HIGH COURT OF JUSTICE (CHANCERY DIVISION)—
3 AND 9 MAY 2001

COURT OF APPEAL—2 MAY AND 20 JUNE 2002

HOUSE OF LORDS—17, 18 NOVEMBER AND 18 DECEMBER 2003

MEPC Holdings Ltd. v. Taylor (H.M. Inspector of Taxes) [1]

Corporation tax—Group relief—Surrender—Determination of profits for purpose of calculating that amount—Whether allowable losses brought forward should be deducted from chargeable gains made in relevant accounting period—Income and Corporation Taxes Act 1988, s 403(8).

MEPC, an investment company, was a member of a group of companies, some of which had made valid claims for group relief in respect of amounts surrendered by MEPC. For the accounting period ended 30 September 1994, charges on MEPC's income exceeded profits (apart from chargeable gains) by £48,344,400. In the same period MEPC had made chargeable gains of £6,040,284. Allowable losses from past periods amounted to £60,583,017.

Under s 403(8) Income and Corporation Taxes Act 1988 profits were, for the purpose of determining the amount available for surrender, to be determined "without regard to any deduction falling to be made in respect of losses or allowances of any other period . . .".

The Inspector of Taxes determined that the sum available for surrender was £42,304,116 on the footing that the chargeable gains for the period were to be taken into account but the losses carried forward were not. MEPC appealed on the grounds that the chargeable gains should not have been taken into account because they were more than offset by the losses carried forward. The Special Commissioners (SpC0256) allowed MEPC's appeal, holding that, in the context of s 403, "losses or allowances" in s 403(8) referred only to trading losses and capital allowances. The Crown appealed.

The Chancery Division held, allowing the Crown's appeal, that it was entirely consistent with the likely policy of the legislature that the words of

[1] Reported TC Leaflet 3640; [2002] EWCA (Civ. 883; [2002] STC 430; [2003] UKHL 70.

s 403(8) should be given their ordinary and natural meaning, which was that, in computing the profits of the surrendering company for the purposes of s 403(7), no regard should be had to any deduction of any loss, including allowable loss, that would otherwise fall to be made in the course of computing those profits; the policy of s 403(8) appeared to be to prevent the amount available for surrender being increased by taking accounting of losses of whatever nature incurred in an earlier period, when in particular the company incurring them may not even have been a member of the relevant group, and there was a similar limitation in relation to the surrender of capital allowances in s 403(3) and management expenses in s 403(5).

MEPC appealed.

The Court of Appeal held, dismissing MEPC's appeal, that:

(1) s 403(8) was not to be read as if the only deductions within its scope were deductions falling to be made "from the profits of the period" or "once profits for the period have been established"; the plain meaning and effect of the direction that a surrendering company's profits of the period "shall be determined . . . without regard to any deduction falling to be made" was that what was to be disregarded was a deduction which would otherwise have fallen to be made in determining the profits of the period; in view of s 6(4)(a) of the 1988 Act and of s 8(1) of the Taxation of Chargeable Gains Act 1992, an allowable capital loss was plainly a deduction which fell to be made in determining the profits of the period; subject to an allowable loss being within the phrase "losses or allowances" in s 403(8), it followed that allowable losses "previously accruing to the company" within s 8(1)(b) of the 1992 Act were losses which s 403(8) required to be disregarded;

(2) an allowable loss was within the phrase "losses or allowances" in s 403(8) because:—

(a) neither the legislation nor the authorities established that an allowable loss was not properly to be regarded as a loss at all, but was nothing more than the product of a computation made on an artificial or notional basis; in particular there was no support in the 1992 Act for the proposition that Parliament intended that a loss which was an allowable loss under ss 8 and 16 of that Act could not or would not be a loss for the purposes of s 403(8), and

(b) the conclusion followed from a true construction of s 403(8) in the context of s 403 as a whole and the related provisions in Chapter IV of Part X of the 1988 Act; in particular s 409 threw no light on the issue, the difference in meaning between "losses or allowances" in s 403(8) and "losses, allowances . . ." in s 409(3)(a) being explained by the different contexts, especially as a restricted construction of s 403(8) would produce an inexplicable exclusion of Sch D Case VI losses; further, nothing in the structure of s 403, taken as a whole, suggested the contrary conclusion, and s 403(3) positively supported the conclusion.

MEPC appealed.

Held, in the House of Lords, allowing MEPC's appeal, that s 403(8) did not preclude regard being had to allowable losses from previous periods deductible, under s 8(1)(b) of the 1992 Act, in computing chargeable gains for the relevant accounting period, because:—

(1) the policy of s 403(8) appeared to be to prevent the excess of profits over charges on income from being inflated by other reliefs carried forward from earlier years; it confined the surrenderable relief to the excess over profits in the accounting period; this policy suggested that allowable losses were not included in the term "losses" in s 403(8); an allowable loss was not a relief; this construction was supported by the language of s 403(8); the most natural reading of the words "profits . . . shall be determined . . . without regard to any deduction falling to be made . . . ." was that the deductions to be disregarded were those which the legislation requires to be made from what would otherwise be the profits—that is to say, reliefs; "allowable losses", on the other hand, were not to be deducted from profits; they were to be deducted as part of the computation of chargeable gains which forms one element of profits;

(2) the careful distinction between a "deduction . . . in respect of losses or allowances" and "expenses of management deductible only by virtue of section 75(3)" reinforced the impression that "losses" meant losses allowed by way of relief against profits and not losses, such as allowable losses, deducted in the computation of profits;

(3) finally, group relief was concerned entirely with the income element in profits; all the reliefs which could be surrendered by way of group relief were deductible from or in computing the income element; the computation of chargeable gains was completely separate and it would be strange if a provision which limited the availability of group relief operated by reference to a deduction made in the computation of chargeable gains.

The Crown appealed against the following decision of the Special Commissioners.

Decision[1]

The appeal

1. MEPC Holdings Ltd. (the Company) appeals against a determination made by the Inland Revenue on 25 May 1999 that the amount available for surrender by the Company by way of group relief for the accounting period ending on 30 September 1994 was £42,304,116. The Company was of the view that the amount should be £48,344,400 and that it should not be reduced by realised chargeable gains of £6,040,284 which were more than offset by allowable losses brought forward from previous accounting periods.

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(1) [2000] STC (SCD) 504.

2. We were informed that three other companies wished to argue a similar point and that this was a test case.

The facts

3. The facts were not disputed. The Company is an investment company and at all material times was within the charge to corporation tax and was a member of a group relief group. Other companies in the group had made valid claims in respect of the amounts eligible for relief surrendered by the Company. In its accounting period ending on 30 September 1994 the Company made profits of £300,000 and had charges on income of £48,644,400. Thus charges on income exceeded profits by £48,344,400. In the same accounting period the Company realised chargeable gains of £6,040,284. Allowable losses brought forward from past periods amounted to £60,583,017 and thus very substantially exceeded the chargeable gains.

The legislation

4. Chapter IV (ss 402 to 413) of Part X of the Income and Corporation Taxes Act 1988 (the 1988 Act) contains provisions about group relief. Section 402 provides that, in certain circumstances, relief for trading losses and other amounts eligible for relief from corporation tax may be surrendered by one company (the surrendering company) and allowed to another company who makes a claim (the claimant company) where both companies are members of the same group.

5. Section 403 describes the amounts eligible for relief which may be surrendered. The subsections of direct relevance to this appeal are subss (7) and (8). At the relevant time those subsections provided:

> "(7) Subject to the provisions of this Chapter and section 494(4), if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits of the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.
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> (8) The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)."

The issue

6. The issue for determination in the appeal was whether, in determining the Company's profits for the purposes of s 403(7), the result of s 403(8) was that the amount to be included in profits in respect of chargeable gains was nil being the net amount of the realised chargeable gain less the allowable losses brought forward (as argued by the Company) or whether the amount to be included in profits in respect of chargeable gains was the realised chargeable gain with no

deduction for the allowable losses brought forward (as argued by the Inland Revenue). A

7. In this decision we use the phrase "allowable losses" to mean losses which may be set against chargeable gains

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The arguments of the parties

8. The Company raised three main arguments. First it said that the meaning of the word "profits" in s 403(7) and (8) meant the inclusion of a net figure for chargeable gains less allowable losses. Secondly it said that the meaning of the words "losses or allowances" in s 403(8) meant trading losses or capital allowances and not allowable losses. And finally it said that it was the intention of the legislation that group relief was not available for brought forward losses and allowances in those cases where the surrendering company had had the option of surrendering them in previous years and had not done so; such an option was not available for allowable losses. C D

9. The Inland Revenue argued that the intention of the legislation was that the only amounts which could be deducted in calculating profits were amounts which could be deducted in the year of surrender and to take into account brought forward allowable losses would be to defeat that intention.

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Reasons for decision

10. In considering the arguments of the parties we have first looked at the words of the legislation and we begin by considering the meaning of the word "profits" as used in s 403(7) and (8). The questions raised by the arguments of the parties about the meaning of these words were: F

(1) Do "profits" for the purposes of s 403(7) and (8) include chargeable gains without any deduction of allowable losses? and

(2) If so, does the same argument apply to trading losses, capital allowances and management expenses? G

11. We then consider the meaning of the words "losses or allowances" in s 403(8). The questions raised by the arguments of the parties about the meaning of those words were:

(3) What meaning of the words "losses or allowances" emerges from a consideration of the context of s 403 as a whole? H

(4) What meaning of the words "losses or allowances" emerges from a consideration of other provisions of the 1988 Act?

(5) What meaning of the word "losses" emerges from the capital gains tax legislation?

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12. Finally, we consider the intention of the legislation and here the question raised by the arguments of the parties was:

(6) What is the relevance of the intention of the legislation?

13. Mr. Goldberg Q.C. also put forward a number of other arguments which were not challenged by Mr. Brennan. We therefore do not consider these but Mr. Goldberg's skeleton argument (which runs to 32 pages) will be available should this Decision be appealed.

14. We consider each of the questions separately.

(1) Do "profits" for the purposes of s 403(7) and (8) include chargeable gains without any deduction of allowable losses?

15. The first question is whether, for the purposes of s 403(7) and (8), the word "profits" includes chargeable gains without any deduction of allowable losses.

16. Subsections (7) and (8) of s 403 refer to the surrendering company's profits. In considering this question references were made to the word profits in ss 6, 8 and 9 of the 1988 Act and in s 8(1) of the Taxation of Chargeable Gains Act 1992 (the 1992 Act).

17. Section 6 of the 1988 Act contains provisions relating to the charge to corporation tax. The relevant parts of s 6 provide:

"(1) Corporation tax shall be charged on profits of companies . . .

(4) In this section . . .

(a) '*profits*' means income and chargeable gains."

18. Section 8 of the 1988 Act contains provisions relating to the general scheme of corporation tax and s 8(1) provides:

"(1) . . . a company shall be chargeable to corporation tax on all its profits wherever arising".

19. Section 9 of the 1988 Act contains provisions relating to the computation of income and s 9(3) provides:

"(3) Accordingly, for purposes of corporation tax, income shall be computed . . . under the like Schedules and Cases as apply for purposes of income tax, and in accordance with the provisions applicable to those Schedules and Cases, but ... the amounts so computed for the several sources of income, if more than one, together with any amount to be included in respect of chargeable gains, shall be aggregated to arrive at the total profits".

20. Section 8 of the 1992 Act contains provisions that a company's total profits should include chargeable gains. Section 8(1) provides:

"(1) . . . the amount to be included in respect of chargeable gains in a company's total profits for any accounting period shall be the total amount of the chargeable gains accruing to the company in the accounting period after deducting—

(a) any allowable losses accruing to the company in the period, and

(b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous accounting period, any allowable losses previously accruing to the company while it has been within the charge to corporation tax."

21. In support of his argument (that the meaning of the word "profits" in s 403(7) and (8) meant the inclusion of a net figure of chargeable gains after deduction of allowable losses brought forward) Mr. Goldberg Q.C. argued that "profits" had to be computed in accordance with the statutory provisions. As a result of ss 6(4)(a), 8(1) and 9(3) of the 1988 Act, and of s 8(1) of the 1992 Act, what was included in the computation of profits was a net figure of chargeable gains after deduction of allowable losses and not a gross figure of chargeable gains from which allowable losses were subsequently deducted. In the present appeal, where the allowable losses were greater than the realised chargeable gain, no amount had been included in the profits but no deduction had been made in computing profits either. Mr. Goldberg Q.C. accepted that the legislation sometimes used the word "profits" and sometimes used the phrase "total profits" but he argued that, for the purposes of the charge to tax, both phrases meant the same thing. Mr. Goldberg Q.C. relied upon *Owton Fens Properties Ltd.* v. *Redden* (1984) 58 TC 218 at p 230H; *Tod* v. *South Essex Motors (Basildon) Ltd.* (1987) 60 TC 598 at pp 611E–613D; and *Jones* v. *Lincoln-Lewis & Others* (1991) 64 TC 112 at p 121G.

22. For the Inland Revenue Mr. Brennan argued that it was the plain meaning of s 6(4) of the 1988 Act that profits meant income and chargeable gains. Chargeable gains were an element of profits. Section 9(3) of the same Act provided that all income and chargeable gains were to be aggregated to arrive at total profits. So chargeable gains were treated as analogous to a source of income.

23. In considering the arguments of the parties we start with the legislation. First we record that we heard detailed argument from Mr. Goldberg Q.C. that, for the purposes of this appeal, the word "profits" meant the same as the phrase "total profits". That was not disputed by Mr. Brennan and so we proceed on the basis that, at least for the purposes of this Decision, profits means the same as total profits.

