

HIGH COURT OF JUSTICE (CHANCERY DIVISION)—  
15TH JULY, 1963

---

COURT OF APPEAL—27TH AND 28TH APRIL,  
28TH MAY AND 17TH JUNE, 1964

---

HOUSE OF LORDS—15TH AND 16TH MARCH  
AND 13TH MAY, 1965

---

**Varty (H.M. Inspector of Taxes)**

v.

**British South Africa Company<sup>(1)</sup>**

---

*Income Tax, Schedule D—Finance company—Loan granted in return for option to subscribe at par for shares in borrower—Option exercised, and loan correspondingly reduced, when shares standing at premium—Whether profit realised.*

*The Respondent Company carried on the trade of a development, general trading and finance company. Its method of accounting, which was accepted for Income Tax purposes, was to include trading stock at cost without regard to the market values, so that a profit or loss could only arise on a realisation. In the course of its trade in 1953 it accepted a 5 per cent. participation in arrangements whereby A Ltd agreed to provide S Ltd, a mining company, with loan facilities up to £4 million on the terms, inter alia, that A Ltd should receive an option to subscribe on or before 30th June, 1955, for 2 million shares in S Ltd at 20s. per share, and that amounts so subscribed should be applied in reducing the loan. The mid-market price of shares in S Ltd was then 19s. 6d. The Respondent Company in due course paid £200,000 to A Ltd by way of loan, and at its request was, in November, 1954, allotted 100,000 shares in S Ltd, the mid-market price being then 43s. 6d. per share; at the same time the Company was informed by A Ltd, that its loan had been reduced by £100,000.*

*The Company was assessed to Income Tax under Case I of Schedule D for the year 1956–57 on the footing that it had realised a profit of £117,500 (the excess of the market value of the shares over £100,000). On appeal the Company contended that no profit had been realised. For the Crown it was contended (a) that the acquisition and exercise of the option constituted a dealing in the option and the exercise of the option was a realisation for money's worth; alternatively, (b) that on the exercise of the option the loan was converted into shares and this constituted a realisation. The Special Commissioners held (1) that the relevant part of the loan had been discharged and not converted into shares; (2) that, although the option right disappeared on the acquisition of the shares for £100,000, no trading profit or loss arose until the shares were sold.*

*Held, that the Commissioners' decision was correct.*

---

<sup>(1)</sup> Reported (C.A.) [1965] Ch. 508 ; [1964] 3 W.L.R. 698 ; 108 S.J. 520 ; [1964] 2 All E.R. 975 ; 235 L.T. Jo. 403 ; (H.L.) [1965] 3 W.L.R. 47 ; 109 S.J. 436 ; [1965] 2 All E.R. 395 ; 235 L.T. Jo. 317.

## CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the High Court of Justice.

1. At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 6th November, 1961, the British South Africa Company (hereinafter called "the Company") appealed against an assessment to Income Tax under Schedule D made upon it for the year 1956-57 in the sum of £10,225,000 (less £55,000 capital allowances) in respect of profits as a development, general trading and finance company.

2. The question for our determination was whether the exercise by the Company, on 14th October, 1954, of a right to acquire certain marketable securities for £100,000 (the market value of which was at the date of allotment, 15th November, 1954, £217,500) gave rise to a profit of £117,500 to be taken into account in the computation of the Company's profits for the year to 30th September, 1955, which year forms the basis period for the 1956-57 assessment.

3. Evidence was given before us by Mr. D. C. Kempson, the chief accountant to the Company, and the following documents were proved or admitted:

(1) The charter and statutes of the Company.

(2) A circular to shareholders of President Steyn Gold Mining Co., Ltd. (hereinafter called "President Steyn"), dated 24th October, 1952. (2A) A circular to shareholders of President Brand Gold Mining Co., Ltd. (hereinafter called "President Brand"), dated 24th October, 1952. (2B) A circular to shareholders of Welkom Gold Mining Co., Ltd. (hereinafter called "Welkom"), dated 7th November, 1952.

(3) and (3A) A letter dated 31st December, 1952, from Anglo-American Corporation of South Africa, Ltd. (hereinafter called "Anglo-American") to the Company, with attached schedule of 5 per cent. participation.

(4) A letter dated 9th January, 1953, from the Company to Anglo-American.

(5) A letter dated 14th October, 1954, from the Company to Anglo-American.

(6) and (6A) A letter dated 23rd November, 1954, from Anglo-American to the Company, enclosing a contract note for 50,000 Welkom shares.

(7) A letter dated 11th November, 1954, from Anglo-American to President Steyn.

(8) A letter dated 22nd November, 1954, from President Steyn to Anglo-American.

(9) A schedule showing the history of the Company's participation in the President Steyn, President Brand and Welkom financial arrangements.

(10) A registered option certificate of President Brand.

(11) The Company's printed accounts for the year ended 30th September, 1955.

(12) The Income Tax return, form I, submitted by the Company for the year 1956-57.

(13) The Company's computation of taxable profits for the year of assessment 1956-57.

(14)-(17) Four schedules showing details not contained in the printed accounts.

The documents marked " 1 " to " 11 " inclusive are attached to and form part of this Case<sup>(1)</sup>. The remaining documents are not attached but are available to the High Court. The facts found by us are set out in paragraphs 4-10 (inclusive) below.

4. (a) The Company was incorporated in England by Royal Charter in 1889 with the object of acquiring and developing mineral concessions in Africa. The Charter was subsequently amended by four supplemental Charters dated 8th June, 1900, 13th March, 1915, 25th March, 1924 and 16th August, 1954. A copy of the Charter, the supplemental Charters and the statutes of the Company are attached hereto (exhibit 1<sup>(1)</sup>). Until it became an Overseas Trade Corporation in March, 1958, the Company was taxed under Case I of Schedule D upon the profits of its trade of exploiting its mineral concessions, and was similarly taxed upon, *inter alia*, its realised profits on the sale of investments.

(b) It was not disputed that the history of the Company, so far as is material, is accurately set out in the judgment delivered by Lord Simon in *British South Africa Co. v. Commissioner of Income Tax*, [1946] A.C. 62.

(c) At all material times the Company carried on the trade of a development, general trading and finance company and in the course of this trade it has acquired considerable interests in mining companies in Central and Southern Africa. These interests figure among the investments in the Company's balance sheet (exhibit 11), and it was agreed between the parties that any profits on the realisation of such investments were properly to be included in the computation of the Company's profits.

(d) In the course of its trade the Company has participated in a number of financial arrangements made by Anglo-American whereby the Company made loans to be used in financing development by mining companies and at the same time received options to take up shares in the mining companies at fixed prices. These arrangements have enabled the Company (i) to employ its liquid circulating capital in earning interest and commissions, and (ii) to acquire at fixed option prices, interests in mining companies of a value exceeding the option price. It was for these purposes that the Company participated in the financial arrangements in connection with President Steyn referred to below.

5. In 1952 Anglo-American agreed to provide President Steyn with loan facilities up to £4,000,000 on the terms contained in paragraphs (a) to (e) inclusive of the circular to shareholders of President Steyn dated 24th October, 1952 (exhibit 2). One of the terms was that Anglo-American should receive an option exercisable up to and including 30th June, 1955, to subscribe for 2,000,000 shares in President Steyn at the price of 20s. per share. At the same time Anglo-American entered into certain financial arrangements with President Brand and with Welkom which are described in the circulars issued by those companies on 24th October, 1952, and 7th November, 1952, respectively (exhibits 2A and 2B). We were not directly concerned in this appeal with the President Brand and Welkom transactions except in so far as they threw light on the President Steyn transaction.

6. Negotiations took place between the Company and Anglo-American in 1952 as a result of which, by letter dated 31st December, 1952 (exhibit 3), Anglo-American offered the Company a 5 per cent. participation in the financial arrangements referred to in paragraph 5 above. Such 5 per cent. participation would involve the Company providing loan facilities up to £200,000 at 6 per cent. interest, and as consideration receiving a raising fee of 2½ per cent. on the amount

---

(1) Not included in the present print.

of the loan facilities, together with an option to subscribe for 100,000 President Steyn shares at par. The acceptance of this offer was formally confirmed by a letter dated 9th January, 1953 (exhibit 4), and the Company in due course paid £200,000 to Anglo-American by way of loan. The mid-market price of shares in President Steyn on 9th January, 1953, was 19s. 6d.

7. By a letter dated 14th October, 1954, addressed to Anglo-American (exhibit 5), the Company asked to be allowed to exercise the option to subscribe for 100,000 shares in President Steyn at 20s. per share, "thus reducing [the] Company's loan to . . . President Steyn . . . by £100,000". In due course, a share certificate for 100,000 shares in President Steyn was forwarded to the Company by Anglo-American and the Company was informed by letter from Anglo-American dated 23rd November, 1954 (exhibit 6), that its loan "under" Anglo-American to President Steyn had been reduced by £100,000. At no time was the Company in direct communication with President Steyn. Annexed hereto<sup>(1)</sup> is a letter from Anglo-American to President Steyn dated 11th November, 1954 (exhibit 7), and a letter from President Steyn to Anglo-American dated 22nd November, 1954 (exhibit 8), concerning the subscription for the shares.

8. There is also annexed hereto a schedule (exhibit 9<sup>(1)</sup>) based on the schedule attached to the letter from Anglo-American dated 31st December, 1952, setting out briefly the subsequent history of the Company's participation in the financial arrangements relating to Welkom and President Brand as well as in the arrangements relating to President Steyn. In the case of President Brand the relevant share options were recorded in registered option certificates and a form of certificate is also annexed hereto (exhibit 10<sup>(1)</sup>).

9. The mid-market price of shares in President Steyn on 15th November, 1954 (the day on which the 100,000 shares were allotted to the Company at 20s. per share), was 43s. 6d. It was agreed between the parties that if a taxable profit arose as a result of the exercise by the Company of the option mentioned in paragraph 7 above the amount of such profit would be £117,500, i.e., 23s. 6d. × 100,000.

