

VOL. XVII.—PART VI

No. 851.—HIGH COURT OF JUSTICE (KING'S BENCH DIVISION).—
5TH AND 8TH JUNE, 1931

COURT OF APPEAL.—18TH JANUARY, 1932

HOUSE OF LORDS.—3RD, 4TH AND 15TH NOVEMBER, 1932

- (1) WESTMINSTER BANK, LIMITED *v.* OSLER (H.M. INSPECTOR OF TAXES).⁽¹⁾
- (2) NATIONAL BANK, LIMITED *v.* BAKER (H.M. INSPECTOR OF TAXES).⁽²⁾

Income Tax, Schedule D—Profits of bank from realisation of investments—Whether conversion of National War Bonds constitutes realisation.

The Appellant Banks, in the course of their business, held large investments which were varied from time to time. The Banks admitted that profits on realisation of investments should be included in their profits for Income Tax purposes, and the Crown admitted that losses on realisation were admissible deductions for Income Tax purposes.

The Banks converted their holdings of National War Bonds, partly under provisions contained in the original terms of issue, and partly under the terms of a subsequent conversion offer, into 5 per cent. War Loan and $3\frac{1}{2}$ per cent. Conversion Loan, the value of the stocks received in exchange being greater than the cost to the Banks of the National War Bonds converted.

The Banks appealed to the Special Commissioners against assessments to Income Tax, Schedule D, made to include the excess value of the stocks received on conversion, contending that

⁽¹⁾ Reported (C.A.) [1932] 1 K.B. 668 and (H.L.) [1933] A.C. 139.

⁽²⁾ Reported (C.A.) [1932] 1 K.B. 668.

no taxable profit was realised by the conversion of the National War Bonds into other Government stocks. The Special Commissioners rejected the Banks' contentions.

Held, that the conversion of the National War Bonds was equivalent to the realisation of investments.

CASES

- (1) *Westminster Bank, Limited v. Osler (H.M. Inspector of Taxes)*
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CASE

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

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at York House, Kingsway, London, on 23rd October, 1929, for the purpose of hearing appeals, the Westminster Bank, Limited, hereinafter called the Bank, appealed against assessments to Income Tax under Schedule D made upon it for the three years ended 5th April, 1924, 5th April, 1925, and 5th April, 1926, respectively. The question at issue is whether the sum of £141,750 hereinafter mentioned should be included in estimating the profits of the Bank liable to assessment under Case I of Schedule D.

The facts are as follows :—

1. In the course of its business, the Bank has occasion to make large investments which are varied from time to time. For the purposes of Income Tax, any profit made by the Bank on the realisation of an investment is admitted by the Bank to be part of its profits and, similarly, any loss made by the Bank on the realisation of an investment is admitted by the Respondent to be a deduction in arriving at the profits of the Bank.

2. During the war, the Bank acquired the following National War Bonds :—

- (a) £4,000,000 5 per cent. National War Bonds (1st Series, October, 1917). These bonds were repayable by the Government on 1st October, 1922, at a price of £102.
- (b) £250,000 5 per cent. National War Bonds (2nd Series, April, 1918). These bonds were repayable by the Government on 1st April, 1923, at a price of £102.
- (c) £2,205,000 5 per cent. National War Bonds (2nd Series, April, 1918). These bonds were repayable by the Government on 1st April, 1923, at a price of £102.

(d) £1,050,000 5 per cent. National War Bonds (3rd Series, September, 1918). These bonds were repayable by the Government on 1st September, 1923, at a price of £102.

In the events which happened as hereinafter set out, none of the said bonds was repaid by the Government, but they were, as it is termed, "converted" into $3\frac{1}{2}$ per cent. Conversion Loan Stock or into 5 per cent. War Loan, 1929-47. The question in this case is whether, in arriving at the profits of the Bank for the purposes of the said assessments, there should be included any sum as representing profit resulting from such conversions.

3. The first series bonds were issued on, *inter alia*, the following terms:—

NATIONAL WAR BONDS

£5 per cent. Bonds. Repayable 1st October, 1922, at 102 per cent.

£5 per cent. Bonds. Repayable 1st October, 1924, at 103 per cent.

£5 per cent. Bonds. Repayable 1st October, 1927, at 105 per cent.

and

£4 per cent. Bonds. Repayable 1st October, 1927, at 100 per cent. ("Income Tax Compounded.")

Interest payable half-yearly on the 1st April and 1st October.
First Dividend payable 1st April, 1918.

PRICE OF ISSUE £100 PER CENT.

PAYABLE ON APPLICATION

The Governor and Company of the Bank of England are authorised by the Lords Commissioners of His Majesty's Treasury to receive on the 2nd October, 1917, and thereafter until further notice, applications for the above Bonds. Applications may be lodged at any Office of the Banks hereafter mentioned.

The Principal and Interest of the Bonds are chargeable on the Consolidated Fund of the United Kingdom. . . .

Bonds of this issue will be accepted at their nominal value, with due allowance for any unpaid interest thereon, by the Commissioners of Inland Revenue in satisfaction of amounts due on account of Death Duties, Excess Profits Duty or Munitions Exchequer Payments: provided, in the case of

Death Duties, that such Bonds have formed part of the Estate of the deceased continuously up to the date of death from the date of the original subscription or for a period of not less than six months immediately preceding the date of death, and, in the case of Excess Profits Duty or Munitions Exchequer Payments, that they have been held continuously by the firm, company or other person, liable for such Duty or Payment, since the date of the original subscription or for a period of not less than six months before such Duty or Payment becomes due and payable.

Holders of £5 per cent. Bonds of this issue may convert their holdings within 14 days after any half-yearly interest date (*viz.* : 1st April and 1st October), and as on such interest date, into £5 per cent. War Loan 1929-1947, at the rate of £100 £5 per cent. War Loan 1929-1947, for each £95 nominal value (excluding any redemption premium) of £5 per cent. National War Bonds surrendered; and holders of £4 per cent. Bonds of this issue may convert their holdings at the same times, and in like manner, into £4 per cent. War Loan, 1929-1942 ("Income Tax Compounded") at the rate of £100 £4 per cent. War Loan, 1929-1942, for each £100 nominal value of £4 per cent. National War Bonds surrendered.

