A HIGH COURT OF JUSTICE (CHANCERY DIVISION)—20TH AND 24TH MARCH 1964

COURT OF APPEAL—21ST, 22ND, 23RD, 26TH, 27TH AND 28TH OCTOBER AND 26TH NOVEMBER 1964

HOUSE OF LORDS—21ST, 25TH, 26TH AND 27TH OCTOBER AND 15TH DECEMBER
B 1965

Chancery Lane Safe Deposit and Offices Co. Ltd.

v.

Commissioners of Inland Revenue(1)

C *Income tax—Mortgage interest charged to capital—Whether payable out of profits or gains brought into charge to tax—Appeal against first assessment to income tax for one year settled by agreement—Whether additional assessment competent—Income Tax Act* 1952 (15 & 16 *Geo*. 6 & 1 *Eliz*. 2, *c*. 10), *ss*. 169, 170 *and* 510.

The Appellant Company borrowed money on mortgage to finance the rebuild-
D *ing of its premises and the erection of new buildings. On the advice of its auditors, a proportion of the interest was charged to capital in the Company's accounts. The Company's income was such that (except in one year) it could have paid the whole of the interest out of profits or gains brought into charge to tax.*

The Company was assessed to income tax under s. 170, *Income Tax Act* 1952, *for the years* 1954–55 *to* 1958–59 *inclusive on the interest so charged to*
E *capital. On appeal, the Company contended* (1) *that the payments fell within s.* 169, *Income Act* 1952, *and* (2) *that the assessment under s.* 170 *for the year* 1955–56 *was barred by an agreement in writing under s.* 510, *Income Tax Act* 1952, *in respect of the original assessment for that year. The Special Commissioners dismissed the appeal.*

Held, (1) *that, since the Company's decision to attribute part of the interest*
F *to capital had a practical effect on the amount of the distributable fund represented by the balances of the profit and loss account carried forward from year to year, the Company could not make an inconsistent attribution for tax purposes;* (2) *that the agreement relating to the assessment for* 1955–56 *did not touch the matter in dispute.*

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(1) Reported (C.A.) [1965] 1 W.L.R. 239; 108 S.J. 1029; [1965] 1 All E.R. 335; 236 L.T. Jo. 108; (H.L.) [1966] A.C.85; [1966] 2 W.L.R. 251; 110 S.J. 35; [1966] 1 All E.R. 1.

CASE A

Stated under the Income Tax Act 1952, s. 64, by the Commissioners for the Special Purposes of the Income Tax Acts, for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 9th and 10th May 1963, Chancery Lane Safe Deposit & Offices Co. Ltd. (hereinafter called "the Company") appealed against the B following assessments to income tax made on various dates in 1960 and 1961 under s. 170 of the Income Tax Act 1952 in respect of mortgage interest:

Year of assessment	*Amount of assessment*
	£
1954–55	3,500
1955–56	12,000
1956–57	14,000
1957–58	5,000
1958–59	1,121

C

2. Shortly stated, the main question for our decision was whether, in the circumstances hereinafter appearing, certain sums of mortgage interest paid by the Company should for tax purposes be regarded as having been paid out D of capital. A further question for our decision, in relation to the year 1955–56 only, was whether the assessment was barred by reason of the provisions of s. 510 of the Income Tax Act 1952.

3. The following witnesses gave evidence before us: Sir William Speight Carrington, partner in the firm of Messrs. Whinney, Smith and Whinney, chartered accountants, and Mr. Leonard Anthony Pye, a higher executive E officer employed by the Commissioners of Inland Revenue.

4. The following documents were proved or admitted before us:

(1) Memorandum and articles of association of the Company.

(2) Summary of income and charges (exhibit 1 hereto[1]).

(3) Copies of accounts for year ended 31st December 1954, 15 months ended 24th March 1956, and each of the years ended 24th March 1957, 1958 F and 1959.

(4) Summary of profit and loss accounts (exhibit 2 hereto[1]).

(5) (*a*) W.S.C.1, (*b*) W.S.C.2, and (*c*) W.S.C.3.—schedules prepared by Sir William Speight Carrington (exhibit 3 hereto[1]).

(6) Notice of assessment for 1955–56 and letter of 5th December 1957, notice of appeal dated 6th December 1957, and letter of 30th December 1957 G (exhibit 4 hereto[1]).

(7) Letter of 16th March 1959 from H.M. Inspector of Taxes to the Company's accountants.

(8) Letter of 21st April 1959 from the Company's accountants to H.M. Inspector of Taxes.

Copies of such of the above as are not annexed hereto as exhibits are H available for inspection by the Court if required.

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[1] Not included in the present print.

A 5. As a result of the evidence, both oral and documentary, adduced before us we find the following facts admitted or proved.

(1) The Company was incorporated in 1894 to purchase and carry on the business known as the Chancery Lane Safe Deposit. It is a public company. The safe deposit was situated in the basement of certain buildings in Chancery Lane; the upper parts of the buildings owned by the Company were let to B various tenants. Most of the upper parts were destroyed by enemy action in 1940 and 1941; thereafter for many years only the safe deposit and some small sections of the buildings were usable. Rebuilding commenced in 1949 and a new safe deposit in a slightly different position was opened in 1953. Rebuilding of the upper structures and the erection of new buildings continued until 1958.

(2) The origin of the dispute between the Company and the Inland Revenue C was this. For the purpose of financing the rebuilding and the erection of new buildings the Company borrowed money on mortgage; £100,000 was borrowed in 1954 and further sums were borrowed in 1955 and 1956, in order to make progress payments to the builders, until the amount of borrowing reached £650,000, at which sum it remained until 1957. In the Company's financial year ending 24th March 1958 a start was made to repay the mortgages, and by D the end of the year to March 1961 the Company had repaid all the mortgages. It is the treatment for tax purposes of part of the interest paid on the aforesaid mortgages that is in dispute between the parties.

(3) A summary of the Company's income and of charges and deductions expended or claimed for the years 1954–55 to 1958–59 inclusive is contained in document (2), which is attached to and forms part of this Case as exhibit E 1([1]). Briefly, the profit assessable under Case I of Schedule D (the safe deposit business) was covered for the most part by capital allowances. The main items of income were rents (assessable under Schedule A) receivable in respect of buildings let by the Company to various tenants. The income assessed under Schedule A showed a progressive increase in step with the completion of rebuilding and the erection of new buildings which were let as soon as they F were ready for occupation. In 1954–55 the total income of the Company as assessed to income tax was £8,933: by 1958–59 it was £75,383. The only items of expenditure by the Company with which we were concerned were those for mortgage interest. It will be seen from exhibit 1 that the mortgage interest paid in the year 1954–55 was £3,260; by 1957–58 it was £29,149 and in 1958–59 (in which year the Company started to repay the mortgages) it was £28,879. G It is apparent from the details contained in exhibit 1 that if the Company had chosen to do so it could have paid the greater part of the mortgage interest out of profits and gains brought into charge to tax.

(4) During the period in question, the Company paid dividends to its shareholders, and the amounts of the dividends in relation to the amounts of mortgage interest charged to capital, and to the balance on the Company's H profit and loss account, are set out in document (4), which is attached to and forms part of this Case as exhibit 2([1]).

(5) The Company consulted its auditors, Messrs. Whinney, Smith & Whinney, and accepted their advice as to the proper treatment of mortgage interest in its accounts. The auditors advised the Company that, in order to give a true and fair view of the Company's affairs, and in particular to bring I out the cost of the rebuilding and the erection of the new buildings above

([1]) Not included in the present print.

referred to, and in accordance with general accountancy practice, it was proper to charge to capital the cost of finance during the period of construction in cases where the outlay was substantial in relation to the size of the Company. We accepted as a fact that this was a proper method for accounting purposes. Sir William Carrington produced a copy of a calculation (document (5)(*a*), which is attached to and forms part of this Case as exhibit 3(*a*)([1])) which he made for the Company's accounting period to 24th March 1957 in order to arrive at the correct proportion of the mortgage interest to be capitalised in the Company's accounts. All other relevant years were dealt with on similar lines. Briefly, the Company's surveyor was asked to estimate the rents that might be obtained when the building was completed: this letting potential is the denominator (£95,000 for the year ending 24th March 1957) in exhibit 3(*a*). The actual rents received from the partly completed building (£48,456) is the numerator. The gross amount of mortgage interest paid for the year was £26,536. Using the aforesaid denominator and numerator, the resulting proportion of the mortgage interest to be charged to revenue was 51 per cent. and to be charged to capital 49 per cent. (£13,000). The amounts of mortgage interest charged to capital in the Company's accounts were (as shewn in exhibit 2) as follows:

1954–55	£2,753
1955–56	£11,324
1956–57	£13,000
1957–58	£4,372
1958–59	£1,121

(6) The facts stated in this sub-paragraph are concerned with the subsidiary question in dispute, i.e., whether the assessment made on 10th February 1961 for the year 1955–56 was barred by reason of the provisions of s. 510, Income Tax Act 1952.

Contained in document (6), which is attached to and forms part of this Case (as exhibit 4)([1]), are the following:

(*a*) A notice of assessment for the year 1955–56, dated 28th November 1957, on interest paid, £4,216.

(*b*) A letter dated 5th December 1957 from Messrs. Whinney, Smith & Whinney to H.M. Inspector of Taxes, with which was enclosed a formal notice of appeal, dated 6th December 1957, against the aforesaid assessment; the letter said

> ". . . . We wish to point out that in connection with the assessment for the year 1955–56, according to our records it was agreed that the Section 170 assessment for that year should be in the sum of £4,113 . . . . We have instructed our clients to pay the tax due for the year 1955–56 in the sum of £1,748 0*s*. 6*d*. . . . ."

(*c*) A letter dated 30th December 1957 from H.M. Inspector of Taxes to Messrs. Whinney, Smith & Whinney which said

> " . . . I agree the adjustment for 1955–56 and must apologise for having previously overlooked the agreed amendment."

We found as a fact that the said assessment for 1955–56 on interest paid £4,216 was made in November 1957 by the General Commissioners of Income Tax (on the initiative of H.M. Inspector of Taxes), whereas the provisions of s. 170 require an assessment under that section to be made by the Special

([1]) Not included in the present print.

A Commissioners. Messrs. Whinney, Smith & Whinney and the Company did not raise any objection to the said assessment on technical grounds.

In a letter dated 16th March 1959, by which time there was a new Inspector of Taxes dealing with the Company's tax affairs for the year 1957–58, this Inspector asked Messrs. Whinney, Smith & Whinney whether there would not be s. 170 liability in respect of mortgage interest charged to capital. In a B letter dated 21st April 1959 (document (8)) Messrs. Whinney, Smith & Whinney replied expressing their view that no such liability arose. This was the first occasion on which the Company or its agents became aware of a change of view by H.M. Inspector of Taxes. After further correspondence (not put before us) the Company in due course received notices of the assessments which were the subject of the appeal before us.

C 6. It was contended on behalf of the Company:

(1) that the mortgage interest covered in the assessments under appeal was wholly payable and paid, or is deemed to have been paid, out of profits or gains brought into charge to income tax within s. 169;

(2) that the said mortgage interest was not paid, and is not to be deemed to have been paid, out of capital;

D (3) that the fact that a sum equal to the said mortgage interest was capitalised in the Company's accounts does not render s. 169 inapplicable or render the assessments under s. 170 competent;

(4) that in any event the assessment under s. 170 for the year of assessment 1955–56 is barred by an agreement in writing within the terms of s. 510.

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

E (1) that the mortgage interest charged in the Company's accounts to capital was not paid or deemed to have been paid out of profits and gains brought into charge to tax within the meaning of the said s. 169, but was paid or should be deemed to have been paid out of capital;

(2) that, subject to adjustment of figures, the said interest was therefore correctly assessed under s. 170;

F (3) that the said assessment for the year 1955–56 was not barred by the provisions of s. 510; and

(4) that the appeal should be dismissed.

8. We, the Commissioners who heard the appeal, found as follows:

On the main question in dispute in the case we thought that we were bound by the decision in *Central London Railway Co.* v. *Commissioners of* G *Inland Revenue*[1] 20 T.C. 102. In that case under the provisions of the Railway Companies Act the company had power to charge debenture interest to capital account and it did so. At page 151, Lord Macmillan said:

> "Now it is true that the Railway Company could lawfully, if they chose, have paid the interest in question out of their profits, and it is also true that the interest was paid out of a general banking account which H contained sufficient profits . . . But the interest was actually paid out of capital, and capital was the real source of payment."

We were of opinion that what Lord Macmillan said in that case could well be said in the present case. The mere fact that the railway company had special

(1) [1937] A.C. 77.

statutory powers to charge the debenture interest to capital, whereas in the present case the Company did so under its inherent powers, was not in our view an adequate ground for distinguishing the present case. What the Company did in the present case was valid, and it was in our view equally binding in its effect. A

On the second question, concerning the possible application of s. 510, one of the submissions made by the Crown was, as we understood it, that the 1955–56 assessment made by the General Commissioners in November 1957 was a bad assessment and therefore we should ignore it. But that assessment had been made on the initiative of H.M. Inspector of Taxes and the Company had accepted it and had paid the tax. The actual notice of that assessment (exhibit 4 hereto[1]) does not specifically say that the assessment had been raised by the General Commissioners of Income Tax. In our opinion the Crown is estopped from setting up the invalidity of that assessment; but in our view the Company's claim to the protection of s. 510 fails on another ground. We had been referred to the case of *Cenlon Finance Co. Ltd.* v. *Ellwood*[2] 40 T.C. 176, and we had listened to arguments from both sides as to the application of that case. In our view the critical question is whether the question now in issue was discussed between the parties at the time of the alleged agreement. It was clear from the evidence that the particular question of liability to tax on interest paid out of capital was not in the mind of the Company's agents or of the first Inspector in 1957, when the first assessment was the subject of interviews and correspondence between the two sides. That being so, we held that the Crown were not prohibited by the provisions of s. 510 from raising the second assessment for the year 1955–56 to bring into charge the interest paid out of capital. B C D E

Accordingly, the appeal failed on all grounds and we adjusted the assessments to the following figures (agreed by the parties):

1954–55 assessment reduced to £2,753
1955–56 assessment reduced to £11,324
1956–57 assessment reduced to £13,000 F
1957–58 assessment reduced to £4,372
1958–59 assessment confirmed.

9. The Company immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law, and on 16th May 1963 required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act 1952, s. 64, which Case I have stated and do sign accordingly. Sir Basil Todd-Jones, with whom I heard and determined this appeal, has since retired from the public service. G

The question for the opinion of the Court is whether our decision was correct in law.

F. Gilbert { Commissioner for the Special Purposes of the Income Tax Acts } H

Turnstile House,
94–99 High Holborn,
London W.C.1.
7th January 1964.

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[1] Not included in the present print. [2] [1962] A.C. 782.

A The case came before Plowman J. in the Chancery Division on 20th and 24th March 1964, when judgment was given against the Crown, with costs.

Sir John Senter Q.C. and *Neil Elles* for the Company.

F. N. Bucher Q.C., *E. Blanshard Stamp* and *J. Raymond Phillips* for the Crown.

B **Plowman J.**—This is an appeal by the Company against certain assessments to income tax for the years 1954–55 to 1958–59 inclusive, made under s. 170 of the Income Tax Act 1952.

The question in issue is whether, as the Crown claims, the Special Commissioners were right in deciding that certain sums of mortgage interest paid by the Company and charged to capital in the Company's accounts should, C for tax purposes, be regarded as having been paid out of capital or whether, as the Company claims, the sums in question can be treated as having been paid wholly out of profits or gains brought into charge to tax within s. 169.

The relevant facts are set out in the Case Stated and I do not propose to recite them, because it is accepted by Mr. Bucher, for the Crown, that the present case is indistinguishable in principle from the previous case of *B. W.* D *Nobes & Co. Ltd.* v. *Commissioners of Inland Revenue*([1]), unless the following matter affords a valid ground of distinction. In the course of my judgment in the *Nobes* case I expressed my opinion that, as a general rule, a taxpayer is entitled to say that annual payments—and this is equally applicable to interest —made in any particular year are to be treated as having been paid out of his taxed income for that year to the extent to which such income was sufficient E to pay them, and that his right to say this was unaffected both by the manner in which the payment had in fact been made and by the manner in which his domestic accounts had in fact been kept. I added that there were two exceptions to this general rule, (1) where it would not have been lawful for the taxpayer to make the annual payment out of the so-called "taxed fund" and (2) where there were special circumstances. I went on to express the opinion that, on F authority, the only circumstances which are special circumstances for this purpose are cases where the taxpayer has elected to attribute annual payments or interest to capital in order thereby to gain some tax or other fiscal advantage, and so is precluded from contending that they were made out of taxed income.

