Neutral Citation Number: [2016] EWCA Civ 468

Case No: A3/2015/2699

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM
The Upper Tribunal (Tax and Chancery Chamber)
Mrs Justice Proudman and Judge Colin Bishopp
FTC 992013

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 20/05/2016

Before :

LADY JUSTICE ARDEN
LORD JUSTICE JACKSON
and
LORD JUSTICE KITCHIN

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Between :

Peninsular & Oriental Steam Navigation Company	**Appellant**
- and -	
The Commissioners for Her Majesty's Revenue and Customs	**Respondents**

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- -

Jonathan Peacock QC and Philip Walford (instructed by **Appellant**) for the **Appellant**
David Goldberg QC and Michael Jones (instructed by **HMRC Solicitors Office**) for the **Respondents**

Hearing dates: 23-24 February 2016

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Judgment

LADY JUSTICE ARDEN:

1. This judgment is about the tax effectiveness of a "rate-boosting" scheme ("the Scheme"), that is, a scheme to boost claims to double tax credit relief ("DTR") in the hands of a UK parent company ("the UK ultimate parent") on a dividend ("a Case V dividend") received by it from any of its overseas subsidiaries and originating from another UK resident company ("the UK subsidiary"). A Case V dividend is taxable under Case V of schedule D to the Income and Corporation Taxes Act 1988 ("ICTA"). The UK ultimate parent is entitled to credit for foreign tax suffered by the paying company ("the paying subsidiary") and its subsidiaries.

2. The object of the Scheme is to maximise the amount of the credit in response to changes in the law made in 2000 and 2001. The Finance Act 2000 for the first time limited the amount of the foreign tax credit to the maximum amount of UK corporation tax via "a mixer cap" (explained below) by amending the double tax code in the ICTA. In the following year the Finance Act 2001 sought to mitigate the effects on multinational companies apparently by allowing credit in a specific case, namely for tax that would have been paid by the UK subsidiary of a foreign subsidiary if it (the UK subsidiary) had not been relieved from paying UK tax at the full rate, for example by using group relief. For this purpose the UK subsidiary might be an indirect subsidiary owned by an overseas intermediate holding company, but each of the companies in the chain would have paid dividends ("intragroup dividends") to the company up the chain. The credit derived from the UK company at the bottom of the chain ("the bottom company") would be reduced as it became diluted by other profits when it went up the chain.

3. The purpose of the relevant provisions of the Finance Act 2001, it is said, was to put the UK subsidiary of a foreign subsidiary of a UK parent which does not pay UK tax at the full rate effectively into the same position as the UK subsidiary of a UK parent company which pays a dividend to its UK parent. That payment of dividend is not subject to UK corporation tax. It was considered by HMRC and others that the absence of DTR in this situation ("the Unfair Case") was unfair.

4. The dispute on this appeal is based on a difference of approach to the relevant charging provisions. Principally, the appellant, which is the UK ultimate parent in this case, contends that, under the legislation as amended, in the Unfair Case the amount of the credit (allowed in this case by unilateral DTR) is fixed mathematically by reference to the difference between the amount of foreign tax credit resulting from the mixer cap and the amount of underlying tax (foreign tax), which might be nil. HMRC, on the other hand, say that this case is answered principally by two propositions: (1) that underlying tax must have been paid for DTR to be given ("the tax borne argument") and (2) that the dividend paid by the UK subsidiary must flow through to the UK ultimate parent, i.e. be the source of profits for successive dividends up the chain to the UK ultimate parent, which to all intents and purposes did not happen in this case ("the disappearing dividend argument").

5. In essence both the First-tier Tribunal ("the FTT") (Sir Stephen Oliver QC and Helen Myerscough FCA) and the Upper Tribunal ("UT") (Proudman J and Colin Bishopp) upheld HMRC's rejection of the appellant's DTR claim. I have come to the conclusion after careful consideration of the arguments that the appeal should be dismissed (save in minor part) but on the basis that the appellant is right on the tax

borne argument but that HMRC is right on the disappearing dividend argument. This will sound like heresy to HMRC which urged on us that double taxation necessarily involved that the original dividend had been paid out of profits which had been taxed in its local jurisdiction. But I see no reason why Parliament should not have decided in the national interest to give a foreign tax credit where A, who is resident overseas, makes a payment of dividend out of profits distributed to it by a UK subsidiary to a UK-resident company B in circumstances where the payment carries tax in the UK but would have carried no tax if A had been in the UK, and to do so without requiring that A or its subsidiary should have suffered tax locally. Parliament might logically impose a condition (as happened here) that the payment should arrive in the UK with B, but equally it could provide for the credit to be reduced in line with the payment that was reduced if the payment only reached the UK to some extent (the extent being matched by a sliding scale of reducing fractions for the credit). That is a very simplified statement of my conclusion, and, even though the legislation with which this appeal is concerned has been repealed there are surely issues here which are relevant to the future development of double tax.

6. At the end of the day there are only two points of statutory interpretation that matter: the interpretation of tax "borne" and cognate expressions (which affects sections 790(1), 799(1) and 801 ICTA) and the interpretation of "higher level dividend" (sections 806B and 806J). Essentially the UT took the same view. I shall explain how the appellant's DTR claim arises and summarise the decisions of the Tribunals. Then I shall:

- summarise the double tax code on tax credits
- summarise the key submissions (organised not as counsel presented them but round the two points I have identified)
- set out my conclusions with reasoning.

7. We are not asked about the amount of any DTR credit: we are simply dealing with questions of principle. Nor are we concerned with the appellant's claim under the UK/Australia double tax treaty for Australian tax paid (the local tax). When in this judgment I refer to a company as a UK company, I am referring to a company which is liable to UK tax. References below to "the legislation" and "the statute" are (unless it appears otherwise) to the statutory provisions on DTR which I am about to outline and which form part of what is effectively a code of statute law.

HOW THE APPELLANT'S DTR CLAIM ARISES

8. Because of the disappearing dividend argument, the sequence of events is important. One of the issues which arises is a timing issue because the intermediate holding company paid a dividend in May 2004 before the UK subsidiary paid it the dividend in November 2004 which the appellant contends gives rises to creditable foreign tax.

9. P & O Australia Ltd ("POAL"), a wholly-owned Australian subsidiary of the appellant ("P & O"), held 99% of the share capital of Liena Pty Ltd ("Liena"). Abbott & Goldman ("A & G") was a UK company, which had not paid the full rate of UK corporation tax. It is common ground that POAL and Liena are members of an Australian tax group that was taxed in Australia as a single entity and accordingly,

where appropriate, the term "POAL" in this judgment includes the two companies so treated.

10. On 26 May 2004, POAL declared an interim dividend ("the First Dividend") of A$ 75m in favour of P & O. The dividend was payable on 27 May 2004 and was from its profits for the year ended 31 December 2004.

11. On 14 October 2004, Liena, a subsidiary of P & O subscribed A$193m for shares in A & G. On 15 October 2004, these shares were cancelled and A & G credited the sum of A$193m arising on that cancellation to a profit and loss account reserve.

