(1988) 02 CAL CK 0032

Calcutta High Court

Case No: None

KIRBY (INSPECTOR OF TAXES) APPELLANT

Vs

THORN E. M. I. PLC. RESPONDENT

Date of Decision: Feb. 15, 1988

Acts Referred:

- Income and Corporation Taxes Act, 1970 - Section 238, 265

Citation: (1990) 183 ITR 503

Hon'ble Judges: Russell, J; Purchas, J; Nicholls, J

Bench: Full Bench

Judgement

NICHOLLS L. J. This appeal raises a question concerning a capital gains tax. The question can be stated shortly, if somewhat loosely, as follows. As part of a transaction where by three trading companies in a group were sold for a cash consideration, the ultimate holding company in the group, for a further cash consideration of U. S. $575,000, entered into a covenant with the purchaser that companies in the group would not, for a defined period, engage in the business carried on by the three trading companies being sold. Is capital gains tax payable in respect of that further cash consideration, paid in return for the covenant? Both the special commissioners and Knox J. have said no. The matter came before the commissioners on an appeal by the taxpayer company, Thorn E. M. I. Plc., against an estimated assessment to corporation tax on profits for its accounting period ended 31 March 1978. On that appeal the only issue related to the sterling equivalent ($315,934) of the sum of U. S. $575,000 received by the taxpayer company in that period. The commissioners allowed the appeal, holding that this sum should not be included as a capital gain in the computation of the taxpayer companys profits. They decided that, by entering into the covenant, the taxpayer company did not dispose of any asset within the meaning of the capital gains tax legislation. On 27 February 1986 Knox J. dismissed the Crowns appeal against that decision. The Crown has now appealed to this court.

Strictly, the tax in issue in the present case is corporation tax, because the chargeable gains accruing to a company the tax charged is corporation tax and not capital gains tax. But in general, and it is not suggested that any exception is relevant in the present case, the amount of the chargeable gains of a company are to be computed in accordance with the principles applying to capital gains tax: see sections 238 and 265 of the Income and Corporation Taxes Act 1970. Accordingly, it will be convenient henceforth in this judgment for me to refer only to capital gains tax.

The facts:

The evidential material before the commissioners consisted of an agreed statement of facts and a copy of the share sale agreement. No oral evidence was given. The essential facts are these. The three companies whose shares were sold were Dynamo and Motor Repairs Ltd. ("D. M."). Tyne and Wear Electrical Co. Ltd. ("T. and W.") and Potters �Electrical Repair Works Ltd. ("Potters Ltd."). I shall refer to these three companies as "the three companies being sold." Each of these companies carried on the trade of repairing and rewinding electrical motors and generators. Potters Ltd. also carried on the trade of manufacturing and repairing heavy industrial lifting magnets, which were sold under the name of Thorn Electrical Magnets. The taxpayer company had never carried on these trades or any allied repairing or manufacturing trade: it was primarily a holding company, but it also carried on the trade of providing management services to companies within its group.

The three companies being sold were members of the Thorn group but they were not direct subsidiaries of the taxpayer company. In 1967 the taxpayer company had acquired the entire issued share capital of Metal Industries Ltd., one of whose wholly owned subsidiaries at that time was D. M. In 1968 and 1970 respectively Potters Ltd. and T. W. became parts of the Thorn group, and in 1970 or 1971 these two companies became wholly-owned subsidiaries of Metal Industries Ltd. By an elaborate agreement dated 9 December 1977 and made between the taxpayer company, Metal Industries Ltd. and a New York corporation called General Electric Metal Company ("G. E.") the taxpayer company agreed to procure the sale and Metal Industries Ltd. agreed to sell, and G. E. agreed to buy, all the shares in the three companies being sold "together with the benefit of the covenant." The aggregate consideration of $1.73 million was appointed as follows:

Convenant 575,000

D. M. 815,000

Potters Ltd. 160,000

T. & W. 180,000

$1,730,000

The consideration for the covenant was payable to the taxpayer company, and the remainder of the consideration was payable to Metal Industries Ltd. The form of the covenant, to be executed by the taxpayer company and handed over on completion, was set out in a schedule to the agreement.

