HOUSE OF LORDS—10 AND 11 OCTOBER AND 9 NOVEMBER 1977

Fitzleet Estates Ltd. and Others *v.* Cherry (H.M. Inspector of Taxes)(1)

B

Income tax—Schedule D, Cases III *and* VI—*Payments of interest and ground rent incurred when property was being developed—Whether capitalised or paid out of profits or gains brought into charge to tax—Income Tax Act* 1952 (15 & 16 *Geo.* 6 & 1 *Eliz.* 2, *c.* 10), *s.* 170.

The Appellant Company, and three others, all part of a group, were property holding companies. During the period whilst its property was being C developed each company charged in its annual profit and loss account bank and other interest and any ground rents payable; each company then credited the account with a sum described in similar terms to the following:—"Transfer to cost of freehold property of an amount equal to the estimated proportion of the net amount for the year of the interest and other expenses charged to profit and loss account attributable to property in the course of development." D Each company, appealing to the Special Commissioners against income tax assessments under s. 170, Income Tax Act 1952, contended (i) that the company was crediting part of an unrealised capital profit on the fixed assets, and (ii) that interest or rent included in such "transfer items" was not thereby being charged to capital. On behalf of the Crown it was contended (i) that the "transfer items" represented a deliberate capitalisation of interest payable, which enabled E net income dividends to be paid, and (ii) that it was wrong to regard such "transfer items" as a credit to profit and loss of an unrealised capital profit. The Commissioners, upholding the Crown's contentions, decided that the amount of the "transfer items" was effectively charged to capital, and they found that there had been a definite decision to attribute expenditure to capital account the effect of which was to produce practical results inconsistent with F attribution to revenue.

The Chancery Division, dismissing the appeals, and applying the decision in *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue* 43 T.C. 83; [1966] A.C. 85, held that the Special Commissioners were correct. The reason for the capitalisation of interest payable was an equivalent unrealised increase in the value of the relevant properties, but this could not G justify the pretence of charging interest to revenue.

The Company appealed to the House of Lords under the "leapfrogging" procedure (Administration of Justice Act 1969, s. 13).

Held, in the House of Lords, that (*a*) (*per curiam*) there had been no such change of circumstances as had been held to exist in *Miliangos* v. *George Frank* (*Textiles*) *Ltd.* [1976] A.C. 443 and the Practice Statement (Judicial Precedent) H [1966] 1 W.L.R. 1234 was not to enable litigants, after a decision of the House had been given with all the appearance of finality, to go before the House in the hope that a different body of their Lordships would take a view which their predecessor (albeit a majority) had rejected; (*b*) (*per* Lords Dilhorne and Edmund-Davies) that the *Chancery Lane* case(2) was rightly decided.

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(1) Reported (Ch.D.) [1977] 1 W.L.R. 538; [1977] 2 All E.R. 218; [1977] S.T.C. 95; 121 S.J. 54; (H.L.) [1977] 1 W.L.R. 1345; [1977] 3 All E.R. 996; [1977] S.T.C. 397; 121 S.J. 818.
(2) 43 T.C. 83.

CASE

A Stated under s. 56, Taxes Management Act 1970, 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 17, 18 and 19 January 1973 Fitzleet Estates Ltd. (hereinafter called "Fitzleet") appealed against the following assessments to B income tax under s. 170, Income Tax Act 1952:

1961–62	£200	interest paid
1962–63	£3,000	interest paid.

2. At the same time we heard appeals against assessments on three other companies associated with Fitzleet, Landward Investments Ltd. ("Landward"), Parkwood Property Trust Ltd. ("Parkwood") and Sunley Properties Ltd. C ("Sunley"). Shortly stated, the question for our decision in all four appeals was to what extent certain payments of interest made by the companies (and also in the case of Landward ground rents reserved under a long lease) were made out of profits or gains brought into charge to income tax.

3. The following witnesses gave evidence before us: Mr. William Arthur Shapland, deputy chairman and managing director of Bernard Sunley Invest- D ment Trust Ltd. (hereinafter called "BSIT"), Mr. Frederick George Rollason, F.C.A., of Allan Charlesworth & Co., chartered accountants, Mr. Edward Lawson, F.C.A., principal advisory accountant to the Board of Inland Revenue.

4. The following documents were proved or admitted before us:

(1) Summary of profit and loss accounts of and payments made by Fitzleet, Landward, Parkwood and Sunley—other associated companies whose appeals E were also before us.

(2) Prospectus of BSIT.

(3) Statement of interest payable by the BSIT group.

(4) Fitzleet's accounts for periods from 1 January 1958 to 31 March 1966 (exhibit A).

(5) Landward's accounts from 30 November 1961 to 31 March 1965 F (exhibit B).

(6) Parkwood's accounts from 1 April 1959 to 31 March 1963 (exhibit C).

(7) Sunley's accounts from 20 May 1959 to 31 March 1964 (exhibit D).

(8) BSIT group's consolidated accounts for year ended 31 March 1960 and directors' report.

