1979 June 19

[TRIANTAFYLLIDES, P., STAVRINIDES, L. LOIZOU, HADJIANASTASSIOU AND MALACHTOS, JJ.]

KOUMIPA LIMITED,

Appellant.

and

THE REPUBLIC OF CYPRUS THROUGH
1. THE MINISTER OF FINANCE,
2. THE COMMISSIONER OF INLAND REVENUE,

Respondents.

(*Revisional Jurisdiction Appeal No.* 173).

Income Tax—Exchange profit—Profit realised on exchange rate on repayment of a loan—Loan from the outset part of the appellant's circulating capital—Exchange profit which accrued a trading profit and not a receipt of a capital nature—Subject to income tax—Section 5(1) *of the Income Tax Laws* 1961 *to* 1973.

The appellant company was incorporated on the 16th September, 1966 for the purpose of buying, at Famagusta, plots C 128 and C 129 and erecting thereon a block of flats and shops for sale. On the 27th November, 1967 they raised a loan of £70,000 from Barclays (Overseas) Development Corporation Ltd., of London for the purpose of completing the buildings in question. This loan was payable in pounds sterling, by 23 monthly instalments of £5,000, plus any accrued interest, the first instalment being payable on the 31st of March, 1969. The construction was completed and the flats and shops sold by the 31st December, 1970. Though when the loan was contracted the Cyprus pound and the pound sterling were in parity, during the repayment period of the loan there was a fall of the pound sterling, as compared with the Cyprus pound, and the appellant company required a sum smaller by 2164 Cyprus pounds to pay the 1973 pound sterling instalment.

The respondent Commissioner decided to treat this amount of C£2,164 as a trading profit and, consequently, taxable, and claimed the amount of £785.825 mils as income tax

The trial Judge dismissed the recourse of the appellant company against the validity of the Commissioner's said decision having held that the said amount was a trading profit and not a receipt of a capital nature.

Upon appeal by the Company:

Held, dismissing the appeal, that whether a receipt is a trading receipt or not, depends on the nature of the trade and is chiefly a question of fact; that where a profit or loss, emanating from changes in the rates of foreign exchange, arises in the course of trading operations it is taxable as trading income; that circulating capital is capital which is turned over and in the process of turning over yields profit or loss in the course of trading operations; that, on the contrary, fixed capital is not involved directly in that process and remains uneffected by it; that the flats and shops sold formed part of the trading stock of the company; that, therefore, once the loan from the outset was part of the appellant's circulating capital, the profit made out of the exchange was part of the company's trading receipts; and that, accordingly, the judgment of the learned trial Judge that the profit made was a trading profit and not a receipt of a capital nature must be affirmed.

Appeal dismissed.

Cases referred to:

Landes Brothers v. *Simpson*, (*H. M. Inspector of Taxes*), 19 T.C. 62;

McKinlay v. *H. T. Jenkins and Son, Limited*, 10 T.C. 372;

Imperial Tobacco Co. (of Great Britain and Ireland) Ltd. v. *Kelly* (*H.M. Inspector of Taxes*), 25 T.C. 292;

Rustproof Metal Window Co. Ltd., v. *Commissioners of Inland Revenue*, 29 T.C. 243;

Davies (*H.M. Inspector of Taxes*) v. *The Shell Co. of China* Ltd., 32 T.C. 133;

Shadbolt (*H.M. Inspector of Taxes*) v. *Salmon Estate* (Kingsbury) Ltd., 25 T.C. 52.

Appeal.

Appeal from the judgment* of a Judge of the Supreme Court (A. Loizou, J.) given on the 28th February, 1976 (Revisional Jurisdiction Case No. 83/75) whereby appellant's recourse

* Reported in (1976) 3 C.L.R. 56.

against the decision of the respondent Commissioner to impose income tax on the profit realised on exchange rate, on repayment of a loan, was dismissed.

R. Stavrakis, for the appellant.

A. Evangelou, Counsel of the Republic, for the respondents.

Cur. adv. vult.

TRIANTAFYLLIDES P.: The judgment of the Court will be delivered by Mr. Justice Hadjianastassiou.

HADJIANASTASSIOU J.: The question which is raised in this Revisional Appeal is whether the profit which resulted from the difference in exchange between the Cyprus pound and the pound sterling on the repayment of a loan contracted by the appellant company from Barclays (Overseas) Development Corporation Limited was a profit which arose from a trading activity, and as such was assessable to income tax.

