

Lord Fraser of Tullybelton. I agree with it, and for the reasons which he gives I would allow the appeal.

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LORD BRIGHTMAN. My Lords, I would allow this appeal for the reasons given by my noble and learned friend, Lord Fraser of Tullybelton.

*Appeal allowed with costs.*

*Declaration that section 18(2) of the Public Utilities Street Works Act 1950 did not impose a duty of strict liability on the defendants.*

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*Solicitors: Hextall Erskine & Co. for Keogh Ritson & Co., Bolton; Treasury Solicitor.*

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M.G.

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[HOUSE OF LORDS]

PATTISON (INSPECTOR OF TAXES) . . . . . APPELLANT

AND

MARINE MIDLAND LTD. . . . . RESPONDENT

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1983 Nov. 16, 17, 21;  
Dec. 8

Lord Fraser of Tullybelton,  
Lord Keith of Kinkel, Lord Roskill,  
Lord Brandon of Oakbrook and  
Lord Templeman

*Revenue—Corporation tax—Profits, computation of—Foreign currency exchange transactions—United Kingdom company issuing loan stock to provide U.S. dollar funds for international banking business—Subsequent repayment out of dollar assets matched against loan—Sterling depreciating against dollar between issue of stock and date of repayment—Whether exchange profit realised on matched dollar assets used to make repayment*

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The taxpayer company, which was incorporated in England in 1971, was a subsidiary of an American bank and carried on an international banking business, providing short-term and medium-term finance, mainly in U.S. dollars. It did not speculate in foreign exchange transactions, and the main part of its trading income consisted of the excess of the interest received from its customers on loans and deposits over the interest it paid on loans and deposits. Immediately after incorporation the company issued U.S. \$15m. of subordinated unsecured loan stock to two U.S. subsidiaries of the parent bank. As intended, the whole of the \$15m. received was used in making dollar loans and deposits in the ordinary course of the company's business, without being

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1 A.C. **Pattison v. Marine Midland Ltd. (H.L.(E.))**

A converted into sterling. In accordance with the company's normal practice, the borrowing and lending transactions were matched in a book maintained for dollar transactions. In 1976, the company purchased the whole of the loan stock, repaying the \$15m. from its existing dollar funds. Apart from interest, the company made no profit on the dollar loans it made but there was a yearly notional sterling profit on them, owing to the depreciation of sterling as against the dollar between 1971 and 1976. The company appealed against assessments of corporation tax on the notional profits. The general commissioners allowed the appeal on the ground that any unrealised appreciation of assets ascertained by translating into sterling the value of loans not converted into sterling did not form part of the company's trading profit for tax purposes. Vinelott J., allowing the Crown's appeal, held that in repaying the loan stock the company realised an exchange profit on which corporation tax was assessable. The Court of Appeal held, allowing the company's appeal, that in respect of matched transactions the notional profit realised from currency fluctuations was not liable to corporation tax.

C On appeal by the Crown:—

D *Held*, dismissing the appeal, that the company realised no actual exchange profit since it made no relevant currency conversions and that, accordingly, it made no taxable profit from the lending and repayment of the \$15m. save for the difference between the interest received from its customers and the interest paid to its loan stock holders (post, pp. 372C–E, H—373B, D–E).

Decision of the Court of Appeal [1983] Ch. 205; [1983] 2 W.L.R. 819 affirmed.

No cases are referred to in their Lordships' opinions.

E The following cases were cited in argument:

*Ammonia Soda Co. Ltd. v. Chamberlain* [1918] 1 Ch. 266, C.A.

*Arizona Copper Co. v. Smiles* (1891) 3 T.C. 149

*B.S.C. Footwear Ltd. v. Ridgway* [1972] A.C. 544; [1971] 2 W.L.R. 1313; [1971] 2 All E.R. 534; 47 T.C. 495, H.L.(E.)

F *Davies v. Shell Company of China Ltd.* (1951) 32 T.C. 133, Danckwerts J. and C.A.

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

*European Investment Trust Co. Ltd. v. Jackson* (1932) 18 T.C. 1, Finlay J. and C.A.

