A COURT OF SESSION (FIRST DIVISION)—
25 MARCH 1980, 3, 4 AND 19 FEBRUARY 1981

HOUSE OF LORDS—26
AND 27 APRIL AND 8 JULY 1982

B **Wilson and Garden Ltd. *v.* Commissioners of Inland Revenue**[1]

Income tax—Close company—Undistributed income—Amount of income which might be apportioned without prejudice to the requirements of the company's business—Whether acquisition of a motor dealership a requirement of the company's business—Finance Act 1972, Sch 16, para 8.

C A notice under para 15(1), Sch 16, Finance Act 1972 was served on a close company which manufactured and sold chalkboards. In terms of the notice the sum of £51,066 was to be apportioned among participators in the company for the accounting period to 30 June 1975. The company appealed, contending that it had no relevant income for the purposes of para 8 of Sch 16. The company considered that none of its distributable income for the accounting D period could be distributed without prejudice to the requirements of its business, having regard to (1) the fact that a decision had been taken by its directors, prior to the adoption of the accounts on 8 October 1976, to acquire a retail motor dealership and (2) the extent of its other capital projects. The Crown contended that (1) the prospective acquisition of the motor dealership was not a requirement of the company's business as manufacturers of E chalkboards and should not therefore be taken into account in determining its relevant income, and (2) even if the acquisition of the dealership was a requirement of the company's business the company had sufficient liquid resources to allow it to make a distribution of the amount specified in the notice of apportionment. The General Commissioners upheld the Crown's first contention and dismissed the appeal against the notice but observed that, F had it been necessary to determine the point, they would not have accepted the Crown's second contention.

The Court of Session, allowing the company's appeal held that the planned expenditure on the acquisition of a motor dealership was a requirement of the company's business because (a) the meaning of a company's "business" in para 8 was not restricted to the trade, activities or G undertaking which it carried on at any particular time but embraced any activities for the generation of profit within its objects, and (b) in any event the findings of fact showed that the reason for the acquisition was in order to maintain its existing trade of manufacturing and selling chalkboards.

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[1] Reported (CS) 1982 SLT 205; [1981] STC 301; (HL) 1982 SLT 541; [1982] 1 WLR 1069; [1982] 3 All ER 219; [1982] STC 597; 126 SJ 513.

Held, in the House of Lords unanimously dismissing the Crown's appeal, that in determining what are "the current requirements of the business" in para 8(1) and "such other requirements as may be necessary or advisable for the maintenance and development of that business" in para 8(2)(*a*) regard may be had not only to the business actually carried on by the company at the relevant date (i.e. the date when the board adopts the accounts) but also to whatever is genuinely in the contemplation of the company at that time as being then required for the future development of the business in whatever form it may think is desirable.

The statement of the Court of Session that "the business" of any company is the application of shareholders' funds for the generation of profit in accordance with its memorandum of association doubted as being of universal application.

CASE

Stated for the opinion of the Court of Session as the Court of Exchequer in Scotland under the Taxes Management Act 1970, s 56.

1. At a meeting of the Commissioners for the General Purposes of the Income Tax for the Division of Stirling, held at Municipal Buildings, Stirling, on 14 December 1977, Wilson & Garden Ltd. (hereinafter called "the Appellant") appealed against a notice under para 15(1)d, Sch 16 to the Finance Act 1972 showing that the sum of £51,066 was to be apportioned among participators for the accounting period to 30 June 1975.

2. The question for our determination was whether, in computing the relevant income of the Appellant in terms of para 8 of Sch 16 to the Finance Act 1972, there fell to be taken into account the possible acquisition by it in the future of a retail motor dealership in that provision in respect that it was a current requirement of the Appellant's business or necessary or advisable for the maintenance and development of that business.

3. The following documents were admitted and are annexed to and form part of this Case(1):

(a) profit and loss account and balance sheet and report of the directors thereon of Wilson & Garden Ltd. for the accounting period to 30 June 1975;

(b) computation of the amount apportionable prepared by H.M. Inspector of Taxes, Stirling;

(c) statement of the liquid position of the company at 30 June 1975;

(d) copy letter from Messrs. Russell & Russell, chartered accountants, Glasgow to H.M. Inspector of Taxes, Stirling dated 8 September 1977.

4. The following facts were admitted before us:

(i) The Appellant is a company incorporated under Companies Acts and has its registered office at 17–21 Newton Street, Kilsyth, Glasgow.

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(1) Not included in the present print.