The facts as found by the learned Judge are these:- The appellant company was incorporated on the 16th September, 1966, for the purpose of buying plots C. 128 and C. 129 at Famagusta in order to erect a block of flats and shops for sale. On 23rd January, 1967, the appellant company agreed with a firm of building contractors to have the said block of flats and shops constructed at a cost of £138,500.- On the 27th January, 1967, a loan of £70,000.- was raised from Barclay's (Overseas) Development Corporation Limited of London for the construction of the said flats and shops. This loan was repayable in pounds sterling by 23 monthly instalments of £5,000.- each, plus any accrued interest, the first instalment being payable on the 31st March, 1969. The flats and shops in question were erected and were sold by 31st December, 1970, but during the repayment period of the loan, a difference in exchange arose between the pound sterling and the Cyprus pound which resulted in the income year 1973, in a surplus of the amount of C£2,164, in favour of the applicant company. This was due to the fact that in 1973 there was a fall of the pound sterling as compared with the Cyprus pound and the appellant company required a smaller sum in Cyprus pounds to pay the 1973 pounds sterling instalments. As a result, the appellant's liability to Barclay's Corporation was being reduced, and there was a diminution in the appellant's liability and an increase in

the appellant's balance as against that liability which was equivalent (as it was said earlier) to the sum of C£2,164. It was claimed on behalf of the respondents that this amount represented a trading profit whilst appellant claimed that the amount in question was a capital profit. Finally, the respondents decided that the amount of C£2,164.– was a trading profit which they brought into the computation of the trading profits of the appellant company and imposed tax amounting to £785.085 mils.

We think we would add, in order to complete the picture, that when the loan was raised, the Cyprus pound and the sterling were in parity. In fact, they had been so for years, and when in 1967 there was a devaluation of the sterling, the Cyprus pound followed suit and remained in parity with it, but the same course was not followed in the year 1972 regarding the devaluation of the sterling.

It is also important to add that the objects of the company in question, as appearing in the Memorandum of Association are wide enough to include the acquisition of land and buildings, their exploitation and the construction of buildings thereon for sale and exploitation, and are not confined to the acquisition of the aforesaid two plots only.

The capital of the company was £100,000, divided into 100,000 ordinary shares of £1 each; 50% of the shares were obtained by Constantinos and Irene Koumouli, and 50% by Ioannou and Paraskevaides Ltd. The paid-up capital of the company was £41,000 out of which £20,000 was used towards the purchase of the two plots in question, and the remaining cash was utilized for the construction of the block of flats and shops.

As we have said earlier, the Commissioner of Income Tax treated the profit made by the said company as a trading receipt being taxable under the provisions of section 5(1) of the Income Tax Laws, 1961 to 1973.

The appellant company, feeling aggrieved, objected to the said assessment, and alleged that the exchange profit which resulted to them was not a trading profit, but a capital receipt not subject to tax.

The learned trial Judge, in a very careful and thorough Judg-

ment, having quoted a number of cases to show that the said amount was of a trading nature, dismissed the recourses of the company and said:-

" In our case, the loan was contracted for the purpose of acquiring stock which is a circulating capital and the profit realised on the exchange rate is assessable to tax, because the purpose for which the loan was made was to carry out an intended commercial transaction, that is, to build and sell flats and not to build flats as an investment. In other words, it was a loan contracted for the purpose of acquiring circulating capital and not fixed capital for the purpose of carrying out a commercial operation and not for the purpose of investing money. In fact, though that is not conclusive, it was not so treated by the applicant Company itself, as the interest payable on this loan was treated as a deductible expense for the computation of profits resulting from the sale of the flats.

That exchange profits arising in the course of the trade and giving rise to corresponding trade liabilities in the form of the tax payers obligation as to repayment are taxable as trading profits is clear also from the *Davies* case (*supra*) where the case stated was to the effect that the deposits in that case were part of its fixed capital and did in fact so use them and not as circulating capital for the purpose of carrying on its trade, whereas in the present case the loan was contracted for the simple reason of forming part of its circulating capital for the purpose of carrying on its trade.

I need not go in detail into the differentiations made by economists between fixed and circulating capital. It is sufficient to refer to the *Davies* case (*supra*) at p. 153, where by reference to Adams Smith who described fixed capital as what the owner tends to profit by circulating capital is what he makes profit of by parting with it and letting it change masters, and as put by Lord McMillan in the case of *Van Den Berghs Ltd.* v. *Clark* (*Inspector of Taxes*), 19 T.C. 390 at p. 431. 'Circulating capital is capital which is turned over and in the process of being turned over, yields profit or loss. Fixed capital is not involved directly in that process and remains unaffected by it.'

Bearing in mind the facts and circumstances of this case and the aforesaid exposition of the law, I have come to the conclusion that Barclay's International were trade creditors and repayments of instalments to them on the loan contracted were trade outgoings. Furthermore, as the purpose of the loan from the outset was to be made and was made part of the circulating or trading capital of the applicant Company, the profit which accrued was reduction in the Company's liabilities in respect of repayments due to the change in the rate of exchange; it was a trading profit and not a receipt of a capital nature giving rise to a corresponding indebtedness on capital account and not forming part of the Company's trading receipts or liabilities, as things were in the *Davies* case (*supra*, at p. 155 of the report)."

