[2015] UKUT 0312 (TCC)

Tribunal ref: FTC/99/2013

CORPORATION TAX — double taxation relief — dividend paid to related company — share subscription by overseas company in UK subsidiary — shares almost immediately cancelled with reduction of capital — subscription money credited to reserves — reserves then paid by way of dividend to overseas company — no UK tax borne by reserves — onward dividend paid to UK holding company — liability for Case V tax — whether ICTA s 801(4B) to be applied to "underlying tax" — no — appeal dismissed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

PENINSULAR & ORIENTAL STEAM NAVIGATION COMPANY	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

Tribunal: Hon Mrs Justice Proudman
Judge Colin Bishopp

Sitting in public in London on 16 and 17 December 2014

Mr Jonathan Peacock QC and Mr Philip Walford, counsel, for the appellant

Mr David Goldberg QC and Mr Michael Jones, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the respondents

DECISION

Introduction

1. This is an appeal from a decision of the First-tier Tribunal ("the F-tT") (Judge Sir Stephen Oliver QC and Ms Helen Myerscough FCA) released on 29 May 2013 and re-released with minor changes on 12 June 2013. By that decision the F-tT dismissed the appeal of Peninsular & Oriental Steam Navigation Company ("P & O") against an amendment made by the respondents ("HMRC") to its corporation tax computation for the year ended 31 December 2004. The effect of the amendment was to reduce P & O's claim for double taxation relief ("DTR") from £20,841,750.30 to £6,768,343.19. P & O now appeals against that decision with the permission of the F-tT.

2. P & O was, at the time, the parent of the well-known P & O group which has and had a world-wide transport and logistics business. The group has since been acquired by the DP World group, and some of the companies mentioned below have changed their names but, like the F-tT, we shall use the names they bore at the time.

3. The principal holding company for the group's Asia-Pacific operations was P & O Australia Limited ("POAL"), a company resident in Australia, and a wholly-owned subsidiary of P & O. It had subsidiaries of its own, among them Liena Pty Ltd ("Liena"), also an Australian company, of whose shares 99% were held by POAL and the remaining 1% by P & O Dover Holdings Ltd ("Dover"), a UK-resident wholly owned subsidiary of P & O. All of those companies took part in the arrangements we describe below. The only other participating company was Abbott & Goldman ("A & G"), which was UK-registered; the details of its ownership changed during the period with which we are concerned.

4. By 2004 POAL had accumulated substantial distributable cash derived from its and its subsidiaries' trading operations and property disposals in Australia which the group wished to transfer to the United Kingdom. On 26 May 2004 POAL declared an interim dividend, payable the following day, of A$75,000,000, and that amount was duly paid to P & O. It appears that when this dividend was paid no thought had been given to the arrangements which were to follow.

5. In September 2004 the various arrangements into which the group companies entered were planned. The planning began with a letter, identified by the F-tT as the "Dear Simon letter", written by P & O's group taxation manager to accountants in which the fact that POAL still had significant cash was noted, and it was pointed out that it had suffered a relatively low rate of Australian tax (low, that is, by comparison with the prevailing UK rate). The letter went on to suggest a means by which the cash might be brought to the UK in a tax-efficient manner. Although, as the F-tT recorded, the arrangements outlined in the letter (which it called "the Dear Simon scheme") did not correspond exactly with those actually adopted, they were similar. The F-tT made no secret of the fact that they looked with some disfavour on the arrangements which they described, at [64], as "an elaborate trick" and "a scripted game of charades".

The arrangements

6. The events and the structure of the arrangements which gave rise to the claim were not in dispute before the F-tT, and can be fairly shortly summarised.

7. In September 2004 A & G, which had been a limited liability company, was converted to an unlimited company. Liena then acquired its 100 issued shares from another group company; it held 99 itself while the remaining share was held by a nominee on Liena's behalf.

8. In the morning of 12 October 2004 the board of A & G resolved to re-designate its existing shares as A ordinary shares and to issue 193 million B ordinary shares, to be allotted to Liena, for A$1 each; the proceeds, save for A$50,000, were to be loaned to P & O at interest. In the afternoon of the same day Liena's board resolved to subscribe for the 193 million shares to be issued by A & G, using for the purpose an interest-free loan of A$192,950,000 provided by POAL (we assume, though it is not apparent from the F-tT's decision, that it made up the balance from its own resources). The board minutes recorded that the interest to be earned by A & G was expected to exceed bank deposit rates and that the investment "may provide POAL with an opportunity to pay enhanced dividends to the UK parent".

9. In the morning of the following day Liena's board met again, to be told that the intended subscription required shareholder approval, which was duly secured. The company was, of course, a wholly-owned group company and the approval was no more than a formality. The resolution to subscribe for the shares was thereupon confirmed. What happened on the following day was described by the F-tT in this way:

> "[31] On the Thursday (14 October) money was introduced to enable Liena to pay the A$193,000,000 subscription monies for the B shares. We now describe the route that the money is said to have taken. The source of our information is a 'Statement of Agreed Facts' signed by both sides. The Statement makes no reference to any preparatory arrangements or negotiations between the participants. We infer that the movements of the money (A$193 million) were dictated by the demands of the 'proposed transactions' referred to in the Dear Simon letter ….
>
> [32] The same day, POAL drew down A$174,664,486 under a 'loan arrangement facility' made available to it on Tuesday 12 October by P & O. POAL obtained a further A$18,335,514 as repayment of an inter-company loan. Together those amounts provided POAL with A$193 million. Liena then drew down A$193 million under an arrangement set up on Wednesday 13 October. The subscription monies, save for the A$50,000 deposited with A & G's bank, were lent by A & G to P & O with interest at 0.625% above 3 month LIBOR."

10. On the following day, Friday 15 October, the board of A & G met again. It resolved, subject to shareholder approval, to cancel the B ordinary shares and reduce A & G's issued share capital to £100. The amount arising on the reduction of the capital, that is A$193 million, was to be credited to reserves. On the following working day the board of Liena met to approve (as A & G's shareholders) the proposed reduction in share capital. The F-tT set out their view of this meeting at [34]:

> "… the only sensible explanation for what would otherwise appear an extraordinary course of conduct on the part of the Liena board and the shareholders in A & G is that they were all doing what they were told and acting out the Dear Simon scheme."

11. There was an interval of about a month before further events occurred. On 16 November, A & G demanded a payment from P & O of A$193,766,877. This sum represented repayment of the A$192,950,000 which A & G had lent to P & O, plus interest of A$1,156,253 less A$339,376 representing an agreed payment for the surrender of group relief by another member of the P & O group. Minutes of an A & G board meeting of 19 November show that the demand had been made in order to ensure that A & G had enough cash to declare and pay a proposed dividend, also of A$193,766,877. The repayment was made by P & O on 19 November. A & G's board resolved to declare and pay an interim dividend of A$193,766,877 in respect of the year to 31 December 2004 on the strength of draft accounts, prepared for the purpose, showing that it had a profit and loss account reserve of A$193,816,877 (that is, the amount just received from P & O plus the A$50,000 which had been deposited). The dividend was paid immediately to Liena. We interpose that HMRC do not accept that the payment was properly described as a dividend for the purposes of the DTR rules even though they accept that it was a dividend in company law terms, and for this reason we shall refer to it as "the A & G payment".

12. Immediately after it had received the A & G payment Liena repaid its interest-free loan of A$192,950,000 to POAL, which in turn repaid the A$174,664,486 it had borrowed from P & O. On the next working day POAL made a short-term loan to P & O of A$18,285,514.

13. On the same day—22 November 2004—Liena's board reviewed draft accounts recording the receipt of the A & G payment and resolved to declare and pay an interim dividend of A$820,000 on the following day. Payment was duly made: A$811,800, representing 99%, to POAL and the remaining 1%, or A$8,200, to Dover.