*Farmer v. Scottish North American Trust Ltd.* [1912] A.C. 118; 5 T.C. 693, H.L.(Sc.)

G *Gold Coast Selection Trust Ltd. v. Humphrey* [1948] A.C. 459; [1948] All E.R. 379; 30 T.C. 209, H.L.(E.)

*Golden Horse Shoe (New) Ltd. v. Thurgood* [1934] 1 K.B. 548; 18 T.C. 280, C.A.

*Gresham Life Assurance Society v. Styles* [1892] A.C. 309, H.L.(E.)

*London County Council v. Attorney-General* [1901] A.C. 26, H.L.(E.)

*Odeon Associated Theatres Ltd. v. Jones* [1973] Ch. 288; [1972] 2 W.L.R. 331; [1972] 1 All E.R. 681; 48 T.C. 257, C.A.

H *Sharkey v. Wernher* [1956] A.C. 58; [1955] 3 W.L.R. 671; [1955] 3 All E.R. 493, H.L.(E.)

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

*Willingale v. International Commercial Bank Ltd.* [1978] A.C. 834; [1978] 2 W.L.R. 452; [1978] 1 All E.R. 754; 52 T.C. 242, H.L.(E.)

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APPEAL from the Court of Appeal.

This was an appeal by the Crown from a judgment of the Court of Appeal (Sir John Donaldson M.R., Griffiths and Dillon L.JJ.) [1983] Ch. 205 on 4 March 1983 allowing an appeal by the taxpayer company, Marine Midland Ltd., from a decision of Vinelott J. [1982] Ch. 145 on 7 May 1981 whereby he allowed the Crown's appeal by case stated from a decision dated 1 February 1979 of the Commissioners for the General Purposes of the Income Tax for the City of London Division allowing the company's appeal against assessments to corporation tax. The Court of Appeal refused the Crown leave to appeal. On 19 May 1983 the Appeal Committee of the House of Lords (Lord Diplock, Lord Roskill and Lord Brandon of Oakbrook) allowed a petition by the Crown for leave to appeal.

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The facts are stated in the opinion of Lord Templeman.

*D. C. Potter Q.C.* and *Peter Goldsmith* for the Crown. The taxpayer is a company trading in the United Kingdom, the trade being that of non-sterling banking. However, the taxpayer is a United Kingdom company whose annual accounts and tax computation use sterling as the measure of all items. The U.S. \$15m. was used entirely in making dollar loans. The taxpayer's profits were primarily the interest differential, but each year it brought into the computation an item of foreign exchange profit, i.e. where there was lending of non-sterling currency which was not matched by borrowing, there could be a different value between the opening and closing of the account. That value was brought in as "foreign exchange profit." The borrowing was a capital transaction, and the obligation to repay was a capital, not a current, liability. For purposes of computing income (as opposed to profit) \$15m. of lending was unmatched because it is not permitted to match current assets against capital liabilities.

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The \$15m. loan stock, being part of the capital structure of the trade, not a current obligation incurred in carrying on the trade, and translation into sterling having been properly adopted by the taxpayer in its accounts as the measure of its profit, the additional cost in sterling of repaying the loan stock represents a capital loss not an income loss; and because the taxpayer matched its \$15m. capital borrowing against \$15m. current lending so as to produce (in sterling as well as dollar terms) neither a gain nor a loss on repaying the \$15m. loan stock, it becomes necessary to "unmatch" the borrowing from the lending in order to segregate income from capital. The result is that the appreciation in sterling value of \$15m. current lending is left unmatched by the \$15m. capital borrowing and thus creates a sterling income equal to the increase in sterling terms of the \$15m. lending. Current assets cannot be matched against capital lending when one is computing income.

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The allowance for losses on capital gains makes no provision for an allowance for a loss of this sort, i.e. where a taxpayer pays more in sterling as a result of a rise in value of the dollar when the loan is repaid. The Crown prays in aid section 130(f) of the Income and Corporation

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A Taxes Act 1970. What is being taxed is income because corporation tax is a tax on income, and in computing income under Case I of Schedule D no deduction is allowed in respect of capital .

