[HOUSE OF LORDS] A

WILLINGALE (INSPECTOR OF TAXES) . . . APPELLANT

AND

INTERNATIONAL COMMERCIAL BANK LTD. . RESPONDENTS

1977 Dec. 7, 8;
1978 Feb. 2

Lord Diplock, Lord Salmon, Lord Fraser of Tullybelton, Lord Russell of Killowen and Lord Keith of Kinkel. B

Revenue—Corporation tax—Profits, computation of—Anticipated profits from bills and promissory notes discounted or purchased by bank—Whether tax payable on fractional part of anticipated profits from bills—Income and Corporation Taxes Act 1970 (*c.* 10), *s.* 108 C

The taxpayer bank was incorporated in 1967 to provide medium-term finance to commercial companies throughout the world. Its business was not that of a clearing bank but included the purchasing or discounting of bills issued by borrowers for periods of less than 10 years. Its normal practice was to hold the bills until they reached maturity but on D occasions it sold them prior to maturity. As some were payable in foreign currency, the profit to be made on these would partly depend on exchange rates when these were repaid or sold. Some of the bills carried interest at a fixed rate and others did not. A time-based proportion of the profit made on each bill held until maturity—called " accrued discount "—was included in the taxpayer bank's annual accounts which were drawn up in the form customary for clearing E banks and were agreed to show a true and fair view of its annual profits in accordance with accountancy principles. Evidence was given to the general commissioners that if the bank's accounts had been drawn up so as to exclude " accrued discount " the auditors would have been prepared to sign them without qualification provided the procedure followed had been fully explained therein. It was assessed to corporation tax for the years from its incorporation to December 1970 F on the basis that its annual profits were as set out in its accounts and included a fractional part of the anticipated profits from the bills. The general commissioners allowed the taxpayer bank's appeal against the assessments, upholding its contention that no " accrued discounts " fell to be included in the bank's profits for the purposes of corporation tax. Walton J., whose decision was affirmed by the Court of Appeal, upheld the commissioners' decision. G

On appeal by the Crown: —

Held, dismissing the appeal (Lord Diplock and Lord Russell of Killowen dissenting), that having regard to the true nature of the bank's relevant transactions, the evidence of the auditors and the fact that the amount of the profit to be made on the transactions was found to be not ascertainable until the bills in question were sold or reached maturity, H the inclusion of " accrued discount " in the bank's profits for any accounting period contravened the rule " that profit shall not be taxed until realised " (post, pp. 841E–G, 844F–H, 847A–B, 852D–G).

A Dictum of Lord Reid in *Duple Motor Bodies Ltd.* v. *Inland Revenue Commissioners* [1961] 1 W.L.R. 739, 751, applied.

Per Lord Salmon and Lord Fraser of Tullybelton. There is an essential difference between interest and discount: interest is earned and accrued from day to day, while discount is not and does not (post, pp. 841H—842A, 845A–B).

Per Lord Salmon, Lord Fraser of Tullybelton and Lord Keith of Kinkel. *Quaere* whether the Crown could have B supported taking into account the "accrued discount" in the year of discounting or purchase, *i.e.*, at a reduced figure, to reflect deferment of receipt (post, pp. 842A–B, 846G–H, 852B–D).

Decision of the Court of Appeal [1977] Ch. 78; [1977] 3 W.L.R. 109; [1977] 2 All E.R. 618 affirmed.

The following cases are referred to in their Lordships' opinions:

C *B.S.C. Footwear Ltd.* v. *Ridgway* [1972] A.C. 544; [1971] 2 W.L.R. 1313; [1971] 2 All E.R. 534, H.L.(E.).

Duple Motor Bodies Ltd. v. *Inland Revenue Commissioners* [1961] 1 W.L.R. 739; [1961] 2 All E.R. 167, H.L.(E.).

Gardner, Mountain and D'Ambrumenil Ltd. v. *Inland Revenue Commissioners* (1947) 177 L.T. 16; [1947] 1 All E.R. 650; 29 T.C. 69, H.L.(E.).

D *Harrison* v. *John Cronk and Sons Ltd.* [1937] A.C. 185; [1936] 3 All E.R. 747, H.L.(E.).

Newcastle Breweries Ltd. v. *Inland Revenue Commissioners* (1927) 96 L.J.K.B. 735; 12 T.C. 927, H.L.(E.).

Southern Railway of Peru Ltd. v. *Owen* [1957] A.C. 334; [1956] 3 W.L.R. 389; [1956] 2 All E.R. 728, H.L.(E.).

Sun Insurance Office v. *Clark* [1912] A.C. 443, H.L.(E.).

E

The following additional cases were cited in argument:

Bennett v. *Ogston* (1930) 15 T.C. 374.

Dailuaine-Talisker Distilleries Ltd. v. *Inland Revenue Commissioners,* 1930 S.C. 878; 15 T.C. 613.

Dimbula Valley (Ceylon) Tea Co. Ltd. v. *Laurie* [1961] Ch. 353; [1961] 2 W.L.R. 253; [1961] 1 All E.R. 769.

F *Odeon Associated Theatres Ltd.* v. *Jones* [1971] 1 W.L.R. 442; [1971] 2 All E.R. 407; [1973] Ch. 288; [1972] 2 W.L.R. 331; [1972] 1 All E.R. 681, C.A.

Pearce v. *Woodall Duckham Ltd.* [1977] 1 W.L.R. 224; [1977] 1 All E.R. 753.

Seaham Harbour Dock Co. v. *Crook* (1930) 16 T.C. 333, C.A.

G *Whitworth Park Coal Co. Ltd.* v. *Inland Revenue Commissioners* [1961] A.C. 31; [1959] 3 W.L.R. 842; [1959] 3 All E.R. 703, H.L.(E.).

APPEAL from the Court of Appeal.

This was an appeal from a decision of the Court of Appeal (Ormrod L.J. and Sir John Pennycuick, Stamp L.J. dissenting) dated March 15, 1977, whereby that court dismissed an appeal from the decision of Walton H J. dated March 12, 1976, who had dismissed an appeal by case stated under section 56 of the Taxes Management Act 1970 from the Commissioners for the General Purposes of the Income Tax for London, City Division. The question raised by this appeal was in what manner gains accruing to the respondent company, International Commercial Bank A Ltd., from bills and promissory notes acquired by them in the course of their trade should be taken into account in the computation of their profits for the purposes of corporation tax. The relevant accounting periods were the periods ending December 31, 1967, 1968, 1969 and 1970.

