HOUSE OF LORDS—29 JUNE, 3 AND 27 JULY 1978

Ben-Odeco Ltd. *v.* Powlson (H.M. Inspector of Taxes)(1)

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Corporation tax—Capital allowances—Machinery and plant—First year allowances—Oil rig—Whether commitment fees and interest on loans form part of expenditure on the provision of machinery or plant—Finance Act 1971 (*c* 68), *s* 41(1).

The Appellant Company was formed to acquire and let out on hire an oil C drilling rig. In 1969, to finance its construction, the company negotiated five loans and paid commitment fees in connection with the loans totalling £59,002. This sum was charged to capital in the Company's accounts for the accounting period ended 31 December 1969. Interest paid in respect of the loans during the accounting periods ended 31 December 1969, 1970 and 1971 amounted to £57,863, £183,783 and £300,820 respectively. Sums drawn down under the D loan agreements and not immediately applied in making payments to the builders of the rig were placed on deposit and interest received during the three accounting periods amounted respectively to £2,648, £10,833 and £4,814. The rig was completed and delivered in July 1971, when it was accepted by the Revenue that the Company commenced trading. However, between July and October 1971 the rig underwent trials and the first time charter commenced E on 8 October 1971. In the Company's accounts the interest payments (net of the interest received) were in 1969 (£55,215) and 1970 (£172,950) charged to capital whereas in 1971 £207,823 was charged to capital and £88,183, representing the proportion of net interest payable between 8 October 1971 and 31 December 1971, was charged against income in the 1971 profit and loss account. Accordingly, the total cost of the completed oil drilling rig, shown in the F Company's balance sheet at 31 December 1971 as £5,691,123, included commitment fees of £59,002 and capitalised interest payments of £494,990.

On appeal to the Special Commissioners against the refusal by the Revenue of the Company's claim for capital allowances in respect of commitment fees and the interest payments it was contended that interest and commitment fees paid on a loan raised specifically and exclusively for the purchase of G machinery or plant, and applied in the purchase thereof, where they were properly charged to capital, constituted an integral part of the capital expenditure on the acquisition of the asset within the provisions of the Finance Act 1971, s 41(1). The Crown contended that they were part of the costs of raising finance and not expenditure on the provision of machinery or plant. The Commissioners rejected the appeal and the Company demanded a Case.

H In the Chancery Division the Company contended that there were four conditions for commitment fees and interest to qualify, all of which were satisfied: (1) the object of the expenditure must be the provision of machinery or plant; (2) the expenditure must not be too remote; (3) it should not be otherwise deductible in computing the profits or gains of the Company; (4) the expenditure must be properly capitalised. Further, it was agreed, the I Finance Act 1969, s 26, removed the prohibition on treating interest as capital expenditure and since the Finance Act 1971 did not exclude it, the interest, by implication, could now be included in the capital expenditure.

(1) Reported (Ch D) [1978] 1 WLR 365; [1978] 1 All ER 913; [1978] STC 111; (HL) [1978] 1 WLR 1093; [1978] 1 All ER 913; [1978] STC 460.

The Chancery Division, confirming the decision of the Special Commissioners, held that the argument of the Crown distinguishing between money spent on the provision of finance by the use of which machinery or plant is acquired and money spent on the provision of such machinery or plant was to be preferred. The Judge drew support for his decision by a comparison of the drafting of s 41(1) of the Finance Act 1971 and s 1(1) of the Capital Allowances Act 1968 ("capital expenditure on the construction of a building or structure"), holding that since the same type of expenditure was intended to be covered by both sections, it was inapt to describe interest on borrowed money as part of the expenditure on the "construction" of a building, therefore it was not intended to be included in the "provision" of machinery or plant. The Company appealed to the House of Lords under the "leapfrog" procedure. A B

In the House of Lords the Company contended (1) that the interest and commitment fees were part of the cost of the rig or part of the cost to the Company of the rig and so were expenditure "on the provision of . . . plant"; (2) that cost and what is capital expenditure had to be treated according to accepted methods of commercial accounting and since the interest and commitment fees had been treated as capital expenditure in accordance with those methods, the expenditure was brought within the words of s 41(1)(*a*) "expenditure on the provision of . . . plant". C D

The House of Lords (by a majority, Lord Salmon dissenting), dismissing the appeal and upholding the judgment of Brightman J. (and the Special Commissioners' decision), held that (1) the words "expenditure on the provision of . . . plant" did not include the expenditure on commitment fees and interest since that was expenditure on the provision of the money used in the acquisition of the rig; (2) the principles of commercial accounting adopted by a particular company (and other companies might treat similar expenditure differently) could not determine the construction of the statutory words. E

CASE

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

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 12 February 1976 Ben-Odeco Ltd. (hereinafter called "the Company") appealed against the following assessment to corporation tax: accounting period to 31 December 1971, £2,000. The Company also appealed against the refusal of its claim for capital allowances in respect of the sum of £494,990 mentioned below. G

2. Shortly stated, the question for our decision was whether or not a sum of £494,990, being the aggregate of the amount of interest and commitment fees payable and paid by the Appellant Company and charged to capital in the Company's accounts on or in respect of a loan of money raised for the financing of a contract for the construction of a drilling rig to be used in the Company's trade, constitutes capital expenditure incurred by the Company "on the provision of" the machinery or plant represented by the drilling rig within the meaning of Part III of the Finance Act 1971. H

A 3. The following documents were proved or admitted before us: (*a*) Directors' report and balance sheet (2 December 1968 to 31 December 1969); (*b*) Directors' report and balance sheet at 31 December 1970; (*c*) Directors' report, balance sheet at 31 December 1971 and profit and loss account (22 July 1971 to 31 December 1971).

Copies of the above are not annexed hereto as exhibits but are available B for inspection by the Court if required.

4. The following facts were admitted between the parties:

(1) The Company was incorporated under the name of Rimrock (UK) Ltd. on 2 December 1968. By special resolution dated 19 June 1974 the name of the Company was changed to Ben-Odeco Ltd.

(2) For the purposes of the trade it was about to carry on, the Company, C in 1969, placed a contract with Upper Clyde Shipbuilding Ltd. for the building of an oil drilling rig.

(3) The oil drilling rig having been delivered and named "Ocean Tide", the Company commenced to carry on trade on 22 July 1971. However, between 22 July 1971 and 8 October 1971 the "Ocean Tide" underwent tests and trials before the commencement of the time charter referred to in para 4 below.

D (4) The trade of the Company has hitherto consisted of the hiring out of the "Ocean Tide" on time charter.

(5) The Company's accounts were made up first for the period commencing 2 December 1968 and ending on 31 December 1969, and thereafter for the calendar years ending 31 December 1970 and 1971.

(6) During 1969 arrangements were made for the Company to obtain the E following loans to finance the construction of the "Ocean Tide", viz: (*a*) a loan of $2,000,000 from the Continental Illinois Bank and Trust Company of Chicago under a loan agreement dated 3 February 1969; (*b*) a loan of £3,000,000 from the National Westminster Bank Ltd. under a loan agreement dated 18 July 1969; (*c*) a loan of £40,000 from Husky Oil Ltd. under a debenture dated 18 July 1969; (*d*) a loan of Sw. Frs. 8,000,000 (later converted to US $1,868,000) F from the Dow Banking Corporation under a loan agreement dated 9 October 1969; (*e*) a loan of C$4,000,000 from the Royal Bank of Canada under a loan agreement dated 30 October 1969.

(7) All sums borrowed under the loan arrangements described in para 6 above were exclusively applied in meeting the cost of the construction of the "Ocean Tide".

G (8) During 1969 the Company was obliged to pay the following commitment fees in connection with certain of the loans mentioned in para 6 above:

	£
Continental Illinois Bank	6,182
National Westminster Bank	30,000
Dow Banking Corporation	10,482
H Ministry of Technology (in connection with the loan from the National Westminster Bank)	12,338
	59,002.

(9) All the commitment fees mentioned in para 8 above were charged to capital in the Company's accounts for the accounting period from 2 December I 1968 to 31 December 1969. Thus the item shown in the balance sheet of the Company under the heading "Fixed Assets" as "expenditure on oil drilling ship in the course of construction" includes the full amount of these commitment fees.