(ii) The Appellant is a "close" company in terms of s 282 (1) of the Income and Corporation Taxes Act 1970.

(iii) The Appellant, from the 1930's carried on and still carries on business as manufacturers of chalkboards.

(iv) The profit and loss account and balance sheet of the Appellant for the year to 30 June 1975, together with the report of its directors thereon were adopted by the Appellant in general meeting on 17 November 1976.

(v) It was the practice of the Appellant not to adopt profit and loss accounts and balance sheets until after the close of the year following the year to which these profit and loss accounts and balance sheet related.

(vi) In the period from 1 July 1972 to 30 June 1977, there was a steady fall in the number of chalkboards sold by the Appellant from 21,368 in the year to 30 June 1973, to 11,618 in the year to 30 June 1977.

(vii) Early in 1976, the directors of the Appellant decided that it was essential to find other means of generating profit to maintain the company's trading position and, during the summer of 1976, they made a number of enquiries about the acquisition of a major motor dealership. On 12 November 1976, the directors of the Appellant decided that the company should acquire the Ford Retail Dealership in Glenrothes. In the accounting period between 1 July 1976 and 30 June 1977, the company acquired the said dealership at a total cost of £109,000. The acquisition of the said motor dealership was *intra vires* of the Appellant in terms of its memorandum of association.

(viii) Prior to its acquisition of the said dealership, the Appellant's only connection with the motor trade was that it owned a number of vehicles for use in connection with its business as manufacturers and sellers of chalkboards.

(ix) As at 30 June 1975, the Appellant had the following liquid assets:

	£
Short term deposits	170,000
Loans to affiliated companies	146,577
Investment	14,577
Cash and bank balances	1,576
	332,706.

The following liabilities shown on the Appellant's balance sheet required to be met:

	£
Taxation	146,581
Bank overdraft	12,396
Proposed dividends	13,114
Directors' loan	3,166
	175,257.

Noted in the notes appended to the accounts were: (a) capital commitments at 30 June 1975 contracted for but not shown in the accounts amounting to £15,100; and (b) orders for timber not dealt with in the accounts involving future expenditure of £110,000. In the accounting period to 30 June 1976, the Appellants expended £9,635 on new buildings. No other capital expenditure

was incurred by the Appellant during that period. After 30 June 1975, but prior to the adoption of the Appellant's accounts for the year then ended, the Appellant's board had resolved upon the acquisition of said retail motor dealership and, in addition upon the following capital projects directly related to their trade as manufacturers and sellers of chalkboard:

	£
1. Motor vehicles	25,000
2. Store at Kilsyth	20,000
3. Depot at Manchester	50,000
4. Factory extension at Kilsyth	60,000
5. Office extension, Kilsyth	25,000
	180,000.

As at the date of the proceedings before us the motor vehicles had been purchased, all expenditure having been incurred prior to 30 June 1977. The store development at Kilsyth was started in June 1977 and was due for completion in January 1978. The depot at Manchester required planning permission which had not been received. Planning permission had been received for the office extension and factory extension at Kilsyth, and contract documents were to be prepared.

(x) The maximum amount to be taken as relevant income of the Appellant for the accounting period to 30 June 1975 in terms of para 9 of Sch 16 to the Finance Act 1972 was £57,680. The distributions for the purposes of para 10 of the said Schedules which were made by the Appellant for the said accounting period amounted to £6,614.

5. Mr. Kenneth W. Russell, chartered accountant, Glasgow, for the Appellant, contended:

(a) that the retail motor dealership in relation to the Appellant's business as manufacturers and sellers of chalkboard fell to be regarded as part of the same commercial enterprise;

(b) that diversification of this kind was essential to maintain the Appellant's profitability;

(c) that the expenditure on the acquisition of the dealership was a requirement of the Appellant's business accordingly;

(d) that in any event the Appellant's capital projects other than the acquisition of said dealership fell to be taken into account in computing relevant income; and

(e) that having regard to the requirements of the business the relevant income should be reduced to nil.

6. It was contended on behalf of the Commissioners of Inland Revenue:

(i) that the prospective acquisition of the Ford retail dealership should not be taken into account in arriving at the company's relevant income as it was not a requirement of the company's business as manufacturers of chalkboards;

(ii) that even if the prospective acquisition of the dealership was a requirement of the company's business there was still available to the company sufficient liquid resources, bearing in mind the profits which it

could expect to earn in the accounting periods to 30 June 1976 and 30 June 1977, to allow it to make a distribution up to the amount of its maximum relevant income;

(iii) alternatively, that even if the manufacturing of chalkboards and the Ford retail dealership constituted one and the same business the sum required for the acquisition of the latter was to be regarded as income available for distribution in terms of para 12(1) of Sch 16 to the Finance Act 1972 as being a sum intended to be expended towards payment for the business which the company was formed to acquire.