24. We agree with Mr. Brennan that profits means income and chargeable gains as that is clear from ss 6(4)(a) and 9(3) of the 1988 Act. But that does not tell us how chargeable gains are to be calculated. It is s 8(1) of the 1992 Act which indicates that the amount of chargeable gains to be included in a company's (total) profits for any accounting period is the total amount after deducting allowable losses both in that period and brought forward from a previous period. Thus the phrase "chargeable gains" is defined in s 8(1) of the 1992 Act as the net amount of realised chargeable gains after deduction of allowable losses for the same period and previous periods. Accordingly we conclude that the effect of the statutory provisions is that the word "profits" means income and the net amount of chargeable gains after deduction of allowable losses for the same accounting period and previous accounting periods.

25. Having reached that point we consider the authorities cited to us.

26. In *Owton Fens* (1984) 58 TC 218 the issue was whether an assessment to corporation tax, which assessment was in respect of interest only, could be amended in order to charge Sch A income and also chargeable gains. The Appellant argued that the assessment had to identify the different sources of income assessed and had failed to do so. Vinelott J. held that the legislation required that all chargeable income and chargeable gains for a given accounting period were to be aggregated and included in a single assessment. An appeal against that assessment was an appeal against the profit chargeable to corporation tax.

27. In *South Essex Motors* (1987) 60 TC 598 the issue was whether the company could set against its chargeable gains of £374 allowable losses of £100,125 which the Inland Revenue had agreed could be carried forward from previous years when in fact no such allowable losses existed. The Inland Revenue argued that, as there had not been an allowable loss, it could not be carried forward and any agreement was not binding for future years of assessment. In a passage relied upon by Mr. Goldberg Q.C. at p 612H Knox J. said:

> "That treatment, [reducing the chargeable gains by the allowable losses carried forward and thus increasing trading losses] assuming for the moment that there were losses for chargeable gains purposes of £100,125, or indeed of any figure of £374 or more, was correct in that chargeable gains for an accounting period are required by s 265(1) of the Income and Corporation Taxes Act 1970 [the predecessor of s 8(1) of the 1992 Act] to be those accruing in the relevant accounting period after deducting allowable losses previously accruing to the company so far as not already allowed as deductions. So that on the hypothesis that there was such an allowable loss of £100,125, the gain of £374 . . . was liable to be extinguished by a set-off of that amount out of the £100,125 loss, reducing it to £99,751, and consequently increasing the trading losses to be carried forward since no set-off under s 177(2) of the Income and Corporation Taxes Act 1970 [the predecessor of s 393A(2) of the 1988 Act] was now necessary or indeed possible under that subsection, there being no chargeable gains to be the subject of set off".

28. *Lincoln-Lewis* (1991) 64 TC 112 concerned s 42(2) of the Finance Act 1965 and the apportionment to three beneficiaries of chargeable gains made by non-resident trustees. The issue was whether the beneficiaries had interests in the settled property at the relevant time. In the passage relied upon by Mr. Goldberg Q.C., Hoffmann J. said at p 121G:

> "Despite the reference in the second part of s 42(2) to the apportionment of 'the chargeable gain', it is clear that what is being apportioned is the amount on which the trustees would have been chargeable under s 20(4) namely, the total amount of chargeable gains accruing in the year of assessment after deducting any allowable losses. It is not an apportionment of any particular gains which may have accrued from time to time. The only time at which the amount to be apportioned can be ascertained in accordance with s 20(4) is the end of the year of assessment . . . ."

29. Although none of these authorities is directly on all fours with the issue in the present appeal they do support the argument of Mr. Goldberg Q.C. that

"chargeable gains" are the total amount of gains for any year reduced by allowable losses for that year and previous years. Thus they are consistent with the provisions of s 8(1) of the 1992 Act.

30. Having reached that point we conclude that in s 403(7) and (8) the surrendering company's "profits" means its income and chargeable gains and its chargeable gains means realised gains less allowable losses for the current and previous years.

(2) If so, does the same argument apply to trading losses, capital allowances and management expenses?

31. For the Company Mr. Goldberg Q.C. accepted that the purpose of s 403(8) was to restrict the availability of group relief so that trading profits could not be reduced by trading losses of preceding periods. Section 393 gave relief for trading losses and so in s 9(1) the calculation of trading profits meant the deduction of trading losses. He referred to ss 393(1) and (8) and 393A(1) of the 1988 Act; s 75(1) of the 1988 Act and ss 144 and 145(3) of the Capital Allowances Act 1990 (the 1990 Act). In each of these cases gross profits were first established and then a deduction made. However, he argued that allowable losses were treated differently as they defined the figure of chargeable gains brought into the computation in the first place. Section 9(3) of the 1988 Act and s 8(1) of the 1992 Act made it plain that the computation of gains was outside the computation of profits. It was the net figure of chargeable gains which was included in profits.

32. For the Inland Revenue Mr. Brennan argued that the same argument (that chargeable gains meant net gains after the deduction of allowable losses) could also be applied to trading losses and the Company accepted that trading losses for previous accounting periods could not reduce profits for the purposes of group relief. He referred to s 393(1) of the 1988 Act where there was an automatic set-off of a loss in a trade from trading income in succeeding accounting periods and that was very like s 8(1) of the 1992 Act which gave an automatic allowance for allowable losses in the preceding accounting periods. The explanation for the reference to s 75(3) at the end of s 403(8) was that brought forward management expenses were treated as management expenses of the accounting period to which they were carried forward.

33. Section 393(1) of the 1988 Act provides that trading losses of companies **shall** be set off against **trading income** of succeeding accounting periods. As s 393(1) provides that it is the **trading income** of succeeding accounting periods (and not profits) which is reduced by the carried forward trading loss, it supports the arguments of Mr. Brennan that it is a net figure of trading income after the deduction of carried forward trading losses which forms part of profits (or total profits). That is similar to the treatment which we have found applies to chargeable gains.

34. Section 75(1) of the 1988 Act provides that, in computing the **total profits** for the purposes of corporation tax for any accounting period of an investment company management expenses for that period **shall** be deducted. Section 75(3) provides that, where management expenses and charges on income exceed the amount of profits, the excess **shall** be carried forward to succeeding accounting periods. Thus s 75(3), by providing that excess management expenses

A are deducted from **total profits** in the succeeding accounting period, is not similar to the treatment which we have found applies to chargeable gains as the carried forward amount is a deduction after the calculation of total profits and not a deduction in making the calculation.

35. Section 144 of the 1990 Act contains the general provision for the B deduction or addition of capital allowances or charges in computing a company's profits for any accounting period. Section 145 provides that a capital allowance which is to be given by discharge or repayment of tax, and is to be available primarily against a specified class of income, shall, so far as may be, be deducted from income of the specified class for the same period. Section 145(2) provides that, if there is not sufficient income of the specified class, then the C amount unallowed **shall** be carried forward to the succeeding period unless effect has been given to it by subs (3). Section 145(3) provides:

> "(3) Where such an allowance which is to be made for any accounting period (otherwise than by being carried forward from an earlier accounting period) cannot be given full effect under subsection (1) above in that period by reason of a want or deficiency of income of the relevant class, the D company may, on making a claim . . ., require that effect shall be given to the allowance against the profits (of whatever description) of that accounting period and, if the company was then within the charge to tax, of preceding accounting periods . . . and . . . the profits of any of those accounting periods shall then be treated as reduced by the amount unallowed under subsection (1) above, or by so much of that amount as E cannot be given effect under this subsection against profits of a later accounting period."

36. Thus, s 145(2) of the 1990 Act, in providing for unused allowances which are primarily to be taken against a specified class of income to be carried forward "in computing a company's profits", is similar to the provision in s 393(1) and F thus is similar to the treatment which we have found applies to chargeable gains. On the other hand, s 145(3), which provides for allowances which cannot be used against specified income to be used against profits of whatever description of that or preceding accounting periods, is similar to the provisions of s 75(3) and thus is not similar to the treatment which we have found applies to chargeable gains.

G 37. We conclude that, in computing profits, it is net trading income after deduction of carried forward trading losses which is brought into account but that excess management expenses are deducted from total profits. The capital allowance provisions have similarities with both procedures.

38. We therefore do not find the references to s 393(1) and 75(3) of the 1988 H Act and to s 145(3) of the 1990 Act to be of great assistance to us. We do, however, note that s 403(8) specifically provides that there is to be no deduction for "losses or allowances" or brought forward management expenses of preceding periods. In our view, therefore, it is necessary to determine the meaning of the words "losses or allowances" in s 403(8).

I **(3) What meaning of the words "losses or allowances" emerges from a consideration of the context of s 403 as a whole?**

39. The third question concerns the meaning of the words "losses or allowances" in s 403(8) and asks what meaning of those words emerges from a consideration of the context of s 403 as a whole.

40. In order to consider this question we need to refer to subss (1), (3), (4), (5), (7) and (8) of s 403 which, at the relevant time, provided:

"403 Losses etc. which may be surrendered by way of group relief.

(1) Subject to the provisions of this Chapter, if in any accounting period the surrendering company has incurred a loss, computed as for the purposes of section 393A(1), in carrying on a trade, the amount of the loss may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period. . . .

(3) Subject to the provisions of this Chapter, if for any accounting period any capital allowances fall to be made to the surrendering company which—

(a) are to be given by discharge or repayment of tax, and

(b) are to be available primarily against a specified class of income,

so much of the amount of those allowances (exclusive of any carry forward from an earlier period) as exceeds its income of the relevant class arising in that accounting period (before deduction of any losses of any other period or of any capital allowances) may be set off for purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.

(4) Subject to the provisions of this Chapter, if for any accounting period the surrendering company (being an investment company) may under subsection (1) of section 75 deduct as expenses of management any amount disbursed for that accounting period, so much of that amount (exclusive of any amount deductible only by virtue of subsection (3) of that section) as exceeds the company's profits of that accounting period may be set off for purposes of corporation tax against the total profits of the claimant company (whether an investment company or not) for its corresponding accounting period.

(5) The surrendering company's profits of the period shall be determined for the purposes of subsection (4) above without any deduction under section 75 and without regard to any deduction falling to be made in respect of losses or allowances of any other period. . . .

(7) Subject to the provisions of this Chapter and section 494(4), if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits of the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.

(8) The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)."

41. In support of his argument that the words "losses or allowances" in s 403(8) meant trading losses and capital allowances and not allowable losses, Mr. Goldberg Q.C. relied upon the context of s 403 as a whole. He argued that under s 403(1) a trading loss for that accounting period could be surrendered. Under s 403(3) certain excess capital allowances for that accounting period could be surrendered. Section 403(4) and (5) contained special provisions for investment companies and subs (5) provided that profits should be determined without regard to "any deduction falling to be made in respect of losses or allowances of any other period". That provision repeated the provisions relating to trading losses and capital allowances in subss (1) and (3). Subsections (7) and (8) contained provisions for charges on income and again precluded the deduction of losses or allowances of any other period. He argued that, within the context of s 403(8), the phrase "losses or allowances" referred back to the trading losses mentioned in s 403(1) and the capital allowances mentioned in s 403(3).

42. For the Inland Revenue Mr. Brennan argued that trading companies were treated differently from investment companies. Section 403(1) dealt with trading losses and s 403(3) with capital allowances. However, s 403(7) dealt with charges on income and s 403(8) restricted charges which could be surrendered. If a s 403(7) company had Case III income of £1,000 and chargeable gains of £1,000 and charges on income of £5,000 then the surrenderable charges on income were £3,000. If a s 403(1) company had Case III income of £1,000, capital gains of £1,000 and a Case I loss of £5,000 then, under s 403(1), the surrenderable loss was £5,000.

43. We accept the arguments of Mr. Brennan that s 403 provides a different treatment for trading companies on the one hand and investment companies on the other. We also note that his example assumes that in each case that there has been a chargeable gain. But the example does not assist in deciding whether, if there were allowable losses for past periods, they might be brought forward to reduce that chargeable gain. What we have to do is to consider the meaning of the words "losses or allowances" in s 403(8) and we find that exactly the same words have been used earlier in the section. In s 403(1) the word "loss" is used to mean a trading loss and the context in which it is used is to restrict a claim to the trading loss of that accounting period. In s 403(3) the word "allowances" is used to mean capital allowances and, again, the context in which it is used is to restrict claims to that accounting period. Subsections 403(4) and (5) deal with investment companies and the deduction of the expenses of management and s 403(5) uses the words "losses or allowances" again within the context of that accounting period. In our view, within the context of s 403, and the context within which the words are used in s 403(5), they are intended to have the same meaning as the word "loss" in s 403(1) and the word "allowances" in s 403(3). Similarly, s 403(7) and (8) deal with charges on income and the same words "losses or allowances" are used within the context of restricting a claim to that accounting period. The conclusion is that the words have the same meaning as the same words used previously in the same section within the same context.

44. Section 403 has a certain symmetry. Subsection (1) deals with trading losses and specifically provides that they must be losses incurred in the accounting period. Subsection (3) deals with capital allowances and again specifically provides that they are exclusive of any carried forward from an earlier period. Subsection (4) deals with investment companies and the expenses

of management and subs (5) contains the provision (also in subss (1) and (3)) that there should be no deduction for losses or allowances of any other period. Subsection (7) deals with charges on income and subs (8) contains the (now familiar) provision about there being no deduction for losses or allowances of earlier periods. In our view, if Parliament had intended that the same words in the same context in the same section should have different meanings, then that would have been made clear.