Mr. Bucher invites me to consider whether I may not have taken too narrow a view of the ambit of special circumstances. He referred me to a G passage from the judgment of Lord Hanworth M.R. in *Central London Railway Co.* v. *Commissioners of Inland Revenue* 20 T.C. 102, at pages 135–6, which shows that the Master of the Rolls attached considerable importance to the form in which the company had kept its accounts. Mr. Bucher points out that the Company in the present case is a public company, unlike the company in the *Nobes* case, which was a private company, and that its accounts carry H what Mr. Bucher calls a "solemn significance". He points out further that in the present case, unlike the *Nobes* case, the sums in question have been brought into the Company's audited accounts, though he concedes that it cannot be suggested that this was done in order to obtain any tax or other fiscal advantage.

([1]) Page 133 *post;* [1964] 1 W.L.R. 761.

(Plowman J.)

In my judgment these matters do not constitute "special circumstances" so as to prevent the operation of the general rule. It is true that in the *Nobes* case([1]) I was not referred to the passage from the judgment of Lord Hanworth M.R. to which Mr. Bucher has referred me in the present case, but two things must be borne in mind: first, that the *Central London* case([2]) was a case of special circumstances in the narrowest sense of that term, and the passage in question must, therefore, be regarded in that context; and secondly, that any significance previously attached to a company's domestic accounts must now be reconsidered in the light of Lord Greene M.R.'s judgment in the subsequent case of *Allchin* v. *Coulthard*([3]) [1942] 2 K.B. 228, which was accepted and adopted by the House of Lords, [1943] A.C. 607.

An additional point was taken by the Company in relation to the assessment for the year 1955–56, on which I should perhaps express my opinion very briefly. That was that the assessment was barred by s. 510 of the Income Tax Act 1952. Subsection (1) of that section is in the following terms:

> "Subject to the provisions of this section, where a person gives notice of appeal to the General Commissioners, the Special Commissioners or the Board of Referees against an assessment to, or a decision of any kind with respect to, income tax other than surtax or surtax, and, before the appeal is determined by the Commissioners or Board, the surveyor or other proper officer of the Crown and the appellant come to an agreement, whether in writing or otherwise, that the assessment or decision should be treated as upheld without variation, or as varied in a particular manner or as discharged or cancelled, the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was come to, the Commissioners or Board had determined the appeal and had upheld the assessment or decision without variation, had varied it in that manner or had discharged or cancelled it, as the case may be."

It is common ground that the question here is whether there was an agreement as to the particular point in dispute, namely, the question of the Company's liability to tax in respect of mortgage interest charged to capital. The Special Commissioners held on the evidence that there was no such agreement and I concur in thinking that, on the evidence to which they refer, that was the inevitable conclusion.

In the result, I allow the appeal and discharge the assessments.

Sir John Senter Q.C.—I ask that the appeal be allowed with costs. I think I ought to say, perhaps, that your Lordship does not accept the Company's argument in respect of the year 1955–56. No doubt Mr. Stamp will ask to except the costs in respect of the year 1955–56; it is a common matter of taxation and should not cause any difficulty.

Plowman J.—Yes. Mr. Stamp, what do you say?

Stamp—I submit your Lordship at the end of your judgment made the correct Order; it should be, allow the appeal, discharge the assessments and order the Crown to pay the costs.

Plowman J.—Yes, I agree.

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(1) Page 133 *post*. (2) 20 T.C. 102.
(3) 25 T.C. (*sub nom.* Allchin *v.* Corporation of South Shields).

A The Crown having appealed against the above decision, the case came before the Court of Appeal (Harman, Danckwerts and Salmon L.JJ.) on 21st, 22nd, 23rd, 26th, 27th and 28th October 1964, when judgment was reserved. On 26th November 1964 judgment was given unanimously in favour of the Crown, with costs.

H. H. Monroe Q.C., *J. Raymond Phillips* and *J. P. Warner* for the Crown.

B *Sir Andrew Clark Q.C.* and *Neil Elles* for the Company.

Harman L.J.—I am authorised by **Salmon L.J.** to say that he concurs with the judgment I am about to deliver.

In the Court below this appeal was decided upon the footing that it was governed by the Judge's decision in the immediately preceding case, namely, C *B. W. Nobes & Co. Ltd.* v. *Commissioners of Inland Revenue*(1), in which we have just given judgment. This was because the Judge decided that case upon the footing that the only special circumstance which could disentitle a company from rewriting its accounts so as to show that a payment of annual interest, appearing in the books to have been paid out of capital, must be taken to have been paid out of profits if profits there were—as the Judge there assumed, D though I think wrongly—was the fact that the company seeking to rewrite its accounts was doing so in order to obtain some fiscal advantage, as in *Birmingham Corporation* v. *Commissioners of Inland Revenue*(2) 15 T.C. 172, where the corporation was claiming a subsidy upon the footing that it had paid out a gross sum in interest whereas in fact it had only paid out a net sum. Lord Atkin treated this as something akin to a case of estoppel, holding that E the fact that the gross sum was claimed by way of subsidy was conclusive evidence that the corporation had, in fact, paid the interest out of untaxed funds. I do not think that the obtaining of such an advantage is necessarily the only criterion. The true test in my judgment is whether there is evidence to the contrary.

The facts of this case are simple enough. The Chancery Lane Safe Deposit F and Offices Co. Ltd. (which I shall call "the Company") was a public company carrying on business before the war in a building in Chancery Lane. The business consisted of carrying on in the basement a safe deposit and letting the upper parts of the building to various tenants. In the war almost everything above the ground was destroyed, though the safe deposit survived and was alone usable until rebuilding began. This spread over the years from 1949 until 1958, and G during that time the Company borrowed large sums of money on mortgage, notably in 1954, 1955 and 1956, and it reached in 1957 the sum of £650,000. Repayments started in 1958 and the whole sum was repaid by 1961. In 1954 the assessed income of the Company was £8,933. By 1959 it had reached over £75,000. This, of course, was due to the fact that as rebuilding progressed lettings to tenants were made. These figures are shown in table C attached to H the Case.

It appears that the Company took the advice of its auditors as to how during the rebuilding process the interest on the mortgages raised to finance the rebuilding ought to be treated in the Company's accounts. Interest in the year

(1) Page 133 *post;* [1964] 1 W.L.R. 761 ; [1965] 1 W.L.R. 229, C.A. (2) [1930] A.C. 307.

(Harman L.J.)

1954–55 was £2,350 and it reached its height in 1957–58, when it was nearly £30,000. It decreased slightly in 1959 and thereafter rapidly disappeared. The Company appears to have received the advice, which it is admitted was perfectly proper in the circumstances, that in order to give a fair view of the Company's affairs it was proper to charge a certain fraction of the interest payments to capital, according to a formula which is set out in the Case and which I need not repeat here. The Company accordingly in the years 1954–55 to 1958–59 charged certain sums of mortgage interest against capital in their accounts. These are set out in para. 5(6) of the Case Stated. The Crown claimed that so much of the interest as was debited to capital account was, in fact, paid out of capital and was not paid out of profits or gains brought into charge to tax. The Company claimed that these allocations to capital were mere bookkeeping entries and irrelevant for tax purposes. The Company was able to show that in the years in question there were profits out of which the portion of the interest attributed to capital might have been paid, and argued that it followed from the decision in *Allchin* v. *Coulthard*(1) [1943] A.C. 607 that the Company's methods of bookkeeping were irrelevant and that the mortgage interest must be deemed to have been paid out of profits brought into charge. The learned Judge assented to this view on the same reasoning as he had adopted in the *Nobes* case(2), namely, that the only special circumstance precluding the Company from taking this course was proof that the object of taking it was to obtain a fiscal advantage. I have already said that I disagree with this view. I think it depends on the facts of the case and the evidence.

What conclusion I should have reached on this matter if it had been *res integra* I am not prepared to say. In my opinion this case cannot be distinguished from the *Central London Railway Co.* v. *Commissioners of Inland Revenue*(3) [1937] A.C. 77. In that case the appellant railway company was empowered to raise additional capital by means of an issue of 5 per cent. debenture stock, and was authorised by its special Act to charge interest on the moneys so raised to capital over a period of five years. It did so as to a part of the interest, and the House of Lords held that, although there were profits out of which the interest could have been paid, still, having regard to the facts, the annual payments had in fact been made out of capital and were chargeable accordingly. Lord Macmillan, who delivered the only speech, in which the rest of the House concurred, said this at pages 88–90(4):

> "I now come to the special circumstances of the case in hand. Accepting the position that in the year in which the interest in question was paid there were 'profits or gains' of the Railway Company 'brought into charge to tax', in the sense of income assessed and charged to tax in that year, in excess of the amount of interest paid, there remains the question whether the interest was 'payable' out of these 'profits or gains'? The word 'payable' is used in Rule 19, s. 1, and Rule 21, s. 1; 'paid' is used in Rule 19, s. 2, relating to patent royalties and in s. 36, sub-s. 1, which deals with interest on bank advances. There are passages in cases in this House in which 'payable' appears to have been read in this connection as equivalent to 'paid' or 'may be deemed to have been paid'. (See, e.g., per Lord Atkinson in *Sugden* v. *Leeds Corporation*(5)). For the present purpose the difference is in my view immaterial.

(1) 25 T.C. 445 (*sub nom.* Allchin *v.* Corporation of South Shields). (2) Page 133 *post.*
(3) 20 T.C. 102. (4) *Ibid.*, at pp. 151–2. (5) 6 T.C. 211; [1914] A.C. 483.

(Harman L.J.)

A Now it is true that the Railway Company could lawfully, if they chose, have paid the interest in question out of their profits, and it is also true that the interest was paid out of a general banking account which contained sufficient profits (though these profits were not their assessed profits—a difficulty which still haunts me). But the interest was actually paid out of capital, and capital was the real source of payment. If the B debiting of the interest were merely a matter of domestic accounting I should not be disposed to lay much stress upon it. But in my opinion it was much more than this. There was a deliberate decision to charge the sum in question against capital and not against revenue. That being so, I do not see how the Railway Company can claim to retain the tax on this interest paid out of capital when the right to retain tax is conditional on C the interest being payable out of profits. If the interest had been paid out of actual profits the sum so paid would have figured in the Railway Company's return of profits to be charged to tax in the next year; but the £2,340 . . . has never appeared and will never appear in any return by the Railway Company for tax purposes, for it is a payment out of capital. Consequently the Crown will never receive any tax either from the Railway D Company or from the debenture holders in respect of the interest paid to the latter in 1930 if the Railway Company are not held accountable to the Crown for the tax which they deducted. The theory of the notional taxed fund covering the amount of the interest paid does not fit such a case, for the transaction is outside the region of profits whether notional or actual. By their own deliberate act the Railway Company have made this sum E not payable out of profits. It is nothing to the purpose that theoretically the Railway Company might in some future year carry this sum of £2,340 . . . back into profit and loss account as income. As to whether in the circumstances they could competently do so I express no opinion. But in the tax year in question they have chosen not to debit this sum to revenue account, and consequently have pro tanto prevented the diminution of the F dividend fund in the distribution of which among their shareholders they have deducted tax and, as they were entitled to do, have retained the tax deducted.

My Lords, I do not think that the same sum can be utilised by the Railway Company to render them those two inconsistent services in the same tax year . . .".

G The only difference between that case and this that I can see is that there the attribution to capital of the interest was made in pursuance of the special Act, whereas here the similar attribution has been made on the advice of the Company's auditors and in exercise of its inherent powers as a company under the Companies Act. I cannot see that this makes any difference.

A point in Lord Macmillan's reasons is that the company, by debiting H part of the interest to capital, increased the amount of the fund available for paying dividends. That too is a feature of the present case, and it seems to me that we are bound to hold in accordance with the decision of the House of Lords that the attribution to capital of the portions of the mortgage interest so treated is binding on the Company, which must account for the tax accordingly. I would therefore allow the appeal on this point. It was argued

(Harman L.J.)

that the decision in the *Central London* case[1] was inconsistent with that in *Allchin* v. *Coulthard*[2] and that the latter decision might be preferred to the former. I do not find any inconsistency. It is to be observed that Lord Romer was a party to both decisions and he did not suggest that any inconsistency existed. A

There was another point in this case, which affected only one year of the five in question, and here the Judge was in favour of the Crown, though that made no difference to the result, having regard to his decision on the main point. This point depends on s. 510 of the Income Tax Act 1952, which is in these terms: B

> "(1) Subject to the provisions of this section, where a person gives notice of appeal to the General Commissioners, the Special Commissioners or the Board of Referees against an assessment to, or a decison of any kind with respect to, income tax other than surtax or surtax, and, before the appeal is determined by the Commissioners or Board, the surveyor or other proper officer of the Crown and the appellant come to an agreement, whether in writing or otherwise, that the assessment or decision should be treated as upheld without variation, or as varied in a particular manner or as discharged or cancelled, the like consequences shall ensue for all purposes as would have ensued if, at the time when the agreement was come to, the Commissioners or Board had determined the appeal and had upheld the assessment or decision without variation, had varied it in that manner or had discharged or cancelled it, as the case may be." C D

It was the Company's case that there had been an agreement between the Company and the Inspector in respect of the year 1955–56 which precluded the Crown from reopening the assessment for that year. The sum involved was £4,216. The Special Commissioners held that s. 510 was no bar and the Judge agreed with this view, and so do I. *Cenlon Finance Co. Ltd.* v. *Ellwood*[3] 40 T.C. 176 made it impossible for the Company to contend that there had been no "discovery" by the Inspector within s. 41 of the Act of 1952. The question under s. 510 was whether the Company and the Inspector had come to an agreement on the point in dispute. That there had been an agreement upon the footing of the tax then demanded was clear enough, but the point now in issue was not then raised nor was the question in the minds of either of the parties. The Commissioners so held, and this is a question of fact on which I do not think this Court is at liberty to take a different view. On this question, therefore, I agree with the Special Commissioners and with the learned Judge. E F G

Danckwerts L.J.—I agree with the judgment of Harman L.J., and I do not think that it is necessary for me to add anything.

Warner—My Lord, I submit that in this case, too, the right Order would be to set aside the Order of the Chancery Division and order that the assessment be restored.

Harman L.J.—What about s. 510? H

Warner—My Lord, what the learned Judge did was to declare that the Commissioners' disallowance of the Appellant's claim to the protection of s. 510 in respect of the assessment for the fiscal year 1955–56 was correct, but it did not affect his Order.

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(1) 20 T.C. 102. (2) 25 T.C. 445. (3) [1962] A.C. 782.

A **Harman L.J.**—I agree it did not.

Warner—I think if your Lordship sets aside the learned Judge's Order that will deal with the whole thing.

Harman L.J.—What did the Commissioners say on this point? If I am satisfied that the Judge is right I would restore that of the Commissioners.

Warner—I am told that if your Lordships allow the appeal, and restore B the decision of the Commissioners, as opposed to the assessments, that will cover the point.

Harman L.J.—Do you agree with that?

Elles—I respectfully agree, my Lord.

Warner—My Lord, again I ask for costs here and in the Court below.

Elles—My Lord, can my client have leave to appeal to the House of C Lords?

Harman L.J.—Yes.

Elles—I am very much obliged.

The Company having appealed against the above decision, the case came before the House of Lords (Lords Reid, Morris of Borth-y-Gest, Upjohn, D Wilberforce and Pearson) on 21st, 25th, 26th and 27th October 1965, when judgment was reserved. On 15th December 1965 judgment was given in favour of the Crown, with costs (Lords Reid and Upjohn dissenting).

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[1]*Sir Andrew Clark Q.C.* and *N. P. M. Elles* for the Appellant Company. There are two questions: (1) whether the mortgage interest which the Company E charged to capital in its domestic accounts should nevertheless be treated for income tax purposes as having been paid out of profits or gains brought into charge to tax, or whether the Company is bound by its own accounts; (2) if the Company fails on the main issue, whether the additional assessment for the year 1955–56 was barred by reason of the provisions of s. 510 of the Income Tax Act 1952.

F On the main issue the relevant statutory provisions are ss. 169, 170 and 184 of the Act of 1952.

The mortgage interest comes within s. 169, and so the Company is entitled to deduct income tax from it without accounting to the Revenue again for the tax so deducted.

The Crown contends that s. 170 applies to so much of the mortgage interest G as was charged to capital, on the ground that it was not paid out of profits or gains brought into charge and the Company is bound to pay the tax deducted over to the Revenue. But in the present case this would result in double taxation.

Section 184 does not arise in the present case, because the total profits in each year were sufficient to cover both the interest and the dividend payments.

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[1] Argument reported by F. H. Cowper, Esq., Barrister-at-Law.

It is submitted: (1) If a company has profits or gains brought into charge to tax in the relevant year, which could legally be applied for the purpose of making the annual payment in question, then, in the absence of special circumstances, the company is entitled to treat the annual payment in its accounts with the Revenue for income tax purposes as having been made out of those profits, irrespective of the manner in which the annual payment may have been treated in the company's domestic accounts: see *Allchin* v. *Corporation of South Shields*(1).