Completion duly took place. The covenant was entered in by the tax-payer company in favour of G. E. This also was an elaborate document. In short, in consideration of the payment of $ 575,000, the taxpayer company covenanted with G. E. that until the end of the year 1982, that is, for a period of just over five years, the taxpayer company and its subsidiaries for the time being would not, within the United Kingdom, engage in the business of repairing and rewinding electric motors and generators of a type and range that the three companies being sold were engaged in repairing and rewinding at the date of agreement, or engaged in business of manufacturing and repairing heavy industrial lifting magnets of a type and range manufactured and repaired by Potters Ltd. at the date of the agreement. There was an exception regarding repair business necessary for servicing products manufactured by any company in the Thorn group. The Thorn group was to be deemed to be engaged in one of the prohibited businesses if a company in the group beneficially owned shares in and managed or controlled, or participated in the management or control of, a company carrying on one of those businesses. There was a corresponding provision in respect of the ownership, management or control of unincorporated �businesses. There were some exceptions to these restrictions which I need not further mention. For its part G. E. agreed to discontinue the use of the trade name "Thorn Electro Magnets."
Creation of an asset by act of disposal

The first argument advanced for the Crown was to the effect that by the covenant the taxpayer company conferred rights on G. E., and the asset thus created by the taxpayer company must have been disposed of by the taxpayer company to G. E. There was a disposal of an asset by the taxpayer company to G. E. even if that asset had no existence prior to the execution of the covenant. In agreement with the commissioners and Knox J., I am unable to accept this submission.

Capital gains tax was introduced by Part III of the Finance Act 1965. With subsequent amendments the provision then enacted were consolidated in the Capital Gains Tax Act 1979. However the year of assessment with which this appeal is concerned preceded the Act of 1979. Accordingly this judgment I shall refer to the provisions of the Act of 1965, although I am not aware that they differ materially from the corresponding provisions in the consolidating Act now in force. The tax is charged on capital gains, which are defined in section 19 of the Act as "chargeable gains computed in accordance with this Act and accruing to person on the disposal of assets". The primary charging provision is section 20(1) under which, subject to exceptions, a person is chargeable to capital gains tax in respect of chargeable gains accruing to him in a year of assessment during which, stated broadly, he is a United

Kingdom resident. Except as otherwise proceeded, every gain accruing after 6 April 1965 is a chargeable gain: section 22(10). In general, the sums allowable as a deduction from the consideration in computing the amount of a gain accruing to person on the disposal of an asset are restricted to the amount or value of the consideration given by that person for the acquisition of the asset or, if he did not acquire the asset, any expenditure incurred in providing the asset, the amount of expenditure incurred by him for the purpose of enhancing the value of the asset or establishing or defending his title t the asset, and his incidental costs of making the disposal: paragraph 4(1) of Schedule 6. All forms of property are assets for the purposes of the relevant part of the Act. This is provided by section 22 which loomed large in the arguments advanced on this appeal, so it will be convenient to set out the material parts of the first three subsections of section 22:

"(1) All forms of property shall be assets for the purposes of this Part of this Act, whether situated in the United Kingdom or not, including - (a) options, debts and incorporeal property generally... and (c) any form of property created by the person disposing of it, or otherwise coming to be owned without being acquired. (2) For the purposes of this Part this Act - (a) references to a disposal of an asset include, except where the context otherwise require, references to a part disposal of an asset, and (b) there is a part disposal of an asset where an interest or right in or over the asset is a created by �the disposal, as well as where it subsists before the disposal, and generally, there is a part disposal of an asset where, on a person making a disposal, any description of property derived from the asset remains undisposed of, (3)... there is for the purposes of this Part of this Act a disposal of assets by their owner where any capital sum is derived from assets notwithstanding that no asset is acquired by the person paying the capital sum, and this subsection applies in particular to - ... (c) capital sums, received in return for forfeiture or surrender of rights, or for refraining from exercising rights..."

Thus the basis structure of the tax is of a charge on gains accruing to a person on disposal of an asset by him. There is no statutory definition of disposal but, having regard to the context, what is envisaged by the expression is a transfer of an asset (i.e. of ownership of an asset) as widely defined, by one person to another. The Act prepossess that, immediately prior to the disposal, there was an asset and that the disposed owned it. Section 22(2)(a) then deals with the case where only part of an asset is desposed of, an section 22 (2)(b) covers the case where, although the disponor owned an asset before the disposal, what he did by the disposal was not to transfer that asset but to carve or create out of it a right in favour of another. The grant of an easement over land is an obvious example. That also is stated to be a part of disposal. In that instance also the disponor owned a relevant asset prior to the disposal. Consistently with this basic structure of an existing asset owned by the disponor, section 22(3) provides that, where a capital sum is derived from assets, there is a disposal of assets "by their owner."

