1979 July 25

[STAVRINIDES, L. LOIZOU, HADJIANASTASSIOU, A. LOIZOU AND MALACHTOS, JJ.]

THE REPUBLIC OF CYPRUS, THROUGH THE COMMISSIONER OF INCOME TAX,

Appellant,

v.

MINERVA CINETHEATRICAL CO. LTD.,

Respondent.

(*Revisional jurisdiction Appeal No.* 157).

Income tax—Capital receipt—Income receipt—Company entering into restrictive covenant upon ceding part of its business to another company—Restriction partial and not substantial—Amount received in consideration of the covenant was an income receipt and as such is taxable—Section 5(1)(*a*) *of the Income Tax Law,* 1961 (*Law* 58 *of* 1961)—Higgs *v.* Olivier, 33 *T.C.* 136 *distinguished.*

On January 22, 1968, the respondent entered into an agreement with another company, Mimoza Films Ltd., the business of which is similar to that of the respondent, whereby the respondent on a consideration of £5,000 undertook to cease for a period of five years all activities relating to the importation, exploitation or purchase of cinematograph films and, also, not to do anything which would amount to competing with the business of the said Mimoza Films Ltd.

The full text of the relevant clause (clause 1) reads as follows:

"In view of the fact that the 1st party cedes to the 2nd party for purposes of exploitation all its films circulating in Cyprus, with the result that the 1st party ceases to import any films, subject to what is provided hereinafter, and because as from now and for a period of 5 years from to-day the 1st party undertakes the obligation to stop all its activities in relation to the importation and or exploitation or purchase of films, subject to what is provided hereinafter,

and because as from now and for a period of 5 years from to-day the 1st party undertakes the obligation to stop all its activities in relation to the importation and or exploitation or purchase of films and not to attempt to do anything which would probably amount to competing with the 2nd party, and because the 1st party gives up all its correspondents, the 2nd party, in view of this, pays to-day to the 1st party the amount of five thousand pounds (£5,000.000 mils) in cash as goodwill".

On the same date the same parties entered into another agreement by which the respondent, for a consideration of £10,000, assigned to Mimoza Films Ltd. the right to exploit in Cyprus a number of cinematograph films; and some time after the signing of the above two agreements the respondent agreed orally with Mimoza Films Ltd. to hire to it, for the exhibition of films, two cinemas in Nicosia of which the respondent was the lessee. In return for the hiring of these two cinemas the respondent was receiving 50% of the collections from the exhibition of films, but sometimes the percentage could vary. Clauses 2 and 3 of the agreement (*exhibit* 1) contained provisions enabling the respondent company to continue the business of exhibiting films but these provisions were never implemented.

The appellant Commissioner decided to treat the aforesaid amount of £5,000 as income from trade subject to income tax by relying on section 5(1)(a) of the Income Tax Law, 1961 (Law 58/61), which reads as follows:-

" 5(1) Tax shall, subject to the provisions of this Law be payable at the rate or rates specified hereafter for each year of assessment upon the income of any person accruing in, derived from, or received in the Republic in respect of—

(a) gains or profits from any trade, business, profession or vocation, for whatsoever period of time such trade, business, profession or vocation may have been carried on or exercised."

The trial Judge, following *Higgs* v. *Olivier*, 33 T.C. 136, annulled the decision of the Commissioner having held that the said amount was a capital receipt because the true effect of the two agreements, as well as the subsequent, arrangement, was basically the creation of a restriction entering on a substantial part of the

business of the respondent company, even though such restriction was of a limited nature

The trial Judge accepted evidence adduced by the respondent Company that in effect its business remained practically the same as it was before the signing of the agreements in question

Upon appeal by the Commissioner of Income tax:

Held, allowing the appeal, that as in effect the business of the company remained practically the same as it was before the signing of the said agreements, that as the covenant was of a limited period of 5 years and was not of an absolute sterilization, that as the restriction was partial and not substantial and that as the restrictive covenant was limited to one branch of the trading affairs of the company this Court does not share the view of the trial Judge that the true and actual result of the relevant transaction between the respondent and Mimoza Films was to prevent the respondent from carrying on a considerable part of its business, that, therefore, the said amount of £5,000 was an income receipt and as such is taxable under section 5(1)(a) of Law 58/61, and that, accordingly, the appeal must be allowed (*Higgs* v *Olivier* (*supra*) *distinguished* because, *inter alia*, in that case the restraint was complete—see p 360 *post*)

Appeal allowed.

Cases referred to:

Barr, Crombie and Co Ltd v *The Commissioners of Inland Revenue*, 26 T.C. 406 at p 411,

A.G v. *London County Council*, 4 *T C.*, (*H.L.*) 265 at p. 293;

Van Den Berghs Limited v *Clark* (*H.M Inspector of Taxes*) 19 T C 390 at pp 428, 429, 431; [1935] A C 431 at p 442;

Higgs (*Inspector of Taxes*) v *Olivier*, 33 T.C. 136 at pp 142, 144–145, 147, 148,

Hagart and Burn—Murdoch v. *The Commissioners of Inland Revenue*, 14 T.C. (H.L.) 440, at p. 443,

A.G. v. *Great Eastern Rly Co.*, [1880] 5 App Cas 473 at p. 478;

Ashbury Railway Carriage and Iron Co. v. *Riche* [1875] L R 7 H L 653,

Thompson v. *Magnesium Elektron Ltd.*, 26 T.C 1,

Shove (*H M. Inspector of Taxes*) v. *Dura Manufacturing Co.* Ltd , 23 T.C. 779 at pp. 782–783.

