

Case No: A3/2009/0486

Neutral Citation Number: [2010] EWCA Civ 394

IN THE HIGH COURT OF JUSTICE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM
The Honourable Mr Justice Patten
[2009] EWHC 60 (Ch)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 16/04/2010

Before:

PRESIDENT OF THE QUEEN'S BENCH DIVISION
LORD JUSTICE RIX
and
LORD JUSTICE MOSES

Between:

**Sun Life Assurance Company of Canada (U.K.)
Limited**

Appellant

- and -

**The Commissioners for Her Majesty's Revenue &
Customs**

Respondent

Mr David Goldberg QC (instructed by **Herbert Smith LLP**) for the Appellant

Mr David Ewart QC and **Mr David Yates** (instructed by **Her Majesty's Revenue & Customs Solicitors**) for the Respondent

Hearing dates: 13th-14th January, 2010

Judgment

Lord Justice Moses :

1. This appeal concerns the taxation of the life assurance business of Sun Life Assurance Company of Canada (U.K) Limited, the taxpayer. That business is taxed under special rules. One aspect of that business is Basic Life and General Annuity Business. In the course of that business, the company undertakes investment activities not only on its own behalf but on behalf of policyholders. The company is charged to tax on all the profits derived from those activities, but the policyholders' share of those profits is charged at a lower rate of tax than the rate at which the shareholders' share of the profit is charged.
2. The imposition of two different rates of tax requires the profits of the taxpayer's life assurance business to be apportioned between the policyholders and the shareholders. It is that process of apportionment which is the first issue in this appeal. The policyholders' share of the profits is calculated by deducting from the profits of the life assurance business the Case I Schedule D profits of the company. The taxpayer contends that, for the purposes of computing those Case I profits, it is not merely entitled but is required to carry forward and set-off unused losses from previous years. The effect of carrying forward those losses is to extinguish Case I profits for the company's accounting periods ending 31st December 2002 and 2003. If the Case I profits are thereby reduced to nothing, the policyholders' share will not fall to be reduced and all the profits will be charged at the lower rate of tax.
3. The Revenue contends that the taxpayer is not entitled to carry forward unused losses from previous years in computing Case I profits for the purposes of apportionment. Accordingly, the taxpayer's Case I profits are not extinguished and the resulting shareholders' proportion of the profits (£8.5m in 2002, £95.4m in 2003) is subject to a higher rate of tax.
4. This controversy gives rise to the first issue: up to 31st December 2002 did the legislation confer a right or impose a duty to carry forward past years' losses when computing "Case I profits" for the purposes of apportionment?
5. The law was amended in respect of the taxpayer's next accounting period, ending 31st December 2003, so as to make specific reference to the right to carry forward losses from previous years. But the amendment applied only to losses for 2002 and later periods. The taxpayer contends that the amendment did not remove its pre-existing entitlement to carry forward the unused losses of previous years in order to compute Case I profits for the purposes of apportionment. The Revenue contends that it permitted, for the first time, the taxpayer to carry forward losses from previous years, but that right was limited to losses for 2002 and later years.
6. Special Commissioner Julian Ghosh QC [2008] STC (SCD) 486 decided that the taxpayer was entitled to carry forward and deduct its past years' unused losses for the accounting period ending 31st December 2002, so the taxpayer won on the first issue. But, on the second issue, he concluded that the amendment in 2003 limited the losses which could be carried forward in 2003 to those which had occurred in the accounting period ending 31st December 2002. Patten J reversed that decision on both issues: in the 2002 accounting period, the taxpayer was not entitled to carry forward and deduct the unused losses of previous years [2009] EWHC 60 (Ch) [2009] STC 768. But if that conclusion was wrong, he took the view that the amendment did not serve to take

away the taxpayer's previous right to carry forward the unused losses of previous years.

