HIGH COURT OF JUSTICE (CHANCERY DIVISION)—9TH, 10TH AND 17TH JULY, 1963

COURT OF APPEAL—19TH, 20TH, 21ST, 22ND AND 29TH NOVEMBER, 1963

HOUSE OF LORDS—22ND, 23RD AND 27TH JULY, AND 19TH NOVEMBER, 1964

Commissioners of Inland Revenue

v.

Frere[1]

Surtax—Total income—Deduction—Interest other than annual interest.

On 28th March, 1957, F borrowed £50,000 repayable with interest not later than 31st January, 1958, and on 14th August, 1958, he borrowed £40,000 repayable with interest within approximately one month. The first loan was repaid on 3rd December, 1957, with interest of £2,211, and the second on 17th September, 1958, with interest of £186. In neither case did the lender carry on business as a bank, discount house or member of a stock exchange in the United Kingdom.

On appeal against the rejection by the Commissioners of Inland Revenue of a claim to relief from Surtax in respect of an error or mistake in his return for the year 1957–58, and against an assessment to Surtax for the year 1958–59, F contended that the interest was deductible in computing his total income. The Special Commissioners allowed the appeal.

Held, *that the deduction claimed was inadmissible.*

CASE

Stated under the Income Tax Act, 1952, Sections 229(4) and 64 by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 20th March, 1962, Mr. Philip B. Frere appealed against:

(1) the refusal of the Commissioners of Inland Revenue to allow his claim for relief from Surtax for the year 1957–58, under Section 66 of the Income Tax Act, 1952, as extended by Section 229(5) of the same Act; and

(2) an assessment to Surtax made upon him for the year 1958–59 in the sum of £11,000.

[1] Reported (Ch.D.) [1964] Ch.359; [1963] 3 W.L.R.854; 107 S.J.852; [1963] 3 All E.R.243; 234 L.T. Jo.513; (C.A.) [1964] Ch.359; [1964] 2 W.L.R.405; 107 S.J.1001; [1964] 1 All E.R.73; 235 L.T. Jo.39; (H.L.) [1964] 3 W.L.R.1193; 108 S.J.938; [1964] 3 All E.R.786; 235 L.T. Jo.697.

The only question for our determination in the case of both appeals was the same, *viz*, whether certain " short " loan interest paid by Mr. Frere to Model Roland and Stone Co. was an admissible deduction from Mr. Frere's total income for Surtax purposes.

2. The following facts were agreed or proved:

(1) Mr. Frere was at all material times a partner in the firm of Wigram & Co., solicitors.

(2) On 28th March, 1957, Mr. Frere borrowed a sum of £50,000 from an unlimited company called Model Roland and Stone Co., under an oral agreement that the money should be repaid not later than 31st January, 1958, together with interest thereon from the date of borrowing to the date of repayment, at a rate equal to ½% per annum above bank rate, with a minimum rate of 6% per annum.

(3) On 3rd December, 1957, Mr. Frere repaid the said sum of £50,000. Interest at the agreed rate, amounting to £2,210 19*s*. 2*d*., was paid by him to Model Roland and Stone Co., without deduction of Income Tax, on 17th December, 1957.

(4) On 11th July, 1958, Model Roland and Stone Co., having been informed by the Inspector of Taxes that they were not carrying on a banking business within the meaning of Section 200 of the Income Tax Act, 1952, paid Mr. Frere a sum of £939 13*s*. 2*d*. representing Income Tax at 8*s*. 6*d*. in the £ computed on the said sum of £2,210 19*s*. 2*d*.

(5) On 23rd December, 1958, Mr. Frere made a return of income for the year ended 5th April, 1958. By inadvertence he omitted to include the said interest paid, amounting to £2,210 19*s*. 2*d*., in the charges on income shown in that return. For the year 1957–58 he was assessed to, and paid, Surtax on a total income of £17,020 computed without deducting the said sum of £2,210 19*s*. 2*d*.

(6) On 28th April, 1961, Mr. Frere applied to the Commissioners of Inland Revenue (under Sections 66 and 229(5) of the Income Tax Act, 1952) for relief in respect of such Surtax paid, on the ground that the assessment was excessive by reason of an error or mistake in the said return of income made by him, in that he omitted to show the said sum of £2,210 19*s*. 2*d*. as a charge on his income. The Commissioners of Inland Revenue refused to grant relief.

(7) On 14th August, 1958, Mr. Frere borrowed a sum of £40,000 from Model Roland and Stone Co., under an oral agreement that the money should be repaid within approximately one month together with interest thereon from the date of borrowing to the date of repayment, at a rate equal to ½% per annum above bank rate.

(8) On 17th September, 1958, he repaid the said sum of £40,000. Interest at the agreed rate, amounting to £186 2*s*. 9*d*., was paid by him to Model Roland and Stone Co., on 23rd September, 1958, less Income Tax at 8*s*. 6*d*. in the £.

(9) Mr. Frere immediately after borrowing the said sum of £40,000 lent the sum of £40,000 to a valued client of his firm of Wigram & Co., and received repayment from that client within one month, together with interest at 6% computed for one month, amounting to £200 less tax.

(10) It was common ground between the parties that neither Section 169 nor Section 170 of the Income Tax Act, 1952, applied to the two payments of interest mentioned in sub-paragraphs (3) and (8) above.

3. It was contended on behalf of Mr. Frere that the two amounts of interest of £2,210 19*s*. 2*d*. and £186 2*s*. 9*d*. were deductible in computing Mr. Frere's total income for the years 1957–58 and 1958–59 respectively.

4. It was contended on behalf of the Crown that the said two payments of interest were not deductible in computing Mr. Frere's total income for the purposes of Surtax.

5. We, the Commissioners who heard the appeal, having taken time to consider our decision, gave it in writing as follows:

It was admitted on behalf of Mr. Frere that the interest in question in this appeal was interest on " short " loans and, as such, did not fall within the term " yearly interest " as used in Section 169, Income Tax Act, 1952, or Paragraph 1(1) (*b*) of the Sixth Schedule to the said Act. The question then arises whether " short " loan interest is deductible in arriving at the payer's total income for Surtax purposes. The Act does not expressly say how total income should be computed, but it seems to us to be implicit in the definition of " total income " in Section 524(1) of the Act, that the total income estimated in accordance with the provisions of the Act, as they apply to Income Tax, may differ from the total income estimated in accordance with these provisions as they apply to Surtax.

Section 524(2) specifically refers to the Twenty-fourth Schedule to the Act, and in our view the third paragraph of this Schedule indicates that in estimating a person's total income all interest (whether " short " or " yearly ") may be deducted. In contradistinction to Section 169 and the Sixth Schedule, the said third paragraph refers to " interest " without the qualification of the word "yearly", and we consider that the words " other annual payments " in that paragraph should not, in these circumstances, govern the word " interest " under the *ejusdem generis* rule. The phrase in the third paragraph is substantially the same as in Section 170 of the Act which admittedly includes " short " loan interest (see *The Lord Advocate* v. *The Lord Provost, Magistrates & Council of the City of Edinburgh*, 4 T.C. 627). In Section 122 the words " interest of money " are used and in Section 123 the words are " interest of money, whether yearly or otherwise " and accordingly the recipient of loan interest, whether " short " or " yearly", is clearly liable to Income Tax and Surtax in respect of the amount received (see *Leeds Permanent Benefit Building Society* v. *Mallandaine*, 3 T.C. 577). It appears to us, therefore, that it would be contrary to principle to charge Surtax, in effect, on two persons in respect of the same " short " loan interest. Some guidance on this aspect of the case is to be found in the judgment of Lawrence, L.J., in *Solomon* v. *Commissioners of Inland Revenue*, 18 T.C. 227, at pages 233–4, where emphasis is laid on the fact that the payment in both that case and the case of *Earl Howe* v. *Commissioners of Inland Revenue*, 7 T.C. 289, was not treated for taxation purposes as income of the recipient.

In our view, the interest in the present case is deductible in arriving at the Appellant's total income for Surtax purposes, and accordingly the appeal succeeds for both years. We leave the figures to be agreed.

Agreement of the figures having been later reported to us, we determined the appeal by:

(1) Allowing relief under Section 66 of the Income Tax Act, 1952, for the year 1957–58 in the amount of £1,091 7*s.* 0*d.* tax.

(2) Increasing the assessment for 1958–59 to £12,374.

6. After our decision had been given, our attention was drawn, on behalf of the Respondent, to the statement in the first sentence of our written decision that it was admitted that the interest in question did not fall within paragraph 1(1)(*b*) of the Sixth Schedule to the Act. On referring to our notes we find that no such admission was expressly made at the hearing of the appeal.

7. The Crown immediately after the determination of the appeal expressed to us their dissatisfaction therewith as being erroneous in point of law, and in due course required us to state a Case for the opinion of the High Court pursuant to the Income Tax Act, 1952, Sections 229(4) and 64, which Case I have stated and do sign accordingly. Mr. N. S. Spendlow, with whom I heard and determined this appeal, has since retired from the public service.

8. The question of law for the opinion of the High Court is whether, on the facts herein set out, the decision set out in paragraph 5 was correct in law.

R. A. Furtado } Commissioner for the Special Purposes of the Income Tax Acts

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

31st January, 1963.

The case came before Wilberforce, J., in the Chancery Division on 9th and 10th July, 1963, when judgment was reserved. On 17th July, 1963, judgment was given in favour of the Crown, with costs.

Mr. F. Heyworth Talbot, Q.C., and Mr. J. Raymond Phillips appeared as Counsel for the Crown, and Mr. C. N. Beattie, Q.C., and Mr. Peter Rees for the taxpayer.

Wilberforce, J.—This is an appeal by the Crown against a decision of the Special Commissioners that the Respondent, Mr. Frere, is entitled to deduct in the computation of his total income for Surtax purposes certain interest paid on loans for less than a year. The only fact which it is necessary to state is that in each of the years whose assessment is in question Mr. Frere borrowed substantial sums of money from an unlimited company, called Model Roland and Stone Co., in each case for periods of less than a year, and in due course paid interest on those loans. There are certain additional facts, set out in the Case Stated, relating to the manner in which Mr. Frere put forward his claim for deduction and relating also to the question of whether he was entitled to deduct Income Tax on the loan interest. But those matters are immaterial to the question which has to be decided.

It is common ground that: (i) the interest is taxable in the hands of the recipient either under Case III of Schedule D or as part of its trading receipts; (ii) the payer could not deduct tax from the interest under Section 169 of the Income Tax Act, 1952, because that Section only applies to annual interest; (iii) the payer could not deduct tax from the interest under Section 170 because it was paid out of profits or gains brought into charge; (iv) if the Crown's claim is right there will be double taxation as regards the interest and, indeed, as regards one of the transactions which involved a loan by the taxpayer to a client and the receipt by the taxpayer of interest from the client, triple taxation.