The only ground argued before the learned trial Judge, and before this Court was that the sum of £2,164 which resulted from a difference in exchange between the Cyprus pound and the pound sterling on the repayment of the loan contracted by the appellant company, was not a receipt made from a trading operation or activity or a receipt assessable to income tax under s. 5(1) of the Income Tax Laws 1961–1973. Section 5(1)(a) says that:–

" Tax shall, subject to the provisions of this Law, be payable at the rate or rates specified hereafter for each year of assessment upon the income of any person accruing in, derived from, or received in the Republic in respect of–

(a) gains or profits from any trade, business, profession or vocation, for whatever period of time such trade, business, profession or vocation may have been carried on or exercised."

On appeal, counsel for the company, in a strong and able argument, in order to persuade this Court, contended that the finding of the Court that the exchange profit of £2,164 was a trading activity, and as such, assessable to income tax, was wrong (1) because the said loan in itself could not amount to a trading transaction, and that the payment of the loan in pounds sterling could not be considered an incident of a trading transaction; (2) that the said loan was part of appellant's fixed

capital and nothing was done to change its character; and the said loan could only be circulating capital if appellant's trade involved in making a profit out of loans by assigning them; and that it was not a necessary incident of appellant's trade to borrow money in sterling; (3) the Court erred in finding that the said loan was part of appellant's circulating capital or that same was made part of appellant's circulating capital, and it also erred because a fixed loan of the type made to appellant could not become circulating capital because it was applied in acquiring circulating capital. Finally, counsel contended that once Barclay's Bank were "trade creditors", the tax repayments by the appellants to Barclay's were "trade outgoings".

We think it is necessary to have in mind firstly, that the loan was raised for the purpose of erecting the flats and shops in question, and secondly, that those flats and shops formed part of the trading stock of the company. This has been accepted by both counsel. It is equally important to state that whether a receipt is a trade receipt or not, depends on the nature of the trade and is chiefly a question of fact. Receipts may consist of moneys-worth, as for example, shares in a company, or money in lieu of the intended trade receipt or of repaid or allowances on prices to be paid. The principal distinction, however, between a receipt that is of a revenue nature and one that is of a capital, is that the latter is not taken into consideration, in general, in the computation of profit. Furthermore, it has been said that a profit on exchange arising as a direct result of trading transactions, is a revenue receipt, but if foreign currency is purchased as an investment, not necessarily connected with the trade, any profit is not a receipt of revenue account. This is, a principle which has been enunciated in a number of cases with which we shall be dealing at a later stage. This principle regarding the fluctuation in rates of exchange appears in Simon's taxes, 3rd edn., Vol. B, para. Bl. 1101v who says that:-

> " It is a general principle that where the profit or loss arises in the course of trading operations, it is taxable as trading income. Where, however, there is a transaction in foreign exchange representing or connected with an investment of capital, the ensuing profit or loss on exchange is not regarded as part of trading operations but may, nonetheless, be caught under Schedule D, case VII or as a capital gain. For example, a forward purchase of foreign

currency intended for application as on capital account, may give rise to a gain or loss within the capital gains tax system. But a mere repayment as between an original debtor and a creditor of a debt incurred in currency terms, which is not in the course of trading operations, nor a chargeable capital gain, is not liable to tax."

We have made it clear earlier that whether a receipt is a trade receipt or not is chiefly a question of fact, and since the point raised in this appeal is of particular interest and a novel one, we propose reviewing some of the authorities in order to decide whether on the facts of the present case, the profit on exchange is a revenue receipt or not.

We think we will start with *Landes Brothers* v. *Simpson* (*H.M. Inspector of Taxes*), 19 T.C. 62, which has laid down that a profit on exchange arising as a result of trading transactions is a revenue receipt. In this case, the appellants who carried on business as fur and skin merchants, and as agents, were appointed sole commission agents of a company for the sale in Britain and elsewhere of furs exported from Russia, on the terms that they should advance to the company, a part of the value of each consignment. All the transactions between the appellants and the company, were conducted on a dollar basis, and, owing to fluctuat ons in the rate of exchange between the dates when advances in dollars were made by the appellants to the company against goods consigned and the dates when the appellants recouped themselves for the advances on the sale of the goods, a profit accrued to the appellants on the conversion of repaid advances into sterling.

Singleton, J., dealing with the point whether the exchange profits arose directly in the course of the appellant's business and formed part of the appellant's trading receipts, said at p. 69:-

" I pause there to say that in my view the profit which arises in the present case is a profit arising directly from the business which had to be done, because, as is found in paragraph 6 of the Case, the business was conducted on a dollar basis and the Appellants had, therefore, to buy dollars in order to make the advances against the goods as prescribed by the agreements. The profit accrued in this

case because they had to do that, thereafter, as a trading concern in this country retransferring or re-exchanging into sterling."

