NO. 987—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—6TH, 7TH, 8TH AND 28TH MARCH, 1934

COURT OF APPEAL—21ST AND 22ND JUNE, 1934

HOUSE OF LORDS—10TH, 11TH, 13TH AND 14TH FEBRUARY AND 21ST MAY, 1936

(1) CENTRAL LONDON RAILWAY CO. *v.* COMMISSIONERS OF INLAND REVENUE[1]

(2) LONDON ELECTRIC RAILWAY CO. *v.* COMMISSIONERS OF INLAND REVENUE[1]

(3) METROPOLITAN RAILWAY CO. *v.* COMMISSIONERS OF INLAND REVENUE[1]

Income Tax—Interest payment charged to capital account under private Act—Taxed income of payer sufficient to meet interest—Whether interest payable or paid out of profits or gains brought into charge—Income Tax Act, 1918 (8 *&* 9 *Geo.* V, *c.* 40), *Section* 36, *and General Rules* 19 *and* 21; *Finance Act*, 1927 (17 *&* 18 *Geo.* V, *c.* 10), *Section* 26.

The Appellant Company in the first case issued certain debenture stock under statutory powers which, inter alia, *enabled the Company, during the material periods, to charge the interest thereon to capital. In the Company's accounts for the year* 1930, *which were in the statutory form prescribed for railway companies' accounts, the interest, which was paid under deduction of tax, was charged, as to part, to capital account.*

The Company had only one banking account into which all moneys were paid and out of which all payments were made. The amount of income on which Income Tax had been paid or suffered by the Company for the year 1930–31 *was ample to satisfy the payment of the debenture interest.*

The Company was assessed under General Rule 21 (*as amended by Section* 26 *of the Finance Act*, 1927) *for the year* 1930–31 *on the amount of the debenture interest charged to capital in its accounts. On appeal, the Company contended* (a) *that the form of its accounts did not affect its liability to Income Tax and, although the payment was debited to capital account, that did not make it a payment out of capital in fact; and* (b) *that, as there existed adequate taxed income out of which the payment of the interest could be made, it must be deemed to have been paid out of that income.*

(1) Reported (K.B. & C.A.) 151 L.T. 333; (H.L.) 155 L.T. 66.

The facts and contentions in the second case presented no material differences from those in the first case.

In the third case, the Appellant Company had statutory power to charge to capital account the interest on certain moneys borrowed from a bank. Up to December, 1929, *the interest was debited in the Company's accounts, which were in statutory form, to a suspense account and was later transferred to a capital account, to which was also charged the interest for subsequent periods. The income of the Company, on which tax had been paid or suffered, was adequate to pay the interest to the bank. The Company claimed repayment of Income Tax under Section* 36 *of the Income Tax Act,* 1918, *for the years* 1927–28, 1928–29 *and* 1929–30, *in respect of the interest paid to the bank, contending that such interest had been paid out of profits or gains brought into charge to tax.*

Held, *that the interest in the first two cases was not " payable " out of profits or gains brought into charge " within the meaning of General Rule* 19 *of the Income Tax Act,* 1918, *and that in the third case the interest was not " paid out of profits or gains " brought into charge " within the meaning of Section* 36 *of that Act.*

CASES

(1) *Central London Railway Co.* v. *Commissioners of Inland Revenue*

CASE

Stated under the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 20th March, 1933, the Central London Railway Company, hereinafter called " the Appellant " Company ", appealed against an assessment to Income Tax in the sum of £2,340 1*s.* 11*d.* for the year ending 5th April, 1931, made upon it under the provisions of the Income Tax Acts.

1. The said assessment was made by the Special Commissioners under the provisions of Rule 21 of the General Rules applicable to Schedules A, B, C, D and E of the Income Tax Act, 1918, as amended by Section 26 of the Finance Act, 1927.

2. Under powers contained in the London Electric, Metropolitan District, Central London and City and South London Railway Companies Act, 1930, hereinafter referred to as " the " Railway Companies Act ", the Appellant Company raised £850,000 by means of an issue of 5 per cent. Redeemable Debenture Stock 1985–95. The interest on this stock ranks as a first charge upon the Company's revenues *pari passu* with the interest upon the Company's other debenture stocks, which stocks amount to £1,534,000. A copy of the Railway Companies Act, marked "A", is annexed to and forms part of the Case(1).

3. Under the provisions of the Railway Companies Act the Appellant Company had power to charge interest on the said debentures to capital account. Parts IX and X of the Railway Companies Act contain the financial provisions affecting the Appellant Company. Our attention was directed, in particular, to Sections 106, 109, 117, 118, 123 and 124.

4. At the hearing reference was made to the Central London Railway Act, 1891, a copy of which, marked " B ", is annexed to and forms part of the Case(1). Section 24 of this Act, in particular, was referred to.

5. The said Debenture Stock was offered for sale to the public on 8th October, 1930, by Baring Brothers & Co., Limited, N. M. Rothschild & Sons and J. Henry Schroder & Co. A copy of the prospectus containing this offer, marked " C ", is annexed to and forms part of the Case(1). The copy of a letter written by the Appellant Company's Chairman, contained therein, was read at the hearing.

6. The following statement shows the amounts on which Income Tax was paid or suffered by the Appellant Company for 1930–31 and the annual payments from which Income Tax was deducted. The sum of £4,250 shown therein as interest on 5 per cent. Debenture Stock charged to capital account represents the gross amount (without deduction of Income Tax) of interest paid upon the 5 per cent. Redeemable Debenture Stock 1985–95 referred to in paragraph 2 hereof :—

Amounts on which Income Tax paid or suffered—1930–31	Amount £
Case I assessment for 1930–31 (based on profits for 1929)	280,282
Assessed under Schedule A	7,897
Income received under deduction of tax	4,982
	£293,161

(1) Not included in the present print.

Payments from which Income Tax was deducted—1930–31

	£
Chief rents paid	827
Interest on Debenture Stocks :—	
Interest on 5 per cent. Debenture Stock charged to capital account	4,250
Interest on other debenture stock	65,150
	£70,227
Dividends :—	
Preference Dividend	21,600
Ordinary Dividend	150,000
	£241,827

7. The Appellant Company's Accounts are published in accordance with the Railway Companies (Accounts and Returns) Act, 1911, and Section 77 (1) of the Railways Act, 1921.

A copy of the Appellant Company's Accounts for the year ended the 31st December, 1930, marked " D ", is annexed to and forms part of the Case(1).

The sum of £2,340 1*s*. 11*d*. appearing in Account Number 5 headed " Details of capital expenditure for year ended 31st Decem- " ber, 1930 ", under the description of " Interest on 5% Redeem- " able Debenture Stock (1985–95) during construction, less interest " on unexpended proceeds ", is the sum of £4,250 referred to in the last preceding paragraph, less an allocation of £1,909 18*s*. 1*d*. out of the general interest received by the Appellant Company to represent interest received upon the unexpended proceeds of the Debenture issue. The general interest received by the Company is all taxed in its hands, and the assessment under appeal has therefore been restricted to the aforesaid amount of £2,340 1*s*. 11*d*.

This item is also reflected in Accounts Numbers 4, 7 and 19. The said sum of £2,340 1*s*. 11*d*. represents the gross amount of the interest in question; the Appellant Company in fact paid its debenture interest (including this sum) less Income Tax at the current rate. The Income Tax so deducted from the said sum of £2,340 1*s*. 11*d*. is held in suspense pending the final determination of the appeal.

8. The following table sets out the available profits of the Appellant Company for the year 1930 and reserves at 31st December, 1930 :—

(1) Not included in the present print.

	£	£
Balance of profits per page 3 of published Accounts		380,809
Less:		
Rentals, &c.	£10,587	
Debenture interest charged to revenue	65,150	
		75,737
		305,072
Less:		
*Appropriation to reserve for contingencies ...		21,410
		283,662
Less:		
Dividend on Preference Stock		21,600
		262,062
Less:		
Dividend on Ordinary Stock		150,000
Revenue account balance carried forward ...		112,062
Less:		
Interest charged to capital account per Rule 21 assessment		2,340
		109,722
Add:		
*The amount appropriated during the year to reserve for contingencies (as above) ...		21,410
		£131,132

In addition there are the following accumulated taxed reserves shown on the General Balance Sheet—

Account No. 19 of published Accounts :—		
Renewal Funds	£287,247	
Contingencies	48,994	
		£336,241

9. The Appellant Company has only one banking account, into which all moneys are paid, and out of which all payments are made.

10. On behalf of the Appellant Company it was contended that :—

(1) The fact that a payment is debited to capital account does not make it a payment out of capital in fact.

(2) The form of the Appellant Company's Accounts does not affect its liability to Income Tax.

(3) As there existed adequate taxed income out of which the payment of the interest in question could be made, it must be deemed to have been paid out of that income.

(4) The assessment, the subject of the appeal, imposes *pro tanto* a double charge to tax upon the Appellant Company's profits.

(5) The true effect of Section 118 of the Railway Companies Act, upon the exercise of the option to charge the interest in question to capital account, was not to cause the interest to be paid out of capital, but to permit a modification of the statutory form of the Accounts and to confer upon the Appellant Company, in relation to that interest, that liberty of action, in the preparation of its Accounts, which may be practised by an individual at his discretion.

(6) The Appellant Company was not liable to be assessed under the provisions of Rule 21.

11. It was contended on behalf of the Respondents that :—

(1) The onus lay upon the Appellant Company to show that the payment of interest in question had in fact been made out of profits and gains brought into charge to tax, *i.e.*, out of taxed income, and it had failed to discharge this onus.

(2) The evidence produced showed that the payment had in fact been made out of capital and not out of profits and gains brought into charge.

(3) The assessment was correct and should be confirmed.

12. We, the Commissioners, gave our decision as follows :—

" The authorities to which our attention was directed, in " our opinion, all deal with cases where payments were made " out of a mixed fund composed of taxed and untaxed income, " or out of a fund provided to supplement income when the " latter was insufficient for the purpose required. We have " been unable to discover any reported case where the question " has arisen, as in the present case, of payments made out of a " fund consisting partly of capital and partly of income. We " regard this as an important distinction to bear in mind when " considering the various speeches and judgments to which we " were referred.

" At the outset we arrive at the three following " conclusions :—

" (1) The Appellant Company possessed taxed income " amply sufficient to satisfy the payment in " question.

" (2) It could with legality have made the payment either " out of capital or income.

" (3) The payment was in fact debited to capital in its " accounts.

" We are fully aware that, as a general principle of Income " Tax law, the form of accounts adopted by the taxpayer " neither assists nor injures him. We think, however, that " different considerations apply to the present case, for the " reason that the accounts have to be prepared in a statutory " form, under the provisions of the Railway Companies " (Accounts and Returns) Act, 1911, in which the First " Schedule thereto enumerates various financial accounts, some " being confined to capital expenditure and receipts. In the " present case all receipts were paid into one banking account " only, but we consider that, in making payments thereout, " at some period a distinction would have to be drawn as to " what expenditure is attributable to capital and what to " income.

" In determining the question of whether the payment was " made out of capital or income the only evidence before us was " the manner in which the payment had been treated in the " accounts, which we consider we must have regard to, and, so " far as it went, a letter from the Appellant Company's " Chairman, contained in the offer for sale relating to the " Debenture issue, stating that the interest thereon would be " charged to capital for a period. In this respect we realise " that the Debentures had already been sold to the issuing " houses and the said statement did not necessarily bind the " Appellant Company.

" No evidence was given before us that payment had in " fact been made out of income.

" We have come to the conclusion that the payment must " be taken to have been in fact paid out of capital, and that it " was lawful so to pay it.

" We confirm the assessment."

13. The representative of the Appellant Company immediately upon the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, which Case we have stated and do sign accordingly.

R. COKE,
H. M. SANDERS, } Commissioners for the Special Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
14th November, 1933.

(2) *London Electric Railway Co.* v. *Commissioners of Inland Revenue*

CASE

Stated under the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 20th March, 1933, the London Electric Railway Company, hereinafter called " the Appellant " Company ", appealed against an assessment to Income Tax in the sum of £30,326 8*s*. 10*d*. for the year ending 5th April, 1931, made upon it under the provisions of the Income Tax Acts.