7. The following cases were cited: *Scales* v. *George Thompson & Co., Ltd.* 13 TC 83; *St. Aubyn Estates, Ltd.* v. *Strick* 17 TC 412.

8. It seemed to us clear that the argument presented on behalf of the Revenue that, in considering what were "such other requirements as may be necessary or advisable for the maintenance and development of *that* business" (Finance Act 1972, Sch 16, para 8(2)(a)), regard must be had to the maintenance and development only of the particular business carried on at the time when the relevant income was calculated was correct. The acquisition of the dealership was the acquisition of a business quite separate from and unconnected to the business of manufacturing chalkboards. On that ground therefore we decided that the appeal must fail. Even if we had come to the contrary view, we should have dismissed the appeal on the ground that the proper moment of time at which the factors determining the relevant income should be viewed was at 30 June 1975 or at some date within a reasonable period thereafter. We had regard to the liquid position of the company at that date, to the low level of capital expenditure in the following year and to the fact that it was not until more than a year later that the Appellant decided to acquire the dealership. In all the circumstances, it did not seem to us that in computing the relevant income of the year to 30 June 1975, regard should be had to a possible future development of a nebulous nature and unknown cost while disregarding the contribution to that development which future earnings of the Appellant might be expected to make. In these circumstances we considered it unnecessary for us to consider the third leg of the Revenue's argument and we dismissed the appeal.

9. The Appellant immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and in due course required us to state and sign a Case for the opinion of the Court of Session of Exchequer in Scotland, which Case we have stated and signed accordingly.

10. The question of law for the opinion of the Court is whether upon the facts found by us our decision was correct in law.

The case came before the First Division of the Court of Session (the Lord President (Emslie) and Lords Cameron and Avonside) on 25 March 1980, 3 and 4 February 1981 when judgment was reserved. On 19 February 1981 judgment was given against the Crown.

G.W. Penrose Q.C. and *J.E. Drummond-Young* for the Company. A

A.C. Hamilton for the Crown.

The following case was cited in argument:—*MacTaggart Scott & Co. Ltd.* v. *Commissioners of Inland Revenue* 48 TC 708.

The Lord President (Emslie) [for the Court—The Lord President (Emslie), Lords Cameron and Avonside]—The appellants are a close B company. In terms of para 1 of Sch 16 to the Finance Act 1972 its "relevant income" in an accounting year could be apportioned by the Inspector of Taxes among the participators. Under reference to para 9 of that Schedule the maximum amount capable of being taken as the "relevant income" of the taxpayer Company in the accounting period to 30 June 1975 was £57,680. Of that sum the actual distributions for the purposes of Sch 16 amounted to C £6,614. By notice under para 15(1) of that Schedule the Inspector declared that the undistributed balance of £57,680, namely £51,066, should be apportioned in terms of para 1. The taxpayer Company challenged this notice on appeal to the General Commissioners. The appeal failed and the decision of these Commissioners is now the subject-matter of appeal to this Court.

The provisions of Sch 16 which are of primary importance in the appeal D are to be found in paras 8(1)(*a*) and 8(2)(*a*). Paragraph 8(1)(*a*) provides as follows:

> "8—(1) Subject to the provisions of this paragraph and of paragraphs 9 and 13 below, the relevant income of a company for an accounting period is— (*a*) in the case of a company which is a trading company or a member of a trading group, so much of its distributable E income for that period as can be distributed without prejudice to the requirements of the company's business;"

Paragraph 8(2)(*a*) is in these terms:—

> "(2) In arriving at the relevant income for any accounting period— (*a*) where under sub-paragraph (1) above regard is to be had to the requirements of a company's business, regard shall be had not only to the F current requirements of the business but also to such other requirements as may be necessary or advisable for the maintenance and development of that business but, for this purpose, the provisions of paragraph 12 below shall apply;"

For the taxpayer Company the contention before the Commissioners was that none of the undistributed "relevant income" for the relevant accounting G period could be distributed without prejudice to the requirements of their business. Upon the facts found, and upon their construction of paras 8(1)(*a*) and 8(2)(*a*), the Commissioners rejected that contention and the question for us is whether they were entitled to do so.