The First Issue: Accounting Period 2002

7. Resolution of the first issue turns on the meaning of "profits computed in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D", the definition of "Case I profits" in s.89, provided by s.89(7) FA 1989. But that short question of construction requires analysis of the statutory scheme for the taxation of a company's life assurance business.
8. The taxpayer company, like any other company, whether or not carrying on life assurance business, is charged on its profits to corporation tax (s.6(1) ICTA 1988). Its profits consist of income and chargeable gains (s.6(4)(a)). A company's income is, for the purposes of corporation tax, computed in accordance with income tax principles (s.9(1)). Accordingly, each source of income must be identified and the income from each source will fall within the various Cases and Schedules set out in Part I of ICTA 1988 (now replaced by the Corporation Tax Act 2009) and will be computed in accordance with the Case and Schedule relevant to the source of that income (s.9(3)). Once that computation has taken place and capital gains have been computed in accordance with the Taxation of Chargeable Gains Act 1992, the amounts thus computed must be aggregated to arrive at the total profits (s.9(3)).
9. Life assurance business must, for the purposes of corporation tax, be treated as a business separate from any other business carried on by a company (s.432(1) ICTA 1988). But that business is, nonetheless, a trade: a company carrying on life assurance business carries on a trade. Its investment activities are part of that trade. Indeed, they are integral to the trade since the company must have a fund easily realisable to meet claims not merely from premiums but by drawing on its investments (*Liverpool and London Globe Insurance Company v Bennett* [1913] AC 610, 619). Accordingly, by virtue of s.18(3) ICTA 1988, its income, including interest and dividends from its investments, falls to be computed under Case I of Schedule D (*Scottish Union and National Insurance Company v Smiles* (1889) 2 TC 551 and, *Bennett* 616 and 619).
10. But, where a company undertakes investment activity as part of its trade, the Crown has always been allowed to choose between taxing the company on the fruits of those investments as an investment company or taxing it as a trading company on its commercial profit, which will include the return on investments. The Crown cannot tax both and must make an election, called the "Crown Option". In the case of a life assurance company, which must hold substantial investments, it is usually to the Crown's advantage to tax the company as an investment company and not on the profits of its trade (*Revell v The Edinburgh Life Insurance Company* 5 TC 221 at 227). This basis of taxation is known as the I-E basis, that is, investment income plus chargeable gains less expenses of management, as allowed by ss.75 and 76 ICTA 1988. As *Revell* (decided in 1906) demonstrates, it is a charging basis of long-standing, although it received statutory recognition in s.65 Finance (No 2) Act 1992, and the "Crown Option" is now enshrined in Paragraph 84 Schedule 18 FA 1998.
11. The reason why it is usually to the Revenue's advantage to tax, not on a Case I basis, but on the I-E basis, demonstrates an important distinction between charging a life

assurance business to tax as a single trade in accordance with the provisions applicable to Case I and taxing the company as an investment company. It is a distinction important to the instant appeal.

12. Expenses of management, deductible on the I-E basis, do not include the cost of claims paid to policyholders, nor do they include any actuarially calculated increase in liabilities to policyholders. Contrast the computation of the profits of a life assurance business under Case I. The trading profits are premium income plus investment income and gains from which are deducted claims, any increase in actuarially calculated liabilities and expenses of management. As the Lord President acknowledged in *Scottish Union and Northern Assurance (q.v. supra 578)*, it is not possible to compute the profits without actuarial calculation.
13. The significant feature of a charge to tax on a Case I basis is that it is the profit which is available to the shareholders that is charged. The computation of profits on a Case I basis produces that proportion of the profits which is available to the shareholders. It excludes the profits which are allocated to meet liabilities to policyholders.
14. As I have indicated, this appeal is concerned with the right, or as the taxpayer would say, its duty to carry forward unused losses from previous years. It is important, therefore, to recall that there is no dispute but that were the taxpayer to be charged to tax under Case I, it would be under an obligation to deduct from its trading income the losses unused in previous years. S.393(1) ICTA 1988 provides:

‘393 Losses other than terminal losses

(1) 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 section 393A(1) be relieved against income or profits of an earlier accounting period.

(7) The amount of a loss incurred in a trade in an accounting period shall be computed for the purposes of this section in the same way as trading income from the trade in that period would have been computed.

(8) For the purposes of this section ‘trading income’ means, in relation to any trade, the income which falls or would fall to be included in respect of the trade in the total profits of the company...”

15. It is important to note, firstly, that s.393(1) imposes a duty on a company to set off unused losses from previous years. Secondly, that it provides for relief but that relief is only in respect of trading income; it is, in other words, a relief specific to a particular source (trading income is defined as income which falls or would fall within Case I (s.393(8))). The obligation to apply the relief is to be contrasted with the relief which an individual may claim for losses in earlier years of trade (s.381) or

which a person may claim under s.385 (a curious provision which persists in referring to “a person”, and thus appears to include a company, despite s.393, a curiosity which need not detain us).