45. We conclude that the meaning which emerges from a consideration of the context of s 403 as a whole is that, in s 403(8), the word "losses" means trading losses and the word "allowances" means capital allowances.

(4) What meaning of the words "losses or allowances" emerges from a consideration of other provisions of the 1988 Act?

46. The fourth question asks what meaning of the words "losses or allowances" emerges from a consideration of other provisions of the 1988 Act.

47. In further support of his argument that the words "losses or allowances" in s 403(8) meant trading losses and capital allowances and not allowable losses, Mr. Goldberg Q.C. referred to ss 407 and 409 of the 1988 Act and argued that s 407 set a ceiling on the claim by the claimant company and the amount which could be surrendered was limited by reference to trading losses and capital allowances but not by allowable losses. Section 409 applied to companies joining or leaving a group and s 409(3)(a) provided that references in s 403 to losses and allowances should be construed in accordance with s 409(2). That only included trading losses and capital allowances and not allowable losses. The references in ss 108, 623(7)(a) and 646(5)(a) were not directly of help but reinforced the pattern that the phrase "loss or allowance" never included a reference to an allowable loss. It would be extraordinary if the only subsection where the phrase "loss or allowance" included an allowable loss were to be subs 403(8).

48. For the Inland Revenue Mr. Brennan accepted that, in the contexts of ss 108, 409, 623(7)(a) and 646(5)(a) the reference was to trading losses and capital allowances but argued that the words did not have the same meaning in s 403(5) and (8). In s 409(3) the whole point of the provision was a reference to an earlier provision. The section was not dealing with allowable losses because allowable losses could not be surrendered by way of group relief but that did not mean that in s 403(8) losses or allowances did not include allowable losses as well as trading losses. Mr. Brennan also cited *Smith* v. *Schofield* (1992) 65 TC 669 and argued that subs 403(8) had to be construed within the context of s 403, the group of sections and the scheme of the legislation and that reference should not be made to other contexts or to marginal anomalies.

49. We agree with Mr. Brennan that, in considering the meaning of words in s 403 we should primarily have regard to that section and to the group of sections of which it is a part. That means that we should consider ss 407 and 409, both of which appear in Chapter IV of Part X with s 403.

50. Section 407 contains provisions relating to the relationship between group relief and other relief. The relevant part of s 407 provides:

A "407. Relationship between group relief and other relief.

(1) Group relief for an accounting period shall be allowed as a deduction against the claimant company's total profits for the period—

(a) before reduction by any relief derived from a subsequent accounting period, but

B (b) as reduced by any other relief from tax (including relief in respect of charges on income under section 338(1)) determined on the assumption that the company makes all relevant claims under section 393A(1) of this Act and section 145(3) of the 1990 Act (set-off of capital allowances against profits)."

C 51. Section 407 looks at the position of the claimant company in relation to group relief and provides that group relief is given after any other relief from tax under s 393A(1) of the 1988 Act and s 145(3) of the 1990 Act. Section 393A(1) of the 1988 Act refers to trading losses and s 145(3) of the 1990 Act refers to capital allowances. Thus we agree with Mr. Goldberg Q.C. that s 407 does not mention allowable losses. However, s 407 deals with the position of the claimant rather than of the surrendering company. Parliament could have intended different D considerations to apply to the claimant company on the one hand and the surrendering company on the other. Accordingly, we do not find the context of s 407 to be conclusive in reaching a decision about the deductions which may not be made by the surrendering company.

52. Section 409 contains provisions about companies joining or leaving a E group. The relevant parts provide:

"409. Companies joining or leaving group or consortium.

(1) Subject to the following provisions of this section, group relief shall be given if, and only if, the surrendering company and the claimant company are members of the same group . . . throughout the whole of the surrendering company's accounting period to which the claim relates, and F throughout the whole of the corresponding accounting period of the claimant company.

(2) Where on any occasion two companies become or cease to be members of the same group, then, for the purposes specified in subsection (3) below, it shall be assumed as respects each company that—

G (a) on that occasion (unless a true accounting period of the company begins or ends then) an accounting period of the company ends and a new one begins, the new accounting period to end with the end of the true accounting period (unless before then there is a further break under this subsection); and

(b) the losses or other amounts of the true accounting period are H apportioned to the component accounting periods; and

(c) the amount of total profits for the true accounting period of the company against which group relief may be allowed in accordance with section 407(1) is also apportioned to the component accounting periods;

and an apportionment under this subsection shall be on a time basis I according to the respective lengths of the component accounting periods . . .

(3) Where the one company is the surrendering company and the other company is the claimant company—

(a) references in section 403 to accounting periods, to profits, and to losses, allowances, expenses of management or charges on income of the surrendering company shall be construed in accordance with subsection (2) above . . ."

53. Section 409(2) and (3) applies to both the surrendering and the claimant company leaving a group. Section 409(2) provides for an apportionment of losses and profits between accounting periods and s 409(3) provides that the provisions of s 403 as to "profits, and to losses, allowances, expenses of management or charges on income of the surrendering company" are applied accordingly. The Inland Revenue accept that the same words, namely "losses, allowances" in s 409(3)(a) mean trading losses and capital allowances. We are at a loss to understand how the words could have a different meaning in s 403(8).

54. We refer very briefly to ss 108, 623(7)(a) and 646(5)(a).

55. Section 108 appears in Chapter VI (Discontinuance and Change of Basis of Computation) of Part II (Income Tax: Basis of Assessment, etc.) of the 1988 Act. Section 105 provides that, where receipts are made after a discontinuance, losses, expenses and debits and capital allowances may be deducted. Section 108 provides an election for carry-back and refers to "any loss or allowance deducted in pursuance of section 105". Section 108 uses the words "loss or allowance" but refers back to s 105 which itself uses the words "losses, expenses and debits and capital allowances". The Inland Revenue accept that these words mean trading losses and capital allowances. The context of s 108 is the discontinuance of a trade and not group relief. Accordingly, we do not consider that the meaning of the words in that context assists in deciding the meaning of similar words in the context of s 403.

56. Section 623 appears in Chapter III of Part IV of the 1988 Act which concerns retirement annuities. Section 623 defines relevant earnings. Subsection (6) provides that "net relevant earnings" means earnings after deductions in respect of losses or capital allowances arising from activities, profits or gains of which would be included in computing relevant earnings". Subsection (7)(a) refers to "any such loss or allowance of the individual as is mentioned in subsection (6)(c) above". Thus, s 623(7)(a) uses the words "loss or allowance" but refers back to s 623(6)(c) which defines the losses and allowances as arising from trading.

57. Section 646 appears in Chapter IV of Part IV of the 1988 Act which Chapter deals with personal pension schemes. Section 646 defines the meaning of net relevant earnings. Subsection 646(2) described the deductions to be made from relevant earnings and subs 646(2)(d) refers to "deductions in respect of losses or capital allowances, being losses or capital allowances arising from activities, profits or gains of which would be included in computing relevant earnings of the individual". Subsection (5)(a) refers to "such loss or allowance of the individual as is mentioned in subsection (2)(d) above". Section 646(5)(a) also refers to "loss or allowance" but refers back to s 646(2)(d) which again defines the losses or capital allowances as arising from trade.

58. We are not surprised, therefore, that the Inland Revenue accept that, in both ss 623(7)(a) and 646(2)(a), the words "losses or allowances" mean trading losses or capital allowances.

59. We conclude that the meaning which emerges from a consideration of other provisions of the 1988 Act, and, in particular from s 409(2) and (3), is that the phrase "losses or allowances" in s 403(8) means trading losses or capital allowances and not allowable losses.

(5) What meaning of the word "losses" emerges from the capital gains tax legislation?

60. The fifth question asks what meaning of the words "losses" emerges from a consideration of the capital gains tax legislation.

61. In further support of his argument that the words "losses or allowances" in s 403(8) meant trading losses and capital allowances and not allowable losses, Mr. Goldberg Q.C. argued that, throughout the Taxes Acts, the word "loss" was used to mean a trading loss (as in ss 393 and 393A of the 1988 Act) and the word "allowance" was used to mean a capital allowance as in ss 9, 144 and 145 of the 1990 Act. In the capital gains tax legislation there was no reference to a loss but always to an allowable loss and he referred in particular to ss 2(2), 8(1) and 16 of the 1992 Act. In s 16 the phrase "allowable loss" was artificially defined. Also, the indexation provisions for capital gains tax had the result that the indexation calculation could give rise to an allowable loss when in fact there had been a gain and he cited *Smith* v. *Schofield* (1992) 65 TC 669 at p 686D and p 709H. Thus allowable losses were not losses in the ordinary meaning of the word and could include what was in fact a gain.

62. Section 393 of the 1988 Act deals with "a loss in the trade" as also does s 393A. The 1990 Act uses the word "allowance" to mean a capital allowance. The 1992 Act uses the words "gains" and "chargeable gains" and "losses" and "allowable losses". However. it is only "chargeable gains" which are chargeable to capital gains tax and it is only "allowable losses" which may be deducted.

63. We therefore conclude that the Taxes Acts use the word "losses" to mean trading losses and "allowable losses" to mean capital losses which may be deducted from capital gains. However, if s 403(8) had referred to "any losses", we might have been open to persuasion that a general reference to "any losses" could include allowable losses. But s 403(8) refers to "losses or allowances" within the context of a whole section where those words mean trading losses and capital allowances.

(6) What is the relevance of the intention of the legislation?

64. The sixth question asks what is the relevance of the intention of the legislation.

65. For the Company Mr. Goldberg Q.C. argued that the policy of the group relief legislation was to ensure that current surplus reliefs could be surrendered and that there should not be relief both for current surplus reliefs and brought forward losses or allowances which could have been surrendered in earlier years but were

not. If a taxpayer failed to surrender reliefs in year 1 it should not be able in effect to surrender them in year 2. That could not happen with an allowable loss which was not surrenderable until the net gains were brought into charge. The taxpayer had no choice but to deduct an allowable loss from a chargeable gain. The requirement to ignore carried forward reliefs was to prevent the abuse of choice and once a choice had been made it could not be changed later. He also argued generally that the Company was entitled to take advantage of a relief subject only to express or implied statutory restrictions, implications being made only where necessary and where the statute unambiguously so required. He cited *Carr* v. *Armpledge* [2000] STC 410 at p 416C.

66. For the Inland Revenue Mr. Brennan argued that the plain words of s 403 demonstrated the intention that only deductible amounts of the period could be taken into account in calculating the profits of the surrendering company. To take into account brought forward capital losses would defeat the intention of the section. The clear policy of s 403(7) and (8) was to prevent a taxpayer company surrendering charges on income save to the extent that they exceeded the profits of the current year. It was not possible to carry forward an allowable loss and surrender it.

67. In our view the intention of the legislation should primarily be derived from the language used, read in the context of the statute as a whole. Words should be given their normal and natural meaning having regard to the context within which they appear. Nothing should be read in or implied. For the reasons mentioned above we consider that the meaning of the words "losses or allowances" in s 403(8) is trading losses or capital allowances and not allowable losses.

Decision

68. Our decision on the issue for determination in the appeal is that, in determining the Company's profits for the purposes of s 403(7), the result of s 403(8) is that the amount to be included in profits in respect of chargeable gains is nil being the net amount of the realised chargeable gain less the allowable losses brought forward.

69. Accordingly, the appeal is allowed.

T H K Everett
Nuala Brice
Special Commissioners
27 September 2000

The Crown's appeal was heard in the Chancery Division before Sir Donald Rattee on 3 May 2001, when judgment was reserved. On 9 May 2001, judgment was given in favour of the Crown, with costs.

A *Timothy Brennan Q.C.* for the Crown.

David Goldberg Q.C. for the Company.

There were no cases referred to in the judgment.

B

The following cases were cited in the arguments:—*Carr (HMIT)* v. *Armpledge Ltd.* (2000) 72 TC 420; [2000] STC 410; *Commissioners of Inland Revenue* v. *McGuckian* (1997) 69 TC 1; [1997] 1 WLR 991; *Jones (HMIT)* v. *Lincoln-Lewis & others* (1991) 64 TC 112; *Owton Fens Properties Ltd.* v. *Redden (HMIT)* (1984) 58 TC 218; [1984] STC 618; *Smith* v. *Schofield* (1993) 65 TC 669;
C [1993] 1 WLR 398; [1993] STC 268; *Tod (HMIT)* v. *South Essex Motors (Basildon) Ltd.* (1987) 60 TC 598; [1988] STC 392; *Turner* v. *Follett (HMIT)* (1973) 48 TC 614; [1973] STC 148.

D

Sir Donald Rattee:—

This is an appeal by the Inland Revenue from a decision of Special
E Commissioners given on 27 September 2000.

The appeal raises a point of construction of s 403 (8) of the Income and Corporation Taxes Act 1988 which forms part of a group of statutory provisions relating to what is called group relief from corporation tax under which one member of a group of companies can obtain relief on certain losses and
F allowances suffered or enjoyed by another member of the same group.

It seems clear that, as counsel for the Revenue submitted, the purpose of those provisions is to mitigate the adverse tax results that might otherwise arise from an undertaking being carried on by separate companies in a group rather than by one single company.