Appeal.

Appeal from the judgment* of the President of the Supreme Court of Cyprus (Triantafyllides, P.) given on the 9th April, 1975 (Case No. 394/71) whereby it was decided that an amount of £5,000, received by the respondent Company in consideration of a restrictive covenant regarding its business, was a capital receipt and as such was non taxable.

A. Evangelou, Counsel of the Republic, for the appellant.

R. Stavrakis, for the respondent.

Cur. adv. vult.

STAVRINIDES J.: The judgment of the Court will be delivered by Mr. Justice Hadjianastassiou.

HADJIANASTASSIOU J.: This is an appeal by the Attorney-General of the Republic from the decision of a Judge of this Court trying the case alone, complaining that the trial Judge wrongly decided (a) that the sum of £5,000.—received by the respondent company, pursuant to an agreement dated January 22, 1968, between the said company and "Mimoza Films Ltd.", was a capital receipt; and (b) that the Judge erred in law in declaring the assessments for the year of assessment 1969 (1968) and 1970 (1969) as being null and void and of no effect whatsoever.

The facts are simple and are these: The respondents, Minerva Cinetheatrical Company, is a private company incorporated in Cyprus in 1964, under the provisions of the Companies Law Cap. 113, and has its registered office in Nicosia. Its main business was the importation, distribution and exhibition of cinematograph films.

On January 22, 1968, the respondent company entered into an agreement with another company, Mimoza Films Ltd., the business of which is similar to that of the respondent, and by such agreement, the respondent company agreed to cease for a period of five years all its activities relating to the importation, exploitation, or purchase of cinematograph films; and in addition, the company agreed not to do anything which would amount to competing with the business of Mimoza Films Ltd., (see *exhibit* 1). Furthermore, it was stated in clause 1 of the

* Reported in (1975) 3 C.L.R. 116.

said agreement, that because the respondent was giving up all "correspondents", Mimoza Films Ltd., would pay at once to it, by way of "goodwill", the sum of £5,000.—.The "correspondents", as it was said, were cinema proprietors all over Cyprus with whom the respondent company co-operated in the course of its business and were known in the trade as the respondent's "circuit". At the material time, the respondent was exhibiting films on its own only in Nicosia.

With this in mind, we turn now to clause 1 of *exhibit* 1, which reads as follows:- "In view of the fact that the first party cedes to the second party for purposes of exploitation all its films circulating in Cyprus, with the result that the first party ceases to import any films, subject to what is provided hereinafter, and because as from now and for a period of five years from today, the first party undertakes the obligation to stop all its activities in relation to the importation and or exploitation or purchase of films, and not to attempt to do anything which would probably amount to competing with the second party and because the first party gives up all its correspondents, the second party, in view of this pays today to the first party the amount of £5,000.—(five thousand pounds) in cash as goodwill."

It appears further that on the same date the same parties entered into a further agreement by which the respondent, for a consideration of £10,000.—, assigned to Mimoza Films Ltd., the right to exploit in Cyprus a number of cinematograph films (see *exhibit* 2). This latter amount, we may add, has been taxed by the Commissioner as income, and the relevant amount of tax assessed on the respondent company, has been paid.

Some time after the signing of these two agreements, the respondent entered into an oral agreement with Mimoza Films Ltd., to hire to it for the exhibition of films, two cinemas in Nicosia, of which the respondent was the lessee (the "Minerva" open-air summer cinema and the "Pallas", winter cinema).

The respondent, at the time of the signing of the two agreements, (*exhibits* 1 and 2), was the lessee of only the "Minerva" cinema, but it secured the lease of "Pallas" cinema some time later. It has not been denied by anyone that in return for the hiring of these two cinemas to Mimoza Films Ltd., the respondent was receiving 50% of the collections from the exhibition of films, but sometimes this percentage might vary.

There is no doubt that clauses 2 and 3 of the agreement (*exhibit* 1) contain provisions enabling the respondent company to continue the business of exhibiting films; but it is equally true to say that those provisions were never implemented. On January 12, 1971, the Commissioner of Inland Revenue addressed a letter to the respondent company informing it that having read the agreement signed between the two companies, he reached the conclusion that the amount of £5,000.— paid by the latter to the former was in the nature of a business transaction, and being income from trade was considered by him as being subject to income tax (see *exhibit* 3). On April 23, 1971, counsel for the respondent, addressed a letter to the Commissioner objecting to his decision, and alleged that the amount of £5,000.— could not be considered as taxable income.

On July 24, 1971, the Commissioner in reply, told counsel for the respondent that having re-examined the matter he continued holding the view that the said amount paid during the year 1968 by Mimoza Films Ltd., was an income subject to taxation. The Commissioner, in the light of his decision raised the assessments Nos. 84/AD/71/69 and 85/AD/71/69, the subject matter of these proceedings (see *exhibits* 5, 6 and 7).