16. Accordingly, were the Revenue to choose to charge the taxpayer on its total profits under Case I, it is undisputed and indisputable that the taxpayer would be required to carry forward its unused previous years losses under s.393(1). Moreover, Paragraph 84(4) Schedule 18 FA 1998 confers power on the Revenue when making its choice, whether to tax on the Case I basis or on the I-E basis, to require documents or information to determine which basis it should adopt. The company’s computation under Case I will, inevitably, deduct from trading income unused losses from previous years. That computation, which will form the basis of the Revenue’s comparison and choice, will identify a figure for total chargeable profits after deduction of past years’ losses. As I have said, the computation of trading income on a Case I basis will produce and bring into charge only those profits available to shareholders, after setting off past years’ losses.
17. The I-E basis, as I have indicated, taxes the company as an investment company. Where life assurance business is taxed on the I-E basis, specific legislative provisions apply to the four main categories of such business. This appeal is concerned with the taxpayer’s Basic Life and General Annuity Business, described with an ugly acronym as “BLAGAB”. By virtue of ICTA 1988 s.431F, BLAGAB is life assurance business other than that which falls under the other three categories: pension business (defined s.431B), life reinsurance business (defined s.431C) and overseas life assurance business (defined s.431D)).
18. The profits of each of the three categories *other* than BLAGAB are chargeable on the I-E basis under Case VI of Schedule D (i.e. as not falling under any other Case of Schedule D), but computed in accordance with the provisions applicable to Case I (pension business s.436(1), life reinsurance business s.439B(1), overseas life assurance business s.441(2)). In relation to all three of those categories of business, specific provision is made to carry forward previous years’ losses (s. 436(3)(c), s.439B(3)(c), s.441(4)(b); this is a point on which Patten J placed reliance [34] and to which I shall return later).
19. The significant effect of a computation under Case I, as I have explained [12], is that a Case I computation will deduct claims paid and potential liabilities to policyholders and, thereby, will produce only a figure for profit available to shareholders. Thus in respect of those three categories of business, the effect of a Case I computation is to give a figure only for profits available to the shareholders, just as if the total profits of such categories of the business had actually been charged to tax under Case I. No profit allocated to meet liabilities to policyholders will be taxed in respect of those three categories of business, any more than it would be if the company were charged to tax under Case I.
20. But BLAGAB is different. In undertaking BLAGAB, a life assurance company’s investment activities include investment activity on behalf of policyholders. Policies usually contain some investment element. As Mr Goldberg QC put it, adopting the demotic, a life company, in some ways, represents a pot in which its policyholders keep their savings. A company, charged to tax on an I-E basis, is charged to tax on all its investment income and gains (see the definition of “relevant profits” in s.88(3) FA

1989). Although that investment income and gain is legally the income and gain of the company, it represents profit attributable both to policyholders and shareholders.

21. When a company is taxed on an I-E basis, as an investment company, its income is all the income from investments and other sources, but it is not trading income. (As I have recalled, the Crown Option does not permit the Revenue to tax income both as investment income and as trading income). Thus the income from BLAGAB is computed under, for example, Case III of Schedule D, or any of the other Cases which apply to investment income but *not* under Case I. This is because, in relation to BLAGAB, there is no equivalent to the provisions relating to the other three categories of life assurance business, the profits of which must be computed on a Case I basis (e.g. s.436(1)). Thus, the profits from BLAGAB are an aggregate of the policyholders' return and the shareholders' profits.
22. The Revenue has, at least since 2002, waxed lyrical about the effect of the I-E basis of charge:

“The beauty of the I minus E basis, and a point that is not often grasped, is that under it the shareholders' profit (SP) from operating life assurance business is also effectively charged to tax, *so obviating a separate Case I charge on those profits.....*

This dual nature of the I-E result is brought out in a number of ways. There are rates of tax on the policyholders' profit (PP) which are lower than the mainstream CT rate. They match (roughly) the basic rate credit the policyholder gets. The profits chargeable at these lower rates are found by calculating the Case I profit (SP) and deducting it from I-E to leave PP. PP is ring-fenced to some extent, in acknowledgement of the fact that it is quasi-fiduciary profit not a real operating profit of the company...” (2.23 of the Revenue's Life Assurance Manual). (my emphasis)

The importance of this view is that it appears to the Revenue that the I-E basis of charge produces a charge on profits available to shareholders equivalent to that which would be levied on a Case I basis. In short, the shareholders' share of the profits is equivalent to the Case I profit or loss and is charged at the same rate. That is the rationale for the imposition of two different rates of tax.

23. It is at this point that it is possible to identify the need for apportionment. Where the computation is on a Case I basis, only a figure for the profits available to the shareholders is produced. Corporation tax is charged on the company in respect of all its investment returns, even though a proportion of that return is attributable to and for the benefit of policyholders, as I have explained at [20]. The company pays tax on that proportion of its investment income and gain, as “proxy” for its policyholders. The policyholders, generally, only pay income tax on that income to the extent they are higher-rate taxpayers. Since the company is, in effect, paying tax on a proportion of profit attributable to and for the benefit of its policyholders, the legislation recognises that it should pay tax on that proportion only at a lower rate than corporation tax rates (at the relevant time 20% or 22% , instead of the usual corporation tax rate of 30%). It acknowledges that had that proportion of the investment return been paid directly to policyholders, they would have had to pay tax at least at the basic or lower rate.