Copies of the above as are not exhibited hereto and form part of this Case are G available for inspection by the Court if required.

5. As a result of the evidence both oral and documentary adduced before us we find the following facts proved or admitted:

(1) BSIT was incorporated in 1944 as a private company and was converted into a public company in 1959. From the time of its incorporation BSIT by itself and through its subsidiaries carried on business as an investment and H property holding company. BSIT and its subsidiaries are hereinafter called "the BSIT group".

(2) Fitzleet was incorporated as a private company and at 1 April 1962 its authorised and issued share capital was £50,000 divided into 50,000 ordinary shares of £1 each. At all material times 25,000 such shares were beneficially

owned by BSIT. Fitzleet was a property holding company and owned property upon sites purchased between August 1959 and July 1960 which were developed between February 1960 and December 1961. A

(3) Fitzleet's balance sheets and profit and loss accounts were audited and signed by Allan Charlesworth & Co., chartered accountants.

(4) The profit and loss accounts included charges in respect of interest payable to BSIT and to a bank as follows: B

	BSIT	Bank	Total
	£	£	£
Period ended 31 March 1960	3,329	262	3,591
Year ,, 31 March 1961	19,042	39	19,081
,, ,, 31 March 1962	44,432	1,537	45,969
,, ,, 31 March 1963	46,059	1,281	47,340
	112,862	3,119	115,981.

C

They also included the following credits (hereinafter called "transfer items"):

Year ended 31 March 1961 £10,941.

"Transfer to the cost of Freehold Land and Buildings an amount equal to the estimated net amount for the year of interest and other expenditure charged to the Income and Expenditure Account". D

Year ended 31 March 1962 £19,119.

"Transfer to cost of Freehold Property of an amount equal to the estimated proportion of the net amount for the year of the interest and other expenses charged to Profit and Loss Account attributable to property in course of development". E

Fitzleet made the following payments of interest:

Year ended	BSIT	Bank	Total
	£	£	£
5 April 1960	nil	262	262
5 April 1961	nil	39	39
5 April 1962	3,543	1,087	4,630
5 April 1963	23,934	1,731	25,665
5 April 1964	nil	nil	nil
5 April 1965	42,688	nil	42,688
5 April 1966	42,697	nil	42,697
	112,862	3,119	115,981.

F

G

The entries in the balance sheets as at the following dates under the description of "fixed assets" included:

		£
31 March 1960	Freehold land and buildings at cost	166,922
31 March 1961	Freehold land and buildings at cost	507,549
31 March 1962	Freehold property at cost	712,946
31 March 1963	Freehold property at cost	800,878
31 March 1964	Freehold property at cost	811,858
31 March 1965	Freehold property at cost	817,585
31 March 1966	Freehold property at cost	817,585.

H

The amounts for the years ended in 1961 and 1962 included the respective transfer items. I

A (5) For the period ended 31 March 1960 and for each of the years ended 31 March 1961, 1962 and 1963 Fitzleet's annual accounts showed losses and there were in the balance sheets for those years deficits on its accumulated profit and loss account. For the year to 31 March 1964 the company's net income was £35,925 out of which it made a subvention payment to the parent company of £32,162. The balance was used to reduce the deficit on profit and loss account B carried forward. For the year to 31 March 1965 the company again made a profit which was used wholly to reduce the deficit carried forward. No dividend was paid for any of these years. For the year to 31 March 1966 Fitzleet made a profit before tax of £53,907. After deducting taxation charges there was a surplus of £48,784. After a further deduction of the deficit of profit and loss brought forward of £13,864 there was a surplus of £34,920. Fitzleet paid an C interim dividend for the year to 31 March 1966 of £34,500 net.

(6) In giving evidence before us Mr. Shapland and Mr. Rollason explained the transfer items as follows. It had originally been the practice for interest payable by members of the BSIT group to be charged to their respective profit and loss accounts. When BSIT became a public company it set out to establish guidelines and accounting procedures to facilitate the production of group D accounts and to ensure that such accounts gave, as far as possible, an accurate statement of profits available to shareholders. It considered capitalizing interest payments in respect of properties being developed but, as this would have had adverse tax effects, it decided to continue to charge interest payments to revenue in the profit and loss accounts. As a public company, however, BSIT also had to consider whether it could produce accounts which would show the true E profitability of the group. In the light of its experience that the majority of property developments when completed threw up a surplus over book cost, BSIT decided that it would be good commercial and good accounting practice to take some part of that surplus to profit and loss account to show a level of profit which would indicate what the company was really doing. The formula adopted for this purpose was to calculate each year an amount equivalent to F the interest and ground rents relating to properties under development and to credit that amount (less tax) to the profit and loss account.

(7) Mr. Lawson told us in evidence, however, that an accountant would not infer from the accounts of Fitzleet (or from those of Landward, Parkwood or Sunley) that the transfer of items represented capital appreciation. In his view the wording relating to these items in the accounts was entirely inapt to G describe a credit to profit and loss account of appreciation of a fixed asset: it was also inconsistent with the balance sheet entries which showed the fixed assets as valued at cost.

