NO. 1396—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—26TH AND 27TH JUNE, 1946

COURT OF APPEAL—18TH AND 19TH NOVEMBER, 1946

HOUSE OF LORDS—29TH AND 30TH JANUARY AND 19TH MARCH, 1948

COMMISSIONERS OF INLAND REVENUE *v.* WESLEYAN AND GENERAL ASSURANCE SOCIETY[1]

Income Tax—Annuity—Monthly loans free of interest and recoverable only by set-off against sum due at death—Income Tax Act, 1918 (8 & 9 *Geo.* V, *c.* 40), *General Rules, Rule* 21; *Finance Act,* 1927 (17 & 18 *Geo.* V, *c.* 10), *Section* 26.

By an agreement dated 25th May, 1944, *the Society, in consideration of the payment of* £500, *agreed to pay H during his life an annuity of* £7 11*s. per annum and on his death a sum equal to the aggregate of* £4 14*s.* 8*d. for each completed month between 25th May,* 1944, *and the date of his death. The agreement also provided that H should have the option of borrowing such sums as he might request but not exceeding the amount that would have been payable by the Society if he had died on that date. Such sums were to be free of interest and recoverable only at H's death by set-off against the lump sum payment due under the bond. H informed the Society that he wished to exercise the option to the maximum extent and at the earliest date permitted by the agreement. Accordingly in the eight months following 25th May,* 1944, *the Society paid to him monthly sums of* 12*s.* 7*d. as annuity and* £4 14*s.* 8*d. as loan. Income Tax was deducted by the Society from the former but not from the latter.*

The Society was assessed to Income Tax for the year 1944-45 *under Rule* 21 *of the General Rules of the Income Tax Act,* 1918, *as amended, in the sum of* £42 18*s., representing the total payments made under the agreement during that year. The Society appealed against the inclusion in the assessment of the sums described as loans on the ground that they were not income payments. The Special Commissioners allowed the appeal.*

Held, *that the decision of the Special Commissioners was correct.*

CASE

Stated under 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.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 15th May, 1945, the Wesleyan and General Assurance Society (hereinafter called "the Respondent Society") appealed

(1) Reported (K.B. and C.A.) 176 L.T. 84; (H.L.) 64 T.L.R. 173.

against an assessment to Income Tax in the sum of £42 18*s.* made upon it for the year ended 5th April, 1945, 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. The question raised by this appeal is whether certain sums paid by the Respondent Society to Mr. C. Hart constitute the payment of an annuity or of money loaned to him by the Respondent Society by reason of the matters hereinafter set out.

3. On 24th May, 1944, Mr. C. Hart signed a proposal form for an annuity and life assurance with optional interest-free loans with the Respondent Society. The said proposal form states that, in consideration of a payment of £500 by Mr. C. Hart, the Respondent Society agreed to pay him (1) an annuity of £7 11*s.* by monthly instalments of 12*s.* 7*d.* and (2) a lump sum payment at death equal to the aggregate of £4 14*s.* 8*d.* for each completed period of one month between the date of receipt of the purchase money by the Respondent Society and the date of his death. In addition Mr. C. Hart had the option of borrowing on the bond to be entered into, sums not exceeding what would be payable by way of lump sum as aforesaid if he had died on the date the loan was granted. The loans were to be free of interest, and were repayable at death by set-off against the lump sum payment due under the bond.

4. Mr. C. Hart elected to borrow from the Respondent Society to the maximum extent permitted by the bond, and an endorsement was made on the bond that loans had been requested and would be granted under the bond. On 25th June, 1944, and monthly thereafter, Mr. C. Hart gave the Respondent Society a receipt for the amount of the annuity less tax, and for the amount received as loan free of interest. In making this payment the Respondent Society deducted Income Tax from the annuity, but not from the loan.

5. Eight monthly payments were the subject-matter of the assessment appealed against, which was computed as follows:—

		£	*s.*	*d.*
Gross annuity 12*s.* 7*d.* x 8 ...	...	5	0	8
Interest-free loans £4 14*s.* 8*d.* x 8	...	37	17	4
		£42	18	0

The Respondent Society admitted that the payments were made otherwise than from profits or gains brought into charge to tax, and that the said assessment was correct in respect of the said annuity payments. The inclusion of the amount of £37 17*s.* 4*d.* in the said assessment advanced by way of loan was disputed.

6. The following documents are annexed hereto and form part of this Case[1]:—

(1) Copy of the said proposal form, marked "A".
(2) Copy of the said bond, marked "B".
(3) Copy of letter dated 26th May, 1944, from Mr. C. Hart to the Respondent Society requesting loans, marked "C".
(4) Copy of receipt for the said annuity and loans to be signed by Mr. C. Hart, marked "D".
(5) Copy of Respondent Society's annual report and statement

(1) Not included in the present print.

of accounts for the year ended 31st December, 1944, marked "E".

7. Mr. A. W. Joseph gave evidence before us at the hearing, which we accepted, as follows.

He was a Fellow of the Institute of Actuaries and assistant actuary to the Respondent Society. The said annuity of £7 11*s.* was calculated as follows. The Respondent Society took Mr. C. Hart's expectation of life, at the time he was 75½, then it estimated the interest it would receive on the purchase money of £500 in the expected period, a sum was deducted to cover expenses and an adjustment made to compensate itself for the option to borrow free of interest. The balance was the annuity of £7 11*s.* per annum. If Mr. C. Hart had required an annuity only, he would have received £67 18*s.* per annum. In calculating the capital sum payable at death no interest factor was included. If Mr. Hart should die on the date which, according to the Respondent Society's tables, he might be expected to die, he would get a capital sum of £500. If he lived longer he would get more, if he died earlier he would get less. In the Respondent Society's balance sheet as at 31st December, 1944, the item "Loans on the Society's "Polices within their Surrender Values" included the amount of the aforesaid loans to Mr. C. Hart totalling at that date £33 2*s.* 8*d.*

8. It was contended on behalf of the Respondent Society that the sums advanced to Mr. C. Hart as loans under the said bond amounting to £37 17*s.* 4*d.* were not payments of income to him and should be excluded in computing the said assessment.