(2) No matter how formal a company's accounts may be, they are never conclusive between the company and the Revenue on tax matters: *Commissioners of Inland Revenue* v. *Ayr Town Council*(2), where the accounts were very formal, far more than in the present case.

(3) It must follow that the fact that the Appellant Company elected to charge part of the mortgage interest to capital in its own accounts cannot of itself be a special circumstance taking the case out of the general rule, though it might be a special circumstance if combined with the special circumstance that it had enabled the Company to pay and the Company had in fact paid a larger dividend that it could otherwise have done.

(4) Here it is immaterial because it does not alter anyone's rights, because no one has a right to a dividend until it is declared. *Non constat* that the Company will declare any increased dividend, or will deduct tax if and when it is paid.

(5) The only special circumstances which can take the case out of the general rule are found in cases where the company has in fact used profits, out of which it claims for tax purposes to have made the payment in question, to obtain a tax advantage (see *Birmingham Corporation* v. *Commissioners of Inland Revenue*(3)) or for some other purpose which affects its tax liability for the relevant year, for example, for some purpose which would have to be shown in its tax accounts with the Revenue, as distinct from its domestic accounts.

(6) There are no special circumstances in this case apart from the fact that the Appellant Company has thought fit in its own domestic accounts to charge the interest to capital, because it has followed the advice of its auditors that this would better reflect the cost of building for the shareholders' information—not to get an advantage, but on proper accounting principles to show the affairs of the Company.

(7) Even if it were a special circumstance that the rights of third parties were affected (which is not conceded) the rights of third parties were not affected here. It has to be shown that in the relevant year the tax liability would have been affected; it is not enough that it might have been affected if it has not in fact been affected.

Reliance is placed on *Allchin* v. *Corporation of South Shields*. The majority of the House of Lords adopted the judgment of Lord Greene M.R. in the Court of Appeal: see also *Commissioners of Inland Revenue* v. *Ayr Town Council*(4). *Birmingham Corporation* v. *Commissioners of Inland Revenue* is a very special case, standing by itself. All the Lords reached the same result by different means, Lord Buckmaster and Lord Atkin one way and Lord Dunedin

(1) 25 T.C. 445; [1943] A.C. 607. (2) 22 T.C. 381; 1938 S.C. 822.
(3) 15 T.C. 172; [1930] A.C. 307. (4) 22 T.C. 381, 400, 409, 412–3, 414.

A and Lord Summer another, while Lord Blanesburgh concurred with both. The case turned on the special nature of the exchequer subsidy and the fact that the corporation based its claim for it on the assertion that it was out of pocket to the extent of the gross amount of the interest.

In *Central London Railway Co.* v. *Commissioners of Inland Revenue*([1]) Lord Macmillan misapprehended the facts and so did the other Lords. The B true *ratio decidendi* of that case is found later in his speech([2]) and that fits in with what was said in the *Ayr* case([3]) and later in *Allchin's* case([4]). The general principles laid down in the latter case should prevail.

On these authorities it is submitted: (1) The general rule laid down by the House of Lords is that, in the absence of special circumstances, if the taxpayer has available in the relevant year taxed profits which can legally be applied to C the payment of the annual interest in question, then, to the extent to which those taxed profits are sufficient for the purpose, he is entitled to treat the annual interest as having been paid out of those taxed profits for income tax purposes and to retain for his own use the tax deducted by him therefrom when making the payment.

(2) The rule is equally applicable to individuals and limited companies, D as well as statutory or charter corporations. Limited companies cannot be excluded from the rule: *Allchin's* case.

(3) It is irrelevant for tax purposes how the taxpayer may have treated the annual interest as having been paid in his own domestic accounts, no matter how formal they may be: *Allchin's* case and the *Ayr* case.

(4) It follows from this last proposition that the mere fact that a company E has charged the annual interest to capital for an accounting purpose in its own domestic accounts cannot of itself constitute a special circumstances to take the case out of the general rule.

(5) In each of the relevant years of assessment the Appellant Company had sufficient profits or gains brought into charge to tax to pay both the mortgage interest and the dividends paid in that year. No notional fund is F involved, and that distinguishes this case from the decision of the Court of Appeal in *B. W. Nobes & Co. Ltd.* v. *Commissioners of Inland Revenue*([5]).

(6) The general rule is not limited to cases where the company's own accounts showed the payment as made out of taxed profits or where the accounts were totally silent as to the source from which the payments were made or where the accounts expressly showed the interest as paid out of a mixed fund.

G (7) The *Central London* case appears to have been decided in the House of Lords on the basis that the company purported to pay both the interest on the debentures and the dividends out of money which was insufficient for both purposes: see also what Lord Greene M.R. said in *Allchin* v. *Corporation of South Shields*([6]). If that is the basis, the *Central London* case has no application to the present case and the Court of Appeal was wrong in holding itself bound H by it. This was expressed by Harman L.J.([7]).

(8) If and in so far as the speech of Lord Macmillan in the *Central London* case goes to the extent of saying that the mere fact of charging the interest to

([1]) 20 T.C. 102; [1937] A.C. 77. ([2]) 20 T.C. 102, 152. ([3]) 22 T.C. 381.
([4]) 25 T.C. 445. ([5]) Page 133 *post;* [1965] 1 W.L.R. 229. ([6]) 25 T.C. 445, 456–7.
([7]) *See page* 92 *ante.*

capital in the company's accounts was enough to oust the general rule, that was inconsistent with *Allchin's* case([1]), and in so far as there is an inconsistency the latter case should be preferred as being one in which the *Central London* case([2]) was cited and considered and was presumably reconciled by Lord Macmillan himself, who may have had second thoughts. It is not easy to reconcile the two cases, but they must be reconciled. A

The subsidiary issue under s. 510(1) only arises if the Appellant Company's argument on the first point fails. B

[Lord Reid intimated that, since that point was quite separate, counsel for the Appellant Company might be called on to argue it at the conclusion of the argument on the main question.]

H. H. Monroe Q.C., *J. Raymond Phillips* and *J. P. Warner* for the Crown. The way in which the Company arranged its domestic accounts increased its tax liability, and it is immaterial that it gained no financial advantage thereby. It charged the interest to capital, but, had the decision been to pay it out of income, the system of paying for the building would have been quite different; there would have been a different balance in the profit and loss account and there would have been *pro tanto* a different balance on the general reserve account. The Company's decision increased the fund of taxed profits available to it for such purposes as the payment of dividends, thereby affecting the rights of third parties. In these circumstances, it was more than a mere matter of domestic accounting. The accounts were evidence of a deliberate decision to charge the interest to capital. It is not that the accounts themselves have a sacrosanct character, but the record shows that the decision to charge the interest to capital was deliberately taken on the advice of the auditors. On the facts the Company is precluded from treating the sums of interest as having been paid out of profits or gains brought into charge to tax, within the meaning of s. 169 of the Income Tax Act 1952, to the extent that those payments were treated by it in its accounts as having been paid out of capital. Admittedly, for the purposes of the section a taxpayer who has paid sums by way of yearly interest, and who has profits or gains brought into charge to tax in the year of payment, is *prima facie* entitled to treat those payments as having been made out of those profits or gains to the extent thereof. But it must be decided by reference to the facts in each case whether the taxpayer has made those payments out of profits or gains brought into charge to tax, and the taxpayer's right to treat them as having been so paid will be lost if the facts are inconsistent with such treatment. (It is admitted that in the present case the parts of the interest which are not included in the assessment fall within the scope of s. 169, so that the Company is entitled to retain the income tax deducted with respect to those parts, on account of the way in which the Company treated this interest in making up its accounts.) C D E F G

For the Crown, the *Central London* case is the crux of the matter, being indistinguishable from the present case. It was a case of special circumstances. There the entry in the accounts was treated as evidence of a deliberate decision, which had produced practical results, as distinct from mere intention. Accordingly, the question in the present case is: has the decision to charge the interest to capital produced some practical effect? H

In the *Central London* case Lord Macmillan knew what he was talking about. Admittedly the interest to which he referred([3]) could never have figured in any return of profits for income tax purposes, but the taxed fund of the I

([1]) 25 T.C. 445. ([2]) 20 T.C. 102. ([3]) *Ibid.* 151.

A company was in fact sufficient to cover both the dividend and part of the interest debited to capital. Lord Macmillan's words can be construed so as to fit the true facts.

Light is thrown on the three linked cases *Central London Railway* v. *Commissioners of Inland Revenue; London Electric Railway* v. *Same; Metropolitan Railway* v. *Same*(1) by an examination of the actual printed cases filed B in the appeals to the House of Lords. Note in particular para. 5, 6 and 7 of the respective cases of the three appellant railways and reason 8 of their reasons, as well as reasons 7 and 8 in the respondents' case. All three cases were presented on the same footing.

The essentials of the decision in the *Central London* case are expressed by Lord Hanworth M.R., Romer L.J. and Lord Macmillan.

C There are, in the present case, special circumstances which take it out of the general rule that a taxpayer is entitled to treat annual interest as paid out of an available fund of taxed profits. The special circumstance here is the charging of that interest to capital in the domestic accounts, thus introducing into the matter a new and different factor. In a sense domestic accounts are always mere accounts for the Company's own purposes. It is only the deliberate D decision which they evidence that matters. Once the decision to charge the interest to capital is recorded in the accounts, it is a representation to all persons who read the accounts that the fund of taxed profits available for other purposes is greater than it would have been if the interest had not been charged to capital. The carrying forward of a particular sum is a representation as to the company's financial position. To allow the Company's appeal would have E the result of falsifying its public accounts. In these matters the Revenue is always an interested party because the representations made in the accounts may affect tax liability in future years.

Allchin's case(2) is not inconsistent with the Crown's contentions. There are limits to the proposition that taxed income is always available for the payment of interest. In *Allchin's* case what was held was that there were no F special circumstances to take the matter out of the general rule. It provides a clue to what constitutes special circumstances and is a contrast to the *Central London* case. The essentials of the decision in the *Allchin* case are expressed by Lord Greene M.R. in the Court of Appeal and Viscount Simon L.C. and Lord Macmillan in the House of Lords: see also *Commissioners of Inland Revenue* v. *Ayr Town Council*(3). When one analyses the facts of that case one G finds that they are essentially the same as in the *Allchin* case. There was one fund derived from the rates and another fund in which there was some taxed income. The difference was that the rates could not be used for certain items which had to be provided for out of the Common Good fund. That case recognised the right of the taxpayer to disregard his domestic accounts, but it also recognised a limit to this right. On the facts of the case it was held that H the carry forward of the Common Good income could not be disregarded because that income could be used for certain purposes for which the rates were not available. The question was whether it was really a case of interchangeability. This appears from the observations of Lord President Normand, Lord Fleming and Lord Carmont.

(1) 20 T.C. 102. (2) 25 T.C. 445. (3) 22 T.C. 381, 403–4. (4) *Ibid.* 402–3, 404, 408, 415.

The basis of the *Birmingham* case(1) was that interest had been paid otherwise than out of profits. *Paton* (*as Fenton's Trustee*) v. *Commissioners of Inland Revenue*(2) adds little to the solution of the present problem: see Romer and Greene L.JJ.(3). The case went against the taxpayer in the House of Lords on the ground that there had never been any payment at all(4). A

As to the eight propositions submitted for the Appellant: (1) The statement of the general rule is accepted, but it is submitted that there were special circumstances here because the payments were charged to capital. (2) The second general proposition is accepted subject to the limitations hinted at by Greene L.J. in *Paton's* case(5). (3) The third proposition is accepted, subject to the limitation expressed by Lord President Normand in *Commissioners of Inland Revenue* v. *Ayr Town Council*(6) that, when it is not just a matter of domestic accounting but of recording a decision which may have practical results, the matter may be different. (4) As to the fourth proposition, the premise on which the conclusion is based is not fully enough stated, and therefore the conclusion does not follow. (5) It is accepted that there was in the *Nobes* case(7) the distinction suggested by the Appellant, but the way in which this Company has dealt with the matter has left a balance on the profit and loss account which can be distributed later. The accounts cannot be left unchanged so far as the shareholders are concerned, but different in dealings with the Revenue. When a company has shown a balance on its profit and loss account, then that is the balance available for distribution. (6) As to the sixth proposition, there is here a relevant special circumstance which takes the case out of the general rule. (7) The *Central London* case(8) was not decided as has been suggested. (8) As to the final proposition, once it is realised that the *Allchin* case(9) was not one of special circumstances, everything fits in. If the *Central London* case is to be treated as an example of a judicial error, *Commissioners of Inland Revenue* v. *Ayr Town Council* must be overruled too, but its fundamental reasoning is sound. B C D E

A reasonable basis has been established for submitting that this Company made the payments in question out of capital and not out of taxed profits. F

J. Raymond Phillips following. The basic question is what the taxpayer has in fact done and in order to see that one looks at the accounts.

The effect of the representation in the accounts of this Company is altogether different from the effect of the accounts in the *Allchin* case. In the case of a commercial undertaking the accounts, as adopted, have the effect that those who have an interest in it can be expected, and are entitled, to order their affairs on the basis of what is shown on those accounts—in this case the balances carried forward on the profit and loss account. From a purely commercial point of view, people seeing an apparent balance on the profit and loss account are entitled to take that as being the commercial reality of the situation, and the Company, as a taxpayer, is not entitled to adopt a course inconsistent with that situation. The seeds of the future inconsistency were sown as soon as the accounts were adopted in this case. But in *Allchin's* case nobody was going to order his affairs on the basis of the equivalent accounts, the general rate fund account, and that distinguishes it from the G H

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(1) 15 T.C. 172. (2) 21 T.C. 626; [1936] 2 K.B. 59. (3) 21 T.C. 626, 645–6, 653.
(4) 21 T.C. 626; [1938] A.C. 341. (5) 21 T.C. 626, 652–3. (6) 22 T.C. 381, 403–4.
(7) Page 133 *post*. (8) 20 T.C. 102. (9) 25 T.C. 445.

A present case. The relevant enactments in that case were discussed by Lord Greene M.R. in the Court of Appeal[1].

As to the Appellant's seventh submission, on the *Central London* case[2], if it were accepted the result would be to leave the whole position in a state of uncertainty. In *Allchin's* case there was no attempt to delimit the boundaries of "special circumstances", a convenient shorthand expression. Lord Greene B M.R. cannot be said to have been doing so; he was merely referring to two cases in which there were special circumstances: see also what Viscount Simon L.C. and Lord Macmillan said in the House of Lords[3].

Sir Andrew Clark Q.C. in reply. In the domestic accounts of a company it is not attempted to reflect the tax position between the company and the Revenue, and all companies every year make a separate tax account: see what C Lord Greene M.R. said in *Allchin's* case[4]. The fact that the domestic accounts have been audited and passed does not make them sacrosanct, and they have nothing to do with the Revenue accounts. Perhaps they may be evidence of some sort of decision, but the directors could not decide to pay this interest out of anything but the Company's banking account. There may or may not have been capital moneys in that banking account; we are not told. But there D cannot have been a decision to pay the interest out of capital. The suggestion that to charge the interest to capital would affect the Company's general reserve is irrelevant, for that cannot affect the Company's tax situation. The fact that a company may represent that it has a general reserve available, should the directors think fit to declare a dividend, does not amount to saying that it is so available because it represents taxed profits. One cannot make a E real payment out of a notional fund. The payment is made out of the company's banking account, which is usually a mixed fund. There is no significance in that.

The only special circumstance suggested to take this case out of the ordinary rule is the charging of the interest to capital. But that should not be the effect of what the Company did. Suppose a trading company has £10,000 F taxed profits, which are available for the purpose of paying the mortgage interest, and the company has already paid tax on £10,000. Suppose the mortgage interest for the year is also £10,000. If the company pays that mortgage interest with the £10,000, it is entitled to deduct the tax and apply it to its own purposes. The Revenue has received the tax to which it is entitled. The object of ss. 169 and 170 of the Act of 1952 is to avoid double taxation. If this interest G had not been charged to capital the balance on the profit and loss account would have been nil. The domestic accounts do not amount to any representation to the Revenue, which is not bound by them: *Commissioners of Inland Revenue* v. *Ayr Town Council*[5], in which Lord President Normand cited with approval what Lord Atkinson said in *Edinburgh Life Assurance Co.* v. *Lord Advocate*[6]. As to *Commissioners of Inland Revenue* v. *Ayr Town* H *Council*, if Lord Normand had meant to say that a mere carrying forward in the accounts was enough to oust the general rule, he would have been wrong, but the decision was not made on that ground.