12. On 19 November 2004, A & G paid a dividend of £193,766,877 to Liena. It is common ground that, as a matter of company law, this was a lawful dividend. The dividend was paid out of the profit and loss account reserve arising on the cancellation of Liena's shares and as to the balance out of trading profits. The profits standing to the credit of the profit and loss account reserve were not chargeable to tax. The trading profits were chargeable to tax and that tax would have constituted "underlying tax" as defined in section 792(1) but for the fact because A & G used group relief, which had been surrendered to it, to discharge its liability to tax.

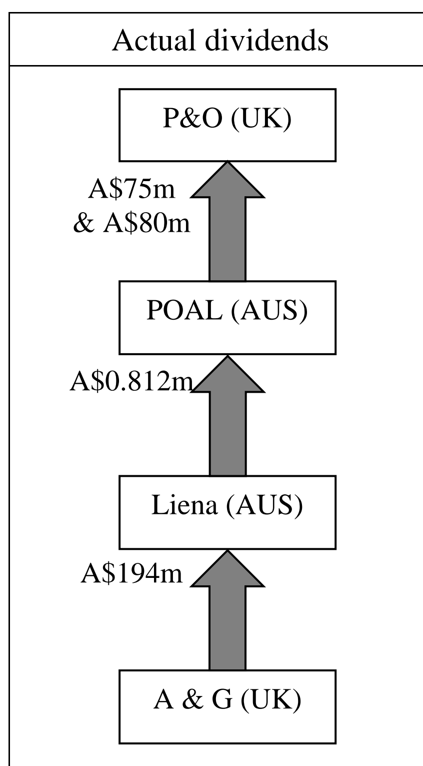
13. Liena applied nearly the whole of the dividend which it received from A & G in writing down the book value of its investment in A & G. The amount written off did not appear in Liena's profit and loss account for the period 1 January to 23 November 2004.

14. On 22 November 2004 Liena declared a dividend of A$820,000 payable on 23 November 2004 to its shareholders. Of this, some A$811,800 was paid to POAL.

15. On 30 November 2004 POAL declared a dividend ("the Second Dividend) of A$80m out of its profits for the year ended 31 December 2004, which it paid the next day.

16. P & O claimed DTR of about £21m. HMRC subsequently allowed DTR for £6.7m only. Foreign tax credit is allowable as a relief in the UK by unilateral relief.

17. The diagram set out below shows the dividends that were actually paid by POAL/Liena and A & G (with their tax residence indicated in brackets next to their names):



18. I have omitted any reference to the substantial intragroup loans that were made. The parties did not refer to them on this appeal or suggest to us that the issues were affected by any sham or steps taken to avoid tax.

THE DECISIONS OF THE TRIBUNALS

19. The FTT rejected the whole of the appellant's claim for DTR. It held that the profits out of which A & G paid its dividend to Liena had "borne" tax for the purposes of section 799(1) even though it had not paid any tax due to group relief ([53]). It then identified the three statutory assumptions in section 801. As I explain below I agree with that approach, and that the profits out of which the A & G dividend was paid fall to be treated as having borne tax.

20. The next part of the FTT's reasoning is not in all respects relevant to this appeal. The FTT sought to identify the amount of the foreign tax which would have been payable on the A & G dividend. It assumed that the item for tax of A$339,376 shown in A & G's accounts was tax paid (it was in fact the sum paid for the surrender of group relief). Nonetheless it held that this tax was not attributable to the dividend ([56]). The FTT went on to hold that neither the dividend from Liena to POAL nor that from POAL to the appellant were higher level dividends because (in the case of Liena) Liena had actually used the monies paid by A & G to repay a loan payable by it to P & O and (in the case of POAL) POAL had other distributable profits which could be used to fund the dividend ([57]). The FTT went on to conclude on the facts that the A & G dividend was not a dividend for the purposes of sections 799(1) and 801 and that it should be characterised as a loan ([60] to [72]). The appellant's expert witness, Mr Steve Parkinson ACA of Ernst & Young, gave evidence on the appropriate

accounting treatment. This part of the decision is superseded by HMRC's agreement that the A & G dividend was lawful as a matter of company law.

21. I shall now summarise some of the detailed reasoning of the UT based on provisions which I summarise in the next section of this judgment, and so this paragraph should be read with that summary. The UT upheld HMRC's argument that section 790(6) could only include tax actually borne and not deemed tax ([72]). Moving to section 799(1), the UT then held that deemed tax could not be "borne" and could not be "attributable" to profits represented by a dividend ([74]). It further held that even if "U" in section 801(4A) could be nil, the mixer cap could not apply because section 799(1) did not apply. The effect of section 801(4B) was to treat as tax paid by POAL the tax payable by A & G, but as that tax as nil, the tax to be treated as paid by POAL similarly was nil ([76]). There was therefore nothing on which section 801(4A) to (4D) could bite. But even if that was wrong, the UT rejected the appellant's submission that section 801(4B) applied because in their judgment it could not be shown that the mixer cap formula resulted in a figure which exceeded U ([77]). So the gateway in section 801(4A) was not open. In any event, the FTT were correct to hold that on the facts there was no higher-level dividend ([78] and [79]).

22. As to the decision of the UT, as appears above, I have come to the contrary view on "tax borne" and on the effect of section 801(4B). I consider that the decision of the UT was therefore in error. As will appear, I agree in part with the UT on higher level dividends.

SUMMARY OF THE DOUBLE TAX CODE ON CREDITS

23. In this case the relevant relationships were that of parent and subsidiary. The legislation with which we are concerned also applies to companies which have a looser relationship. Nothing turns on that so for simplicity I will describe the provisions as if they were limited to parent and subsidiary companies. The code which I next summarise is that applying at the time relevant for the purposes of this appeal. The focus of this judgment will as indicated above be on sections 790, 799, 801, 806B and 806J but I have taken the sections in sequence for ease of explanation.

24. The relevant provisions may be summarised as follows:

- Section 792 defines "underlying tax" as in effect the tax imposed on the profits out of which the dividend has been paid. This is to be distinguished from withholding tax paid out of dividends.

- Section 790(12): credit is given only for foreign tax which corresponds to UK corporation tax.

- Section 795(2): the amount of the Case V dividend is grossed up by the underlying tax to determine the amount of the income chargeable to tax.

- Section 797(1): the amount of a credit for foreign tax is capped at the current corporation tax rate. Prior to the introduction of the mixer cap, any limit on the rate of tax was avoided by the use of "mixer companies" but that was negated by the mixer cap in section 799(2).

- Section 799: is the basic provision that determines the amount of underlying tax to be set against the tax chargeable on the Case V dividend.

- Section 799(1)(a): where relief is provided for, the creditable foreign tax is limited to the attributable proportion of the foreign tax “borne” on the “relevant profits” by the bottom company. There is no definition of “borne”. This limit applies to each company in the chain.