9. On behalf of the Appellants it was contended:—

(1) That the monthly sums of £4 14*s.* 8*d.* were payments of an annuity, and that this being their true nature it was immaterial that they were described in the said bond as loans.

(2) That the assessment was correct and should be confirmed.

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

Under the bond, the bona fides of which was not challenged, Mr. C. Hart had power to borrow certain sums if he so desired. We held that it was not permissible to go behind the terms of the bond and that the sum in dispute was not an annuity but was money loaned to him by the Respondent Society at his request. We held that the appeal succeeded and reduced the assessment of £5 0*s.* 8*d.*

11. The representative of the Appellants 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 Section 26 of the Finance Act, 1927, and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

R. COKE,
MARK GRANT-STURGIS, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99 High Holborn,
London, W.C.1.
30th November, 1945.

The case came before Macnaghten, J., in the King's Bench Division on 26th and 27th June, 1946, and on the latter date judgment was given in favour of the Crown, with costs.

The Solicitor-General (Sir Frank Soskice, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. Terence Donovan, K.C., and Mr. L. C. Graham-Dixon for the Society.

JUDGMENT

Macnaghten, J.—By an instrument in writing described as a bond, dated 25th May, 1944 (a copy whereof is annexed to the Case and marked "B"), the Respondents, the Wesleyan and General Assurance Society, in consideration of the payment of £500 covenanted to pay to Mr. Charles Hart during his life an annuity of £7 11*s.* 0*d.* by instalments of 12*s.* 7*d.* on the twenty-fifth day of each month, the first payment to be made on 25th June, 1944, and to pay, on the death of Mr. Hart, a sum equal to the aggregate of £4 14*s.* 8*d.* for each completed period of one month between 25th May, 1944, and the date of his death. The bond also provided that Mr. Hart should be entitled during his life to borrow from the Society, on the twenty-fifth day of each month of any year, such sum or sums as he might request, not exceeding the amount which would have been payable by the Society if the annuitant had died on that date. Such loans were to be free of interest, and were not to be recoverable by the Society otherwise than on the death of the annuitant and out of the sum then payable under the provisions of the bond. A loan which carries no interest and which neither the borrower nor any other person can ever be under any obligation to repay seems almost too good to be true, and Mr. Hart hastened to take advantage of that provision in the bond. On 26th May, 1944, the day following the delivery of the bond, he addressed the following letter to the Society: "I wish to avail myself of the privilege "of borrowing upon the security of the above Bond. Will you kindly "make loans to me free of interest to the maximum extent and on the "earliest date permitted by the Bond unless and until this request is "cancelled."

Accordingly, during the eight months following 25th May, 1944, the Society paid to Mr. Hart month by month, on the twenty-fifth day of each month, the sum of 12*s.* 7*d.*, amounting to £5 0*s.* 8*d.*, in respect of the annuity of £7 11*s.* 0*d.*, and also pursuant to his request the sum of £4 14*s.* 8*d.*, amounting to £37 17*s.* 4*d.* The moneys so paid by the Society were paid otherwise than out of profits or gains brought into charge, and accordingly, pursuant to the provisions of Rule 21 of the All Schedules Rules of the Income Tax Act, 1918, the Society deducted from the 12*s.* 7*d.* paid in respect of the annuity of £7 11*s.* 0*d.* Income Tax at the standard rate. The Society did not, however, deduct any Income Tax in respect of the so-called loans of £4 14*s.* 8*d.* per month.

The bond recited that it was agreed that a proposal signed by Mr. Hart dated 24th May, 1944 (a copy whereof is annexed to the Case, marked "A"), should be the basis of the contract between him and the Society; and in the proposal it was stated that the interest-free loans would not be subject to Income Tax. In these circumstances an assessment to Income Tax was made upon the Society in respect of the said sums of £5 0*s.* 8*d.* and £37 17*s.* 4*d.* On appeal to the Special Commissioners that assessment was reduced by excluding therefrom the said sum of £37 17*s.* 4*d.* From that decision of the Special Commissioners the Crown appeals to this Court.

The case for the Crown is that these payments of £4 14*s.* 8*d.* per month, though they are called "loans" in the bond, have none of the

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characteristics of a loan and are in truth and in fact "an annuity or annual "sum" within the meaning of the Income Tax Acts, since no interest is payable thereon and they are not repayable by anyone. It is said for the Crown that it is an essential charactertistic of a loan that it should be repayable. The description given to a payment does not necessarily conclude the question whether it is or is not an annuity or annual sum within the meaning of the Income Tax Acts. The payment may be described as an annuity and yet it may not be assessable to tax, as in the case of *Perrin* v. *Dickson*, 14 T.C. 608. So, too, a payment which is in truth and in fact an annuity within the meaning of the Income Tax Acts cannot escape liability to tax by being described as a loan.

I agree with the contention for the Crown that the payments in question were not loans; that they were payments which, in the event that happened, namely, the request by Mr. Hart, the Society was bound to make month by month, and were therefore an annuity.

Mr. Donovan, who argued the case very clearly as usual, contended that the "loans" were repayable out of the sum payable by the Society on the death of Mr. Hart; but unless and until Mr. Hart revokes the request made in his letter of 26th May, 1944, no sum will be payable by the Society on his death and, therefore, the "loans" cannot be repaid.