24. Accordingly, where BLAGAB profits are charged on an I-E basis, it is necessary to identify that proportion of the investment income and gains which represents the policyholders' share of the profits and that which represents the shareholders' share. S.88(1) FA 1989 imposes the lower, basic rate of tax on what it describes as "the policyholders' share of the relevant profits". S.88(3) defines the relevant profits as the income and gains of the life assurance business less identified amounts such as s.76 expenses of management. S.89(1) identifies the policyholders' share as that which is left after deducting from the relevant profits the Case I profits of the company:

"89 Policy holders' share of profits

(1)The references in sections 88 and 88A above to the policy holders' share of the relevant profits for an accounting period of a company carrying on life assurance business or, as the case may be, basic life assurance and general annuity business are references to the amount arrived at by deducting from those profits the Case I profits of the company for the period in respect of its life assurance business, reduced in accordance with subsection (2) below."

s.89(7) defines Case I profits as :

"(7) In this section –

'Case I profits' means profits computed in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D."

25. The differential rate of tax imposed by s.88(1) has the consequence that the larger the policyholders' share, the smaller the amount of tax the company will have to pay: hence the dispute. The extent of the policyholders' share depends upon the extent of the Case I profits, which fall to be deducted from the relevant profits. It is in the company's interest to be able to reduce those Case I profits, and thereby enlarge the policyholders' share. The smaller the Case I profits, the larger the policyholders' share, the share which attracts the lower rate of tax. The taxpayer seeks to reduce its Case I profits by insisting that the Case I computation requires it to carry forward unused losses of previous years and set those losses against its trading income for 2002. This appeal therefore turns on the question whether as a matter of construction, s.89(7) permits or requires those losses to be carried forward.
26. S.89(7) poses three questions:
- i) Is s.393(1) a provision of the Taxes Act 1988?
 - ii) Is it a provision applicable to Case I of Schedule D?
 - iii) Are the Case I profits of the taxpayer computed in accordance with the provisions of the Taxes Act 1988, including s.393?
27. There was no dispute as to the answer to the first question: s.393 is a provision of ICTA 1988 (s.186(1) FA 1989). There was a dispute as to the second. Mr Ewart QC contended that s.393(1) was not a provision applicable to Case I of Schedule D in the context of the process of apportionment of profits, all of which are charged to tax on

an I-E basis and not on a Case I basis. S.393, he says, is a provision applicable only when a company is charged to corporation tax on a Case I basis. It relieves trading income which is computed and charged, by virtue of sections 6 and 9 TA 1988, on the Case I basis identified in s.18(3). It has no application where ascertainment of the “Case I profits” is relevant only to the process of apportionment.

28. In my view, s.393 is plainly a provision applicable to Case I Schedule D. Indeed, (disregarding the remote possibility of an overseas trade being taxed under Case V) it is only applicable to Case I of Schedule D since the relief for which it provides is restricted to income from a trade; it is, in short, specific to that single source. Case I refers only to tax in respect of a trade and s.393 relieves only trading income.
29. It is nothing to the point that the question of apportionment only arises where a company is charged to tax on an I-E basis, and not on a Case I basis. The definition of “Case I profits” in s.89(7) assumes that there are “profits computed in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D”. It is important to observe which categories of life assurance business are brought within the scope of “Case I profits” by that definition. The profits arising from pension business, from life reinsurance business and from overseas life assurance business, are all brought within the scope of “Case I profits” because they are all computed in accordance with the provisions of the TA 1988 applicable to Case I, whether or not those profits are charged under Case VI or Case I. If they were *charged* under Case I they would be computed in accordance with the provisions of that Case and so be outwith the scope of ss. 88-89 altogether by virtue of s.436(1), s.439B(1) and s.441(2). Those profits are all brought within the calculation of the amount which must be deducted from the total income and gains of the company (the “relevant profits” after reduction of the amounts specified in s.88(3)).
30. The second feature to note is that all the profits from those categories of business are computed after deduction of the unused losses of past years, whether by operation of s.393(1), as the taxpayer would have it, or s.436(3)(c), s.439B(3)(c) or s.441(4)(b). Accordingly, all the profits from those categories of business are included within the amount to be deducted from the relevant profits, but reduced by unused past years’ losses carried forward.
31. What then of BLAGAB profits? Those clearly and beyond dispute come within the scope of Case I profits. No one could or has suggested that, in order to apportion between policyholders and shareholders, nothing should be deducted from the relevant profits in respect of BLAGAB (the specific reference to such profits is the result of amendment in the FA 1996 and cannot therefore add to the argument). But unless the company is charged as a trading company there are no profits from BLAGAB computed in accordance with the provisions of the ICTA 1988 applicable to Case I of Schedule D. On the contrary, the BLAGAB profits are charged to corporation tax as income from investments under other Cases and Schedules of ICTA 1988 (e.g. Case III). There is no provision relating to BLAGAB equivalent to those provisions which specifically require profits to be computed in accordance with the provisions applicable to Case I.
32. Thus, in relation to BLAGAB profits, s.89(1) creates a statutory hypothesis. It assumes in relation to BLAGAB, for the purposes of the deduction from the relevant profits, that there are BLAGAB profits computed in accordance with the provisions