The respondent, feeling aggrieved, filed recourse No. 394/71, complaining that the two assessments raised on the respondent by the Commissioner, were null and void and of no effect whatsoever. In this recourse, it was argued by counsel, that the sum of £5,000.— received by the respondent was not a receipt from any trading operation or activity, or a receipt assessable to income tax under section 5 of the Income Tax(Foreign Persons) Law 1961, (Law 58/61), because it was received in consideration of the restrictive covenant, *exhibit* 1, and was a capital receipt.

On the contrary, counsel appearing for the appellants, opposed the application of the company and claimed that the assessments were properly and lawfully raised under the relevant law, and that the sum of £5,000.— was a receipt in the course of the respondent company's trade, and as such it was assessable to income tax.

On April 24, 1972, Mr. Sarris, the executive director of the respondent company, gave evidence and said that in relation to clause 1 of the agreement (*exhibit* 1), all the obligations undertaken by the respondent company under such clause, were dis-

charged, but regarding clauses 2 and 3 of the same contract, they have not exercised their rights at all under such clauses.

In addition, he said that the company has never received any amount under clause 2 and no amount had ever become payable under such clause. Furthermore, he said that the income of the company derived from films was reduced to nil after the signing of *exhibit* 1, and they were left only with the income from the cinemas. Their income was derived by hiring their cinemas mainly to Mimoza Films Ltd., and they were receiving by way of rent either a fixed amount or a percentage on the collections of cinema performances.

Then, having referred to the accounts, (*exhibit* 10), he added that their profits were consequently reduced when the company stopped having income from the exploitation of films; and because of the agreement, (*exhibit* 1) they had to discharge personnel which was in the service of the company. In fact, he said, the company has never entered into any other agreement, such as the one in *exhibit* 1. He conceded that there was an increase of their income from the cinemas for the years 1968–1969 and 1970, and added that after the signing of *exhibit* 1, the business of the company was limited to the exploitation of the cinemas as premises.

In cross-examination, he said that the company had never entered into any subsequent agreement after the agreement *exhibit* 1, which cancelled clauses 2 and 3 of *exhibit* 1; nor there was any agreement amending *exhibit* 1 in any way. He further explained that they did not enter into any written agreement with Mimoza Films Ltd., in relation to hiring to it the use of the cinemas Minerva and Pallas, but were acting on an oral agreement. Furthermore, he said that they undertook not to import and exploit their own films, and as they had the cinemas, they had to use them for the projection of films and so they entered into this arrangement with Mimoza Films Ltd. The films, the witness added, belonged to Mimoza Films Ltd., and the cost of advertising them burdened that company.

Referring also to their co-operation with Mimoza Films Ltd., he said that they did not receive rent by way of a fixed amount, but only an amount calculated on a percentage basis in relation to the collections from the projections of their films.

This, the witness explained, was the usual practice of being paid for cinema performances. They were letting to Mimoza Films Ltd. their cinemas fully equipped including the necessary personnel for the performances. Pressed further, the witness admitted that they were hiring those premises mainly to Mimoza Films Ltd., but also to other people who wanted to use them for public performances, such as theatrical performances, cultural events, and so on. In effect, he concluded, apart from the fact that they abandoned the importation, and exploitation of the films, the nature of their business remained practically the same.

In re-examination, the witness said that when *exhibit* 1 was signed, the Minerva cinema was in their possession as lessees and there were another seven or eight years of that lease to run. Furthermore, he said that they became lessees of the premises of the Pallas cinema after signing *exhibit* 1; and they did so in the interest of their business as they only had a summer open-air cinema.

The learned Judge, having addressed his mind to a number of cases cited before him, and to the strong and able arguments of both counsel, said that though these cases give valuable guidance as regards the general principle involved, nevertheless, he added, it is clear that though there cannot be any real difficulty in formulating the principle applicable, it is a matter depending entirely on the facts of each particular case whether the receipt concerned was a capital or an income receipt.

Pausing here for a moment, we fully endorse and support the statement made by the learned trial Judge, which finds further support from the well-known textbook of Simon's Income Tax, vol. 1, 1964–1965, paras. 60–65. In fact, there is strong support in favour of this view, by Lord Norman, in *Barr, Crombie and Co. Ltd.* v. *The Commissioners of Inland Revenue*, 26 T.C. 406, where at p. 411 he said:-

> " It has been truly said that every case must be considered on its own facts and that no legal criterion for distinguishing between capital payments and income payments is readily applicable. Therefore, though we have had a considerable citation of cases, I do not propose to refer to more than a few of them."

In the present case, we think it is necessary to state that al-

though both in England and in Cyprus the Income Tax Laws impose a tax on income, nowhere in the statutes is there a single comprehensive definition of what is income. The method of the English Acts, which is now embodied in the Income Tax Act, 1952, is to classify income by reference to the source from which it is derived, and then to measure and tax each class of income according to particular sets of rules. Income is in the first place separated into main divisions or "Schedules"; secondly the income within each Schedule may in its turn be subdivided into classes by means of the respective rules or "Cases" applicable to each Schedule. There are now four Schedules in operation—Scheds. B to E; Sched. A was abolished as from April 6, 1964. But although income for the purposes of the charge to income tax is thus ascertained and measured by different rules according to its source, the tax remains one tax. See Simon's Income Tax Vol. 1 1964–65 at p. 4. The nature of income tax was explained by Lord Macnaghten in *A.-G.* v. *London County Council*, 4 T.C., H.L. 265 at p. 293:

> " Income tax, if I may be pardoned for saying so, is a tax on income. It is not meant to be a tax on anything else. It is one tax, not a collection of taxes essentially distinct. There is no difference in kind between the duties of Income Tax assessed under Schedule D and those assessed under Schedule A or any of the other schedules of charge. One man has fixed property, another lives by his wits; each contributes to the tax if his income is above the prescribed limit. The standard of assessment varies according to the nature of the source from which taxable income is derived. That is all."