In my opinion the contention of the Crown is right, and the assessment originally made on the Society must be restored.

The Solicitor-General.—Your Lordship orders that the appeal be allowed with costs and the original assessment restored ?

Macnaghten, J.—Yes.

An appeal having been entered against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Greene, M.R., and Cohen and Asquith, L.JJ.) on 18th and 19th November, 1946, and on the latter date judgment was given unanimously against the Crown, with costs, reversing the decision of the Court below.

Mr. Terence Donovan, K.C., and Mr. L. C. Graham-Dixon appeared as Counsel for the Society, and the Solicitor-General (Sir Frank Soskice, K.C.), Mr. D. L. Jenkins, K.C., and Mr. Reginald P. Hills for the Crown.

JUDGMENT

Lord Greene, M.R.—We need not call upon you, Mr. Donovan.

The Appellants, the Wesleyan and General Assurance Society, appealed to the Special Commissioners against an assessment to Income Tax in respect of certain sums which had been paid by them to a policy-holder, Mr. Charles Hart. The question—and the only question—arising on this appeal is whether or not, on the true construction of the contractual documents executed between Mr. Hart and the Appellants, and in view of the legal rights and obligations which those documents create, the sums so paid were payments of an annuity, or, as the Appellants contend, merely loans. If the Crown is right the payments attract Income Tax. If the

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Appellants are right Income Tax is not payable. That is the short point. The Special Commissioners decided in favour of the Appellants that the payments, on the true understanding of the contractual documents, were loans and not payments of an annuity. Macnaghten, J., reversed that decision, and this appeal results.

It is perhaps convenient to call to mind some of the elementary principles which govern cases of this kind. The function of the Court in dealing with contractual documents is to construe those documents according to the ordinary principles of construction, giving to the language used its normal ordinary meaning save in so far as the context requires some different meaning to be attributed to it. Effect must be given to every word in the contract save in so far as the context otherwise requires.

Another principle which must be remembered is this. In considering tax matters a document is not to have placed upon it a strained or forced construction in order to attract tax, nor is a strained or forced construction to be placed upon it in order to avoid tax. The document must be construed in the ordinary way and the tax legislation then applied to it. If on its true construction it falls within a certain taxing category, then it is taxed. If on its true construction it falls outside the taxing category, then it escapes tax.

In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable. It is sufficient to refer to the quite common case where property is sold for a lump sum payable by instalments. If a piece of property is sold for £1,000 and the purchase price is to be paid in ten instalments of £100 each, no tax is payable. If, on the other hand, the property is sold in consideration of an annuity of £100 a year for ten years, tax is payable. The net result from the financial point of view is precisely the same in each case, but one method of achieving it attracts tax and the other method does not.

There have been cases in the past where what has been called the substance of the transaction has been thought to enable the Court to construe a document in such a way as to attract tax. That particular doctrine of substance as distinct from form was, I hope, finally exploded by the decision of the House of Lords in the case of *Duke of Westminster* v. *Commissioners of Inland Revenue*, 19 T.C. 490. The argument of the Crown in the present case, when really understood, appears to me to be an attempt to resurrect it. The doctrine means no more than that the language that the parties use is not necessarily to be adopted as conclusive proof of what the legal relationship is. That is indeed a common principle of construction. To take one example, where parties enter into a contract, though they describe it as a licence, but the contract according to its true interpretation creates the relationship of landlord and tenant, the parties can call it a licence as much as they like but it will be a lease. There are other cases in the books in which the parties have described a particular document as a lease when the relationship created by it is that of licensor and licensee. In those cases it is not a lease but a licence. Similarly here, if the parties have entered into a contract the legal result of which on its true construction is to create an annuity, the parties could not avoid the legal consequences by referring to the payments as loans.

Bearing in mind those principles I will briefly examine the facts of

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this case. The assured, Mr. Hart, signed a proposal form for what was described as an "annuity and life assurance with optional interest-free "loans." Under paragraph 3 of that form he is to receive an annuity of £7 11*s.* 0*d.* a year by monthly instalments of 12*s.* 7*d.* There is no question that that sum is an annuity and therefore taxable. It has no real importance in this case because precisely the same points would have arisen if that annuity had not formed part of the transaction. Then, under paragraph 4, he is asking for what is described as a "sum payable at the death "of the person described in 1, above"—that is, Mr. Hart. Against that this is said: "A sum equal to the aggregate of £4 14*s.* 8*d.* for each com- "pleted period of one month between the date of receipt of the purchase "money at the Chief Office of the Society and the death of the person "described in 1, above"—that is, Mr. Hart. That is described, and correctly described, as a "sum payable at death". In the title of the proposal form it is correctly described as "life assurance", which in fact it is. The sum payable at death is not, as in the case of the ordinary type of life assurance, a sum which is fixed when the contract is made, but is a sum which will fall to be ascertained when it is known what are the number of months for which the assured survives. It is an assurance under which a lump sum is to be payable at the death of the assured quantified by reference to the number of months he lives. It seems to me that there is no reason whatever to construe that contract as anything different from what it purports to be, namely, a contract of life assurance under which the Company is to pay a lump sum at the death of the policy-holder.

Then paragraph 5 sets out the purchase money, £500; in other words a single premium is payable. Then comes this clause which has given rise to the controversy: "The owner"—that is, Mr. Hart—"will have the "right to borrow on the security of the Bond"—that is how they describe the policy which is going to be issued—"sums such that the aggregate "of the loans outstanding at any date shall not exceed the amount which "would have been payable by the Society if the Annuitant had died on "that date." So far that language seems to me to be completely free of ambiguity. The right which the assured is given, which he is not bound to exercise if he does not want to, is to borrow certain sums on the security of the policy. That would mean, in so far as he exercised the power of borrowing, that the assurance office would be entitled to call for the deposit of the policy. The policy is to be security for the amounts which he so borrows, which may be nothing, or may be a very small sum for a month or two, or may cover every month for the rest of his life.

