

COURT OF APPEAL.—18TH AND 19TH FEBRUARY AND 11TH MARCH,
1931.

HOUSE OF LORDS.—7TH, 8TH, 10TH AND 11TH MARCH AND
15TH APRIL, 1932.

THE COMMISSIONERS OF INLAND REVENUE v. SIR H. C. HOLDER,
BART., AND J. A. HOLDER.⁽¹⁾

Income Tax—Interest payable on advance from bank—Claim for repayment of tax by guarantor—Income Tax Act, 1918 (8 & 9, Geo. V, c. 40) Section 36.

The Respondents guaranteed the indebtedness to its bankers of a company in which they were interested. For a number of years the company was indebted to the bank continuously. Interest on the amounts owing to the bank was debited half-yearly in the company's account with the bank and, except in one instance, the amount due to the bank increased each half-year.

The Respondents finally satisfied the whole indebtedness of the company to the bank by a single payment, and they claimed repayment under Section 36 of the Income Tax Act, 1918, in respect of so much of the amount paid by them to the bank as represented the interest which had been debited to the company's account.

Held, that the Respondents were not entitled to the repayment claimed.

CASE

Stated under the Finance Act, 1925, Section 19 (3), and the Income Tax Act, 1918, Section 149, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the King's Bench Division of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on the 24th June, 1929, and an adjourned meeting held on the 9th July, 1929, we heard the claim of Sir Henry C. Holder, Bart., and Mr. J. A. Holder, hereinafter called the Respondents, who were aggrieved by the decision of the Commissioners of Inland Revenue (hereinafter called the Appellants) in respect of a claim made by the Respondents for repayment of Income Tax under Section 36 of the Income Tax Act, 1918 (which provides for the repayment in certain cases of Income Tax in respect of interest paid to banks without deduction of tax out of taxed profits).

⁽¹⁾ Reported (K.B.D. and C.A.) [1931] 2 K.B. 81 and (H.L.) 48 T.L.R. 365.

2. The Respondents were interested in a company called Blumfield, Limited, hereinafter referred to as "the company". The company had been indebted for many years to its bankers, the London City and Midland Bank, Limited, which changed its name to the Midland Bank, Limited, and is hereinafter referred to as "the bank". To secure the company's indebtedness to the bank, guarantees were given from time to time by the Respondents to the bank. In some cases the guarantees were given by the Respondents individually, and in the other cases by the Respondents jointly and severally.

3. Under these guarantees, all of which were in similar form, the guarantor (or guarantors) undertook, in consideration of the bank allowing the company (therein called "the principal") to keep an account with the bank or otherwise granting the company banking facilities or accommodation, "to pay and satisfy to the bank all and every the sum or sums of money which shall at any time be owing to the bank . . . anywhere on any account . . . for notes or bills discounted or paid or for other loans credits or advances made to or for the accommodation or at the request . . . of the principal . . . or for any moneys for which the principal may be liable as surety or in any other way whatsoever, together with in all the cases aforesaid all interest discount and other bankers' charges including legal charges occasioned by or incident to this or any other security held by or offered to the bank for the same indebtedness or by or to the enforcement of any such security."

The total liability ultimately enforceable against the guarantor (or guarantors) under each guarantee was limited to a definite sum.

A copy, marked "A", of a specimen of the guarantees is annexed hereto and forms part of this Case.

4. From the year 1920 onwards, the company was indebted to the bank continuously in large amounts. The interest on the amounts owing from time to time to the bank was debited half-yearly in the company's account with the bank. Payments into the account were made by the company from time to time, but the amount due to the bank, with the exception of the half-year to 31st December, 1924, increased each half-year.

The bank pressed the Respondents from time to time for payment, and the whole indebtedness of the company to the bank was finally satisfied by the Respondents on the 17th November, 1926, by means of a loan made by the bank to the Respondents personally.

The company is completely insolvent and there is no chance of the Respondents obtaining any reimbursement from the company of the amount paid by them to the bank under the guarantees.

A copy, marked "B", of a summary of the company's account with the bank from the 31st December, 1919, to the 17th November, 1926, and a copy, marked "C", of a summary of the Respondent's

personal joint loan account with the bank from the 17th November, 1926, to the 15th May, 1929, are annexed hereto and form part of this Case.

5. The Respondents, in terms of Section 19 of the Finance Act, 1925, claimed repayment of Income Tax under Section 36 of the Income Tax Act, 1918, on the interest amounting to £17,861 16s. 5d. debited half-yearly to the company's account with the bank from the 1st January, 1920, to the 17th November, 1926, which the Respondents contended was paid by them on 17th November, 1926, when the company's indebtedness to the bank was satisfied by them as aforesaid. The Appellants refused the claim *in toto* and also contended at the hearing of the appeal that, as regards the interest debited for the first three of the half-years, this had been satisfied under the rule in *Clayton's case*⁽¹⁾ by the subsequent payments by the company into their account with the bank.

6. It was contended on behalf of the Respondents :

- (1) That the payment made by the Respondents to the bank on the 17th November, 1926, was a payment of principal and interest due to the bank, and included a payment of interest as such ;
- (2) That the debiting of the interest in the account did not amount to payment of the interest (*Re Morris, Mayhew v. Halton*, [1921] 1 Ch. 172, *Re Jauncey, Bird v. Arnold*, [1926] Ch. 471) ;
- (3) That the rule in *Clayton's case* did not apply ; and
- (4) That repayment of Income Tax should be made for the year 1926-27 in respect of the whole of the interest amounting to £17,861 16s. 5d.

7. It was contended on behalf of the Commissioners of Inland Revenue (*inter alia*) :

- (1) That the whole of the payment made by the Respondents to the bank was in satisfaction of the debt due under the guarantee, and that no part of the payment was interest as such (*Bradford Old Bank v. Sutcliffe*, [1918] 2 K.B. 833).
- (2) That, in view of the bank's practice of adding the interest each half-year to the amount advanced, the interest was, in effect, paid each half-year, and that for this reason also no part of the payment made by the Respondent (except the amount of interest charged from the 1st July, 1926, to the 17th November, 1926) was interest.

(1) 1 Mer. 572.

The following cases were referred to in support :—

Bradford Old Bank v. Sutcliffe, [1918] 2 K.B. 833.

Eaton v. Bell, [1821] 5 B. & Al. 34.

Crosskill v. Bower, 32 L.J. (Ch.) 540.

Parr's Banking Co. v. Yates, [1898] 2 Q.B. 460.

Provincial Bank of Ireland v. O'Reilly, 26 I.R. 313.

Reddie v. Williamson, [1863] 1 Macpherson 228.

- (3) That alternatively the interest for the first three of the half-years had under the rule in *Clayton's* case been satisfied by the subsequent payments by the Company into the account (*Deeley v. Lloyds Bank*, [1912] A.C. 756).
- (4) That the Respondents were not entitled to the relief claimed.

8. We held, following previous decisions of the Special Commissioners on this point, that having regard to the decision in the case of *Parr's Banking Company v. Yates*, the payment made by the Respondents on the 17th November, 1926, included interest paid as interest.

We further held that the interest was not in effect paid each half-year by being added to the amount of the advance.

We accordingly admitted the claim for repayment for the year 1926-27 under Section 36 of the Income Tax Act, 1918, but we decided that under the rule in *Clayton's* case the interest debited in the account for the first three half-years to 30th June, 1921, must be regarded as having been paid by the Company, and that accordingly the Respondents claim must be restricted to the interest charged from the 1st July, 1921.

9. The Appellants, immediately after the determination of the appeal, declared to us their dissatisfaction therewith as being erroneous in point of law and in due course required us to state a Case for the opinion of the High Court pursuant to the Finance Act, 1925, Section 19 (3), and the Income Tax Act, 1918, Section 149, which Case we have stated and do sign accordingly.

10. The question of law for the opinion of the Court is whether any, and if so what, portion of the payment made by the Respondents to the bank under their guarantees was interest, so as to entitle them to repayment of Income Tax thereon under Section 36 of the Income Tax Act, 1918.

J. JACOBS, }
H. M. SANDERS, } Commissioners for the Special
Purposes of the Income Tax Acts.

York House,
23, Kingsway,
London, W.C.2.