(8) The extent to which we accepted the evidence given before us is indicated in our decision.

6. It was contended on behalf of the Appellant:

H (i) that the transfer items represented a credit to Fitzleet's profit and loss account of appreciation of fixed assets;

(ii) that the interest payable by Fitzleet was charged to profit and loss account and none of it was capitalized and that any liability by Fitzleet to income tax under s. 170, Income Tax Act 1952, should be calculated on that footing.

I 7. It was contended on behalf of H.M. Inspector of Taxes:

(i) that the transfer items represented a deliberate capitalization of interest payable, in that Fitzleet had taken part of the expenditure which it could have charged to revenue and effectively charged it to capital;

(ii) that it was demonstrably wrong to regard the transfer items as a credit to profit and loss of an unrealised capital profit; A

(iii) that such capitalization had practical effects, in particular in enabling net income dividends to be paid; and, accordingly,

(iv) that Fitzleet's liability to income tax under s. 170, Income Tax Act 1952, should be calculated on the footing that in so far as payments of interest which it made were attributable to the transfer items such interest was not paid "out of profits or gains brought into charge" for the purposes of that section. B

8. The following authorities were cited before us: *Allchin* v. *South Shields Corporation* 25 T.C. 445; [1943] A.C. 607; *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue* 43 T.C. 83; [1966] A.C. 85; *Dimbula Valley (Ceylon) Tea Co. Ltd.* v. *Laurie* [1961] Ch. 353.

9. We, the Commissioners who heard the appeal and those of three other associated companies, gave our decision on all the appeals as follows: C

In approaching the problem before us we should perhaps mention briefly certain matters which are common ground. In the first place we have to consider it in the light of the majority decision of the House of Lords in the *Chancery Lane* case. So what Lord Morris of Borth-y-Gest referred to as "the rule of the road"(1) applies unless there are circumstances which negative its application. As to that, Lord Wilberforce said, at page 128, that the cases to which he there referred D

> "without laying down any exhaustive rule, at least show that the taxpayer loses the right which I have described as one of allocation or attribution, namely, to prepare a special account for Revenue purposes in which the annual payment is compared with the amount of his assessed profits, if he has made a decision or election in fact to attribute the payment to capital account which decision has produced practical results inconsistent with allocation to revenue." E

In the present cases we have to consider whether or not that right has been so lost.

Further we would mention one other matter as to which there can be no dispute. It is clear from the evidence before us that the companies decided to charge the interest and rents in question to revenue or profit and loss accounts in the sense of including entries in those accounts appearing before the transfer items entries and showing the interest and rents as a deduction. That that is so is apparent from inspection of the various accounts before us. The matter which is in dispute is whether that was or was not affected by the transfer items. As to that, it was said in evidence before us that consideration was given to the production of accounts giving a fair view of the group as a whole and also the distribution position, that experience showed that valuation of completed developments usually threw up a surplus against the book cost of development, and that that being so it was decided to take some of the surplus (measured as described in the transfer item entries) and credit this revaluation surplus to profit and loss account to make it reflect a level of profit showing what the company was really doing. In other words the transfer items were said to be the crediting of a revaluation surplus and not items affecting a deduction of interest and rent in revenue accounts. F G H

(1) 43 T.C. 83, at p. 114.

A We have no doubt that there was a decision—firm and not provisional—to bring the transfer items in as a credit in the revenue accounts, but we find it difficult to accept that what was decided was to bring in in this way a revaluation surplus, as distinct from bringing into account the transfer items, measured as they were measured and described as they are described, against the background that experience showed that a revaluation of developments on completion, if B made, would normally throw up a surplus. In saying this we have in mind a number of considerations. First, if there had been an actual revaluation, producing a surplus brought into fixed assets, we would have expected the balance sheet to refer to this matter explicitly, or at any rate that we should find some reference in the accounts to the matter apart from the description of the transfer item in the revenue account. We are quite unable to regard the amounts C involved in these cases as something that could reasonably be ignored as *de minimis*. Secondly, it seems to us that such a revaluation is inconsistent with the description of fixed assets as "at cost"—they would in fact have been in at cost plus a revaluation surplus. Further, we note that in the Parkwood accounts for the year ended 31 March 1962—where there were surpluses on revaluation—this was carefully shown in the balance sheet—see the entry "Let Properties at D professional valuation as at 31 March 1961 or cost" and note 1. On reviewing the position with those matters in mind we think that the proper conclusion on all the evidence before us is that the decision which was made was to bring in the transfer items, measured as they were measured and described as they were described, and that revaluation came into the picture only in that that decision was made against the background that experience showed that a revaluation, E if made, would be likely to throw up a surplus, we proceed accordingly to consider the matter before us on that basis; that is, on the footing of the transfer items as entered in the accounts. As to that, what was transferred by the transfer items was a transfer to cost of balance sheet fixed assets, and in the profit and loss accounts the transfer item was a credit entry. That being the position, it seems to us that it necessarily operates to reduce the preceding debit of interest F or rents, with the result that the amount of the transfer item is effectively charged to capital. Further, it seems to us evident from the accounts before us that the decision to credit the transfer items in the revenue accounts did have practical results inconsistent with allocation of the relevant amount of interest or rent to revenue.