Then it goes on: "Such loans shall be free of interest". Of course, to make an interest-free loan is a perfectly legitimate transaction. If a party chooses to lend money free of interest the fact that it is free of interest does not make it any the less a loan. Then the clause proceeds: "and shall not be recoverable by the Society otherwise than on death and "out of the sum then payable." There, again, I see no ambiguity in that language. The fact that a sum of money advanced is not to be recoverable by action, for instance, but is only to be recoverable out of a named asset, is a familiar transaction and is perfectly consistent with the ordinary legal conception of a loan. This is the position therefore. If one takes the language of the clause down to that point, one can find no ambiguity about it at all. The proposal form is a proposal for life assurance under which a sum of money quantified in the way indicated would be payable at death, with the right to borrow against that sum up to the stated amounts free of

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interest, and the Company is only of recoup itself out of the amount which is to be paid at the death of the assured.

The clause goes on: "When the Bond is issued the Purchaser may "request the Society to make loans free of interest to the maximum extent "and on the earliest date permitted unless and until the request is can- "celled." That enables the assured to obtain month by month a loan of the amount stated, namely, £4 14*s.* 8*d.*, but he is entitled, so to speak, to make a running request which remains valid until it is cancelled, and by that means he secures for himself into his pocket a sum of £4 14*s.* 8*d.* in every month. It is in respect of sums so advanced—I should not say "advanced" because that is begging the question—or so paid to him that the assessment was made.

Then comes this explanatory clause: "Assuming maximum loans are "requested to be advanced at the earliest possible date the total annual "payments under the Bond will be Annuity . . . £7 11*s.* 0*d.* subject to "income tax; Interest Free Loan (equal to twelve month's increase in the "sum payable at death . . .) £56 16*s.* 0*d.* not subject to income tax", total "£64 7*s.* 0*d.*, by Monthly Instalments of £5 7*s.* 3*d.*" That is merely an example of how the contract works out as a matter of pounds, shillings and pence. It is to be noted that the Company is disclaiming any right to deduct tax from the interest-free loans. If the payments of what are called loans are in fact payments of an annuity, that provision that their payment is not to be subject to Income Tax would be void under Rule 23 of the General Rules. That is all that I need read in the proposal form.

I now come to the policy itself, which was dated 25th May, 1944. By the terms of the policy the proposal form was to be the basis of the contract. That means that the two documents are to be read together, and the proposal form is to be regarded as the basis of the definitive policy. It contains a covenant by the Society to pay to the assured or his ex- ecutors: "(1) an annuity or annual sum as stated in the third section of "the said Schedule" to the policy during the lifetime of Mr. Hart, that is to say, £7 11*s.* 0*d.* as mentioned in the proposal form. Then (2) is: "the "sum as stated in the fourth section of the said Schedule on the death of" Mr. Hart. That I will come to in a moment. Then it goes on to put in the provisions stipulated for by the proposal form under which Mr. Hart was entitled to borrow every month £4 14*s.* 8*d.*, and it contains a provision that any sum so borrowed should not be recoverable by the Society otherwise than on the death of Mr. Hart, "and out of the sum then payable under the "fourth section of the said Schedule." So far the policy is following the stipulations of the proposal form, and what I have said with regard to the construction of the proposal form applies equally to the construction of the policy. The other provisions in the body of the policy I need not mention. The schedule sets out £500 which is called "Consideration money", but which, of course, is really a single premium. Then the schedule sets out the name of Mr. Hart, who is described as the "Annuitant." It sets out the amount of the annuity, £7 11*s.* 0*d.*, payable by monthly instalments. Then comes the following: "Sum payable at death." That is described as: "A sum equal to the aggregate of £4 14*s.* 8*d.* for each completed "period of one month between the 25th day of May One thousand nine "hundred and forty-four and the date of death of the Annuitant". So far that is following exactly the provisions of the proposal form. It is what the assured had stipulated for, and what the Company, in accepting the

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proposal, agreed to give him, namely, a lump sum payable at death quantified in the manner indicated. Then the clause goes on to say in brackets, "less the amounts of any loans made by the Society to the "Purchaser"—that is, Mr. Hart—"under the provisions of this Bond." Some emphasis was laid on those words in connection with an argument which I shall have to describe in a moment. I think it is worth noticing that, if the introduction of those words had the effect of varying what was stipulated for in the proposal form, it would appear that Mr. Hart would be entitled to have the policy rectified by striking them out. Either they are consistent with the proposal form or they are inconsistent with it. If they are consistent with it, then the proposal form has not been departed from. If they are inconsistent with it, then the policy does not follow the terms of the proposal form which was what Mr. Hart was stipulating for.

On considering the language of that contract I see no reason why what it says should not be accepted. If full effect is given to the language the parties have used, the obligation of the Assurance Company is to provide a sum at death. The right of the assured is to borrow such sums as he thinks fit month by month, subject to the limitation, against the sum so to be paid at death. He is not to pay interest upon such advances, and he is not to be bound to repay them save out of the sum payable at death. That seems to me to be a perfectly intelligible and ordinary type of operation. Why the legal relationship which the parties have in terms created of lender and borrower in respect of those sums should not be given effect to, I fail to understand, unless it be that, by giving effect to what the parties have said, the transaction would avoid tax. I cannot think myself that, if it had not been for the existence of the Income Tax Acts, anyone would have dreamt of suggesting that this contract means anything else than what it sets forth. It is because, if effect is given to it according to its terms, tax will be avoided, that the argument has come into existence, simply in order to try and get tax out of a transaction which, if it had been done in a different way, achieving the same financial result, would undoubtedly have attracted tax. The Company could have contracted to pay Mr. Hart £4 14*s.* 8*d.* a month, if it had chosen to do so, as an annuity, and in that case tax would have been payable. The Company would have had to deduct tax, and under Rule 21 of the General Rules, which admittedly would apply in the present case, would be accountable for it to the Crown. But to say that when parties set up a legal relationship, according to their language and its meaning, of lender and borrower you must construe the word "loan" as meaning annuity and modify or alter or strike out all the provisions relating to that loan as being inappropriate to an annuity, seems to me to be rewriting the contract, and I can see no justification for doing so.