7th January, 1930.

EXHIBITS.

"A"

751/S.1. (Individual Guarantee).

To :

THE LONDON CITY & MIDLAND BANK, LIMITED.

IN consideration of The London City and Midland Bank Limited (hereinafter called "the Bank") allowing Messrs. Blumfield Limited of 70, Lower Essex Street, Birmingham (hereinafter called "the Principal") to keep an account with them or otherwise granting him banking facilities or accommodation upon the terms that the Bank should be secured as hereinafter appearing I HEREBY AGREE to pay and satisfy to the Bank their successors or assigns all and every the sum and sums of money which shall at any time be owing to the Bank their successors or assigns anywhere on any account whether from the Principal solely or from the Principal jointly with any other person or persons or from any firm in which the Principal may be a partner for notes or bills discounted or paid or for other loans credits or advances made to or for the accommodation or at the request either of the Principal solely or jointly or of any such firm as aforesaid or for any moneys for which the Principal may be liable as surety or in any other way whatsoever together with in all the cases aforesaid all interest discount and other Bankers' charges including legal charges occasioned by or incident to this or any other security held by or offered to the Bank for the same indebtedness or by or to the enforcement of any such security.

PROVIDED ALWAYS that the total liability ultimately enforceable against me under this Guarantee shall not exceed the sum of One thousand pounds.

THIS Guarantee shall not be considered as satisfied by any intermediate payment or satisfaction of the whole or any part of any sum or sums of money owing as aforesaid but shall be a continuing security and shall extend to cover any sum or sums of money which shall for the time being constitute the balance due from the Principal to the Bank their successors or assigns upon any such account as hereinbefore mentioned.

THIS Guarantee shall be binding as a continuing security on me my executors administrators and legal representatives until the expiration of three calendar months after I or in case of my dying or becoming under disability my executors administrators or legal representatives shall have given to the Bank their successors or assigns notice in writing to discontinue and determine the same.

IN THE event of this Guarantee ceasing from any cause whatsoever to be binding as a continuing security on me or my legal representatives the Bank their successors or assigns shall be at liberty without thereby affecting their rights hereunder to open a

fresh account or accounts and to continue any then existing account with the Principal. And no moneys paid from time to time into any such account or accounts by or on behalf of the Principal and subsequently drawn out by the Principal shall on settlement of any claim in respect of this Guarantee be appropriated towards or have the effect of payment of any part of the moneys due from the Principal at the time of this Guarantee ceasing to be so binding as a continuing security or of the interest thereon unless the person or persons paying in such moneys shall at the time in writing direct the Bank their successors or assigns specially to appropriate the same to that purpose.

ANY admission or acknowledgment in writing by the Principal or by any person authorised by the Principal of the amount of indebtedness of the Principal to the Bank their successors or assigns shall be binding and conclusive on and against me my executors and administrators in all Courts of Law and elsewhere.

THE Bank their successors and assigns shall be at liberty without thereby affecting their rights against me hereunder at any time to determine enlarge or vary any credit to the Principal to vary exchange or release any other securities held or to be held by the Bank their successors or assigns for or on account of the moneys intended to be hereby secured or any part thereof to renew bills and promissory notes in any manner and to compound with give time for payment to accept compositions from and make any other arrangements with the Principal or any obligants on bills notes or other securities held or to be held by the Bank their successors or assigns for and on behalf of the Principal.

THIS Guarantee shall be in addition to and shall not be in any way prejudiced or affected by any collateral or other security now or hereafter held by the Bank their successors or assigns for all or any part of the moneys hereby guaranteed nor shall such collateral or other security or any lien to which the Bank their successors or assigns may be otherwise entitled or the liability of any person or persons not parties hereto for all or any part of the moneys hereby secured be in anywise prejudiced or affected by this present Guarantee. And the Bank their successors and assigns shall have full power at their discretion to give time for payment to or make any other arrangement with any such other person or persons without prejudice to this present Guarantee or any liability hereunder. And all moneys received by the Bank their successors or assigns from me or the Principal or any person or persons liable to pay the same may be applied by the Bank their successors or assigns to any account or item of account or to any transaction to which the same may be applicable.

ALTHOUGH my ultimate liability hereunder cannot exceed the limit hereinbefore mentioned yet this present Guarantee shall be construed and take effect as a guarantee of the whole and every part of the principal moneys and interest owing and to become

owing as aforesaid and accordingly I am not to be entitled as against the Bank their successors or assigns to any right of proof in the bankruptcy or insolvency of the Principal or other right of a surety discharging his liability in respect of the principal debt unless and until the whole of such principal moneys and interest shall have first been completely discharged and satisfied. And further for the purpose of enabling the Bank their successors or assigns to sue the Principal or prove against his estate for the whole of the moneys owing as aforesaid or to preserve intact the liability of any other party the Bank their successors or assigns may at any time place and keep for such time as they may think prudent any moneys received recovered or realised hereunder to and at a separate or suspense account to the credit either of me or of such other person or persons or transaction if any as they shall think fit without any intermediate obligation on the part of the Bank their successors or assigns to apply the same or any part thereof in or towards the discharge of the moneys owing as aforesaid or any intermediate right on my part to sue the Principal or prove against his estate in competition with or so as to diminish any dividend or other advantage that would or might come to the Bank their successors or assigns or to treat the liability of the Principal as diminished.

I have not taken in respect of the liability hereby undertaken by me on behalf of the Principal and I will not take from the Principal either directly or indirectly without the consent of the Bank any promissory note bill of exchange mortgage charge or other counter-security whether merely personal or involving a charge on any property whatsoever of the Principal whereby I or any person claiming through me by endorsement assignment or otherwise would or might on the Bankruptcy or insolvency of the Principal and to the prejudice of the Bank their successors or assigns increase the proofs in such bankruptcy or insolvency or diminish the property distributable amongst the creditors of the Principal. And as regards any such counter-security as aforesaid which I may have taken or may take with such consent as aforesaid the same shall be a security to the Bank their successors and assigns for the fulfilment of my obligations hereunder and shall be forthwith deposited by me with them for that purpose.

THE Bank their successors and assigns shall so long as any moneys remain owing hereunder have a lien therefor on all moneys now or hereafter standing to my credit with the Bank their successors or assigns whether on any current or other account.

If it shall so happen that the name of the Principal hereinbefore inserted shall be that either of a firm or of a limited company or other corporation or of any committee or association or other unincorporated body any of the printed provisions hereinbefore contained which shall be primarily and literally applicable to the case of a single and individual Principal only shall be construed and take effect so as to give the Bank hereunder a guarantee for the

moneys owing from such firm and every member thereof or from such limited company or corporation or committee or association or other unincorporated body as identical or analogous as may be with or to that which would have been given for the moneys owing from a single individual if the Principal had been a single individual. And any moneys shall be deemed to be so owing notwithstanding any defect informality or insufficiency in the borrowing powers of the Principal or in the exercise thereof which might be a defence as between the Principal and the Bank. And further in the case of a firm this Guarantee shall be deemed to be a continuing Guarantee of all moneys owing on any such account as hereinbefore mentioned from the persons or person carrying on business in the name of or in succession to the firm or from any one or more of such persons although by death retirement or admission of partners or other causes the constitution of the firm may have been partially or wholly varied. And in the case of a limited company or other corporation any reference to bankruptcy shall be deemed to be a reference to liquidation or other analogous proceeding and the moneys owing as aforesaid and hereby guaranteed shall be deemed to include any moneys owing in respect of debentures or debenture of stock of such limited company or other corporation held by or on behalf of the Bank their successors or assigns IN WITNESS whereof I have hereunto set my hand this twenty-eighth day of November One thousand nine hundred and thirteen.

*Witnesses to the signature
of Norman F. Holder.*

6d. Stamp.

Norman F. Holder.

Nov. 28th, 1913.

Pitmaston,

Moor Green,

Birmingham.

Names and addresses of witnesses.

A. Ashton Smith,
New Street,
Birmingham.

Francis H. Fennell,
Varna Road,
Edgbaston.

" B "

BLUMFIELD, LIMITED (Copy of Bank Account).