Now, one would think that interest is a simple enough type of income payment and that it would be dealt with under some single head in the legislation. As is well known, a distinction is and has for a long time been made between yearly interest and short interest. However illogical it may appear that these should be treated differently, the fact must be accepted that they are taxed by different machinery and that, in consequence, there may be differences in the substantial result.

I state first the position in general terms. As regards the recipient of interest, he is taxed under Schedule D by virtue of Section 122. That Section makes no distinction between yearly interest and other interest and must refer to both. That it does so is underlined by Section 123 which, under Case III, speaks of " any interest of money, whether yearly or otherwise ". As regards the payer of interest, the Act, in Sections 169 and 170, provides for the deduction of tax by the payer and for the retention or payment over to the Revenue of the tax so deducted according as the interest is or is not paid out of taxed income. This deals with the situation as regards Income Tax and does so in a manner which effectively prevents double taxation.

As regards Surtax, the governing Section is Section 2(2), which provides that, if a person makes a payment of annual interest out of taxed income, he is only to be charged at the standard rate (i.e., he is not to be charged with Surtax) in respect of an amount of his income equal to the payment. The words in this Sub-section " and may be deducted in computing his total income " are obscure. They may mean one of two things: either that it is a condition of freedom from Surtax (or charge at the standard rate only) that the annual interest should be deductible in computing the total income; or they may mean that it is a consequence of the payment that deduction may be made of it in computing the payer's total income. Harman, J., in *Bingham* v. *Commissioners of Inland Revenue*, 36 T.C. 254, seems to have interpreted the words in the former sense; see page 257, line 8. This, however, creates difficulties. First, if it is correct, the reference to " charge at the standard rate "—indeed, the whole provision—would seem unnecessary—or at least could have been expressed much more simply—for the mere fulfilment of the condition, namely that the payment is deductible in computing total income, would suffice to avoid payment of Surtax. Secondly, no guidance is given, either here or, indeed, elsewhere in the Act, on the question of whether any of the payments of the kind mentioned may be deducted. The Act, but for the Twenty-fourth Schedule, which I will deal with shortly, is silent.

So much for the annual interest. There is a complete and coherent scheme.

Now I come to the position of " short interest ". That such interest is not annual interest—even if computed by reference to an annual rate—was established in 1888 in *Goslings and Sharpe* v. *Blake*, 2 T.C. 450. In that case the Court of Appeal decided that tax could not be deducted from interest on short loans. The short loans in that case were bankers' loans, and it is interesting to see that Lindley, L.J., evidently thought that the typical short loan was a banker's loan. He said, at page 456, " That is real short loans, business short loans ". In the same year, Section 24(3) of the Customs and Inland Revenue Act, 1888, dealt with interest (including short interest) not payable out of taxed income by obliging the payer to deduct tax from it and to account to the Revenue. Apart from this there was, until 1915, nothing in the legislation which applied to interest on short loans, and all that had been established about it was that tax could not be deducted from it if it was paid out of taxed income

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and that it must be so deducted if it was not. In practice, the obligation to deduct from short interest was probably largely ignored. In 1915 the Legislature intervened and passed what is now Section 200 (1) of the 1952 Act. That Section recognised the practice of paying short interest without deduction of tax and provided that, if it was paid out of taxed income, the payer should be entitled to repayment of Income Tax in respect of such interest. No express reference was made to Surtax. The Section was confined to bankers' loans, possibly reflecting the view of the Court of Appeal in *Goslings*' case[1] that these were the typical short loans. In 1917 this provision was extended to short interest paid to stockbrokers and discount houses. It remained the case that, as regards short interest paid to bodies other than banks, stockbrokers and discount houses, Income Tax could not be deducted from the payment (unless it was not payable out of taxed income) nor could repayment of Income Tax be claimed. So it follows that, however this appeal is decided as regards Surtax, the taxpayer cannot recover Income Tax on the amount of the interest and that interest is, to some extent, the subject of double taxation.

Before I state the rival contentions I must refer to some other provisions. The Section which deals with " total income ", the relevant expression for the purposes of Surtax, is Section 524. That says—

> " (1) In this Act, ' total income ', in relation to any person, means the total income of that person from all sources estimated, as the case may be, either in accordance with the provisions of this Act as they apply to income tax chargeable at the standard rate or in accordance with those provisions as they apply to surtax. (2) Any person who, on his own behalf or on behalf of another person, delivers a statement of the amount of his or that other person's total income shall observe the rules and directions contained in the Twenty-fourth Schedule to this Act."

The Twenty-fourth Schedule is headed " Declarations and Statements of Total Income ".

> " Third.—Declaration of the amount of interest, annuities or other annual payments to be made out of the property or profits or gains assessed on the person in question, distinguishing each source . . . . Fifth.—Statement of any tax which the person in question may be entitled to deduct, retain or charge against any other person."

There are two points on this Schedule. First, the word " interest " in Paragraph 3 is not, in my view, limited to annual interest, in spite of the following words " or other annual payments ". This seems to follow from the fact that the same expression is used in Section 170, as contrasted with Section 169 which speaks of yearly interest, and that a similar expression is used in Section 122 which, as I have said, is not limited to annual interest. Secondly, in my judgment, this Schedule is a pure machinery Section stating the form in which a return is to be made, and it is impossible to regard it as a substantive provision that all interest, yearly or otherwise, could be deducted. It is simply defining the compartments into which such interest or other payments as are taxed under the substantive provisions of this Act are to be placed. Its only relevance is that, if any interest or other annual payment may be deducted, a statement of it is to appear in accordance with the Schedule. I note that a similar view was taken of the Sixth Schedule (then Section 164 of the Income Tax Act, 1842) in the *Earl Howe* case[2]. Section 524 says nothing else about what deductions are allowable in computing total income.

The rival arguments are as follows. For the Crown it is said: that the only Section which deals with the assessment of Surtax on a person who makes payments of interest is Section 2 (2); that in a case to which that Sub-section applies, freedom is obtained from Surtax because it is provided that an amount equal

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[1] 2 T.C. 450. [2] 7 T.C. 289.

to the payment is taxed only at the standard rate; that this Sub-section only applies to annual interest and the other payments specifically mentioned; that no deduction can be made from total income for Surtax purposes unless authority can be found for it, and that no such authority exists as regards short interest payable otherwise than to banks, etc. The true principle, which derives from Section 2 (2) and from the authorities, is that no payment may be deducted in the computation of total income unless the payer can deduct tax from it, and he can only deduct tax from annual interest.

For the Respondent it is claimed: that the question whether interest (of any kind, whether yearly or not) may be deducted in ascertaining total income is not expressly dealt with in the Act; that as a matter of principle such interest is the payee's income and not the income of the payer; a payment of interest is simply a transfer from one owner of income of part of that income to another. It was not necessary that this matter should be dealt with expressly by legislation, but in fact the Act recognised that such is the position both in Section 2 (2), which assumes that interest is deductible, and in the Twenty-fourth Schedule, which provides a space in which all interest payable may be returned. The decided authorities also recognise the principle that any payment may be deducted so long as that payment is taxable in the hands of the payee and that such a result is necessary if double taxation is to be avoided.

Both sides found an argument on Section 200. The Crown say (it is fair to say Mr. Talbot did not press this argument, but I think he accepted its consequences) that the Legislature in 1915 and 1917 expressly dealt, both as regards Income Tax and Surtax, with short interest in specific cases. In other cases, however anomalous the position may be, there is no provision allowing Income Tax or Surtax relief in respect of them. The fact that Parliament legislated (in a limited field) with regard to short interest supports the argument that without legislation no relief could be obtained. The Respondent says that Section 200 is only dealing with Income Tax. It was passed to remove the difficulty that a payer of short interest had to pay Income Tax on the whole of his income and could get no reduction or repayment of Income Tax on his interest. The Surtax position is unaffected by the Section. It always was and still is dealt with by allowing a deduction against total income. This is supported by the reference in Section 200 (1) to the " repayment of income tax on the amount of the interest ", which can only refer to Income Tax at the standard rate and not to Surtax.

To decide between these two contentions, I must first examine the authorities. The first is *Earl Howe* v. *Commissioners of Inland Revenue*, 7 T.C. 289, the observations of the Court of Appeal in which have often been quoted. These observations appear to me to be directed towards the establishment of a negative proposition, namely, that an annual payment cannot be deducted unless the payer can deduct tax on behalf of the recipient. They do not appear to me to support a positive proposition that in any case where the recipient is taxable in respect of the payment (whether by deduction or otherwise) the payment may be deducted from the income of the payer. Neither the reasoning of Scrutton, L.J., nor that of Warrington, L.J., (whose rather more general language was relied on by Mr. Beattie) justify any such proposition. Both Lords Justices—and also, for that matter, Sir Charles Swinfen Eady, M.R.,—found their reasoning upon those provisions of the legislation which allow tax to be deducted from annual payments. This case was applied by Harman, J., in *Bingham*[1], where the payment was an annual payment payable to a woman

[1] 36 T.C. 254.

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not herself liable to United Kingdom tax. Harman, J., referred to *Earl Howe*[1] as one of

> " a line of cases which shows that no deduction can be made unless the payment is one from which the payer can deduct Income Tax under Rule 19 "

—now Section 169—

> " and pass it on to the recipient ".

The argument he rejected was

> " that where a payment made is what is called a pure income payment it ought to be treated as against the Crown as deductible, even though . . . it cannot be deducted "

—i.e., tax cannot be deducted from it—

> " against her."

So this, too, endorses the negative character of the *Howe* decision and is authority against the proposition that the fact that the payment is of an income character in the recipient's hands entitles the payer to deduct for Surtax. Thirdly, there is *Commissioners of Inland Revenue* v. *Hay*, 8 T.C. 636, where a positive decision was given that an interest payment could be deducted for Surtax. The headnote states that the decision was based on a finding that this interest was yearly interest. The Lord Justice Clerk (Alness) and Lord Anderson undoubtedly so decided. But Mr. Beattie suggests that Lord Hunter based his decision on a wider principle, namely, that deduction is allowable whenever not to do so would give rise to double taxation. It is certainly not entirely clear whether his judgment went on the same gounds as those of the other learned lords or on wider grounds. Lord Alness seems to have thought the former—see the last paragraph of his judgment. But in my opinion it should not be read in the sense contended for by Mr. Beattie. When on page 644 he is dealing with the Crown's contention that the interest was not annual and so not deductible, he says,

> " If the Income Tax authorities choose to collect the tax payable on the income of A at its source in the hands of B they cannot maintain that the amount on which it was paid does not form a proper deduction from the income of B. To do so would enable them to tax the same income twice, contrary to the principle on which the *London County Council* case[2] to which I have referred was decided."

