.), reversing the decision of Cross J., held that the payments were of income within s. 177. We will have to refer to the judgments of the Court of Appeal in that case later in this judgment. On appeal to the House of Lords the House allowed the appeal but on a point not dealt with by the Court of Appeal. The question which fell
G to be answered was whether, in computing the profits of Land Securities (which was an investment company) for the purposes of profit tax, the payments were properly deductible. The House of Lords answered that question in the negative, not because they were not annual payments, but because the payments were made for the purpose of acquiring capital assets and so were not proper items to debit in the computation of Land Securities' profits.

H It was the submission of the Crown on this appeal that whenever property is sold for a series of sums certain over a period certain it must inevitably follow that part of each sum is capital and part income. Such is the nature of the financial calculation involved that part of each sum represents an instalment of the price of the property and part represents interest on the outstanding amount of that price. Section 177 charges only so much of each payment as is

(1) 45 T.C. 495.

(Stamp L.J.)

income and it is, so the argument runs, necessary to dissect each payment for the purpose of ascertaining its income content. Furthermore, the burden of showing that the Church Commissioners are entitled to recover tax is upon them and, if there is no means of calculating how much income tax was properly deducted, they must wholly fail on their s. 447 claim.

It is, we think, right to point out in parenthesis that in the instant case, subject to any difficulty they might have in recovering from Land Securities any sum wrongly deducted, it makes no difference to the Church Commissioners whether the payments are to be treated as wholly consisting of capital or wholly consisting of income, or partly of one and partly of the other; for, to the extent that the payments are not income, they bear no income tax, which accordingly ought not to have been deducted, and to the extent that they are income the Church Commissioners, being exempt from tax, may recover the amount deducted from the payments.

Section 177 of the Income Tax Act 1952 provides as follows:

> "(1) This section applies to the following payments, that is to say—(*a*) rents under long leases; and (*b*) any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land, not being rent under a short lease or an annuity within the meaning of the Tithe Acts, 1936 and 1951. (2) Any payment to which this section applies shall, so far as it does not fall under any other Case of Schedule D, be charged with tax under Case VI of Schedule D and be subject to deduction of tax under Chapter 1 of this Part of this Act as if it were a royalty or other sum paid in respect of the user of a patent. (3) . . . "

It is common ground between the parties that not every sum which is payable annually falls within that section but only so much thereof as is income. If you have the simple case of a contract to buy land for £10,000 payable by ten annual instalments of £1,000 each together with interest at 5 per cent. per annum on the amount for the time being outstanding, the several instalments of £1,000 have not the character of income and are not "annuity" within the meaning of the section and are not taxable.

Megarry J. in the Court below subjected the relevant case law to a careful analysis and we will not travel again over the whole field. Some of the cases are not easy to reconcile but we extract from them the following propositions.

First, it is, we think, common ground, or if it is not it is established by authority, that in determining whether sums payable annually are to be regarded as wholly or partly income for the purposes of income tax one must ascertain the true legal nature of the transaction or agreement between the parties which is the source of the payments and not the labels which the parties put upon the sums payable: see, for example, the judgment of Stirling L.J. in *Scoble* v. *Secretary of State for India*[1] [1903] 1 K.B. 494, at page 503, and all the speeches in the House of Lords which proceeded upon that basis. This proposition is no doubt easier to state than to apply; but in none of the cases to which we have been referred has it been doubted. It is the true legal result of the transaction with which one is concerned and not its financial result: see *per* Sir Wilfrid Greene M.R. in *Sothern-Smith* v. *Clancy*[2] 24 T.C. 1, at page 6.

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(1) 4 T.C. 618, at p. 621. (2) [1941] 1 K.B. 276.

Secondly, if there be an agreement for the sale of property for an agreed principal sum which is to be paid over a period of years by instalments, the aggregate of which is equal to the principal sum, then neither the instalments nor any part of them is income exigible to income tax: see, for example, *Foley* v. *Fletcher* (1858) 3 H. & N. 769 and *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79. Although one may think that the agreed principal sum represents more than the value of the property sold and that part of it, and so of each instalment, was the price of the convenience of getting the payment postponed the real legal, as distinct from the financial, nature of the transaction is a sale for a price payable by instalments.

Thirdly, if a principal sum be paid as the price of the purchase of a terminable "annuity", the whole of each annual payment is to be regarded as income and liable to income tax. As Sir Wilfrid Greene M.R. pointed out in *Sothern-Smith* v. *Clancy*(1), in such a case the legal nature of such a contract is beyond question. The property in the principal sum passes absolutely to the recipient of that sum; no relationship of debtor and creditor with regard to that sum is ever constituted. The sum as a sum ceases to exist once it is paid. Its place is taken by the promise to pay the annuity and the annuitant's only right is to demand payment of the annuity as it accrues due. The financial result of the transaction will, however, be that the recipient of the annual payments will receive by the end of the period of years a sum equal to the amount which he paid together with a sum in respect of interest, and if each annual payment is struck with tax he will in one sense be paying tax on capital. "Nevertheless", remarked Sir Wilfrid Greene M.R.(2),

> "it has throughout been assumed by the Courts that such payments are liable to tax (see . . . *Coltness Iron Co.* v. *Black*(3), (1881) 1 T.C. 287, at page 308, *Jones* v. *Commissioners of Inland Revenue*(4), 7 T.C. 310, at page 314, *Perrin* v. *Dickson*(5), 14 T.C. 608, at page 627; the reasoning in *Scoble's* case, 4 T.C. 478 and 618, seems to be based on the same view)."

To these citations we would add a reference to the speech of Lord Blackburn in *Coltness Iron Co.* v. *Black* 1 T.C., at page 321, and cite a further passage from Sir Wilfrid Greene M.R.'s own judgment in *Sothern-Smith* v. *Clancy*(6):

> "If the law were that in the ordinary case of an annuity for a term of years, the nature of the financial calculation involved stamped part of the payment as a capital payment, leaving only the interest element to be taxed on the ground that an annuity is only taxable in so far as it is a profit, the position would be simple and perhaps not unjust . . . But I do not feel myself at liberty in this Court to adopt any such principle."

Fourthly, if there be an agreement for the sale of property for an agreed principal sum to be paid over a period by annual payments, the aggregate of which exceeds the amount of the principal sum and which are calculated so as to include interest on the amount for the time being outstanding at an agreed rate, income tax is exigible only on so much of each payment as consists of interest: see *Scoble's* case.

Standing in the way of the submission of the Crown that whenever property is sold for a series of sums certain over a period certain it must inevitably follow that part of each sum is capital—or, as we prefer to call it, an instalment

(1) 24 T.C. 1. (2) *Ibid.*, at p. 7. (3) 6 App. Cas. 315.
(4) [1920] 1 K.B. 711. (5) [1930] 1 K.B. 107. (6) 24 T.C. 1, at p. 7.

(Stamp L.J.)

of a principal sum—and part income there is, as we have indicated, a formidable array of authority, including at least one decision binding on this Court, namely, that in *Commissioners of Inland Revenue* v. *Ramsay*(1); and in our judgment it is not open to this Court to accept that the law is what was described by Sir Wilfrid Greene M.R. in *Sothern-Smith v. Clancy*(2) as "simple and perhaps not unjust". We would respectfully adopt a passage in the judgment of Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay* as correctly setting out the law(3). "If", he said,

> "a man has some property which he wishes to sell on terms which will result in his receiving for the next twenty years the annual sum of £500, he can do it in either of two methods. He can either sell his property in consideration of a payment by the purchaser to him of an annuity of £500 for the next twenty years, or he can sell his property to the purchaser for £10,000, the £10,000 to be paid by equal instalments of £500 over the next twenty years. If he adopts the former of the two methods, then the sums of £500 . . . are exigible to Income Tax. If he adopts the second method, then the sums of £500 . . . are not liable to Income Tax . . . The question which method has been adopted must be a question of the proper construction to be placed upon the documents by which the transaction is carried out."

In *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (1946) 30 T.C. 11 Lord Greene M.R. spoke to the same effect(4):

> "In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable. It is sufficient to refer to the quite common case where property is sold for a lump sum payable by instalments. If a piece of property is sold for £1,000 and the purchase price is to be paid in ten instalments of £100 each, no tax is payable. If, on the other hand, the property is sold in consideration of an annuity of £100 a year for ten years, tax is payable. The net result from the financial point of view is precisely the same in each case, but one method of achieving it attracts tax and the other method does not."

In the instant case the Church Commissioners did not sell their reversion for a principal sum of £960,000 payable by ten instalments of £96,000 each but in exchange for ten annual payments of £96,000. Although the financial result was precisely the same, the legal result was different. Just as in the purchase of an annuity the purchase price has ceased to exist, so here there never was a principal sum of which the payments could be said to be instalments, and, consistently with authority, we can only hold that the whole of each payment of the rentcharge was income. To adopt the Crown's submission that part of each payment was income and part the payment of a principal sum would involve turning the transaction upside down and holding that the real legal effect of the transaction was the sale of the reversion for some unspecified sum of an amount far less than £960,000 payable by ten instalments of an unspecified amount together with interest at an unspecified rate. Mr. Potter on behalf of the Crown did not quail from this conclusion. He urged that by applying an appropriate rate of interest an actuary could calculate the principle sum which with interest at that rate would by ten annual instalments produce £960,000 and, proceeding from there, could calculate how much of each payment consisted of

(1) 20 T.C. 79. (2) 24 T.C. 1. (3) 20 T.C. 79. at p. 98.
(4) 30 T.C. 11, at p. 16.

principal and how much of interest on the principal, the proportion of interest in each payment of course decreasing from year to year by the effect of the reduction of the principal sum. Apart from the difficulty of finding an appropriate rate of interest, which would, we suppose, be dependent upon the view which would have to be taken of the likely trend of interest rates at the date of the agreement and the solvency of the payer, to adopt this course would in our judgment be to make for the parties an agreement different from that which they in fact made.

In support of the submission that part of the payments of £96,000 fell to be regarded as an instalment of payment of the purchase price of the reversion, the Crown relied principally upon three cases: *Scoble* v. *Secretary of State for India*(1) [1903] A.C. 299, *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276 and *Vestey* v. *Commissioners of Inland Revenue*(2) [1962] Ch. 861. Because of what has since been said about *Scoble's* case, we must refer shortly to the facts of that case. There was an agreement whereunder the East India Company had an option, which was exercised, to buy at a price to be ascertained as therein mentioned the shares or stock of a railway company which was carried on on property let to the railway company for a term of 99 years. The East India Company also had the option, also exercised, instead of paying the ascertained price in one lump sum, to pay an "annuity" so described, for the then residue of the 99 years. As we see it, the two important features of that case were these: first, by the very terms of the agreement the annual amount of the "annuity" to be paid was to be ascertained by taking a rate of interest which was to be determined(3)

> "by the average rate of interest during the preceding two years received in London upon public obligations of the East India Company and which shall be ascertained by reference to the Governor or Deputy-Governor of the Bank of England";

secondly, and this, of course, inevitably follows from the manner in which the annual amount was to be calculated, the aggregate of the annual payments during the residue of the period exceeded the amount of the ascertained price, the excess of course representing interest at the ascertained rate. It was conceded that income tax was payable upon so much of each payment as consisted of interest; but the payer sought to deduct income tax on the whole of each payment, particular reliance being placed upon the use of the word "annuity" and on a passage in the judgment of Pollock C.B. in *Foley* v. *Fletcher*(4): "if the plaintiff had sold her estate for an annuity, so calling it, the annuity would have been liable to income tax". Now if ever there was a case of a purchase of property for a price payable by equal payments consisting of principal and interest, it was that case. The contract on the face of it was of such a nature that you could say on reading it that it was a contract under which a debt was made payable by instalments with interest and so income tax was not payable upon so much of the annual sum as consisted of a mere payment of an instalment of the ascertained debt. We do not find it surprising that both in the Court of Appeal and the House of Lords the case was dealt with rather summarily. It might, perhaps, be put in another way, but only for the purpose of emphasis, by saying that the agreement was by its terms one by which a principal sum was to be paid over a period certain by equal payments each of which was to consist in part of principal and as to the rest of interest at a specified

(1) 4 T.C. 478 and 618. (2) 40 T.C. 112. (3) 4 T.C. 478, at p. 480.
(4) 3 H. & N. 769, at p. 780.