The points upon which the Crown based its contentions were of this nature. It was argued that, if Mr. Hart exercised his right of borrowing up to the full permissible amount, no sum would be payable to his executors at his death. That is perfectly true. It was also pointed out that, if he did not exercise the right of borrowing up to its full extent, the sum payable at his death to his executors would be *pro tanto* diminished, and it was said that that shows that this was nothing more than the payment of an annuity.

It was argued that in effect no sum on that basis could be treated as payable at death, because it was meaningless to say that a loan was to be repayable out of a sum of money which *ex hypothesi* might never come

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into existence at all. It is perfectly true that if he exercised his borrowing right up to the limit no sum would in fact be payable at death. But I do not see myself what that has to do with it. If you borrow up to the limit of a sum which would otherwise be payable to you, that sum can never in fact come into your pocket because you have exhausted it. That does not alter the fact that the liability of the Company under the policy was unquestionably a liability to pay a lump sum at death. If no borrowing took place that lump sum would be payable. If borrowing did take place it would either not be payable at all in fact, or it would be smaller than it would otherwise have been. But to say that the provision for recovering these so-called loans out of the sum payable at death is meaningless is an argument which I confess I do not understand.

At this point I may return to the language of the schedule to which I referred a moment ago, because, if the schedule is looked at by itself, it might be thought to suggest that the sum which is to be payable at the death of the assured is to be only such a sum as is arrived at after deducting the amounts of any loans. It is said that the only sum which is covenanted to be paid at death is a net sum and not a gross sum. I do not so construe the language because it seems to me that that would run counter to the whole tenor of the transaction and, in particular, as I have said, would be contrary to what is stipulated for in the proposal form. It seems to me that, reading the two documents together, the reference in the schedule in the words in brackets, "less the amounts of "any loans made by the Society to the Purchaser under the provisions "of this Bond", is merely put in as a warning, as Cohen, L.J., pointed out in the course of the argument, to show that the sum which the executors will receive at the death of the assured is liable to be diminished by any advances made against it which by the terms of the contract are recoverable at death and not otherwise by the Society.

The argument was put in rather a different way by Mr. Jenkins. I think his main point was this. He said: "Looking at the contract and "the actuarial method by which these various sums were arrived at, the "assured, if he did not exercise his right of borrowing so-called, would "not be getting the full financial benefit of the policy, because the cal-"culations on which the policy was based were made on the assumption "that he would exercise the right of borrowing." So be it. I cannot myself see that that alters the legal relationship of the parties. He is not bound to take the full financial benefit by borrowing. He might have very good reasons for not doing so because he might prefer not to borrow, with the result that the sum payable to his executors would remain at the agreed figure. He might find this desirable even if he incurred a small loss by not exercising the right of borrowing. Moreover, he would be entitled, if he did borrow, to repay on whatever day he pleased the amount that he borrowed. It is a loan and is described as a loan and he could repay it when he liked. It is perfectly true that he is under no obligation to repay it, but there is nothing to prevent him repaying it if he wants to. Again, that seems to me to stamp it with the character of a loan, not the character of an annuity.

Then Mr. Jenkins said that the contract was really of this nature. The Appellants, he said, were really contracting to pay at death what must be regarded as deferred payment of an annuity built up month by month, but not payable at death. He said that what Mr. Hart would become entitled to under that provision for payment at death was a month-

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ly sum which could not be called for, save by his executors at his death, unless he exercised the right of borrowing, and the right of borrowing really amounted to taking from the Assurance Company the monthly sum which it was said the Assurance Company was obliging itself to pay to him. With all respect I cannot accept that view. It seems to me quite inaccurate to refer to the sum which the Company convenanted to pay at the death of the assured as a series or collection of monthly sums. The real interpretation of that particular obligation seems to me to be this. It is an obligation to pay at death a lump sum which is to be quantified by reference to the number of months which the assured lives. There is all the difference in the world between that and an undertaking to pay a monthly sum. It is a sum the quantum of which increases month by month, but that is not the same thing as saying that it is a monthly sum. The object of the argument, of course, was to get the character of a collection of monthly sums imprinted upon the sum payable at death in order then to say that, when the assured borrows a monthly sum against that, he is merely getting the prepayment of what, in its essence, is a monthly sum, and that stamps it with the character of an annuity. But, with all respect to the argument, I cannot go through the mental process which would involve arriving at that result. It seems to me to be rewriting this contract—to be placing upon the legal relationship created by it something quite different to what the language imports.

Putting it quite shortly, I find the parties to this contract express in clear language the nature of the legal relationship which they are entering into, using language properly adapted to create that legal relationship. I cannot see any reason for rewriting their contract and construing the language they have used in some unnatural and strained sense.

There were only two cases referred to by the Crown, *Perrin* v. *Dickson*, 14 T.C. 608, and *Sothern-Smith* v. *Clancy*, 24 T.C. 1. I cannot find that either of those cases gives any assistance to the solution of the present question. *Perrin* v. *Dickson* was a very special case, and, speaking for myself, I should not find it possible to extract from it any principle which would be applicable to a case which was different on its facts. *Sothern-Smith* v. *Clancy* also was a very special case, and it does no more—I think neither of those cases does more— than to lay down the proposition that in each contract the true meaning and effect of the contract is to be ascertained on ordinary principles of construction. When you have done that you have done all that is necessary.

