VOL. XXXII—PART V

No. 1465—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION)—19TH, 20TH AND 26TH JULY, 1948

COURT OF APPEAL—15TH, 18TH, 22ND AND 26TH JULY, 1949

HOUSE OF LORDS—20TH AND 21ST NOVEMBER AND 14TH DECEMBER, 1950

Potts' Executors *v.* Commissioners of Inland Revenue [1]

Surtax—Settlement—Payments by a body corporate connected with a settlement made to third parties at settlor's request and debited to his current account with the company—Whether payments constitute capital sums paid directly or indirectly to the settlor—Finance Act, 1938 (1 & 2 *Geo.* VI, *c.* 46), *Section* 40.

P, the settlor of a settlement made in 1939, *sold to the trustees of the settlement all except one of the shares in a company of which he was governing director. It was admitted that the company was a body corporate connected with the settlement within the meaning of Section* 41 (4) (*e*) *of the Finance Act,* 1938. *For many years P had had a current account with the company. This account was credited with amounts due to P from the company in respect of director's remuneration and expenses, and was debited with various payments made by the company to P or to other persons at his request. On 6th April,* 1939, *the account showed a debit balance, which was substantially increased during the year to 5th April,* 1940, *mainly by reason of large payments on account of Surtax on P's behalf. The debit balance was paid off in December,* 1940.

Additional assessments to Surtax were made on the Appellants, as P's Executors for the years 1939-40 *and* 1940-41 *on the ground that the payments to third parties debited to the account constituted loans to him and were therefore capital sums within the definition in Sub-section* (5) (*a*) *of Section* 40, *Finance Act,* 1938, *which fell to be treated as income of P by virtue of Sub-section* (1) *and* (3) *of that Section.*

Held, (*Lord Morton of Henryton dissenting*), *that the sums in question were not paid directly or indirectly to the settlor and Section* 40 *of the Finance Act,* 1938, *did not apply.*

CASE

Stated under the Finance Act, 1927, Section 42 (7), and 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 16th June, 1947, the executors of G. W. Potts deceased (hereinafter called "the Appellants") appealed against the following additional assessments to Surtax, namely:—

[1] Reported (C.A.) [1949] 2 All E.R. 555; (H.L.) [1951] 1 All E.R. 76.

(*a*) an assessment in the sum of £50,107 for the year ended 5th April, 1940,
and (*b*) an assessment in the sum of £19,924 for the year ended 5th April, 1941.

The said assessments were made under Section 40 of the Finance Act, 1938.

2. By a deed of settlement dated 31st March, 1939, and made between George William Potts (thereinafter called "the Settlor") and Carron Trust, Ltd. (thereinafter called "the Trustees") the settlor paid to the trustees the sum of £150,000 to be held by the trustees upon trust to invest the same and hold the investments and income thereof and all accumulations of such income upon trusts for the Appellant's infant grandchildren. A copy of the said settlement is attached hereto, marked "A", and forms part of this Case(1). The trustees were a trust company incorporated on 25th November, 1936, with a capital of £100 divided into shares of £1 each. All the shares but two were held by nominees for Mr. G. W. Potts.

3. On 25th April, 1939, the trustees purchased 49,999 fully paid shares of £1 each in G. W. Potts, Ltd. (hereinafter called "the company") at £3 per share from Mr. G. W. Potts or his nominees.

4. The company was incorporated on 23rd March, 1925, with a capital of £50,000 divided into 50,000 shares of £1 each.

5. There is attached hereto, marked "B", a copy of the memorandum and articles of association of the company(1). By clause 3 (*i*) of the memorandum of association the company has power: "To make advances as "well to any Director as to customers and others with or without security, "and upon such terms as the Company may approve, and generally to act "as bankers for customers and others."

Mr. G. W. Potts was until 23rd December, 1940, governing director of the company receiving £5,000 as remuneration and £1,500 for expenses each year.

6. For many years Mr. Potts had had a current account with the company. In these accounts Mr. Potts was credited with his remuneration as governing director and expenses and various payments were made by the company at Mr. Potts' request, some payments being to third parties (*e.g.*, the Commissioners of Inland Revenue for tax, and charities) and some being payments to himself (cash drawings).

In order that the Court may see the nature of these accounts there are attached hereto, marked "C" (1), the directors' current accounts (*a*) for the year to 28th December, 1935, (*b*) for the 53 weeks to 2nd January, 1937, (*c*) for the year to 1st January, 1938.

7. In the account for the year to 1st January, 1938, there appears under date 1st January, 1938, an item, "Loan Interest £1,136 19*s.* 9*d.*"

This item of loan interest debited to Mr. G. W. Potts was interest at 4 per cent. on a loan of £50,000. The said sum was lent by the company to Mr. Potts on 9th July, 1937, and repaid on 23rd December, 1937. This transaction was entered in the books of the company in an account headed "G. W. Potts, Esq.; Loan Account", a copy of which is attached hereto, marked "D"(1).

8. The current accounts of Mr. Potts with the company for the year to 30th December, 1939, and for the period to 28th December, 1940, are attached hereto, marked "E" (1), and form part of this Case.

(1) Not included in the present print.

At 30th December, 1939, there was owing by Mr. Potts to the company the sum of £8,850 7*s.* 7*d.* There were further sums paid by the company in the following year to or on behalf of Mr. Potts, the principal payments being £28,000 in March, 1940, on account of Mr. Potts' Surtax liability. Mr. Potts was a rich man and had at all times ample liquid resources to pay all that he owed to the company. On 23rd December, 1940, Mr. Potts paid £32,570 1*s.* 3*d.* to the company thereby clearing off his indebtedness to the company.

9. A summary of the said accounts to 30th December, 1939, and 28th December, 1940, subdivided into years of assessment, together with an analysis of the payments contained in the said accounts, is attached hereto, marked "F", and forms part of this Case [1].

10. The total statutory income of the said settlement for the years ending 5th April, 1940 and 1941, was as follows:—

	gross	*tax*
1940	£50,583 6*s.* 1*d.*	£17,704 3*s.* 2*d.*
1941	£47,985 1*s.* 0*d.* (less expenses £357 7*s.* 0*d.*)	£20,393 12*s.* 8*d.*

11. It is admitted that the company is a body corporate connected with the said settlement within Section 41 (4) (*e*) of the Finance Act, 1938.

12. The assessments under appeal have been made under Section 40 of the Finance Act, 1938, on the footing that capital sums (as defined by Section 40 (5) (*a*)) having been paid by the Company, a body corporate connected with the settlement, must be treated as paid by the trustees of the settlement (see Sub-section (3)) to Mr. Potts, the settlor.

The exact nature of the Crown's claim can be seen from the letter of 12th June, 1947, written by the Solicitor of Inland Revenue to the Appellants' solicitors which is annexed hereto, marked "G", and forms part of this Case [1].

The general effect of the Crown's contentions as expressed in this letter is that the advances in each of the years 1939-40 and 1940-41 should be dealt with separately, and credit should in each of those years be given in respect of director's fees and expenses as credited in the respective years. To the extent that the difference between these amounts in the year 1939-40 fell within the total trust income for that year a Surtax assessment was competent, by virtue of Section 40 (1) (*a*), Finance Act, 1938. To the extent of any surplus the total trust income for 1940-41 was available to justify a Surtax assessment for that year by virtue of Sub-section (1) (*b*) of the said Section.

On the assumption that the decision of the Special Commissioners is correct the figures set out in the said letter of 12th June, 1947, have been agreed and are the figures appearing in the last sentence of paragraph 15 of this Case.

13. It was contended on behalf of the Appellants that:—

(*a*) no capital sums were paid by the company directly or indirectly to the settlor;

(*b*) the sums paid by the company to third parties at the request of Mr. Potts were (*i*) not sums paid by way of loan and therefore not capital sums as defined by Section 40 (5) (*a*) (i) of the

[1] Not included in the present print.

Finance Act, 1938, and were (*ii*) not paid indirectly to Mr. Potts; alternatively,

(*c*) the said sums were paid by the company for full consideration in money or money's worth and were therefore not capital sums as defined by the said Section 40 (5) (*a*);

(*d*) the sums paid to Mr. Potts (*e.g.*, cash drawings) are not sums paid by way of loan, but sums paid to him on account of remuneration or expenses and therefore not paid "otherwise than as income" and accordingly are not capital sums as defined by the said Section 40 (5) (*a*);

(*e*) the assessments should be discharged.

14. It was contended on behalf of the Crown that:—

(*a*) the sums paid by the company to the third parties at Mr. Potts's request and the sums paid to Mr. Potts are sums paid by way of loan within the meaning of Sub-section 5 (*a*) (i) of Section 40, Finance Act, 1938, and are therefore capital sums;

(*b*) alternatively, they fell within Sub-section 5 (*a*) (ii) of the said Section;

(*c*) the said sums were paid directly or indirectly to Mr. Potts, the settlor;

(*d*) the assessments are correct in principle and in accordance with the provisions of Section 40, Finance Act, 1938.

15. Having considered the arguments and evidence adduced before us we decided as follows:—

(1) The assessments under appeal are made under Section 40 of the Finance Act, 1938.