(Stamp L.J.)

rate, on the amount of the outstanding principal. So far as relevant, the transaction had the legal character of what is today sometimes called an instalment mortgage. *Scoble's* case(1) is authority, if such be needed, for the proposition that the fact that a periodical payment is expressed to be an annuity or annual payment does not determine its character for the purposes of the Income Tax Acts and that you must examine the transaction to determine its true legal nature and not be bound by mere words. We can find nothing in that case which throws doubt on the statement of the law to be found in the passages from the judgments of Lord Greene M.R. and Romer L.J. to which we have referred.

Nor, in our judgment, does the *Goole* case(2) take the matter any further. There the Judge held that the amount by which the aggregate of the annual payments exceeded the amount which in the view of the Judge was the amount of the liability which fell to be discharged was income. Again the true legal nature of the transaction was held to be one by which a liability to pay a sum of money was to be satisfied by instalments in which interest had been included.

This brings us to *Vestey* v. *Commissioners of Inland Revenue*(3) [1962] Ch. 861 decided by Cross J. We will summarise the facts of that case in the words of Megarry J. in the instant case(4):

> "There the owner of some shares entered into a written contract to sell them to the trustees of a family settlement for £5,500,000, to be paid 'without interest by 125 yearly instalments of £44,000'. If the purchaser defaulted for 90 days in paying any instalment, all the remaining instalments were to become immediately payable with 4 per cent. interest. The shares were worth about £2,000,000 at the time of sale. Extrinsic evidence showed that prior to the sale the trustees had been advised that the shares were worth this sum, and that if, as was proposed, they were to be sold in consideration of annual payments for a long period such as 125 years, a 2 per cent. rate of interest should, on certain assumptions, be taken, thereby yielding a payment of £44,278 a year for 125 years, which could be rounded down to £44,000."

Cross J., affirming the Special Commissioners, treated the transaction as a sale of the shares for £2,000,000 payable by 125 instalments consisting of principal and interest. Cross J., founding himself, we think, on *Scoble's* case, took the view that the passages we have quoted from Lord Greene M.R.'s judgment in the *Wesleyan* case(5) and Romer L.J.'s judgment in the *Ramsay* case(6) were not correct. In doing so he attached some importance to a remark made by Lord Greene M.R. himself in *Sothern-Smith* v. *Clancy*. There Lord Greene M.R. had said this(7):

> "If the transaction be one under which A, being or becoming indebted to B for a sum of £1,000, agrees with B to repay this sum by ten yearly instalments, or if A being the purchaser of the property from B for £1,000 agrees to pay the purchase price by ten yearly instalments, the 'real nature' of the transaction from the legal point of view is that A is contracting to pay by instalments in the one case a debt and in the other a purchase price. In such cases the very nature of the legal relationship constituted by the contract prevents the annual payments from being anything but payments of capital."

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(1) 4 T.C. 478 and 618. (2) [1942] 2 All E.R. 276. (3) 40 T.C. 112.
(4) Page 535 *ante*. (5) 30 T.C. 11. (6) 20 T.C. 79. (7) 24 T.C. 1, at p. 6.

There then followed the passage to which Cross J. attached importance[1]:

> "If to the instalments there is added an element of interest, that element would presumably attract tax as being an annual profit or gain—this would appear to be the result of *Scoble* v. *Secretary of State for India*[2] . . . and *Perrin* v. *Dickson*[3] . . ., although in *Foley* v. *Fletcher*[4] . . . the opposite view was expressed."

Cross J. found in that passage an indication that Lord Greene M.R. might have thought that what he had said in the *Wesleyan* case[5] was wrong and that where the aggregate of the annual payments exceeds the true value of the property there must, on the authority of *Scoble's* case, be an element of interest. In view of Lord Greene M.R.'s earlier remarks in the very same case of *Sothern-Smith*, where he rejected "the simple and perhaps not unjust" approach, we cannot attach that significance which Cross J. found in the passage to which he referred. As we have indicated, our view of the earlier authorities constrains us to reject the approach adopted by Cross J. in that case.

In the instant case the Special Commissioners made findings of fact on the evidence which they admitted *de bene esse* which we will summarise as Megarry J. did. They found that in 1956 the Church Commissioners offered to sell the property, but Land Securities were not prepared to buy. Later the chairman of Land Securities said that he was prepared to purchase the properties in exchange for rentcharges but he would on no account buy them for a lump sum. The Church Commissioners considered various aspects of this proposal, and were willing to accept it if the rentcharges were large enough to maintain the existing income of the taxpayers from the properties and also to provide a sinking fund which, when the rentcharges ended, would at least suffice to maintain that income. In the course of considering the proposal, various capital values of the properties were assumed by officers of the Church Commissioners and also various interest rates, these being important, of course, in relation to building up the sinking fund and to the yield to be obtained from it. Thus, one calculation showed that if a 6 per cent. basis was adopted, the total rentcharge would be £90,000 a year and the equivalent capital value was £666,666, whereas on a 5 per cent. basis the figures were £103,000 a year and £800,000, and on a 4½ per cent. basis £112,000 a year and £888,888. These percentages could, as a matter of valuation, also be expressed in the form of a number of years' purchase, and in the end the deal settled down to being on an 18 years' purchase basis, which is the equivalent of an interest rate of 5·55 per cent., yielding rentcharges of £96,000 a year and an equivalent capital value of about £720,000. These figures appeared in correspondence with Land Securities, who were also sent a tabular statement which set out in separate columns for each property various details of the rents, the "purchase price", the "rent" charge and so on.

There is, however, nothing in the correspondence to show that there was ever any concluded agreement between the parties other than that embodied in the agreement dated 5th January 1960. The negotiations show, as might have been surmised, that this was not a sale for £960,000 payable by instalments with interest but for ten annual sums of £96,000 amounting to £960,000 and that one of the parties would not agree to sell for a principal sum of a lesser amount payable by instalments of principal and interest. The Crown does not suggest that the agreement did not contain the true bargain between the parties,

(1) 24 T.C. 1, at p. 6. (2) 4 T.C. 478 and 618. (3) 14 T.C. 608.
(4) 3 H. & N. 769. (5) 30 T.C. 11.

(Stamp L.J.)

and in our judgment the extrinsic evidence is nothing to the point in ascertaining the real legal effect of the agreement. Nor can we see any relevant difference between the purchase of a terminable rentcharge in exchange for a reversion, which in our judgment was the real legal effect of this transaction, and the purchase of a terminable annuity in exchange for cash. The transaction here was nothing more nor less than the replacement of one income-producing property, namely, the reversion, for another income-producing property, namely, the rentcharge allied with the covenant to pay its amount. The fact that the latter property is wasting in its nature, or more wasting than the former property, does not deprive its produce of the character of income, any more than exhaustion of minerals deprives a mineral rent of that character.

We turn to refer to the appeal in the *Land Securities* case(1). Cross J. had followed his decision in the *Vestey* case(2) and directed a reference to the Special Commissioners to determine by extrinsic evidence how much of each payment represented income. In the Court of Appeal each of the Judges expressed the view that payments of rentcharges were *prima facie* income and that since there was no agreement for payment of a capital sum there was nothing to rebut that *prima facie* view. Because we have, perhaps quite unnecessarily by a longer route, come, in effect, to precisely the same conclusion, we need not consider what was not the subject of any argument before us, namely, whether the decision of this Court in that case, reversed by the House of Lords on a quite different point, is binding on us.

There was, in the course of the hearing of this appeal, some discussion on whether it makes any difference that the consideration for sale was a "rentcharge" and not an "annuity", and we have assumed in favour of the Crown that it does not.

There is one further observation we would make. In the context of the question whether annual payments are income and so fall within s. 177, we think, with all respect to those who have used such expressions, that references to "capital", the purchase of a "capital" asset or instalments of "capital" tend to introduce confusion. Although we agree in general with the judgment of Megarry J. in the instant case, we have for this reason not found it easy to accept without qualification his summary of the law at [1975] 1 W.L.R., at page 269(3). In the context of s. 177 one is not concerned with the treatment of payments or receipts in the accounts of a taxpayer, and we think it inappropriate to describe an asset sold as a "capital" asset, a description which we think adds nothing to the solution of the problem, and for the same reason where an obligation to pay a debt is incurred we think it simpler not to describe the obligation as a "capital" obligation but as an obligation to pay the principal sum. The relevant dichotomy is, we think, between principal and interest.

The appeal is dismissed.

Nolan Q.C.—Would your Lordships say that the appeal is dismissed with costs?

Russell L.J.—That must follow, Mr. Potter.

Potter Q.C.—I cannot resist that. My Lords, may I apply for leave to take the matter to the House of Lords?

Russell L.J.—We had a feeling that we were really being used as an Irish bank on which you were going to change feet. But tell me this: I have been

(1) 45 T.C. 495. (2) 40 T.C. 112. (3) Page 540 *ante*.

A doing some very rough calculations. On the assumption that we are right, then the Church Commissioners have been kept out of a lot of money for a number of years. If we are upheld in the Lords, if we give leave, will the Church Commissioners get any interest?

Potter Q.C.—I rather understood that the Church Commissioners have already had the money.

B **Nolan Q.C.**—My Lord, we have had the money in two instalments, effectively. The Crown, at a fairly early stage in the litigation—I cannot remember precisely when—made their own calculation of what they regarded as the interest element in these payments and paid to the Church Commissioners tax upon that element. The rest of the tax withheld from the payments was received by the Church Commissioners after the decision of the Special Com-
C missioners in the appeal which has come before your Lordships. Both payments, I am instructed, were made without interest; so that it is true to say that the Church Commissioners were out of their money, with no interest on it, for a substantial number of years.

Russell L.J.—If they were still out of their money, we might have invited the Crown to have agreed to pay interest at least from now on. But that point
D does not arise.

Nolan Q.C.—No. We have had all our money since the Special Commissioners' hearing.

Potter Q.C.—As your Lordships appreciate, it is a matter with a good deal of money at stake. It is a very important principle. The authorities are certainly inconsistent one with another, and your Lordships have been largely guided
E by Lord Greene M.R.'s statements which, as your Lordships have indicated, though possibly not binding, apply as authority in this Court. For those reasons, I submit that it would be proper to grant leave.

Russell L.J.—Do you think you will get the whole situation cleared up if you go to the House of Lords?

Potter Q.C.—We hope we will get the whole situation cleared up if we go to
F the Lords.

Russell L.J.—What say you, Mr. Nolan?

Nolan Q.C.—My Lord, it might be said against that that the principles applied by your Lordships in this case have been considered and approved in a very large number of earlier cases, including at any rate two (namely, the *Scoble* case(1) and the *Wesleyan and General* case(2))t hat have been to the House of
G Lords. But if your Lordships think, none the less, that leave should be granted in the public interest, may I put it to your Lordships that the case is one in which my clients should be spared the further risk of costs. They have, as your Lordships have observed, no real interest in the principle which the case raises. They are, of course, a charitable body with many calls upon their funds. Therefore, my Lord, I would ask that if leave is granted, it should be on terms.

H **Russell L.J.**—What do you say to that, Mr. Potter?

Potter Q.C.—Of course, we recognise that it is perfectly usual in such a case to impose terms.

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(1) 4 T.C. 618. (2) 30 T.C. 11.

Russell L.J.—The Church Commissioners have substantial funds, but they have substantial obligations. A

Potter Q.C.—Quite so, my Lord.