The first dividend on a holding of £5 per cent. War Loan 1929-1947, or of £4 per cent. War Loan, 1929-1942, issued in lieu of National War Bonds converted, will represent interest from the date of conversion to the next succeeding interest date of the Loan into which the Bonds have been converted.

In the event of future issues (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short dated Securities), being made by His Majesty's Government for the purpose of carrying on the War, Bonds of this issue will be accepted at par as the equivalent of cash for the purpose of subscriptions to such issues, and an allowance will be made for any interest accrued on Bonds so accepted. . . .

A copy of the prospectus containing the terms of issue of the first series bonds is annexed hereto, marked "A", and forms part of this Case⁽¹⁾.

4. The terms of issue of the second and third series bonds were similar to those of the first series, the only difference in the conversion rights offered being that, as regards the third series, it was required that any conversion into 5 per cent. War Loan, 1929-47, was to be effected within fourteen days of the half-yearly interest date on War Loan (*viz.* : 1st June and 1st December).

Copies of the prospectuses containing in full the terms of the offer of second and third series of bonds, marked B and C, respectively, are annexed to and form part of this Case⁽¹⁾.

⁽¹⁾ Not included in the present print.

5. (a) On 21st April, 1922, an offer, a copy of which is annexed hereto, marked " D ", and forms part of this Case⁽¹⁾, was brought to the notice of the Bank, of which the following are the material terms :—

OFFER OF CONVERSION TO HOLDERS OF 5 PER CENT. NATIONAL
WAR BONDS

due 1st October, 1922, and 1st April, 1923.

Holders of the above Bonds may surrender their holdings in whole or in part and receive in exchange therefor :

either

£4 10s. PER CENT. TREASURY BONDS

Repayable at par on the 15th April, 1932, at the rate of £100 £4 10s. per cent. Treasury Bonds, with a cash payment of £4 (payable on completion of conversion), for each £100 nominal £5 per cent. National War Bonds surrendered

or

£3 10s. PER CENT. CONVERSION LOAN

at the rate of £134 £3 10s. per cent. Conversion Loan for each £100 nominal of £5 per cent. National War Bonds surrendered.

The Governor and Company of the Bank of England are authorised to receive from holders of £5 per cent. National War Bonds due 1st October, 1922, and/or 1st April, 1923, application for the conversion of their holdings as above.

Conversions will be effected as on the 1st April, 1922.

£3 10s. PER CENT. CONVERSION LOAN

Stock issued in exchange for converted holdings of £5 per cent. National War Bonds will rank *pari passu* and be consolidated with the existing £3 10s. per cent. Conversion Loan.

A full half-year's Dividend will be payable on the Stock on the 1st October, 1922.

The latest date for the receipt of applications by the Bank of England will be Monday, the 15th May, 1922.

(b) In response to the last named offer, the Bank, on 6th May, 1922, surrendered its holdings of £4,000,000 first series bonds and £2,205,000 second series bonds in exchange for £8,314,700 (nominal) 3½ per cent. Conversion Loan, the conversion being effected at the stipulated rate of conversion, namely, £134 (nominal) of 3½ per cent. Conversion Loan for £100 (nominal) of National War Bonds.

(1) Not included in the present print.

6. Subsequently, in exercise of its rights under the terms of the original issue of the National War Bonds, the Bank, on the 6th October, 1922, exchanged its holding of £250,000 second series National War Bonds for 5 per cent. War Loan, 1929-47, at the rate of £100 (nominal) of War Loan for £95 (nominal) of bonds.

Similarly, in June, 1922, it had already exchanged its holding of £1,050,000 third series bonds into 5 per cent. War Loan on the same terms.

The Bank thus received £1,368,421 (nominal) 5 per cent. War Loan for £1,300,000 National War Bonds.

7. The Bank, in its own books of account, carried forward the new stocks at the same price as the National War Bonds appeared in those books at the time of the respective conversions, that is, at the original cost of the National War Bonds to the Bank, either making a new entry at the old price or merely altering the name at the top of the old entry. No profit was thus shown in the Bank's books or accounts as arising from the conversion. It was admitted, however, that the value of the new stocks received in exchange for the bonds was greater than the original cost of the bonds to the Bank and the assessments appealed against were made to include such excess value.

8. For the purposes of computing its profits liable to Income Tax, the Bank does not make any charge for the depreciation of its securities. It is, however, the custom of the Bank to provide in its accounts for its own purposes for depreciation of its securities, but not to bring into account as a profit any appreciation, except upon an actual sale of the security which has appreciated.

9. It was contended on behalf of the Bank that no taxable profit had been realised by the conversion of the National War Bonds into 3½ per cent. Conversion Loan and 5 per cent. War Loan.

10. It was contended on behalf of the Inspector (*inter alia*):

- (a) that, on the occasion of each conversion, the Bank had realised the National War Bonds and, by receiving in exchange investments of greater value, had thereby made a profit;
- (b) that, accordingly, such profit should be taken into consideration in arriving at the said assessments;
- (c) that the assessments had, in principle, been rightly made.

11. The following cases were referred to:—

Royal Insurance Co., Ltd. v. Stephen, 14 T.C. 22.

Commissioners of Taxes v. Melbourne Trust Co., [1914] A.C. 1001.

National Provident Institution v. Brown, 8 T.C. 57.

12. We, the Commissioners who heard the appeal, decided that the conversion of the National War Bonds into $3\frac{1}{2}$ per cent. Conversion Loan must be regarded as the making of a new bargain and that, following the decision in the *Royal Insurance Co.* case, Income Tax was chargeable upon the excess value which had accrued therefrom to the Bank. We also held that, while the exercise of an existing right of conversion might be somewhat different, yet we could not distinguish, for taxation purposes, the conversion of National Bonds into 5 per cent. War Loan from the conversion into $3\frac{1}{2}$ per cent. Conversion Loan.