Here he is stating exactly the same principle as the Court of Appeal stated in the *Earl Howe* case—that the right to deduct follows from the right to deduct the tax. Similarly, Lord Macnaghten in the *London County Council* case, on whose opinion Lord Hunter and also Mr. Beattie rely, when stating the principle that double taxation ought to be avoided (Lord Macnaghten called it whimsical to do otherwise) does so in the context of Section 24 (3) of the Customs and Inland Revenue Act, 1888 (later Section 170 of the Income Tax Act, 1952), which requires deduction of tax at the source. So that in my judgment all these three cases connect the right to deduct the payment for Surtax purposes with the right given by specific Sections, namely, Sections 169 and 170, to deduct tax against the recipient—which is exactly what Section 2 (2) does—and they support the argument of the Crown.

Is it, then, possible to maintain the general proposition that an interest payment is merely a transfer of income to the recipient so that, without any specific provision in the Act saying so, it can be deducted from the income of the payer? In my judgment, the authorities I have referred to do not

[1] 7 T.C. 289. [2] 4 T.C. 265.

support it and, indeed, are inconsistent with the existence of any such general right. I would adopt, as a correct statement of the position as regards short interest, what was said by Greene, L.J., in *Paton* v. *Commissioners of Inland Revenue*, 21 T.C. 626. After referring to the statutory provisions corresponding to Sections 169 and 170, he says, at page 648:

> " Previously to the passing of the Finance Act, 1915, the scheme outlined above did not apply to interest on ' short loans ', with the result (*a*) that, as in the case of annual interest, the payer was assessed on his gross profits without any deduction of interest paid; (*b*) he was not entitled to deduct tax on paying the interest; (*c*) the recipient was bound to include the interest which he received for the purpose of calculating his taxable income. This result was an anomalous one. There does not appear to be any difference in principle between annual interest and interest on short loans; in each case the interest paid may be regarded as part of the income of the payer transferred to the recipient, as distinguished from a mere expenditure of income by the payer. Nevertheless, the result was that the Crown received Income Tax twice in respect of the interest, once from the payer inasmuch as he was taxed on his gross profits, and once from the recipient in that the sums received had to be brought into account in ascertaining his taxable income . . . . The anomaly was removed so far as regards banks by the Finance Act, 1915, and as regards members of Stock Exchanges and discount houses by the Finance Act, 1917, and the relevant provisions of those Acts are now incorporated in Section 36 of the Income Tax Act, 1918. In substance, the position with regard to interest on short loans is assimilated to that of annual interest."

So he is expressly rejecting an argument, attractive from a common-sense point of view, that interest is a mere transfer of income, and doing so in relation to short interest. Notwithstanding the apparent character of interest, he says, the payer was assessed on his gross profits without any deduction of interest paid, and the Crown got double tax. Although this passage is not binding on me, I respectfully adopt it as applicable to short interest where Section 200 of the Income Tax Act, 1952, does not apply. I regret the anomaly which consequently arises (none the less because even on the taxpayer's argument some anomaly remains, namely as regards Income Tax), but the remedy for it does not lie here but in a provision extending to short interest payments generally the rule which applies to banks. The appeal must therefore be allowed.

Mr. J. Raymond Phillips.—I therefore ask that the appeal be allowed with costs.

Wilberforce, J.—Yes. It will have to go back to the Commissioners.

Mr. Phillips.—Yes. The proposed form of the Order is in these terms—that it should be remitted to the Special Commissioners with a declaration that the interest paid by the Respondent is not deductible in arriving at the Respondent's total income for Surtax and a declaration that a claim for relief for error or mistake for the year 1957–58 be rejected, and that for the year 1958–59 the assessment is to be adjusted accordingly.

Wilberforce, J.—That seems to be right.

Mr. C. N. Beattie.—Yes, my Lord. I respectfully agree.

Wilberforce, J.—Very well.

Mr. Phillips.—Your Lordship says with costs?

Wilberforce, J.—Yes.

The taxpayer having appealed against the above decision, the case came before the Court of Appeal (Lord Denning, M.R., and Donovan and Russell, L.JJ.) on 19th, 20th, 21st and 22nd November, 1963, when judgment was reserved. On 29th November, 1963, judgment was given against the Crown, with costs (Russell, L.J., dissenting).

Mr. C. N. Beattie, Q.C., and Mr. Peter Rees appeared as Counsel for the taxpayer, and Mr. Alan Orr, Q.C., and Mr. J. Raymond Phillips for the Crown.

Lord Denning, M.R.—I will ask Donovan, L.J., to give the first judgment in this case.

Donovan, L.J.—The question in this case is whether interest payable for less than a year is deductible by a taxpayer in computing his total income from all sources for the purposes of Surtax. Such interest is usually called " short interest ", in contrast to " annual interest " or " yearly interest ", which is payable, or at any rate potentially payable, for a year or more.

Mr. Frere, the Appellant, paid short interest to a concern called Model Roland and Stone Co. during the two years of assessment 1957–58 and 1958–59. He sought to deduct this interest in computing his total income for Surtax purposes. For 1957–58 he had to do this by what is known as an error or mistake claim because, by inadvertence, he omitted to deduct the interest in his return of total income for that year. For the next year, 1958–59, he did so deduct the interest paid in that year. The Inland Revenue refused to admit the error or mistake claim for 1957–58, and refused to allow the deduction claimed for 1958–59. Mr. Frere appealed to the Special Commissioners, who allowed both claims. The Crown appealed by way of Case Stated to the High Court, and Wilberforce, J., allowed the Crown's appeal. Mr. Frere now appeals to this Court. The remainder of the facts will be found set out in the Case Stated.

The question is a simple one to state, but the argument has been long and elaborate. This comes about because, in order to meet the case made against him by the Crown, the taxpayer has been obliged to go back almost to the beginnings of Income Tax, and to the actual beginnings of Super-tax, in order to demonstrate, as he says, that the Crown are wrong and that he is right. It is a good thing, no doubt, from time to time to get back to first principles to help to resolve some troublesome problem. The difficulty about doing this in relation to Income Tax problems is usually that principles, first or otherwise, are few and far between; and such of them as may exist are expressed in the language of well over a century ago, which today is at times obscure.

If Mr. Frere had paid interest for a year or more, his claim to deduct it in computing his total income for Surtax purposes would be conceded. On what principle should interest paid for less than a year be differently treated? To that question, nobody knows the answer. The Crown simply say that that is the effect of the Statutes. What can, I suppose, be asserted with some confidence is that, leaving out those cases where the contrary, for one reason or another, is specially provided, one would not expect to have to pay Surtax on somebody else's income. For the Appellant, it is asserted that this basic principle is indeed to be found in the relevant statutory provisions, and effect should be given to it by excluding the short interest here in question from his Surtaxable income, for it is really the income of the payee. The Crown's approach is different. They point to certain provisions allowing such exclusion in the case

of yearly interest or annual interest, and say that this is as far as the Statutes go. As regards judicial authority, each side cites decisions said to be in its favour. Some of these decisions are relied upon by both sides.

In 1927, Surtax took the place of Super-tax and was called a deferred instalment of Income Tax. Section 39(3) of the Finance Act, 1927, dealt in a somewhat oblique fashion with the deduction of annual interest from a return of total income for Surtax purposes. The provision now appears as Section 2(2) in the consolidating Income Tax Act, 1952, and, so far as is here material, reads as follows. I preface the citation with the remark that, by its reference back to Sub-section (1), the Act is dealing with a year for which Surtax is imposed.

> " Where, for a year for which income tax is charged in the manner specified in subsection (1) of this section, a person is required to be assessed and charged with income tax in respect of any property, profits or gains out of which he makes any payment in respect of—(*a*) any annual interest, annuity or other annual sum . . . he shall, in respect of so much of the property, profits or gains as is equal to the said payment, and may be deducted in computing his total income, be charged at the standard rate only."

The Crown do not claim that this provision is conclusive of the present problem; but it is some indication, they say, that you may deduct only annual interest in computing your Surtaxable income. On such interest you are to be taxed at the standard rate only. By implication, on any other interest you must pay Surtax as though it were your own income.

This contention, if it be right, involves that the Crown may get Surtax twice on the same income, for the recipient of short interest has undoubtedly to include it as part of his total income. If the Crown be right, so has the payer, in the sense that he may deduct nothing in respect of the payment of such interest. This anomaly the Crown recognises with suitable regret. But when Section 2(2) enacts that yearly interest shall be taxed at the standard rate only in the case of an individual who has to pay it, and thus that it shall not be charged to Surtax in his hands, the conclusion does not follow necessarily that in the case of short interest a different result shall obtain. The matter is left at large, unless it be legitimate to draw the inference for which the Crown contend. The contention for the Appellant is that it is wholly illegitimate, and it is for the purpose of establishing this contention that he goes back to the beginnings of Super-tax. It was, of course, introduced in the historic Budget of 1909. It was to be an additional tax in respect of total incomes of over £5,000. Income Tax, as distinct from Super-tax, was, although one single tax, levied Schedule by Schedule on different categories of income. Super-tax, by contrast, was now to be levied on " the income of any individual, the total of which from all sources exceeds five thousand pounds ": see Section 66(1) of the Finance (1909–10) Act, 1910.

How was this " total income " to be calculated? It might, of course, have been done by making some special provision solely for the purpose of Super-tax. But the Legislature found ready to hand a different solution. Already the taxpayer, who wanted to claim exemption or abatement from Income Tax, was obliged to make a return of his total income. So, said the Legislature, the Super-tax payer shall make a similar return on the same lines, and the total income thus estimated " shall be taken to be " his income for Super-tax purposes. This was enacted by Section 66(2) of the Finance (1909-10) Act, 1910, reading as follows:

> " For the purposes of the super-tax, the total income of any individual from all sources shall be taken to be the total income of that individual from all sources for the previous year, estimated in the same manner as the total income from all sources is estimated for the purposes of exemptions or abatements under the Income Tax Acts."

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This takes us first to Section 163 of the Income Tax Act, 1842, providing that any person shall be exempt from tax who proves that his aggregate income is less than £150, such aggregate income being estimated " according to the several Rules and Directions of this Act ". These rules and directions are laid down by Section 190 of the same Act, and the combined effect of the Section and Rule XVII of the Schedule G to which it refers is that the claimant for exemption must return: (1) the amount of any profits on which he is or is liable to be assessed; (2) the amount of any income which he receives under deduction of tax; (3) the amount of any interest, annuities or other annual payments which he has to make out of the profits assessed upon him; (4) the amount of his income after deducting (3) from the total of (1) and (2). Thus " interest " payable by the claimant would form a deduction in arriving at his total income for the purposes of exemption; and, since the calculation of total income for the new Super-tax was to be the same, it would follow that " interest " —that is, not merely yearly or annual interest—would form a deduction in computing total income for the purposes of Super-tax. It may here be usefully remarked that the Legislature deliberately distinguished for some reason between " interest " and " annual interest ": see, for example, Section 100 of the same 1842 Act and the Third Case of Schedule D, taxing, under that Case, " all Interest of Money, not being annual Interest ".

