**BRITISH-BORNEO PETROLEUM SYNDICATE LIMITED**

**V**

**CROPPER (INSPECTOR OF TAXES)**

CHANCERY DIVISION OF THE HIGH COURT

22TH DAY OF JULY 1968

**LEX (1968) – 1 ALL E.R. 104**

OTHER CITATIONS

2PLR/1969/9 (CH)

[1969] 1 All ER 104

**BEFORE:** PLOWMAN J

**BETWEEN**

BRITISH-BORNEO PETROLEUM SYNDICATE LIMITED – Appellant

AND

CROPPER (INSPECTOR OF TAXES) – Respondent

**REPRESENTATION**

FRESHFIELDS (for the taxpayer company);

Solicitor of Inland Revenue.

F. A. AMIES - Barrister.

**ISSUES FROM THE CAUSE(S) OF ACTION**

TAXATION AND REVENUE LAW:- Income Tax – Profits – Computation of profits – Capital receipts – Disposal of capital asset – Royalty agreement – Finding that initially it was stock-in-trade – Conversion by company as fixed capital asset – Inference of appropriation as such – Income Tax Act, 1952 (15 ” 16 Geo 6 ” 1 Eliz 2 c 10), Sch D.

**MAIN JUDGEMENT**

22 July 1968. The following judgment was delivered.

PLOWMAN J read the following judgment.

This is an appeal by the taxpayer company, British-Borneo Petroleum Syndicate Ltd, against assessments to income tax under Sch D to the Income Tax Act, 1952, for 1965–66 and profits tax for the chargeable accounting period 1 April 1964, to 31 March 1965. It is common ground that the decision in the profits tax case must follow that in the income tax case, and I therefore confine my remarks to the latter. The question which I have to decide is whether a sum of £900,000 paid to the taxpayer company in 1964 in consideration (inter alia) of the surrender and release of the company’s rights under a certain royalty agreement was a trading receipt, as the Special Commissioners of Income Tax held, or a capital receipt, as the company claims.

The history of the matter is as follows. The taxpayer company was incorporated in 1912. Its business was to prospect for oil. Its principal objects, as set forth in its memorandum of association, were as follows:

”(1) To acquire oil fields, oil bearing properties, mines and mining rights and concessions, and any rights and interests in such properties of any kind in any part of the world.

(2) To bore for, sink wells, raise, win, manipulate and prepare for market petroleum and other mineral oils, to mine for and otherwise raise, win and get ores and other mineral substances …

(6) To carry on the business of well sinkers, miners, metallurgists … ”,

and so on.

Four years earlier another company with the same name and the same objects had been incorporated and obtained mining concessions over an area of some thirty thousand square miles in British North Borneo. It also has a lease of 440 square miles in the Klias Peninsula of British North Borneo, and it also bought prospecting rights over an area of 250 square miles in Brunei. It later acquired concessions in Burma. In 1912 that company was wound up and its assets sold to the taxpayer company in exchange for shares. For the next ten years the taxpayer company engaged in oil prospecting either alone or with others, including the Shell Petroleum Co Ltd, and during this period spent some £45,000 in connection with its concession in Brunei. In 1922 the taxpayer company sold out its concession and mining rights in Brunei to the Shell group in consideration of a perpetual royalty of 1s per ton of crude oil produced within Brunei by the purchasing company. The royalty agreement contained the following provision in cl 6:

“The [taxpayer company] shall and will at all times hereafter use its best endeavours to assist the purchasing company to obtain any further concessions which it may require in the said state, and will not at any time hereafter so long as the purchasing company or any of its associated companies shall be engaged in operations connected with the winning or working oil in the said state itself or by or through any person firm or corporation whatsoever either directly or indirectly except as debenture holders debenture stockholders or shareholders in the purchasing company or any of its associated companies be interested engaged or concerned in or assist any person firm or corporation whatsoever in prospecting for producing refining or marketing crude oil or products of crude oil in or derived from the said state.”

That clause has been referred to during the hearing as the "keep out” covenant.

From 1922 to 1934, the Shell group produced no oil in Brunei, and the taxpayer company wrote down its Brunei asset, which had appeared in its books at the figure of its expenditure, from £45,000 to £10. After 1922, the taxpayer company itself ceased to prospect for oil. Instead, it embarked on the business of investing and dealing in the shares of oil production companies; and, in 1928, it extended the objects clause of its memorandum by the addition of the following sub-clause (22A):

"Whether or not in connection with any of the preceding or succeeding objects to undertake and/or carry on any business undertaking, transactions, or operations commonly carried on or undertaken by bankers, financiers, financial houses, or underwriters, and to deal in shares, investments, property and securities of all kinds.”

Since the 1930s, the taxpayer company has not owned any concessions or mining rights anywhere, and its operations, apart from the royalty agreement, have been confined to share-dealing. In 1933, Shell company developments in Brunei began to bear fruit. In 1935, the first royalities were paid under the royalty agreement, and except for a short period during the last war, when production was held up, they continued to be paid to the end. In the ten years up to and including 1964, they averaged over £250,000 a year. In 1964, as the result of pressure from the Shell company extending over a considerable period, the taxpayer company released and surrendered all its rights under the royalty agreement to a company in the Shell group for the sum of £900,000, and it is with that sum that I am concerned.