We adjourned the appeal accordingly for the settlement of the figures of the assessments.

Upon the 25th July, 1930, the parties to the appeal appeared before us and stated that it had been agreed that, on the basis of our decision, the profits or excess value on the conversions amounted to £141,750 and we amended the assessments appealed against accordingly.

13. Immediately upon our so determining the appeal, the Bank expressed to us its dissatisfaction with our decision as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

W. J. BRAITHWAITE, } Commissioners for the Special
H. M. SANDERS, } Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.
1st January, 1931.

(2) *National Bank, Limited v. Baker (H.M. Inspector of Taxes)*

CASE

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

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held at York House, Kingsway, London, on 25th June, 1930, for the purpose of hearing appeals, the National

Bank, Ltd., (hereinafter called the Bank), appealed against assessments to Income Tax under Schedule D made upon it for the five years ended 5th April, 1924, 5th April, 1925, 5th April, 1926, 5th April, 1927, and 5th April, 1928.

1. In the course of its business, the Bank has occasion to make large investments which are varied from time to time. For the purposes of Income Tax, any profit made by the Bank on the realisation of an investment is admitted by the Bank to be part of its profits and, similarly, any loss made by the Bank on the realisation of an investment is admitted by the Respondent to be a deduction in arriving at the profits of the Bank.

2. At various times the Bank acquired certain National War Bonds, the particulars of those which are material to this case being as follows:—

War Bond	Amount acquired and subsequently converted
1st series, issued October, 1917 ...	£30,000
1st " " " " ...	£518,502
2nd " " April, 1918 ...	£2,522,000
2nd " " " " ...	£445,000
3rd " " September, 1918... ..	£44,300
3rd " " " " ...	£25,000
3rd " " " " ...	£700,000

In the events which happened as hereinafter set out, none of the said bonds was repaid by the Government or sold by the Bank but they were, as it is termed, "converted" into 5 per cent. War Loan, 1929-47. The sole question in this case on which the opinion of the Court is sought is whether, in arriving at the profits of the Bank for the purposes of the said assessments, there should be included any sum as representing profit resulting from such conversions.

3.

4.⁽¹⁾

5. In exercise of its rights under the terms of the issues of the National War Bonds, the Bank, at various times, converted the bonds set out in paragraph 2 of this Case into 5 per cent. War Loan, 1929-47, at the rate of £100 (nominal) of War Loan for £95 (nominal) of bonds. The market value of the War Loan so received was admittedly greater than the original cost of the bonds to the Bank and the assessments appealed against were made to include such excess value.

⁽¹⁾ These paragraphs are identical with paragraphs 3 and 4 in the Stated Case of *Westminster Bank, Limited v. Osler*, pp. 383/4 *ante*.

6. For the purposes of computing its profits liable to Income Tax, the Bank does not make any charge for the depreciation of its securities.

7. It was contended on behalf of the Bank that no taxable profit had been realised by the conversion of the National War Bonds into War Loan.

8. It was contended on behalf of the Inspector (*inter alia*):

(a) that, on the occasion of each conversion, the Bank had realised the National War Bonds and, by receiving in exchange investments of greater value, had thereby made a profit;

(b) that, accordingly, such profit should be taken into consideration in arriving at the said assessments;

(c) that the assessments had, in principle, been rightly made.

9. The case of *Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22, was referred to.

10. We, the Commissioners who heard the appeal, decided that following the decision in the *Royal Insurance Co.* case, Income Tax was chargeable upon the excess value which had accrued to the Bank.

11. Immediately upon our so determining the appeal, the Bank expressed to us its dissatisfaction with our decision as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

W. J. BRAITHWAITE, } Commissioners for the Special
H. M. SANDERS, } Purposes of the Income Tax Acts.

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

18th February, 1931.

The cases came before Rowlatt, J., in the King's Bench Division on the 5th and 8th June, 1931, and on the latter date judgment was given, in both cases, in favour of the Crown, with costs.

Mr. A. M. Latter, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Westminster Bank, Limited, Mr. G. M. Edwardes Jones, K.C., and Mr. J. S. Scrimgeour for the National Bank, Limited, and the Attorney-General (Sir W. A. Jowitt, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT

Rowlatt, J.—I need not trouble you, Mr. Hills. I do not think it is necessary to hear you again in reply to practically the same argument, and I am not prepared to differ from the Commissioners in this case.

This case, of course, is a very difficult one. I thought the *Insurance* case⁽¹⁾ was a difficult one, but the *Insurance* case, I think, was a stronger one in favour of the line of decision which the Commissioners have taken in this case and which I took in that case. Naturally, I refer to all the elements of strength in that case, such as the substitution of a new company and that sort of thing which existed in that case and which do not exist in this case, but it seems to me that on the principle of the thing this case must follow that one.

Taking the two cases together, the positions which come before me are of two kinds. There is the case of the National Bank which subscribed for the bonds, and in subscribing for the bonds, by the terms of their subscription for the bonds, obtained an option to exchange them into a then known loan, the War Loan 1929-47. The other case is a case where bonds were subscribed for—terminable bonds, short-dated bonds—and then the Government came forward with an offer to issue new securities instead of the old ones at a certain rate of exchange—I am using the vaguest words on purpose—and the Bank availed themselves of that offer. In either case, what the Banks held ceased to be the original bonds and became the new securities into which they were converted.

I do not think that much help is to be gained, or any help is to be gained, from cases like the *Wallpaper* case⁽²⁾, I do not think the *Melbourne* case⁽³⁾ really helps us much, and I really do not think the *National Provident* case⁽⁴⁾, which dealt with the question of profits and discounts, really has much bearing on this particular point. What I have to consider is really the narrow question which arose in the *Insurance Company* case.⁽¹⁾

Mr. Latter and Mr. Edwardes Jones have presented their views in a very simple and perfectly intelligible form. What they have said is that here there is really no realisation at all; you have not got your money back from the Government. All you have done is to vary the terms upon which they are still keeping your money, and your money is outstanding with the Government all the time. It is outstanding on certain rather different terms; and Mr. Edwardes Jones emphasised in his case that it could be

(1) *The Royal Insurance Company, Ltd., v. Stephen*, 14 T.C. 22.