In course of the hearing of the appeal it became necessary, on consent of parties, to invite the General Commissioners to report upon certain matters of H importance upon which the Stated Case was silent. That report is now before us and it has at least resolved one problem. The accounts for the year to 30 June 1975 were adopted by the directors of the taxpayer Company on 8 October 1976 and it is now common ground that this is the date which matters

A when considering how much of the taxpayer Company's distributable income for the year of account could be distributed without prejudice to the requirements of their business.

The facts found which provide the background against which the submissions for the taxpayer Company fall to be tested may be summarised thus. From the 1930s down to and including November 1976 and thereafter the B taxpayer Company carried on business as manufacturers of chalkboards. In the period from 1 July 1972 to 30 June 1977 there was a steady fall in the number of chalkboards sold by the taxpayer Company. Finding (vii) tells us this:

> "Early in 1976, the directors of the Appellant decided that it was essential to find other means of generating profit to maintain the C company's trading position and, during the summer of 1976, they made a number of enquiries about the acquisition of a major motor dealership. On 12 November 1976, the directors of the Appellant decided that the company should acquire the Ford Retail Dealership in Glenrothes. In the accounting period between 1 July 1976 and 30 June 1977, the company acquired the said dealership at a total cost of £109,000. The acquisition of D the said Motor dealership was *intra vires* of the Appellant in terms of its Memorandum of Association."

For the sake of completeness it is to be observed that by 8 October 1976 expenditure on a Ford Motor Dealership up to an authorised sum of £110,000 had already been planned. This appears in the letter from the taxpayer Company's accountant which forms part of the Case. Prior to its acquisition E of this dealership the taxpayer Company's only connection with the motor trade was that it owned a number of vehicles for use in connection with its business as manufacturers of chalkboards. As at 30 June 1975 the net liquid assets of the taxpayer Company amounted to £157,449 including the profit for the year which ended on that date. As at that date the taxpayer Company had capital commitments of an unspecified nature amounting to £15,100 which F had been contracted for but which did not appear in the accounts. A note to this effect was appended to the accounts. A similar note referred to orders for timber involving future expenditure of £110,000. Further, after 30 June 1975, but before the adoption of the accounts for the year ending on that date, the taxpayer Company directors had resolved upon capital projects directly related to their trade as manufacturers of chalkboards. These were:—

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	£
"1. Motor vehicles	25,000
2. Store at Kilsyth	20,000
3. Depot at Manchester	50,000
4. Factory extension at Kilsyth	60,000
5. Office extension, Kilsyth	25,000
H	180,000."

The Stated Case tells us that at the date of the hearing of the appeal by the General Commissioners

> "the motor vehicles had been purchased, all expenditure having been I incurred prior to 30 June 1977. The store development at Kilsyth was started in June 1977 and was due for completion in January 1978. The

Depot at Manchester required planning permission which had not been received. Planning permission had been received for the office extension and factory extension at Kilsyth, and contract documents were to be prepared."

The first question for the General Commissioners was whether the planned future expenditure on the acquisition of a major motor dealership was a requirement which was necessary or advisable for the maintenance and development of the taxpayer Company's business within the meaning of para 8 of Sch 16. Their answer to that question was given in the following terms:

"It seemed to us clear that the argument presented on behalf of the Revenue that, in considering what were 'such other requirements as may be necessary or advisable for the maintenance and development of *that* business' (Finance Act 1972, Sch 16 para 8(2)(*a*)), regard must be had to the maintenance and development only of the particular business carried on at the time when the relevant income was calculated was correct. The acquisition of the dealership was the acquisition of a business quite separate from and unconnected to the business of manufacturing chalkboards. On that ground therefore we decided that the appeal must fail."

What the Commissioners did, accordingly, was to construe the words "the Company's business" in paras 8(1)(*a*) and 8(2)(*a*) in the narrow sense contended for by the Crown i.e. the particular trading activity or activities actually being carried on by a company at the relevant date—in this case 8 October 1976. The question for us is whether this is a sound construction of the words "the Company's business" in the context in which they appear in para 8.