14. On 30 November 2004 POAL declared and immediately paid to P & O a further dividend for the year to 31 December 2004 of A$80 million. The aggregate of the dividends paid by POAL to P & O for the year amounted therefore to A$155 million (together, "the POAL dividends"). It is the POAL dividends which, if P & O is right, attract DTR. In its corporation tax computation for the year to 31 December 2004 P & O claimed relief of £21,103,383 (but reduced by other reliefs of no relevance to this appeal to £20,841,750) in respect of them. HMRC accept that some relief is due, but of no more than £7,029,976 (reduced by the other reliefs to £6,768,343).

The legislation

15. It is common ground that ordinarily the dividends paid by POAL to P & O, representing "income arising from possessions out of the United Kingdom", would be subject to UK tax in accordance with Case V of Schedule D, as it was defined by s 18 of the Income and Corporation Taxes Act 1988 ("ICTA"). Such a dividend is, for that reason, often referred to as a "Case V dividend" in the legislation and elsewhere. It is also common ground that some relief, the £7,029,976 we have mentioned, from that charge to tax is available by operation

of the DTR provisions which, in 2004, were to be found in Part XVIII of ICTA, consisting of ss 788 to 812. All of the extracts from the legislation which follow are in the form in which it was in force at the relevant time.

16. Section 788 dealt with the position in those cases in which relief was provided by a relevant double taxation treaty between the United Kingdom and another country, but in this case the relief was not provided by treaty. It was necessary instead to look to the "unilateral relief" for which s 790 provided. So far as material to this appeal, that section was in these terms:

> "(1) To the extent appearing from the following provisions of this section, relief from income tax and corporation tax in respect of income and chargeable gains shall be given in respect of tax payable under the law of any territory outside the United Kingdom by allowing that tax as a credit against income tax or corporation tax, notwithstanding that there are not for the time being in force any arrangements under section 788 providing for such relief.
>
> (2) Relief under subsection (1) above is referred to in this Part as 'unilateral relief'.…
>
> (3) Unilateral relief shall be such relief as would fall to be given under Chapter II of this Part if arrangements in relation to the territory in question containing the provisions specified in subsections (4) to (10C) below were in force by virtue of section 788, but subject to any particular provision made with respect to unilateral relief in that Chapter; and any expression in that Chapter which imports a reference to relief under arrangements for the time being having effect by virtue of that section shall be deemed to import also a reference to unilateral relief.
>
> (4) Credit for tax paid under the law of the territory outside the United Kingdom and computed by reference to income arising or any chargeable gain accruing in that territory shall be allowed against any United Kingdom income tax or corporation tax computed by reference to that income or gain …."

17. It can be seen from those subsections that the relief was given, subject to the detailed rules to which we shall come, by pound-for-pound credit for overseas tax paid against the UK corporation tax chargeable in accordance with Case V. Section 795, which we do not need to set out, provided that the dividend had to be grossed up by the amount of the relevant tax, and the UK tax due (before relief) was calculated by reference to the grossed-up amount. Section 797, however, limited the amount by which the dividend could be grossed up to the current rate of UK corporation tax—thus if the overseas rate was 40% and the UK rate 30%, the additional 10% was left out of account.

18. Section 790(6) and (6A) added further provisions relevant in this case:

> "(6) Where a dividend paid by a company resident in the territory is paid to a company falling within subsection (6A) below which either directly or indirectly controls, or is a subsidiary of a company which directly or indirectly controls—
>
> (a) not less than 10 per cent of the voting power in the company paying the dividend …

any tax in respect of its profits paid under the law of the territory by the company paying the dividend shall be taken into account in considering whether any, and if so what, credit is to be allowed in respect of the dividend.

In this subsection references to one company being a subsidiary of another are to be construed in accordance with section 792(2).

(6A) A company falls within this subsection if—

(a) it is resident in the United Kingdom; ….”

19. It is undisputed that P & O fell within sub-s (6A) and that sub-s (6)(a) was therefore satisfied.

20. Section 792 identified the tax for which credit might be given, which was “in relation to any dividend, tax which is not chargeable in respect of that dividend directly or by deduction”. In other words, it was tax which had been borne indirectly, usually by its having been assessed on the profits out of which the dividend was paid—hence the phrase adopted in the legislation, “underlying tax”.

21. The amount of the underlying tax had to be calculated in accordance with the formula found in s 799:

“(1) Where in the case of any dividend arrangements provide for underlying tax to be taken into account in considering whether any and if so what credit is to be allowed against the United Kingdom taxes in respect of the dividend, the tax to be taken into account by virtue of that provision shall be so much of the foreign tax borne on the relevant profits by the body corporate paying the dividend as

(a) is properly attributable to the proportion of the relevant profits represented by the dividend, and

(b) does not exceed the amount calculated by applying the formula set out in subsection (1A) below.

(1A) The formula is—

$(D + U) \times M\%$

where—

D is the amount of the dividend;

U is the amount of underlying tax that would fall to be taken into account as mentioned in subsection (1) above, apart from paragraph (b) of that subsection; and

M% is the maximum relievable rate;

and for the purposes of this subsection the maximum relievable rate is the rate of corporation tax in force when the dividend was paid.…

(3) For the purposes of subsection (1) above the relevant profits, subject to subsection (4) below, are—

(a) if the dividend is paid for a specified period, the profits of that period; and

(b) [repealed]

> (c) if the dividend is not paid for a specified period, the profits of the last period for which accounts of the body corporate were made up which ended before the dividend became payable.
>
> (4) If, in a case falling under paragraph (a) or (c) of subsection (3) above, the total dividend exceeds the profits available for distribution of the period mentioned in that paragraph the relevant profits shall be the profits of that period plus so much of the profits available for distribution of preceding periods (other than profits previously distributed or previously treated as relevant profits for the purposes of this section or section 506 of [ICTA 1970]) as is equal to the excess; and for the purposes of this subsection the profits of the most recent preceding period shall first be taken into account, then the profits of the next most recent preceding period, and so on.
>
> (5) For the purposes of paragraphs (a) and (c) of subsection (3) above, 'profits', in the case of any period, means the profits available for distribution.
>
> (6) In subsections (4) and (5) above, 'profits available for distribution' means, in the case of any company, the profits available for distribution as shown in accounts relating to the company—
>
> (a) drawn up in accordance with the law of the company's home State, and
>
> (b) making no provision for reserves, bad debts, impairment losses or contingencies other than such as is required to be made under that law.
>
> (7) In this section, 'home State', in the case of any company, means the country or territory under whose law the company is incorporated or formed."

22. The formula set out at sub-s (1A) is known as the "mixer cap". Its operation is important in this case and we shall return to it.

23. A further provision of importance is s 801, entitled "Dividends paid between related companies: relief for UK and third country taxes". Those of its provisions which are material here are as follows:

> "(1) Where a company resident outside the United Kingdom ('the overseas company') pays a dividend to a company falling within subsection (1A) below ('the relevant company') and the overseas company is related to the relevant company, then for the purpose of allowing credit under any arrangements against corporation tax in respect of the dividend, there shall be taken into account, as if it were tax payable under the law of the territory in which the overseas company is resident—
>
> (a) any United Kingdom income tax or corporation tax payable by the overseas company in respect of its profits; and
>
> (b) any tax which, under the law of any other territory, is payable by the overseas company in respect of its profits.
>
> (1A) A company falls within this subsection if—
>
> (a) it is resident in the United Kingdom; or
>
> (b) it is resident outside the United Kingdom but the dividend mentioned in subsection (1) above forms part of the profits of a

permanent establishment of the company's in the United Kingdom.

(2) Where the overseas company has received a dividend from a third company and the third company is related to the overseas company, then, subject to subsection (4) below, there shall be treated for the purposes of subsection (1) above as tax paid by the overseas company in respect of its profits any underlying tax payable by the third company, to the extent that it would be taken into account under this Part if the dividend had been paid by a company resident outside the United Kingdom to a company resident in the United Kingdom and arrangements had provided for underlying tax to be taken into account.