G

The relevant facts are refreshingly simple and uncontroversial. They can be described by quotation of a single paragraph from the Special Commissioners' decision. I read para 3 of that decision:

> "The Company is an investment company and at all material times was within the charge to corporation tax and was a member of a group relief
H group. Other companies in the group had made valid claims in respect of the amounts eligible for relief surrendered by the Company. In its accounting period ending on 30 September 1994 the Company made profits of £300,000 and had charges on income of £48,644,400. Thus charges on income exceeded profits by £48,344,400. In the same accounting period the Company realised chargeable gains of £6,040,284. Allowable losses brought
I forward from past periods amounted to £60,583,017 and thus very substantially exceeded the chargeable gains."

The company there referred to—and, of course, the Respondent to the appeal before this Court—was the successful party before the Special Commissioners, that is to say, MEPC Holdings Ltd. The subject matter of the appeal before the Special Commissioners, and now before this Court, is succinctly and accurately described in para 1 of the Special Commissioners' decision as follows, and I quote:

> "MEPC Holdings Ltd. (the Company), appeals against a determination made by the Inland Revenue on 25 May 1999 that the amount available for surrender by the Company by way of group relief for the accounting period ending on 30 September 1994 was £42,304,116. The Company was of the view that the amount should be £48,344,400 and that it should not be reduced by realised chargeable gains of £6,040,284 which were more than offset by allowable losses brought forward from previous accounting periods."

The answer to the dispute between the parties depends on the proper construction of s 403, subss (7) and (8), of the Income and Corporation Taxes Act 1988. I should read those subsections but before I do, in order to construe them in the relevant context it is necessary to refer to some of the other provisions of the Taxes Act and the Taxation of Chargeable Gains Act of 1992.

Section 6(1) of the 1988 Act provides that corporation tax shall be charged on the profits of companies. Section 6(4) provides that for this purpose profits means income and chargeable gains.

Section 8(1) of the Taxes Act provides that:

> "Subject to any exceptions provided for by the Corporation Tax Acts, a company shall be chargeable to corporation tax on all its profits wherever arising."

The reference to the Corporation Tax Act in that subsection now, as I understand it, includes the Taxation of Chargeable Gains Act of 1992, to which I shall refer a little later.

Section 9 (3) of the 1988 Taxes Act provides as follows:

> . . .
>
> "for purposes of corporation tax, income shall be computed, and the assessment shall be made, under the like Schedules and Cases as apply for purposes of income tax, and in accordance with the provisions applicable to those Schedules and Cases but, (subject to the provisions of the Corporation Tax Act) the amounts so computed for the several sources of income, if more than one, together with any amount to be included in respect of chargeable gains, shall be aggregated to arrive at the total profits."

The computation of the amount to be included in respect of chargeable gains is now provided for by s 8 of the Taxation of Chargeable Gains Act of 1992, subs (1), which I shall read. It provides:

> "Subject to the provisions of this section and section 400 of the Taxes Act, the amount to be included in respect of chargeable gains in a company's total profits for any accounting period shall be the total amount of

chargeable gains accruing to the company in the accounting period after deducting—

(a) any allowable losses accruing to the company in the period, and

(b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous accounting period, any allowable losses previously accruing to the company while it has been within the charge to corporation tax."

The computation of allowable losses is provided by s 16 of that Act, which I need not read for present purposes.

Section 12 (1) of the 1988 Taxes Act provides:

"Except as otherwise provided by the Corporation Tax Acts, corporation tax shall be assessed and charged for any accounting period of a company on the full amount of the profits arising in the period (whether or not received in or transmitted to the United Kingdom) without any other deduction than is authorised by those Acts."

One deduction authorised by those Acts is provided for by s 75 of the Taxes Act. Subsection (1) of s 75 provides as follows:

"In computing for the purposes of corporation tax the total profits for any accounting period of an investment company resident in the United Kingdom there shall be deducted any sums disbursed as expenses of management (including commissions) for that period, except any such expenses as are deductible in computing profits apart from this section."

Subsection (3) of s 75 provides:

"Where in any accounting period of an investment company the expenses of management deductible under subsection (1) above, together with any charges on income paid in the accounting period wholly and exclusively for purposes of the company's business, exceed the amount of the profits from which they are deductible—

(a) the excess shall be carried forward to the succeeding accounting period; and

(b) the amount so carried forward to the succeeding accounting period shall be treated for the purposes of this section, including any further application of this subsection, as if it had been disbursed as expenses of management for that accounting period."

Another such deduction authorised by the Corporation Tax Acts, this time in relation to trading companies, is to be found in s 393 (1) of the Taxes Act. That subsection provides:

"Where in any accounting period a company carrying on a trade incurs a loss in the trade, [the loss shall] be set off for the purposes of corporation tax against any trading income from the trade in succeeding accounting periods; and (so long as the company continues to carry on the trade) its trading income from the trade in any succeeding accounting period shall then be treated as reduced by the amount of the loss, or by so much of that

amount as cannot, [under this subsection] or on a claim (if made) under [s 393 A (1)] be relieved against income or profits of an earlier accounting period."

Next I come to the group relief provisions in Chapter IV of the Taxes Act. Section 402, subss (1) and (2), provides as follows:

"(1) Subject to and in accordance with this Chapter and section 492 (8), relief for trading losses and other amounts eligible for relief from corporation tax may, in the cases set out in subsections (2) and (3) below, be surrendered by a company ('the surrendering company') and, on the making of a claim by another company ('the claimant company') may be allowed to the claimant company by way of a relief from corporation tax called 'group relief'.

(2) Group relief shall be available in a case where the surrendering company and the claimant company are both members of the same group."

Section 403 defines the losses, etc., that may be surrendered for the purposes of group relief.

Section 403(1) deals with trading losses and provides as follows, quote:

"Subject to the provisions of this Chapter, if in any accounting period the surrendering company has incurred a loss, computed as for the purposes of section [393A(1)], in carrying on a trade, the amount of the loss may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period."

Section 403 (3) deals with capital allowances. It provides:

"Subject to the provisions of this Chapter, if for any accounting period any capital allowances fall to be made to the surrendering company which—

(a) are to be given by discharge or repayment of tax, and

(b) are to be available primarily against a specified class of income,

so much of the amount of those allowances (exclusive of any carried forward from an earlier period) as exceeds its income of the relevant class arising in that accounting period (before deductions of any losses of any other period or of any capital allowances) may be set off for purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period."

Section 403 subss (4) and (5) deal with expenses of management of an investment company allowed as a deduction from profits by s 75, the relevant parts of which I have already read.

Section 403 (4) and (5) provide as follows:

"(4) Subject to the provision of this Chapter, if for any accounting period the surrendering company (being an investment company) may under subsection (1) of section 75 deduct as expenses of management any amount disbursed for that accounting period, so much of that amount (exclusive of any amount deductible only by virtue of subsection (3) of that

A section) as exceeds the company's profits of that accounting period may be set off for purposes of corporation tax against the total profits of the claimant company (whether an investment company or not) for its corresponding accounting period.

(5) The surrendering company's profits of the period shall be determined for the purposes of subsection (4) above without any deduction
B under section 75 and without regard to any deduction falling to be made in respect of losses or allowances of any other period."

Then one comes to the two subsections directly relevant in the present case and I should read them.

C Subsections (7) and (8) provide as follows:

"(7) Subject to the provisions of this Chapter and section 494(4), if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits for the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting
D period.

(8) The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)."

E

Charges on income are defined by ss 338 and 339 of the Taxes Act, but the precise provisions of those sections are not relevant for present purposes.

As appears from the quotation from the Special Commissioners' decision, which I made earlier in this judgment, the question in this case is whether the
F effect of s 403(8) is that, in computing the profits of the surrendering company for the purposes of s 403(7), allowable capital losses of that company for an earlier accounting period cannot be taken into account. The Revenue say they cannot; the company says that they can.

Submissions of the Revenue

G Mr. Brennan's submissions on behalf of the Revenue are attractively simple. He submits that on their natural construction the words of s 403(8) mean that in computing the profits of the surrendering company for the purposes of s 403(7), there must be left out of account any deduction that would otherwise fall to be made in computing such profits in respect of losses or allowances of any period other than the accounting period in question.

H

This means, submits Mr. Brennan, that in particular the deduction that would *prima facie* fall to be made under s 8(1)(b) of the Taxation of Chargeable Gains Act 1992 in computing the amount of chargeable gains that should be included in a company's profit for corporation tax purposes in respect of allowable losses accrued to the company in a period prior to the relevant
I accounting period which have not been deducted from earlier chargeable gains, must not be made when computing the profits of the surrendering company for

the purposes of s 403(7). Therefore, in the present case s 403(8) has the effect of preventing the deduction of any part of the company's allowable losses of past periods from its chargeable gains of £6,040,284 when computing its profits for the purpose of s 403(7).

The company's submissions

As before the Special Commissioners, the company put forward three principal arguments. The first was that the company's method of computing its profit for s 403(7), that is, setting past allowable losses against current chargeable gains before reaching a figure for chargeable gains to be included in the company's profits, did not involve any deduction from what would otherwise be its profits.

What s 403(8) prohibits is a deduction of losses of past years from the current year's profits. The deduction sought to be made by the company is a deduction not from the profits, but from chargeable gains that would otherwise fall to be included in the figure for the company's profits.

The true figure for profits can, by virtue of s 8(1) of the 1992 Act, only be ascertained after net chargeable gains less allowable losses have been computed. One does not ascertain a figure for profits as including gross chargeable gains and then deduct allowable losses from the profits.

The Special Commissioners, not surprisingly, accepted the company's argument that the figure to be included in a company's profit by virtue of s 8(1) of the 1992 Act in respect of chargeable gains is a net amount of chargeable gains after deducting allowable losses. If I may say so, that is obvious, but it does not seem to me to bear on the true construction of s 403(8). That subsection refers not to a deduction from profits. It says that for the purposes of s 403(7) profits shall be determined without regard to **any** [my emphasis] deduction falling to be made in respect of losses of any other period.

Apart from s 403(8) the process of determining the company's profits would involve the process of determining what amount has to be included in respect of chargeable gains under s 8(1) of the 1992 Act. That process would involve making a deduction from gross chargeable gains of allowable losses, including unused losses from previous periods. Therefore, the deduction of those losses is a deduction that, apart from s 403(8), would fall to be made in the process of computing a company's profits.

I accept the Revenue's submission that such a deduction falls within the ordinary meaning of the words "any deduction falling to be made" in s 403(8). In my judgment the natural meaning of the words is: any deduction that would, apart from this subsection, fall to be made in the process of determining the surrendering company's profits.

The second and third heads of argument put forward by Mr. Goldberg for the company should be considered together. The second is that the words "losses or allowances" in s 403(8) are not apt to include allowable losses which under the legislation can be deducted only from chargeable gains.

A In s 403(8) losses or allowances include only losses and allowances of the type already dealt with by earlier subsections of s 403, namely, trading losses (s 403(1)) and capital allowances (s 403(3)). In other words, losses or allowances that could themselves form the subject matter of a surrender under s 403.

Mr. Goldberg's third argument was that this restricted construction of
B losses and allowances in s 403(8) is consistent with what he submitted was the policy of s 403(8), namely, to prohibit the use for the purposes of increasing a surrender of excess charges on income of losses and allowances which could have been surrendered for group relief purposes in a previous year. Allowable capital losses could never have been so surrendered, they can be used only as a deduction from chargeable gains.

C

Mr. Goldberg drew attention to the fact that the words in issue in s 403(8) are "losses and allowances" and an allowable loss deductible from chargeable gains under s 8(1) of the 1992 Act may not in reality be a loss at all, just as a chargeable gain may not be a real gain; as, for example, the notional gain on the gift of an asset. Allowable loss means a figure arrived at by application of the
D provisions of the Acts, including, for example, those relating to rebasing, and may not be an accounting loss at all.

Section 403(7) clearly is dealing with excess charges on income and in that context, as in the context of the provisions of s 403(1) relating to trading losses, one should construe loss as meaning an accounting loss.

E

I did not find this particular argument of any significant weight. Of course some allowable losses may not be real losses, but some clearly are. Mr. Goldberg's argument would exclude both types from the effect of s 403(8). In my judgment losses in s 403(8) means amounts treated as losses by the Taxes Act.

F Mr. Goldberg also drew my attention to s 409(3)(a) of the Taxes Act, another provision dealing with group relief, in which the words "losses and allowances" appear. I should read s 409(3)(a). It provides:

> "(3) Where the one company is the surrendering company and the other company is the claimant company—
>
> (a) references in section 403 to accounting periods, to profits, and
G to losses, allowances, expenses of management, or charges on income of the surrendering company shall be construed in accordance with subsection (2) above."

Section 409 provides for the situation where a company leaves or joins a group and for time apportionment of profits and losses, or other amounts
H relevant to group relief.

I agree with Mr. Goldberg's argument that in that context the references in s 409(3)(a) to losses, allowances, expenses of management, or charges on income, are references to the subject matter of possible surrenders under subss (1), (3), (4) and (7) respectively of s 403. Clearly in that context losses does not include
I allowable losses which cannot be surrendered, but only used against the incurring company's own chargeable gains.

However, I do not find convincing Mr. Goldberg's argument that therefore in the wholly different context of s 403(8) losses and allowances mean only losses and allowances that can themselves be the subject matter of a surrender under s 403.

I was similarly unconvinced by Mr. Goldberg's point that in s 403(3) the reference to losses is to losses of a revenue not a capital nature. Of course it is, because s 403(3) is dealing with the deduction of losses from income. It does not to my mind follow that wherever in s 403 one finds a reference to losses, it means only losses of an income nature.