Stamp L.J.—Which are not becoming any easier to perform.

Potter Q.C.—Yes. But your Lordships appreciate that I am instructed not to volunteer to your Lordships any undertaking.

(*The Court conferred.*) B

Russell L.J.—Mr. Potter, you may have leave to appeal on condition that the Crown does not seek to upset the costs ordered below and in this Court.

Potter Q.C.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came before the House of Lords (Lords Wilberforce, Morris of Borth-y-Gest, Kilbrandon, Salmon and Fraser of Tullybelton) on 3rd, 4th, 5th, 6th and 10th May 1976, when judgment was reserved. On 7th July 1976 judgment was given unanimously against the Crown, with costs. C

(1) *D. C. Potter Q.C.* and *D. K. Rattee* for the Crown. It is a perfectly proper, though not the only, way for trustees wishing to sell charitable land to sell it for a rentcharge, and s. 39 of the Settled Land Act 1925 states that the conveyance shall distinguish the part attributable to capital and that attributable to interest. This shows clearly that not merely can there be a capital element in a rentcharge but in certain circumstances it is obligatory to state what it is; see also ss. 84, 85, etc. D

Section 177 of and Schedule D, Cases III and VI, to the Act of 1952 impose liability on sums that are in their nature income. They do not convert capital into income. A rentcharge may be either capital or income, or partly the one and partly the other. To determine the character of a rentcharge one looks not merely at the document creating it, or at the contract of which that document was the completion, but at all the circumstances of the case. E

The principle applied by Cross J. in *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* 45 T.C. 495; [1968] 1 W.L.R. 423; [1968] 1 W.L.R. 1446; [1969] 1 W.L.R. 604 applies here. The House is invited to disapprove the statement of Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11; [1946] 2 All E.R. 749, 751. As to the *Land Securities* case 45 T.C. 495, first, ignoring the *dictum* of Lord Donovan, at page 516, which is wrong, and looking at the ratio of the case, it is authority for the proposition that the identical sums had a capital character when they left Land Securities. That does not necessarily determine that they had a capital character when they arrived at the taxpayers, but it is some support for that proposition. Secondly, as to Lord Donovan's last paragraph, the present litigation arises under s. 447 of the Act of 1952: a claim by a charity for repayment of tax on income. The onus is on the charity to show that part or all of the payments were received as income. It may be that the charity simply fails on the evidence to establish that any part was income. F G H

(1) Argument reported by Michael Gardner Esq., Barrister-at-law.

The mere fact that the word "rentcharge" is used does not of itself make it income. [Reference was made to the Act of 1952, ss. 123 (Schedule D), Case III, and 318, and *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29; [1938] 2 K.B. 482.] On the facts and the principle involved, *Mallaby-Deeley* v. *Commissioners of Inland Revenue* (1938) 23 T.C. 153 is not very far removed from the present case. Section 177 of the Act of 1952, like Schedule D, Case III, and ss. 169 and 170, only comes into operation after one has determined, under the general law, that the payment, or some part of it, is income rather than of a capital nature. There was no dissection in *Mallaby-Deeley*, to which the answers are that no submission in the case that there should be dissection can be traced and the new sums were substituted for obligations in the future of a capital nature. The Crown relies on *Mallaby-Deeley* and *British Salmson* to submit that, whereas Lord Donovan's ratio in *Land Securities* 45 T.C. 495 is correct and should determine this case, his *dictum*, at page 516, is not justified by the authorities, which were not cited to the House in that case. [Reference was made to *Foley* v. *Fletcher* (1858) 3 H. & N. 769.] The Crown relies on the judgments of Rowlatt J. and Lord Hanworth M.R. in *Perrin* v. *Dickson* 14 T.C. 608; [1929] 2 K.B. 85; [1930] 1 K.B. 107 to resist any suggestion that *Scoble* v. *Secretary of State for India* 4 T.C. 618; [1903] A.C. 299 was decided on its particular facts, that is, that there was a pre-existing debt which was converted into an annuity. Contrast *Sothern-Smith* v. *Clancy* 24 T.C. 1; [1941] 1 K.B. 276, where, at page 12, Goddard L.J. makes the true distinction between *Sothern-Smith* v. *Clancy* and *Perrin* v. *Dickson*.

On the main question in this appeal the House is invited to adopt the following as a general principle of income tax law: "Where capital is transferred, or a capital obligation is discharged, or a capital payment is made, in consideration of a series of cash receipts of fixed amount over a fixed period so that the total debt may be immediately calculated, then those cash receipts are in the hands of the recipient partly income and partly capital, whether the parties call the series of cash receipts 'rent' or 'annuity' or 'annual sums' or 'rentcharges' or 'instalments', and whether the payments are secured or unsecured."

Scoble v. *Secretary of State for India* 4 T.C. 618 is a case of general application, not limited in the way in which Danckwerts L.J. in the *Land Securities* case 45 T.C. 495, 509–11, said it was. *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413 shows that in *Scoble*-type cases one does not need a predetermined price; it takes *Scoble* that much further. It is indistinguishable from *Scoble*, but shows that attempts to limit the applicability of *Scoble* are misconceived.

There are two other "dissection" cases: *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276 and *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112; [1962] Ch. 861. The latter was correctly decided, and the present case is indistinguishable from it in any material particular. The House should disapprove the statements of Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79, 98 and Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (1946) 30 T.C. 11, 16. In the *Land Securities* case 45 T.C. 495, 510, Danckwerts L.J. distinguished *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112 on a false ground.

The test of whether sums are capital or income is whether one can add them up and arrive at a fixed amount. It is not conclusive that the parties thought that they had an income character. *Lomax* v. *Peter Dixon & Son Ltd.*

25 T.C. 353; [1943] K.B. 671 shows that one looks at all the circumstances of the case, and that in a commercial case the premium may be income, may be capital. The case is authority for dissection. As to "discounts", see the Act of 1952, s. 123, but it is clear from the judgment of Lord Greene M.R. in *Lomax* v. *Peter Dixon & Son Ltd.* that this means only discounts of an income character. The case shows that there is consistency between the approach which the Crown is here suggesting and that which is adopted towards premiums on debts.

The principle in *Scoble* v. *Secretary of State for India* 4 T.C. 618 does not depend on the fact that a capital sum had been agreed and then converted into annual payments which necessarily included an interest element (see also *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413). The Crown relies on *Sothern-Smith* v. *Clancy* 24 T.C. 1 as pointing the distinction between cases where there are payments of a predetermined amount and cases where there are not. Megarry J. was bound by *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276 and *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112. He was not entitled to distinguish the *Goole Corporation* case on the ground on which he did, and *Vestey* is not distinguishable from the present case. There is no reason (see page 536 *ante*) for any distinction between discharge of a capital obligation and other transactions with a capital aspect. The Crown repeats its contention, at page 536 *ante*, that from the creditor's point of view a debt that is owed to him is as much of an asset as his land or his shares are. The ratio of Megarry J.'s judgment is at page 541 *ante*. The Court of Appeal held themselves to be constrained by authority. *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112 was correctly decided. It is in line with a respectable line of authorities and it governs the present case.

The Crown makes the following observations on the form of the transfer here. 1. The total amount is only a matter of arithmetic. 2. There is nothing on the face of the document to indicate that the rentcharge is to be income. 3. In fact, the rentcharge exceeds the income of the property. 4. The rentcharge is only consideration for the acquisition of a capital asset. 5. Were the taxpayers not a privileged charity, under ss. 29 and 39 of the Settled Land Act 1925, had they followed the mandatory provisions of s. 39, dissection would be compulsory —but this is saved by the finding of the Commissioners that the taxpayers have all the powers of a freeholder. 6. Had ss. 29 and 39 of the Settled Land Act 1925 applied here, dissection would have been compulsory, but that is not the case: see also ss. 84 and 85.

So on the face of the document there are only two permissible conclusions in the light of the decided cases: (i) that the sum of £12,000 is entirely capital (*Scoble* v. *Secretary of State for India* 4 T.C. 618; *Foley* v. *Fletcher* 3 H. & N. 769; *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413 and *Perrin* v. *Dickson* 14 T.C. 608 are in favour of this); (ii) that dissection is to be made as in *Foley*, *East Indian Railway Co.* and *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112. On the face of the conveyance it is not possible to arrive at the conclusion that the sum is entirely of an income character. The word "rentcharge" may as a word carry the connotation of income, but that is not to say that by making the sum into a rentcharge with security one in some way converts the capital quality of the payments into income. If one wants to have income, one can use income language (*Mallaby-Deeley* v. *Commissioners of Inland Revenue* 23 T.C. 153). It is not correct to say that the concept of a rentcharge is *prima facie* an income concept. It carries an income connotation, but that is a different proposition.

The onus is thus on the taxpayers, seeking repayment of money from the Exchequer, to establish affirmatively that these payments are income, so that income tax at the standard rate is properly deductible from each payment. They cannot do this on the face of the transaction itself. Either side is at liberty to look at the course of the negotiations to see whether something was in the common contemplation on the parties which does confer an income character on the entirety of these payments. When one looks, however, it is the word "capital" which is used on the documents.

The question of dissection is one which should be remitted to the Commissioners.

Michael Nolan Q.C. and *S. J. Oliver* for the taxpayers. The right to a ten-year rentcharge or a ten year annuity is *prima facie* a right to taxable income. There is nothing in the circumstances of the present case to displace that *prima facie* inference. In particular, the fact that an annuity or a rentcharge is paid for a consideration, rather than being voluntary, does not displace its character as income.

With regard to the last proposition, the case for the Crown is that when a right to a fixed annual sum for a fixed period is acquired by way of bounty it is income, but that if it is acquired for cash or the transfer of property it must be partly income and partly capital. But the Act does not make such a distinction: it is a major heresy. The taxpayers' proposition has been accepted by the courts, including the House of Lords, for over 100 years. *Foley* v. *Fletcher* 3 H. & N. 769 was the first case for the clear principle of law that a term annuity was taxable whether it was voluntary or had been purchased with money or the transfer of an asset. The Court of Session and the House of Lords adopted the same principle in *Coltness Iron Co.* v. *Black* (1881) 1 T.C. 287, 307; 6 App. Cas. 315, 330; 18 S.L.R. 221.

Even if there were a capital element in the rentcharges here, that would not protect them from the charge imposed by the Act of 1952. A charge of income tax is sometimes imposed on what is normally regarded as capital: see the Income Tax Act 1842, Sch. A, No. IV; the Public Money Drainage Act 1846, s. 34 (advance to landowners in exchange for rentcharge); the Income Tax Act 1853, ss. 5, 11, 42. Section 182 (1) (*e*) of the Act of 1952 has been described by the Court of Appeal *obiter* as applying to any normal premium on the grant of a lease: see *B. G. Utting & Co. Ltd.* v. *Hughes* 23 T.C. 174, 187–8; [1939] 2 K.B. 231. Sections 177 and 182 were repealed in the reform of the charging provisions by the Finance Act 1963 (see ss. 15, 73, Sch. 13) but s. 22 of that Act introduced a new charge of income tax on premiums. What is capital for the purposes of the Settled Land Act 1925 is not necessarily outside the scope of the Income Tax Acts. [Reference was made to the Act of 1925, ss.39 (2), 45 (mining rents) and to *Coltness Iron Co.* v. *Black* 1 T.C. 287. It is therefore dangerous to approach the Income Tax Acts with preconceived ideas about what is income: those Acts have their own ideas on the subject.

As to Lord Greene M.R.'s statement in *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29, one must begin by looking at every document, but when, as in the present case, the whole transaction is in the contract, then the other documents are seen to be irrelevant. To be capital, the £720,000 must appear in the contract in that form. In the present case, the true nature of the bargain recorded in the contract is that of a bargain for income.