Then, having addressed his mind to a number of cases, the learned Justice, in dismissing the appeal, said at p. 71:-

"I was referred to various other authorities; in particular, the Solicitor-General referred me to two which show that the making of advances by somebody who is dealing with goods on a commission basis is an ordinary trading transaction of an advance against goods. It hardly needs authority to show that that is a usual course of business by people either buying goods or selling goods on commission in this country. I am not sure how far it is necessary to go into that. I think one has to look at the circumstances of this case, and if one looks at the circumstances of this case and realises what had to be done by the Appellants in the way of trade, I find it impossible to come to any conclusion other than that this profit which is described in the Case, which arose in one sense out of exchange rates altering, was profit which arose directly from the trade which the Appellants were doing with Arcos Limited. It was a profit earned in the course of that trade, a profit arising from it, and a profit which certainly is incidental to it in every respect, in my view."

In *McKinlay* v. *H.T. Jenkins and Son, Limited*, 10 T.C. 372, under an agreement dated the 8th March, 1921 for the supply of a quantity of marble by a Torquay company of marble and stone merchants to certain building contractors, the contractors agreed, on receipt of a guarantee for the fulfilment of the contract, to advance £20,000 of the price, percentage deductions being made from the amount due on each consignment of marble until the advance had been repaid.

On the 17th March, 1921, the £20,000 was paid to the company and was credited to an account at a London bank in the joint names of nominees of an insurance company, acting as guarantor, and of the Torquay company, the nominee of the latter being its controlling shareholder. In anticipation of the required marble being purchased in Italy—though not till the Autumn of 1921—the company at once arranged for the conver-

sion of the greater part of the £20,000 into lire at 103 to the £, and a lire account in the same joint names was opened.

In May, 1921, the lire had appreciated in value and, as the money was not yet required by the Torquay company, its nominee, on the 25th May, 1921, without the company's knowledge or authority, but with the consent of the nominee of the insurance company, directed the sale of the balance of the lira joint account. At 72 to the £, the lire realized £22,870, (for which a further account in the joint names was opened), a profit on their original purchase price, (103 to the £) of 6,707, which was received by the Torquay company. The lire was subsequently repurchased for the purposes of the contract for £19,386 which was allowed as a deduction from the company's profits for income tax purposes.

In computing the company's profits for the purposes of assessment to income tax for the year 1922–23, the said sum of £6,707 arising from the exchange transaction was included as a profit, but the special commissioners, on appeal, decided that it was not a profit assessable to income tax. It was held that the said sum of £6,707 was not a profit arising out of the contract for the supply of marble, but was merely an appreciation of a temporary investment and was not assessable to income tax as part of the profits of the company's trade.

Rowlatt, J., dealing with the finding of the Commissioners that the profit made was not a receipt on revenue account, and also with the argument of the Attorney-General, in dismissing the appeal, said at pp. 404–405:-

> " But in this connection what is meant is that the contention was quite obviously that, it being an appreciation of an object bought, it was an isolated appreciation of that object, and was not merged in a trade, because, as the first contention showed, it was no part of the Company's business to speculate in the exchanges. That is what it means, and the Commissioners have given effect to those arguments. I think that this appeal fails, but I do not want to put it upon the ground that the Commissioners have decided it in point of fact, and that I cannot go beyond that. Whether that would be right or not, I do not pause to consider, but I think that from every point of view their decision was

perfectly right, and I do not think they could very well have decided the other way, if I may go as far as that. It seems to me that this profit out of the change from currency to currency three times does not touch the question of what the profit on the contract was at all. The profit on the contract is the difference between the sum they received and what it cost them to supply the marble, and this intermediate use that was made of the sum which they happened have because they had got this contract has nothing to do with the profits of the contract, I think, at all. It was an accident that this sum can be identified, as I have already explained, as coming from the contract, but it has nothing to do with the profit of the contract. If that is so, what is it? It seems to me it is the mere appreciation of an investment into which they had put their money temporarily; an appreciation of something, if you like to look at it one way; that they had bought forward, because they would want it later, namely, the lire; a temporary appreciation of which they took advantage. If you look at it the other way, it was a profit which they had made by buying forward, instead of waiting until they had to provide the money. I do not think it has anything to do with the profit of the contract itself. It was, as I say, a mere appreciation of something which they had got in hand, and I think the Commissioners were bound to hold (because I see no evidence at all to the contrary) that it was not merged in a business of the Company. It may be that, if the Company were seeking to declare a dividend, nobody could say it was ultra vires to treat this advantage as a divisible sum. Their capital was intact; they had had cash; they had put it into an article of commerce; they had got it out again; they had got all the cash they ever had, and more cash, and as far as I understand it there would be no objection to their treating that as a divisible profit as a matter of Company Law. But I do not think that affects the case I have got to decide. I have to decide whether they made this profit in the way of their business, as a profit of their trade, or not, and I frankly say that I do not see how it really can be argued that it was.

The Attorney-General and Mr. Hills, of course, were very sedulous in arguing that you must treat this as a profit of the contract. I think they realise that, if it is not a

profit of the contract, then it cannot be taxed. To my mind it is quite clear it is not a profit of the contract, and therefore I think that, not only could I not disturb the finding of the Commissioners, but that the finding could not have been the other way."