As one would expect, there are exceptions to this basic structure. One of these relates to the grant of an option. Paragraph 14(1) of Schedule 7 provides that the grant of an option is the disposal of an asset, namely, the option, and the paragraph then deals with two particular types of option. This provision in paragraph 14(1) is expressed to be without prejudice to the provision of section 22, but I do not think this assists the Crown. If a landowner grants to another in option to buy all or some of his land, that would be a part disposal u/s 22(2)(b). So that the preservation of the position u/s 22 by the opening words of paragraph 14 does not point to the conclusion that every grant of an option, including the two particular cases mentioned in paragraph 14(1)(a) and (b), is the disposal of an asset u/s 22. Nor, I add in passing, does the reference to options in section 22(1)(a) assist the Crown, because that reference is sufficiently explained by the draftsmans wish to make clear that options, like other forms of incorporeal property, are property for the purposes of the tax. That reference does not deal with the grant of options.

The Crown submitted that this construction of the Act, that, apart from express provisions, there cannot be a disposal unless the disponor had an asset of which he could dispose, would produce results which could not have �been intended. Particular reliance was placed on the example of a contract to sell an asset not yet acquired, such as the copyright in a script still to be written or shares not yet owned. The grant to another of an option to purchase the script or the shares would be a disposal, and it was submitted that it would be remarkable if the greater transaction, an out that sale, would not be a disposal although the lesser transaction, the grant of an option, would be. I do not find this argument compelling. The argument draws a comparison between the grant of an option in respect of property not yet acquired, which is a disposal, and the outright sale of such property, not a disposal. But the grant of such an option is brought within the scope of the Act by an express provision, paragraph 14 of Schedule 7. To the anomalies, if they are such, shown by the Crowns examples spring from the limited scope of the express provisions in paragraph 14. They do not assist in showing that the analysis I have sought to make to the basic of the Act is misconceived.

The Crown submitted that there are indications in the Act that the creation of an asset by the act of disposal is a disposal of that asset. I have ready commented on the effect of paragraph 14(1) of Schedule 7, dealing with the grant of options. The next indication was said to be found in section 22(1)(c). Under that paragraph property is an asset for the purposes of the Act even when it is created by the disponor. It was submitted that it would be anomalous to recognise the disposal of an asset created immediately before the disposition but to exclude the case where the assets is created by the disposition. But from the second limb of section 22(1)(c), or otherwise coming to be owned without being acquired," it is clear that, on the first limb of section 22(1)(c), it is assumed that the person making the disposition was the owner of the property created by him. Whether the result is to be regarded as an anomaly or not, this is consistent with the Act applying to dispositions of assets by disponors, regardless of the length of time for which they may have owned the assets prior to the disposals, but not applying, subject to express provision, in circumstances where, prior to the disposition, the disponor had no asset. Finally, the Crown pointed out the section 22(2)(b) makes clear that the draftsmen had in mind that a disposal could be an act of creation. So be it. I do not fell able to draw from this the conclusion which the Crown submitted followed, namely that an asset created by a disposition must be assumed to have been intended to fall within the ambit of the tax unless expressly excluded.

I should add one further point. I have set out above my reason for being unable to accept the Crowns argument that there was a disposal of an asset by the taxpayer company even if, prior to the disposal, that asset did not exist. The further point I add is that the present type of case, where rights were conferred on another by the taxpayer company accepting restrictions on its future freedom of action, is not the only type of case where a transaction may result in the acquisition of an asset by a �person without a disposal of that asset to him. Another example would be subscribing for shares in a company: the subscriber acquires an asset but the company does not dispose of one: see Harrison v. Williamson Ltd. [1978] 1 W. L. R. 145 per Buckley L. J.

Goodwill

The second argument advanced for the Crown was not one advanced before Knox J. The argument was to the effect that, if there needed to be a pre-existing asset owned by the taxpayer company for the tax to apply, then there was such an asset here, namely, the goodwill of the taxpayer company. By the convent the taxpayer company made a part disposal of that asset. Alternatively, the taxpayer company derived a capital sum from that asset and hence there was a disposal u/s 22(3). The taxpayer companys principle answer had two limbs. First, it accepted that goodwill is an "asset". Indeed, the Act proceeds on that footing: see sections 33(6) and 34(6). However the taxpayer company submitted that it had no goodwill which it could dispose by the covenant, or from which it could derive a capital sum, because it did not carry on any of the trades in questions: it had no goodwill in those trades. Second the taxpayer company accepted that by the covenant what it did was to curtail its liberty to compete. But it submitted that by curtailing its liberty to compete it did not dispose of an asset or derive a capital sum from an asset because the liberty to trade is not "property."