So, in our view, the position as respects the transfer items is that there was a G decision or election in fact to attribute the payments in question to capital account and that this decision has produced practical results inconsistent with allocation to revenue. We conclude accordingly as respects each of the cases before us that the appeal fails in principle and we leave figures to be agreed on that basis.

10. Figures were not agreed between the parties until April 1975 and on H 19 May 1975 we adjusted the assessments accordingly.

11. The Appellant immediately after the determination of the appeal declared to us its dissatisfaction therewith as being erroneous in point of law and on 27 May 1975 required us to state a Case for the opinion of the High Court pursuant to s. 56, Taxes Management Act 1970, which Case I have stated and do sign accordingly.

I 12. Mr. G. R. East who heard this appeal (and those of Landward, Parkwood and Sunley) with me has since retired from the public service.

13. The question of law for the opinion of the Court is whether there was evidence to support our decision and whether our decision was correct. A

J. G. Lewis { Commissioner for the Special Purposes of the Income Tax Acts

Turnstile House,
94–99 High Holborn,
London, WC1V 6LQ B

16 January 1976

The case came before Templeman J. in the Chancery Division on 29 and 30 November 1976, when judgment was reserved. On 3 December 1976 judgment was given in favour of the Crown, with costs. C

Stewart Bates Q.C. and *Stephen Oliver* for the Companies.

The Solicitor-General (*Peter Archer Q.C.*), *Michael Nolan Q.C.* and *Brian Davenport* for the Crown.

The following cases were cited in argument in addition to that referred to in the judgment:—*Allchin* v. *South Shields Corporation* 25 T.C. 445; [1943] A.C. 607; *Birmingham Corporation* v. *Commissioners of Inland Revenue* 15 T.C. 172; [1930] A.C. 307; *Central London Ry. Co.* v. *Commissioners of Inland Revenue* 20 T.C. 102; [1937] A.C. 77; *Commissioners of Inland Revenue* v. *Ayr Town Council* 22 T.C. 381; 1938 S.C. 822; *Dimbula Valley* (*Ceylon*) *Tea Co. Ltd.* v. *Laurie* [1961] Ch. 353. D

Templeman J.—This appeal concerns the vexed question of accountability for tax deducted from interest payments. By s. 169 of the Income Tax Act 1952 the payer of yearly interest may deduct income tax at the standard rate and may retain the tax so deducted provided the interest is "payable wholly out of profits or gains brought into charge to tax". If the interest is not so payable the tax must be deducted and, by s. 170, must be paid over to the Revenue. In order to ascertain whether tax may be retained or must be paid over to the Revenue, the general rule is: E F

> "Look at your interest payments for the year; look at your assessed profits for the same year (the actual profits for the previous year); compare the two and, if the latter exceeds the former, the interest deducted may be retained by the taxpayer in the absence of special circumstances."

Thus Lord Upjohn in *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue*(1), a 1965 decision reported in 43 T.C. 83, at page 120F. The *Chancery Lane* case established by a majority that there are special circumstances whereby the taxpayer loses the right to compare the interest payments with his assessed profits if he has made a decision to attribute the payments to capital account, which decision has produced practical results inconsistent with allocation to revenue: see the explanation by Lord Wilberforce in the *Chancery Lane* case at page 128D. Practical results include an improvement in the taxpayer's profit and loss account: see Lord Wilberforce at page 128D of the *Chancery Lane* case. G H

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(1) [1966] A.C. 85.

