HIGH COURT OF JUSTICE (CHANCERY DIVISION)—7 AND 8 APRIL 1987 A

COURT OF APPEAL—15, 16, 20 AND 21 JUNE and 28 JULY 1988.

HOUSE OF LORDS—8, 9, 10, 11 MAY and 8 JUNE 1989

Beauchamp (H.M. Inspector of Taxes) *v.* F.W. Woolworth plc.[1] B

Co-operation tax—Exchange losses incurred in repayment of foreign loans—Whether loans on capital or revenue account—Whether losses allowable deductions in computing profits—Income and Corporation Taxes Act 1970, *s* 130(*f*).

In 1971 F.W. Woolworth plc ("the company") raised from a consortium C of Swiss banks a loan of 50 million Swiss francs carrying interest at 7 per cent. repayable at par after five years or earlier at the company's option on payment of a premium. A further loan of the same amount carrying interest at 6 per cent. and also for a period of five years was raised in 1972. Both loans took the form of the issue and sale by the company to the Swiss banks of bearer notes. The exchange control rules then in force provided that consent D to such a borrowing would be granted only if the loan was outstanding for a minimum period of five years. The first loan was repaid six months early in 1976 with the consent of the Bank of England. The second loan was repaid on the due date. In each case the company converted the loan proceeds into sterling and used the money for the general purposes of its business. For repayment it bought Swiss francs out of its general funds. The exchange E transactions gave rise to losses of about £11.4m.

Before the Special Commissioners the company contended that the losses were deductible in computing its profits for corporation tax purposes as arising on revenue account. The Special Commissioners found that the purpose of the loans was to tide the company over a short-term cash flow problem and so represented temporary facilities rather than a permanent F addition to its capital. Thus the losses arising therefrom were not on capital account and were deductions in computing the profits of the company not prohibited by the effect of s 130(*f*) of the Income and Corporation Taxes Act 1970. The Crown appealed.

The Chancery Division, allowing the Crown's appeal, held that the Commissioners misdirected themselves in attaching importance to the G purpose of the loans and what the company was seeking to do rather than what it had actually done. The loans were fixed in amount and term and were for substantial periods. They could not reasonably be regarded as anything

(1) Reported (ChD) [1987] STC 279; (CA) [1989] 1 WLR 50; [1988] STC 714; 132 SJ 1431; (H/L) [1989] STC 510; 133 SJ 850.

A other than accretions to the company's capital as distinct from a mere temporary accommodation. It followed that the exchange losses incurred in repayment of the loans were not deductible in computing the company's profits. The company appealed.

The Court of Appeal, allowing the company's appeal, held that the question whether the exchange losses were deductible depended on general B principles, i.e. whether the loans were revenue transactions, as being a means of fluctuating and temporary accommodation, or an accretion to capital, which the authorities showed (and the parties before the Commissioners had asked to be treated) as a question of fact; and it was impossible to say that the facts found by the Commissioners were such that no person acting judicially and properly instructed as to the relevant law could have come to the C conclusion which they did. The Crown appealed.

Held, by the House of Lords, allowing the Crown's appeal, that:

(1) The weight of authority supported the view that the question whether the loan transactions were of a revenue or capital nature was a question of law to be determined in the light of the facts found by the Commissioners.

D Dicta in *Jeffrey* v. *Rolls-Royce Ltd.* 40 TC 443 at p 490; *Strick* v. *Regent Oil Co., Ltd.* 43 TC 1 at pp 29–30, *Commissioners of Inland Revenue* v. *Carron Co.* 45 TC 18 at p 73 and *Tucker* v. *Granada Motorway Services Ltd.* 53 TC 92 at pp 109 and 112 followed; dicta in *British Insulated & Helsby Cables, Ltd.* v. *Atherton* 10 TC 155 at p 192 and *The European Investment Trust Co., Ltd.* v. *Jackson* 18 TC 1 at p 13 disapproved.

E (2) A loan was only a revenue transaction if it was temporary and fluctuating and incurred in meeting the ordinary running expenses of the taxpayer's trade.

The Scottish North American Trust, Ltd., v. *Farmer* 5 TC 693 and *Vallambrosa Rubber Co., Ltd.* v. *Farmer* 5 TC 529 applied.

(3) The borrowing of a definite sum for a fixed term of 5 years was not F part of the taxpayer's day-to-day activities in earning profits but an increase of its capital, and the exchange loss incurred in connection with it was accordingly not allowable.

Strick v. *Regent Oil Co., Ltd.* distinguished.

CASE

G Stated under the Taxes Management Act 1970 s 56 by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. On 20 to 23 July 1981 the Commissioners for the Special Purposes of the Income Tax Acts heard appeals by F.W. Woolworth plc (hereinafter

called "the Company") against assessments to corporation tax for the accounting periods ended: A

		£
31/12/1973	–	200,000
31/ 1/1974	–	20,000
31/ 1/1975	–	18m
31/ 1/1976	–	23m
31/ 1/1977	–	17m
31/ 1/1978	–	20m (main assessment)
		20m (further assessment)

B

2. Shortly stated the questions for our decision were (1) whether in computing its profits for corporation tax purposes, the Company was entitled to deduct the amount of losses on foreign exchange incurred in connection with the repayment of loans which it had obtained in foreign currency and (2) if so, whether those losses should be allowed on an "accrued" or a "realised" basis. C

3. The following witnesses gave evidence before us:

Mr. C.M. Beddow	–	the Company's Finance Director from 1969 to March 1973
Mr. G.C. Seligman	–	a director of S.G. Warburg & Co. Ltd., merchant bankers
Mr. C.J. Stronge	–	a partner in Messrs. Deloitte Haskins & Sells, chartered accountants
Mr. J.R. Baker	–	a partner in Messrs. Ernst & Whinney, chartered accountants
Mr. G. Miller	–	Senior Principal Advisory Accountant to the Board of Inland Revenue

D E

The following documents were put in evidence—

Bundle 1	–	Agreed Statement of Facts
Bundle 2	–	Documents referred to in the Statement of Facts
Bundle 3	–	the Company's Annual Reports and Accounts for the year ended 31 December 1970 to the year ended 31 January 1978 inclusive
Bundle 4	–	Extracts from Minutes of Board and Executive Committee Meetings
Bundle 5	–	Proofs of Evidence of Mr. Seligman, Mr. Stronge, Mr. Baker and Mr. Miller

F G

Extract from The Times newspaper of 15 July 1981

"The World's Currency Casino" by Lord Lever.

Copies of those documents are available to the Court if required.

5. At the close of the hearing we reserved our decision and gave it in writing on 19 November 1981, allowing the Company's appeals in principle. H

A Our written Decision set out the facts which seemed to us material to the issues before us, the contentions of the parties and the reasons for our conclusions. A copy of that Decision, into which I have inserted some additional facts at the request of one or other of the parties, is annexed to and forms part of this Case.

6. The following cases were cited in argument in addition to those B referred to in our Decision:—*Anglo-Continental Guano Works* v. *Bell* 3 TC 239; *Commissioners of Inland Revenue* v. *Pullman Car Company Ltd.*(1) 35 TC 221; *Owen* v. *Southern Railway of Peru Ltd.*(2) 36 TC 602.

7. Agreed figures to give effect to our decision in principle were not reported until 5 September 1983. In the meantime Mr. H.H. Monroe Q.C., with whom I heard the appeals, had died. On 14 September 1983 I C determined the appeals by adjusting the assessments in accordance with the agreed figures as follows:

			£
Accounting Period to	31/12/73	Reduced To	33,359
	31/1/74	" "	2,101
D	31/1/75	" "	14,091,485
	31/1/76	" "	17,120,069
	31/1/77	Increased To	17,435,652
	31/1/78	Confirmed At	20,000,000
	31/1/78	And Reduced To	10,804,419

8. The Appellant immediately after the determination of the appeals E declared his dissatisfaction therewith as being erroneous in point of law and on 13 October 1983 required me to state a case for the opinion of the High Court pursuant to the Taxes Management Act 1970 s 56 which Case I have stated and do sign accordingly.

9. The question of law for the opinion of the Court is whether, on the facts found, we erred in law in holding that the Company's exchange losses F were to be treated as revenue expenses of its trade.

R.H. Widdows } Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House
98 High Holborn
London WC1V 6LQ

G 21 October 1985

Decision

1. The issue in this case is whether, in computing its profits for Corporation Tax purposes, the Appellant Company can deduct certain losses which it incurred in connection with the repayment of foreign loans by reason of the fall in the value of sterling against other currencies, in particular the

(1) [1954] 1 WLR 1029. (2) [1957] AC 334.

Swiss franc. This issue turns on whether the loans in question represented long-term, or permanent borrowing to provide resources with which to extend the Company's trade or merely temporary facilities obtained for ordinary trading purposes in the course of the Company's trade. It arises on appeals against assessments for accounting periods covering the years 1973 to 1978 inclusive, the details of which are not material to this Decision. A

Facts B

2. The transactions out of which the losses arose are described in an Agreed Statement of Facts which was put before us with supporting documents. For present purposes they can sufficiently be summarised as follows:

(i) The Company, a publicly quoted company, was at all material times a subsidiary of an American corporation which owned 52.7 per cent. of its issued share capital and was resident for Exchange Control purposes in the Scheduled Territories. It runs a well known chain of retail shops selling a variety of goods throughout the United Kingdom. On 23 June 1971 the Company raised from a consortium of Swiss banks a loan of 50 million Swiss francs carrying interest at 7 per cent. repayable at par after 5 years or earlier, at the Company's option, on payment of a premium ("the first loan"). A further loan of the same amount, but carrying interest at 6 per cent., ("the second loan") was raised in February 1972. C D

(ii) Both loans took the form of the issue and sale by the Company to the Swiss banks of Bearer Notes, under the terms of two Note Purchase and Paying Agency Agreements. (In the case of the first loan the documents which were in evidence included a Note of Swiss Francs 50 million dated 23 June which recorded that the Company owed that sum to two Swiss Banks and in the case of the second loan a similar Note dated 11 February 1972 recorded that the Company owed a similar sum to three Swiss Banks. The preamble to both Note Purchase and Paying Agency Agreements stated that the proceeds were to be "utilised wholly for the purposes of activities of the Company's trade". There was no evidence of the extent, if any, to which the loans were "placed" with clients of the Banks. In the Notes to the Company's balance sheets the loans were described as "Swiss Bank Notes (Swiss Francs 50,000,000"). E F

(iii) The exchange rate was 9.91 Swiss francs to the pound when the first loan was negotiated and 10.04 Swiss francs to the pound when the second loan was negotiated. G

(iv) At the relevant times the following Exchange Control rules were in force:

(a) Under Exchange Control Notice 4 (3rd issue dated 2/5/68) the general rule was that the non-resident shareholders' stake in a United Kingdom Company (by way of equity, loan finance reserves and unremitted profits) had to be maintained to cover the non-resident shareholders' pro rata share of fixed assets. H

(b) Under Exchange Control Notice 66 (dated 12/1/71) consent would be granted for a foreign currency borrowing by a company resident in the Scheduled Territories only if the loan was outstanding for

A a minimum period of 5 years, reduced to 2 years by Supplement No. 2 to that Notice dated 19/10/73 for loans raised after that date.

(c) Under Exchange Control Notice 54 (issued on 24/11/70) a contract for the forward purchase of foreign currency could only be made with a maturity date not later than 6 months after the forward contract was entered into.

B (v) Before each Swiss loan was raised the Company obtained consent from the Bank of England under the Exchange Control legislation for the initial borrowing in Swiss francs and for its subsequent repayment (in that currency—see EC54 and 66). A condition was imposed that if repayment should be made in less than five years in either case or if, whenever made, repayment would reduce the Company's non-resident finance below the level C which the Bank of England thought acceptable for companies in foreign ownership, the Company might be required to refinance the borrowing from other foreign sources.

(vi) When the money was received it was immediately converted into sterling and became available for use regularly in the Company's business in the United Kingdom.

D (vii) In March 1975 the Company asked the Bank of England for consent to repay both loans at once or, alternatively, to make forward contracts for the purchase of sufficient Swiss francs to pay off the loans on maturity; but such consent was refused. However in April 1975 the Bank of England indicated that consent might be given to refinancing the loans with fresh foreign loans repayable on the maturity dates of the original loans.

E (viii) Subsequently consent was obtained to repayment of the first loan six months early—that is to say in January 1976—with funds raised by a new foreign loan which was itself repayable on 25 June 1976 with foreign currency bought forward. (The forward purchase was only for 6 months pursuant to EC54). In pursuance of that consent a Canadian dollar loan was raised and the proceeds used to purchase 50 million Swiss francs with which to repay the F first loan on 16 January 1976. Canadian dollars were bought forward to repay the Canadian loan, with interest, on 23 June 1976; and on that date the Canadian loan was repaid. The loss incurred on repayment of the first loan was £4,392,892 which arose solely from the fall in the value of sterling between 1971 and 1976.

(ix) The second loan, with outstanding interest, was repaid on the due G date, 15 February 1977 with Swiss francs purchased 6 months forward with Bank of England permission on 16 August 1976 (again see EC54). The loss on the repayment of the second loan was £7,007,726 which again arose from the fall in the value of sterling during the term of the loan.