		£	s.	d.			£	s.	d.
1919.					1920.				
Dec. 31	Balance ...	14,370	11	6	June 30	Cash ...	6,498	0	10
						Balance ...	28,894	15	11
1920.									
June 30	Cheques ...	20,208	0	5					
	Charges ...	814	4	10					
		<u>£35,392</u>	<u>16</u>	<u>9</u>			<u>£35,392</u>	<u>16</u>	<u>9</u>
1920.					1920.				
June 30	Balance ...	28,894	15	11	Dec. 31	Cash ...	7,935	6	8
Dec. 31	Cheques ...	17,991	7	5		Balance ...	40,304	18	1
	Charges ...	1,354	1	5					
		<u>£48,240</u>	<u>4</u>	<u>9</u>			<u>£48,240</u>	<u>4</u>	<u>9</u>
1920.					1921.				
Dec. 31	Balance ...	48,340	18	1	June 30	Cash ...	6,482	3	6
1921.						Balance ...	44,641	9	10
June 30	Cheques ...	9,311	6	0					
	Charges ...	1,507	9	3					
		<u>£51,123</u>	<u>13</u>	<u>4</u>			<u>£51,123</u>	<u>13</u>	<u>4</u>
June 30	Balance ...	44,641	9	10	1921.				
Dec. 31	Cheques ...	10,551	16	1	Dec. 31	Cash ...	9,146	1	7
	Charges ...	1,358	19	5		Balance ...	47,406	3	9
		<u>£56,552</u>	<u>5</u>	<u>4</u>			<u>£56,552</u>	<u>5</u>	<u>4</u>
1921.					1922.				
Dec. 31	Balance ...	47,406	3	9	June 30	Cash ...	3,920	0	0
1922.						Balance ...	49,119	9	8
June 30	Cheques ...	4,460	19	10					
	Charges ...	1,172	6	1					
		<u>£53,039</u>	<u>9</u>	<u>8</u>			<u>£53,039</u>	<u>9</u>	<u>8</u>
1922.					1922.				
June 30	Balance ...	49,119	9	8	Dec. 31	Cash ...	3,400	0	0
Dec. 31	Cheques ...	3,963	9	4		Balance ...	50,810	19	8
	Charges ...	1,128	0	8					
		<u>£54,210</u>	<u>19</u>	<u>8</u>			<u>£54,210</u>	<u>19</u>	<u>8</u>
1922.					1923.				
Dec. 31	Balance ...	50,810	19	8	June 30	Cash ...	4,350	0	0
1923.						Balance ...	51,582	5	5
June 30	Cheques ...	3,976	5	1					
	Charges ...	1,145	0	8					
		<u>£55,932</u>	<u>5</u>	<u>5</u>			<u>£55,932</u>	<u>5</u>	<u>5</u>

<i>1923.</i>			<i>1923.</i>		
June 30	Balance ...	£ 51,582 5 5	Dec. 31	Cash ...	£ 3,500 0 0
Dec. 31	Cheques ...	3,377 5 0		Balance ...	52,625 8 5
	Charges ...	1,165 18 0			
		<u>£56,125 8 5</u>			<u>£56,125 8 5</u>
<i>1923.</i>			<i>1924.</i>		
Dec. 31	Balance ...	52,625 8 5	June 30	Cash ...	2,300 0 0
<i>1924.</i>				Balance ...	56,042 9 4
June 30	Cheques ...	4,507 11 5			
	Charges ...	1,209 9 6			
		<u>£58,342 9 4</u>			<u>£58,342 9 4</u>
<i>1924.</i>			<i>1924.</i>		
June 30	Balance ...	56,042 9 4	Dec. 31	Cash ...	9,500 0 0
Dec. 31	Cheques ...	4,069 11 11		Balance ...	51,792 8 4
	Charges ...	1,180 7 1			
		<u>£61,292 8 4</u>			<u>£61,292 8 4</u>
<i>1924.</i>			<i>1925.</i>		
Dec. 31	Balance ...	51,792 8 4	June 30	Cash ...	500 0 0
<i>1925.</i>				Balance ...	57,159 15 3
June 30	Cheques ...	4,487 9 9			
	Charges ...	1,379 17 2			
		<u>£57,659 15 3</u>			<u>£57,659 15 3</u>
<i>1925.</i>			<i>1925.</i>		
June 30	Balance ...	57,159 15 3	Dec. 31	Cash ...	4,077 9 7
Dec. 31	Cheques ...	5,575 6 4		Balance ...	60,096 3 8
	Charges ...	1,438 11 8			
		<u>£64,173 13 3</u>			<u>£64,173 13 3</u>
<i>1925.</i>			<i>1926.</i>		
Dec. 31	Balance ...	60,096 3 8	June 30	Cash ...	4,000 0 0
<i>1926.</i>				Balance ...	63,158 13 10
June 30	Cheques ...	5,396 17 7			
	Charges ...	1,665 12 7			
		<u>£67,158 13 10</u>			<u>£67,158 13 10</u>
<i>1926.</i>			<i>1926.</i>		
June 30	Balance ...	63,158 13 10	Nov. 17	Cash ...	3,000 0 0
Nov. 17	Cheques ...	3,427 7 3		Transfer to	
	Charges ...	1,341 18 1		Sir H. C.	
		<u>£67,927 19 2</u>		Holder and	
				J. A. Holder	64,482 16 8
				No. 2 Account	445 2 6
					<u>£67,927 19 2</u>

"C"

15th May, 1929.

SIR H. C. HOLDER, BART., AND J. A. HOLDER, ESQ.

JOINT LOAN A/C.

DR. IN ACCOUNT WITH THE MIDLAND BANK, LIMITED,
NEW STREET, BIRMINGHAM.

<i>1926.</i>		£	<i>s.</i>	<i>d.</i>	<i>1926.</i>		£	<i>s.</i>	<i>d.</i>
Nov. 17	Blumfields, Ltd. ...	64,482	16	8	Dec. 31	Balance ...	64,910	7	6
Dec. 31	Interest ...	427	10	10					
		<u>£64,910</u>	<u>7</u>	<u>6</u>			<u>£64,910</u>	<u>7</u>	<u>6</u>
<i>1926.</i>					<i>1927.</i>				
Dec. 31	Balance ...	64,910	7	6	May 13	Cox Car- buretters	30,000	0	0
<i>1927.</i>					June 30	Balance ...	36,421	4	3
June 30	Interest ...	1,510	16	9					
		<u>£66,421</u>	<u>4</u>	<u>3</u>			<u>£66,421</u>	<u>4</u>	<u>3</u>
<i>1927.</i>					<i>1927.</i>				
June 30	Balance ...	36,421	4	3	Dec. 31	Balance ...	37,339	4	4
Dec. 31	Interest ...	918	0	1					
		<u>£37,339</u>	<u>4</u>	<u>4</u>			<u>£37,339</u>	<u>4</u>	<u>4</u>
<i>1927.</i>					<i>1927.</i>				
Dec. 31	Balance ...	37,339	4	4	June 30	Shakespeare and V. ...	1,848	18	4
<i>1928.</i>						Balance ...	36,421	4	3
June 30	Interest ...	930	18	3					
		<u>£38,270</u>	<u>2</u>	<u>7</u>			<u>£38,270</u>	<u>2</u>	<u>7</u>
<i>1928.</i>					<i>1928.</i>				
June 30	Balance ...	36,421	4	3	Oct. 30	Sds. ...	10,000	0	0
Oct. 30	Interest ...	459	0	1	Dec. 15	Sds. per post	5,000	0	0
Dec. 31	Interest ...	367	0	2	„ 31	Balance ...	22,247	4	6
		<u>£37,247</u>	<u>4</u>	<u>6</u>			<u>£37,247</u>	<u>4</u>	<u>6</u>
<i>1928.</i>					<i>1929.</i>				
Dec. 31	Balance ...	22,247	4	6	Feb. 20	Sds. ...	1,000	10	10
May 15	Chq. Dupli- cate State- ment, Blum- fields, Ltd.	2	2	0	Jan. 9	„ ...	11,000	0	0

The case came before Rowlatt, *J.*, in the King's Bench Division on the 16th December, 1930, when judgment was given against the Crown, with costs.