*Arizona Copper Co. v. Smiles* (1891) 3 T.C. 149 illustrates that a bonus or premium on a capital borrowing is not deductible in computing trading income. In principle there is a distinction between current borrowing and fixed borrowing. Income tax is and has always been a tax on income, so that capital profits and capital losses are left out of account, or if brought into a commercial profit and loss account are removed from it. The income on which corporation tax is chargeable has to be computed in accordance with income tax principles.

C The distinction between capital and income is exemplified in the decisions of the Court of Appeal in *European Investment Trust Co. Ltd. v. Jackson* (1932) 18 T.C. 1, 12 and *Davies v. Shell Company of China Ltd.* (1951) 32 T.C. 133, 145. The latter case is of particular relevance to the present appeal because there the taxpayer successfully contended that the capital profit in sterling terms realised from foreign borrowings had to be taken out of account in arriving at trading income for income tax purposes.

D Although it may be thought that a company that makes no commercial profit should not pay tax, it is commonplace that a company's trading income for tax purposes may bear little resemblance to its commercial profit; e.g. (i) the entire trading income from a leasehold shop, which in a few years will become worthless, is nevertheless chargeable to corporation tax, and nothing is deductible for depreciation; (ii) the deduction of capital allowances equal to the cost of capital assets in computing a company's income, thus producing a tax loss, although the company is making profits; (iii) a dairy farming company moving a heifer from the herd of young stock (trading stock) to the milking herd (capital asset), where the excess of value of the heifer over the cost of producing it becomes part of trading income: see also *Sharkey v. Wernher* [1956] A.C. 58.

F Thus the term "notional profit" cannot be used to support the view that the law forbids the revenue to exact tax when there is no commercial profit. In a sense all trading income is both real and notional: real in that it is based on real costs, prices and valuations; notional in that it is a figure arrived at by balancing credits, including valuations, against debits, including valuations.

G There does not have to be a cash realisation in order to find a profit. In *Sharkey v. Wernher* [1956] A.C. 58 where a horse was moved from a stud farm to racing stock there was no realisation of any profit. The word used is "disposed" although it was simply moving an animal from one stable to another. It means that a farmer who consumes his own products has to bring them in at full market value as if he had sold them to someone else. In 1976 the taxpayer company paid off the debt in dollars and that is a realisation of the dollars for their sterling equivalent. Where there is a realisation of something other than sterling value that is a realisation which can throw up profit: see *Gold Coast Selection Trust Ltd. v. Humphrey* [1948] A.C. 459, 472.

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In 1976 there was a realisation of \$15m. in sterling terms. There was then a profit of the trade chargeable to tax as income. The capital obligation of 1971 was discharged in 1976 at a loss (because of currency fluctuation) but that is a capital loss on which no allowance can be made.

*Willingale v. International Commercial Bank Ltd.* [1978] A.C. 834 shows that profits should not be taxed until realised. On its face value, applied to the case under appeal, it would delay harvesting of the profits till 1976.

*London County Council v. Attorney-General* [1901] A.C. 26, 35 says income is a tax on income, not on anything else. Although the present taxpayer was in the trade of borrowing and lending money, the \$15m. was not borrowed in the course of that trade.

The \$15m. was loan capital and not a current liability of the trade. The additional sterling value of the dollars used to repay over that of the dollars acquired was a capital loss, not income loss. The \$15m. loan capital was matched at all times against \$15m. current assets. Thus it was commercially irrelevant whether the matching was done in dollars or in sterling; either way it is self-cancelling. But in order to distinguish capital from income the matching must be undone. Thus in sterling terms current assets valued at £6,240,090 acquired in 1971 were realised in 1976 at £8,465,011. That is an income trading profit. Arithmetically it is the same amount as the loss in sterling terms between 1971 and 1976 of the loan capital.

The taxpayer company prepared its computations of accounts in sterling. The fact that the taxpayer acquired and disposed of a commodity, being dollars, is no reason to use that commodity and abandon sterling as the measure of income.