As a condition of exemption from tax, Section 163 of the 1842 Act required a claimant to prove—and here I quote the words of the Section—

> " . . . before the Commissioners for General Purposes, in the Manner hereinafter mentioned, that the aggregate annual Amount of his Income, estimated according to the several Rules and Directions of this Act, is less than One hundred and fifty Pounds . . .".

The manner in which the claim is to be proved is prescribed in Section 164, which requires a claimant to deliver to the assessor, *inter alia*, a statement

> " setting forth therein all the particular Sources from whence the Income of such Claimant shall arise, and the particular Amount arising from each Source, and also every Sum of annual Interest or other annual Payment reserved or charged thereon, whereby the Income shall or may be diminished . . .".

Thus in this Section the claimant is told to show the annual interest he has to pay, and not " the interest ".

But this Section does not contain the rules for estimating total income. These are contained in Section 190 and Schedule G, Rule XVII, the effect of which is that in that estimate all interest payable must be deducted, not merely annual interest. The reason why Section 164, prescribing the mode of proving a claim, refers to annual interest may well be this. From such annual interest paid out of his taxable income, the claimant for exemption was entitled to deduct Income Tax at source. If his claim for exemption were allowed, effect might have to be given to it by repaying tax which the claimant had himself suffered at source—for example, on some annuity payable to him. In calculating what was due to him, however, there had to be a set-off of the tax he had himself deducted and retained when paying, for example, annual interest. The Revenue would, therefore, want to know specifically what annual interest or other annual payments the claimant had made. Hence the provision in Section 164.

The Crown in the present case, however, want to treat that Section as though it overrode Section 163, Section 190 and Schedule G, Rule XVII, and as enacting that, in a return of total income for the purposes of exemption (and therefore later for the purposes of Super-tax), only annual interest could

be deducted. To test this contention one may suppose a claimant for exemption from tax in 1842 seeking advice as to how to fill up the necessary form. He has a gross income of £250. He has paid £50 of annual interest on a mortgage. He has also paid £60 short interest on a bank overdraft. If he follows the directions contained in Section 163, Section 190 and Rule XVII of Schedule G, he will show: income, £250; less interest (that is, both annual and short), £110; leaving, £140. Thus he will get exemption from tax. From the £50 of annual interest he will have deducted and retained the tax, which tax will go to offset any repayment otherwise due. The £60 of short interest he has paid will be assessable to tax in the hands of the recipient. On the Crown's contention, however, the claimant for exemption will show: income, £250; less annual interest only, £50; leaving, £200 as his total income from all sources, and exemption will not be due. Alternatively (as I understand the Crown's argument), he will deduct both short interest and annual interest, leaving £140 net again as his total income, but only for the purposes of exemption. For the later purposes of Super-tax, the true calculation would be £200—that is, making no deduction for the short interest.

How this is to be squared with Section 190 and Rule XVII of Schedule G, I do not know. It seems to me to give the go-by entirely to the direction that " any interest " paid by the claimant is to be deducted in computing his total income. And, if the claimant is to deduct it in such a return, so, by virtue of Section 66(2) of the Finance (1909–10) Act, 1910, must the Super-tax payer. I may here remark that the reference in Section 66(2) to " exemption or abatement " is explained by the fact that in 1853 the Legislature introduced abatements as well as exemptions, but no change was made in the method of computing total income.

The provisions of the 1842 legislation to which I have referred were re-enacted in the consolidating Income Tax Acts of 1918 and 1952. So, also, was the provision of the 1910 Act. It is common ground, however, that there has been no material change in the language. If, on the language of the 1842 and 1910 Acts, the Appellant would have been entitled to deduct short interest for Super-tax purposes, the Crown concede that he is entitled to deduct it today for Surtax purposes upon the language of the 1952 Act. For the Appellant, Mr. Beattie concedes the converse. The change of Super-tax into Surtax, effected by the Finance Act, 1927, is likewise agreed to make no difference. In these circumstances, there is no point in tracing the descent of the various Sections and Schedules in the old legislation right through to the present day. Suffice it to say that Section 163 of the 1842 Act is found in Section 221 of, and Paragraph 2 of the Sixth Schedule to, the 1952 Act; Section 164 is Paragraph 1 of the same Sixth Schedule; Section 190 of the 1842 Act is Section 524(2) of the 1952 Act; Schedule G, Rule XVII, of 1842 is the Twenty-fourth Schedule to the 1952 Act; and Section 66(2) of the Finance (1909–10) Act, 1910, is Section 524(1) of the Income Tax Act of 1952.

In 1915, the Legislature was moved to deal with the anomalous situation in relation to Income Tax of the taxpayer who paid interest to a bank, without deduction of tax at source, out of profits on which he had already paid tax. He might have been unable to avoid this because, even if the interest he paid were susceptible of deduction of tax at source, the bank may simply have debited the gross sum against a credit in his account. In the result, the taxpayer suffered Income Tax on an income undiminished by this payment of interest, though he was bound still, in his return of total income for the purposes of exemption or abatement, to show the interest as a deduction. On the other hand, the bank

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too had to pay on the interest. It could be made to pay on it as a separate item of receipt: compare *Clerical, Medical & General Insurance Society* v. *Carter*, 2 T.C. 437. Or the bank could be made to include it among the bank's taxable trading profits. By Section 22 of the Finance Act, 1915, the Legislature gave the taxpayer in these circumstances the right to get back Income Tax on the interest he had so paid, and this provision, slightly extended, has continued to the present day. It is now to be found in Section 200 of the 1952 Act. In terms, it gives such a taxpayer the right to repayment of " income tax on the amount of the interest ". So far as a bank is concerned, relief is given to the taxpayer in this way if what he pays is " interest "—that is, short or yearly interest. The taxpayer can get a corresponding relief if he pays interest without deduction of tax at source to a stockbroker or member of a discount house, but here the relief is given only in respect of short interest so paid. As regards yearly interest, it was no doubt considered that, as against such persons, the taxpayer would be able to rely on his right to deduct Income Tax at source. In no case, however, is the taxpayer to get a repayment unless the Revenue is satisfied that " the interest " will be brought into account for Income Tax purposes by the bank, the stockbroker or the members of the discount house.

This provision, first made in 1915 and continued since, is, in my opinion, a recognition by the Legislature that the payment of interest by A to B should be treated as giving rise to one subject matter of tax only. It takes power to make B, the recipient, pay on it without any deduction at all. If it is yearly interest paid out of profits or gains already taxed, it makes no assessment on the recipient: it gets the tax from the payer, and allows him to recoup himself at source. Now in the case of short interest, again only one person is to suffer the tax. In other words, interest, short or yearly, is treated for Income Tax purposes as one income, taken out of the income of the payer, and becoming the income of the payee. This is, in my opinion, also the underlying concept of the direction that, when one is computing total income for the purposes of exemption or abatement, all interest must be deducted. When this total income similarly computed is to be subjected to Surtax, it is difficult to understand why annual interest alone may be deducted. In fact, where relief from Income Tax is granted in respect of interest paid to a bank, a stockbroker or a member of a discount house, relief from Surtax is also granted. Mr. Orr, for the Crown, says that this is because the Statute directs repayment of " income tax on the amount of the interest ", and Income Tax now includes Surtax, which is defined to be a deferred instalment of Income Tax. Surtax, however, is not imposed upon specific classes of income, but only in respect of total income, and one would not know, therefore, what precise amount of Surtax (since the rates of Surtax vary with the amount of income) was attributable to the interest. But, leaving this difficulty aside, and assuming Mr. Orr to be correct, the situation results that relief from Surtax is given whenever short interest is paid to a bank or stockbroker or member of a discount house, but not when it is paid to any other member of the community. Why the Legislature should be so whimsical, no one can explain. But there is no such oddity if the statutory direction to compute total income for Surtax purposes in the same way as total income for the purposes of abatement and relief is obeyed, for then all interest is deducted.

As to the authorities, the present point is *res integra*. There is little value, therefore, in parading them all, seeking from them an implication, now one way and now the other, and relying upon judicial remarks made without this problem being in mind at all. This is not intended as a criticism of the arguments of either side, which indeed have been most helpful: it is merely my reason for keeping an examination of the authorities down to a minimum. For it is agreed

on both sides that the question can be treated as one of the true construction of the provisions of the 1842 and 1910 Acts which I have cited. Their modern equivalents in the 1952 legislation admittedly exhibit no material difference.

The Crown rely principally upon the decision in *Earl Howe* v. *Commissioners of Inland Revenue*[1], a case in which Earl Howe argued that insurance premiums were " annual payments " which diminished his income for Surtax purposes. This Court held otherwise, saying, in effect, that the premiums were simply an application or spending of the Earl's income, and that the only way one could diminish one's income for Income Tax purposes was by a passing on of that income as such. When one did this, one was entitled to deduct Income Tax at source under the provisions of the Act. Another way of expressing the same proposition is this: that, if the payment is one from which you may deduct Income Tax at source, then you may deduct that payment in computing your total income for Surtax purposes. Scrutton, L.J., did say this[2], and so have other learned Judges since: see, for example, the Lord Justice Clerk (Alness) in *Commissioners of Inland Revenue* v. *Hay*, 8 T.C. 636, at page 648. But, never having the case of short interest in mind, the language used was wide and, literally construed, might turn the proposition into a different one—namely, *unless* you may deduct Income Tax at source, then you cannot deduct the payment in computing your total income. But if the real reason for allowing such a deduction is that, for tax purposes, the payment is treated as a shifting or alienation of part of A's income so that it becomes B's, then this applies just as much to short interest as to annual interest. In these circumstances, to prescribe as the universal test of deductibility, " May you deduct tax at source? ", is to elevate what is really a symbol of recognition only into the object matter of the search. In 99 cases out of 100, the answer to the question, " May tax be deducted at source? ", will also answer the question, " May the payment be deducted from total income for Surtax purposes? ". In the one case of short interest, it may not give you the answer, for if short interest is also to be treated as an alienation of income as opposed to a mere spending of it, then it stands for present purposes exactly on the same footing as any other annual payment. In the circumstances, I cannot treat the remarks in *Earl Howe's* case as conclusive of the present. Nor, indeed, would I rely on judicial *dicta* in other cases where the point was not in issue: see, for example, Swinfen Eady, L.J., in *Brooks* v. *Commissioners of Inland Revenue*, 7 T.C. 236, at page 245, which *dictum* favours the present Appellant.