(2A) Section 799(1)(b) applies for the purposes of subsection (2) above only—

(a) if the overseas company and the third company are not resident in the same territory …

(3) Where the third company has received a dividend from a fourth company and the fourth company is related to the third company, then, subject to subsection (4) below, tax payable by the fourth company shall similarly be treated for the purposes of subsection (2) above as tax paid by the third company; and so on for successive companies each of which is related to the one before.…

(4A) If, in the application of section 799(1)(b) by subsection (2) or (3) above in relation to a dividend paid by a company resident in the United Kingdom—

(a) the amount given by the formula in section 799(1A),

exceeds

(b) the value of U in that formula,

subsection (4B) below shall apply.

(4B) Where this subsection applies, in the application (otherwise than by subsection (2) or (3) above) of subsection (1) of section 799 in relation to the dividend mentioned in that subsection ('the Case V dividend'), the amount of foreign tax which by virtue of the provision made by the arrangements mentioned in that subsection would fall to be taken into account under this Part in respect of the Case V dividend—

(a) apart from this subsection, and

(b) after applying paragraphs (a) and (b) of that subsection,

shall be increased by an amount of underlying tax equal to the appropriate portion of the amount of the excess described in subsection (4A) above in relation to the dividend paid by the company resident in the United Kingdom.

(4C) Subsection (6) of section 806B (meaning of 'appropriate portion'), as read with subsections (7) and (10) of that section, shall have effect for the purposes of subsection (4B) above as it has effect for the purposes of subsection (5) of that section (but taking the references in subsection (10) of that section to the Case V dividend as references to the Case V dividend within the meaning of subsection (4B) above).

> (5) For the purposes of this section a company is related to another company if that other company—
>
> (a) controls directly or indirectly, or
>
> (b) is a subsidiary of a company which controls directly or indirectly,
>
> not less than 10 per cent of the voting power in the first-mentioned company."

24. Subsections (1) to (3) together addressed the treatment of a chain of dividends paid by related companies, as all of the participants in the arrangements were. Their purpose was to allow for the carrying forward of eligible underlying tax from one dividend to the next, subject to application of the mixer cap when a dividend was paid from one jurisdiction to another (see sub-s (2A)). They also had the effect of treating underlying tax paid in the UK as if it were overseas (or foreign) tax if a dividend to which that tax attached was paid to an overseas parent which then paid a dividend to its own UK parent. The remainder of the section contains some supplementary provisions to which we will refer later.

25. There are a few further statutory provisions to which we shall need to refer, but it will be more convenient to set them out as we reach them.

The issues between the parties

26. The foundation of P & O's case is that the underlying tax attached to the A & G payment to Liena was transferred, by operation of these provisions, to the dividend paid by Liena to POAL, and in turn to the POAL dividends, and that all of it was to be treated as foreign tax within the scope of s 799(1). P & O go on to argue that it does not matter that A & G did not actually pay any tax; it is the mechanistic application of the legislation, and in particular the mixer cap, which determines the amount which is to be treated as underlying tax for which DTR is available. Because the legislation applies various deeming provisions it is possible that the underlying tax for which relief is given may differ considerably in amount from the tax actually paid.

27. For P & O, Mr Jonathan Peacock QC, leading Mr Philip Walford, told us that the incidence of Case V tax presented a serious problem for multinational companies at the time, a problem which the government has since recognised by removing the tax charge on dividends paid by overseas subsidiaries to their UK parents. He went on to explain that the problem in P & O's case was particularly acute because, for reasons of Australian tax law, POAL's profits had suffered a very low rate of tax, with the consequence that the DTR which would be available had it paid a simple dividend to P & O would be correspondingly small. The scheme was, he said, typical of the tax planning which multinational companies in a similar position routinely adopted at the time. The motive, however, was irrelevant: all that was in issue was the application to the transactions in question of a formulaic code which lacked any relevant anti-avoidance provisions.

28. HMRC do not dispute, as a matter of mechanics, that the DTR code works as P & O claims. Their position, as it was put by Mr David Goldberg QC, leading Mr Michael Jones, is, in short summary, that P & O's case is flawed because the A & G payment did not bear any tax, because it was not a dividend of the kind

with which the DTR provisions deal and because it did not contribute to the profits from which the POAL dividends were paid. The scheme was a device designed to inflate the DTR to which P & O was legitimately entitled by means, correctly identified by the F-tT as wholly artificial, which failed in that objective. It was irrelevant that later legislation might have removed the liability to a Case V charge; what mattered was the legislation in force at the time.

The F-tT's decision

29. The F-tT recorded, at [8] and [9], P & O's wish to bring about A$155 million from Australia to the UK, the fact that if it did so by the payment of a dividend by POAL that Case V tax would be payable, and that the scheme, recommended by accountants, was designed to avoid that result. It heard the evidence of P & O's then group finance manager, Mr Peter Walker, who had no involvement in the scheme but was called in order to assist the tribunal in their understanding of the commercial rationale of the various events, a topic on which the decision is almost wholly silent. The F-tT also heard from two expert witnesses, both chartered accountants, about the appropriate accounting treatment of the transactions—Mr Steve Parkinson for P & O and Mr Stephen Lamb for HMRC.

30. After a survey of the relevant legislation the F-tT described the events, as we have summarised them above, and then turned to the treatment of the transactions in the accounts of A & G and Liena. A & G's draft accounts dated 17 November 2004 (two days before the A & G payment was made) showed assets of A$193,766,877, consisting of its share capital of £100 and a "profit and loss account reserve" of A$193,816,877. Its audited accounts for the period to 31 December 2004 contained notes explaining its reserves. One was to the effect that the sum of A$193,000,000 shown in the profit and loss account was the result of the "cancellation of share capital and conversion into distributable profit". The accounts also showed the payment of A$193,766,877, a payment described as a dividend. As the F-tT also recorded, there was no dispute that A & G's liability for tax on the interest of A$1,156,253 it had received on the loan to P & O (which would have amounted to A$339,376 or its equivalent) was eliminated by transferred group relief. Liena's draft accounts, made up to 23 November 2004, recorded a profit of A$816,877 representing the "dividend from A & G" of A$193,766,877, "less amount accounted for as return of investment (A$192,950,000)".

31. The F-tT then dealt with the parties' arguments in two ways. In the first they assumed as their starting point (even though it was disputed by HMRC) that P & O was correct to say that the A & G payment was a dividend for the purposes of the DTR code, and that the POAL dividend represented the A & G payment (or, as assumed, dividend). In the second they considered whether the A & G payment was a dividend within the meaning of ICTA ss 799 and 801.

32. At [45] the F-tT pointed out (which is uncontroversial) that POAL and Liena were to be taken together as a single taxable entity, by virtue of ICTA s 803A(2)(a), since, for Australian tax purposes, they were part of a consolidated group for the relevant year. The mixer cap was also not applied to the dividend paid by Liena to POAL, because of s 801(2A) (set out above). At [47] the F-tT set out the application of the mixer cap in this case:

> "Bearing in mind that A & G's tax liability was eliminated by group relief, in applying the mixer cap formula in section 799, the value of 'U' [the underlying tax] will have been zero. The formula then becomes D [the value of the dividend] multiplied by M [the maximum relievable rate], i.e. 30% of the amount of the dividend. This exceeded the value of 'U'. Consequently section 801(4B) will have applied. On that basis, the underlying tax attributable to the Case V dividend paid by POAL will have been increased by the appropriate portion of that excess. The total amount of that excess, being the deemed underlying tax credit on A & G's dividend, is (on P&O's explanation) calculated as follows:
>
> A$193,766,877 (i.e. D) plus A$0 (i.e. U) = A$193,766,877 multiplied by 30% = A$58,130,063."