1. The said assessment was made by the Special Commissioners under the provisions of Rule 21 of the General Rules applicable to Schedules A, B, C, D and E of the Income Tax Act, 1918, as amended by Section 26 of the Finance Act, 1927.

2. Under powers contained in the London Electric, Metropolitan District, Central London and City and South London Railway Companies Act, 1930, hereinafter referred to as " the Railway " Companies Act ", the Appellant Company raised £8,450,000 by means of an issue of 5 per cent. Redeemable Debenture Stock 1985–95. The interest on this stock ranks with the interest on £5,296,000 4 per cent. Debenture Stock as a first charge on the revenues of the Company. A copy of the Railway Companies Act, marked " A ", is annexed to and forms part of the Case[1].

3. Under the provisions of the Railway Companies Act the Appellant Company had power to charge interest on the said debentures to capital account. Parts VII and X of the Railway Companies Act contain the financial provisions affecting the Appellant Company. Our attention was directed, in particular, to Sections 92, 98, 99, 117, 118, 123 and 124.

4. The said Debenture Stock was offered for sale to the public on 10th July, 1930, and 8th October, 1930, by Baring Brothers & Co., Limited, N. M. Rothschild & Sons and J. Henry Schroder & Co. A copy of the prospectus containing the offer of £3,450,000, part of the said Debenture Stock, marked " B ", is annexed to and forms part of the Case[1]. The copy of a letter written by the Appellant Company's Chairman, contained in this offer for sale dated 8th October, 1930, was read at the hearing.

5. The following statement shows the amounts on which Income Tax was paid or suffered by the Appellant Company for 1930–31 and the annual payments by the Company from which Income Tax was

[1] Not included in the present print.

deducted. The sum of £83,916 shown therein as interest on 5 per cent. Debenture Stock charged to capital account represents the gross amount (without deduction of Income Tax) of interest paid upon the 5 per cent. Redeemable Debenture Stock 1985–95 referred to in paragraph 2 hereof :—

Amount on which Income Tax paid or suffered—1930–31	Amount £
Case I assessment for 1930–31 (based on profits for 1929)	964,550
Assessed under Schedule A	18,587
Income received under deduction of tax	41,591
	£1,024,728
Payments from which Income Tax was deducted—1930–31	
Rents paid :—	
Rent charges	10,211
Chief rents, etc.	20,938
Interest and sundries	14,922
Interest on Debenture Stocks, etc. :—	
Interest on 5 per cent. Debenture Stock charged to capital account	83,916
Interest on other debenture stocks	464,110
Interest on loan from London Midland and Scottish Railway Company	33,244
	£627,341
Dividends :—	
Preference Dividend	126,947
Ordinary Dividend	466,397
	£1,220,685

6. The Appellant Company's Accounts are published in accordance with the Railway Companies (Accounts and Returns) Act, 1911, and Section 77 (1) of the Railways Act, 1921.

Copies of the Appellant Company's Accounts for the years ended the 31st December, 1929 and 1930, marked " C " and " C.1 ", are annexed to and form part of the Case(1).

The sum of £29,009 13*s.* 4*d.* debenture interest, which is computed as appears in the next following paragraph, and is the principal subject matter of this appeal, appears in Account Number 5 headed " Details of capital expenditure for year ended " 31st December, 1930 ".

It is also reflected in Accounts Numbers 4, 7 and 19. The said sum of £29,009 13*s.* 4*d.* represents the gross amount of the interest in question computed as aforesaid; the Appellant Company in fact paid its debenture interest (including this sum) less Income Tax at the current rate.

7. The Income Tax so deducted from the said sum of £29,009 13*s.* 4*d.* is held in suspense pending the final determination of the appeal. The following table sets out how the assessment under appeal was computed :—

Interest debited or credited to capital account, fiscal year 1930–31	Amount £ *s.* *d.*
Debited to capital account :—	
Interest on 5 per cent. Redeemable Debenture Stock 1985–95 to 31st December, 1930	83,916 13 4
Less :	
Interest on unexpended proceeds (estimated) to 31st December, 1930, (included in Case I assessment, 1931–32)	54,907 0 0
Charged to capital account—per Statement No. 5 of published Accounts for 1930 ...	29,009 13 4
Interest on purchase money or compensation paid to vendors, etc., in connection with the acquisition of land and property	641 14 3
(Tax on this sum at 4*s.* 6*d.* in the £ is equal to £144 7*s.* 10*d.* compared with £144 0*s.* 11*d.* actually deducted).	
Payments made to Metropolitan Surplus Lands Committee	701 5 0
Forward ...	**£30,352 12 7**

(1) Not included in the present print.

		Amount
Forward ...		£30,352 12 7
Less:		
Credited to capital account :—		
Interest received from the Supreme Court Pay Office in respect of money deposited in connection with the purchase of properties :—		
Re G. T. Martin, 15, High Street, Camden Town ...	£4 11 6	
Re A. L. Palmer, 39, Beadon Road, Hammersmith ...	21 12 3	
		26 3 9
		£30,326 8 10

The sum of £54,907 represents an allocation by the Appellant Company of its general interest received (which is all taxed in its hands) to represent the interest received upon the unexpended proceeds of the Debenture issue, the balance only of Debenture interest paid after deducting this sum, *viz.* : £29,009 13*s.* 4*d.*, being debited to capital account in its accounts as shown under the authority of Section 118 of the Railway Companies Act.

The nature of the payment of £641 14*s.* 3*d.* sufficiently appears from its description. The payment of £701 5*s.* 0*d.* is in the nature of an annual payment made under the term of a contract in respect of certain property owned by the Committee and occupied by the Committee or its tenants which the Company possessed Parliamentary powers to buy ; and in order to induce the Committee not to grant long leases of this property (in respect of which the Company might have to pay large compensation when they bought the property) the Company made an annual payment of £701 5*s.* 0*d.* to the Committee. Both these sums of £641 14*s.* 3*d.* and £701 5*s.* 0*d.* are debited to capital account in the Accounts. The sum of £26 3*s.* 9*d.* represents certain taxed income which has been credited to capital. The assessment of £30,326 8*s.* 10*d.* has thus been made upon the net sum debited to capital account taking into account all the items set out.

8. The Appellant Company has only one banking account, into which all moneys are paid, and out of which all payments are made.

9. On behalf of the Appellant Company it was contended that :—

(1) The fact that a payment is debited to capital account does not make it a payment out of capital in fact.

(2) The form of the Appellant Company's Accounts does not affect its liability to Income Tax.

(3) As there existed adequate taxed income out of which the payment of the interest (including the two sums of £641 14*s*. 3*d*. and £701 5*s*. 0*d*.) in question could be made, it must be deemed to have been paid out of that income.

(4) The assessment, the subject of the appeal, imposes *pro tanto* a double charge to tax upon the Appellant Company's profits.

(5) The true effect of Section 118 of the Railway Companies Act, upon the exercise of the option to charge the interest in question to capital account, was not to cause the interest to be paid out of capital, but to permit a modification of the statutory form of the Accounts and to confer upon the Appellant Company, in relation to that interest, that liberty of action, in the preparation of its Accounts, which may be practised by an individual at his discretion.

(6) The Appellant Company was not liable to be assessed under the provisions of Rule 21.

10. It was contended on behalf of the Respondents that :—

(1) The onus lay upon the Appellant Company to show that the payments of interest in question had in fact been made out of profits and gains brought into charge to tax, *i.e.*, out of taxed income, and it had failed to discharge this onus.

(2) The evidence produced showed that the payments had in fact been made out of capital and not out of profits and gains brought into charge.

(3) The assessment was correct and should be confirmed.

(4) The Respondents did not contend that there was not sufficient taxed income of the Appellant Company to satisfy the payments in question.

11. We, the Commissioners, gave our decision as follows :—

" The authorities to which our attention was directed, in " our opinion, all deal with cases where payments were made " out of a mixed fund composed of taxed and untaxed income, " or out of a fund provided to supplement income when the " latter was insufficient for the purpose required. We have

" been unable to discover any reported case where the question " has arisen, as in the present case, of payments made out of a " fund consisting partly of capital and partly of income. We " regard this as an important distinction to bear in mind when " considering the various speeches and judgments to which we " were referred.

" At the outset we arrive at the three following " conclusions :—

" (1) The Appellant Company possessed taxed income " amply sufficient to satisfy the payment in " question.

" (2) It could with legality have made the payment either " out of capital or income.

" (3) The payment was in fact debited to capital in its " accounts.

" We are fully aware that, as a general principle of Income " Tax law, the form of accounts adopted by the taxpayer " neither assists nor injures him. We think, however, that " different considerations apply to the present case, for the " reason that the accounts have to be prepared in a statutory " form, under the provisions of the Railway Companies " (Accounts and Returns) Act, 1911, in which the First " Schedule thereto enumerates various financial accounts, some " being confined to capital expenditure and receipts. In the " present case all receipts were paid into one banking account " only, but we consider that, in making payments thereout, " at some period a distinction would have to be drawn as to " what expenditure is attributable to capital and what to " income.

" In determining the question of whether the payment was " made out of capital or income the only evidence before us was " the manner in which the payment had been treated in the " accounts, which we consider we must have regard to, and, so " far as it went, a letter from the Appellant Company's " Chairman, contained in the offer for sale relating to the " Debenture issue, stating that the interest thereon would be " charged to capital for a period. In this respect we realise " that the Debentures had already been sold to the issuing " houses and the said statement did not necessarily bind the " Appellant Company.

" No evidence was given before us that payment had in " fact been made out of income.

" We have come to the conclusion that the payment must " be taken to have been in fact paid out of capital, and that it " was lawful so to pay it.

" We can draw no distinction regarding the two payments " of £641 and £701, both of which were debited to capital in " the accounts. We hold these sums are rightly included in the " assessment, which we confirm."

12. The representative of the Appellant Company immediately upon the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, and the Finance Act, 1927, Section 26, which Case we have stated and do sign accordingly.

R. COKE,
H. M. SANDERS, } Commissioners for the Special Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.

14th November, 1933.

(3) *Metropolitan Railway Co.* v. *Commissioners of Inland Revenue*

CASE

Stated under the Finance Act, 1925, Section 19 (3), and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 24th March, 1933, the Metropolitan Railway Company, hereinafter called " the Appellant " Company ", claimed repayment of Income Tax under the provisions of Section 36 of the Income Tax Act, 1918, by reason of the matters hereinafter set out, for the three years ending 5th April, 1928, 1929 and 1930, respectively.

1. Under the provisions of Section 19 of the Finance Act, 1925, the said claim had been made to the Commissioners of Inland Revenue who refused the same. Notice of appeal to the Special Commissioners against this decision was duly given under the provisions of Sub-section (2) of the said Section.

2. In 1927 the Appellant Company decided to erect a building known as Chiltern Court over Baker Street Station.

In order to provide the necessary finance the Appellant Company borrowed money from the National Provincial Bank, hereinafter referred to as " the Bank ", on a special account.

A statement, marked " A ", which is annexed to and forms part of the Case(1), contains extracts from the minutes of the Appellant Company's directors' meetings respecting the sums advanced by the Bank and copies of two contracts relating thereto.

3. The Appellant Company under the provisions of the Metropolitan Railway Act, 1929, had power to charge the interest on the said advance from the Bank to capital account.

A copy of this Act, marked " B ", is annexed to and forms part of the Case(1).

Our attention, in particular, was drawn to Sections 61 and 63 of this Act.

4. A document, marked " C ", which is annexed to and forms part of the Case(1), contains four statements.

Statement Number 1 shows the amount of interest paid to the Bank in respect of the said advance for the three years ending 5th April, 1930, amounting in all to the sum of £35,292 2*s.* 2*d.*

It is in respect of this sum that repayment of Income Tax under the provisions of Section 36 of the Income Tax Act, 1918, is claimed, on the ground that such interest was paid without deduction of tax out of profits and gains brought into charge to tax.