If the contract discloses no capital sum, but solely an income consideration, then that is the end of the inquiry from the taxation point of view. If, however, a lump sum were payable over a number of years by instalments and nothing were said about interest, extrinsic evidence might be required in order to see whether the instalments contained an element of interest. [Reference was made to *Commissioners of Inland Revenue* v. *Ramsay* 20 T.C. 79; *Mallaby-Deeley* v. *Commissioners of Inland Revenue* 23 T.C. 153, 166, 169; *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112.] As to *Foley* v. *Fletcher* 3 H. & N. 769, see *per* Stirling L.J. in *Scoble* v. *Secretary of State for India* 4 T.C. 618, 620–1; [1903] 1 K.B. 494. *Scoble* 4 T.C. 618, 624 is distinguishable on its facts from the present case; it is consistent with the taxpayers' case and supports it in principle. *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413 raised no new principle. The court decided that the sum was a debt to be discharged by instalments. The case supports the taxpayers' principle.

As appears from *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11, one should analyse these transactions on normal legal principles and see where that leads. There are many cases all applying the principle to which it is not necessary to refer. By 1940, the principle had become part of our law; the taxpayers adopt what Sir Wilfrid Greene M.R. said in *Sothern-Smith* v. *Clancy* 24 T.C. 1. See also *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.* 45 T.C. 495.

The Special Commissioners' decision was a correct decision on the agreement, and they were right to exclude the extrinsic evidence. Even if admitted, that evidence is consistent with the taxpayers' case.

Eight propositions summarise the taxpayers' argument. 1. Property may either be exchanged for the right to a term annuity (rather than "sold for an income", the words used in some cases) or rentcharge, the annual payments of which will be only income, or it may be sold for a lump sum price payable by instalments, with or without interest. The authority for that consists of all the cases cited to the House on Case III of Schedule D to the Act of 1952, with the possible exception of *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112. 2. The question which alternatively has been chosen must depend on the true legal nature of the bargain on which the parties have agreed. The taxpayers rely on all the "annuity" cases cited to the House, especially *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11 in the House of Lords, again with the exception of some *dicta* in *Vestey*. 3. In the present case, the parties never intended to agree on a sale for a lump sum. There is only one document in which there is mention of a purchase price, a schedule attached to a letter of 11th November 1959 written on behalf of the taxpayers to the chairman of Land Securities (followed by one of 11th December 1959 summarising the transaction which the parties proposed to carry out). 4. Even if at some stage the parties had had the intention of a sale for a lump sum price, that could not alter the true legal nature of the bargain which they in fact struck when they executed the agreement and transfers. It is not right to go into the extrinsic evidence but if one does there is still no evidence of any intention to sell for a lump sum. For the words "Even if" at the beginning of this proposition the authority is that of Sir Wilfrid Greene M.R. in *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29, 40–1. 5. The true legal nature of the bargain is an exchange of freeholds or leaseholds for term rentcharges. Those rentcharges, measured by the yardstick of the Case III, Schedule D, decisions, are wholly income. 6. Even if the rentcharges had contained a capital element, they would still be rentcharges properly so called, and therefore within s. 177.

The taxpayers' last two propositions are of a more general nature. 7. Whatever may be the demerits of taxing income from wasting assets in full without an allowance for the capital invested in them, it has been part of our law for so long that to disturb it at this stage would create widespread uncertainty and probably produce new and greater anomalies. 8. Whatever may be the demerits of the particular transactions which were under consideration in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11 (or even *Duke of Westminster* v. *Commissioners of Inland Revenue* 19 T.C. 490; [1936] A.C. 1), to overturn the principles established in those cases in favour of a doctrine that one can rewrite a bargain for tax purposes would produce a much greater evil.

Potter Q.C. in reply. On the taxpayers' proposition 1, a rentcharge is not *prima facie* income. It is necessary to distinguish the almost emotive connotation which every word in the English language carries from the true legal condition of a rentcharge. To refer to "rent" immediately gives rise to the concept of income, but it does not follow that it is necessarily income. As to the Settled Land Act 1925, in relation to a settlement made by a life tenant, this is treated entirely as capital. Under ss. 29 and 39 a rentcharge is stated to be so much on the capital side of the line that there is an obligation to state how much is capital and how much income. It is not the security that determines the nature of the payments but the payments themselves.

On the taxpayers' proposition 3, the Crown does not say that seven-year covenants made voluntarily are necessarily income. It says that nothing that the House says in this case should affect the quality of seven-year covenants—a different proposition.

As to *Foley* v. *Fletcher* 3 H. & N. 769 and the references there to a 30-year annuity being taxable in its entirety, those were mere *dicta*. In *Scoble* v. *Secretary of State for India* 4 T.C. 618, however, there was an annuity, and nevertheless the Court of Appeal and the House of Lords determined that it was not entirely income. No one suggested that the use of the word "annuity" was a misnomer. Lord Lindley made a statement, at page 626, which should put paid to any idea that an annuity should be entirely income. There is no magic in the words "annuity" or "rentcharge".

Coltness Iron Co. v. *Black* 1 T.C. 287 is not relevant to the present dispute. It does not make income tax law different from company law or trust law on the matter in issue. It just decided that one does not have to make good a capital asset before estimating the profits of the trade. In so far as s. 60 of the Income Tax Act 1842 and s. 42 of the Act of 1853 (which together created the "tax code") and ss. 34 and 42 (2) of the Land Drainage Act 1846 assist, they assist the Crown rather than the taxpayers. [Reference was made to the Act of 1952, ss. 179 and 182 (1) (*e*), and *B. G. Utting & Co. Ltd.* v. *Hughes* 23 T.C. 174.] As to s. 318 of the Act of 1952, the machinery of deduction does not make all the difference: see s. 177. [Reference was made to the Settled Land Act 1925, s. 37, and *Scoble* v. *Secretary of State for India* 4 T.C. 618.

One should not first look at the evidence in the present case and see whether it is admissible and then reject it. The distinction is between admissibility and weight. All evidence relating to the payments here is admissible.

The taxpayers say that *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413 raises no new principle and is close in terms to *Scoble* v *Secretary of State for India*, but this is on the footing that the *Scoble* principle. is the narrow one.

The part of the passage from Lord Greene M.R.'s judgment in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11, 16, quoted by Cross J. in *Vestey* v. *Commissioners of Inland Revenue* 40 T.C. 112, 121, but omitted by Viscount Simon in the *Wesleyan and General* case 30 T.C. 11, 25, did not have Viscount Simon's wholehearted support. *Vestey* v. *Commissioners of Inland Revenue* is *a fortiori* the present case. There was nothing in the contract there to show that the payments should be divided in a particular way; here there is. There is no real distinction between *Vestey* and the present case unless one starts with the proposition that a rentcharge is necessarily income.

The taxpayers' proposition 1 is heresy. As to 2, it is not a question of the true legal nature of the bargain alone but of all the circumstances. The law on the point as to evidence is well summarised by Megarry J., pages 538–9 *ante*. On the taxpayers' point 3, it is true that the parties never intended to agree in principle on a sale for a lump sum, but that is irrelevant. On 4, as between the parties the true legal nature of the bargain, if reduced to writing, is found by looking at the writing. *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.* 22 T.C. 29 deals with the position where the parties change their minds.

As to the taxpayers' points 7 and 8, the question of taxing wasting assets is different from the question now in issue, and the Crown's submissions do not weaken the authority of *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* 30 T.C. 11 or of the *Duke of Westminster's* case 19 T.C. 490.

Lord Wilberforce—My Lords, the appeal concerns a claim by the Church Commissioners for England ("Respondents") to recover from the Commissioners of Inland Revenue ("Appellants") certain sums representing income tax deducted from rentcharge payments made to the Church Commissioners by Land Securities Investment Trust Ltd. ("Land Securities") and Associated London Properties Ltd. in the years 1959–60 to 1963–64 inclusive. Associated London Properties Ltd. is an associated company of Land Securities and for convenience I can treat all payments as having been made by Land Securities. So far, in all hearings, the Respondents have succeeded in their claim.

I shall have to elaborate upon some aspects of the facts later, but as an introduction they can be simply explained. The Respondents were the owners, in some cases for freehold, in others for leasehold interests, of a number of properties which were let or underlet to Land Securities on long leases. The rents payable by Land Securities to the Respondents came, in aggregate, to £40,000 a year. By an agreement dated 5th January 1960 the Respondents agreed to sell these properties to Land Securities in consideration of what were described as yearly rentcharges issuing out of the properties for a period of ten years from 1st April 1960. There was also a covenant by Land Securities to pay the amounts of the rentcharges. The rentcharges came, in all, to £96,000 a year. It is not disputed that the object of this was to enable the Respondents, while maintaining their current income at £40,000 a year during the ten years, to accumulate the balance in each year so that at the end of the period they would have a capital sum which would yield them at least £40,000 in perpetuity. On their side Land Securities would secure capital assets which would improve the value of their investments. On paying the rentcharges Land Securities deducted income tax in accordance with the Income Tax Act 1952, s. 177(1). There was litigation as regards their own tax position. They claimed that the rentcharges represented a revenue outgoing and could be deducted from their

A gross income for purposes of profits tax. This claim was disputed and came to this House which held that the rentcharges could not be so deducted (*Commissioners of Inland Revenue* v. *Land Securities Trust Ltd.*(1) [1969] 1 W.L.R. 604). Lord Donovan, in his speech, said that he was willing to assume that, as against the Church Commissioners, income tax was deductible from the rentcharges under s. 177 but he did not so decide and the question is entirely B open on this occasion.

If the present issue had to be decided on the terms of the agreement of 5th January 1960, between Land Securities and the Church Commissioners, alone, there would be a strong *prima facie* case in favour of the taxpayers' claim. Section 177 refers to (*a*) rents under long leases; and (*b*) "any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu C duty, . . . or other annual payment reserved or charged upon land". Any payment of these kinds is charged with income tax by deduction, as if it were a royalty or other sum paid in respect of the user of a patent. Then s. 447 gives express exemption from this tax to charities. This provides a strong foundation for the Respondents' claim.

In answer to this, the Crown has two arguments, one general and one D particular on the individual facts of this case. I will deal with the general argument first. This is expressed in the following formula which the Crown invites us to adopt as a general principle of tax law.

> "Where a capital asset is transferred, or a capital obligation is discharged, or a capital payment is made, in consideration of a series of cash receipts of fixed amount over a fixed period so that the total E debt may be immediately calculated, then those cash receipts are in the hands of the recipient partly income and partly capital, whether the parties call the series of cash receipts 'rent' or 'annuity' or 'annual sums' or 'rentcharges' or 'instalments', and whether the payments are secured or unsecured."

My Lords, of this general rule I would say two things. First, it is on the face F of it extremely reasonable. Nothing more apparently correct, just and in accordance with sound principle, can be laid down than that when payment of the purchase price for a capital asset is spread over a number of years, each payment should be treated as containing a capital element and an income element, the latter reflecting the deferred character of the payment. That such a rule has much to commend it was cautiously recognised by Sir Wilfrid Greene G M.R. in 1941 as "simple and perhaps not unjust" (*Sothern-Smith* v. *Clancy* (2) [1941] 1 K.B. 276, at page 285). But as clearly as it appears to be consistent with simple justice so, equally clearly, it is inconsistent with our tax law as it has developed and as it has been applied—to the benefit incidentally of the Revenue which is now arguing for a change.

English tax law has consistently taxed, as revenue, periodical payments of H the kinds enumerated in s. 177, in spite of the fact that they may be payments for wasting assets—i.e., assets the capital value of which is to disappear after a time, and without any distinction (such as the Crown seeks to draw here) between perpetual payments or payments for an indeterminate period, such as the life of a person, and terminable payments, in the sense of payments for

(1) 45 T.C. 495. (2) 24 T.C. 1, at p. 7.