A In the present case the taxpayer company, Fitzleet Estates Ltd., is a property-holding company which purchased sites in 1959 and 1960 and developed them between 1960 and 1961. In the course of the development the Company incurred interest charges on money borrowed from its parent company and from its bankers. For the year ending 31 March 1961 the Company's income from property after expenses was £223 and it paid interest on the borrowings B amounting to only £39, thus satisfying the general rule for the retention of income tax deducted from the payment of interest; namely, that income must exceed interest. The interest payable for the year, as distinct from the interest in fact paid, was £19,081, so there was an initial deficit on profit and loss account for the year of £18,858. This deficiency was reduced by the sum of £10,941 transferred to the cost of property, leaving a net deficit of £7,917, C which was added to the deficit from previous years and carried forward to the next year. In the year ending 31 March 1962 the Company's income from property net of expenses had risen to £4,630, and the Company paid interest of £4,630, thus satisfying the general rule. The interest payable for the year was £45,969, so that there was an initial deficit on profit and loss account for the year of £41,339. This deficit was reduced by the sum of £19,119 transferred to D the cost of property, leaving a net deficit for the year of £22,220, which was added to the accumulated deficit from previous years and carried forward. In the next and subsequent years the Company's income increased steeply, enabling the Company to discharge not only its current interest charges for the year but also arrears of interest from previous years. In each year the interest actually paid was less than the income received, thus satisfying the general rule. The E Company discharged all its interest liabilities by 1966, and in that year declared a dividend of £34,500. Thus the transfer items of £10,941 in 1961 and £19,119 in 1962, amounting in all to £30,060, improved the balance of the profit and loss account and enabled a dividend to be declared in 1966. The question is whether the transfer items represent a decision by the Company to attribute interest payments to the extent of £30,060 to capital. A note on the profit and F loss account of the Company for the year ending 31 March 1961 described the transfer item of £10,941 in these words: "Transfer to the cost of freehold land and buildings an amount equal to the estimated net amount for the year of interest and other expenditure charged to the Income and Expenditure Account". The Commissioners decided that the inference from the profit and loss account and the note was that the Company had decided to charge £10,941 of the interest G to capital. There is nothing in the accounts to cast doubt on this inference. A note on the profit and loss account for the year ending 31 March 1962 described the transfer item of £19,119 in similar words; namely, "Transfer to cost of freehold property of an amount equal to the estimated proportion of the net amount for the year of the interest and other expenses charged to Profit and Loss Account attributable to property in course of development". The Com- H missioners drew the same conclusions from these accounts as they drew from the 1961 accounts.

In evidence before the Commissioners the Company produced another explanation. The transfer items represented part of an unrealised capital profit transferred from capital to revenue. The directors of the Company were aware that money borrowed and spent for the development of a property resulted in I an increase in the net value of the property over and above the aggregate of the cost of the purchase and the cost of the borrowing. That increase, a capital profit, exceeded the amount of the interest payable in respect of the borrowing. The directors decided to transfer part of that capital profit to revenue. The amount which they decided to transfer was an amount equal to the interest less

(Templeman J.)

a sum equal to tax at the standard rate on the interest. The application of that formula resulted in £10,941, part of the capital profit, being transferred from capital to revenue in 1961, and £19,119 in 1962. The decision was made because the parent company decided it would be good commercial and good accounting practice to take some part of that surplus—that is to say, the surplus attributable to development—to profit and loss account, to show a level of profit which would indicate what the Company was really doing. On this analysis, the dividend in 1966 was ultimately made possible, not by charging interest to capital but by a transfer of a capital profit from capital to revenue.

The Commissioners did not accept this analysis, and neither do I. The Company decided to relieve income of the burden of £30,060 of interest charges. The Company could do so only by charging £30,060 interest to capital. If the £30,060 was charged to capital without more, it was plain that the Company would be bound to account to the Revenue for the tax deducted from the interest thus capitalised. Thus the Company's evidence was that "it considered capitalising interest payments in respect of properties being developed but, as this would have had adverse tax effects, it decided to continue to charge interest payments to revenue in the Profit and Loss accounts". But in fact the Company charged the interest payments in the profit and loss accounts to a mixed fund, composed partly of revenue and partly of a sum of £30,060 transferred from capital. The justification for the transfer of £30,060 from capital was an increase in the value of the relevant properties, but this justification does not alter the nature or consequences of the transfer. The Company justify the capitalisation of interest by pointing to a capital gain, but cannot pretend that they were charging interest to revenue just because there was an unrealised capital profit equal to the interest and available to be transferred to revenue. It is not possible to substitute claret for burgundy by changing the label on the bottle. The appeal of the Company must be dismissed.

Appeals dismissed, with costs. Leave to "leapfrog" the Court of Appeal given and (later) leave to appeal given by the House of Lords.

The Company's appeal came before the House of Lords (Lord Wilberforce, Viscount Dilhorne and Lords Salmon, Edmund-Davies and Keith of Kinkel) on 10 and 11 October 1977, when judgment was reserved. On 9 November 1977 judgment was given unanimously in favour of the Crown, with costs.

Stewart Bates Q.C., *Stephen Oliver* and *S. J. Allcock* for the Company.

The Solicitor-General (*Peter Archer Q.C.*), *Michael Nolan Q.C.* and *Brian Davenport* for the Crown.

The following cases were cited in argument in addition to those referred to in the speeches:—*Attorney-General* v. *London County Council* (*No. 1*) 4 T.C. 265; [1901] A.C. 26; *Allchin* v. *South Shields Corporation* 25 T.C. 445; [1943] A.C. 607; *Commissioners of Inland Revenue* v. *Frere* 42 T.C. 125; [1965] A.C. 402; *Central London Ry. Co.* v. *Commissioners of Inland Revenue* 20 T.C. 102; [1937] A.C. 77; *Commissioners of Inland Revenue* v. *Ayr Town Council* 22 T.C. 381; 1938 S.C. 822.