(2) By a settlement dated 31st March, 1939, Mr. G. W. Potts settled £150,000 on trust in favour of his grandchildren. On 25th April, 1939, the trustees of the settlement, Carron Trust, Ltd., purchased 49,999 shares of £1 each in G. W. Potts, Ltd., at £3 per share.

(3) G. W. Potts, Ltd. (hereinafter called "the company") was incorporated in March, 1925, with a capital of £50,000 divided into 50,000 shares of £1. Mr. G. W. Potts was governing director of the company receiving £5,000 as directors' fees and £1,500 for expenses each year. The company had power by clause 3 (i) of the memorandum of association to lend money.

(4) For many years Mr. Potts had a current account with the company. In these accounts Mr. Potts was credited with his directors' fees and expenses and various payments were made by the company at Mr. Potts' request, some payments being to third parties (*e.g.*, the Commissioners of Inland Revenue for tax, and charities) and some payments to himself (cash drawings).

(5) The question for our decision is whether under the circumstances proved before us capital sums have been paid directly or indirectly by the trustees of the settlement to Mr. G. W. Potts, the settlor. "Capital sum" is defined by Section 40 (5) (*a*) (i) and (ii).

(6) In our opinion the question whether the payments in question constitute sums paid by way of loan is a question to be decided upon the facts proved before us. We do not think that assistance is to be derived from such cases as *Victors* v. *Davies*, 12 M. & W. 758, or the notes in Bullen & Leake, Ed. 7, pages 198 and 199.

Upon the facts before us we hold that the sums paid by the company at Mr. Potts' request are sums paid by way of loan.

If the company was called upon to justify its action in making the said payments reliance would have to be placed upon clause 3 (*i*) of the memorandum of association (power to lend money). We therefore hold that the said payments constitute capital sums and we further hold that capital sums have been paid indirectly to Mr. Potts, the settlor. The payments by the company direct to (for example) the Commissioners of Inland Revenue for Surtax are in substance merely a convenient method which avoided the necessity of the company paying to Mr. Potts and Mr. Potts then paying the Commissioners of Inland Revenue.

The capital sums paid by the company must be treated as paid by the trustees of the settlement (see Section 40 (3)) because the company is a body corporate connected with the settlement (see Section 41 (4) (*e*)).

(7) We hold that the terms of Section 40 of the Finance Act, 1938, are fulfilled and that the assessments under appeal must be confirmed in principle.

The correct figures of assessment in accordance with our decision having been agreed between the parties we increased the assessment for 1939-40 to £50,583 and reduced the assessment for 1940-41 to £5,470.

16. The Appellants immediately after the determination of the appeal declared to us their 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, 1927, Section 42 (7), and Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

N. ANDERSON,
H. H. C. GRAHAM, } Commissioners for the Special Purposes of the Income Tax Acts.

Turnstile House,
94/99, High Holborn,
London, W.C.1.

29th January, 1948.

The case came before Singleton, J., in the King's Bench Division on 19th and 20th July, 1948, when judgment was reserved. On 26th July, 1948, judgment was given against the Crown, with costs.

Mr. Frederick Grant, K.C., and Mr. F. Heyworth Talbot appeared as Counsel for the Appellants, and the Solicitor-General (Sir Frank Soskice, K.C.), and Mr. Reginald P. Hills for the Crown.

Singleton, J.—At all material times Mr. George William Potts was governing director of G. W. Potts, Ltd., a company which was incorporated on 23rd March, 1925.

By a deed of settlement dated 31st March, 1939, and made between Mr. George William Potts (thereinafter called "the Settlor") and Carron Trust, Ltd. (thereinafter called "the Trustees") the settlor paid to the trustees the sum of £150,000 to be held by the trustees upon trust to invest the same and hold the investments and income thereof and all accumulations of such income upon trust for the Appellant's infant grandchildren. A copy of the settlement was attached to the Stated Case and forms part of it. The trustees of that settlement were a trust company

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incorporated on 25th November, 1936, with a capital of £100 divided into shares of £1 each. All the shares except two were held by nominees for Mr. Potts. On 25th April, 1939, the trustees purchased 49,999 fully paid shares of £1 each in G. W. Potts, Ltd., at £3 per share from Mr. Potts or from his nominees.

For many years Mr. Potts had a current account with the company. In that account he was credited each year with his salary, £5,000, and with his allowance for expenses, £1,500. Various payments were made by the company for him and these were debited to his account, as were his cash drawings which were comparatively small. As a rule Mr. Potts was in credit on this account, but on 30th December, 1939, he owed the company £8,850 7*s.* 7*d.* (owing to the fact that £12,613 15*s.* 7*d.* Surtax had been paid for him during that year). In the following year the company paid £28,000 Surtax for him and the debit against him rose to £32,570 1*s.* 3*d.* It is the payments made from this account which give rise to the question for decision in this case.

Mr. Potts was a rich man, and he had at all times ample liquid resources to pay all he owed to the company, and on 23rd December, 1940, he paid the sum of £32,570 1*s.* 3*d.* and so discharged his indebtedness to the company. It would appear that the current account grew up over a long period. Through it payments were made which, in other cases, might be made through a banker. There was no financial difficulty at any time, it was only a matter of convenience.

The matters for consideration arise under Part IV of the Finance Act, 1938, which deals with income under certain settlements, and in particular under Section 40, which contains provisions in regard to sums paid to a settlor otherwise than as income. Mr. Potts was the settlor, and it is admitted that the company, G. W. Potts, Ltd., was a body corporate connected with the settlement within the meaning of those words in Section 40 (3) of the 1938 Act. The claim made on behalf of the Crown is that the sums paid to third parties through the current account were capital sums paid, directly or indirectly, to Mr. Potts, and that they must be treated as his income by reason of Section 40. Section 40 (1) provides as follows: "Any capital sum paid directly or indirectly in any relevant "year of assessment by the trustees of a settlement to which this section "applies to the settlor shall—(*a*) to the extent to which the amount of "that sum falls within the amount of income available up to the end of "that year, be treated for all the purposes of the Income Tax Acts as "the income of the settlor for that year". Sub-clause (*b*) contains provisions as to dealing with any balance in the following year, and so on.

If this claim is right—and the Special Commissioners decided that it was—it entails additional assessments to Surtax for something over £50,000 in respect of the year ending 5th April, 1940, and for some smaller sum in respect of the following year. There is no dispute as to the figures, which are set out and explained in a letter of 12th June, 1947, which was exhibit "G" attached to the Case.

The claim may well have surprised the executors of Mr. Potts, though the Solicitor-General submitted that it was just the kind of case which Part IV of the Act of 1938 was designed to meet. With that I am not concerned. All I have to decide is whether Section 40 extends to cover payments of this character made to third parties through the current account, the account between the company, G. W. Potts, Ltd., and Mr. Potts.

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It is right that, in approaching a matter of this kind, I should bear in mind the words of Lord Cairns in the case of *Partington* v. *Attorney-General* (1869), L.R. 4 H.L. 100, at page 122. Lord Cairns said: "As I "understand the principle of all fiscal legislation, it is this: If the person "sought to be taxed comes within the letter of the law he must be taxed, "however great the hardship may appear to the judicial mind to be. On "the other hand, if the Crown, seeking to recover the tax, cannot bring "the subject within the letter of the law, the subject is free, however "apparently within the spirit of the law the case might otherwise appear "to be. In other words, if there be admissible, in any statute, what is called "an equitable construction, certainly such a construction is not admissible "in a taxing statute, where you can simply adhere to the words of the "statute."

It is unnecessary to pay any attention to the cash drawings of Mr. Potts, for they were small, and they were more than covered by the credits for salary, etc. The real question is as to the payments made for him, of which the main ones were payments for Surtax. It is important to remember that the company and the trustees were separate legal entities. No payments were made to the settlor by the trustees of the settlement.

It is contended on behalf of the Crown that the main payments should be treated as within Section 40 (1) and as paid directly or indirectly to the settlor by reason of Sub-section (3) of that Section. Sub-section (3) reads: "For the purpose of this section, any capital sum paid to the settlor in "any year of assessment by any body corporate connected with the settle-"ment in that year shall be treated as having been paid by the trustees "of the settlement in that year."

The result of that Sub-section seems to me to be that, when you have a company connected with the settlement (as in this case), Section 40 is brought into operation if a capital sum is paid to the settlor by the company. Unless it is shown that there is the payment of a capital sum by the company to Mr. Potts, the case for the Crown fails.

Bearing in mind the words of Lord Cairns, to which I have referred, I do not regard the payments of Surtax, or other payments to third parties through the current account, as payments made to the settlor. In making payments of this kind the company was carrying out an old practice, and a practice which existed long before the settlement came into existence. It was not making payments to the settlor. The making of the payments for Surtax caused a debit against Mr. Potts on the current account, and he paid that before the end of 1940. The position created was much the same as that of banker and customer. If a bank pays a subscription on a banker's order when the customer already has an overdraft, the result is to increase the overdraft. But it is not a payment to the customer; it is rather a payment to someone else at the request of the customer or for his benefit. Sub-section (3) of Section 40 only deals with a capital sum paid to the settlor. If there were such a sum paid in any year of assessment, it is, for the purposes of Section 40, to be treated as having been paid by the trustees of the settlement in that year. In my view there was no such sum paid to the settlor, and Section 40 does not apply.