(10) The Company was also obliged to pay interest in respect of the loans mentioned in para 6 above. The total amount of the interest so paid attributable for the purpose of the Company's accounts to the three accounting periods referred to in para 5 above (and computed for this purpose on an accruals basis) was £542,466. A

(11) From time to time during the three accounting periods above mentioned, sums drawn down under certain of the loan agreements were not immediately applied in making payments to the shipbuilders. Such sums were placed on deposit to earn interest for the Company, and the total amount of such deposit interest arising in the course of the said three accounting periods was £18,295. Only the net amount of the interest payable on loans (i.e. after deducting the deposit interest received from time to time) was taken into account for the purposes of the Company's accounts. B C

(12) The amounts of interest so payable on the loans and the amounts of deposit interest so received in each of the three accounting periods above mentioned may be summarised as follows:

	1969	1970	1971	*Total*
	£	£	£	£
Interest payable	57,863	183,783	300,820	542,466
Interest received	2,648	10,833	4,814	18,295
Net interest for the period	55,215	172,950	296,006	524,171.

D

(13) The net amount of such interest attributable to the accounting period ended 31 December 1969, namely £55,215, was charged to capital in the Company's accounts for that accounting period. Thus the item shown in the balance sheet of the Company referred to in para 9 above includes the full amount of the net interest for that accounting period. E

(14) The net amount of such interest attributable to the accounting period ended 31 December 1970, namely £172,950, was also charged to capital in the Company's accounts for that accounting period. Thus the item shown in the balance sheet of the Company at 31 December 1970 corresponding to the item referred to in para 9 above includes the full amount of the net interest for that accounting period, as well as the net interest referred to in para 13 above. F

(15) Part of the net interest attributable to the year ended 31 December 1971, namely £88,183, corresponding to the proportion of the interest payable on the said loans for the period between 8 October 1971 and 31 December 1971, was in the profit and loss account of the Company for that year charged against the profits earned during the year. The remainder of the said interest for that year, namely £207,823 was charged to capital in the Company's accounts for that accounting period. Together with the net interest capitalised for the two previous accounting periods as mentioned in paras 13 and 14 above, it thus formed part of the item shown in the balance sheet at 31 December 1971 under the heading "Fixed Asset" as the cost of the completed oil drilling rig. G H

(16) Accordingly, the total cost of the completed oil drilling rig shown on the balance sheet at 31 December 1971 as £5,691,123 includes the commitment fees of £59,002 referred to in paras 8 and 9 above and the total amount of the interest capitalised in the manner described in paras 13 to 15 above, namely £435,988.

I

5. It was contended on behalf of the Appellant Company that:

(*a*) if money was borrowed at interest specifically to finance a purchase, and having been so borrowed, was devoted wholly to the making of that

A purchase, the interest payable on the borrowing and any incidental expense by way of commitment fees was part of the cost to the purchaser of the subject matter of the purchase;

(*b*) having regard *inter alia* to the four matters of common ground between the parties (set out in the decision hereunder), the above sums of £435,988 (interest) and £59,002 (commitment fees) constituted capital expenditure on B the provision of the machinery and plant represented by "Ocean Tide" within the meaning of Part III of the Finance Act 1971;

(*c*) the appeal should be upheld in principle and the assessments adjusted accordingly.

6. It was contended on behalf of the Inspector of Taxes:

(*a*) that the sums in question were incurred on the provision of finance C capital, and *not* on the provision of machinery and plant within the statutory wording;

(*b*) that there was a clear distinction in law and in practice between (i) the costs of raising initial finance, and (ii) expenditure on fixed or current assets for use in trade;

(*c*) that in this case the provision of finance capital may have been an D essential preliminary but was not directly related to the provision and installation of "Ocean Tide";

(*d*) that the appeal should be dismissed and no deduction or allowance made for the sums in question.

7. The following cases were cited: *Commissioners of Inland Revenue* v. *George Guthrie and Son* 33 TC 327; 1952 SC 402; *Chancery Lane Safe Deposit* E *and Offices Co. Ltd.* v. *Commissioners of Inland Revenue* 43 TC 83; [1966] AC 85; *Commissioners of Inland Revenue* v. *Barclay, Curle & Co. Ltd.* 45 TC 221; [1969] 1 WLR 675.

8. We, the Commissioners who heard the appeal, took time to consider our decision and gave it in writing on 17 March 1976 as follows:

The question, which we are asked to decide in principle, is whether the F large sums paid by the Appellant Company by way of interest and commitment fees in respect of money borrowed to finance the purchase of the oil drilling rig "Ocean Tide" constituted capital expenditure "on the provision of machinery or plant for the purposes of the trade", within the meaning of s 41(1)(*a*) of the Finance Act 1971.

We have had the benefit of an agreed Statement of Facts, which sets out G (*inter alia*) how finance for the purchase was raised. In the course of argument it emerged that the following matters were common ground between the parties: (1) the purchase price of "Ocean Tide" was capital expenditure which qualified for the statutory capital allowances; (2) the large loans were obtained to finance the purchase of "Ocean Tide" and were exclusively so applied; (3) to obtain those loans the Company was obliged to pay interest and commitment fees; (4) the H commitment fees and interest charged in the Company's accounts to capital account were, as a matter of commercial accounting, properly so charged.

Mr. Heyworth Talbot, Counsel for the Company, submitted that if moneys were borrowed at interest specifically to finance a purchase and were devoted wholly to the making of that purchase, interest on the borrowing and any incidental expenses (such as commitment fees) were part of the cost to the I purchaser of the subject-matter of the purchase. He relied especially on *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue* 43 TC 83, *per* Lord Upjohn at page 119G, and Lord Pearson at page 129B and I.

He also called in aid the deletion, consequent upon the change effected by s 26(3) of the Finance Act 1969, of any reference to "interest" in s 82(1) of the Capital Allowances Act 1968, which is made applicable by s 50(3) of the Finance Act 1971. Mr. Tillson, for the Crown, submitted that there was a vital difference between expenditure on the provision of what he called "finance capital" and expenditure on the provision of machinery or plant: although the former was obviously connected with the latter, each was a separate transaction, related to a separate subject-matter. He sought some support or guidance for his arguments from *Commissioners of Inland Revenue* v. *George Guthrie and Son* 33 TC 327, *per* Lord President Cooper at pages 329, 330; and *Commissioners of Inland Revenue* v. *Barclay, Curle & Co. Ltd.* 45 TC 221, *per* Lord Reid at pages 239H, 240A, and Lord Guest, at page 245G.

The point is a short one, not covered by direct authority, and not susceptible of elaboration, whichever way argued or decided. In the passages cited to us from the *Chancery Lane* case it seems to us that Lord Upjohn and Lord Pearson were saying no more than that the cost of money raised for a capital purpose will usually itself be a capital cost and may conveniently be shown as part of the total capital cost of a particular asset. They were not, we think, saying that the cost of raising money is expenditure on that which it is used to purchase. Having considered the facts and arguments, we have reached the conclusion that this appeal should not be upheld. It seems to us that the provision of finance was a preliminary and separate matter, rather than an incidental part of the purchase or provision of the drilling rig. It is true that expenditure incurred in financing the purchase and expenditure incurred in making the purchase was part of the overall outlay incurred by the Company before commencing to trade, but whereas the purchase price of "Ocean Tide" clearly fell within the statutory wording as capital expenditure on the provision of the drilling rig, the costs incidental to financing that purchase were, in our view, one material stage removed from the provision of the rig and represented money spent on providing the means to acquire the rig and not on the provision of the rig itself.

Accordingly we dismiss the appeal in principle and adjourn the final determination of figures for two months to enable agreement to be reached thereon.

9. Figures were agreed between the parties on 21 May 1976, and on 23 June 1976 we adjusted the assessment as follows:

Corporation tax	£	£
Case I profit	323,384	
Less capital allowances (free depreciation)	323,384	
Corporation tax profit	Nil	
Capital allowances		
Capitalised cost of drilling rig		5,691,123
Less investment grants		933,157
		4,757,966
Less capitalised interest etc.		494,990
		4,262,976
Free depreciation at period ending 31 December 1971		323,384
Written down value 31 December 1971		3,939,592.

A 10. The Appellant Company, immediately after the determination of the appeal, declared to us its dissatisfaction therewith as being erroneous in point of law and on 6 July 1976 required us to state a Case for the opinion of the High Court pursuant to the Taxes Management Act 1970, s 56, which Case we have stated and do sign accordingly.