Monthly and yearly valuations of its assets and liabilities were made by the taxpayer. The taxpayer brought into account foreign exchange profit, being movements in valuation of current assets. That method of accounting, but no other, is correct. All the accounts and computations are based on translation, or valuation, not on actual exchange or realisation. You cannot now assert that there was no income just because \$15m. was never exchanged: it was in fact translated or valued.

Foreign exchange profit of each year of accounting should for purposes of income taxation be adjusted by adding back the movement in sterling terms of \$15m. of current lending. Translation, being the basis of the accounts, cannot be ignored.

These submissions would be the same if the dollar loan were not repaid in 1976 and do not depend in any way on it. The company translated the dollar loan, and thus a corresponding amount of dollar lending, year by year.

The taxpayer's business is irrelevant once it is established that its loan capital is a capital liability and not a profit of trading. If the fact that the taxpayer is in the business of borrowing and lending money were relevant, it would be to treat the loan as if it were borrowing in the course of a trade. But there is authority in *Davies v. Shell Company of China Ltd.*, 32 T.C. 133 and *European Investment Trust Co. Ltd. v. Jackson*, 18 T.C. 1 which shows that such borrowing is a capital liability. The evidence that it was loan capital is overwhelming.

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1 A.C.

Pattison v. Marine Midland Ltd. (H.L.(E.))

A The commissioners correctly held that the loss on the capital of \$15m. was not deductible, and therefore it must inevitably follow that they were in error in matching that \$15m. against current lending.

B *F. Heyworth Talbot Q.C., John Gardiner Q.C. and Roger C. Thomas* for the taxpayer company. The Crown say a company located in the United Kingdom and taxable in respect of United Kingdom trade must make up its accounts solely in sterling. The taxpayer says that is perfectly true when one comes to the presentation of accounts. But it is not true as far as determination of the profit is concerned. Otherwise an English company trading in Germany in Deutschmarks would have to translate every transaction into sterling. That is not correct. All one has to translate is profit. It is well established practice that a trader can wait until the end of an accounting period and translate the profit then found.

C The return to the debtor of the specific subject matter of a loan can never give rise to a profit to the borrower notwithstanding the change in value of the subject matter of the borrowing. That proposition is true whether or not the making of the loan takes place in the course of trade and whether the loan is made on capital account or on revenue account. The taxpayer borrowed \$15m. and returned \$15m. It was similar to the borrowing and returning of a Rembrandt painting. The taxpayer did not convert a single dollar of the \$15m. into sterling although it translated it into sterling for the purposes of its accounts. In *Sharkey v. Wernher* [1956] A.C. 58 if the taxpayer had only borrowed a stallion when the value was £50,000 and at the end of five years it was restored to its owner when its value had risen to £100,000, is the difference of £50,000 a profit or gain?

E When one is dealing with money it is perfectly correct to say one is dealing with a specific subject matter. During the five-year period from 1971 to 1976 the dollar had risen against sterling and therefore when returning the dollars the borrower returned an item with a higher sterling value than it had when it was borrowed. But the value of the \$15m. in dollars in 1976 was precisely the same as it was in 1971.

F The profit and loss account of the taxpayer was prepared in accordance with principles of sound commercial accounting. Profits and gains must be ascertained on ordinary principles of commercial accounting: see *Gresham Life Assurance Society v. Styles* [1892] A.C. 309; *Sun Insurance Office v. Clark* [1912] A.C. 443, 445 and *Duple Motor Bodies Ltd. v. Inland Revenue Commissioners* [1961] 1 W.L.R. 739, 746.