33. The F-tT then worked through the provisions of s 801(4C) and of s 806B, to which it refers. The relevant provisions of that section are as follows:

> "(5) In the case of any dividend (the 'relevant dividend') received as mentioned in subsection (2) or (3) of section 801 which is a lower level dividend in relation to the Case V dividend, the upper rate amount to be brought into account for the purposes of subsection (3)(a) above—
>
> (a) in a case where the mixer cap does not restrict the amount of underlying tax that is treated as mentioned in subsection (2) or (3), as the case may be, of section 801 in the case of the relevant dividend, is the appropriate portion of that amount of underlying tax;
>
> (b) in a case where—
>
> (i) the relevant dividend was paid by a company resident in the United Kingdom, and
>
> (ii) the mixer cap restricts the amount of underlying tax that is treated as mentioned in subsection (2) or (3), as the case may be, of section 801 in the case of that dividend,
>
> is the appropriate portion of that restricted amount of underlying tax; or
>
> (c) in a case where—
>
> (i) the relevant dividend was paid by a company resident outside the United Kingdom, and
>
> (ii) the mixer cap restricts the amount of underlying tax that is treated as mentioned in subsection (2) or (3), as the case may be, of section 801 in the case of that dividend,
>
> is the appropriate portion of the greater amount of tax that would have been so treated if, in the application of the formula in section 799(1A) in the case of that dividend (but not any other dividend) M% had, in relation to so much of D as does not represent any lower level dividend, and so much of U as is not underlying tax attributable to any lower level dividend, been the upper percentage.
>
> (6) For the purposes of subsection (5) above, the 'appropriate portion' of any amount there mentioned in the case of a dividend is found by

multiplying that amount by the product of the reducing fractions for each of the higher level dividends.

(7) For the purposes of subsection (6) above, the ‘reducing fraction’ for any dividend is the fraction—

(a) whose numerator is the amount of the dividend; and

(b) whose denominator is the amount of the relevant profits (within the meaning of section 799(1)) out of which the dividend is paid.

(8) Any reference in this section to any tax being restricted by the mixer cap in the case of any dividend is a reference to that tax being so restricted otherwise than by virtue only of the application of the mixer cap in the case of one or more lower level dividends.…

(10) In this section—

‘the Case V dividend’ means the dividend mentioned in section 806A(1);

‘higher level dividend’, in relation to another dividend, means any dividend—

(a) by which that other dividend is to any extent represented; and

(b) which either is the Case V dividend or is to any extent represented by the Case V dividend;

‘lower level dividend’, in relation to another dividend, means any dividend which—

(a) is received as mentioned in section 801(2) or (3); and

(b) is to any extent represented by that other dividend;

‘the relevant tax’ means—

(a) in the case of the Case V dividend, the foreign tax to be taken into account as mentioned in section 799(1); and

(b) in the case of any other dividend, the amount of underlying tax to be treated as mentioned in section 801(2) or (3) in the case of the dividend.”

34. We shall need to say more about those provisions. At this stage we merely mention that, as the F-tT recorded, they have the effect if they are engaged of deeming the underlying tax credit attached to the first POAL dividend to be A$20,426,422 (or £8,316,947 at the then exchange rate) and on the second A$21,788,184 (£8,882,260), figures which are not challenged.

35. HMRC’s argument before the F-tT, recorded at [50] and [51], was that the A & G payment, even if it was a dividend in company law terms, was to be disregarded for the application of the DTR provisions since in substance it amounted to the repayment of a loan. Even if it was a dividend for DTR purposes it carried no tax credit with it, as A & G had paid no tax for which credit could be given.

36. At [53] the F-tT indicated that they considered that the profit that A & G had earned (that is, the interest on its loan to P & O) should be treated as a profit which had borne tax, even though the tax charge had been eliminated by the transferred group relief. They therefore rejected part of HMRC’s argument. At

[54] and [55] they analysed how s 801, on which P & O relied, operated in the circumstances of this case, and still making the assumption that the A & G payment was a dividend within the meaning of the DTR code. The exercise, they said, made it necessary to determine the amount of A & G's underlying tax. At [56] they concluded that it could consist only of the tax which, but for the group relief, would have been borne on the interest; it could not include any tax on the amount equivalent to the subscription cost of the B ordinary shares, A$193 million.

37. Although the F-tT did not put it in quite this way, that reasoning assumed that the dividend could be split into two components, the interest element which (on this analysis) was a payment of profit and the A$193 million which represented the repayment of a loan. Mr Peacock argued that it was not possible to divide the dividend in that way, a proposition from which Mr Goldberg did not demur. We agree; we see no warrant in the legislation for any such division. However, the F-tT then went on, at [57], to consider what would be the outcome if the dividend were to be treated as a whole:

> "Suppose, however, that section 801(4B) applied to the whole of A & G's dividend, we know that the interest element, as shown in Liena's accounts, was A$816,899 and we know that the rest of the payment received from A & G was not taken into Liena's profit and loss account The rest was applied against the cost of its investment in A & G as a return of capital. Turning to section 801(4B), the question is what 'portion of the amount of the excess' qualifies as the 'appropriate portion'. Before there can be an appropriate proportion, there must be a 'higher level dividend' in relation to the dividend paid by A & G: see section 806B(6), (7) and (10). A higher level dividend is one by which the A & G dividend is 'to any extent represented'. Here, the facts record that Liena, on receipt of the dividend on 19 November 2004, spent A$192,950,000 by way of repayment to POAL of its interest-free loan: and POAL paid to P & O the sum of A$172,664,486 in respect of its interest-free loan. Those amounts should, therefore, be ignored in determining what part of the relevant profits of POAL featured as component parts of the higher level dividend. The dividends actually paid by POAL to P & O (A$75 million and A$80 million) were, even ignoring the contribution made by the A & G dividend, well within POAL's distributable profits. (In any event the A$75 million dividend, paid on 26 May 2004, happened long before the Dear Simon scheme was even mooted.)"

38. The F-tT therefore concluded that the computational rules defeated P & O's claim for DTR. They added that the claim, "based as it is on tax that has never been payable, is completely at odds with the terms of Chapter 1 [of Part XVIII] which grants the relief in respect of tax payable."

39. At [60] the F-tT turned their attention to the question whether the A & G payment was a dividend for the purposes of the DTR code. The competing arguments were principally derived from the expert evidence. Mr Lamb, for HMRC, considered that the A & G payment, or at least A$193 million of it, represented the repayment of a loan, itself the result of a circular set of transactions. Mr Lamb's view was that A & G's accounts should have shown a borrowing returned a month later together with the interest cost (which reflected the substance of what happened) rather than, as they did, a profit and loss account reserve. Mr Parkinson, however, considered that the accounts were correctly

prepared and presented. The cancellation of the B ordinary shares and the consequent reduction in share capital, he said, represented a realised profit for A & G.

40. Although it is clear from what else the F-tT said that they preferred the approach of Mr Lamb, they did not express a conclusion about the proper accounting treatment of the transactions. They embarked instead on an examination of the purpose of the Dear Simon scheme, which (as we have indicated) they regarded as an artificial, orchestrated set of steps designed to create credit for an amount of tax which had never been paid or payable. Their overall conclusion on the question whether A & G paid a dividend within the meaning of the DTR code appears at [71]:

> "The only conclusion that we can reach is that the A$193 million was introduced for the purposes of the Dear Simon scheme and for no other purpose. When the scheme was 'done' the money was to be restored to P & O by the preordained route. It was absolutely alien to the scheme that A & G should benefit from its participation, save for £50,034 left in the company. There was no risk that any of the participants, companies or directors, would step out of line. On that basis our conclusion is that A & G held the 'subscription monies' for the sole purpose of the Dear Simon scheme and to restore it to where it came from. None of the A$193,000,000 ever became distributable reserves in any real sense of A & G. By making the payment on 19 November 2004 that purported to be a dividend, A & G was returning money that was no longer required. There was, in reality, no dividend for the purposes of P & O's claim for DTR."