11. The question of law for the opinion of the Court is whether our decision B was erroneous in point of law.

B. James
H. H. Monroe
{Commissioners for the Special Purposes of the Income Tax Acts

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

C 14 June 1977

The case came before Brightman J. in the Chancery Division on 17 and 18 November 1977, when judgment was given in favour of the Crown, with costs.

Peter Whiteman Q.C. and *H. Webb* for the Company.

D *Brian Davenport* for the Crown.

The cases cited in argument are referred to in the judgment.

Brightman J.—This is an appeal from a decision of the Special Commissioners refusing the claim of the Appellant, Ben-Odeco Ltd., to capital allowances under s 41 of the Finance Act 1971 in connection with the acquisition of an oil E drilling rig.

In 1969 the Company, which had not started to trade, placed a contract for the building of an oil drilling rig. The construction was financed by means of five loans negotiated in 1969 which were the subject-matter of four loan agreements and a debenture. The obtaining of certain of these loans involved the payment of commitment fees amounting to £59,002. The Company also had F to pay interest on the money lent as and when it was forthcoming. The construction, testing and trials of the oil rig were completed by 8 October 1971, when the Company commenced trading. The rig was then let out on hire. The total interest on the loans down to that date has been calculated at a sum of £435,988 after giving credit for a small amount of interest which was earned on the borrowed money before it was required. In its accounts, the Company charged G to capital not only the contract price of the completed oil rig but also the commitment fees for the loans and the interest which I have mentioned down to the date of final completion. It is common ground between the parties that this was correct accounting practice. In the words of Lord Upjohn in *Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue*(1) [1966] AC 85, at page 124, "the cost of hiring money to rebuild a house is just H as much a capital cost as the cost of hiring labour to do the rebuilding": see also *Commissioners of Inland Revenue* v. *Land Securities Investment Trust Ltd.*(2) 45 TC 495. However, the question for decision before me goes further than that. It is whether these items were capital expenditure incurred "on the provision of" the oil rig.

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(1) 43 TC 83, at p 119. (2) [1969] 1 WLR 604.

(Brightman J.)

I turn to the statutory enactment. The Finance Act 1971, s 41, so far as relevant for present purposes, provides: A

"(1) Subject to the provisions of this Chapter, where—(*a*) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (*b*) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expendi- B ture, there shall be made to him for that period an allowance (in this Chapter referred to as 'a first-year allowance') which shall be of an amount determined in accordance with section 42 below."

I need not read s 42. Section 48 deals with the manner in which the allowance is to be made, and that, also, I need not read.

Counsel for the Appellant made these submissions. First, where a loan is C raised specifically and exclusively for the purchase of machinery or plant and the borrowed funds are thereafter wholly devoted to the purchase of the asset, then and in that case interest and any commitment fees paid on the borrowing, if treated in the company's accounts as capital, constitute an integral part of the capital cost of the acquisition of the asset. For this purpose one looks to the object of raising the money. Secondly, this is a general principle that applies D to the capital allowance legislation. Therefore, the expenditure in the present case, representing interest and commitment fees, constitutes capital expenditure for the purposes of that legislation.

The point is not one upon which there is as yet any direct authority. Counsel for the Appellant relied on two cases: *Commissioners of Inland Revenue* v. *George Guthrie and Son*(1) 33 TC 327 and *Commissioners of Inland Revenue* v. E *Barclay, Curle & Co. Ltd.*(2) 45 TC 221. The assistance to be derived from the *Guthrie* case is that the question whether capital expenditure is incurred "on the provision of" an asset is not to be answered by a strict proximity test, nor is the test purely objective. In that case a taxpayer had paid some £1,400 as the purchase price of a motor car to be used for business purposes. The taxpayer never received delivery of the car because it had already been fraudulently sold F to another purchaser. He claimed an initial allowance under the then capital allowance legislation, and the Court of Session held that he was entitled to that allowance. Lord President Cooper, with whom Lords Carmont and Russell agreed, expressed his opinion as follows(3):

"When, as in this case, there has been a *bona fide* expenditure of capital for an approved purpose, I consider that the Special Commissioners G were justified in concluding that their concern was with the fact and the object of the expenditure and not with the subsidiary question whether the money was well spent or ill spent, or whether (*bona fides* being always assumed) the intended object was or was not actually realised."

That decision was relied upon by the Appellant as an indication that the question I ought to ask myself is: What object did the taxpayer have in view in incurring H the expenditure in question? Here, it was submitted, the only object which the Company had in view in borrowing the money was the acquisition of the oil drilling rig.

In the *Barclay, Curle* case there were two questions at issue, but for present purposes the relevant problem was whether the cost of excavating a basin for the accommodation of a dry dock qualified for an initial allowance as I

(1) 1952 SC 402. (2) [1969] 1 WLR 675. (3) 33 TC 327, at p 330.

A expenditure on the provision of plant. In the Court of Session Lord Guthrie, agreeing that the excavation qualified for the allowance, said, at page 235(1): "In deciding whether expenditure qualifies for capital allowances the crucial question is the object of the expenditure"; and there is a reference to *Commissioners of Inland Revenue* v. *Guthrie*.(2) He decided that the object of excavating the basin was the provision of plant. In the House of Lords, Lord Reid said, B at page 239:

> "So the question is whether, if the dock is plant, the cost of making room for it is expenditure on the provision of the plant for the purposes of the trade of the dock owner. In my view this can include more than the cost of the plant itself, because plant cannot be said to have been provided for the purposes of the trade until it is installed: until then it is of no use C for the purposes of the trade. This plant, the dock, could not even be made until the necessary excavating had been done. All the Commissioners say in refusing this part of the claim is that this expenditure was too remote for the provision of the dry dock. There, I think, they misdirected themselves. If the cost of the provision of plant can include more than the cost of the plant itself, I do not see how expenditure which must be incurred D before the plant can be provided can be too remote."

Lord Guest said, at page 245:

> "The excavation was a necessary preliminary to the construction of the dry dock, and in my view was covered by the provision of plant under s. 279. 'Provision' must cover something more than the actual supply."

In the instant case it is said that it was essential for the Company to raise the E money by loan if it were to acquire the oil rig.

Counsel for the Appellant was careful not to place his case on too broad a base. He submitted that there were four limitations, four conditions which had to be satisfied in order that the commitment fees and interest should qualify as part of the expenditure incurred on the provision of the machinery or plant. First, he said, as already indicated, that one must look at the object of the F expenditure. Why was the commitment secured? Why was the money borrowed and the interest paid? The purpose must be the provision of the machinery or plant. Secondly, it must be established that the expenditure is not too remote. To take the case of a dry dock, there are many incidental expenses which might fall to be considered. For example, not only the cost of designing the dry dock, but probably also legal and other costs in connection with financial and building G contracts; and there might be all sorts of other incidental expenditure incurred in a broad sense in connection with the provision of the dock, some expenditure being of the closest proximity, such as the drawing of plans, and some much more remote. It would often be necessary to apply a remoteness test to a particular item. A third limitation was that interest would not qualify as part of the expenditure on the provision of the machinery or plant if deductible in comput-H ing the profits or gains of a trade: see s 50(3) of the Finance Act 1971, incorporating s 82(1) of the Capital Allowances Act 1968. The fourth limitation was that the commitment fees and the interest must be items which, on proper accounting principles, can be and are capitalised. Whether a particular item of expenditure is properly to be regarded as capital expenditure or income expenditure is a question of law, to be decided by the Court after hearing expert accountancy I evidence. Those four limitations, all of which, Counsel submitted, were satisfied

(1) 45 TC 221. (2) 33 TC 327.