10. The loan of £200,000 referred to in paragraph 6 above is included in the investments in the Company's balance sheet; like all the assets so included, if the said loan were realised any profit so realised would (it was agreed) form part of the Company's taxable profit. When the loan was reduced by £100,000 (*vide* paragraph 7 above), £100,000 was credited to the relative loan account in the Company's ledger, and the transaction figured in a schedule of realisations of investments submitted to the Inspector in support of the Company's tax computations as if the loan, to the extent of £100,000, had been realised, showing nil profit or loss.

The said loan of £200,000 figures in a schedule of investments similarly submitted, wherein the reduction of £100,000 is shown; against this entry is a footnote reading "converted into shares during the year under option".

11. It was contended by H.M. Inspector of Taxes:

(1) that the Company's acquisition and subsequent exercise of the option to subscribe for the President Steyn shares constituted a dealing in the option in the course of the Company's trade, and that the exercise of the option was a realisation in the course of trade for money's worth, giving rise to a taxable profit of £117,500;

(<sup>1</sup>) Not included in the present print.

(2) alternatively, that on the exercise of the option one item of the Company's trading stock (viz., the Company's loan to the extent of £100,000), was converted into, or exchanged for, President Steyn shares; that this conversion or exchange constituted a realisation of the said loan, giving rise to a taxable profit of £117,500.

12. It was contended on behalf of the Company:

(1) that the Company did not acquire the option in order to deal in it by way of trade;

(2) that the exercise of the option was not a realisation and did not give rise to a taxable profit;

(3) that the Company did not make the loan in order to deal in it by way of trade;

(4) that no part of the loan was ever converted into, or exchanged for, President Steyn shares in such a way as to give rise to a realised taxable profit.

13. We, the Commissioners who heard the appeal, gave our decision as follows:

(1) We find that the Company participated in the arrangement for granting loan facilities in 1952, and later made the loans totalling £200,000, in the ordinary course of its trade, and that part of the consideration therefor was a contractual right (which we will for convenience call the option right) to obtain the allotment on or before 30th June, 1955, of 100,000 shares in President Steyn Gold Mining Co., Ltd., at 20s. per share; in the event of the Company exercising this right the amount of the loan facilities, and of the loan if made (as it was), was to be reduced by the amount paid in respect of such allotment. In November, 1954, the Company, standing on its option right, obtained the allotment of 100,000 President Steyn shares, the amount payable therefor (£100,000) being applied in reduction of its loan from £200,000 to £100,000.

(2) It was no part of the case of either side that the option right had any value when it was obtained, and no value was ascribed to it in the Company's accounts at that time. It is, however, clear that by November, 1954, it had considerable value, as the market price of 100,000 President Steyn shares was then £217,500. The question for our determination, as we see it, is whether as a result of the events of November, 1954, the Company realised a profit chargeable to Income Tax of £117,500; we put the question in this way because the method of accounting employed by the Company, and accepted by the Inland Revenue for the purpose of computing the Company's profits for Income Tax, is to include trading stock at cost without regard to higher or lower market values, so that a profit or loss can only arise on a realisation.

(3) One of the alternative contentions on the part of the Crown was that the loan (to the extent of £100,000) was exchanged for, or converted into, marketable shares worth £217,500, and that the difference of £117,500 was a realised profit on the authority of the line of cases starting with *Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22. We do not think this is a correct view of the transaction. We have noted that in the schedule of investments attached to the Company's accounts the loan was described as converted into shares. We note also that the loan (to the extent of £100,000) has gone; it no longer figures in the investments held by the Company as part of its stock-in-trade, while the President Steyn shares do so figure; but it has gone, we think, simply because it has been discharged, and in our view it would not be either realistic or correct to regard it as exchanged for or converted into the shares. Accordingly, we think that if a taxable profit arose in November, 1954, at all, it can only have arisen as a result of a realisation or exploitation of the option right.

(4) We therefore turn to the Crown's other contention. We find, with some hesitation, that the option right was a trading asset of the Company, and accordingly we see the question before us as being whether or not the Company, by exercising it, has exploited or realised its value in such a way as to give rise to a trading profit. This question we have found puzzling and difficult. When we find that this Company, which makes profits in many different ways, has acquired a readily marketable holding by exercising a right such as this, acquired in the way it was, we must clearly pause before saying that nothing has been realised, but nevertheless we think that this view is correct. In our opinion the position is that the Company, as a result of its participation in the 1952 arrangements, was able in 1954 to acquire the 100,000 President Steyn shares for £100,000; in the meantime one of its trading assets (the option right) has disappeared, but we do not think any trading profit or loss arises until such time as the shares are sold.

(5) For these reasons we hold that the £117,500 in question is not a profit to be taken into account for the purpose of the assessment before us. We allow the appeal and leave the figures to be agreed.

The agreed figures having been reported to us we determined the appeal on 23rd January, 1962, by adjusting the assessment to £10,231,853 (less £58,167 capital allowances).

14. The Inspector of Taxes, immediately after the determination of the appeal, declared to us his 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 Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

15. The question of law for the opinion of the High Court is whether, on the facts found by us, our decision was correct in law.

R. A. Furtado	}	Commissioners for the Special Purposes of the Income Tax Acts.
N. S. Spendlow		

Turnstile House,  
94-99 High Holborn,  
London, W.C.1.

1st August, 1962.

---

The case came before Wilberforce, J., in the Chancery Division on 15th July, 1963, when judgment was given against the Crown, with costs.

Sir John Senter, Q.C., and Mr. J. Raymond Phillips appeared as Counsel for the Crown, and Mr. H. H. Monroe, Q.C., and Mr. M. P. Nolan for the Company.

---

**Wilberforce, J.**—This is an appeal by the Crown from a decision of the Special Commissioners relating to an assessment for Income Tax under Schedule D upon the Respondent, the British South Africa Company. The transaction in question arises out of certain arrangements, which were made in 1952, for the financing of a goldmining enterprise known as President Steyn Gold Mining Co., Ltd. The arrangements were made with the President Steyn Gold Mining Co., Ltd., by the Anglo-American Corporation of South Africa, Ltd., and they were these. Putting it very shortly—I shall give the exact terms

**(Wilberforce, J.)**

later—they were that Anglo-American should provide President Steyn with loan facilities up to £4 million, any money advanced to carry interest, and that Anglo-American should have an option, exercisable up to 30th June, 1955, to subscribe for two million shares in President Steyn at the price of 20s. per share. Anglo-American in turn granted to the British South Africa Company, by a letter of 31st December, 1952, a five per cent. participation in the arrangement, so that the British South Africa Company committed itself to providing loan facilities up to £200,000, and in turn, of course, it received an option to subscribe for 100,000 shares of President Steyn at 20s.

In 1954 the Respondent Company decided to exercise its option in respect of 100,000 shares, and it did so through Anglo-American. In November, 1954, accordingly, that was carried out and 100,000 shares in President Steyn were allotted to the Respondent Company. At 15th November, 1954, the shares in President Steyn were valued at 43s. 6d., so that as a result of this transaction the Respondent Company acquired shares in President Steyn at a figure which showed a book profit of £117,500 over the amount at which they had agreed to take up the shares, and it is that amount of £117,500 which is in question in this case.

There are one or two points on the document to which I shall refer. First of all, I have seen the charters and statutes of the Respondent Company, and I do not think anything in detail turns upon them. It is quite clear that they have wide powers as a development, general trading and finance company, and it is not disputed that in the course of their business the Company participate in a number of financial arrangements, sometimes with Anglo-American and sometimes otherwise, with a view to employing their circulating capital to the best advantage. Amongst those arrangements from time to time is the acquiring of options over shares.

Secondly, I should refer in rather more detail to the terms of the arrangements between Anglo-American and President Steyn, which I treat, as I think it is common ground, as available by way of partial assignment to the Respondent Company. They are set out in a circular to shareholders sent by President Steyn in October, 1952, and the relevant terms are these:

“(a) Anglo American Corporation will provide the Company with loan facilities up to £4,000,000. The Company will have the right to draw on these loan facilities as and when funds are required, all amounts drawn bearing interest at the rate of 6 per cent. per annum. Of the amount drawn, and subject to paragraph (d) below, not less than £2,000,000 must be repaid by the 31st December, 1957, and the balance by 31st December, 1962.”

(b) contains a provision which, as events turned out, was not material, so that I shall not read it.

“(c) As consideration for the granting of these facilities, Anglo American Corporation will receive a raising fee of 2½ per cent. payable in cash on acceptance of the offer on the full amount of the loan facilities, namely £4,000,000, and an option exercisable up to and including the 30th June, 1955 to subscribe at the price of 20s. per share (South African currency) for 2,000,000 shares in your Company. (d) If and when Anglo American Corporation subscribes for shares in terms of paragraphs (b) and/or (c) above, the loan facilities provided by Anglo American Corporation in terms of (a) above will be reduced by a sum equal to the amount/s paid by Anglo American Corporation in subscription of shares, and the amount due for repayment on or before 31st December, 1957 in terms of (a) above will be reduced by the amount/s so paid by Anglo American Corporation in subscription of shares. (e) The Corporation will be entitled at any time after 30th June, 1955 to call upon the Company to issue to the Corporation or its nominees Unsecured Notes for the amount of the loan outstanding and to request the Company to apply for quotations for such Notes on the Johannesburg Stock Exchange and The Stock Exchange, London.”

(Wilberforce, J.)

That is all I need read of the relevant arrangements. I now come to the contentions put forward by the Crown in support of their appeal. These are the same contentions as were before the Special Commissioners, and they have been adopted by the Crown for the purposes of this appeal. In the first place, it is said that the Company's acquisition and subsequent exercise of the option to subscribe for the President Steyn shares constituted a dealing in the option in the course of the Company's trade, and that the exercise of the option was a realisation in the course of trade for money's worth, giving rise to a taxable profit of £117,500. Secondly, and alternatively, it is said that, on the exercise of the option, one item of the Company's trading stock, namely the Company's loan to the extent of £100,000, was converted into or exchanged for President Steyn shares, and that this conversion or exchange constituted a realisation of the said loan, giving rise to a taxable profit of £117,500.