(x) In the Company's Balance Sheets each loan was shown as a non-current liability under the heading "Loans" until the time when it became H repayable within twelve months of the Balance Sheet date. It then appeared as a current liability and finally disappeared on repayment. In the Balance Sheets as at 31 December 1971, 31 December 1972, 31 January 1974 and 31 January 1975 the amount of such loan was expressed in sterling by translations at the historical rate of exchange obtaining at the time when it was taken out. In its Balance Sheets as at 31 January 1976 and 31 January I 1977 the Company adopted a general policy of translating foreign currency assets and liabilities into sterling at the rates obtaining on the Balance Sheet dates.

(xi) In the Company's successive accounts provision was made for exchange fluctuations arising in respect of the Swiss Loans. For the year to 31 December 1972 and the period of thirteen months to 31 January 1974 such provision was charged to capital reserves. For the years ended 31 January 1975, 1976 and 1977 the provision was charged to profit and loss account as part of an extraordinary item in each year but no tax deduction was claimed. The policy was explained in notes to the accounts.

(xii) The fluctuations in the Swiss franc/sterling exchange rate are shown on a schedule annexed to this Decision as an Appendix(1), which also shows the corresponding increase in the cost of repaying the loans for each period of accounts, alongside the amounts actually dealt with in the Company's accounts.

3. We heard evidence from Mr. C.M. Beddow who was Finance Director of the Company from 1969 until he resigned in March 1973. From his evidence and from the Minutes of certain Board and Executive Committee meetings of the Company and the Company's accounts we find the following further facts:

(i) On 8 December 1970 Mr. Beddow reported to the Board that a recent review of the Capital Budget had shown that the requirements for 1971 exceeded the cash flow by £7½ million. As it was considered that there was no need for permanent finance the means of obtaining the additional funds could be by reduction in stockholding, property sale and lease back or bank accommodation. In discussion there was agreement that the problem was short term as stock levels were expected to be reduced by what was called a new merchandising system recently introduced. Sale and lease back possibilities to produce £4 million were also to be investigated.

(ii) On 15 April 1971 the Board again discussed the problem of financing the Company's commitments, in particular to capital expenditure, having regard to the decline in the Company's cash flow then reported. The possibility of making an issue of Euro Dollar Bonds had been discussed with the Company's Merchant Bankers. That possibility was not pursued. The possibility of a Rights Issue was also considered and rejected. It was explained to the Board that the Company's immediate future short term requirements could, if necessary, be covered by Bank facilities. The sale and lease back possibility was also again mentioned.

(iii) On 8 June 1971 the Board decided that arrangements should be made forthwith to effect a private borrowing in Switzerland of 50,000,000 Swiss Francs (approximately £5 million) for a five year period. The final arrangements were approved at a Board Meeting on 22 June 1971. At that meeting Mr. Beddow reported that the Swiss loan would not entirely satisfy the Company's need for money. Because of capital commitments in excess of anticipated cash flow the full requirement would be of the order of £10 million. He had discussed with National Westminster Bank the possibility of borrowing £5 million for a term of five years. At a later stage this suggestion was pursued. Meanwhile the Board favoured the property sale and lease back method of raising money, in view of the use to which the borrowed funds were to be put, as representing a redeployment of assets.

(iv) Mr. Beddow explained in evidence that the Company required increased working capital for a great variety of reasons. The need for finance would largely depend upon the fluctuation of cash balance, which in turn depended upon the state of trading and stock levels. The Company was, for example, engaged in an extensive modernisation programme involving the

(1) Not included in the present print.

A repair, refurbishing and enlargement of premises. It was intended to finance this programme and the Company's other requirements out of the cash flow generated by the Company's normal trading activities. The inadequacy of the cash flow was largely caused by faulty stock control. With the Company's annual turnover in excess of £300 million a £5 million loan represented no more than a week's turnover, and with stock at £54 million Mr Beddow hoped B within a short time to recover the amount of the loan by a 10 per cent. reduction in stock held. He did not himself regard the £5 million loan as anything other than a temporary facility. Mr Beddow considered that long-term borrowing, which he said would have been for a substantial sum well in excess of £5 million, was not required at the time. (It would be inappropriate for a Company of this size to borrow such a modest amount of C long-term money). As appears from the Board Minutes, he continually stressed to his colleagues the need to secure an adequate return on new projects and to generate a greater cash flow in due course to pay off the Company's borrowings. The decision to borrow abroad was taken partly because the Bank of England required the Company, as it was 52.7 per cent. foreign owned, to obtain the equivalent percentage of its funds abroad (and D the Company did not wish to approach the Bank for any special favours if that could be avoided), partly because a foreign loan was attractive in that interest rates would be lower than on a United Kingdom borrowing, and partly because no additional burden would be put on the Company's overdraft facilities in the United Kingdom which would continue to be available to cushion temporary fluctuations in the cash position. That the foreign E borrowing had to be for a minimum five-year period was a Bank of England requirement. The risk of exchange fluctuations was noted but was accepted since sterling was comparatively stable at that time.

(v) At a Board Meeting on 18 August 1971 the Chairman said that the latest appraisal showed that capital requirements during 1971 could exceed £20 million and only half that sum had been covered in the borrowing F arrangements to date. He recommended that authority be given for immediate funding of a further £5 million on a reasonable term basis. The Board authorised Mr. Beddow to pursue negotiations for a loan of £5 million, and agreed that a borrowing in England and in all probability from the Company's Bankers was to be preferred to a borrowing abroad in the present volatile situation. At a Board Meeting on 23 September 1971 it was resolved G that the Company borrow £5 million from National Westminster Bank for a period of 5 years.

(vi) At a Board Meeting on 9 December 1971 Mr. Beddow again reviewed the Company's cash position. Apparently at that date stock levels were still high. Mr. Beddow commented that with the borrowings already made—which included the first Swiss loan and the five-year loan from H National Westminster Bank—together with £4 million awaited from sale and lease back transactions, the Company would finish the year with net current assets approximately level with 1970. The £4 million would provide cover for the higher stocks and the slightly adverse trading position compared with the budget set at the beginning of the year. Mr. Beddow went on to report on source and disposition of funds by reference to actual 1970 figures and I estimates for 1971 and 1972. Broadly speaking the figures indicated that there would not be a need to effect further borrowing in 1972 to meet the programmes proposed. On the other hand, with money rates at their present low levels and in the certain knowledge that the Company would need further finance in the future, it was suggested that proposals should be sought for a

further borrowing for the Board's consideration in the New Year. This was agreed. A

(vii) On 14 January 1972 a special meeting of the Board was convened at short notice to discuss the Company's cash position and it was reported that the stockholding was considerably in excess of earlier estimates. The much reduced balance on deposit with the bank reflected that position. It was decided that, in the changed financial circumstances of the Company, further borrowing was prudent and after discussion the Board decided that a further loan of 50 million Swiss francs should be taken out. The merchant bankers advising the Company had concluded that borrowing in Switzerland could offer the Company the best terms and interest rates would be keener than those in the UK. That was the background to the second loan which was arranged immediately after that meeting. B C

4. Mr. G.C. Seligman, a director and former Joint Chairman of the merchant bankers S. G. Warburg & Co. Ltd. and Deputy Chairman of that company's parent company, said in evidence that there had been a complete change in the economic climate in recent years. The pre-war stability of foreign currencies no longer existed. Until the 1970s gains and losses due to exchange fluctuations were infrequent and borrowers did not normally budget for this eventuality. The importance of exchange risks had however grown in recent years and they were now a major consideration in all financial planning. Exchange risks were now regarded as an integral part of the cost of borrowing in a foreign currency and constituted a major factor in determining the currency in which to borrow, together with the rates of interest available. He knew of no yardstick by which a loan could be categorised. He considered that even a short term loan could form part of the capital employed by a company; but again there was no consensus of opinion as to what was meant by capital base or capital employed in a company. To him all monies available for a company's use were capital employed in the business and he would describe this Company's borrowings in Swiss francs as part of its working capital. He considered that fluctuations in currency must be taken into account when assessing the results of a company with foreign assets or liabilities in order to determine its general trading profitability, by which he meant the profitability of its current transactions. We accepted Mr. Seligman's evidence insofar as it was factual and we took account of his opinions when reaching the decision set out below. D E F

5. We heard expert evidence from three Chartered Accountants. Mr. C. J. Stronge, a partner in Messrs. Deloitte Haskins & Sells of Queen Victoria Street, London, who is a member of the Accounting Standards Committee ("ASC") and Mr. J. R. Baker, a partner in Messrs. Ernst & Whinney who are the Company's auditors, gave evidence for the Company; and Mr. G. Miller, the Senior Principal Advisory Accountant to the Board of Inland Revenue gave evidence for the Revenue. G H

6. Mr. Stronge said that the proper treatment of foreign currency transactions had been on the agenda of the ASC for a long while but there was as yet no accounting standard which had to be followed. In general, the ASC thought it right to limit the items which could be charged directly to reserves and required the profit and loss account to reflect all profits and losses of the year. That was laid down in 1974 in a statement of standard accounting practice (SSAP6) which acknowledged that the accounting treatment of foreign currency transactions at a time of frequent movement of currency exchange rates posed many problems. Pending the issue of a I

A standard, the accounting policies adopted should be disclosed and explained in the accounts. The ASC had issued "exposure drafts" on this subject in 1975, 1977 and October 1980, in all of which it had proposed that gains or losses on foreign currency borrowings in circumstances similar to those of the present case should be dealt with through the profit and loss account. In each of those drafts foreign borrowings were to be translated at the rate ruling at B the Balance Sheet date so that unrealised gains and losses would be recognised and not deferred until realisation.

7. Mr. Stronge also told us that before the ASC was set up the Council of the Institute of Chartered Accountants of England and Wales had made certain recommendations for the guidance of its members and one in particular issued in 1968 related to "The accounting treatment of major C changes in the sterling parity of overseas currencies". These recommendations were, he said, made in the days of fixed parities and only occasional revaluations to deal with sudden, significant and evidently permanent adjustments outside the normal run of exchange fluctuations. Paragraph 11 of that document read:

> "Exceptional gains or losses which may be regarded as not of a D revenue nature, such as those relating to long term loans granted or received, may be shown in the profit and loss account or dealt with by direct transfer to or from reserve according to which method will better present a true and fair view, as suggested in Paragraph 3 above. Where there are both gains and losses of other than a revenue nature, they are off-set in the first instance."

E Paragraph 3 of that recommendation considered the circumstances in which it would be better to enter such gains or losses in the profit and loss account either in the computation of profit or loss or as an exceptional item shown separately after the profit after taxation or when it would be more appropriate to make a direct transfer to or from reserve.

8. In Mr. Stronge's opinion the Appellant Company's accounting F treatment of losses on Swiss loans for 1975, 1976 and 1977 was broadly in line with the ASC's draft proposals in that the losses were dealt with through the profit and loss account. It was arguable that they could properly have been dealt with as ordinary, rather than as extraordinary, items given that raising finance was part of the Company's activities and exchange fluctuations had become increasingly commonplace by 1975, but that was not significant. The G treatment in the previous two years, that is to say the making of a provision by a charge to capital reserves, was also acceptable and understandable practice at that time and it had the advantage of maximising trading results which would be attractive to a trading company. The current accounting view is that in similar circumstances exchange losses are revenue items and Mr. Stronge agrees. He considers that, where a company borrows foreign money for H general use in its business, exchange losses are similar in nature to interest as far as the borrower is concerned and should be treated as revenue items chargeable to the profit and loss account in order to give a true view of the trader's profitability. Asked about the term "capital base" Mr. Stronge found it difficult to give any real meaning to that term and to decide which liabilities constituted it.

I 9. Mr. J.R. Baker worked as an audit partner on the audit of the Company's accounts throughout the relevant period although he was not the partner in charge of the audit until 1979. As to the Balance Sheet treatment of

the Swiss loans he thought it generally accepted accounting practice that a liability which is not repayable within twelve months should be treated as a non-current liability. He did not consider that the purpose for which the loans were used should affect the matter at all since the treatment depended solely upon the time of repayment. As to the treatment of the loans in the accounts, he had found that the Company had dealt with them through reserves in the periods down to 31 January 1974 and, since that treatment was regarded by the profession as acceptable at that time, his firm had agreed to it. In the consolidated accounts for the year ended 31 January 1974, exchange differences arising on translation of the accounts of overseas subsidiaries were dealt with in the same way as the Swiss Loans through capital reserves. The differences arising on translation of all assets and liabilities, both fixed and current, were so treated. The accounts for the year ended 31 January 1975 were made up in the light of SSAP6 and treated the provisions for exchange losses as extraordinary items, but this did not imply that they were capital rather than revenue items because the accountancy division of ordinary items and extraordinary items did not coincide with the taxation distinction between revenue and capital items. The current view was that exchange gains and losses in the context of a company's operations should ultimately be reflected in cash flows, so that all such differences would be regarded as part of the profit and loss for the year either as extraordinary or ordinary items. In the present economic circumstances, exchange fluctuations having become much more common, the view might be taken that similar loans taken out by this Company should be accounted for as part of the ordinary trading activities of the Company. Mr. Baker added that the Company was also required to make up its accounts according to American principles for the purposes of its US parent. On this basis for each of the years in question the exchange losses were charged to the profit and loss account. In view of all the circumstances Mr. Baker did not consider that the accounting treatment of the Swiss Loans in the first two years could properly be taken as establishing their nature for taxation purposes.