(Lord Wilberforce)

a fixed term. The principle of this was explained with elegance and authority in *Coltness Iron Co.* v. *Black*(1) (1881) 1 T.C. 287 both in the Court of Session and in this House, and since I cannot find that citation from these judgments has been made in recent authority, I may be allowed to quote some passages verbatim.

In the Inner House, the judgment of Lord President Inglis, after stating that the Taxing Statute does not take account of balance sheet principles as to capital and income, but taxes the whole income received—less only working expenses—continues as follows(2):

> "Any other construction of the statute would not only be inconsistent with the leading principle on which it is based and with its express words, but would lead to very embarrassing consequences. A man who employs his whole capital in the purchase of terminable annuities increases his income, and is assessed to the income tax for the full amount of the annuity; but after the step has been taken, he is in practical effect living on his capital, and when the account terminates it will all be gone. He might have left his money on an ordinary investment, and have consumed every year a portion of the capital in addition to the interest. Nay, he might calculate the matter so nicely, that the whole capital would be gone just at the same time that the annuity would terminate. In this case this assessable income would be only the interest accruing annually on the principal sum, gradually diminishing year by year, and would not include the portion of the capital which he chose to expend year by year. But when he purchases an annuity he converts his whole estate into an income which represents no capital but that which he has paid away and exhausted to purchase the income. But the statute takes no heed of his exhausted capital, and makes no deduction from the actual amount of his income on that account."

Similarly, in this House, Lord Blackburn said(3):

> "It has also been sometimes argued that it is very unjust to tax at the same rate a terminable interest such as that in a mine which must at some time be worked out, and a fee simple interest which will endure so long as this world continues in its present state. I will not inquire whether this is just or not. There is much force in the argument on the other side, that if the interest is terminable, so is the tax, and will cease when the interest ceases; but whether just or not, there can be no doubt that the same annual charge is imposed upon a terminal annuity and on one in perpetuity, and, what seems harder, that the same annual charge is imposed upon a professional income earned by hard labour, often extending over many years before any return is got, and when earned precarious as depending on the health of the earner."

There is support in the Income Tax legislation for this approach to the taxation of terminable payments, including rentcharges. In the Income Tax Act 1842, s. 60, Sch. A(IV), Rule 10 contained the predecessor of s. 177, and imposed taxation on (*inter alia*) rentcharges by deduction. This was followed soon after by Land Drainage legislation securing the repayment of capital expenditure by rentcharge payments. The Income Tax Act 1853, s. 42, then makes express provision for relief from tax in respect of a proportion of the rentcharges—a

(1) 6 App. Cas. 315. (2) 1 T.C. 287, at p. 308. (3) *Ibid.*, at p. 321.

A provision which would be quite unnecessary if the rule contended for by the Crown existed, and which is only consistent with the whole of the rentcharges being, otherwise, regarded as income.

My Lords, the position, so firmly taken up, with regard to annuities and rentcharges has certain consequences. It is immaterial for income tax purposes that, for accountancy purposes, payments, e.g., in respect of wasting assets B may be treated as containing a capital element. It is immaterial that, in accordance with equitable principles, or with express provisions in the Settled Land Act 1925 (see s. 39) a proportion of a terminable payment should have to be put aside to capital. The Church Commissioners are an "exempt charity" but if they were not, they would be obliged by ss. 29 and 39 of the Settled Land Act 1925 to segregate a capital element in a terminable payment and to treat C it as capital. But this would be irrelevant for taxation purposes. It is immaterial that a series of payments made to a beneficiary out of a trust fund should be shown to have been made out of the capital of the trust: the whole of these payments may be taxable as income (*Brodie's Will Trustees* v. *Commissioners of Inland Revenue* (1933) 17 T.C. 432; *Jackson's Trustees* v. *Commissioners of Inland Revenue* (1942) 25 T.C. 13). In other words, except in particular D cases where a different rule is stated, all payments which fall within the charging words are *prima facie* taxable as income notwithstanding that, as a matter of accountancy or prudence or trust administration, some part ought to be treated as capital. I have said "*prima facie*" because there are two cases in which the courts have held that although the payment appears to fall within this description income tax is not chargeable on the payment or not wholly chargeable. The E first is where there is a sale for a consideration represented by a principal amount which is payable by instalments. The distinction between such a case and that where the sale is for an annuity or a rentcharge has been recognised by many authorities. I need only refer to its acceptance in this House in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society*(1) [1948] 1 All E.R. 555, at page 557, *per* Viscount Simon approving the much quoted passage from F the judgment of Lord Greene M.R. in the Court of Appeal [1946] 2 All E.R. 749, at page 751. I do not think that the Crown can succeed on the general argument without destroying this dichotomy, but in my opinion they attempt the impossible. On general logical grounds, and perhaps on considerations of an economic character, there may be much to be said for a rule which recognises the existence of an interest element in all deferred capital payments—I think that Cross J. G was attracted by this kind of argument in *Vestey* v. *Commissioners of Inland Revenue*(2) [1962] Ch. 861. But illogical or not (and the consequences of rejecting the dichotomy might introduce other illogicalities) it is too clearly and firmly rooted in the income tax law to be displaced except, in selected cases, by legislation. And it has been, if not without difficulty, at least with fair consistency, applied by the courts. I shall not go through the long list of cases in which the H courts have considered the problem of "income" or "capital" in relation to terminable payments. But leaving aside *Foley* v. *Fletcher* (1858) 3 H. & N. 769 which was decided on demurrer, *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79, *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.*(3) [1938] 2 K.B. 482, *Commissioners of Inland Revenue* v. *Mallaby-Deeley* (1938) 23 T.C. 153, *Sothern-Smith* v. *Clancy*(4) [1941] 1 K.B. 276 all I rest upon the basis that there are two alternatives—instalments of capital, or production of an annual payment—and that the task of the court is to find

(1) 30 T.C. 11, at pp. 25 and 16. (2) 40 T.C. 112. (3) 22 T.C. 29. (4) 24 T.C. 1.

(Lord Wilberforce)

which it is. That this basis is a solid one is borne out by the fact that most of these decisions, as well as that in the *Wesleyan and General Assurance Society* case(1), bear the authority, or contain the judgment of Lord Greene M.R.—a hallmark of gold.

I cannot, therefore, for these reasons accept that the Crown's proposition either represents, or ought to represent, the existing law, and I now must consider their alternative particular argument. This argument involves the proposition that, even though it may be impermissible to predicate, in general, that payments of a purchase price, spread over a number of years, contain a capital element and an interest element, this "dissection", as it has come to be called, is permissible where the true legal character of the bargain, or transaction, calls for it. Dissection is, at least as a plain case, permissible if the parties who are buying and selling a capital asset, having agreed upon a price, then make provision for payment of that price by instalments, the amount of which is so calculated and shown to be so calculated as to include an interest element. Whether there are other possible cases of dissection, i.e., apart from the case where a lump purchase price has been agreed upon, may be a debatable area.

There is no doubt, in my opinion, that the plain case is recognised by authority—*Scoble* v. *Secretary of State for India*(2) [1903] A.C. 299. There was an agreed purchase price for the railway but the Secretary of State had an option, instead of paying the lump sum, of making payment by an annuity spread over a long period "the interest used in calculating the annuity being determined" as prescribed. There was no difficulty whatever in deciding that, under the bargain between the parties, there was a (taxable) interest element and a capital element, and the fact that the word "annuity" was used did not prevent the capital element being recognised, and consequently not taxed. This case has never been doubted or qualified; if it has not been much followed, that is because it is seldom that the case for dissection is so clear as it was there. There is not much light to be derived from *East Indian Railway Co.* v. *Secretary of State for India* [1905] 2 K.B. 413, which seems to have followed *Scoble's* case. *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276 was one where dissection was allowed on the basis that there was a pre-existing capital sum: but *Scoble's* case does not seem to have been cited. *Perrin* v. *Dickson*(3) [1930] 1 K.B. 107 again followed *Scoble's* case on a consideration of the true nature of the bargain, i.e., as one for capital sums carrying interest. *Vestey* v. *Commissioners of Inland Revenue*(4) [1962] Ch. 861 is much more directly relevant, and is the decision on which the Crown chiefly relies. The agreement in that case was for a sale of shares for £5,500,000, to be paid without interest by 125 yearly instalments of £44,000. On the face of it—a face with some cosmetic reconstruction—this was a case of a principal sum payable over a period of years, within Lord Greene M.R.'s first category, and not admitting of dissection. However, evidence was given and admitted (i) that the value of the shares at the time of transfer was approximately £2,000,000 and (ii) that on an actuarial basis, the annual sum payable over 125 years, equivalent to a present value of £2,000,000 and taking interest at 2 per cent., was £43,670. On this, Cross J. felt able to decide that the case was one for dissection of each annual payment between capital and income. This case represents, so far, the high water mark of dissection cases and the Crown seeks to apply it here. I would, for myself, accept this decision as correct, even though I would be unable to follow those portions of the judgment in which the learned Judge

(1) 30 T.C. 11. (2) 4 T.C. 618. (3) 14 T.C. 608. (4) 40 T.C. 112.

A appears to favour a general rule of dissection wherever there is a deferred payment of a purchase price. And on that basis I will consider whether on the same principle the Crown can succeed in the present case.

Before the Special Commissioners the Crown sought to adduce extrinsic evidence outside and beyond the actual contract between the Church Commissioners and Land Securities. The Special Commissioners held that this
B was not admissible, but, in case the courts should take a different view, they allowed it to be assembled *de bene esse*, and they made certain factual findings. Megarry J. admitted this excluded evidence. In Revenue cases, he held, extrinsic evidence is admissible if it tends to show the true character of the transaction: he explained that by this he did not mean that evidence could be looked at for the purpose of treating a transaction of one legal character as
C if it were a transaction of another legal character. He referred to a number of cases in which evidence of this character had been allowed—*Commissioners of Inland Revenue* v. *Mallaby-Deeley* 23 T.C. 153, *Perrin* v. *Dickson*(1) [1930] 1 K.B. 107, *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.*(2) [1938] 2 K.B. 482, *Lomax* v. *Peter Dixon & Son Ltd.*(3) [1943] K.B. 671 and others including *Vestey* v. *Commissioners of Inland Revenue*(4) [1962]
D Ch. 861. In my opinion these authorities support the view taken by the learned Judge and his conclusion was correct. The evidence in question consists of correspondence, file notes and inter-office memoranda relating to the negotiations between the Church Commissioners and Land Securities before the agreement of 5th January 1960 and of a series of findings made by the Special Commissioners after hearing the evidence of the Secretary to the Church
E Commissioners. The significance of this evidence from the point of view of the Crown was that it introduced a figure of £720,000 which, they claimed, represented the "purchase price" and upon which, taking an assumed rate of interest of 5½ per cent., the Commissioners could obtain an income of £40,000 in perpetuity if they were paid rentcharges totalling £96,000 for ten years. Therefore, the Crown claimed the present case was indistinguishable from *Vestey's*
F case and was within the *Scoble*(5) principle. I was impressed by this argument and it came near to convincing me, but the conclusion I have come to, on reflection, is that the case is on the other side of a narrow line.

The essential feature of the negotiations and of the bargain, as shown by the documents, was that Land Securities did not wish, on any account, to pay a lump sum for the properties. This is so found in terms. The Church
G Commissioners, on their side, wished to maintain their existing income by rentcharges for a longer period. The figure of £720,000 was not an agreed purchase price or even an agreed valuation. It was, as I understand it, simply a checking figure in the calculations, worked out on the basis of 18 years' purchase (corresponding to 5½ per cent.) of the existing rents of £40,000. The bargain was always thought of in income terms, and was concluded on income terms,
H and there is nothing in the documents which gives to the transaction, or to any element in it, a capital character. The resemblance to the facts of *Vestey* (itself a borderline case), though at first sight striking, is, in the end, more superficial than real, and the essential "true" character found to exist in *Vestey* is missing here. *A fortiori*, the present case differs from the clear factual situation in

(1) 14 T.C. 608. (2) 22 T.C. 29. (3) 25 T.C. 353.
(4) 40 T.C. 112. (5) 4 T.C. 618.