- Section 799(3) to (6): “relevant profits” are in general distributable profits for a specified period or, if no period was specified, the last period prior to the date of the dividend for which the company had drawn up accounts.

- Section 799(1) (b) and (2) (“the mixer cap”): under arrangements for relief, the UK ultimate parent company can claim foreign tax credit for the dividend paid by the bottom company up to the maximum rate of corporation tax. This is achieved through the formula: (D+U) x M% where D is the dividend, U is the foreign tax attributable to that dividend and M is the maximum relievable UK corporation tax. The mixer cap applies to underlying tax only but to all companies in the chain.

- Section 801 adapts the method in section 799 for the computation of DTR in three ways: (1) third country taxes, (2) dividends paid by companies below the company paying the Case V dividend in the corporate chain and (3) tax on dividends paid by UK subsidiaries of a foreign subsidiary. This appeal is concerned only with (3), which is achieved by sections 801(2) and 801(4) to (D).

- Section 801(4A): constitutes the gateway to section 801(4B). A dividend passes through this gateway if with respect to any Case V dividend the amount produced by the mixer cap formula exceeds the actual underlying tax (“the excess”).

- Section 801(4B): if a dividend goes through the gateway, then (on the appellant’s case) an “appropriate portion” of the excess is added to underlying tax which may be set against the tax payable on the Case V dividend.

- Section 801(4C): the appropriate portion is ascertained in accordance with section 806B by reference to higher level dividends. These are dividends which “to any extent” represent the dividend paid by the UK subsidiary or is the Case V dividend (section 806B(10)). The appropriate portion is obtained by (a) working out for each higher level dividend a simplified fraction of the dividend divided by the dividend-paying company’s profits and (b) multiplying these fractions. The resultant fraction is then applied to the excess (see section 806B (5) and (6)).

SUBMISSIONS

"Tax borne" argument: how should these words in section 799(1) and cognate expressions be interpreted in the context of DTR in relation to dividends from UK subsidiaries of overseas intermediate holding companies?

25. This issue is crucial because A & G did not pay any UK tax on the profits out of which it paid the A & G dividend. A claim to DTR is given against "tax payable" (section 790(1)) and "tax borne" (section 799(1)). Section 799(1) is imported into section 801, which extends the relieving provision in section 799(1) to UK tax incurred by UK subsidiaries of overseas intermediate holding companies. The appellant must lose if the legislation imposed a requirement that A & G should actually have paid underlying tax (which in its case was UK tax). As I see it the ultimate issue is what "underlying tax payable" in section 801(2) means. The rest follows.

26. Jonathan Peacock QC, for the appellant, summarises his wider submission here: under section 801(4A) the only question is whether there was an excess between the amount produced by the mixer cap and the underlying tax. For this purpose U could be a nil amount. If there was an excess, then under section 801(4B), the amount of the underlying tax was increased. Mr Peacock deals in detail with the tax borne argument.

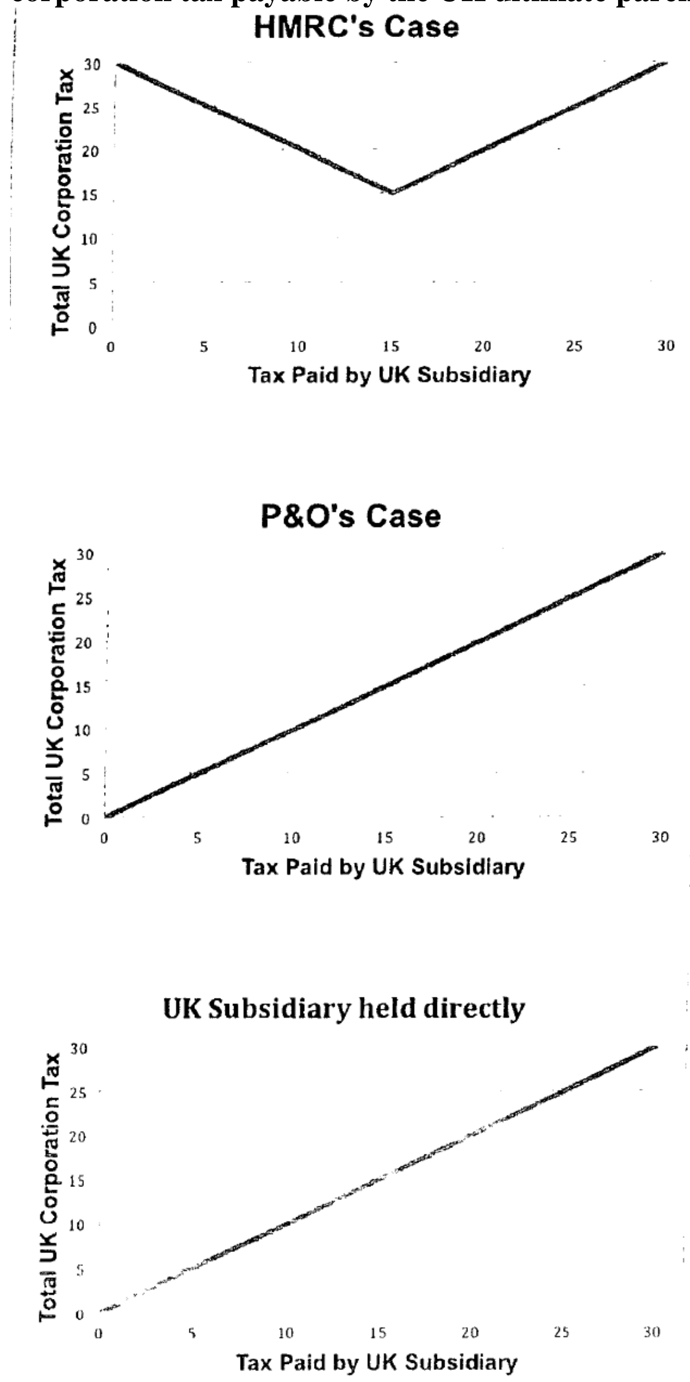
27. First, submits Mr Peacock, despite the reference to section 799(1) in the opening words of section 801(4A), once a claim comes within section 801(4B), there is no need to go back to section 799(1) because section 801(4B) applies where section 799(1)(a) and (b) have already been applied. Parliament would not have intended a result whereby it was necessary to go back to section 799(1) because that would lead to a "world of endless iterations."

28. On Mr Peacock's submission, the purpose of section 801 is that a dividend paid by a UK subsidiary of an overseas holding company should give rise to a foreign tax credit even if the UK subsidiary had not paid UK corporation tax in full (see the explanation of the purpose of this legislation in paragraphs 2 and 3 of this judgment). Section 801 asks whether any underlying tax is "payable". It is only necessary to find whether there is an excess between the statutory amount and the underlying tax. If there is an excess, the effect of section 801(4B) to increase underlying tax. That then becomes underlying tax even though no tax has been paid. Unless there is no local tax, the underlying tax is payable.