Two other matters must be mentioned briefly. Mr. Orr argued that the expression in Schedule G, Rule XVII, of the 1842 Act, now the Twenty-fourth Schedule to the 1952 Act—namely, " interest, annuities or other annual payments "—connoted yearly or annual interest by reference to the rule *noscitur a sociis*. But, since the Act carefully distinguishes in other places between " interest " and " yearly interest ", I would not accept this argument.

Secondly, in 1944, I think, the Legislature introduced a provision to the effect that small maintenance payments under a Court Order should be made without deduction of tax at source. It is now to be found in Section 206 of the 1952 Act. Sub-section (3) of the Section enacts that such payments shall be deducted in computing total income. The Crown rely, though not heavily, on this Sub-section in support of their argument. It is said that this is a case where Income Tax cannot be deducted at source, and therefore special provision

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[1] 7 T.C. 289. [2] *Ibid.*, at p. 303.

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had to be made to enable the payment to be deducted from total income. This argument is really covered by what I have already said about the decision in *Earl Howe's* case[1]. Moreover, there might well have been some doubt whether payments by a husband for the maintenance of his wife were really no more than a spending of a part of his income as opposed to a passing on of that part so as to become her income for tax purposes, and not his. Hence the provisions of Sub-section (3) *ex majore cautela*. It is to be noted, moreover, that this Section gives relief from Income Tax at the standard rate also in respect of such payments.

Returning to the Act of 1842, I think that Section 163, directing a claimant for exemption to estimate his aggregate income

> " according to the several Rules and Directions of this Act ",

takes one to Section 190 and Rule XVII of Schedule G. In obedience to these provisions, a claimant must deduct " interest "—that is, all interest—in computing his total income. Section 164 does not conflict with this direction. The reference in that Section to " annual interest " is to be explained by the necessity on the part of the Revenue authorities to know how much of the " interest " is annual interest, for from such interest tax could be deducted at source by the claimant and might be retained by him. This would affect the extent of the relief available to him on his claim. Then, since Section 66(2) of the 1910 Act directed that total income for the purposes of Super-tax was to be computed in the same way as total income for the purpose of exemption or abatement, it follows that " interest "—that is, all interest—shall be deducted for the purposes of Surtax, too.

I do not think the taxpayer needs to pray in aid any rule or principle against double taxation, assuming that any such rule or principle exists in a form which would be applicable here. But at any rate the construction of the Acts which I favour has the merit of avoiding it, whereas the Crown's contention admittedly inflicts it.

Finally, I think it probable that the reason for the distinction drawn between annual interest and short interest for the purposes of Income Tax at the standard rate is this. The easy method of collecting tax on interest is by making the payer deduct it at source and accounting for it to the Revenue. He will either hand over the tax so deducted or he will suffer tax on the interest himself as part of his general taxed profits, and recoup himself by retaining the tax he deducts at source. This works all right, no doubt, in the case of interest payable year by year; but if the system were applied in its totality to short interest, there would be a myriad of payments, all subject to deduction of tax at source, with the subsequent accounting to the Revenue, and leading, perhaps, to a multitude of claims for repayment of the tax so deducted where the recipient of the short interest was a person of small means: see in this connection Lord Esher, M.R.'s remarks in *Goslings and Sharpe* v. *Blake*, 2 T.C. 450, at page 455. To obviate such administrative difficulties and to make certain of getting its tax on short interest, the Legislature has forbidden any deduction in respect of it to the payer. He must pay tax in full on his profits without any deduction for short interest. If he has no profits, he must deduct tax at source and hand it over to the Crown. He gets no relief from Income Tax at the standard rate unless he pays this short interest to a bank, a stockbroker or a member of a discount house, where no doubt the Crown can be sure of getting tax on it from such a recipient. None of these considerations, however, affect Surtax. Just as in the three cases I have mentioned the payer of short interest is allowed

[1] 7 T.C. 289.

to deduct it from his total income for Surtax purposes, so also should the payer of short interest who pays it to other persons. The justification in each case is not some extra-statutory concession by the Revenue, but the provision of the 1842 and 1910 Statutes, which I have cited, and their modern equivalents.

I would allow the appeal.

Lord Denning, M.R.—I will ask Russell, L.J., to give his judgment next.

Russell, L.J.—It became, as I understand it, common ground between the parties that the solution to the present problem depends basically upon the question whether, on the true construction of the 1842 Act, short interest such as this was to be deducted from the aggregate of annual values and profits from all sources in order to ascertain whether a person's income was less than £150, and consequently exempted from Income Tax.

In approaching that question, it is to be observed that for the purpose of ascertaining the amount of a person's liability for Income Tax short interest could not be deducted. If deduction for purposes of exemption was permissible, the result would be, for example, that a taxpayer with total chargeable income of £180 and short interest liability of £29 would suffer tax on £180, but had his short interest liability been £31 he would have been totally exempt.

Sections 163 to 170 of the 1842 Act are the Sections which deal primarily with exemption. These Sections are followed by Sections dealing with miscellaneous matters. These include relief from double assessment, details as to collection and payment, liability of parents for infants and personal representatives for deceased taxpayers, parish liability for collectors, penalties and payment of Revenue officials. Section 189 incorporates in the Act Schedule F, forms of oaths to be taken by Commissioners and Revenue officials in relation to their duties in connection with Schedule D. It would seem that Section 38 sufficiently achieved this without any Section 189, but the system then was to attach a Schedule to a Section rather than to the Statute as a whole. Next follows Section 190, and with it Schedule G, and in particular head XVII of what are described in the Section as the rules and directions therein contained, on which prime reliance has been placed by the Appellant as showing that short interest is deductible in computing total income.

Section 163 provides that any person chargeable

> " who shall prove before the [General Commissioners] in the Manner hereinafter mentioned, that the aggregate annual Amount of his Income, estimated according to the several Rules and Directions of this Act, is less than One hundred and fifty Pounds, shall be exempted "

from Income Tax, and shall be entitled to be repaid the amount of all deductions or payments on account except so far as the claimant is entitled to charge tax against or deduct or retain tax from any payment to another. The Section finally provided that

> " such Exemption shall be claimed and proved, and the Proceedings thereupon shall be had "

before the local General Commissioners pursuant to and under the powers and provisions by which tax under Schedule D is directed to be ascertained and charged,

> " but nevertheless subject to the Rules and Directions hereinafter contained."

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Section 164 required a claimant to exemption to deliver a nctice of his claim within a time laid down,

> " together with a Declaration and Statement, signed by such Claimant, and in such Form as may be provided under the Authority of this Act, declaring and setting forth therein all the particular Sources "

—that is, of his income—

> " and the particular Amount arising from each Source, and also every Sum of annual Interest or other annual Payment reserved or charged thereon, whereby the Income shall or may be diminished ".

The claimant was also required to set out every sum of tax which, put shortly, he was entitled to charge against or retain from another. The Section then provided for scrutiny of such a claim, statement and declaration by the Inspector or Surveyor; for transmission to the Commissioners; for discharge of assessments if the claim should appear good; for objections by the Inspector, and for hearing and determination in that case of the matter by the Commissioners. Section 165 provided for repayment of tax already deducted, for example, from dividends should an exemption claim succeed. Section 166 imposed penalties for fraudulent claims, and when condescending to detail expressly refers to an untrue declaration of any income or of any sum of tax which the claimant is entitled to deduct from payment to another. It does not in terms suggest that an overstatement of short interest payments is to be deprecated. Section 167 provides for the manner of " estimation " of the annual amount of lands, etc., for exemption claim purposes. Such estimation is to be

> " according to the Rules and Directions contained in . . . Schedules (A.) and (B.) ",

with additional special provisions. Section 168 provides for several claims by tenants in common, partners, etc. Sections 169 and 170 I need not notice for present purposes.

I come now to Section 190. That Section enacts that Schedule G,

> " with the Rules and Directions therein contained, shall, in making Returns of the Amount of annual Value or Profits on which any Duty is chargeable under this Act. . . be observed ".

The body of the Section makes no reference to exemption. Section 52 had already imposed upon persons chargeable the duty to make returns " in such Form as this Act requires ", stating the annual value of all lands, etc., and the amount of the profits or gains arising to them from all and every source chargeable under the Act according to the respective charging Schedules. Schedule G has 17 headings, described in the margin as " *Sched.* (G.) *Rules.* " Rule I contains the rules to be observed by every occupier of lands in making his return for Schedules A and B. Rules II to VI contain rules in relation to Schedule A returns for people in special situations corresponding to the various Sections and Rules of Schedule A. Rules VII to XII cover the various Cases under Schedule D. None of these requirements as to the form of returns adds anything to the substance of what has gone before; and, indeed, in most cases they are a re-statement in abbreviated form. Rule XIII provides for the content of declarations about partnerships by partners. Rule XIV deals with profits of office not chargeable by specially appointed Commissioners. Rule XV repeats the requirements of Section 52 of a declaration of truth of the return. Rule XVI requires a list and declaration designed to give information about other persons who may be chargeable. Thus far, the function of Section 190 and Schedule G appears to be purely to provide mechanical aids to carrying out the substance of the Statute.

Rule XVII is in the following terms. It is headed:

> " Lists, Declarations, and Statements of Discharge, or in order to obtain Exemptions."

It then says:

> " First.—Declaration of the Amount of Value or Property or Profits returned, or for which the Claimant hath been or is liable to be assessed: Second.—Declaration of the Amount of Rents, Interests, Annuities, or other annual Payments, for which the Party is liable to allow and deduct the Duty, with the Names of the respective Persons by whom such Payments are to be made, distinguishing the Amount of each Payment: Third.—Declaration of the Amount of Interest, Annuities, or other annual Payments, to be made out of the Property or Profits assessed on the Claimant, distinguishing each Source: Fourth.—Statement of the Amount of Income derived according to the Three preceding Declarations: Fifth.—Statement of any Payment which the Claimant may be liable to make, and out of which he may be entitled to deduct or retain any Portion of the Duty charged upon him, and of any Charge which he may be entitled to make against any other Person for any Portion of such Duty."

Let me say first that I also reject the argument that the word " Interest " in the phrase in the third paragraph, " Interest, Annuities, or other annual Payments ", if taken in isolation, is confined to annual interest merely by reason of the words " or other annual Payments ". But, taken in the context of the whole Statute, I cannot agree with the conclusion that the third paragraph is to be construed as introducing for the first time in the reading of the Statute the conception of deduction of short interest payments in connection with the payer's liability to Income Tax. In my view, Section 190 and Schedule G in all their parts are to be regarded merely as formal machinery for working out that which has gone before. Rule XVII is merely the " form " referred to in Section 164, which Section, by its express reference to annual interest whereby the income may be diminished, surely indicates that short interest is not to be regarded as diminishing the income for exemption purposes. The reference to " interest " in Rule XVII, paragraph 3, is not in my view to be taken to be other than a reference to the annual interest already mentioned.