I must say a word as to the judgment of Macnaghten, J., who took a different view to that taken by the Special Commissioners. He began in the early part of his judgment by using this language: "A loan which "carries no interest and which neither the borrower nor any other person "can ever be under any obligation to repay seems almost too good to be "true". With all respect to the learned Judge, that approach to the question does not seem to me to be the right one. There is an obligation to repay the loans provided for by this contract. It is an obligation to repay, not by personal payment, but to repay out of a sum which under the contract is going to be payable to the borrower at a future date. To say that that is a transaction where there is no obligation to repay seems to me, with all respect, to be misunderstanding the true nature of the transaction.

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(1) Page 14 *ante*.

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Then the learned Judge goes on to state the argument for the Crown, and perhaps I had better read that: "The case for the Crown is that "these payments of £4 14*s.* 8*d.* per month, though they are called 'loans' "in the bond, have none of the characteristics of a loan and are in truth "and in fact 'an annuity or annual sum' within the meaning of the In- "come Tax Acts, since no interest is payable thereon and they are not "repayable by anyone." As I have already said, the fact that a loan is made free of interest does not make it any the less a loan. The fact that it is only repayable out of a sum which is payable in future does not make it any the less a loan. One of the commonest forms of loan is of that description. I do not understand the proposition that these payments "are in truth and in fact 'an annuity or annual sum'". That is, as I ventured to suggest at the beginning of this judgment, no more than an attempt to revive the old suggested principle of substance and form. It is really saying that this transaction has produced the same financial result as if it were an annuity and, therefore, the contract must be construed as a contract to pay an annuity and not to pay what it says it is to pay. The phrase "in truth and in fact" appears to me in the context to be very misleading, and I am afraid it must have misled the learned Judge.

He then goes on to say: "I agree with the contention for the Crown "that the payments in question were not loans; that they were payments "which, in the event that happened, namely, the request by Mr. Hart, the "Society was bound to make month by month, and were therefore an "annuity."(2) I need not go into that because my reasons for disagreeing with it appear from what I have already said.

Then he refers to Mr. Donovan's argument that the loans were repayable out of the sum payable by the Society on the death of Mr. Hart. Then he says: "but unless and until Mr. Hart revokes the request made in his "letter of 26th May, 1944, no sum will be payable by the Society on his "death and, therefore, the 'loans' cannot be repaid."(2) I do not think I have mentioned that letter before, but it was the letter under which Mr. Hart said he wished to avail himself of the privilege of borrowing. His request was in this form: "Will you kindly make loans to me free of in- "terest to the maximum extent .... unless and until this request is can- "celled." It is perfectly true, if he did not cancel this request, the sum payable at death would melt away. But there was nothing to compel him to go on borrowing. He might stop the next day and the result would be that there would be a sum payable at death, the loans being repayable out of that sum. In any event it seems to me that the primary obligation on the Company is to pay the sum payable at death, and, even if borrowings which are equal to that amount eventually turn out to be made, it is, nevertheless, true to say that the loans are repaid to itself by the Assurance Company by setting them against what is primarily a capital obligation, namely, to pay a sum at death.

I think that disposes of the case. In my opinion the Special Commissioners were perfectly right in the conclusion to which they came, and this appeal should be allowed with costs.

Cohen, L.J.—I agree, and I do not think I can usefully add anything.

Asquith, L.J.—I also agree.

Mr. Jenkins.—Will your Lordships give leave to appeal to the House of Lords? Your Lordships are differing from the learned Judge, and the case is obviously one of great general importance. The actual transaction

(1) Page 14 *ante.* (2) Page 15 *ante.*

(Mr. Jenkins.)

in the particular case is small in amount, but obviously it involves a principle which is widespread in its application.

Lord Greene, M.R.—What do you say, Mr. Donovan ?

Mr. Donovan.—I would say this. It is quite clear from the argument between the parties that there is no difference of principle at all in this case. The Income Tax principles which have been canvassed here are principles upon which we are both agreed. Therefore, all there was in this case really was the question of the true construction of a particular contract. I would ask your Lordships whether in that case it might not be better to leave the House of Lords to decide for themselves whether they wish to hear an appeal.

Lord Greene, M.R.—I quite understand what you say, Mr. Donovan, but this decision is one which will have a fairly wide effect.

Mr. Donovan.—Yes, my Lord.

Lord Greene, M.R.—I do not know what your Company will do, and whether it has issued other policies of this kind, but it is a matter that does interest your Company and no doubt will interest a great many other companies. Whatever we may think in this Court about the lack of foundation in the Crown's argument, it is in a sense unsatisfactory not to have a matter of this kind decided by the final tribunal.

Mr. Donovan.—I fully appreciate that.

Lord Greene, M.R.—That applies as much to you, as representing the Assurance Company, as to the Crown.

Mr. Donovan.—Yes, my Lord.

(*The Court conferred.*)

Lord Greene, M.R.—Mr. Jenkins and Mr. Donovan, the view of this Court is perfectly clear and expressed without any hesitation, but nevertheless I think it is unsatisfactory that a matter, far-reaching in importance both to the Crown and to insurance companies and policy-holders, should be left without a final decision of the final Court. On that basis we will give leave to the Crown to go to the House of Lords.

Mr. Jenkins.—If your Lordship pleases.

Mr. Donovan.—Might I ask the Crown to say whether, in view of the widespread importance of the case to them, they are prepared to pay the costs of the appeal in any event ?