(Brightman J.)

in the case before me, were sufficient, he said, to prevent any extravagant interpretation being given in other cases to the expression "expenditure on the provision of machinery or plant". A

For the Crown it was argued that the commitment fees were money spent on obtaining the right to borrow and that the interest payable on the five loans was money spent for the use of the money borrowed. If, said Counsel, one were asked what was provided in return for the commitment fees, the proper answer would be, not the oil drilling rig but the financial facility. Again, if one were asked what was provided in return for the interest, the correct reply would be, not the oil rig but the use of the money. It was submitted that the taxpayer's proposition amounted to a rewriting of the section so as to permit a first-year allowance not merely on capital expenditure incurred "on the provision of" machinery or plant but also capital expenditure incurred "in connection with" the machinery or plant, or the provision thereof. It was right to treat the price of borrowing money as an element to be taken into account in costing the provision of the oil rig. It was also right to treat that price as part of the capital cost of the project. But that, it was submitted, is not the same thing as saying that the price of borrowing the money is part of the capital expenditure "on the provision of" the oil rig; it was rather the cost of the provision of the money with which the oil rig was acquired. B C D

Counsel for the Crown posed the question where one would stop once it was accepted that the cost of obtaining finance for acquiring machinery or plant was part of the expenditure "on the provision of" such machinery or plant, even if, to satisfy the limitations accepted by the Appellant, the money were raised for the sole and exclusive purpose, and wholly used for the purpose, of the machinery or plant in question. Finance can be obtained in numerous ways. A common method would be a public issue of debenture stock. Such an issue involves expense on legal advice, expense on underwriting the issue, expense on advertising the offer and all the other multifarious expenses of a public issue. All such expenditure of money would be the price of securing the necessary finance. On the taxpayer's argument, it must follow, said Counsel, that all such expenditure was to be treated as expenditure on the provision of the machinery or plant, that being the purpose for which the money was raised. Counsel for the Appellant would surmount this difficulty by relying on the limitation of remoteness, but I am not certain that it wholly answers the question. A commitment fee guarantees the provision of the money sought to be borrowed; the expense of underwriting a public issue guarantees that the money will be forthcoming. So, just to take those two items, there would not seem to be any significant difference. I have selected one way of raising money, but the devices are endless. The case before me is attractively simple because nothing is involved except the commitment fees and interest: other cases may be far more complicated. On the logic of the taxpayer's argument, all such expenditure on raising money, however involved the procedure, would, I think, have to be classified as expenditure on the provision of the machinery or plant which is the ultimate object of the exercise. E F G H

Counsel for the Crown submitted that the *Barclay, Curle* case(1) does not assist the taxpayer. The excavation of the basin was essential to the creation of the dock; the dock could never have been made without such excavation. The concrete lining would not stand up on its own; nor could a ship get into the dock if the basin had not been made. So the expense of such excavation was essential for the creation of the dry dock, without which it could never have I

(1) 45 TC 221

A existed at all. The reasoning in the *Barclay, Curle* case[1], he submitted, was that the excavation of the basin and the concrete lining thereto were a single entity. The present problem is entirely different, and the same reasoning cannot be applied to the cost of borrowing money. A rig can be built without borrowing money, and the buying price of the structure will be the same whether the money is borrowed or not.

B Counsel for the taxpayer also relied on s 50(3) of the 1971 Act, and said that interest on money before commencement of trading is now by implication blessed by statute for inclusion in expenditure "on the provision of" machinery or plant. The argument is somewhat involved. Section 50(3) reads as follows: "Section 82(1) of the Capital Allowances Act 1968 (construction of references to capital expenditure and capital sums) shall apply for the purposes of this C Chapter as it applies for the purposes of Part I of that Act." Section 82(1) of the Capital Allowances Act 1968, before amendment and so far as relevant for present purposes, provided:

> "References in this Part of this Act to capital expenditure and capital sums—(*a*) in relation to the person incurring the expenditure or paying the sums, do not include any expenditure or sum which is allowed to be D deducted in computing, for the purposes of tax, the profits or gains of a trade, profession, office, employment or vocation carried on or held by him, . . . and do not include, in relation to any such person as aforesaid, any expenditure or sum in the case of which a deduction of tax falls or may fall to be made under Chapter I of Part VII of the Income Tax Act 1952 (interest and other annual payments)."

E Section 170 of the Income Tax Act 1952, which is one of the sections referred to in s 82, related to "any interest of money, annuity or other annual payment charged with tax under Schedule D". In and before 1968, therefore, interest of money could not by statute be treated as capital expenditure. Section 26 of the Finance Act 1969, which reorganised, in the case of corporations, the tax treatment of interest and took such interest out of s 170 of the Income Tax F Act 1952 provided (subs (3)): "In section 170(1)(*a*) of the Income Tax Act 1952 (payments not out of profits or gains charged to income tax) the words 'interest of money' shall be omitted." It was therefore said that there is no longer an absolute prohibition against the treatment of interest on money as capital expenditure. That argument may be logically correct as a matter of statutory enactment. Why, asked Counsel for the Appellant, did the draftsman of the G 1971 Act not make an express reference to s 26 of the Finance Act 1969 if it were intended that interest on money should continue to be outside the ambit of capital expenditure on the provision of machinery or plant? I reject the argument because it does not seem to me to follow that the *prima facie* meaning of "expenditure on the provision of machinery or plant" has been altered by a side wind so as to permit an allowance for interest if it would not otherwise be H regarded as expenditure on the provision of machinery or plant but as expenditure on the provision of a loan. I therefore intend to reach my conclusion without regard to s 50(3) of the 1971 Act.

There is one other provision to which I should refer. The Capital Allowances Act 1968, under the heading of "The Main Reliefs for Capital Expenditure", dealt with industrial buildings and structures as well as machinery and plant. I Section 1(1) of the Act reads: "Subject to the provisions of this Act, where a person incurs capital expenditure on the construction of a building or structure which is to be an industrial building or structure occupied for the purposes of a

(1) 45 TC 221.

(Brightman J.)

trade", an initial allowance shall be granted. Section 18(1) reads: "Subject to the provisions of this Act, where—(*a*) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade", an initial allowance was to be granted. It seems to me that, as a matter of drafting elegance, where one was dealing with the erection of a building or structure a natural formula would be "capital expenditure on the *construction* of a building or structure". It would perhaps be a little strange to refer to "capital expenditure on the *provision* of a building or structure". Similarly, when dealing with machinery and plant, almost inevitably one uses the words "*provision* of machinery or plant". The words "capital expenditure on the *construction* of machinery or plant" would be inelegant. So it seems to me that, as a matter of necessary wording, one finds in the one case the expression "*construction* of a building or structure" and, in the other case, "*provision* of machinery or plant". I have difficulty in believing that interest on borrowed money could be aptly described as part of the expenditure on the "construction" of a building or structure. If one accepts that Parliament did not intend to have a different code in this respect for dealing with buildings and structures on the one hand, and machinery and plant on the other hand in the context of capital allowance, one is led to the reasonable conclusion that the two formulae were intended to comprise the same type of expenditure. An object may qualify not only as a building or structure but at the same time as machinery or plant: see s 14 of the 1968 Act, and the *Barclay, Curle* case(1), at page 679. Comparable sections were contained in the Income Tax Act 1952.

The point with which I am concerned is a short one. As said by the Special Commissioners, it is not one which is susceptible of immense elaboration. Having listened to the compelling arguments advanced on both sides, I have reached the view that the argument of the Crown is to be preferred. I think that a distinction is to be drawn in the context of this present case between money spent on the provision of finance by the use of which the machinery or plant is acquired and money spent on the provision of such machinery or plant. I therefore decide that the appeal fails.

Appeal dismissed, with costs.

The Judge granted the Company's application for a certificate under the Administration of Justice Act 1969, *s* 12, *to "leapfrog" the Court of Appeal and the House of Lords gave the necessary leave.*

The Company's appeal came before the House of Lords (Lords Wilberforce, Hailsham of St. Marylebone, Russell and Scarman, Lord Salmon dissenting) on 29 June and 3 July 1978 when judgment was reserved. On 27 July 1978, judgment was given in favour of the Crown, with costs.

Peter Whiteman Q.C. and *Graham Aaronson* for the Company.

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:—*Hinton* v. *Maden & Ireland, Ltd.* 38 TC 391; [1959] 1 WLR 875; *Sun Insurance Office* v. *Clark* 6 TC 59; [1912] AC 443; *Lothian Chemical Co. Ltd.* v. *Commissioners of Inland Revenue* (1926) 11 TC 508; *Roebank Printing Co. Ltd.* v. *Commissioners of Inland Revenue* 13 TC 864; 1928 SC 701; *Odeon Associated Theatres Ltd.* v. *Jones* 48 TC 257; [1973] Ch 288.

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(1) [1969] 1 WLR 675; 45 TC 221, at p 239.

A **Lord Wilberforce**—My Lords, this appeal is concerned with a claim by the Appellant Company to a first-year capital allowance in respect of expenditure incurred in connection with the construction of an oil rig, "Ocean Tide". The claim arises under s 41(1)(*a*) of the Finance Act 1971 and its validity depends upon the construction of the four words "on the provision of". Are interest and commitment fees paid in respect of a loan contracted in order to finance B the provision of machinery or plant capital expenditure incurred on the provision of machinery or plant? That is the whole of the question.