The facts are set out in the opinion of Lord Fraser of Tullybelton as follows:

The bank was incorporated in 1967 by a consortium of five major B banks in different countries. The British member of the consortium was the National Westminster Bank. It was formed to provide medium-term finance in world markets to commercial companies by way of loans running for between two and seven years, later extended to 10 years. The appeal related to the period from July 30, 1967, to December 31, 1967, and the three years ended respectively December 31, 1968, 1969 and 1970. C Tax fell to be charged under Case I of Schedule D and for the latest of the years in question the relevant provisions were in section 108 of the Income and Corporation Taxes Act 1970 as follows:

> "1. Tax under this Schedule shall be charged in respect of—(*a*) the annual profits or gains arising or accruing— . . . (ii) to any person residing in the United Kingdom from any trade, profession or D vocation . . ."

The corresponding provision for the earlier year was in section 122 of the Income Tax Act 1952.

Part of the bank's business in each of the years in question consisted of discounting or purchasing bills or notes or similar obligations issued by borrowers all over the world, with an over-all limit fixed by the bank E for loans to borrowers in each country. The bills were often issued in sets of six to 12. Some carried interest at fixed rates; others carried none. The bank in preparing its annual accounts followed the accounting practice usually adopted by clearing banks in relation to bills and notes. It did so with the approval of the eminent firm of chartered accountants who were its auditors. The practice was to divide the total discount applicable to F each bill or note by the number of days to which the discount related. The appropriate number of days' discount was then taken into the annual profit and loss accounts as part of the receipts or earnings for each year. An example was given in one of the exhibits before the general commissioners of a note with a face value of £100 acquired by the bank on January 1, 1970, and payable exactly six years later. Assuming that its discounted value on January 1, 1970, was £63·1, the total discount (£36·9) G would be divided by six, disregarding leap years, and £6·15 would be credited in the bank's profit and loss account in each of the six years during which the note was held. In that way the amount of the discount was treated as accruing at an even rate over the whole period during which the bank held the note. If, as sometimes happened, it sold a note before maturity, it would bring into its accounts for the year in which H the bill was sold the difference between the discounted value of the note at the beginning of that year and the sale price. The difference might of course be either an increase (credit) or a decrease (debit).

A *Michael Nolan Q.C.* and *Brian Davenport* for the Crown. The question is: When is the profit on these transactions earned and when does it accrue? Does it accrue in the final year as the taxpayer contends, or gradually over the life of the notes, as the Crown contends? The correct approach is to apply the tests of ordinary business, i.e., as the bank has treated the matter in its accounts. The auditors have accepted this as being in accordance with the ordinary principles of commercial
B accountancy. These principles are subject to taxation law. Here there is nothing to override those principles, but the bank contends that as a matter of law a different principle applies and that for taxation purposes the discount element should not be dealt with on the basis of accrual. It is wrong for the bank to seek a departure from the ordinary principles of commercial accountancy. That would introduce into the
C law for the first time two different sets of profit, one for tax purposes and one for commercial purposes. Admittedly there may be more than one way of bringing in the interest accruing on a bill and the Crown does not wish to take a rigid line, but there is no rule of law against taking credit for a debt payable at a future time. The relevant enactment is section 108 of the Income and Corporation Taxes Act 1970.

Reliance is placed on *Sun Insurance Office* v. *Clark* [1912] A.C.
D 443, 455 (Viscount Haldane), 454 (Earl Loreburn L.C.); *Newcastle Breweries Ltd.* v. *Inland Revenue Commissioners* (1927) 96 L.J.K.B 735, 737 (Viscount Cave L.C.); *Gardner, Mountain and D'Ambrumenil Ltd.* v. *Inland Revenue Commissioners* (1947) 177 L.T. 16, 18 and *Southern Railway of Peru Ltd.* v. *Owen* [1957] A.C. 334, 354, 358, 360. These authorities show that there is no breach of any principle of taxation
E if, in appropriate circumstances credit is taken in year 1 for part of a debt payable in year 4. In the present circumstances it is positively required by law, since the bank's auditors consider that the accrued discount is sufficiently certain for a figure to be placed upon it.

The courts apply the ordinary principles of commercial accounting: *Odeon Associated Theatres Ltd.* v. *Jones* [1971] 1 W.L.R. 442, 453;
F [1973] Ch. 288, 299.

Here one is not dealing with trading stock but with a right to money, a right in contract to a sum of money at a future date as distinguished from unsold trading stock, which gives no right to anything. Here the trade is buying and holding to maturity bills and notes. The question is whether the bank has in the intervening period earned anything which can be quantified. In this context, expressions like "realise" are very
G elusive. Whether a profit is anticipated is a question of fact.

In what he said in *B.S.C. Footwear Ltd.* v. *Ridgway* [1972] A.C. 544, 552, Lord Reid was not intending to make any general rule as to what constitutes a realised profit: see also Lord Morris of Borth-y-Gest at p. 560. Here these are realised profits in accounting terms, why not in legal terms also? The bank seems to be saying that it is a cardinal
H principle of income tax law that a debt cannot be counted till it is due for payment. But that is plainly wrong. Further it must be noted that in the present case the trade is that of a banker, not a dealer in bills. The question is whether a profit has been realised on the bank's service

in supplying finance. On all the authorities there is nothing to show that the accounting method here adopted conflicts with any principle of law. A Reliance is placed on *Dailuaine-Talisker Distilleries* v. *Inland Revenue Commissioners*, 1930 S.C. 878, 884, 890; 15 T.C. 613, 620, 626–627 and *Pearce* v. *Woodall Duckham Ltd.* [1977] 1 W.L.R. 224, 225.

The bank's accounts avoid the error of bringing the whole credit into year 1 or year 4; they spread it over the whole period. For tax purposes one must take each year, finding the profits and losses accruing B in each year. Here what is in issue is a monetary obligation, not trading stock, and that is crucial. It is curious for a bank which has prepared its accounts on the conventional basis to contend that they have anticipated profits. If its submissions were accepted it would establish that there were two standards of profit, a tax standard and an accounting standard. But what one must ask is: What are the results of the bank's trading?

C If the appellant is wrong so are several House of Lords decisions. The question of fact has been answered that the proper commercial treatment of these items is that adopted by the bank in its accounts. To bring the whole transaction into year 1 would not show the profit because the purchase is not isolated but must be paid for. On the other hand, to bring nothing into credit till the last year would ignore the agreement entered into in year 1 fixing the rate of discount over the years. The D result of the discounting system should be shown each year. The method adopted in the bank's accounts fully accords with Lord Radcliffe's approach in *Southern Railway of Peru Ltd.* v. *Owen* [1957] A.C. 334. This is the best practice and should be followed for taxation purposes. See also *Whitworth Park Coal Co. Ltd.* v. *Inland Revenue Commissioners* [1961] A.C. 31, 61–63 and *Bennett* v. *Ogston* (1930) 15 T.C. 374, 375, 379.