I will deal first with the second contention relating to the loan and the suggestion that it has been converted into or exchanged for shares. That, it seems to me, depends upon a correct understanding of the arrangements made between Anglo-American and President Steyn. As I read those arrangements, they provide this, that Anglo-American had granted an option, exercisable up to a certain date, to subscribe for President Steyn shares at par, and that if and when it decided to exercise that option the loan facilities would be automatically reduced by the amount paid by Anglo-American on the exercise of the option. That, of course, contemplated two possible events: first, that President Steyn might not have drawn on the whole of the loan facilities at the time when the option should be exercised, and in that event the arrangement was that the amount of the loan facilities should be automatically reduced by whatever sum Anglo-American should pay in exercise of the option; alternatively, President Steyn might have drawn on the whole of the loan facilities, and in that event the arrangement was that the amount paid in exercise of the option should be applied in reducing the loan.

It seems to me that all that that means is this: that, whereas in the normal way, if nothing had been said, Anglo-American on exercising the option would have to pay President Steyn a sum equal to 20s. in respect of each share over which the option should be exercisable, and President Steyn, of course, would be entitled to take that money into its accounts and retain it, this particular arrangement provided that, notwithstanding that under paragraph (a) there was no obligation to repay anything until 31st December, 1957, as soon as President Steyn got the money from Anglo-American in respect of the exercise of the option rights, it had to use that money in reducing the loan. That, it seems to me, is the only effect on the loan of the exercise of the option, and consequently I cannot see that it is possible to say that the loan has been in some way realised or exchanged, or that a realised profit has been made on the loan when the option is exercised and the option money, in accordance with the contract, is applied in reducing the loan. It seems to me that there were two elements in the transaction—the option on the one hand resulting in the payment of the money to President Steyn, and the loan on the other side—and that these were only related by the obligation on the part of President Steyn, when they got the money in the exercise of the option, to use that money in repaying the loan. So I consider the Commissioners came to the correct conclusion when, on this argument of the Crown, they said that there had been no realisation of the loan giving rise to a taxable profit.

Then I come to the other contention, which is that there was a dealing in the option in the course of trade, which resulted in a realisation and a profit. That seems to me to be a more difficult question, and I find myself at



(**Wilberforce, J.**)

one with the Special Commissioners in finding it in some way puzzling. The way in which the Crown put it, and this is based on the well-known case of *Gold Coast Selection Trust, Ltd. v. Humphrey*<sup>(1)</sup> which went to the House of Lords in 1948, is that there was either a sale or an exchange of the option, resulting in the obtaining by the Company of a marketable asset, which marketable asset then represented a profit. I think it cannot really be said that there had been either literally a sale or literally an exchange, but I think it is a much more difficult question to decide whether it is right to say that there had been—on the exercise of the option—the realisation of a profit. I see the force of the argument which says that until the option is exercised there is a period of uncertainty, a period during which perhaps fluctuations in the value of the option may take place; that when the option is exercised that period comes to an end, and that there is some sort of crystallisation of the position giving rise to something which can be ascertained as a profit. But, on the other hand, it seems to me that there is much to be said for the argument that there has been no change—no essential change—in the nature of the asset of the Company.

Before the option was exercised the Company had what may, I think, be described as some kind of equitable interest in the shares of President Steyn, or what might be described as a conditional contract to acquire shares in President Steyn; the value of that asset, of course, directly depended upon the value of the shares in President Steyn, which no doubt went up and down, and I have no doubt that in November, 1954, the value of the option was precisely related to the value of the shares. Consequently, it seems to me that the true view of what happened in November, 1954, is that there was not a realisation of one asset for another but simply a removal of a condition, or the conversion of the equitable right into a further right but which still preserved the essential nature of the asset as it was before, namely, an interest in the shares of President Steyn.

Putting it another way, it does not seem to me that it would be right, from the commercial point of view, to draw a line under the transaction in November, 1954, and say that at that time one period came to an end and from then on a new period began. It seems to me that throughout the Company held an asset which was likely to fluctuate according to exactly the same considerations, namely, the value of the enterprise of President Steyn, and that so far from starting a new period in November, 1954, one and the same history with fluctuations up and down should be treated as continuing from the date that the option was acquired up to such date as the shares in President Steyn should come to be realised.

Consequently, although I agree the matter is a difficult and delicate one, as I find most questions relating to options are, I think that the Commissioners came to a correct conclusion on the second point as well as the first, and holding that view I reach the conclusion that the appeal must fail.

**Mr. H. H. Monroe.**—Would your Lordship say the appeal is dismissed with costs?

**Wilberforce, J.**—Yes, dismissed with costs.

---

The Crown having appealed against the above decision, the case came before the Court of Appeal (Lord Denning, M.R., and Danckwerts and Diplock, L.JJ.)

on 27th and 28th April, 1964, when the Court gave reasons *ex tempore* for dismissing the appeal. The Court having subsequently directed that an Order should not be drawn up, but that the case should be set down for further argument, it came before them again on 28th May, 1964, when judgment was reserved. On 17th June, 1964, judgment was given in favour of the Crown, with costs (Danckwerts, L.J., dissenting).

Sir John Senter, Q.C., and Mr. J. Raymond Phillips appeared as Counsel for the Crown, and Mr. H. H. Monroe, Q.C., and Mr. M. P. Nolan for the Company.

**Lord Denning, M.R.**—On Tuesday, 28th April, we first heard argument in this case. We then gave reasons for dismissing the appeal. But on thinking over the case afterwards, we thought that there were points on which we would like to hear further argument. We directed, therefore, that the Order of dismissal should not be drawn up and the case should be set down for further argument. We told Counsel of the points we had in mind and on 28th May we had the benefit of their submissions upon them. In these circumstances our previous judgments should be regarded as interlocutory observations only: and we will now give our final judgments.

The facts are set out in the Case Stated, and I need only summarise them here. The British South Africa Company carried on business (amongst other things) as an investment company. It is a finance house which makes loans, buys and sells shares, and so forth. It is taxed on the basis that, as and when investments are realised, any profit or loss on the realisation over or below the cost figure has to be brought into account. This case concerns an investment that it made in conjunction with the Anglo-American Corporation of South Africa, Ltd. In 1952 the Anglo-American Corporation agreed to finance three gold-mining companies in the Orange Free State. One of these companies was the President Steyn Gold Mining Co., Ltd. The Anglo-American Corporation agreed to provide the President Steyn Co. with loan facilities up to £4,000,000. In short, the Anglo-American Corporation agreed to lend President Steyn money as required up to a total of £4,000,000. In return the Anglo-American Corporation were to receive, first, a raising fee, that is, a commission of 2½ per cent. on the £4,000,000; secondly, interest at 6 per cent. on the money as and when it was lent; and thirdly, an option, exercisable up to and including 30th June, 1955, to subscribe at the price of 20s. per share for 2,000,000 shares in the President Steyn Co. If, in pursuance of this option, the Anglo-American Corporation subscribed for shares, the loan facilities (or, if the money had been lent, the loans themselves) were to be reduced by the amount paid for the shares.

Shortly after those arrangements were made the Anglo-American Corporation granted to the British South Africa Company a 5 per cent. participation in them. In pursuance thereof, early in 1953 the British South Africa Company lent to the President Steyn Co. a sum of £200,000, and in return they received, first, a raising fee of 2½ per cent. on the £200,000; secondly, interest at 6 per cent. on the £200,000; and, thirdly, an option to subscribe for 100,000 shares in the President Steyn Co. at £1 a share. The value of the shares at the time was 19s. 6d. a share, so that there was no point in exercising the option at that time. It was worth nothing then. But by November, 1954, the value of the President Steyn shares had gone up to 43s. 6d. a share. On 15th November, 1954, the British South Africa Company exercised the option. They did so through the Anglo-American Corporation. They subscribed for 100,000 shares, which were worth 43s. 6d. apiece, and paid £1 each for them out of the loan. So the British South Africa Company got 100,000 shares, and the loan of £200,000 was reduced by £100,000 to £100,000. This meant that by paying, or rather allowing in

**(Lord Denning, M.R.)**

account, £100,000, the British South Africa Company got shares which were worth at that time £217,000. In other words they were £117,000 to the good. The question is whether that £117,000 is taxable or not.

The rival views are these. On the one hand the Crown say that the Company was carrying on trade, not only as a dealer in shares, but also as a dealer in options: and that this option (to take up shares in the mining company) was an asset which was part of its stock-in-trade. The Company acquired this option in January, 1963, and realised it in November, 1964. If the Company had sold the option in November, 1954, for £117,000 (as it is conceded it could have done), it is admitted that that sum would have been taxable as part of its trading receipts. The option would have been realised for that sum. Now what has happened? Instead of selling the option, the Company has exercised it itself and acquired shares with it. The Crown say that that is the exchange of one asset (the option) for another asset (the shares). And that, they say, is a realisation of the asset. It is just the same, they say, as any trader who has an asset which is part of his stock-in-trade available for disposal, and, when it has gone up in value, instead of selling it, he takes it and exchanges it for another asset. He cannot get out of tax in that way. He must bring the asset which he thus realised into his trading account at its realisable value at the time of exchange. The Crown rely on the decision of the House of Lords in *Westminster Bank, Ltd. v. Osler*<sup>(1)</sup>, [1933] A.C. 139.

