

GUINNESS v MAHON

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THE HIGH COURT

REVENUE

1416R/1984

BETWEEN

GUINNESS & MAHON LIMITED

APPELLANT

AND

J. A. BROWNE INSPECTOR OF TAXES

RESPONDENT

Judgment of Mr. Justice Barrington delivered the 24<sup>th</sup> day of July, 1985

This is a case stated for the opinion of the High Court pursuant to the provisions of Section 428 of the Income Tax Act 1967 as applied by Section 146 of the Corporation Tax Act 1976.

The transaction referred to is the same as that discussed in Mara -v- Hummingbird Limited 1982 ILRM page 421. The taxpayer however is different. In the Hummingbird case the taxpayer was Hummingbird Limited, a subsidiary company within the Guinness Mahon Group, whereas in the present case the taxpayer is the merchant bank Guinness & Mahon Limited.

The matter for decision by the Appeal Commissioners was whether the sum of £675,000 which arose to the appellant on the liquidation of a wholly owned subsidiary company, Hummingbird Limited, was part of the trading profits of the business of merchant banker carried on by the appellant, or a gain on capital account, or a transaction to which the provisions of section 131 of the Corporation

Tax Act 1976 applied.

Among the relevant facts were the following -

- (a) The appellant is a company which was incorporated in the State in 1931 and which has since carried on business as a merchant banker at 17 College Green, Dublin 2.
- (b) The appellant has a wholly owned subsidiary company, the Trinity Trust and Agency Limited, which is incorporated in Ireland and which has been since incorporation an investment holding company.
- (c) Hummingbird Limited is a company which was incorporated on the 25th of August, 1965. It had an authorised capital of £100 divided into shares of £1 each of which only two shares had been issued.

On the 13th of April 1967, the Trinity Trust and Agency Company Limited acquired the two issued shares in Hummingbird Limited. One of these shares was registered in the name of the Trinity Trust and Agency Company Limited and the second share was registered in the name of Mars Nominees Limited, which is another wholly owned subsidiary of Guinness & Mahon Limited and which made a declaration that it held the one share in Hummingbird Limited as nominee for the Trinity Trust & Agency Company Limited.

- (d) In 1965 the directors of appellant became aware that a desirable site for development as an office block, in Baggot Street, would shortly become available. They negotiated with the owners of the site and on the 3rd of October 1966, a formal contract was entered into between appellant and the owners, whereby the appellant secured

an option to purchase the Baggot Street premises on the 31st December 1967 on the terms and conditions therein set out.

- (e) The directors of appellant decided to use Hummingbird Limited to acquire this site and develop it. The option to purchase the site was duly exercised and by Deed of Assignment dated the 31st day of December 1967 these premises were conveyed to Hummingbird Limited. Afterwards development work commenced.
- (f) In March 1968, the Bank of Ireland Group indicated that it was interested in acquiring the Baggot Street premises for development as a bank headquarters. After negotiations, it was agreed to sell the Baggot Street premises for £1,000,000 and on the 17th of May, 1968, a contract for sale was signed, and the premises were assigned to a member of the Bank of Ireland Group on the 22nd of May, 1968.
- (g) The purchase price of the Baggot Street premises, £210,000 and subsequent development costs had been financed by interest free advances from appellant to Hummingbird Limited.
- In 1968 after the sale of the property, Hummingbird Limited re-paid the advances which had been made by the appellant and placed the balance of the amount realised from the sale on current account with the appellant.
- (h) The appeal by Hummingbird Limited against an assessment raised on it in respect of profits from dealing in/or developing land, was heard by an Appeal Commissioner in March 1971. All of the circumstances surrounding the

purchase, development, and sale of the Baggot Street property and the involvement of the appellant, its directors and subsidiaries therein were examined by the Appeal Commissioner who held that Hummingbird Limited, had acquired the premises, with the intention of re-developing them as an office block, which it would hold as a long term investment, and not with a view to sale. Accordingly, he determined the appeal by discharging the assessment which had been raised on Hummingbird Limited. On appeal to the High Court, the decision of the Appeal Commissioner was affirmed and the appeal from the High Court decision was dismissed by the Supreme Court. In the course of the appeal hearing in March 1971, the then Appeal Commissioner had held as a fact that the Trinity Trust & Agency Company Limited was an investment holding company.