The Special Commissioners accepted Mr. Goldberg's second and third arguments. I do not. As Mr. Brennan pointed out, they produce the odd result that whereas trading losses of a previous period cannot be taken into account to increase a surrender for group relief under s 403(1), allowable capital losses of a previous period are available to increase the amount capable of surrender under s 403(7).

I see no sense in this and Mr. Goldberg failed to satisfy me that there is any rational justification for his contention that the policy of s 403(8) is to prevent a surrendering company's surrender being increased in one accounting period by losses or allowances of a previous period of a type that could have been surrendered in such earlier period.

I prefer the argument of Mr. Brennan on behalf of the Revenue that the policy of the subsection is similar to that of subs (1) in relation to trading losses, namely, to prevent the amount available for surrender being increased by taking account of losses of whatever nature incurred in an earlier period, when in particular the company incurring them may not even have been a member of the relevant group.

There is a similar limitation in relation to the surrender of capital allowances in s 403(3) and management expenses in s 403(5). In my judgment it is entirely consistent with this likely policy of the legislature that the words of s 403(8) should be given their ordinary and natural meaning, which in my judgment is that, in computing the profits of the surrendering company for the purposes of s 403(7), no regard should be had to any deduction of any loss, including allowable loss, that would otherwise fall to be made in the course of computing those profits. In my judgment this means that no deduction can be made from a company's chargeable gains in respect of allowable losses of a previous period.

The amount available for surrender in the present case is therefore as contended by the Revenue, £42,304,116, and the appeal from the Special Commissioners must be allowed.

The Company's appeal was heard in the Court of Appeal before Pill, Chadwick and Clarke L.JJ. on 2 May 2002 when judgment was reserved. On 20 June 2002 judgment was given in favour of the Crown, with costs.

A *David Goldberg Q.C.* and *Barrie Atkin* for the Company.

Timothy Brennan Q.C. for the Crown.

There were no cases referred to in the judgment.

B The following cases were cited in the arguments:—*Carr (HMIT)* v. *Armpledge Ltd.* (2000) 72 TC 420; [2000] STC 410; *Commissioners of Inland Revenue* v. *City of London (as conservators of Epping Forest)* (1953) 34 TC 293; [1953] 1 WLR 652; [1953] 1 All ER 1075; *Commissioners of Inland Revenue* v. *McGuckian* (1997) 69 TC 1; [1997] 1 WLR 991; *Jones (HMIT)* v. *Lincoln-Lewis & others* (1991) 64 TC 112; *Owton Fens Properties Ltd.* v. *Redden (HMIT)* (1984)
C 58 TC 218; [1984] STC 618; *Smith* v. *Schofield* (1993) 65 TC 669; [1993] 1 WLR 398; [1993] STC 268; *Tod (HMIT)* v. *South Essex Motors (Basildon) Ltd.* (1987) 60 TC 598; [1988] STC 392; *Turner* v. *Follett (HMIT)* (1973) 48 TC 614; [1973] STC 148.

D

Chadwick L.J.:—

1. Corporation tax is a tax on the profits of a company—see s 6(1) of the
E Income and Corporation Taxes Act 1988. It is assessed and charged for any accounting period of the company on the full amount of the profits arising in the period—s 12(1) of that Act. "Profits" means income and chargeable gains—s 6(4) of the Act. In computing the corporation tax chargeable for any accounting period of a company any charges on income paid by the company in the accounting period shall be allowed as deductions against the total profits for the
F period—s 338(1) of the Act. "Charges on income" include payments of any description mentioned in s 338(3) of the Act—see s 338(2)(a). At the time of the assessment which has given rise to this appeal—that is to say, before the new provisions for the treatment of loan relationships were enacted in the Finance Act 1996—charges on income included interest on borrowing.

2. The amount to be included in respect of chargeable gains in a company's
G total profits for any accounting period shall be the total amount of chargeable gains accruing to the company in the accounting period after deducting (a) any allowable losses accruing to the company in the period, and (b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous accounting period, any allowable losses previously accruing to the company while it has been within the charge to corporation tax—see s 8(1) of the
H Taxation of Chargeable Gains Act 1992.

3. Chapter IV in Part X of the 1988 Act contains provisions for group relief; that is to say, relief from corporation tax which is available to one company ("the claimant company") in respect of losses and other amounts eligible for relief which have been surrendered by another company ("the surrendering
I company") in the same group. In that context, companies are in the same group if they meet the condition set out in s 413(3) of the Act. Section 402 of the 1988

Act sets out the circumstances in which a claim for group relief may be made. Section 403 of the Act identifies the losses and other amounts which, if surrendered by the surrendering company, may be set off for the purposes of corporation tax against the total profits of the claimant company. They include charges on income. Section 403(7) of the 1988 Act is in these terms:

> "Subject to the provisions of this Chapter and section 494(4), if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits of the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding period."

4. The Appellant company, MEPC Holdings Ltd. is an investment company. In its accounting period ending on 30 September 1994 it had income of £300,000; and paid an amount of £48,644,400 by way of charges on income. That amount was, I think, interest on borrowing, but nothing turns on that. The chargeable gains accruing to the company in that accounting period were £6,040,284; but "the amount to be included in respect of chargeable gains in [its] total profits for [that] accounting period" was nil. That followed from the provisions of s 8(1) of the Taxation of Chargeable Gains Act 1992. The amount to be included in respect of chargeable gains for the accounting period ending on 30 September 1994 was the amount of chargeable gains accruing in that period after deducting not only "(a) any allowable losses accruing to the company in [that] period", but also "(b) any allowable losses previously accruing to the company while it has been within the charge to corporation tax" in so far as not already allowed as a deduction in any previous accounting period. And the allowable losses which had accrued to the Appellant company in earlier accounting periods (and not already allowed as a deduction against chargeable gains accruing in earlier periods) were £60,583,017.

5. At first sight, therefore, the profits of the Appellant company in the accounting period ending 30 September 1994 for the purposes of s 403(7) of the 1988 Act were £300,000—see s 6(4)(a) of that Act. And so the amount available, under the provisions of s 403(7), for set off against the total profits of a claimant company for its corresponding accounting period—that is to say, an accounting period of the claimant company which fell wholly or partly within the accounting period of the Appellant company ending 30 September 1994 (see s408(1) of the 1988 Act)—was £48,344,400; that being the amount by which the amount (£48,644,400) which the Appellant company had paid by way of charges on income exceeded its profits for the period (£300,000). But that would be to ignore the direction in s 403(8) of the Act. The subsection is in these terms:

> "The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)."

If, as the Inland Revenue contend, that direction requires that, in determining the Appellant company's profits for the purposes of s 403(7) of the 1988 Act, there shall be left out of account the deduction from the chargeable gains accruing to the Appellant company in the accounting period ending 30 September 1994 (£6,040,284) which would otherwise be made, under s 8(1)(b) of

the 1992 Act, in respect of allowable losses (£60,583,017) accruing in earlier accounting periods, the Appellant company's profits for the accounting period ending 30 September 1994 **for the purposes of s 403(7) of the 1988 Act** are £6,340,284. That is the aggregate of income (£300,000) and chargeable gains (£6,040,284) in that period if chargeable gains are to be determined without making any deduction in respect of allowable losses accruing in earlier accounting periods. And, on that basis, the amount by which the amount paid by way of charges on income (£48,644,400) exceeds the Appellant company's profits of the period ending 30 September 1994 (£6,340,284) is £42,304,116.

6. On 25 May 1999 the Inspector of Taxes determined that the amount available for surrender by the Appellant company by way of group relief for the accounting period ending on 30 September 1994 was £42,304,116. The company appealed from that determination to the Special Commissioners. The Commissioners (Mr. T H K Everett and Dr. A N Brice) allowed that appeal. They held that the amount to be included in the Appellant company's profits for the accounting period ending 30 September 1994 was nil (not £6,340,284). It followed that the amount available for surrender was £48,344,284.

7. The Inspector appealed to the High Court. Sir Donald Rattee, sitting as an additional judge in the Chancery Division, allowed the appeal; and declared that the amount available for surrender by the company, by way of group relief, in respect of the accounting period ending 30 September 1994 was £42,304,116. The company's appeal from the order made by the Judge on 4 May 2001 is now before this Court.

The decision of the Special Commissioners

8. The provisions in ss 403(7) and (8) of the 1988 Act must, of course, be construed in the context of s 403 as a whole. Subsections (1), (3) and (4) of the section are in these terms:

> "(1) Subject to the provisions of this Chapter, if in any accounting period the surrendering company has incurred a loss, computed as for the purposes of section 393A(1), in carrying on a trade, the amount of the loss may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.
>
> (2) . . .
>
> (3) Subject to the provisions of this Chapter, if for any accounting period any capital allowances fall to be made to the surrendering company which—
>
> (a) are to be given by discharge or repayment of tax, and
>
> (b) are to be available primarily against a specified class of income,
>
> so much of the amount of those allowances (exclusive of any carried forward from an earlier period) as exceeds its income of the relevant class arising in that accounting period (before deduction of any losses of any other period or of any capital allowances) may be set off for purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.

(4) Subject to the provisions of this Chapter, if for any accounting period the surrendering company (being an investment company) may under subsection (1) of section 75 deduct as expenses of management any amount disbursed for that accounting period, so much of that amount (exclusive of any amount deductible only by virtue of subsection (3) of that section) as exceeds the company's profits of that accounting period may be set off for purposes of corporation tax against the total profits of the claimant company (whether an investment company or not) for its corresponding accounting period."

9. The Special Commissioners reached the conclusion which they did because they were persuaded that the words "losses" and "allowances" in the phrase "losses or allowances" in s 403(8) meant, and meant only, the "losses" referred to in s 403(1) and the "allowances" referred to in s 403(3)—that is to say, trading losses and capital allowances—so that that phrase did not include allowable losses which fell to be deducted under s 8(1) of the 1992 Act in determining the amount to be included in respect of chargeable gains in the company's total profits for the relevant accounting period. In particular, the expression "losses or allowances of any other period" in s 403(8) of the 1988 Act did not include "allowable losses previously accruing to the company" which fell to be deducted under s 8(1)(b) of the 1992 Act.

The decision in the High Court

10. The Judge recognised that the "losses" referred to in s 403(1) of the 1988 Act, and the "allowances" referred to in s 403(3) of that Act, were losses and allowances which, themselves, could be the subject matter of a surrender; and that the "allowable losses" referred to in s 8(1) of the 1992 Act could not be surrendered. "Allowable losses" could be used only as a deduction from gains. But he was not persuaded that[1]:

"... there is any rational justification for [the Appellant company's] contention that the policy of s 403(8) is to prevent a surrendering company's surrender being increased in one accounting period by losses or allowances of a previous period of a type that could have been [but were not] surrendered in such earlier period."

He preferred the Revenue's argument that the policy of s 403(8) of the 1988 Act was to prevent the amount available for surrender being increased by taking account of losses of whatever nature incurred in an earlier period "when in particular the company surrendering them may not even have been a member of the relevant group." But he founded his decision on what he regarded as the plain and obvious meaning of the words "any deduction falling to be made" which appear in s 403(8). As he put it[2]:

"In my judgment the natural meaning of the words is: any deduction that would, apart from this subsection, fall to be made in the process of determining the surrendering company's profits."

and[3]

([1]) p 656 *ante* ([2]) p 654 *ante* ([3]) p 656 *ante*

A ". . . [the] ordinary and natural meaning [of the words] . . . is that, in computing the profits of the surrendering company for the purposes of s 403(7), no regard should be had to any deduction of any loss, including allowable loss, that would otherwise fall to be made in the course of computing those profits. In my judgment this means that no deduction can be made from a company's chargeable gains in respect of allowable losses
B of a previous period."

The submissions on this appeal

11. The Revenue submit that the Judge was correct for the reasons that he
C gave. The language of s 403(8) of the 1988 Act is clear and unambiguous. Effect must be given to it.

12. It is pointed out that, whatever meaning is given to the phrase "losses or allowances" in s 403(8) of the 1988 Act, the effect of that section is that the relief from tax provided by group relief will not, or not necessarily, have the result
D that no more tax will be payable than would have been payable if the activities carried on by the group had been carried on by a single company. That is because s 403(8) plainly does prevent the deduction from the surrendering company's profits (for the purposes of s 403(7)) of some losses and allowances which would otherwise be deductible. So, it is said, the assumption which underlies the Appellant company's approach to the group relief provisions—that those provisions are seeking to achieve, for a group taken as a whole, the same results
E as would be achieved if all the activities of the group were carried on in a single company—is not well founded. It is not the purpose of those provisions that a group should be treated for the purposes of corporation tax as if it were a single company. Group relief is deliberately restricted to losses and other amounts of the particular accounting period. If that were not so, the reliefs which could be surrendered for the purposes of group relief would be treated more generously
F in the hands of the claimant company than they would be in the hands of the surrendering company. A further indication of the intention to restrict group relief to the losses and other amounts of a particular accounting period is to be found in the anti-avoidance rules enacted in s 410 and s 413(7) and (8) of the 1988 Act and in sch 18 to that Act. It is said that those rules are all directed to ensuring that the surrendering company and the claimant company are, truly, in the same
G group in the relevant accounting period. They are not aimed—as they would need to be if losses and other amounts carried forward or carried back from other accounting periods could be surrendered—at ensuring that the surrendering company and the claimant company were members of the same group in those other accounting periods also.