10. Mr. G. Miller is a member of the Institute of Chartered Accountants for Scotland who qualified in 1952 and, apart from two years Army service, was in professional practice from then until 1971 when he joined the Inland Revenue. In his opinion the Company's Balance Sheets followed good accountancy practice in showing loans along with capital and reserves, thus showing how the loans have been used as if they were part of the shareholders' interest. It was good sense for shareholders to have capital other than their own as part of the permanent capital of their company so long as the earnings on that loan capital were higher than the cost in terms of interest, etc; such indebtedness could form part of the capital with which the company traded. He emphasised that a company which wishes to obtain further capital to finance expansion can either find the money from its own resources (e.g. from retained profits or the sale of a fixed asset, as the Company had done in the past through the sale and leaseback of properties) or it could issue further shares for subscription or obtain a medium or long term loan. He would regard a short term loan as one which was required for a short time to assist the business over a temporary short term problem. The Company's accounts showed that it had pursued a policy of modernising its stores from the mid 1960s and the capital had been found in several of those ways. At 31 December 1970 it had commitment to capital expenditure of 12.25 million pounds but its net current assets had fallen to 5.6 million and its retained profits had also fallen. It therefore had to ensure that liquid funds were available to meet its capital expenditure and maintain liquidity for trading purposes. At 31 December 1971 it had, he said, a capital shortfall of

A £11 million and covered this by raising the first Swiss Loan of about £5 million and a loan from the National Westminster Bank also of £5 million. At 31 December 1972 the second Swiss Loan had been taken out giving a total of loans (at historic cost) of £15 million. The net current assets at that date were nearly £18 million. Further expenditure had been incurred on fixed assets in that year but the retained profits were much higher than in previous years and B it was clear, with hindsight, that the Company did not need the second Swiss Loan although this would not have been clear when it was negotiated in January 1972. Mr. Miller considered that both loans were part of the Company's permanent capital structure. The fact that the loans took a form which prevented the holders from demanding repayment within five years in normal circumstances put that beyond doubt, in his opinion. The Notes were C finance of a capital nature and accordingly any sterling profit or loss arising on translating and eventually repaying them represented a profit or loss on capital account which had to be excluded from the income tax computations.

11. So far as Mr. Miller's evidence dealt with matters of fact we accept it as wholly accurate. We also found helpful and relevant his description of a short term loan as one required to assist a business over a temporary short D term problem. In expressing the opinion, however, that the Swiss Loans were part of the Company's permanent capital structure, Mr. Miller seems to us to stray beyond accountancy into the realm of law. Moreover he bases his opinion, apparently, on the documentation and on the circumstance that the loans were in each case for a term of five years. As to the documentation, there was no evidence before us, one way or the other, as to whether the form E of the loans was the usual way of setting up a borrowing from Swiss banks or represented something more "permanent"; and as to the term of the loans, the evidence was that this was an Exchange Control requirement rather than what the Company wanted.

Contentions

12. The contentions advanced by Mr. M. Nolan Q.C. on behalf of the F Company were that:

(i) While there was no single, infallible test and the courts can do little more than form an opinion as to where the balance lies, the decided cases suggested that, in considering whether a transaction was on capital or revenue account, attention should be directed in particular to:

(a) The durability or enduring nature of the advantage sought G by it—*Strick* v. *Regent Oil Co Ltd.*(1) 43 TC 1 and *BP Australia Ltd* v. *Commissioner for Taxation* [1966] AC 224, in which it was acknowledged that a five year tie could be a transaction of a revenue character.

(b) The size of the sum involved in relation to the overall circumstances of the trade—*Van Den Berghs Ltd.* v. *Clark*(2) 19 TC H 390.

(c) Whether the advantage sought was of a fixed or fluctuating nature in the context of the trade.

(d) Whether it resulted in the creation or improvement of an identifiable asset—*Tucker* v. *Granada Motorway Services Ltd.*(3) [1979] 1 WLR 683.

(1) [1966] AC 295. (2) [1935] AC 431. (3) 53 TC 92.

(ii) The circumstances of the present case were that the Company, which had been trading for many years, found itself with a temporary shortage of cash and needed money to maintain its liquidity for the purpose of carrying on its day to day business. It raised loans from Swiss sources because its overdraft with its bank in England was already large enough and Swiss loans had advantages in lower rates of interest, although they involved a risk of deterioration in the exchange rate. On each occasion the loan was of a sum amounting to no more than one week's turnover and was immediately converted into sterling and put into the common pool. The five year term was dictated by the Bank of England's requirements. At the end of the 5 years the loans were not replaced by anything other than overdraft facilities. There was no identifiable asset involved in the transaction and nothing of a capital nature at all.

(iii) The borrowing was, in its nature, akin to the obtaining of overdraft facilities rather than the raising of fresh capital and should be regarded as a transaction entirely on revenue account. The facts should be contrasted with those in *Pattison* v. *Marine Midland Ltd.*(1) [1981] 3 WLR 673 in which the loan was said to have "all the characteristics of preference share capital".

(iv) Whether or not the borrowing was on revenue account the risk that fluctuations in the rate of exchange through the currency of the loan might involve the Company in loss was a matter on revenue account, just like the payment of interest. That view accorded with the evidence of Mr. Seligman as to the commercial realities of the matter and of the witnesses as to accountancy practice; and there was no reason why treatment for tax purposes should depart from commercial and accountancy principles.

(v) The exchange loss was accordingly allowable for tax purposes either as an accrued loss year by year on the basis of the annual translation of the value of the loan in the Balance Sheet or alternatively as a realised loss in the year in which each loan was repaid. That point might be debatable but the realised loss basis was to the advantage of the Company in this case and Mr. Nolan contended for that basis as the first choice.

13. The Inland Revenue's contentions, advanced by Mr. R.S. Waterson of the Inland Revenue Solicitor's Office, were:—

(1) The first question being whether the borrowings were on capital or on revenue account, no guidance could be obtained from the cases relating to the acquisition of assets, such as *Strick* v. *Regent Oil* and *Tucker* v. *Granada Motorway Services Ltd.* The question is one of fact and degree.

(2) The answer to that question depends upon whether the indebtedness is incurred in the course of carrying on the trade or to provide finance with which to trade. The factors to be considered include:—

a. The length of the term; the distinction being between mere temporary accommodation and borrowing which has some degree of permanence: *Scottish North American Trust* v. *Farmer*(2) 5 TC 693 and *Ward* v. *Anglo-American Oil Co. Ltd.* 19 TC 94 at pages 106 to 108.

(1) 57 TC 219. (2) [1912] AC 118.

A b. The formality with which the borrowing is made.

c. The nature of the trade; since anything more formal than an overdraft is unlikely to be on revenue account unless the trade is of a financial character which includes borrowing and lending money.

(3) If the borrowing is on capital account then the exchange loss incurred on repayment is non-deductible both on general principles and by reason of B s 130(f) of the Taxes Act.

In support of those propositions Mr. Waterson referred to *European Investment Trust Company Ltd.* v. *Jackson* 18 TC 1, *Ascot Gas Water Heaters Ltd.* v. *Duff* 24 TC 171, *E.J. Bridgwater* v. *King* 25 TC 385, *Davies* v. *Shell Company of China Ltd.* 32 TC 133 and the *Midland Marine* case, in addition to those referred to above.

C (4) The facts of this case pointed to the conclusion that the borrowings were on each occasion on capital account. The Company was short of cash for general use in its business both for capital projects, such as the improvement of its retail stores, and for day to day trading. It had a number of options open to it, including further sale and lease back transactions and extended overdraft facilities, but what it did was to take out medium term loans with D appropriate formalities. The five year term may have been adopted to meet the Bank of England's requirements but that did not affect the matter. The only material difference between this case and the *Marine Midland* case (in which the loans were said to have all the characteristics of share capital, being long term obligations to enable the company to start trading) was that this company had been trading for many years; but that was not a significant E matter when considering the point of principle.

(5) The exchange loss could not be regarded as analagous to a payment of interest: it was more akin to a premium on redemption of preference shares and was a matter on capital account.

(6) The evidence of the accountants amounted merely to the fact that the profession was still working out the proper treatment of exchange losses F for accountancy purposes; but the issue had to be decided on legal principles rather than accountancy practice.

(7) If, contrary to those submissions, there was an allowable deduction it should be made on the basis of a realised loss in the year of the payment and not of an accrued loss year by year at the translation figure.

Conclusion

G 14. We are satisfied on the evidence that the first Swiss loan was raised in June 1971 simply to provide the Company with money for the general purposes of its trade. This money together with the loan of £5 million from the National Westminster Bank made good a cash shortage estimated at £7½ million in December 1970 and at £10 million by June 1971. When the second loan was raised in January 1972 no particular shortage had been identified but H the cash flow resulting from the retail operations had proved disappointing and the circumstances were thought appropriate for a further borrowing for general purposes. Our understanding is that some of the money raised on each occasion went on meeting expenditure which for tax purposes would be classified as capital expenditure, such as enlargement or improvement of shop

premises, some on expenditure which would be deductible, such as the repair and refurbishing of shop premises, and the balance simply on meeting the day to day cash needs of the Company's business; but no significance appears to attach, in the circumstances of this case, to how the money was spent. Both parties accepted the proposition stated by Vinelott J. in the *Marine Midland* case [1981] 3WLR 673 at page 689([1]):— A

> "The most that can be extracted from [the decision in *Davies* v. *Shell Company of China Ltd.* 32 TC 133,] so far as relevant to this case, is that in a doubtful case the use made by a company of monies borrowed—whether the monies are embarked in the trade in the acquisition of current assets or otherwise, on the one hand, or are retained on deposit or invested or used in the acquisition of fixed assets, on the other hand—may throw some light on the borrowing. But if a borrowing is clearly stamped as a borrowing on capital account, as were the advances in *European Investment Trust Co. Ltd.* v. *Jackson* 18 TC 1 the fact that the monies borrowed are embarked in the trade in the purchase of the current assets becomes irrelevant." B C

On that basis neither party invited us to analyse closely the use made of the monies raised in this case. D

15. Nor do we think it necessary to examine the distinction between fixed and circulating capital, which may be relevant when items of expenditure are under consideration. Money raised by borrowing necessarily comes to the company as capital, as opposed to income, but the issue we have to decide is whether the borrowing took place in such circumstances that the borrowed monies are to be regarded as an addition to the Company's capital resources or whether the borrowing formed part of the day to day activities in the earning of profits in the business. That distinction emerges from the cases which were cited to us in relation to the deductibility of interest and commissions on borrowed money. E

16. In *Scottish North American Trust Ltd.* v. *Farmer* 5 TC 693, which related to interest payable on a fluctuating overdraft and on a six-month loan it was held that the borrowings were not sums employed as capital. At page 698 Lord Johnston in the Court of Session said:— F

> "It may be well said if money is borrowed on a permanent footing, as from year to year, the capital of the concern is in a commercial sense enlarged thereby and the business extended, whereas no commercial man would consider that his banking facilities were part of his capital or the consideration he paid for them anything but an expense of his business." G

and in the House of Lords Lord Atkinson after drawing attention to the fact that trading companies had implied power to borrow money for the purposes of their businesses even if their Memorandum and Articles of Association contained no express borrowing power, said at page 707:— H

> "These authorities show that money borrowed by such a company as the appellant company in this case in the fluctuating temporary manner in which it has been borrowed by them—the daily borrowing and lending of money being part of their trade and business—is not to be treated under the Joint Stock Companies Act as capital. There is nothing to show that that word should bear a different meaning in the Income Tax Acts when applied to the proceedings of joint stock companies." I

([1]) 57 TC 219 at p 245 A-C.

A 17. The same approach was adopted by Finlay J. in *European Investment Trust Company Ltd.* v. *Jackson* 18 TC 1, which also concerned a finance company. In his view (page 9) the real point in the case was whether the interest on fluctuating advances was a sum expended in order to earn profits. In principle (page 11) if a finance company obtained a temporary accommodation from its bank then the interest on that money could properly be B regarded as an expenditure of the business, an outgoing to earn the profits. He added:—

> "On the other hand if the truth of the thing is that by the payment of the interest the company does not obtain mere temporary accommodation, day to day accommodation of that sort, but does in truth add to its capital and gets sums which are used as capital and nothing else then I C think that in that case all the authorities show that that deduction cannot properly be made."

and, to the same effect, in *Ward* v. *Anglo American Oil Co. Ltd.* 19 TC 94 Singleton J. said at page 108:—

> "Interest on ordinary bankers' overdrafts which has arisen for ordinary trading purposes is a legitimate deduction, because it is money D wholly and exclusively laid out or expended for the purpose of trade. On the other hand, interest on an issue of notes, whether for one year or for a longer period, may fall and in the circumstances of this case does fall into an entirely different category. It seems to me to savour much more of a capital nature or of some fund employed or intended to be employed as capital and I do not think the issue of notes on which interest accrued E would be regarded by businessmen as of the same nature as facilities obtained for ordinary trading purposes."

18. That case concerned an ordinary trading company, not a finance company. *Ascot Gas Water Heaters Ltd.* v. *Duff* 24 TC 171 also concerned a trading company which obtained its raw materials on credit and was required to provide guarantees of its indebtedness. It also borrowed on the security of F mortgage debenture stock, which was guaranteed, and in respect of each type of borrowing it paid commission. The Special Commissioners held that the commission on the former guarantee was deductible and the commission on the latter was not. Lawrence J. affirming that decision said at page 176, after reviewing the authorities:—

> "The principle, therefore, which the Commissioners ought to have G applied in each of these cases was whether the sums in respect of which the commission dealt with in these two cases was payable, were sums which although capital were temporary in their nature and might be regarded as an ordinary incident of carrying on the business of the Company."