41. Then, after quoting the well-known apothegm of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Limited* [2003] HKCFA 46 at [35] that "The ultimate question is whether the statutory provisions, construed purposively, were intended to apply to the transaction, viewed realistically" they dismissed the appeal, at [72], in these words:

> "The statutory purpose of Part XVIII is to give credits for tax paid on the profits out of which the relevant dividend is paid: see section 799(1). As the provisions of section 801(4A) and (4B) make plain, the central objective in section 799(1) applies just as much to credits claimed in respect of dividends from UK companies. For the DTR claim to be effective, there has to be a payment that can properly and realistically be characterised as a dividend; and the claim must relate to foreign or UK tax borne on the relevant profits represented by the dividend. There were, in the course of the implementation of the Dear Simon scheme, neither profits on which tax was borne nor any payment that could realistically be classed as a dividend for the purposes of section 799(1)."

P & O's arguments

42. The underlying theme of all Mr Peacock's arguments was one on which we have already touched, namely that the legislation works by the application of fictions, deeming provisions and formulæ to identify the amount for which relief is given, an amount which may or may not coincide with the amount of tax actually paid. Both he and Mr Goldberg produced charts, diagrams and examples aimed at demonstrating how the legislation worked in various different situations, and we should record immediately that we accept, as indeed did Mr Goldberg,

that there are cases in which the application of the legislation produces results which differ from what one might imagine was intended. While we have found the charts, diagrams and examples helpful, they do not directly answer the questions before us.

43. Mr Peacock identified five points on which the parties disagreed, all of them concerned with the mechanical functioning of the DTR provisions. Those points were: (1) whether the provision that deems UK tax to be additional foreign tax can apply where no UK tax has actually been paid; (2) whether, in any event, the deemed additional foreign tax is limited to the amount of UK tax which has been paid; (3) whether, in this case, there is a relevant chain of dividends; (4) whether there is a requirement for the additional deemed foreign tax to have been "borne" and, if so, whether it should in this case be treated as having been borne; and (5) whether the A & G payment was a dividend for the purposes of the DTR code.

44. The starting point for the first of those issues is ICTA s 801(4A) and (4B) (see para 23 above). It is to be noted, in particular, that s 801(4A) does not include a requirement, as HMRC argue, that the relevant UK subsidiary has borne any tax. The threshold condition appears in s 801(2), and it is no more than that the "overseas company" [in this case Liena] "has received a dividend from the third company" [in this case A & G]. The consequence of satisfying that threshold condition is that there is treated as "tax paid by the overseas company in respect of its profits any underlying tax payable by the third company". The fallacy of HMRC's argument is that it assumes, wrongly, that the consequence determines whether the subsection applies; but it is capable of applying regardless of the amount of the underlying tax. What sub-s (4A) then does is identify the figures to be used in the mixer cap calculation, and it is only then that it can be seen whether or not there is an excess of the kind to which sub-s (4A) refers (*ie* the result of the mixer cap calculation exceeds U). The only requirement is that U is less than (D + U) × M%, and there is no basis for implying a requirement that U should be a positive number. That proposition is consistent with the wording of s 799(1), which speaks of "considering whether any and if so what credit is to be allowed", necessarily leaving open the possibility that the credit will be nil.

45. The F-tT's reasoning on this point was unclear. They recognised, at [47], that U, in relation to the A & G payment, was nil; yet at [57] (see para 37 above) they divided the A & G payment into different elements apparently because, as they said at [53], they took the view that so much of it as represented the interest A & G had received should be treated as having borne tax. That approach did not reflect what either party had argued; it was always agreed that, group relief having removed the charge to tax, U was nil in respect of the entirety of the payment.

46. Once it is accepted that the s 801(4A) threshold condition is met it is necessary to move on to sub-s (4B), which provides that the amount of foreign tax for which credit may be given "shall be increased by an amount of underlying tax equal to the appropriate portion of the amount of the excess described in subsection (4A) above". It follows that it is necessary first to determine the excess described in s 801(4A), then the appropriate portion of it (for which one turns to ss 801(4C) and 806B), and finally multiply them together. The product is treated as underlying tax, increasing the amount of foreign tax for which credit may be taken against a Case V liability.

47. P & O’s contention is that HMRC’s argument that the increase is restricted to the amount of underlying tax that has actually been borne by the UK company paying the dividend is fallacious. The clear purpose of the provisions is to provide credit for DTR purposes when the actual underlying tax falls short of the prevailing rate of UK corporation tax, and not to provide credit only to the extent of the tax actually paid. Subsections (4A) to (4D) of s 801 are intended to ensure that in a case such as this, in which a UK subsidiary pays a dividend to an overseas intermediate company which in turn pays a dividend to a UK parent, the total UK corporation tax which is borne is the same as it would be if the UK subsidiary was directly held by the parent; they are designed to ensure that there is no fiscal disadvantage when there is an intermediate overseas holding company. Mr Peacock says that this is a rational objective which P & O’s interpretation of the legislation achieves.

48. HMRC’s approach, by contrast, would put a group with UK parent, overseas intermediate holding company and UK subsidiary at a disadvantage if the overseas tax rate was less than the UK rate, as it would fail to give full credit for the UK tax paid by the subsidiary. As we have mentioned, the parties produced to the F-tT, and to us, various calculations and graphs designed to illustrate the working of the legislative provisions in different situations. Those provided by Mr Peacock to illustrate this particular point do indeed show, in a case in which the overseas corporation tax rate is nil, that there is an exact correlation between tax paid and credit on P & O’s approach, but a markedly inexact correlation on HMRC’s approach. This difference, says Mr Peacock, was alluded to by the F-tT, at [50], but not addressed by them.

49. Once the argument that the absence of any payment of tax is a material consideration is discarded, Mr Peacock continues, the next task is to identify the “appropriate portion” by which the available credit is to be increased. As sub-s 801(4C) indicates, certain provisions of s 806B (see para 33 above) are engaged, of which the most important in this context is the definition, within sub-s (10), of “higher level dividend”. In the context of this appeal, the POAL dividend was (if P & O’s arguments are correct) a higher level dividend in relation to the A & G payment (taking that to be a dividend). The relevance of the definition is that the relationship between the higher level dividend and “another dividend” depends on the representation of the former by the latter “to any extent” (see limb (a) of the definition).

50. HMRC argued before the F-tT that the POAL dividend was not a higher level dividend because there were sufficient distributable profits in the Australian group companies to pay the dividend without any contribution from the A & G payment. The F-tT accepted that argument at [57]. They were wrong to do so because nothing in the statute supports the proposition that this is a relevant consideration. The introduction of a “tracing” requirement adds an unjustified gloss on the legislation, and one which would have equally unjustified consequences in relation to other parts of the DTR code. The F-tT should, instead, have looked to s 806J(3), a provision they did not mention. It provided as follows:

> “For the purposes of the foreign dividend provisions of this Chapter, where—

> (a) one company pays a dividend ('dividend A') to another company, and
>
> (b) that other company, or a company which is related to it, pays a dividend ('dividend B') to another company,
>
> dividend B represents dividend A, and dividend A is represented by dividend B, to the extent that dividend B is paid out of profits which are derived, directly or indirectly, from the whole or part of dividend A."

51. It is undisputed that the profits of the Australian group were increased by at least A$817,000 and that the group (through POAL) paid dividends of A$155 million out of relevant profits of A$213 million. It must therefore follow, by application of s 806J(3), that those dividends represent the A & G dividend, even if only to a limited extent, and that they are higher level dividends. The extent of the representation is to be calculated in accordance with s 806B(6) (see para 33 above) and in this case amounts to A$593,000. The concern expressed by the F-tT at [57] about the fact that there were two POAL dividends, one paid before the A & G payment was made, is misplaced because it is necessary to have regard to the Australian group's profits for the whole of the relevant year, to which the A & G payment contributed, rather than to the sequence in which the various payments were made. Thus both of the POAL dividends are to be regarded as higher level dividends, and the necessary chain of dividends is established.