I observe that the Commissioners describe the payments as "in "substance merely a convenient method which avoided the necessity "of the company paying to Mr. Potts and Mr. Potts then paying the "Commissioners of Inland Revenue."

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In a taxing Act one has to look at what is clearly said, and one must pay regard to the actual words of the Section. In this connection the words of Lord Tomlin in *Duke of Westminster* v. *Commissioners of Inland Revenue,* 19 T.C. 490, at page 520, are well worth repeating: "Apart, however, from the question of contract with which I have dealt "it is said that in Revenue cases there is a doctrine that the Court may "ignore the legal position and regard what is called 'the substance of the "'matter' and that here the substance of the matter is that the annuitant "was serving the Duke for something equal to his former salary or wages "and that, therefore, while he is so serving, the annuity must be treated "as salary or wages. This supposed doctrine (upon which the Commis-"sioners apparently acted) seems to rest for its support upon a misunder-"standing of language used in some earlier cases. The sooner this mis-"understanding is dispelled and the supposed doctrine given its quietus "the better it will be for all concerned, for the doctrine seems to involve "substituting 'the uncertain and crooked cord of discretion' for 'the "'golden and straight mete wand of the law' (4 Inst. 41)."

The view which I have expressed makes it unnecessary for me to go into other matters, but, in deference to the arguments, I think it is right to add a word or two as to the definition of "capital sum" in Section 40 (5) (*a*). If I had taken a different view of Sub-sections (1) and (3), I should have been disposed to hold that the payments were payments of capital sums within Section 5 (*a*). I do not regard them as covered by Sub-section (5) (*a*) (i). "Any sum paid by way of loan" is equivalent, I think, to a loan, and the words ought not in the context to be read in a wider sense. The payments were not loans in the ordinary meaning of the word. I think, however, that the payments would fall within Sub-section (5) (*a*) (ii), and I do not see that they were made "for full consideration in "money or money's worth" within the meaning of that Sub-section. The words "money or money's worth" were inserted for some purpose, and "money's worth" I should read as meaning property or goods or the like. I do not think it is met by a promise to pay, or by concurrent promises to pay, on a current account; and it may well be that an idea of this kind was not in the contemplation of the Legislature at all.

The appeal will be allowed.

Mr. Talbot.—It will be allowed with costs, my Lord?

Singleton, J.—Yes, I suppose so. It follows that the additional assessments are quashed.

Mr. Talbot.—Yes. I do not think there are any other matters outstanding.

The Crown having appealed against the decision in the King's Bench Division the case came before the Court of Appeal (Sir Raymond Evershed, M.R., and Somervell and Denning, L.JJ.) on 15th, 18th and 22nd July, 1949, when judgment was reserved. On 26th July, 1949, judgment was given unanimously in favour of the Crown, with costs.

Mr. Frederick Grant, K.C., Mr. F. Heyworth Talbot, K.C., and Mr. Desmond Miller appeared as Counsel for the Appellants, and Mr. John Pennycuick, K.C., and Mr. Reginald P. Hills for the Crown.

Sir Raymond Evershed, M.R.—This appeal raises a question of the application of Section 40 of the Finance Act, 1938, to certain sums paid at the request of the deceased Mr. G. W. Potts by a company known as G. W. Potts, Ltd., in the financial years ended 5th April, 1940, and 5th April, 1941. If the Section does apply to these payments, then it is conceded that Mr. Potts' estate is now liable to Surtax for those years in respect of the payments. The figures have been agreed and after appropriate "grossing up" the assessments are respectively for £50,583 and £5,470.

The material facts as found by the Special Commissioners and stated by them in the Special Case may be summarised as follows. In March, 1939, Mr. Potts executed a settlement in favour of his infant grandchildren in the sum of £150,000. The trustees of the settlement were a company known as Carron Trust, Ltd., a company wholly owned by the settlor. Shortly after the date of settlement, namely 25th April, 1939, the trustees applied the settled moneys in the purchase from Mr. Potts of the whole of the issued share capital, save one share, that is 49,999 shares, in the company, G. W. Potts, Ltd., above mentioned, which I shall hereinafter refer to as "the company". The settlor was at the time the sole governing director of the company, and he continued in that capacity at all relevant dates after the date of the purchase. It is conceded that the company is and was a "body corporate connected with the settlement" within the meaning of Sub-section (3) of Section 40 of the Act of 1938.

By clause 3 (*i*) of its memorandum of association the company was given power, in what is now a common form, to make advances to directors and others. The memorandum of association also contained clause 3 (*w*), the usual clause empowering the company to carry on any activities which might conveniently be carried on in connection with its principal business. In fact for many years prior to the two years in question and during such two years the settlor had in effect a current account with the company, the company making on his behalf and at his request numerous payments of various kinds and crediting him in the account with the fees and expenses to which he was entitled as director. A copy of the account in the company's books, which is called the "G. W. Potts, Esq. director's account", for the years ended 30th December, 1939, and 28th December, 1940, is annexed to the Special Case and marked "E." During the first of those two years the payments made included a considerable number of payments to charities, subscriptions to clubs, motor insurance, weekly cash payments to the settlor and others, and last, but by no means least, payments in respect of Income Tax and Surtax amounting to £13,800 odd. In the second of the two years, which opened with a debit balance of £8,850, the tax payments amounted to approximately £28,800. There were also a number of cash payments, and at the end of the year the debit balance of the settlor was £32,570 1*s*. 3*d*., which the settlor discharged by his cheque on 23rd December, 1940.

In these circumstances the conclusion of the Special Commissioners, as stated in paragraph 15 (6) of the Special Case, was as follows, so far as is material: "In our opinion the question whether the payments in question "constitute sums paid by way of loan is a question to be decided upon the "facts proved before us . . . Upon the facts before us we hold that the "sums paid by the company at Mr. Potts' request are sums paid by way "of loan. If the company was called upon to justify its action in making "the said payments reliance would have to be placed upon clause 3 (*i*) "of the memorandum of association (power to lend money). We therefore "hold that the said payments constitute capital sums and we further hold

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"that capital sums have been paid indirectly to Mr. Potts, the settlor. The "payments by the company direct to (for example) the Commissioners of "Inland Revenue for Surtax are in substance merely a convenient method "which avoided the necessity of the company paying to Mr. Potts and "Mr. Potts then paying the Commissioners of Inland Revenue. The capital "sums paid by the company must be treated as paid by the trustees of "the settlement (see Section 40 (3)) because the company is a body cor-"porate connected with the settlement (see Section 41 (4) (*e*))."

Mr. Grant has directed some criticism to this conclusion. He has said that there is no justification for concluding that the payments were made pursuant to clause 3 (*i*) of the memorandum of association. They might equally, for example, have been made by virtue of the general power of sub-clause (20). He says accordingly that the inference that the sums paid should be treated as loans (an inference based, he contended, on the supposed application of clause 3 (*i*) of the memorandum of association) is unsupported by proper evidence, and should be rejected. The various sums paid, according to Mr. Grant's contention, were admittedly sums paid at the request of Mr. Potts, but Mr. Potts' liability to reimburse the company was not for money lent but rested on the footing of a promise to pay implicit in the request, a real and substantial distinction to be found in the old forms of action and the old forms of pleading (see, for example, Bullen and Leake, 3rd Edition, at pages 839-846).

For reasons which later appear, I do not think these criticisms are valid; nor do I think that the solution of the problem rests on the assumption that the company did or did not make payments in exercise of the particular power in clause 3 (*i*) of the memorandum of association. The real question on the appeal is, of course, whether on the facts as I have stated them the case is or is not caught by the provisions of Section 40 of the Act of 1938. If it is, the financial result to Mr. Potts' estate is no doubt severe. The claim may or may not have surprised the executors of Mr. Potts, but, as Singleton, J., (as he then was) pointed out [1], we are not concerned with considerations of that kind. I follow the learned Judge in citing and bearing in mind the observations of Lord Cairns in *Partington* v. *Attorney-General* (1869), L.R. 4 H.L. 100, at page 122: "As I under-"stand the principle of all fiscal legislation, it is this: If the person sought "to be taxed comes within the letter of the law he must be taxed, however "great the hardship may appear to the judicial mind to be. On the "other hand, if the Crown, seeking to recover the tax, cannot bring the "subject within the letter of the law, the subject is free, however apparently "within the spirit of the law the case might otherwise appear to be. In "other words, if there be admissible, in any statute, what is called an "equitable construction, certainly such a construction is not admissible in a "taxing statute, where you can simply adhere to the words of the statute." It is also not to be forgotten, as has been said in this Court before, that if the complexity and artificiality of taxing statutes are sometimes regarded as matters of comment and criticism, the blame should be laid not so much upon Parliament and the Parliamentary draftsmen as upon those private persons who have employed their ingenuity in devising elaborate schemes for avoiding taxes which would otherwise fall upon them.

I now turn to the relevant parts of the Section. Sub-section (1) opens as follows: "Any capital sum paid directly or indirectly in any relevant

(1) Page 217 *ante*.

(Sir Raymond Evershed, M.R.)