I can dispose of one point at once. I agree that the liberty or freedom to trade enjoyed by everyone is not a form of "property" within the meaning of section 22. This liberty or freedom is a "right" if that word is given a very wide meaning, as when we speak of a persons "rights" in a free society. But in section 22 the words used are "asset" and "property." "Property" is not a term of art, but takes its meaning from its context and from its collection in the document or Act of Parliament in which it is found and from the mischief with which that Act or document is intended to deal: see Lord Porter in Nokes v. Doncaster Amalgamated Collieries Ltd. [1940] A. C. 1014, 1051. The context in the instant case is taxing Act which is concerned with assets, and with disposal and acquisitions, gains and losses. I can see no reason to doubt that in section 22 "property" bears the meaning of that which is capable of being owned, in the normal, legal sense, and that it does not bear the extended meaning that would be needed if it were to include a persons freedom to trade. I accept, therefore, that, if the taxpayer company had no goodwill in respect of the trades in question, and its non-competition covenant impinged only on its freedom to trade, the giving of the covenant would not constitute the disposal of an asset.

I pause, however, to observe that, if the taxpayer company had no goodwill in respect of the trades from which it agreed to bar itself for the years, it may open of doubt whether the covenant would have been enforceable by G. E. If the taxpayer company, as distinct from the three companies being sold, had no goodwill in the trades, the correct an analysis of the position may be that, so far as �the taxpayer company was concerned, although given on the occasion of the sale of the three companies being sold and as part of one transaction, the covenant was a covenant against "mere competition," and, as such, subject to the difficulties considered in one well-known case of Vancouver Malt and Sake Brewing Co. Ltd. v. Vancouver Breweries Ltd. [1934] A. C. 181. The enforceability of the covenant is, of course, not a matter of moment so far as liability to capital gains tax is concerned, but it is a matter which is pertinent to keep in mind in considering the nature and effect of the taxpayer companys non competition covenant.

I turn to the first limb of the taxpayer companys argument on this point. Having regard to the emphasis placed by the taxpayer company on a submission that non-competition covenants are not disposals of goodwill, but are given "to protect goodwill," and that the taxpayer company as the holding company had no goodwill in the relevant treads, it is necessary first all to consider shortly the nature of a non-competition covenant given by a vendor on the occasion of the sale of a business and, in this regard, are somewhat elusive concept of goodwill of a business. In Inland Revenue Commissioner v. Muller and Co.s Margarine Ltd. [1901] A. C. 217, Lord Macnaghten said, at pp. 223-224:

"What is goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the thing which distinguishes and old-established business from a new business at its first start."

Lord Macnaghten also pointed out, at p. 224, that goodwill is composed of a variety of elements, and that it differs in its composition in different trades and in different business in the same trade: "One element may preponderate here and another element there."

One of the recognised elements of goodwill is the reputation of the person owing or running the business. The importance of this element will very from case to case, but often it will be an important element. (Sometimes this element had been described picturesquely as "dog" goodwill as distinct from "cat" goodwill, "rat" goodwill and even "rabbit" goodwill: see Whiteman Smith Motor Co. Ltd. v. Chaplin [1934] 2 K. B. 35, 42, 49, 50.) When the owner of a small one-man business sells his business as a going concern, it is common for him as vendor to enter into a covenant with the purchaser precluding him from opening up a new, competing business for a stated period and within a defined area. In such a case the vendor is fettering his liberty to trade but in my view it would be wrong to regard his restraint covenant as doing to more that that. The purchaser is concerned not merely, and it may be not primarily, to prevent competition as such: he is, or may be, concerned to prevent competition by the vendor, because of the vendors existing connection and trade reputation. Thus the covenant is the means by which all the advantages that the purchaser was intended to have by taking over the goodwill �of the business are secured to him. As Lord Parker of Waddington said in Herbert Morris Ltd. v. Saxelby [1916] 1 A. C. 688, 709:

"Without... a covenant on the part of the vendor against competition, a purchaser would not get what he is contracting to buy, nor could the vendor give what he is intending to sell."

The covenant is the means by which, amongst other matters, the vendor, for the benefit of the purchaser, precludes himself, from exploiting the reputation he has regarding the trade in question. That reputation, as already mentioned, is a form of goodwill. It is not something possessed by everyone. It has a value, even though of its nature it is not assignable. It can be protected by an action for passing off. It is discernibly distinct from a mere liberty to trade.

The point can be illustrate by a simple example. Suppose the owner of a one-man retail business, who has a good reputation with his customers, is prepared to sell his business, including the goodwill, for a stated sum of money. A purchaser is willing to buy at this price, but on being advised that a sale on these terms would leave the vendor free to set up a competing business next door at once, the purchaser agrees to pay an additional sum of money in return for a covenant from the vendor not to open a shop nearby in the same line of business for a stated period. I am unable to accept that that additional sum of money would not be chargeable capital gains tax as a gain accruing from an asset, namely goodwill. To regards such a covenant as being given merely in right of the liberty to trade shared by everyone seems to me to fly in the face of commercial reality.