Scoble's case. In the end, the decision in the present case rests upon a narrow point but I find that it does not come within a dissection principle. I agree with both Courts below and I would dismiss the appeal.

Lord Morris of Borth-y-Gest—My Lords, when in the years of assessment to which this appeal relates Land Securities made payments of rentcharges pursuant to the terms of the agreement of 5th January 1960, they made deductions of income tax. If the payments were payments of an income nature then it is not in dispute that by reason of ss. 177 and 447 of the Income Tax Act 1952 the deductions were properly made and the amounts of them became payable by the Commissioners of Inland Revenue to the Church Commissioners. The agreement of 5th January 1960 was an agreement for the sale by the Church Commissioners of seven properties. Six of these were purchased by Land Securities and the seventh by a company called Associated London Properties Ltd., a subsidiary of Land Securities. No distinction in principle arises in reference to that last propery and the case can be approached as though the properties were purchased by Land Securities. A schedule to the agreement set out the tenure of the Church Commissioners: some of the properties which they owned were freehold and some were leasehold: all the properties were held by Land Securities (or in the one case by the subsidiary company) either as lessees or underlessees or as sub-underlessee: the very earliest of any of their expiry dates was in the year 2020: some of the dates were much more remote: the rentals payable to the Church Commissioners were in total £62,500 per annum: rentals payable by the Church Commissioners were in total £22,000. In purchasing the reversions Land Securities agreed to pay rentcharges of varying amounts referable to the individual properties. They also covenanted to pay such amounts. The rentcharges and covenanted amounts were to be paid for ten years and in each year their amount in total was £96,000. If the amounts (which were of an income nature) receivable by the Church Commissioners before 5th January 1960 in respect of the properties be regarded as yielding them in total £40,000 per annum (by disregarding £500 per annum) the sale of the reversions was on the basis that instead of obtaining net amounts to that total until the year 2020 and thereafter varying lesser amounts for varying but for some very long periods they would be receiving in total £96,000 in each of the succeeding ten years.

The contractual obligations as between the Church Commissioners and Land Securities are recorded in their written agreement. It is not suggested that those contractual obligations could be or ought to be varied by any examination of any of the documents which in the ordinary course of affairs came into existence prior to and leading up to the making of a concluded agreement. In the Case Stated it is recorded that it was common ground between the parties to the appeal that in the negotiations leading up to the agreement of 5th January 1960 there was no legally enforceable agreement for the purchase of any of the properties for a lump sum. The Case Stated further recorded that in the course of the hearing before the Special Commissioners a question arose whether there should be admitted in evidence a bundle of documents comprising copies of correspondence, file notes and inter-office memoranda relating to the negotiations which took place prior to the agreement of 5th January 1960 and also certain oral evidence from the Secretary to the Church Commissioners.

The decision of the Special Commissioners was that the evidence should not be admitted though very appropriately it was decided to receive the evidence *de bene esse*. An addendum was attached to the Case Stated setting out the excluded bundle of documents and the findings in relation to the Secretary's

A evidence. The reason why the Special Commissioners decided that "the documents and Mr. Ryle's testimony should not be admitted in evidence" was expressed as follows:

> "In interpreting the agreement of 5th January 1960 it is, we think, on authority incumbent on us to ascertain 'the precise character of the transaction' and to determine 'the terms of the contract as properly
> B interpreted in the light of all admissible extrinsic evidence'. It is, however, admittedly the case that the preliminary negotiations leading up to that agreement did not create any legally enforceable contract and therefore did not bring into being a price or lump sum capital obligation, and, this being so, we hold the bundle of documents embodying those negotiations and the Secretary's oral testimony do not constitute admissible
> C extrinsic evidence. We hold that in the circumstances there is no pre-existing legal position which is relevant to the interpretation of the agreement of 5th January 1960. If no binding obligation to sell for a lump sum was created prior to that agreement, it seems to us irrelevant in interpreting that agreement to know that in the prior negotiations either party to the agreement for its own purpose calculated the capital
> D value of the payments by way of rentcharges."

One question of law raised in the Case Stated was expressed as being "whether we were wrong to exclude certain evidence". The other questions were whether the Special Commissioners' substantive decision was wrong either on the footing that the excluded evidence ought to have been admitted or on the footing that it ought not.

E If two parties have made an agreement in writing then, apart from cases where it is sought to rectify the agreement, evidence relating to the steps and negotiations prior to and leading up to the agreement will as a rule be inadmissible. It will be irrelevant. But if under revenue laws certain receipts or payments may be taxable or subject to tax deductions it becomes in my view necessary to consider all evidence which has relevance in deciding the nature of a receipt or
F payment. Income tax being a tax on income evidence will in my view be relevant and therefore admissible if it shows whether what is received is of an income nature or is *per contra* of a capital nature.

The tax position of Land Securities arose for consideration in the case which reached this House (*Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.*[1] 45 T.C. 495). Land Securities were assessed to profits
G tax. They are a property investment company. They acquire properties for letting. Such properties are their capital assets. They make profits from the rentals they receive. Were the payments to be made by them pursuant to the agreement of 5th January 1960 payments of such a nature that they were allowable deductible expenses in computing the company's taxable profits? Were the rentcharges proper items to debit against the company's incomings
H of its trade when computing its profits for profits tax purposes? In holding, in effect, that the payments were the cost to Land Securities of acquiring capital assets and accordingly were not allowable deductions, the House was content to assume, without expressly deciding, that the rentcharges were income in the Church Commissioners' hands and were in their entirety liable to deduction at source under s. 177. Whether that assumption was correct is
I the question which now arises. The House clearly considered that capital

(1) [1969] 1 W.L.R. 604.

(Lord Morris of Borth-y-Gest)

assets could be purchased by payments which, when made, were of a capital nature so far as concerned the payer but which so far as concerned the recipient could be or might be of an income nature. When the sale of the reversions was under consideration there might have been an agreement to pay a lump sum or an agreement to pay such a sum by instalments. The contract of 5th January 1960 contains no such agreement. There might have been an agreement to pay certain annual sums each one of which was to comprise in part a principal or capital amount and in part interest on some outstanding principal or capital amount. The agreement that was made and that is set out in terms in the contract of 5th January 1960 was merely an agreement to pay sums of varying amounts which in total amounted to £96,000 a year (secured by respective rentcharges on the seven respective properties) for ten years.

What then was the nature of the annual payments? In a closely reasoned judgment Megarry J. summed up his conclusion by holding that the case was one in which the Church Commissioners sold their capital assets in return for an income. He held that the rentcharges were wholly of an income nature in the hands of the Church Commissioners. That was his conclusion after considering all the documents and all the evidence. To the same effect was the conclusion of the Court of Appeal.

It has not at any time been submitted that the contract of 5th January 1960 was founded on any sham basis or that any wording was selected with a view to disguising its real nature and effect. No impropriety on the part of anyone has been suggested. The inquiry that has been pursued has been an inquiry to ascertain the true nature or substance of the transaction. In such an inquiry it is necessary and legitimate to examine all the available documentary and other evidence. If a receipt of money might be of an income nature or might be of a capital nature or might be partly the one and partly the other, then in the search for truth and reality all established facts should in my view be brought into survey.

In his judgment in the *Mallaby-Deeley* case (1938) 23 T.C. 153, Sir Wilfrid Greene M.R. said, at page 166:

> "The distinction which is to be drawn for the purposes of the Income Tax Acts between payments of an income character and payments of a capital nature is sometimes a very fine and rather artificial one. It may depend upon—in fact it does depend upon—the precise character of the transaction."

He contrasted two simple cases. In the one, "the true bargain" being that a capital sum was to be paid, the fact that the method of payment was by instalments did not give to such instalments the character of income. In the other, there being no undertaking or obligation to pay a capital sum and there being merely an undertaking to pay annual sums, such sums might in the absence of other considerations be payments of an income nature. So he felt that it was always "not merely legitimate, but necessary", to examine what the true legal position and true legal transaction was. It follows that all the elements in the legal relationship between parties and the legal results of their transactions must be examined. The approach of Lord Halsbury L.C. in *Scoble* v. *Secretary of State for India*(1) [1903] A.C. 299 was that "the whole nature and substance" of a transaction must be looked at. Over and again it has been stated that in an inquiry such as is involved in the present case it is the "real nature" of the transaction that must be ascertained. While this

(1) 4 T.C. 618.

A is true it is salutary to bear in mind, as Sir Wilfrid Greene M.R. in his judgment in *Sothern-Smith* v. *Clancy*(1) [1941] 1 K.B. 276 pointed out (at page 282), that the proposition has "an engaging appearance of simplicity". If an asset of a capital nature is being sold it is clearly both natural and reasonable to consider whether the purchase price which is received may not also either in whole or in part be of a capital nature. When the Church Commissioners B sold their properties could the whole of what they received be regarded as capital? In the present case the Crown do not so suggest. The contention which was advanced was based upon what was submitted to be a general principle of income tax law. It was formulated in the following words:

> "Where a capital asset is transferred or a capital payment is made, in consideration of a series of cash receipts of fixed amount over a fixed C period so that the total debt may be immediately calculated, then those cash payments are in the hands of the recipient partly income and partly capital, whether the parties call the series of cash receipts 'rent' or 'annuity' or 'annual sums' or 'rentcharges' or 'instalments' and whether the payments are secured or unsecured."

When analysed this contention involves that, so far as concerns income tax D law, it is not possible to regard annual payments as being all of an income nature if they are of fixed amount payable over a fixed number of years and if they become payable as the price of a capital asset. The contention involves that some part of each amount must perforce have to be regarded as being a principal payment (and therefore of a capital nature) and the remainder as being interest (and therefore of an income nature). The parties must be treated as E having mixed up principal and interest and the Court must direct a determination as to how each payment is comprised. As applied to the present case that would mean that even if it was the firm and genuine mutual understanding and wish of the Church Commissioners and of Land Securities that in exchange for their properties the former would receive certain income payments for a period of ten years it would not in law be possible for the payments to have F the character that was intended and that the parties wished. The "real nature" of their bargain as they truly and faithfully understood it and intended it would by some process of law have to be transformed so that it possessed quite a different "real nature". A process of legal surgery called "dissection" would inevitably have to follow. Any belief of the parties that they had a measure of freedom to decide how they would voluntarily dispose of their affairs would G be shown to be quite illusory. It is to be observed that the proposition as formulated refers to a series of cash receipts of fixed amount over a fixed period "so that the total debt may be immediately calculated". But in the present case there never was a total "debt". The agreement provided that in each of the succeeding ten years there would be seven separate payments in each year which would total £96,000 each year. It would be known that over H the extent of the period the total of the 70 separate sums payable would add up to £960,000. That sum however never became a "debt". There never was an obligation to pay that amount as a capital sum. It never existed as such. This important fact distinguishes the present case from certain others that were cited in argument.

In my view two questions now arise. The first is whether in income tax I law it is possible to regard annual payments of fixed amounts over a fixed

(1) 24 T.C. 1, at p. 6.

(Lord Morris of Borth-y-Gest)

period as being of an income nature in cases where parties have agreed that such payments will be made in exchange for the transfer of a capital asset. If that is in law possible the second question is whether on a consideration of all the evidence in the present case the payments that were made were in fact of an income nature. Unless by some principle of law an annual payment must be given a particular characterisation it would be surprising if the result had to be reached that the "real nature" of an arrangement was wholly different from that which the parties to it honestly intended and wished and truly and faithfully thought that they had made. Nor need a search for the real nature of an arrangement be deflected by considering what would be the real nature of some alternative arrangement that might have been made but was not. The real nature of a transaction is not automatically changed merely because its net result is the same as that of a different transaction. In *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (1948) 30 T.C. 11 Viscount Simon, at page 25, pointed out that

> "a transaction which, on its true construction, is of a kind that would escape tax, is not taxable on the ground that the same result could be brought about by a transaction in another form which would attract tax."