"year of assessment by the trustees of a settlement to which this section "applies to the settlor shall (*a*)"—to the extent there stated be treated as the income of the said settlor.

Sub-section (3) is as follows: "For the purpose of this section, any "capital sum paid to the settlor in any year of assesment by any body "corporate connected with the settlement in that year shall be treated as "having been paid by the trustees of the settlement in that year."

Sub-section (5) is as follows: "This section applies to any settlement "wherever made and whether made before or after the commencement of "this Act, and in this section—(*a*) the expression 'capital sum' means (*i*) "any sum paid by way of loan or repayment of a loan; and (*ii*) any other "sum paid otherwise than as income, being a sum which is not paid for "full consideration in money or money's worth", and then there is an exception which is not relevant, and finally (*c*) provides: "references to "sums paid to the settlor include references to sums paid to the wife or "husband of the settlor."

The question therefore, having regard to the concession in reference to the company already stated, is whether the sums paid were capital sums paid to the settlor within the meaning of Sub-section (3). The learned Judge thought they were not. He thought that whatever the effect of the definition of a capital sum they were not paid to the settlor. "Bearing "in mind", he said (1), "the words of Lord Cairns, to which I have "referred, I do not regard the payments of Surtax, or other payments to "third parties through the current account, as payments made to the settlor. "In making payments of this kind the company was carrying out an old "practice, and a practice which existed long before the settlement came "into existence. It was not making payments to the settlor. The making "of the payments for Surtax caused a debit against Mr. Potts on the "current account, and he paid that before the end of 1940. The position "created was much the same as that of banker and customer. If a bank "pays a subscription on a banker's order when the customer already has "an overdraft, the result is to increase the overdraft. But it is not a pay-"ment to the customer; it is rather a payment to someone else at the "request of the customer or for his benefit. Sub-section (3) of Section 40 "only deals with a capital sum paid to the settlor." The learned Judge, however, indicated his opinion—in case he should be wrong on his main conclusion—that the sums in question were not capital sums paid by way of loan within Sub-section 5 (*a*) (i), but would have fallen within sub-paragraph (*a*) (ii). With all respect to the learned Judge, I have formed on these matters a different opinion.

Mr. Pennycuick's first point was that the formula "paid to the settlor" in Sub-section (3) must in its context be read as meaning "paid directly "or indirectly to the settlor". I think, as I read his judgment, that on this point the learned Judge declined to read in the words "directly or "indirectly" in Sub-section (3). Though a decision on this point may not have been strictly necessary for his conclusion, in my opinion however, Mr. Pennycuick's argument on this point is correct. My first impression was, I confess, the other way. If there were no other context than that provided by Sub-sections (1) and (3), I should conclude that the omission of the words "directly or indirectly" within the latter was, notwithstanding the change in the construction of the sentence, deliberate, with the result that

(1) Page 217 *ante*.

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Sub-section (3) would be more limited in this respect than Sub-section (1). Nor do I think that reference to the definitions in Sub-section (5), which of course apply equally to Sub-sections (1) and (3), would be sufficient to tip the balance in favour of the Crown's argument. For the effect of the definition Sub-section is that wherever you find the words "capital sum" in Sub-sections (1) or (3) you must read in the full definition supplied, and this process does not seem to me necessarily to produce the result contended for by the Crown. But there are other indications. I think it is true to say, as Mr. Pennycuick put it, that direct and indirect payments are both species of the genus "payments to the settlor". In other words, the phrase "paid to the settlor" is one capable in itself of covering payments of both kinds. If it is to be limited to direct payments only, then the result seems to depend on the absence of the alternative formula in Sub-section (3) which is present in Sub-section (1).

Mr. Hills referred us to Sub-section (2); that is as follows: "For the "purpose of the last foregoing subsection, the amount of income available "up to the end of any year shall, in relation to any capital sum paid as "aforesaid, be taken to be the aggregate amount of income arising under "the settlement in that year and any previous relevant year which has not "been distributed, less—(*a*) the amount of any other capital sums paid to "the settlor in any relevant year before that sum was paid" etc. In the opening lines it is, of course, quite obvious that the words "paid as afore-"said" mean and cover payments both direct and indirect, but it is also equally manifest that the words "paid to the settlor" in paragraph (*a*) must mean payments both direct and indirect. Finally, Mr. Hills referred to the language of Paragraph 3 of Part II of the Third Schedule to the Act. This Part of the Schedule is related to a different taxing section, Section 38 in the same Part IV of the Act. By that Section the income arising under certain settlements is treated for tax purposes as income of the settlor. By Sub-section (7) (*c*) the Section is applied to settlements made before 27th April, 1938, subject to the provisions of Part II of the Third Schedule, Paragraph 3 of which is as follows: "The foregoing provisions of this "Part of this Schedule shall not apply to any settlement if, in any year to "which this Part of this Schedule applies, any capital sum within the "meaning of section forty of this Act has been paid to the settlor directly "or indirectly by the trustees of the settlement or any body corporate "connected with the settlement in that year." It is plain from the final words of this Paragraph that Parliament conceived that for the purposes of Section 40 payments made to the settlor directly or indirectly by a body corporate connected with the settlement were no less liable to be caught by that Section than payments made to the settlor directly or indirectly by the trustees of the settlement.

In my judgment, it is in the present case legitimate, in construing Section 40 (3), to have regard to the whole of Part IV of the Act including the Schedule to which I have referred. So to do does not seem to me to invoke any "equitable construction" within the meaning of Lord Cairns' words in the passage I have quoted in his speech. In my view, taking account of all the considerations to which I have alluded, the phrase "paid "to the settlor" in Sub-section (3) must, upon a fair interpretation, include payments to him both direct and indirect.

This conclusion still leaves the question to which, as I have indicated, most of Mr. Grant's argument was directed, whether the payments here in

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question were paid to the settlor at all, whether direct or indirect. I confess that if the question had to be determined apart from the definition Sub-section (5), I should feel much attracted to Mr. Grant's argument. But in my judgment the question cannot be so determined, and if the definition in Sub-section (5) (*a*) (i) is incorporated, as it must be, into the language of Sub-section (3), then the question becomes: "Were the sums with which we are here concerned paid by the company by way of loan directly or indirectly to the settlor?" Though I think the expression "by way of" may in some contexts involve a somewhat wider meaning than the single word "as", I am prepared to assume that in the present case no material significance can be attached to them.

Nevertheless, it seems to me that on the facts of this case the sums here in question were—according to the ordinary use of language no less than according to the language of the Section—"paid by way of loan "directly or indirectly to the settlor". It does not seem to me in such a context that any weight can be attached to the old distinction, reflected in the old forms of pleading, between money lent and money paid by request. Whether or not the company must be taken to have acted in exercise of its powers under clause 3 (*i*) of the memorandum of association, it is, I think, abundantly plain, as the Special Case found and as the Judge below also stated, that the company acted for practical purposes exactly in the office of the settlor's banker. On 1st January, 1939, the account was in credit to the extent of £1,316 7*s.* 4*d.*; but on the 18th January, £1,350 7*s.* 4*d.* was transferred to the settlor's private banking account and thenceforward the settlor's account with the company was continuously overdrawn (that is, throughout the whole financial year 1939-40 and thereafter till the 23rd December, 1940). In the ordinary case of banker and customer, where the former gives credit to the latter by meeting the cheques from time to time drawn by the customer upon the banker, the resulting overdraft is always regarded as money lent by the banker to the customer. See, for example, the language of Lord Cozens-Hardy, M.R., in the case of *Cuthbert* v. *Robarts, Lubbock & Co.*, [1909] 2 Ch., at page 233, where he says: "If a customer draws a cheque for a sum in excess of the amount "standing to the credit of his current account, it is really a request for a "loan, and if the cheque is honoured the customer has borrowed money." In the same way, as it seems to me, the various payments made by the company throughout the period in question ought fairly to be regarded as money paid directly or indirectly by way of loan to Mr. Potts within the meaning of the Sub-section. The problem is, I think, largely one of first impression and I do not attempt to improve upon my conclusion by elaboration. In my judgment, the Crown succeeds in showing that the sums for which it is sought to tax the settlor are within the scope of the Section which the Crown invokes.

In the circumstances, it is strictly unnecessary for me to express an opinion upon the scope of paragraph (ii) of the definition Sub-section 5 (*a*). But since the matter has been argued, my own view is that the sums in question do not fall within its ambit. Mr. Pennycuick did not himself at all attempt to justify the view to which the learned Judge felt himself inclined—that a promise to repay was not money or money's worth within the meaning of the paragraph because the last two words indicated goods or property. He sought rather to say that in the absence of a charge for interest, that is, a charge for the use of the sums advanced, there was no

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"full" consideration. I cannot for myself accept that argument. The formula "full consideration for money or money's worth" is common enough and is generally used to exclude, for example, the marriage consideration. But in my view the settlor's promise or obligation to repay in full the sums paid on his behalf constitutes full consideration in money or money's worth within the meaning of the paragraph in question.

The result, however, in my judgment, is that the appeal succeeds.

Somervell, L.J.—I agree that the appeal succeeds for the reasons which have been given by the Master of the Rolls.

Denning, L.J.—I also agree.