On the other hand the Company says that the option was not part of their stock-in-trade at all. The Company admit that they were dealers in shares, but not that they were dealers in options. They liken this case to a grocer who deals in beans and makes a forward contract which entitles him to delivery of the beans next year at £1 a case. This forward contract is, no doubt, an asset of the grocer which he may sell. But it is not part of his stock-in-trade. It does not come into his trading account. When he takes delivery of the beans, he brings them into his accounts at their cost of £1 a case, and when he sells them he brings in the price they fetch. The Company also likened this case to a shipowner who carries goods by sea and buys coal as fuel for his ships. The coal is an asset but it is not part of his stock-in-trade. If he finds he does not need to use all of the coal, and sells part which he does not need, he has to bring into charge for tax the price realised, but only on sale, not otherwise. The Company relied on *Imperial Tobacco Co., Ltd. v. Kelly* (1943), 25 T.C. 292. To which the Crown make this answer. The grocer was not a dealer in forward contracts, nor was the shipowner a dealer in coal; whereas here the Company were dealers in options. When weighing these rival contentions, I think the issue depends on this. Was this option part of the stock-in-trade of the British South Africa Company? I think it was. The option was a distinct contractual right, available in the hands of the British South Africa Company against the President Steyn Co. and transferable by the British South Africa Company to any purchaser. It was an asset just as much as any other asset of the Company. The Commissioners found that it was a "trading asset", and by that phrase I think they meant it was part of the stock-in-trade. I say that for two reasons: first, the phrase "trading asset" is taken from the judgment of Somervell, L.J., in *Gold Coast Selection Trust, Ltd. v. Humphrey*<sup>(2)</sup>, which was adopted by Viscount Simon in the House of Lords<sup>(3)</sup>. It was used in that case in reference to a gold-mining concession which was part of the stock-in-trade of the taxpaying company. Secondly, the Commissioners in the present case drew attention to the financial arrangements with the other two mining companies. In one case the Company received "registered option certificates" which were transferable

<sup>(1)</sup> 17 T.C. 381.<sup>(2)</sup> 30 T.C. 209, at p. 232.<sup>(3)</sup> *Ibid.*, at p. 238.

(Lord Denning, M.R.)

in the market. Those option certificates were undoubtedly part of the stock-in-trade of the Company. This option is indistinguishable in point of law from those options. The Company were dealers in options, and this option was part of their stock-in-trade.

Once it is found that the option was part of the stock-in-trade of the Company, the next question is this: When did the Company realise it? It seems to me that when they exercised the option, they disposed of one asset (the option) and acquired a new asset (the shares themselves). The learned Judge seems to have thought that the asset was one and the same asset before and after the option was exercised. That one asset was, he said, an interest in the shares. I cannot take that view. The option gave the Company no interest in the shares at all. It only gave the Company the right to acquire shares. I think these were two different assets. One was the option and the other was the shares. When the one was exchanged for the other there was a realisation of the one asset and the acquisition of another. If the Company had realised the option by selling it for cash, they would certainly have had to bring the proceeds into account for tax. So also when they realise the option by exercising it. They have realised part of their stock-in-trade, not by selling it for cash, but by receiving its equivalent in money's worth. They must account for this equivalent by bringing it into charge for tax. The case is governed in this respect by *Westminster Bank, Ltd. v. Osler*<sup>(1)</sup>, [1933] A.C. 139.

I ought to say that the Crown put forward an alternative contention. They said that the loan of £100,000 was part of the trading stock of the British South Africa Company, and then, when the option was exercised, this loan was realised and that the £117,000 was a taxable profit on the realisation. Both the Commissioners and the Judge rejected that contention. I would reject it too. In November, 1954, the loan was not realised. It was repaid. So far as the loan was concerned the British South Africa Company have to bring into tax the raising fee of 2½ per cent. and the interest at 6 per cent. But that is all.

My conclusion is rested on the ground that the option was part of the stock-in-trade of the British South Africa Company and that they realised the asset when they exercised the option. They realised it for their own benefit just as if they had sold it. I think they are taxable on the profits they realised in November, 1954. I would therefore allow the appeal.

**Danckwerts, L.J.**—In my view, the essential procedure in this matter is to appreciate the facts of the case. Once those facts are clearly understood, it seems to me that the conclusions must follow without difficulty and as night follows day. The British South Africa Company is, as the Master of the Rolls pointed out, an investment company. Through the Anglo-American Corporation's negotiations with the President Steyn Gold Mining Co., Ltd., the British South Africa Company agreed to participate in the financing of that company to the extent of 5 per cent. of the transaction. The result of this was that the Company in 1953 provided a loan of £200,000 to the President Steyn Gold Mining Co., Ltd. The rewards to the Company for this transaction included an option, exercisable up to and including 30th June, 1955, to subscribe, at the price of 20s. a share, for 100,000 shares in the President Steyn Co. The amount required to pay for these shares, if the option was exercised, was to be provided by reducing the loan by £100,000; that is, the loan was to be treated as having been repaid to that extent.

Now, of course, the option was an asset of the British South Africa Company if, and only if, the shares were of value of more than £1 per share.

**(Danckwerts, L.J.)**

Two methods of dealing with this asset were open to the British South Africa Company. The Company could, if the Company thought fit, sell the option for such price as they could obtain for it (as the Company in fact did in regard to an option which the Company had in respect of shares in the President Brand Gold Mining Co., Ltd.). But it was equally open to the Company not to realise the asset represented by the option in that way, and to retain the option until it became evident that the shares in the President Steyn Co. were worth taking up. And this is what the Company did. The Company exercised the option and received 100,000 shares in the President Steyn Co., which were said to be worth at the date of acquisition £217,000, paying therefor the sum of £100,000 by a corresponding reduction in the amount owing by the President Steyn Co. in respect of the loan.

Of course, if these shares could be sold then for £217,000, and were sold for £217,000, there would be a profit of £117,000 to the Company on the transaction. But so far as this case is concerned, the shares have not been sold, and no such profit has in fact been realised by the Company. And it might never be realised, because conceivably the shares might fall in value, the price on realisation might be much less, and, if the price on realisation fell below £1 per share, there would, instead of a profit, be a loss. And this seems to me to be "jam tomorrow" and not "jam today". The claim of the Crown to tax the Company on a profit of £117,000 seems to me to be premature and unreal. All this seems to me to be utterly clear and obvious.

But am I compelled by previous decisions binding upon us to come to some different result? It seems to me that it is a very artificial situation if I am so compelled. In *Ammonia Soda Co., Ltd. v. Chamberlain*, [1918] 1 Ch. 266, it was held that a company (which, of course, may only pay dividends out of profits) was entitled to set off appreciation of capital assets against trading losses for such a purpose. Reliance was placed on behalf of the Crown on the distinction made by Swinfen Eady, L.J., at pages 286-7, between "fixed" capital and "circulating" capital. What Swinfen Eady, L.J., in fact said, at page 287, was:

"The terms 'fixed' and 'circulating' are merely terms convenient for describing the purpose to which the capital is for the time being devoted when considering its position in respect to the profits for dividend."

But he added:

"Thus when circulating capital is expended in buying goods which are sold at a profit, or in buying raw materials from which goods are manufactured and sold at a profit, the amount so expended must be charged against, or deducted from, receipts before the amount of any profits can be arrived at."

In other words he was referring in those examples to profits actually realised. In *John Smith & Son v. Moore*<sup>(1)</sup>, [1921] 2 A.C. 13, the nature of fixed and circulating capital is discussed by Lord Haldane, at pages 19-20<sup>(2)</sup>. The opening sentences are:

"My Lords, profit may be produced in two ways. It may result from purchases on income account, the cost of which is debited to that account, and the prices realised therefrom are credited, or it may result from realisation at a profit of assets forming part of the concern."

Both those cases are clearly cases of profits actually realised.

In *Imperial Tobacco Co., Ltd. v. Kelly* (1943), 25 T.C. 292, the question was whether the profit on realisation of the company's dollars was a profit of its trade, but there was no doubt that it was a realised profit in actual

<sup>(1)</sup> 12 T.C. 266.

<sup>(2)</sup> *Ibid.*, at p. 282.

(Danckwerts, L.J.)

fact. In *Gold Coast Selection Trust, Ltd. v. Humphrey* (1948), 30 T.C. 209; [1948] A.C. 459, there had been a sale of a concession by a company which owned it to another company for fully-paid shares in that company, and it was held that tax was payable on the basis of the value of the shares at the end of the accounting year of receipt. But it is quite plain that the basis of liability was that there had been a sale of the concession and the shares were the price. This distinguishes the decision from the present case, which is simply the acquisition of the shares by the exercise of an option. It was admitted in the case above-mentioned that there had been a realisation of a trading asset, and the question really was how the value of the shares should be ascertained: see per Viscount Simon (adopting the conclusion of Somervell, L.J., 30 T.C., at page 238; [1948] A.C., at page 470). For a similar reason, *Westminster Bank, Ltd. v. Osler* (1932), 17 T.C. 381, is distinguishable from the present case. *Sharkey v. Wernher*<sup>(1)</sup>, [1956] A.C. 58, seems to me to have very little to do with the present case. The same applies to *Davies v. Shell Company of China, Ltd.* (1951), 32 T.C. 133; *Petrotim Securities, Ltd. v. Ayres*<sup>(2)</sup>, [1964] 1 W.L.R. 190; and *Ridge Securities, Ltd. v. Commissioners of Inland Revenue*<sup>(3)</sup>, [1964] 1 W.L.R. 479, which were decisions not favourable to the claim of the Crown.

I do not find my view to be inconsistent with the authorities. In my view, the case is not to be decided by describing the option as a "trading asset", or "stock-in-trade", or part of the company's "circulating capital". The point is whether there has been a realisation. It seems to me that, for this purpose, there is all the difference in the world between selling the option for a price, and acquiring shares by the exercise of the option.

As Dr. Johnson said of the attorney, "I would be loth to speak ill of any person who I do not know deserves it", but I have a suspicion that the difficulties of this subject have not been eased by the philosophising of economists and the practices of accountants. In a matter of this kind the issue should be decided by realities. In reality it is plain that the British South Africa Company, have not realised in fact their potential profit. In my opinion, the Commissioners and the learned Judge reached the right conclusion and the appeal should be dismissed.

**Diplock, L.J.**—This case is very much one of impression—second impression. To me at any rate it has lain in that twilight zone where it was not instantaneously clear whether or not the night of realisation has yet followed the day of investment. The Respondent, whom I will call "the Chartered Company", is a general trading and finance company. Investments form part of its stock-in-trade. It is common ground that any profit which accrues to it upon the realisation of any of its investments is properly included in the computation of the Chartered Company's profits. It is also common ground that the exchange of one investment for another may amount to the realisation of the former, in which case the profit on realisation is assessed by reference to the value of the investment received in exchange: see *Westminster Bank, Ltd. v. Osler*<sup>(4)</sup>.