E The accounts prepared as these have been show how this part of the bank's business has contributed to each year's balance of profit and loss; if nothing was taken into account until the bills matured the profits would be understated. The "accrued discount" is equivalent to the interest the bank might have earned by investing or lending the money with which it purchased the bills of exchange. The difference between the amount paid for a bill and the amount payable on maturity F is a debt payable in the future and a part of that difference should be brought into account in each year before maturity.

Frank Heyworth Talbot Q.C. and *John Gardiner* for the respondent company. This point must be decided on first principles. The foundation of the bank's argument is that it is a cardinal and accepted principle of tax law that profit in the case of a trade shall not be taxed until it is realised: see *B.S.C. Footwear Ltd.* v. *Ridgway* [1972] A.C. 544, 552 and G *Duple Motor Bodies Ltd.* v. *Inland Revenue Commissioners* [1961] 1 W.L.R. 739, 751. A profit, whether taxable or not, does not arise till an event occurs which constitutes realisation. When property increases in realisable value while in the hands of the owner no profit or gain arises or accrues. If a man holds I.C.I. shares their appreciation does not constitute a profit or gain accruing to him; at most there is a potentiality H of profit or gain, but some event must occur to cause a profit or gain to arise from that potentiality. The same principle applies to bills of exchange, the values of which are constantly varying. So long as the

A property continues to be held by its owner there cannot be a profit or gain accruing to him, nor can there be a loss, till some event constitutes realisation.

There are three forms of operation to which the term "realisation" can aptly be applied: (1) An asset may be converted into cash; a bill of exchange or a note may mature, or a redeemable security may be redeemed.

B (2) The conversion may take the form of a substitution of a debt for another asset, as in the case of a credit sale. It is not submitted that the bank should only be taxed on the basis of a cash receipt. It may be that in the case of some businesses it is thought prudent to bring into account unrealised appreciations to present an economically true picture of the company's capital situation, but that is an optional process of C accountancy which some banks and property investment trusts adopt. But that fashion of accounting does not justify the conclusion that assets written up but not realised have produced a profit.

(3) There is also conversion by a process of exchange, involving acquisition and disposal.

It cannot be properly said that a profit or gain has arisen or accrued by reason only of the increase in value of property. The Crown now D denies the fundamental principle and seeks to bring into account an appreciation before there has been any disposal. In the case of the acquisition of a bill of exchange by a dealer in bills of exchange there has occurred, so long as there has been no realisation, only the first of the two incidents necessary for the making of a profit. It is delusive to try to equate transactions in bills of exchange with direct loans of money. E The trader hopes that he will make a profit on the bill of exchange either on maturity or on sale. What accrues is the value of the bill and it is not right to balance the expected appreciation of the bill of exchange against money which may have been borrowed at interest to finance the transaction. Suppose an art dealer buys a picture for £8,000 having borrowed the money from his bank at interest F and, after holding the picture for five years, sells it for £15,000. While it is unsold it remains stock and only when it is sold a profit arises. Meanwhile the dealer may be is paying interest on the loan but that does not affect the value of the picture. In the case of bills of exchange there is no justification for spreading the eventual profit.

There is nothing in statute law or any authority in tax cases which deprives the bank's proposition of its validity; that is the end of the case.

G Alternatively, having regard to the nature of the bank's trade, the bills of exchange are trading stock in which it deals, acquired to earn profits. There is an almost infinite variety of forms of trading stock which can include bills of exchange acquired by a bank. Trading stock is defined in section 137 of the Income and Corporation Taxes Act 1970. On the facts found in this case there is ample material for a finding of law that these H bills are stock-in-trade of the bank.

As to the analysis of Stamp L.J. in his dissenting judgment in the Court of Appeal [1977] Ch. 78, 91–92, his proposition (i) is accepted. On proposition (ii), what is brought in is the sale price or the service

consideration. On proposition (iii), a bill of exchange is a chose A
in action indivisible in its juristic nature. The so-called discount cannot be equated with interest; no part of the amount can be regarded as interest in any sense. Proposition (iv) is a misconception. Proposition (v) has never been common ground because it has never been accepted by the bank that for any purpose the discounts are earned or accrued. What is being dealt with in commercial accounting is the way to credit
an estimated appreciation of the asset, a very different thing. The writing B
up does not affect the tax situation, for tax purposes one produces accounts different from those required by company law. One must consider whether the accounts offend against a statute or against some principle of taxation. These discounts are not earned. What arises is an appreciation of the asset.

Gardiner following. The relevant finding on accounting in the case C
stated discloses two equally acceptable accounting bases at the relevant time. The only case for the Crown is that the bank must be taxed on the basis of accounting which it has actually adopted for purposes of company law. That is contrary to law and common sense. One must look at the true substance of the matter: *Seaham Harbour Dock Co.* v. *Crook* (1930) 16 T.C. 333, 345. The accounts must accord with the
principles of sound commercial accountancy, but where, as here, two D
different methods would satisfy those principles the law must choose the most appropriate for tax purposes: see the *Odeon* case [1973] Ch. 288, 295. The Crown's contentions are contrary to common sense because they depend on whichever basis the bank's accountants or auditors choose to present its accounts. On the facts found by the commissioners their
decision cannot be said to be erroneous in law. They found on the E
evidence that it was not possible for the bank to realise before maturity the discount on the discounted bills otherwise than by sale on the market. For tax purposes one must not anticipate a profit, since one is charged on profits or gains arising or accruing in the accounting period or year in question: see section 188 of the Income and Corporation Taxes Act 1970.

Nolan Q.C. in reply. As to revaluation of a company's assets, see
Dimbula Valley (Ceylon) Tea Co. Ltd. v. *Laurie* [1961] Ch. 353. F
Should the House of Lords decide in favour of the Crown for the reasons given by Stamp L.J. [1977] Ch. 78, 85G, the Crown would not oppose the case being remitted to the commissioners on the stock-in-trade point: see also Sir John Pennycuick at p. 95D.

Talbot Q.C. On such a submission both sides should be at liberty to
call further evidence. G

Their Lordships took time for consideration.

February 2, 1978. LORD DIPLOCK. My Lords, for reasons given in the Court of Appeal by Stamp L.J. and those to be given shortly in this House
by my noble and learned friend, Lord Russell of Killowen, I would H
have allowed this appeal. The question seems to me to turn upon whether in its commercial nature, the transaction entered into by the bank was a loan of money repayable by a larger sum at a future date, or whether it

was the acquisition of an asset similar to any chattel. I think it was the A former; the bank's accountants treated it as such.