applicable to Case I, despite the statutory reality that on an I-E basis there are none. Accordingly, the Case I profits, to be deducted from relevant profits, must also include those amounts derived from BLAGAB, alongside the pension business, life reinsurance business and overseas life assurance business, which would have been brought into charge as trading income had the company been charged on a Case I basis. The statutory hypothesis requires all income which could have been charged as Case I trading income from whatever category of life assurance business to be computed as Case I profits, that is, computed in accordance with the provisions of the ICTA 1988 applicable to Case I, notwithstanding the reality that none of those profits are *charged* on a Case I basis.

33. There is no warrant for restricting the statutory hypothesis so as to exclude from those provisions applicable to Case I Schedule D, a relieving provision which can only apply to those profits of a company which fall within Case I. S.393 is a provision applicable to Case I requiring unused losses from previous years to be set off against current year trading income.
34. The judge concluded that s.393 was not a provision applicable to Case I of Schedule D (his judgment [34] and [35]), because in relation to the other three categories of business, express provision is made for carrying forward the past years' losses (see e.g. s.436(3)(c)). If s.393 was to be regarded as a provision applicable to Case I, then the express provisions were unnecessary.
35. It does not seem to me surprising that the draftsman should think it necessary to make explicit reference to a power to carry forward to avoid any dispute, such as has arisen in this case, as to the applicability of s.393 within those sections which charge the profits from the separate categories of life assurance business. But I do not infer from that that he intended to exclude a provision which can only apply to Case I trading income. The most that can be said is that it was unnecessary for the draftsman to make explicit provision in s.436(3)(c), s.439B(c) and s.441(4)(b). Unnecessary duplication does not seem to me to compel the exclusion of a provision which is so obviously applicable to Case I. As Lord Hoffmann put it, "an argument from redundancy seldom carries great weight, even in a Finance Act. It is not unusual for Parliament to say expressly what the courts would have inferred anyway" (*Walker v Centaur Clothes Group Ltd* [2000] 1 WLR 799, 805D).
36. Moreover, to be set against the judge's view are the opening words of s.434A (2):

"Where for any accounting period the loss arising to an insurance company from its life assurance business falls to be computed in accordance with the provisions of this Act applicable to Case I of Schedule D...."
37. This provision assumes that losses may fall to be computed in accordance with the provisions of the ICTA 1988 applicable to Case I of Schedule D. Those words can only refer to s.393(7).
38. I conclude, for those reasons, that the second statutory question posed by s.89(7) must be answered in the affirmative and that s.393 is a provision applicable to Case I.

39. The third statutory question is whether the BLAGAB profits are *computed* in accordance with the provisions of the ICTA 1988 applicable to Case I, including s.393. Mr Ewart contends that they are not because s.393 merely gives relief once the figure for trading profits has been struck. S.89(7) is, so he argues, merely a reference to the first stage of the computation at which an amount is identified by deducting from trading income the expense incurred in earning such income. The judge agreed [40] and [41].
40. It is not disputed that s.393 is a section which gives relief. Without it, there would be no carry forward of past years' losses. But it does not follow that the duty to set off such losses against trading income is not part of the computation of the profits in accordance with the provisions applicable to Case I. The first stage of the computation requires not only a figure for trading profits to be computed (i.e. income less the expense of earning that income), but also at that first stage, the compulsory set off against that income of the losses brought forward. That obligation to set off is part of the process of computation and I can see no basis for saying that it is not part of the computation of the Case I profits merely because s.393 is a relieving provision. The scheme for corporation tax operates by a process of computation and then aggregation. If authority is needed it can be found in the description of the scheme of corporation tax by Peter Gibson LJ in *Commercial Union Assurance Co plc v Shaw* 72 TC 101,126G:
- “The scheme of the corporation tax legislation requires, first the ascertainment of income from a particular source and chargeable gains, as reduced by any relief applicable to income from that source or to those gains, then the ascertainment of the total profits by aggregating the income from the various sources and the gains as reduced by any relief applicable to those total profits, and once the amount of the net total profits has been ascertained the corporation tax *prima facie* chargeable on the total profits can be determined. That corporation tax may in turn be reduced or extinguished by other reliefs which are expressed to apply to that tax. Only then is the amount of corporation tax payable ascertained.”
41. S.393 can only operate to reduce trading income. Thus it operates at the very first stage of the computation. Any set off against trading income must be computed before aggregation and thus before the net total profits are ascertained. After aggregation other reliefs may apply. Against the aggregated profits, group relief may operate to reduce the total aggregated profits and thereafter other reliefs (like s.338) may operate to reduce, not the income of the company, but the corporation tax for which it is liable.
42. Contrary to the view of the judge [42], the relief does alter the profits calculated on a Case I basis. The judge is correct to say that the very first stage must be to strike a figure for the trading income, but *non sequitur* that the very next stage, whereby that income is reduced by losses carried forward, is not part of the computation. Unlike the judge, I find no guidance to the contrary in the dicta of Lord Hoffmann in *Taylor v MEPC Holdings Ltd* [2003] UKHL 70, which he cites at [23]. In that case, for the purposes of a different question (the inter-action of capital losses with group relief), Lord Hoffmann distinguished between deductions (e.g. trading revenue less expenses) and reliefs. He described the deduction of expenses not as a relief but as part of the computation of the taxable amount [14]. That dichotomy was of importance for the