At the hearing before us Counsel for the Crown resolutely maintained that the narrow construction adopted by the Commissioners was the correct one, and in presenting this contention he sought to find assistance in paras 12 and 13 of the Schedule. Counsel for the taxpayer Company, however, submitted that there was nothing in para 8 to compel one so to read the words in question, and that far from supporting the meaning contended for by the Crown paras 12 and 13 tended to show that the words fell to be construed otherwise. Paragraph 8 required attention to be given to the requirements of a company's "business" and not to its trade or to the activities or to the undertaking which it may be carrying on at any particular time. The "business" of any company is the application of shareholders' funds for the generation of profit in accordance with its memorandum of association. This is the meaning to be given to the word "business" in para 8. Upon the construction contended for by the Crown perfectly ordinary forms of development would be inhibited for no good reason and prudent directors of a close company would be permitted to retain distributable income for the limited purpose of maintaining or expanding an activity actually being carried on. This is only one form of development of a company's business and there is no good reason, commercial, fiscal or equitable, why retention should not be permitted for the employment of retained income in *bona fide* and prudent development of a business in other ways, e.g. by embarking upon additional activities within the company's objects.

In our opinion the construction upon which the decision of the General Commissioners proceeded is unsound. The only objective of Sch 16 appears to have been to prevent close companies being used to hold and accumulate

A income and thus reduce the income tax liabilities of the participators. So far as we are aware it was not to obstruct close companies from retaining and employing income actively in the prosecution of its affairs. To adopt the construction defended by the Crown would have the result that while retention of income for "horizontal" expansion is permissible, retention for "vertical" expansion (i.e. by embarking upon additional activities) is not. This seems to
B us to be an astonishing result for which no good reason has been suggested to us. The retention and employment of income by a close company for "vertical" expansion would not in any way defeat the only objective of Sch 16 which the parties were able to identify for our assistance. All these considerations lead us to conclude, accordingly, that the construction supported by the Crown should be rejected unless we are compelled to adopt it
C by the language of para 8 as a whole. Upon a consideration of the language used we are not, we are glad to say, compelled to do any such thing. In fiscal legislation the word "business" is commonly used in contradistinction to the words "trade" or "activity" or "undertaking". In para 8 the wording is "the company's business". Paragraph 8 does not direct attention in terms to the particular trade, activities, or undertakings, actually being carried on by a
D company at any particular time. It directs attention only to the requirements of a company's business and for that reason, and since there is no good reason for adopting the narrow meaning of the word "business", it would fall in our judgment to be construed, reading para 8 by itself, in the wide sense contended for by the taxpayer Company. So to construe it produces a result which appeals to common sense, commercial and otherwise. All we now require to do
E is to ask ourselves whether there is anything said in paras 12 and 13 which requires us to adopt the narrow construction favoured by the General Commissioners—a construction which appears to lack any sound fiscal purpose. In our opinion when paras 12 and 13 are properly understood they are designed to deal with special cases which would otherwise fall within the scope of para 8. Neither paragraph, accordingly, assists in defence of the
F narrow construction which, as we read para 8, the words used cannot reasonably bear.

What we have said so far is sufficient for the disposal of the appeal because in their report the General Commissioners have told us that if they had not construed para 8 in the narrow way they did they would have held that the undistributed portion of the relevant income of the taxpayer Company could
G not be distributed without prejudice to the requirements of the taxpayer Company's business. The matter ought not, however, be allowed to rest there. Even upon their own construction of the words "the company's business" the General Commissioners ought to have found in favour of the Company. The words "maintenance and development" which appear in para 8(2)(*a*) must, as Counsel for the Crown agreed, be read disjunctively. It follows, accordingly,
H that if the findings in fact disclose that the decision to acquire the Ford Dealership was taken in order to maintain the trade carried on by the Company as at 8 October 1976—i.e. the manufacture and sale of chalkboards—the planned expenditure on the acquisition of that dealership was a requirement of the Company's business. The findings in fact disclose precisely this. We refer in particular to finding (vii) in statement 4 of the Case
I which falls to be read against the background provided by finding (vi) which tells us that over the five year period to 30 June 1977 there had been a steady fall in the number of chalkboards sold by the Company.

In the result it becomes unnecessary for us to express a concluded opinion upon the other submission for the Company in this appeal. That was directed

to the treatment by the General Commissioners of the other known capital commitments of the Company as at 8 October 1976, the orders for timber, and the capital projects which have already been mentioned. The Stated Case and the report provide a wholly unsatisfactory account of the approach of the General Commissioners to all this future expenditure and in paras 1 and 2 of the report, at least, they appear to have misdirected themselves by attempting to judge the importance of the capital commitment of £15,100, and of the orders for timber, by looking at turnover only. It is perhaps fortunate that we have not found it necessary to examine this chapter of the appeal in any greater detail. Had we required to do so it is in the highest degree likely that a further remit to the General Commissioners could hardly have been avoided.