- (i) In April, 1976, the appellant, which was then experiencing trading difficulties, decided to realise the investment held by the Trinity Trust and Agency Company Limited. On the 20th of April, 1976, the Trinity Trust & Agency Company Limited, sold to the appellant for £2 the two shares in Hummingbird Limited which it had held since 1968 and transferred to appellant the one share standing in its own name and Mars Nominee Limited executed a revised declaration of trust in favour of appellant in respect of the second share.
- (j) On the 26th of April 1976, a resolution was passed to wind up Hummingbird Limited, and accordingly afterwards the liquidator of that company paid over to the appellant

the amount standing to the credit of Hummingbird Limited in its current account with the appellant after deducting the costs of liquidation.

(k) The sum thus received by appellant, £675,000, was credited in its accounts as an exceptional item which was netted against another exceptional item consisting of a substantial charge in respect of bad debts written off and provided against (less recoveries), so that in the general profit and loss account for the year ended the 30th of April 1976 the net bad debts were only charged and the sum realised on the liquidation of Hummingbird Limited was distinguished only by way of a note.

(l) It was admitted that as long as the shares were held by the Trinity Trust & Agency Company Limited that they were held by that company as an investment.

At the hearing before the Commissioners, and again before me, it was contended on behalf of the appellant -

(1) When the appeal by Hummingbird Limited against an assessment raised on income from "dealing in/or developing land" was being heard, all the facts connected with the negotiations, including the involvement of the appellant, its subsidiaries and its directors, about purchase and sale of the premises at Baggot Street were considered by the Appeal Commissioner. He decided that the surplus arising from the sale of this property was not a trading transaction of dealing in/or developing land, but was the realisation of a long term investment and so was a capital profit. The Commissioner's decision was upheld by the High Court and the Supreme Court. The facts of that

decision could not now be reviewed or overturned in this appeal, in the absence of further evidence, of which there was none.

- (2) No part of the surplus realised on the liquidation of Hummingbird Limited was a trading receipt in the hands of the appellant, because the activity of appellant which gave rise to the surplus was not the activity of dealing in stocks and shares. A bank, in the course of its trade, normally buys and sells stocks and shares at arms length. Buying shares worth £675,000 for £2 was a transaction carried out in a manner entirely outside the bank's normal course of trading. This was entirely a special inter group transaction, which was unlikely ever to be repeated. It was entirely out of character with the business carried on by the appellant.
- (3) It was submitted in the alternative that if the two shares in Hummingbird Limited were regarded as trading stock of the appellant the provisions of Section 131 of the Corporation Tax Act 1976 would apply to the shares on their acquisition from the Trinity Trust & Agency Company Limited, which it had been admitted had held the shares as an investment and that accordingly paragraph 15 of Schedule 1 to the Capital Gains Tax Act would also apply.

In the present case it was clear that the market value of the shares at the date of transfer to the appellant, 20th April, 1976, was higher than at the date of the resolution for the winding up of Hummingbird Limited, 26th April, 1976, because at the latter date the costs

of liquidation would have to be paid. Consequently, it was submitted on behalf of the appellant that since no increase in the value of the Hummingbird shares took place in this period there could be no question of liability to corporation tax since the cost deductible under paragraph 15 of Schedule 1 of the Capital Gains Tax Act, as applied by Section 131 of the Corporation Tax Act, exceeded the proceeds, the evidence being that at the 20th April, 1976 the value of the shares was £679,854, while at the 26th of April the value was the same less the costs of liquidation, which were approximately £1,000.

On behalf of the Inspector of Taxes, it was submitted that:-

- (1) There was agreement between the parties that Hummingbird Limited was set up by appellant in 1967 to hold an investment in property. Subsequently this company purchased a site, partially developed it and sold it at a profit. In the income tax appeal by Hummingbird Limited the property transactions were scrutinised and it was decided that the premises had been acquired as a long term investment and not with a view to sale. It was because of this decision that the Inspector of Taxes contended that the amount realised by the appellant on liquidation of Hummingbird Limited should be regarded as part of the profits of the appellant's trade.
- (2) A crucial feature of the case was that the appellant carried on business as a merchant bank. It was clear from the evidence that, as a merchant bank, it carried on a trade or business involving a large range of financial and advisory services, including the making of investments. It was agreed in evidence that the investments were

invariably carried out through the medium of subsidiary companies, a separate company being set up for each separate investment. The realisation of any of these investments should be regarded as part of the appellant's trading profits.