The Attorney-General (Sir W. A. Jowitt, K.C.) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. W. P. Spens, K.C., and Mr. C. L. King for the Respondents.

JUDGMENT.

Rowlatt, J.—In this case the Respondents, Sir Henry C. Holder and Mr. J. A. Holder, were guarantors, under the usual stringent form of a bank guarantee, for a company called Blumfield, Limited, and they were guarantors for the company for a number of years. To put it shortly, the indebtedness of the company grew worse and worse, the interest was not kept up except partially, and the interest was added to the principal at the end of each half-year in what I believe is the usual way, and thereupon it was itself added to the principal as interest. The guarantors had paid it all off, and in respect of the amount which represents interest, save for a certain part of it, they claim to be repaid the Income Tax which they did not deduct when they paid the interest, although they paid the interest out of profits and gains brought into charge to tax. They did not deduct it, and they claim to be repaid the Income Tax which they might, if it had been annual interest paid out of profits and gains, have deducted and kept for themselves in the ordinary course. They seek to have it repaid to them under Section 36, Sub-section (1), of the Income Tax Act, 1918, and the Commissioners have allowed that.

Now the Attorney-General takes two points. He says, first of all, that a guarantor paying like this is not within Section 36, Sub-section (1), at all, because he is not the person who has had the accommodation; he is merely a friend who has stood by and has been victimised or has suffered by the loss of his friends, and he is not a person of merits in the matter at all. That is roughly his point, but I cannot see where that is to be found. The Section simply says that "Where interest payable in the United Kingdom on an advance from a bank . . . is paid to the bank without deduction of tax out of profits or gains brought into charge to tax." Well, if they paid it out of profits or gains brought into charge to tax, why have not they paid interest upon an advance from the bank? The contract was that they would pay the interest if the person guaranteed did not, and I really cannot see any reason for cutting it down. It is true that curious results might perhaps happen, that the guarantors might pay the interest and deduct the tax or get the tax back. They might deduct the tax if the arrangement was suitable; but anyhow, they might get it back and then be repaid by the principal debtor, we will say, out

(Rowlatt, J.)

of capital; they could not be repaid more than they would have paid. A guarantor has many privileges, but making a profit out of a guarantee is, I am bound to say, new to me unless you choose to pay for it. It would only be the principal debtor who would repay him what he actually paid less tax, and then in those circumstances the Crown would lose this money, although in fact ultimately the money had been found. In the end the interest had been found out of a fund which had not suffered tax and not out of profits and gains brought into charge. It is a small and curious point and I do not see quite how it helps one to narrow this Section. The real truth is that there should have been a little more elaborate precautions made when this Section was passed. Anyhow, I do not think I can say that the guarantor is not within the Section. It seems to me that the guarantor is in just the same position as a principal debtor who would pay, as he always does. That point I do not think has been made good.

The other point is this. The Attorney-General said that this interest when they paid it off had been transformed into principal because it had been debited in the accounts for every half-year and swelled the balance of the accounts in the ordinary way. There have been a certain number of cases about what happens when there are special arrangements between the parties as to how the matter of principal and interest shall be reckoned, and so on, and questions have arisen as to how the account stands in the end. But I think one thing is clear, that if you get interest capitalised in the sense in which it is charged in this case, you must not take it that it is necessarily capitalised for all purposes; and that seems to be the sense of the matter and to answer this point. We are here simply applying this Section. We are not concerned with the particular arrangement for calculating these things; we are simply concerned with this Revenue Section which says where interest is payable. Now why should it be treated as capital? There is no reason at all for treating it as capital except to defeat this application. It is simply arrears of interest when all is said and done. It has been treated as capital in the accounts of the bank but I cannot see why it should be treated as capital for the purpose of this Section however it may be treated for other purposes.

I am bound to say that there is another thing which strikes me very forcibly. Of course, this interest that is paid to the bank has been charged to Income Tax. Of course, there would have been no room for the application of this Section if it was not, and it has been charged to Income Tax sure enough. As I have said, I do not see how you could treat it as capital for this purpose. The guarantor comes and says: "That is just the position. Here is "Income Tax on varying payments of interest. I paid it, I can "assure you, out of profits and gains brought into charge. I want

(Rowlatt, J.)

“ to be put in the same position as if I had deducted the Income Tax “ and kept it.” I am bound to say I think that is a very plausible way of putting it, and I cannot see the answer to it. It seems to me that what is interest for one purpose is surely interest for another. The Attorney-General said it is interest as the bank receive it; they receive it as income; but it is not interest as the payer pays it. It is the same sum of money, there is no question about it, and the same passing of the money which is interest in one sense and not interest in another. The Attorney-General says, apparently, that if you meet this money from the point of view of the recipient and see it coming to you, then it bears all the appearance of interest; but if you go round behind and look at it as it is going forth from you, it is a totally different thing; it is not interest at all. I am afraid that is a great crudity; it must be, and I cannot get out of it if there was nothing else in the case. I think, therefore, the right way is to dismiss this appeal with costs.

Mr. Hills.—My Lord, the figures are actually agreed, and the question for assessment will have to go back to the Commissioners.

Rowlatt, J.—Yes.

The Crown having appealed against the decision in the King's Bench Division, the case came before the Court of Appeal (Lord Hanworth, *M.R.*, and Lawrence and Romer, *L.JJ.*) on the 18th and 19th February, 1931, when judgment was reserved. On the 11th March, 1931, judgment was given unanimously in favour of the Crown, with costs, reversing the decision of the Court below.

The Attorney-General (Sir W. A. Jowitt, *K.C.*) and Mr. R. P. Hills appeared as Counsel for the Crown and Mr. W. P. Spens, *K.C.*, and Mr. C. L. King for the Respondents.

JUDGMENT.

Lord Hanworth, M.R.—This is an appeal from a judgment of Mr. Justice Rowlatt dated the 16th December, 1930, whereby he confirmed the decision of the Commissioners for Special Purposes, who decided in favour of the Respondents to the appeal.

The Respondents gave guarantees to the London City and Midland Bank, Ltd., under which they made themselves responsible for the indebtedness to the bank of Blumfield, Ltd. The total sum which the Respondents were called upon to pay upon the default of Blumfield, Ltd. was large, amounting to £64,482 16s. 8d. The question that has to be determined is whether the Respondents are entitled to have this total sum of over £64,000 analysed and split up into its component parts of capital and interest, and to

(Lord Hanworth, M.R.)

pray in aid the terms of Section 36 of the Income Tax Act, 1918, under which a claim may be made for the repayment of Income Tax upon sums paid to banks in respect of interest, out of taxed profits without deduction of tax.

The account of Blumfield, Ltd. with the bank from 1919 to 1926—the period covered by the guarantees—was always in debit, and interest was charged half-yearly on the 30th June and the 31st December upon the advances made by the bank to the company. The system adopted was that at each half-year the charges for interest were added to the capital sum advanced, and the total sum carried forward into the next half-year as one undivided advance.

The interest was thus capitalised and became an integral part of the advance to the company. The Commissioners held that when the Respondents paid up the total sum due under their guarantee to the bank, as they did on the 17th November, 1926, that payment included interest, paid as interest. They further held that that interest was not in effect paid each half-year by being added to the amount of the capital advanced, and therefore they held that Section 36 applied and operated in the Respondent's favour, and justified a claim for repayment of the Income Tax not deducted.

The decision of the Commissioners was based upon the judgment in *Parr's Banking Company v. Yates*, [1898] 2 Q.B. 460. Mr. Justice Rowlatt affirmed the Commissioners, and rejected the two points on which the Attorney-General based his argument and now appeals to this Court.

They are, firstly, that Section 36 does not apply to such a lump payment as this. Whatever has been paid by the Respondents has been paid as a totality. The sum paid is capital and interest upon it, capitalised in the way usual with bankers. The sum now paid over on account of interest to the bank is not interest during the year of charge such as is contemplated by Section 36. The Section only applies to payments of interest which at the times when the payments are made are respectively subject to the annual charge made upon them when the annual Finance Act charging Income Tax is passed.