Upon the whole matter—and on the assumption that the question had been properly framed to read:"On the facts found by us were we entitled to confirm the Notice of Apportionment?"—we shall answer the question in the negative and discharge the notice.

Appeal allowed.

The Crown's appeal against the above decision came before the House of Lords (Lords Fraser of Tullybelton, Russell of Killowen, Lowry, Roskill, and Brandon of Oakbrook) on 26 and 27 April 1982 when judgment was reserved. On 8 July 1982 judgment was given against the Crown, with costs.

G.W. Penrose Q.C. and *J.E. Drummond-Young* for the Company.

Lord Mackay of Clashfern, Robert Carnwath and *A.C. Hamilton* for the Crown.

The following cases were cited in argument:—*Town Investments Ltd.* v. *Dept. of the Environment* [1978] AC 359; *Craigengillan Estates Co. Ltd.* v. *Commissioners of Inland Revenue* 50 TC 298; 1975 SC 124; *Commissioners of Inland Revenue* v. *Thompson Bros. (London) Ltd.* 49 TC 110; [1974] STC 16; *Thomas Fattorini (Lancashire) Ltd.* v. *Commissioners of Inland Revenue* 24 TC 328; [1942] AC 643; *Commissioners of Inland Revenue* v. *White Bros. Ltd. (in Liquidation)* 36 TC 587; *MacTaggart Scott & Co. Ltd.* v. *Commissioners of Inland Revenue* 48 TC 708; [1973] STC 180; *Montague Burton, Ltd. (in Liquidation)* v. *Commissioners of Inland Revenue* 20 TC 48; *The Liverpool and London and Globe Insurance Co.* v. *Bennett* 6 TC 327; [1913] AC 610.

Lord Fraser of Tullybelton—My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Roskill. I agree with it, and for the reasons stated in it I would dismiss this appeal.

Lord Russell of Killowen—My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Roskill. I agree with it and for the reasons he gives I also would dismiss this appeal.

Lord Lowry—My Lords, I have had the advantage of reading in draft the speech about to be delivered by my noble and learned friend, Lord Roskill. I agree with his conclusions and, for the reasons which he gives, I would dismiss this appeal.

Lord Roskill—My Lords, this is an appeal by the Commissioners of Inland Revenue from interlocutors of the First Division of the Court of Session as the Court of Exchequer in Scotland (the Lord President and Lords Cameron and Avonside) dated 19 February and 5 May 1981. By those interlocutors the First Division allowed an appeal by the Respondents by way of Case Stated by the General Commissioners for the Division of Stirling. The Respondents had appealed to the General Commissioners against a notice served on them by H.M. Inspector of Taxes under para 15(1) of Sch 16 to the Finance Act 1972. The General Commissioners had refused that appeal. On 25 March 1980, before those two interlocutors presently appealed from, the First Division had during the hearing of the appeal remitted the case to the General Commissioners on certain matters and in due course the General Commissioners reported to the First Division upon those matters.

My Lords, the principal question for determination in this appeal arises in this way. The Respondents were a close company for the purposes of s 282(1) of the Income and Corporation Taxes Act 1970. The Respondents had from the 1930s onwards carried on a business as manufacturers of chalkboards. They still did so at the material times giving rise to the present dispute. But in the five years from 1 July 1972 to 30 June 1977 there was a steady fall in the number of chalkboards which they sold though it was found that that fall was not necessarily matched by a fall in the value of the Respondents' sales or of their trading profit. None the less early in 1976 the Respondents' board of directors came to the conclusion that it was essential for the Respondents to find other means of creating profits in order to maintain their trading position. Later that year they made enquiries about the acquisition of a major motor dealership. This was an entirely new departure for the Respondents since hitherto their connection with the motor trade had been only the ownership of a number of vehicles which they used in connection with their business of making and selling chalkboards.

My Lords the Respondents' accounts for the year ending 30 June 1975 were approved by their directors on 8 October 1976, "the relevant date". The accompanying report recommended that out of a profit of £68,573 for that financial year dividends totalling £6,614 should be paid. Those accounts were adopted by the Respondents in General Meeting on 17 November 1976. Meanwhile on 12 November 1976 the Respondents had decided to acquire a Ford Retail Dealership at Glenrothes in Fife. This was later acquired at a cost of £109,000. This acquisition had been in contemplation on the relevant date and it was common ground that the transaction was *intra vires* the Respondents.