As to *Paton* (*as Fenton's Trustee*) v. *Commissioners of Inland Revenue*[7], the relevant point only arose in the Court of Appeal, where it was decided after the decision of the *Central London* case in the Court of Appeal but

[1] 25 T.C. 445, 453–4. [2] 20 T.C. 102. [3] 25 T.C. 445, 463, 464–5. [4] *Ibid.* 456–7. [5] 22 T.C. 381, 401. [6] 5 T.C. 472, 486; [1910] A.C. 143, 158. [7] 21 T.C. 626.

before its decision in the House of Lords, and of course before *Allchin's* case([1]). A
In *Paton's* case([2]) in the Court of Appeal Greene L.J. dissented, delivering a judgment diametrically opposed to the judgments of Lord Wright M.R. and Romer L.J. His dissenting judgment was in terms almost identical with those of his subsequent judgment in *Allchin's* case, which was adopted in the House of Lords. So in *Paton's* case his is the only judgment which stands and the other two judgments must be taken as having been overruled. B

To say that the basic question is to find what the taxpayer has in fact done is contrary to *Allchin's* case. It is undesirable to lay down a hard and fast rule as to what constitutes "special circumstances." At the very least, leaving out illegality, one must find either that the company has treated the taxed profits in the year in question in some special way to gain some tax advantage inconsistent with the use actually made of them, or else that the rights of third C parties have been affected.

As to the subsidiary point, relating to the agreement of 1957, this depends on ss. 41, 50 and 510 of the Income Tax Act 1952. It is submitted that it was not competent to make the additional assessment in respect of the year 1955–56. The matter fell fairly within s. 510. The Company had duly appealed against the assessment for the year 1955–56 and the appeal was settled by an D agreement in writing. Under s. 510 this had the same effect as if the appeal had been finally heard and determined. No additional assessment could have been made on the ground that this was a s. 170 liability. All the facts which gave rise to that contention were fully before the Inspector of Taxes, and if the appeal had been heard and determined on these facts the mere circumstance that the particular issue was not raised at the hearing of the appeal would not E have permitted an additional assessment being made. In view of *Cenlon Finance Co. Ltd.* v. *Ellwood*([3]) it cannot be contended that there was no "discovery" by the Inspector. But reliance is placed on the decision of the Court of Appeal in that case, which dealt with a point under ss. 50 and 510 which was never before the House of Lords. It is submitted that here the particular matter dealt with was the amount of the Company's total liability to tax under s. 170, not F the amount paid out of the Company's taxed profits. For the Appellant Company everything laid down in the *Cenlon* case is accepted, but it does not necessarily cover the present case: see also *Kidston* v. *Aspinall*([4]). Section 50(2) of the Act takes away the right to alter a determination of the Commissioners or an assessment made thereon, except by order of the Court when a Case has been required as provided by the Act. This is so, save where the full facts G have not been disclosed and it is consistent with *Cenlon's* case and *Kidston's* case. One must distinguish between a case where the full facts are not before the Crown and a case of a change of mind as to the law. In the latter case the Crown cannot go back to reopen a case which has been decided against it any more than the taxpayer can.

The total amount of the assessment for 1955–56 was the subject-matter H of the agreement, and in the absence of s. 41(1) of the Act this could not have been reopened. The fact that in March 1959 the Inspector of Taxes first took the view that there should have been an assessment under s. 170 in respect of the mortgage interest did not amount to a "discovery" within that subsection and so did not justify an additional assessment. The discovery must be a discovery of a fact not known to either party. Otherwise the section does not I justify the reopening of a matter which could not otherwise be reopened.

([1]) 25 T.C. 445. ([2]) 21 T.C. 626. ([3]) 40 T.C. 176.
([4]) (1963) 41 T.C. 371.

A **Lord Reid**—My Lords, the Appellants were assessed to income tax under s. 170 of the Income Tax Act 1952 for the five years 1954–55 to 1958–59 in respect of sums amounting in all to some £35,000. Subject to slight reduction in amount, these assessments were confirmed by the Special Commissioners. On appeal Plowman J. discharged the assessments, but they were restored by the Court of Appeal.

B The Appellants have owned for many years premises in Chancery Lane consisting of a basement which they use as a safe deposit and upper storeys which they let out. During the last war the upper storeys were destroyed by enemy action and, in order to finance reconstruction, they borrowed large sums from time to time. In paying interest on these sums they properly deducted tax. The sums in these assessments are part of the interest so paid, so that, if C these assessments stand, the Appellants will have to pay over to the Commissioners of Inland Revenue the amounts of tax which they have deducted and retained in respect of this interest. It is admitted by the Crown that the parts of the interest not included in the assessment fall within the scope of s. 169, so that the Appellants are entitled to retain the income tax deducted with respect to these parts.

D The Crown make this difference because of the way in which the Appellants treated this interest in making up their accounts. On the advice of their auditors the Appellants debited to capital those parts of the interest which are now the subject of this assessment, and debited the rest to revenue account. Apart from one year about which no question now arises, the Appellants had in each year ample profits to cover the whole of this interest, and admittedly it would E have been quite proper both from an accounting and from a legal point of view for them to have debited the whole of the interest in each year to revenue account. But the Appellants chose to follow their auditors' advice, and it is not disputed that in so doing they acted quite legally and followed the better accounting practice. But the Crown assert that by taking this course the Appellants have increased their tax liability, though they gained no financial F advantage by doing so. I find it impossible to suppose that Parliament can have intended such a strange result, but I must proceed to consider whether we are compelled either by the wording of the relevant section or by weight of authority so to find.

The relevant parts of ss. 169 and 170 are as follows:

"169.—(1) Where any yearly interest of money, annuity or other G annual payment is payable wholly out of profits or gains brought into charge to tax—(*a*) no assessment shall be made on the person entitled to the interest, annuity or annual payment; and (*b*) the whole of the profits or gains shall be assessed and charged with tax on the person liable to the interest, annuity or annual payment, without distinguishing the interest, annuity or annual payment; and (*c*) the person liable to make H the payment, whether out of the profits or gains charged with tax or out of any annual payment liable to deduction, or from which a deduction has been made, shall be entitled, on making the payment, to deduct and retain out of it a sum representing the amount of the tax thereon at the standard rate for the year in which the amount payable becomes due; and (*d*) the person to whom the payment is made shall allow the deduction I on receipt of the residue of the payment, and the person making the deduction shall be acquitted and discharged of so much money as is represented by the deduction, as if that sum had been actually paid."

(Lord Reid)

> "170.—(1) Where—(*a*) any interest of money, annuity or other annual payment charged with tax under Schedule D; . . . is not payable or not wholly payable out of profits or gains brought into charge, the person by or through whom any payment thereof is made shall, on making the payment, deduct out of it a sum representing the amount of the tax thereon at the standard rate in force at the time of the payment. (2) Where any such payment as aforesaid is made by or through any person, that person shall forthwith deliver to the Commissioners of Inland Revenue, for the use of the Special Commissioners, an account of the payment, or of so much thereof as is not made out of profits or gains brought into charge, and of the tax deducted out of the payment or out of that part thereof, and the Special Commissioners shall assess and charge the payment for which an account is so delivered on that person."

There has been in the past a good deal of misunderstanding of s. 169 (or of the old r. 19 of the General Rules applicable to all Schedules of the Income Tax Act 1918, which it replaced), so I think it best to begin by analysing its language. There is no doubt that in applying s. 169 each year must be taken separately—there is no question of carrying forward any balance, real or notional, from a previous year. So you must first find an annual payment actually paid during the year in question, and it is not disputed that the sums now assessed are such payments. Then the annual payments must have been "payable wholly out of profits or gains". I shall have to return to this phrase later, and I only note here that the word is "payable", not "paid". And finally the annual payment must have been payable out of "profits or gains brought into charge to tax". And that requires a good deal of explanation.

If these conditions are satisfied the taxpayer is entitled to deduct tax when paying the annual payment to his creditor, and he is permitted to retain that tax. That produces a fair result. In making up profit and loss accounts for income tax purposes these annual payments are not permissible deductions, although ordinary principles of commercial accounting would require them to be deducted before the taxpayer's real profit was determined. So in the first instance the taxpayer pays too much tax, but as against that he gets the right under s. 169 to retain the tax which he deducts. But the working out of this scheme is complicated by the fact that the "profits or gains brought into charge to tax" for a particular year are not the actual profits for that year. They are a notional sum computed on income tax principles from the trader's accounts for the previous year. So the apparent difficulty arises—how can a real annual payment be payable out of such a notional sum? The solution of that problem requires a close examination of the authorities. But if one carries the matter a stage further the real situation may become clearer. The profits brought into charge may be a notional sum, but the tax which the taxpayer has to pay on that notional sum is a very real sum, and there is no difficulty in comparing that sum with the amount of tax which he actually deducts in making the annual payments to his creditor. The practical result is that, if the taxpayer actually pays for a particular year a larger amount of tax than the amount of tax which he deducts in that year in making the annual payments, then he is entitled to retain the tax which he has so deducted.

If one were entitled to adopt such a straightforward approach, the point for decision in this case would become simple. In each of the years in question the Appellant Company did pay more tax than the amounts of tax deducted in making the annual payments. It is not disputed that, but for the way in

(Lord Reid)

A which they chose to make up their accounts, they were entitled to retain the whole of the tax so deducted. So why should the way in which they kept their accounts produce a windfall for the Revenue and in effect produce double taxation?

The true interpretation of the old r. 19 was first explained by Lord Macmillan in his speech, unanimously adopted, in *Central London Railway* B *Co.* v. *Commissioners of Inland Revenue*(1), [1937] A.C. 77, and it was further developed by Lord Greene M.R. in *Allchin* v. *Corporation of South Shields*(2) [1942] 2 K.B. 228, and his explanation was unanimously accepted in this House ([1943] A.C. 607). As Lord Macmillan pointed out, the real difficulty was not discussed in the earlier cases in this House. So it can hardly be profitable to analyse the language used in these earlier cases. The decisions are easy to C explain and justify, but the reasoning is not. The law appears to me to be accurately stated by Lord Macmillan, [1937] A.C., at page 84(3):

> "Whenever in any year the amount of interest paid by the taxpayer does not exceed the amount of his profits or gains as assessed for income tax purposes for that year, then the interest paid in that year is, within the statutory meaning, 'payable out of profits or gains brought into charge D to tax', and the taxpayer is entitled to retain the tax which he deducts in paying the interest. There are qualifications of this principle but that is the general effect of the decision."

Lord Greene M.R. ([1942] 2 K.B. at page 233(4)), takes up two questions propounded by Lord Atkinson in *Sugden* v. *Leeds Corporation*( ), [1914] A.C. 483: (1) Has the interest been in fact paid or must it in the circumstances of E the case be taken to have been paid out of profits or gains brought into charge, i.e. out of the so called taxed fund? (2) Was it lawful to pay it out of the fund? It is not disputed that the Appellants satisfy the second question in the present case. Then Lord Greene went on to explain what is meant by the taxed fund. And then he said, at page 235(6):

> "The word can only be used in the accountancy sense of a fund of F profits ascertained for the purposes of an account between the taxpayer and the revenue. As the result of taking that account the taxpayer is deemed to have in his hands a fund of taxed profits up to, but not exceeding, the amount of the assessment. Accordingly it becomes necessary for the purpose of giving effect to rr. 19 and 21 to draw up a further account as between the taxpayer and the revenue. On the one side is entered the G interest paid and on the other side the 'taxed fund', which may consist of profits as assessed to tax under different schedules. The taxpayer is not entitled to bring in on this side of the account a taxed fund if the profits in respect of which the relevant assessment is made cannot lawfully be applied in payment of the interest. Subject to this, in the absence of special circumstances to which I will refer later, the taxpayer is, in my opinion, H entitled to treat the interest entered on one side of the account as having been paid out of the items of taxed profit entered on the other side. In the accountancy sense, he has paid it, since as between him and the revenue he is entitled to have the account drawn in this way and to debit his payments to the taxed fund. It follows from this that (again apart from special

(1) 20 T.C. 102. (2) 25 T.C. 445. (3) 20 T.C., at p. 147.
(4) 25 T.C., at p. 455. (5) 6 T.C. 211, at p. 264. (6) 25 T.C., at p. 456.

(Lord Reid)

circumstances) the question out of what cash resources was the payment made is entirely irrelevant." A

Then later he says, at page 236([1]):

"To speak of this as re-writing the trader's accounts is a misdescription. His domestic accounts stand, and there is no question of re-writing them. The account which is drawn up between himself and the revenue is a totally different account drawn up for totally different purposes . . . B it follows that, in the present case, the fact that the corporation in their domestic accounts have chosen, without any legal compulsion, to show the profits of their undertakings for the year as having been wholly applied for the purposes of the undertakings does not in any way disentitle them from saying that the interest has been or must be deemed to have been paid *pro tanto* out of the taxed fund at which these profits are quantified C by assessment."

If the authorities stopped there—and that is the latest pronouncement—I would think it clear that the Appellants must succeed. And I did not understand Counsel for the Crown to deny that in order to succeed he must bring the facts of this case within the category of what Lord Greene M.R. calls special circumstances. What then is special about this case? In their domestic accounts D the Appellants debited part of this interest to capital with the inevitable result that the balances in their profit and loss accounts are larger than they would have been if the whole of the interest had been charged against revenue. I do not understand the Crown to rely on any other circumstance. But there is nothing special in that. It must always happen if a company debits to some other account interest which it could have debited to revenue account. So if E the Crown are right there can be few if any cases in which a company can disregard their domestic accounts made up at the end of the year, although Lord Greene says that as a general rule the taxpayer is entitled to do that under s. 169. The Revenue is not bound by domestic accounts in questions of income tax; admittedly a private trader would not be bound by his accounts in such circumstances; *Allchin's* case([2]) shows that a local authority is not bound; so F why should a company be bound?

One can see what Lord Greene M.R. meant by special circumstances by looking at the two instances which he gives. There is no difficulty in seeing the special reason in *Birmingham Corporation* v. *Commissioners of Inland Revenue*([3]) [1930] A.C. 307. He says with regard to that case([4]):

"The decision turned entirely on the special nature of the exchequer G subsidy and the action of the corporation in basing its claim for subsidy on the assertion that it was out of pocket to the extent of the gross amount of the interest."

The Corporation was, in effect, claiming the same sum from the Crown twice.

Lord Greene M.R. also dealt with the *Central London Railway* case([5]). He said([6]) that the circumstances were very special, but before I explain why he H thought that I must go back to the *Central London Railway* case itself. In that case three similar appeals were dealt with together. It now appears on a close examination of the facts in these cases that in two of them (but probably not in the third) the facts were virtually indistinguishable from those in this

([1]) 25 T.C. 445., at p. 457. ([2]) 25 T.C. 445. ([3]) 15 T.C. 172. ([4]) 25 T.C., at p. 458. ([5]) 20 T.C. 102. ([6]) 25 T.C., at p. 457.

(Lord Reid)

A present case. But, as I shall try to demonstrate, the language used by Lord Macmillan in his speech shews that he must have misapprehended the facts, and his ground of judgment does not apply to the present case. Moreover, the language used by Lord Greene in the *Allchin* case([1]) shews that he must have shared Lord Macmillan's misapprehension. On appeal *Allchin's* case was argued for eight days in this House, and there is no indication in the reported B argument of any attempt to correct this misapprehension: it would have been most relevant to do so because, if the *Central London Railway* case([2]) really decided what the Crown now says it decided, Lord Greene's treatment of the whole subject would require substantial modification. In this House Lord Macmillan was a party to the decision of *Allchin's* case, but he simply adopted Lord Greene's analysis. If he had realised how inappropriate his language in C the *Central London Railway* case was in relation to the true facts, he could not have said what he did, and the Inland Revenue themselves only appear to have discovered in 1959 what they now say is the true effect of the *Central London Railway* case. In connection with another point in the present case, with which I need not deal, it has been brought out that until that year the Revenue were content to allow the whole of the interest in the present case to be dealt with D under s. 169: they only discovered in 1959 the case for applying s. 170.

I must now go to what Lord Macmillan said in the *Central London Railway* case. He said near the beginning of his speech ([1937] A.C., at page 80([3])) that the case was solely concerned with the company's claim to retain the tax which they had deducted in paying debenture interest in so far as that interest had been debited to capital in their accounts. He then gave the novel and E illuminating explanation of the operation of r. 19 to which I have already referred, and finally and comparatively briefly he gave his reasons for deciding against the company. I must quote the whole passage([4]).