(1) Not included in the present print.

The sum of £2,011 16*s*. 6*d*. contained in this statement is not material to this appeal and can be ignored.

Statement Number 2 shows the profits or gains of the Appellant Company brought into charge to tax out of which it is claimed that the said interest was paid.

Statement Number 3 shows the manner in which the interest was treated in the Bank Pass Books. The said advance and the interest thereon were the subject of a special account at the Bank. Shortly after the interest was debited to this account, a transfer was made by the Company from its current banking account. The current account contained all receipts and expenditure made by the Appellant Company whether in respect of capital or income.

The sums transferred from the debit of the special account to the debit of the current account include the interest debited in the special account, being sometimes included in a larger amount and sometimes being the exact sum.

The items in red are cases where the Bank had overcharged in respect of the said interest or where an adjustment was necessary in the current account Pass Book.

Statement Number 4 shows how the said interest was treated in the Appellant Company's Accounts.

5. The Appellant Company's Accounts are published in accordance with the Railway Companies (Accounts and Returns) Act, 1911, and Section 77 (1) of the Railways Act, 1921.

Copies of the Appellant Company's Accounts for three years, 1928, 1929 and 1930, marked " D ", " E " and " F ", respectively, are annexed to and form part of the Case(1).

The interest on the said advance from October, 1927, to June, 1929, was, as appears from Statement Number 4 contained in " C " above, firstly debited to a suspense account.

At December, 1929, this debit was transferred to Account Number 5 in the Appellant Company's Accounts. This Account is headed " Details of capital expenditure for year ended " 31st December, 1929 ". To this Account the interest was debited directly for the year ending 31st December, 1930. The debit is also reflected in Accounts Numbers 4, 7 and 19 for each year.

6. At all times material to this appeal the capital account of the Company showed a debit balance largely in excess of the cost of Chiltern Court, which amounted to £673,364 14*s*. 4*d*. up to the end of the year 1929. Apart from the special account with the Bank (referred to in paragraph 2 hereof) the Appellant Company has only one banking account, into which all moneys are paid, and out of which all payments are made.

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(1) Not included in the present print.

7. It was contended on behalf of the Appellant Company that :—

(1) The fact that a payment is debited to capital account does not make it a payment out of capital in fact.

(2) The form of the Appellant Company's Accounts does not affect its liability to Income Tax.

(3) As there existed adequate taxed income out of which the payment of the interest in question could be made, it must be deemed to have been paid out of that income.

(4) The refusal of the claim imposes *pro tanto* a charge to tax upon a revenue disbursement.

(5) The true effect of Section 61 of the Metropolitan Railway Act, 1929, upon the exercise of the option to charge the interest in question to capital account, was not to cause the interest to be paid out of capital, but to permit a modification of the statutory form of the Accounts and to confer upon the Appellant Company, in relation to that interest, that liberty of action, in the preparation of its Accounts, which may be practised by an individual at his discretion.

(6) The charging to capital account at December, 1929, of the interest paid during the years 1927 and 1928 could not in any case affect the claim to relief for the fiscal years 1927–28 and 1928–29.

(7) The Appellant Company was entitled to repayment of Income Tax upon the said sum of £35,292 2*s.* 2*d.* under the provisions of Section 36 of the Income Tax Act, 1918.

8. It was contended on behalf of the Respondents that :—

(1) The onus lay upon the Appellant Company to show that the payments of interest in question had in fact been made out of profits and gains brought into charge to tax, *i.e.*, out of taxed income, and it had failed to discharge this onus.

(2) The evidence produced showed that the payments had in fact been made out of capital and not out of profits and gains brought into charge.

(3) The assessment was correct and should be confirmed.

(4) The Respondents did not contend that there was not sufficient taxed income of the Appellant Company to satisfy the payments in question.

9. We, the Commissioners, gave our decision as follows :—

" The authorities to which our attention was directed, in " our opinion, all deal with cases where payments were made " out of a mixed fund composed of taxed and untaxed income,

" or out of a fund provided to supplement income when the " latter was insufficient for the purpose required. We have " been unable to discover any reported case where the question " has arisen, as in the present case, of payments made out of a " fund consisting partly of capital and partly of income. We " regard this as an important distinction to bear in mind when " considering the various speeches and judgments to which we " were referred.

" At the outset we arrive at the three following " conclusions :—

" (1) The Appellant Company possessed taxed income " amply sufficient to satisfy the payment in " question.

" (2) It could with legality have made the payment either " out of capital or income.

" (3) The payment was in fact debited to capital in its " accounts.

" We are fully aware that, as a general principle of Income " Tax law, the form of accounts adopted by the taxpayer " neither assists nor injures him. We think, however, that " different considerations apply to the present case, for the " reason that the accounts have to be prepared in a statutory " form, under the provisions of the Railway Companies " (Accounts and Returns) Act, 1911, in which the First " Schedule thereto enumerates various financial accounts, some " being confined to capital expenditure and receipts. In the " present case all receipts were paid into one banking account " only, but we consider that, in making payments thereout, " at some period a distinction would have to be drawn as to " what expenditure is attributable to capital and what to " income.

" In determining the question of whether the payment was " made out of capital or income the only evidence before us was " the manner in which the payment had been treated in the " accounts, which we consider we must have regard to.

" No evidence was given before us that payment had in " fact been made out of income.

" We have come to the conclusion that the payment must " be taken to have been in fact paid out of capital, and that it " was lawful so to pay it.

" It follows therefore that it was not proved to our satis- " faction that the payment was made out of profits or gains " brought into charge to tax.

" We can draw no distinction with regard to the sums debited " firstly to a suspense account and subsequently transferred to " Number 5 Account in the Appellant Company's Accounts for

" the year ending 31st December, 1929, and we hold that no " repayment of Income Tax falls to be made in respect thereof " for the reasons given above.

" We refuse the claim for all three years."

10. The representative of the Appellant Company immediately after the determination of the appeal declared to us his dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1925, Section 19 (3), and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

R. COKE,
H. M. SANDERS, } Commissioners for the Special Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
14th November, 1933.

The first two cases came before Finlay, *J.*, in the King's Bench Division on the 6th, 7th and 8th March, 1934, and the third case on the 8th March, 1934, when judgment was reserved. On the 28th March, 1934, judgment was given in all three cases against the Crown, with costs.

Mr. A. M. Latter, K.C., and Mr. A. C. Alcock appeared as Counsel for the three Companies and the Solicitor-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Finlay, J.—These three cases raise substantially the same point. The *Central London Railway* case and the *London Electric Railway* case, indeed, appear to be exactly the same, and no distinction is suggested as to them. There is a slight difference in the *Metropolitan Railway* case, but the point in all these three cases is substantially the same, and that point is whether the payment of certain interest was out of a fund which had already borne tax, so that the Company deducting tax from the interest might retain it. It is sufficient to deal with the facts in the *Central London* case in the first instance. I shall then call attention, quite shortly, to the *Metropolitan* case.

The assessment, in the *Central London* case, was made by the Special Commissioners under the provisions of Rule 21 of the General Rules applicable to all Schedules. There was a Private

(Finlay, J.).

Act, the London Electric, Metropolitan District, Central London and City and South London Railway Companies Act of 1930, and, under it, the Appellant Company raised £850,000 by means of an issue of 5 per cent. redeemable stock. The Railway Companies Act is attached to the Case. It is not necessary to discuss it in detail, but it is desirable to refer to two sections, Sections 117 and 118, under which there is power to charge interest, including this interest, to capital account. The exact terms of the sections must, of course, be referred to, but that is the substantial result. The debenture stock with which we are dealing was offered for sale to the public by three firms, Baring Brothers & Co., Rothschild & Sons, and J. Henry Schroder & Co., and a copy of the prospectus was attached to and made part of the Case. The prospectus refers to this stock in these terms: " As stated in the Chairman's letter " overleaf, the three Companies, together with The City & South " London Railway Company and The London General Omnibus " Company, Limited, are parties to an Agreement constituting a " ' Common Fund ' which is available for meeting their " respective ' Revenue Liabilities ' should their respective " revenue receipts prove inadequate. The interest on all " Debenture Stock which each of the three Companies is " authorised to issue under the Act of 1930 forms part " of its ' Revenue Liabilities ', but during the period of " construction, which is not to extend beyond 31st December, 1933, " this interest, less a sum equal to the appropriate amount of " the Government Grant, will be met out of capital ". The letter from the chairman, to which reference is there made, is substantially in the same terms. Reference is made to that. It is proper to point out, of course, that that is an offer by these three firms who had themselves acquired the stock. In paragraph 6 of the Case will be found details of the income of the Company in the year in question, on which tax had been paid and suffered, and of the payments out, from which Income Tax was deducted. It is unnecessary to go into the details. It is clear, and was admitted and was found by the Commissioners, that there was ample tax-borne income available to pay this interest. The accounts are made part of the Case. It is unnecessary there, again, to go into them in detail, but there is no doubt that this interest on this 5 per cent. redeemable stock does appear in an account, No. 5, which is headed: " Details of capital expenditure for " year ended 31st December, 1930 ". The item appears in other accounts, and appears in the same way. Paragraph 8 sets out details of the profits, and of their application. Paragraph 9 states the fact, which has its importance, that the Company had only one banking account. Into that all moneys were paid, and out of it all payments were made.

(Finlay, J.)

In these circumstances, the matter came before the Commissioners, and the substance of the contention of the Appellant Company can be got from their first three contentions. The first was this : " The fact that a payment is debited to capital account " does not make it a payment out of capital in fact. (2) The form " of the Appellant Company's Accounts does not affect its liability " to Income Tax. (3) As there existed adequate taxed income out " of which the payment of the interest in question could be made, " it must be deemed to have been paid out of that income ". The substantial contention of the Respondents was that the onus lay upon the Appellant Company to show that the payment of interest had, in fact, been made out of profits and gains brought into charge, and it had failed to discharge this onus. Of course, as the second contention goes on to say : " The evidence produced showed that " the payment had in fact been made out of capital and not out of " profits and gains brought into charge ".

The Commissioners who heard the case gave their decision in favour of the Crown. It is not long, and it is desirable to read it : " The authorities to which our attention was directed, in our " opinion, all deal with cases where payments were made out of " a mixed fund composed of taxed and untaxed income, or out of a " fund provided to supplement income when the latter was in- " sufficient for the purpose required. We have been unable to " discover any reported case where the question has arisen, as in " the present case, of payments made out of a fund consisting " partly of capital and partly of income. We regard this as an " important distinction to bear in mind when considering the " various speeches and judgments to which we were referred. At " the outset we arrive at the three following conclusions :—(1) The " Appellant Company possessed taxed income amply sufficient to " satisfy the payment in question. (2) It could with legality have " made the payment either out of capital or income. (3) The " payment was in fact debited to capital in its accounts. We are " fully aware that, as a general principle of Income Tax law, " the form of accounts adopted by the taxpayer neither assists " nor injures him. We think, however, that different consider- " ations apply to the present case, for the reason that the accounts " have to be prepared in a statutory form, under the provisions " of the Railway Companies (Accounts and Returns) Act, 1911, " in which the First Schedule thereto enumerates various financial " accounts, some being confined to capital expenditure and receipts. " In the present case all receipts were paid into one banking " account only, but we consider that, in making payments thereout, " at some period a distinction would have to be drawn as to what " expenditure is attributable to capital and what to income. In

(Finlay, J.)

" determining the question of whether the payment was made out " of capital or income the only evidence before us was the manner " in which the payment had been treated in the accounts, which " we consider we must have regard to, and, so far as it went, a " letter from the Appellant Company's Chairman, contained in " the offer for sale relating to the Debenture issue, stating that " the interest thereon would be charged to capital for a period. " In this respect we realise that the Debentures had already been " sold to the issuing houses and the said statement did not neces- " sarily bind the Appellant Company. No evidence was given " before us that payment had in fact been made out of income. " We have come to the conclusion that the payment must be taken " to have been in fact paid out of capital, and that it was lawful " so to pay it. We confirm the assessment." That is the case of the *Central London Railway*. I have already indicated that it is unnecessary to say anything about the *London Electric* case, which was not suggested to be in any way different.