(2) *Merrifield v. The Wallpaper Manufacturers, Ltd.*, 16 T.C. 40.

(3) *Commissioners of Taxes v. Melbourne Trust, Limited*, [1914] A.C. 1001.

(4) *The National Provident Institution v. Brown*, 8 T.C. 57.

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put even more strongly than that, because he said these new terms were looked to in the very prospectus on which the original subscription was made, so that there has not been any change at all; they are merely working out the rights given by the original prospectus. But the circumstance, of course, remains that whereas before this happened they had bonds, with the rights attached to the bonds, now they have a new security, War Loan, or whatever it is, with the rights attaching to that security. Therefore, that is the fact which emerges, namely, that that change has undoubtedly taken place.

Just to get rid of it, I do not think there is any question here of double assessment at all. I mean, while a thing is bearing annual profits in the shape of interest, of course it is taxed on that interest, but, as a matter of dealing, it may show a profit when it is dealt with, in the way that any article that is sold shows a profit when it is sold. I do not think there is any question of double assessment here.

Now is there any distinction between this case and the *Royal Insurance* case? What is at the bottom of it all? Banks do not show yearly, in the computation of their profits, a rise and fall in the value of securities which they hold as bankers. Mr. Edwardes Jones says that a Stock Exchange value is a thing which does not concern an investor so long as he is holding. In the sense Mr. Edwardes Jones uses it, it is quite true; he does not like to see things going down; he likes to see things going up, as we all do, but, of course, it does not materialise in anything until he changes his investments. When he changes them, it does.

Now, for the purpose of the present point, is what has happened a change of the investment which brings up what it is worth, what it will fetch? It seems to me it is. As I have said in the other case, the period of suspense, the period of the ups and downs, is at an end and the thing has become crystallised and you find in the end the things they have got; they have got something. We all know it is so. At the moment of getting it, of course the thing has a value. They have something which at the moment of getting it is of greater value than the money which they gave for the bonds. They have got it. At that moment have they not made a profit upon the money which they invested in the bonds and which they have carried through at that rate in their books all through? It has come to an end. They have got a new thing and at the moment they get it they have got something which is worth more than that which is represented in their books as the thing they got it for.

That is the whole of it, and it seems to me that for the purpose of arriving at this system of making profits, which is a perfectly

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proper system, there is a profit here, and therefore the Crown must succeed in this case. I apprehend that other opinions will be taken on the point, but that is my view.

Mr. Hills.—My Lord, the appeal is dismissed with costs?

Rowlatt, J.—Yes.

Appeals having been entered against the decision in the King's Bench Division, the cases came before the Court of Appeal (Lord Hanworth, *M.R.*, and Greer and Romer, *L.JJ.*) on the 18th January, 1932, when judgment was given unanimously in favour of the Crown, with costs, in both cases, confirming the decision of the Court below.

Mr. A. M. Latter, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Westminster Bank, Limited, Mr. W. Greene, K.C., and Mr. J. S. Scrimgeour for the National Bank, Limited, and the Attorney-General (Sir W. A. Jowitt, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT

Lord Hanworth, M.R.—These appeals raise intrinsically difficult questions, and I say at once that my mind has fluctuated between the two views presented. I say that in order to make it plain that I am not unmindful of the arguments that could be presented with force in favour of the appeal.

The facts can be very shortly stated indeed. The Westminster Bank subscribed during the war for a large number of War Bonds; they subscribed to a series in October, 1917, and took no less than £4,000,000 of 5 per cent. War Bonds; they were repayable by the Government on the 1st October, 1922, at a price of £102. They subscribed to a 2nd Series in April, 1918, for a quarter of a million 5 per cent. National War Bonds, and they were repayable in April of 1923 at a price of £102. They subscribed in April, 1918, also for £2,205,000 5 per cent. National War Bonds, repayable also by the Government on the 1st April, 1923, at a price of £102; and they subscribed for, or they took, £1,050,000 5 per cent. National War Bonds (3rd series, September, 1918). These bonds were repayable by the Government on the 1st September, 1923, at a price of £102. These National War Bonds which were taken were taken on terms which are set out in the Case. They could be "accepted at their nominal value, with due allowance for any unpaid interest thereon, by the Commissioners of Inland Revenue in satisfaction of amounts due on account of Death Duties, Excess Profits Duty or Munitions Exchequer

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"Payments", and so on. Also, the holders of these 5 per cent. Bonds "may convert their holdings within 14 days after any half-yearly interest date (*viz.*: 1st April and 1st October), and as on such interest date, into 5 per cent. War Loan"—that is, the big War Loan of 1929-1947—"at the rate of £100 5 per cent. War Loan 1929-1947 for each £95 nominal value of 5 per cent. National War Bonds surrendered; and holders of £4 per cent. Bonds of this issue may convert their holdings" into other tax-free War Loan. Also, "In the event of future issues (other than issues made abroad or issues of Exchequer Bonds, Treasury Bills, or similar short dated Securities), being made by His Majesty's Government for the purpose of carrying on the War, Bonds of this issue will be accepted at par as the equivalent of cash for the purpose of subscriptions to such issues, and an allowance will be made for any interest accrued on Bonds so accepted." There was therefore inherent in the bonds a right to take advantage of an alternative which was offered in the War Loan to subscribe to future issues. As a matter of fact, what happened was that of the four subscriptions to which I have referred, the £250,000 of the 2nd Series taken in April, 1918, and the £1,050,000 5 per cent. National War Bonds taken in September of 1918, were changed into War Loan. There was another Conversion Loan—a 3½ per cent. Conversion Loan—and that was issued in 1922. The offer was made to those persons who were holders of such bonds as were held by the Westminster Bank that those bonds could be converted on terms that each nominal £100 of War Bonds surrendered should be converted into £134 of 3½ per cent. Conversion Loan, and the item 1, that is, £4,000,000 of 5 per cent. National War Bonds, and the item 3, the £2,205,000 5 per cent. National War Bonds, were converted by the Bank into 3½ per cent. Conversion Loan.