If that is right, I can see no difference in principle if the fact were the same save that the business was owned by a one-man company. On the sale of shares in such a company it would accord with common practice for the vendor shareholder to enter into a comparable restraint clause with, as it seems to me, the same consequences for capital gains tax as in the case where the business was unincorporated. A person owning and running a business can have a personal reputation in the relevant field as such in the case where the business is conducted through a one-man company as where it is unincorporated. That will be so even though, in the case of the company, it is strictly the company and not the vendor who is carrying on the business.

Likewise, in principle, with a group of companies. A company can have a reputation in field of trade as much as an individual. Accordingly, although in the present case the taxpayer company was primarily a holding company in the group and it had never itself carried on the trades of manufacturing and repairing heavy industrial lifting magnets or of repairing and rewinding electrical motors and generators, those facts do not by themselves establish, in my view, that only D. M., T. & W. and Potters Ltd. had any relevant goodwill and that the taxpayer company itself had no goodwill in respect of the trades in question. On the contrary, from the agreed fact it seems to me that one possible inference is that the three companies being sold would have been known to be �part of the Thorn group. Indeed, the lifting magnets were sold under the name "Thorn Elect Magnets." So that if, following the sale, the taxpayer company had opened new manufacturing and repairing business in a blaze of general publicity, satisfied customers of D. M., T. & W. and Potters Ltd. might will have been attracted to those new business because of the taxpayer companys pervious connection with these trades. It would also in my view not be an unreasonable inference that it was for this reason, or primarily for this reason, that G. E. had indicated during negotiations that it would require a covenant by the Thorn group not to compete with the trades then being carried on by the three companies being sold, and that is was for this reason, or primarily for this reason, that G. E. was willing to pay and paid to the taxpayer company the substantial sum of $575,000 out of a total purchase price of $1,730,000. Failing cogent evidence to the contrary, it seems to me that that is the inference naturally to be drawn.
Mr. Whiteman submitted that the fact that the taxpayer companys covenant precluded it from acquiring other companies in the relevant fields showed that G. E. was not looking at any existing goodwill of the taxpayer company but was looking at its economic power and its use in the future of its economic resources. I am unable to accept this, I cans see no material distinction between the Thorn group engaging in one of the prohibited trades by means of an existing subsidiary setting up new business in such a trade on the one hand and the Thorn group engaging in that trade by means of acquiring an outside concern already carrying on such a business on the other hand. So far as G. E. is concerned the vice would be the same in each case: having a company, in the Thorn group, carrying on the business in question.

In the present case the taxpayer companys covenant was in respect, not only of its own future activities, but also in respect of the activities of all the companies in the group. But I do not think that this affects the essential nature of the covenant or of the interest in respect of which a was given. If I am right that the taxpayer company had, or may well have had, relevant goodwill which constituted an asset, extending the covenant to all companies for the time being in the Thorn group was necessary to give G. E. the protection it sought. The taxpayer company, as the ultimate holding company, was in a position effectively to give that protection, by coventing in respect of all those companies.

Mr. Whiteman further submitted that, in the case of the part disposal of goodwill, the apportionment provided for in paragraph 7(2) of Schedule 6 cannot be made where the taxpayer company has not itself carried on the trade in question - as where the taxpayer is the holding company in a group, and the trade has been carried on by a wholly-owned subsidiary in the group - because the market value of the goodwill undisposed of cannot be ascertained. That market value cannot be ascertained because one can never know whether anybody will offer a sum of money in exchange for a non-competition covenant. I am not �persuaded by this. There may be difficulties in valuing the taxpayer companys goodwill in this case, if any valuation is necessary, and in ascertaining matters such as the cost of acquisition of goodwill or of providing the goodwill, and the amount of the expenditure incurred in enhancing the value of the goodwill, but I do not think these will be insuperable.

For these reasons, and subject to one point which I shall mention at the conclusion of this judgment, I am unable to accept the taxpayer companys submission that it had no relevant asset a the time it entered into the covenant.