The present case is one of many tax cases appearing before the Courts, and it is clear that it depends on the particular facts of each case whether a receipt is a capital or an income receipt. It has been said that these cases raised both questions of fact and law. In *Van Den Berghs Limited* v. *Clark* (*H.M. Inspector of Taxes*), 19 T.C. 390 H.L., Lord MacMillan had this to say at pp. 428, 429:-

> " The Income Tax Acts nowhere define 'income' any more than they difine 'capital'; they describe sources of income and prescribe methods of computing income, but what constitutes income they discreetly refrain from saying.

Nor do they define 'profits or gains'; while as for 'trade', the 'interpretation' section of the 1918 Act (section 237) only informs us, with a fine disregard of logic, that it 'includes every trade, manufacture, adventure or concern in the 'nature of trade'. Consequently it is to decided cases that one must go in search of light. While each case is found to turn upon its own facts, and no infallible criterion emerges, nevertheless the decisions are useful as illustrations and as affording indications of the kind of considerations which may relevantly be borne in mind in approaching the problem.

The reported cases fall into two categories, those in which the subject is found claiming that an item of receipt ought not to be included in computing his profits and those in which the subject is found claiming that an item of disbursement ought to be included among the admissible deductions in computing his profits. In the former case the Crown is found maintaining that the item is an item of income; in the latter, that it is a capital item. Consequently the argumentative position alternates according as it is an item of receipt or an item of disbursement that is in question, and the taxpayer and the Crown are found alternately arguing for the restriction or the expansion of the conception of income."

In *Barr, Crombie and Co. Ltd.* v. *Commissioners of Inland Revenue* (*supra*), Lord Normand, dealing with the question whether the sum received by the company was a capital payment or a trading receipt, said at pp. 411-412:-

" Lord Cave, L.C., in the case of *British Insulated and Helsby Cables, Ltd.* v. *Atherton*, [1926] A.C. 205, at p. 213; 10 T.C. 155, at page 192, said: 'But when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.' And, of course, one may equally say that an expenditure made once and for all as payment for abandoning or surrendering an asset is received by the recipient as a capital and not as

a revenue payment, in the absence of any indication to the contrary. In the present case virtually the whole assets of the Appellant Company consisted in this agreement. When the agreement was surrendered or abandoned practically nothing remained of the Company's business. It was forced to reduce its staff and to transfer into other premises, and it really started a new trading life. Its trading existence as practised up to that time had ceased with the liquidation of the shipping company. The proportions of its profits, to which I have referred, demonstrate that.

It is, therefore, an entirely different case from *Kelsall Parsons & Co.* v. *Commissioners of Inland Revenue*, 1938 S.C. 238; 21 T.C. 608. I regard the payment here as a payment made, in the sense of Lord Cave's observations, 'once and for all', and received by the Appellant Company as the price of the surrender of its only important capital asset. In *Kelsall Parsons & Co.*, on the other hand, the payment was in return for the loss of a single agency out of about a dozen agencies carried on by the company, and the fact that the payment in that case did not represent the whole capital assets of the company is easily shown by the fact that in the year after the surrender of the single agency profits were no less than they had been the year before the surrender. There is another distinction between the *Kelsall Parsons & Co.* case and the present which is not conclusive, but is, I think, something helpful. Here we are not dealing with a single payment in return for the surrender of the prospect of making profits in the final year of the agreement, but with a payment for the surrender of an agreement while there was still a substantial period—indeed, more than half of the period of the agreement—to run, and a period which extended to many years of accountancy for the purpose of this Company's business.

Then, again, to apply what was said by Lord Macmillan in the case of *Van den Berghs, Ltd.* v. *Clark*, [1935] A.C. 431, at p. 442; 19 T.C. 390, at p. 431, it is manifest that, after the liquidation of the shipping company and the payment to the Appellant Company of this sum of money, the structure of the Company was radically affected and its whole character as a business was decisively altered.

Though each one of the distinctions may be in itself indecisive, and though each is open to criticism, yet juncta juvant. And where you have a payment for the loss of the contract upon which the whole trade of the Company has been built, where the expected profits of the contract are used to measure the loss of them for a period of future years, and where in consequence of the loss the Company's structure and character are greatly affected, the payment seems to me to be beyond doubt a capital payment. For these reasons, therefore, I think that the question of law ought to be answered in the negative."

As we said earlier the Commissioner is adopting the stand that the amount of £5,000.—was a trading receipt and relied on s. 5(1)(a) of the Income Tax (Foreign Persons) Law 1961, (Law 58/61), which says that:-

" 5.-(1) Tax shall, subject to the provisions of this Law, be payable at the rate or rates specified hereafter for each year of assessment upon the income of any person accruing in, derived from, or redeived in the Republic in respect of—

(a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised;"

It should be noted that by virtue of the Income Tax (Foreign Persons) (Amendment) Law, 1966 (Law 21/66), Law 58/61 ceased to be applicable to foreign persons only. So it became applicable to the respondent in the present case too.