My Lords, the notice served by H.M. Inspector, to which I have referred, showed that the sum of £51,066 was to be apportioned among participators in respect of the Respondents' financial year ending 30 June 1975. As already stated it was against that notice that the Respondents appealed to the General Commissioners. Whether the First Division or the General Commissioners were correct must depend on the application to the facts which I have summarised of the relevant statutory provisions upon their proper construction. It is therefore to these that I now turn.

Section 94 of the Finance Act 1972 provided that Sch 16 of that Act should have effect instead of certain statutory provisions relating to the charge to income tax in respect of shortfall in distributions of close companies and apportionment of income of close companies among participators. It is

therefore to Sch 16 that I next turn. The most relevant provisions of that Schedule are as follows:

"Schedule 16. Apportionment of Income Etc. of Close Companies. Part I. Powers of Apportionment and Consequences of Apportionment. Power to apportion excess of company's relevant income over its distributions. 1.—(1) Subject to sub-paragraphs (2) and (3) below, the income of a close company for any accounting period may, for the purposes of this Schedule, be apportioned by the inspector among the participators. (2) Subject to paragraphs 2 and 3 below—(*a*) an apportionment shall not be made under this paragraph unless the relevant income of the company for the accounting period exceeds its distributions for that period; and (*b*) the amount apportioned shall be the amount of that excess, and Part II of this Schedule shall have effect for determining the relevant income and distributions of a company for an accounting period and whether or not there is any such excess.... Manner of apportionment. 4.—(1) Subject to the provisions of this paragraph, any apportionment under paragraph 1 above, including any sub-apportionment of an amount directly or indirectly apportioned to a company, shall be made according to the respective interests in the company in question of the participators.... Consequences of apportionment: income tax. 5.—(1)...(2) Where a sum is so apportioned to an individual—(*a*) it shall be treated for the purpose of computing his total income as income received by him at the end of the accounting period to which the apportionment relates and, subject to section 529 of the Taxes Act, shall be deemed to be the highest part of his total income;....

Part II. Provisions for Determining Relevant Income and Distributions, Etc. Determination of 'relevant income'. 8.—(1) Subject to the provisions of this paragraph and of paragraphs 9 and 13 below, the relevant income of a company for an accounting period is—(*a*) in the case of a company which is a trading company or a member of a trading group, so much of its distributable income for that period as can be distributed without prejudice to the requirements of the company's business; (*b*) in the case of a company not within paragraph (*a*) above whose distributable income for that period consists of or includes estate or trading income—(i) so much of the estate or trading income as can be distributed without prejudice to the requirements of the company's business so far as concerned with the activities or assets giving rise to estate or trading income; and (ii) its distributable income, if any, other than estate or trading income; (*c*) in the case of any other company, its distributable income for that period. (2) In arriving at the relevant income for any accounting period—(*a*) where under sub-paragraph (1) above regard is to be had to the requirements of a company's business, regard shall be had not only to the current requirements of the business but also to such other requirements as may be necessary or advisable for the maintenance and development of that business but, for this purpose, the provisions of paragraph 12 below shall apply;(*b*) the amount of the estate or trading income shall be taken as the amount included in respect of it in the distributable income.... Requirements of the company's business. 12.—(1) For the purposes of paragraph 8(2) above there shall be regarded as income available for distribution and not as having been applied, or as being applicable, to the current requirements of a company's business, or to such other requirements as may be necessary or advisable for the maintenance and development of that business—(*a*) any sum expended or applied, or intended to be expended or applied, out of the income of the company, otherwise than in pursuance of an obligation entered into by the company before 4th August 1914—....(*b*) any sum expended or applied,

A or intended to be expended or applied, in pursuance or in consequence of any fictitious or artificial transaction, and....''

My Lords, though I have for ease of reference set out the foregoing statutory provisions, the all important words are to be found in para 8(2)(*a*). What, upon the facts already summarised, were ''the current requirements of the business'' of the Respondents and what in this context is meant by ''such B other requirements as may be necessary or advisable for the maintenance and development of that business''? Learned Counsel were at least agreed upon two matters. First the phrase ''maintenance and development'' must be read disjunctively. Secondly, the date as at which these matters have to be decided, which I have called ''the relevant date'', was 8 October 1976, this being the date at which the Respondents' board approved the accounts for the financial C year ending 30 June 1975.