19. *Davies* v. *The Shell Company of China Ltd. (supra)* is nearer to the H present case on its facts in that it concerned profit made by a trading company on repaying deposits made in a foreign currency which had depreciated in value since the deposits were made. But the arguments and the judgments in that case concentrated upon the question whether the deposits had been used as fixed or circulating capital and therefore, like Vinelott J. in *Marine Midland*[1], we derive little assistance from it.

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(1) 57 TC 219.

20. In *Marine Midland* itself the loan stock was issued at or immediately before the commencement of the trade and was included in the original capitalisation plan some time before the Company was formed; it was subordinated to other creditors so that the stockholders came in after all other creditors but before shareholders; it was repayable after 10 years unless previously purchased and cancelled at the Company's option; it was issued with the formality of a deed poll; it was described in the balance sheet as loan capital and was included as part of the "total share and loan capital and reserves"; and it was described also in the Bank of England application as loan capital. Vinelott J. held that the Commissioners were entitled to find that it was part of the capital structure of the Company. In commercial terms the loan stock had all the characteristics of preference share capital. It represented a long term obligation entered into to raise monies which the company could employ to enable it to commence trading.

21. The Revenue concede that the Swiss loans in this case lacked most of the characteristics which caused the loan stock to be regarded as part of the capital structure of the business in *Marine Midland*. Their argument nevertheless is that the borrowing was on capital account because the Company, being a retail trader and not a finance company, had provided itself with funds with which to trade by means of a fixed term loan of medium length with some degree of formality. This was quite different from fluctuating overdraft facilities with a bank and was in a different category from the kind of temporary accommodation which had been held as a matter of commercial sense to be on revenue account in some of the cases.

22. We were invited by both parties to treat the issue as one of fact and degree to be determined in all the circumstances of the case and the authorities seem to us to support that approach. So regarded we do not find the issue an easy one to resolve; but on balance we conclude that the Company has made out its case to treat the exchange losses as revenue expenses.

23. In reaching that conclusion we do not attach great significance to the size of the sum involved. We accept that it was not a large sum in the context of the Company's business and that this was one of the reasons which led the Board to decide against raising the money by a "rights issue" through the Stock Exchange; but even in a business of this size £5 million is a substantial sum and it could well have been raised by means which would have impressed the borrowing with the quality of capital. The more significant fact is, in our opinion, that the Company was not seeking to add permanently to its capital structure but was dealing with what appeared to be a short-term problem of cash shortage. At the time of the first loan it was thought that the problem of cash flow could, for the future, be dealt with by improving the stock-keeping discipline of the store managers; and at the time of the second loan the need to borrow was prompted by disappointing trade results for the previous twelve months, a trend which the Board had every hope of reversing. The Company already had a substantial overdraft with its bankers and the decision to raise the money abroad was taken, after discussion with the Company's financial advisers, to take advantage of the lower interest rate obtainable overseas. It is also relevant that account had to be taken of the Bank of England's requirement as to the financing of companies under foreign control.

24. The fact that the loan was for a period of five years, with little prospect of the Company being able to obtain permission to pay it off before

A time, is perhaps the strongest factor in the Crown's argument that the borrowing had a permanence which places it on capital account; but in the circumstances we cannot regard it as decisive. We note that in the petrol company cases the fact that a tie was to last for a number of years was not in itself conclusive of the question whether payment for it was on revenue or capital account. As Lord Reid said in *Strick* v. *Regent Oil*(1) 43 TC 1 at page B 37:—

> "A business cannot simply be managed on a day to day basis. There must be arrangements for future supplies and sales and it may not be unreasonable to look five or six years ahead—one hears of five year plans in various connections. So I would think that making arrangements for the next five or six years could generally be regarded as an ordinary C incident of marketing and that the cost of making such arrangements would therefore be part of the ordinary running expenses of the business."

By the same reasoning it may be said that making arrangements to provide for a trader's "cash flow" for five years ahead is within the ordinary activities of running the business.

D 25. We accept Mr. Seligman's evidence that, in the economic climate of the 1970s exchange fluctuations on foreign borrowings should be considered from the commercial point of view to affect a trader's profitability. We also accept, from Mr. Stronge's and Mr. Baker's evidence, that it is good accountancy practice to reflect such gains and losses in the profit and loss account although there is not yet an accounting standard to be followed. We E understood Mr. Miller to disagree with that view only because he considered these loans to have a permanence which prevented them from being treated as short-term borrowing. Regard may be had to the views of businessmen and accountants on matters within their own fields in so far as they do not conflict with statutory provisions or legal principles and we see no conflict in that respect.

F 26. To summarise, we find the loans to have been loans arranged to tide the Company over a short-term problem namely the failure of the Company's trading activities to generate a sufficient cash flow to cover the Company's commitments and day to day needs. We find that more efficient stock control and better trading results were expected within a short time to solve the problem.

G On that basis we hold that the loans represented temporary facilities rather than permanent capital and we attach significance to the following circumstances:—

(1) that the 5 year term was a Bank of England requirement;

(2) that the formalities associated with the loans appear to have been dealt with as simply and accepted as readily by the Board of the Company as H might be the documentation required to secure a bank overdraft;

(3) that for accounting purposes the loans appear to have been placed in the same category as the 5 year £5 million loan from National Westminster Bank;

(4) that proposals for raising "permanent capital" were not pursued but the loans were regarded as adequate to meet the Company's needs;

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(1) [1966] AC 295 at p 324D.

(5) that the evident intention of the Company was to repay the loans out of profits generated in the course of the Company's trade; A

(6) that the loans were no part of the shareholders' funds and were not intended to provide additional funds with which to trade.

27. We therefore hold that the appeals succeed in principle and the exchange losses are allowable on the "realised" basis which is favoured by both sides. We adjourn the matter for one month for the parties to agree the figures on which our final determination of the appeals will be based. B

R.H. Widdows } Commissioners for the Special Purposes
H.H. Monroe } of the Income Tax Acts

Turnstile House
98 High Holborn
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19 November 1981

The case was heard in the Chancery Division before Hoffmann J. on 7 April 1987 when judgment was reserved. On 8 April 1987 judgment was given in favour of the Crown, with costs.

A Moses for the Crown. D

S.J.L. Oliver Q.C. and *W.G.S. Massey* for the Company.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Ascot Gas Water Heaters, Ltd.* v. *Duff* 24 TC 171; *Davies* v. *The Shell Company of China, Ltd.* 32 TC 133; *Tucker* v. *Granada Motorway Services Ltd.* 53 TC 92; [1979] 1 WLR 683; *E.J. Bridgewater* v. *King* 25 TC 385. E

Hoffmann J.:—This is an appeal by way of Case Stated from a decision of the Special Commissioners dated 19 November 1981. The issue is whether F. W. Woolworth plc (which I shall call "Woolworths") in computing its profits for corporation tax was entitled to deduct losses which had resulted from converting the proceeds of two Swiss franc loans into sterling and subsequently buying Swiss francs to repay the loans. The Special Commissioners held that the losses were deductible and the Crown appeals on the ground that the loans were additions to the capital which the company employed and therefore deduction of the losses was prohibited by s 130(*f*) of the Taxes Act 1970. F

The loans were each for 50 million Swiss francs and were constituted by the issue of bearer notes to the Swiss banks which lent the money. Each was for a term of five years repayable earlier at the option of Woolworths but subject to payment of a graduated premium. The first note was issued in June 1971 and carried interest at 7 per cent., and the second was issued in February G

A 1972 and carried interest at 6 per cent. The first loan was repaid in January 1976, six months before due date, and the second on due date in February 1977. In the case of each loan Woolworths converted the proceeds into sterling immediately upon receipt and used the money for the general purposes of its business. For the purposes of repayment it bought the Swiss francs out of its general funds. The exchange transactions gave rise to losses B of about £11.4 million.

The exchange losses are allowable as deductions only if the borrowings were themselves part of the Company's revenue transactions rather than accretions to the capital which it employed. An accretion to the Company's capital connotes some degree of permanence. Thus in *Scottish North American Trust, Ltd.* v. *Farmer* 5 TC 693, the Court of Session and the C House of Lords held that short-term banking facilities, described by Lord Johnston as "short in the sense that they were for short and indefinite periods, borrowed as occasion required, and repaid as opportunity permitted", were not additions to the Company's capital. The learned Judge contrasted such borrowings with a case in which "money is borrowed on a permanent footing, as from year to year, the capital of the concern is in a commercial sense D enlarged thereby, and the business extended". A similar distinction between "mere temporary accommodation" and sums which the company may be said to "add to its capital" is made by Finlay J. in *European Investment Trust Co. Ltd.* v. *Jackson* 18 TC 1, at page 12.

Now if one applies this distinction I think that these loans cannot reasonably be regarded as anything other than accretions to the Company's E capital. No one can describe a loan for a fixed term of five years as a mere temporary accommodation. The amount and the term were fixed, and the loan was for a substantial period. I do not think it matters that the Company was entitled to make earlier repayment if it was willing to pay a capital premium. In practice it was not contemplated that the Bank of England would allow payment to be made much earlier than the five-year term of the F loan.

The money was raised because the Company needed additional cash for its business. The purposes for which cash was required included both revenue items, like financing stock, and capital items, like enlarging shops. In the letter of 14 June 1971 which was written by Lazard Brothers to the Bank of England asking for exchange control permission they said: "It is the intention G of Woolworth to apply the proceeds of the issue to its continuing programme of expansion and modernisation of its stores throughout the United Kingdom". That suggests a capital flavour, but there is no doubt that the Company was able to spend, and probably did spend, some of the money on revenue items as well. The agreements under which the notes were issued said that the proceeds were to be utilised wholly for the purposes of activities of H the Company's trade. The Bank of England, giving exchange control consent for the second loan in a letter dated 9 February 1972, said that it was understood that the proceeds of the issue "are to be used by the above-named Company for working capital purposes". That seems to me an accurate description.

The view that the loans formed an addition to the Company's capital is I confirmed by the way the Company's auditors dealt with them in the accounts. Accounting treatment is not of course conclusive on whether or not borrowings are accretions to capital, but it is, as Lord Wilberforce said in

Strick v. *Regent Oil Co. Ltd.*(1) 43 TC 1, a useful cross-check. The balance sheet for the year ended 31 January 1976, for example, sets out "Fixed Assets", "Investments" and "Net Current Assets" (that is to say, "Current Assets" less "Current Liabilities and Provisions"). From the total of these items it deducts "Deferred Taxation" and so arrives at "Total Net Assets". Then, under the heading "Financed By", it sets out the stockholders' funds—that is to say, "Issued Capital", "Capital Reserves" and "Revenue Reserves" and "Other loans". The aggregate of the stockholders' funds and the loans is described as the "Total Capital Employed", and this is of course equal to the "Total Net Assets". The Swiss franc loans were listed in the balance sheet as part of the "Total Capital Employment". The auditors therefore treated them as accretions to capital. Only when they were repayable within a year of the balance sheet date were they removed from capital and included in current liabilities. Hence, in the balance sheet to which I refer only one of the loans appears under the heading "Other Loans", the other one having been treated as a current liability. In earlier years both appear as part of the "Total Capital Employed".

I do not of course suggest that the conventional period of one year used by accountants to distinguish between current liabilities and capital employed is an infallible yardstick for the purposes of corporation tax. However, since the purpose of the accounts is to give a true and fair view of the Company's position, it is a useful point of departure; and when the loan is for a fixed period of as long as five years, it seems to me that one would need fairly powerful reasons for differing from the accountants and not treating it as part of the capital employed by the Company.

There was also accountancy evidence on the treatment of the exchange losses. For the first two years they were provided for against capital reserves, and in later years they were charged to profit and loss account. The expert evidence was that this reflected a shift in opinion among accountants and that the modern tendency is to treat exchange losses on foreign currency loans, whatever their duration, as a revenue cost similar to interest. On this point, however, the accountancy evidence does not seem to me to assist because s 130(f) of the Taxes Act excludes the deduction of exchange losses on loans raised on capital account whether or not as a matter of accountancy those losses could fairly be regarded as expenditure of a revenue nature.

But how did the Special Commissioners arrive at the conclusion that the loans were not capital? They attached great importance to the evidence of the Company's finance director, who said that the purpose of the loans was to tide the Company over a temporary shortage of cash. The Company considered various options, from making a rights issue to asking its bankers for increased overdraft facilities, and in the end decided to deal with the problem by raising the Swiss loans. It went abroad for the loans partly because the rate of interest was more favourable and partly because it was then controlled by a United States corporation and was required under exchange control regulations to raise a proportion of its funds in foreign currency. The loans were for five years because the Bank of England would not allow borrowings for this purpose to be repaid within a shorter period. But, said the Commissioners—and this is a matter to which they attached great significance—"the Company was not seeking to add permanently to its capital structure but was dealing with ... a short-term problem of cash shortage".

(1) [1966] AC 295.