G The ordinary principles of commercial accounting bring nothing into the profit and loss account in respect of the items in issue. Consequently this is not a case where the revenue are simply seeking to exclude or disallow an item in that account. In order to succeed on this issue the Crown must show that there is a principle of tax law which requires the sterling value of the principal sums involved (which as mere borrowings and lendings are incapable of yielding profit and loss) to be brought into the profit and loss account. The only purpose of bringing such items in H would be to afford the Crown grounds for a contention that one of those items (the increase in the sterling value of the indebtedness) should be disallowed as capital expenditure. There is no such rule of law and no authority supports it. The whole purpose of the Crown's contention is to

contrive by arithmetical artifice the production of a figure having the appearance of profit in a situation where, apart from interest differential, there could be no profit. *Odeon Associated Theatres Ltd. v. Jones* [1973] Ch. 288, 293–294 sums up well established law. In the taxpayer's profit and loss account nothing was credited or debited in respect of the \$15m. It is for the Crown to show some regulation or statutory provision which would justify an "unscrambling".

The taxpayer has paid tax on its profits arising from the interest differential, but if the Crown's contentions were right the taxpayer would have to find the funds to pay tax on a profit which it had not made, or, if exchange rates had moved the other way, would be entitled to relief from tax in respect of a loss which it has not suffered.

*Davies v. Shell Company of China Ltd.*, 32 T.C. 133 is distinguishable because the \$15m. loan was so used that the potential profit which resulted from the currency fluctuation was never realised by conversion. Unrealised profit is not taxable: see *Duple Motor Bodies Ltd. v. Inland Revenue Commissioners* [1961] 1 W.L.R. 739; *B.S.C. Footwear Ltd. v. Ridgway* [1972] A.C. 544 and *Willingale v. International Commercial Bank Ltd.* [1978] A.C. 834.

In the taxpayer company's submission, the above is the only issue that arises in this appeal. It was the only issue dealt with by the Court of Appeal who rightly rejected the Crown's argument. If the taxpayer had converted the dollars into sterling and used them to make sterling advances, when it came to repaying the \$15m. it would have had to realise more sterling than it would have received on the original conversion of the \$15m. and would have claimed the additional sterling cost of repaying the loan as a loss for the purposes of its profit and loss account. In that hypothetical situation the issue as to whether such loss was of a revenue or of a capital nature would have arisen. In the taxpayer's submission that issue does not arise in the present appeal, but if it did, the taxpayer contends that the loss was of a revenue nature for the following reasons.

The \$15m. was borrowed for use as circulating (as opposed to fixed) capital. The whole of that amount was employed in the taxpayer's trade as circulating capital and all transactions in which it figured were on circulating capital account. The distinction between fixed and circulating capital is set out in the judgment of Romer L.J. in *Golden Horse Shoe (New) Ltd. v. Thurgood* [1934] 1 K.B. 548, 563–565. Circulating capital is a portion of the subscribed capital which is intended to be used by being temporarily parted with and circulated in the business and which, or the proceeds of which, are intended to return to the company with an increment and are intended to be used again and again: see *Ammonia Soda Co. Ltd. v. Chamberlain* [1918] 1 Ch. 266, 286, 287.

That loss which arose on circulating capital would have arisen from the conversion of the dollar loan into sterling and its use in the ordinary course of the taxpayer's business. It was used not to purchase a fixed asset such as the taxpayer's premises, but was in itself the making of ordinary loans and advances in the course of its business. The taxpayer was in the trade of banking and the essence of that trade is the borrowing and lending of funds at an interest or profit differential. When a bank borrows so as to lend such funds for the purpose of earning such a profit any

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1 A.C.

Pattison v. Marine Midland Ltd. (H.L.(E.))

A resultant profit or loss from the transaction is a profit or loss on circulating capital or of a revenue nature and this is so regardless of the length of time of any indebtedness.

Thus, even assuming that there was a prima facie profit from the increase in sterling terms of the dollar loan, there was also a corresponding loss of a revenue nature arising from the increase in sterling terms of the obligation to repay the \$15m.

B The taxpayer would comment on the Crown's submissions thus. Even assuming that the \$15m. was "loan capital" as opposed to a current liability, there was no loss of any kind on the repayment of the dollars. There would have been a loss had the original \$15m. been converted into sterling and more sterling been required to repay the loan. However, that did not happen. Since the dollars were not repaid out of sterling there was no cost in sterling of the repayment: a fortiori no additional cost.