Lord Wilberforce—My Lords, the Appellant, a property holding company, borrowed sums of money in connection with its business and paid interest upon them. The sums of interest payable were charged to its profit and loss

A account. If nothing more had happened, the Appellant would have been entitled, under s. 169 of the Income Tax Act 1952, to retain income tax deducted from such interest as it in fact paid, if it had taxed profits equal to or greater than the interest. What the Company did, however, was to transfer sums equivalent to the (net) interest payable in the years in question (1961–62 and 1962–63) and add them to the cost of land and buildings acquired as shown in the balance B sheet. This process is called "capitalising" the interest. There were no doubt sound business reasons for doing so and this course was approved by the Company's auditors. It led however to a claim by the Revenue for the Company to account to it for income tax on the interest paid in each year, on the basis that s. 170 of the Act applied. That s. 170 does apply in such a case was held by this House in *Chancery Lane Safe Deposit & Offices Co. Ltd.* v. *Commissioners* C *of Inland Revenue*(1) [1966] A.C. 85, by majority from which Lord Reid and Lord Upjohn dissented. There were certain issues raised in the present case which might have enabled it to be distinguished from the *Chancery Lane* case, but these have disappeared, and it is now conceded that the present case is, on the facts, indistinguishable from the earlier decision. In particular it is true of both cases that in each of the years in question the taxed fund of the company's D profits was sufficient to cover the interest and any dividend paid in that year. The Appellant therefore had to challenge directly the *Chancery Lane* case. The present appeal comes direct to this House from the High Court of Justice in accordance with the Administration of Justice Act 1969, s. 13, and we are invited to depart from the earlier decision in accordance with the Practice Statement (Judicial Precedent) [1966] 1 W.L.R. 1234.

E My Lords, two points are clear:

(1) Although Mr. Bates Q.C., for the Appellant Company, developed his argument with freshness and vigour, it became clear that there was no contention advanced or which could be advanced by him which was not before this House in 1966. The very full report of the arguments of counsel on that occasion leaves no doubt as to this. In particular, the Appellant's main contention which F is that all that is necessary in such cases as these is to draw up a simple account showing the interest payments on one side and the fund of taxed profits on the other, and to see whether the latter covers the former, was clearly before the House and, for reasons then thought good, by the majority rejected. The desperate argument of "*per incuriam*" is certainly not available here.

(2) There has been no change of circumstance such as some of their G Lordships found to exist in *Miliangos* v. *George Frank* (*Textiles*) *Ltd.* [1976] A.C. 443 such as would call for or justify a review of the 1966 decision. The fact, if it be so, that the 1966 decision works hardly upon property companies is not such a change of circumstance.

There is therefore nothing left to the Appellant but to contend—as he frankly does—that the 1966 decision is wrong. This contention means, when H interpreted, that three or more of your Lordships ought to take the view which appealed then to the minority. My Lords, in my firm opinion, the 1966 Practice Statement was never intended to allow and should not be considered to allow such a course. Nothing could be more undesirable, in fact, than to permit litigants, after a decision has been given by this House with all appearance of finality, to return to this House in the hope that a differently constituted I committee might be persuaded to take the view which its predecessors rejected. True that the earlier decision was by majority: I say nothing as to its correctness

(1) 43 T.C. 83.

(Lord Wilberforce)

or as to the validity of the reasoning by which it was supported. That there were two eminently possible views is shown by the support for each by at any rate two members of the House. But doubtful issues have to be resolved and the law knows no better way of resolving them than by the considered majority opinion of the ultimate tribunal. It requires much more than doubts as to the correctness of such opinion to justify departing from it. A

My Lords, it may be—I do not know—that a result which causes property companies which, as advised by their accountants, capitalise interest on investments or development, to suffer fiscally as compared with those who charge their interest payments to revenue, or, perhaps more accurately, do not decide to capitalise them, is unjust or economically unsound. But the remedy for this does not lie here. It is for the Revenue not merely to rest upon its victory, but to consider the broad merits or otherwise of the result, after such representations as the affected taxpayers may make. I suggest that your Lordships have no alternative but to dismiss the appeal. B C

Viscount Dilhorne—My Lords, after hearing Mr. Bates's forceful argument for the Appellants I am disposed to come to the same conclusion as that reached by the majority of the House in *Chancery Lane Safe Deposit & Offices Co. Ltd.* v. *Commissioners of Inland Revenue*(1) [1966] A.C. 85 where the issues raised in this appeal were considered and decided. D

The interest paid by the Appellants on moneys borrowed by them was originally charged to their profit and loss account. In the year 1961–62 the interest paid was £39 and was exceeded by the profits or gains brought into charge to tax. In the year 1962–63 the interest paid was equal to the amount of profits or gains brought into tax. If the matter had rested there it is clear that the Appellants would not have had to account to the Revenue for the tax deducted by them on payment of the interest (Income Tax Act 1952, s. 169). But the sums paid in interest in those years were then added to the cost of the freehold land and buildings owned by the Appellants and included under that head in their balance sheets. This was called "capitalising" the interest. It had the effect of reducing the debit balance in their income and expenditure account for the year ended 31 March 1961 and the debit balance in their profit and loss account for the year ending 31 March 1962. I do not question the propriety of so doing. No dividend was paid by the Appellants for the years 1961 to 1965 but for the year ending 31 March 1966 an interim dividend of £34,500 nett was paid. The effect of the capitalisation of the interest paid in 1961–62 and 1962–63 was to make more money available for distribution of dividends in later years and, that being the consequence, I cannot regard the transfer to capital of the interest paid as a mere matter of domestic accounting. The transfer had practical results and reflected a decision to charge the interest to capital. As my noble and learned friend Lord Morris of Borth-y-Gest said, at page 118, in the *Chancery Lane* case(2): E F G