One or two more facts must be stated. The figures are given as to the actual amounts received. I need not trouble about that; they are stated in the Case. In the Bank's own books of account they "carried forward the new stocks at the same price as the National War Bonds appeared in those books at the time of the respective conversions, that is, at the original cost of the National War Bonds to the Bank, either making a new entry at the old price or merely altering the name at the top of the old entry. No profit was thus shown in the Bank's books or accounts as arising from the conversion. It was admitted, however, that the value of the new stocks received in exchange for the bonds was greater than the original cost of the bonds to the Bank and the assessments appealed against were made to include such "excess value." We are told what the practice is of the Bank for the purposes of computing its profits liable to Income Tax:

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“ The Bank does not make any charge for the depreciation of its securities. It is, however, the custom of the Bank to provide in its accounts for its own purposes for depreciation of its securities, but not to bring into account as a profit any appreciation, except upon an actual sale of the security which has appreciated.” With regard to the Westminster case, paragraph 12 of the Case says: “ We, the Commissioners who heard the appeal, decided that the conversion of the National War Bonds into 3½ per cent. Conversion Loan must be regarded as the making of a new bargain and that, following the decision in the *Royal Insurance Co.*⁽¹⁾ case, Income Tax was chargeable upon the excess value which had accrued therefrom to the Bank. We also held that while the exercise of an existing right of conversion might be somewhat different, yet we could not distinguish for taxation purposes the conversion of National Bonds into 5 per cent. War Loan from the conversion into 3½ per cent. Conversion Loan.”

That is how the matter arises. In reference to the Westminster Bank case, Mr. Justice Rowlatt upheld the decision of the Commissioners and upheld his own decision in the case of the *Royal Insurance Co., Ltd. v. Stephen*.

In the case of the National Bank, Limited, the facts are simpler. There, there were a number of War Bonds which were taken by the Bank over a succession of the war years, and all those bonds so taken by them were, in exercise of the right given by the bonds themselves, converted into 5 per cent. War Loan in consequence of the original rights contained and expressed in the bonds themselves. So far as I read the Case, there is nothing to differentiate the case from the facts which I have stated in reference to the Westminster Bank.

Now, first of all, I have had great doubt as to whether this is one of those cases which falls within the jurisdiction and sphere of the Commissioners to decide as upon a question of fact. Admittedly it is a troublesome question; it is one on which accountants might advise their clients that they ought to treat a profit which had appeared—I use a neutral term—in one way or another. It is just that class of case in which business men are far better equipped than a mere lawyer for its decision. But the Commissioners, while holding on a question of fact, followed the decision in the *Royal Insurance Co.'s* case. They have, therefore, not decided it merely as a question of fact upon their own initiative, but have decided it upon guidance given to them under the law. We therefore have to look at it, I think, as a question of law, that question being, Was a right decision come to in the case of the *Royal Insurance Co., Ltd. v. Stephen* and were the Commissioners therefore right in directing

(¹) *Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22.

(Lord Hanworth, M.R.)

themselves in law when they followed that case? The *Royal Insurance Co., Ltd. v. Stephen* is a case the facts of which must be stated. It is reported in 14 T.C. at page 22. The Royal Insurance Company for the purpose of its general business held large investments including a variety of British railway stocks. "Under the Railways Act, 1921, the Company was required to accept new stocks in the amalgamated companies in exchange for the stocks previously held in the companies which under the Act were either amalgamated or absorbed. The new stocks received had a definite market value on the date of exchange and this value was less than the original cost to the Company of the stocks surrendered. The Company claimed that the difference should be allowed as a deduction"—because there was a loss on the original purchase value—" . . . under Case I of Schedule D. The Crown contended that the Company had not realised any loss and that its claim was in effect a claim to write down the book value of investments still held "(1). The Special Commissioners upheld those contentions of the Crown. Mr. Justice Rowlatt held that the surrender of the old stocks enabled the result of the Company's holding of those investments to be definitely ascertained and was equivalent to a realisation "(1).

Mr. Latter quite rightly, with his great knowledge of these matters, disclaimed the suggestion that any difference was introduced by the fact that the one investment was imposed upon the insurance company by the statute of 1891(2) and that their volition in the matter was taken away, but he rightly referred to the fact that that has never been taken as a test or touchstone by which a decision could be reached, for a profit has been held to be a profit and taxable even though it has arisen from the compulsory act of the authorities who took, and so for the purpose bought at a profit, some of the assets of a company. Those are cases which have been decided in connection with the Excess Profits tax. Now, the reasoning upon which Mr. Justice Rowlatt held that the insurance company were entitled to deduct the loss which they had realised was this, that at the time when they took the new stock in the new amalgamated companies there was a new starting point set up "so that there will be a new profit or loss when the substituted stocks are sold by comparison of what they are sold for or realised for with the figure at which the stocks have now been acquired". He refers to the way it was put by Lord Dunedin; his words are :(3) "this transaction is a fair starting point for a new period, in substance, a new period starting with regard to the substituted stocks." Now, we have to see whether or not

(1) 14 T.C. 22. (2) 1921. (3) 14 T.C. at p. 28.

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Railway Act, 1921, in Stephen's case

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there was a new starting point, a realisation in the sense that you can put your finger upon a point of time at which it could be said by the Banks that they had acquired an increased sum, as against the amount originally paid for the security, and with that increased sum in their hands were able to make a larger investment than they would have been able to make if they had only had the original purchase price of the first investment to deal with. It does appear upon the facts that there was a new starting point, and here I will deal with the difficulty which occurred to my mind.