29. So on Mr Peacock's submission section 801(4B) must apply where tax is neither payable nor paid. The legislative scheme applies to distributable profits, which are different from taxable profits precisely because the profits may be relieved from tax, as in this case (or by capital allowances and so on). It can hardly have been intended, therefore, that underlying tax should either be paid or payable before section 801 applies. Moreover there are textual indications that this is so since (i) section 801(4B) applies directly to the Case V dividend "after applying paragraphs (a) and (b) of" section 799(1), which are paragraphs which deal with underlying tax; (ii) section 801(4B) expressly increases the foreign tax for which unilateral relief is available, and (iii) the increased foreign tax is described as underlying tax even though no such tax actually exists.

30. One of the diagrams produced by Mr Peacock shows the amount of corporation tax which the UK ultimate parent will have to pay (having taken into account DTR) in three situations (i) as a result of section 801(4B) construed in accordance with (a) HMRC's approach and (b) the appellant's approach and (ii) the amount of corporation tax which would have to be paid in relation to a dividend paid by the UK subsidiary where there is no overseas intermediate holding company. The appellant's interpretation leads to a consistent straight-line progression according to the amount of underlying tax paid by the UK subsidiary (shown by a line on the graph) whereas using HMRC's approach, the result is an inverted Laffer-type shape (my description) where the rate of tax paid by the UK subsidiary is half or less than the full rate of corporation tax, the rate of corporation tax rises (and DTR falls). The diagram also shows the UK company to UK company situation which the situation of a dividend paid by the UK subsidiary of an overseas intermediate holding company was intended to mirror.

Mr Peacock's diagram showing the effect of the parties' rival contentions on the corporation tax payable by the UK ultimate parent:



31. Mr Peacock submits that HMRC's approach, which means that the subsidiary must pay some underlying tax, leads to the anomaly that relief may be given even though only £1 tax has been paid. A UK subsidiary may therefore get the relief as if it had been a direct subsidiary where only £1 relief taken, but not if no tax was paid. This is incoherent. On Mr Peacock's submission, the legislation does not require the question to be asked why no tax was paid.

32. Mr Peacock draws an analogy with "tax spared": in some cases an otherwise taxable event is "spared" tax i.e. given DTR, even though there is no underlying tax paid. Provision is made for tax sparing in section 788(10A). Mr Peacock submits that in section 788(10A) Parliament does not ask why tax was not paid. Likewise section 788(5) provides that in the particular circumstances there described tax not paid shall be treated as payable. Section 801 is a mini-code to equate the position of a UK subsidiary of an overseas intermediate holding company with that of a UK company which pays a dividend direct to its parent free of tax.

33. Mr Peacock relies on the treatment of the excess as foreign tax in 801(4B). "Foreign tax" is defined by section 792 as tax which is chargeable and thus as payable. The fact that it is not paid is irrelevant. Moreover, he submits the charging provisions work by reference to "relevant" (i.e. distributable) profits, not taxable profits. This is a deliberate choice and is consistent with the intention that the provisions should apply to tax whether or not it has become payable or been paid.

34. David Goldberg QC, for HMRC, submits that as A & G paid no underlying tax, the section 801(2) gateway was not open, that section 801(4A) was not satisfied and that section 801(4B) is not applicable.

35. Mr Goldberg submits that the appellant ignores the express wording of the legislative scheme. He submits that sections 790(6) and 799(1) refer to actual, not deemed, tax. The section 801(4A) gateway has not been opened and so section 801(4B) does not apply.

36. In any event, submits Mr Goldberg, both section 801(4A) and section 801(4B) apply when the exercise is one of applying section 799, that is, for the purposes of ascertaining DTR in relation to the Case V dividend. Having regard to the provisions of section 790(3) and (6), only foreign tax which is actual tax falls to be taken into account. That is because the reference to local tax "paid" in section 790(6) is by implication the underlying tax. That means that in the field of DTR arising out of dividends paid by subsidiaries there is not just a mixer cap but also a cap in that the tax must be "borne": section 799(1). Contrary to the appellant's case, the legislation does not refer to deemed tax. The words "of the underlying tax" in the mixer cap formula have to be given meaning. Moreover, the statutory definitions of "foreign tax" and "underlying tax" in section 792(1) both look to actual, not deemed, tax.

37. Section 801(4B) provides that foreign tax is to be increased, and that must on Mr Goldberg's submission be actual underlying tax. Mr Goldberg accepts that the inverted Laffer-type graph produced by Mr Peacock may produce odd results but the words "underlying tax" are in section 801(4B) and impose a cap.

38. Mr Goldberg submits that the tax must be paid or payable. Mr Goldberg submits that section 799(1) continues to be relevant because otherwise there may be no application of section 799(1)(b). On his submission it is unnecessary on this appeal to determine whether the expression "tax payable" includes tax set off against losses. It might do so, but here U is nil. As the appellant states, the sum of A$193m could never have borne tax.

39. Mr Goldberg also submits that tax "paid" does not include tax "payable". Tax "paid" does not therefore include tax set against losses or reduced to nil because of losses

surrendered and credit taken. On Mr Goldberg's submission it is the same in section 801(4A) and (4B). He further submits that the expression "tax borne" in section 799(1) is contemplating the type of profits which could bear tax. He submits that in the events which happened, the profits of A & G used for the payment of dividend could never have borne tax.

40. In addition, the tailpiece to section 801(4B) uses the words "of underlying tax". Therefore, submits Mr Goldberg, the "tax borne" argument is sound.

41. Mr Goldberg accepts that it is sufficient to get through section 801(2) that only £1 of tax is paid. On Mr Goldberg's submission, there are two caps in section 801(4B). There is a reference to foreign tax in relation to the UK company's dividend. That must be foreign tax. Then there is a cap in section 799(1) itself ("so much of the foreign tax borne…"). The reference here is to the amount paid by A & G, reference to foreign tax must be to actual tax. So there must be tax borne on the profits for which claim is made, or at least they have to be profits of the kind that can bear tax.

42. Mr Goldberg submits that there are further indications in the legislation that section 790(6) and section 799(1) must refer to actual and not deemed tax. These include section 806(1)(b)(ii) which he submits makes it clear that tax must be paid before a taxpayer must make a claim for DTR. Another indication, Mr Goldberg submits, can be found in the tax sparing provisions (sections 788(5) and 790(10A) to (C)). These provisions show that, where the legislation intends to give relief when tax is not paid, it says so expressly.

43. Mr Goldberg submits that before section 801(2) can apply, the overseas company must be in a position to claim DTR because DTR is only given on a claim: see sections 806, 788(5) and 788(6). For this purpose the tax must be paid: section 790 (6). Therefore "payable" in section 790(2) must mean "paid".

44. Mr Goldberg further submits that the A & G dividend was the wrong kind of dividend because it must be paid out of a fund liable to tax. He submits that the whole tenor of the legislation is that there needs to be an actual tax charge before the DTR provisions can apply.