The *McKinlay* case was explained in *Imperial Tobacco Co. (of Great Britain and Ireland), Ltd.* v. *Kelly (H.M. Inspector of Taxes)*, 25 T.C. 292, where the company carried on the business of tobacco manufacture, for which large quantities of tobacco leaf were purchased in the United States, where the Company maintained a large buying organisation. To finance the purchases and the expenses of this organisation the Company bought dollars in the United Kingdom through its bankers who remitted them to banking accounts of the Company in the United States, and it was the practice of the Company to accumulate a large holding of dollars each year before the leaf season commenced. The Company never bought dollars for the purpose of resale as a speculation.

On the outbreak of war, in September, 1939, the appellant Company, at the request of the Treasury, stopped all further purchases of tobacco leaf in the United States, and, as a result, the Company had on hand a holding of dollars which had been accumulated between January and August, 1939. On 30th September, 1939, the Company was required under the Defence (Finance) Regulations, 1939, to sell its surplus dollars to the Treasury, and, owing to the rise which had occurred in the dollar exchange, the sale resulted in a profit for the Company. This profit was included in assessments upon the Company to Income Tax under Schedule D, Case I, and to National Defence Contribution.

On appeal to the Special Commissioners, the Company contended that, in the events which had happened, the profit was a realised appreciation of a temporary investment in foreign currency, and not a profit of its trade. The Commissioners found that the profit from the sale of dollars to the Treasury had been correctly brought into the computation of the profits of the Company's trade, and dismissed the appeals.

It was held that the profit made by the Company on the compulsory sale of surplus dollars to the Treasury must be

included in the computation of the profits of its trade for Income Tax and National Defence Contribution purposes.

Macnaghten J., dealing with the question whether the profit made was part of the profits of the company's trade or not, said at pp. 297–298:–

> "The Company, however, contends that although the dollars were in fact purchased for the purpose of its trade they ought, in the events that happened, to be regarded as having been purchased for the purpose of making a 'temporary investment in foreign currency' and as having, therefore, no connection with its trade. It is said that the decision of *Rowlatt J., in McKinlay* v. *H.T. Jenkin and Son, Ltd.* 10 T.C. 372, supports that view of the matter."

Then, in dismissing the appeal, he concluded in these terms:–

> "That this was his view of the matter is made plain by his observations in a case that came before him 18 months later, *George Thompson & Co., Ltd.* v. *Commissioners of Inland Revenue*, 12 T.C. 1091. In that case the company carried on business as shipowners. In 1916 some of the company's ships were requisitioned by the Australian Government and, the company having in consequence of the requisition no immediate use for a quantity of coal to be delivered under a contract already made, transferred the benefit of the contract to another company at a premium of so much per ton. The company contended that the premium received on this transaction was not liable to Excess Profits Duty. Rowlatt, J., in his judgment, said at p. 1102: 'On the facts I think this is simply a case of a person who is bound to buy a certain amount of consumable stores, who overbuys and is lucky enough to dispose of those consumable stores which he has got in the way of his business in relief of his business at a profit.... there is something put in his pocket for it in the way of his business. I think the whole of it comes in. That is my straightforward view.... on the facts. I think no other question is involved.' Then, referring to *McKinlay* v. *H.T. Jenkins and Son, Ltd.*, (10 T.C. 372), he went on: 'The case which does bear rather an interesting affinity to this case is the marble case, but there the way I looked at it... was simply

this, that they had some capital lying idle, and they embarked upon an exchange speculation. They bought the lire as a speculation, not as consumable stores, or anything of that sort, but they simply bought them as a speculation rather than keep the money in the bank.'

In my opinion, so far from Jenkin's case being an authority for the contention put forward by the Appellant, the judment of the learned Judge in that case, as in the case of George Thompson & Co., Ltd., supports the decision of the Special Commissioners that the profit made by the Company on the compulsory sale of its surplus dollars to the British Treasury must be included in the computation of the profits of its trade."

The company, feeling aggrieved, appealed against that decision and the cases came before the Court of Appeal and judgment was given unanimously in favour of the Crown, confirming the decision of the Court below. Lord Greene, M.R., having observed that they must decide this case having regard to the facts as found, and that in the light of those facts the acquisition of these dollars could not be regarded as colourless but that they were an essential part of a contemplated commercial operation, had this to say at pp. 300-301:-

"To reduce the matter to its simplest elements, the Appellant Company has sold a surplus stock of dollars which it had acquired for the purpose of effecting a transaction on revenue account. If the transaction is regarded in that light, it seems to me it is precisely on all fours with the case of any trader who, having acquired commodities for the purpose of carrying out a contract, which falls under the head of revenue for the purpose of assessment under Schedule D, Case I, then finds that he has bought more than he ultimately needs and proceeds to sell the surplus. In that case it could not be suggested that the profit so made was anything but income. It had an income character impressed upon it from the very first.