The Appellant Company was incorporated on 2 December 1968. Its only trade at all material times consisted in hiring out the rig "Ocean Tide" on time charter. It had an authorised and issued share capital of £5,000. The contract for the construction of "Ocean Tide" was placed in 1969. In order to pay for it, C the Appellant entered into five loan agreements, one of them secured by a debenture. Interest was payable on the money borrowed and commitment fees had to be paid in order to maintain a right to draw the money. The amounts of interest and commitment fees paid by the Appellant until it started to trade (in July 1971) were capitalised in its accounts. It was common ground (and so recorded by the Special Commissioners) that as a matter of commercial account- D ing these amounts were properly so charged to capital. The total cost of the completed rig as shown in the Appellant's balance sheet on 31 December 1971 was £5,691,123 of which the capitalised interest and commitment fees represented £435,988 and £59,002 respectively. It is not disputed that the price of the "Ocean Tide" was capital expenditure which qualified for the statutory capital allowance. It is agreed that the loans were obtained in order E to finance the purchase of "Ocean Tide" and were exclusively so applied. It is also agreed that the Appellant, in order to obtain the loans, was obliged to pay interest and commitment fees.

The Appellant's argument in favour of the allowance is, basically, twofold. First, it is said that the interest and commitment fees are, in a real sense, part of the cost of the rig or, at least, part of the cost to the Appellant of the rig. F They ought, consistently with the statutory purposes (viz., to encourage investment) to be treated in exactly the same way as the other elements of the cost. Secondly, it is contended that what in a particular case is cost and what is capital expenditure has to be determined according to accepted methods of commercial accounting, and that, since the interest and commitment fees up to the date when trading commenced were, in accordance with these methods, G treated as capital expenditure, that is sufficient to bring these sums within the statutory provision. The contention of the Crown is simpler. They point to the relevant words "capital expenditure on the provision of machinery or plant"; the only question is whether the amounts in question fall within this phrase. It is not sufficient for the relevant expenditure to attain the status of capital expenditure: nor for it to be described, in popular language, as part of the cost. H Capital expenditure in order to qualify must be on the provision of plant or machinery and it does not follow that, because a trader treats expenditure as part of the cost of the rig, the expenditure qualifies under the Statute. Here the interest and commitment fees were expended not in order to provide the plant, but in order to obtain, or on, the loans. They represented money spent on providing the means to acquire the rig and not on the provision of the rig I itself.

I must first refer to such authority as was cited, though in the end it provides no decisive assistance. It falls into three groups. First, the Appellant referred to the series of cases which establish that sound principles of commercial accounting may be invoked in order to determine such questions of internal accounting as what is profit, how profit is to be calculated, what, on the other

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hand, is capital (*Whimster & Co.* v. *Commissioners of Inland Revenue*(1) 1926 SC 20; *Ryan* v. *Asia Mill, Ltd.* (1951) 32 TC 275; *Duple Motor Bodies Ltd.* v. *Commissioners of Inland Revenue*(2) [1961] 1 WLR 739; *B.S.C. Footwear Ltd.* v. *Ridgway*(3) [1972] AC 544). I shall not discuss these authorities because there is no occasion here to dispute them, nor were they disputed by the Crown. They establish no more than, as is conceded in the present case, the amounts in question were, during the pre-trading period, properly charged to capital account. To establish this however is not enough for the Appellant; in order to succeed it must show that they represented "capital expenditure on the provision of machinery or plant" and the task of the Court is to interpret these words. Accounting methods adopted by a particular company (and other companies might treat similar expenditure differently) cannot determine the construction of statutory words. Secondly, reliance was placed on the *Chancery Lane* case (*Chancery Lane Safe Deposit and Offices Co. Ltd.* v. *Commissioners of Inland Revenue*(4) [1966] AC 85) and in particular the observations of Lord Upjohn and Lord Pearson to the effect that capitalised items might be shown in the balance sheet as part of the total capital cost of a particular asset. But I do not understand them to be saying more than that interest, if capitalised, can be shown as a capital cost: the question of relating it to the acquired asset did not arise. Thirdly, through the diligent researches of Counsel, we were referred to two Commonwealth cases, said to support the Appellants. The first was *B.P. Refinery* (*Kwinana*) *Ltd.* v. *Federal Commissioner of Taxation* [1961] ALR 52, decided by Kitto J. as single Judge in the High Court of Australia. The appellant company entered into a contract for the construction of a refinery for a fee which included an amount equal to the expenditure of the contractor in carrying out the work. The contractor incurred expenditure in the erection of temporary buildings for (*inter alia*) the accommodation of workmen. The company paid to the contractor a sum equal to this expenditure. The question in this case was how this sum ought to be allocated as between depreciable and non-depreciable assets—whether by a direct cost method, or one based upon labour costs, and the decision was that the method adopted by the taxpayer company, though not the only possible method, was appropriate. In the course of his judgment Kitto J. said "I am satisfied that this amount" (the net cost of the temporary buildings) "was paid by the appellant to [the contractor] and accordingly formed part of the cost of the refinery to the appellant." But his Honour was in that passage only concerned to arrive at the quantum of the payment, and not with relating it, in its nature, to any statutory formula. The actual decision was purely as to the method of allocation. The second case is much more in point; indeed it bears, on its facts, much resemblance to the present. In *Sherritt Gordon Mines Ltd.* v. *Minister of National Revenue* [1968] 2 Ex CR 459 the Exchequer Court of Canada decided that commitment fees paid in respect of development properties during the construction period were part of the capital cost of those properties within s 11(1)(*a*) of the Income Tax Act and therefore subject to capital cost allowances. In that case interest and the commitment fees were capitalised until the mine, or the refinery, were operating and thereafter charged against operating. His Honour referred in detail to accountancy evidence, some of which supported such capitalisation as accepted practice, some of which did not and to the arguments of counsel, which were close to those used in the present appeal. Reference was made to U.K. authorities, including *Whimster & Co.* v. *Commissioners of Inland Revenue* and the *Chancery Lane* case. His judgment contains this passage:

> "However, even if it is found as a fact, as counsel for Sherritt submits it should be, that Sherritt's treatment of payments of bond interest and

(1) 12 TC 813. (2) 39 TC 537. (3) 47 TC 495. (4) 43 TC 83.

A commitment fee during construction was in accordance with generally accepted accountancy principles and that the method followed was an appropriate method of accounting for Sherritt, that is not conclusive of the question the court has to decide, for the prescriptions of the *Income Tax Act* prevail."

In the end he found that the question was "fairly arguable" but he was disposed B to think that interest during construction can be a part of the capital cost of property within s 11(1)(*a*)—similarly the commitment fees. The relevant statutory expression there was the "capital cost to the taxpayer of property": this His Honour considered could include, certainly the price, probably legal costs, might well include the cost of moving the asset to the place of use, and in his opinion would include the "cost to him" of borrowing the capital required. C My Lords, this judgment is an impressive one, perhaps more for the full statement of the arguments on either side than for the actual decision which, as the learned Judge himself said, was arguable. In considering whether it should be followed and so, in effect, preferred to the judgment of Brightman J.(1), I bear in mind that it arose under a different statute and one which not only uses a different expression, but whose policy as regards deduction seems to be D more liberal than the U.K. statute. The expression "capital cost to the taxpayer" makes it easier to include within deductible expenditure costs which the particular taxpayer incurs, whereas the U.K. words, more objectively, focus on expenditure directly related to the plant. The one draws a line round the taxpayer and the plant; the other confines the limiting curve to the plant itself. As to policy, the Canadian Act allows deduction of the expense of issuing or selling shares of E the capital stock of the taxpayer (s 11(1)(*c*)) and the Minister had allowed the taxpayer's claim as regards interest. Further I note that the judgment cites two United States authorities which appear to take a different view as regards interest charges (l.c. page 484). Unless therefore, on principle and in logic, it is preferable to the judgment appealed from, there are sound reasons for distinguishing it. I therefore turn to this question.