The Chartered Company in the ordinary course of its business acquires for valuable consideration options to subscribe for new shares in other companies. Such options are, it is conceded, capable of being dealt with as investments forming part of its stock-in-trade. The questions in this case are: (1) whether the Chartered Company did deal with its option to subscribe at par for 100,000 new shares of £1 in the President Steyn Gold Mining Co., Ltd., as

(<sup>1</sup>) 36 T.C. 275. (<sup>2</sup>) 41 T.C. 389. (<sup>3</sup>) To be printed later in this volume. (<sup>4</sup>) 17 T.C. 381.

**(Diplock, L.J.)**

an investment forming part of its stock-in-trade and (2) if so, whether it realised that investment when it exercised the option and so acquired new shares to the value of £217,000.

Although I have stated the issue in this appeal as involving two questions they are really two aspects of a single question, the answer to which, I think, even at the risk of philosophising, depends upon the juristic nature of an option to subscribe to new shares in a company. In English law this is complicated by the doctrine of consideration where the option is not granted by deed, for a promise to grant an option requires consideration passing from the promisee to the promisor in order to create an enforceable obligation on the part of the promisor. But once consideration has been given or the option granted by deed, there comes into existence a unilateral obligation on the part of the grantor to issue new shares in its capital. The obligation so created is conditional (1) upon the grantee's demand for its performance and (2) upon tender by the grantee of the agreed price, but of itself it creates no rights on the part of the grantor. The grant of the option itself creates no obligation on the part of the grantee—only a right to demand performance of his obligation by the grantor. In the absence of such demand he assumes no obligation, conditional or otherwise. An enforceable option to subscribe for new shares in a company is thus of a different juristic character from a mere offer to issue new shares. A mere offer creates no obligations or rights on the part of either the offeror or the offeree. It is only upon the acceptance of the offer that any obligations come into existence. Such obligations are not unilateral but bilateral on the part of both offeror and acceptor. The offeror assumes an obligation to issue the shares to the acceptor conditional upon the acceptor's tender of the agreed price; the acceptor assumes an obligation to pay the agreed price conditional upon the offeror's issuing the shares: each acquires a corresponding right to enforce the obligation of the other. To speak of an enforceable option as an "irrevocable offer" is juristically a contradiction in terms, for the adjective "irrevocable" connotes the existence of an obligation on the part of the offeror while the noun "offer" connotes the absence of any obligation until the offer has been accepted.

It is also true to say that a contract with a company to subscribe for new shares in its capital is of a different juristic nature from the shares themselves when issued pursuant to the contract. The former is a right against the company; the latter an interest in the company. But this juristic difference would be relevant for Income Tax purposes only if the taxpayer were a dealer in contracts of this kind and the contracts were forward contracts so that the value of the shares when issued might vary from the contract price. The right to demand performance, by the grantor company, of its obligation created by an option to subscribe for new shares in its capital, is an asset or investment in the hands of the grantee. It is an investment which may be put into account, to use a neutral term, in a number of different ways, three of which are illustrated by the three options which the Chartered Company obtained through the Anglo-American Corporation on 9th January, 1953, to subscribe for new shares in the President Brand, the Welkom Corporation and the President Steyn companies respectively: (1) the option may be sold to a third party for cash, as was done in the case of the President Brand Co.; (2) the option may be assigned to a third party for a consideration other than cash, as was done in the case of the Welkom Corporation's option which, together with the benefit of the Welkom Corporation's promise to repay its indebtedness to the Chartered Company, was assigned to the Anglo-American Corporation in exchange for existing shares in the Welkom Corporation; (3) the option may be exercised against the grantor,

(Diplock, L. J.)

as was done in the case of the President Steyn option in the circumstances described by the Master of the Rolls.

It is conceded that (1) was a realisation of the investment represented by the option and that such investment formed part of the Chartered Company's stock-in-trade. It must, I think, also be conceded that (2) was a realisation of the investment represented by the option and that such investment formed part of the Company's stock-in-trade. One investment, that is, an option to subscribe for new shares, was bartered in the course of trade for another investment; that is, existing shares in the same company. (3), however, differs from (1) and (2) in that the option was not transferred to a third party. But this distinction is not crucial. If one investment has been substituted for another it matters not that both investments consist of rights against the same obligee: *Westminster Bank, Ltd. v. Osler*<sup>(1)</sup>. The Chartered Company's case is really based on the contention that the option did not differ in juristic character from the bilateral contract to issue and subscribe for new shares which was created when the option was exercised; that this contract was merely a means by which the Chartered Company acquired an investment forming part of its stock-in-trade, namely, the new shares, and that there will be no realisation of that investment until the new shares are sold.

For the reasons which I have stated I think that the premise is wrong. The option was an investment; it was of a different juristic character from the contract of sale into which it was converted when it was exercised and this was a realisation of an investment forming part of its stock-in-trade. I, too, would allow this appeal.

**Sir John Senter.**—May it please your Lordships, I ask your Lordships to say that this appeal is allowed with costs here and in the Court below. With great respect to your Lordship, the precise figure involved, as appears from the Case Stated, is £117,500. I hope that does not sound over-meticulous, but it appears from paragraph 2 of the Case Stated.

**Lord Denning, M.R.**—£117,500, is it?

**Sir John Senter.**—Yes, my Lord. That is the figure at issue. I am told by my learned junior that this Court has taken exception to what used to be in some cases the old form of remitting to the Commissioners to give effect to the decision of the Court, and it appears to be agreed on all sides, subject, of course, to what your Lordships think, that the rest of the Order should be a declaration—a remission to the Commissioners with the declaration that the exercise of the option referred to in the Case Stated gave rise to a profit of £117,500 to be taken into account for the computation of the profits of the Respondent for the year of assessment 1956–57. I think my learned friend would agree.

**Lord Denning, M.R.**—I think that would be in order, Sir John.

**Sir John Senter.**—If your Lordship pleases.

**Lord Denning, M.R.**—The appeal will be allowed with costs both here and below with a declaration accordingly that the £117,500 is taken into account.

**Mr. H. H. Monroe.**—Just on the question of costs, my Lord, I do not know whether in the circumstances of this case it might be appropriate that no Order was made as to costs in your Lordships' Court.



**Lord Denning, M.R.**—I know it is exceptional, but I think an Order ought to be made.

**Mr. Monroe.**—I am also instructed to ask for leave to appeal to the House of Lords.

**Lord Denning, M.R.**—I think you can certainly have that. You are welcome to it.

---

The Company having appealed against the above decision, the case came before the House of Lords (Lords Morris of Borth-y-Gest, Hodson, Guest, Donovan and Pearson) on 15th and 16th March, 1965, when judgment was reserved. On 13th May, 1965, judgment was given against the Crown, with costs (Lord Guest dissenting).

Mr. H. H. Monroe, Q.C., and Mr. M. P. Nolan appeared as Counsel for the Company, and Sir John Senter, Q.C., and Mr. J. Raymond Phillips for the Crown.

---

**Lord Morris of Borth-y-Gest.**—My Lords, the question which arises in this appeal is whether the exercise by the Appellant Company, on 14th October, 1954, of an option to acquire certain shares for £100,000 (the market value of which shares was at the date of allotment, 15th November, 1954, £217,500) gave rise to a profit of £117,500 which had to be taken into account in the Company's profits for the year to 30th September, 1955, which year formed the basis period for the 1956-57 assessment. For that year the Company had an assessment to Income Tax under Schedule D made upon it in a sum in respect of profits as a development, general trading and finance company which sum included the item of £117,500. The Company appealed to the Special Commissioners who held that the £117,500 in question was not a profit to be taken into account for the purpose of the assessment. On a Case Stated the appeal of the Crown was dismissed by Wilberforce, J. On appeal by the Crown to the Court of Appeal (Lord Denning, M.R., Danckwerts and Diplock, L.J.J.) the appeal was allowed, Danckwerts, L.J., dissenting.

There is no doubt that the Company was at all material times an investment dealing company, and that it carried on the trade of a development, general trading and finance company. At the relevant date it was taxed under Case I of Schedule D upon the profits of its trade of exploiting its mineral concessions and upon its realised profits on the sale of investments. The facts, which are fully set out in the Case Stated, relate to certain arrangements made by Anglo-American Corporation of South Africa, Ltd. (Anglo-American), and to certain arrangements made between the Company and Anglo-American. In the year 1952 Anglo-American made certain financing arrangements with three gold mining companies in the Orange Free State. They were President Steyn Gold Mining Co., Ltd. (President Steyn), President Brand Gold Mining Co., Ltd. (President Brand), and Welkom Gold Mining Co., Ltd. (Welkom). The present case relates to arrangements made between the Company and Anglo-American in connection with arrangements made by Anglo-American with President Steyn. Shortly stated Anglo-American agreed to make loans to

**(Lord Morris of Borth-y-Gest)**

President Steyn (for use in financing development) on terms which included giving Anglo-American an option to take up shares in President Steyn. The Company made an arrangement with Anglo-American to "participate". That meant that the Company found a part of the loan money and became entitled to a proportionate part of the rights of Anglo-American. The Case Stated finds that in this way the Company was able to employ its liquid circulating capital in earning interest and commissions and was able to acquire (at fixed option prices) interests in mining companies of a value exceeding the option price. Those were the purposes for which the Company participated in the arrangements made between Anglo-American and President Steyn.

So far as now material the arrangements which were made in 1952 between Anglo-American and President Steyn were as follows:

(1) Anglo-American agreed to provide President Steyn with loan facilities up to £4,000,000; President Steyn had the right to draw on the loan facilities as and when funds were required; the amounts drawn were to bear interest at the rate of 6 per cent. per annum: not less than £2,000,000 was to be repaid by 31st December, 1957, and the balance by 31st December, 1962.

(2) As consideration for the granting of the facilities Anglo-American were to have a raising fee of  $2\frac{1}{2}$  per cent. (payable in cash) on the full amount of the loan facilities (£4,000,000):

"and an option exercisable up to and including the 30th June, 1955 to subscribe at the price of 20s. per share (South African currency) for 2,000,000 shares"

in President Steyn.