Lord Greene, M.R.—The Crown will pay the costs of the appeal to this Court.

Mr. Donovan.—And in the House of Lords ?

Lord Greene, M.R—If you wish to suggest that they should be put on some undertaking about the costs in the House of Lords of course we will hear you, but it is right to point out this. In the ordinary case, where the taxpayer is only concerned with a particular transaction and the Crown is concerned with it as it affects other taxpayers, we often put the Crown on terms, but here we have a transaction which not only affects this policy which you have issued but no doubt will affect many other policies which you will issue in the future.

Mr. Donovan.—That is why I did not ask your Lordships to put the Crown on terms. I am really addressing a query here to the Crown through your Lordships as to whether they would be willing to do so.

Lord Greene, M.R.—Is the Crown, Mr. Jenkins, prepared to do anything about this ?

Mr. Jenkins.—No doubt the Commissioners will consider the matter, but it does not seem at first sight to be an appropriate case, if I may say so. It is a matter of great importance to this Assurance Company. It affects every single policy of this kind they have entered into so far, or may enter into hereafter. It would be quite a different matter if the question were raised in proceedings against one individual annuitant only. Then he would, of course, require protection.

Lord Greene, M.R.—Mr. Jenkins, we are not imposing terms upon you, but if the authorities consider that they might make some concession it would be entirely for them to decide.

Mr. Jenkins.—If your Lordship pleases.

The Crown having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Simon and Lords Porter, Uthwatt, du Parcq and Oaksey) on 29th and 30th January, 1948, when judgment was reserved. On 19th March, 1948, judgment was given unanimously against the Crown, with costs, confirming the decision of the Court below.

The Solicitor-General (Sir Frank Soskice, K.C.), Mr. J. H. Stamp and Mr. Reginald P. Hills appeared as Counsel for the Crown, and Mr. Terence Donovan, K.C., and Mr. L. C. Graham-Dixon for the Society.

JUDGMENT

Viscount Simon.—My Lords, this appeal comes before the House in the following circumstances. The Respondent Society appealed to the Commissioners for the Special Purposes of the Income Tax Acts against an assessment to Income Tax of the sum of £42 18*s.* made upon it for the year ended 5th April, 1945. The assessment purported to be made under the provisions of Rule 21 of the General Rules applicable to all Schedules of the Income Tax Act, 1918, on the ground that this sum was "payment of any interest of money, annuity, or other annual payment "charged with tax under Schedule D" from which the Respondent Society was bound to deduct tax, and was thus rightly assessed against the Respondent Society, who paid the amount to a Mr. Hart without deduction in pursuance of a transaction between Mr. Hart and the Respondent Society. The Respondent Society denied that the sum which it paid to Mr. Hart was a payment from which tax had to be deducted and contended that it was money lent to him.

The Commissioners decided in favour of the Respondent Society, but stated a Case for the opinion of the High Court. Macnaghten, J., reversed the Commissioners' decision, holding that the payment in question was not a loan, but was an annuity or other annual payment. On appeal to the Court of Appeal, that Court (Lord Greene, M.R., and Cohen and Asquith, L.JJ.) reversed the decision of Macnaghten, J., and restored the conclusion of the Commissioners. The Crown now comes to this House and argues that the decision of the Court of Appeal is wrong.

The whole matter depends on the terms of the transaction entered into between Mr. Hart and the Respondent Society, and this transaction is con-

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tained in three documents—a proposal form "for Annuity and Life Assur-"ance", dated 24th May, 1944; a policy dated 25th May, 1944, which is described as a bond and in which Mr. Hart is called the purchaser; and a letter dated 26th May, 1944, from Mr. Hart to the Respondent Society exercising an option under the terms of the bond. The bond, which recites that the proposal is agreed to be the basis of the contract, provides, in return for the sum of £500 paid by the purchaser to the Society, for the payment of a sum at Mr. Hart's death equal to the aggregate of £4 14*s.* 8*d.* for each month between 25th May, 1944, and the date of death, less the amounts of any loans made by the Respondent Society to Mr. Hart under the provisions of the bond. The bond also provides that he may borrow from the Respondent Society on the security of the bond on the twenty-fifth day of each month "such sum or sums as the Purchaser may request "provided that the aggregate of the amounts of such loans at any date "shall not exceed the amount which would have been payable by the "Society . . . if the Annuitant had died on that date. Such loans shall "be free of interest and shall not be recoverable by the Society "otherwise than on the death of the Annuitant and out of the sum then "payable". By his letter of 26th May, 1944, Mr. Hart called on the Respondent Society to make loans to him free of interest to the maximum extent and on the earliest date permitted by the bond unless and until this request was cancelled.

In accordance with the option thus exercised, the Respondent Society paid to Mr. Hart £4 14*s.* 8*d.* in eight successive months until the end of the fiscal year, amounting to £37 17*s.* 4*d.* in all, and the question is whether such payments are in the nature of annuities or are, as the Respondent Society contends, loans. The balance of £5 0*s.* 8*d.* making up the £42 18*s.* is admittedly an annuity.

It may be well to repeat two propositions which are well established in the application of the law relating to Income Tax. First, the name given to a transaction by the parties concerned does not necessarily decide the nature of the transaction. To call a payment a loan if it is really an annuity does not assist the taxpayer, any more than to call an item a capital payment would prevent it from being regarded as an income payment if that is its true nature. The question always is what is the real character of the payment, not what the parties call it.