It is right to say a very few words about the *Metropolitan* case. That related to a claim by the Company for repayment of Income Tax. That claim had been made to the Commissioners under Section 19 of the Act of 1925, and they had refused it. The facts are set out in the Case, and I do not think it is necessary that I should review them. The subject matter is different from that in the other case. This relates to the erection of a building, Chiltern Court, over Baker Street Station, and to the provision of the necessary finance for that purpose, and the position is clearly shown in four statements, marked " C ", which were attached to the Case. I have indicated already that, in my opinion, there is no real distinction in principle between this and the other case, but there is a point in this case which perhaps affords an illustration of Mr. Latter's general argument. The interest in this case, in 1927 and 1928, when it was paid, was debited to a suspense account. In 1929 it was transferred to an account of the details of capital expenditure. The point, of course, is that the payment had been made in two successive years, and it was not until the third year that the transfer was made to the account of capital expenditure. The contentions here, on these facts, are set out in the Case, paragraph 7, and it is perhaps worth just looking at the fifth and sixth contentions of the Appellants. " The true effect of Section 61 of " the Metropolitan Railway Act, 1929, upon the exercise of the " option to charge the interest in question to capital account, was " not to cause the interest to be paid out of capital, but to permit " a modification of the statutory form of the Accounts and to confer " upon the Appellant Company, in relation to that interest, that

(Finlay, J.)

" liberty of action, in the preparation of its Accounts, which may " be practised by an individual at his discretion. (6) The charging " to capital account at December, 1929, of the interest paid during " the years 1927 and 1928 could not in any case affect the claim " to relief for the fiscal years 1927–28 and 1928–29."

That is sufficient to outline, I think, the facts in the cases. The detailed facts, of course, will be got from the Cases themselves and from the documents attached to them. The question in the cases, a difficult and important question, is whether this interest was payable and paid out of a taxed fund. The matter arises upon two well-known and difficult Rules, Rules 19 and 21. It is proper to read Rules 19 and 21 of the General Rules of all Schedules : " (1) Where any yearly interest of money, annuity, or any other " annual payment (whether payable within or out of the United " Kingdom, either as a charge on any property of the person paying " the same by virtue of any deed or will or otherwise, or as a reserva- " tion thereout, or as a personal debt or obligation by virtue of any " contract, or whether payable half-yearly or at any shorter or more " distant periods), is payable wholly out of profits or gains brought " into charge to tax, no assessment shall be made upon the person " entitled to such interest, annuity, or annual payment, but the " whole of those profits or gains shall be assessed and charged " with tax on the person liable to the interest, annuity, or annual " payment, without distinguishing the same, and the person liable " to make such 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 such payment, to deduct and retain thereout a sum " representing the amount of the tax thereon at the rate or rates " of tax in force during the period through which the said pay- " ment was accruing due." Then Rule 21 is this : " (1) Upon pay- " ment of any interest of money, annuity, or other annual payment " charged with tax under Schedule D, or of any royalty or other " sum paid in respect of the user of a patent, not payable, or not " wholly payable, out of profits or gains brought into charge, the " person by or through whom any such payment is made shall " deduct thereout a sum representing the amount of the tax thereon " at the rate of tax in force at the time of payment. (2) Any " such person shall forthwith render an account to the Com- " missioners of Inland Revenue of the amount so deducted, or " of the amount deducted out of so much of the interest, annuity, " annual payment, royalty, or other sum respectively, as is not " paid out of profits or gains brought into charge, as the case " may be, and every such amount shall be a debt from him to " the Crown and shall be recoverable as such;" and so on. It is

(Finlay, J.)

unnecessary to read the rest. The question is, as I indicated a moment ago, whether this was payable and paid out of a taxed fund. The Solicitor-General admitted that the interest was payable out of a taxed fund in the sense that it legally could be so paid. He further admitted, and, indeed, it is quite clear, that the taxed fund was amply sufficient to pay it. He said, however—and if he establishes this, he wins—that, though payable, it was not paid out of taxed funds.

A series of cases was cited to me, cases which inevitably must be cited whenever this particular question arises. I am not going to refer to them all. The leading cases, perhaps the most important cases, are *Attorney-General* v. *London County Council*, 4 T.C. 265; *Attorney-General* v. *London County Council*—the second *County Council* case—5 T.C. 242; *Edinburgh Life Assurance Company* v. *Lord Advocate*, 5 T.C. 472; and *Sugden* v. *Leeds Corporation*, 6 T.C. 211. I also wish to refer to a passage in the *Sterling Trust* case, 12 T.C. 868. The question appears to me to be stated with great clearness by Lord Atkinson in two passages. The first is in 5 T.C., page 485, where he says this: "In my "opinion, where annuities such as these are charged upon a tax-"bearing fund amply sufficient to pay them in full, though not "set apart for that purpose, they cannot be held to be 'not "'payable' or 'not wholly payable' out of gains and profits "brought into charge within the meaning of the 24th Section. "For the purposes of that section I think that the interest on "annuities charged upon the tax-bearing fund must under such "circumstances be treated as payable out of that fund, so far "as it will reach. If the taxed fund be insufficient to pay all "the interest and annuities, then the Income Tax deducted on "the interest or annuities not satisfied out of it must be accounted "for. In short, I attach no special virtue to the manipulation "of the funds of a corporation, in the manner above mentioned, "as a means of escape from a liability to pay Income Tax. To "do so would, in effect, be, I think, to lose sight of what appears "to me to be one of the main objects, if not the main object, "of the section, namely, to avoid obliging a subject to pay Income "Tax twice over on the same sum. That object would, in the "result, be defeated, if the subject were obliged first to pay "Income Tax on a given fund and then to pay Income Tax on "sums properly payable out of it, simply because he had omitted "formally to dedicate the funds specially to that use and formally "to pay those sums out of it." The other passage I will quote from Lord Atkinson is in 6 T.C., page 264, but before I read that it may perhaps be well to read a very well-known passage from the judgment of Lord Gorell in the *Edinburgh* case(1). It is in 5 T.C.,

(1) Edinburgh Life Assurance Co. *v.* Lord Advocate, ST. C. 472.

(Finlay, J.)

at page 491, and what he says is this : " But then it was argued " for the Respondent that it has not been shown that the annuities " have been paid out of the taxable income. This argument would " seem to make the rights of the Crown depend upon the book- " keeping of the Company; but this cannot be, nor do I think " the liabilities of the Company can be made to depend upon their " system of accounts. This argument could hardly be open if the " Company had, in fact, kept the interest, dividends, and rents " from their investments apart from their other moneys, and paid " the annuities out of the former. Can it then make any difference " to their rights and liabilities if they choose to mix the funds " for the purpose of their accounts and pay thereout whatever " sum is necessary to discharge their liabilities to the annuitants?" A little later, after referring to a well-known passage from Lord Macnaghten's speech in the *County Council* case(1), he says this : " But it does not appear to me to follow that where the annuities " are payable out of profits or gains brought into charge it is " necessary to use in paying the annuities the actual moneys " received in respect of the profits or gains in order to obtain the " benefit of the deduction and retention ". Then there is a passage in Lord Atkinson's speech, 6 T.C., page 264, in *Sugden* v. *Leeds Corporation*, where he propounds the two questions which he says have to be answered, and what he says is this : " In my " view, therefore, the right of the debtor who has paid ' interest " ' or annuities ' brought into charge to the income tax to retain " for his own benefit the amount of the tax he has deducted from " his creditors depends upon whether he can answer in the affirma- " tive each of the two following questions :—(1) Have the interest " and the annuities been, in fact, paid, or must they in the " circumstances of the case be taken to have been, in fact, paid " out of profits or gains brought into charge, *i.e.*, out of the " so-called ' taxed fund '? (2) Was it lawful to pay them out " of the fund?" I have already indicated that it was conceded in this case that it was lawful to pay them out of the fund. But the real argument in the case before me is centred upon this : whether the first question ought to be answered by saying that the interest has been paid, or must, in the circumstances of the case, be taken to have been, in fact, paid out of profits or gains brought into charge.

Lastly, I will refer to a passage in the *Sterling Trust* case, 12 T.C. 868, where, at pages 881 and 882, the present Master of the Rolls discusses the meaning of these Rules, or, rather, of the Section which then was operating. What he says is this : " It " appears to me that that judgment, and further the judgment

(1) Attorney-General *v.* London County Council, 4 T.C. 265, at p. 292.

(Finlay, J.)

" of Lord Gorell which contains passages which we have referred " to in the argument, clearly indicates that where you are con- " sidering the business of a company which has two sources of " income, the one subjected to tax and the other not, you are " entitled to assume and deem that it has paid the money that it " ought to pay according to the most businesslike way of appro- " priating the revenue to the expenses; further, that even though " that has not been done in fact by any separate allocation of " the money, as was done here "—that is, in the particular case the Master of the Rolls was referring to—" in the later years " by putting it at a special bank, still you are entitled to treat " the money as having been paid out of the fund which is most " favourable to the company, which is, in this case, the taxpayer. " That case appears to me to be binding upon us and to clearly " negative the proposition which had been held good in the Court " of Session, that is the system of proportionate payment." He goes on a little later(1) : " For my own part, I do not think, as we " have decided this on the broad ground, it is necessary to deal " with the question of whether or not the separation to a separate " banking account makes any difference and it may be that what " Lord Gorell said will have to be more carefully considered in " another case. For my own part, I am very reluctant to think " that on any occasion it is possible for these questions of the " liability of the subject to be affected or still less decided by " the actual proceedings which have taken place in drawing up " a balance sheet or a profit and loss account, because it appears " to me, and it has often been laid down, that the Court has to " look at the substance of the matter and that the Crown is not " bound by a balance sheet which would be favourable to the " taxpayer, nor is the taxpayer subject to be charged because he " has drawn up a balance sheet or profit and loss account which " imperfectly shows the immunity which he would otherwise be " entitled to claim from the tax which is assessed upon him." I said a moment ago that the Master of the Rolls was referring to the earlier Sections. He was not. Of course, at the time he spoke, the present Rules were in operation, but he was referring to judgments which had dealt with the earlier Sections.

The question is whether here this is to be taken to have been paid out of a taxed fund. The strength of the Crown's case, and I fully appreciate it, resides, of course, in this, that the Company had authority to charge this against capital, and in their accounts they did so charge it. The Special Commissioners appear to have been greatly impressed with the fact, which, of course, cannot be

(1) 12 T.C., at p. 882.

(Finlay, J.)

lost sight of, that these accounts were in a statutory form. I cannot, however, think that that makes any very great difference. They were bound, of course, to comply with the form of the statute. Still, it is nothing more and nothing less than the accounts of the Company. The question seems to me to be, not so much how did they treat it in their accounts, but what did they pay it out of. The answer to that question seems to me to be that they paid it out of one banking account and, in that banking account, there were taxed funds amply sufficient for the purpose. The rest seems to me to be a matter of bookkeeping. It does not matter, as I think, whether it is statutory bookkeeping, or mere ordinary bookkeeping. The matter is illustrated, as I said quite early in my judgment(1), by the *Metropolitan Railway* case, the third of the cases. There the payment was made in 1927 and 1928. It is not difficult to see that, in 1929, they might easily, for bookkeeping purposes, say that that payment is to be recorded as a payment out of capital. It is not so easy, I think, to say in 1929 that the payment in 1927 and 1928 was made out of capital. It seems to me just a distinction between the payment and the allocation in books afterwards of what has been paid.

I have arrived, though not without hesitation, because the case is important and difficult, and, also, I am differing from very experienced Special Commissioners, at the conclusion that, applying the question which Lord Atkinson propounded as being the test, one ought here to say, not merely, which is admitted, that this was payable out of taxed funds, but also, which has been the subject in dispute, that it was paid, or must be taken to have been paid, out of taxed funds.

For these reasons I have arrived at the conclusion that the appeals in all these cases are entitled to succeed, and there will, accordingly, be judgment for the Appellants.

Mr. Alcock.—With costs, my Lord?