From the facts which I have stated it is plain that the Westminster Bank in two cases, and the National Bank in all, took advantage of a right which was given them by the terms of the original bargain. They exchanged their National Bonds into War Loan, and it might be said that they had therefore, merely by a sequence of events, retained the same investment, an investment in respect of which the debtor was the same, an investment in which they had the alternative right to hold it as it was originally placed in their hands, or to alter it into a new character—a right which was given under the original terms of the bargain. I am satisfied that that is not the true view. The same point does not arise in respect of the exchange into the $3\frac{1}{2}$ per cent. Conversion Loan, because the $3\frac{1}{2}$ per cent. Conversion Loan was a new issue in 1922; but going back to the exercise of the existing right of conversion and converting the National Bonds into War Loan, what was the position? The Bank could have held those bonds until their due date and been paid off at the full value to which they were then entitled, or they could have sold them, or they could, as they did, convert into 5 per cent. War Loan; but equally, whichever alternative they adopted, it was an alternative which put an end to the existence of the National Bonds as such in their hands, and they preferred, instead of waiting till the due date, to exchange the bonds at the time when they did for 5 per cent. War Loan. I therefore think that the Commissioners are right in saying that they cannot distinguish between the two operations which were carried out by the Westminster Bank in respect of their choice of 5 per cent. War Loan and $3\frac{1}{2}$ per cent. Conversion Loan. I go back, therefore, to consider whether Mr. Justice Rowlatt is right in what he held in the case of the *Royal Insurance Company, Limited v. Stephen*. I think it is important and useful to see what Lord Dunedin said in the *Melbourne Trust* case, reported in [1914] A.C., at page 1001. He there had to consider what was the effect of the operation whereby three companies had taken over the assets of the several Australian banks that were in difficulties, when those three companies were ultimately taken over by one single company, and

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he goes back to the case of the *Californian Copper Syndicate v. Harris*⁽¹⁾, and he says this at page 1010: "Holding, then, that the shareholders of this company are shareholders in an ordinary venture, the only question that remains is whether the surpluses realised represent profits. Their Lordships think that the principle is correctly stated in the Scottish case quoted, *Californian Copper Syndicate v. Harris*⁽²⁾: 'It is quite a well settled principle in dealing with questions of income tax that where the owner of an ordinary investment chooses to realise it, and obtains a greater price for it than he originally acquired it at, the enhanced price is not profit in the sense of Schedule D of the Income Tax Act of 1842 assessable to income tax'—he there deals with what I might call the lay investor—"But it is equally well established that enhanced values obtained from realisation or conversion of securities may be so assessable where what is done is not merely a realisation or change of investment, but an act done in what is truly the carrying on, or carrying out, of a business.'" It will be observed there that once this is a business transaction, whether it is realisation or whether it is conversion, it may be assessable then to Income Tax in respect of the enhanced values obtained. The *Californian Copper Syndicate v. Harris* provides a little more authority besides that which was accepted by the members of the Board who were there sitting in that case—Lord Loreburn, Lord Dunedin, Lord Atkinson, Lord Sumner, Sir Joshua Williams and Sir Arthur Channell. The *Californian Copper Syndicate* case, which is in 5 T.C., contains that passage which I have read. Lord Trayner says⁽³⁾: "But it was said that the profit—if it was profit—was not realised profit, and, therefore, not taxable. I think the profit was realised. A profit is realised when the seller gets the price he has bargained for. No doubt here the price took the form of fully paid up shares in another company, but, if there can be no realised profit, except when that is paid in cash, the shares were realisable and could have been turned into cash, if the Appellants had been pleased to do so. I cannot think that Income Tax is due or not according to the manner in which the person making the profit pleases to deal with it." And then he gives a cogent illustration to re-enforce that view. In other words, the *Californian Copper Syndicate* case, which has been approved by the Privy Council, gives an illustration of what is a realised profit, and applies that, not merely to the case where cash is paid, but where something that could be turned into cash is paid for the original investment. It would be a bold action on the part of this Court if we were to neglect those statements, the statement by the Privy Council and

⁽¹⁾ 5 T.C. 169.⁽²⁾ *Ibid.* at pp. 165/6.⁽³⁾ *Ibid.* at pp. 167/8.

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the statement made in the Court of Session, and also if we were to say that Mr. Justice Rowlatt, who had advised himself on the basis of those decisions, was wrong.

There is, however, still one authority which I find it impossible to neglect, the authority in *Brown's*⁽¹⁾ case, which is in 8 T.C. It is quite true, as Mr. Lattier said—and he is entitled to make what he can of it—that the point was not definitely placed in issue in the House of Lords. It was, I think, adverted to both by Mr. Justice Rowlatt and in the Court of Appeal, although it may not have been absolutely necessary for the ultimate decision of the case; but they were considering the effect of the change of security, and, without going through all the passages to which our attention has been called, Mr. Justice Rowlatt does say at page 67: “I treat the so-called conversion of a Treasury Bill into War Loan as being in substance, as it was in form, a sale to or re-discount with the Government at a price representing the original price plus the proportion of interest or discount accrued.” Lord Justice Warrington says this⁽²⁾: “Profits made by discounting bills seem to me to rest on the same footing, and conversion into War Loans also. This last is simply a sale on certain terms fixed by the Government and investment of the proceeds.” When the matter was in the House of Lords, Lord Haldane said this⁽³⁾: “I see no answer to the argument as stated by Lord Justice Warrington. It is concise and I will adopt his words: ‘When a holder, whether the original purchaser or not, realises during currency, he really receives a proportion of the total profit resulting from the fact that the bill was bought at a discount.’” Then he goes on: “Profits made by discounting bills seem to me to rest on the same footing, and conversion into War Loans also. This last is simply a sale on certain terms fixed by the Government, and investment of the proceeds.” Is it possible to set aside those expressions of opinion, even though they do not impose an estoppel upon the parties before this Court? What is the nature of this transaction? How ought one to regard it? It appears to me that it has been said by the great authorities to whom I have referred that it is simply a case of a sale on certain terms fixed by the Government, and investment of the proceeds. Whether, therefore, in the books of the Bank they did that or not—and that does not weigh either against or for the Bank—what is the substance of the matter? How is one to treat it? I think one must regard it as a definite change of an investment upon certain terms which reveal an enhanced price, and the margin so revealed by that enhancement of the price is a profit, and is therefore a profit which is subject to tax.