45. In reply Mr Peacock sums up the appellant's case by submitting that the "tax borne" argument adds nothing:

a) the fact that the dividend was paid out of profits available for distribution was enough. Parliament did not provide that those profits had to be capable of being taxed in the circumstances of the Scheme.

b) Parliament was concerned that DTR should be given where the UK subsidiary had not paid tax without stipulating or inquiring into the circumstances in which it had not paid tax.

c) the correct order of priority is to apply section 799(1A) and (B) to the dividend paid by the UK company (section 790(2)). Then the taxpayer goes to section 801 (4A) and (4B). At that stage the taxpayer does not go back to section 799 to see if tax borne or capable of being borne because that would lead to a world of endless iterations. As to the

words "in the application of section 799…" when the words "tax borne" are applied in this context, they must mean that it is borne as a necessary consequence of the fiction in section 801(4B).

d) irrespective of the "tax borne" argument, HMRC's interpretation defeats the purpose of the provision, and depends on anomalies for which there is no rational explanation and which do not exist under the appellant's approach.

The "disappearing dividend" argument

46. Mr Peacock submits that the dividends paid by Liena and POAL were higher level dividends because they were the intermediate companies in the corporate chain. It is sufficient that they included profits of a UK company "to any extent". Those words do not mean "to that extent". Moreover a dividend for company law purposes was all that was required.

47. Mr Peacock rejects the argument that the DTR rules do not apply where a dividend is not needed to fund a higher level dividend or a Case V dividend. He submits (in my view correctly) that there is no statutory requirement for this.

48. On the timing of the First Dividend, Mr Peacock submits that Liena could pay this dividend even before it had received the relevant dividend from A & G.

49. Mr Peacock rejects HMRC's approach in the Tribunals that the A & G dividend was "the wrong kind of dividend." He submits that "dividend" is not defined and that it should bear its ordinary meaning.

50. Mr Goldberg submits that the A & G dividend must flow through to the appellant for this legislation to apply. He submits that:

1) the A & G dividend was "the wrong sort of dividend" for the purposes of this legislation in that:

    a) it was not received in full as part of the profits of the intermediate holding company;

    b) it disappeared as a result of the write-off by Liena;

    c) to the extent it disappeared, the recipient did not, and could not, bear any sort of tax and

    d) it was not paid out of profits which had borne tax, or which were capable of bearing tax.

2) as a matter of fact, the payment by A & G was not properly regarded as a dividend.

3) the "appropriate portion" is zero because there was no higher level dividend.

51. So, to have a higher level dividend, there must be dividends representing one another (section 806J(3)). Derivation is a question of fact which Mr Goldberg submits the

FTT decided in HMRC's favour (see FTT Decision, [57]). The appellant has the onus of establishing derivation. Mr Peter Walker, group finance director, (a factual witness called by the appellant at the FTT hearing) as much as accepted that there was no chain of dividends here. He was not able to say that the POAL dividend was derived from the A & G dividend. He gave evidence to the FTT that he could not comment on what happened in Australia. In answer to the question "Read the accounts and tell me whether the A$193m passes back to the UK" he replied: "It would appear not."

52. Moreover, POAL paid the first dividend before the A & G dividend and so it cannot be a higher level dividend.

53. Mr Goldberg stresses that the amount of the dividend must be distributable profit in the hands of both the payer and payee. It must be wholly income in the payee's hands. That, he submits, is not this case. Section 790(6) also shows it must be the same for the payer and the payee: it must be paid "by" one company and "to" another company. Mr Goldberg submits that it is inconceivable that the drafter thought they were not distributable profits in both companies' hands.

54. Mr Goldberg submits that the court should examine the facts realistically. He also submits that the dividend was the wrong kind of dividend. While, when pressed, Mr Goldberg accepts that it is not open to him in this court to argue that the A & G dividend was actually the repayment of a loan and that it should have been characterised as a loan and not as a dividend, he asks us to take into account odd features of the accounting in determining whether it is a dividend or not. I will deal with that point here. HMRC failed to prove that the A & G dividend was not paid out of distributable profits and in my judgment the Court should not speculate about what might have happened if they had done so.

55. Mr Goldberg further submits that the A & G dividend was the wrong kind of dividend because it must be paid out of a fund liable to tax. He submits that the whole tenor of the legislation is that there needs to be an actual tax charge before the DTR provisions can apply.

56. Mr Goldberg submits that the dividends paid by POAL could not represent dividends from A & G. The UT rightly held that that was essential to the purposes of the legislation. As a result of the write down by Liena of the cost of its investment in A & G it is, he submits, impossible to track the dividend paid by A & G through to the appellant and so the appellant's DTR claim is wrong.

CONCLUSIONS

TWO PRELIMINARY POINTS

57. I have two preliminary points to make about the approach to the issues in this appeal. First, Mr Peacock, in his carefully marshalled submissions, picked his way through the statutory thicket by focusing on individual phrases taken from the statutory scheme. He drew a parallel between Humpty Dumpty's well-known words in Lewis Carroll's *Alice though the Looking Glass*, quoted by Lord Atkin in *Liversidge v Anderson* [1942] 1 AC 206 at 245, and the argument put forward by HMRC. I will respond to his atomised approach with a quotation from another work by the same author, *Alice in Wonderland*:

> "'Begin at the beginning,' the King said, very gravely, 'and go on till you come to the end: then stop.'"

58. The right way to interpret this statutory code, in my judgment, is to read it as best one can as a whole piece of prose and to work through it from the beginning and then stop and not to pull out phrases, potentially without their context, or to overcomplicate the matter with numerous possible and, if I may say so, in some cases (necessarily) selective, examples of the operation of the provisions. I am of course very grateful for all the visual aids that we have been given to help us decide this appeal (including flip-chart size diagrams in multi-colour) but I have endeavoured simply to follow the intended sequence of the statutory provisions in my summary of reasons in paragraphs 64 and 65 below, and then (almost) stop.

59. My second point is about the relevance of the purpose of the legislative amendments enacted by the Finance Act 2001 so far as relevant to this case. Mr Peacock emphasises that the purpose of these amendments was to ensure the result that no corporation tax charge was levied where a UK company paid a dividend to another UK company, even where there was an overseas intermediate holding company between the paying company and the receiving company. He relies for instance on statements in the notes on clauses presented by HM Treasury to Parliament:

> …If the rate of underlying tax paid on a dividend from a United Kingdom company is below the amount given by applying the mixer cap formula, the shortfall is made up so that no further United Kingdom tax is payable in respect of that part of the dividend from the foreign company which represents the dividend from its United Kingdom subsidiary….

60. In my judgment, one must be somewhat cautious before accepting any assertion of purpose of an Act of Parliament not set out in any provision of the Act itself made by a party propounding a particular statutory interpretation. Of course I make exceptions for assertion of purpose deducible by implication from the legislative scheme or clearly stated in some material which is admissible as an aid to interpretation. The reason for being cautious (without intending any disrespect to either of the distinguished advocates in this case) is that such assertions can be self-fulfilling or examples of what is sometimes called "confirmation bias".