> "Now it is true that the Railway Company could lawfully, if they chose, have paid the interest in question out of their profits, and it is also true that the interest was paid out of a general banking account which F contained sufficient profits (though these profits were not their assessed profits—a difficulty which still haunts me). But the interest was actually paid out of capital, and capital was the real source of payment. If the debiting of the interest were merely a matter of domestic accounting I should not be disposed to lay much stress upon it. But in my opinion it was much more than this. There was a deliberate decision to charge the G sum in question against capital and not against revenue. That being so, I do not see how the Railway Company can claim to retain the tax on this interest paid out of capital when the right to retain tax is conditional on the interest being payable out of profits. If the interest had been paid out of actual profits the sum so paid would have figured in the Railway Company's return of profits to be charged to tax in the next year; but the H £2,340 1*s*. 11*d*. has never appeared and will never appear in any return by the Railway Company for tax purposes, for it is a payment out of capital. Consequently the Crown will never receive any tax either from the Railway Company or from the debenture holders in respect of the interest paid to the latter in 1930 if the Railway Company are not held accountable to the Crown for the tax which they deducted. The theory

([1]) 25 T.C. 445. ([2]) 20 T.C. 102. ([3]) *Ibid.*, at p. 144.
([4]) *Ibid.*, at p. 151; [1937] A.C., at p. 89.

(Lord Reid)

of the notional taxed fund covering the amount of the interest paid does not fit such a case, for the transaction is outside the region of profits whether notional or actual. By their own deliberate act the Railway Company have made this sum not payable out of profits. It is nothing to the purpose that theoretically the Railway Company might in some future year carry this sum of £2,340 1*s*. 11*d*. back into profit and loss account as income. As to whether in the circumstances they could competently do so I express no opinion. But in the tax year in question they have chosen not to debit this sum to revenue account, and consequently have pro tanto prevented the diminution of the dividend fund in the distribution of which among their shareholders they have deducted tax and, as they were entitled to do, have retained the tax deducted. My Lords, I do not think that the same sum can be utilized by the Railway Company to render them those two inconsistent services in the same tax year, so as to entitle them first to attribute the £2,340 1*s*. 11*d*. to the payment of interest to their creditors and claim to retain the tax deducted therefrom as if it were paid out of revenue, and then, by debiting it to capital, to enhance the dividend fund and claim to retain the tax deducted from their shareholders on paying them their dividends. Whatever view be taken of the meaning of Rule 19 I do not think that the Railway Company can bring such a case within it."

The first point which he makes is that there was a deliberate decision to charge this interest against capital and not against revenue. He cannot have meant that that in itself would be enough to oust the company's right to invoke s. 169 (then r. 19). Every decision by a company as to how its annual accounts are to be framed must surely be deliberate. A company could hardly say that its accounts had been framed casually or negligently and I can think of no other alternative to deliberate. And to hold that a company must be held to every deliberate entry in its accounts would be quite inconsistent with Lord Greene M.R.'s analysis in *Allchin's* case [1] to which I have already referred and with which Lord Macmillan expressly agreed.

Then Lord Macmillan made a statement which I am afraid is simply erroneous. He said[2]:

"If the interest had been paid out of actual profits the sum so paid would have figured in the Railway Company's return of profits to be charged to tax in the next year".

As Counsel for the Crown freely admitted to your Lordships, such interest could never have figured in any return of profits for income tax purposes. If it had been put in it would have been struck out by the Revenue for the reason that interest is not a permissible deduction in striking the balance of profit for income tax purposes. And that error led Lord Macmillan to a conclusion which is equally erroneous and which may have had some influence on the ultimate decision. He appears to have supposed that the effect of charging this interest against capital would be to cause the Crown to receive less tax. But again admittedly that is not so. If the company had sufficient money in hand which had borne tax they could deduct tax in paying the interest and retain the tax so deducted, whatever the actual source of the money used to pay the interest or whatever entries were in their books. But I need not consider the effect on the authority of a decision of this House if one of the grounds of

(1) 25 T.C. 445. (2) 20 T.C. 102, at p. 151.

(Lord Reid)

A judgment can be shown to be based on error. It is the remainder of the passage which is in my view crucial.

In order to understand Lord Macmillan's concluding argument it is necessary to have in mind the position where a company pay a dividend. Under s. 184 it is entitled to deduct and retain tax if the dividend is or can properly be regarded as having been paid out of profits which have borne tax. If it B cannot be so regarded, if there is not a sufficient taxed fund to cover it, then the company cannot deduct and retain tax. And the rights of third parties, the shareholders, are affected if the company misuses its rights under this section. What seems to me to be clearly established is that the taxed fund in the hands of the company cannot even notionally be used twice over. It is difficult to see how the company could do that without prejudice either to the C Revenue or the shareholders or perhaps some other person interested. So if part of the taxed fund has been used to cover payment of dividend that part cannot even notionally be used again to cover payment of interest. But if the taxed fund is ample to cover both the whole dividend and the whole interest paid during the year, there is no need even notionally to use any part of it twice.

Counsel for the Crown have shown that in the *Central London Railway* D case[1] the taxed fund of the Company was in fact sufficient to cover both dividend and part of the interest debited to capital. But I think that it is obvious that Lord Macmillan thought otherwise and that he based his judgment on this misunderstanding. The end of the penultimate paragraph which I have quoted points to that. But I think that the matter is put beyond doubt by the next paragraph[2], where he speaks of the same sum being used by the company E to render them two inconsistent services in the same tax year—first to cover the interest and then to enable them to "claim to retain the tax deducted from their shareholders on paying them their dividends". He could not have said that if he had realised that there was in fact ample to cover both the interest and the dividends: there would then be no need to use the same sum twice, for one part of the dividend fund would cover the dividend and another part would F cover the interest.

Of course one tries to avoid the conclusion that this House based its decision on a mistaken view of the facts, and Counsel for the Crown strove to show that Lord Macmillan's words could be construed so as to make them fit the true facts. I do not think that he succeeded: but if he did we should have to choose between attributing to Lord Macmillan an error in appreciating the G facts or attributing to him the greatest obscurity of language. Any one may fall into error, but I refuse to contemplate the possibility that a master of the English language, as Lord Macmillan was, could have said what he did say if he had had the true facts in mind.

It is unfortunate that in such an intricate case none of the other noble and learned Lords expressed his reasons in his own words. This is by no H means the first time in my experience when ambiguity or possible confusion or error in a single speech or judgment has given rise to difficulties of interpretation which would probably have been avoided if we had had a second statement with which to compare the first. But we must do our best with what we have, and in the end I have no doubt that Lord Macmillan's conclusion

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(1) 20 T.C. 102. (2) *Ibid.*, at p. 152.

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depends on his assumption that the company were trying to make the same sum render two inconsistent services. If that is essential to the *ratio decidendi* then the *ratio* does not apply to the present case. A

I am fortified in my conclusion by the fact that Lord Macmillan appears to have been so understood in every subsequent case where *Central London Railway*(1) was discussed. I think that that was certainly Lord Greene M.R.'s view in *Allchin's* case(2). Having said that the circumstances in *Central London Railway* were very special, he went on to paraphrase what Lord Macmillan said in that case in this way(3): B

> "The effect of charging the interest to capital was to swell the dividend fund on the distribution of which the company *retained* a larger sum of tax than they would have retained if the interest had been charged to revenue and the dividend fund in consequence reduced. They could not at *one and the same time claim to enjoy this larger retention* and treat the interest as chargeable as between themselves and the Crown to revenue account." C

Lord Greene was not unacquainted with company accounts or with the way in which tax is retained when dividends are paid, and he could not have used the words which I have italicised if he had thought otherwise—nor could he have said that the circumstances in the *Central London Railway* case were very special. D

This House still regards itself as bound by the rule that it must not reverse or depart from a previous decision of the House. But it would in my view be pedantic and unreasonable to apply that rule to the present case, and to say that, because it has now been ascertained that the facts in the *Central London Railway* case were indistinguishable from the facts of this case, therefore we must disregard the reasoning in that case but follow its result. E

In the end the case for the Crown was based on the submission that to allow the Appellants' appeal would in some way result in falsifying their published accounts. They have represented to the Revenue, the shareholders and the world at large that they were carrying forward balances in their profit and loss accounts. But I do not see how allowing this appeal would make that representation false or misleading. It is not a representation that the whole of the balance carried forward is money which has borne tax, and it is not a representation that the whole or any part of the balance will be distributed to the shareholders. If the result of operating s. 169 is to prejudice the Revenue or others, that cannot be done, and it might be that it could not be done if the result would be to falsify some deliberate representation—such a case can be decided when it arises. But I can see nothing in the facts of the present case to exclude the general rule as to the application of s.169. So I am of opinion that the sums assessed in this case fall within the scope of that section and are not within the scope of s. 170. I would therefore allow the appeal. F G

Lord Morris of Borth-y-Gest—My Lords, the Appellants, a public company, were incorporated in 1894 to purchase and to conduct a business known as the Chancery Lane Safe Deposit. They owned certain buildings in Chancery Lane. In the basement there was the safe deposit. The upper parts of the buildings were let to tenants. As a result of enemy action in the years 1940 and 1941 the upper parts of the buildings were largely destroyed. For some years H

(1) 20 T.C. 102. (2) 25 T.C. 445. (3) *Ibid.*, at p. 458.

A thereafter only the safe deposit and a few sections of the buildings could be used. In the year 1949 rebuilding began. In 1953 a new safe deposit (in a slightly different position) was opened. For the next five years thereafter the upper structures were being rebuilt and certain new buildings were being erected. In connection with these operations and in order to finance them the Company borrowed sums of money on mortgage. They did so in the years 1954, 1955 B and 1956. The sums borrowed amounted in total to £650,000. Repayment began in the financial year ending 24th March 1958. By the end of the financial year to March 1961 repayment was complete. In the period when the borrowings were increasing the amounts of mortgage interest payable naturally increased; after repayments began the amounts of mortgage interest payable naturally decreased. As rebuilding became complete and as new buildings C became erected, the Company were able to make more lettings and to receive rents from tenants. The main items of the Company's income were the rents (assessable to income tax under Schedule A) so received.

In the year 1954–55 the Company paid £3,260 in mortgage interest; in the year 1955–56 the amount they paid was £11,324; in the year 1956–57 it was £26,536; in the year 1957–58 it was £29,149; in the year 1958–59 it was D £28,879. In the years to which I have referred the Company decided to charge part of those sums to capital. Their decision was deliberate and calculated. It was supported by the reasoning, the soundness of which has not been challenged, that during the period of construction, when the money being spent was substantial in relation to the size of the Company, it was proper to make the cost of finance a charge to capital. The proportion of the mortgage interest E which was so to be charged to capital was carefully calculated on the basis of the proportion which actual rents received bore to the estimated amount of the rents that might be obtained when the buildings were completed. By so charging to capital it was considered that a true and fair view of the Company's affairs and of the capital cost of the rebuilding and of the erection of the new buildings would be given.

F Pursuant to the decision which they had made the Company proceeded in their accounts to charge to capital certain amounts of the mortgage interest which they paid. They continued to do so during the years now being considered. Thus, for the year 1954–55, when they paid £3,260 as interest, they charged £2,753 of such amount to capital. In the year 1955–56, when they paid £11,324, they charged the whole of it to capital. In the year 1956–57, when they paid G £26,536, they charged £13,000 of it to capital. In the year 1957–58, when they paid £29,149, they charged £4,372 to capital. In the year 1958–59, when they paid £28,879, they charged £1,121 to capital. When the Company made the interest payments they deducted tax. If the payments were "not payable or not wholly payable out of profits or gains brought into charge" (see s. 170 of the Income Tax Act 1952) their deduction of the tax was obligatory and H they must account to the Revenue. Furthermore, if the payments were not payable or not wholly payable out of profits or gains brought into charge the Company had been under the obligation (see s. 170(2)) "forthwith" to deliver to the Commissioners of Inland Revenue, for the use of the Special Commissioners, an account of the payment and of the tax deducted. If the payments were "payable wholly out of profits or gains brought into charge to I tax" then the provisions of s. 169 applied and the Company were entitled both to deduct tax and to retain it. The Company were assessed under s. 170

(Lord Morris of Borth-y-Gest)

in respect of the sums which they had decided to charge to capital. The liability to account for the tax which they deducted has been in issue in this litigation. A

Certain further facts call for mention. In four out of the five years now being considered the amount of the "profits or gains brought into charge" exceeded the total of the gross mortgage interest paid (including that part of the mortgage interest charged to capital). In those years the Company paid dividends to its shareholders and deducted tax from the gross amounts. It has not been in dispute that, if in each of those years the whole of the gross mortgage interest payments was "payable out of" or attributed to the "profits or gains brought into charge" for the year in which payment was made, there would have been balances remaining of such "profits or gains brought into charge" which (if necessary by carrying forward) were sufficient to cover the payments of dividends (with tax deducted) that were made. In one of the five years now in question (the year 1955–56) the Company paid no dividend, and even if the total of the gross mortgage interest was deemed to be payable out of the profits or gains brought into charge for that year there would have been a shortage of £4,113. For tax in respect of that amount the Appellant Company acknowledges that it is in any event under a liability. B C

There was a subsidiary issue which concerned only one of the years. The Company contended that there had been an agreement in writing within the terms of s. 510 of the Income Tax Act 1952 which barred the assessment under s. 170 for the year of assessment 1955–56. The Special Commissioners decided that issue against the Company. Their decision was supported by the learned Judge and by the Court of Appeal. On the main issue the Special Commissioners held that the case was governed by the decision in *Central London Railway Co.* v. *Commissioners of Inland Revenue* 20 T.C. 102, and that the mortgage interest charged to capital by the Company was correctly to be assessed under s. 170. The learned Judge took a different view, and allowed the Company's appeal against the income tax assessments. The Crown appealed to the Court of Appeal, who allowed the appeal on the main issue. D E

My Lords, the perplexing words "payable . . . out of profits or gains brought into charge to tax" were fully analysed in the *Central London* case. The words "payable out of" are words which might often be used to denote an actual payment out of some actual fund. In ss. 169 and 170 the words involve a different conception. There is a statutory figure of "profits or gains brought into charge to tax". It is an assessment based at any rate so far as trading profits are concerned upon the actual results of the previous year. It is not, therefore, an actual fund. If the word "fund" is used in reference to it it must be classed as a notional fund. An annual payment, on the other hand, is not something notional: it is actual and real. But since, as Lord Macmillan has pointed out, you cannot make an actual payment out of a notional fund the word "payable" comes to mean notionally payable. It denotes, therefore, a right which the taxpayer may decide to exercise: he may attribute his payment as being within and under the statutory figure of his profits or gains brought into charge to tax. He can say that in paying tax on his profits or gains brought into charge to tax he has paid tax on the amount of a smaller annual payment which he has to make: he may, therefore, deduct tax in making such annual payment: the recipient must allow that deduction if it is made. It may be, however, that the taxpayer cannot link his annual payment with "profits or gains brought into charge to tax": there may not be any: in that event the annual payment cannot be "payable out" of them: F G H I

A there cannot be any attribution to them. In that situation the taxpayer must deduct tax when making his annual payment. He is, so to speak, collecting the tax for the Revenue, to whom he must pay it. The same result will follow if the taxpayer firmly decides not to link and in fact does not link his annual payment with profits or gains. This may be so if he decides to make his annual payment out of capital.

B The principle which had been enunciated in the earlier case of *Attorney-General* v. *Metropolitan Water Board*([1]), [1928] 1 K.B. 833, was described by Lord Macmillan in the *Central London* case([2]) when, at page 147, he said:

> "whenever, in any year, the amount of interest paid by the taxpayer does not exceed the amount of his profits or gains as assessed for Income Tax purposes for that year, then the interest paid in that year is, within the C statutory meaning, 'payable . . . out of profits or gains brought into charge to tax', and the taxpayer is entitled to retain the tax which he deducts in paying the interest."

He went on to say that "there are qualifications of this principle". The present case is concerned with one of those qualifications. It is the same qualification as arose in the *Central London* case and which has been referred to in other D cases.

In the *Central London* case the company issued debenture stock under statutory powers which enabled them to charge the interest on the stock to capital. They had but one banking account: all moneys were paid in to it and all payments were made out of it. Debenture interest was in fact paid by drawing on the account. For the year 1930–31 the company in their accounts E charged the interest in question to capital. The issue which arose was whether the company could retain the tax which they had deducted. The company paid dividends during the year. The profits or gains brought into charge to tax for the year amounted to a sum much in excess of the total of the gross sums paid as mortgage interest (both on the new debenture stock and on already existing debenture stock) and of the gross dividend payments. That F was made very clear by the Stated Case.

There were two other cases which were heard together with the *Central London* case. In one of these (*London Electric Railway Co.*) an exactly similar point arose. In the other (*Metropolitan Railway Co.*) there was an analogous point. The only difference in the *London Electric Railway* case was that the total of all payments from which tax was deducted (that is, including the gross G debenture interest in question together with the gross interest on other debenture stocks together with gross preference and ordinary dividend payments) exceeded the total amount on which income tax was paid or suffered. In all courts it was agreed that the question of principle was the same in all three cases. The position in the *Central London* case was, therefore, the same as was the position in four out of the five years in the present case, namely, that the amount H of profits or gains brought into charge to tax exceeded the total of the interest payments and the dividends.