52. Once it is shown, by the application of s 801(4B), that there is some foreign tax for which credit may be given there is no further obstacle to overcome before DTR can be claimed. HMRC are therefore wrong to argue that there is an additional condition that the tax must have been actually borne. The purpose of s 801(4A) to (4D), as sub-s (4B) clearly shows, is to increase the amount of the foreign tax for which credit may be given, in order to make the underlying tax rate of the UK subsidiary match the prevailing rate of UK corporation tax. This was announced by the then Inland Revenue as the purpose of the provisions when they were enacted. In some cases this can be achieved only by a fiction, that is by creating foreign tax that would not otherwise exist, just as the statutory provisions sometimes treat UK tax as foreign tax. It would be inconsistent with that purpose, and the legislative scheme, to deny relief on the basis that tax has not actually been paid.

53. Once it is accepted, as HMRC now do accept, that the A & G payment was a dividend in the company law sense it is unnecessary to go further and it is, says Mr Peacock, irrelevant to the question whether it was a dividend of the kind contemplated by the DTR code that in accounting terms it should be treated (for reasons of economic equivalence) as the repayment of debt.

54. Part XVIII of ICTA makes no attempt to define the word "dividend". Its meaning, for the purposes of the DTR code, was, however, dealt with by Peter Gibson LJ in *Memec plc v IRC* [1998] STC 754. At p 768 he said:

> "The judge … found against the taxpayer on the meaning of 'dividend' in Pt XVIII of the 1988 Act. There is no definition of the term in that Part. [Counsel for the taxpayer] submitted that in s 801(1), 'dividend' should have the meaning which it has under the double taxation arrangements referred to in the subsection and applicable in relation to the dividend in question. I am not able to agree. The form of the subsection is to state as a condition

> precedent, 'Where [the overseas company] pays a dividend to [the United Kingdom company]'. That presupposes that 'dividend' has its ordinary meaning in United Kingdom law. Unless the condition is satisfied the subsection cannot have effect. The subsequent reference to the arrangements is not worded in such a way as would require 'dividend' to have the meaning, if any, given to the term in the arrangements. In my judgment express wording would have been needed to extend the meaning of 'dividend' beyond its ordinary significance in United Kingdom law."

55. That view is consistent with the way in which other terms, such as "profits available for distribution", are used, and with the fact that the legislation is concerned with dividends paid by companies. In the absence of clear words to the contrary, the word "dividend" must be taken to have its ordinary meaning. It might be necessary, in the case of foreign companies, to look at the law in force in the foreign jurisdiction in order to determine whether a payment would amount to a dividend in English law, but in the case of a UK company such an enquiry is redundant: once it is clear that the payment is of a dividend, no more is required. HMRC and the F-tT, however, have sought to deal with the matter by reference to economic equivalence, but that is not a permissible approach. It is the mechanism that a company employs to make a distribution that determines the nature of the payment; one cannot say that because the company could have achieved the same result in a different, economically equivalent, way the tax consequences should be those which would attach to that other way. That point had been made, judicially, on many occasions and perhaps most clearly by Lord Greene MR in *IRC v Wesleyan and General Assurance Society* (1946) 30 TC 11 at 16:

> "In dealing with Income Tax questions it frequently happens that there are two methods at least of achieving a particular financial result. If one of those methods is adopted, tax will be payable. If the other method is adopted, tax will not be payable. It is sufficient to refer to the quite common case where property is sold for a lump sum payable by instalments. If a piece of property is sold for £1,000 and the purchase price is to be paid in ten instalments of £100 each, no tax is payable. If, on the other hand, the property is sold in consideration of an annuity of £100 a year for ten years, tax is payable. The net result from the financial point of view is precisely the same in each case, but one method of achieving it attracts tax and the other method does not."

56. The law in relation to the identification of a dividend was analysed and summarised by Moses LJ in *First Nationwide v Revenue and Customs Commissioners* [2012] STC 1261, in which he said:

> "[16] The principle that the form of the distribution dictates its character is expressed in two speeches of Lord Reid, 14 years apart. In *IRC v Reid's Trustees* (1949) 30 TC 431, [1949] AC 361, the capital profits realised on the sale of properties were distributed to shareholders by way of dividend; this was crucial to the identification of the payments as income. Lord Reid said ((1949) 30 TC 431 at 450, [1949] AC 361 at 386):
>
>> '… if a foreign company chooses to distribute its surplus profits as dividend, the nature and origin of those profits do not and cannot be made to affect the quality of the receipt for the purposes of Income Tax.'

> All depended upon the method adopted by the company for dealing with its surplus assets; it could create new capital assets or distribute those assets as income.
>
> [17] Lord Reid adhered to that view in *Rae (Inspector of Taxes) v Lazard Investment Co Ltd* (1963) 41 TC 1, [1963] 1 WLR 555. A Maryland company had hived off part of its business by a process, unknown to English company law, of partial liquidation; shares in a new company to which the hived-off business was sold were distributed to an English investment company which held shares in the Maryland company. The Court of Appeal and the House of Lords concluded that shares which the English company shareholders received on the partial liquidation were capital and not, as the Revenue contended, income. That conclusion was dictated by the machinery by which the shares were distributed. Lord Reid said (41 TC 1 at 26, [1963] 1 WLR 555 at 567):
>
>> 'In deciding whether a shareholder receives a distribution as capital or income our law goes by the form in which the distribution is made rather than by the substance of the transaction. Capital in the hands of the company becomes income in the hands of the shareholders if distributed as a dividend, while accumulated income in the hands of the company becomes capital in the hands of the shareholders if distributed in a liquidation'.
>
> By the law of Maryland, which recognised the transaction as a partial liquidation, the shares distributed were capital. Both Lord Guest (41 TC 1 at 29, [1963] 1 WLR 555 at 570) and Lord Pearce (41 TC 1 at 30, [1963] 1 WLR 555 at 572) reiterated that it was the machinery by which assets were distributed which determined the question whether the assets were received as capital or income.
>
> [18] The principle that it is the machinery by which the assets are distributed which determines whether they are capital or income finds expression, yet again, in *Courtaulds Investments Ltd v Fleming (Inspector of Taxes)* (1969) 46 TC 111, [1969] 1 WLR 1683. Italian law identified the distribution from a share premium reserve as a distribution of capital. It brought share premium within the scope of the rules for protection of capital in a manner similar to s 56 Companies Act 1948. Share premium could not be distributed while the legal reserve fell below 20% of the company's capital. Italian law introduced a new tax on the payment of dividends. To avoid that tax, the Italian company transferred profits of the year, which would have been distributed as dividends, to the legal reserve and thereby freed the share premium for distribution to shareholders. Such a distribution was, under Italian law, a distribution of capital free from the new *imposta cedolare*. (The Weekly Law Report's headnote incorrectly describes the distribution as a dividend (1684), the description in the Tax Cases headnote, a withdrawal from share premium reserve, is correct.) Buckley J rejected the Revenue's contention that once the share premium was freely distributable it was, as in the United Kingdom before 1948, income. Italian law regarded the distribution as capital, and grafted the share premium onto the paid-up capital of the company ((1969) 46 TC 111 at 126, 127, [1969] 1 WLR 1683 at 1694)."

57. The F-tT dealt in their decision with the legitimacy of the process of creating distributable reserves. They were wrong to do so because there is nothing unusual or untoward about the process, which now has legislative recognition in

the Companies (Reduction of Share Capital) Order 2008 (SI 2008/1915). It is equally commonplace for corporate transactions to be planned in advance and the F-tT was wrong to focus on factors such as the preparation in advance of board minutes. The only requirement is that the board members do in fact discuss the matter and that they reach the decision recorded by the minutes (see the observation to that effect of Stanley Burnton J in *R (IRC) v Kingston Crown Court* [2001] EWHC Admin 581, [2001] STC 1615, at [21]). The pejorative terms in which they described the arrangements were unwarranted, and ignored the genuine commercial objective of bringing overseas profits to the UK. Part XVIII does not have a tax avoidance test or purpose, and it contains no provision by which HMRC or the tribunal can set aside, or redefine, transactions. Nor does it have, as Lord Hoffmann put it in *Norglen Ltd v Reeds Rains Prudential Ltd* [1999] 2 AC 1, at p 14, "a penumbral spirit which strikes down devices or stratagems designed to avoid its terms or exploit its loopholes."