C The principal amounts of \$15m. were not matched in the form of constituting debits or credits in the profit and loss account because, as amounts of matched principal, they were incapable of giving rise to profit or loss. Therefore they never entered the profit and loss account at all. The repayment of a loan is not a realisation of any kind. If it had been necessary to convert sterling into dollars so as to repay the loan then the conversion, but not the repayment, would have been a realisation giving rise to profit or loss which would have been recognised in the profit and loss account. The taxpayer had no such need and accordingly there was no realisation of \$15m. in 1976. Consequently there was no income trading profit nor any loss.

D The taxpayer's trading accounts, from which its profit is to be derived, were kept in the particular currencies in which it traded. Since the taxpayer had a sterling share capital it had to produce annual accounts in sterling by translating into sterling the result of its trade in foreign currency. The profits or gains arising or accruing in respect of the trade, which is the basis of the charge to tax under sections 108 and 109 of the Income and Corporation Taxes Act 1970, arose or accrued in foreign currency. Sterling was not the measure of income: the income was earned in dollars, and sterling was merely used so as to present the income so earned in sterling.

E What the taxpayer did bring into its profit and loss account were revaluations in sterling of foreign assets held in an open position, i.e. such that were available for disposal at which time real profit or loss would be realised. In bringing these values into its profit and loss account the taxpayer was anticipating a profit or loss which it could have made by sale of currency and might ultimately make. *Willingale v. International Commercial Bank Ltd.* [1978] A.C. 834 is authority for the proposition that a bank is only obliged to be taxed when that profit is realised. Although for convenience the taxpayer and the Crown accept the basis adopted as determining profit, albeit that this is contrary to the decision in *Willingale*, that treatment has no bearing on the items in issue which were incapable of producing profit or loss.

H One cannot add back a foreign exchange profit when it has never been there. The principles of sound commercial accounting do not require any such item to be included because there is no profit or loss. In such

circumstances the Crown must point to a principle of law requiring the introduction of an additional amount into the profit and loss account. They have established no such principle. In particular section 130(f) of the Act of 1970 is no such authority: it merely prohibits the deduction of certain sums which ex hypothesi are components of the profit and loss account. The only directly applicable observations in the cases are those of Jenkins L.J. in *Davies v. Shell Company of China Ltd.* (1951) 32 T.C. 133, 148 which completely refute the Crown's propositions.

The taxpayer agrees that the issue does not turn on the repayment of the \$15m.

The taxpayer therefore submits that the appeal should be dismissed because apart from the interest differential there was no taxable profit arising from the borrowing and repayment of the \$15m. If however there was a profit from the increased sterling value of the dollar loan that is exactly matched by the increased sterling loss arising on the repayment of the loan, which loss is a loss on revenue account. Accordingly the reasoning of the Court of Appeal is correct.

*Gardiner Q.C.* following. The fact that there was no profit resolves this case completely. If that be right, the second point whether there was a loss of capital does not arise.

Section 130(f) of the Act of 1970 does not assist the Crown's case because it allows the striking out of an item but does not provide for putting an item into a profit and loss account. Thus there is no statutory proposition for bringing into the profit and loss account the sterling value of the \$15m.

The taxpayer company was a bank. There is a distinction between a bank and any other commercial enterprise because the latter would have to borrow money for purchasing stock-in-trade but in the case of a bank the money is the very thing in which it trades. *Arizona Copper Co. v. Smiles*, 3 T.C. 149 and *European Investment Trust Co. Ltd. v. Jackson*, 18 T.C. 1 are therefore distinguishable from the present appeal. *Farmer v. Scottish North American Trust Ltd.* [1912] A.C. 118, 125—129 shows that a bank borrowing and lending money is not, when it is borrowing, borrowing capital.

In the case of a bank money is quasi stock-in-trade and therefore the loss cannot be disallowed on the ground that it is a capital loss.

*Potter Q.C.* replied.

Their Lordships took time for consideration.

8 December. LORD FRASER OF TULLYBELTON. My Lords, I have read in draft the speech to be delivered by my noble and learned friend, Lord Templeman. I entirely agree with it and I would dismiss this appeal for the reasons stated in that speech.