61. Fortunately I can find a statutory statement which throws light on the purpose, or one of the purposes, in section 801(2). That states near the end (and here I paraphrase) that where there is a dividend by a UK subsidiary foreign tax will be taken into account as if the dividend were paid by an overseas subsidiary and there was DTR for the underlying tax. That confirms that the object is, in substance, to ameliorate the Unfair Case and (through this and other provisions) to make the tax position analogous to that of a dividend paid by one UK subsidiary to another, as explained in more detail below. But that only takes one so far: it does not set out all the conditions spoken or unspoken on which the amelioration takes place. Moreover, Mr Peacock recognises in his skeleton argument that the purpose also involves the payment of a dividend from one UK company to another UK company, that is, the flow of that dividend from one UK company to another and a taxable receipt in the UK. That, too, is deductible from the detailed provisions for higher level dividends in sections 806B and 806J.

62. In the next section of this judgment, I will summarise my conclusions as to how the relevant provisions work. In fact, if my summary is right, both the appellant's legislative purpose and HMRC's legislative purpose are ultimately achieved. The economic effect of the exemption from corporation tax for a dividend paid by a UK company to another UK company is in certain cases achieved by prescribing an amount of creditable foreign tax with respect to the dividend. It will be achieved where the dividends flow through to the UK ultimate parent. There will then be an amount of creditable notional foreign tax for the UK ultimate parent though the amount will not necessarily be the same because that depends on the amount of the dividends paid successively up the chain. Moreover, the UK ultimate parent has no further tax to pay so far as it has a foreign tax credit which it can use.

63. As I see it, the legislation contains a trilogy of statutory hypotheses. The first hypothesis is in section 801(1). It treats third country and UK taxes payable by an overseas subsidiary as taxes payable under the law of the country in which that company is resident. So UK tax becomes notionally foreign tax. The second hypothesis is in section 802(2). It states that "underlying tax payable by the third company [the UK subsidiary]" is to be treated for the purpose of section 801(1) as tax paid by the overseas company [here, POAL]. The third hypothesis is in the tailpiece to section 801(2): "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 [UK] to a company resident in the [UK] and arrangements had provided for underlying tax to be taken into account." The underlying tax attributed to the UK company by the second hypothesis undergoes a further transformation because the dividend is treated as paid by an overseas company and as qualifying to be taken into account for DTR purposes.

64. In the process of interpretation I would give the textual points second place to the trilogy of statutory hypotheses, to which I attach greater significance. I would, therefore prefer to focus on where they lead. It seems to me that, when one follows the drafter's process of thought as reflected in the words he or she has chosen, it is possible to see more easily the meaning of the words.

65. I now summarise my conclusions and then I will respond to the parties' key submissions.

SUMMARY OF MY CONCLUSIONS

66. In my judgment, for the detailed reasons given below, this appeal should be dismissed. The statutory scheme contains a trilogy of statutory hypotheses (see paragraphs 63 above and the next paragraph). The appellant's scheme fails (as to very nearly 100%) not because of the statutory trilogy but because of the way in which the scheme was implemented in this case.

67. The way that legislation operates in this case is, as I see it, as follows:

    i) Where, as here, the intermediate holding company is a company to which section 801(1A) applies in relation to a dividend which it pays to its UK ultimate parent, section 801(1) creates a statutory hypothesis, for the purpose of allowing a credit against that dividend as unilateral relief, that the UK tax payable by it (the intermediate holding company) in respect of its profits is underlying tax.

ii) Section 801(2) creates a second statutory hypothesis for the purpose of section 801(1), which is relevant in this case, that where the intermediate holding company has received a dividend from its subsidiary (in this case a UK subsidiary) the underlying tax payable by the UK subsidiary is treated as tax paid by the overseas company for the purpose of applying section 801(1).

iii) The second statutory hypothesis is to be worked out in accordance with subsections (4A) and (4B), to which it is "subject".

iv) The underlying tax payable by the subsidiary is subject to a third statutory hypothesis, for the purpose of section 801(1), namely that the subsidiary was not a UK subsidiary, that it had paid a dividend to a UK subsidiary and DTR arrangements provide for underlying tax to be taken into account. On that basis, the subsidiary is deemed to be liable to pay the rate of tax that would be payable on a dividend payable by a non-resident company (30%). There is nothing in section 801(2) which requires or authorises the deduction from underlying tax of any relief to which the paying company is entitled. Moreover, the use in the tailpiece of the words "underlying tax payable," without any definite article, confirms that the tailpiece is looking at underlying tax generically, not with reference to the specific case of any particular dividend-paying subsidiary.

v) Section 801(4A) applies in the application of section 799(1)(b) (the mixer cap) by virtue of section 801(2) in relation to the dividend paid by the UK resident subsidiary: see opening words of section 801(4A). So section 801(2) contemplates that the ultimate UK holding company is in the process of applying section 799(1)(b) with the benefit of subsection (2) to the dividend paid by the UK subsidiary. To apply section 801(4A)(a), the UK ultimate parent works out the "amount given" by the mixer cap formula which in the case of a dividend is (100 + 30%) x 30% because the third statutory hypothesis applies, and so the UK holding company obtains the excess. It is not necessary to ask whether the value of U is nil because the third statutory hypothesis requires the application of the relevant rate of corporation tax.

vi) As a result the ultimate holding company has gone through the gateway and now goes to subsection (4B). It now has to apply section 799 without the second and third statutory hypotheses. The final calculation of creditable foreign tax must be increased by the appropriate portion of the excess in relation to the dividend paid by the UK company. The appropriate portion must be calculated in accordance with section 806B (with modifications which need not be further mentioned).

vii) By virtue of section 806B(6), this is a mathematical calculation based on the higher level dividends only.

viii) Higher level dividends must be dividends which flow through to the UK ultimate parent to some extent (which could be £1). The resultant figure is the amount of the creditable foreign tax in the hands of the UK ultimate parent as a result of the dividend by the UK subsidiary referred to in (ii) above.

ix) However, in this case, only a part of the UK subsidiary's dividend flowed through as the dividend paid to its parents (POAL/Liena) ceased to form part of the profits of the intermediate holding company (save for the sum of about A$820,000) because the book value of the shares was written down by the amount of the profits so applied.

x) Even if that was not so, the First Dividend of A$75m was paid out before the profits were received. The fact that the profits are related to a financial period which covers the date does not help because the question is whether the Case V dividend represented the dividend paid to the intermediate holding company, which it did not. There was no evidence that the anticipated dividend could be taken into account as profit before the date on which it was declared.

xi) That leaves the sum of A$811,800. This was paid by Liena to POAL as a stand-alone dividend on 22 November 2004. It thereafter formed part of the profits out of which POAL paid a dividend of A$80m on 30 December 2004. Liena and POAL were taxed as a single entity so that section 803A applies. Subject to the effect of that section (which has not been fully argued), the sum of A$811,800 constitutes the numerator for the reducing fraction to be applied to this dividend under section 806(6) and (7). It is common ground that the denominator is equal to the relevant profits of the consolidated Australian tax group and that the multiplicand is the amount of tax which is deemed to be underlying tax.