> "It would seem to be incongruous, however, if a company, having decided . . . to charge a payment to capital and having regulated its proceedings on that basis, could say that the payment was not to be deemed to be charged to capital. This does not mean that, in any ordinary case, a company in seeking vis-à-vis the Revenue to make an attribution of an annual payment, is fettered merely because of some form of entry that it has made in the books or accounts. It merely means that what was in H I

(1) 43 T.C. 83. (2) *Ibid.* at p. 115.

A fact and in reality a payment out of capital cannot be paraded in the guise of a payment out of revenue. That would be more than departing from documents or accounts: it would be departing from fact: it would be a distortion of history."

I need not, however, consider the facts of this case further, for Mr. Bates frankly admitted his inability to put forward any argument not advanced B on behalf of the taxpayer in the *Chancery Lane* case(1). He sought to persuade this House not to follow that decision. Even if I thought that the decision in that case was wrong, which I do not, I would not think it right now to depart from it. The Practice Statement of this House of July 1966 ([1966] 1 W.L.R. 1234) to which my noble and learned friend Lord Wilberforce and I were parties, stresses the importance of the use of precedent as providing a C degree of certainty upon which individuals can rely in the conduct of their affairs, as well as a basis for orderly development of legal rules. That certainty would in my view be impaired if, where there had been a decision by a majority, the House permitted the matter to be re-opened and re-argued before a differently constituted House with the possibility that a majority in that House preferred the view of the minority in the decided case. If this House acceded to such an D application it would open the door to a similar application in years to come to restore the view of the majority in the first decision on the ground that the majority when the question had been re-argued, had erred. If the decision in the *Chancery Lane* case was wrong, it certainly was not so clearly wrong and productive of injustice as to make it right for the House to depart from it. Before that decision, it is true that the consequences of capitalising interest E payments may not have been appreciated. Since that decision companies have been free, as they were before it, to decide whether or not to capitalise. If they do, there is the certainty that they will have to account to the Revenue for the tax deducted.

I think it would be a considerable extension of what was intended in 1966 if this House were now to entertain this application and that it would be F destructive to a considerable degree of that certainty, the desirability of which was, as I have said, stressed in 1966. I would dismiss the appeal.

Lord Salmon—My Lords, for the reasons given by my noble and learned friend Lord Wilberforce, I would dismiss this appeal.

Lord Edmund-Davies—My Lords, while recognising that an earlier decision of this House is, as Lord Reid said in *Midland Silicones Ltd.* v. *Scruttons Ltd.* G [1962] A.C. 446, at page 479, "... authoritative in cases of which the circumstances are not reasonably distinguishable from those which gave rise to the decision", the Practice Statement (Judicial Precedent) [1966] 1 W.L.R. 1234 enabled your Lordships to depart from a previous decision "... when it appears right to do so." This welcome departure from the rigid rule which previously prevailed (see, for example, *Radcliffe* v. *Ribble Motor Services Ltd.* [1939] H A.C. 215 and *Nash* v. *Tamplin & Son's Brewery* (*Brighton*) *Ltd.*(2) [1952] A.C. 231) resulted from the recognition "that too rigid adherence to precedent may lead to injustice in a particular case and also unduly restrict the proper development of the law." But the Practice Direction also recognised that departure from an earlier decision on the sole ground of its being wrong is not of itself always justified by stressing the general advantage of certainty in the law and,

(1) 43 T.C 83 (2) 32 T.C. 415.

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in particular, "the danger of disturbing retrospectively the basis on which contracts, settlements of property and fiscal arrangements have been entered into and also the especial need for certainty as to the criminal law." A

Some feared that the new Practice Direction would effect revolutionary changes (see (1966) 82 L.Q.R. 442 and (1969) 85 L.Q.R. 172). But not Lord Reid, who said of it in *Regina* v. *National Insurance Commissioner* (ex parte *Hudson*) [1972] A.C. 944, at page 966: B

> "... this practice was not to be used to weaken existing certainty in the law. The old view was that any departure from rigid adherence to precedent would weaken that certainty. I did not and do not accept that view. It is notorious that where an existing decision is disapproved but cannot be overruled, courts tend to distinguish it on inadequate grounds. I do not think that they act wrongly in so doing: they are adopting C the less bad of the only alternatives open to them. But this is bound to lead to uncertainty for no one can say in advance whether in a particular case the court will or will not feel bound to follow the old unsatisfactory decision. On balance it seems to me that overruling such a decision will promote and not impair the certainty of the law."