H 13. The Appellant company advances two principal submissions. The first is that allowable losses are not a "deduction falling to be made" in the determination of "the surrendering company's profits of the period"; and so allowable losses of a previous period are not a deduction which s 403(8) of the 1988 Act requires to be disregarded. As it is put in para 11 of the skeleton argument prepared for use on this appeal:

I "Allowable losses are not deducted from profits and they are not deducted in determining profits, but at an earlier stage of the process, the

stage of working out net chargeable gains so that the deduction of allowable losses is not a deduction of the kind referred to in s 403(8)." A

It is said, correctly, that s 403(8) does not specify when, or from what, the deduction "falling to be made" does fall to be made. It is said, also correctly, that the deduction must be a deduction "falling to be made" in the determination of the surrendering company's "profits of the period". And that, it is said, requires B that the deduction must be a deduction "from the profits of the period"—that is to say, a deduction made "once profits of the period have been established".

14. The second submission made on behalf of the Appellant company is that allowable capital losses are not within the phrase "losses or allowances" in C s 403(8) of the 1988 Act. As I have said, that submission was accepted by the Special Commissioners.

Whether allowable losses are a deduction falling to be made in the determination of profits?

D

15. For my part, I would accept that if the only deductions which s 403(8) of the 1988 Act requires to be disregarded were deductions falling to be made "from the profits of the period"—or "once profits of the period have been established"—then there would be much force in the contention that a deduction of allowable losses made for the purpose of determining "the amount to be E included in respect of chargeable gains in a company's total profits" for the relevant accounting period (as required by s 8(1) of the 1992 Act) was not a deduction "from the profits of the period" and so was not a deduction within the scope of s 403(8). But I am unable to accept the premise. I can see no reason why s 403(8) of the 1988 Act should be read as if the only deductions within its scope were deductions falling to be made "from the profits of the period" or "once F profits of the period have been established".

16. In my view the plain meaning and effect of the direction that the surrendering company's profits of the period "shall be determined . . . without regard to any deduction falling to be made" is that what is to be disregarded is G a deduction which would otherwise fall to be made in determining the profits of the period. The answer to the question "from what do deductions fall to be made?" is "from whatever, under the relevant legislative provision, deductions do fall to be made in determining the profits of the period." An allowable capital loss is, plainly, a deduction which falls to be made in determining the profits of the period—see s 6(4)(a) of the 1988 Act and s 8(1) of the 1992 Act. So, if an H allowable loss is within the phrase "losses or allowances" for the purposes of s 403(8) of the 1988 Act, then—as it seems to me—it must follow that allowable losses "previously accruing to the company" within s 8(1)(b) of the 1992 Act are losses which s 403(8) of the 1988 Act requires to be disregarded.

17. The point made in para 11 of the Appellant company's skeleton I argument—which I have already set out—is re-iterated and expanded in para 67, and in paras 69 to 72. At the risk of repetition, but in order to avoid the risk of appearing to have approached the point with less deliberation than it is thought to deserve, I think it appropriate to set out those paragraphs also:

A "67. The deduction of allowable losses is made in computing a sum of chargeable gains to be brought into the computation of profits: it is not made in computing or determining profits but at an earlier and distinct stage of the process. The profit [in this case] is never more than £300,000.

68. . . .

B 69. The Company's first submission is thus that what comes into the computation of the Company's profits in respect of chargeable gains and into the profits themselves is a net figure of gains less allowable losses so that, where there are brought forward allowable losses, no deduction is made from, or in computing or determining, profits at all.

C 70. The point is that there is a difference between the determination of the chargeable gains to be brought into profits and profits: allowable losses are deducted from chargeable gains before the computation or determination of profit begins; they are not deducted from or in computing or determining profits at all.

71. Thus, where, as in this case, the allowable losses carried forward exceed the chargeable gain for the period, no figure for chargeable gains comes into the computation of profits at all.

D 72. It is not a case of something (a gain) coming in and something else (an allowable loss) then being deducted: it is a case of nothing at all being brought in, in the first place, into the profits or the computation of profits in respect of chargeable gains".

E 18. The point can, I think, be analysed schematically. "Profits" (P) means income (I) and chargeable gains (G)—s 6(4)(a) of the 1988 Act. The amount to be included as chargeable gains (G) in the formula $P = I + G$ is the total amount of chargeable gains accruing to the company in the accounting period (G^1) after deducting (a) any allowable losses accruing to the company in the period (L^1) and (b) any previous unused allowable losses (L^2)—s 8(1) of the 1992 Act. So $G = G^1-(L^1 + L^2)$. But G cannot be less than nil; it can never be a negative amount. F So it is not apt to treat the formula for computing profits as if it were $P = I + G^1-(L^1 + L^2)$. It follows that L^2 cannot be treated as a deduction in computing or determining profits.

19. I accept that analysis, so far as it goes. But I do not accept the conclusion to which it is said to lead. The analysis is less than complete. A more G complete analysis would recognise that, because G cannot be a negative amount, the relevant formula is not $G = G^1-(L^1 + L^2)$. The relevant formula is $G = G^1 - L$; where L is whichever is the less of G^1 and $(L^1 + L^2)$. The amount to be deducted in respect of allowable losses under s 8(1) of the 1992 Act is not—or not necessarily—the whole of the allowable losses accruing or previously accruing to the company; the amount to be deducted (L) is only so much of the whole of the H allowable losses accruing or previously accruing $(L^1 + L^2)$ as does not exceed the total amount of chargeable gains accruing in the relevant accounting period (G^1). So, although it is not apt to treat the formula for computing profits as $P = I + G^1-(L^1 + L^2)$, the more complete formula $P = I + G^1-L$ (where L is whichever is the less of G^1 and $(L^1 + L^2)$) is valid.

I 20. The question, under this head of the Appellant company's submissions, is whether the deduction from the total amount of chargeable gains accruing in

the relevant accounting period of allowable losses can properly be regarded as "any deduction falling to be made in respect of losses" in determining the surrendering company's profits of the relevant accounting period. Subject to the distinct question whether allowable losses are "losses" in that context (to which I now turn), I would answer that first question in the affirmative.

Whether "losses or allowances" excludes allowable losses?

21. It is said that, while "losses" and "allowances"—at least in the sense of "trading losses" and "capital allowances"—are well recognised concepts in the context of computing the "income" element of "profits" for the purposes of corporation tax, those concepts have no place in the context of computing the "chargeable gains" element. At first sight that is a surprising submission, given that s 8(1) of the 1992 Act requires the deduction of allowable "losses" in the computation of the amount to be included in respect of chargeable gains in a company's total profits. But that, it is said, is to be explained by the fact that "allowable losses" has a special meaning in relation to the computation of chargeable gains; that a "finding that an allowable loss exists is just the result of making a computation: the computation may be made using actual or notional disposal proceeds and actual or notional base costs and the result, if an allowable loss, may not be something which can properly be described as a loss at all"—see para 89 of the Appellant company's skeleton argument.

22. Section 288(1) of the 1992 Act requires that "allowable loss" shall be construed in accordance with ss 8(2) and 16 of that Act. Section 8(2) provides that, for the purposes of corporation tax in respect of chargeable gains, "allowable loss" does not include a loss accruing to a company in such circumstances that if a gain accrued the company would be exempt from corporation tax in respect of it. Section 16(1) of the Act sets out the general rule that the amount of a loss accruing on the disposal of an asset shall be computed in the same way as the amount of a gain is computed. Section 16(2) is in these terms:

> "Except as otherwise expressly provided, all the provisions of this Act which distinguish gains which are chargeable gains from those which are not, or which make part of a gain a chargeable gain, and part not, shall apply also to distinguish losses which are allowable losses from those which are not, and to make part of a loss an allowable loss, and part not; and references in this Act to an allowable loss shall be construed accordingly."

Sections 16(3) and (4) of the 1992 Act identify particular cases in which losses accruing on the disposal of assets shall not be allowable assets.

23. The 1992 Act prescribes how the amount of a loss accruing on the disposal of an asset shall be computed; and distinguishes between losses which are allowable and those which are not. It seems to me reasonably plain that Parliament had in mind that, on the disposal of an asset, there would ordinarily be either a gain or a loss; intended that the amount of that gain or loss would be computed in a way which (in general) equated the transaction with a disposal at market value, but which allowed for inflation through indexation; and intended, further, that most (but not all) losses would be allowable against chargeable gains for the purpose of taxation. I accept, of course, that the effect of indexation—or "re-basing" under s 35(2) of the 1992 Act—may lead, in some

A circumstances, to a situation in which, although the monetary consideration received on the disposal of an asset is greater than the monetary consideration paid on the acquisition of that asset, there will be a "loss" for the purposes of s 16(1) of the Act. But that arises from the requirements in Part II of the Act as to the computation of gains and losses; it has nothing to do with the separate question whether the "loss" is an "allowable loss" for the purposes of the Act. B And I find nothing artificial or notional in the concept that a loss has been suffered in circumstances where, although the monetary consideration received on disposal is greater than the monetary value paid on acquisition, the change in the value of money (as a result of inflation) has been such that the real value of the consideration received on disposal is less than the real value of the consideration paid on acquisition. I find no support in the legislation, or in the C authorities to which we were referred, for the proposition that an allowable loss is not properly to be regarded as a loss at all; but rather as nothing more than the product of a computation made on an artificial or notional basis. In particular, I find no support in the 1992 Act for the proposition that Parliament intended that a loss which was an allowable loss under the provisions in ss 8 and 16 of that Act could not or would not be a loss for the purposes of s 403(8) of the 1988 Act.

D 24. That does not, of course, lead to the conclusion that a loss which is an allowable loss for the purposes of the 1992 Act must be a loss within the phrase "losses or allowances" in s 403(8) of the 1988 Act. It leads only to the conclusion that it may be. Whether or not a loss which is an allowable loss for the purposes of the 1992 Act is within the phrase "losses or allowances" in s 403(8) of the 1988 Act turns on the true construction of that subsection in the context of s 403 as a E whole and the related provisions in Chapter IV of Part X of the Act.

25. The Appellant company relies on the requirement in s 409(3) of the 1988 Act that:

> "Where the one company is the surrendering company and the other F company is the claimant company–(a) references in section 403 to accounting periods, to profits, and to losses, allowances, expenses of management or charges on income of the surrendering company shall be construed in accordance with subsection (2) above."

Section 409 of the 1988 Act is directed to the position where a company joins G or leaves a group. The basic rule is set out in s 409(1): group relief shall be given if, and only if, the surrendering company and the claimant company are members of the same group throughout the whole of the surrendering company's accounting period to which the claim for group relief relates and throughout the whole of the corresponding accounting period of the claimant company. Section 409(2) is in these terms, so far as material:

H > "Where on any occasion two companies become or cease to be members of the same group, then, for the purposes specified in subsection (3) below, it shall be assumed as respects each company that—
>
> (a) on that occasion (unless a true accounting period of the company begins or ends then) an accounting period of the company ends and a new one begins, the new accounting period to end with the I end of the true accounting period (unless before then there is a further break under this subsection); and

(b) the losses or other amounts of the true accounting period are apportioned to the component accounting periods; and

(c) . . .

and an apportionment under this subsection shall be on a time basis according to the respective lengths of the component accounting periods . . ."

26. The effect of s 409(2) of the 1988 Act, read in conjunction with s 409(3), is that, where on any occasion (the "break") two companies become or cease to be members of the same group, and the one company is the surrendering company and the other company is the claimant company, s 403 has to be read as if (i) an accounting period of each company ends (and a new accounting period begins) on the break and (ii) the profits of each company of the true accounting period, and the losses, allowances, expenses of management or charges on income of the surrendering company of its true accounting period, are apportioned to the component accounting periods which arise on the break. So, in such a case, the loss incurred by the surrendering company in carrying on a trade (in the context of s 403(1) of the Act) is the amount treated as the loss incurred in the component accounting period—that is to say, the time-based proportion of the trading loss incurred by the surrendering company in its true accounting period. The capital allowances falling to be made to the surrendering company (in the context of s 403(3)) are the allowances treated as falling to be made in the component accounting period. And the expenses of management deductible by a surrendering company (being an investment company) under s 75(1) of the Act and the company's profits (in the context of s 403(4)) are the expenses of management and the profits treated as such in respect of the component accounting period.

27. In particular, the amount paid by the surrendering company by way of charges on income, for the purposes of s 403(7) of the Act, is the amount treated as paid in the component accounting period—that is to say, a proportion of the amount actually paid in the true accounting period—and (in the same context) the amount of the profits of the surrendering company "of the period" is the amount treated as the profits of the component period—that is to say, a proportion of the profits of the true accounting period. But the apportionment directed by s 409(2) has no direct application to s 403(8) of the Act. Section 403(8) prescribes how "the surrendering company's profits of the period" are to be determined for the purposes of s 403(7). The methodology, in a case to which s 409(2) applies, is to determine the surrendering company's profits for its true accounting period—having regard to the requirement in s 403(8) that deductions to be made in respect of losses or allowances in respect of any other period are to be left out of account—and then to treat a time-based proportion of the profits so determined as the profits of the component accounting period for the purposes of s 403(7) of the Act.

28. It follows, in my view, that s 409 of the Act—and, in particular, s 409(3)—throws no light on the meaning of the phrase "losses or allowances" in s 403(8). I accept that the "losses" and "allowances" referred to in s 409(3) of the Act are trading losses (within s 403(1)) and capital allowances (within s 403(3)); but that is because losses and allowances within ss 403(1) and 403(3) are the only losses and allowances to which s 409(2) can apply. There is no occasion for any

separate apportionment of the "losses or allowances" to which s 403(8) refers; the relevant apportionment in a case to which s 408(3) applies is an apportionment of "charges on income" and "profits of the period" in the context of s 403(7). I agree with the Judge that, although the references in s 409(3)(a) to losses, allowances, expenses of management or charges on income are to losses and other amounts which could be surrendered under subss (1), (3), (4) or (7) of s 403 of the Act (and so could not include allowable losses, which cannot be surrendered), it does not follow that, in the different context of subs (8), "losses or allowances" means only losses or allowances that can be the subject matter of a surrender under those earlier subsections.