MY RESPONSES TO THE KEY SUBMISSIONS AND DETAILED REASONING ON SPECIFIC POINTS

The "tax borne" argument

68. Most of the points which I would wish to make here have already been made in my summary of my conclusions. In my judgment, the fulcrum is section 801(2) which contains two of the statutory hypotheses. As to the tax borne argument, it is very attractive to read the words "tax borne" in tax legislation as meaning "tax paid" (by deduction or however). Tax "borne" is generally tax suffered. But in section 801 we are not in the actual world but in a hypothetical world. When the hypotheses in that section are given effect, in my judgment the underlying tax payable is correctly described as deemed underlying tax payable for the purposes of section 801(1) and thus for the purposes of section 799(1). The underlying tax payable produced by the hypotheses is treated as underlying tax paid and there is no need to discount the actual underlying tax by any amount if it was not in fact payable because it was relieved by group relief or capital allowances or whatever it might have been. In other words, the hypotheses are exclusive. They prescribe the only facts which can be taken into account in the hypothetical world. If the legislation were to permit the reading in of further facts, it would lead to the anomalies that HMRC's argument entails. The inverted Laffer-type shape curve is one of those anomalies, as Mr Goldberg fairly accepted. Moreover, as the UT remarked, the idea that DTR would be available under section 801(2) if only £1 tax was paid but not if tax was fully relieved by capital allowances is capricious. In my view it is just unreal to conclude that Parliament

would have provided for foreign tax credit in a group situation in all cases except the common one where a subsidiary has for reasons of sensible group financial management taken advantage of reliefs available to it. Therefore I would resist the temptation to read section 801(2) as including a restriction to actual tax paid. The resultant interpretation is consistent with the commercial purpose which Mr Peacock has urged upon us.

69. I have not accepted the appellant's argument about the endless world of iterations. I consider that sections 799 and 801 can be read together in the manner set out in my summary of conclusions. I have accepted Mr Goldberg's argument that "in the application" of section 799(1) at the start of sections 801(4A) and (4B) require the taxpayer to perform the exercise required by the relevant part of section 799, subject of course to the modifications which follow from section 801(1) and (2), which extend the field of operation of section 799(1).

70. Once the hypotheses are recognised it is clear that many of the textual points extracted out of other parts of the legislation are simply irrelevant and unhelpful. Thus, for example, section 790(1) refers only to tax "chargeable" which in the context must mean tax capable of being levied, and not "paid" or "payable". The same word is used in the definitions of "foreign tax" and "underlying tax" in section 792. Section 790(6) refers to tax "paid" but in the context of dividends paid by overseas subsidiaries not UK subsidiaries. Section 799(1) refers to "tax borne" but section 799(1) operates in the context of dividends paid by UK subsidiaries of overseas intermediate holding companies in the way set out in section 801 and so is in that context subject to contrary provision in section 801. In section 801(2), the expression "underlying tax payable" is modified by the tailpiece, which makes underlying tax payable by a dividend-paying UK subsidiary to the extent, i.e. the full extent, that DTR on underlying tax would have been available on a dividend paid by an overseas subsidiary. Put another way the expression "underlying tax payable" is in this context explicated by the tailpiece ("to the extent that" etc). The tax sparing provisions demonstrate that tax need not always actually be paid to be given DTR. Section 801(4A) applies section 799(1) but that is modified by section 801(2) and section 801(4B) is dealing with the Case V dividend so section 799(1) applies without any modification. Section 801(4B) itself does not refer to tax paid or payable.

"the disappearing dividend" argument

71. The Scheme fails in my judgment because of the disappearing dividend argument. A & G paid a lawful dividend but the recipient used most of it to write down its investment in A & G, which is perhaps unsurprising. Only a comparatively minor balance remained which may when the calculations are done be a higher level dividend.

72. There were a number of other arguments which I must address. The first is about whether the dividend from POAL to the appellant was incapable of being a higher level dividend because POAL did not use profits derived from A & G. The FTT accepted this argument when it held 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 [Scheme] was even mooted.) (Decision, [57]).

73. The UT accepted (as I infer from the second sentence quoted) that the FTT had made a finding in this paragraph that the POAL/appellant dividends were not higher level dividends in relation to the A & G dividend but expressed doubts as to whether it was a finding of fact, as did Mr Goldberg. In my judgment, the findings in the passage cited, so far as controversial on this appeal, were the findings of law. I therefore reject the argument which Mr Goldberg advanced about Mr Walker's evidence. It matters not on this appeal what Mr Walker conceded in his evidence to the FTT.

74. The FTT proceeded on the basis that the proper approach to the question whether there was a higher level dividend was to follow the sequence in which they were paid as if it were a tracing exercise. But there is also the question whether they were paid out of distributable profits and if so whether it mattered that the monies had been used for some other purpose. In my judgment the issue was not the use of cash, but of distributable profits, and the fact that the cash was used for some purpose is not relevant.

75. Therefore in relation to the POAL dividend the question is whether there were distributable profits representing at least to some extent the dividend paid by A & G. I will deal first with the First Dividend. In my judgment, at the time POAL paid the First Dividend to the appellant it had not received any dividend from A & G and no part of that dividend could therefore "represent" the dividend from A & G for this purpose of paragraph (a) of the definition of higher level dividend in section 806B(10). There was no finding that POAL could include the amount of that dividend in its distributable profits at the date of the First Dividend. (Mr Peacock suggested that this problem for POAL was resolved in its favour by section 799(3) as the First Dividend was covered by the profits for the year ended after the date of payment, but that does not add to the undefined concept of representation in the definition of higher level dividend but deals only with proof of distributable profits: see generally section 790(3) to (6)). By the time of the Second Dividend all but A$820,000 had been applied in writing down the cost of the investment in A & G and so only that sum could represent profits of Liena (subject to scaling down for any other distributable profits that it had). Subject to the effect, if any, of section 803A, only the portion of that sum used to pay a dividend to the appellant (A$811,800) therefore could represent a higher level dividend in relation to the A & G dividend.

76. I pay tribute to the concision of reasoning in the decisions of the Tribunals. I have disagreed with the reasoning of the UT on the "tax borne" argument because as I see it they failed to give full weight to the statutory hypotheses.

OVERALL CONCLUSION

77. For the reasons given, I would dismiss this appeal save in so far as necessary to ensure the appellant has appropriate relief in relation to the amount of the dividend of A$811,800 paid by Liena to POAL.

Lord Justice Jackson

78. I agree.

Lord Justice Kitchin

79. I also agree.

Annex

EXTRACTS FROM ICTA 1988, PART XVIII

Section 788 Relief by agreement with other territories

(5) For the purposes of this section and, subject to section 795(3), Chapter II of this Part in its application to relief under this section, any amount of tax which would have been payable under the law of territory outside the United Kingdom but for a relief to which this subsection applies given under the law of that territory shall be treated as having been payable; and references in this section and that Chapter to double taxation, to tax payable or chargeable, or to tax not chargeable directly or by deduction shall be construed accordingly.