Finlay, J.—Yes.

Mr. Alcock.—The Order in the *Metropolitan* case, I take it, will be to repay the tax claimed?

Finlay, J.—Yes, I suppose so; that will be right, no doubt.

The Crown having appealed against the decision in the King's Bench Division, the cases came before the Court of Appeal (Lord Hanworth, *M.R.*, and Slesser and Romer, *L.JJ.*) on the 21st and

(1) *See* page 123 *ante*.

22nd June, 1934, and on the latter date judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Solicitor-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills appeared as Counsel for the Crown and Mr. A. M. Latter, K.C., and Mr. A. C. Alcock for the three Companies.

JUDGMENT

Lord Hanworth, M.R.—We need not trouble you, Mr. Solicitor.

These are appeals in which the first two cases are on an exactly similar point and the third case on an analogous point, raised by these three Companies, the Central London Railway Company, the London Electric Railway Company and the Metropolitan Railway Company, appealing against assessments which have been made to Income Tax.

I take the facts from the first Case, which will be sufficient for the purpose. The Appellant Company, the Central London Railway Company, appealed against an assessment to Income Tax in the sum of £2,340—I need not go into the shillings and pence—for the year ended 5th April, 1931. That assessment was in respect of a sum or, rather, the remainder of a sum, of £4,250 which was interest on 5 per cent. debenture stock issued by the Railway Company. It appears that under a Railway Act of 1930 (1), in which the several Companies were interested, the Appellant Company, the Central London Railway Company, raised £850,000 by an issue of 5 per cent. redeemable debenture stock; the interest on this stock ranks as a first charge on the Company's revenues *pari passu* with the interest on the Company's other debenture stock. The Railway Companies Act, under which that issue was made, contains two Sections to which I wish to refer. There is a power under Section 118 to "charge "to capital account the interest accruing during the period expiring "on the thirty-first day of October one thousand nine hundred and "thirty-five or such less period as the directors of the company may "determine on all money raised by borrowing or by mortgage or by "the issue of debenture stock under any former Acts and this Act "or any of them". By Section 124 it is provided that: "All "moneys raised by the company under the powers of this Act shall "be applied only to the purposes of its undertaking to which capital "is properly applicable including the purchase of rolling stock". It will be seen, therefore, that this debenture stock was issued under the powers of the Act and, under that Act, by virtue of Section 118, there was a power to charge the interest accruing due upon it during

(1) London Electric, Metropolitan District, Central London and City and South London Railway Companies Act, 1930.

(Lord Hanworth, M.R.)

a particular period to capital account, and it was also provided that the money which was raised by the debenture issue could only be applied to the purposes to which capital is properly applicable. As a matter of fact, in the year in question, the sum that was payable on this debenture stock, as I have said, was £4,250, but, when they had raised the £850,000, they did not immediately need to make use of it and so, pending its use on capital account, it was invested by the Railway Company and the investments in which this balance was put produced, during the year, a certain sum, namely, a sum which enabled them to pay a portion of this interest of £4,250. The interest or the dividends that they received in respect of the investment of that portion was subjected to tax in the ordinary way, but it provided a fund which went *pro tanto* towards the payment of this £4,250. After that sum had been so used, there remained a balance payable as interest on the debenture stock of £2,340. That £2,340 was taken out of capital account under the powers of Section 118, and it is upon that sum so taken out of capital account that this assessment is made.

It is claimed by the Crown that this net sum of £2,340 is subject to, and properly subject to, assessment. In respect of it the arguments which are set out by the Appellant Company say this : " It " is quite true that, for certain purposes and in some accounts, you " will find that we have debited this £2,340 to capital, but that does " not make it a payment out of capital in fact, and the form of the " Railway Company's accounts does not affect its liability to tax. " There was a sufficient revenue or profits and gains obtained in " this same period which would have enabled us, if we had liked, to " pay the whole of the debenture interest in question out of our " ordinary income, and the fact that we dealt with it and paid it, as " we did, in part out of the interest or dividends accruing upon the " invested portion, and in part took it from what we have so far " called capital account, does not prevent the total payment of " £4,250 being notionally treated as having been paid out of our " profits or gains already subject to charge". The Crown, on the other hand, said that it lay upon the Appellant Company to show that this sum of £2,340 had, in fact, been paid out of profits or gains brought into charge and that, so far as the evidence went, it showed that it had been paid out of capital and not out of profits or gains brought into charge.

It is convenient to remind ourselves of what we have discussed so freely during the course of these two days, that what we are dealing with are two Rules, Rule 19 and Rule 21, of the General Rules applicable to all the Schedules under the Income Tax Act of 1918. Broadly speaking, it will be remembered that, under Rule 19, where a payment of interest on money is made and the payment

(Lord Hanworth, M.R.)

is made wholly out of profits and gains brought into charge, then there is to be no assessment made on the person entitled to such interest and to whom it is paid, but the whole of the profits and gains are to be assessed and charged with tax on the person liable to pay the interest, and the person liable to pay it out of the profits brought into charge is entitled, on making such payment, to deduct and retain thereout a sum representing the amount of the tax thereon. That provides for the case where there has been a payment out of profits or gains charged with tax. If, on the other hand, the payment of the interest is made out of moneys which are not brought into charge or not wholly brought into charge or, rather, where the payment is made partially or not wholly out of profits and gains brought into charge, then the person by whom such payment is made is entitled to deduct a sum representing the amount of the tax in force, but, in so far as the amount of the tax deducted is not paid out of profits and gains brought into charge, then he is to make a return to the Crown and deliver up the sum of which he has been the collector for the Crown. That last Sub-rule (2)(1) has been modified by recent legislation, and the system now in practice is that the Crown can make an assessment upon the payer in respect of, and so far as there has been, a payment out of profits and gains not brought into charge.

We must look at the facts which are found for us by the Commissioners in this case. They say: "We arrive at the three "following conclusions:—(1) The Appellant Company possessed "taxed income amply sufficient to satisfy the payment in question. "(2) It could with legality have made the payment either out of "capital or income. (3) The payment was in fact debited to capital "in its accounts". Then they say they recognise that, as a general principle, the form of the accounts is not to inure to the benefit of or to injure the taxpayer, but, in determining the question they had to determine, they took into account a letter which was written by the Appellant Company's chairman in which he indicated the fact that the payment of the interest on this debenture issue would be made out of capital. Then they say: "No evidence was given before us "that payment had in fact been made out of income". The Commissioners, therefore, came to the conclusion that the payment must be taken to have been made in fact out of capital, and it was lawful so to pay it. From that decision of the Commissioners, an appeal was taken to Finlay, J., who reversed the decision of the Commissioners. Quite broadly, he came to the conclusion that, inasmuch as, whether regarding the sum of £2,340 or the total sum of £4,250, the payment was made out of what I will call the general banking fund of the Railway Company and that there

(1) *I.e.*, General Rule 21 (2).

(Lord Hanworth, M.R.)

was nothing which militated against or prevented this case following rules which had been laid down in a number of cases, then, in the absence of anything militating against such a view, it might be taken that the subject makes the best use of his money so as to avoid taxation, and that, in the present case, it might be treated as if there had been payment of this £4,250 wholly out of profits or gains brought into charge.

I confess that I have had some doubts in this case. At first, I own, I was inclined to take the same view that was taken by Finlay, J., but a careful consideration of the cases and of the facts has led me to the conclusion that the decision of the Commissioners was right and ought to be restored.

First of all, let me clear away certain matters which have been raised on points which, to my mind, are quite clearly laid down in the canons which are binding upon us. It is right to say, as Lord Davey said in *Attorney-General* v. *London County Council*(1)—the case to which reference has been made—that "it is difficult to see how any account-"keeping by the debtor could alter the rights of the Crown". I will say: "how any account-keeping could militate against the rights "of the subject". I myself have said in the *Sterling Trust* case, 12 T.C. 868, at page 882: "I am very reluctant to think that on any "occasion it is possible for these questions of the liability of the "subject to be affected or still less decided by the actual proceedings "which have taken place in drawing up a balance sheet or a profit "and loss account, because it appears to me, and it has often been "laid down, that the Court has to look at the substance of the matter "and that the Crown is not bound by a balance sheet which would "be favourable to the taxpayer, nor is the taxpayer subject to be "charged because he has drawn up a balance sheet or profit and "loss account which imperfectly shows the immunity which he would "otherwise be entitled to claim from the tax which is assessed upon "him". Those words of mine were used after a careful consideration of a number of authorities and can be, I think, substantiated in plenty from passages which are to be found in the speeches of the noble Lords.

It is also perfectly clear that we have to look at the substance of the matter. If you want authority for that, it is to be found in the speech of Lord Halsbury in the case of the *Secretary of State for India* v. *Scoble*, which is reported in [1903] A.C. 299(2). I refer to these propositions in order to show that I have in no way intended to run counter to them but to respect them and to appreciate them,

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(1) 4 T.C. 265, at pp. 301/2. (2) 4 T.C. 618, at pp. 624/5.

(Lord Hanworth, M.R.)

and I have come to my decision although quite cognisant of the fact that they have been laid down and must be respected and followed in proper cases.

In *Edinburgh Life Assurance Company* v. *Lord Advocate*, 5 T.C. 472, Lord Gorell says this, at page 491: "But it does not "appear to me to follow that where the annuities are payable out of "profits or gains brought into charge it is necessary to use in paying "the annuities the actual moneys received in respect of the profits "or gains in order to obtain the benefit of the deduction and reten- "tion. In the case of a business like the Appellants', and taking "into account the language and object of the three Acts, it seems to "me that, if the annuities are made payable out of the interest, "dividends, and rents charged with the tax, it is immaterial whether "the money to pay them is taken out of the general till of the Company "or not, provided that it does not exceed the amount of income on "which tax is charged". That same principle is confirmed and established in the case of *Sugden* v. *Leeds Corporation*, 6 T.C. 211, where, at page 259, Lord Atkinson says: "the results of the "application of the subsection "—that is, in effect, Rule 19 now— "would . . . apparently be the following:—(1) Where no portion of the "interest or annuities charged with the tax could be lawfully paid "out of the 'taxed fund', the debtor, who on paying this interest "or these annuities deducts the appropriate tax from his creditor "or creditors, must account to the Commissioners of Inland Revenue "for the full amount of the tax so deducted. (2) When only a portion "of this interest or these annuities can lawfully be paid out of the "'taxed fund', then the debtor, though bound to deduct the tax "from his creditors on the full sums paid to them, is only bound to "account to the Revenue Authorities for the amount of the tax "deducted from that portion of the interest or annuities actually paid "out of his untaxed fund. The remainder of the entire sum deducted "he is entitled to retain for his own benefit. (3) When the interest "and annuities so charged may with equal legality be paid out of "either the 'taxed' or 'untaxed' fund of the debtor, and the taxed "fund is adequate in amount to pay them, it will not be necessary "for the debtor, in order to entitle him to retain for his own benefit "the entire sum deducted, that he should have, in his books or other- "wise, specifically appropriated, or set apart, the taxed fund to "discharge this interest or these annuities, or to prove that he had in "fact paid them out of the 'taxed fund'. It will suffice, should the "two funds be blended and formed into a mixed fund, that the "interest and annuities charged should be paid out of this mixed "fund. They will, if so paid, be treated as having been paid out of "the taxed fund, especially where in the ordinary course of business "it should be applied for that purpose." Then, at page 264, he says

(Lord Hanworth, M.R.)

this: "In my view, therefore, the right of the debtor who has paid "'interest or annuities' brought into charge to the income tax to "retain for his own benefit the amount of the tax he has deducted "from his creditors depends upon whether he can answer in the "affirmative each of the two following questions:—(1) Have the "interest and the annuities been, in fact, paid, or must they in the "circumstances of the case be taken to have been, in fact, paid out "of profits or gains brought into charge, *i.e.*, out of the so-called "'taxed fund'? (2) Was it lawful to pay them out of the fund?" He proceeds to follow out what the answer to those questions would be.