The Commissioners in the *Central London* case recognised that, in general, the particular form adopted by a taxpayer in his accounts should neither assist nor injure him, but they came to the conclusion, on the evidence in the case,

([1]) 13 T.C. 294. ([2]) 20 T.C. 102.

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that the interest debited to capital in the company's accounts should be taken to have been in fact paid out of capital. The learned Judge paid regard to the fact that the interest payment was made out of the general banking fund of the company and that there was nothing which prevented the company, *vis-à-vis* the Revenue, from treating the interest payment as having been made wholly out of profits or gains brought into charge. On appeal it was unanimously held in the Court of Appeal that the interest which the company had debited to capital should be taken to have been paid out of capital. The same view was unanimously held in your Lordships' House. In his judgment in the Court of Appeal, Lord Hanworth M.R. pointed out that the mere fact that accounts are kept in some particular way ought not to alter the rights of the Crown and ought not to militate against the rights of the taxpayer. He said, at page 134, that:

> "in the ordinary course, where there is a mixed fund but where there is an abundance of funds brought into charge, the ordinary appropriation should be deemed to take place, namely, that the subject has paid the money which he has paid out of the available fund which has been already brought into charge and that he is entitled, therefore to retain the tax deducted . . ."

He called that the "rule of the road". But he proceeded to show that, on the facts of the case, the company had decided to charge part of the interest to capital. He attached no importance to the circumstance that the accounts of the railway company were in statutory form. Nor was he influenced by the circumstance that in a letter from the chairman (referred to in the prospectus for the stock) it had been said that interest would be met out of capital. What was of consequence was that the company, being entitled to take one course or the other, decided, for good business reasons, to charge certain interest to capital. One result of that would be that a larger sum would be available "if necessary" for the distribution of dividends. It was, however, a question of definite appropriation. As Lord Hanworth M.R. said, at page 134:

> "They had the power to do either one or the other; they would be deemed to have made the payment out of their profits and gains brought into charge unless they had demonstrated that they had adopted another perfectly legal course and one which, on the whole, they thought more beneficial to them."

Slesser L.J., was of the same opinion. He did not decide the case on the form of the accounts, but on the ground that there had been a "decision of fact" that "in reality" the interest was paid out of capital. Romer L.J. was of the same opinion. He pointed out that the object of what was then Rule 19 was to prevent double taxation. He said, at page 140:

> "Where, therefore, say, a company is possessed of profits and gains in a certain year which are brought into charge for Income Tax purposes, and a sum is paid out of those profits and gains—interest say, on debentures—the sum in the hands of the company represents partly interest which belongs to the debenture holders and partly profits which belong to the company. The company has to pay, in the first instance, Income Tax on both; it pays the Income Tax on the interest, that is to say, on the debenture holders' interest, and it pays Income Tax on its profits. If, therefore, after deducting Income Tax from the interest paid to the debenture holders the company has to hand over that Income Tax so deducted to the Crown,

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A that interest would have been taxed twice over. Those considerations do not apply in the least if the interest has never been paid or deemed to have been paid out of the profits in question. In such a case the whole of the profits belong to the company and no part of the interest can be treated as belonging to the debenture holders."

In that part of his judgment the learned Lord Justice was expressing a rationalisation of the theory of the rule similar to that which appears in *Commissioners of Inland Revenue* v. *Frere*(1) [1965] A.C. 402. He went on to point out that, though the form in which accounts may have been kept is by no means conclusive, yet it may be that a particular form has been adopted for the purpose of definitely deciding and of recording the fact that a decision has been made, that a certain payment of interest is to be paid out of capital. Such a form of account, which debits the payment of interest to capital, may have been adopted for the purpose of making it clear that revenue is set free for the benefit of shareholders.

My Lords, I have ventured to refer to the judgments in the Court of Appeal because in my view the reasoning contained in them was not only followed when the case reached your Lordships' House but has been followed since. Even if some alternative principles might have been adopted, the line of authority is, as I think, too clear and has existed for too long to be now overthrown. In any event, the rule has much to commend it. If a company makes and adheres to a decision that a payment should be out of capital and orders all its affairs on that basis, it would be strange if it could assert that the payment should be deemed to be one payable out of profits or gains. An attribution of a yearly payment to profits or gains brought into charge to tax can only be in reference to the year in which the payment is made. If a payment is attributed to capital, the practical result follows that the sum available or carried forward as available for distribution by way of dividends is increased. If a sum is so carried forward it does not, of course, follow that distribution by way of dividends will take place, nor does it follow that, if there are dividends, there will be deductions of tax. It would seem to be incongruous, however, if a company, having decided (which means the same as "definitely" decided) to charge a payment to capital and having regulated its proceedings on that basis, could say that the payment was not to be deemed to be charged to capital. This does not mean that in any ordinary case a company, in seeking *vis-à-vis* the Revenue to make an attribution of an annual payment, is fettered merely because of some form of entry that it has made in books or accounts. It merely means that what was in fact and in reality a payment out of capital cannot be paraded in the guise of a payment out of revenue. That would be more than departing from documents or accounts: it would be departing from fact: it would be a distortion of history.

The decision of the Court of Appeal in the *Central London* case(2) and those cases heard with it was affirmed in your Lordships' House. The only speech was that of Lord Macmillan. Lord Hailsham L.C., Lord Blanesburgh, Lord Russell of Killowen and Lord Roche concurred in it. Lord Macmillan began by referring to the facts in the *Central London Railway* case, which he selected as being typical of the three cases. He referred in some detail to the figures

(1) 42 T.C. 125. (2) 20 T.C. 102.

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referable to the Central London Railway set out in the Stated Case: he mentioned the item which gave rise to the dispute (a balance figure of £2,340 1*s.* 11*d.* gross in one tax year which was charged to capital account): he mentioned the total sum (including the above figure) of interest paid on debenture stocks (a sum under £70,000) and he mentioned the profits or gains as assessed to income tax (a figure of £280,282). Near the end of his judgment he also said[1]: A

> "The material facts, though of course not the figures, in the case of the *London Electric Railway* are identical with those of the *Central London Railway Company's* case, and the same result must follow." B

I refer to these matters because a submission was made to the effect that Lord Macmillan and all their Lordships who concurred with him (and presumably all in the Court of Appeal) were under a misapprehension as to the facts and that their conclusions are, as a result, invalidated. I cannot agree with this contention. The figures which Lord Macmillan quoted were contained in a very clear statement set out in the Stated Case. It showed that, on the one hand, the total of the amounts on which income tax was paid or suffered in the year was £293,161. The total payments from which income tax was deducted in the year (including the item in dispute and all interest on other debenture stock and all preference and ordinary dividends) came to £241,827. Lord Macmillan could not, in my view, have laboured under the delusion (as is suggested) that the payment of the dividends which were distributed was made possible by the payment of debenture interest (to the extent of £2,340) out of capital. That amount of interest (£2,340), which was described as interest "during construction", appeared as an item in one of the company's accounts of "Details of capital expenditure" for the year in question. C D E

In the printed Case for the appellant company when the case was before your Lordships' House it was stated that the company had an ample fund of income which had been charged to income tax in and for the year 1930–31 out of which to pay all the interest payable by it in that year including the interest in question. The total of the amounts on which income tax had been paid or suffered for 1930–31 was £293,161. The total of the payments from which income tax was deducted for 1930–31, including the interest (charged to capital account) on the new debenture stock as well as the interest (charged to revenue on the previously existing debenture stock, was £70,227. It was set out in the printed Case that, accordingly, there was a surplus of taxed income over annual payments of £222,934. The printed Case then proceeded to refer to the revenue account, and para. 8 of the printed Case of the appellants was in these terms: F G

> "The dividends declared in respect of the year amounted only to £171,600. After providing for these dividends and the debenture interest charged to revenue there was a surplus of profit in Revenue Account to be carried forward of £112,060. If the debenture interest amounting to £2,340 charged to Capital Account (and sought to be assessed as herein-after explained) had been charged to revenue there would still have been a surplus of profit in the Revenue Account of £109,722. In addition there were accumulated taxed reserves shown in the General Balance Sheet of 31st December, 1930, of £357,651." H

It was submitted in the present appeal that a misunderstanding on Lord Macmillan's part was revealed when he said[2]: I

(1) 20 T.C. 102., at p. 152. (2) *Ibid.*, at p. 151.

(Lord Morris of Borth-y-Gest)

A "If the interest had been paid out of actual profits the sum so paid would have figured in the Railway Company's return of profits to be charged to tax in the next year; but the £2,340 1*s*. 11*d*. has never appeared and will never appear in any return by the Railway Company for tax purposes, for it is a payment out of capital."

The figures that I have quoted were, however, so significant that Lord Macmillan B and all the other members of the House could not, in my view, have misunderstood them. Nor could Lord Macmillan have overlooked the provisions of s. 169(1)(*b*): when assessment is made on profits or gains there cannot, in arriving at the amount of them, be any deduction in respect of any yearly interest or annual payment. In my view, Lord Macmillan was only emphasising the essential difference between a payment made out of income and a payment C made out of capital. Throughout his speech Lord Macmillan was pointing out (as did Lord Greene M.R. in the later case of *Allchin* v. *Corporation of South Shields*(1)), that, if interest is charged to capital rather than to revenue, the dividend fund is *pro tanto* increased. An interest payment cannot in one and the same year be debited to capital, with the result that the dividend fund (whether it is to be distributed or to be carried forward) is enhanced, and also D notionally be treated as debited to revenue so as to enable tax which is deducted to be retained. That would be to require the sum in the one year to render two incompatible and inconsistent services. The money must speak either as a payment out of capital or as a payment out of income. The benefit of s. 169 is not to be gained by the ventriloquist's art.

In his speech Lord Macmillan gave careful attention to the meaning of E the word "payable" in its context in the Rules he was considering, and then he came to what he called "the special circumstances of the case in hand". He then said(2):

"Now it is true that the Railway Company could lawfully, if they chose, have paid the interest in question out of their profits, and it is also true that the interest was paid out of a general banking account which F contained sufficient profits (though these profits were not their assessed profits—a difficulty which still haunts me). But the interest was actually paid out of capital, and capital was the real source of payment. If the debiting of the interest were merely a matter of domestic accounting I should not be disposed to lay much stress upon it. But in my opinion it was much more than this. There was a deliberate decision to charge the G sum in question against capital and not against revenue. That being so, I do not see how the Railway Company can claim to retain the tax on this interest paid out of capital when the right to retain tax is conditional on the interest being payable out of profits."

Later he added(3) that the transaction was

"outside the region of profits whether notional or actual. By their own H deliberate act the Railway Company have made this sum not payable out of profits."

One obvious result of choosing not to debit the interest to revenue account was, of course, that they prevented *pro tanto* the diminution of the dividend fund and they were treating the dividend fund as available for distribution among

(1) 25 T.C. 445. (2) 20 T.C. 102, at p. 151. (3) *Ibid.*, at p. 152.

(Lord Morris of Borth-y-Gest)

shareholders with tax deducted from dividends. The result of debiting the interest to capital was, as Lord Macmillan put it, "to enhance the dividend fund". Had he been under the misapprehension that the result of so debiting was to make a dividend declaration possible he would surely have said so. In short, the company could not do two quite inconsistent things. A

My Lords, in my view, the reasoning of that clear decision fully covers the present case. The Appellant Company of their own free choice made a similar decision to that made by the Central London Railway Co. Doubtless "during construction" there were good reasons in each case for the decision. There was a deliberate choosing of attribution to capital rather than to revenue. It was not a matter of method of domestic bookkeeping. The accounts merely evidenced the fact that a decision was taken, was acted upon and was maintained. The Company's definite attribution precluded an entirely inconsistent attribution. The Company "had deliberately elected to charge the interest against capital" (see per Romer L.J., in *Paton* v. *Commissioners of Inland Revenue* [1]) 21 T.C. 626, at page 646). B C

In the later case of *Allchin* v. *Corporation of South Shields* 25 T.C. 445 many points arose concerning the interpretation of the South Shields Corporation Act 1935. In the Court of Appeal Lord Greene M.R. referred to the decision in the *Central London Railway* case[2]. In a judgment that earned commendation he expounded the principles which justify attribution by a taxpayer. Having explained them, he said that there may be what he called "special circumstances" which may point to a particular result. Special circumstances existed, he said, in the *Central London* case, where, as he put it, the company "elected to exercise" a power which they possessed. He proceeded to say, at page 458: D E

> "Now, the fact that the company chose to charge the interest to capital might at first sight appear to be a mere matter of domestic accountancy. Had it charged the interest to revenue, as it was perfectly entitled to do, it could unquestionably have retained the tax; but by taking the course which it did it set the amount of its profits free for payment of dividend. Its action, as Lord Macmillan said (at page 151), was much more than a mere matter of domestic accountancy. He went on to explain why this was so. The effect of charging the interest to capital was to swell the dividend fund upon the distribution of which the company retained a larger amount of tax than they would have retained if the interest had been charged to revenue and the dividend fund in consequence reduced. They could not at one and the same time claim to enjoy this larger retention and treat the interest as chargeable, as between themselves and the Crown, to revenue account." F G

I can see no basis for any view that Lord Greene M.R. misapprehended the facts in the *Central London Railway* case or that he thought that there had been any misapprehension of them in your Lordships' House. When the *Allchin* case reached your Lordships' House, Lord Russell of Killowen and Lord Macmillan (who had heard the *Central London* case) were sitting, as also was Lord Romer, who had heard the *Central London* case in the Court of Appeal. Again, there was no suggestion that there had been any misapprehension in the *Central* H

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[1] [1936] 2 K.B. 59 (*sub nom.* Fenton's Trustee *v.* Inland Revenue Commissioners).

[2] 20 T.C. 102.

(Lord Morris of Borth-y-Gest)

A *London* case([1]) and there was no wish to explain or qualify anything that had been said. Viscount Simon L.C. expounded the general rule, which he said was([2]):

> "to hold that annual payments paid in a particular year, which, if the profits or gains brought into charge for that year were large enough, would have been properly payable thereout, are to be treated as having notionally been paid out of the payer's assessed income for that year, and the payer is to B be allowed to deduct and retain the tax on the annual payments, provided that the amount so deducted and retained does not exceed the amount of tax payable by him in that year on his assessed income."

Viscount Simon agreed with Lord Greene's interpretation of the sections of the South Shields Act, with the result that there would be nothing illegal in the Corporation paying interest out of the mixed fund which contained its profits C or gains. Neither in that case was there anything to show that the Corporation had "precluded themselves by inconsistent action" from being treated as paying the interest out of profits or gains brought into charge, as there had been in the case of *Birmingham Corporation* v. *Commissioners of Inland Revenue* 15 T.C. 172. Lord Macmillan in his speech did not in any way depart from what he had said in the *Central London* case. His speech was in accord with his earlier one, D when he said, at page 464, that:

> "the taxpayer cannot be deemed to have paid interest out of profits which cannot legally be applied in payment of that interest or which he has by his own deliberate actings debarred himself from so applying."

In agreement with Harman L.J., I do not consider that there is any inconsistency between the decisions in the *Allchin* case([3]) and the *Central London* E case. Though in the present case no fiscal advantage (but rather the contrary) resulted for the Company, their calculated and maintained decision to attribute payments to capital precluded a contrary and inconsistent attribution. You cannot treat a payment actually made out of capital as notionally made out of income.

In regard to the subsidiary issue, which arose on the facts which are clearly F set out in the Case Stated, I am fully in accord with the decision of the learned Judge and of the Court of Appeal.

For the reasons which I have stated I would dismiss the appeal.

Lord Upjohn—My Lords, when the Appellants wanted to rebuild their safe deposit premises in Chancery Lane, which had been damaged in the war, they decided to do so by financing it on borrowed money. They had, of course, to G pay interest on it, and they were advised by their accountants that it would be proper to treat part of that interest as attributable to capital expenditure. That was plainly right and is not in dispute; the cost of hiring money to rebuild a house is just as much a capital cost as the cost of hiring labour to do the rebuilding. So, in their company accounts issued to shareholders for the relevant years, they debited part of the interest on the borrowed money against their profit and H loss account, in the usual way, and part to capital account. This meant, of course, that the profit and loss account was not as diminished as it would have been had the whole been so debited.

([1]) 20 T.C. 102. ([2]) 25 T.C., at p. 463. ([3]) 25 T.C. 445.