The learned trial Judge having in mind the arguments of counsel on behalf of the appellant that the amount of £5,000.— was received in consideration of restrictive covenant—clause 1— which in the facts of the case was an income receipt, and having quoted *Higgs (Inspector of Taxes)* v. *Olivier*, 33 T.C. 136, observed that in spite of the fact that Harman J., observed that the case was "a very special case in very special circumstances"; and the Master of Rolls also commented that it is a rather unusual case, he added that "it cannot be overlooked or disregarded as not being capable of being treated in a proper case as a relevant precedent; nor can I accept the proposition that the approach adopted in it is to be regarded as specially

confined to cases in which the taxpayer concerned exercises a vocation and is not a trader;"

The learned Judge dealing also with the effect of *exhibits* 1 and 2 said:

> " In my view the true effect of *exhibits* 1 and 2—as well as of the said subsequent arrangement—was, basically, that the applicant agreed with Mimoza Films Ltd., to create a restriction extending to a substantial part of the business of the applicant, even though such restriction was of a limited nature..... and I do not agree with learned counsel for the respondents that the effect of the relevant transaction, between the applicant and Mimoza Films Ltd., was not to restrain the applicant from carrying on its business but was merely an agreement as to how the applicant would continue to carry on such business. In my view, the true and actual result was, as in the *Higgs* case, to prevent the applicant from carrying on a considerable part of its business; and in this respect, it was not necessary, as shown by the *Higgs* case, that the whole business of the applicant should have been affected in order to render the receipt concerned a capital receipt."

Then turning to clauses 2 and 3 of *exhibit* 1, said:

> " I have not lost sight of the fact that clauses 2 and 3 enabled the applicant to continue carrying on, to a limited extent, its business as a trader in, or as an exhibitor of, films; but in actual fact, as it has been clearly stated before me, the said clauses 2 and 3 were never implemented; and, in any case, they cannot be treated as being of such significance as to alter the essential nature of the restriction on the applicant's business, imposed by clause 1 of *exhibit* 1; I regard them as being only consequential arrangements, of minor importance, which were made as a result of the restrictive covenant contained in such clause."

Finally, having adopted and followed the *Higgs* case (*supra*) the learned Judge said:–

> " As already indicated earlier, I have reached the conclusion that the amount of £5,000 mentioned in clause 1 of *exhibit*

1, was, in the circumstanes of this case, a capital receipt, non-taxable; and in this respect, I have taken into account all relevant considerations, on the basis of the particular facts of the case before me."

Counsel for the Attorney-General, (appellant) in a full and strong argument, submitted in support of grounds 1 & 2 of the appeal, (1) that the said sum was not a capital receipt because it was received on account of a mere restriction of respondent company's trading activities, and not in respect of a complete sterilization of a capital asset; and that the structure of the company's business was not radically altered; (2) that the learned Judge wrongly construed the oral arrangement that it was a hiring, but in effect a joint venture between the two companies; and that the finding of the Judge based on Sarris' evidence—which he accepted in toto, was wrong, because that evidence shows that the respondent company hired other cinemas, and because Minerva Cine Co. Ltd. did not ceased operating; (3) that in the light of the admission of Mr. Sarris apart from the fact that they abandoned the importation and exploitation of the films, the nature of their business remained the same. That evidence, counsel added, shows clearly that the two companies in fact were continuing a joint venture; (4) that the Court erred in law in following the case of *Higgs* v. *Olivier*, (*supra*), (a) inasmuch as in that case the restraint was complete whereas in the case in hand the restraint was partial and temporary; (b) that in that case it was found that the restrictive covenant was not a regular practice with actors, whereas in the present case, the restrictive covenant was not ultra vires the objects of the company; and (c) in the *Higgs* case the restrictive covenant did not form part of the original agreement, a material fact upon which the decision was based, but on the contrary, in the present case, the Court found that the two agreements should be read together.

We think before dealing with the contentions of counsel, it is necessary to deal with the question of income derived from gains of any profession or vocation. In *Higgs* (*H.M. Inspector of Taxes*) v. *Olivier*, (*supra*) under an agreement dated 12th September, 1943, the respondent, a well-known actor, (Sir Laurence Olivier), gave his exclusive services to a film company as producer, director and actor in a certain film. For these services, he was to receive a fixed sum (payable in instalments)

and a proportion of the net profits from the exploitation of the film. The agreement was fulfilled and the film first shown about December, 1944. On 18th July, 1945, the respondent entered into a restrictive deed of covenant with the film company under which he received £15,000.—as consideration for the undertaking by him not to act in, produce or direct any film for any other person for a period of eighteen months. On appeal to the Special Commissioners, against an assessment of Income Tax under case 11 of Schedule D, the respondent contended that the sum of £15,000.— arose solely under the terms of the deed, that it was not paid for any activity by him, and that it was not assessable to tax. For the Crown it was contended that the agreement and the deed were interdependent, and that even if they were not interdependent the £15,000 arose from the respondent's vocation as an actor and formed part of his taxable income from that source. The Commissioners held that the agreement and the deed of covenant could not be read together and that the £15,000 was not a receipt of the respondent's vocation.