- (3) It was submitted that the provisions of Section 131, Corporation Tax Act 1976, should not be applied to the transfer of two shares from the Trinity Trust & Agency Company Limited to appellants on the 20th of April, 1976. To do so, would be to ignore the fact that Hummingbird Limited was set up as an investment holding company by the appellant in 1967 and that the two shares issued were not the investment but rather the large interest-free loans. It ignored also the fact that the profit from the property sale, from 1968 to 1976, was held by the appellant on a current loan which was tantamount to an interest-free loan.
- (4) It was clear from the evidence that appellant had no particular pattern in the way in which it dealt with investment holding subsidiaries. The fact that the liquidation of Hummingbird Limited was an isolated transaction, did not, therefore, affect the issue. It was simply one of the ways in which the appellant could realise an investment, and investments realised by a bank should always be regarded as income from its trade.
- (5) This fact was further supported by the fact that both the bank and its accountants apparently regarded and treated the surplus as a trading surplus in that they had transferred Hummingbird Limited out of the ownership of the Trinity Trust & Agency Company Limited prior to the winding up so as to make the surplus available to write off the provision for bad debts.



The Commissioners, having taken time for consideration, gave their decision as follows -

"We are satisfied that it is accepted law in this county that any profit made by a bank on the realisation of an investment is part of the bank's taxable profits.

Accordingly, we decided that the sum of £675,000 realised by the appellant on the liquidation of Hummingbird Limited was a taxable profit and that Section 131 of the Corporation Tax Act 1976 did not apply".

It will be noted that the Commissioners do not purport to change the findings of fact made in the Hummingbird case. They appear to accept that the Hummingbird Investment was a long term, or permanent, investment made outside the normal course of trade. But they appear to hold that because a bank deals in investments of various kinds that any profit made by a bank, on the realisation of an investment, is a trading profit and liable to be taxed as such.

It this is so it would appear that a bank, alone among businesses, cannot make a capital gain.

No doubt, a bank, and particularly a merchant bank, makes investments of various kinds - some short term and some long term. But all the evidence in the present case indicates that the property in Baggot Street was acquired for the purposes of a long term, in the sense of a permanent, investment. The intention was to build an office block and lease out space in it. It would also appear that it was the extremely attractive offer from the Bank of Ireland for the site which caused the appellant and its subsidiaries to change the plans they had for the development of the site. Again it appears to me to be quite unreal to regard as a normal trading dealing the purchase by the appellants on the 20th April 1976 from Trinity Trust of its shares in Hummingbird Limited for the sum of £2. These shares were worth £675,000 so that it would be absurd to regard this transaction as a normal commercial dealing. Rather was it one of the steps whereby the bank

reduced into its direct possession assets which had previously been held by it through subsidiaries: Finally, I do not think that the fact that the bank applied proceeds coming to it from a capital gain to defray trading losses can be used to suggest that these proceeds were normal trading profits.

Having reached this conclusion I do not find it necessary to deal with the submissions under Section 131 of the Corporation Tax Act 1976.

I would hold that the Commissioners were not entitled to hold that the said sum of £675,000 arising to the appellant on the liquidation of Hummingbird Limited was part of the trading profits of the business of merchant banker carried on by the appellant.

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LIST OF CASES CITED

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- J. P. Harrison (Watford) Limited -v- Griffith 40 T.C. 281
- Petrotin Securities Limited -v- Ayres 41 T.C. 389
- Ridge Securities Limited -v- C.I.R. 44 T.C. 373
- The Dunn Trust (In Voluntary Liquidation) -v- Williams 31 T.C. 477
- Harvey -v- Coulcott 33 T.C. 189
- West -v- Phillips 38 T.C. 203
- Bradshaw -v- Blundon 36 T.C. 397
- Northern Insurance Company -v- Russell 2 T.C. 571
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- Royal Insurance Company Limited -v- Stephen 14 T.C. 22
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- Agricultural Credit Corporation Ltd. -v- Vale 21 Tax Cases 46.
- W.J. Davis -v- Hibernian Bank Limited 21 T.C. page 111
- A.B. Limited -v- Mac Giolla Riogh 31 T.C. 305