My Lords, the crucial question is whether in determining what are ''the current requirements of the business'' and ''such other requirements as may be necessary or advisable for the maintenance and development of that business'' regard is to be had only to the business which the taxpayer is actually carrying on at the relevant date so that the phrase ''the maintenance and development D of that business'' must be read as referring to and only to that business which the taxpayer is then actually carrying on (for brevity I will call this ''the narrow construction'') or whether regard may also be had to whatever is genuinely in the contemplation of the taxpayer at the relevant date as being then required for the future maintenance and development of the business in whatever form the taxpayer may think is desirable (I will call this ''the wide construction''). E The General Commissioners preferred the narrow construction. The First Division preferred the wide construction.

My Lords, both learned Counsel sought support for their respective contentions by reference to other paragraphs of Sch 16. Of course, the crucial phrases must be construed in the context of the Schedule as a whole. But, for my part, I do not derive any assistance from those other paragraphs. I ask first F what the purpose is of Sch 16. Clearly, it is to prevent the accumulation by close companies of undistributed profits which are in truth income and thereby the conversion of what is in truth income into tax-free capital. Your Lordships were referred by Counsel for the Respondents to s 21 of the Finance Act 1922 which was the legislative ancestor of the present legislation and was designed to impose liability for supertax on the undistributed income of certain G companies; and the proviso to subs (1) of s 21 contains language identical with that which now appears in para 8(2) of Sch 16. The language of s 21 clearly shows the legislative purpose of the section and of its statutory successors. My Lords, acceptance of the wide construction does not of itself seem to me to offend against that legislative purpose for in the instant case its effect would be to enable the Respondents to seek to generate further profits, not to seek to H capitalise those profits which they have already earned.

My Lords, once it is accepted that the relevant date is a date substantially later than the end of the financial year in question, it seems to me necessarily to follow that events between the end of that financial year and the taking of the crucial decision on the relevant date must be able to be legitimately taken into account. It is easy to envisage many changes in circumstances during that I period, which in some cases might well be substantially longer than it was in the present case and which might make it essential in the taxpayer's interest as a matter of prudent business management to take decisions which could not

possibly have been envisaged at the end of that financial year. There might have been a complete change during that period in the demand for the taxpayer's products so that commercial prudence would dictate discontinuance and, unless liquidation were to follow, the development of some new line of business. Is this to be regarded as an irrelevant consideration? Or the normal supply to the taxpayer of raw materials might suddenly cease and the only alternative source of supply might be the acquisition of some trading company whose business was not only producing that particular raw material but perhaps other materials or products as well. It is not easy in these circumstances to see why "current requirements" should not reflect all these matters or why, if as a matter of ordinary commercial prudence distribution of profits is to be restricted in the interests of the sound financing of future developments, the taxpayer should be in peril of the invocation by the Appellants of the provisions of Sch 16. The phrase "requirements of the business" seems to me to connote something which is continuous and will or may from time to time require maintaining or developing or both. I do not see why "development" should not include what today is usually called "diversification". As my noble and learned friend Lord Brandon of Oakbrook pointed out during the argument, the Appellants' narrow construction involves that if on the day before the relevant date the new business had already been acquired the Respondents would succeed but if it is only in contemplation on the relevant date the Respondents must fail. Such a result seems to me to be indefensible. The language of the statute does not require it. Nor does the legislative purpose of s 16 demand it. My Lords, with profound respect I venture to doubt whether the statement in the judgment of the First Division that "the business of any company is the application of shareholders' funds for the generation of profit in accordance with its memorandum of association" is necessarily of universal application. But, whether that be so or not, I respectfully agree with the First Division that it is the wide construction which is correct.

My Lords, on this view it becomes unnecessary to deal with the second question which the learned Lord Advocate argued and which arose from a passage in the last paragraph but two of the judgment of the First Division. As to the third question which he argued and which arose out of the findings in the report of the General Commissioners to the First Division following remission on 25 March 1980, I agree that these findings could have been more happily expressed—indeed they were severely criticised by the First Division. But I am inclined to think that the four paragraphs consecutively numbered (1) to (4) must be read cumulatively and that the General Commissioners intended to convey that if their view on the question of construction were wrong, as in my view it was, then taking all four matters into account the Respondents' business on the basis that the wide construction was correct would be prejudiced by the distribution. The Lord Advocate made it plain that in any event he did not seek further remission on this issue.

I would dismiss this appeal.

Lord Brandon of Oakbrook—My Lords, I have had the advantage of reading in advance the speech prepared by my noble and learned friend, Lord Roskill. I agree with it and would dismiss the appeal accordingly.

Appeal dismissed, with costs.

[Solicitors:—Messrs. Lee Bolton & Lee Agents for Messrs. Dundas & Wilson CS; Solicitor of Inland Revenue (Scotland).]