On appeal by the Crown, from the decision of the Special Commissioners, Harman, J., in dismissing the appeal said at p. 142:-

> " It seems to me that there clearly was evidence which justified the Commissioners in saying that this was an agreement by which he refrained from carrying on a part of his vocation and therefore that that could not be incidental to the carrying of that vocation.
>
> Had there been evidence that this was a regular practice with actors—or for all I know successful barristers or other persons in that kind of position—to accept sums as a condition of not practising their mystery or exercising their art then of course one would say that it was not right to come to the conclusion that this was not an incident of the vocation of such persons. When that kind of circumstance arises it can no doubt be dealt with, but Sir Laurence Olivier gave evidence that he had never entered into such an agreement before and there was no evidence that anybody else had ever done anything of the sort either. Therefore, it seems to me that it would not have been open to the Commissioners to find that this was an ordinary incident to the carrying on of the actor's vocation. It was in fact

a very special case in very special circumstances and the Commissioners seem so to have found, and I do not think I could upset the finding.

A great many cases were cited to me but under the circumstances I do not think a review of them would be very valuable because, as Lord Macmillan said (in *Van der Berghs* v. *Clark*, 19 T.C. 390) in the passage I have cited, all these cases depend on their own facts and no one is very like any of the other ones.....

Consequently, if I were at liberty to regard this, as the Attorney-General invited me to do, as res integra, I should come to the same conclusion as that at which the Commissioners arrived. All I think I need say is that there is evidence on which they could come to the conclusion in my judgment, and that conclusion being one of fact it is not for me to dispute it".

The Crown, having appealed against the above decision, the case came before the Court of Appeal. Sir Raymond Evershed, in delivering the first judgment, and in dismissing the appeal, said at pp. 144-145:-

"The findings of the Commissioners make it quite plain that the agreement was of a very unusual character. They accepted the evidence of Sir Laurence Olivier that so far as he was concerned he had never entered into such a covenant before, and it was made no less clear that covenants of this character cannot possibly be regarded as in the ordinary run of the profession or vocation of actors. I say that at once because I think it is important in all cases of this kind that the decision should not be thought to stray beyond the limits of the matters submitted for determination. The conclusion which I reach, which is in accord with that of the learned Judge, is one which is related, and related only, to the rather unusual facts of this rather unusual case.....

In order that the sum in question may be liable to Income Tax under the Schedule it must fall within the proper significance of the relevant words; it must be 'profits or gains arising or accruing' from Sir Laurence Olivier's

profession or vocation as an actor. The argument, which has been considerable and has involved the study of a large number of cases, has ranged round that apparently simple question. It is undoubtedly true that the payment of this large sum was something which Sir Laurence was able to obtain because of his high credit as an actor upon the films. In the broadest sense, therefore, it might be said to be something which he got out of being an actor, which he got in his capacity as an actor. Again (as it was forcibly put on behalf of the Crown) this restriction was a service which he, Sir Laurence, in his capacity as an actor, was able to perform for the company; because by refraining from acting, he, so to speak, protected the company from the risk of his own competition. But those approaches to the matter involve, as I think, too loose and liberal a construction of the simple words which I have quoted. I think that according to their ordinary sense profits or gains in order to be taxable must arise or accrue from a profession in the sense that they arise from the exercise of the profession. I agree that so stated it is not a necessary answer to Sir Frank's case, because (for reasons I have already indicated) it might be said that this service was after all an exercise, in a sense, of his profession or vocation; but not I think in a proper or ordinary sense.

I will say what has to be said about the many cases cited, but it is right first to observe and emphasise one matter of fact found by the Special Commissioners, namely, that the two deeds, the original deed of employment and the deed containing the restriction, were in no sense inter-connected; they were not part of one transaction. There is no suggestion that there is any subterfuge here, or that these deeds did not give effect to what they purport to represent. I also refer again to the finding that restrictive covenants of this sort are in no ordinary sense to be regarded as being in the run of an actor's profession."

Finally, he said at pp. 147, 148:-

"I follow the point that the restriction here is limited; it only relates to film acting and only excludes services with companies and persons other than the Two Cities Films, Ltd. Sir Laurence Olivier was free to act upon the stage,

I take it, to undertake broadcasting work if he felt so disposed: and he was free to act for the Two Cities Films, Ltd. if they asked him to do so, which in fact they did not. Still it was a substantial piece, so to speak, out of the ordinary scope of the professional activities which otherwise were open to him. It was in other words, a restriction extending to a substantial portion of the professional activities, which were open to him. The sum he received therefore cannot properly, in my view, be regarded—and I now treat the question as res integra—as money which came to him (and which he received) from—that is in—the ordinary course of the exercise of his profession. Nor do I think that such a conclusion involves the difficulty which Sir Frank indicated, and which arises out of clause 14 of the original service agreement already quoted. We are however not concerned to deal with that question. If Sir Laurence Olivier said that some part of his salary under that agreement had not to be taxed because it was referable to the restriction he then entered into against acting for anyone else that question could be decided; and I should expect to find it decided adversely to him on the ground that it was an ordinary incident of his profession that when an actor undertakes a particular job of this kind he has to give for the period of that job his whole time and attention to it. But we are not determining that case. The learned Judge has treated the matter as properly determined by the Special Commissioners: but he has also said (and I agree with him) that in any case the sum of money in question is outside the proper scope of the formula 'profits or gains arising or accruing' from Sir Laurence Olivier's profession or vocation as an actor.