(Lord Upjohn)

As I understood the Crown's argument, in the end it was that the deliberate decision of the Appellant Company to attribute part of that interest to capital and not to the debit of profit and loss was the sole foundation of its claim in this case. A

In the relevant years the Appellant paid interest on the sums it had borrowed, and it was bound to deduct tax in making those payments; the whole question is whether it is entitled to retain the tax on that part of the interest attributable to capital or is bound to account for it to the Crown. That depends upon the true construction of ss. 169 and 170 of the Income Tax Act 1952, as interpreted by a number of decisions upon that Act or its predecessor, nearly all in this House. B

My Lords, the original difficulty lay in the proper interpretation of the words of s. 169 (or the previous r. 19 of the General Rules applicable to all Schedules of the Income Tax Act 1918) that the annual payments must have been "payable wholly out of profits or gains brought into charge to tax". Obviously these words were capable of differing constructions but, as a result of many authorities, culminating in *Central London Railway Co.* v. *Commissioners of Inland Revenue*([1]) [1937] A.C. 77, and the judgment of Lord Greene M.R. in *Allchin* v. *Coulthard*([2]) [1942] 2 K.B. 228, as unanimously approved in your Lordships' House, [1943] A.C. 607, certain matters may be taken to be clearly established. C D

First, that if in a particular year the taxpayer pays interest on a debt to a creditor and (of course) deducts tax, that tax may, under s. 169, be retained, provided that the taxpayer has in hand profits assessed to tax for that particular year which exceed the interest. The profits assessed to tax are not the profits of that year but of the previous year; this has given rise to some discussion in the cases about the difficulty of equating the payment of real interest out of a notional fund. I confess this difficulty does not worry me very much, and the decisions lead to the clear practical conclusion: look at your interest payments for the year; look at your assessed profits for the same year (the actual profits for the previous year); compare the two, and if the latter exceed the former, the interest deducted may be retained by the taxpayer in the absence of special circumstances: see Lord Macmillan in the *Central London Railway* case([3]) [1937] A.C., at page 84, already set out in the opinions of my noble and learned friends Lord Reid and Lord Morris of Borth-y-Gest, which I shall not repeat. That is the general rule or "the rule of the road". E F

Secondly, and this is a cardinal principle, the actual cash fund out of which any payment is made, whether it be of the interest due to the creditor or of the tax due to the Crown, is utterly immaterial; if these payments are in fact made wholly out of the proceeds of sale of some capital assets, such as a factory, it matters not. So we must consider the tax liability solely in reference to payment out of funds used in a purely accountancy sense or category as explained by Lord Greene M.R. in *Allchin's* case([4]) [1942] 2 K.B., at pages 234–5. The company's banking accounts have nothing to do with it. Now, as Lord Greene pointed out, the company's accounts prepared for submission to its shareholders are quite different from the accounts which have to be prepared in accordance with the statutory requirements of the Income Tax Acts, and in conformity to G H

([1]) 20 T.C. 102. ([2]) 25 T.C. 445. ([3]) 20 T.C. 102, at p. 147. ([4]) 25 T.C., at p. 456.

A income tax principles, for submission to the Inland Revenue. In particular, interest payments, which *prima facie* must be deducted from the profit and loss account to show the true position to shareholders, cannot by Statute be deducted from the profits for submission to the Crown for the assessment of income tax for the relevant year. But this apparent unfairness to the taxpayer is adjusted as, under the scheme of our tax laws, the recipient of interest is not assessed to B tax on it, but the payer deducts it in any event and retains it if he has paid an equivalent amount of tax for that year: so fairness is obtained, and in effect the taxpayer only pays tax on his profits and gains less the interest paid away. In the present case that is what has happened, for it has been conceded throughout that in each relevant year the taxpayer has had sufficient profits and gains brought into charge to tax (that is assessed profits) and so why does the Crown C claim to recover from him the tax so deducted?

The claim, if successful, will effect double taxation of the same fund, which, as Lord Atkinson pointed out in *Sugden* v. *Leeds Corporation*([1]) [1914] A.C. 483, at page 498, the scheme of the Acts seemed designed to avoid. As I said at the beginning of this opinion, the claim is made solely because in his own accounts the taxpayer has attributed some part of the interest paid to capital. But the D Crown is not bound, or affected in any way, by the Company's accounts. There can be no question of misrepresentation or of estoppel. It is conceded that, so far as an individual is concerned, the way in which he keeps his private accounts (if any) is immaterial and, as the authorities (particularly the *South Shields* case([2])) shew, it is immaterial in the case of statutory corporations: provided that the profits could lawfully be attributed to payments of interest, it matters E not whether they are so attributed in the corporation's accounts. Illegality or unlawfulness is not in point here.

I fear that much of the trouble that has arisen in this case has been the unfortunate distinction drawn by Lord Macmillan in the *Central London Railway* case([3]) between "domestic accounting" and a "deliberate decision" to allocate an interest payment to capital. Of course, domestic accounting F may have a different meaning from a deliberate decision when the company's accounting branch is asked to put up some figures for the consideration of the directors; but no one has suggested that such internal accounting was in any one's mind in that case or in any of the authorities which your Lordships have considered where only the formal annual accounts of the taxpayer were under review. With all respect to Lord Macmillan, I find it quite impossible to under- G stand what he meant or what he intended to contrast by drawing a distinction between domestic accounting and a deliberate decision. In my opinion, the distinction is meaningless and is the real source of trouble in this case. Why should the accounts prepared for its shareholders showing lawfully and truthfully a debit to capital account or, for that matter, to any other account, such as a suspense account or a reserve account or a deduction from some property H account, affect the company's liability to tax?

The Crown's plea is "special circumstances", but the mere increase of the profit and loss fund by the attribution of the interest to some other account cannot be a special circumstance, for that would destroy the whole basis of the general rule; for, as the actual cash fund as the source of payment is immaterial,

([1]) 6 T.C. 211, at p. 258. ([2]) 25 T.C. 445. ([3]) 20 T.C., at p. 151.

(Lord Upjohn)

so must the accountancy fund to which the payment is debited be immaterial when we have got away from some meaningless idea of a "deliberate" decision to be attributed to an accountancy allocation to some account other than the profit and loss account. So special circumstances must be sought elsewhere. A

No doubt if the taxed profits are sufficient to cover the interest payment but insufficient at the same time to cover a dividend payment in the same year from which tax is deducted that might be a special circumstance, for that would be using one amount of taxed profits for two purposes. Though here one must be careful to distinguish between a taxed fund for the purposes of ss. 169 and 170 and a taxed fund for the purposes of s. 184, which may cover earlier profits. However, for my part I can see no reason why the Crown should be enabled to rely on that, for the only sufferer is the shareholder, part of whose dividend has wrongly been withheld from him because the company has not satisfied s. 184. The shareholder may have a complaint but not the Crown, for it is a commonplace that dividends do not suffer deduction of tax at the hands of the Crown; the company merely has the right to deduct tax if it is paying the dividend out of profits which have borne tax. However, that is not in point here, for it is conceded that in fact in each of the relevant years the Company had sufficient tax-borne profits to cover not only the interest payments but the dividends paid. B C D

So far, I would have thought this a very plain case and the Appellants must succeed, but it is the circumstance mentioned in my last sentence that has given rise to all the trouble; for the recent researches of the Board of Inland Revenue have disclosed what they had never realised before 1959, that this circumstance was the same in at least two out of three of the *Central London Railway* cases[1]. So it is said we must follow that case, admittedly utterly indistinguishable on its facts, and dismiss the appeal. My Lords, we are not bound to follow a case merely because it is indistinguishable upon the facts. A decision even in your Lordships' House is binding on your Lordships only because it lays down some principle of law or for its reasoning on some particular facts. It was upon the obscure opinion of Lord Macmillan in that case, contrasted with his approval of Lord Greene M.R.'s judgment in the subsequent *South Shields* case[2], that much of the argument centred before your Lordships. Upon this matter I cannot usefully add anything to the penetrating analysis and ultimate criticism by Lord Reid, whose opinion I have had the privilege of reading, of Lord Macmillan's opinion in the *Central London Railway* case; I agree with every word of Lord Reid. I venture to think Lord Greene expressed himself completely accurately as to the general principles to be applied in the *South Shields* case and Lord Macmillan gave his wholehearted approval thereto. The fact that in the *Central London Railway* case taxed profits were sufficient to cover both interest and dividends must *per incuriam* have been overlooked. E F G

I would allow this appeal.

Lord Wilberforce—My Lords, this appeal is concerned with the treatment for income tax purposes of certain annual payments made by Chancery Lane Safe Deposit and Offices Co. Ltd. in the five years of assessment 1954–55 to 1958–59; the question being whether the Company has been correctly assessed to income tax under s. 170 of the Income Tax Act 1952 in respect of a part of the payments made. H

(1) 20 T.C. 102. (2) 25 T.C. 445.

(Lord Wilberforce)

A The annual payments represented interest paid on sums borrowed by the Company on mortgage in order to finance the reconstruction of its building in Chancery Lane, the amounts varying from a minimum of £3,260 in 1954–55 to a maximum of £29,149 in 1957–58. The Company deducted income tax from these payments of interest, and since (as is not disputed) it had in each year (except 1955–56) sufficient "profits or gains brought into charge to tax" to cover B the whole of the payments made and sufficient in 1955–56 to cover part, it would in the normal course have been entitled (by virtue of s. 169) to retain the whole (or in 1955–56 the appropriate part) of the income tax so deducted. But the Crown claims that the Company is obliged, under s. 170, to pay over to it a portion of this tax as not having been paid out of taxed profits.

It is necessary first to understand exactly what it was that the Company did. C The Company's expenditure on reconstruction was to be very substantial in relation to its resources and, since the building to be reconstructed would not at once be fully revenue producing, it was thought advisable, during the period of reconstruction, to "capitalise"—which means to charge to capital account—a proportion of the mortgage interest paid. The Company's auditors worked out the proportion so to be capitalised in each year through a formula based D upon the proportion which the rents from the partly completed building bore to its full letting potential. According to this formula the following amounts of mortgage interest were charged to capital account:

1954–55	£2,753
1955–56	£11,324
1956–57	£13,000
E 1957–58	£4,372
1958–59	£1,121
Total ..	£32,570

The remainder of the interest paid in each year was charged against profits in the same way as other current expenditure, and there is no doubt that s. 169 F applies as regards those sums.

One other set of facts must be referred to. In each relevant year, except 1955–56, the Company paid dividends, and in each year carried forward to the next year a credit balance to profit and loss account arrived at in the normal manner, by deducting from the profits of each year, plus the amount brought forward from the previous year, the net amount distributed by way of dividend. G The precise figures are shown in an exhibit to the Case Stated. The balance at the end of the period, that is, for the year ended 24th March 1959, was £15,180 16*s*. In addition, the Company had throughout the period a general reserve, which could have been used to pay dividends, of £29,500.

The Company's claim to retain the tax deducted from the mortgage interest is simply stated. Once it is shown that there are enough profits and gains brought H into charge to tax to cover the interest payment in each relevant year, the taxpayer has the right without any specific attribution to claim as against the Revenue that the interest is payable out of those profits and gains. This right is not affected by any domestic act of bookkeeping, and the charge of the interest to

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capital account is nothing more than that. Before the right is lost, so it is contended, something more is required which can be described as a special circumstance. What can amount to a special circumstance the Company does not precisely define but, negatively, it claims that the mere debiting to capital account is not such a special circumstance. So the Company's case really comes to this, that the action of the Company in capitalising the mortgage interest in question does not deprive it of the normal right which a taxpayer has to attribute, in his account with the Revenue, the interest to his taxed profits. A B

In considering whether this contention is valid, I find it convenient to start from the two main sections of the Income Tax Act which deal with annual payments, ss. 169 and 170. These deal respectively with the cases where, on the one hand, an annual payment is payable wholly out of taxed profits and where, on the other hand, an annual payment is not payable or wholly payable out of taxed profits and, according as the facts fit one case or the other, they direct that, when the payment is made, one course or the other may or must be taken. It seems apparent that these sections must contemplate, in addition to cases where the annual payment is exclusively payable either out of taxed profits or out of something other than taxed profits (for example capital), cases where the annual payment might be payable out of either source. Many amenities are of this character, and the same may be true of interest on borrowed money. *Central London Railway Co.* v. *Commissioners of Inland Revenue*(1), to which I shall return, was a case where interest could be paid out of capital or out of income and the same is, as shown by the event, true of the present case. How, then, do the sections apply to such mixed cases? A first approximation to an answer is to say that the taxpayer has the right, at his choice, to attribute the payment to one source or the other, so that if he attributes it to taxed profits he obtains the benefit of s. 169 and can retain tax deducted, and if (for some reason which appears good to him) he attributes it to some other source, he does not and must account for the tax. This solution must, however, be reconciled with the rule, at which the Courts have arrived, that attribution of an annual payment to taxed profits (if they exist) is assumed, and that a contrary conclusion is not to be drawn from the form of the taxpayer's domestic accounts. So some way must be found of distinguishing the kind of choice on the taxpayer's part which brings him under s. 170 rather than s. 169. One way of dealing with this would be to say that, in order to displace the assumed attribution, there must be a "deliberate" decision—and some judicial pronouncements can be found which give support to this formula. There are obvious difficulties inherent in basing the subject's liability to tax on the sole criterion whether what he has decided to do he has done deliberately. So the Courts have tended towards another solution and to say that a decision or a deliberate decision is not enough unless accompanied or followed by practical results or consequences. Those judicial statements which take this course qualify in some instances the kind of consequences which, when added to a decision, bind the taxpayer by referring to them as inconsistent with the claim to attribute the payment to taxed profits, or as irretrievable. Plowman J. in the present case(2) thought that they should be such as bring fiscal advantage to the taxpayer, but I think that this is too narrow a qualification. In my opinion, the line of approach just mentioned is basically sound as being in accordance with the statutory scheme. A point must come when the taxpayer has committed himself as to the source from which C D E F G H I

(1) 20 T.C. 102. (2) *See* page 89, *ante*.

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A an annual payment is made, beyond which, in his dealings with the Revenue, he cannot reverse the course which he has taken: if this were not to be so, the sections would have to be recast so as to confer an automatic right to retain deducted tax wherever sufficient taxed profits exist, saving only (so far as I can see) the case where the payment could not legally be made out of them. Exactly when this point is reached is, I think, impossible to define in general terms: some B Judges have said it is a matter of evidence (for example Lord Atkin in *Birmingham Corporation* v. *Commissioners of Inland Revenue*[1] [1930] A.C. 307, at page 320): I would not disagree with that, but it remains to decide what kind of evidence is decisive. I think at any rate that a decision taken which has practical results inconsistent with the actual claim to attribute the payment to taxed profits must bind the taxpayer, and that so much (and I repeat that this should C not be taken as an exhaustive statement of a rule) seems to emerge as the fair result of the authorities.

The key decision for the present case is that given in the three cases decided together and generally referred to as the *Central London Railway Co.* case 20 T.C. 102. The Court of Appeal took the view that this decision covered the present case, but this has been contested by the Appellants here. The cases were D concerned with debenture and bank interest payable (under statutory authority) either out of capital or out of income—in using these expressions I am not of course referring to payment out of any particular banking account but to a fund or account under one head or the other to which the payments are debited. The companies chose to charge part of it to capital—a "deliberate decision" which passed beyond a matter of domestic accounting. In the Court of Appeal, E which, as did all three Courts that considered the matter, thought that there was no material difference between the three cases, both Lord Hanworth M.R. and Romer L.J. evidently considered that the company's decision went beyond a matter of domestic accounting because it affected the amount of its distributable profits. This was clearly justifiable on the figures, whether one takes those in the case of the *Central London Railway Co.* or those in the *London* F *Electric Railway*. I quote from Romer L.J., who says (20 T.C., at page 141):

> "In the present case a company, not for the purposes of convenience, not for the purposes of indulging in some fancy idea as to the proper method of keeping accounts, has debited this particular payment of interest to capital for the purpose of making it clear that the revenue, from which it might otherwise have been deducted, is to be free for distribution as G dividend."

In such a case he regarded the account, in the absence of evidence to the contrary, as conclusive upon the matter. In this House Lord Macmillan delivered the only speech. His language has been criticised as having been based on a misapprehension of the figures, namely, upon a belief that in each of the three cases the effect of debiting the interest against capital was to enable increased dividends H to be paid in the relevant year—a belief which the figures in at any rate two of the cases do not seem to bear out. Some difficulty there may be in relating everything that he said to all the facts in each case, though Counsel for the Crown defended his language almost as vigorously as it was attacked. For my part, I do not find it necessary or profitable to attempt to resolve this controversy,

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(1) 15 T.C. 172, at p. 214.