If authority be required for that proposition, it is to be found in the case of *George Thompson & Co., Ltd.* v. *Commissioners of Inland Revenue*, 12 T.C. 1091. That was a case where a company which had acquired a stock of coal

for its normal operations found, for reasons which are not material, that it no longer required that stock; and, accordingly, it sold it. Rowlatt, J., held, affirming the decision of the Commissioners, that the transaction of selling the coal which was no longer required was a transaction on revenue account. It seems to me, if I may say so, that that decision was manifestly right.

In the present case it is truly said that it was no part of the Company's business to buy and sell dollars. But in each case the commodity (in the one case the coal and in the other case the dollars) was acquired for the purpose of transactions on revenue account and nothing else. In each case there was a surplus which was not needed for the purpose of those transactions. In each case the surplus was realized at a profit. It seems to me that Thompson's case is a very strong authority in favour of my view of the present case.

We were referred to several other cases. With regard to three of them, *Stott* v. *Hoddinott*, 7 T.C. 85; *Curtis* v. *J. & G. Oldfield, Ltd.* 9 T.C. 319, and *Landes Brothers* v. *Simpson*, 19 T.C. 62, I need say no more than that they were very different to the present case, and I get no assistance from them. The only case which might be thought to give some colour to the argument for the Appellants is the case of *McKinlay* v. *H.T. Jenkins and Son, Ltd.*, 10 T.C. 372..... Rowlatt, J.'s own view of his decision in that case, and the grounds of it, are referred to by him in Thompson's case. In Thompson's case Rowlatt, J., said that McKinlay's case was decided by him on the footing that the original purchase of the lire had been 'a speculation' (12 T.C., at p. 1102).

It is, perhaps, fair to say that the Case Stated in McKinlay's case does not appear to contain any basis for a finding that the original purchase was a speculation. It does not appear that that was the intention of the original purchase, so far as the Case Stated shews. But, however that may be, that was Rowlatt J.'s own view; and on that basis, in my opinion, no criticism could be made of the decision in McKinlay's case (10 T.C. 372)".

Finally, the Master of the Rolls, in dismissing the appeals, said:-

"Leaving that on one side, and taking McKinlay's case by itself, I call attention to the fact that the circumstances there were very different to the circumstances in the present case. In the present case the intention with which the dollars were bought was as I have stated; and that intention persisted. In McKinlay's case the company took the opportunity to use its lire as a speculation. Even if that had not been their intention in the first instance, what they did was this. They took advantage of the turn in the exchange market to make a quick profit on the exchange, intending to provide the lire that they would ultimately need at a later date, in the hope and on the speculation that in the meanwhile the price of lire would go down, as in fact it did. That is what they were doing. Whether or not McKinlay's case is one which was rightly decided is a matter which I feel it quite unnecessary to discuss, because the circumstances of that case were different, in the respect which I have mentioned, to the circumstances of the present case. I therefore do not find anything in McKinlay's case which helps me one way or the other and the present case, in my opinion, must be decided upon its own particular facts. The result is, as I have stated, that this profit was a revenue profit, and the assessment was correct".

We think, before dealing with the next case, we should have added that the questions between capital and income, trading profit or no trading profit are questions which, though they may depend no doubt to a very great extent on the particular facts of each case, do involve a conclusion of law to be drawn from those facts. This view was supported by Lord Greene, then Master of the Rolls, in *Rustproof Metal Window Co. Ltd.* v. *Commissioners of Inland Revenue*, 29 T.C. 243. The passage we wish to cite is on p. 266:-

"It was argued by Counsel on behalf of the Crown that the decision of the Special Commissioners upon a question of this kind ought not to be disturbed unless it could be said that they had misdirected themselves in law. This, I think, is to put the matter too high. Great weight should no doubt be given to their view, but the Courts have on

many occasions acted on the principle that the decision of Commissioners on the question whether a receipt is of a capital or an income nature is open to review, and I propose so to treat it in this case. It is a question which is to be answered upon a consideration of all the relevant facts."

Turning now to the case mostly relied upon by counsel for the appellant company, *Davies (H.M. Inspector of Taxes)* v. *The Shell Co. of China Ltd.*, 32 T.C. 133, the company was a British company which sold any distributed petroleum products in China. The Company made a practice of requiring its agents to deposit with the Company a sum of money, usually in Chinese dollars, which was repayable when the agency came to an end. Previously the Company had left on deposit with banks in Shanghai amounts approximately equal to the agency deposits, but because of the hostilities between China and Japan the Company transferred these sums to the United Kingdom and deposited the sterling equivalents with its parent company, which acted as its banker. Owing to the subsequent depreciation of the Chinese dollar with respect to sterling, the amounts eventually required to repay agency deposits in Chinese currency were much less than the sums held by the Company to meet the claims, and a substantial profit accrued to the Company.