Similarly, I take the phrase in the second paragraph of Rule XVII, " Rents, Interests, Annuities, or other annual Payments ", to be an echo of the phrase, " Rent, Annuity, Interest, or other annual Payment " in Section 163. When Section 163 speaks of " the aggregate annual Amount of his Income, estimated according to the several Rules and Directions of this Act ", it is a reference to the various rules and directions in the charging provisions of the Act, the aggregate being arrived at by applying to each source those rules and directions.

In short, therefore, I consider that Rule XVII is to be regarded merely as providing a form foreshadowed by Section 164 in which the claim to exemption is to be put forward, containing the content of Sections 163 and 164, the right to exemption being dependent upon the substantive provisions. Similarly, earlier Rules of Schedule G are mere forms in which returns are to be made, the substantive taxing provisions being elsewhere. For these reasons, the word " interest " in Rule XVII is to be regarded in the context of the whole Act only as an abbreviated reference to annual interest.

Accordingly, I would dismiss the appeal. I add two comments. First, I can see no justification in the language of the Sections that provide for repayment of Income Tax in some cases of short interest—for example, bank interest—for the allowance of such interest as a deduction in computing total income for Surtax purposes. If I am right in my view that short interest of the kind in the present case is not deductible for Surtax purposes, then for Surtax purposes all short interest is on the same footing. If I am wrong, then for Surtax purposes

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all short interest is on the same footing in the contrary sense; but, in the case of short interest of the present type, the somewhat unusual result will follow that the Legislature has dealt more tenderly with the Surtax payer than with the mere Income Tax payer.

Second, my view of the construction of the 1842 Act may find some support from the Income Tax Act, 1853. When extending the Income Tax to Ireland, including the provisions for exemption and abatement, Section 31 provided that all such claims in Ireland

> " shall be made in such Manner and Form as the Commissioners of Inland Revenue shall direct and provide in that Behalf ".

It seems to me that that would entitle the Commissioners of Inland Revenue to substitute in Ireland their own preferred form for Schedule G, Rule XVII. If this be so, it suggests at least that the Legislature in 1853 regarded Rule XVII as a matter of form only, and not of substance.

Lord Denning, M.R.—In the long run, the decision of this case depends on the true construction of the Income Tax Act, 1842. As I read that Act, in estimating a man's total income there was to be deducted " Interest, Annuties, or other annual Payments " which he has to make. I am satisfied that that included short interest as well as annual interest. So also, subsequently, for the purpose of Super-tax, and now of Surtax, in ascertaining his total income, short interest must be deducted.

I find myself in full agreement with the judgment of Donovan, L.J., who has dealt with the matter most convincingly. I would allow the appeal.

Mr. C. N. Beattie.—So your Lordships will say that the appeal will be allowed with costs here and below?

Lord Denning, M.R.—Yes.

Mr. Alan Orr.—My Lord, I am instructed to ask, and I ask now, for leave to appeal to the House of Lords if, after considering the judgments, my clients should desire to take that course.

Lord Denning, M.R.—I have been wondering about that, and I was wondering whether this was a case in which there should be some conditions.

Mr. Orr.—I am entirely in your Lordships' hands as regards that, but I would submit that in this case there should not, in all the circumstances, be terms.

Lord Denning, M.R.—We will see what Mr. Beattie says about that.

Mr. Beattie.—I would submit, in the first place, my Lords, that leave should not be granted, because your Lordships' judgment has brought the matter of all short interest into line for Surtax purposes, which seems very satisfactory. But if your Lordships do give leave, I would respectfully ask that it should be on terms that the Order as to costs in this Court should not be disturbed. I would even go so far as to submit that, as the case involves such a small amount of money——

Lord Denning, M.R.—How much is involved?

Mr. Beattie.—It is £1,000 odd, my Lord. I would submit that Mr. Frere should not be asked to pay the costs in the House of Lords in any event.

Donovan, L.J.—Why do you say it is not a case for terms? You can only be asking to go to the House of Lords because it is a matter of principle affecting taxing matters.

Mr. Orr.—I accept that, my Lord. I would submit that where there has been a dissenting judgment in this Court, and where this Court, in its majority, differs from the Court below, that might be a reason for thinking that in this case there should not be terms.

Donovan, L.J.—I have never heard that before.

Russell, L.J.—That is just counting heads.

Mr. Orr.—If your Lordships think it a proper case for terms, I should not, perhaps, say more.

(*The Court conferred.*)

Lord Denning, M.R.—Leave to appeal will be given, Mr. Orr, but on the terms and conditions that you do not seek to disturb the Order as to costs in this Court, and that if you succeed in the House of Lords you will not ask for costs there.

Mr. Orr.—If your Lordship pleases.

The Crown having appealed against the above decision, the case came before the House of Lords (Viscount Radcliffe and Lords Morris of Borth-y-Gest, Guest, Pearce and Upjohn) on 22nd, 23rd and 27th July, 1964, when judgment was reserved. On 19th November, 1964, judgment was given unanimously in favour of the Crown.

Mr. F. Heyworth Talbot, Q.C., and Mr. J. Raymond Phillips appeared as Counsel for the Crown, and Mr. C. N. Beattie, Q.C., and Mr. Peter Rees for the taxpayer.

Viscount Radcliffe.—My Lords, Mr. Frere, the Respondent, on two occasions borrowed large sums of money for short periods. On 28th March, 1957, he borrowed £50,000 at interest on the terms that the loan should be repaid by 31st January, 1958; it was repaid on 3rd December, 1957, together with £2,210 19*s.* 2*d.* by way of interest. On 14th August, 1958, he borrowed £40,000 at interest for one month and repaid it on 17th September of the same year. The interest cost of the borrowing was £186 2*s.* 9*d.* The concern which made these loans to him was an unlimited company which, it is common ground, did not satisfy the description of a " banker ", whatever that description may be.

The Respondent's claim is that in computing his total income for assessment to Surtax, the moneys which he paid by way of interest on these loans ought to be deducted from the assessable figure. It is, again, common ground that the payments that he made were, in each case, " short interest ". This is a technical phrase, significant to those who administer Income Tax law; but

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what it means for the present purpose is that the payments were not " annual interest " and are not, therefore, interest payments of the class that is, for instance, recognised or dealt with by Section 2 (2), Section 169 (" yearly " interest), Section 511, or the Sixth Schedule (" yearly " interest) of the Income Tax Act, 1952.

His claim was allowed by the Special Commissioners. They found their authority to do so in a construction which they placed upon the joint effect of Section 524 (2) of the Act (which requires a person making a return of " total income " to observe the rules and directions contained in the Twenty-fourth Schedule to the Act), and of the third sub-head of that Schedule, which calls for a declaration of the

> " amount of interest, annuities or other annual payments to be made out of the property or profits or gains assessed on the person in question ".

In their view the " interest " referred to in that sub-head is all interest, annual, yearly or short, and they concluded that, since the return had to cover all such interest, the total income as computable for Surtax must somehow be treated as diminished by an amount equal to " short ", as well as " annual ", interest. This view of the operative significance of the wording of the Twenty-fourth Schedule, sub-head (3), though it did not prevail with Wilberforce, J., in the High Court[1] or with Russell, L.J., in the Court of Appeal[2], is, I think, accepted by the majority of the members of the Court of Appeal (Lord Denning, M.R., and Donovan, L.J.), and constitutes the ground of their decision, which has allowed to the Respondent the deduction that he claims. With great respect to their view, I think it mistaken. In my opinion, the wide construction that it places upon the meaning of " interest " in this sub-head is unwarranted: even if, semantically, it were the right construction, I should still think that it was insufficient to support the deduction claimed, when the claim is set in the context of the Income Tax Act and the scheme of assessment which, however dimly, can be observed as that proposed and regulated by the Act. But, before I come to this in detail, I must say something about the question of principle which appears to have been the foundation of the Special Commissioners' decision, and which, as I read it, was also influential in the opinion expressed by Donovan, L.J., and given effect to in his judgment.

> " It appears to us, therefore "

says the Case Stated (see paragraph 5)

> " that it would be contrary to principle to charge Surtax, in effect, on two persons in respect of the same ' short ' loan interest."

Now I have two difficulties in seeing what principle is envisaged as threatened by a refusal to allow the Respondent to deduct short interest from his Surtax assessment. First, if one uses ordinary language uncoloured by Income Tax conceptions, no one, I believe, would imagine that this refusal did involve charging two persons to tax in respect of the same interest. There is only one item of interest, that which arises out of the Respondent's transaction with the lenders, and there is only one payment of this, that which the Respondent makes to them. No one is surprised if they are charged to tax on that payment as being part of their income, but in the practical sense, again, no one is concerned to ask out of what resources the payer finds the money that constitutes the payment. He draws on his bankers, and that closes the transaction. The idea that the Respondent somehow has all along had this amount of interest embedded

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[1] *See* page 130, *ante*. [2] *See* pages 142–3, *ante*.

as such, not merely in his personal resources but in his own taxable income of the year in which he pays it, and that all he does when he pays it is to transfer the item from his income to that of the recipient, is an esoteric idea which belongs to the mystique of tax doctrine, not to the realities of ordinary dealing. But then, if the case is to stand or fall by the special doctrines of the tax system, one has to establish that those who framed that system did in fact hold a doctrine about short interest that supports the Respondent's case and, moreover, made legislative provisions that would give effect to its allowance in the computation of total income.

So I turn to my second difficulty about this supposed principle, which is to see what indications there are in the tax code that the payment of short interest is to be treated as a diminution of the payer's taxable income. One can start with some safe generalisations on this subject. Income that is assessed to tax is neither measured by expenditure nor is it the residual income that lies after expenditure of an income nature. It is not the savings of income. In principle, it is gross income as reduced for the purposes of assessment by such deductions only as are actually specified in the tax code, or are granted by way of reliefs, usually in the form of fixed sums or proportions. No doubt the assessment of profits under Schedule D has come to require a rather different approach, since in that case the basic figure for assessment is the balance between receipts and expenditure; but even there it is plain that the code is intended to keep a control over the forms of expenditure that can appear in the profit account. It follows from this general conception that in principle it is irrelevant to the determination of a person's taxable income that some part of it has been expended by him on what would normally be regarded as his own income account, in paying rent, wages, mortgage interest, rates, insurance, for example, or that the payments that he makes for such purposes will themselves constitute or contribute to assessable income in the recipient's hands. Under our system payments may run to and fro many times in the course of a single tax year, creating new taxable income at each separate point of receipt. The idea of double taxation does not even arise in these multiple assessments. The mere fact, then, that part of a taxpayer's income has been used to pay interest on a loan during a year, even assuming that you visualise " income " as a separate spending fund, would not in itself set up a reason for reducing the assessment of his taxable income. The payment of the interest, whether long or short, would be no more, for this purpose, than an " application " of his income.