Secondly, it is not right to analyse the total sum paid by the guarantors. The sum due on the 17th November, 1926, is no longer severable, but all, whether in part composed of capital advance, and interest, and charges thereon, is payable under a direct liability to the bank assumed by the guarantors which becomes effective upon the default of the principal debtor, and each component item that makes up the total to be paid is of the same quality and degree, as between the bank and the guarantors.

(Lord Hanworth, M.R.)

It is the person who has had the accommodation and has to pay interest from time to time upon it that is entitled to the repayment permitted under Section 36—not a person whose liability to pay arises from a different contract.

It is necessary, therefore, to examine these questions. *Parr's Banking Co. v. Yates*, [1898] 2 Q.B. 460, does not in my judgment cover the point to be decided. In fact Lord Justice Rigby in his judgment on page 467 seems expressly to hold that an account kept as this was, effected a transposition of the interest, due and unpaid, into capital. His words are—"I think one must assume that . . . the account would be kept as between the person guaranteed and the bank on the usual principle with regard to such accounts—that is to say, by treating moneys paid in from time to time by the customer as a deduction from the general amount due from the customer in respect of the loan and interest thereon, and at the end of each half-year carrying over the debit balance to the next half-year as principal."

Lord Justice Vaughan Williams agreed and pointed out that for the purpose of that case the cause of action on the guarantee arose as to each item of the account, whether principal or interest, as soon as it became due and was not paid, and that the Statute of Limitations began to run in favour of the defendants in respect of each item from that date.

The observations thus made by the Lords Justices appear to have been relevant to the decision, which was that the claim of the bankers in respect of the principal sum due was barred, by the lapse of six years before action brought since the last capital sum accrued due.

The case is important for it recognises the system of bankers in turning interest into capital as usual, and binding on the parties who have acquiesced in it. It seems to be a question in each case whether the customer did acquiesce in it—see *Fergusson v. Fyffe*, 8. Clark and Finnely 121, and *Spencer v. Wakefield*, 4. T.L.R. 194. The Commissioners' finding that interest was not in effect paid each half-year by being added to the amount of the advance, appears to follow a misunderstanding of *Parr's Banking Co. v. Yates*; and if so, not to be conclusive as a question of fact.

The plan of capitalizing interest at the end of each half-year was adopted by bankers in order to enable them in effect to secure what is usually termed compound interest, which could not have otherwise been claimed by reason of the usury laws. See *Ex-parte Bevan*, 9 Vesey Junior 223, *Eaton v. Bell*, 5 Barnewall and Alderson 34, and see *Clancarty v. Latouche*, 1 Ball and Beatty at page 430.

(Lord Hanworth, M.R.)

The usury laws were repealed by 17 and 18 Vic. c. 90, which by Section 3 left untouched the payment of any interest "now payable upon any contract, express or implied."

There seems no reason to apply a different effect in law to a system under which, before the Act repealing the usury laws was passed, unpaid interest was turned into capital, even though the reason or necessity for it has passed away or changed. The terms of the contract remain whether express or implied.

It was held by the Court of Session in Scotland in 1863, in *Reddie v. Williamson*, 3rd Series, page 228⁽¹⁾, that the effect of the method adopted by the bank in the present case, viz., the accumulation of interest at each stop, converted the interest so accumulated into an advance by the bank. The Lord Justice Clerk held—"the true view is that the periodical interest at the end of each year is a debt to be then paid, and which must be held to have been paid when placed to the debit of the account as an additional advance by the Bank for the convenience of the obligants." I respectfully agree with this view. See also *Yourell v. Hibernian Bank*, [1918] A.C. at page 385, per Lord Atkinson.

There are some cases in which it has been held that half-yearly or yearly rests had not made the interest so dealt with capital for all purposes. See *Cravens' Mortgage*, [1907] 2 Ch. 448, and *Re Morris*, [1922] 1 Ch. 126.

In the first of these Mr. Justice Warrington followed *Bebb v. Bunny*, 1 Kay and Johnson, page 216, and held that the interest paid on a mortgage fell within Section 40 of the Income Tax Act, 1853. He expressly decided, upon the terms of the deed before him, that there was nothing in it to capitalize the interest, or to change its character or make it something which it was not before.

In re Morris was also decided upon the terms of the mortgage deed under which the expectancies of the mortgagors were conveyed to an insurance society subject to redemption on payment to the society of a sum of £40,000 at a time contemplated, with compound interest thereon at the rate of 4½ per cent. with annual rests. *Craven's* case was followed, and it was held that the compound interest had not been capitalized. Lord Sterndale expressly decided the case upon the terms used in the mortgage which in his opinion were not sufficient to connote capitalization. Lord Justice Warrington declined to deal with anything except the document which was before the Court, and Lord Justice Younger thought the operation whereby the compound interest was calculated, although it produced a result not in substance distinguishable from a capitalization of interest, was not, and was not intended to be, capitalization.

(¹) 1 Macph. 228.

(Lord Hanworth, M.R.)

We are here considering not the terms of a particular deed entered into between the parties, but a practice which has been adopted by bankers for over a century and which has had certain qualities attributed to it. It prevailed between Blumfield, Ltd. and their bankers for nearly seven years; and I think that upon the true inference from the facts, and under direction of the cases rightly understood, it must be held that the interest down to November, 1926, had been capitalized with the approval of the principal debtors. This concludes the appeal as to all except £1,341 18s. 1d. which formed part of the total paid but was in fact interest.

As to the second point of the Attorney-General which covers the total sum paid up to the bank under the guarantees, the question is, does Section 36 enure in favour of a guarantor?

The Income Tax Act, 1918, is a Consolidation Act, and the origin of Section 36 may be looked at. Sub-section (1) corresponds with Section 22 of the Finance Act, 1915, and Sub-section (2) with Section 15 of the Finance Act, 1917.

Both these Sections provide a special procedure. It is not the system of deduction of the tax from the interest paid by the payer who is authorised by Rule 19 of the All Schedules Rules to deduct the tax and to retain it for his own benefit—if the amount paid has been provided out of profits and gains brought into charge by him; while if payment is not made out of profits or gains brought into charge, the payer under Rule 21 has to render an account of the amount so deducted.

The procedure is for repayment to be made on proof to the satisfaction of the Special Commissioners, and it was introduced to meet the necessities of the times of 1915 and 1917. What is the meaning of—"Where interest payable in the United Kingdom " on an advance from a bank is paid without deduction of tax?" Does it cover the case of someone to whom no advance was made and who never paid any interest on such advance, but became liable under a separate contract to make good another's default who did not pay interest on the advance to him? I cannot so construe the Section.

The sum of £64,482 16s. 8d., including the £1,341 18s. 1d., was taken over by Holders' as a bulk payment due from them under their contract with the bank. I cannot agree that Section 36 has any application to such a liability and payment. For these reasons, in my judgment, the appeal must be allowed, and the claim of the Respondents for repayment of Income Tax rejected.

I have been asked by Lord Justice Lawrence to say that he has read the judgment which I have just read, and agrees with it.

Romer, L.J.—From the facts of this case there emerges the following question of law: Did the Respondents pay to the bank any interest on an advance from the bank within the meaning of Section 36 (1) of the Income Tax Act, 1918? It is contended by the Crown that they did not, and for two reasons. It is said in the first place that the balances which were debited to Blumfield, Limited, in the books of the bank half-yearly on the 30th June and 31st December, and on which simple interest was charged for the ensuing six months, consisted, as between the bank and the company, entirely of capital; in other words, that the bank is to be treated as having made an advance to the company at the end of each half-year of the sum necessary for payment of the interest accruing during that half-year, thus discharging the bank's claim to that interest and increasing the company's capital indebtedness by a corresponding amount. In the second place it is said on behalf of the Crown that whether this be so or not, yet as between the bank and the Respondents the latter paid nothing as interest but merely paid a principal sum of £64,482 16s. 8d., which in the events that had happened they had covenanted to pay to the bank.

If the Crown be right in this second contention, the appeal must succeed altogether. If it be wrong in this contention, but right in the first one, the appeal will succeed except as to the interest charged from the 30th June to the 17th November, 1926.