I said at the beginning, and I repeat it, that the case depends entirely upon its own peculiar facts, all of which have been found and set out in the Case Stated. For the reasons which I have given I think that this appeal fails and should be dismissed."

Having read the judgments of the Court of Appeal it is clear in our view that the decision in *Higgs* (*supra*) would have been otherwise if such a covenant had been held to be an ordinary incident of his vocation as an actor. And in *Hagart and Burn*—

Murdoch v. *The Commissioners of Inland Revenue*, 14 T.C. H.L. 440, 443, regarding the distinction between capital and income, the House of Lords held that the lending of money to clients was no part of the profession of a writer to the signet, so that losses incurred in so doing were not deductible against profits.

Turning once again to the factual issues, we find ourselves in agreement with the learned trial Judge that the two written agreements are closely inter-related and should be treated as one transaction. But as to the effect of the relevant transaction between the respondent company and Mimoza Films Ltd., we do not, with respect, share the view expressed that the true and actual result was to prevent the former company from carrying on a considerable part of its business. In taking this view, we take it from the lips of Mr. Sarris—whose evidence was accepted in toto,—that in effect the business of the company remained practically the same as it was before the signing of the agreement in question. In fact Mr. Sarris stated clearly that the business of the company was limited to the exploitation of the premises, but he admitted that they did not reduce substantially the personnel they were employing for the operation of the two cinemas. There was further supporting evidence which shows that the business remained the same because the company in order to carry on its business, leased Pallas cinema after signing the agreement. In addition the covenant in question was of a limited period of 5 years, and was not of an absolute sterilization. Finally, the restrictive covenant was limited to one branch of the trading affairs of the company.

In the light of the clear and unambiguous statement of Mr. Sarris, we think that the learned trial Judge failed to give due effect to the fact that the company in question was not really restrained, since the nature of the business remained practically the same. In any event, the restriction was partial and not substantial.

The next question is whether the restrictive covenant was ultra vires the objects of the company in question. According to paragraph 3(0) of the memorandum of association of the company, the said company was entitled "to sell, hire, mortgage, charge or otherwise alienate the enterprise, business, assets, property, rights or interests of the company or any part thereof

either all together or in portions or parts for such consideration as the company may deem fit".

There is no doubt that a trading company incorporated under the Companies Act is required to have Articles of Association and also a momorandum of association. The memorandum is the charter which advanced the statutory creature by stating the objects of its existence, the scope of its operations and the extent of its powers. A company created can pursue only those objects set out in the momorandum. Its area of corporate activity is thereby restricted so that if for instance, it is authorized to run tramways, it is not entitled to run omnibuses. It may exercise and only exercise the powers set out in the momorandum and such powers as are reasonably incidental to or consequential upon the operations that it is authorized to perform. Everything else is ultra vires and void. (*A.—G.* v. *Great Eastern Rly. Co.*, [1880] 5 App. Cas. 473 at p. 478.) Thus a contract which relates to some objects not defined either expressly or by implication in the memorandum is void as there are no possible means by which it can be validated not even by the unanimous vote of all corporators. (See *Ashbury Railway Carriage and Iron Company* v. *Riche*, [1875] L.R. 7 H.L. 653).

The learned trial Judge in dealing with the argument of counsel, and in the light of paragraph 3(0) of the memorandum of association came to the conclusion that the restrictive covenant was not ultra vires the objects of the company, once it was clearly provided therein that the said company may alienate its rights or interests in whole or in part. We find ourselves in agreement and we would add that the agreement was not ultra vires of the objects of the company but with respect we do not share the observations of the learned Judge that such a consideration may be decisive in a case such as the present one, because we think that once the restrictive covenant is not ultra vires, it is considered by us, *inter alia*, as answering the question whether the amount paid was of an income or capital receipt. The final question is whether the learned trial Judge rightly relied and followed *Higgs* case (*supra*) in reaching the conclusion that the amount of £5,000.—received by the respondent company was of a capital receipt and not of an income one.

Having considered carefully the long and able arguments of both counsel we have reached the conclusion that *Higgs* case

is distinguishable for the following reasons:- (a) because it was found as a fact that the restrain was complete; (b) that for a famous actor, like Sir Laurence Olivier to be away from the scene for 18 months, was in our opinion a considerable time; (c) there was a complete or a very substantial restriction of the professional activities of a great actor, and we think that it was rightly found as a fact that the restriction was a very substantial one, and we cannot go behind that finding of the Court in that case, viz., that the restriction was very substantial and that the income went to Sir Laurence because he refrained to exercise his vocation and not on account of his vocation. Finally (d) it was found that the restrictive covenant was not a regular practice with actors, and such restrictive covenant was found not to form part of the original agreement.

By contrast in the present case the restrain was temporary in that, though it was for five years, one should not lose sight of the fact that in *Higgs* case it was applied to a person and an actor at that with limited span of profitable years of activity, whereas here it relates to a company with perpetual succession. We think, therefore, that a period of five years cannot be considered as being a substantial period of time.

Moreover in the present case the learned Judge found, and we agree with him, that the two agreements were co-related and should be read together. It should also be stressed that according to clauses 2 and 3 of the restrictive covenant the company in question was entitled to continue carrying on its business as a trading company or as an exhibitor of films.