Secondly, a transaction which, on its true construction, is of a kind that would escape tax, is not taxable on the ground that the same result could be brought about by a transaction in another form which would attract tax. As the Master of the Rolls said in the present case[1]: "In "dealing with Income Tax questions it frequently happens that there are "two methods at least of achieving a particular financial result. If one "of those methods is adopted tax will be payable. If the other method "is adopted, tax will not be payable . . . The net result from the financial "point of view is precisely the same in each case, but one method of "achieving it attracts tax and the other method does not. There have been "cases in the past where what has been called the substance of the trans-"action has been thought to enable the Court to construe a document in "such a way as to attract tax. That particular doctrine of substance as "distinct from form was, I hope, finally exploded by the decision of the "House of Lords in the case of *Duke of Westminster* v. *Commissioners of* "*Inland Revenue*, 19 T.C. 490."

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(1) Page 16 *ante*.

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Applying these principles, I reach the same conclusion as that arrived at by the Court of Appeal and expressed by the Master of the Rolls in a manner which I find quite conclusive. The obligation of the Respondent Society is to provide a sum at death; the right of Mr. Hart is to borrow such sums as he thinks fit month by month, subject to the limitation above set out, against the sum so to be paid at death. He is not to pay interest upon such advances, and there is no obligation to repay them save out of the sum payable at death. Though he is not bound to repay them in his lifetime, it seems to me that upon the true construction of the documents he would be entitled to do so if he chose—though, as the loan carries no interest, this would not seem to be a very likely choice for him to make. The legal relationship created by the transaction between the parties to it is that of lender and borrower, and there seems no reason for denying that this is their real relationship on the ground that, if Mr. Hart exercises his right of borrowing up to the full amount permitted, his executors will find that the net sum to be payable at his death has been reduced to nothing. While it is true that Mr. Hart's letter of request of 26th May, 1944, if it remained uncancelled, would reduce the sum payable at death to zero, there was nothing to compel Mr. Hart to go on borrowing these monthly sums. If he cancelled his request, then there would be a sum payable at death arrived at by deducting the loans which had been paid out of what would otherwise be the total sum. The primary obligation of the Respondent Society is to pay the sum payable at death and, however much or however little is borrowed in the meantime, the loans are repaid by setting them against what is a primary capital obligation.

The Special Commissioners were right in deciding that these payments were loans, and I move that the appeal be dismissed with costs.

Lord Porter.—My Lords, I agree with the reasoning and conclusion reached by the noble Lord upon the Woolsack and have nothing to add.

Lord Uthwatt.—My Lords, it is conceded by the Commissioners of Inland Revenue that the whole transaction between the Respondents and Mr. Hart is to be found in the bond of 25th May, 1944, and the letter of 26th May, 1944, and that the transaction so disclosed is to be taken at its face value. It follows that the task before your Lordships is to ascertain what, upon the true construction of the deed, are the legal rights of the parties, and in the light of that construction to determine whether the sums paid to Mr. Hart in accordance with the direction given in his letter fall within the description "annuities, and other annual profits or "gains".

There is no exceptional rule of construction applicable to the case. Here, as in all other cases of construction, mere nomenclature descriptive of an operation provided for by the bond may be disregarded as of no weight, if it mis-describes the operation. But under cover of that rule it is not right to attribute to words appearing in the bond a sense they do not naturally bear by reason of the odd legal or practical position that results. The argument for the Commissioners appears to me to have embodied this error.

In my opinion the construction of the bond is clear. Mr. Hart's executor was to be entitled at Mr. Hart's death to receive payment of a sum (I will call it the gross sum) ascertained by multiplying £4 14*s.* 8*d.* by the number of calendar months he might live after 25th May, 1944. He was to be entitled on the 25th day of each month to borrow money

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from the Society, but so that the aggregate of the amounts of the loans at any date should not exceed the amount payable by the Society if he died on that date. Interest was not to be charged on any loan and the Society could not sue to recover any loan. When Mr. Hart died the aggregate of the loans was to be deducted from the gross sum.

It will be observed that if Mr. Hart chose to exercise his right of borrowing to the full and at the earliest date open to him, he would receive £4 14*s.* 8*d.* every month and his executor would receive nothing. Financially it would pay him so to exercise his right. The transaction has the same commercial result as an agreement to pay a monthly annuity of £4 14*s.* 8*d.* coupled with a stipulation that Mr. Hart was to be entitled to leave in the hands of the Society any instalment of the annuity which he did not wish to receive when it became due and was to be entitled to demand payment at a later date. There was no automatic set-off between sums borrowed and the gross sum.

One other matter has to be added. Mr. Hart was entitled, in my opinion, as a matter of construction of the bond, at any time to repay the moneys borrowed. If he wished to exercise that right he would, I apprehend, be bound, unless the Society otherwise agreed, to repay all. Commercially that right might be worth little or nothing, but it existed.

Those are my views as to the construction of the bond. What is the legal transaction embedded in it? My Lords, in my opinion, the transaction, both in substance and in form, is an obligation to pay on Mr. Hart's death a sum quantified in the manner I have stated above, with a right on Mr. Hart's part to borrow on the security of that sum without subjecting himself to personal liability, Mr. Hart being at liberty to make repayment. There is a coincidence between the payer of the gross sum and the lender of the money. In my view that coincidence does not alter the transaction. Indeed, for the purpose in hand I do not regard the case as differing in legal effect from a case where the obligation to make the loan rested on a third party, whether a subsidiary of the Society or not.

Taking this view of the construction of the contract and the transaction, the sums received by Mr. Hart do not fall within the description "annuities, and other annual profits or gains". A man may live by borrowing; but that habit of life does not attract Income Tax.

I would dismiss the appeal.

Lord du Parcq.—My Lords, I concur.

Lord Uthwatt.—My Lords, my noble and learned friend, **Lord Oaksey,** who is unable to be present today, asks me to say that he has had the advantage of reading my opinion and he agrees with it.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

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

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Field, Roscoe & Co., for Eversheds & Tomkinson, Birmingham.]