These cases, to my mind, make it perfectly clear 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 from the sum which he has paid over to the annuitant in his own hands; that would be what might be called the "rule of the road". That does not quite answer the question that has to be determined in this case. Upon the findings of the Commissioners, in the ordinary course, as the Company have got a taxed income amply sufficient to satisfy the payment in question, and the payment could have been made legally out of income or capital, it might well be that evidence could have been adduced that the payment had, in fact, been made out of income or, at least, that there should have been no evidence to negative the fact that the "rule of the road" had been followed and that these payments inured to the benefit of the subject. I have come to the conclusion that, upon the materials which were before the Commissioners, the matter was concluded against the Railway Company. I am not going into the question of the letter of the chairman. I am going into the facts, which clearly show that the Company had raised debenture stock, and they had taken power to make a payment of interest upon that debenture stock, charging it to capital account. They did that for good business reasons, in order to leave a larger sum available, if necessary, for the distribution of dividends. But, in considering the accounts which have been produced, one asks the question: Have they left the sum available for distribution as dividends larger by reason of their having used capital moneys to pay the interest on the debentures? In other words: Have they used up capital in the payment of dividends and so depleted the capital funds? This is not a question of presumption. It is not a question of the "rule of the road". It is a question of fact, a question of definite appropriation. They had the power to do either

(Lord Hanworth, M.R.)

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.

Let me just look at two more cases. In the *Birmingham Corporation* case, 15 T.C. 172, Lord Buckmaster, at page 209, puts the actual facts as the determining factor in his judgment. He says : " The Corporation by the accounts put forward for the purpose of " obtaining and measuring the subsidy, represented that the sum " required for interest was the gross sum. If the interest was paid " out of moneys already taxed this was not the sum required ; they " only required the lower figure. The statement therefore was equiva- " lent to saying that the interest had not been paid out of moneys " which had already paid tax. They cannot therefore now set up the " contrary". At page 210, Lord Sumner says : " I will spare your Lord- " ships any citation of them, but they lay down a limitation on the right " to do this, depending on its being lawful or legitimate to have made " the payments out of such chargeable profits, if this had actually been " done". Lord Atkin says, at page 214, that the only basis on which the claim could be made is " on the footing that they have in fact " paid the interest out of their untaxed funds".

When one turns to these accounts, they are not merely matters of bookkeeping, simply for the compliance with the Railways Act of 1911. I do not attach importance, really, to whether they are in statutory form or not ; a mistake might have been made in the statutory form. But I do attach importance to these accounts— " Report of the Directors, together with financial accounts and " statistical returns, for the year ended 31st December, 1930." This report of the directors gives a certain number of items of which the details are to be found in the financial accounts. When one looks to see what has been expended on capital account in table No. 4, one finds that there has been a sum of £132,283 expended during the year as per statement No. 5. Then, in No. 5 you find that the interest on 5 per cent. redeemable bonds during construction, less interest on unexpended proceeds, was £2,340, clearly, to my mind, showing that, for all purposes, there had been this nice distinction drawn between what had been paid out of profits and gains brought into charge and what it was thought wise to debit to capital account. That also showed, in No. 7, the capital powers and other assets available to meet further expenditure on capital account, and that sum was £612,000, and that £612,000 is the sum which is also found in No. 19, which gives the general balance as at 31st December, and shows that there is the balance at the credit of the capital account of so much and no more. What does that mean ? It means this, that, having the power to pay either out of profits and gains brought into charge

(Lord Hanworth, M.R.)

or out of capital account, they thought right to divide up the £4,250 and to pay a portion of it out of the profits and gains brought into charge and a portion of it out of capital funds. I do not see how it is possible to countervail or to alter that and to say that those are mere bookkeeping matters. In the *Luipaard's Vlei Estate* case, 15 T.C. 573, at page 589, I refer back to the *Metropolitan Water Board* case [1] and say this: "I stand by the words which I used [2] " . . . . 'There is in my judgment good ground for the Attorney-" 'General's argument that in Rule 19 the words "payable wholly " '"out of profits or gains brought into charge to tax" do " 'not mean payment out of a fund that may be brought into " 'charge, or is, or will be, a factor for the purpose of charge, but " 'refer to a fund brought into charge out of which tax is payable " 'and to be paid. So that in an account between the Crown, the " 'Appellants, as tax collectors for the Crown, and the stockholders, " 'it would be clearly seen that the sum deducted from the payments " 'to the stockholders was passed on to and reached the Crown.' " In other words, it appears to me that what is contemplated as to " be stopped from payment over to the payee is the sum for which " both the payer and the payee are liable under the Finance Act for " the year which has imposed the tax. Rule 19 pre-supposes that " the payer and the payee are both liable to pay the tax and that " the payee might have been assessed to the tax if the method of " assessment had prevailed in his case." In the present case, it appears to me that the facts are too strong. It is not possible to give the Railway Companies the benefit of what might be called the ordinary procedure. They have at their own volition come to a determination, and by that determination they are bound.

I will add just a word upon another part of the argument which has been presented to us by Mr. Latter. He says this: "You must " ask yourself what are the profits and gains brought into charge, " and, if they equal the amount of the assessment, if the assessment " is adequate and it is paid out of it, what you have in your pocket " does not matter, and it does not matter exactly what your accounts " are under review". In my judgment, Sargant, L.J., puts the matter very clearly in the *Metropolitan Water Board* case, 13 T.C., at page 307, when he says: "In my opinion the words " 'brought into charge' are more naturally and satisfactorily " satisfied by the meaning placed on them by the Crown. The " past participle 'brought' naturally refers to something that has " been completed in the year in question, if not by actual payment " at any rate by accrued liability to pay. It is only in a looser

(1) Attorney-General *v.* Metropolitan Water Board, 13 T.C. 294.
(2) *Ibid.*, at p. 304.

(Lord Hanworth, M.R.)

"sense that it can be applied to a payment or liability to pay in "respect of a succeeding year". I think, in the present case, you have got that marked division between the £4,250 and the £2,340 which exactly indicates the source from which this money has been paid, and that this sum of £2,340 is plainly and obviously drawn, not from profits and gains brought into charge, but *aliunde*.

On these grounds, it appears to me, therefore, that, while not, in my judgment, conflicting at all with any of the cases that have been cited or any of the propositions which have been laid down for us to follow, it must be held, in this case, that the decision of the Commissioners was right.

The appeal, therefore, will be allowed, with costs, in all these cases.

Slesser, L.J.—I am of the same opinion.

I do not think, in this case, that it is necessary further to discuss the principles which have been laid down in the various authorities which have been argued before us by the Solicitor-General, Mr. Hills, Mr. Latter and Mr. Alcock. I have come to the conclusion that this appeal must be allowed entirely upon the facts of this particular case and the statutory provisions which have enabled the Railway Company in this case (I speak now of the first case and of the second case) to do that which they have done.

By Section 118 of the London Electric, Metropolitan District, Central London and City and South London Railway Companies Act, 1930, it is expressly provided that the Company "may charge "to capital account the interest accruing during" a certain defined period. By Section 113 of the same Act, the directors of the Company were given power to issue debenture stock and, by Section 124, it is provided that "all moneys raised by the company under the "powers of this Act shall be applied only to the purposes of its under-"taking to which capital is properly applicable". In my view, Section 118 does a good deal more than merely authorise some amendment in the form of the accounts of the Company. Railway companies are compelled by statute to keep their accounts in a certain form. A series of Acts has been passed for that purpose, of which the latest is the Railway Companies (Accounts and Returns) Act, 1911, and penalties are imposed on those responsible who do not keep the accounts in a true and proper form and as the statutes require. It is to be noticed in that statute that, under the heading No. 9, "interest on debenture stock" is cited as one of the entries necessary in relation to the proposed appropriation of net income, and that statute, so far as the mere form of the account is concerned, seems

(Slesser, L.J.)

to contemplate that interest will be paid on debenture stock, and, no doubt, among other matters, Section 118 of the Act of 1930 did authorise the Company to prepare its accounts in this case in the way in which it has prepared them, differing from the provisions as to the preparation of accounts in the Schedule to the 1911 Act in this respect, that they show these moneys as interest payable out of capital and not out of income, as provided in the 1911 Act. But that is only one part—a necessary part, but only one part—of the powers conferred upon the Railway Company under Section 118. It is not merely a question of accounting, but of express power to charge " to capital account ", which is, as has been pointed out to us by Mr. Hills, an old phrase of constant application and does refer, not merely to an amendment of the account as such, but actually to a payment of the moneys out of capital.

I have been concerned to consider what was the purpose of Section 118 in making this power so to charge, and to ask myself whether, apart from that Section, the Company would have the power to charge to capital account. It is to be noticed in this Section that the power is limited to a prescribed period. I think the solution may be—it is not necessary to decide it—that the Legislature, in dealing with railway companies, has dealt with them somewhat differently from the way in which it has dealt with ordinary limited liability companies. In *Bloxam* v. *The Metropolitan Railway Company*, 3 Ch. 337, at page 350, Lord Chelmsford, L.C., speaking of a railway company, says this: " The prohibitions contained in " the different provisions of the Acts which were referred to " in the argument apply to share capital, and not to borrowed " capital, with the exception of the 196th section of the Defendants' " Act. That section does contain a prohibition against paying " dividends out of borrowed capital; and the 120th and 121st " sections of the *Companies Clauses Act*,"—that is, of 1845— " taken together, seem to me to imply, if they do not express, that " dividends can only be paid out of profits, and consequently not " out of borrowed capital". I see that, in the second Act which was exhibited to the Case—the Central London Railway Act, 1891—the Companies Clauses Act of 1863, which consolidates the provisions dealing with debenture stock in the Act of 1845 referred to by Lord Chelmsford, is incorporated into that Act, and that, in terms, the Act of 1930 incorporates the Act of 1891. It may, therefore, be that, by reason of special railway legislation, apart from any other provisions, it is not possible under the Companies Clauses Acts to pay dividends out of capital, as suggested by Lord Chelmsford. However that may be, there is here a direct and express power so to do if the Company so choose, and the Company have, as the findings of the

(Slesser, L.J.)

Commissioners indicate, elected to exercise that power. They have, in fact, dealt with this interest by payment out of capital and in no other way.

The Commissioners, I think, if they are to be criticised, may be criticised in that part of their conclusion where they say that different considerations apply to cases where the form of account has been decided not to be decisive on questions of whether the taxpayer is or is not liable, because the accounts have to be prepared in a statutory form. I think that is probably erroneous, and I think the case which was cited to us (1) by Mr. Alcock supports that view. But, taking their findings as a whole, namely, that the only evidence before them was the manner in which the payment had been treated in the accounts, and the fact, which, perhaps, is one element in the matter, that the Company offered these debentures on the terms that the interest thereon should be paid out of capital during the prescribed period and not otherwise, I think that amply justified them in coming to a finding of fact that this money was paid out of capital. If that be the case, I think that one authority is sufficient to decide this appeal in favour of the Appellants, and that is the decision of the House of Lords in *Sugden* v. *Leeds Corporation* (2), where the question is put first by the Lord Chancellor at page 253, where he says: "If . . . . the annual "payments were not really and properly made out of profits, he" —that is, the subject—"is treated as having received these profits "undiminished, and, though still bound to deduct the tax from "what he has to pay to the creditor, he must account to the Crown "for what has been so deducted". And, again: "In each case the "question is whether the annual payments taxed are actually and "properly payable out of the profits". Lord Atkinson, at page 259, in the passage which my Lord has quoted (3), puts the matter, as I read it, in a similar way. If it be regarded here as a question of fact and if the Commissioners have rightly come to the conclusion that this was paid out of capital, then I do not think it can be said that in any sense, because there was enough money actually in the hands of the Company which might have been expended in paying this interest out of income and profit, if they had elected to do so, which they did not, it falls within the ambit of Rule 19 and not of Rule 21.

In my view, these cases which deal with very difficult and vexed questions, of recourse to mixed funds, of considerations of various forms of security, of questions of external subsidies, and the like, do not arise in this particular case, which depends on its facts. Here there is a decision of fact that this money was paid out of capital, and I

(1) London, Midland and Scottish Railway Co. *v.* Anglo-Scottish Railways Assessment Authority, 150 L.T. 361. (2) 6 T.C. 211. (3) *See* page 133 *ante*.