My Lords, when this House is asked to apply the 1966 Practice Direction and D thereby to depart from one of its earlier decisions, competing considerations invariably arise. In the present case the Appellants seek the complete reversal of a decision delivered only eleven years ago in *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue*[1] [1966] A.C. 85, on facts indistinguishable from those of the instant case, and this they seek on no grounds other than that, in their submission, it was wrong. They have E not, for example, urged that, although the *Chancery Lane* decision may have been sound when delivered, circumstances have so altered even during the short period since it was delivered that a new and juster approach to the tax problem giving rise to this appeal should now be evolved and adopted. On the contrary, learned counsel has submitted that it was wrong when delivered and that nothing has since happened to make right today what was wrong in 1966. F The situation is therefore quite unlike that which arose when in *Miliangos* v. *George Frank* (*Textiles*) *Ltd.* [1976] A.C. 443 this House concluded that, consonant with the Practice Direction, it could and should depart from the decision it had delivered only 15 years earlier in In re *United Railways of Havana and Regla Warehouses Ltd.* [1961] A.C. 1007, because of the instability which had meanwhile overtaken sterling and other major currencies and the procedures G which had consequently been evolved by courts and arbitrators in this country to secure payment of foreign currency debts in foreign currency.

That is not to say, however, that material changes in circumstances must always have supervened before your Lordships may properly decline to follow an earlier decision of this House. Thus, while it is true that some of their Lordships in *Herrington* v. *British Railways Board* [1972] A.C. 877 were led to H dismiss the defendant occupier's appeal by holding that intervening changes in physical and social conditions justified "reconsideration" of and a departure from, the rule regarding the duty of occupiers to trespassers enunciated 40 years earlier in *Robert Addie & Sons* (*Collieries*) *Ltd.* v. *Dumbreck* [1929] A.C. 358, Lord Reid rejected the argument that the departure was justified on

(1) 43 T.C. 83.

A the ground that what had earlier been regarded as good public policy had ceased to be so. He said, at page 898 A(1):

> "... it appears to me that we are confronted with the choice of following *Addie*(2) and putting the clock back or drastically modifying the *Addie* rules. It is suggested that such a modification can be achieved by developing the law as laid down in *Addie's* case without actually overruling any B part of the decision. I do not think that that is possible. It can properly be said that one is developing the law laid down in a leading case so long but only so long as the 'development' does not require us to say that the original case was wrongly decided. But it appears to me that any acceptable 'development' of *Addie's* case must mean that *Addie's* case if it arose today would be decided the other way."

C But no such course was, in the opinion of Lord Reid, open, for, while concurring that the occupiers' appeal must be dismissed, he added:

> "The case for the pursuer in *Addie's* case was stronger on the facts than the case for the present [pursuer], and I do not think that we could dismiss this appeal without holding or at least necessarily implying that *Addie's* case was wrongly decided."

D The instant case has nothing to do with the criminal law, which is singled out in the Practice Direction for special consideration; see *Regina* v. *Knuller* (*Publishing, Printing and Promotions*) *Ltd.* [1973] A.C. 435 where this House declined to depart from a decision given six years earlier even if it had been wrong. Nor does it relate to fiscal arrangements made by the Appellants on the basis of any earlier decision of your Lordships' House, for their fiscal actions in E 1961–62 and 1962–63 can have had no possible relation to the speeches delivered by their Lordships on 15 December 1965 in the *Chancery Lane Safe Deposit* case(3). Not only do the Appellants recognise that the two cases are indistinguishable on their facts but their Counsel have been unable to advance any fresh arguments in law or to suggest any approach to the facts which were not urged in the earlier case. Nor, my Lords, is this a case where it can be F seriously urged that manifest "injustice" flowed from the majority decision in the *Chancery Lane* case and that only by departing from it can justice now be done to these Appellants. The most that could be properly urged on their behalf is that the 3:2 division of opinion of their Lordships' House in the earlier case showed that it was a "near thing", that the decision might well have gone the other way, and that the time has now come when it should.

G My Lords, I respectfully share your views that the *Chancery Lane* decision was correct. But even had I come to the opposite conclusion, the circumstances adverted to are such that I should not have thought it "right" to depart from it now. To do so would have been to open the floodgates to similar appeals and thereby to impair that reasonable certainty in the law which the Direction itself declared to be "an indispensable foundation upon which to decide what H is the law and its application to individual cases". I therefore concur in holding that this appeal should be dismissed.

Lord Keith of Kinkel—My Lords, I also agree that, for the reasons given by my noble and learned friend, Lord Wilberforce, this appeal should be dismissed.

Appeal dismissed, with costs.

I [Solicitors:—Slaughter & May; Solicitor of Inland Revenue.]

(1) [1972] A.C. 877. (2) [1929] A.C. 358. (3) 43 T.C. 83.

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