purposes of the enquiry into what could be surrendered by way of group relief. Deduction of expense from revenue is not a relief but is part of the process of computation. It does not follow that a relief cannot be regarded as part of the process of computation.

43. As Lord Hoffmann pointed out [13], the mechanism by which reliefs are given will vary. A relief given by way of set-off against the profits from a particular source is plainly part of the computation, and, as I have sought to demonstrate, differs from reliefs given at a later stage. Lord Hoffmann did not say and cannot be understood as saying that no relief can operate as part of the process of computation.
44. Accordingly, I conclude that the judge was wrong to decide that the mere fact that s.393 is a relieving provision affords a basis for deciding that it is not a provision applicable to Case I in accordance with which the taxpayer's profits are computed. I would answer the third statutory question in the affirmative.
45. Now that I have answered all three of the statutory questions posed by s.89(7) in the affirmative, it appears, as a matter of construction, that the taxpayer succeeds on the first issue: it is entitled to carry forward unused losses from previous years. But neither side was content to leave it there; no revenue appeal worth its salt is complete without a battle of anomalies. This appeal was no exception: both taxpayer and the Revenue sought to argue that any conclusion contrary to that for which they contended would lead, at best, to distortion and at worst to anomaly.
46. Patten J took the view that the process of apportionment would be distorted if the deduction of the amount of the Case I profits included the losses of previous years. He took the view that the process of apportionment is confined to profits and losses of the current year in question. Thus:

“There is nothing in the legislation which clearly supports the view that the Case I profit figure employed in ss.88-89 was intended to be the net accrued profits available for shareholders having regard to previous losses as opposed to the Case I profits for *that year*. The apportionment of relevant profits under s.89(1) is intended to produce the policyholders' share of relevant profits accruing in *that period*. On the face of it, it does so by deducting the company's profits from the same business *and for the same period* when computed under Case I. Section 89(3) talks in terms of Case I profits for the period in question. This suggests to me that what is contemplated is the deduction of like from like in the sense that the profit figure should in the case of each computation represent the net profit figure based on receipts minus relevant expenses or liabilities occurring in that year. The application of s.393 to the computation of the Case I profit figure would distort this basis of comparison both in relation to the basic deduction under s.89(1) and in respect of the reduction of Case I profits under the formula contained in s.89(2). In each case accrued losses would be carried forward to reduce the Case I profit figure but without any equivalent adjustment of the I-E figure”.[45](my emphasis)

47. The proposition that s.89(1) is designed to produce the policyholders' share for the current year requires qualification. The relevant profits which are apportioned under s.89(1) are computed by deducting from the income and gains of the life assurance

business, amounts which include expenses of management falling to be deducted under s.76 ICTA 1988 (s.88(3)(a)). The taxpayer and the Revenue are in agreement that such expenses will reflect losses carried forward. As I have demonstrated, the profits of the three other categories of life assurance business may be computed by reference to previous years' losses (e.g. s.436(3)(c) in relation to pension business). So too, by virtue of s.88(3)(a), are the profits of BLAGAB. S.88(3)(a) expenses of management will inevitably include elements of losses carried forward from previous years. Accordingly, in the sense which the judge conveyed, it is not correct to say that the relevant profits are current year figures. They will include losses carried forward from previous years. But, in any event, I jib at the notion that a figure for profits reduced by unused losses from past years is not a computation of the profits for the "period in question" or for "that year".