Mr. Hills.—The appeal will be allowed with costs, my Lord?

Sir Raymond Evershed, M.R.—Yes, that is right, Mr. Hills.

Mr. Talbot.—I think my learned friend requires an Order with regard to the interest. Following the judgment of Singleton, J. (as he then was) the Crown repaid to us, and repaid with interest, taking from us an undertaking that we would consent to the inclusion of the restoration of the interest in the Order.

Sir Raymond Evershed, M.R.—What form ought the Order to take in those circumstances?

Mr. Talbot.—There is a customary form in the office. The fact that it is just mentioned will be enough for the purposes of the office.

Sir Raymond Evershed, M.R.—Very well.

Mr. Hills.—That is so, my Lord.

Mr. Talbot.—I have also to ask your Lordship for leave to appeal to the House of Lords in this case.

Sir Raymond Evershed, M.R.—What do you say, Mr. Hills?

Mr. Hills.—It is customary in a case like this for my clients, unless there is something special, or the Court requires some assistance, to leave the matter to the Court.

Sir Raymond Evershed, M.R.—I think we should give leave.

Mr. Talbot.—If your Lordship pleases.

An appeal having been entered against the decision in the Court of Appeal, the case came before the House of Lords (Lords Simonds, Normand, Oaksey, Morton of Henryton and MacDermott) on 20th and 21st November, 1950, when judgment was reserved. On 14th December, 1950, judgment was given against the Crown (Lord Morton of Henryton dissenting) with costs.

Mr. Frederick Grant, K.C., Mr. F. Heyworth Talbot, K.C., and Mr. Desmond Miller appeared as Counsel for the Appellants, and Mr. John Pennycuick, K.C., and Mr. Reginald P. Hills for the Crown.

Lord Simonds.—My Lords, this appeal raises a question upon Section 40 of the Finance Act, 1938, a section which has not previously been considered in this House. Before I refer to its provisions, I will state the relevant facts.

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The late G. W. Potts was until April, 1939, the owner of substantially the whole of the share capital of G. W. Potts, Ltd., which consisted of 50,000 shares of £1 each. He was also governing director of the company, receiving each year £5,000 as remuneration and £1,500 for expenses. He had for many years before 1939 a current account with the company in which he was credited with his remuneration and expenses and debited with payments made by the company at his request, sometimes to third parties and sometimes to himself.

In the year 1936 he formed the Carron Trust, Ltd., a trust company with a capital of £100 divided into 100 shares of £1 each. He held all these shares by himself or his nominees but was not a director of the company. On 31st March, 1939, he, as settlor, executed a settlement of which Carron Trust, Ltd., was trustee and paid to that company as trustee the sum of £150,000 upon trust to be invested at the trustee's sole discretion and to be held (subject to certain powers therein mentioned) upon trust for accumulation for the benefit of four named infant grandchildren of the settlor in the manner therein mentioned. On 25th April, 1939, the trustee company as trustee of the settlement bought from the settlor or his nominees 49,999 fully paid shares of £1 each in G. W. Potts, Ltd., at £3 each. It has been throughout admitted that this company was a "body corporate connected with the settlement" within the meaning of Section 40 (3) of the Finance Act, 1938.

I have said that the settlor had a current account with the company. It appears that at the end of the year 1935, after being debited with various sums, including subscriptions to charities, payments of tax and weekly cash drawings, he was in credit in the sum of £2,612 4*s.* 7*d.* which was carried forward to the year 1936. At the end of 1936 he was similarly in credit in the sum of £1,377; at the end of 1937 the account was exactly square; at the end of 1938 he had a credit of £1,316, but at the end of 1939, largely owing to the payment by the company on his behalf of a large sum for Surtax, he was in debit in the sum of £8,850. At the end of 1940 the account was again square, but during that year the company had paid very large sums on his behalf, including £28,000 for Surtax, and he was largely in debit until on 23rd December, 1940, he paid the sum of £32,570 to the company. On the same day he resigned his directorship of the company. He was at all material times a rich man and had ample liquid resources to pay all that he owed to the company. It has not been suggested that the transactions between himself and the company were in any way colourable or a device for the evasion of tax. The only other facts that I need mention is that the company, whose primary business was that of meat salesmen, had power under clause 3 (*i*) of its memorandum of association to make advances as well to any director as to customers and others with or without security and upon such terms as the company might approve and generally to act as bankers for customers and others, and under clause 3 (*l*) to invest and deal with the moneys of the company not immediately required in or upon such securities and in such manner as might from time to time be determined in the absolute discretion of the directors. I mention these powers because upon them and particularly the first of them the Respondents relied.

It was under these circumstances that, the settlor having then died, additional assessments to Surtax were made upon his executors in the sum of £50,107 for the year ending 5th April, 1940, and in the sum of £19,924 for that ending 5th April, 1941. These figures were subsequently adjusted and became respectively £55,383 and £5,426 and, after a further

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adjustment, £50,583 and £5,470. The assessments were made upon the footing that these sums represented capital sums paid directly or indirectly to the settlor by the trustee of the settlement. It is time then to turn to the Section which is said to have such a result. No question arises in regard to the quantum of the assessment, the only matter in dispute being whether the sums with which the settlor was credited in the current account already mentioned were capital sums upon which the Section operated. It will be necessary, therefore, to refer to a few provisions only of the Section.

Section 40 of the Finance Act, 1938, so far as relevant provides as follows:

"(1) Any capital sum paid directly or indirectly in any relevant "year of assessment by the trustees of a settlement to which this "section applies to the settlor shall—

"(*a*) to the extent to which the amount of that sum falls within "the amount of income available up to the end of that year, be "treated for all the purposes of the Income Tax Acts as the "income of the settlor for that year; . . .

"(3) For the purpose of this section, any capital sum paid to the "settlor in any year of assessment by any body corporate connected "with the settlement in that year shall be treated as having been paid "by the trustees of the settlement in that year.

"(5) . . . . in this section—

"(*a*) the expression 'capital sum' means—

"(i) any sum paid by way of loan or repayment of a loan; and

"(ii) any other sum paid otherwise than as income, being "a sum which is not paid for full consideration in money or "money's worth; . . . ."

It is, as I have already said, admitted that the company is a "body "corporate connected with the settlement", and it follows that the validity of the assessments to which I have referred depends upon the nature of the relevant transactions between the settlor and the company.

There was in the first place some argument whether the words "directly "or indirectly" which occur in Sub-section (1) are to be read into Sub-section (3). In my opinion they clearly are, for the purpose and effect of that Sub-section are merely to substitute payment by a body corporate connected with the settlement for payment by the trustees of the settlement. In other respects the measure of liability is intended to be the same.

The question then is whether the sums with which the settlor was debited in current account with the company were capital sums paid directly or indirectly by the company to him. This they would be if they were sums paid to him by way of loan or repayment of a loan, or were sums paid to him otherwise than as income which were not paid for full consideration in money or money's worth. These are true alternatives, and I will consider the latter first. I cannot doubt, and the matter was not seriously contested by the Respondents, that the sums in question having been paid at the request of the settlor and upon his promise express or implied to repay, there was full consideration given by the settlor for the payment. Some suggestion was made that inasmuch as there was no provision for payment of interest there was not full consideration. But that was an arrangement which was no doubt convenient to both parties.

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Though latterly the company was largely in credit, in the earlier years it had been the other way about and no interest was charged against the company. In my opinion this contention fails, and I turn to the question whether these sums were paid by way of loan directly or indirectly by the company to the settlor. The Special Commissioners held that the sums in question were "sums paid by way of loan". They thought that if the company was called upon to justify the payments they would have to rely on the power to lend money contained in clause 3 (*i*) of the memorandum of association and said: "The payments by the company direct "to (for example) the Commissioners of Inland Revenue for Surtax are "in substance merely a convenient method which avoided the necessity "of the company paying to Mr. Potts and Mr. Potts then paying the "Commissioners of Inland Revenue."

There are, I think, sections in Revenue Acts which justify a reference to the substance of a transaction. But there is danger in forgetting the words used by Lord Tomlin in the *Duke of Westminster's* case, 19 T.C. 490, at page 520, which are cited by Singleton, J., in this case (1). The question is not what the transactions between the settlor and the company in substance were but whether they fell within the fair meaning of the Section.

From the determination of the Commissioners the Appellants appealed by way of Case Stated to the High Court, and on 26th July, 1948, Singleton, J., allowed their appeal, holding in effect that no capital sum within the meaning of the Section was during the relevant years paid to the settlor. From his judgment the Respondents appealed to the Court of Appeal, who allowed the appeal and restored the decision of the Commissioners. The learned Master of the Rolls, in whose judgment Somervell and Denning, L.JJ., concurred, took the view which I have already expressed as to importing into Sub-section (3) the words "directly or indirectly" and came to the conclusion that "the various payments made by the company ". . . ought fairly to be regarded as money paid directly or indirectly by "way of loan to Mr. Potts within the meaning of the Sub-section (2)." He was, I think, partly at least led to this conclusion by considering the position of a bank which by meeting a customer's cheques when he is overdrawn is deemed to have lent him money.