LORD SALMON. My Lords, I have had the advantage of reading the speeches which are about to be delivered by my noble and learned friends, Lords Fraser of Tullybelton and Keith of Kinkel. I agree that for the reasons which they give and also for the reasons stated in the judgments B of Walton J. and the majority of the Court of Appeal that this appeal should be dismissed.

I wish to add only a very few observations of my own. Take the case of a bank which buys for the equivalent of £10,000 a foreign bill of exchange with a face value equivalent to £15,000, maturing five years after the date of its purchase. The bank in calculating the price which it was prepared to pay for the bill, on which it expected to make a C profit, may well have taken into consideration the interest it would be losing on the purchase price. This, however, would be only one factor in arriving at the price which the bank was prepared to pay. Some of the other factors taken into account would no doubt be the estimated strength of the currency in which the bill was made out and the standing of the commercial house which issued it. None of these factors can D alter the nature of the transaction which is the purchase of a bill at a price considered by the bank to be its market value at the date of purchase. The bank would have the option of holding the bill until it matures or selling it at any time before it reaches maturity. In the instant case, the bank usually held the bills until they matured but it sold many of the bills before maturity, often at a profit but sometimes at a loss. The bill being bought in foreign currency whose rate of exchange fluctuates E considerably, the profit the bills might yield would be unpredictable. If the rate went against sterling at the date of maturity or at the date when the bill was sold, the profit made by the bank would be diminished and indeed the transaction might, as it sometimes did, result in the bank making a loss. If the rate went in favour of sterling at the material date, the bank would make a larger profit than it had expected.

F It is well settled by the authorities cited by my noble and learned friends that a profit may not be taxed until it is realised. This does not mean until it has been received in cash but it does mean until it has been ascertained and earned. It follows in my view that corporation tax cannot be levied in respect of the bank's transactions until the fiscal year in which the bank sells the bill or if the bank holds it until maturity, until the fiscal year in which it matures. The tax is leviable even if the G bank does not receive the cash in that fiscal year. If the bank's customer defaults, an adjustment would be made for the bad debt in the following year.

The difference between the price at which the bank buys the bill, and the bill's face value is something referred to as "a *discount*." A discount however is different from interest: it is not earned nor does it accrue H from day to day. Even, if contrary to my view, the profit on a bill could be taxed before it is sold or matures, the profit could not, for tax purposes, be spread over the years elapsing between the date of purchase and the date of maturity or of the sale of the bill. I agree, however, that it is arguable although the Crown does not rely on the argument, that the bank on entering into the transaction which I have postulated acquires the A right to be paid the £5,000 in five years' time and that accordingly the bank earns that sum in the fiscal year in which the transaction is made. It follows, so the argument runs, that the bank can be taxed on the £5,000 in that fiscal year subject to a suitable adjustment for the deferment of the payment. The rate of corporation tax does not vary according to the amount of profit upon which it is assessed, but the rate of income B tax does. If an individual was carrying on the same kind of business as does the bank, I cannot imagine that the Inland Revenue would contend that a substantial profit accruing in year 1 or in year 5 should be spread over the intervening years for tax purposes.

If I understand him correctly, my noble and learned friend, Lord Russell of Killowen, considers that the bank's transactions are no different C from loans of money at compound interest made in this country. My noble and learned friend equates compound interest on a loan with discount on a bill because he considers that compound interest is the content of the discount. I am afraid I cannot agree. As I have already pointed out, in my view, particularly so far as foreign bills are concerned, the interest on the purchase price is only one of the factors taken into account D by the bank in deciding the price which it is prepared to pay for the bill.

Although there may be some superficial similarity between (*a*) lending £10,000 for 5 years at a rate of interest of X per cent. per annum on the terms that none of the interest amounting in all to £5,000 shall be payable until the principal becomes repayable and (*b*) buying a foreign bill of exchange with a face value equivalent to £15,000 for a price equivalent to £10,000, the two transactions are, in my view, essentially different from E each other in character.

The lender is entitled to be paid £15,000 at the end of five years; no more and no less. The purchaser of the bill is entitled to sell the bill when he likes, or keep it until maturity. The amount he receives for it, translated into sterling, will depend upon the currency rate of exchange at the material time. I would also point out that to imagine a bank or any F other commercial institution lending money at interest none of which is payable until the principal is repayable is a very bizarre conception. I doubt whether any such a loan has ever been made or ever will be. If it were, corporation tax would, I think, be exigible on the £5,000 for the fiscal year in which the loan agreement was made with an allowance for the deferment of the payment of interest. That would be the year in which the bank earned the right to be paid the £5,000 in five years' time. The other G alternative may be that the bank might be taxable on the £5,000 in the year in which it fell due for payment. I do not think that the bank could have been taxed in respect of interest in any of the intervening years, for the bank would not have earned nor have been entitled to be paid any interest in any of them.

Accordingly, if, contrary to my opinion, it is possible in the circum- H stances of the instant case, to equate the profit made on a bill with compound interest due and payable on a loan but only payable when the loan itself becomes repayable, still no tax would be exigible in respect of any fiscal years other than the years in which the bill was issued to the A bank or in which it matured or was sold by the bank.

My Lords, I would dismiss the appeal.

LORD FRASER OF TULLYBELTON. My Lords, this appeal is concerned with the question of how gains accruing to the respondent bank ("the bank") from the discounting and purchase of bills and notes in the B course of its business should be taken into account in computing its profits for purposes of corporation tax. The bank's accounts prepared for commercial purposes take account of such gains by bringing into the profit and loss account for each year a proportionate part of the difference between the price paid for each bill and its value at maturity. But the bank maintains, at first sight perhaps rather surprisingly, that accounts prepared in that way conflict with the principle of income tax law that C profits may not be anticipated, and therefore that they cannot be used for purposes of corporation tax. The Crown maintains the contrary. The general commissioners for the City of London decided in favour of the bank. Walton J. dismissed an appeal by the Crown by way of stated case, and the Court of Appeal by a majority (Ormrod L.J. and Sir John Pennycuick, with Stamp L.J. dissenting) dismissed a further appeal.

D [His Lordship stated the facts and set out the bank's method of dealing with the discount on the bills in its annual accounts and continued:] The amounts thus taken into account have been referred to as "accrued discount" or "earned discount" but these are no more than convenient shorthand descriptions and they are obviously not accurate, for discount, unlike interest, does not accrue and is not earned, and I think the expressions are apt to be misleading.