As to the first of these two contentions, it is to be observed that the relations between the company and the bank were regulated, not by any special agreement, but by the ordinary usage prevailing between bankers and their customers as to the method of keeping accounts. In accordance with this usage the balance of principal and interest was struck at the end of each half-year and the aggregate sum was introduced as the first item in the subsequent half-yearly account and interest calculated upon it. It was in fact the very method of keeping accounts that was considered by Lord Chancellor Manners in the case of *Lord Clancarty v. Latouche*, 1 Ball & Beatty's Reports, page 420, except that there the balances were struck yearly and not half-yearly. The result of this method of keeping the accounts is, of course, to charge the customer with compound interest, and the question that had to be considered in *Lord Clancarty v. Latouche* was as to the legality of such a charge. Now it had been laid down by Lord Eldon in the case of *Ex parte Bevan*, 9 Vesey 223, that a contract to allow the charging of compound interest was bad. That was because such a contract was usurious. ". . . it is clear", said Lord Eldon, "you cannot *a priori* agree to let a man have money for twelve months, settling the balance at the end of six months; and that the interest shall carry interest for the subsequent six months: that is, you cannot contract for more than 5 per cent.; agreeing to forbear for six months. But, if you agree to settle accounts at the end of six months, that not being part of the prior contract, and then

(Romer, L.J.)

“ stipulate, that you will forbear for six months upon those terms, that is legal. So this is legal between merchants; where there is no agreement to lend to either; but they stipulate for mutual transactions; each making advances; and that, if at the end of six months the balance is with A, he will lend to B; and *vice versa*.”

This in effect was a decision that, though an agreement for charging compound interest was illegal as being usurious, it was not illegal for the parties to strike a balance at any particular time without any antecedent agreement to do so, and then agree that such balance should continue on loan at interest for a further period.

It was by reason of this principle that Lord Chancellor Manners in *Clancarty v. Latouche* was able to allow the charge of compound interest. He said this: “ From the acquiescence of Mr. Connolly I ought to presume an agreement at the end of every year that the interest then due should become principal and carry interest, which according to *Ex parte Bevan* this Court will admit of.”

A similar view of the effect of this method of keeping bankers' accounts was taken in the later case of *Eaton v. Bell*, 5 Barnewall and Alderson, page 34. The effect was there described as converting the interest from time to time into capital.

In the case of *Reddie v. Williamson*, 1 Macpherson 228, decided by the Court of Session in 1863, the same view prevailed. As that case bears a curious resemblance to the present one it is desirable to allude shortly to the facts with which the Court of Session had to deal. A bank had, in effect, agreed to allow a customer an overdraft not exceeding £400 upon the guarantee of three other persons. The customer drew upon the account, but without the consent of the guarantors was allowed by the bank to exceed the limit of £400. The account was not operated upon after the 30th May, 1849, at which time there was a balance of over £800 standing to the customer's debit. The account had been kept in the same way as the company's account in the present case, except that the balances were struck yearly instead of half-yearly. The balance of £800 consisted therefore of the advances made to the customer and of compound interest on those advances. Now the guarantors were admittedly liable to pay to the bank advances made up to £400 and interest upon those advances. It was nevertheless held that the £800 was to be treated as consisting wholly of capital and that the guarantors were accordingly only liable for £400 with interest thereon from the 30th May, 1849. In giving judgment, Lord Inglis, after stating how the account had been kept, said this: “ Where an account is kept in this way the interest thus accumulated with principal at the end of each year not only becomes principal but never thereafter ceases to be

(Romer, L.J.)

“dealt with as principal.” Then, after pointing out that the bank could have demanded from the guarantors at the end of each year interest upon advances made up to £400, he said that if the bank, instead of demanding that interest, chose to accumulate it with the capital, they were dealing with the account, so far as the guarantors were concerned, in precisely the same way as if the customer had given the bank a cheque upon the account for the amount in question with which the bank extinguished the interest and then placed the amount of the cheque to the debit of the account as an ordinary draft. Lord Cowan in his judgment said: “The true view is that the periodical interest at the end of each year is a debt to be then paid, and which must be held to have been paid when placed to the debit of the account as an additional advance by the bank.” With these observations I desire to express my respectful concurrence.

I am therefore of opinion that, having regard to the method in which, with the concurrence of the company, the account was kept by the bank, the company must be deemed to have paid each half-year the accruing interest by means of an advance made for that purpose by the bank to the company.

It is true that the reason that originally induced the banks to keep accounts in this way has disappeared with the repeal of the usury laws. But that repeal cannot, as it seems to me, have changed the nature and effect of accounts that continue to be kept in the same way as before.

Upon this part of the case I only desire to add this. Cases such as that of *re Morris*, [1922] 1 Ch. 126, are in no way in conflict with the conclusion to which I have come. In that case the mortgagors were not personally liable to pay interest on the capital sum advanced and there was an express contract which was good in law that as from the death of the lunatic that sum was to carry compound interest. It was therefore quite impossible, and in any case unnecessary, to regard the insurance company as making advances from time to time to the mortgagors to enable them to pay the interest. The case has no bearing upon the present one in which there is no express contract between the parties, in which the bank could have sued the company for the interest each half-year, and in which the account is kept in a way devised by banks at a time when it was necessary owing to the usury laws to treat them as making such advances.

Having arrived at the conclusion, for the reasons I have indicated, that the money due from the company to the bank at the time the Respondents were called upon to fulfil their obligations under the guarantees, consisted entirely of principal with the exception of the sum of £1,341 18s. 1d. due for interest from the 30th June to the 17th November, 1926, I must now consider the question whether even to that extent the Respondents can truly be

(Romer, L.J.)

said to have paid interest to the bank. In my opinion they can not. What they paid to the bank was the debt due from them under the guarantees. The debt became due, no doubt, because the company had failed to discharge its own indebtedness to the bank, and part of that indebtedness consisted of interest. But the Respondents owed no interest to the bank. As I read the guarantees the Respondents agreed to pay all sums of money at any time owing to the bank by the company on any account regardless of what that account might be. They were in no way concerned with the origin of the various items going to make up the company's indebtedness, and cannot in my opinion be regarded as being the bank's debtors in respect of each of those items. Supposing, for instance, the company had been tenants of the bank, and arrears of rent had been debited to the company in the account. It would not be accurate to say that the guarantors owed rent to the bank, or that when they discharged their liability under the guarantees they had paid the bank rent for the demised premises. They would merely have paid to the bank, with other money, a sum equal to the amount that the company should have paid to the bank for rent, which sum had become payable by them because the rent had not in fact been paid by the company. To return to the present case, the Respondents did not pay the bank the sum of £1,341 18s. 1d. because they owed the bank any interest. They paid it because they owed the bank that sum by reason of the company's failure to pay interest. It was on similar reasoning that the case of *Parrs Banking Company v. Yates*, [1898] 2 Q.B. 460, appears to have been decided. If in that case the guarantor's liability to pay the sums that were charged to the principal debtor for interest accruing within six years of action brought was truly a liability to pay interest on the moneys advanced to the principal debtor, the guarantor was entitled to judgment, because his liability to pay the moneys advanced was barred by the Statute of Limitations and his liability to pay interest thereon would have been barred also. He was, however, held liable to pay the sums so charged for interest, and this must have been on the footing that he had agreed to pay the bank sums equal to the interest charged in the event, which had happened, of the principal debtor failing to do so.

For most practical purposes the debt due from the company and the debt due from the Respondent guarantors may be regarded as one and the same. But in fact and in law I think that they are different. I am not, therefore, prepared to come to the conclusion that the Respondents have paid the bank any interest on an advance from the bank within the meaning of Section 36 (1) of the Income Tax Act, 1918.

For these reasons I agree that the appeal should be allowed.

Mr. Alan Bell (for Mr. Reginald Hills).—My Lords, the appeal will be allowed with costs here and below?

Lord Hanworth, M.R.—Yes, here and below, and the decision of the Commissioners will be reversed.