An agreement not to carry on a particular venture was before the Court in England in *Thompson* v. *Magnesium Elektron*, Ltd., 26 T.C. 1, where a company manufacturing magnesium, which required chlorine for use in the business, undertook not to manufacture chlorine (abandoning a project which the company had formed for its manufacture) as part and parcel, as it was held, of an arrangement for the supply to the company of chlorine made by another concern. The payment, made ostensibly for the complete abandonment of the project and for the covenant not to manufacture, was held by the Court of Appeal to be in reality compensation for the loss of the profit which would have resulted from the sale of a by-product of chlorine (caustic soda), and to be itself a profit item.

Lord Greene M.R., in dismissing the appeal said at p. 11:-

"A manufacturer of magnesium desires to obtain a firm contract for the supply of chlorine which he requires in manufacturing his magnesium. He gets that contract by entering into a complicated arrangement under which he agrees not to manufacture or be interested in the manufacture of chlorine or caustic soda; that undertaking being qualified, so to speak, by a payment made to him to cover either the whole or a part of the loss that he incurred by not manufacturing chlorine or caustic soda. When the whole thing is linked up together, it must be regarded, in my opinion, that one of the terms under which he was to get his contract was the incurring of a liability under the covenant, minus the benefit of this payment. Regarded in that way the payments seem to me to be trade receipts, just the same as if, in order to get a contract for the supply of chlorine, they had entered into some collateral bargain, under which they incurred expense. Here they are getting their chlorine on terms under which with one hand they give away their covenant, and with the other at the same time they get these payments. That appears to me to stamp them with the character of trade receipts, and in my opinion, the assessment was rightly made under Case I, and the appeal fails."

Another case is *Shove (H.M. Inspector of Taxes)* v. *Duna Manufacturing Co. Ltd.*, 23 T.C. 779. In that case a lump sum was paid as compensation for the cancellation of a contract to pay commission. On appeal against assessment to Income Tax under Case I of Schedule D in an amount which included this sum, the respondent Company contended that the introduction of business on commission was outside the structure of its business and that the £1,500 was a capital receipt. The General Commissioners allowed the appeal.

Held, that the £1,500 was received in the ordinary course of the Company's business and was properly included in the Computation of the Company's profits for Income Tax purposes.

Lawrence, J., dealing with the question whether the sum in question was a capital receipt or profits of trade, said at pp. 782-783:-

"It has been argued that the contract which was cancelled

was not made in the ordinary course of the respondents' business, and that, therefore, such cases as *Short Bros.*, Ltd. v. *Commissioners of Inland Revenue*, 12 T.C. 955, and Commissioners of *Inland Revenue* v. *Northfleet Coal and Ballast C., Ltd.*, 12 T.C. 1102, are inapplicable.

It is true that the respondent Company's ordinary business was to polish steel and not introduce companies to each other; but it is not suggested that the contract was ultra vires, or that the sums received thereunder were not revenue receipts. But it is said they should have been assessed under Case VI and not under Case I, and that different considerations, therefore, apply. In my opinion any intra vires contract which is of a revenue nature is in the ordinary course of business. I think the phrase 'in the ordinary course of' a trader's business, which has been used in some of the cases—e.g. in 12 T.C., at pages 972 and 974—has been used to connote contracts of a trading nature, not contracts which form the bulk of its trade. If the proceeds of a contract are of a revenue nature, I cannot think that it makes any difference whether the contract is usual or not. Of course, some contracts themselves may be of a capital nature (*cf. John Smith & Son* v. *Moore*, 12 *T.C.* 266); or may involve the acquisition of capital assets, e.g. land or plant; and the realisation of such capital contracts, or such capital assets as land or plant, would produce capital receipts. But a contract does not in my view become a capital asset because it is a contract in a new or unusual line of business (cf. *Bush, Beach & Gent, Ltd.* v. *Road*, 22 T.C. 519).

There was, however, nothing of a capital nature in this contract. No money was spent to secure it; no capital assets was acquired to carry it out; its cancellation was only an ordinary method of modifying and realising the profit to be derived from it.

Reliance was also placed on certain dicta in the Court of Session in *Kelsall Parsons & Co.* v. *Commissioners of Inland Revenue*, 21 T.C. 608, at pages 620, 622 and 624, which suggest that if the contract cancelled has more than one year to run, the sum received for its cancellation may be capital. The learned Judges who expressed this view did

not say that such sum must be capital. They were dealing with a contract different from the present, namely, an agency contract, which constituted a very large part of the taxpayer's business.

In view of the decision in *Short Bros., Ltd.* v. *Commissioners of Inland Revenue*, 12 T.C. 955, and in *Commissioners of Inland Revenue* v. *Northfleet Coal and Ballast Co.*, Ltd., 12 T.C. 1102, and the differences of facts, I do not feel that those dicta ought to be applied to the present case."

Having reviewed a number of authorities, and in view of our approach that *Higgs* case is distinguishable, in our opinion the learned trial Judge has erred in adopting the principle enunciated in that case.

For all the reasons we have given the appeal succeeds, because we think that the amount of £5,000.— paid to the respondent company by Mimoza Films Ltd., is an income receipt, and as such is taxable, and is within the provisions of s. 5(1)(a) of our Law.

Appeal allowed. No order as to costs.

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