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for two reasons. First, I can find nothing in the reports of these cases, nothing in the Cases Stated, in the findings of the Commissioners, in the judgments of the Court of Appeal or in the Cases lodged by the parties in this House to suggest that any distinction was sought to be made at any time between a decision to capitalise which had the effect of increasing the dividend paid and one which had the effect of increasing the distributable fund, or, indeed, to suggest that any argument was based on the actual payment of an increased dividend. I take the liberty here of referring to the citation from the Case lodged by the Central London Railway Co. made by my noble friend, Lord Morris of Borth-y-Gest. The reasonable assumption—and one which would explain any ambiguity in his language—would seem to be that Lord Macmillan did not have the suggested distinction in mind, or regard it as critical or even important for the decision of the case. So that I would regard the decision of this House as based (as was that in the Court of Appeal) on the broad ground that a decision had been taken which had an effect on the distributable, and possibly in one case on the distributed, profits of the companies. A B C

But, secondly, if the decision of this House in the *Central London Railway* and connected cases[1] is to be regarded as based upon the narrow ground that the amount of the dividend paid had been increased, I would find myself quite unable to discover in that circumstance a reason for distinguishing the present case from it on the ground that this is merely a case of increasing a distributable balance. Such a distinction would be an illogical and undesirable refinement. The course taken in the one case I find just as inconsistent with the claim to attribute the payment to taxed profits as the other—just as practical, just as irretrievable. And if the argument is that there is a difference as regards the inconsistency of the company's action between an actual payment and the creation of a balance, then I find it necessary to ask why this should be so. What the taxpayer seeks to do when he prepares the special account as between himself and the Revenue (I am accepting here the account of the matter given by Lord Greene M.R. in *Allchin* v. *South Shields Corporation*, 25 T.C. 445) is to prepare a notional account which contrasts with the annual payment a notional figure, being that of the assessed profits. This being so, I cannot see why any difference in actuality between the payment of a dividend and the increase of a distributable balance (if there is any such difference) should be relevant. The question is whether the company has committed itself to another course. In either case it would seem to me to have done so. Furthermore, the suggested distinction involves different treatment for, on the one hand, a company which "capitalises" an annual payment and in the same year pays an increased dividend and, on the other, a company which "capitalises" an annual payment and thereby increases its distributable surplus but pays the same increased dividend in a subsequent year. I find this unattractive. D E F G

The decisions which follow the *Central London Railway Company* case, although they contain in the judgments passages which seem to show that they read Lord Macmillan's speech as related to an actual distribution, do not, as decisions, depend on that narrower view of the facts. Rather when they come to state a rule they adopt the broader approach. H

In *Allchin* v. *South Shields Corporation* 25 T.C.445 Lord Greene M.R. certainly used expressions, in relation to the *Central London Railway* case,

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([1]) 20 T.C. 102.

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A which reflect the narrower view of Lord Macmillan's speech, but nothing in the decision founds upon it, and it is interesting to compare his judgment in this case with his remarks in *Paton* v. *Commissioners of Inland Revenue* 21 T.C. 626, where he said, at page 654:

> "In the *Central London Railway* case([1]) the action of the company in charging interest to capital had the effect of setting free a fund for dividend B purposes, and it was held that after this election had been made it would have been improper to charge the interest to revenue".

Certainly this passage was written before the *Central London Railway* case had reached the House of Lords, but when, in *Allchin* v. *South Shields Corporation*, Lord Greene considered the House of Lords judgment, though he referred to his previous judgment in *Paton's* case he did not correct it (25 T.C., at page 456). C This seems to suggest that he did not regard a distinction between an actual distribution of dividends and an increase of a distributable fund as legally material. When *Allchin* v. *South Shields Corporation*([2]) reached this House none of the members present, who included Lord Macmillan and Lord Romer, whose judgment in the Court of Appeal clearly reflects the view that what the company had done increased the distributable fund, felt it necessary to explain D the earlier case or said anything to show that they regarded *Allchin* v. *South Shields Corporation* as inconsistent with it. The case itself was, as I understand it, a clear case of "domestic accounting". The effect of a recent Act (the South Shields Corporation Act 1935) was to put an end to the previous state of affairs in which the borough was, in effect, divided into separate compartments. For its internal purposes separate accounts showing specified particulars had to be E kept in respect of each undertaking. But Lord Greene M.R. considered that the manner in which the profits of the undertakings had been shown as applied in the accounts was a domestic matter precisely in the same way as if the borough had been a trader carrying on two businesses. Regarded in this way the case is the converse of the *Central London Railway* case: there was here no deliberate decision to allocate, with external consequences; the matter never went beyond F the point of domestic bookkeeping. As Viscount Simon L.C. said, at page 463, the interest could be paid out of the mixed fund and the Corporation had not precluded themselves by inconsistent action from being treated as having done so.

I need only refer to one other authority, *Commissioners of Inland Revenue* v. *Ayr Town Council*([3]) 22 T.C. 381. In referring to the *Central London Railway* case, Lord President Normand again used language which seems to show that G he understood Lord Macmillan's speech in the *Central London Railway* case to be referring to a distribution of the dividend fund. But his own statement of the law is expressed thus (at page 403):

> "Lastly, though the taxpayer is not bound by the mere form of the accounts, he is bound by the accounts so far as they have recorded a decision to debit the various funds in a particular way which has practical H results apart from his right to retain Income Tax under Rule 19."

The Corporation there was held not to be bound by its accounts except in one respect which bears an analogy to the present case: they had in their accounts shown a balance carried forward in one fund which they were free to use for purposes for which it could not be used if reallocated to the other fund, and it

([1]) 20 T.C. 102. ([2]) 25 T.C. 445. ([3]) 1938 S.C. 822.

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was held that this "was a real fact which cannot be changed by any restatement of the account". The step so taken was described as "irretrievable" by Lord Carmont. A

These cases, then, as I understand them, without laying down any exhaustive rule, at least show that the taxpayer loses the right which I have described as one of allocation or attribution, namely, to prepare a special account for Revenue purposes in which the annual payment is compared with the amount of his assessed profits, if he has made a decision or election in fact to attribute the payment to capital account which decision has produced practical results inconsistent with allocation to revenue. B

I must now apply this test to the present case. Here the Company has done more than merely to produce accounts of a domestic character: it has made a decision—and if the adjective adds anything it was certainly a deliberate decision—to charge part of the interest to a capital account. This had, as no doubt it was intended to have, the practical effect of not charging current revenue with expenditure which might properly be considered as of a capital character. The effect of so doing was to affect the amount brought in by the Company to its account of distributable profits and, ultimately, the balance to the credit of its profit and loss account. What binds the Company, in these circumstances, is not its accounts as such but the decision, recorded in the accounts, to charge the interest in this way with this result. C D

It was contended by the Company that what it did had no relevant practical result: there was merely created a fund, or figure in account, of £15,180 16*s*. which had no specific character; if the reallocation of the interest to revenue were made it might be necessary to reconsider the character of the fund. I am not convinced by this argument. As the successive profit and loss accounts show, the Company's decision has been given effect to over five successive years. In each year a balance of profits has been carried forward which would not have been the same had the interest been debited to profits: this balance in each year has been brought into the distributable fund, a distribution made out of that fund and a new balance carried forward. These are real facts which cannot be changed. To charge that interest now to revenue would have the effect of giving this fund, or part of it, a capital character so as to be unavailable for dividends—a close analogy to the balance in the *Ayr* case[1], which was held not to be available for allocation to the annual payments. E F

On the main point raised by this appeal involving the five years' assessments I have therefore reached the same conclusion as the Court of Appeal. As regards the special point relating to the year 1955–56, which depends upon the question whether the Revenue are precluded from making a fresh assessment, I am content to say that I agree with Plowman J. and with the Court of Appeal that the Revenue are not bound by the agreement reached with the taxpayer in 1957, which did not touch the matter now in dispute. I would therefore dismiss the appeal. G H

Lord Pearson—My Lords, the Appellant Company carries on in the basement of its buildings in Chancery Lane a safe deposit business, and lets the upper parts of the buildings to tenants. Most of the upper parts were destroyed by enemy action in the years 1940 and 1941. Building operations for rebuilding

(1) 22 T.C. 381.

A the upper parts and effecting some new construction were carried out in the period from 1949 to 1958. For the purpose of financing the building operations the Company borrowed large sums on mortgage in the years 1954 to 1956 and repayment was made in the years 1958 to 1961. In the meantime interest was paid on the sums outstanding and secured by the mortgages. The Company consulted its auditors as to the proper treatment of the mortgage interest in its B accounts. The auditors advised the Company that, in order to give a true and fair view of the Company's affairs and in particular to bring out the cost of the building operations, and in accordance with general accountancy practice, it was proper to charge to capital the cost of finance during the period of construction in cases where the outlay was substantial in relation to the size of the Company. This was found by the Special Commissioners to be a proper method C for accounting purposes, and it was adopted by the Company. A calculation was made for each of the relevant years in order to arrive at the correct proportion of the mortgage interest to be charged to capital in the Company's accounts in that year.

For purposes of illustration, it will be convenient to take from exhibits 2, 3 and 4 to the Case Stated figures for the year ending on 24th March 1957. D The mortgage interest paid amounted to £26,536, and the calculated proportion was 49 per cent. A round sum of £13,000, approximating to that proportion, was charged to capital. The rest of the mortgage interest, amounting to £13,536, was charged as a revenue expense and so was taken into account as a deduction in arriving at the net profit, which amounted to £17,441. The appropriation account included this net profit of £17,441, and "profit from last year" amount- E ing to £10,079 and a figure for "adjustments and miscellaneous" amounting to £1,893, and the total in the appropriation account was £29,413. A dividend was declared and paid, and the net amount of it was £14,375. Evidently the Company in paying the dividend to its shareholders out of its own taxed profits deducted and retained the amount of the income tax at the standard rate on the dividend, as the Company was entitled to do under s. 184 of the Income F Tax Act 1952. The balance of profit remaining in the appropriation account was £15,038 (£29,413 less £14,375) and this was carried forward to the next year. In the next year this sum of £15,038 appears as "profit from last year" in the appropriation account, together with the net profit for the year of £14,726 and a sum of £248 for "adjustments and miscellaneous"; and out of the resulting total of £30,012 there was paid a "net dividend" of £14,375, and the balance G of profit amounting to £15,637 was carried forward to the following year. In the following year there was a similar payment of "net dividend" and there was a similar carry-forward of a balance of profit.

Thus in the year ending on 24th March 1957 the sum of £13,000, representing the calculated 49 per cent. proportion of the mortgage interest paid in that year, was in fact charged by the Company in its accounts as a capital expense. H If it had been charged as a revenue expense, there would have been less money for appropriation and either the dividend for the year or the balance of profit carried forward or both would have been reduced, and there would in the ordinary course of events have been less dividend in that year or in some future year or years or in both. The Company's decision to charge that sum of £13,000 as a capital expense was not a mere exercise in accountancy. The Company I was adopting a proper accounting method, as the auditors advised and the Special Commissioners found. The decision was in accordance with reality, because the cost of financing the building operations could naturally be treated

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as part of the cost of the building operations. The decision had practical effects, because it increased the sums available for payment of dividends. There is no eivdence that the Company ever intended to, or in fact did, in any later year retract or seek to retract the decision. A

The question is whether that part of the mortgage interest which was charged as a capital expense in each of the relevant years (for example, the sum of £13,000 in the year ending 24th March 1957) was or was not "payable" out of "profits or gains brought into charge to tax" (conveniently referred to as "taxed profits") within the meaning of ss. 169 and 170 of the Income Tax Act 1952. If it was "payable" out of taxed profits, s. 169 applied and the Company was entitled, on making the payment, to deduct and retain an amount equal to income tax at the standard rate. If it was "not payable" out of taxed profits, s. 170 applied and the Company was bound on making the payment to deduct the amount of the tax and to account for it to the Commissioners of Inland Revenue. Section 170 (2) throws light on the meaning of "payable" in ss. 169 and 170. That subsection provides: B C

> "Where any such payment as aforesaid is made by or through any person, that person shall forthwith deliver to the Commissioners of Inland Revenue, for the use of the Special Commissioners, an account of the payment, or of so much thereof as is not made out of profits or gains brought into charge, and of the tax deducted out of the payment or out of that part thereof and the Special Commissioners shall assess and charge the payment for which an account is delivered on that person." D

It is evident that the question of how the sum was "payable" cannot be kept wholly separate from the question of how it was paid, and indeed the question, as seen after the payment has been made, comes to be how the sum was paid or may be deemed to have been paid: *Sugden* v. *Leeds Corporation*(1) [1914] A.C. 483,499; *Central London Railway Co.* v. *Commissioners of Inland Revenue*(2) [1937] A.C. 77, 89; *Allchin* v. *Coulthard*(3) [1943] A.C. 607,617. E

The second part of the question—how the sum may be deemed to have been paid—brings in a notional element. But the notional element is not unduly prominent, and does not become unmanageable, if one applies the exposition of rr. 19 and 21 of the General Rules applicable to all Schedules of the Income Tax Act 1918—predecessors of ss. 169 and 170—given by Viscount Simon L.C. in *Allchin* v. *Coulthard* in a speech with which Lord Russell of Killowen and Lord Wright concurred. Viscount Simon said, at pages 619–21(4): F

> "The difficulty that remains to be solved arises from the fact that the figure at which profits or gains are assessed under cases I and II of schedule D are not normally the actual profits or gains of the year of charge, but a figure, formerly arrived at by averaging the profits or gains of three preceding years and now arrived at by taking those of the preceding year. Yet, if an annual payment in any year is made 'out of profits or gains' this suggests that it is made out of actual profits or gains and not out of a conventional figure arrived at from the past which is taken to represent them for taxing purposes. . . . The 'profits or gains brought into charge' must, in my view, mean the actual profits of the year calculated with such deductions, additions, or allowances as the income tax law prescribes . . . G H

(1) 6 T.C. 211, at p. 259. (2) 20 T.C. 102, at p. 151. (3) 25 T.C. 445, at p. 459.
(4) *Ibid.*, at pp. 461–2.

A The matter is put beyond doubt, in my opinion, by observing that in rule 19 these profits or gains brought into charge 'shall be assessed and charged with tax': they cannot, therefore, be themselves the assessed figure. But I think the true solution of the difficulty is to be found by treating rule 19, while predicating a payment of interest out of actual profits, as measuring these actual profits by the figure (whether larger or smaller, or the same) B of assessment of them to tax . . . This amounts to saying that tax is set off against tax, the tax deducted on paying interest against the tax charged for the same year on an assessed figure of profits or gains from which the interest payment has not been deducted . . . The phrase 'profits or gains brought into charge' in a given year cannot, I think, itself mean the figure of assessment in respect of them reached when those profits or gains have C been assessed and charged, but, while interest may in proper circumstances be treated as payable and paid out of these actual profits or gains, the extent to which income tax deducted from such interest may be set off against income tax charged on those profits or gains is to be ascertained by reference to the assessment made on the latter."

When the exposition is applied to the present case, the question of principle, D which is the only material question in this appeal, is whether the sum concerned was payable, and can be deemed to have been paid, out of the *actual* taxed profits. By "the sum concerned" I mean the proportion of the interest payments which was treated in the Company's accounts as a capital expense, being in the example given above the sum of £13,000. If there were a question of *quantum*, whether the amount of the taxed profits was sufficient to cover the whole of E the interest payments, the relevant figure of the taxed profits would be the assessed figure equal to the profits of the preceding year. But there is no question of *quantum* raised in this appeal. The sum concerned (the £13,000 in the example) may or may not have been initially payable out of the taxed profits. There is no finding in the Case Stated as to the propriety of treating this sum as a revenue expense. But however that may be, the Company has in my F opinion by its conduct debarred itself from treating the sum concerned as payable out of the taxed profits. The Company has treated the sum concerned as capital expenditure, and has thereby increased the amount in the profit and and loss account available for payment of dividends. That was a deliberate decision of the Company, having practical effects. There is no evidence of its having been a provisional decision subsequently reversed or modified. The G Company has committed itself. The sum concerned was not in fact paid out of taxed profits, and cannot now be deemed to have been so paid: *Central London Railway Co.* v. *Commissioners of Inland Revenue*(1) [1937] A.C. 77, at page 89; *Commissioners of Inland Revenue* v. *Ayr Town Council* (1938) 22 T.C. 381, at pages 403–4, per Lord President Normand. As Romer L.J. said in the *Central London Railway Co.* case, 20 T.C. 102, at page 141:

H "... where, not for the purposes of convenience or for the purposes of giving effect to the payer's own notions of account keeping, but for the purpose of definitely deciding and of recording the fact that a decision has been come to that a certain payment of interest is to be paid out of capital and not out of interest, then the account is not only of great importance but, in the absence of evidence to the contrary, is conclusive upon the

(1) 20 T.C. 102., at p. 151.

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matter. In the present case a company, not for the purposes of indulging in some fancy idea as to the proper method of keeping accounts, has debited this particular payment of interest to capital for the purpose of making it clear that the revenue, from which it might otherwise have been deducted, is to be free for distribution as dividend." A

I would dismiss the appeal.

Questions put: B

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dismissed with costs.

The Contents have it.

[Solicitors:—Paisner & Co.; Solicitor of Inland Revenue.] C