(3) If Anglo-American subscribed for shares (in the terms above set out) the loan facilities provided by Anglo-American were to be reduced by a sum equal to the amount paid by Anglo-American in subscription of shares, and furthermore the amount due for repayment on or before the earlier of the two repayment dates (31st December, 1957) was to be reduced by the amount paid by Anglo-American in subscription of shares.

In 1952 Anglo-American also made arrangements in somewhat comparable terms with President Brand and with Welkom. In the case of President Brand the arrangements included an agreement by Anglo-American to subscribe for a certain number of 5s. shares in President Brand at the price of 17s. 6d., on terms that on subscription for the shares there would be granted registered option certificates conferring the right, exercisable up to and including 30th April, 1954, to subscribe for an equal number of shares at the price of 22s. 6d.

The present case relates only to the arrangements made between the Company and Anglo-American in relation to the arrangements made between Anglo-American and President Steyn. What happened was that Anglo-American informed the Company of the arrangements which they (Anglo-American) had made with the three Orange Free State mining companies and offered the Company "a 5 per cent. participation". In January, 1953, the Company accepted such participation. That meant that the Company had to find or had a loan commitment (as far as the President Steyn arrangements were concerned) of £200,000 and would be entitled to the proportionate part of the interest, the raising fee and the option rights. The dealings of the Company were with Anglo-American and not with President Steyn but nothing turns on this in the present case and no question arises as to the nature or the extent of the contractual position which resulted from the arrangements. In due course the Company paid the sum of £200,000 (referable to the President Steyn arrangements) to Anglo-American.

**(Lord Morris of Borth-y-Gest)**

In October, 1954, the Company wished to exercise their option. As their dealings were not directly with President Steyn they wrote a letter (dated 14th October, 1954) to Anglo-American in which they stated that they would like

“ to exercise the option, in the case of the President Steyn Company to subscribe for 100,000 shares at 20s. per share thus reducing this Company's loan to the President Steyn Company by £100,000”.

On receipt of that letter Anglo-American did what was necessary with the result that they were able (on 23rd November, 1954) to send to the Company a certificate for 100,000 fully paid 5s. shares in President Steyn allotted on 15th November, 1954: by their letter of the same date (23rd November) enclosing the shares, Anglo-American referred to the shares as being

“ in respect of the option exercised by your Company, and the reduction by £100,000 on that date [15th November] of its loan under this Corporation to the President Steyn Company.”

There being no necessity to consider whether this language was or was not as a matter of law strictly accurate, the question which calls for decision arises from the circumstance that, whereas on 9th January, 1953, the mid-market price of President Steyn shares was 19s. 6d., their mid-market price on 15th November, 1954, was 43s. 6d. The claim made by the Crown was that as a result of the exercise of the option the Company had made a taxable profit of £117,500, which represented the difference between the option price of 20s. and the price of 43s. 6d.

One way in which the claim of the Crown was put was that on the exercise of the option one item which formed part of its stock-in-trade (i.e. £100,000 of the £200,000 loan which it had made) was cancelled or was exchanged for or converted into or replaced by shares, that the shares constituted a different item of stock-in-trade, and that as they were worth or could have been sold for £217,500, there was a realisation of the loan which gave rise to an immediate taxable profit of £117,500. That contention has not found any judicial support. The Special Commissioners noted that in the schedule of investments attached to the Company's accounts for the relevant period the loan had been described as having been “ converted ” into shares: they noted also that thereafter the loan (to the extent of £100,000) no longer figured in the investments held by the Company as part of its stock-in-trade, but that the President Steyn shares did so figure. My Lords, I consider that the Special Commissioners were eminently right in concluding that the loan (to the extent of £100,000) had gone simply because it had been discharged. I agree also with their view that

“ it would not be either realistic or correct to regard it as exchanged for or converted into the shares ”.

The simple truth of the matter was that to the extent of £100,000 the loan was repaid. On the exercise of the option the Company had to pay £100,000 for the shares. They were owed £200,000, though repayment as to the first half of that sum was not due until 31st December, 1957, and as to the second half until 31st December, 1962. There was, however, the express provision, already noted, the effect of which was that the purchase price of the shares went in partial reduction of the loan. The payment (though effected by a set-off arrangement) of a sum of £100,000 in partial repayment of a loan of £200,000 cannot be regarded as resulting in any taxable profit.

I pass to the main contention by which the claim of the Crown was supported. It was put thus. The acquisition and later exercise of the option constituted a dealing in the course of the Company's trade: upon the exercise of the option there was a realisation: the option (which was a “ trading asset ” or an item of “ stock-in-hand ”) was exchanged for or was replaced by a different item of stock-in-trade which had a value in money's worth: the exercise of the

(Lord Morris of Borth-y-Gest)

option marked the end of one period and the start of a new one in the affairs of the Company: there was one composite transaction which was completed when the option was exercised, at which time there was a realisation in the course of trade for money's worth giving rise to a taxable profit of £117,500.

My Lords, this contention calls for an examination of the nature of that which the Company possessed. I cannot think that it matters much what it was or is called. In the argument for the Crown significance was attached to the finding of the Special Commissioners that the option was a trading asset. But there was also a finding, as already noted, that the Company participated in the financial arrangements for the purpose of acquiring (at a fixed option price) an interest in President Steyn. The facts themselves are entirely clear. They do not need the attachment of any descriptive names or labels. The Company, for good consideration, acquired a right. It was a right to have, on payment, a certain number of shares if, before a certain date, the Company called for and paid for the shares. The right was something that they owned. The value of the right that they owned would fluctuate. The value would increase if the prospects of President Steyn advanced favourably. The current market price of such shares as were already issued could be a guide to the value or future market price of new shares if issued. In the Case Stated it is recorded that it was no part of the case of either side that the option right had any value when it was obtained, and furthermore it is recorded that if a taxable profit arose as a result of the exercise of the option the amount of the profit would be £117,500. In view of this, no question arises for consideration as to what the taxable profit would have been if the Company had sold the right which they owned. In fact there was no such sale. The Company used the right which they owned and the only question which arises is whether by using or availing themselves of their right they then made a taxable profit. My Lords, I cannot think that they did. They had the right within a certain period of time to subscribe for shares at an agreed price. In using that right they were neither selling nor exchanging what they owned. They were deciding to purchase shares at the price of 20s. per share. If at a later date they had sold the shares which they had decided to purchase, they would then (because of the nature of their trade) have made either a trading profit or a trading loss according as to how the sale price compared with the purchase price of 20s. But the Company never in fact realised their option in the sense of passing it on, for a consideration, to someone else. There was no sale of the option. There was no exchange of it for something else. An exercise of an option involves an entirely different conception. When the Company exercised their option or, in other words, used or availed themselves of their rights that did not mark the end of a trading transaction: there was merely the end of a beginning of a trading transaction. There was a subscription for shares by a Company that dealt in shares and which might later make a trading profit by selling the shares.

If the shares had later been sold there might have been a profit. It would be natural to calculate a profit by relating the sale price and the purchase price. If, however, tax had already been paid on the basis now contended for by the Crown the result would be illogical and unjust. The Crown suggest that in the circumstance postulated the sum of 43s. 6d. would be, or ought to be taken to be, the closing figure of one transaction and the opening figure of another transaction. But that would be to falsify history. The shares were not acquired at 43s. 6d. They were acquired at 20s. Reasonable accountancy would not require the calculation of a paper profit at the date when the shares were acquired pursuant to the option.

My Lords, I do not consider that the case is advanced by designating the option rights as being stock-in-trade or as comprising a trading asset. The

**(Lord Morris of Borth-y-Gest)**

nature of the option rights admits of no doubt. While it is true that at one time the Company had the right to subscribe for shares, and that at a subsequent time and after they had exercised their option they had the shares, I cannot regard the exercise of an option as being a realisation of an asset giving rise to a trading profit. There was no element of sale as there was in *Imperial Tobacco Co., Ltd. v. Kelly*, 25 T.C. 292. There was no element of exchange as there was in *The Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22, and in *Westminster Bank, Ltd. v. Osler*, 17 T.C. 381. In his speech in the latter case Viscount Buckmaster, at page 402, said:

“The exchange effected in the present case was, in fact, the exact equivalent of what would have taken place had instructions been given to sell the original stock and invest the proceeds in the new security.”

The features of the present case are quite different.

For reasons which I have given I consider, in agreement with Danckwerts, L.J., that the learned Judge came to a correct conclusion. I would allow the appeal.

**Lord Hodson.**—My Lords, this case has provoked much division of opinion. The Court of Appeal by a majority reversed the decision of Wilberforce, J., who had affirmed the decision of the Commissioners for the Special Purposes of the Income Tax Acts given in favour of the Appellant, the British South Africa Company, which I will call “the Company”.

The Company carried on the trade of a development, general trading and finance company and in the course of this trade had acquired interests in African mining companies. The question at issue is whether the acquisition and subsequent exercise by the Company of an option to subscribe for shares constituted a dealing in the option in the course of the Company's trade, and whether the exercise of the option was a realisation in the course of trade giving rise to a taxable profit of £117,500. Alternatively, the question was posed whether on the exercise of this option one item of the Company's trading stock, viz., the Company's loan to the President Steyn Gold Mining Co., Ltd., to the extent of £100,000, was converted into or exchanged for President Steyn shares and so constituted a realisation giving rise to a taxable profit of £117,500.

There is no question but that the Company was a dealer in shares for tax purposes and that when shares were sold at a profit the profit was taxable. The Company in the course of its business made loans to various companies at interest, receiving in addition a raising fee and an option to take up shares in the company to which the loan was made.

In 1952 the Anglo-American Corporation of South Africa, Ltd., which I will call “Anglo-American”, offered the Company a 5 per cent. participation in financing three South African mining companies. President Steyn was one. The Welkom Gold Mining Co. was another and the President Brand Gold Mining Co. a third. The Appellant accepted a 5 per cent. participation and loaned President Steyn £200,000 at 6 per cent. interest in return for a raising fee of 2½ per cent. and an option to subscribe for 100,000 shares of President Steyn at par (20s.). The option was thus obtained for valuable consideration but was at that time regarded as valueless, since the shares stood at 19s. 6d., or 6d. under par.