E It is well established that "the question of what is or is not profit or gain must primarily be one of fact, and of fact to be ascertained by the tests applied in ordinary business"—*Sun Insurance Office* v. *Clark* [1912] A.C. 443, 455 *per* Viscount Haldane. But that general rule is subject to the exception that where ordinary commercial principles run counter to the principles of income tax they must yield to the latter when F computing profits or gains for tax purposes. In *B.S.C. Footwear Ltd.* v. *Ridgway* [1972] A.C. 544, 552G Lord Reid said:

> "The application of the principles of commercial accounting is, however, subject to one well-established though non-statutory principle. Neither profit nor loss may be anticipated. A trader may have made such a good contract in year one that it is virtually certain to produce G a large profit in year two. But he cannot be required to pay tax on that profit until it actually accrues."

Lord Morris of Borth-y-Gest at p. 560E quoted from the speech of Lord Reid in *Duple Motor Bodies Ltd.* v. *Inland Revenue Commissioners* [1961] 1 W.L.R. 739, 751 the statement that ". . . it is a cardinal principle that profit shall not be taxed until realised." The bank maintains that H that cardinal principle would be contravened in the present case if it were compelled to pay corporation tax on the basis of its accounts prepared for commercial purposes.

Mr Nolan on behalf of the Crown relied on the general rule that the principles of commercial accounting should normally prevail. But that rule is of little or no assistance to his argument, because the method in A which the bank's accounts were drawn up was not the only method that would be in accordance with sound principles of commercial accounting. The effect of the auditor's evidence to the general commissioners was that if the bank's commercial accounts had been prepared in a manner so as to exclude so-called accrued discount (that is, in the manner that would accord with what the bank maintains are the principles of income tax B law) that would not have been in accordance with the procedure customarily adopted by the clearing banks. But because the business of this bank differs materially from that of a conventional clearing bank the auditors would have signed their report on the accounts so prepared without qualification, "provided that the procedure which had been followed had been fully explained in those accounts." That means that accounts which excluded "accrued discount" would have given a "true and fair view" C of the state of the bank's business and would have been just as satisfactory for commercial purposes as the accounts that were in fact prepared. The reason for including an express explanation would have been not that the procedure was less acceptable than that actually used, but only that it differed from that used by the clearing banks.

Mr. Nolan also said that the accounts as prepared for commercial D purposes have the practical advantage that they show in each year on the debit side the interest paid by the bank on money borrowed by it and on the credit side the "accrued discount" earned by using the borrowed money. If, and insofar as, the bills are purchased with the bank's own funds, the "accrued discount" takes the place of the interest that might have been earned by investing or lending the money. Accounts E prepared in that way thus show the contribution of this part of the bank's business towards the balance of profit and loss in each year. If on the other hand nothing is taken into account on the credit side until each bill matures the accounts for the years during which a bill is held understate the profits. That is perfectly true, but, as it is not the only method that is commercially satisfactory, it does not assist his argument. F

The solution to the problem depends in my opinion upon the true nature of what the bank is doing when it discounts or purchases a bill. In my view it is acquiring an asset and, so long as it continues to hold that asset, it does not, and cannot, realise any profit or loss in respect of it. If the bank takes credit for any "accrued discount" while it is still holding the bill, it is therefore anticipating a profit that has not yet been realised. If the bills were ordinary commodities, there can be no doubt that that G would be the position, and I cannot see that it makes any difference for this purpose that the bills were for fixed sums of money. Of course the fact that the money value at maturity is fixed means that the bank could ascertain in advance the profit that it would make if a bill is held to maturity. But we know that it quite often did not do so but sold bills before maturity. In such cases the realised profit would be unlikely to be H exactly the same as the profit expected on maturity, and the sale might even be at a loss. Even where bills were held to maturity a substantial number of them were in currencies other than sterling and fluctuations

A in the foreign exchange rates would therefore affect the sterling value and
the profit on maturity of such bills.

Stamp L.J. reached his conclusion in favour of the Crown by accepting
the submission [1977] Ch. 78, 87B, "that there is no distinction in prin-
ciple between earning interest and earning discount." With respect I
cannot agree with that view. In my opinion there is an essential difference
between interest and discount, so much so that to speak of "earning"
B discount, seems to me wrong. Interest accrues from day to day, or at
other fixed intervals, but discount does not. Two consequences follow.
Firstly, when periodical interest is received (or is due to be received) the
profit or gain on the loan is realised from time to time. But when a bill
is discounted nothing is realised until the bill matures or is sold, and the
whole profit is postponed or rolled up until one of these events occurs.
That accords with the finding of the general commissioners to the following
C effect:

> "We find on the evidence before us that it was not possible for the
> bank to realise before maturity the discount on the discounted bills
> and notes otherwise than by sale on the market."

Secondly, it is possible to calculate, if necessary in advance, the interest that
D is, or will be, due at any date while the bill is outstanding, and therefore
to calculate the profit as at that date. But when a bill is discounted
no such calculation is possible; the general commissioners summarised the
evidence of experts on this point as follows:

> "Current prices of discounted bills are affected by the risk involved
> in rates of interest which are subject to wide fluctuations. The amount
> of profit a purchaser or discounter of a bill may make is not ascertain-
> E able before the bill (*a*) is sold or (*b*) reaches maturity."

In these circumstances I agree with the conclusion of Walton J. that
when the bank brought part of the "accrued discount" into its accounts
during the currency of a bill it was anticipating a profit which had not
yet been realised.

The view that I take does not involve any departure from an earnings
F basis in favour of a cash basis of accounting. The repayment value of
each bill will, if I am right, be brought into its accounts at the date on which
it is due for repayment, and not at the date at which it is actually repaid
if that is later than the due date. We were much pressed with the speech
of Lord Radcliffe in *Southern Railway of Peru Ltd.* v. *Owen* [1957]
A.C. 334, 354 which includes this passage:

> G "The courts have not found it impossible hitherto to make consider-
> able adjustments in the actual fall of receipts or payments in order
> to arrive at a truer statement of the profits of successive years.
> After all, that is why income and expenditure accounting is preferred
> to cash accounting for this purpose. As I understand the matter,
> the principle that justified the attribution of something that was in fact
> H received in one year to the profits of an earlier year, as in such
> cases as *Isaac Holden & Sons Ltd.* v. *Inland Revenue Commissioners*
> (1924) 12 T.C. 768 and *Newcastle Breweries Ltd.* v. *Inland Revenue*
> *Commissioners* (1927) 96 L.J.K.B. 735 was just this, that the pay-

> ment had been earned by services given in the earlier year and therefore a true statement of profit required that the year which had borne A
> the burden of the cost should have appropriated to it the benefit of the receipt. The principle is clearly stated in a speech of Lord Simon in *Gardner, Mountain and D'Ambrumenil Ltd.* v. *Inland Revenue Commissioners* (1946) 177 L.T. 16, 19 and I take leave to quote his words: 'In calculating the taxable profit of a business on income tax principles . . . services completely rendered or goods B
> supplied, which are not to be paid for till a subsequent year, cannot, generally speaking, be dealt with by treating the taxpayer's outlay as pure loss in the year in which it was incurred and bringing in the remuneration as pure profit in the subsequent year in which it was paid, or is due to be paid.'"