I pass then to consider the first of the two questions that I have raised. I see no reason in principle to doubt that it is possible to transfer a capital asset on the terms that in return annual payments of fixed amounts will be made which payments will be entirely of an income nature. It is accepted that such payments will be entirely of an income nature if they are to be perpetual. I see no reason in principle why it is not possible for them also to be of an income nature if they are to be made for a fixed period. The passages from the judgment of Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay*[1] and of Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society* (in the years 1935 and 1946 respectively) which were quoted in the judgment of the Court of Appeal show that both those learned Judges thought that of two possible methods of selling property one could be by way of making annual payments of fixed amounts for fixed periods which payments would be of an income nature. When the latter of the two cases was before this House (see 30 T.C. 11) and when Viscount Simon quoted Lord Greene M.R.'s words (though with the omission of the precise illustration and the figures used by Lord Greene M.R.) he indicated accord with the principle that Lord Greene M.R. had enunciated. This in my view clearly appears from the following words[2]:

> "As the Master of the Rolls said in the present case: 'In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted tax will be payable. If the other method is adopted, tax will not be payable . . . The net result from the financial point of view is precisely the same in each case, but one method of achieving its attracts tax and the other method does not."

If someone disposes of a capital asset he will naturally consider carefully whether what he is to receive in return will be acceptable to him. He may agree a price with his purchaser and then find that the purchaser is only able to pay over a period of time: he may feel that he can only give indulgence to the purchaser if the latter pays for his indulgence by way of paying interest on the part of the purchase price which is outstanding: he may agree with his

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(1) (1935) 20 T.C. 79. (2) 30 T.C. 11, at p. 25.

purchaser that principal and interest will be taken into account if the purchaser pays a certain agreed annual sum over a period of time. Into that annual sum both principal and interest will be compounded. The part of a payment that is interest will be of an income nature. The available documentary and other evidence may clearly show the true nature and substance of the agreement made as to the annual payments. But supposing a prospective purchaser merely offers to acquire the asset in return for making an annual payment over a period of years. The owner will make his own calculations as to how he will be placed: he may consider whether he would be better or worse off if he made an out and out sale for a lump sum immediately payable: he may consider whether he would be better or worse off if payments were to be for some period other than for a fixed period: he may make his calculations on the basis of varying figures as to the value of his asset and of the possible obtainable purchase prices. But I see no reason in principle why he should not proceed on the basis that he is merely to receive an income of a certain amount over a stated period of years which income he will plan and decide for himself how he will use. Nor do I see any reason in principle why he should not so proceed even if he had informed his purchaser of the lines of his thinking and calculations and informed him of figures that he had in mind.

A study of decided cases is valuable and in the present case has been helpful in a search for principle and by way of furnishing illustrations of various and differing transactions, but ultimately decision requires examination of the features of the particular transaction under review. *Scoble* v. *Secretary of State for India*(1) [1903] A.C. 299 was a case in which it was not disputed that certain payments made under a contract embraced both capital and interest. There was the purchase of a railway at a price which was determined and became payable: an option provided for by contract was exercised: pursuant to such option instead of a payment of the gross sum of the determined price there was to be payment of what was called an annuity in the calculation of which there was to be a rate of interest ascertained as provided for by the contract. It was a clear case where what was called an "annuity" embraced both principal and interest: only the interest was of an income nature: only the interest was taxable. It was apparent on the face of the contract that part of the annuity was by way of capital repayment. The present case is in my view wholly different from *Scoble's* case. It is very different also from *Vestey* v. *Commissioners of Inland Revenue*(2) [1962] Ch. 861. In that case an agreement provided for the sale of shares for the sum of £5,500,000: it provided that such purchase price was to be paid without interest by yearly instalments of £44,000 for the next 125 years: if there was default in the payment of an instalment all the unpaid instalments became payable. The taxpayer claimed that the annual sums of £44,000 were capital sums (as instalments of the purchase price) and that no part of such sums was to be included in computing his total income. The Special Commissioners decided that they should consider the surrounding circumstances. One circumstance was that the shares sold for £5,500,000 were worth £2,000,000: another was that, as accountants had advised at the time of the contract, if £2,000,000 was to be paid by annual instalments over 125 years with interest on the unpaid balance at two per cent. per annum such instalments would approximate to £44,000 per annum. The Special Commissioners found that the payments contained an interest element. On the facts of the case that

(1) 4 T.C. 618. (2) 40 T.C. 112.

(Lord Morris of Borth-y-Gest)

was perhaps a very reasonable inference. Cross J. upheld the Special Commissioners and said that what was "called" the purchase price clearly contained an interest element. A

As I consider that the answer to the first question which I posed is in the affirmative I pass to consider the second question.

It is clear that the only contract that was made was that of 5th January 1960. The agreement of that date does not provide for any individual purchase price for any one of the properties and does not provide for any overall purchase price. The payments to be made were the seven separate annual payments for the seven properties. The documentary evidence shows that discussions and negotiations concerning the possible purchase by Land Securities of the freehold and leasehold properties extended over many months prior to January 1960. As far back as about the year 1956 the Church Commissioners had decided that they would sell all their leasehold properties where the leases had more than 50 years to run. Some of the properties were offered to the chairman of Land Securities but he was not prepared by buy. Later, however, the chairman said that he was prepared to purchase the properties in exchange for rentcharges but would on no account buy them for a lump sum. So the Church Commissioners had to consider whether they were agreeable to proceeding on that basis. They were an exempt charity and did not need the consent of the Charity Commissioners to dispose of their property: they had all the powers of a freeholder. On a consideration of the proposed basis the Church Commissioners were not adverse to it provided that the rentcharges were enough in amount both to maintain during the period of the rentcharges the income which they derived from the properties and also to provide a sinking fund which, by the end of the period of the rentcharges, would yield a continuing income. If the rentcharges were to be payable for ten years the Church Commissioners had to consider what the amount of such rentcharges should be if out of them £40,000 a year was to be taken during the ten years (to maintain their income) and if the remainder was built into a fund which at the end of the ten years would have accumulated so that it would produce an income equivalent to the income which they were deriving. This involved consideration as to what rate of interest should be taken. Various calculations were made on the basis of different rates of interest. These rates could also be expressed in the form of a certain number of years' purchase of the reversions. A memorandum placed before the Estates and Finance Committee of the Church Commissioners in October 1959 recorded that the chairman of Land Securities had said that he was not interested in a straightforward purchase of the freehold reversions but that he had come forward with a proposal that he might purchase all the reversions for £720,000 (representing 18 years' purchase) on the terms that the Church Commissioners would receive a rentcharge of £96,000 per annum for ten years. (There was a proposal, later abandoned, that part of this only was to be charged on the properties, the remainder being charged on the company's income.) The Church Commissioners considered the proposal on the basis that they would be enabled to continue to derive their current income (£40,000) for the ten years and that they could accumulate the remainder (£56,000) for ten years at $5\frac{1}{2}$ per cent. and be able thereafter to derive £40,000 a year in perpetuity. Having considered the matter the Church Commissioners' reply to the proposal was that they agreed in principle to sell their interests in the properties "for the equivalent of £720,000 and to take in exchange a rentcharge of £96,000 a year for ten years". They pointed out that though from a schedule of the properties it would be seen that the net rents receivable came to £40,500, three of the properties were leasehold properties with between 60 and 75 years B C D E F G H I

to run and that the £720,000 was calculated on the basis of 18 years' purchase of a rent of £40,000 per annum. It was made clear that the rentcharge of £96,000 per annum was calculated on the basis of £40,000 per annum being the Church Commissioners' income for the next ten years and £56,000 being the sum which, accumulated at 5½ per cent. over the ten years would produce the sum of £720,000. The Church Commissioners were therefore content to receive certain income payments because they had calculated how, to their own satisfaction, they would use and apply the payments that they would receive. The Church Commissioners stated that they wished to be satisfied that Land Securities would be in order in deducting income tax from the whole rentcharge of £96,000 as they (the Church Commissioners) would have to recover such tax. While the assurance as to this which was received had of course no effect in law the intentions of the parties are clearly illustrated.

It is manifest that the discussions between the Church Commissioners and Land Securities might have resulted in any one of various possible agreements. What has to be considered is what after all the discussions and correspondence they did actually do and what agreement they actually made. Though I have thought it fitting to consider the additional documents and evidence I have found nothing to suggest that the parties made any agreement other than that of 5th January 1960 and nothing to suggest that the true nature of their agreement is to be determined other than upon a consideration and interpretation of that written agreement. I do not accept the submission that the additional (or excluded) evidence was admissible for the purpose of determining the true nature of the sums payable by Land Securities. Their true nature appears in the terms that were agreed. The difference between the conclusion of the Special Commissioners that the additional material should not be admitted in evidence and the conclusion of Megarry J. (recorded in the formal judgment of the Court) that the material was wrongly excluded really becomes academic. I think that it was right to hear the additional evidence and to examine the additional material, but, that having been done, it was correct to hold that the true nature and substance of the agreement that the parties decided to make was embodied in the written agreement of 5th January 1960. The true legal position was that the parties made that agreement and no other. As was said in the Court of Appeal the so-called extrinsic evidence was in this case nothing to the point in ascertaining the real legal effect of the agreement. I agree with the conclusion of the Court of Appeal that "The transaction here was nothing more nor less than the replacement of one income-producing property, namely, the reversion, for another income-producing property, namely, the rentcharge allied with the covenant to pay its amount".

I would dismiss the appeal.

Lord Kilbrandon—My Lords, I have had the advantage of reading a draft of the speech prepared by my noble and learned friend Lord Fraser of Tullybelton. It so closely follows the line of reasoning which I would have adopted that it is unnecessary to place my own views before your Lordships.

I would accordingly dismiss this appeal.

Lord Salmon—My Lords, I entirely agree with the speech of my noble and learned friend Lord Wilberforce, and for the reasons he states I would dismiss the appeal.

Lord Fraser of Tullybelton—My Lords, the Respondents owned certain freehold and leasehold properties which until 1960 were let on long leases to

(Lord Fraser of Tullybelton)

Land Securities Investment Trust Ltd. ("Land Securities") for rents of approximately £40,000 a year. In 1960 the Respondents sold the reversions to Land Securities for a consideration which consisted of rentcharges of £96,000 a year payable for ten years beginning on 31st March 1960. The question in the appeal is whether these rentcharges are, as the Respondents maintain, wholly income in their hands, or, as the Crown maintains, partly income and partly capital. The question arises in an unusual way with the argument that the payments are income being advanced by the taxpayers who are the Respondents; that is because they are a charity and they are seeking repayment of income tax which was deducted by Land Securities from the whole of each payment of the rentcharges in the years 1959–60 to 1963–64 inclusive.

The Respondents rely on the Income Tax Act 1952, s. 177 (1) and (2), which they say applies to all rentcharges including these particular ones. That section provides as follows:

> "177.—(1) This section applies to the following payments, that is to say—(*a*) rents under long leases; and (*b*) any yearly interest, annuity, rent, rentcharge, fee farm rent, rent service, quit rent, feu duty, teind duty, stipend to a licensed curate, or other annual payment reserved or charged upon land . . . (2) Any payment to which this section applies shall, so far as it does not fall under any other Case of Schedule D, be charged with tax under Case VI of Schedule D and be subject to deduction of tax under Chapter 1 of this Part of this Act as if it were a royalty or other sum paid in respect of the user of a patent."