That makes it unnecessary to decide the question raised by the respondent's secondary contention. But I wish briefly to mention the question out of respect for the interesting argument upon it addressed to us by counsel on both sides. I do not repeat the facts which are sufficiently stated for this purpose by Lord Templeman. Mr. Heyworth Talbot's

A second argument depended upon distinguishing between circulating capital and fixed capital. He said that as the \$15m. had been borrowed for use as circulating capital, and had been employed in the taxpayer's business for that purpose, the loss of any part of it would give rise to a permissible deduction in ascertaining the taxpayer's profits. Mr. Potter, for the revenue, had contended that the \$15m. was stamped with the character of capital, and retained that character regardless of how it was employed, so that any loss would not be deductible in arriving at the profit.

It is not necessary for us, in the circumstances, to decide this question and I refrain from expressing any opinion upon it because I doubt whether we have sufficient material on which to answer it adequately. It appears to me to be a question upon which expert evidence of accountants, and possibly bankers, would have been desirable, if not necessary, and in the absence of such evidence, I am not sure that the court is in a position to answer the question.

I would dismiss the appeal.

LORD KEITH OF KINKEL. My Lords, for the reasons given in the speech to be delivered by my noble and learned friend, Lord Templeman, with which I agree, I too would dismiss the appeal.

LORD ROSKILL. My Lords, I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Templeman. I entirely agree with it and would dismiss this appeal for the reasons he gives. I have also had the like advantage in the case of the speech of my noble and learned friend, Lord Fraser of Tullybelton. I agree with my noble and learned friend that it is unnecessary to decide the question raised by the respondents' second contention which was argued at some length by counsel on both sides. This argument depended for its validity upon a suggested distinction between circulating capital and fixed capital, as my noble and learned friend points out. Like him, I decline to express any opinion upon this contention, not only because it is not necessary for the House so to do, but because I doubt whether the case stated contains sufficient material upon which an adequate answer could be provided. For my part, I would be reluctant even to attempt an answer without the benefit of expert evidence, certainly from accountants and possibly from others, upon what seems to me to be a most difficult topic.

LORD BRANDON OF OAKBROOK. My Lords, I have had the advantage of reading in draft the speech prepared by my noble and learned friend, Lord Templeman. I agree with it, and for the reasons which he gives would dismiss the appeal.

LORD TEMPLEMAN. My Lords, on 12 October 1971 the respondent taxpayer company, Marine Midland Ltd., which carried on the business of international commercial banking, borrowed U.S. \$15m. by an issue of unsecured loan stock at par for that amount. At the prevailing rate of exchange the \$15m. borrowed by the company were then worth £6,024,096. On 15 June 1976 the company redeemed the loan stock by repaying \$15m. At the then rate of exchange \$15m. were worth £8,465,011. The revenue,

acting through Mr. Pattison, the appellant inspector of taxes, assert that the difference between the sterling value, namely £6,024,096, of \$15m. borrowed by the company on 12 October 1971 and the sterling value, namely £8,465,011, of \$15m. repaid by the company on 15 June 1976 was a capital loss of £2,440,915 non-deductible for the purpose of computing the profits of the company which are liable to corporation tax.

Between 12 October 1971 and 15 June 1976 the company used the \$15m. which it had raised by the unsecured loan stock to lend dollars to its banking customers. By 15 June 1976 the whole of the customers' loans, amounting to \$15m., had been repaid to the company. The revenue claim that the difference between the sterling value, namely £6,024,096, of \$15m. lent by the company to its customers, and the sterling value, namely £8,465,011, of \$15m. repaid by the customers to the company, was an income profit of £2,440,915 received by the company and liable to corporation tax over the period between 12 October 1971 and 15 June 1976 as and when earned.