Part disposal of Thorns goodwill

The Crown submitted that the asset in question consisted of the whole of the taxpayer companys goodwill, and that either (a) there was a part disposal of that asset or (b) the taxpayer company derived a capital sum from that asset within the meaning of section 22(3). It was further submitted that there was no practical difference between (a) and (b). I am not satisfied that it is right to view the matter in this way. I prefer to regard the asset as consisting, not of the entirely of the taxpayer companys goodwill, but of the taxpayer companys goodwill in respect of the trades being carried on by the three companies being sold. Moreover, I am not persuaded that the covenant constituted a part disposal (for a period of five years) of that asset. By the covenant the taxpayer company did not assign or pass that goodwill to G. E.: the taxpayer companys reputation remained where it was, with the taxpayer company. That reputation was not transferred to G. E. What happened was that the taxpayer received a capital sum as defined in the Act (section 22(9)) in exchange for agreeing not to exploit that goodwill. I reject alternative (a), therefore. This leaves alternative (b).

"Derived from"

So I come next to a submission by the taxpayer company, to the effect that the present case does not come within section 22(3) because the sum of $575,000 derived, not from the taxpayer companys goodwill, but from the giving of the covenant, which was not a pre-existing asset. I my view, this point is misconceived. If the taxpayer company owned an asset comprising relevant goodwill, by the covenant it turned that asset to account in a particular way: by accepting a substantial sum in return for agreeing not to use that asset, for a period, to the disadvantage of G. E., the covenantee. That seems to me to fall four square within the opening words of section 22(3). It is unnecessary therefore to consider whether the case falls within the particular instances dealt with in section 22(3)(c). Nor does it matter that in this case an asset was acquired by the person paying the capital sum, because the words "notwithstandings that no asset is acquired by the person paying the capital sum" are words of extension and not of limitation: see Marren v. Ingles [1980] 1 W. L. R. 983. I do not think this matter is inconsistent with any of the authorities to which we were referred. Of these authorities I need mention only one, which indeed lends some support to the conclusion I have reached: O Brien v. Bensons Hosiery (Holdings) Ltd. [1980] A. C. 562, 573. There the House of Lords, �upholding the views of the Court of Appeal and Fox J. on this point, held that a sum of money paid to a company by a director in consideration for releasing him from his obligations under a service agreement was a capital sum derived from the service agreement.

The taxpayer companys undertaking

For completeness I add that when Mr. Nugee opened this appeal for the Crown, one of the alternative submission he advanced was that, by giving its covenant, the taxpayer company derived a capital sum from the whole of its undertaking, namely its shareholdings in all its subsidiaries together with its own assets including its goodwill. Having heard Mr. Whitemans criticisms of this concept of a part disposal of the taxpayer companys "undertaking," Mr.Nugee, rightly in my view, did not pursue this contention.

Conclusion

I would therefore allow this appeal. As to the order which should be made, It is common ground that the Crowns argument based on a disposal by the taxpayer company of its own goodwill was not advanced to the commissioners, nor was this way of presenting the Crowns case canvassed when the statement of facts was being agreed by the parties. Accordingly, it is only right that the taxpayer company should have the opportunity to adduce such evidence and arguments as it wishes on the issue of what sums. if any, are properly allowable as a deduction from the sum of $575,000 in the computation of the gain accruing to the taxpayer company on the execution of the covenant.

There is one further point. I have mentioned the natural inference to be drawn in the circumstances concerning the existence of goodwill in the taxpayer company even though the taxpayer company was not itself carrying on the trades in question.

No doubt for the same reason as that just mentioned, the existence or not of such goodwill, which is question of fact, was also not a matter expressly dealt with in the agreed statement of facts, which contains only minimal information about the Thorn group. The implications of this were not canvassed in argument before this court. But, subject to any submission counsel may wish to make on this point, my present view is that the taxpayer company should also have an opportunity to adduce such evidence and arguments as it may wish on the further issue of whether, at the time of the execution of the covenant, the taxpayer company as the holding companys in the Thorn group had any reputation in respect of the trades in question by reason of those trades having been carried on as they were for some years by companies in the Thorn group, so that the taxpayer company would thereby have had a commercial advantages over otherwise if, after the sale of the three companies being sold, the taxpayer company or a company in the Thorn group had engaged in one or more of these trades.

Accordingly, I would remit this matter to the commissioners for them to reconsider the taxpayer companys appeal in the light of this judgment and of any further evidence or arguments on the two issues I have mentioned, subject, as I have indicated, to any observations of counsel on the second issue and, generally, on the precise form of the order.

PURCHAS L. J. I agree that, on the one narrow point argued �neither before the commissioner nor before Knox J. the Crown succeeds. The circumstances in which the appeal comes before this court have been fully set out in the judgment of Nicholls L. J. and need not be repeated here. Although the tax in issue is corporation tax chargeable to the taxpayer company under the provisions of section 265(2) of the Income and Corporation Taxes Act 1970, for all purpose relevant to this appeal the provisions to be considered are those for assessing chargeable gains of capital gains tax under Part III of the Finance Act 1965. Section 19(1) provides:

"Tax shall be charged in accordance with this Act in respect of capital gains, that is to say chargeable gains computed in accordance with this Act and accruing to a person on the disposal of assets."