29. The Special Commissioners expressed themselves "at a loss to understand" how the words "losses or allowances" in s 403(8) could have a different meaning from the same words "losses, allowances, . . ." in s 409(3)(a) of the Act. The reason why the words may have a different meaning, as it seems to me, is that each phrase must be construed in its own context; and the context in which s 403(8) falls to be construed is not that to which s 409 of the Act is directed. And to hold, as the Special Commissioners did, that the phrase "losses or allowances" in s 403(8)—or in s 403(5)—must be confined to trading losses (within s 403(1)) and capital allowances (within s 403(3)) is to ignore Case VI losses allowable under s 396(1) of the Act. I can see no reason—and none has been advanced (save that it was suggested that Parliament had overlooked the point)—why "losses", in the context of the restriction on group relief which s 403(5) and s 403(8) are plainly intended to impose, should not include Case VI losses—which are subject to a carry forward provision but which cannot themselves be surrendered by way of group relief.

30. I turn, therefore, to consider the structure of s 403 of the 1988 Act in order to see whether there is some identifiable policy which emerges from the section as a whole and which should be given effect in the interpretation of the phrase "losses or allowances" in s 403(8).

31. Section 403(1) of the Act provides for the surrender of a trading loss incurred by the surrendering company in any accounting period; and for the set off of that loss against the total profits of the claimant company for its corresponding accounting period. It is, I think, pertinent to note that the subsection does not allow the claimant company to set off against its profits in one accounting period a trading loss incurred by the surrendering company in a non-corresponding accounting period. That is in contrast with the position under s 393 of the Act in relation to the set off of trading losses incurred by the claimant company itself in earlier accounting periods against profits of subsequent accounting periods (carry forward); and, under s 393A, in relation to the set off of trading losses incurred by the claimant company in later accounting periods against profits of earlier accounting periods (carry back).

32. Section 403(3) of the Act provides for the surrender of so much of the amount of any capital allowances falling to be made to the surrendering company for any accounting period "(exclusive of any carried forward from an earlier period)"as exceeds its income of the relevant class arising in that accounting period "(before deduction of any losses of any other period or of any capital allowances)"; and for the set off of that amount against the total profits of the claimant company for its corresponding accounting period. Again, it is

pertinent to note that, in contrast to the position where capital allowances fall to be made to the claimant company itself—as to which see s 145 of the Capital Allowances Act 1990—there is no carry forward or carry back of capital allowances which are surrendered. Further, the amount of the capital allowances which can be surrendered is restricted to the excess over the surrendering company's income of the relevant class before deduction of (i) any losses of any other period or (ii) any capital allowances—that is to say, capital allowances carried forward or carried back from any other period.

33. Section 403(4) of the Act must be read in conjunction with s 403(5) and with s 75. Section 75 provides, so far as material:

> "(1) In computing for the purposes of corporation tax the total profits for any accounting period of an investment company resident in the United Kingdom there shall be deducted any sums disbursed as expenses of management (including commissions) for that period, except any such expenses as are deductible in computing profits apart from this section.
>
> (2) . . .
>
> (3) Where in any accounting period of an investment company the expenses of management deductible under subsection (1) above, together with any charges on income paid in the accounting period wholly and exclusively for purposes of the company's business, exceed the amount of the profits from which they are deductible—
>
> (a) the excess shall be carried forward to the succeeding accounting period; and
>
> (b) the amount so carried forward to the succeeding accounting period shall be treated for the purposes of this section, including any further application of this subsection, as if it had been disbursed as expenses of management for that accounting period . . ."

Section 403(4) provides that any amount which the surrendering company could deduct as expenses of management disbursed in an accounting period "exclusive of any amount deductible only by virtue of [s 75(3)]" as exceed the surrendering company's profits for that period may be set off against the total profits of the claimant company (whether or not itself an investment company) for its corresponding period. It is to be noted that the carry forward provision in relation to expenses, contained in s 75(3), takes effect by treating the amount of the expenses carried forward as if they had been disbursed in the succeeding accounting period to which they have been carried forward. The words in parenthesis—"exclusive of any amount deductible only by virtue of [s 75(3)]"—have the effect of preventing expenses of management disbursed by the surrendering company in earlier accounting periods from being set off by the claimant company in a non-corresponding accounting period.

34. Section 403(5) of the 1988 Act is in terms which reflect those in s 403(8):

> "The surrendering company's profits of the period shall be determined for the purposes of subsection (4) above without any deduction under section 75 and without regard to any deduction falling to be made in respect of losses or allowances of any other period."

A The effect of s 403(5) is that not only are the expenses of management which may be surrendered restricted to those disbursed in the corresponding period (s 403(4)) but, in computing the amount which may be surrendered—that is to say, the amount by which expenses of management disbursed in the relevant accounting period exceeds the surrendering company's profits of that period—the profits of the period must be determined without regard to expenses of B management disbursed in earlier periods; and without regard to "any deduction falling to be made in respect of losses or allowances of any other period". Plainly, the question which arises in the present case could equally arise in relation to a computation of profits for the purposes of s 403(5).

35. The common thread which runs through the provisions of s 403 to C which I have referred is the restriction of what may be set off by the claimant company in its relevant accounting period to losses, allowances or expenses of management which have been incurred, fallen to be made or been disbursed by the surrendering company in its corresponding accounting period. Losses, allowances or expenses of management which have been incurred, fallen to be made or been disbursed in a non-corresponding accounting period cannot be surrendered or set off either directly or by being taken into account in the D determination of the income of the surrendering company (for the purposes of subs (3)) or in the determination of its profits (subs (5)). In so far as it is possible to identify a policy which underlies those provisions, it is to restrict group relief to the particular accounting period. It may well be that the reason for that restriction is—as the Revenue suggest—the difficulty of formulating satisfactory anti-avoidance provisions to cover carry forward and carry back relief which E could be allowed to the surrendering company in respect of an accounting period during no part of which the claimant company was a member of the group.

36. Be that as it may, the common thread persists in ss 403(7) and 403(8) of the Act. It was unnecessary to go further, in s 403(7), than to restrict the amount paid by way of charges on income to the amount paid in the corresponding F accounting period; because s 338 of the 1988 Act—which gives the relief—contains no provision for carry forward or carry back. But the restriction, in s 403(8), in relation to the determination of the surrendering company's profits, is consistent with the earlier provisions in s 403. In particular, the requirement that no regard shall be had to "expenses of management deductible only by virtue of section 75(3)" has the effect of excluding expenses of management disbursed in any earlier accounting period from the determination of the surrendering G company's profits for the relevant period in the same way as in s 403(5).

37. I find nothing in the structure of s 403 of the 1988 Act, taken as a whole, which suggests that the phrase "losses or allowances" in subs (8)—or the same phrase in subs (5)—is to be given a meaning which excludes allowable losses for the purposes of the 1992 Act. Indeed, there is, I think, some indication to the H contrary. Section 403(3) provides for a special determination of the surrendering company's "income of the relevant class". That has to be determined before the deduction of "any losses of any other period or of any capital allowances". It is plain that, in that context, "losses of any other period" cannot include allowable losses—because allowable losses have no part in the determination of "income of the relevant class". It is equally plain that, in that context, "allowances" are I "capital allowances"—the subsection so provides. But Parliament has not chosen, in subss (5) and (8) of s 403, to provide, as it easily could have done, that

in determining the surrendering company's profits of the period "its **income** shall be determined without regard to any **losses or capital allowances** of any other period". It has used the more general expression "its **profits** shall be determined . . . without regard to any deduction falling to be made in respect of **losses or allowances** of any other period". And it must be taken to have done so in the knowledge that, in the determination of **profits** it is necessary to include chargeable gains; and that in determining chargeable gains it is necessary to deduct allowable losses.

Conclusion

38. It follows that I can see no reason why the phrase "losses or allowances" in s 403(8) of the 1988 Act should be given a meaning which excludes allowable losses; and no reason why it should be held (in the context of that section) that allowable losses are not losses which fall to be deducted in determining the surrendering company's profits of the relevant accounting period. In my view the Judge was right to reach the conclusion which he did.

39. I would dismiss this appeal.

Clarke L.J.:—

40. I agree.

Pill L.J.:—

41. This appeal turns upon the construction of s 403, subss (7) and (8) of the Income and Corporation Taxes Act 1988 ("the 1988 Act"). The subsections must of course be construed in the context of the section as a whole and with an acknowledgement that it is a part of a complex scheme of revenue control. The subsections provide:

> "(7) Subject to the provisions of this Chapter and section 494(4), if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits of the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period.
>
> (8) The surrendering company's profit of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)."

42. I gratefully adopt Chadwick L.J.'s recital of the facts.

43. I make two general observations before posing the two questions raised by the Appellant company. I too approach the questions of statutory construction which arise on the basis that it cannot be assumed that the relevant provisions are seeking to achieve the same results for a group of companies as

A would occur if all the activities of the group were carried on by a single company. There is nothing surprising about a scheme which provides group relief, that is a reduction in the tax disadvantages which would otherwise occur when a business operates through a group of companies rather than a single company, but provides it only on a restricted basis. A restriction of group relief to the losses and other amounts of the relevant accounting period safeguards the Revenue against
B arrangements between companies (not the present case) being made with the object of carried forward losses being surrendered as group relief by a set-off against the profits of the claimant company.

44. I also agree with Chadwick L.J. that there is in s 403 of the 1988 Act a common thread that what may be set off by the claimant company in its relevant
C accounting period is restricted to amounts in the corresponding accounting period of the surrendering company.

45. The first question raised by the Appellant company is whether, within the terms of s 403(8), a "deduction" has been made in respect of "any other period". It is forcefully argued by Mr. Goldberg Q.C. on behalf of the company
D that what is included in the computation of the profits of a company which has chargeable gains and current or past allowable losses is not a gross figure of gains from which allowable losses are then deducted but a net figure, being the sum of chargeable gains net of allowable losses. The Taxation of Chargeable Gains Act 1992 ("the 1992 Act"), s 8(1), provides, insofar as is material:

> "... the amount to be included in respect of chargeable gains in a company's
E total profits for any accounting period shall be the total amount of chargeable gains accruing to the company in the accounting period after deducting—
>
> (a) any allowable losses ..."

46. There are two stages, it is submitted. First, net chargeable gains are
F calculated. That involves a deduction of allowable losses. Only then does the calculation of profits begin. The gain in this case never features as profit because the allowable losses brought forward exceed the chargeable gain. No "deduction" falls to be made in respect of another period within the meaning of subs (8) because the chargeable gain is not a part of the "profits of the period" under subs (7).

G

47. Moreover, "deduction" in subs (8), it is submitted, must mean a deduction from something and linguistically can mean only a deduction from the "surrendering company's profits of the period", the entity identified in the opening words of the subsection. In the absence of profits, there can be no deduction.

H

48. Save as a general illustration of how corporation tax operates, reliance on s 8(1) of the 1992 Act is in my judgment misplaced. As Mr. Brennan Q.C. for the Respondents points out, s 8(3) of the Act provides that capital gains tax principles are to be applied to the calculation of chargeable gains for corporation tax purposes except as otherwise provided by any other provision of the
I Corporation Tax Acts, which include the 1988 Act. He submits that s 403(8) of the 1988 Act does otherwise provide.

49. Subsections (7) and (8) of s 403 of the 1988 Act must plainly be read together. Subsection (8) provides expressly the way in which the profits identified in subs (7) are to be determined. They are to be determined without regard to any deduction falling to be made in respect of any period other than the accounting period for which the claimant company is making the claim.

50. In my judgment s 403(8) does provide specifically and comprehensively the manner in which the surrendering company's profits shall be determined. They shall be determined without regard to any deduction falling to be made in respect of losses of any other period. I acknowledge the argument that the expression "falling to be made" in the subsection does create the possibility of losses which are not deductible but in my judgment the intention and effect of the subsection is to prevent losses of any other period being taken into account in determining profits of the period. I cannot accept the two stage process advocated on behalf of the Appellant company. Subject to deciding what are to be included in the "losses" contemplated in the subsection, the Judge's conclusion on the first question was in my view correct.

51. The second question raised by the Appellant company is whether, if a deduction has been made in this case in respect of another period, it was a deduction of "losses or allowances" within the meaning of s 403(8). It is submitted that while the expression includes trading losses and capital allowances taken into account in computing income or profits (as in s 409(3)(a) of the 1988 Act) it does not include allowable losses which may be set only against chargeable gains.

52. Section 409 of the 1988 Act makes the detailed provision to be expected in a scheme for group relief to cover the situation in which a company joins or leaves a group and to provide for the apportionment of group relief. I agree with Chadwick L.J., for the reasons he gives, that the section throws no light on the meaning of the expression "losses or allowances" in s 403(8). Secondly, I agree that there is no justification for limiting the expression "losses or allowances" in the subsection to the trading losses identified in a specific context in s 403(1) and the capital allowances identified in s 403(3). Had such a limitation or qualification been intended, subs (8) could and would have included the simple wording necessary to achieve that result.