Mr. Alan Bell.—If your Lordships please. I ought perhaps to inform your Lordships that in view of the novelty and importance of this case, the Commissioners have arranged with the Respondents that each side shall bear its own costs in this Court—or rather of the appeal; but of course with regard to the Court below, the costs will follow the event in the normal course.

Lord Hanworth, M.R.—You mean the Attorney-General has arranged that?

Mr. Alan Bell.—Yes, the Attorney-General has arranged it.

Lord Hanworth, M.R.—That is to say, for the purposes of bringing the case to this Court, no costs should be charged on either side?

Mr. Alan Bell.—If your Lordship pleases.

Mr. Cyril King.—In that event your Lordships' Order will be: Appeal allowed with costs here and below, save as regards the Appellants' costs in the Court of Appeal?

Lord Hanworth, M.R.—I think it ought to be: Appeal allowed, no costs in this Court by agreement, but the Appellants to have the costs in the Court below.

Mr. Cyril King.—If your Lordship pleases.

Lord Hanworth, M.R.—That is a little more correct.

An appeal having been entered against the decision in the Court of Appeal, the case came before the House of Lords (Viscount Dunedin, Lords Warrington of Clyffe, Atkin, Thankerton and Macmillan) on the 7th, 8th, 10th and 11th March, 1932, when judgment was reserved. On the 15th April, 1932, judgment was given unanimously in favour of the Crown, with costs, confirming the decision of the Court below.

Mr. W. P. Spens, K.C., and Mr. C. L. King appeared as Counsel for the Appellants and the Solicitor-General (Sir Boyd Merriman, K.C.) and Mr. R. P. Hills for the Crown.

JUDGMENT.

Viscount Dunedin.—My Lords, the Appellants were interested in a company called Blumfield, Limited, (hereinafter referred to as "the company") which had for many years been indebted to its bankers.

The Appellants, in some cases individually and in others jointly and severally, gave guarantees to the bank to secure the company's indebtedness. The Appellants undertook thereby "to pay and satisfy to the bank all and every the sum or sums of money which shall at any time be owing to the bank . . . on any account . . . together with . . . all interest, discount and other bankers' charges." The total liability ultimately enforceable against the guarantor or guarantors under each guarantee was limited to a definite sum.

From 1920 onwards, the company was continuously indebted to the bank and, in accordance with the usual custom of bankers, the interest on the amounts owing to the bank from time to time was debited half-yearly to the company's capital account with the bank. Though from time to time payments were made by the company into the account, the amount due to the bank increased each half-year save that ending 31st December, 1924.

After being pressed by the bank to discharge the company's indebtedness, the Appellants, on the 17th November, 1926, paid to the bank the sum due on the company's account, this sum being covered by the guarantees that had been given by the Appellants. The sum paid by the Appellants was £64,482 16s. 8d.

By examination of the bank accounts, the Appellants contend that it can be shown that, of this sum, £16,519 18s. 4d. represents interest added as aforesaid to the half-yearly rests and £1,341 18s. 1d. represents the interest due on the current half-year in which the whole sum was paid. They accordingly made a claim against the Commissioners of Inland Revenue for that whole sum. The claim was founded on Sub-section (1) of Section 36 of the Income Tax Act, 1918, which is as follows: "Where interest payable in the United Kingdom on an advance from a bank carrying on a bonâ fide banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest."

Their claim was disallowed but, on appeal to the Special Commissioners, they allowed it. A stated case was asked and, upon the stated case, Mr. Justice Rowlatt affirmed the judgment of the Special Commissioners. Appeal being taken to the Court of Appeal, they reversed the judgment of Mr. Justice Rowlatt and of the Special Commissioners.

(Viscount Dunedin.)

The Court of Appeal approached the case first of all from the point of view of whether the great bulk of the sums paid was really interest at all, or whether the half-yearly interests, as they became due and were, according to the practice of the bank, added to the capital so that interest might run on the whole sum, did not lose their quality of interest by having become capital.

There is no question that in the case of *Reddie v. Williamson*, in Scotland, 1 M. 228, it was so laid down by the Lord Justice Clerk, as he then was, better known to English lawyers as Lord President Inglis; but it was argued by counsel for the plaintiffs that that was not the law in England. The Court of Appeal held that it was consonant to England law. This view, although it determined the case as to the greater part of the sum paid, did not determine the question of the £1,341 odd, the current interest for the last half-year. This point also the Court of Appeal decided against the plaintiff upon the ground that Section 36 did not apply to the case in point of a guarantor paying money under his guarantee. The Court of Appeal did not accentuate the fact that, if their view on this point was right, it disposed of the whole case without the question of the first point at all.

I am of opinion that, on this point, first really for consideration although taken second by the Court of Appeal, their judgment is right. I agree with the view of the Master of the Rolls. I think that interest payable on an advance from a bank means interest on an advance made to the person paying. The guarantor does not pay on an advance made to him, but pays under his guarantee. It is true that he pays a sum which pays all interest due by the person to whom the advance is made, but his debt is his debt under the guarantee, not a debt in respect of the advance made to him. That disposes of the whole case, and I think it was therefore unnecessary to decide the other and wider question, and I say so because I think it would be very advisable, if that question is to be determined, that the bank in question should be a party to the suit. That is my only reason for thinking it better not to decide the question. It must not be inferred at all from this view that I express any doubts as to the soundness of the judgment of the Court of Appeal on this point. I move that the appeal be dismissed with costs.

Lord Warrington of Clyffe.—My Lords, I have had the advantage of reading the opinion expressed by my noble and learned friend on the Woolsack and the other opinions about to be expressed, and I concur therein.

Lord Atkin (read by Lord Tomlin).—My Lords, there are two questions of importance in this case. The first is whether when a person has had an overdraft with his bank for a number of years kept in the ordinary way by which interest at the end of each

(Lord Atkin.)

half-year is added to the total sum then due and interest charged on that total sum, the person who pays the accumulated overdraft at the end of three or four years has paid interest on the overdraft for those years. The second is whether if he has, a guarantor of the advance with interest who pays the total sum due can be said to be "the person by whom the interest is paid" within the meaning of Section 36 (1) of the Income Tax Act, 1918. My Lords, I understand that the majority of your Lordships are of opinion that the guarantor in such a case cannot be said to have paid the interest within the meaning of the Section. I confess to feeling doubts on this point, for there can be no doubt, I think, that as the result of the sum of money paid by the guarantor, the interest due from the principal debtor was in fact paid and that if the principal debtor were sued he could support a plea of payment. Similarly, it might, I think, be said that, if a guarantor of rent pays under the guarantee, he pays the rent, not, it is true, his rent, but the rent of the tenant. No one would, I think, doubt that payment by a guarantor made within the stipulated time would defeat a forfeiture for non-payment of rent. But one has to construe the words used in a particular case and if your Lordships have come to the conclusion that the words of the Section do not give the guarantor the relief that is given to the principal debtor, I do not dissent.

The result is that it becomes unnecessary to consider the first point. The question there raised, involving consideration of the statement that by adding interest to the advance at the end of each half-yearly "rest" the interest is in fact paid, is one of great mercantile importance, and one which I venture to think it would, unless necessary, be undesirable to decide in a case where your Lordships could not have the advantage of hearing the views of any bank. I concur with the motion proposed.

Lord Thankerton.—My Lords, the Appellants, who were interested in a company called Blumfield, Ltd., from time to time gave guarantees to the Midland Bank, Ltd., to secure the indebtedness of the company to the bank *inter alia* on the company's current account with the bank, the total liability under each guarantee being limited to a definite sum.

From the year 1920 onwards, the company was continuously indebted to the bank in large amounts. In accordance with the ordinary custom of banks, the interest accruing on the overdraft amounts was added to the amount overdrawn by half-yearly rests, interest being thereafter charged on the amount so added. Payments into the account were made by the company from time to time, but, with the exception of the half-year to 31st December, 1924, the amounts paid in were insufficient to meet the borrowings each half-year and the indebtedness steadily increased. As at 30th June,

(Lord Thankerton.)

1920, the balance due to the bank was £28,894 15s. 11d. and upon 17th November, 1926, when the account was closed, the total amount due to the bank was £64,482 16s. 8d.