In 1954 the Company exercised the option when the shares stood at 43s. 6d. thus making a paper profit of 23s. 6d. a share, which is the £117,500 claimed as profit on realisation in the course of dealing. At the same time, in pursuance of the arrangement previously made with Anglo-American, the Company received the share certificate for 100,000 shares and the loan was reduced by £100,000 at a date earlier than it would otherwise have been repayable. Since the share

(Lord Hodson)

certificate was worth more than £100,000 the alternative claim is made that the excess value over £100,000 is a taxable profit which is, of course, £117,500, the same figure as that claimed under the first alternative, the loan having been exchanged for or replaced by the shares.

I can deal with the second contention shortly. The Company had lent £200,000 to President Steyn and when the option was exercised the Company had to subscribe £100,000 for the shares which they acquired. In the result all that happened so far as the loan was concerned was that half was repaid and no profit thrown up so far as that transaction was concerned.

There remains the question whether the exercise of the option by the Company is a realisation of a profit. The Company contends that when the option was exercised trading stock was acquired and profit cannot be found until the shares are sold. It was found by the Special Commissioners that the intention of the Company was to acquire at fixed option prices interests in mining companies of a value exceeding the option price and that for these purposes the Company participated in the financial arrangements in connection with President Steyn.

This is precisely what happened, but the matter which influenced the majority in the Court of Appeal decisively in favour of the Crown was that the Company was a dealer in options and could have sold the option at a profit and, having done so, would have included the money paid in respect of the sale as part of its trading receipts.

It is said that when the Company exercised the option they realised it and acquired another asset in its place, thus bringing themselves within the principle of those cases like *The Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22, and *Westminster Bank, Ltd. v. Osler*, 17 T.C. 381, which in effect decide that the exchange of one asset for another is a realisation. In the first case a company was required under the Railways Act, 1921, to accept new stocks in the amalgamated companies in exchange for the stocks held in the companies which were absorbed. A loss having arisen to a company by virtue of this arrangement, it was claimed that the company was entitled to deduct this loss in making its returns and the claim was upheld by Rowlatt, J. Rowlatt, J., said that the old investment was closed and realised and a new investment started. In the second case this House expressly approved and followed Rowlatt, J.'s decision in the first case. These cases do not, however, answer the question whether the exercise of an option is its realisation. In my opinion it is not. If it were, one would of course have to draw a line after the profit of £117,500 had been shown and start again with the figure of presumably £217,500 made up of £100,000, the price of the shares, and £117,500, the profit figure, and thus having entered the new starting figure wait to see whether a profit was made on realisation of the shares when they were sold. This does not seem to me to represent the reality of the case.

It is true that the option could be dealt with and, as the Company's accounts show, this was done in the case of at least one other company. It is also true that in the case of, for example, the President Brand registered option certificates were issued with the ordinary share certificates in order to facilitate dealing. It does not follow, however, that the exercise of an option is a realisation of it just as much as if it had been sold. I do not think that the exercise of an option is the exchange of one investment for another. It is the acquisition of the shares which gives rise to the realisation of a profit if and when the shares are sold to advantage, but the option was in this case never realised because it was never dealt with in the course of trade. The option was never dealt with at all. It was, on the other hand, retained until, as had been intended, it was

**(Lord Hodson)**

exercised by the acquisition of shares. That there is nothing to prevent an option being at the same time part of the stock-in-trade available for dealing purposes, and at the same time something which is not dealt with independently but forms an ingredient of the ultimate product, is illustrated by the case of *Imperial Tobacco Co., Ltd. v. Kelly*<sup>(1)</sup>. The company's dollar requirements for the purchase of the American crop of tobacco were each year large but varied according to the size of the American crop and the prices paid at auction sales. The company did not buy dollars for the purpose of re-sale in the way of speculation but exclusively for meeting the requirements of the company's buying organization at Richmond, Virginia. Owing to the outbreak of war in 1939 the company had on hand a holding of dollars which on sale produced a profit to the company. It was held by the Court of Appeal that the profit made on the sale must be included in the computation of the profits of its branch of the company. The dollars were not used for the purpose for which they were intended, namely, the purpose of a transaction on revenue account, viz., the purchase of tobacco leaf, but disposed of to a third party which was expressed in a trading result. If they had been used for the intended purpose no tax question would have arisen. The Imperial Tobacco Co. could not have claimed a loss if the dollars went down in value nor be assessed on a profit if they went up. The dollars would have been used as intended, to buy tobacco. That would have been an exercise of a right which gave rise to no trading profit or loss.

In the instant case the option was used for the purpose for which it was intended, that is to enable shares to be acquired by the Company at a favourable price, and the exercise of the right to buy shares gave rise to no trading profit or loss. It would be otherwise if the option had been dealt with by sale to a third party; there would then be a dealing in the option. As the accounts show, this occurred in the case of an option to acquire shares in another company which was rightly so shown in the accounts. I would allow the appeal.

**Lord Guest.**—My Lords, the facts out of which this appeal arises are fully set out in the Case Stated and in the judgment of Wilberforce, J.

As a result of a financial arrangement entered into between Anglo-American Corporation of South Africa, Ltd., and the President Steyn Gold Mining Co., Ltd., in 1952, the Appellants were granted an option to subscribe for 100,000 shares in President Steyn at 20s. As part of the transaction Anglo-American provided loan facilities to President Steyn and these were to be *pro tanto* reduced upon the exercise of the option. In 1954 the Appellants exercised their option in respect of 100,000 shares and in November, 1954, 100,000 shares were allotted to the Appellants at par. Simultaneously the loan of £200,000 to President Steyn by Anglo-American was reduced to £100,000. As at that date the shares in President Steyn had a market value of 43s. 6d., so that the Appellants acquired shares in President Steyn for £100,000 which showed a book profit of £117,500.

The Crown contend that this sum was a profit from a dealing in the course of the Appellants' trade and as such liable to Income Tax under Schedule D. A difference of opinion resulted in the Courts below, Wilberforce, J., holding that it was not and the Court of Appeal by a majority holding that it was.

From the facts as found by the Special Commissioners it is plain that in the course of its trade the Appellant Company made loans to be used in financing development by mining companies, and at the same time received options to take up at fixed prices shares in mining companies at a value exceeding the option price. Thus the transaction in question whereby the Appellants received

<sup>(1)</sup> 25 T.C. 292.

(Lord Guest)

an option to purchase shares in President Steyn was in the course of their trade. It is said that there is no finding that the Appellants dealt in options in the course of their trade in the sense that they bought and sold options as part of that trade. To my mind this is immaterial: they certainly gave consideration for this option and they might have disposed of it for value if they had been so minded.

It is conceded that the option was not held on capital account but was on revenue account. There is, moreover, a finding by the Commissioners that the option right was a trading asset of the Company. I understand it to be suggested that this does not necessarily mean "stock-in-trade", but in the context means an asset with which to acquire stock-in-trade, in other words the means whereby shares can be purchased. I understand the terms "trading asset" and "stock-in-trade" to be synonymous. But in any case it is not legitimate, in my judgment, to go behind the Commissioners' finding on what is a pure question of fact. The option was a trading asset of the Appellants. Although it did not apparently figure in the Appellant Company's accounts, it had some value as at 1952.

Therefore, the position is reached that the option is a trading asset and that the Company deals in options in the course of its trade; the only remaining question is whether it has been realised so as to result in a trading profit to the Appellants. There is no authority precisely in point, but assistance can, in my opinion, be obtained from two cases where the question of realisation arose. In the first case, *The Royal Insurance Co., Ltd. v. Stephen*, 14 T.C. 22, the company held investments in British railway stocks and under the Railways Act, 1921, the company was required to accept new stocks in the amalgamated companies in exchange for stocks previously held by the company. The new stocks had a definite market value at the date of the exchange and this was less than the original cost to the company of the stocks surrendered. It was held by Rowlatt, J., that the surrender of the old stocks was equivalent to realisation and that that difference between cost price and the market value should be allowed as a deduction in computing its profits. The whole question in the case turned on whether there was a realisation. Rowlatt, J., in giving judgment, at page 28, said:

"At the bottom of this principle of waiting for a realisation, I think there is this idea: while an investment is going up or down for Income Tax purposes the Company cannot take any notice of fluctuations, but it has to take notice of them when all that state of affairs comes to an end, when that investment is wound up I will say—'wound up' is an unfortunate expression perhaps and I will say when an investment ceases to figure in the Company's affairs, when it is known exactly what the holding of that investment has meant, plus or minus to the Company, and then the Company starts so far as that portion of its resources is concerned with a new investment. Then one knows where one is and it is no longer a question of paper, it is a question of fact and that is a realisation. I think that is the point of view from which it ought to be looked at, and looking at it from that point of view the Company is right. It has done with the investments in the companies. They have disappeared. It is known exactly in money. It is known now exactly what their holding of them has meant to the Company. They will never more go up or down. What will go up or down now are the different shares in the new companies, altogether different investments really, and therefore I think that the old investment is closed and realised and a new investment is started."

The next case is *Westminster Bank, Ltd. v. Osler*, 17 T.C. 381, where the bank converted their holdings of National War Bonds partly under provisions contained in the original terms of issue and partly under the terms of a subsequent conversion offer into War Loan and Conversion Loan, the value of the stocks received in exchange being greater than the cost to the bank of the National War Bonds converted. It was held that the conversion of the National War Bonds was equivalent to the realisation of investments. In the later case of *Gold*



**(Lord Guest)**

*Coast Selection Trust, Ltd. v. Humphrey*, 30 T.C. 209, the words of Somervell, L.J., at page 232:

“ We have come to the conclusion that when there has been, as is now admitted here, a realisation of a trading asset and the receipt of another asset, and when that latter asset is marketable in its nature and not some merely personal advantage which by its nature cannot be turned into money, the profits and gains must be arrived at for the year in which the transaction took place by putting a fair value on the asset received ”

were approved by Viscount Simon at page 238.