58. Instead, it is necessary to do what the statute requires, starting from the premise that the A & G payment was a dividend not only in company law terms but within the meaning of that word as it is used in Part XVIII. In the present case it is plain, once that premise is accepted, that there was a chain of dividends within the scope of s 801: the A & G dividend (the lower level dividend, as defined by s 806B(10)) and the POAL dividends (the higher level dividend, or Case V dividend). As there was no actual underlying tax borne by A & G, the value of U in the application of the mixer cap to the lower level dividend was nil, and in consequence the s 801(4A) excess is equal to the amount of that dividend, in round figures A$194 million, multiplied by the rate of UK corporation tax which at that time was 30%. The "appropriate portion" derived from the application of s 806B(6) is the aggregate of the POAL dividends, A$155 million, divided by the relevant profits of the Australian group, namely A$213 million. The result of all those calculations, A$42.35 million, is then added to the amount of foreign tax borne by the Australian group which can be credited against the Case V charge arising on receipt by P & O of the POAL dividends. It is undisputed that the foreign tax amounted, in sterling, to just over £7 million.

HMRC's arguments

59. Mr Goldberg's starting point is that the A & G payment represented nothing more than one step in a rotation of funds designed to make the payment look as if it was a dividend. In reality, the A & G payment was made, as a feature of what the F-tT had rightly described as a scheme, out of funds which did not bear any tax, and it did not, in any way, contribute to the payment of the POAL dividends. There were more than sufficient distributable profits of the Australian group for POAL to pay the dividends. The claim that nevertheless P & O was entitled to relief of about £14 million, in addition to the agreed relief of about £7 million, was based on a misunderstanding of the DTR code and in particular of the operation of s 801B(4).

60. Although there was some disagreement between the accounting experts about the correct accounting treatment of the transactions, the treatment actually adopted (which we have set out at para 30 above) was informative. It was of particular note that Liena stated, in its relevant tax return, that of the A & G payment A$192,950,000 was an "amount attributed to return of capital"; it was

not included in its profit and loss account. That statement reflected A & G's treatment of the subscription monies as share capital which, on cancellation of the shares, was transferred from share capital to the profit and loss distributable reserve before it was paid to Liena. All that happened was that Liena made a capital investment in A & G, which was then returned.

61. The purpose of Part XVIII of ICTA was to allow relief for tax borne on profits out of which a dividend was paid. So much is plain from the wording of the basic relieving provision, s 799(1)(a); the underlying tax for which relief is given was:

> "… so much of the foreign tax borne on the relevant profits … as
>
> (a) is properly attributable to the proportion of the relevant profits represented by the dividend …."

62. The purpose of s 801(4B) was to restore tax neutrality to what were, economically, UK to UK dividends. That was accepted in Mr Peacock's skeleton argument for the purposes of this appeal; he agreed that s 801(4B) was intended to deal with those cases in which, in economic terms, a dividend flowed from a UK company to another UK company but through an intermediate non-UK company. If that is right, it follows that it was not the purpose of the provision to allow foreign profits to be brought to the UK without bearing UK tax. Mr Peacock's skeleton argument also suggested that P & O was endeavouring to "return" profits to the UK, but that is not what it was doing. Rather, it was bringing overseas profits to the UK, and endeavouring, by abuse of s 801(4B), to avoid much of the Case V charge attracted by those profits.

63. It is plain from the wording of the legislation that DTR is available only when a dividend is paid, and that the dividends contemplated are only those which meet certain criteria. The first, derived from the reference in s 799(1) to "tax borne" and "relevant profit", is that the draftsman has included within the scope of the subsection only a dividend which is paid out of (and therefore represents or, to use the word of the subsection, is attributable to) profits which have actually borne tax (or which were, at least, capable of bearing tax). The second, derived from s 801(4C) read with s 806B(6), (7) and (10) and s 806J(3), is that the dividend must contribute to (or, again, must at the least be capable of contributing to) a flow of funds out of and back to the UK. If the legislation is construed in that way it works as it is intended to work: it produces tax neutrality for what are, economically, UK to UK dividends. Here, however, there was no payment from the UK which then returned to the UK. The legislation ceases to work in such a case, and this in turn demonstrates that if it is to be a dividend of the kind contemplated by the statutory wording it must be capable of returning to the UK.

64. HMRC do not argue that the A & G payment was not a dividend in the company law sense, but do argue that it did not meet those criteria. A & G had no profits which had borne tax and the reserves which it created by the cancellation of the B shares did not and could not bear tax; the absence of any liability to tax on those reserves was an essential feature of the scheme. As the legislation contemplates that, if it is to carry credit for underlying tax, a dividend must be paid out of profits at least capable of bearing tax the A & G payment cannot have been a dividend contemplated by the legislation. Indeed, A & G did not even have distributable profits, let alone profits capable of bearing tax.

65. The commercial reality was that its subscription for the B shares amounted to a loan by Liena to A & G. As the F-tT had clearly found, in the observation at [34] (set out at para 10 above), at [65] and [66], and at [71] (see para 40 above) in commercial, even if not legal, terms A & G was under an obligation to repay that loan 36 days after it was received by making the A & G payment, a payment which was made possible by the cancellation of the B shares only three days after they were issued. The transactions were, and were always intended to be, entirely self-cancelling. Their treatment in Liena's accounts was consistent with that reality: of the A & G payment, A$192,950,000 was described as the repayment of the cost of an investment, and only the balance of A$816,877 contributed to Liena's profits. As the F-tT correctly found, it was an entirely circular transaction and the cancellation of the B shares did not result in the accrual of any profit to A & G in any real sense. Despite what appeared in its accounts, A & G's tax computation did recognise that reality since only A$1,156,296 (equivalent to £472,150) was shown as its profit for the year. Thus the A & G payment was not attributable to A & G's profits, as s 799(1)(a) requires.

66. The purpose of s 801(4B) is to give credit for "an amount of underlying tax". It is not possible to read the provision in such a way that it gives credit for something which is not underlying tax such as (on P & O's case) imaginary or computed tax which has not been paid and is not payable. Even if, contrary to that argument, the A & G payment did carry some underlying tax with it the statutory scheme does not give a direct or indirect recipient of the payment greater relief than is carried to Liena; the provisions do not, as P & O maintains, increase the relief, but ensure that the amount of tax which has been paid (or is payable) is preserved as it is carried forward. The purpose of the mixer cap is to preserve any relief to which a UK company paying a lower level dividend was entitled, and not to inflate the value of the underlying tax, and properly applied that is what it does.

67. Only A$816,877 of the A & G payment was taken to profit in Liena's accounts. As Liena and POAL must be treated for the DTR code as a single entity, it follows that the maximum extent of the contribution of the A & G payment to the POAL dividends was the same amount, A$816,877. It is only the tax borne on that amount which can be available for credit; but A & G bore no tax on its profits, and the underlying tax carried with the A & G payment must be nil. No relief is available because there is nothing to relieve.

68. The fallacy in P & O's argument is that it treats s 801(4B) as if it were a stand-alone relieving provision, which it is not. It is engaged only if one of sub-ss (2) and (3) applies, and they apply only if there is an amount of underlying tax, meaning real tax, in respect of which the overseas company could have claimed relief had it been UK resident. Even if it is assumed for this purpose that the A & G payment was a dividend for DTR code purposes, the fact that there was no underlying tax has the consequence that the gateways in sub-ss (2) and (3) remain closed. Subsection (4B) is therefore not triggered.