(1) *The National Provident Institution v. Brown*, 8 T.C. 57.

(2) *Ibid.* at p. 75.

(3) *Ibid.* at p. 83.

(Lord Hanworth, M.R.)

On these grounds, therefore, I find that there is no distinction in the two operations of the Westminster Bank, and the National Bank falls into line. There is, or was, a realisation at the time when the change of investment was made, even though that was made on terms originally offered to the Banks, or offered to them in respect of a new prospectus, and the new Conversion Loan. For these reasons I have come to the conclusion that Mr. Justice Rowlatt is right, and the appeal must be dismissed with costs.

Greer, L.J.—I agree and I can state my views quite shortly.

The points raised in the appeal of the Westminster Bank, if both of them are decided against the Bank, will dispose of the appeal in the case of the National Bank. The substance of the facts in the Westminster Bank case is this: the Westminster Bank, whose business it is, amongst other things, to make investments of the monies in their hands and to realise profits by means of those investments, in fact invested a very large part of their money in National War Bonds. Those bonds gave them the right, when the time came, if they thought it advisable to do so, to exchange their National War Bonds for War Loan, and subsequently provision was made by Parliament to enable them to have a further option to change their investment into $3\frac{1}{2}$ per cent. Conversion Loan. With regard to the change which occurred when they converted their National War Bonds into War Loan, their position was this. They had an investment which they could either sell or which they could hold until the due date arrived for payment, and they could thus realise their profit, either by selling at that time or could realise their profit when the due date came; or they were given the opportunity of realising a profit in another way, namely, by taking the equivalent which was offered to them on the terms of the War Bonds in War Loan. It seems to me, whichever of these three courses they took, they were in fact realising a profit, or rather, to use the words of the statute, "a profit was accruing to them", when they took, instead of selling their War Bonds, War Loan in its place. After all, one must not forget that money is not necessarily value. Money is only a measure of value, and you may realise your stocks or shares by taking something of value without going through the form of, first of all, converting them into money, and afterwards, converting the money into that which you desire to estimate your realisations of that in which you deal, and it seems to me that, quite apart from authority, the true view of these transactions is that when the Bank decided that they would no longer hold their War Bonds, but would in effect realise their War Bonds by selling them to the Government and taking payment in War Loan or in Conversion Loan, they were bringing to an end the enterprise on which they had started when they invested in War

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Bonds, and they had realised a profit on those War Bonds which it was quite simple, when the time came, to quantify into money, as the parties did by agreement before the Commissioners.

My Lord has made it unnecessary for me to refer to authorities, but I should like to say that, in my view, the opinion which I have expressed is that which is to be found though perhaps only in the form of dicta, in the *Californian*⁽¹⁾ case, the *Royal Insurance*⁽²⁾ case and the *National Provident Institution v. Brown*⁽³⁾.

I agree, for these reasons, that the appeal should be dismissed.

Romer, L.J.—In this case I have felt and, to some extent, I still continue to feel, great doubt, and for this reason: it is admitted that if a company, whose business it is to deal in stock exchange and other securities, purchases a quantity of stock, say, of £900 nominal value, and that stock subsequently appreciates in value so that it becomes worth £1,000, although the company has made a paper profit of £100, that profit is not subject to taxation as such, yet, if one thinks of it, the profit is there represented by one-tenth of the stock. But it is not said as against the public: "This profit" is represented by one-tenth of stock; that has a certain value, and "we shall charge you with Income Tax on that profit." It is said in such a case that the profit has not been realised so as to subject it to taxation. Now, supposing, without going through the form of sale, without even purporting to sell the stock, the company exchanges it for £1,000 value of another stock, it is difficult, at first sight, to see why in that case a profit should be said to be realised, any more than it can be said to be realised in the first case. The profit is there represented by one-tenth of the purchased stock. Therefore, were it not for the decision to which I will now refer, I should have hesitated long before coming to the conclusion that in the present cases, where there has been a conversion without anyone purporting to enter into a transaction of sale and re-investment, there has been a profit realised. But the case to which I refer is the case of the *National Provident Institution v. Brown*⁽³⁾. In that case Lord Justice Warrington expresses the view, quite clearly, that in a case of conversion—that was the case of a conversion of some Treasury Bills into National War Loan—the transaction really is a transaction of sale to the Government and re-investment of the proceeds in National War Loan. I think Lord Sterndale was clearly of the same opinion. When the case went to the House of Lords the passage in which Lord Justice

⁽¹⁾ *Californian Copper Syndicate v. Harris*, 5 T.C. 159.

⁽²⁾ *Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22.

⁽³⁾ 8 T.C. 57.

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Warrington had expressed his view on the nature of the transaction was expressly approved by Lord Haldane. In view of that case, and of the fact that the other members of the Court take the view that that is really the nature of the transaction, I am not prepared to differ. In those circumstances, I agree that the appeal must be dismissed.

Westminster Bank, Limited v. Osler (H.M. Inspector of Taxes)

The Westminster Bank, Limited, having appealed against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Buckmaster, Lords Blanesburgh, Warrington of Clyffe, Russell of Killowen and Wright) on the 3rd and 4th November, 1932, when judgment was reserved. On the 15th November, 1932, judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. W. Greene, K.C., and Mr. J. S. Scrimgeour appeared as Counsel for the Company and the Attorney-General (Sir T. W. Inskip, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT

Viscount Buckmaster.—My Lords, the Appellants are the Westminster Bank, Limited, who have occasion, while carrying on their business, to make, and from time to time to vary, large investments. It is not disputed that any profit made by them on the realisation of an investment is part of the profits of their trade for the purposes of Income Tax. The question on this appeal is whether, in the circumstances I will state, such profit has been made.