(Slesser, L.J.)

do not think, therefore, that the observations of the learned Judge, with every respect to him, that these matters must not be decided merely on the form of the accounts, decide the matter at all. I do not decide this appeal on the ground of the form of the accounts. I decide it on the evidence and the facts found, indeed, the uncontradicted evidence, that, in fact, not merely as a matter of accounting but in reality, this interest was paid out of capital; it was said, to those who lent the money, to be bound to be paid out of capital, and it was never considered that it should be paid in any other way.

For that reason, I think that this appeal must succeed, but, as I say, without disturbing or in any way qualifying the long line of decisions which are binding upon us which have been cited by Mr. Latter.

Romer, L. J.—I agree.

The decisions that have been quoted to us seem to me to lay down quite clearly that the word " payable " in Rule 19 of the All Schedules Rules in the Income Tax Act, 1918, means " payable and paid, or deemed to have been paid, out of " profits or gains brought into charge ". The reason for introducing the word " paid " appears to me to be obvious. The Rule is intended to prevent double taxation. 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, 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. The reason for the introduction of the words " deemed to have been paid " seems to me to be also reasonably obvious. Take the case of a company that is chargeable under Schedule D in respect of its profits and gains. As was pointed out by Mr. Latter, a company may, in a particular year, earn no profit at all from its trading, and yet, because it has earned a large profit in the preceding year, it will be charged on a sum calculated by reference to the profits of that preceding year. In such a case as that there

(Romer, L.J.)

is no fund representing profits of the year of charge out of which the interest can be paid, and yet, it is necessary, to do justice, that the company should be allowed to be deemed to have paid the interest out of the sum on which tax has to be paid. Another instance in which it is necessary to deem that the money has been paid was put by, I think it was, Lord Atkinson in the case of *Sugden* v. *Leeds Corporation* (1). A company may, in fact, pay the interest, in the first instance, out of a mixed fund, consisting partly of profits and gains brought into charge and partly of sums not so brought into charge. In such a case as that, as Lord Atkinson pointed out, the company is, for taxation purposes, for the purposes of Rule 19, to be deemed to have paid the interest out of that part of the fund which consists of profits and gains. He adds—and it is very important for the present case—"in the absence of evidence to the contrary". I should myself go even further. Where the interest is, in fact, and as a matter of convenience, paid out of the fund no part of which consists of profits and gains brought into charge, I should still say that in proper circumstances, in the absence of evidence to the contrary, that payment may be deemed for the purposes of Rule 19 to have been paid out of profits and gains.

For the purpose of ascertaining whether a sum is or is not in fact paid out of the profits and gains brought into charge or is to be deemed to be paid out of profits and gains brought into charge, I agree, as has been stated in many cases, that the accounts, or the form in which the person chooses to have kept his accounts, are by no means conclusive of the matter. In the case that Lord Atkinson put of a payment out of a mixed fund, the fact that the payer for his own convenience, or for any other purpose, chooses in his accounts to treat the money as being paid out, or shows in his accounts that interest has in fact been paid out, of that mixed fund is by no means conclusive of the matter.

I do venture to say this, that, 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 matter. 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 dividend.

(1) 6 T.C. 211, at p. 263.

(Romer, L.J.)

The Section in the Act to which reference has been made, that is to say, the Section which enables the Company to pay the interest on its debenture stock up to a certain point out of capital, was obviously inserted in the Act for one purpose—I do not say one purpose only; there may have been other purposes—but certainly for this purpose, amongst others, that, during the time that the capital to be raised was unproductive, the shareholders of the Company should not suffer a reduction in their dividends by reason of the interest on that capital being paid out of revenue. Whether it would have been legal or illegal for the directors, in the absence of such a clause, to have paid the interest out of capital I do not pause to consider, but most assuredly it was a thing which, in the absence of that clause, no wise director would dream of doing. Here, as I say, for the purposes of setting free revenue for the benefit of the shareholders, the Company has deliberately in its accounts allocated this payment of interest to capital and, that being so, it appears to me impossible to contend that, within the meaning of Rule 19, this interest has been paid, or must be deemed to have been paid, out of profits and gains brought into charge.

For these reasons, in addition to those which have been given by the other members of the Court, I agree that this appeal succeeds.

The Solicitor-General.—Your Lordship, I think, said that the Order covered all the three appeals for costs ?

Lord Hanworth, M.R.—Yes; I said that the appeal is allowed here and below with costs in each case, and the Commissioners' decision is restored.

The Solicitor-General.—If your Lordship pleases.

Appeals having been entered against the decision in the Court of Appeal, the first two cases came before the House of Lords (Lord Hailsham, *L.C.*, and Lords Blanesburgh, Russell of Killowen, Macmillan and Roche) on the 10th, 11th, 13th and 14th February, 1936, and the third case on the 11th, 13th and 14th February, 1936, when judgment was reserved. On the 21st May, 1936, judgment was given unanimously in all three cases in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. A. M. Latter, K.C., Mr. W. T. Monckton, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the three Companies and the Attorney-General (Sir Donald Somervell, K.C.) and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Blanesburgh.—My Lords, I have had the advantage of reading in print the opinion which my noble and learned friend Lord Macmillan has prepared and which he is about to deliver. I entirely concur in that opinion and in the motion with which my noble and learned friend proposes to conclude.

Lord Macmillan.—My Lords, I am authorised by the **Lord Chancellor, Lord Russell of Killowen** and **Lord Roche** to indicate their concurrence in the opinion which I am about to deliver.

My Lords, in these three appeals, which were heard together, substantially the same question is raised. I propose to follow the example of Counsel in selecting as typical the case of the Central London Railway Company.

The facts may be briefly stated. In 1930 the Railway Company, by a private Act(1) passed in that session, were empowered to raise £850,000 of additional capital by means of an issue of 5 per cent. redeemable debenture stock. By Section 118 of the Act the Railway Company were authorised to charge to capital account for five years the interest accruing on all money raised by the issue. The debenture stock was duly issued and was purchased by certain issuing houses, which in turn offered it for sale to the public.

In the year ending 31st December, 1930, the Railway Company paid interest amounting to £4,250 to the holders of this stock. To the extent of £1,909 18*s.* 1*d.* this sum was met out of interest on the unexpended proceeds of the issue. The balance of £2,340 1*s.* 11*d.* was charged to capital account by the Railway Company in pursuance of the power to do so conferred by Section 118 of the Act. In the statutory accounts compiled and published by the Railway Company in compliance with the Railway Companies (Accounts and Returns) Act, 1911, for the year to 31st December, 1930, this sum of £2,340 1*s.* 11*d.* appeared as an item in Account No. 5, " Details of capital expenditure for year " ended 31st December, 1930 ", where it was described as "Interest " on 5% Redeemable Debenture Stock (1985–95) during " construction, less interest on unexpended proceeds ".

The total interest paid by the Railway Company in the year 1930 on this and their other debenture stocks was just under £70,000. For the fiscal year ending 5th April, 1931, the profits or gains of the Railway Company as assessed for Income Tax purposes, on the basis of their profits for the year to 31st December, 1929, under Case I of Schedule D of the Income Tax Act, 1918, amounted

(1) London Electric, Metropolitan District, Central London and City and South London Railway Companies Act, 1930.

(Lord Macmillan.)

to over £280,000, apart from an assessment of £7,897 under Schedule A and £4,982 of income received under deduction of tax. It will thus be seen that the total interest which the Railway Company paid to their debenture stockholders in 1930 was a much smaller sum than their assessed income for tax purposes for the year 1930–31.

On paying the £4,250 of interest to their new debenture stockholders in the year 1930 the Railway Company deducted the Income Tax thereon. They maintain that they are entitled to retain for their own uses the whole of the tax so deducted and are not bound to account for any part of it to the Crown. No question has been raised as to their right to retain the tax on the £1,909 18*s.* 1*d.* of interest which they charged to revenue account. It is solely with the question of their right to retain the tax deducted from the £2,340 1*s.* 11*d.* which they debited to capital account that the present case is concerned.

To answer this question your Lordships have once more to consider Rules 19 and 21 of the General Rules applicable to All Schedules of the Income Tax Act, 1918. These two Rules and the previous similar enactments which they replaced have on several occasions been the subject of examination by your Lordships.

The material words of Rule 19 are as follows : " 19.—(1) Where " any yearly interest . . . . is payable wholly out of profits or " gains brought into charge to tax, no assessment shall be made " upon the person entitled to such interest, ... but the whole " of those profits or gains shall be assessed and charged with tax " on the person liable to the interest . . . . and the person liable " to make such payment . . . . shall be entitled, on making such " payment, to deduct and retain thereout a sum representing the " amount of the tax thereon . . . ." Rule 21 deals with the converse case of payments of interest " not payable, or not wholly " payable, out of profits or gains brought into charge ", and requires the payer in such cases to deduct tax when making payment and to deliver an account of the amount of tax so deducted to the Commissioners, who are thereupon directed to assess and charge the same against the payer.

It will thus be seen that the Railway Company, in order to justify the retention of the tax deducted by them in paying the £2,340 1*s.* 11*d.* of interest, must show that it was " payable wholly " out of profits or gains brought into charge to tax ".

In ordinary course, a company in preparing its profit and loss account, in order to ascertain the profit on its year's trading available for dividend, debits revenue with the interest which it has had

(Lord Macmillan.)

to pay to its debenture holders, who are among its creditors. But in compiling a return of its profits or gains for tax purposes a company is not permitted to deduct such interest. This is forbidden by Rule 3 of the Rules applicable to Cases I and II of Schedule D which enacts that: " In computing the amount of the profits or " gains to be charged, no sum shall be deducted in respect of— " (*l*) any annual interest ". Consequently, as the amount of the debenture interest is not a permissible deduction, it forms an element in the computation of the company's profits or gains for Income Tax purposes, on which it pays tax in the following year. But in a question with its debenture holders the company is entitled to deduct Income Tax from the interest which it pays to them and to retain the tax so deducted if the interest is " payable " . . . . out of profits or gains brought into charge to tax ".

The requirement that the company shall, at any rate *primo loco*, pay Income Tax in respect of what it has to pay out to its debenture holders is part of the general scheme of deduction of tax at the source. The qualified right which it possesses to recoup itself by retaining the tax, which it in turn deducts in making payment to its debenture holders of the interest which it owes to them, has been justified on various grounds, as, for example, that the company may be regarded as sharing its income with its debenture holders and, having paid the tax both on its own and on their share, is properly entitled, on handing the debenture holders their share, to deduct and retain the tax it has paid on that share. (*Cf.*, *per* Lord Davey in *London County Council* v. *Attorney-General*, [1901] A.C. 26, at page 42[1].) The object is plainly to avoid double taxation of the same income.

But the language in which Rule 19 is expressed gives rise to much difficulty. The critical words " payable . . . . out of profits or gains " brought into charge to tax " manifestly cannot be read literally. If the expression " profits or gains brought into charge to tax " be taken to mean the assessed profits or gains on which the company is charged to and pays tax in the year in which it makes the payment of interest, then the statutory requirement could never be fulfilled when the assessed profits are based on a return made by the company of its actual profits for the preceding year. It is only where interest is paid out of income taxed in the year of its receipt, as, for example, out of dividends taxed by deduction, that the payment can be made out of actual profits or gains brought into charge in the same year as that in which the payment of interest is made, for it is only in such a case that assessed income is based on the year of charge and not on the preceding year.

(1) 4 T.C. 265, at p. 299.

(Lord Macmillan.)