F An important principle of the laws of taxation is that, in the absence of clear contrary direction, taxpayers in, objectively, similar situations should receive similar tax treatment. The taxpayer's argument in the present case does not bring this about. On the contrary, a different result would follow according as he pays for the provision of plant out of his own resources, or borrows it. In the latter case he would get an allowance, in the former he would not— G this may amount to treating an investor worse than a speculator. Moreover, on the same argument, a different allowance in respect of identical plant would result according as he (i) borrows from a bank, (ii) raises money by a public issue of debentures, (iii) obtains money from his shareholders. And, again, a different result would follow according as (i) he is able to capitalise the interest on the money borrowed or (ii) (because he is carrying on a profit-making trade H or for other reasons) does not or cannot capitalise it. If the law is such that it offers the taxpayer these options he is of course entitled to select that which suits him best, but an interpretation which introduces such a large element of subjectivity is to be avoided. The words "expenditure on the provision of" do not appear to me to be designed for this purpose. They focus attention on the plant and the expenditure on the plant—not limiting it necessarily to the I bare purchase price, but including such items as transport and installation, in any event not extending to expenditure more remote in purpose. In the end the issue remains whether it is correct to say that the interest and commitment

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(1) Page 465 *ante*; [1978] 1 WLR 365.

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fees were expenditure on the provision of money to be used on the provision of plant, but not expenditure on the provision of plant and so not within the subsection. This was the brief but clear opinion of the Special Commissioners and of the Judge and little more is possible than after reflection to express agreement or disagreement. For me, only agreement is possible. I would dismiss the appeal. A

Lord Hailsham of St. Marylebone—My Lords, the Appellants entered into a contract with Upper Clyde Shipbuilding Ltd. for the construction and delivery of an oil rig now known as the "Ocean Tide". The contract price was approximately £5,000,000. In order to pay for this they borrowed the money and this cost them just short of a further £500,000 up to and including the time when they started trading. This sum of £500,000 was made up in part of commitment fees and in part of interest, and was correctly charged by their accountants to capital account. After trading commenced the interest was, of course, charged to revenue and deductible in the ascertainment of profits for the purposes of charge to tax. The Appellants claim first-year allowances not merely for the cost of the rig, which is conceded by the Crown, but also for the commitment fees and interest incurred in financing their payment for it. Whether they succeed or not depends upon the answer to the question whether they can bring these items of expenditure within the language of s 41(1)(*a*) of the Finance Act 1971. This provides as follows: B C D

> "41.—(1) Subject to the provisions of this Chapter where—(*a*) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (*b*) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure, there shall be made to him for that period an allowance (in this Chapter referred to as 'a first-year allowance') which shall be of an amount determined in accordance with section 42 below: Provided that no first-year allowance shall be made in respect of any expenditure if the chargeable period related to the incurring of the expenditure is also the chargeable period related to the permanent discontinuance of the trade." E F

Nothing turns in this case on the proviso, nor on the terms of para (*b*) of the subsection. Moreover there is no dispute either that the Appellants are "a person carrying on trade" or that in incurring the items in question the Appellants can properly be described as "incurring capital expenditure". It is further agreed that "Ocean Tide" is correctly described as "machinery or plant" and that it was required for the purposes of the Appellants' trade. It follows that the only question in dispute is whether the fees and interest were items of "expenditure on . . . machinery or plant". This depends on whether a narrow or a broad construction is to be placed on the words. The Appellants contended that the words include all items properly incurred in the provision of the "Ocean Tide" which would include the cost of financing the payment for it. For the Respondent it was argued that the only expenditure on the provision of the "Ocean Tide" was, in effect, its price and that the commitment fees and interest were not expended on the provision of the "Ocean Tide" within the meaning of s 41(1), but on the provision of the money to pay for it and that this for the purposes of the subsection is to be regarded as a distinct and separate operation. In my view the actual words of the Statute are capable of bearing either construction according to the context in which they are used, but, at the end of the day, I agree with the judgment of Brightman J.[1] and the view of the G H I

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(1) Page 465 *ante*; [1978] 1 WLR 365.

A Special Commissioners that in the context of s 41(1) of the Finance Act 1971 they bear the narrower of the two meanings, that is, that contended for by the Crown. It follows that, in my view, the appeal should be dismissed.

Great stress was laid on the part of the Appellants on the long line of cases which establish that for the purpose of computing profits or gains the courts will accept the ordinary principles of commercial accounting even where there B may be more than one acceptable alternative method available to the taxpayer (c.f. *Duple Motor Bodies Ltd.* v. *Commissioners of Inland Revenue*(1) [1961] 1 WLR 739). There are limits to this doctrine (see *B.S.C. Footwear Ltd.* v. *Ridgway*(2) [1972] AC 544). But the real answer to the Appellants' contention is that, at the best, the application of the ordinary principles of commercial accounting only establish that the items in question were correctly charged to C capital account, which, for the purposes of this case is not in dispute. The principles of commercial accounting cannot assist as to the meaning of the words "the provision of machinery or plant" where these occur in the Statute. The Appellants also relied on *Commissioners of Inland Revenue* v. *George Guthrie and Son*(3) 33 TC 327, a decision on the former initial allowance. I do not find that case analogous to the present. In it the taxpayer had actually D expended moneys on the purchase of a motor car which proved abortive owing to the fraud of the vendor in failing to supply the car after it had been paid for. Equally I do not find analogous the case of *Commissioners of Inland Revenue* v. *Barclay, Curle & Co. Ltd.*(4) 45 TC 221 which decided that the excavation of the necessary basin for the construction of a dry dock was physically part of the same operation and ranked for allowance as part of the E expenditure on the provision of the dry dock itself. Neither of these cases really touches the question whether the words "expenditure on the provision of machinery or plant" are wide enough to include money spent on the acquisition of money the main purpose of which was to pay for machinery or plant, as distinct from money actually expended in order to pay for the construction (or purchase) transport and installation of the machinery or plant itself. In addition F to the cases cited to Brightman J. Appellants' Counsel drew the attention of your Lordships to two Commonwealth cases, the decision of the High Court of Australia in *B.P. Refinery (Kwinana) Ltd.* v. *Federal Commissioner of Taxation* [1961] ALR 52, and the decision in Canada in *Sherritt Gordon Mines Ltd.* v. *Minister of National Revenue* [1968] 2 Ex CR 459. The former case seems to me, on analysis, to depend on a question of the correct apportionment G between depreciable and non-depreciable items of expenditure of certain overhead costs and not, therefore, to be directly in point. The argument in *Sherritt*'s case (*supra*) is much closer to the present, but not of higher authority than Brightman J.'s own decision in the present case. In any event it depends on the terms of the relevant Canadian statute which are different from those of s 41 of the U.K. Finance Act 1971, and, on analysis, both in language and H policy, plainly more liberal in construction and intent. Incidentally the decision of Kerr J. in that case cites some U.S. authorities which at least point in the opposite direction to his own conclusions.

In the outcome, and whilst admitting that during the course of argument my inclination tended at different points of time to favour each of the two possible constructions, I come down decisively in favour of the narrower I meaning. I summarise my reasoning as follows. In the first place I believe that the more accurate and the more natural answer to the question on what was the £5,500,000 spent, is that £5,000,000 was spent on the provision of

(1) 39 TC 537. (2) 47 TC 495. (3) 1952 SC 402. (4) [1969] 1 WLR 675.

(Lord Hailsham of St. Marylebone)

plant and machinery and £500,000 on the loan charges required in order to obtain the money to pay for the plant and machinery. In the second place I favour a meaning to the Statute which will provide the same allowance for the taxpayer who meets the cost of an oil rig out of his own accumulated resources, the taxpayer who meets the same cost by a debenture issue or an issue of shares to the public, and the taxpayer who simply borrows the money from a bank, or some other source of liquid finance. In the third place I am not satisfied that the policy of the Statute really conforms with the Appellants' contention. Granted that its main purpose was to encourage investment in new machinery and plant, I am not convinced that to include interest charges and commitment fees would serve this purpose without giving rise to abuse. It was agreed in argument that if the constructing company borrowed money in order to finance the construction of the rig and added the interest and commitment fees into the price charged to the purchaser, the total price to the purchaser would rank for first-year allowance. But how if the purchaser in his turn borrowed the money to pay the price containing these components? It seems to me that, on the Appellants' contention, he would be able to add the second tier of commitment fees and interest. By the time a complicated piece of machinery was ultimately delivered and paid for there might be more than one, indeed more than two, sets of commitment charges and interest payments included in the ultimate purchase price and several additional costs of financing the project by the trader to be included in the allowance the Revenue might be compelled to make to the trader. It is true, of course, that, if the Appellants' case were conceded what would emerge would be a coherent and superficially elegant system of taxation in which the interest charges before trading would be allowable as first-year capital allowance, and after the commencement of trading would be deductible as expenses in the computation of profits. But I am by no means certain that this was the intention of the Legislature. To qualify for an allowance the taxpayer must bring himself within the conditions set by the benevolence of Parliament. I am not convinced that this taxpayer has done so in the present case. I feel therefore constrained to say that the appeal should be dismissed with costs and that the judgment appealed from should be affirmed.