A It seems to me that in attaching importance to what the Company was seeking to do, rather than to what it actually did, the Commissioners misdirected themselves. The fact that the object of the borrowings was to deal with a temporary shortage of cash is irrelevant if the solution actually adopted was to make an addition to the Company's liquid resources sufficiently B permanent to be regarded as an accretion to its capital. The rights issue contemplated as one solution would undoubtedly have fallen within this category and I think a five-year loan would do so also. The Commissioners seem to have discounted the effect of the five-year term on the ground that the Bank of England insisted on this period. Again, it seems to me irrelevant that the Company borrowed for five years because for one reason or another C it was not possible or convenient to obtain accommodation for a shorter period: what matters is what the Company actually did.

In cases where there is no fixed term for repayment, or where the term is of a borderline nature, the use to which the money was put may throw some light on whether or not it was an accretion to capital. The terms of the borrowing must be examined in their factual context. The *European* D *Investment Trust Co. Ltd.*[1] case is an example of the nature of a company's trade and its capital structure being used to illuminate the nature of a borrowing which on its terms was for an indefinite period and in a fluctuating amount. The company there financed hire-purchase transactions and enjoyed a facility from its parent company which had no expressed limits or terms of repayment but which was in practical terms, however, essential to provide the E company with working capital for its business. It could not have been withdrawn without causing the business to collapse. The facility was therefore treated as a borrowing on capital account.

An example of a borderline case is *Ward* v. *Anglo-American Oil Co. Ltd.,* 19 TC 94, where the Company issued loan notes repayable in a year. They were issued to finance an investment in the form of the purchase of a F controlling interest in another oil company, and in deciding that the borrowing was on capital account Singleton J. said that he had come to this conclusion in the light of the way in which the money raised by the notes had been used.

These cases support the view of Vinelott J. in *Pattison* v. *Marine Midland Ltd.*[2] 57 TC 219, at page 245 A-B,

G "... that in a doubtful case the use made by a company of moneys borrowed—whether the moneys are embarked in the trade in the acquisition of current assets or otherwise, on the one hand, or are retained on deposit or invested or used in the acquisition of fixed assets, on the other hand—may throw some light on the character of the borrowing".

H But this is not a doubtful case. The terms of the loans are in my judgment sufficient to make it clear that they constitute additions to the capital employed by the Company, and it does not matter whether they were intended to be employed in the making of payments of a revenue or of a capital nature. In this case evidence on that question would be of little help because it is clear from the evidence before the Commissioners and the

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(1) 18 TC 1. (2) [1982] Ch 145 at pp 166H–167A.

documents to which I have referred that the money was not intended to be used, and nor was it actually used, specifically for purposes of one character or the other. It was simply an addition to the Company's general funds. It follows that there are in my judgment no relevant factors pointing to the borrowing being a revenue receipt which can displace the inference to be drawn from the terms upon which the money was actually borrowed. A

Mr. Oliver, who appeared for Woolworths, relied upon the cases of *B.P. Australia Ltd.* v. *Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224, and *Strick* v. *Regent Oil Co. Ltd.*(1) 43 TC 1, which are concerned with whether expenditure upon some asset or advantage is to be treated as being of a revenue or capital nature. These cases show that the fact that the asset or advantage may endure for as long as five years is not inconsistent with the money having been paid as a revenue expense. Other factors, such as the nature of the advantage and the part it played in the company's trade, may be more relevant. From these cases he argued that by parity of reasoning a loan to provide a company with cash over a period of five years might still be regarded as a revenue transaction. The Commissioners appear to have accepted this argument. B C

I do not however find these cases of any assistance. The question with which they were concerned is in my view quite different. D

In deciding whether a loan is on revenue or capital account there can be no question of examining the nature of the asset or advantage gained by the Company: it is always the same—namely, money. The only question is whether the terms of repayment or the circumstances in which it is likely to be repaid (or the use to which it is put may throw some light) make it appropriate to treat the money as a sufficiently permanent addition to the Company's funds to be regarded as capital, and both the authorities and the practice of the accountants seem to me to show that the loans in this case unquestionably came within that description. In my view the contrary conclusion of the Commissioners was erroneous in law, and I therefore allow the Crown's appeal. E F

Appeal allowed, with costs.

The Company's appeal was heard in the Court of Appeal (Sir Nicolas Browne-Wilkinson, Vice-Chancellor, Nourse and Stuart-Smith L.JJ.) on 15, 16, 20 and 21 June 1988 when judgment as reserved. On 28 July 1988 judgment was given unanimously against the Crown, with costs. Leave to appeal to the House of Lords granted. G

Andrew Park Q.C. and *D. Goy* for the Company.

A. Moses for the Crown.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Ward* v. *Anglo-American Oil Co. Ltd.* 19 TC 94; *Knight* v. *Calder Grove Estates* 35 TC 447; *Whitehead* v. *Tubbs (Elastics) Ltd.* 57 TC 472; [1984] STC 1. H

(1) [1966] AC 295.

A **Nourse L.J.:**—The deductibility of expenditure or losses for income or corporation tax purposes is a much frequented area of dispute between taxpayers and the Inland Revenue, in which the governing principles are settled and familiar. But because the facts of one case are rarely the same as B those of any other, the authorities, in giving prominence to considerations occasioned by their particular facts, are often unhelpful in solving the problems which arise in later cases, more especially those which arise in changed commercial conditions.

In the present case we have to decide whether the Appellants, F.W. Woolworth PLC, in computing their profits for corporation tax purposes, C were entitled to deduct sums amounting to £11.4m, being the amount of losses on foreign exchange incurred in connection with the repayment of loans which they had obtained in foreign currency. It is agreed that the outcome of that question depends on whether *the loans* were part of the Appellants' revenue transactions or accretions to their capital, a question which was decided by the Special Commissioners (Mr. R.H. Widdows and D the late Mr. H.H. Monroe Q.C.) in the former sense and in favour of the Appellants, and by Hoffmann J. in the latter sense and in favour of the Crown. The Appellants now ask us to restore the decision of the Commissioners.

The facts of the case are stated in the decision of the Commissioners, which is set out in full in the report of the decision of Hoffmann J.(1) at [1987] E STC 279. I can therefore confine myself to the more important of the agreed facts and findings, which were to the following effect:

(1) As a matter of contract the loans, of which there were two, were repayable after five years, or earlier at the Appellants' option and on payment of a premium, but the practical effect of the exchange control regulations then in force was that there was little prospect of repayment being F allowed before the expiration of five years.

(2) Both loans were raised in order to provide the Appellants with cash for the general purposes of their trade, there being a cash shortage at the time of the first loan and no particular shortage at the time of the second, although the cash flow resulting from the Appellants' retail operations had proved disappointing.

G (3) The actual or anticipated cash shortages were expected to be short-term, and the Appellants intended to repay the loans out of profits generated in the course of their trade.

(4) When the foreign currency was received it was immediately converted into sterling and put into the common pool of the Appellants' cash resources, whence it went partly to meet expenditure which for tax purposes H would be classified as capital expenditure, and partly to meet the day-to-day cash needs of the Appellants' business.

Embroiled in the argument in this Court were what were ultimately seen to be two preliminary questions. First, can the Crown claim that the deductions were disallowed by s 130(f) of the Income and Corporation Taxes Act 1970 (now s 74(f) of the Income and Corporation Taxes Act 1988), or is it

(1) Pages 560–564 ante.

restricted simply to a claim for disallowance on general principles? Secondly, is the question whether the loans were revenue transactions or accretions to capital, which is obviously one of fact, nevertheless required by authority to be treated as if it were one of law or, in other words, is this or is it not an *Edwards* v. *Bairstow*(1) case? I deal with these preliminary questions in turn. A

So far as material, s 130 of the 1970 Act provided as follows:

"Subject to the provisions of the Tax Acts, in computing the amount of the profits or gains to be charged under Case I or Case II of Schedule D, no sum shall be deducted in respect of ...(f) Any capital withdrawn from, or any sum employed or intended to be employed as capital in, the trade, profession or vocation, but so that this paragraph shall not be treated as disallowing the deduction of any interest, ..." B

The final words, whose effect is expressly to allow the deduction of interest on sums which are caught by para (f), were added by the Finance Act 1969. Mr. Park Q.C., for the Appellants, traced the statutory ancestors of the provision back to the Schedule D rules in the Income Tax Act 1842, the third of which, so far as material, provided as follows: C

"In estimating the Balance of Profits and Gains chargeable under Schedule (D), or for the purpose of assessing the duty thereon, no sum shall be set against or deducted from, or allowed to be set against or deducted from, such Profits or Gains, on account of any sum expended for repairs of premises occupied for the purpose of such trade, manufacture, adventure, or concern ...*nor on account of* any capital withdrawn therefrom; *nor for* any sum employed or intended to be employed as capital in such trade, manufacture, adventure, or concern ..." (emphasis added). D E

Mr. Park told us that there had been a similar provision in a statute enacted at the turn of the previous century or thereabouts.

Mr. Park submitted that the clear intention of Parliament, as appearing from the words "nor on account of" and "nor for" in the 1842 Act, had been to disallow as deductions, and only to disallow, capital withdrawn from a business and sums employed or intended to be employed as capital therein. He said that in those rudimentary and unsophisticated times, had there been no provision to the contrary, it might have been thought, for example, that someone who put capital into a partnership could claim an equivalent amount as a deduction from his share of the profits for tax purposes. However that might be, Mr. Park submitted that the words above quoted were incapable of being read as "in connection with" or the like, and were thus incapable of extending to interest on, or expenditure or losses incurred in connection with, the sums expressly mentioned in the provision. The same point was made by Mr. J.R. Atkin Q.C. in 1911; see below. F G

It was in this context that Mr. Park invited us to consider the decision of this Court in *The European Investment Trust Co. Ltd.* v. *Jackson* 18 TC 1, which is on any view a very curious case. The Act then in force was the Income Tax Act 1918, in which Rule 3 had, for the first time, assumed the same form as s 130(f) of the 1970 Act, but without the words which were added in 1969. Accordingly, the material provision was one which provided H

(1) 36 TC 207.

A that no sum should be deducted "in respect of" any capital withdrawn from, or any sum employed or intended to be employed as capital, etc. The main business of the Appellant company, which was the subsidiary of an American finance company, was the advancing of money on hire purchase for the acquisition of motor cars which were initially bought and owned by the Appellant company itself. In order to finance the hire purchase transactions B of the Appellant company, the American company made advances to it, interest on the advances being paid by reference to the amounts outstanding from day-to-day. The Appellant company claimed that the interest on the advances was an allowable deduction under Rule 3 of Schedule D, but that claim was rejected at all three levels of decision. The Case Stated recorded that it had been contended on behalf of the Appellant company that it was a C finance company dealing in money, that the interest paid by it on the advances was deductible as an outgoing for the purposes of its business, and that the advances were short loans.

The General Commissioners considered that the interest was not an admissible deduction "as the monies advanced . . . were, in our opinion, monies employed, or intended to be employed, as capital in the trade". That D suggests that they assumed that the status of the interest as a deductible item was governed by the status of the advances. The same assumption appears to have been made by Finlay J. in the High Court and all three members of this Court. Indeed, in none of the three judgments in this Court is interest mentioned in any relevant way, far less is there a suggestion that it might have stood on a different footing from the advances themselves. There is one E passage in the judgment of Finlay J. at first instance, which must be quoted. At 18 TC 1, p 9, having referred to para (f) of Rule 3, and also to para (1) which disallowed any annual interest or any annuity or other annual payment payable out of profits or gains, he said:

> "To my mind, it is not necessary to form here a definite opinion upon the much vexed question of whether this is or is not annual F interest: the real point in the case, I think, is whether it forms a valid deduction in arriving at the profits or gains; that is to say, whether it is a sum expended in order to earn profits. It is, of course, thoroughly well established by a long line of cases that it is not deductible if it is in truth the interest on capital."

With regard to that last sentence, Mr. Park, with all his immense G experience and learning in these matters, has told us that he knows of no long line of cases which establish the proposition there mentioned. He said that there was only one previous case where the point had been considered, and there it had been left undecided; see *The Scottish North American Trust, Ltd.* v. *Farmer*[1] 5 TC 693 (HL), at p 708, *per* Lord Atkinson:

> "Mr. Atkin, though not called on, pointed out that the words of the H Rule are 'no sum shall be deducted *for* any sum employed or intended to be employed as capital' and would have argued, I presume, that these words could not apply to *interest* paid by a trading company for the use of money borrowed for the purposes of their trade. It is not necessary to decide the point. He may be right, but I prefer to rest my judgment on the broader ground."

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(1) [1912] AC 118.

Having read and re-read the report of *The European Investment Trust Co. Ltd* v. *Jackson*(1) several times, I have come to a clear conclusion that it can only be explained on the footing that it was conceded throughout that the status of the interest as a deductible item was governed by the status of the advances, and that that concession was made because it was assumed that the words "in respect of" were the equivalent of "in connection with" or the like. Perhaps the words of the 1842 Act had been forgotten. If that assumption is made, I can well see that it can be said that the interest on the advances would be sums in respect of the advances and thus no more deductible than the advances themselves. However, a concession on that point is not the equivalent of a binding decision. Indeed, it is no decision at all. So I think that we are free to disregard that case so far as it related to interest, although its authority would no doubt be unimpeachable in regard to the advances themselves.