My Lords, I have come to a different conclusion. Reading the definition into the Sub-section I must be satisfied that according to the fair meaning of the words these sums were sums paid by way of loan to the settlor directly or indirectly by the company. I do not think it matters whether the words "directly or indirectly" qualify the payment or the receipt. I will assume they qualify both or either. The question is still whether the conditions of the composite phrase are fulfilled—were the sums paid to the settlor by way of loan? I do not doubt that in certain contexts money paid at A's request to B may be properly described as "paid to A"; see, for example, *Parsons* v. *Equitable Investment Co., Ltd.*, [1916] 2 Ch. 527, per Lord Cozens-Hardy, M.R., at page 530. The explanation of this is to be found in the judgment of Shearman, J., in *Stott* v. *Shaw and Lee, Ltd.*, [1928] 2 K.B. 26, at page 31: ". . . if "the legal or business or commercial effect of the transaction can be taken "to be the same as that described in the bill of sale, then the Courts will "hold the consideration to be truly stated." But this is not the way in which a taxing statute is to be read. I am not, in the construction of such a statute, entitled to say that because the legal or business result is the

(1) See page 218 *ante*. (2) Page 223 *ante*.

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same whether on the one hand I borrow money from the company and with it make certain payments, or on the other hand the company at my request makes certain payments upon my implied promise to repay, therefore it is immaterial what words are in the statute if that result is attained. Nor again is it relevant that, where a bank allows its customer to overdraw, the customer is to be regarded as having borrowed from the bank to the extent of the overdraft: a proposition in regard to which no doubt can be entertained: see *Cunliffe Brooks & Co.* v. *Blackburn Benefit Society*, 9 A.C. 857, at page 868. The company was not a bank and it would in my opinion be an abuse of language or at least the merest colloquialism to speak of the transaction between the company and the settlor as a banking transaction. The fact that the objects for which the company was established included that to which I have referred does not in my opinion affect the question. That question remains as I have stated it, and my answer is that according to the ordinary fair meaning of the words the company did not pay any sums to the settlor by way of loan. It would in fact be as inapt to say that the company paid him sums by way of loan when he was in debit on the account as to say that he paid the company sums by way of loan when he was in credit. Some stress was laid on the distinction in the old forms of pleading between the plea for money lent to the defendant and the plea for money paid at the request of the defendant to a third party. I am not inclined to give much weight to this consideration but it does indicate that there is at least a formal difference between the two transactions.

So far, my Lords, I have not specifically dealt with the word "indirectly". It is sufficient to say that it cannot so enlarge the meaning of the words "paid to the settlor" as to include payment to some other person than the settlor for his own use and benefit. I do not feel called upon to determine positively what transactions it might be apt to cover. It may be that it is not apt to cover any that are not already covered by the normal meaning of the words "paid to the settlor".

It was finally urged by learned Counsel for the Respondents that, if this appeal is allowed, an easy way of evading tax will be open to the taxpayer. This is an argument which is of no weight whatever. The question is what is the fair meaning of words in a taxing Act. I have given my answer to it and move that this appeal be allowed and the matter be remitted accordingly.

Lord Normand.—My Lords, I shall not restate the facts, nor repeat the provisions of the Section on which the result of the appeal depends.

The first and more difficult question is whether sums paid by the company to third parties by the settlor's request were within the meaning of the Act, capital sums paid directly or indirectly to him by way of loan. These sums were either sums paid to the Inland Revenue in discharge of the settlor's tax obligations or other sums of which subscriptions paid to charities were taken as typical. There were also sums which were paid to the settlor himself, but these were treated by the Special Commissioners as sums paid on account of the settlor's remuneration and expenses as the company's managing director.

It is not suggested that the words "capital sums paid directly or "indirectly to the settlor by way of a loan" have any special meaning imposed upon them by the context. Each word must if possible be allowed its appropriate effect; yet it is the meaning of the whole expression, all the words being read together, that has to be found. The principles

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to be observed in applying the provisions of a taxing Act are stated by Lord Cairns in *Partington* v. *Attorney General* (1869), L.R. 4 E. & I. App. H.L. 100, at page 122: "As I understand the principle of all fiscal "legislation, it is this: If the person sought to be taxed comes within the "letter of the law he must be taxed, however great the hardship may "appear to the judicial mind to be. On the other hand, if the Crown, "seeking to recover the tax, cannot bring the subject within the letter of "the law, the subject is free, however apparently within the spirit of the "law the case might otherwise appear to be. In other words, if there be "admissible, in any statute, what is called an equitable construction, "certainly such a construction is not admissible in a taxing statute, where "you can simply adhere to the words of the statute."

The Crown submitted that the payments made by request were capital sums paid indirectly to the settlor as loans. I shall refer presently to the authorities by which the submission was supported. But first I shall consider the meaning of the relevant words apart from authority. In my view they are apt to cover payments made as loans to third parties through whom the payment reaches the settlor himself, but they are not apt to cover payments made to third parties who are not accountable to the settlor and are entitled to retain the sums as their own moneys. This is a taxing Act and its terms are not to be enlarged by reasoning that the same final result is achieved as by a loan made to the settlor followed by a payment made by him to the third party. The principle stated by Lord Tomlin in *Duke of Westminster* v. *Commissioners of Inland Revenue*, 19 T.C. 490, is on the point conclusive. Lord Tomlin said (1) ". . . it is said "that in Revenue cases there is a doctrine that the Court may ignore "the legal position and regard what is called 'the substance of the matter' "and that here the substance of the matter is that the annuitant was "serving the Duke for something equal to his former salary or wages and "that, therefore, while he is so serving, the annuity must be treated as "salary or wages. This supposed doctrine (upon which the Commissioners "apparently acted) seems to rest for its support upon a misunderstanding "of language used in some earlier cases. The sooner this misunderstanding "is dispelled and the supposed doctrine given its quietus the better it will "be for all concerned, for the doctrine seems to involve substituting 'the "'uncertain and crooked cord of discretion' for 'the golden and straight "'mete wand of the law' (4 Inst. 41)." It would be inconsistent with this principle to accept the contention that the words should be extended to any payment made by the settlor's request to a third party which produces a pecuniary benefit to the settlor equivalent to the sum paid. It was said however that a payment made by the settlor's request to an agent or other person accountable to him is in law a payment made directly to the settlor and, therefore, that the word "indirectly" must have a wider significance than I have assigned to it. That is, with respect, to beg the question. In a taxing Act designed to prevent tax evasion by affecting with liability to tax sums paid to a settlor otherwise than as income it was obviously necessary to provide for the case when persons accountable to the settlor are interposed between the payer and the settlor for the purpose of disguising the transaction. That is a satisfactory explanation of the use of the words "directly or indirectly". There is therefore no reason for extending the meaning of "indirectly" so as to include payments to third parties which the settlor has an interest to make whether in discharge of his legal liabilities or in furtherance of

(1) 19 T.C. 490, at p. 520.

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charities favoured by him. If that had been the intention other words would have been added.

The Respondents relied on *Parsons* v. *Equitable Investment Co., Ltd.*, [1916] 2 Ch. 527. In that case it was held that a sum of money borrowed on a bill of sale and paid by the grantor's request to a creditor or another person was properly described as a payment to the grantor. But the ground of this conclusion was not that a payment made to B by A's direction is as matter of general law a payment to A, but that the requirement of the Bills of Sale Act (1878) Amendment Act, 1882, Section 8, that the bill of sale shall truly set forth the consideration, had been construed in accordance with the principle that "if the legal or business or "commercial effect of the transaction can be taken to be the same as that "described in the bill of sale, then the Courts will hold the consideration to "be truly stated", although "it is perfectly clear that, strictly understood, "it was untrue" (*Stott* v. *Shaw and Lee Ltd.*, [1928] 2 K.B. 26, Shearman, J., pages 30-31). In *B.S. Lyle, Ltd.* v. *Chappell* (1) another case relied on by the Crown, the rule of *Parsons* v. *Equitable Investment Co.* was applied in a moneylender's action to the statements in the moneylender's memorandum. To apply these cases in construing a taxing Act is again flatly inconsistent with the principle established by the *Duke of Westminster's* case (2). The Court is not entitled to say that for the purposes of taxation the actual transaction is to be disregarded as "machinery" and that the substance or equivalent financial results are the relevant consideration. It may indeed be said that if these loose principles of construction had been liberally applied, they would in many instances have been adequate to deal with tax evasion and there would have been less frequent cause for the intervention of Parliament.

I therefore hold that the payments made by the settlor's request to third parties were not payments made directly or indirectly to the settlor. It is not necessary to consider whether they were payments made by way of loans. But since the question was argued I will state my opinion. There is a real distinction between a loan to A to enable him to pay his creditors and a payment to A's creditors made for the purpose of discharging his debts. It is a distinction recognised and taken advantage of both by commercial men and by others. But there are exceptions; for example in banking law payments to third parties are customers' loans if the account is overdrawn (*Cunliffe Brooks & Co.* v. *Blackburn Benefit Society*, 9 A.C. 857; *Cuthbert* v. *Robarts, Lubbock & Co.*, [1909] 2 Ch. 226). All the controversial payments in the present case appear as items in a current account described as a director's account. It is a fair inference that the payments, whether to the settlor himself or to third parties, were deemed by the company to be authorised by the power in the memorandum of association to make advances to directors and customers and generally to act as bankers for customers and others. Nevertheless, the account is not a banker's account with its customer. For example, the payments with which the settlor is credited are not loans to the company, as are the payments into the bank when the customer's account is not overdrawn; nor were any of the payments made for the purpose of granting credit required by the settlor, who had at all times liquid resources ready to pay all that he owed to the company. I therefore think that the payments in question were not payments by way of loans as that word is understood in common parlance and as it is used in Section 40.