The bank pressed the Appellants for payment under their guarantees from time to time and eventually the company's whole indebtedness of £64,482 16s. 8d. was satisfied by the Appellants on 17th November, 1926, by means of a loan made by the bank to the Appellants personally. The company is completely insolvent and there is no chance of the Appellants obtaining any reimbursement from the company.

The Appellants, in terms of Section 19 of the Finance Act, 1926, claimed repayment of Income Tax under Section 36 of the Income Tax Act, 1918, on the interest amounting to £17,861 16s. 5d., debited half-yearly to the company's account with the bank from 1st January, 1920, to 17th November, 1926, when the account was closed.

The provisions of Section 36 of the Act of 1918, so far as relevant, are as follows: " 36.—(1) Where interest payable in the United Kingdom on an advance from a bank carrying on a bonâ fide banking business in the United Kingdom is paid to the bank without deduction of tax out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled, on proof of the facts to the satisfaction of the special commissioners, to repayment of tax on the amount of the interest. . . . Provided that no repayment shall be made unless the Commissioners of Inland Revenue are satisfied that the interest has been or will be brought into account in the statement delivered or to be delivered for the purposes of income tax by the person making the advance."

It is not disputed that the sum in question was paid by the Appellants out of profits or gains brought into charge or that the proviso to the Section has been satisfied. Further, it is not now disputed by the Appellants that, under the rule in *Clayton's case*⁽¹⁾, the appropriation of the amounts paid in by the company during the currency of the account to satisfaction of the debits in their chronological order, includes the discharge by the company of the interest for the first three half-years, which amounts to £3,675 15s. 6d., and that their claim falls to be reduced by that amount.

Two questions were in issue in this appeal, *viz.*, (a) whether the claim came within Section 36 and (b), if so, whether the claim, so far as it related to the amounts of interest entered as a debit at each of the half-yearly rests up to and including the rest at 30th June, 1926, constituted interest within the meaning of the Section.

The Respondents maintained that the Appellants' claim did not fall within the Section on two alternative grounds, *viz.*, first, in

(1) 1 Mer. 572.

(Lord Thankerton.)

respect that the Appellants, as guarantors to the bank, did not pay interest on advances by the bank, but a sum due under the guarantee, the quality of the payment being determined by the guarantee and not by the quality of the obligations of the principal debtor, although the latter were invoked for the purpose of ascertaining the amount of the guarantors' liability; and secondly, that the Section only related to payment of interest by the person to whom the advances were made. The Appellants disputed both these contentions on general grounds and also on the terms of the particular guarantees granted by them.

My Lords, I am of opinion that both contentions of the Respondents are right and that on a ground that is really common to both. Interest is the return given for the use of the advances and is due by the person who obtains the advances; the liability of the guarantor is direct to the creditor and is an undertaking to indemnify him against loss. The creditor computes his loss by the amount of the failure of the principal debtor to pay him principal and interest. In paying the amount of the indemnity, whether limited or otherwise, I am of opinion that the guarantor cannot be said to be paying interest to the creditor, though he is making good the loss of interest. The terms of the specimen guarantee included in the Stated Case is a guarantee for "all and every the sum or sums of money which shall at any time be owing to the bank" with a long list of how the debt may arise, including unpaid interest as a possible source of the indebtedness, and is in conformity with the view above expressed. I am therefore of opinion that Section 36 (1) only relates to the person who has obtained the advances and that a guarantor does not pay interest to the bank within the meaning of the Section.

In that view, it becomes unnecessary to consider question (b), which raises a question of importance as to what is the effect of the practice of adding the amount of interest accrued at half-yearly or yearly rests as a debit item in the account, and whether such debit item retains the quality of interest. On that question I desire to reserve my opinion.

I am therefore of opinion that the appeal should be dismissed.

Lord Macmillan.—My Lords, the Appellants assisted the finances of a company known as Blumfield, Limited, by granting their personal guarantees to secure the company's indebtedness to the Midland Bank. The guarantees were all in similar terms and the specimen exhibited shows that the Appellants undertook to pay to the bank all sums which should at any time be owing by the company to the bank together with all interest, discount and other banker's charges, the liability under each guarantee being limited to a definite sum. Having been called upon by the bank under these

(Lord Macmillan.)

guarantees to discharge the company's indebtedness, the Appellants on 17th November, 1926, paid to the bank a sum of £64,482 16s. 8d., being the sum then due by the company to the bank. It appears from a summarised statement of the company's account with the bank from 31st December, 1919, to 17th November, 1926, that during this period the bank calculated the interest on the company's indebtedness at half-yearly intervals and at the end of each half-year accumulated the interest with the principal. Of the total sum of £64,482 16s. 8d. paid by the Appellants to the bank, the sum of £17,861 16s. 5d. consisted of these half-yearly interest debits together with the interest accrued for the broken period from 30th June to 17th November, 1926.

The Appellants contended that in paying to the bank the sum of £64,482 16s. 8d., they paid £46,621 0s. 3d. as principal and £17,861 16s. 5d. as interest. They so contended in order to secure the benefit of Section 36 (1) of the Income Tax Act, 1918, which provides that where interest payable on an advance from a bank is paid to the bank, without deduction of tax, out of profits or gains brought into charge to tax, the person by whom the interest is paid shall be entitled to repayment of tax on the amount of the interest so paid. This provision was first introduced into the Income Tax system by Section 22 of the Finance Act, 1915. In the ordinary case a borrower from a bank who is not carrying on a trade or business is not entitled, in computing his income for tax purposes, to deduct the interest paid by him to the bank, nor is he entitled, in paying the interest to the bank, to deduct the tax thereon, for such interest is not treated as annual or yearly interest. A person engaged in trade or business on the other hand who has obtained an advance from the bank for the purposes of his trade or business is permitted, in computing the balance of his profits or gains, to deduct the interest which he has to pay to the bank. The effect of Section 36 (1) of the Income Tax Act is to give everyone, whether engaged in trade or business or not, who pays interest on an advance obtained from the bank, the right to repayment of tax on the amount of such interest if he has paid it without deduction of tax and out of profits or gains brought into charge. Persons engaged in trade or business, however, will not ordinarily benefit by this provision for, as they deduct such interest in making the return of their profits, they do not pay it out of profits or gains brought into charge. On the other hand, borrowers from a bank who are not engaged in trade or business or who have obtained an advance for purposes not connected with their trade or business obtain by virtue of the Section the benefit of recoupment of tax on the interest paid by them to the bank. The rights of the Revenue are safeguarded by the proviso to the Section under which no repayment is to be made unless the Commissioners of Inland Revenue are satisfied that the interest has been, or will be, brought into account in the return made by the bank for Income Tax purposes.

(Lord Macmillan.)

The Appellants claim that they are entitled to this benefit in respect of the sum of £17,861 16s. 5d., forming part of the total sum of £64,482 16s. 8d. paid by them to the bank under their guarantees, on the ground that they paid this sum of £17,861 16s. 5d. as "interest payable on an advance from a bank." The short answer, in my opinion, is that the Appellants received no advance from the bank and owed no interest to the bank.

Their relationship to the bank was not that of borrower and lender, and their liability to the bank was solely that of guarantors of a third party's indebtedness to the bank. When they paid the sum of £64,482 16s. 8d. to the bank, they did so in discharge of their liability to pay whatever sum, whether of principal or interest, Blumfield, Limited, owed to the bank. It cannot, therefore, with legal accuracy be said that the Appellants made payment to the bank of interest on an advance from the bank within the meaning of the Section. The benefit of the Section, in my opinion, is confined to persons who pay interest to a bank on advances which they themselves have received from the bank.

As this ground of judgment is sufficient for the disposal of the appeal, I do not find it necessary to express any opinion as to the question decided adversely to the Appellants in the Court of Appeal and upon which a very full argument was developed at your Lordships' Bar, namely, whether the sums of interest accumulated half-yearly in the account between the bank and the company still retained on 17th November, 1926, their original character as interest or had become capitalised by being merged with the principal.

I agree with your Lordships that the appeal should be dismissed.

Questions put :

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and this appeal dismissed with costs.

The Contents have it.

[Solicitors :—Solicitor of Inland Revenue ; Peacock & Goddard.]