A B C D E F

Lord Salmon—My Lords, the result of this appeal turns upon the construction of a few words, viz., "capital expenditure on the provision of machinery or plant", in s 41 of the Finance Act 1971. That section so far as relevant reads as follows:

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"(1) Subject to the provisions of this Chapter, where—(*a*) a person carrying on a trade incurs capital expenditure on the provision of machinery or plant for the purposes of the trade, and (*b*) in consequence of his incurring the expenditure, the machinery or plant belongs to him at some time during the chargeable period related to the incurring of the expenditure, there shall be made to him for that period an allowance (in this Chapter referred to as a 'first-year allowance') which shall be an amount determined in accordance with section 42 below."

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The amount of the first-year allowance under s 42 was 60 per cent. of the expenditure in respect of which it was made. This percentage was raised to 80 per cent. by the Finance Act of 1972 and later to 100 per cent. The Appellants made arrangements to raise loans of approximately £5,200,000 in order to pay for the construction of an oil drilling rig to be named "Ocean Tide". As soon as this rig was constructed and ready for use in their trade, the Appellants intended to let it on time charter for the purpose of drilling for oil in the seas

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(Lord Salmon)

A around this country. It was a term of all the loan agreements that the loans should carry interest at the going rate and that in addition to the interest, the Appellants should pay commitment fees. The whole of the £5,200,000 (except for £40,000) was raised by loans from four banks of the highest standing and taken up as required to pay for the construction of the rig during the three years ending 31 December 1969, 1970 and 1971. The construction of the rig B was completed in 1971 and was brought into use in the Appellants' trade when from 9 October 1971 it was first let on time charter. The interest and the comparatively small commitment fees amounting in all to approximately £500,000 were capitalised as they accrued and appeared in the Appellants' accounts for each of the three years to which I have referred as part of the cost of the rig which the Appellants had acquired. The Crown concedes that this was in C accordance with sound commercial practice. The Crown also concedes that the total cost of the rig as at 31 December 1971 was correctly shown in the Appellants' accounts as approximately £5,700,000 being the aggregate of the price paid to Upper Clyde Shipbuilding Ltd. who constructed the rig and the interest and commitment fees accrued as at 31 December 1971. The crucial question which arises on this appeal is whether the whole of the sum of approximately D £5,700,000 constituted capital expenditure incurred on the provision of the rig. The Appellants contend that it did. The Crown contends that the capital expenditure of approximately £500,000 in respect of interest and commitment fees was not part of the capital expenditure so incurred. The argument on behalf of the Crown is that, on the true construction of s 41(1), the interest and commitment fees were too remote to constitute any part of the capital E expenditure incurred on the provision of the rig but should be regarded only as capital necessarily expended on acquiring the capital expended on the rig. I confess that I regard this narrow construction of s 41(1) to be too artificial and unreal to be accepted.

The case for the Crown can, I think, best be tested in this way. If the Crown were asked firstly "what was the capital cost incurred by the Appellants F in acquiring the rig?" the answer must be £5,700,000; for this was the capital cost appearing in the Appellants' audited accounts which have been conceded by the Crown to be correct. If, however, the question I have formulated were to be translated into the language of the Statute it would then read "what capital expenditure was incurred by the Appellants on the provision of the rig for the purpose of their trade?" Both questions though worded differently have G precisely the same meaning and can only be answered in the same way. The Crown, however, would answer the second version of the question "only £5,200,000 in round figures. The balance of £500,000 was incurred in providing the Appellants with the £5,200,000 and is too remote to have been incurred on providing them with the rig." I confess that this does not seem to me to make any commercial sense and that it is also wholly inconsistent with the concession H which the Crown has rightly made in relation to the first question. I entirely agree with my noble and learned friend, Lord Hailsham of St. Marylebone, when he says that the actual words of the Statute are capable of bearing either the narrower meaning for which the Crown contends, or the wider meaning for which the Appellants contend. I am afraid, however, that I do not agree that the context of the material words in s 41(1) of the Act of 1971 affords I any support to the meaning attributed to that subsection by the Crown. Nor, in common with all your Lordships, do I think that any of the authorities to which we have been referred are of any real help in deciding the question of construction raised by this appeal. They, no doubt, establish that the expenditure of the £500,000 was a capital expenditure; but this point has never been contested.

(Lord Salmon)

The question is—was the £500,000 capital expenditure, expenditure incurred on the provision of the rig? When, as in the present case, words of a statute are capable of more than one meaning, the policy or objective of the statute is a most important factor to be taken into account in deciding the true meaning of those words: *River Wear Commissioners* v. *Adamson* (1877) 2 App Cas 743, *per* Lord Blackburn, at page 763; *Attorney-General* v. *Prince Ernest Augustus of Hanover* [1957] AC 436, *per* Viscount Simonds, at page 462.

Part III, Chapter 1 of the Act of 1971 (which includes s 41(1)) is headed: "New System of Allowances and Charges in respect of Trade (etc.) Machinery and Plant." For many years prior to 1971 it had been generally recognised that the overall level of industrial productivity in this country was deplorable. One of the reasons for this extremely low level of productivity was the large proportion of obsolescent, and the serious shortage of modern and efficient plant and machinery used for industrial purposes. The obvious objective of that part of the Act of 1971 with which this appeal is concerned was to introduce an entirely new system of capital allowances which would afford a really effective incentive to industrial undertakings to provide themselves with new and efficient plant and machinery. This perhaps is underlined by the fact to which I have already referred that the first-year capital allowance was originally put as high as 60 per cent., then almost immediately raised to 80 per cent. and soon after to 100 per cent. It must, I think, be generally recognised that new plant and machinery is often acquired with money which has been borrowed from banks for this specific purpose alone. This is especially so when the acquisition involves expenditure which is very large in relation to liquid assets of the undertaking making the acquisition. Providing that the industrial concerns in question can supply the necessary security and are considered by the banks to be credit worthy, there will normally be no difficulty in obtaining loans from the banks for the purpose of buying new plant and machinery. Indeed the banks are in business to make such loans. When, as in the present case, millions of pounds are involved, the interest payable on the loans will be very large indeed. I think that Parliament must also have recognised (*a*) that if any company in the position of the Appellants were asked how much it had expended on providing itself with a rig such as the "Ocean Tide", the company would have replied, without hesitation, and correctly, "in round figures £5,700,000" and (*b*) that it would be a great incentive for any such company to decide upon buying such a rig if it knew that the £500,000 covering the interest incurred before the rig came into commission would be included in, rather than excluded from the capital expenditure on the provision of the rig, and would thus qualify for the first-year capital allowance. If the £500,000 does not qualify for the first year's capital allowance then there is no relief available to the Appellants in respect of that expenditure. I find it difficult to believe that when Parliament introduced a new system of capital allowances in order to offer the highest incentives for industrial concerns to acquire new machinery and plant, it could have intended s 41(1) of the Act of 1971 to bear the narrow meaning for which the Crown contends rather than the broader meaning attributed to it by the Appellants and which it is admittedly capable of bearing. I consider that the construction of s 41(1) which I favour is also supported by s 50(3) of the Act of 1971 which reads as follows: "Section 82(1) of the Capital Allowances Act 1968 . . . shall apply for the purposes of this Chapter as it applies for the purposes of Part I of that Act." Section 82(1), so far as relevant, provided:

> "References in this part of this Act to capital expenditure . . . (*a*) in relation to the person incurring the expenditure . . . do not include any expenditure . . . which is allowed to be deducted in computing, for the

A purposes of tax, the profits or gains of a trade . . . carried on . . . by him, and . . . do not include, in relation to any such person as aforesaid, any expenditure . . . in the case of which a deduction of tax falls or may fall to be made under Chapter I of Part VII of the Income Tax Act 1952 (interest and other annual payments)."