During the years 1917 and 1918 the Appellants obtained the following holdings of National War Bonds:—

Amount.	Series.	Date of issue.	Date when repayable.	Price at which repayable.
£4,000,000	1st	October, 1917	October 1st, 1922 ...	£102
£250,000	2nd	April, 1918	April 1st, 1923 ...	£102
£2,205,000	2nd	April, 1918	April 1st, 1923 ...	£102
£1,050,000	3rd	September, 1918	September 1st, 1923	£102

The prospectus that was issued inviting application for the bonds contained a provision entitling the holders to convert the bonds into 5 per cent. War Loan 1929-47, at the rate of £100 of such Loan for £95 nominal of the value of the surrendered War Bonds.

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On 21st April, 1922, the Treasury made an offer to the holders of all the above bonds entitling them to surrender their holdings in exchange for £134 3½ per cent. Conversion Loan for each £100 5 per cent. National War Bonds. In response to this offer, the Appellants surrendered their holdings of £4,000,000 of the 1st series, and £2,205,000 of the 2nd series, and subsequently, in exercise of their rights under the terms of the original issue, exchanged their remaining holdings into the 5 per cent. War Loan.

If such transactions be accepted as the equivalent of the realisation of the original holdings, it is agreed that the profit, or excess value, would amount to £141,750, and it was sought on behalf of the Inland Revenue to bring this sum into the account in determining the profits of the Appellants' trade for purposes of Income Tax under Case I of Schedule D. The Bank contended that there had, in fact, been no realisation of profit, and that there was a mere accretion of capital value which could not be brought into account until, in fact, it had been realised.

The Commissioners decided against this contention, and their opinion has been supported, though with some hesitation, by Mr. Justice Rowlatt and the Court of Appeal.

On behalf of the Appellants, it was plausibly argued before the House that the nature of this transaction was equivalent to the mere exchange of an item in the stock-in-trade of a trader, in which case it was contended that, unless an item so taken in exchange was sold, or taken out of the business, no tax would be exigible by reason of the fact that the article taken in exchange was of greater value than that for which it was bartered.

I appreciate the strength of this argument, and I am not surprised at the perplexity in which the judges have found themselves, but the wholly different character of the businesses, the uncertainty of values in dealing with a trader's stock, and the probability that articles exchanged in the way of trade would *primâ facie* be of equal commercial value, renders the analogy unsound. The exchange effected in the present case was, in fact, the exact equivalent of what would have taken place had instructions been given to sell the original stock and invest the proceeds in the new security.

The investment represented by the original War Bonds came to an end as soon as the new securities were taken in its place, when a new venture was begun in relation to the new holding, and the fact that this transformation took place by the process of exchange does not, in my opinion, avoid the conclusion that there has been what is described as a realisation of the security. This view is, I think, supported by the authority of this House.

In *Brown's case*⁽¹⁾, reported in 8 T.C. 57, and in [1921] 2 A.C. 222, a discounting firm had bought Treasury Bills; some had been

(1) *The National Provident Institution v. Brown*, 8 T.C. 57.

(Viscount Buckmaster.)

sold, some discounted and others, before maturity, had been exchanged for War Loan under an offer then made by the Government. It was held that the profit obtained by such exchange was equivalent to the discount value that had accrued since the original issue.

It is perfectly true, as was pointed out, that the liability of discounts to tax is under a special head by itself, Case III, Rule I (b), but Lord Warrington, in giving judgment in the Court of Appeal, stated, with regard to this conversion, that it was simply a sale on certain terms fixed by the Government and investment of the proceeds, and this expression of opinion was approved in terms in this House. But from this it follows that the process of exchange of one security for another in such circumstances is the equivalent of a sale or realisation and a re-investment, and this principle must apply whether the purpose of its application is the determining the amount of accrued discount or the profit made by the original investment.

The case of *California Copper Syndicate* in 5 T.C.⁽¹⁾, although again the facts are different, accepts the same principle. In that case, a company formed to deal in mining properties sold property for fully-paid shares in another company, and Lord Trayner stated that the profit was realised and that the price was shares, and adds that, though there could be no realised profit except when paid in cash, the shares were realisable and could have been turned into cash. Lord Dunedin, in the *Melbourne Trust*, reported in [1914] A.C. 1001, approves of this principle, and states that enhanced values may be assessable where what is done is not merely a realisation or change of investment, but an act in the carrying on or carrying out of the business.

Finally, the case of *The Royal Insurance Company v. Stephen*, in 14 T.C. 22, is, in my opinion, indistinguishable from the present. There, a company was required under the Railways Act of 1921 to accept new stocks in the amalgamated companies in exchange for the stock held in the companies which were absorbed. A loss having arisen to a company by virtue of this arrangement, it was claimed that the company was entitled to deduct this loss in making its returns, and the claim was upheld by Mr. Justice Rowlatt. That case was decided some three or four years ago, and it has not been questioned, and, indeed, upon the basis that it was accurate, the Finance Act of 1931 expressly provided that it should not apply to future exchanges that were then contemplated.

It is not, in my opinion, necessary for this decision to rely upon the fact that legislation has therefore been based upon the hypothesis that the decision in *The Royal Insurance Company v. Stephen*, was right, for, in my opinion, the view upon which that

(1) *Californian Copper Syndicate v. Harris*, 5 T.C. 159.

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legislation was based was, for the reason that I have given, accurate, and there is no need to consider its effect upon the present case.

For this reason I am of opinion that the appeal must fail, and that the Bank must pay the Income Tax.

Lord Blanesburgh.—My Lords, I am of the same opinion.

Lord Warrington of Clyffe.—My Lords, I concur.

Lord Russell of Killowen.—My Lords, I also concur.

Lord Wright.—My Lords, I agree.

Questions put :

That the judgment appealed from be reversed.

The Not Contents have it.

That this appeal be dismissed with costs.

The Contents have it.

[Solicitors :—(for Westminster Bank, Limited) Travers Smith, Braithwaite & Co.; (for National Bank, Limited) Stephenson, Harwood & Tatham; Solicitor of Inland Revenue.]