Counsel for the taxpayer company submitted that it was a capital receipt on two alternative grounds. The first, based on Moriarty (Inspector of Taxes) v Evans Medical Supplies Ltd, Evans Medical Supplies Ltd v Moriarty (Inspector of Taxes) as distinguished in Rolls-Royce Ltd v Jeffrey (Inspector of Taxes), Same v Inland Revenue Comrs, and Musker (Inspector of Taxes) v English Electric Co Ltd, Inland Revenue Comrs v English Electric Co Ltd, was to the effect that, by entering into the royalty agreement with its "keep out” covenant, the taxpayer company was not just selling an oil concession which it held as part of its stock-in-trade, but was giving up its Brunei trade altogether and cutting itself off from an important area of trading operation; that it was therefore disposing of a capital asset, and that the royalty agreement, as the price of that capital asset, was itself a capital asset ab initio, although of course the periodic payments of royalty would be income in the taxpayer company’s hands.  
This point of law was not taken before the Special Commissioners, whose view of the matter is expressed in the Case Stated as follows:

"We think that there can be no doubt that the royalty agreement, when it was first entered into, was stock-in-trade of the [taxpayer company], and had it been disposed of at that time the proceeds must have been assessable to income tax …”

On the evidence I think they were entitled to come to that conclusion, and I propose to assume that they were right.

I turn, therefore, to the alternative submission of counsel for the taxpayer company. This was to the effect that even if in 1922 the royalty agreement became part of the taxpayer company’s stock-in-trade, it had become transmuted long before 1964 into a fixed asset. It was not suggested on behalf of the Crown that there is any reason in law why a trader should not appropriate stock-in-trade as a fixed capital asset; nor was it suggested on behalf of the taxpayer company that the mere effluxion of time could have that effect. The dispute is what is the proper inference to be drawn from the facts.

In the first place, the commissioners found as a fact that the board of the taxpayer company regarded the royalty agreement as having become a permanent income-producing asset. The facts admitted or proved on the evidence adduced at the hearing before them are set out in para 3 of the Case Stated. Sub-paragraph (16) of that paragraph, in the Case Stated, includes the following finding:

"In order to provide for and maintain a slowly increasing dividend in the future when the royalty income would be diminished, the directors invested a large part of the royalty receipts in stocks and shares with growth possibilities. The present directors of the [taxpayer company], one of whom had joined the board in 1933, had never considered the possibility of realising or terminating the royalty agreement which they looked upon as having become a permanent income-producing asset of the [taxpayer company].”

On the evidence before them, the Special Commissioners might have gone even further and said that the board regarded the royalty agreement not merely as "a” but as ” the principal” income-producing asset of the taxpayer company.

Secondly, there is the evidence of the taxpayer company’s balance sheets. The balance sheet as at Mar 31, 1948, showed under the heading ” assets”, ” oil interests and investments at or under cost, £287,967” . That figure included the sum of £10 to which I referred earlier. On 1 July 1948, however, the Companies Act, 1948, came into force, and para 4 of Sch 8 to that Act required fixed assets to be distinguished from current assets in a company’s balance sheet. This led to consultation between an accountant member of the taxpayer company’s board and its auditors, and as a result of this the item ” Oil interests and investments at or under cost” was expanded in the balance sheet as at 31 March 1949, to read as follows:

” Quoted investments, £297,030; unquoted investments, £1,078; fixed asset: royalty interests at net amount standing in company’s book at July 1, 1948, £10.”

Then follow the items designated ”current assets” .

The Special Commissioners’ decision on this matter is set out in the Case Stated as follows:

”We apprehend, from the cases cited to us, that the mere passage of time would not of itself convert stock-in-trade into a fixed asset, and we are unable to find, in the circumstances of this case, that the making of the royalty agreement and its subsequent retirement [which I take to mean surrender] for the consideration referred to above, represented anything other than the best method of exploiting the former Borneo and Brunei concessions of the [taxpayer company].”

I was invited on behalf of the Crown to treat that as a finding of fact with which I ought not to interfere.

The relevant finding of fact is, I suppose, contained in the words

”we are unable to find … that the … [surrender of the royalty agreement] … represented anything other than the best method of exploiting the former Borneo and Brunei concessions of the [taxpayer company].”

If that is intended to be a finding that the royalty agreement had at no time become converted into a fixed asset, it is far from happily expressed. But in any case such a finding cannot, in my judgment, be supported on the evidence. In my judgment, the only inference which is consistent with the evidence is that at some time which cannot be pinpointed, but long before 1964, the taxpayer company had appropriated the royalty agreement as a fixed capital asset. I can see no evidence to displace that inference. In these circumstances, I allow the appeal, and with it the profits tax appeal.

Appeals allowed.

**Cases referred to in judgment**

Moriarty (Inspector of Taxes) v Evans Medical Supplies Ltd, Evans Medical Supplies Ltd v Moriarty (Inspector of Taxes) [1957] 3 All ER 718, [1958] 1 WLR 66, 37 Tax Cas 540, 28 Digest (Repl) 26, 112.

Musker (Inspector of Taxes) v English Electric Co Ltd,

Inland Revenue Comrs v English Electric Co Ltd (1964), 41 Tax Cas 556, Digest (Cont Vol B) 386, 112b.

Rolls-Royce Ltd v Jeffrey (Inspector of Taxes),

Same v Inland Revenue Comrs [1962] 1 All ER 801, [1962] 1 WLR 425, 40 Tax Cas 443, Digest (Cont Vol A) 845, 112a