In my view, this section makes it plain that capital expenditure may include B the expenditure of interest which qualifies for all capital allowances; but no such expenditure of interest can be treated as a capital expense if it is allowed to be deducted in computing, for the purposes of tax, the profit or gains of a trade. It follows that although, whilst the rig was being completed, and the interest payable to the banks was being correctly capitalised and, in my opinion, qualified for the first year's capital allowance, once the rig was completed and C delivered and came into operation in the Appellants' trade, the interest then accruing no longer qualified for a capital allowance because it could be deducted in computing, for the purposes of tax, the profits or gains of the Appellants' trade. With all respect, I cannot agree with Brightman J. that s 170(1)(*a*) of the Income Tax Act of 1952 has anything to do with the present appeal. It concerns only a person who pays interest which is not derived wholly out of D profits or gains brought into charge and obliges him, in making such payments, to deduct a sum representing the amount of the standard rate of tax and to account for that deduction to the Commissioners of Inland Revenue. In my view s 26 of the Finance Act of 1969 which amends s 170 *ibid.* is wholly immaterial and in no way impinges on s 82 of the Capital Allowances Act of 1968 which is incorporated into the Act of 1971 by s 50(3) of that Act. I am not convinced E by the argument that the construction of s 41(1) which I favour works any injustice between taxpayers. There must be few who could meet the cost of an oil rig out of their own accumulated resources. If, however, they have such resources on deposit or invested they will use them for the provision of an oil rig only because they contemplate that those resources will produce more for them so invested than if left as they are. A company which borrows money F from banks in order to meet the cost of an oil rig and has sufficient profits from other sources from which it can deduct the interest and commitment fees in respect of the money lent, could not (see s 50(3) *supra*) and would have no need to capitalise those items or treat them as part of the capital cost of the oil rig. A company which is making no such profits would not, I think, find any enthusiastic response to a debenture issue or an issue of shares to the public G for the sole purpose of buying an oil rig or any other plant or machinery; and I think that it would be impossible to underwrite such issues except at exorbitant rates. Nor do I consider that the construction of s 41(1) which I favour, would give rise to any abuse. If the purchaser of an oil rig, for example, devised a scheme through subsidiaries and sub-subsidiaries which would enable a second or even a third tier of commitment fees and interest to come into existence, I H have no doubt that the courts would find that the second and third tiers were far too remote—indeed a mere colourable device for inflating the capital cost of the oil rig and the capital allowance claimed in respect of it. Simple loans from the banks such as the present are, however, a common and reputable way of financing the acquisition of expensive plant and machinery. The policy of the Legislature in enacting Part III of Chapter 1 of the 1971 Act was certainly I not to bestow benevolence upon taxpayers. It was to lighten the burden of taxation for taxpayers such as the Appellants who would thereby be encouraged to borrow money for the acquisition of the new industrial plant and machinery which would play an important part in substantially increasing the level of industrial productivity; a project which Parliament clearly regarded as being of the greatest economic importance for the nation.

(Lord Salmon)

My Lords, in my opinion, the construction of s 41(1) of the 1971 Act for which the Appellants contend accords with the ordinary and natural meaning of the language of that section no less than with the policy of the Act; and I would accordingly allow the appeal. A

Lord Russell of Killowen—My Lords, the point in this appeal is easily stated, but not so easily solved. The Appellant Company was formed with the purpose of ordering the construction for it of an oil rig, the trade proposed being to earn profits by leasing out the rig. In order to finance its payments to the builders of the rig, the Appellant arranged for loans to it of some £5,000,000. The obtaining of that finance involved not only liability in due course to repay to the lenders the sum borrowed but two other items. First: interest on the sums advanced from the time of their advancement until repayment. Second: commitment fees payable to the lenders as a means of ensuring that the lenders would have available the sums required by the Appellant from time to time. The question is whether in the initial period such expenditures qualify for capital allowance against corporation tax liability in the period after trading began as being "capital expenditure incurred on the provision of machinery or plant for the purposes of the trade" of the taxpayer. It is clear that in the accounts of the Appellant in the relevant period these expenditures were quite properly treated, according to commercial accounting systems, as capital expenditure, and indeed as part of the cost of the rig. But whatever may have been said, and rightly said, on the impact of proper commercial accounting systems upon the ascertainment for tax purposes of the true figure of trading profit or the true balance on profit and loss account, the present problem, which is one of construction of the words "incurred on the provision of machinery or plant", cannot be thus solved. The proper commercial practice halts in its impact after the phrase "capital expenditure": and a concept, however commercially reasonable, that the items now in question may be regarded as part of the cost of the rig cannot solve the question of construction whether the expenditure was incurred "on the provision of" the rig. B C D E

I start, my Lords, with the fact that this is a provision affording relief from tax. The taxpayer must persuade me that he is within it. If the reasons pro and con were in precise balance, the taxpayer on that basis would lose. But in upholding the view of the Special Commissioners and Brightman J., as I do, I find the balance is in fact against the Appellant. It is true to say that in this case the money was borrowed and the consequent liability for the relevant interest and commitment fees was incurred entirely in order that the Appellant should be in a financial position to obtain provision of the rig from the shipbuilders. But in my opinion the true view is that the relevant items of expenditure were incurred on the provision of finance, and not on the provision of the plant. There are many ways in which a company may put itself in a position financially to provide itself with plant. It can borrow from banks, and pay for its borrowing in interest and commitment fees. It can put out a share issue, or a debenture issue, and incur expenditure of various kinds in so doing, including legal, accountancy and underwriting fees and advertisement costs. It may in the net result be in a financial position to incur capital expenditure on the provision of plant, to provide itself with plant: but expenditure incidental to attaining that financial position is not in my opinion within the language of the section. Had it been otherwise intended quite different language would surely have been selected in order to embrace expenditure so commonly involved as a preliminary to the provision of plant of magnitude. I contrast the present case with that of a company with already available assets used to buy the plant: on the Appellant's argument such a company using its already available assets would be relatively F G H I

A disadvantaged in respect of loss of any fruit of such available assets. The point was made for the Appellant that if the provider of the plant borrowed for working capital and incurred as a result liability for interest and perhaps a commitment fee in respect of such borrowing, these liabilities would be reflected in the price paid, the whole of which would qualify as relevant capital expenditure by the company buying the plant. That is so: but I do not follow the con-
B clusion from that fact. It does not appear to me to be an alternative to borrowing by the purchaser. The supplier's price would reflect the whole cost to him of supplying the plant, including overheads, interest on necessary borrowing, or on commitment of working capital, and a profit element, the whole price being subject to a perhaps competitive market. I am not able to see how the build up of the supplier's price can have any relevance to the problem raised in this
C appeal. The point is made that the purpose of these provisions for capital allowance is to encourage investment in new plant and machinery. So it is. But the question remains how extensive, and how expensive to the *fiscus*, is that encouragement: and in this connection I note the extent of encouragement in terms of percentages allowed has varied through the years. We were referred to two cases which were not before Brightman J., one Australian(1) and one
D Canadian(2), already mentioned by your Lordships. I do not find guidance from either. The former concerned a very different problem. The latter, dealing with commitment fees, was under a statute which spoke of "cost", which provided anyway for the comparable interest to be allowed, and which in other respects also pointed to a wide scope of the relevant allowable expenditure. For the Appellant it was additionally argued that since, once trading had begun,
E interest thereafter on the outstanding borrowings would be offset against trading profits, it would afford a neat and coherent scheme if the interest now under consideration qualified for capital allowance. Maybe so. But the offset of interest during the trading period against trading profits is quite a different fiscal plank from the provision for capital allowances, and there is no compelling reason that they should dovetail. In my view the question to be asked is,
F what is the effect of particular capital expenditure? Is it the provision of finance to the taxpayer, or is it the provision of plant to the taxpayer? In my opinion the effect of the expenditure was the provision of finance and not the provision of plant. I would add that I do not seek to confine qualifying capital expenditure to the price paid to the supplier of the plant. I should have thought, for example, that if the cost of transport from the supplier to the place of user is directly
G borne by the taxpayer it would be expenditue on the provision of plant for the purposes of the taxpayer's trade. And there may well be other examples of expenditure, additional to the price paid to the supplier, which would qualify on similar grounds. But such matters are not for decision in this appeal.

Accordingly, I would dismiss this appeal with costs.

Lord Scarman—My Lords, I have had the advantage of reading in draft
H the speech delivered by my noble and learned friend, Lord Wilberforce. I agree with it and, for the reasons he gives, would dismiss the appeal with costs.

Appeal dismissed, with costs.

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

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(1) *B.P. Refinery (Kwinana) Ltd.* v. *Federal Commissioner of Taxation* [1961] ALR 52.
(2) *Sherritt Gordon Mines Ltd.* v. *Minister of National Revenue* [1968] 2 Ex CR 459.