Approaching the matter in that way, and having regard to the original language used in the 1842 Act, I think that Mr. Park was correct in submitting that the words "in respect of" ought not to be construed in their widest sense, but as being no more than the equivalent of "on account of" or "for". On that view of s 130(f) it cannot, as a matter of construction, apply to the losses on foreign exchange which were incurred by the Appellants in connection with the repayment of the loans, but only to the loans themselves. Accordingly, the Crown's case for disallowance of the deductions can be based only on general principles.

I turn to the second preliminary question. The Commissioners were invited by both parties to treat the question whether the loans were revenue transactions or accretions to capital as one of fact and degree to be determined in all the circumstances of the case. A question of fact and degree, although it involves the application of a legal test, is a question of fact. Such a question is one to be determined by the Commissioners. Their determination can be interfered with only if it must have been arrived at by an application of the wrong legal test. That is what is meant by a question of fact in this context. A valuable discussion of the difference between a question of fact and a question of law will be found in the judgments of Sir John Donaldson M.R. and Fox L.J. in *O'Kelly & Ors* v. *Trusthouse Forte PLC* [1984] QB 90.

It seems clear from his judgment that Hoffmann J. treated the question as being one of fact. However, Mr. Moses, for the Crown, submitted that it is one of law for the Court, an approach which is said to be justified by the observations of some very eminent judges, in particular those of Jenkins L.J. in *Davies v. The Shell Company of China, Ltd.* 32 TC 133, at pp 150–151, and Lord Reid in *Strick* v. *Regent Oil Co. Ltd.*(2) [1966] AC 295, at p 313F–G. The first of those cases was decided before *Edwards* v. *Bairstow*(3) [1956] AC 14, and my recollection is that in the period after that case was decided it was regarded as having come as a forcible reminder to the profession of the necessity of making distinctions between questions of fact and questions of law in tax cases. Perhaps another reminder is now overdue. Moreover, what Lord Reid said was that the question was "ultimately" a question of law for the court, an observation which is not necessarily inconsistent with its being in the first instance a question of fact for the Commissioners.

I have already said that the question is obviously one of fact, and I

(1) 18 TC 1. (2) 43 TC 1. (3) 36 TC 207.

A respectfully adhere to that view. There is plenty of support for it in the earlier authorities; see e.g. *British Insulated and Helsby Cables, Ltd.* v. *Atherton*(1) [1926] AC 205, at p 213, *per* Viscount Cave L.C.; and *European Investment Trust Co. Ltd.* v. *Jackson*(2) (*supra*) at p 13, *per* Lord Hanworth M.R.; and in some of those more recent as well; see e.g. *Tucker* v. *Granada Motorway* B *Services Ltd.*(3) [1979] 1 WLR 683. It seems to me that it is just as much a question of fact as the question which arose in *Edwards* v. *Bairstow* itself, which was whether a transaction was or was not an adventure in the nature of a trade.

I should record that Mr. Park exhibited some lack of enthusiasm in adopting this approach. Notwithstanding his primary submission, Mr. Moses C was more or less indifferent to the point, his stance being that the Crown would succeed whichever view was correct. I do not think that the Court can be indifferent to it. We must know what approach we should adopt to the Commissioners' decision. Being of the clear opinion that it is a question of fact, I think that we must proceed by asking ourselves whether the facts found are such that no person acting judicially and properly instructed as to the D relevant law could have come to the determination that the loans were revenue transactions and not accretions to capital. If that question is answered in the affirmative, the Crown will succeed. If in the negative, the Appellants.

Having held that the Crown's case for disallowance of the deductions can be based only on general principles, I now ask what was the legal test which E those principles required the Commissioners to apply in deciding whether the loans were revenue transactions or accretions to capital. Mr. Park referred us to the leading authorities in the House of Lords and the Privy Council which bear on this question, there being no distinction in principle between the deductibility of expenditure, with which they were concerned, and the deductibility of losses: *British Insulated and Helsby Cables Ltd.* v. *Atherton* F (*supra*); *Commissioner of Taxes* v. *Nchanga Consolidated Copper Mines Ltd.* [1964] AC 984; *B.P. Australia Ltd.* v. *Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224; *Regent Oil Co. Ltd.* v. *Strick* [1966] AC 295; *Commissioners of Inland Revenue* v. *Carron Company*(4) 45 TC 18 and *Tucker* v. *Granada Motorway Services Ltd.* (*supra*).

Although, as I said at the outset, these and other authorities are often G unhelpful in solving the problems which arise in later cases, several considerations which are relevant to the present case can be extracted from them. Because the relevant legal test cannot readily be more precisely stated than by repeating the question which must be decided, it is only by this process of extraction and application that the later case can be determined. It was by this process that the Commissioners arrived at their determination. H Provided that they did not attach weight to considerations which were irrelevant or no weight to those which were relevant, their determination must prevail.

Moreover, since they were the tribunal who saw and heard the witnesses, they and they alone were in the best position to decide how much or how little weight should be attached to any relevant consideration.

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(1) 10 TC 155. (2) 18 TC 1. (3) 53 TC 92. (4) 1968 SC 47.

The basic principle in regard to loans is that if they are a means of fluctuating and temporary accommodation, they are to be regarded as revenue transactions and not accretions to capital; see *The Scottish American Trust Ltd.* v. *Farmer* (*supra*). Having considered that and many other authorities, the Commissioners anticipated their conclusion in para 22([1]) of their decision: A

"We were invited by both parties to treat the issue as one of fact and degree to be determined in all the circumstances of the case and the authorities seen to us to support that approach. So regarded we do not find the issue an easy one to resolve; but on balance we conclude that the Company has made out its case to treat the exchange losses as revenue expenses." B

In paragraph 23([1]), having stated that they did not attach great significance to the size of the sum involved, they continued: C

"The more significant fact is, in our opinion, that the Company was not seeking to add permanently to its capital structure but was dealing with what appeared to be a short-term problem of cash shortage."

In para 24([2]) they said:

"The fact that the loan was for a period of five years, with little prospect of the Company being able to obtain permission to pay it off before that time, is perhaps the strongest factor in the Crown's argument that the borrowing had a permanence which places it on capital account; but in the circumstances we cannot regard it as decisive. We note that in the petrol company cases the fact that a tie was to last for a number of years was not in itself conclusive of the question whether payment for it was on revenue or capital account." D E

They then quoted what was said by Lord Reid in *Regent Oil Co. Ltd.* v. *Strick* (*supra*)([3]) at 324D–E, and continued:

"By the same reasoning it may be said that making arrangements to provide for a trader's 'cash flow' for five years ahead is within the ordinary activities of running the business." F

In para 26 they summarised their views and said that they attached significance to six further circumstances, of which the fifth was that the evident intention of the Appellants was to repay the loans out of profits generated in the course of their trade.

Mr. Moses submitted that there was only one relevant consideration in the case, which was that the loans, so far from being fluctuating and temporary accommodation, were fixed in amount and were repayable over a fixed long-term period of five years. That was the view of Hoffmann J., before whom the case cannot, I think, have been as fully argued as it has been in this Court. He stated his conclusion thus [1987] STC 279, at 295G–H: G

([1]) Page 558 *ante*. ([2]) Pages 558–559 *ante*. ([3]) 43 TC 1 at p 37F-G; [1966] AC 295.

A "The terms of the loans are in my judgment sufficient to make it clear that they constitute additions to the capital employed by the taxpayer company, and it does not matter whether they were intended to be employed in the making of payments of a revenue or of a capital nature. In this case evidence on that question would be of little help because it is clear from the evidence before the Commissioners and the B documents to which I have referred that the money was not intended to be used, and nor was it actually used, specifically for purposes of one character or the other. It was simply an addition to the taxpayer company's general funds. It follows that there are in my judgment no relevant factors pointing to the borrowing being a revenue receipt which can displace the inference to be drawn from the terms upon which the C money was actually borrowed."

Mr. Moses also strongly relied on what was said by Jenkins L.J. in *Davies* v. *The Shell Company of China, Ltd.* (*supra*)(1) at p 157:

"As loans it seems to me they must *prima facie* be loans on capital not revenue account; which perhaps is only another way of saying that they must *prima facie* be considered as part of the company's fixed and D not of its circulating capital."

In my judgment it is not open to the Court to hold that there was only one relevant consideration in the case. The Commissioners were entitled both to think that there was at least one other such consideration and to give it more weight than the terms of the loans pure and simple. That consideration was the Appellants' purpose in raising the loans, namely to provide them with E cash for the general purposes of their trade over the five-year periods when they would be repaid out of profits generated in the course of their business. Mr. Moses was prepared to accept that purpose, as opposed to motive, can be a relevant consideration, but he submitted that here the nature of the borrowing was such as to reduce it to no significance at all.

In order to explain why I am unable to accept that submission, I must F quote the passage from Lord Reid's speech in *Strick* v. *Regent Oil Co. Ltd.*(2) [1966] AC 295 at p 324 D–E on which the Commissioners relied:

"A business cannot simply be managed on a day-to-day basis. There must be arrangements for future supplies and sales and it may not be unreasonable to look five or six years ahead—one hears of five-year plans in various connections. So I would think that making arrange- G ments for the next five or six years could generally be regarded as an ordinary incident of marketing and that the cost of making such arrangements would therefore be part of the ordinary running expenses of the business."

Hoffmann J. did not find the petrol company cases of any assistance. At [1987] STC 279, 296 (b)(3) he said:

H "The question with which they were concerned is in my view quite different. In deciding whether a loan is on revenue or capital account there can be no question of examining the nature of the asset or advantage gained by the company; it is always the same—namely, money. The only question is whether the terms of repayment or the

(1) 32 TC 133. (2) 43 TC 1 at p 37F-G. (3) Page 564D *ante*.

circumstances in which it is likely to be repaid (on which the use to which it is put may throw some light) make it appropriate to treat the money as a sufficiently permanent addition to the company's funds to be regarded as capital, and both the authorities and the practice of the accountants seem to me to show that the loans in this case unquestionably came within that description." A

In a particularly impressive section of his argument, which was not, I think, rehearsed in the court below, Mr. Park succeeded in convincing me that the learned Judge's view of the utility of the petrol company cases was erroneous. He did it in this way. It is well settled that if the purpose of an expenditure is to acquire a specific asset, its deductibility will be governed by the nature of the asset. Thus if the asset is trading stock, its cost will be deductible; if, on the other hand, it is a freehold factory at which the taxpayer's business is to be carried on, it will not. The petrol company cases show that a similar principle governs expenditure incurred in order to acquire an advantage in the taxpayer's trade. Turning to the present case, Mr. Park said, correctly, that it was one where the Appellants had incurred a liability and then suffered a loss in discharging it. In the petrol company cases the question is whether the expenditure is of a revenue or capital nature, and the answer depends on the nature of the advantage to be acquired. In the present case the question is whether the Appellants' loss is of a revenue or capital nature, and the answer depends on the nature of the liability which the Appellants incurred, which in turn depends on the nature of the advantage to be acquired by the transaction which created the liability. That advantage was the furtherance of the Appellants' trade over the five-year periods. It is an over-simplification, and therefore misleading, to say that the advantage was no more than the cash received. B C D E

That, as I understand it, was the thinking behind para 24, the crucial paragraph of the Commissioners' decision. There they weighed one relevant consideration against another and found that the Appellants' purpose in raising the loans outweighed the terms of the loans pure and simple. In concluding that the arrangements for providing cash for the general purposes of the Appellants' trade over the five-year periods were within the ordinary activities of running the business, the Commissioners were not only echoing the words of Lord Reid, but also the test stated by Lawrence J. in *Ascot Gas Water Heaters Ltd.* v. *Duff* 24 TC 171, at page 176: "... an ordinary incident of carrying on the business of the company". F G

Moreover, there was evidence on which they could properly conclude that the test was satisfied in this case. That was the evidence of Mr. G.C. Seligman, a director and former joint chairman of S.G. Warburg & Co. Ltd. In para 4 of the decision, we find part of his evidence recorded thus: "To him all monies available for a company's use were capital employed in the business and he would describe this company's borrowings in Swiss francs as part of its working capital". H

To that must be added the general knowledge of current commercial conditions which is gained by the Commissioners from their day-to-day experience of these matters, an experience in which Parliament has placed its confidence and which cannot be lightly disregarded by the court.

Three further points must be mentioned. First, in reliance on what was said by Vinelott J. in *Pattison* v. *Marine Midland Ltd*(1) [1982] Ch 145 at page I

(1) 57 TC 219 at p 245A.

A 166H, both sides have throughout accepted that it is only in a doubt that the use which is actually made of borrowed moneys may throw some light on the character of the borrowing. Accordingly, neither side invited the Commissioners to make a close analysis of the use made of the cash raised in the present case, and they did not do so. All that is known is that it went partly to meet expenditure which, for tax purposes, would be classified as capital B expenditure and partly to meet the day-to-day cash needs of the Appellants' business. With that knowledge, and even if it had been a doubtful case, the use factor would seem to have been entirely equivocal and of no assistance to the Commissioners. Secondly, Hoffmann J. attributed some significance to the way in which the auditors dealt with the loans in the Appellants' accounts, but I do not myself think that that assists either in one way or the other. C Thirdly, it may be that some of the six further circumstances to which the Commissioners attached significance in para 26 of their decision are only of marginal significance, or even of no significance at all. However, they certainly do not militate against their conclusion and it cannot be said that any of them ought not to have been taken into account.