These observations by Lord Radcliffe and Lord Simon do not appear C
to me to bear upon the point that is at issue here. When the bank purchases or discounts a bill it does not, except in a very loose sense, render services to the borrower; it acquires an asset. Accordingly no payment has been "earned by services given in the earlier years" (i.e. years between the date of purchase of the bill and its maturity) nor are any "services completely rendered" then.

D
It may be suggested that the view that I have taken depends upon an unduly exact analysis of the legal form of the transaction of purchasing bills and that it is inconsistent with a later passage in Lord Radcliffe's speech in the *Southern Railway of Peru* case where he said, at p. 357:

> "The answer to the question what can or cannot be admitted into E
> the annual account is not provided by any exact analysis of the legal form of the relevant obligation. In this case, as in the *Sun Insurance* case [1912] A.C. 443, you get into a world of unreality if you try to solve your problem in that way, because, where you are dealing with a number of similar obligations that arise from trading, although it may be true to say of each separate one that it may never mature, it is the sum of the obligations that matters to the trader, and F
> experience may show that, while each remains uncertain, the aggregate can be fixed with some precision."

But in that passage Lord Radcliffe was referring to provisions for contingent liability and nothing of that sort arises in the present case. There is no question of entering a world of unreality if receipts for bills are taken into account when the bills are mature and due for repayment rather than G
by being anticipated during the currency of the bills.

I can see that there might be a case for taking bills into account as receipts on the dates when they are purchased, at values discounted by reference to the date of maturity, like the deposits with the building society in *Harrison* v. *John Cronk and Sons Ltd.* [1937] A.C. 185. I do not know how the values discounted in that way would compare with H
the sums paid by the bank for acquiring the bills and it is not necessary to pursue the matter as no argument was advanced in favour of this method.

A For these reasons I am of opinion that the bank's accounts prepared for commercial purposes are drawn up on the principle of anticipating future profits from its holding of bills and notes. There are no doubt excellent commercial reasons for preparing the accounts in that way; if I may borrow the words of Walton J. [1976] 1 W.L.R. 657, 663c, they

> "are much better economic indicators than corporation tax accounts would be as to whether a bank is or is not doing what it ought
> B to be doing, that is to say, steadily making an economic profit for its shareholders."

But they are not a proper basis for assessing the bank's liability to corporation tax.

The bank has an alternative case, based on the contention that the
C bills and notes were their stock-in-trade. As there is no finding on this point by the general commissioners, I do not think that we could have dealt with it without remitting the case to them. But if my view is right, the point does not have to be decided.

I would dismiss the appeal.

LORD RUSSELL OF KILLOWEN. My Lords, I approach the problem
D in this case in three stages.

First: suppose a transaction in which A (by way of his trade) advances to B a sum of money to be repaid at the expiration of three years with simple interest thereon at a rate per centum per annum, the obligation to pay the interest being, however, postponed to the date for repayment of the loan. The question arises whether the interest is to be brought into
E computation of A's trading profits for tax purposes in each of the three years of its accrual, or not until on the date fixed for payment of principal when three years interest becomes payable. I defer the answer to that question.

Second: the answer to the first question cannot be different if the interest payable is compound rather than simple. This seems to me to be
F clear. Compound interest accrues annually no less than simple interest.

Third: what is the essential nature of the transaction selected by my noble and learned friend, Lord Fraser of Tullybelton, from page 48 of the record? The bank provides finance of £63·1, against a promise by the acceptor of the bill to pay £100 at the expiration of six years. The difference between the two sums (referred to as a convenient label as discount) can on analysis only be attributable to interest on the finance
G provided at eight per cent. per annum for each of the six years compounded with yearly rests. It is not commercially realistic to regard the make-up of the "discount" as anything else—as a figure plucked from the sky. (The straight line treatment in the bank's accounts of £6·15 annually is a convenient simplification: strictly to represent the discount in terms of accrual of compound interest at eight per cent. p.a. would
H involve figures varying from approximately £5·05 in the first year to approximately £7·41 in the sixth.)

Accordingly in my opinion the problem in this case is thrown back to that which I have described as the first stage plus the distinguishable difference of the second stage: for I see no essential distinction between that and the third stage. A

Before reverting to the first stage, I set aside from consideration as immaterial the fact that many relevant bills or notes were in non-sterling currencies. In such cases the resulting profits in sterling (and tax) terms might fluctuate: but that could not affect for tax purposes the question whether the "growth in value" of a bill in any year was in principle a relevant profit or gain of that year. B

I set aside also from consideration that there may and will be fluctuations in interest rates. The interest rate upon which a "discount" was based would not be altered by such fluctuation. I do not therefore consider that in the solution of the present problem there is a relevant uncertainty under those heads, any more than an uncertainty whether the acceptor will be good for the money in the end, with possibly a bad debt later to be written off. C Prima facie the expiration of time per se adds annually to the entitlement of the bank.

The argument for the Crown is that, the accounts of the bank being based upon sound commercial accounting practice—as they are—they are to be accepted for tax purposes as showing the profits of the trade year by year, unless they are in conflict with some requirement or principle of tax law. The bank accepts this, but contends that this conflict exists, D inasmuch as there is conflict with the principle that for tax purposes there must be no anticipation of profits. For this principle the bank appealed to the statements of Lord Reid and Lord Morris of Borth-y-Gest referred to by my noble and learned friend, Lord Fraser of Tullybelton. At the same time the bank firmly disclaimed any attempt to depart from the principle of taxation law that profits "earned" in a particular year are for tax purposes profits or gains arising or accruing to the trader in E that year; and also disclaimed any assertion of liability to tax only upon a cash receipts basis.