(1) [1932] 1 K.B. 691. (2) 19 T.C. 490.

(Lord Normand.)

The Crown did not offer more than a perfunctory submission that the payments made to third parties were not paid for full consideration in money or money's worth. The consideration was, in my opinion, the services rendered by the managing director coupled with an implied obligation of repayment on demand. Further, there is no finding that the consideration was not full consideration, and I can find no ground for holding that full consideration was not given.

Courts of Law are not concerned with extrinsic circumstances, such as that the provisions of Section 40 as I have construed them are of little value because they may easily be evaded by those who have the will to evade them, or that persons who contract genuine loans or receive repayment of genuine loans without any purpose of evasion and without in fact evading any liability to tax are as likely to be taxed under Section 40 as persons who contrive elaborate schemes of pretended loans for the purpose of evasion.

I would allow the appeal with costs.

Lord Oaksey.—My Lords, I agree that this appeal should be allowed. The object of the Act in my opinion was to tax a settlor who obtained payment of capital sums from the trustees of his settlement or from companies connected with the settlement for which he had not given full consideration in money or money's worth; it cannot have been the object of the Act to tax him in respect of payments for which he had given full consideration.

In these circumstances it appears to me that if the words of the Act are fairly susceptible of a meaning which attains this object they should be given that meaning rather than a meaning which goes beyond the object of the Act and leads to admitted injustice.

The first question is whether the sums in question are capital sums within the meaning of Section 40 (5) (*a*). It was contended for the Crown that the sums paid by the company were sums paid by way of loan. In my opinion in the particular circumstances of this case the payments were not made by way of loan. They were made in accordance with the practice which had long existed by which the governing director of the company in which he had held all the shares directed or requested the company to make payments on his behalf as a matter of ordinary convenience. The company had never carried on a business of bankers or moneylenders, and it is not in my opinion a fair use of language to describe payments made for the governing director in such circumstances as loans. According to the Respondents' argument, whenever the governing director's account became in debit there was a loan by the company to him and whenever it was credited with any sum thereafter until the account balanced there were repayments of loans.

The second question is whether even if the payments were made by way of loan they were paid directly or indirectly to the settlor. None of them was in fact paid to the settlor, and from some of them the settlor derived no financial benefit since some of them were contributions to charities.

Having regard to the object of the statute, I think the words "paid "directly or indirectly . . . to the settlor" should be held to mean paid into the settlor's hands or into the hands of someone accountable to him.

For my own part I should also be prepared to decide the case upon the ground that the true construction of Sub-section (5) (*a*) (i) is that it

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refers only to sums paid by way of loan which are not paid for full consideration in money or money's worth, and that in the present case the accommodation afforded to the Appellant was given for full consideration in money or money's worth.

Lord Morton of Henryton.—My Lords, the charging Sub-section in Section 40 of the Finance Act, 1938, is Sub-section (1). It begins: "Any "capital sum paid directly or indirectly in any relevant year of assessment "by the trustees of a settlement to which this section applies to the settlor "shall . . ." Then follow the words which give rise to the charge to tax. The ambit of the Sub-section is enlarged by Sub-section (3), which provides: "For the purpose of this section any capital sum paid to the settlor "in any year of assessment by any body corporate connected with the "settlement in that year shall be treated as having been paid by the "trustees of the settlement in that year." The effect of this latter Sub-section is to insert in Sub-section (1) immediately after the words "to "which this section applies" the words "or by any body corporate con-"nected with the settlement in that year". It is admitted by the Appellants that G. W. Potts, Ltd. (hereafter called "the company") is such a company.

The expression "capital sum" is defined by Sub-section (5) (*a*) as follows:

> "The expression 'capital sum' means—
>
> "(i) any sum paid by way of loan or repayment of a loan; and
>
> "(ii) any other sum paid otherwise than as income, being a sum "which is not paid for full consideration in money or money's "worth".

Then follow some words which are immaterial for the present purpose. I agree with the Court of Appeal in thinking that sub-paragraph (ii) has no application in the present case, and the relevant words are "any sum "paid by way of loan". The question for decision may therefore be expressed as follows, reading Sub-sections (1), (3) and (5) (*a*) (i) together and applying them to the facts of the present case: Were the sums paid out by the company in the relevant years of assessment, at the request of the settlor and upon his promise to repay, sums paid by way of loan directly or indirectly to the settlor? This question can be subdivided into two questions: (*a*) Were these sums paid by way of loan? (*b*) If so, were they paid directly or indirectly to the settlor?

For the purpose of considering the first of these two questions it is, I think, important to note the circumstances in which the sums under consideration were paid out by the company. To quote the Case Stated: "For many years Mr. Potts had had a current account with the company. "In these accounts Mr. Potts was credited with his remuneration as "governing director and expenses and various payments were made by the "company at Mr. Potts' request, some payments being to third parties "(*e.g.*, the Commissioners of Inland Revenue for tax, and charities) and "some being payments to himself (cash drawings)."

It is argued on behalf of the Appellants that where there is a current account, with payments out and payments in from time to time, it would be wrong to treat every payment out as a "loan" within Section 40 (5) (*a*) (i) and every payment in as a repayment of a loan. That case can be considered if and when it arises, but it is not the case now before your Lordships. The relevant period is from 5th April, 1939, to 5th April,

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1941, and the details appear in the "Director's Account" for the period from 18th January, 1939, to 31st December, 1940,—see Exhibit E to the Case Stated. On 5th May, 1939, the company paid the settlor's Surtax amounting to £12,613 15*s.* 7*d.* The settlor's account was overdrawn before this payment was made, and from that time on his account was never in credit. Between 5th May and 31st December, 1939, a large number of payments were made by the company at the request of the settlor. I need not pause to analyse them in detail at the moment, but they included payments of the settlor's Income Tax, Schedule E, various sums of cash paid to the settlor himself and a number of payments to charities. During this period the settlor paid nothing into the account. At the end of the year the settlor was credited with his director's fees, £5,000, and director's expenses, £1,500, and this left his account in debit to the amount of £8,850 7*s.* 7*d.* In the year 1940 further payments were made by the company at the request of the settlor, including Surtax, £28,000 and Income Tax, £779 12*s.* 6*d.* On 23rd December, 1940, when the settlor resigned his position as governing director, he was credited with director's fees and expenses from 1st January to 23rd December, 1940. This credit reduced his debit balance to £32,570 1*s.* 3*d.*, and on 23rd December, 1940, the settlor gave the company a cheque for that amount to balance the account.

I have mentioned these facts in order to show that on every occasion on which a sum was paid out by the company during the relevant period, it was in the nature of an overdraft. At the end of the year the settlor's director's fees and expenses were credited to him, and this had the effect of reducing the overdraft, but no sum was ever paid in by the settlor during the relevant period until he gave the company the balancing cheque of £32,570 1*s.* 3*d.* on 23rd December, 1940.

Whether or not it is accurate to describe the company as carrying on the business of banking, there is no doubt that during the relevant period the company supplied money to the settlor as and when he requested the company to do so and debited him with each of these amounts. The only difference between the procedure adopted by the company and the procedure adopted by a bank granting an overdraft is that the company did not apparently require any security and did not charge any interest on the sums debited to the settlor. This is not surprising, as the settlor was a rich man and all the shares in the company except two were held by nominees for the settlor.

For the moment, I shall only deal with the substantial sums amounting to over £40,000, which the company paid out, at the settlor's request, in discharge of his liabilities for Income Tax and Surtax.

My Lords, I think that the sums so paid out cannot accurately be described as anything other than loans to the settlor. To quote Lord Blackburn in *Cunliffe Brooks & Co.* v. *Blackburn Benefit Society*, 9 A.C. 857, at page 864: "Bankers . . . are under no obligation to honour "cheques which exceed the amount of the balance, or, in other words, to "allow the customer to overdraw. Bankers generally do accommodate their "customers by allowing such overdrafts to some extent; when they do so "the legal effect is that they lend the surplus to the customer". For the sake of example I shall take the sum of £28,000 paid out in the month of March, 1940, in discharge of the settlor's liability for Surtax. That transaction can I think be accurately stated as follows: The settlor said: "Please pay my Surtax; if you do pay it I promise to repay the sum on demand."

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When the money was paid to the Inland Revenue, it seems to me that it was lent to the settlor just as much as if the company had been a bank and had granted him an overdraft of that amount.