53. Section 403(8) of the Act has the specific purpose of limiting the right to set-off conferred by s 403(7). It does so by the use of the words "losses or allowances". Those words have, and were in context intended to have, a broad and general meaning. I see no justification for excluding allowable losses.

54. In this context I do not consider that a narrow or technical construction of subs (8) was intended. Just as profits are to be determined in a manner which gives full effect to the words "without regard to any deductions . . . of any other period" (the first question) so full effect is to be given to the word "losses" so as to include allowable losses (the second question).

55. I agree that the appeal should be dismissed.

A The Company's appeal was heard in the House of Lords before Lord Nicholls of Birkenhead, Lord Slynn of Hadley, Lord Hoffmann, Lord Millett and Lord Walker of Gestingthorpe on 17 and 18 November, when judgment was reserved. On 18 December 2003, judgment was given against the Crown, with costs.

B *Timothy Brennan Q.C.* for the Crown.

David Goldberg Q.C. for the Company.

There were no cases referred to in the speeches.

C The cases cited in the arguments were as follows; *Bowles* v. *The Governor & Co. of the Bank of England* [1913] 1 Ch 57; (1912) 6 TC 136; *Brown (Surveyor of Taxes)* v. *National Provident Institution* [1921] 2 AC 222; (1921) 8 TC 57; *Carr (HMIT)* v. *Armpledge Ltd.* (2000) 72 TC 420; [2000] STC 410; *Commissioners of Inland Revenue* v. *City of London (as conservators of Epping Forest)* (1953) 34 TC 293; [1953] 1 WLR 652; [1953] 1 All ER 1075; *Jones (HMIT)* v. *Lincoln-Lewis & others* (1991) 64 TC 112; *MacNiven (HMIT)* v. *Westmoreland Investments Ltd.* (2001) 73 TC 1; [2001] 2 WLR 377; [2001] 1 All ER 865; [2001] STC 237; *Owton Fens Properties Ltd.* v. *Redden (HMIT)* (1984) 58 TC 218; [1984] STC 618; *Smith* v. *Schofield* (1993) 65 TC 669; [1993] 1 WLR 398; [1993] STC 268; *Tod (HMIT)* v. *South Essex Motors (Basildon) Ltd.* (1987) 60 TC 598; *Turner* v. *Follett (HMIT)* (1973) 48 TC 614; [1973] STC 148; *Whimster & Co.* v. *Commissioners of Inland Revenue* (1925) 12 TC 813.

F **Lord Nicholls of Birkenhead**

1. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Hoffmann. For the reasons he gives, with which I agree, I would allow this appeal.

G **Lord Slynn of Hadley**

My Lords,

2. I have had the advantage of reading in draft the opinion of my noble and learned friend Lord Hoffmann. For the reasons he gives I too will allow the H appeal and restore the order of the Special Commissioners.

I

Lord Hoffmann

My Lords,

3. MEPC Holdings Ltd. ("MEPC") belongs to a group of property development and investment companies. In its accounting period ended 30 September 1994 it made profits of £300,000 and paid charges on income of £48,644,400. It wishes to surrender the surplus charges on income to other companies in the group for deduction from their profits for the purposes of corporation tax.

4. Eligibility for group relief is claimed pursuant to ss 402(1) and 403(7) of the Income and Corporation Taxes Act 1988:

> "402(1) Subject to and in accordance with this Chapter, . . . relief for trading losses and other amounts eligible for relief from corporation tax may, . . . be surrendered by a company ('the surrendering company') and, on the making of a claim by another company ('the claimant company') may be allowed to the claimant company by way of a relief from corporation tax called 'group relief'.
>
> 403(7) Subject to the provisions of this Chapter, . . . if in any accounting period the surrendering company has paid any amount by way of charges on income, so much of that amount as exceeds its profits of the period may be set off for the purposes of corporation tax against the total profits of the claimant company for its corresponding accounting period."

5. There is no dispute that MEPC is entitled to surrender its relief for charges on income. The question is how one calculates the surplus over the "profits of the period" which is available for surrender. This is governed by s 403(8):

> "(8) The surrendering company's profits of the period shall be determined for the purposes of subsection (7) above without regard to any deduction falling to be made in respect of losses or allowances of any other period, or to expenses of management deductible only by virtue of section 75(3)".

6. "Profits" for the purposes of corporation tax means "income and chargeable gains": s 6(4). MEPC's £300,000 of profits consisted entirely of income. During the accounting period it had made disposals of property which, if taken in isolation, realised chargeable gains of £6,040,284. But it had £60,583,017 of allowable losses available from earlier accounting periods. Section 8(1) of the Taxation of Chargeable Gains Act 1992 provides that

> ". . .the amount to be included in respect of chargeable gains in a company's total profits for any accounting period shall be the total amount of chargeable gains accruing to the company in the accounting period after deducting—
>
> (a) any allowable losses accruing to the company in the period, and

A (b) so far as they have not been allowed as a deduction from chargeable gains accruing in any previous accounting period, any allowable losses previously accruing to the company while it has been within the charge to corporation tax."

7. The result was that after deduction of allowable losses under s 8(1)(b), B there was nothing in respect of chargeable gains to be included in MEPC's total profits.

8. The Revenue say nevertheless that for the purposes of calculating the charges on income relief available for surrender, MEPC's profits must be deemed to have included the £6,040,284 of chargeable gains which accrued in the relevant C accounting period. The deduction of past allowable losses is a "deduction falling to be made in respect of losses of any other period" within the meaning of s 403(8) and must be disregarded. This argument was rejected by the Special Commissioners but accepted by Rattee J. [2002] STC 430 and the Court of Appeal (Pill, Chadwick and Clarke L.JJ.) [2002] EWCA Civ 883; [2002] STC 997.

D 9. Group relief was introduced by the Finance Act 1967 (s 20 and Sch 10), very soon after the introduction of corporation tax by the Finance Act 1965. As stated in s 402(1) of the 1988 Act (which substantially reproduces s 20 of the 1967 Act) it provided a new relief by enabling "relief for trading losses and other amounts eligible for relief from corporation tax" to be surrendered by one group company and claimed by another. The amounts which can be surrendered are all E within the description of "amounts eligible for relief".

10. The word "relief" is not a term of art but has been used in tax legislation since the earliest statutes to refer to a provision which reduces the tax which would otherwise be payable. To explain how reliefs against corporation tax work, it is necessary first to describe the structure of the tax. Before 1965, companies had paid income tax on their income in the same way as individuals. F The Finance Act 1965 not only introduced corporation tax but also for the first time imposed a new tax on chargeable gains called capital gains tax. But this tax is payable only by individuals. In the case of a company, its chargeable gains are added to the income which would previously have been liable to income tax to arrive at "profits" for the purpose of corporation tax. The two component parts of "profits" are separately computed before being added together. "Income" is G computed and assessed according to income tax principles (s 9(3) of the 1988 Act) and "chargeable gains" are computed and assessed according to capital gains tax principles (s 8(3) of the 1992 Act).

11. The reliefs which may be surrendered under s 403 of the 1988 Act by way of group relief are all reliefs against corporation tax on the income element H of profits. They are reliefs for trading losses (subs (1)), capital allowances (subs (3), management expenses (subs (4)) and charges on income (subs (7)). The need for these reliefs arises from two features of the income tax. First, it is in theory an annual tax, imposed on the income arising within a single year. The charge to tax is contained in the annual Finance Act and expires with the relevant year of assessment. Secondly, the tax is imposed on income arising from the sources I specified in the well-known Schedules and computed according to the rules applicable to each source.

12. The fact that the tax is computed annually means that a special provision is needed by way of relief to enable a trading loss in one to be set off against profits in a subsequent year: see s 393 of the 1988 Act. Capital allowances are deductions allowed in order to encourage investment. A relief for management expenses is needed because the charge to tax on income arising from investments under Schs A and F (rents and dividends) does not in itself provide for any deductions for the cost of managing the investments. But such a deduction by way of relief is allowed to investment companies (see s 75 of the 1988 Act). Finally, the computation of profits does not allow for the cost of the capital invested in a business but a relief is given for "charges on income" by way of interest and certain covenanted payments: s 338 of the 1988 Act.

13. The mechanism by which a relief is given is not always the same. It may be simply a deduction from the overall tax which would otherwise be payable. Or it may be a deduction from the total profits. Or (as in the case of trading loss relief) it may be a deduction from the profits from a particular source, namely, the same trade in a subsequent year. Or it may be fed into the calculation of income from the source in question. This is what is done with certain capital allowances, which by s 144(2) of the Capital Allowances Act 1990 are given effect by being treated as trading expenses. This treatment may create a loss which can form the subject of group relief but the allowances are not in themselves capable of being surrendered. On the other hand, some capital allowances are given "by discharge or repayment of tax" and these can be the subject of group relief under s 403(3). The relief for management expenses disbursed by an investment company is given by deducting them in computing its total profits for the purposes of corporation tax (s 75(1) and (3) of the 1988 Act), but they can nevertheless be surrendered by way of group relief.

14. Whatever the mechanism by which a relief is given effect, it is to be distinguished from deductions which fall to be made in computing the primary liability under the Schedules. For example, the trading profits which are charged as income under Sch D, Case I are the revenue less the expenses. Section 74 of the 1988 Act restricts the amounts which may be deducted as expenses but the computation is otherwise made according to ordinary accounting principles. No one would describe the deduction of expenses as a relief. It is not a deduction from what would otherwise be taxable under the Schedule but part of the computation of the taxable amount.

15. In the case of the chargeable gains of companies, the corporation tax is imposed on the total amount of chargeable gains accruing in the accounting period after deducting the allowable losses of that and earlier periods: s 8(1) of the 1992 Act. As in the case of the deduction of expenses in the ascertainment of trading profits, the deduction of allowable losses is in my opinion part of the primary calculation of the amount brought into charge. Although, as I have said, a "relief" is not a term of art, I think it would be surprising to find the deduction of allowable losses described as a relief. The 1992 Act contains various reliefs expressly so called, such as s 222 (relief on disposal of private residence). But the deduction of allowable losses is not one of them.

16. Section 403(8) of the 1988 Act requires, in summary, that for the purposes of calculating for any accounting period the excess of charges on income over profits which can be surrendered, the profits must be calculated

without regard to (a) deductions for losses or (b) deductions for allowances or (c) expenses of management, of other periods. These three categories appear, with one qualification, to correspond to the other three categories of reliefs which can be surrendered under s 403. The policy of the subsection appears to be to prevent the excess of charges on income over profits from being inflated by other reliefs carried forward from earlier years. It confines the surrenderable relief to the excess over profits in the accounting period.

17. So, for example, if a company has in a given accounting period a total profit of £1m and charges on income of £2m, it may surrender the excess of £1m. It may have had a £1m trading loss in an earlier accounting period which actually reduces the taxable profits to zero, but that does not enable it to surrender more than £1m by way of excess charges on income. And the same goes for earlier reliefs in respect of management expenses and capital allowances.

18. The qualification upon the proposition that the three categories in s 403(8) correspond with the three other forms of relief which can be surrendered is that the term "loss" may include losses other than the trading losses in respect of which a relief is allowed. An example is a loss in a transaction which falls within Case VI of Sch D, which can also be carried forward by way of relief against Case VI profits in a subsequent period (s 396 of the 1988 Act), but cannot be surrendered under s 403(1). So the class of reliefs from earlier periods which cannot be used to inflate the excess of chargeable gains over profits does not correspond precisely with those which could have been surrendered. But that does not affect the conclusion that the policy of s 403(8) is to exclude reliefs granted in respect of earlier periods.

19. In my opinion this policy suggests that allowable losses are not included in the term "losses" in s 403(8). An allowable loss is not a relief. This construction is also in my opinion supported by the language of the subsection. The most natural reading of the words "profits shall be determined without regard to any deduction falling to be made etc." is that the deductions to be disregarded are those which the legislation requires to be made from what would otherwise be the profits—that is to say, reliefs. "Allowable losses", on the other hand, are not deducted from profits. They are deducted as part of the computation of chargeable gains which forms one element of profits.

20. Furthermore, the subsection carefully distinguishes between a "deduction in respect of losses or allowances" and "expenses of management deductible only by virtue of section 75(3)." Why is the concept of deduction used twice, instead of a single reference to deductions in respect of losses, allowances and management expenses? The answer in my opinion is that losses and allowances are reliefs which operate by way of deduction from profits whereas, by virtue of s 75(1) and (3), the relief from management expenses operates by deduction in the computation of profits. This use of language reinforces the impression that "losses" means losses allowed by way of relief against profits and not losses, such as allowable losses, deducted in the computation of profits.

21. Finally, group relief is concerned entirely with the income element in profits. All the reliefs which can be surrendered by way of group relief are deductible from or in computing the income element. The computation of chargeable gains is completely separate and I think it would be strange if a

provision which limited the availability of group relief operated by reference to a deduction made in the computation of chargeable gains.

22. For these reasons, with respect to the contrary views of Rattee J. and the Court of Appeal (before whom the arguments appear not to have been quite the same as those advanced to your Lordships) I think that the taxpayer's construction of s 403(8) is correct. I would allow the appeal and restore the decision of the Special Commissioners.

Lord Millett

My Lords,

23. I have had the advantage of reading in draft the speech of my noble and learned friend, Lord Hoffmann. I agree with it, and for the reasons he gives I too would allow the appeal.

Lord Walker of Gestingthorpe

My Lords,

24. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Hoffmann. For the reasons which he gives I too would allow this appeal.

Appeal allowed, with costs.

[Solicitors:—Messrs. Landwells; Solicitor of Inland Revenue.]