On appeal to the Special Commissioners against assessment to Income Tax under Case 1 of Schedule D, the Company contended that the deposits received from its agents had been used as fixed capital and not as circulating capital and that the profit on exchange was a capital profit not subject to Income Tax. For the Crown it was contended that the deposits, to which the Company could have recourse in the event of default by the agent, were circulating capital and that the exchange profit was made in the course of the Company's business and must be included in the computation of its profits for Income Tax purposes. The Commissioners found that the exchange profit was a capital profit not subject to Income Tax.

The case came before Danckwerts, J. and judgment was given against the Crown with costs. Danckwerts, J., having reviewed the facts, and having addressed his mind to a number of cases cited before him by counsel as well as the argument put forward on behalf of the company that this was a case where all that has happened has been an increase in value of the fixed capital

of the company and not a trading profit at all, said at pp. 144-145:-

"It seems to me that that is evidence upon which the Commissioners could reach the conclusion which they did. It has been stated as a question of law for me to decide, whether the Commissioners were right in holding that the profits in question were capital profits not subject to Income Tax; but that seems to me to be not a question of law but a question of fact, and, the Commissioners really being the people to decide questions of fact, it seems to me I am not entitled to interfere with that finding. I think there was evidence upon which they could reach the conclusion they did reach and for that reason the appeal must be dismissed."

With respect to the learned Justice, we think that he has misdirected himself in taking the view that he was not entitled to interfere with the finding of the Commissioners on the question whether a receipt is of a capital organ income nature once it is open to review. (See Lord Greene M.R. in *Rustproof Metal Window Co. Ltd.* (*supra*) *at p.* 266; and also the judgment of Jenkins L.J. in the *Davies* case at p. 151).

The Crown, having appealed against the decision of Danckwerts Justice, the case came before the Court of Appeal. Judgment was given unanimously against the Crown. Jenkins, L.J., delivering the first Judgment, having reviewed the facts, and having cited a number of cases on the question of exchange profit, said at pp. 154 and 157:-

"The real question in the case, in my view, must be whether, looking at the nature of the Company's business, the nature of the receipts represented by the agents' deposits and of the liabilities represented by the company's obligations as to their repayment, and the terms of the documents governing these receipts and liabilities, the transactions with respect to the agents' deposits were trading transactions or not...

After paying the best attention I can to the arguments for the Crown and those for the Respondent Company, I find nothing in the facts of this case to divest those deposits of the character which it seems to me they originally bore,

that is to say the character of loans by the agents to the Company, given no doubt to provide the Company with a security, but nevertheless loans. As loans it seems to me they must prima facie be loans on capital not revenue account; which perhaps is only another way of saying that they must prima facie be considered as part of the Company's fixed and not of its circulating capital. As appears from what I have said above, the evidence does not show that there was anything in the Company's mode of dealing with the deposits when received to displace this prima facie conclusion.

In my view, therefore, the conversion of the Company's balances of Chinese dollars into sterling and the subsequent re-purchase of Chinese dollars at a lower rate, which enabled the Company to pay off its agents' deposits at a smaller cost in sterling than the amount it had realised by converting the deposits into sterling, was not a trading profit, but it was simply the equivalent of an appreciation in a capital asset not forming part of the assets employed as circulating capital in the trade. That being so it was a profit of the nature not properly taxable under Schedule D, and the Special Commissioners in my view came to a right conclusion, which was rightly affirmed by the learned Judge, and I would therefore dismiss the appeal."

Cohen L.J. delivering the second judgment said at pp. 157-158:-

" I agree entirely with the conclusion and the reasoning which my brother Jenkins has given. I only desire to add a very few words about the decisions in the Landes case[1] and the Imperial Tobacco Company case[2], on the principle of which I think Sir Andrew and Mr. Hills rely.

That principle appears clearly from a study of the language used by Lord Greene at page 300 of the Imperial Tobacco Company case. He says there: 'We have here a finding of fact as to the purpose for which the dollars were bought. The purchase of the dollars was the first step in carrying out an intended commercial transaction, namely,

1. 19 T.C. 62.
2. 25 T.C. 292.

the purchase of tobacco leaf. The dollars were bought in contemplation of that and nothing else. The purchase on the facts found was, as I say, a first step in the carrying out of a commercial transaction, which would be completed by the purchase and delivery of the leaf and payment of the dollar purchase price for it. We must decide this case having regard to the facts as found. In the light of those facts, the acquisition of these dollars cannot be regarded as colourless. They were an essential part of a contemplated commercial operation.' Then after considering the matter at a little greater length he says, lower down on the same page: 'To reduce the matter to its simplest elements, the Appellant Company has sold a surplus stock of dollars which it has acquired for the purpose of effecting a transaction on revenue account.' In the present case it seems to me it is impossible to say that the Chinese dollars which were acquired here, and out of the transactions in which the profit in question arose, were acquired for the purpose of effecting a transaction on revenue account. No doubt the deposits were a part of the arrangements under which the agents were appointed and the appointment of the agents was a necessary step in establishing the structure which was required to carry on the business of dealing in petroleum products. The trading activity of this company was the dealing in petroleum products; the receipts of such dealings would of course be a revenue receipt, but I agree with my brother Jekins that the dollars deposited for the purposes indicated in the agency agreements were in the nature of loans and were not part of a transaction on revenue account."