I now come to the second of the two questions already stated, namely: Were the sums in question paid directly or indirectly to the settlor? In agreement with the Court of Appeal and the Special Commissioners, I think that they were so paid. It is argued on behalf of the Appellants that no sum can be "paid to the settlor", even indirectly, unless it is either paid into his hands or reaches his hands through some agent who is accountable to him. I find myself unable to accept this argument. I think that a sum is paid *to* A.B., in the ordinary meaning of these words, if it is either paid into the hands of A.B. or into the hands of his duly authorised agent. and that the construction contended for by the Appellants really gives no force to the words "directly or indirectly". I think that these words cover at least two types of payment: a payment direct to the settlor or his agent, and a payment made at the request of the settlor which confers a pecuniary advantage to the settlor equal to the sum paid, for example, payment of a debt presently due from the settlor such as the Income Tax and Surtax in the present case.

It seems to me that this construction accords with the intention of Section 40 as expressed by the words used therein, and the contrary view gives rise to some strange results. Let me assume that two rich men, X and Y, each make a settlement of the kind to which the Section applies, for instance, a settlement of a sum of £50,000 under which the income is to be accumulated so that no Surtax attaches to that income. Assume further that both X and Y have other substantial income which attracts Surtax and that they desire this Surtax to be paid by the trustees of the settlement. X says to the trustees: "Pay my Surtax and I promise to repay you." Y says to the trustees: "I need £10,000 in order to pay my Surtax; give me a cheque and I promise to repay you." If the Appellants' contention is correct, the payment to X will not come within Section 40 and the payment to Y will come within it. This seems a very strange and capricious result, and incidentally it reveals an extremely simple way of making the Section wholly ineffective. On the other hand, if my view is correct, X has received payment by way of loan indirectly and Y has received payment by way of loan directly within the meaning of the Section and they will both equally be charged with tax. This is, I venture to think, a result which the Legislature intended to achieve and in my view it has been achieved by the words used in the Section.

I do not think it right to detain your Lordships by considering in detail the other payments, such as subscriptions to charities. If the view which I have expressed commends itself to your Lordships, there is no dispute between the parties as to the figures in the assessments; if your Lordships are of a contrary opinion, the assessments cannot stand.

I would dismiss the appeal.

Lord MacDermott.—My Lords, the question here is whether the aggregate of certain sums paid by G. W. Potts, Ltd. (hereinafter called "the company") for and on behalf of the late Mr. G. W. Potts constituted (after certain deductions which need not be specified) a "capital sum paid "directly or indirectly . . . by the trustees of a settlement . . . to the "settlor . . ." within the meaning of those words as used in Sub-section (1) of Section 40 of the Finance Act, 1938.

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It was agreed that the company was a "body corporate connected "with the settlement" mentioned in the Case Stated for the purposes of Sub-section (3) of that Section and accordingly that the payments in question, if otherwise within Sub-section (1), were to be treated as having been paid by the trustees of the said settlement of which Mr. Potts was the settlor. But it was in dispute whether the need to resort to Sub-section (3), in which the words "directly or indirectly" do not occur, had the effect of allowing those words to be ignored in applying Sub-section (1). I am satisfied that on the true construction of the Section the expression "directly or indirectly" contained in Sub-section (1) forms a constant part of the enactment, whatever its effect may be, and I have therefore incorporated it in stating the question for decision.

This leaves two matters for consideration: (1) Did the payments made by the company constitute a "capital sum" as defined by Sub-section (5) (*a*)? and (2) If so, was such capital sum paid to the settlor? It is only if the answer to both these queries is in the affirmative that the assessments under review can be upheld.

My Lords, I incline to the opinion that the sums paid by the company could not, in any event, be brought within Sub-section (5) (*a*) (ii). If they come within that Sub-section at all it must, I think, be under paragraph (*a*) (i), and then only by virtue of that part thereof which reads "any sum "paid by way of loan". Now I entertain little doubt that in certain circumstances it may properly be said that, if A out of his own moneys pays a sum to B for and at the request of C, A has paid the sum by way of loan, and by way of loan to C in the sense, and only in the sense, that he has thereby created the relation of lender and borrower between himself and C. But this is not to say that all transactions of that kind are loans. They may be but incidents in some wider relationship other than that of lender and borrower and take, as it were, their colour from it. For example, a rent agent may have to pay rates and a solicitor may have to pay stamp duties for clients whose accounts are not in credit at the time of payment. But in the ordinary course of events I do not think it would occur to anyone, or be a correct use of language, to say that such disbursements were loans or made by way of loan. On the other hand the kind of wider relationship to which I am referring may provide opportunity for transactions within it which are exceptional and beyond the normal scope of the relationship and which may properly be describable as loans and as nothing else. The true view must depend on the circumstances. In the present case no attempt has been made to explore the position with these considerations in mind. It may have been impossible to do so. But whatever the reason there is no distinction drawn between the relevant items in the accounts; big or little, fiscal or charitable, they are all treated alike. Accordingly, I think the first question can only be settled on an assumption of normality which, with debits ranging from "Dunhill—2*s.* 10*d.*" to "Surtax—£18,000" (*vide* Exhibit E, Director's account for 1940) seems to me to be assuming a good deal. For this reason and because on the view I take of the rest of the case it becomes unnecessary to do so I do not propose to express any concluded opinion on this branch of the matter. I therefore proceed to the second question assuming, for the purpose, an affirmative answer to the first.

For the Crown it was submitted that whatever was paid to the order of the settlor was a payment to him within the meaning of Sub-section (1) and, in the alternative, that if a sum paid in that way was not paid directly to the settlor it was nevertheless paid indirectly to him. On the facts of

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this case I do not think there is room for this alternative argument. The relatively small amounts paid directly to Mr. Potts were well within his salary and may be left out of account. Of the other payments those that matter here were not made to Mr. Potts' agents or in some circuitous way designed to put the money under his control eventually. Had they been, the word "indirectly" might have had a part to play, for in that case the issue would be whether, as a matter of fact, payment had been made one way or another to the settlor. In short, as it appears to me, the words "directly or indirectly" bear only on the mechanics of payment in fact. But the issue under consideration has to be related to payments which moved *from* Mr. Potts and is really one of law and not of fact. It is whether a payment made by A on behalf of C to B (which B is to retain as a gift or as in discharge of some obligation owed him by C) is a payment by A to C within the meaning of Sub-section (1). As the learned Master of the Rolls observes, this question is largely one of first impression. Differing from him with great respect, I would answer it in the negative. A man who pays his creditor does not pay himself, and if his agent discharges the debt on his behalf the position in this respect surely remains the same. I think the natural meaning of the words "paid . . . to the settlor" signifies a payment that goes to the settlor, not one that goes away from him, and I see no good reason, either within Section 40 or without it, for substituting something else for the natural meaning. It was said for the Crown that it was no straining of language, where A paid a sum to B at C's request and for C's benefit, tc say that A had paid C. I cannot agree; the person paid is B and no one else, and the consideration that the payment is advantageous to C seems to me beside the point so far as concerns the construction of the material words. It was also urged that to hold against this last submission would be to make Section 40 so easy to circumvent that it would be useless for its purpose. That purpose, doubtless, was to prevent or discourage certain forms of tax evasion. But the Section attempts this in a manner which may work great harm to innocent people, as by inflicting tax on the grossed-up amount of a loan so temporary that it might only be till the banks opened, or of a loan genuinely borrowed and as genuinely repaid to the settlor. Tax evasion often places the draftsman in great difficulty and it may not always be possible to avoid hurting the guiltless. But Section 40 seems capable of involving straightforward transactions to such a considerable extent that a decision which may encourage the substitution of something better need not be a matter for regret.

I would hold, then, that no capital sum was paid to the settlor within the meaning of Sub-section (1), and for that reason I would allow the appeal and restore the order of Singleton, J.

Questions put:

That the Order appealed from be reversed.

The Contents have it

That the judgment of Singleton, J., be restored, and that the Respondents do pay to the Appellants their costs here and in the Court of Appeal.

The Contents have it

Mr. Miller.—My Lords, there is the question of interest outstanding on the tax paid. We have paid a very considerable sum of tax on account of this debt, and under your Lordships' judgment I apprehend that that tax will be repaid. I have to ask your Lordships for an Order that interest be paid on the tax which has been paid to the Crown.

Lord Simonds.—Mr. Hills, what do you say to that? Is there a practice in this matter?

Mr. Hills.—My Lords, I should have thought that it was not necessary for your Lordships to embody that in your Lordships' Order. It will follow as a result of the statutory direction.

Lord Simonds.—Is there a statutory direction?

Mr. Miller.—Yes, my Lord.

Mr. Hills.—Yes, my Lord.

Lord Simonds.—Then upon that statement by Mr. Hills it will not be necessary for us to embody it in the Order.

Lord Morton of Henryton.—The interest to be repaid is simply the same rate as has been paid. The total amount paid is to be repaid.

Mr. Hills.—We have had the tax.

Mr. Miller.—The amount paid and interest.

Mr. Hills.—There will have to be, I suppose, additional interest for the time during which this tax has been in the hands of the Crown, but with great respect I do not think it is necessary for your Lordships to determine that; it will involve complications in your Lordships' Order, and your Lordships may be sure that your Lordships' desire will be carried out by the Revenue authorities.

Lord Simonds.—You can rest on that, I think.

Mr. Miller.—I am quite content with that, my Lord.

[Solicitors:—Allen & Overy; Solicitor of Inland Revenue.]