69. Even if s 801(4B) were engaged it would not have the effect for which P & O argues. It gives additional credit for an amount of underlying tax "equal to the appropriate portion" of the amount of the excess determined by the application of s 799(1) and s 801(4A), but if there is no appropriate portion there can be no relief. The existence of the appropriate portion to which s 801(4B) refers is in turn

dependent on the existence, in relation to the A & G payment, of a higher level dividend which, as s 806B(10) makes clear, is one by which the A & G payment is "to any extent represented". The first POAL dividend could not possibly represent the A & G payment as it was paid before the A & G payment was made. The second POAL dividend was of an amount less than the remaining distributable profits of the Australian group, even disregarding the modest contribution to those profits made by the A & G payment. It followed that neither of the POAL dividends represented the A & G payment to any extent at all, and therefore neither of them was a higher level dividend. No other possible higher level dividend has been, or could be, identified. If there is no higher level dividend, there can be no appropriate portion and without an appropriate portion there is nothing for which s 801(4B) can give credit.

70. In any event, whether there is a higher level dividend is not, as P & O argues, a question of arithmetic but a question of fact. At [57] the F-tT made a finding that the POAL dividends did not represent the A & G payment. That finding was consistent with the evidence of P & O's own witness, Mr Walker, who accepted that the first POAL dividend was in no way derived from the A & G payment, and could not say that the A & G payment contributed in any meaningful sense to the second. The F-tT's finding cannot be challenged on appeal to this tribunal.

Discussion

71. The F-tT was, we have no doubt, right to conclude that the Dear Simon scheme was a device designed to generate DTR by artificial means, but we agree with Mr Peacock that the question is not whether the arrangements were artificial but whether they work, in the sense that P & O's objective was achieved. We can also agree with Mr Peacock that although the DTR code is complex, it is possible to step through it in order to apply it to the individual case. We do not, however, accept his identification of the path which those steps trace, nor do we consider that he has arrived at the correct destination. We are satisfied that the arrangements did not work and that, save to the extent which is undisputed, P & O's claim for DTR must fail and this appeal must be dismissed.

72. The starting point must be ICTA s 790(6). The subsection is engaged by the payment of a dividend by one company to another company which has a prescribed relationship to the paying company, a relationship which it is common ground existed in this case and which we need not explore further. If the subsection is engaged, "any tax in respect of its profits paid … by the company paying the dividend shall be taken into account in considering whether any, and if so what, credit is to be allowed …". We agree with Mr Goldberg that there is no basis upon which that provision can be read so as to include deemed tax, or indeed anything other than tax actually borne. The subsection clearly identifies as its subject tax paid, and nothing else.

73. One needs to move on next to sub-s 799(1) which, for convenience, we repeat:

> "(1) Where in the case of any dividend arrangements provide for underlying tax to be taken into account in considering whether any and if so what credit is to be allowed against the United Kingdom taxes in respect of the dividend, the tax to be taken into account by virtue of that provision shall

> be so much of the foreign tax borne on the relevant profits by the body corporate paying the dividend as
>
> (a) is properly attributable to the proportion of the relevant profits represented by the dividend, and
>
> (b) does not exceed the amount calculated by applying the formula set out in subsection (1A) below."

74. The significant phrases in that subsection are "tax borne" and "is properly attributable to … the profits". We do not see any scope for reading the provision as one which applies to deemed tax, and we find it impossible to understand how tax which has not been borne, and which can never be borne because there is no liability for it—in other words, something which does not exist—can be attributable to the profits, if any, represented by the dividend. In our judgment the natural, and correct, construction of this provision is that where there is no foreign tax (or, as in this case, UK tax which is treated as if it were foreign tax) there is also no tax which can be taken into account.

75. Mr Peacock argued, as we have said, that it does not matter that U, for the purpose of the application of the mixer cap, is equal to zero because the formula works whatever the value of U might be, including zero. That is true as a matter of arithmetic; but the difficulty which Mr Peacock's argument does not overcome is that the mixer cap, that is sub-s (1A), does not come into play if the sub-s (1) gateway is closed as, in our view, it is when there is no tax which can be attributed to profits. Mr Peacock's argument, as we see it, ignores the fact that paragraphs (a) and (b) of the subsection are cumulative; if paragraph (a) is not met, because there is nothing to attribute, the application of the mixer cap of sub-s (1A) is no more than an inconsequential exercise.

76. We also agree with Mr Goldberg that s 801(4B) can apply only if sub-s (2) or (3) of the same section is in point. The latter merely extends the application of the former by one link in a chain of dividends and it is therefore necessary to examine only sub-s (2). It is, as we have said, undisputed that the A & G payment was a dividend, at least in company law terms, and A & G is, for the purposes of this subsection the "third company". The "overseas company" is POAL, since it and Liena, for the reasons we have explained, are treated as a single entity. The effect of the subsection is to treat as tax paid by POAL the tax payable by A & G, but as that tax was nil, so too must be the tax to be treated as paid by POAL.

77. In our view, the examination of s 801 stops there. Subsection (2) is expressed to be subject to sub-ss (4) to (4D), which modify the amount identified by sub-s (2); but if the amount so identified is nil, there is nothing to modify. In other words, it is only if some underlying tax is payable by the third company that the possibility arises of its being treated as tax paid by the overseas company, and if there is no such possibility there is nothing on which sub-ss (4) to (4D) can bite. But even if that proposition is wrong and one does need to go on to consider sub-ss (4) to (4D) we do not agree with Mr Peacock that sub-s (4B) assists him. The obstacle in his path is sub-s (4A), which imposes the condition which must be met if sub-s (4B) is to be engaged, namely that the application of the mixer cap formula results in a figure which exceeds U. If we are right in what we have said about s 799(1), the application of the mixer cap does not have that result because it cannot be applied at all.

78. If, nevertheless, it is assumed in P & O's favour that we are wrong about s 799(1) and that the mixer cap can be applied, it is correct that in this case it would result in a figure greater than U, with the consequence that sub-s (4B) is brought into play. Its purpose—on which we agree with Mr Goldberg—is to preserve reliefs but it does so by an arithmetical rather than purposive approach and it is therefore necessary to examine whether, if it is engaged at all, it has the result for which Mr Peacock contends. The difficulty here, as we perceive it, is that identified by Mr Goldberg: there has to be a relevant higher level dividend within the meaning of s 806B(10) if s 806B(6) is to apply; and if that subsection does not apply no "appropriate amount" can be identified. We are not entirely convinced by Mr Goldberg's proposition that the F-tT's finding that there was no higher level dividend is a finding of fact but whether or not his proposition is right the F-tT's conclusion on the point was plainly correct. The first POAL dividend cannot realistically be said to represent a dividend, the A & G payment, which was not even in contemplation when it was declared and paid, and the second POAL dividend cannot realistically be said to represent a dividend almost all of which was taken to a capital account and not to profit and loss account, where even the residue was unnecessary for the payment of the POAL dividend, and where there was no evidence that it was taken into account in the declaration of the dividend or appropriated to that purpose.

79. We do not accept Mr Peacock's counter-argument that all that is necessary is that the A & G payment was received in the accounting year in which the POAL dividends were paid. Closer examination of s 806J(3), on which Mr Peacock relied in this context, shows that it is not enough that the lower level dividend (dividend A) brings some profit into the recipient's accounts for any dividend paid out by the recipient in the course of the same accounting year to rank, in relation to dividend A, as a higher level dividend. That is not what the subsection provides; even though the derivation to which it refers may be indirect, there must be derivation. Here, there was not. The plain purpose of the requirement of representation is that it is possible to track the underlying tax as it passes from one dividend to another. If Mr Peacock is right that would not be possible, and there would be no more than an adventitious link between the tax and the relief.

80. Although we have adopted rather different reasoning from that of the F-tT, we are satisfied that they arrived at the correct conclusion, namely that no more DTR is due than that accepted by HMRC. We should add that we do not think it necessary to explore the possible application of what is commonly referred to as the *Ramsay* line of authority (beginning with *W T Ramsay Ltd v IRC* [1982] AC 300) at which the F-tT hinted and which was touched on briefly in argument before us. The scheme did not work and that is sufficient to dispose of the appeal which, as we have already said, is dismissed.

Mrs Justice Proudman

Colin Bishopp
Upper Tribunal Judge

Release date 19 June 2015