An illustration will make the matter clear. Assume that the results of a company's trading for three consecutive years are as follows :—1st Year : Profits before payment of debenture interest, £10,000 ; 2nd Year : Profits before payment of debenture interest, Nil ; 3rd Year : Profits before payment of debenture interest, £10,000 ; and assume that the company has in each year to pay £5,000 of debenture interest. In the second year the company is assessed and charged to tax in respect of the £10,000 profits of the preceding year, but it has got no actual profits out of which to pay its debenture interest. It certainly cannot pay its debenture interest out of the notional income which the Income Tax Acts attribute to it for tax purposes. A real payment cannot be made out of an imaginary fund nor can it be " payable " out of an imaginary fund. Assume that the company borrows from the bank £5,000 to enable it to pay its debenture interest. Is it then entitled to retain the tax which it deducts on making payment of interest to its debenture holders out of this borrowed money? Can the interest so paid be said to be " payable . . . . out of profits or gains brought " into charge to tax "? Then take the third year. This time the company's assessed income for tax purposes is nil and it pays no Income Tax in that year. Yet it has ample profits out of which to pay its debenture interest and it does, in fact, pay it out of these profits under deduction of tax. Is the company entitled to retain the tax so paid as being " payable . . . . out of profits or gains " brought into charge to tax "?

Once, then, it is recognised that a real payment of interest cannot in fact be " payable " out of a notional assessed sum, it becomes necessary to find an interpretation of the words of the Rule which will not attribute to it so absurd a conception and which will bring the requirement which it prescribes within the realm of reality.

The difficulty of interpretation which I have just described is not discussed in the earlier cases. It seems to have emerged for the first time in the Courts in the case of *Attorney-General* v. *Metropolitan Water Board*, [1928] 1 K.B. 833(1). The facts there resembled those in the illustration which I have already given. Lord Hanworth, M.R., at page 842(2), thus poses the question : "Are " those words " (*i.e.*, " payable wholly out of profits or gains " brought into charge "), he asks, " to be interpreted as meaning " ' profits or gains that have in fact actually been brought into " ' charge ', or do they mean ' profits and gains that are subject to " ' charge and will in due course become factors in the assessment " ' of the liability of the appellants to tax '?" This question he

(1) 13 T.C. 294. (2) *Ibid.*, at p. 303.

(Lord Macmillan.)

answers in favour of the first interpretation, and so do Sargant and Lawrence, L.JJ. But I do not find in any of the judgments an explanation of how a real payment can be made out of a notional income. Lawrence, L.J., alone alludes to this difficulty and at page 851(1) seeks to solve it by construing the words " payable out " of " as equivalent to " properly chargeable against ". " The " meaning and effect of the Rule ", he says, " is that, in order to " come within its scope, the annual payments must be of such a " character that they can properly be charged against the taxable " income—*e.g.*, if the taxable income consists of the profits of a " business, the annual payment must be one that is charged upon " the profits of that business, and not a payment unconnected with " it." " ' Profits or gains brought into charge to tax ' ", he concludes at page 852(2), " . . . . means the taxable and not the " actual profits or gains in the year of assessment ", and the anomalies which would result from any other reading are adduced in support of this conclusion. The general principle of the *Metropolitan Water Board* case may be stated thus : 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 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.

My Lords, the result of applying this principle is that, to revert to my illustration, the company would be entitled to retain the deducted tax in the second year but not in the third year, because, in the second year, its assessed income for tax purposes in that year exceeded the amount of the debenture interest paid in that year, while in the third year its assessed income for tax purposes was nil and therefore did not cover any part of the debenture interest paid. The incongruous result is that in the year in which the company paid its debenture interest out of its actual profits it is to be held disentitled to retain the deducted tax, while in the year in which it had no profits out of which to pay its debenture interest, and had to borrow from the bank to enable it to do so, it is to be held entitled to retain the deducted interest. This is justified on the ground that in the former year the debenture interest was not " payable . . . . out of profits or gains brought into " charge ", while in the latter year it was " payable . . . . out of " profits or gains brought into charge ", whereas the truth is that in neither year was the debenture interest in fact paid out of " profits

(1) 13 T.C. 294, at pp. 310/1. (2) *Ibid.*, at p. 311.

(Lord Macmillan.)

" or gains brought into charge ", if those words mean the notional income attributed to the company in each of these years for Income Tax purposes.

On the other hand it may be said that it is only fair that in the second year in my illustration, when the company has made no actual profits but has had to pay tax on assessed profits of £10,000, it should be entitled to recoup itself by retaining the tax which it has deducted in that year on paying its debenture interest. Moreover, if tax is deducted on paying interest in year A out of the actual profits of that year, those profits will not be assessed and become chargeable to tax till the following year B; consequently, the taxpayer will retain the tax deducted in year A, but the Crown will have to wait till year B to get its tax on the profits out of which the interest was paid in year A.

The Legislature has in one instance at least shown itself not averse from such a result as I have just indicated. Section 7 (1) of the Finance Act, 1931, dealing with General Rule 20, which relates to the deduction of tax from dividends, enacts that that Rule shall " be construed as authorising the deduction of tax from the full " amount paid out of profits and gains of the said body which have " been charged to tax or which, under the provisions of the Income " Tax Acts, would fall to be included in computing the liability " of the said body to assessment to tax for any year if the said " provisions required the computation to be made by reference " to the profits and gains of that year and not by reference to those " of any other year or period ". In other words, tax may apparently be deducted from dividends (and retained) if the dividends are paid out of profits which have been, or will form, the subject of assessment and charge in some other year.

My Lords, it is remarkable that, until the *Metropolitan Water Board* case(1), this aspect of the problem presented by the words " payable . . . . out of profits or gains brought into charge to tax " does not seem to have been judicially noticed. All the cases which have reached this House were concerned with other questions. The leading case of *London County Council* v. *Attorney-General*, [1901] A.C. 26(2), decided that " profits or gains brought into charge " means the totality of the taxpayer's assessed income under all Schedules and not merely the portion of his income assessed under Schedule D. In the special circumstances of the second *London County Council* case, [1907] A.C. 131(3), it was held that the County Council was not entitled to reckon as " profits or gains " brought into charge ", for the purpose of Rule 19, the

(1) 13 T.C. 294. (2) 4 T.C. 265. (3) 5 T.C. 242.

(Lord Macmillan.)

Schedule A assessment of premises belonging to and occupied by the County Council. In neither of these cases does the language employed by the noble and learned Lords convey any hint that they were thinking of payments of interest out of a notional fund. Thus, in the first of these cases, Lord Macnaghten, at page 34(1), speaks of the interest being " in fact paid out of profits or gains " ' brought into charge ' " ; and, in the second of these cases, the keynote of the speech of Lord Loreburn, L.C., is to be found in the sentence at page 134(2) : " This sum represents interest paid by " the county council to the holders of Consolidated Stock, which " is *not* paid out of profits or gains brought into charge. It is paid " out of rates ". I cannot doubt that the Lord Chancellor was here contrasting actual payment out of actual rates with actual payment out of actual profits or gains.

The subsequent case of the *Edinburgh Life Assurance Company* v. *Lord Advocate*, [1910] A.C. 143(3), decided that the requirement was satisfied if the amount of the profits or gains brought into charge was sufficient to cover the amount of the annuities disbursed, from which tax was deducted, and that it was not necessary, in order to justify retention of the deducted tax, that the annuities should be specifically paid out of these profits or gains. Then, in *Sugden* v. *Corporation of Leeds*, [1914] A.C. 483(4), and in *Corporation of Birmingham* v. *Commissioners of Inland Revenue*, [1930] A.C. 307(5), the real point was whether the interest in question could properly and lawfully be paid out of the profits or gains brought into charge. Again I find that in the speeches of the noble and learned Lords in these later cases the language employed is appropriate to payment out of an actual rather than out of a merely notional fund. Thus, in the former case, Lord Haldane, L.C., at page 491(6), says that " in each case the question " is whether the annual payments taxed are actually and properly " payable out of the profits ". But the next sentence is a little disconcerting. " If they are," proceeds the Lord Chancellor, " these profits are treated by the Acts as diminished *pro tanto* in " the hands of the owner, and he, having paid once for all on the " whole, is thus entitled to retain for his own benefit the amount of " tax he deducts from the annual payments before making them, " as being tax that he has already paid." I confess to some difficulty in understanding how notional profits—if by " profits " is meant " assessed profits "—can be " diminished *pro tanto* in the " hands of the owner " by payment out of actual profits. I am bound, however, to say that the implication of these cases is that

(1) 4 T.C., at pp. 292/3. (2) 5 T.C., at p. 259. (3) 5 T.C. 472. (4) 6 T.C. 211.
(5) 15 T.C. 172. (6) 6 T.C., at p. 253.

(Lord Macmillan.)

the words " profits or gains brought into charge to tax " were there understood to refer to profits or gains as assessed to tax, although I do not think that attention was directed to the practical difficulty of paying actual interest out of a notional income. But it is unprofitable to scrutinise the language of these cases and unjustifiable to criticise it when once it is seen that they are not directly concerned with that difficulty.

My Lords, the present Stated Case and the judgment of the Court of Appeal naturally and properly proceed on the interpretation of Rule 19 which was adopted in the *Metropolitan Water Board* case(1), that is to say, they treat as the relevant " profits or " gains brought into charge to tax " in the year in which the interest in question was paid, the profits or gains of the Railway Company as assessed for tax purposes in that year. Thus, the Commissioners in the Stated Case find that the Railway Company in that year " possessed taxed income amply sufficient to satisfy " the payment in question ". I find it difficult to understand how a notional income can be possessed, but I assume that what is meant is that, in the year in which the interest was paid, the Railway Company was charged with Income Tax on a sum in excess of the interest paid. In point of fact, the actual profits of the Railway Company for the year 1930, as distinguished from their assessed profits for 1930–31, would also appear from the accounts scheduled to the Stated Case to have been largely in excess of the debenture interest paid in 1930, but this circumstance was not adverted to and has throughout been treated as irrelevant.

At your Lordships' bar neither party challenged the soundness of the decision in the *Metropolitan Water Board* case, and the House is not on this occasion required to review it. I am not to be taken as accepting it or as doubting it, for I should not like to come to any conclusion upon so difficult a point except after full argument. Your Lordships may well ask why I have thought it right to discuss so laboriously what it is not necessary to decide. My justification, if it be a justification, is that on the previous occasions when Rules 19 and 21 have been expounded in this House, the difficulty in their practical interpretation with which I have been dealing has not been in issue and, so far from any certain conclusion upon it having been expressed, the matter has been left in an ambiguous position. I think it would be unfortunate if your Lordships were once more to ignore the existence of this difficulty or to leave it to inference or conjecture whether the principle of the *Metropolitan Water Board* case had or had not been adopted by this House. I am content if I have made it clear that the matter has not, in my

(1) 13 T.C. 294.

(Lord Macmillan.)

opinion, been concluded by any judgment hitherto of this House and that, so far as the present case is concerned, the point is still left open for your Lordships' consideration should it arise on a future occasion. It is perhaps not too much to hope that, in view of the practical importance of the matter, the Legislature may see fit to put it beyond doubt, as they have sought to do in the case of Rule 20.

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 (1) and in Rule 21 (1); " paid " is used in Rule 19 (2), relating to patent royalties, and in Section 36 (1)(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*, for example, Lord Atkinson in *Sugden* v. *Leeds Corporation*, [1914] A.C. 483, at page 499(2).) For the present purpose the difference is in my view immaterial.

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 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 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 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

(1) Section 36 (1), Income Tax Act, 1918. (2) 6 T.C. 211, at p. 259.

(Lord Macmillan.)

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

In the appeal of the Metropolitan Railway Company there is this distinction, that the Company there are seeking to recover, under Section 36 of the Act of 1918, Income Tax on certain sums of interest paid by them on money borrowed from their bank, which interest they debited to capital account. But for the present purpose this is a distinction without a difference, and no independent argument was submitted on this Company's behalf.

My opinion, accordingly, is that all three appeals should be dismissed and that the Order of the Court of Appeal in each case should be affirmed. The Respondents should have their costs from the Appellants, but as all three cases were heard together there should be a limitation, as regards the hearing before your Lordships, to one set of costs.

Questions Put:

Central London Railway Company v. *Commissioners of Inland Revenue.*

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

London Electric Railway Company v. *Commissioners of Inland Revenue.*

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

Metropolitan Railway Company v. *Commissioners of Inland Revenue.*

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

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

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