This subsection applies-

(a) to any relief given with a view to promoting industrial, commercial, scientific, educational or other development in a territory outside the United Kingdom, being a relief with respect to which provision is made in the arrangements in question for double taxation relief;…

Relief does not fall to be given in accordance with section 801 by virtute of this subsection unless the arrangements in question make express provision for such relief (but this paragraph is without prejudice to section 790(10B)).

(10A) In any case where-

(a) under the law of the territory outside the United Kingdom, an amount of tax ("the spared tax") would, but for a relief, have been payable by a company resident in that territory ("company A") in respect of any of its profits,

(b) company A pays a dividend out of those profits to another company resident in that territory ("company B"),

(c) company B, out of profits which consist of or include the whole or part of that dividend, pays a dividend to a company resident in the United Kingdom ("company C"), and

(d) the circumstances are such that, had company B been resident in the United Kingdom, it would have been entitled, under arrangements made in relation to the territory outside the United Kingdom and having effect by virtue of section 788, to a relief to which subsection (5) of that section applies in respect of the spared tax,

subsection (10B) below shall apply.

(10B) In any case falling within subsection (10A) above, the spared tax shall be taken into account for the purpose of-

(a) the other provisions of this section, and

(b) subject to section 795(3), Chapter II of this Part in its application to relief under this section in relation to the dividend paid to company C,

as if it had been payable and paid; and references in this section and that Chapter to double taxation, to tax payable or chargeable, or to tax not chargeable directly or by deduction shall be construed accordingly…

Section 790 Unilateral relief

(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.

…

(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 (profits from, or remuneration for, personal or professional services performed in that territory being deemed for this purpose to be income arising in that territory).

…

(6) Where a dividend paid by a company resident in the territory is paid to a company falling within subsection (6A) below[1] 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. …

Section 792 Interpretation of credit code

(1) In this Chapter, except where the context otherwise requires—

[1] e.g. a company resident in the UK.

"foreign tax" means, in relation to any territory, arrangements in relation to which have effect by virtue of section 788, any tax chargeable under the laws of that territory for which credit may be allowed under the arrangements (other than special withholding tax within the meaning of Chapter 7 of Part 3 of the Finance Act 2004.

… "underlying tax" means, in relation to any dividend, tax which is not chargeable in respect of that dividend directly or by deduction ...

Section 795 Computation of income subject to foreign tax

…

(2) Where credit for foreign tax falls under any arrangements to be allowed in respect of any income or gain and subsection (1) above does not apply, then, in computing the amount of the income or gain for the purposes of income tax or corporation tax--

(a) no deduction shall be made for foreign tax or special withholding tax, whether in respect of the same or any other income or gain; and

(b) the amount of the income shall, in the case of a dividend, be treated as increased by—

(i) any underlying tax which, under the arrangements, is to be taken into account in considering whether any and if so what credit is to be allowed in respect of the dividend, and

(ii) any underlying tax which, by virtue of section 799(1)(b) or section 799(1B)(b), does not fall to be so taken into account.

…

(3A) The amount of any income or gain shall not be increased under subsection (2)(b)(i) above by so much of any underlying tax—

(a) as represents an increase under section 801(4B); or

(b) as represents relievable underlying tax (within the meaning of sections 806A to 806J) arising in respect of another dividend and treated as underlying tax under those sections.

…

Section 797 Limits on credit: corporation tax

(1) The amount of the credit for foreign tax which under any arrangements is to be allowed against corporation tax in respect of any income or chargeable gain ("the relevant income or gain") shall not exceed the corporation tax attributable to the relevant income or gain, determined in accordance with the following provisions of this section.

…

Section 799 Computation of underlying tax

(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.

(1B) Where, under any arrangements, a company makes a claim for an allowance by way of credit in accordance with this Chapter—

(a) the claim may be so framed as to exclude such amounts of underlying tax as may be specified for the purpose in the claim; and

(b) any amounts of underlying tax so excluded shall be left out of account for the purposes of this section.

(2) Where under the foreign tax law the dividend has been increased for tax purposes by an amount to be set off against the recipient's own tax under that law or, to the extent that it exceeds his own tax thereunder, paid to him, then, from the amount of the underlying tax to be taken into account under subsection (1) above there is to be subtracted the amount of that increase.

(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) ...

(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 the 1970 Act) 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 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.

Section 801 Dividends between related companies: relief for UK and third country taxes

(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 subsections (4) to (4D) 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; or

(b) in such other cases as may be prescribed by regulations made by the Treasury.

(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.

(4) Subsections (2) and (3) above are subject to the following limitations—

(a) no tax shall be taken into account in respect of a dividend paid by a company resident in the United Kingdom except United Kingdom corporation tax and any tax for which that company is entitled to credit under this Part; and

(b) no tax shall be taken into account in respect of a dividend paid by a company resident outside the United Kingdom to another such company unless it could have been taken into account under the other provisions of this Part had the other company been resident in the United Kingdom.

(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).

(4D) Subsections (4A) to (4C) above shall be ignored in determining for the purposes of subsection (2) or (3) above the extent to which any underlying tax paid by a company would be taken into account under this Part if the dividend in question had been paid by a company resident outside the United Kingdom to a company resident in the United Kingdom.

(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.

Section 803A Foreign taxtaion of group as single entity

(1) This section applies in any case where, under the law of a territory outside the United Kingdom, tax is payable by any one company resident in that territory ("the responsible company") in respect of the aggregate profits, or aggregate profits and aggregate gains, of that company and one or more other companies so resident, taken together as a single taxable entity.

(2) Where this section applies, this Part shall have effect, so far as relating to the determination of underlying tax in relation to any dividend paid by any of the companies mentioned in subsection (1) above (the "non-resident companies") to another company ("the recipient company"), as if—

(a) the non-resident companies, taken together, were a single company,

(b) anything done by or in relation to any of the non-resident companies (including the payment of the dividend) were done by or in relation to that single company, and

(c) that single company were related to the recipient company, if that one of the non-resident companies which actually pays the dividend is related to the recipient company,

(so that, in particular, the relevant profits for the purposes of section 799(1) is a single aggregate figure in respect of that single company and the foreign tax paid by the responsible company is foreign tax paid by that single company).

(3) 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.

Section 806B The amounts which are eligible unrelieved foreign tax

…

(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.

…

(10) In this section—

…

"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;

…

Section 806J Interpretation of foreign dividend provisions of this Chapter

(1) This section has effect for the interpretation of the foreign dividend provisions of this Chapter.

(2) In this section, "the foreign dividend provisions of this Chapter" means sections 806A to 806H and this section.

(3) 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.

(4) Where—

(a) one company is related to another, and

(b) that other is related to a third company,

the first company shall be taken for the purposes of paragraph (b) of subsection (3) above to be related to the third, and so on where there is a chain of companies, each of which is related to the next.