On a view of the case as a whole, I find it impossible to say that the facts D found by the Commissioners were such that no person acting judicially and properly instructed as to the relevant law could have come to the determination that the loans were revenue transactions and not accretions to capital. I am satisfied that it would be an excess of the court's function to interfere with the determination of the two very experienced Special Commissioners who decided this case. I would therefore allow the appeal and E restore their decision.

Stuart-Smith L.J.:— I agree.

Sir Nicholas Browne-Wilkinson V–C.:— I also agree.

Appeal allowed with costs.
Leave to appeal to the House of Lords granted.

F The Crown's appeal was heard in the House of Lords (Lords Keith of Kinkel, Brandon of Oakbrook, Templeman, Oliver of Aylmerton and Goff of Chieveley) on 8, 9, 10 and 11 May 1989 when judgment was reserved. On 8 June 1989 judgment was given unanimously in favour of the Crown, with costs.

C. McCall Q.C. and *A.G. Moses* for the Crown.

G *A. Park Q.C.* and *D. Goy* for the taxpayer.

The following cases were cited in argument in addition to the cases referred to in the judgment:—*Usher's Wiltshire Brewery, Ltd.* v. *Bruce* 6 TC 399; [1915] AC 433; *Nchanga Consolidated Copper Mines Ltd.* v. *Commissioners of Taxes* [1964] AC 948; *O'Kelly* v. *Trusthouse Forte plc* [1984] QB

90; *Bolam* v. *Regent Oil Co. Ltd.* 37 TC 56; *B.P. Australia Ltd.* v. *Commissioner of Taxation of the Commonwealth of Australia* [1966] AC 224 (PC). A

Lord Keith of Kinkel—My Lords, I have had the opportunity of considering in draft the speech to be delivered by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons he gives would allow the appeal. B

Lord Brandon of Oakbrook—My Lords, for the reasons set out in the speech to be delivered by my noble and learned friend, Lord Templeman, I would allow the appeal and restore the order of Hoffmann J.

Lord Templeman—My Lords, section 1 of the Income and Corporation Taxes Act 1970, now s 1 of the Act of 1988 of the same name and reproducing earlier enactments, directs, *inter alia,* that income tax shall be charged in respect of profits described in Schedule D set out in s 108 of the Act of 1970. That section directs, *inter alia,* that tax shall be charged in respect of the annual profits arising or accruing to any person residing in the United Kingdom from any trade. The expression "profits" is not defined, and there is no express provision for the deduction of the expenses incurred in earning profits, but it is only possible to arrive at the computation of the profits of a trade after setting against the receipts the expenditure necessary to earn them according to the ordinary principles of commercial accounting: see Lord Herschell in *Gresham Life Assurance Society* v. *Styles* [1892] AC 309, 323. The expression "annual profits" confirms that income tax is to be charged on profits of an income nature as opposed to capital profits: see *The Scottish Provident Institution* v. *Farmer* 6 TC 34, 38. Moreover, by s 130(*f*) of the Act of 1970, in computing the amount of the profits of a trade, no sum shall be deducted in respect of any sum employed or intended to be employed as capital "but so that this paragraph shall not be treated as disallowing the deduction of any interest." It follows that while expenses incurred in earning profits may be deducted for the purposes of assessing income tax on the profits of a trade, such expenses as may be incurred in respect of capital transactions are not so deductible. *A fortiori*, capital losses are not deductible from income profits. The question which arises in the present case is whether an expense or loss was incurred by a trader in earning profits, or was incurred in the course of a capital transaction. C D E F

The trader in question is the respondent taxpayer company F.W. Woolworth Plc. By s 238 of the Act of 1970, a company is not chargeable to income tax, but its profits are chargeable to corporation tax, "profits" include income and by s 250 the amount of any income shall for the purposes of corporation tax be computed in accordance with income tax principles. The taxpayer is resident in the United Kingdom and carries on the trade of providing and selling by retail a wide range of articles from its numerous well known chains of shops. In 1971 the taxpayer borrowed 50 million Swiss francs repayable in five years time or earlier at the option of the taxpayer, subject to a premium for early repayment. The taxpayer converted the Swiss francs into sterling. In 1976 the taxpayer purchased 50 million Swiss francs and repaid the loan to the lender, a Swiss bank. In 1972 the taxpayer borrowed a further 50 million Swiss francs and converted them into sterling. In 1977 the taxpayer purchased and repaid 50 million Swiss francs. As a result of a fall in the value G H I

A of sterling in relation to Swiss currency, the proceeds of converting 100 million Swiss francs into sterling in 1971 and 1972 were £11.4m. less than the cost to the taxpayer of purchasing and repaying 100 million Swiss francs in 1976 and 1977. The taxpayer undoubtedly incurred a currency exchange loss of £11.4m. The taxpayer claims that this loss is deductible from the profits of the retail trade carried on by the taxpayer during the period of the loan. If the B loans of 100 million Swiss francs were revenue transactions, then the currency exchange loss is deductible in computing the profits of the taxpayer's trade. If the loans were capital transactions the currency exchange loss is a capital loss and is not deductible from profits. The taxpayer submits that the loans were revenue transactions; the Inland Revenue submit that the loans were capital transactions. The Special Commissioners found in favour of the taxpayer. C Hoffmann J. held [1987] STC 279 that the Commissioners had misdirected themselves in law. The Court of Appeal (Sir Nicolas Browne-Wilkinson V.C. and Nourse and Stuart-Smith L.JJ.) [1989] 1 WLR 50 restored the order made by the Special Commissioners on the grounds that the question was one of fact and that the facts found by the Commissioners were not such that no person acting judicially and properly instructed as to the relevant law could D come to the conclusion that the loans were revenue transactions. The Inland Revenue appealed.

My Lords, the weight of authority supports the view that the question whether the transactions in the present case were of a revenue or capital nature is a question of law to be determined in the light of the facts found by the Commissioners, and that a trader who borrows 100 million Swiss francs E for a fixed period of five years thereby enlarges the capital employed in the trade.

Mr. Park who appeared for the taxpayer relied on the statement by Viscount Cave L.C. in *British Insulated and Helsby Cables Ltd.* v. *Atherton*(1) [1926] AC 205, 213 that the question whether a contribution to form the nucleus of a pension fund was revenue or capital expenditure was "a question F of fact which is proper to be decided by the Commissioners upon the evidence brought before them in each case." And Lord Hanworth M.R. said much the same thing in *The European Investment Trust Co., Ltd.* v. *Jackson* 18 TC 1, 13. These dicta are inconsistent with the fact that in a multitude of cases there have been disputes before the courts involving the consideration and determination of the question whether expenditure is capital or income, and G that in some cases the Commissioners were upheld and in other cases the Commissioners were reversed, and the courts do not appear to have been inhibited from reaching their own conclusion. In *Davies* v. *Shell Co. of China, Ltd.* 32 TC 133, 151, Jenkins L.J. said:

> "I think it is recognised that these questions between capital and income, trading profit or no trading profit, are questions which, though H they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts ... "

In *Jeffrey* v. *Rolls-Royce Ltd.*(2) 40 TC 443 this House, overruling the Special Commissioners, held that a sum received on the sale of "know-how" was capital. Viscount Simonds said, at p 490(3):

(1) 10 TC 155. (2) [1962] 1 WLR 425. (3) *Ibid* at pp 426–427.

"It is common ground between the parties that the court, while paying proper regard (as to which, see *Edwards* v. *Bairstow*(1) [1956] AC 14) to the facts found by the Commissioners and to the inferences drawn by them from those facts, must ultimately determine as a question of law alike whether receipts by the taxpayer are capital or income for purposes of Income Tax and whether expenses incurred by him are for the same purposes to be treated as incurred on income or capital account." A B

In *Strick* v. *Regent Oil Co., Ltd.*(2) [1966] AC 295, the question was whether lump sums paid by an oil company to a garage owner on a lease and lease-back arrangement which tied the garage to the oil company's products were revenue or capital expenditure. Lord Reid said, at p 313:

"The question is ultimately a question of law for the court, but it is a question which must be answered in light of all the circumstances which it is reasonable to take into account, and the weight which must be given to a particular circumstance in a particular case must depend rather on common sense than on strict application of any single legal principle." C

In *Inland Revenue Commissioners* v. *Carron Co.*(3) 45 TC 18 the question was whether expenditure incurred in removing restrictions in the company's charter which obstructed profitable trading was expenditure on income account or was capital expenditure. Lord Wilberforce said, at p 73: D

"The second question, whether the expenditure had the character of capital or of revenue expenditure, is difficult, as this type of question invariably is. It is a question of law, so that the Special Commissioners' decision is open to review." E

In *Tucker* v. *Granada Motorway Services Ltd.*(4) [1979] 1 WLR 683 the question was whether a sum paid to secure a reduction in rent was an income or a capital expenditure. Lord Wilberforce said, at p 688:

"I add one word as to the decision of the Special Commissioners, who took the opposite view. It seems to me clear that to reverse their decision involves no interference with any finding of fact within their exclusive competence. The finding submitted by them to the Court—clearly one of fact—has been accepted throughout. It is only on the consequence of that finding that the Courts are taking a different view. That involves a pure question of law on the decided cases." F

In the same case Lord Edmund-Davies, discussing the findings of the Commissioners put forward in the form of propositions, said, at p 692(5): G

"In respect of each of these propositions the Special Commissioners cited authorities in support. In so far as the propositions embody statements of fact they must be treated as unassailable unless they do not measure up to the well-known test propounded by Viscount Simonds in *Edwards* v. *Bairstow* [1956] AC 14, 29. But the relevance of any facts found, the means adopted in evaluating them, and, finally, the acceptability of the test evolved by the Special Commissioners in determining whether the expenditure was of a capital or revenue nature are all questions of law and, as such, freely appealable." H

(1) 36 TC 207. (2) 43 TC 1. (3) 1968 SC (H.L.) 47.
(4) 53 TC 92 at p 109. (5) *Ibid* at p 112D-E.

A On principle, and in the light of the judicial pronouncements which I have cited, the question involved in the present case is one of law, and was rightly so dealt with by Hoffmann J., who held that the Commissioners had misdirected themselves.

My Lords, in the course of business a trading company of the type exemplified by Woolworths can only earn profits if it provides for the B payment of trading expenses and for the receipt of trading revenue. The most common form of provision is by means of a current account which may be in credit when earnings are received and in debit when expenses are paid out. The bank charges for providing the facilities afforded by the current account and for the sums involved in accepting cheques drawn on the account when it is overdrawn. The temporary and fluctuating borrowings incurred in C transacting business are revenue transactions. On the other hand, a trading company which borrows unconditionally a fixed amount for a definite period may use the money generally for the purposes of its business or for any other purpose authorised by its constitution, and even when the money is employed in the business, the money may be laid out on income expenditure or capital expenditure. The taxpayer could do as it pleased with 100 million borrowed D Swiss francs, provided that the application of the money was *intra vires* the objects of the taxpayer company. The Commissioners found as a fact that the taxpayer intended to use the 100 million Swiss francs to overcome a difficulty which was hoped to be of short duration and which was caused by the fact that stocks were high and trade depressed. But there was nothing to stop the taxpayer spending the whole or part of the money on capital items, and E indeed part was spent on capital items. For my part, I do not attach any importance in the present circumstances to the intentions of the taxpayer or to the actual use made of the money in the present circumstances. The 100 million Swiss francs, worth some £10m., were available to the taxpayer as additional capital. Mr. Park, on behalf of the taxpayer, said that the taxpayer's capital was enormous, £10m. was a small sum and the taxpayer had F carried on business for so many years that it was preposterous to think that the taxpayer needed extra capital. In my opinion, these assertions are interesting but irrelevant. The capital of the company was increased by £10m. in 1971 and 1972. True it is that the £10m. was loan capital, but it was capital nevertheless; it was not income. The capital of the company was reduced by £21.4m. in 1976 and 1977 when the loans were repaid, and in the result the G taxpayer made a capital loss of £11.4m.

Mr. Park agreed that a premium paid by an oil company for the lease of a garage for five years was a capital payment even though the payment was made for the purpose of ensuring that the oil company's petrol would be traded and sold at the garage. Mr. Park argued that a premium paid by a trader for an unconditional loan of 100 million Swiss francs for five years was H not a capital payment, but he was unable to give any reason supporting this argument save that Swiss francs unlike a petrol tie can be converted and spent. Mr. Park conceded that a premium paid by a trader for a loan of 100 million Swiss francs for ten years would be a capital payment, but he was unable to give any reason save that ten years is twice as long as five years.