Applying the principles of these decisions, and in particular the reasoning of Rowlatt, J., in the *Royal Insurance* case<sup>(1)</sup>, I have reached the conclusion, not without some difficulty, that the exercise of the option right amounted to a realisation of the option which resulted in a trading profit of £117,500. No doubt the circumstances of these cases are not the same, but, in my opinion, they bear a close analogy to the present. As at 1952 when the option was granted it was an asset of value: if it had appeared in the Company's books in between 1952 and 1954 its value might have increased or the value might have decreased. Upon exercise of the option in 1954 the option as such would disappear from the books and the shares appear in the books. In the words of Rowlatt, J., that is “ an end of the old suspense ”<sup>(2)</sup>. The value of the option has crystallised. The act of exercising the option may be compared to the act of conversion in the *Westminster Bank* case<sup>(3)</sup>, where the bank were exercising a right of conversion which attached to the original National War Bonds. The argument for the Crown in the latter case was that the bank were merely working out the rights given them on the prospectus. This was precisely the argument for the Appellants in the present case, that they were merely exercising an option and not realising an asset.

For these reasons I for my part am satisfied that the exercise of the option in 1954 by the Appellants amounted to a realisation and that the majority of the Court of Appeal came to the right conclusion. I would dismiss the appeal.

**Lord Donovan.**—My Lords, so far as the material before your Lordships shows, there was no privity of contract between the Appellant Company and the President Steyn company. The bargain was between the Appellant Company and Anglo-American. Nevertheless, the appeal has been argued on the footing that this is immaterial; and that the case can be considered as if the Appellant Company lent £200,000 direct to the President Steyn company, and had an option from that company to subscribe for 100,000 of its shares at par.

The Crown's argument is simple. The option has been realised. Money's worth has been obtained in return. That money's worth is of such a value that the Company is £117,500 better off for having had the option. Income Tax is payable on that profit. If the case were as easy as this, there would hardly have been the existing difference of judicial opinion about it; and the Court of Appeal would hardly have recalled what would have been its judgment in favour of the taxpayer, and substituted a contrary judgment in favour of the Crown. The truth is that the case is not easy, and that the right decision is elusive.

If the Appellant Company had selected some particular holding out of its portfolio of shares and exchanged them for a different holding which was worth more in the market, then it is common ground that the surplus would have been taxable. Stock-in-trade would have been realised, and money's worth of a

(1) 14 T.C. 22. (2) *Ibid.*, at p.28. (3) 17 T.C. 381.

(Lord Donovan)

greater value obtained in return. This is enough, in the case of a company like the Appellant, to attract Income Tax—see *The Royal Insurance Co., Ltd. v. Stephen*<sup>(1)</sup> and other cases. The present case, say the Crown, is no different. But is it true to say that the option right has been realised so as to yield an immediate profit? What after all was the option? It was the right to require acceptance of the Appellant Company's offer to subscribe for 100,000 shares at par. When this kind of right is exercised does a profit at once emerge?

Your Lordships may be helped to the proper answer by considering where the Crown's contention leads. If the present claim is upheld and the shares in President Steyn are eventually sold for £417,000 how much profit will then result? The Company would say £317,000, i.e., £417,000 less the cost of £100,000. The Crown say £200,000 only. If it were otherwise, of course, the Company would pay tax twice on the sum of £117,500, since it is being asked to pay tax on that sum today. The Crown justify their figure by saying that £217,000 would have to be entered on the debit side of the account for the purpose of computing the profit. Yet it is not the cost—the cost was £100,000. The £217,000 is, however, the right figure to debit, argue the Crown, because a line has to be drawn separating the effect of exercising the option from the effect of any subsequent dealing in the shares. They are, as it were, two self-contained transactions. Therefore, one should start the new account with the closing figure of the old, namely, £217,500. To say, however, that there are really two transactions, requiring separation in this way, is simply another facet of the contention that a profit was made when the option was exercised, and does not help to establish the truth of that proposition. But one finds it leading to the consequence that a figure of £217,500 has to be debited as the cost of the shares in the face of a contract which declared that cost to be £100,000.

There are, it is true, cases where the market value of an asset at the time of its acquisition has to be debited as the opening figure for an item of stock-in-trade in a trading account because there is no figure of cost, e.g., where the stock has been obtained otherwise than by purchase; but it is common ground that there is no reported case when the known and *bona fide* cost in money of such an item has been displaced by the figure of market value.

Again, assume the case of a dealer in stocks and shares who enters into a binding contract for the purchase of shares and, between the date of the contract and the delivery of the shares, their value rises. Has he made a profit? Consistently with their argument, the Crown, when this example was put to them, asserted that he had. In relation to such a case the difference in law between a contract and an option, which is stressed by Diplock, L.J., is immaterial. What is material is that the dealer had a right to obtain certain shares. The right cost him £*x*. When the shares are delivered they are worth £*x* + *y*. A "profit" has thus been realised of £*y*; and if contracts of this kind are trading assets of the dealer he must, say the Crown, pay Income Tax now on £*y*. This, I imagine, will be surprising news in the City of London.

So far the Courts have never had to consider the validity of any such claim, and it would be unreal to suppose that this comes about because no taxpayer has felt it worth while to resist it. So far as I am aware the claim in the present case is novel, but it is easy to appreciate why it has been made. The Company is an overseas trade corporation and, pursuant to Sections 25 and 37 of the Finance Act, 1957, will, as from 1957–58, be immune from Income Tax on any profit resulting from the disposal of the President Steyn shares. Hence the claim made here for Income Tax for the year 1956–57 on "profit" from the

---

(<sup>1</sup>) 14 T.C. 22.

**(Lord Donovan)**

exercise of the option. The claim is, of course, no worse for being made in such circumstances, Nor is it any better.

In *Whimster & Co. v. Commissioners of Inland Revenue*, 12 T.C. 813, at page 823, occurs the well-known passage from the judgment of the Lord President (long accepted as authoritative) to the effect that, subject to any special direction in the Income Tax Acts, profits are to be computed, for Income Tax purposes, consistently with the ordinary principles of commercial accounting. There are no special statutory directions here in point. True, there was no evidence before the Special Commissioners directly dealing with the application of commercial principles to the facts of this case; but the Commissioners do find that the method of accounting employed by the Company for the purpose of computing its profits for Income Tax was to treat profits as arising only upon a realisation—that word meaning, in its context in the Case Stated, a disposal, e.g., by sale or exchange. With this method of computing profits the Crown have agreed; and, of course, they would not admit that they are changing their attitude now, for their case is that an asset, to wit, the option, has been realised. But the problem remains—would commercial men in their accounts separate this transaction into two parts and show a separate profit emerging when the option was exercised and the shares acquired? Certainly the Company did not do so, nor did the Crown, with all the wealth of experience at their disposal, attempt to prove that this was what commercial principles required. Of course no taxpayer can defeat the rights of the Crown by the method he chooses for keeping his accounts. That is a different point. What is material here is that the Crown have not attempted, by evidence or by argument, to show that their case is supported by reference to commercial principles or practice.

In the light of the foregoing considerations I come back to the question which is crucial, namely, whether the option was realised with the result for which the Crown contend. The Special Commissioners thought it had not; and my noble and learned friend Lord Wilberforce, when this case was before him in the High Court, clearly took the like view. In the Court of Appeal, and in robust language, Danckwerts, L.J., said that there was all the difference in the world between selling the option for a price and acquiring shares by its exercise and that the potential profit had not yet been realised. “Realisation” is a word of many and varied meanings. It certainly covers the case where one kind of property is converted into another and different kind. So that no misuse of language necessarily occurs by saying that the option in the present case was realised (though the more natural word would be the word “exercised”). But was the option realised in such a way as to produce an immediate profit? This is the crucial question.

I find myself in entire agreement with those who have given a negative answer. The Company here simply did what it was entitled to do, namely, acquire the President Steyn shares for a particular price. It did not have to pay away cash for the purpose nor exchange any other asset by way of barter. All it did was to exercise a right. Diplock, L.J., did not find the distinction to be crucial, but like the majority of your Lordships I respectfully take the opposite view. I think that all the Company did was to use the means which it had to hand of buying the shares in the President Steyn company at an advantageous price. I do not think that any profit emerges at this stage, and no commercial principle of accounting known to me supports the opposite view. If one existed, there is little doubt that your Lordships would have heard of it. On this view of the case it is irrelevant to go into the question whether as things stood the option was an “asset of the business” or “stock-in-trade” or both. Nor is it in the least fatal to the Company’s case that if it had sold the option for money

(Lord Donovan)

or money's worth any profit would have been taxable. The argument would then have been that the Company had elected to treat this option as stock-in-trade, and the Company, its business being what it is, could scarcely have resisted successfully. But in the events which happened, and whatever label is given to the option, it was treated as and remained throughout the means whereby the Company could acquire the President Steyn shares "on the ground floor" as the saying is.

With regard to the alternative contention of the Crown, it is clear from the terms of the arrangement between the Anglo-American company and the President Steyn company, as set out in the Case Stated, that when the Appellant Company acquired the shares, £100,000 of the loan moneys due to it was set off against the like sum due from it in respect of the shares. In law this operated as a repayment of the loan, and a subscription of the shares in cash (cf. *Spargo's Case* (1873), L.R. 8 Ch. App. 407). It is not possible, therefore, to argue that the loan was directly converted into shares as the Crown must do.

I agree that the appeal should be allowed.

**Lord Pearson.**—My Lords, for the reasons given by my noble and learned friend, Lord Donovan, whose opinion I have had an opportunity of reading, I would allow the appeal.

*Questions put:*

That the Order appealed from be reversed and the judgment of Wilberforce, J., restored.

*The Contents have it.*

That the Respondent do pay to the Appellants their costs here and in the Court of Appeal.

*The Contents have it.*

[Solicitors:—Solicitor of Inland Revenue; Coward, Chance & Co.]

---