Accordingly the answer to the question posed by me at the outset of my opinion (the first stage) depends upon what is meant by "anticipation of profit": what is meant by "earnings." Neither is a word of universal application in the same sense in all circumstances. In that sense they are F imprecise, and cannot be an instant solution to every problem. Nevertheless the question may be posed at that first stage: is a profit earned in year 1 though payment of the amount is deferred by reason of the terms of the commercial transaction until year 3? In my opinion it is so earned, and the treatment of it as a profit of that year is not a relevant (and forbidden) anticipation of profit. In the example given at the outset of this opinion (the first stage) it is, I consider, correct to say G that in year 1 the finance afforded, or loan, earned in that year interest at X per centum. At the end of that year time had passed upon the basis of which the lender become entitled to a sum of X per centum on the amount of his loan, and nothing could deprive him of the fruits of that entitlement save default of the borrower, which would require ultimate adjustment for a bad debt in the ordinary way. I can well understand H a ban on anticipation of profits for tax purposes when, for example, a trader buys goods with a view to future sale on a virtually certain rising market: if they are stock-in-trade there are of course special rules: but, A if they be not, there is no time-plus-annual-interest element in the appreciation in value as there is in the case of the chose in action considered at the first stage of this opinion.

It follows from what I have said that in my opinion the computed interest which is the content of the "discount" on a bill is not anticipated by being brought in as an annual profit or gain in respect of its periods of accrual. This applies equally whether the bill or note was acquired B from the original acceptor or by subsequent purchase: the reason is that the difference between the face value of the bill and the cost of acquisition inevitably represents as a commercial matter compound interest. A money lender in the case of a loan on what I have called an original bill would be hard put to it to deny that.

These, my Lords, I believe to be, though doubtless not so well expressed, the reasons which led Stamp L.J. to dissent in his judgment, C and I agree with him.

The burden of the argument for the bank was that the difference between the cost of a bill and the amount due on maturity is not interest: the bill is one chose in action providing for one sum due on maturity and can show no profit until maturity or earlier sale: consequently to treat any part of the difference (discount) as a profit or gain arising or D accruing in any fiscal period before one of those events is anticipation of profit not permitted by principles of tax law. But if my analysis of the essential make-up of the "discount" is correct, that contention is not correct.

Now it is true that the accounting method of the bank does not with precision reflect the attribution of the compound interest composition of the discount, because of the adoption for convenience and simplicity of E the straight line method. But it is common ground that that method is commercially acceptable, and it does not seem to me to conflict with any principle of tax law.

In the course of argument it was suggested that if the Crown were correct it would lead to the conclusion that the whole of the "discount" should be brought in as an earning in the fiscal year in which the bill or F note was acquired, though at a reduced figure to reflect deferment for (in the example given) six years. I do not accept that suggestion.

But for one matter I would accordingly allow the appeal and remit the matter to the commissioners for decision upon the basis of the bank's accounts. The one matter is that the bank advanced an alternative contention that the bills and notes should be regarded as stock-in-trade. I should have thought that contention difficult to support: in most cases G the bank advanced money on original bills to hold to maturity. But this question was not ruled upon by the commissioners and it would have to be remitted to them. However, since the majority of your Lordships are for dismissing the appeal the question does not arise.

LORD KEITH OF KINKEL. My Lords, the respondents in this appeal H were incorporated in 1967 with the object of providing medium-term finance in world markets to commercial companies. At all material times a substantial part of the respondents' business consisted in the discounting or purchase of bills of exchange and similar obligations issued by borrowers all over the world. The maturity periods of the obligations varied between one year and ten years; some carried a fixed rate of interest and others carried none. The respondents usually held such bills to maturity, but on many occasions they sold them before maturity. The purpose of discounting or purchasing a bill is to make a profit, and it is found in the case stated that the amount of profit a purchaser or discounter of bills may make is not ascertainable before the bill (*a*) is sold or (*b*) reaches maturity. A B

The respondents, however, in making up their annual profit and loss accounts, brought into account on the credit side at the end of each year a fractional part of the profit expected to be made if their bills were held to maturity. Their practice was to isolate the discount applicable to each bill or note, divide by the total number of days covered, and then take the appropriate number of days of discount into each profit and loss period. It was common ground that this procedure had the result that the respondents' account showed a true and fair view of the profit for the year in accordance with accountancy principles. C

In respect of the respondents' accounting periods for the years ended December 31, 1967, to December 31, 1970, inclusive, the appellant assessed them to corporation tax on the basis of their audited accounts prepared in the manner I have described. The respondents appealed to the general commissioners for the City Division of London, and contended primarily that the assessments contravened the cardinal principle of income tax law that in ascertaining the assessable profit a profit is not to be taxed until it has been realised. They also advanced the alternative contention that the bills constituted stock-in-trade, and should be treated as such in the computation of the taxable profits of the respondents' trade. The commissioners found in the respondents' favour on their primary contention and accordingly found it unnecessary to reach any conclusion on their alternative contention, and made no findings in relation to it. The commissioners, at the appellant's request, stated a case for the opinion of the High Court and on March 12, 1976, Walton J. affirmed the decision of the commissioners. On March 15, 1977, the Court of Appeal by a majority (Ormrod L.J. and Sir John Pennycuick, Stamp L.J. dissenting) dismissed an appeal from Walton J. The appellant now appeals to this House. D E F

The argument for the appellant started from the statement of Lord Haldane in *Sun Insurance Office* v. *Clark* [1912] A.C. 443, 455:

> "It is plain that the question of what is or is not profit or gain must primarily be one of fact, and of fact to be ascertained by the tests applied in ordinary business. Questions of law can only arise when (as was not the case here) some express statutory direction applies and excludes ordinary commercial practice, or where, by reason of its being impracticable to ascertain the facts sufficiently, some presumption has to be invoked to fill the gap." G

It was accepted that, in the words of Lord Reid in *B.S.C. Footwear Ltd.* v. *Ridgway* [1972] A.C. 544, 552: H

> "The application of the principles of commercial accounting is, how-

ever, subject to one well-established though non-statutory principle. Neither profit nor loss may be anticipated."

But it was contended that the bringing in on the credit side of a profit and loss account of a present debt payable in the future does not offend that principle; that the difference between the amount paid for a bill of exchange and the amount payable on maturity was a debt of that nature; and that sound principles of commercial accountancy having led in the present case to the bringing in of a particular part of that difference in each year before maturity, there was no good reason why the result should not be applicable for tax purposes. Reliance was placed on *Newcastle Breweries Ltd.* v. *Inland Revenue Commissioners* (1927) 96 L.J.K.B. 735, *Harrison* v. *John Cronk and Sons Ltd.* [1937] A.C. 185, *Gardner, Mountain and D'Ambrumenil Ltd.* v. *Inland Revenue Commissioners* (1947) 177 L.T. 16 and *Southern Railway of Peru Ltd.* v. *Owen* [1957] A.C. 334.