On the other hand, it is notorious that, quite apart from fixed reliefs for such kinds of expenditure as support of dependants or life assurance premiums, the code does make provision for certain " charges " on income being treated for tax purposes as if the income of the payer was, to the extent of the charge, not his income but the income of the recipient. To take the crudest case, that of the income received by a trustee for his beneficiary, probably the holder of a life interest under a settlement. If you wanted to calculate the " total income " of those two persons for the purpose of working out their rights to tax relief, as individuals, you would not, nor does the tax code, stop at the bare fact that the income payments received by the trustee were actually charged to tax in his hands, either by direct assessment or by the machinery of deduction. You would say that, when it came to arriving at a " total income " under the tax scheme, such payments must not be attributed to the trustee, through whose hands they passed, but must on the contrary be attributed to the beneficiary, whose hands they were from the beginning destined to reach. That is straightforward. But now take the next most straightforward case, that of the

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annuity which is by legal right charged upon property, income primarily, capital by way of resort. A man comes into the right to that income subject to the charge of the annuity. Under the tax system, as in ordinary thinking, his own income is reduced by the amount of the charge. The gross income accruing to him is divided in ownership right, a part equal to the annuity figure belonging to the annuitant, the balance to him. The reality of this situation was recognised and allowed for by the tax system, because, while the payer of the annuity was assessed and charged on the gross income, he was from the earliest days allowed to deduct from his payments a proportionate part of the tax which he had borne or was to bear on the total. By this means his true taxable income was treated as being the residue left after the charge of the annuity, the burden of the tax being shifted from payer to recipient by the former's statutory right to recoup himself out of the payment due to the latter.

This recognition of a division of ownership between two or more persons entitled to rights in a single " fund " of income was not, however, confined to such cases as those where there was trust income or an annuity charge. There was also the case of " annual " or " yearly " interest—I do not distinguish between the two adjectives—payable under a mortgage, the characteristic feature of which seems to have been that, in setting up the mortgage situation, the borrower had in effect divided the gross income of his estate between himself and the mortgagee. Up to this point it could fairly be said that the division corresponded with and followed the lines of enforceable legal rights in an identifiable fund of property, the accruing income. But the tax system can be seen to go further than this, for it applied the same idea of division of proprietary right to situations in which legal distinctions draw no dividing line. Thus an annual payment secured by personal covenant only, involving no charge on any actual security, whether income or capital, was treated in the same way for tax purposes. It had to be " annual ", and it had also to be payable " out of profits or gains brought into charge " in order to rank as income of payee not of payer, because it was the division of taxable income with which the code was dealing; and it may well be asked what at this stage is the significance of the words " out of " as applied to a payment, the obligation for which was merely the personal one to find the money required out of whatever resources the payer might mobilise for the purpose. The answer was provided by the application of what is in truth an accountant's, not a lawyer's, conception, for it was accepted that, so far as the payer was found to have in the relevant year a taxable income larger than the gross amount required to make the payment, to that extent he was entitled to claim that he had made the payment " out of profits or gains brought into charge ", and to deduct and retain for his own account tax at what in due course (after 1927) became the " standard rate ".

This system of charging tax at source and then setting up machinery for distributing the burden of that tax between the source holder and the person who was regarded, *pro tanto*, as the real owner of the source, was evolved for the purposes of Income Tax, which was assessed and collected under the various Schedules, item by item. The problem of exempting those with incomes below a statutory minimum was that which first raised in a practical form the question what was a person's total income from all sources (as we should now call it) or, to use the words of Section 163 of the 1842 Act, what was the

> " aggregate annual Amount of his Income, estimated according to the several Rules and Directions of this Act."

It was Section 164 of that Act which, as I read it, laid down explicitly the range of matters that were to be taken into account in determining whether or not a

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person had an aggregate income within the exemption. He was to deliver to the Assessor a notice of his claim, together with a declaration

> " setting forth therein all the particular Sources from whence the Income of such Claimant shall arise, and the particular Amount arising from each Source, and also every Sum of annual Interest or other annual Payment reserved or charged thereon, whereby the Income shall or may be diminished . . ."

On the basis of a claim made out in this way, if not objected to by the Inspector or Surveyor, the Commissioners were authorised to " allow such claim of exemption ". Nothing, I agree, is ever plain when one comes to deal with the Income Tax code, but I would, with respect, have thought it reasonably clear that, when the makers of the 1842 Act wished to prescribe what was to be taken as the " aggregate annual amount " of a man's income for the purposes of their Act, they allowed the amount to be reduced by the sum of any annual interest payable out of his income, but not by the sum of any interest that did not qualify as " annual ". If you like to put it that way, they thought that annual interest and other annual payments " diminished " the income, or that the amount required to pay them was not the payer's income at all: they do not seem to have thought of other kinds of payment as having this effect.

I must note in passing that it is at this point that I find myself directly at variance with the opinion formed by the majority of the Court of Appeal. They thought that under the 1842 Act aggregate annual income could be reduced by the figure of any short interest paid, and they found warrant for that in the interpretation they placed on the words used in Schedule G of the Act to describe one of the statutory declarations there called for. I must return later to this point. For the moment I will only say that to extract this consequence from the use of that Schedule appears to me to involve a straight contradiction of what Section 164 had enacted, without any supporting provisions in the Act which would even make the contradiction effective.

The first statutory use of our current phrase " total income from all sources " seems to have been in Section 8 of the Customs and Inland Revenue Act of 1876, and this, significantly, occurs in an exemption Section. When Super-tax was introduced in 1910, its basis of charge was, as we know, the total income of an individual from all sources

> " estimated in the same manner as the total income from all sources is estimated for the purposes of exemptions or abatements under the Income Tax Acts "

(*see* Finance (1909–10) Act, 1910, Section 66 (2)). It is not in dispute, therefore, that, though we are now dealing with a claim to make deductions from or reductions of total income for the purposes of Surtax, the test of what is to be brought into that computation is derived from the test of what formed aggregate or total income for the purposes of exemption, relief or abatement under the original Income Tax system. This assumption is the basis of the decision of the Court of Appeal in *Earl Howe* v. *Inland Revenue Commissioners*[1], [1919] 2 K.B. 336, and there is no need to enlarge upon it further.

It was also the basis of the Court's decision in that case that, in arriving at the figure of total income, only those annual payments could be allowed as deductions which were themselves payable under deduction and retention of tax as between payer and payee. The decision itself is very well known, and I must say that until this case I had never heard it questioned that the principle the Court had proceeded upon was the correct one. It is, after all, " yearly interest of money, annuity or other annual payment " that the income tax code indentified as forming the taxable income of the recipient and not of the payer,

[1] 7 T.C. 289.

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and it seems to me correct therefore to assume that it is only payments so identified that are to be taken as reducing the payer's " total income " under the code. The same principle was resorted to and applied by Harman, J., in deciding *Bingham* v. *Inland Revenue Commissioners*[1], [1956] Ch. 95, and by, at any rate, two of the three members of the Court which decided *Commissioners of Inland Revenue* v. *Hay*[2], 1924 S.C. 521. In my opinion, the principle so applied is the correct one. It is, plainly, that which is recognised by the wording of Section 2(2) of the Income Tax Act, 1952, and no other principle that I can envisage would be consistent with that wording. I have done what I can to attend to the argument which I understand the Respondent to propound as being the true and alternative principle, that all payments are deductible in arriving at the payer's total income which represent what is called " pure income " in the hands of the payee. The conception of " pure income " as a significant category of income under the tax code is, I think, a recent discovery which might have surprised, for instance, the makers of the Income Tax Act of 1842. All I can say is that, apart from the argument founded upon the wording of Schedule G of that Act, to which I must come, I cannot find any trace of an intention to treat part of a person's income as not being taxable income, merely because he uses it to make payments to another person which are themselves taxable directly as part of the income of the recipient. Nor can I see any principle which would support such a deduction, once it is accepted that the making of a payment out of one person's income does not in itself operate to frank that payment for purposes of tax when it reaches the hands of the recipient. Conversely, the fact that a receipt will be taxed as an element of the payee's income is not, without more, a ground for holding that the taxable income of the payer is less by the amount of the payment. To think that, unless some such principle can be imported into the tax system, there is an anomalous case of double taxation is, with great respect to those who may have said otherwise, a begging of the question, for everything depends upon just that question whether there is involved in the payment one single income which is merely transferred, or two separate elements of income which have independent sources of origin.

If *Earl Howe* v. *Commissioners of Inland Revenue*[3] is followed out, the Respondent's claim must fail, since it is not suggested that a payer of short interest is entitled to deduct and retain tax against the payee, even if his payment can be treated as made out of profits or gains brought into charge. What he will get will be the measure of relief now to be found in Section 200 of the Income Tax Act, 1952, if he is dealing with banker, stockbroker or discount house: but that relief, which is not operated through deduction at source, is beside the point of the present argument. As was decided in 1888 in *Goslings and Sharpe* v. *Blake*[4], 23 Q.B.D. 324, short interest is not subject to the procedure of tax deduction and retention under what used to be Rule 19 of the General Rules, and is now Section 169 of the 1952 Act. Unless, therefore, it is possible to support the opinion of the majority of the Court of Appeal that all interest, including short interest, is and always has been deductible in the computation of a taxpayer's total income, the appeal must, I think, succeed.

The argument for deducting short interest proceeds as follows. It has been worked out in terms of the 1842 Act, and there is no objection to this, for I agree that, if such interest can be shown to have been deductible under that Act, it can safely be assumed that a similar line of reasoning would carry it through the 1918 and the 1952 Acts and would produce a similar result. One must, of

[1] 36 T.C. 254. [2] 8 T.C. 636. [3] 7 T.C. 289. [4] 2 T.C. 450.

course, turn the old Section 190 into the present Section 524(2) and the old Schedule G into the Twenty-Fourth Schedule and make other necessary transpositions, but the essential argument remains the same. It is said then that, if one reads Section 163 of the 1842 Act, one finds that the " aggregate annual Amount " of a person's income is to be " estimated according to the several Rules and Directions of this Act ". These rules and directions, it is said, are laid down by Section 190 of the same Act, a Section which requires the observance of

> " the Schedule marked (G), with the Rules and Directions therein contained "

by any person who is making returns of the

> " Amount of annual Value or Profits on which any Duty is chargeable under this Act."

Then, when Schedule G is resorted to, it is seen to contain a considerable number of rules which prescribe forms of returns and declarations relating to different kinds of income under the various taxing Schedules, and there is among them Rule XVII, entitled:

> " Lists, Declarations, and Statements of Discharge, or in order to obtain Exemptions."