It is, I think, fair to say that the purpose of the tax was to provide that part of the wealth gained or, according to how one views it, the protection against erosion by inflation as a result of appreciation in the value assets without any effort on the part of the owner should be taxed so as part of the gain achieved, or loss avoided, to the benefit of the Crown. Against this simple concept special provisions were enacted to prepared for exceptional circumstances. But the general concept is that an accretion in the capital value of an asset during ownership should be shared between the owner and the state. A chargeable gain, therefore, imports the following elements: (1) the acquisition of the asset; (2) an increase in the capital value of the assets whilst in the ownership of the person to be charged; (3) a disposal of the asset giving rise to a realisation of the gain which has accrued during the period of the ownership.

Special provisions were obviously required to deal with assets that had come into the ownership of the person to be charged prior to the coming into force of the Act. Provision had also to be made to deal with assets which had come into the possession of the owner without his acquiring them by a transaction at arms length, as a result of neutral increase, by his own artistic manufacture, or by gift, or special transaction. [His Lordship then set out the material parts of section 22 of the Finance Act 1965 and continued: Further provisions for computing chargeable gains are contained in Schedules 6, 7 and 8 to the Act of 1965. Costs incurred in acquiring the asset, enhancing its worth and disposing of it may be taken into account in assessing the gain: Paragraph 4 of Schedule 6: Paragraph 14(1) of Schedule 7 provides that the grant of an option should be considered subject to special provisions as the disposal of an asset.

Before the commissioners and Knox J. the Crown contended that it was sufficient for a gain to be chargeable if the asset to which the gain is attached is created at the moment of or by the disposal. In support of this contention reliance was placed on section 22(2)(b) and the provisions dealing with the granting of options in paragraph 14 of Schedule 7. It was argued that options were examples of an asset coming into existence at the moment of disposal. Options are included in the definition �of "assets" in section 22(1)(a). If the granting of an option constituted both the acquisition and disposal of an asset then there would be no need for many of the provisions of paragraph 14 of Schedule 7 of the Act of 1965. The argument based on section 22(2)(b) is in my judgment a false argument. The creation of the asset by the act of referred to in section 22(2)(b) must be read in the context of that subsection as a whole and clearly relates to the creation of the asset by subdivision of a previously existing larger entity. This is an irrelevant concept in the argument of creating an original asset in its entirety by the mere act of disposal. In my judgment, the Crowns arguments based on the creation of an asset by the act of disposal was rightly reject by the commissioners and by the judge.

An Alternative argument proffered by the Crown was that the right to trade freely and to compete in the marketplace was an asset enjoyed by everyone. Therefore, it was said that, by entering a covenant restricting their freedom to trade, the taxpayer company had disposed of a part of an asset which they had previously possessed so that there was a part disposal within section 22(2)(b). It was submitted that the right to trade was incorporeal property falling within section 22(2)(b) and, therefore, was an asset. In my judgment, this is torturing the language of the Act. The right to trade in the marketplace is a right which is common to all, as has already been described by Nicholls L. J. To suggest that it is an incorporeal right within section 22(1)(a) is wholly unjustifiable within the basic concept of an acquisition of an asset with its accretion in value owing to changes in economic circumstances, etc., over a period of inflation followed by disposal with a realisation of a chargeable gain. With respect to those who proposes it, I think that this was a fanciful submission and was rightly rejected by the commissioners and by Knox J.

The absurdity of treating the covenant as a part disposal of the right to trade is demonstrated by considering the provision of paragraph 7(1) of Schedule 6. Sub-paragraph (2) provides that the apportionment shall be made by reference: (a) to the amount or value of the consideration for the disposal on the one hand ("A"); and (b) to the market value of the property which remains undisposed of on the other hand (call that market value "B") and the nominal expense of acquisition, which never in fact takes place. The consideration for acquisition of an asset is provided for in section 22(4) where that asset is acquired otherwise than by a bargain made at arms length. It is taken to be equal to the current market value of the asset. If acquisition and disposal are simultaneous, i.e., at the moment of acquisition, then the best evidence of the market value must be the consideration for the disposal. There cannot be, therefore, a chargeable gain. If, on the other hand, the provisions of paragraph 7(1) of Schedule 6 are brought into play, then this involves the value of the whole of the asset assuming that the value of the disposed part is in fact only part. So, it must be �argued, that the value of the taxpayer companys freedom to trade and compete as an entity embracing all its activities must be valued as well as its freedom to trade in respect of the part which is separated and these two figures inserted into the formula provided for in paragraph 7 of Schedule 6, A i.e. A + B But what is difference between the value to trade freely in the market place of one person as hypothetical consideration as against that of another entity? Whilst I appreciate that the courage and skill of valuers remains undaunted even in the most difficult circumstances, the exercise of assessing the commercial value of the unrestricted freedom to trade in the market place of a large multi-national conglomerate so as to calculate factor B would be gargantuan.