I accept the submission put forward on behalf of the company by Mr. Heyworth Talbot with his customary clarity that the revenue's contentions are fundamentally unsound. The company did not make any capital or other loss when it repaid with \$15m. loan stock of \$15m. issued at par. The company did not make any income or other profit when it lent \$15m. to its customers and was repaid \$15m. Between 12 October 1971 and 15 June 1976 the company made a profit which consisted of the difference between the interest paid to the loan stock holders and the interest received by the bank from its customers. This profit was brought into account in the computation of the profits upon which the company paid corporation tax.

My Lords, a profit or loss may be earned or suffered if a borrower changes the currency he borrows but that profit or loss arises from the exchange transaction and not from the borrowing. For example, the company could have borrowed £6m. sterling by means of unsecured loan stock. The company could have changed the £6m. thus raised into U.S. \$15m. in 1971 and lent those dollars to its customers. If then the customers had finally repaid their loans of \$15m. in 1976 and the company had converted those dollars into sterling, realising £8m. available to redeem the loan stock of £6m., the bank would have made an exchange profit of £2m. That profit would have been made by converting sterling into dollars in 1971 and reconverting dollars into sterling in 1976. The company would have gambled and won on an increase in value of the dollar vis-à-vis sterling between 1971 and 1976. Similarly if the company, having in fact borrowed \$15m. worth £6m. by the issue of unsecured loan stock at par in 1971, and having lent those \$15m. to its customers, had called in the loans of its customers in 1973, received back \$15m. and converted those dollars into sterling, producing say £7m. at that stage, then the company would have made an exchange profit of £1m. by acquiring dollars in 1971 and selling dollars in 1973. The bank would have gambled and won on an increase in value of the dollar vis-à-vis sterling between 1971 and 1973. If then in 1976 the bank had been obliged to purchase \$15m. at the then current sterling cost of £8m. in order to repay the \$15m. owing under the unsecured loan stock, the company would have made an exchange loss of £2m. by converting dollars into sterling. The bank would have gambled and lost on an increase in value of sterling vis-à-vis the dollar between 1971 and 1976. The exchange profit of

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A £1m. realised in 1973 and the exchange loss of £2m. suffered in 1976 would both be taken into the bank's profit and loss account for income and for corporation tax purposes as incidents in the company's currency transactions in the course of carrying on a commercial banking business. But as between the company and the holders of the unsecured loan stock and as between the company and its customers, there was and never could be any profit and loss to lender or borrower except for interest paid and received. The revenue

B argument that the company made a capital loss on its unsecured loan stock and an income profit on its customers' borrowing is misconceived. There never was any loss or profit from the lending and borrowing and there never was any exchange profit because the company did not make any relevant currency conversions.

C If at any time the company's dollar assets exceeded the company's dollar liabilities the company, in preparing its profit and loss account for income and corporation tax purposes, brought in as a profit or loss any increase or decrease in the value of the excess dollars expressed in sterling from time to time so long as the excess holding of dollar assets was not absorbed by an increase in the company's dollar liabilities. These accounts reflected the success or failure of the company in acquiring and holding excess dollars which could be converted into sterling and were not required to be retained

D to meet dollar liabilities. The company's method of accounting for exchange profits and losses attributable to excess dollars was accepted by the revenue and is not inconsistent with the company's submission that no profit or loss was attributable to dollar assets equal in dollar terms to dollar liabilities. The company avoided exchange profits or losses on a substantial scale by ensuring that the amount of its dollar assets did not substantially exceed or substantially fall short of its dollar liabilities, so that alterations in the dollar and sterling rate of exchange could not produce a substantial exchange profit or loss. The company in 1971 increased its dollar assets by \$15m. and its dollar liabilities by \$15m. The company thereafter ensured that \$15m. of liabilities continued to be matched by \$15m. of assets until in 1976 the dollar liabilities were discharged out of dollar assets without involving the company in an exchange or any other profit or loss.

F The Court of Appeal reached the same conclusion. For the reasons I have endeavoured to express I am of the opinion that the appeal of the revenue must be dismissed with costs.

*Appeal dismissed with costs.  
Order of the Court of  
Appeal affirmed.*

*Solicitors: Solicitor, Inland Revenue; Freshfields.*

S. H.