48. In those circumstances I do not see why the inclusion, within the computation of Case I profits, of losses carried forward from previous years offends the statutory scheme of ss.88-89, even in the context that the purpose of apportionment is to identify the policyholders' share of current years' relevant profits. Accepting that purpose, it must not be overlooked that the profits from pension business, and the other categories, apart from BLAGAB, will be computed by reference to the losses of previous years. Those profits form part of the process of apportionment for "the period in question" or, as the judge would have it, the "current year".
49. In those circumstances, I detect no incongruity in including, within the Case I figure, losses carried forward from previous years. Profits from other categories of business computed in accordance with the provisions of Case I may have losses from previous years set against them. The taxpayer contends that, accordingly, the Case I profits from BLAGAB must be computed in the same way.
50. It is unnecessary to go as far as Mr Goldberg QC wishes to lead us. Whether or not the existence of a right to set off past losses against the profits of other types of life assurance business, computed on a Case I basis, compels the conclusion that such a right exists in relation to BLAGAB profits, computed on a Case I basis, it does seem to me that, at the very least, permitting past years' losses to be set off against Case I profits from all categories of life assurance, including BLAGAB, does not undermine the scheme of apportionment under s.89.
51. The judge also relied upon s.89(3):

“(3) For the purposes of this section “the shareholders’ share” in relation to any income is so much of the income as is represented by the fraction

A

B

where –

A is an amount equal to the Case I profits of the company for the period in question in respect of its life assurance business, and

B is an amount equal to the excess of the company's relevant non-premium income and relevant gains over its relevant expenses and relevant interest for the period."

52. The calculation of the fraction given in s.89(3) does not, in my view, support the judge's view that inclusion of past years' losses creates distortion. The purpose of the provisions in s.89(2) and (3) is to exclude the shareholders' share of franked investment income (dividends from UK companies grossed up by the available tax credit), which but for these provisions would be included (because s.434(1) disappplies s.208 which provides that the distributions of UK companies are not chargeable to corporation tax). The denominator in s.89(3) is defined in s.89(5), and will thus be identified by reference to Form 40, that is the regulatory revenue account prepared by the company (as to which see s.83 as defined in s.83A). The results for a life assurance company for any particular year may well reflect the financial performance of investments in previous years. Contrary to the judge's view (which he records as being common ground [27]) the denominator will not be an entirely current year figure but will include transfers to and from the reserve to the long term fund. Such transfers may include income and gains from previous years.
53. The essence of the dispute concerns the rate at which losses carried forward are to be relieved. Both sides contend that to allow the other side's contention to prevail would be to allow Case I losses to be relieved at, in the taxpayer's submission, too low a rate (22%) or, in the Revenue's submission, too high a rate (30%). The reality seems to me to be that Parliament was entitled to determine the appropriate rate and if the wording of the provisions dictates the conclusion that carried forward losses should be relieved at the rate of 22%, the taxpayer does not succeed in establishing such an anomaly as to compel a different construction from that which the wording of s.89(7) indicates.
54. Equally, if, as it appears to me, s.393 is a provision of the ICTA 1988 applicable to Case I, I can detect no anomaly or absurdity which compels the opposite conclusion. The effect, on the taxpayer's construction, is merely to align Case I profits computed for the purposes of *apportionment* with Case I profits computed for the purposes of *charging* the taxpayer on a Case I basis. Any computation of Case I profits, whether for the purposes of charge or for the purposes of apportionment, is calculated to provide a figure for shareholders' profits. Those are the profits available to shareholders because they are not allocated to meet liabilities to policyholders. I see no anomaly or distortion in computing shareholders' profits for the purposes of identifying the appropriate rate of tax in the same way as they would have been computed for the purposes of a charge under Case I.
55. After all, as the Special Commissioner recognized:

“..in the context of a regime which equates a life assurance company's notional Sch D, Case I profits to the amount available to its shareholders (in order to calculate the proportion of the BLAGAB profits allocated to its policyholders), the amount of a life assurance company's profits available to its shareholders is as equally affected by brought forward losses as current year losses...the receipts of a current accounting period cannot be said to be available to shareholders until those receipts exceed the expenses of the current and prior accounting periods.” [45].

56. If the taxpayer were charged on a Case I basis, only the profits available to the shareholders would be charged. Those profits are only available after setting off unused past years' losses, in accordance with the obligation imposed by s.393. So too, as I construe s.89, the taxpayer is entitled to set off unused past years' losses for the purposes of identifying what proportion of the relevant profits *available to the shareholders* should bear the higher and what proportion *available to the policyholders* should bear the lower rate of tax. That seems to me consistent with the Revenue's own assessment of the aesthetics of the legislation (see [22]).