I now turn to the question of goodwill which, as I have indicated, is the one aspect on which I think this appeal should succeed. Since the point was not taken before the commissioners there are no relevant findings of fact against which this concept can be properly considered. I assume, because it would accord with general experience that when the taxpayer company acquired the entire issued capital of Metal Industries Ltd. and with it their wholly-owned subsidiary D. M., in the usual published marketing literature the taxpayer company, on the one hand, would include Metal Industries Ltd. and D. M. as amongest their group and, likewise, on the marketing and trade literature of Metal Industries Ltd. and D. M. they would be described as part of "the Thorn group" or words to that effect. Similarly, when Potters Ltd. and T. and W. became wholly-owned subsidiary of Metal Industries Ltd. and, therefore, became part of the Thorn group, a similar situation would prevail. In general parlance, therefore, there would be goodwill acquired on the one hand by Metal Industries Ltd. and the three companies as being part of the world-famous multi-national group "Thorn," and for their part the taxpayer company would acquire a proportionate degree of goodwill because they were able to announce that, amongst their companies were the presumable successful and reputable companies Metal Industries Ltd. and the three companies. It was accepted by the taxpayer company as a matter of principle that goodwill is an asset for the purpose of section 22 of the Act of 1965. But it contended that it was normally part and parcel of the sale of the business and, therefore, did not fall for separate consideration. It was argued on its behalf that the taxpayer company did not as a matter of practice carry on any of the trades of the three companies save only in certain limited respects which were excluded by the terms of the agreement from the restricting provisions of the covenant. On the other hand, Mr. Nugee, for the Crown, pointed out that G. E. were prepared to pay U. S. $575,000 for something. As I have already indicated in this judgment, I agree with Nicholls L. J. in holding the view that the asset within the terms of section 22 and, therefore, any agreement to restrict this cannot be the �disposal of an asset for the purpose of computing a chargeable gain.

No doubt a considerable part of the consideration paid by G. E. was to prevent the taxpayer company acquiring other companies to compete with the companies sold, but this would not be the disposal of goodwill, save in so far as such new companies, would benefit from being "a member of the Thorn group" which in the past had derived goodwill from having the three companies as part of the group. This is an acceptable approach but one which would have to be carefully assessed and quantified so as to distinguish that portion of the consideration paid to the taxpayer company attributed to buying a sense of security from competition and that portion of the same sum which was paid to prevent the taxpayer company exploiting such goodwill as they had acquired from the three companies via Metal Industries Ltd. In my judgment, the proportion duly attributable to the element of goodwill possessed by the taxpayer company as a result of the participation of the three companies within the activities of the Thorn group would be a capital asset in respect of which a capital sum was derived notwithstanding that no asset had been acquired by G. E. This would bring it within section 22(3) although not specifically under any one of the three paragraph of that subsection. On this aspect only in my judgment has a chargeable gain arisen.
For the reason in this judgment and those included in the judgment of Nicholls L. J. I respectfully agree with his conclusion and with the course that he recommends in his judgment.

RUSSELL L. J. I have had the advantage of reading in draft the judgments of Purchas and Nicholls L. JJ. I agree that this appeal should be allowed and I also agree that the matter should be remitted to the commissioners for reconsideration once this court, in the light of any further submissions by counsel, has determined the precise form of the order. As to the merits there is nothing that I can usefully add.

16 November 1987. The Court of Appeal heard further argument from the taxpayer company as to whether the case should be remitted to the special commissioners for further evidence to be adduced. On that occasion the court adjourned the matter part heard to a further date.

15 February 1988. A consent order setting out final terms agreed between the parties was approved by the court. Thereby there was to be no remitter of the case to the special commissioners and (1) the order of Knox J. dismissing the Crowns appeal from the commissioners determination and (2) that determination, were both to be varied in specified terms set out by the parties in a schedule of "terms of compromise."

Solicitors: Solicitor of Inland Revenue; Rowe and May.

[Reported by MRS. HARRIET DUTTON, Barrister-at-Law]