The authorities do not support the proposition that a borrowing of a I definite sum for a fixed term of five years can be an income transaction. In *Anglo-Continental Guano Works* v. *Bell* 3 TC 239 a trader in guano borrowed large sums of money from a bank of fluctuating amounts to enable the trader to pay cash for cargoes of guano. The sums advanced by the bank were not repayable at fixed date, but were short loans, interest-bearing, repayable and

repaid from time to time as suited the convenience of both parties. The Divisional Court held that the interest was interest on capital employed in the business. Cave J. said, at pp 245–246: A

> "It is contended by Mr. Finlay that in order to ascertain the balance of profits or gains of such trade you must take into consideration the question whether the trader is trading with borrowed money, or with the capital of his own. It seem to me that that is not so—that the gains of the trade are quite independent of the question of how the capital money is found, that the gains of the trade are those which are made by legitimate trading after paying the necessary expenses which you have necessarily to incur in order to get the profits; and that you cannot for that purpose take into consideration the fact that the firm or trader has to borrow some portion of the money which is employed in the business." B C

In *Texas Land and Mortgage Co.* v. *Holtham* 3 TC 255 a mortgage company engaging in the business of lending money claimed to deduct the expenses of issuing debentures as "part of the expense of carrying on the business of the Company, because before they lend money they have to raise it." Cave J., in argument, said at p 260: "To the extent that you borrow you increase the capital of a company" and Matthew J., delivering judgment, said, at p 260: D

> "in this case this Company raised money by shares with the intention of lending money on mortgage. To increase its capital it raised money on debentures. The argument is that the cost of raising the money ought to be deducted from the profits in a particular year. We are clearly of opinion that that cannot be done. The amount paid in order to raise the money on debentures, comes off the amount advanced upon the debentures, and, therefore, is so much paid for the cost of getting it, but there cannot be one law for a company having sufficient money to carry on all its operations and another which is content to pay for the accommodation." E

In *Scottish North American Trust Ltd.* v. *Farmer*(1) 5 TC 693 a company's main business was the purchase and sale of investments. When the Company bought securities they were deposited with a bank and the purchase price was paid out of the Company's bank account. When the Company sold securities, the sale price was paid into the bank account. The bank account was allowed to be overdrawn and the amount of the overdraft fluctuated from time to time as the Company bought and sold securities. The Company also operated a loan account with the bank whereunder the sum lent might fluctuate from time to time up to a limit of $200,000. The Commissioners held that the sums of money raised by loan and overdraft were additional capital. In the Court of Session Lord Johnston said, at pp 697–698: F G

> "The question is whether, in striking the balance of profits or gains of this company, the company is entitled to debit their profit with interest paid to bankers in New York on short loans. ... They were short, in the sense that they were for short and indefinite periods, borrowed as occasion required, and repaid as opportunity permitted. They were, in fact, banking facilities or advances such as are represented by the ups and downs of a banking overdraft account. ... It is fully recognised that the profits or gains of a trade in the sense of the Income Tax Acts are not the profits which reach the partners, or the net profits, but the profits which the business, regarded as an entity, makes by the employment of its H I

(1) 1910 SC 966 at pp 972–973.

A capital, and that its capital may be supplied by borrowing as well as be contributed by the partners. ... It may be well said that if money is borrowed on a permanent footing, as from year to year, the capital of the concern is in a commercial sense enlarged thereby, and the business extended, whereas no commercial man would consider that his banking B facilities were part of his capital, or the consideration he paid for them anything but an expense of his business. ... Where the interest is payable in respect of an obligation having 'a tract of future time', it may, in the sense of the statute be understood as annual, and where not, not."

Lord Atkinson, on appeal to this House, said [1912] AC 118, 127(1) that the authorities showed:

C "that money borrowed by such a company as the respondent company in this case in the fluctuating temporary manner in which it has been borrowed by them—the daily borrowing and lending of money being part of their trade and business—is not to be treated under the Joint Stock Companies Act as 'capital'. There is nothing to show that that word should bear a different meaning in the Income Tax Acts when D applied to the proceedings of joint stock companies. The interest is, in truth, money paid for the use or hire of an instrument of their trade, as much as is the rent paid for their office or the hire paid for a typewriting machine. It is an outgoing by means of which the company procures the use of the thing by which it makes a profit, and, like any similar outgoing, should be deducted from the receipts to ascertain the taxable profits and E gains which the company earns."

Lord Atkinson distinguished the decision in *Anglo-Continental Guano Works* v. *Bell*, 3 TC 239 by saying, at pp 128–129:

"It does not appear to me that the reasoning on which this decision is based can apply to a bank whose business is the borrowing and lending of money, or to an investment company whose business is conducted as is F that of the respondents in the present case."

In *Vallambrosa Rubber Co. Ltd.* v. *Farmer* 5 TC 529, 536 the Lord President said:

"in a rough way, I think it is not a bad criterion of what is capital expenditure as against what is income expenditure to say that capital expenditure is a thing that is going to be spent once and for all, and G income expenditure is a thing that is going to recur every year."

Similarly, in a rough way, it is not a bad criterion of what is a capital borrowing as against what is an income borrowing to say that capital borrowing is a thing that is going to be borrowed once and for all, and income borrowing is a thing that is going to recur every year.

In European Investment Trust Co., Ltd. v. *Jackson* 18 TC 1 a company H bought motor cars and sold them on hire purchase with a capital of £1,000 and £10,000 borrowed from its parent company, and then borrowed further large sums from its parent company as and when the company purchased motor cars. The advances for the purchase of motor cars were paid out of the hire purchase instalments as and when they were received. The moneys advanced were held to be moneys employed or intended to be employed as capital in the trade.

(1) 5 TC 693 at p 707

In *Ward* v. *Anglo-American Oil Co., Ltd.* 19 TC 94 a company carrying on business in the United Kingdom borrowed dollars and issued interest bearing gold notes repayable after one year, partly to enable the Company to purchase a rival business, and partly for the general purpose of the Company, and in the event suffered an exchange loss. The Company was not allowed to deduct the interest or the exchange control loss because the loans were capital employed in the business. Singleton J., reversing the Commissioners, held that the interest, the expenses of issue of the notes and the amount of the exchange losses were not admissible deductions in arriving at the Company's profits for income tax purposes. He said, at pp 108–109:

> " . . . I conceive the scheme of that part of the Act and of Schedule D, which deals with profits or gains from trade and deductions which can be made therefrom, to be this: that one must arrive at profits or gains in the ordinary commercial or business sense. Interest on ordinary bankers' overdrafts which has arisen for ordinary trading purposes is a legitimate deduction, because it is money wholly and exclusively laid out or expended for the purpose of trade. On the other hand, interest on an issue of notes, whether for one year or for a longer period, may fall, and in the circumstances of this case does fall, into an entirely different category. It seems to me to savour much more of a capital nature or of some fund employed or intended to be employed as capital, and I do not think the issue of notes on which interest accrued would be regarded by businessmen as of the same nature as facilities obtained for ordinary trading purposes."

In *Ascot Gas Water Heaters, Ltd.* v. *Duff* 24 TC 171 a company purchased stock in trade from a supplier which at first allowed nine months—but later reduced the period of credit—and demanded and received a personal guarantee from one, Nakib, up to £200,000. Nakib charged a commission of three per cent. per annum for his guarantee. The company also borrowed £150,000 from the Prudential Company, and payment of this loan was guaranteed by Mendelssohn for a commission. It was held that the commission paid to Nakib was deductible, but the commission payable to Mendelssohn was not. Lawrence J. said, at p 176:

> "The principle, therefore, which the Commissioners ought to have applied in each of these cases was whether the sums in respect of which the commission dealt with in these two cases was payable, were sums which, although capital, were temporary in their nature and might be regarded as an ordinary incident of carrying on the business of the company."

Mr. Park prayed in aid certain observations of Viscount Cave L.C. in *British Insulated and Helsby Cables Ltd.* v. *Atherton*(1) [1926] AC 205. In the course of deciding that a once-for-all contribution of £30,000 by a company to form the nucleus of a pension fund for its employees was capital expenditure, Lord Cave said, at pp 213–214(2), that:

> "when an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade . . . there is very good reason (in the absence of special

(1) 10 TC 155. (2) *Ibid* at pp 192–193.

A circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital."

Mr. Park submitted that an asset or advantage which only endured for five years was not enduring, although a loan which endured for 10 years would be sufficiently enduring. But when a taxpayer borrows money for five years, he obtains an asset or an advantage which endures for five years and the B authorities show that such a loan increases the capital of the taxpayer for that period. A loan is only a revenue transaction if it is part of the ordinary day to day incidents of carrying on the business. Mr. Park also relied on the observations of Lord Reid in *Strick* v. *Regent Oil Co., Ltd.*(1) [1966] AC 295. Dealing with sums paid for petrol ties for five or six years' duration, Lord Reid said, at p 324:

C "A business cannot simply be managed on a day to day basis. There must be arrangements for future supplies and sales, and it may not be unreasonable to look five or six years ahead—one hears of five-year plans in various connections. So I would think that making arrangements for the next five or six years could generally be regarded as an ordinary incident of marketing and that the cost of making such arrangements D would therefore be part of the ordinary running expenses of the business."

But a petrol tie has become, or is imagined to have become, an integral and essential method of trading in petroleum products, and the petrol tie has indeed become "an ordinary incident of marketing". A loan is not an "ordinary incident of marketing" unless, as the authorities show, the loan is E temporary and fluctuating and is incurred in meeting the ordinary running expenses of the business.

In their Stated Case the Special Commissioners, [1987] STC 279, 289–290(2), said:

"the issue we have to decide is whether the borrowing took place in such circumstances that the borrowed monies are to be regarded as an F addition to the taxpayer company's capital resources or whether the borrowing formed part of the day to day activities in the earning of profits in the business."

In my opinion, that question only permitted one answer: the borrowing itself did not form part of the day to day activities of the taxpayer in earning profits. The Special Commissioners came to the contrary conclusion and summarised G their reasons as follows, at p 292(3):

"we find the loans to have been loans arranged to tide the taxpayer company over a short-term problem namely the failure of the taxpayer company's trading activities to generate a sufficient cash flow to cover the taxpayer company's commitments and day to day needs. We find that more efficient stock control and better trading results were expected H within a short time to solve the problem. On that basis we hold the loans represented temporary facilities rather than permanent capital and we attach significance to the following circumstances: (1) that the five-year term was a Bank of England requirement; (2) that the formalities associated with the loans appear to have been dealt with as simply and

(1) 43 TC 1 at p 37F-G. (2) Page 556D-E *ante*. (3) Pages 559F–560A *ante*.

accepted as readily by the Board of the taxpayer Company as might be the documentation required to secure a bank overdraft; (3) That for accounting purposes the loans appear to have been placed in the same category as the 5 year £5m. loan from National Westminster Bank; (4) that proposals for raising 'permanent capital' were not pursued but the loans were regarded as adequate to meet the taxpayer Company's needs;)5) that the evident intention of the taxpayer Company was to repay the loans out of profits generated in the course of the taxpayer Company's trade; (6) that the loans were no part of the shareholders' funds and were not intended to provide additional funds with which to trade."

After no more than two days, and without reserving judgment, Hoffmann J. referred to all the relevant authorities and arguments and succinctly and correctly reversed the Special Commissioners, saying [1987] STC 279, 295(1):

> "It seems to me that in attaching importance to what the taxpayer company was seeking to do, rather than to what it actually did, the Commissioners misdirected themselves. The fact that the object of the borrowings was to deal with a temporary shortage of cash is irrelevant if the solution actually adopted was to make an addition to the taxpayer Company's liquid resources sufficiently permanent to be regarded as an accretion to its capital. ... In cases where there is no fixed term for repayment, or where the term is of a borderline nature, the use to which the money was put may throw some light on whether or not it was an accretion to capital. ... But this is not a doubtful case. The terms of the loans are in my judgment sufficient to make it clear that they constitute additions to the capital employed by the taxpayer company, and it does not matter whether they were intended to be employed in the making of payments of a revenue or of a capital nature. In this case evidence on that question would be of little help because it is clear from the evidence before the Commissioners and the documents to which I have referred that the money was not intended to be used, and nor was it actually used, specifically for purposes of one character or the other. It was simply an addition to the taxpayer Company's general funds. It follows that there are in my judgment no relevant factors pointing to the borrowing being a revenue receipt which can displace the inference to be drawn from the terms upon which the money was actually borrowed."

In the Court of Appeal [1989] 1 WLR 50 Nourse L.J., with whose judgment the other members of the court agreed, rightly accepted, at p 57(2), that:

> "The basic principle in regard to loans is that if they are a means of fluctuating and temporary accommodation, they are to be regarded as revenue transactions and not accretions to capital ..."

Nourse L.J. accepted the argument of Mr. Park based on *Strick* v. *Regent Oil Co., Ltd.* [1966] AC 295 and accepted, at pp 59–60(3), that:

> "In the present case, the question is whether the taxpayer company's loss is of a revenue or capital nature, and the answer depends on the nature of the liability which the taxpayer company incurred, which in turn depends on the nature of the advantage to be acquired by the

(1) Pages 563A–564A *ante*. (2) Page 570A *ante*. (3) Page 572D *ante*.

A transaction which created the liability. That advantage was the furtherance of the taxpayer company's trade over five-year periods."

But the taxpayer's trade was furthered over a five-year period by an increase of capital during that period and not by fluctuating and temporary accommodation.

The taxpayer undoubtedly made a loss of £11.4m. but that loss was a loss B in connection with a capital transaction. Unfortunately the capital gains legislation does not apply to a currency exchange profit as a chargeable gain and does not apply to a currency exchange loss as an allowable loss. I understand that the legislation is under review.

As the law now stands I would allow the appeal and restore the order made by Hoffmann J.

C **Lord Oliver of Aylmerton**—My Lords, I have had the advantage of reading in draft the speech delivered by my noble and learned friend, Lord Templeman. I agree that the appeal should be allowed for the reasons which he has given.

Lord Goff of Chieveley—My Lords, for the reasons given in the speech delivered by my noble and learned friend, Lord Templeman, I would allow D the appeal and restore the order of Hoffmann J.

Appeal allowed, with costs.

[Solicitors:—Solicitor of Inland Revenue; Messrs. Lovell White Durrant.]