2nd issue: Changes in FA 2003

57. The second issue only arises once it is concluded that prior to 1st January 2003, the taxpayer had a right to carry forward unused losses in the computation of Case I profits. The Revenue contend that the effect of the amendment is to make exhaustive provision for the use of carried forward losses, and prohibit the use of such losses to the extent that they related to any accounting period before 1st January 2003. If, as the Revenue contends, no such right existed prior to 1st January 2003, it was introduced in the FA 2003 but limited to accounting periods beginning on or after 1st January 2003.
58. FA 2003 (by s.170 and Paragraph 7 Schedule 33) amended s.89(7) by adding the words I have italicised:

“Case I profits” means profits computed in accordance with the provisions of the Taxes Act 1988 applicable to Case I of Schedule D *and adjusted in respect of losses in accordance with section 76(2C) and (2D) of the Taxes Act 1988.*”

59. S.76(2C) provides:

“(2C) the adjustment in respect of losses that is to be made for any accounting period under paragraph (a) of subsection (2A) above is a deduction of the amount equal to the unused part of the sum which -

(a) by reference to computations made in respect of the company's life assurance business in accordance with the provisions applicable to Case I of Schedule D, and

(b) disregarding section 434A(2),

would fall, in the case of the company, to be set off under section 393 against the company's income for that period.”

S.76(2D) contains provision explaining how the quantum of the losses which may be said to be *unused* is to be calculated and is not relevant.

60. Those subsections of s.76 were introduced in the FA 1996 and, as the Revenue accept and Patten J acknowledged [36], cannot be deployed to interpret the provisions of s. 89 introduced in FA 1989.
61. The effect of s.76(2C) is to require s.434A(2) to be disregarded. Absent the application of s.76(2C) to losses which the taxpayer is entitled to carry forward by virtue of s.393 (as I have already concluded), such losses would be restricted by the

operation of s.434A(2). The details of that subsection need not detain us, but its effect is plain:

“(a) the loss resulting from the computation (i.e. the computation in accordance with the provisions applicable to Case I) *shall be reduced...*”

62. The amendment is limited by paragraph 7 to periods of account beginning on or after 1st January 2003. It reads:

“7-(1) In section 89(7) of the Finance Act 1989 (which defines Case I profits for the purposes of determining the policy holders’ share of relevant profits and the shareholders’ share of income), in the definition of ‘Case I profits’, insert at the end ‘and adjusted in respect of losses in accordance with section 76(2C) and (2D) of the Taxes Act 1988’.

(2)Sub-paragraph (1) has effect for accounting periods beginning on or after 1st January 2003.

(3)But section 76(2C) of the Taxes Act 1988, as it applies by virtue of sub-paragraph (1) has effect as if the reference in it to the amount which would fall, in the case of a company, to be set off under section 393 of that Act were to only so much of that amount as is attributable to losses incurred in the accounting period of the company in which 31st December 2002 is included or any later accounting period.”

63. Thus the amendment removed a restriction on losses available hitherto but only in relation to accounting periods on or after 1st January 2003 (7(2)). But Paragraph 7(2) was not of itself sufficient to limit the benefit to the taxpayer of the removal of the restriction on available losses contained in s.434A(2). By itself 7(2) could have had the effect of removing the restriction in relation to all losses which had accrued, even those which had accrued prior to the introduction of the amending provisions since such losses might be carried forward into accounting periods beginning on or after 1st January 2003.
64. Paragraph 7(3), therefore, identifies the losses to which the removal of the previous restriction applies. It is designed to limit the availability of the benefit to losses *incurred in the accounting period in which 31st December 2002 is included or any later period.*
65. I agree with Patten J [53] and [54] that if, as I have concluded, the taxpayer has a right to set off unused losses for the purposes of the s.89 calculation, there is nothing within the amendments which can operate to remove that right. To that extent I disagree with the Special Commissioner [58].
66. Mr Ewart repeated his reliance on the Explanatory Notes to Schedule 33 of the Finance Bill 2003 which make it plain that the intention was to introduce the right to carry forward unused losses but only with effect from 1st January 2003.
67. Even if such Notes were admissible, as to which I entertain doubt, they are of no assistance since they merely demonstrate the Revenue’s mistaken belief that it was

appropriate to introduce a right which already existed. They do not assist as to whether the amendment had the effect of removing a pre-existing right. On the contrary, on the Revenue's mistaken view of the unamended legislation there was no need to do so, the previous legislation contained no such right.

68. I agree with the judge, who stated his reasons with greater brevity than I have been able to achieve, on the second issue. I would allow the taxpayer's appeal on the first issue and dismiss the Revenue's contingent appeal on the second issue.

Lord Justice Rix:

69. I agree.

Sir Anthony May, President of the Queen's Bench Division:

70. I also agree that the appeal should be allowed for the reasons given by Moses LJ and the Revenue's contingent appeal be dismissed.