This rule starts with four sub-headings which run:

> " First.—Declaration of the Amount of Value or Property or Profits returned, or for which the Claimant hath been or is liable to be assessed: Second.—Declaration of the Amount of Rents, Interests, Annuities, or other annual Payments, for which the Party is liable to allow and deduct the Duty, with the Names of the respective Persons by whom such Payments are to be made, distinguishing the Amount of each Payment: Third.—Declaration of the Amount of Interest, Annuities, or other annual Payments, to be made out of the Property or Profits assessed on the Claimant, distinguishing each Source: Fourth.—Statement of the Amount of Income derived according to the Three preceding Declarations."

The argument then concentrates upon the wording of the third declaration in this rule. " Interest " here, it is said, means interest of any kind, not merely what is called " annual Interest ". If that is so, the Legislature is calling for a declaration to be made, *inter alia*, for the purposes of claiming exemption, which requires the showing in the return of all interest payments that are to be made out of the property or profits of the claimant. The conclusion is that, notwithstanding the provisions of Section 164 and the reference to " annual Interest " which is found there, all interest is to be regarded as impliedly authorised as a permissible deduction when aggregate annual income is being computed for the purpose of exemption.

I hope that I have not omitted any step in an argument which is to me an elusive one. With sincere respect for those who have propounded it, I find it unconvincing as well as elusive. And this for a number of reasons. For instance, I do not think that it is correct to say that the rules and directions for estimating aggregate annual income which are referred to in Section 163 are in any special sense the rules and directions which are found in Schedule G. On the contrary, what are referred to are the " Rules and Directions of this Act "; and the Act, of course, contains a great many sets of rules and directions for estimating different types of income, none of which has any connection with deductions or exemptions at all. There is, therefore, no real link between Section 163 and Schedule G. That Schedule is in fact brought into operation by a separate Section, 190, which requires the observance of the Schedule and its rules and directions for the administrative purpose of the making of returns of income: but investigation shows that the rules and directions which are to be found in Schedule G with reference to its forms are not in any case (unless, exceptionally, in the third heading of Rule XVII) original and independent rules, but are merely repetitions of rules and directions which have been laid down in

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other, and what I think I must call substantive, parts of the Act. That is what one would expect. One would not look to find, in a Schedule describing the forms of returns required for the implementing of the taxing provisions of the Act, the introduction of a special rule allowing certain deductions from assessable income which are not mentioned or, it would seem, envisaged in any preceding part of the legislative scheme. And no one, I think, suggests that there is any other part of the whole Act in which interest not being annual interest is contemplated or spoken of as an allowable deduction from aggregate or total income.

I do not, however, wish to elaborate my criticisms of the process by which the argument is constructed because, in my opinion, the conclusion upon which it all depends, the comprehensive meaning attached to the word " Interest " in the third heading of Rule XVII, is wrong in itself. I do not think that it can be taken as referring to anything more than annual interest. To read it otherwise is to ignore the very definite instruction that the Legislature has already given in Section 164 in the body of the Act. There it has been laid down that, when a claim of exemption is to be submitted for proof and allowance, the sum total of the income from various sources may have put against it

> " every Sum of annual Interest or other annual Payment reserved or charged thereon, whereby the Income shall or may be diminished ".

There is no mention of allowing any other kind of interest. When one comes, therefore, to the reading of Rule XVII in Schedule G, which is prescribing the contents of a declaration " in order to obtain exemption ", it seems to me that it would be capricious not to construe the word " Interest " in the third heading, which evidently relates to deductions, so as to make it congruous with the kind of interest which the Act has already said is to be allowed in the computation of total income for the purpose of exemption.

The context of the words in Rule XVII appears to me to indicate exactly the same meaning. The first heading covers income upon which the claimant is directly assessable. The second heading relates to income to which he is taxable by deduction and retention on the part of the payer, in other words the kinds of payment which the Act treats as being the taxable income of payee, not payer. These payments are described in the words

> " Rents, Interests, Annuities or other annual payments ".

The word " Interests " is not qualified by any adjective, but I think it inescapable that one must read it here, either because of its collocation with " other annual payments " or for common sense, as meaning annual interest only, because it is only for that kind of interest that the Act has allowed deduction and retention of tax by the payer. Then there comes the third heading, described as

> " Declaration of the Amount of Interest, Annuities, or other annual Payments, to be made out of the Property or Profits assessed on the Claimant. . . ".

The collocation of interest with annuities and other annual payments is the same as in the preceding heading, and as a straightforward question of construction alone I think that any reader would naturally suppose that the word " Interest " was being used in the same sense in each of the two successive headings, and would never guess that in the second one it was being used with a different meaning from that which he had attributed to it in the first. In my opinion, there is no change in the meaning that is intended.

It seems to me useless to seek to interpret the word " Interest " in this heading with reference to the meaning of " Interest " in other unrelated parts of the 1842 Act or later Acts, for instance, in contexts where it is being dealt with as a chargeable subject or as an element of taxable income, not as a deduction from such income. The relative considerations are different in these respective

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cases. References to Section 100 of the 1842 Act or to the current form of the charge under Case III of Schedule D are, therefore, beside the point for the purposes of interpretation; indeed, the phrase used in the 1952 Act

> " any interest of money, whether yearly or otherwise, or any annuity, or other annual payment "

shows a plain intention to exclude the doubts that might otherwise arise from the collocation of " interest " with " other annual payments ". It is equally wrong, in my opinion, to found any argument upon the meaning to be attributed to " interest " in what is now Section 170 of the current Act, the former Rule 21, which obliges a person who is paying interest not out of profits or gains brought into charge to deduct tax at the standard rate and, in this case, to account for it to the Revenue. This Rule, incidentally, had no place in the 1842 Act, and did not enter the tax code until 1888. The use of it as an analogy in aid of construction appears, however, to have appealed to the Special Commissioners, but I think that it is no analogy at all. It is true that in *Lord Advocate* v. *Lord Provost, Magistrates and Council of City of Edinburgh*, 4 T.C. 627, the Court of Session decided that " interest " here covered short interest. The decision itself has stood for a long time and had better therefore be left alone, but I am bound to say that I think it a singularly ill-judged one, for how in practice can anyone paying short interest on, say, 24 hours' or 7 days' money detect at the time of payment whether he is paying it out of profits or gains brought into charge (in which case he has neither right nor duty to deduct), or out of a source which is not such a profit (in which case he is under a statutory duty to deduct and account)? But it is sufficient to say of this decision that it is neither so persuasive in itself as to be a guide to the interpretation of other parts of the Act nor, even if it were impeccable in its own context, could it throw any light on the meaning of the words used in Rule XVII of Schedule G.

I have come to the conclusion, therefore, that the Crown's argument in this case is right and that the appeal ought to be allowed. There is a special arrangement about costs which will be embodied in the Order made by the House.

I will add one word, if I may, about the general proposition that the distinction which I have recognised between the tax treatment of annual interest and the tax treatment of short interest represents an unjustifiable anomaly, only mitigated in certain respects by the provisions now contained in Section 200 of the present Act. I have already spoken of the argument that such treatment involves double taxation of short interest. I cannot see that it does. But if there is here an anomaly, to which the attention of the Legislature ought to be directed, I think that we ought to be clear what the anomaly is. The long maintenance of the tax scheme that produces this difference of treatment does, I think, suggest that there may be less similarity between the nature of annual interest and the nature of short interest than is sometimes allowed for. Of course, if you take the distinction between interest on a 13 months' loan and interest on an 11 months' loan (assuming those to be true examples) the distinction is meaningless. But then that is true wherever differences of degree are allowed to constitute differences of category. If you take, on the other hand, what are perhaps more representative examples of the two categories and set interest on a long term mortgage or the charge of a life annuity against the interest on 24 hours' money, 7 days' money or a 3 months' bill, it is possible to see a real difference between their respective impacts on the payer's true taxable income. In the first place, there is something like a permanent set-up under which the man's income accrues to him each year subject to a fixed and recurring charge for this outgoing. In the second, the short interest can be regarded as merely part of the cost of

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getting, using and returning money, and is often accounted for as a discount only, and its relation to the payer's annual income is much less direct. If he is borrowing professionally on short loan to get the return by lending *pro tanto* longer, it is only the difference on the incoming and outgoing that he would think of as his income. If he is borrowing short to finance a purchase transaction, the interest, as I have said, is part of the cost which has to be set against the final gross return.

It is no more than speculation to ask whether these differences, which I believe to be real, are the historical basis of the difference in treatment for purposes of tax. Of the maker of the tax code, as of another inscrutable author,

" we ask and ask: Thou smilest and art still, Out-topping knowledge ".

I have merely thought it worthwhile to put on record a possible explanation of this " anomaly ".

On the other hand, while it is possible to think that there is no true anomaly in principle in recognising these differences, I do think that there is by now a clear anomaly in practice, which has been created by the statutory allowance of repayment of Income Tax on short interest, when paid out of taxable income to a banker or stockbroker or discount house. This allowance was started with the 1915 Section that dealt with bank interest only. It is all now contained in Section 200 of the 1952 Act. The allowance is given by way of relief, not of deduction and retention. It authorises a claim for repayment of Income Tax. Being given as a relief against Income Tax it does not by any means necessarily justify a claim for repayment of Surtax, since Income Tax reliefs are not automatically reliefs against Surtax. We are told, however, that the Revenue recognise the claim against Surtax as an " extra-statutory concession ". I have never understood the procedure of extra-statutory concessions in the case of a body to whom at least the door of Parliament is opened every year for adjustment of the tax code. But however that may be, if short interest is to be the subject of tax relief at all, there can be no relevant difference, so far as I can see, between such interest paid to one category of recipient in this country and the same interest paid to another. It is an anomaly to give a relief in the one case and not in the other.

Lord Morris of Borth-y-Gest.—My Lords, I have had the privilege of reading and considering the speech which has been prepared by my noble and learned friend, Viscount Radcliffe, and I am in agreement with his reasoning and his conclusion.

Lord Guest.—My Lords, I have had the opportunity of reading the speech of my noble and learned friend, Viscount Radcliffe, with which I concur. There is nothing I can usefully add. I agree that the appeal should be allowed.

Lord Pearce.—My Lords, I have had the privilege of reading the speech which has been prepared by my noble and learned friend, Viscount Radcliffe, and I am in agreement with it.

Lord Upjohn.—My Lords, I have had the opportunity of reading the speech of my noble and learned friend, Viscount Radcliffe, and entirely agree with it.

Question put:

That the Order appealed from be reversed except as to costs, and that the judgment of Wilberforce, J., be restored, except as to costs.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Frere, Cholmeley & Nicholsons.]

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