We turn to *Shadbolt* (*H. M. Inspector of Taxies*) v. *Salmon Estate* (*Kingsbury*), *Ltd.*, 25 T.C. 52. This case having being decided by the Commissioners of Taxes came before Macnaghten, J. and judgment was given in favour of the Crown. Macnaghten, J. had this to say at p. 57:-

"I think this is a very plain case. The Respondents, Salmon Estate (Kingsbury), Ltd., carry on the business of building and selling houses.

By an agreement dated 8th November, 1934, the Company acquired the right to develop some land belonging

to the College of All Souls in the University of Oxford, situate in the parish of Kingsbury in Middlesex. Attached to the agreement is a plan setting out some 405 plots of land on which the Company undertook to erect houses, in accordance with the terms of the agreement; and it was provided by the agreement that when these houses had been erected, the College of All Souls would grant to the Company, or to its nominees, leases for 99 years, at a comparatively small ground rent.

It is not disputed that in the case of such a trade as this, the trade of building houses for sale, the land on which the houses are built is part of the stock-in-trade of the business and is not a capital asset. Clause 21 of the agreement enabled the College of All Souls to vary the plan of development and to withdraw some of the plots from the agreement; and the College served a notice upon the Respondents withdrawing 87 plots from the agreement. The Company objected that this notice was not a valid notice and, although the College did not admit that the notice was invalid, nevertheless they thought fit to pay the sum of £5,000 in order to induce the Company to withdraw its objection to the validity of the notice. The result was that the Company lost 87 plots, but received £5,000.- instead.

The question at issue is: Was the right to build on these 87 plots a trading asset? Was it part of their stock-in trade? If the land had been actually bought by the Company and then they had sold part of it for £5,000, it is admitted that the £5,000 received for the bit so sold would have been a trading receipt, and, as it seems to me, the right to build on the plots was likewise a trading asset.

The Commissioners for the Division of the Duchy of Lancaster in the County of London, before whom this case came, seem to have been misled by the case of Glenboig Union Fireclay Co., Ltd. *v.* Commissioners of Inland Revenue, 12 T.C. 427; they thought that they were bound by that case to hold that this right which the Company held over the land belonging to All Souls College was a Capital asset and that therefore this sum of money ought

not to be brought into the trading account of the Company for the purposes of an assessment to Income Tax.

The appeal must be allowed with costs."

Having indicated earlier that as a result of changes in rates of foreign exchange, profits or losses may arise, we think we would add that it is a general principle that where the profit or loss arises in the course of trading operations, it is taxable as trading income. Whether, of course, a currency transaction is or is not an incident of trading is a question to be determined in the light of the facts and of the particular contractual arrangements. These were examined in McKinlay (*supra*) already quoted in this judgment, where it was held that the profit on exchange was merely an appreciation on a temporary investment and therefore not assessable. This case, as it appears from Simon's Taxes Third Edition Volume B under the heading "Trading" was criticised. At p. 542 we read:-

> " It is doubtful, however, whether this case is now a valid authority. At least, it was not accepted as such in Landes Bros. *v.* Simpson (1934) 19 T.C. 62 in which a profit of £16,446 was realised on dollar advances by fur commission agents to their principals. This profit was held to arise directly in the course of the firm's business and was therefore, assessable as a trading receipt."

On the other hand, in *Davies* case (*supra*), deposits by an overseas company in London were held as part of fixed capital—and in fact so used—and not as circulating capital, so that the exhange profit was a capital profit not assessable to income tax. We think, with respect, that this case is distinguishable from the present case, because the loan was contracted for the reason of forming part of the appellant's circulating capital and for the purpose of carrying on its trade. It is by now, we think, an accepted proposition that circulating capital is capital which is turned over and in the process of turning over yields profit or loss in the course of trading operations. On the contrary, fixed capital is not involved directly in that process and remains unaffected by it. That the flats and shops sold formed part of the trading stock of the company was accepted by counsel for the appellant company. In our view, therefore, once the loan from the outset was part of the appellant's circulating capital,

the profit made out of the exchange was part of the company's trading receipts.

Having reviewed and analysed the legal principles in a number of cases, we have reached the conclusion to affirm the judgment of the learned trial Judge that the profit made was a trading profit and not a receipt of a capital nature. Before concluding this judgment, we feel that we ought to express our indebtedness to both counsel for the most able way they have presented this case, which we think, was a most interesting and difficult case to decide.

For the reasons we have given at length, we would dismiss the appeal, but we are not making an order of costs in favour of the appellants.

Appeal dismissed. No order as to costs.

Appeal dismissed. No order as to costs.