The Crown says that s. 177 applies to rentcharges and to the other kinds of payment therein mentioned only so far as they are of an income nature, and that it does not convert capital payments into income. They may be either capital or income, or partly one and partly the other. The nature of a rentcharge has to be determined in any particular case by considering the agreement or other document by which it was created and also the nature of the whole transaction of which the creation of the rentcharge formed part. Finally, they say that the rentcharges with which this appeal is concerned were partly income and partly capital, that they should be dissected into the two parts, and that the only tax repayable is that which was properly deducted from the income part. The Crown's contention was advanced as one application of a general proposition which they invited this House to approve as a correct statement of the law. The proposition was as follows:

> "Where a capital asset is transferred, or a capital obligation is discharged, or a capital payment is made, in consideration of a series of cash receipts of fixed amount over a fixed period so that the total debt may be immediately calculated, then those cash receipts are in the hands of the recipient partly income and partly capital, whether the parties call the series of cash receipts 'rent' or 'annuity' or 'annual sums' or 'rentcharges' or 'instalments' and whether the payments are secured or unsecured."

That general proposition seems to have its root in the view that the right to consideration in each of these three types of transaction is in its nature a wasting asset, and therefore that each payment must in the hands of the recipient contain a capital element. That is a very reasonable view, but it is contrary to well-established authority in this branch of the law. As long ago as 1881 in *Coltness Iron Co.* v. *Black*[1] 8 R (H.L.) 67 your Lordships' House

(1) (1881) 1 T.C. 287; 6 App. Cas. 315.

held that the profits of a coal and iron field were taxable without any deduction to allow for the wasting nature of the asset. The principle of that decision remains applicable in the law relating to income tax, except so far as it has been modified by statute for particular cases. Statutes in other branches of the law, such as the Settled Land Act 1925, which provides for treating certain payments as being partly capital for the purpose of accounting between beneficiaries in a trust, give rise to no inference as to liability to income tax and they are not in my opinion relevant in the present case. The proposition proposed by the Crown was limited to cases where "the total debt may be immediately calculated" and it would therefore exclude an annuity payable for a period of uncertain length such as the life of any person. There does not seem to me to be any logical reason for limiting it in that way as the value of a life annuity can be ascertained by actuarial calculation. Moreover in the *Coltness Iron* case Lord Blackburn said at page 76 that(1): "Whether just or not, there can be no doubt that the same annual charge is imposed upon a terminable annuity and on one in perpetuity." By the expression "terminable annuity" Lord Blackburn evidently meant an annuity for a fixed term. The point was more fully dealt with when that case was in the Court of Session by Lord President Inglis at 8 R. 351, at page 355(2), in the passage which has been quoted by my noble and learned friend Lord Wilberforce, and in *Sothern-Smith* v. *Clancy* [1941] 1 K.B. 276, at pages 284–5, Sir Wilfrid Greene M.R. said this(3):

> "If the law were that in the ordinary case of an annuity for a term of years, the nature of the financial calculation involved stamped part of the payment as a capital payment, leaving only the interest element to be taxed on the ground that an annuity is only taxable in so far as it is a profit, the position would be simple and perhaps not unjust."

But he held that it was not open to him in the Court of Appeal to adopt any such principle. No doubt it would be open to your Lordships to adopt the principle but it would be an entirely new departure which would involve upsetting the established rules on the subject and might well lead to unforeseen anomalies and difficulties. I do not think there is sufficient reason for making such a departure, and I would therefore not accept the Crown's proposition.

Until the case of *Vestey* v. *Commissioners of Inland Revenue*(4) [1962] Ch. 861 it had been generally accepted that the law on this subject was correctly stated in the following passage from the judgment of Romer L.J. in *Commissioners of Inland Revenue* v. *Ramsay* (1935) 20 T.C. 79, at page 98, as follows:

> "If a man has some property which he wishes to sell on terms which will result in his receiving for the next twenty years an annual sum of £500, he can do it in either of two methods. He can either sell his property in consideration of a payment by the purchaser to him of an annuity of £500 for the next twenty years, or he can sell his property to the purchaser for £10,000, the £10,000 to be paid by equal instalments of £500 over the next twenty years. If he adopts the former of the two methods, then the sums of £500 . . . are exigible to Income Tax. If he adopts the second method, then the sums of £500 . . . are not liable to Income Tax. . . . The question which method has been adopted must be a question of the proper construction to be placed upon the documents by which the transaction is carried out."

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(1) 1 T.C. 287, at p. 321. (2) *Ibid.*, at p. 308. (3) 24 T.C. 1, at p. 7.
(4) 40 T.C. 112.

(Lord Fraser of Tullybelton)

There is a passage in very similar words in the judgment of Lord Greene M.R. in *Commissioners of Inland Revenue* v. *Wesleyan and General Assurance Society*(1) [1946] 2 All E.R. 749, at page 751. Those statements were quoted in the present case by the Court of Appeal and were accepted by them and by Megarry J. as correctly setting out the law on the subject. I agree, and I agree also with the four propositions in which the Court of Appeal summarised the law.

It was argued for the Crown that the statements by Romer L.J., and by Lord Greene M.R. in the *Wesleyan and General* case, were inconsistent with cases where the Court had declined to treat the name "annuity" or "annual payment" as conclusive for the purpose of determining whether payments were of an income nature but had inquired into the true nature of the transaction and held that payments so described were partly or even wholly of a capital nature. Thus in *Scoble* v. *Secretary of State for India*(2) [1903] A.C. 299 this House held that certain "annuities" payable by the Secretary of State for a fixed number of years as the purchase price of Indian Railways were not annuities within the meaning of the Income Tax Act and were not wholly taxable as income. Once it was accepted, as it was, that the word "annuity" was ambiguous it was not difficult on the facts of that case to reach the result that the so-called annuities consisted partly of capital. Similarly in *Perrin* v. *Dickson*(3) [1929] 2 K.B. 85 and *Commissioners of Inland Revenue* v. *Mallaby-Deeley*(4) [1938] 4 All E.R. 818, the label was disregarded in favour of what the Court regarded as the real nature of the transaction, which was that the parties had a pre-existing relationship of debtor and creditor for a capital sum so that when that sum was paid the payments, by whatever name they were called, were stamped as capital. Substantially the same position arose in *Goole Corporation* v. *Aire and Calder Navigation Trustees* [1942] 2 All E.R. 276, where the Court held that annual payments consisted mainly of instalments of a pre-existing capital sum which had been in the contemplation of both parties and that income tax should not be deducted on that part of the payments.

The strongest case of looking to the real nature of the transaction was *Vestey* v. *Commissioners of Inland Revenue*(5) [1962] Ch. 861, where it was held that, notwithstanding an obvious attempt to label the payments as being of a wholly capital nature, they were in truth partly capital and partly income and should be dissected accordingly. The nature of the transaction there showed that they must contain an element of interest, particularly having regard to (1) the large difference between the purchase price of £5,500,000 and the value of the shares at the date of the contract which, as the evidence showed, was £2,000,000, (2) the fact that payment was to take place by annual instalments over a long period of 125 years and (3) the absence of separate provision for payment of interest emphasised by the statement that the price was to be payable without interest. The length of the period for repayment seems to me very significant and, although I recognise the difficulty of knowing where to draw the line, I think that, with a period as long as 125 years, much the most likely explanation of the difference between the £2,000,000 and the £5,500,000 was that it included some element of interest. Cross J. considered that the passages I have referred to in the judgments of Romer L.J. and Lord Greene M.R. could not be reconciled with the decision in *Scoble* (*supra*) and that they were wrong, but I am with great respect unable to agree with that part of the reasoning, in *Vestey*.

(1) 30 T.C. 11, at p. 16. (2) 4 T.C. 618.
(3) 14 T.C. 608. (4) 23 T.C. 153. (5) 40 T.C. 112.

(Lord Fraser of Tullybelton)

A Counsel for the Crown argued that if the label "annuity" was not conclusive as to the income character of payments, the label "rentcharge" was equally inconclusive. I am not sure that I would go the whole way with that argument. It seems to me that the words "annuity" and (even more) "annual payment" are wide enough to be fairly described as ambiguous as to the capital or income nature of the payments but that "rentcharge" and some of the other B words used in s. 177(1) are much more strongly suggestive of income. For instance it is difficult to imagine that payments of "feu duty" could ever be capital. But however that may be, I think the effect of s. 177 is that the kinds of payment there described, including rentcharges, are at least *prima facie* of an income character. Assuming that rentcharges could, like annuities, lose their *prima facie* character by reference to the transaction as a whole, I do not C think the transaction in this case leads to that result. In the formal agreement all the indicia point towards the payments being of an income nature. The consideration is stated to be the rentcharges supported by the personal covenant of the purchasers, and there is no mention of a capital sum. It happens that the total amount of the rentcharges which are payable for ten years is immediately obvious and hardly even requires to be calculated, but that is no reason for D treating the contract as if it had provided for payment of a capital sum by instalments when it does not do so. The relatively short period for which the rentcharges are payable is certainly consistent with their being partly capital, but it is not enough by itself to lead to that conclusion. The transfers of the separate reversions giving effect to the agreement are exactly in line with its provisions and contain nothing to show that the rentcharges are not income. Extrinsic E evidence in relation to the transaction as a whole was received by the Special Commissioners *de bene esse*. In my opinion the evidence is properly admissible in order to ascertain the nature of the transaction. See *Commissioners of Inland Revenue* v. *British Salmson Aero Engines Ltd.*(1) [1938] 2 K.B. 482, at page 495. That evidence does not seem to me to lead to any different conclusion from that appearing on the fact of the agreement and the transfers. The most important F point that emerges from it is that from the beginning Land Securities were not prepared on any account to buy the reversions for a lump sum. That remained their position throughout, and any reference to a lump sum or a purchase price that occurs in the correspondence never was a description of what Land Securities were willing to pay; it could have been no more than a calculation showing the present capital equivalent of the rentcharges payable over ten years. Quite G consistently with that we find a letter dated 27th October 1959 passing between the parties which states that the Respondents have agreed in principle to sell the reversion to Land Securities "for the *equivalent of* £720,000 and to take in exchange a rentcharge of £96,000". £720,000 was, we know, the Respondents' estimate of the present value of their properties, being in fact 18 years' purchase of the rents of £40,000 per annum. This transaction has already been before H your Lordships' House on the question whether the rentcharges were deductible from the profits of Land Securities for the assessment of their liability to profits tax. See *Commissioners of Inland Revenue* v. *Land Securities Trust Ltd.*(2) [1969] 1 W.L.R. 604. Lord Donovan, with whose speech all the other noble and learned Lords agreed, said, at page 611:

> "For my part, I am content to assume, without expressly deciding, I that these rentcharges are income in the Church Commissioners' hands and are in their entirety liable to deduction of tax at source under section 177. This, however, does not, I repeat, necessarily qualify them as allowable

(1) 22 T.C. 29, at p. 40. (2) 45 T.C. 495, at p. 516.

(Lord Fraser of Tullybelton)

> deductions in computing the respondent company's [Land Securities] profits for tax purposes—which is the present issue."

Both parties claimed to find some comfort in that decision. The Respondents naturally relied upon Lord Donovan's assumption that the rentcharges were income in their hands but, as Lord Donovan expressly refrained from deciding the matter, I do not think it would be right to place much weight upon his statement. The Crown on the other hand relied upon the decision in that case that the rentcharges were not deductible from the profits of Land Securities and said that if they were capital at the paying end they would seem *prima facie*, at least, to be capital at the receiving end also. I cannot accept that argument because it is well known that payments may be capital to the payer but income to the recipient. Moreover, in the *Land Securities* case Lord Donovan said at page 610(1): "whether or not tax was so deductible at source from these rentcharges is quite inconclusive of the question whether they are deductible expenses in computing the company's taxable profits." I therefore regard the Land Securities' case as having no direct bearing upon the decision of the present appeal.

I would refuse the appeal.

[Solicitors:—Solicitor of Inland Revenue; Herbert Smith & Co.]

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(1) 45 T.C. 495, at p. 515.