That group of cases establishes that it may be right in principle to bring into credit in a particular accounting year something which will not be received until a later year, and likewise to bring into debit an expenditure which will not require to be made until a future year, and further that it may be correct to strike the appropriate credit or debit by a process of estimation or of discounting. The principle which justifies this is that the receipt has been earned by services rendered or goods supplied in the earlier year, or that the liability for the expenditure arises from some transaction in the earlier year, and it is not a necessary objection to the inclusion in the account of the receipt or expenditure in question that is uncertain, deferred or contingent. Whether or not the credit or debit should be included was said by Lord Radcliffe in the *Southern Railway of Peru* case at p. 357 to turn on the answer to the practical question, how much more will the trader have to pay out or be able to get in than his current accounts of the year are recording, and later on he said:

> "But, whatever the legal analysis, I think that for liabilities as for debts their proper treatment in annual statements of profit depends not upon the legal form but upon the trader's answers to two separate questions. The first is: Have I adequately stated my profits for the year if I do not include some figure in respect of these obligations? The second is: Do the circumstances of the case, which include the techniques of established accounting practice, make it possible to supply a figure reliable enough for the purpose?"

Cases suitable for the application of these principles may in many instances be identified without difficulty. In my opinion the present case is not one of these, having regard to the nature of the transactions which form the relevant part of the respondent bank's business. In each case a sum of money is paid out by the bank in a particular year and in return for it the bank receives a bill of exchange, a chose in action. The bill obliges the issuer or acceptor to pay the bank a larger sum at the expiration of a number of years. The situation presents some analogy to the purchase by a trader of goods, which he expects later to sell at a profit, so that one might have expected to see the bank in the year of purchase enter the cost of the bill in its profit and loss account as a debit, in subsequent A years to enter as a debit the cost or market value of the bill whichever was the less, and in the year of maturity to enter as a credit the face value of the bill, whether or not it was actually paid in that year. But here the cost of the bill does not enter the profit and loss account; it goes in the balance sheet. It is only the difference between the cost and the maturity value of the bill which ever finds its way into the profit and B loss account in annual fractions over the period of maturity. There can be no doubt that from the beginning the issuer or acceptor of the bill is under a present obligation to pay the bank a sum certain on a particular future date. So there is attraction in the view that under the principles to which I have referred the bank, since it has by the transaction received in return for its payment the present right to receive a larger payment at a future date, should bring into its profit and loss account on the credit side the value of C that right, suitably discounted, the payment out being likewise brought in on the debit side. But that again is not what was done, nor is it suggested that it should have been done. Nor has the amount of profit expected been brought in at a valuation or at a discount. The reason why accounts prepared in the manner adopted by the respondent bank show a true and fair view of its profits over the years is that, in order to have funds available D for its bill of exchange transactions, the bank borrows money at interest. The interest payable each year goes into the debit side of the profit and loss account, and it is with the object of showing what benefit there is to counter-balance these payments that a fractional part of the discount on the bills is taken into the account on the credit side in each year. But it is not accurate to say that the interest payments are earning these fractional parts of the discount. The borrowing transactions and the bill E of exchange transactions are separate and distinct from each other. It is the bill of exchange transactions upon which attention must for present purposes be concentrated. The substance as well as the form of these transactions are such, in my opinion, that the respondent bank is by them acquiring assets which in the future they expect to realise at a profit. It is not reasonably to be regarded as rendering services to the issuers of the F bills for which the latter there and then become liable to pay. The case stated speaks of the respondent bank making a profit when the bills reach maturity, and I think that is in accordance with the plain common sense of the matter. What goes into the profit and loss account each year is a fractional part of what it is hoped the profit will ultimately be, although it is found in the case stated that the amount of the profit is not ascertainable, due to a number of circumstances, until the bill is sold or reaches G maturity. So I am of opinion that the assessment of the respondent bank to corporation tax on the basis of accounts made up in this way does contravene the rule that a profit may not be taxed until it is realised.

Part of the accountancy evidence before the commissioners was to the effect that accounts drawn up so as to exclude so called accrued discount, and presumably so as to show the profit on the bills as and when realised, H would have accorded with proper principles of accounting, provided that the procedure followed was fully explained in the accounts. This shows that accounts prepared on what I regard as the proper basis for tax

A purposes would not have contravened sound principles of accounting and helps to neutralise the appellant's argument in so far as it is founded upon the principle that for taxation purposes profits are to be ascertained in accordance with commercial accountancy practice.

In the circumstances it is unnecessary to deal with the respondent bank's alternative contention that the bills of exchange represent stock-in-trade, a contention which could not in any event be disposed of without B a remit to the commissioners.

My Lords, for the reasons I have given I would dismiss the appeal.

Appeal dismissed.

Solicitors: *Solicitor of Inland Revenue; Travers Smith, Braithwaite & C Co.*

F. C.

[HOUSE OF LORDS]

D

NAVIERA DE CANARIAS S.A. . . . . . . RESPONDENTS

AND

NACIONAL HISPANICA ASEGURADORA S.A. . . . APPELLANTS

1976	March 18, 19;	Lord Denning M.R.,
E	April 14	Goff and Shaw L.JJ.
1977	Jan. 11, 12;	Lord Diplock, Viscount Dilhorne,
	Feb. 16	Lord Simon of Glaisdale, Lord Salmon and Lord Fraser of Tullybelton

Insurance—Marine—Exemption clause—Vessel on time charter—Machinery breakdown—Vessel off hire from time of break-F down and stranding until repairs completed—Claim by assured owners for loss of hire incurred under freight policy—Whether claim "consequent on loss of time"—Institute Time Clauses: Freight, cl. 8—New York Produce Exchange Time Charter, cl. 15

The plaintiffs, Spanish shipowners, insured their fleet of vessels with Spanish insurers under a policy of marine insur-G ance which incorporated, inter alia, the standard Institute Time Clauses: Freight conditions, clause 8 of which exempted the insurers from liability in respect of ". . . any claim consequent on loss of time whether arising from a peril of the sea or otherwise." During the currency of the policy the shipowners chartered one of their vessels on a time charter on the New York Produce Exchange form containing an off-hire clause, clause 15, which provided that " . . . in the event of loss of H time from . . . breakdown . . . to . . . machinery . . . grounding or by any other cause preventing the full working of the vessel, the payment of hire shall cease for the time thereby lost; . . ." The vessel was delivered to the charterers at 21.00 hours on April 18, 1972, at a Spanish port and sailed at 01.55