HIGH COURT OF JUSTICE (CHANCERY DIVISION)—21ST AND 22ND OCTOBER, 1954

COURT OF APPEAL—17TH AND 18TH FEBRUARY, 1955

HOUSE OF LORDS—27TH FEBRUARY AND 26TH MARCH, 1956

Gahan (H.M. Inspector of Taxes)

v.

Chloride Batteries, Ltd.[1]

Income Tax, Schedule D—Profits of trade—Deduction—Sums paid by subsidiary to principal company "by way of reimbursement of profits tax"—Finance Act, 1937 (1 *Edw.* VIII & 1 *Geo.* VI, *c.* 54), *Sections* 22 *and* 25; *Finance Act,* 1947 (10 & 11 *Geo.* VI, *c.* 35), *Section* 38 (3).

The Respondent Company was a wholly-owned subsidiary of a principal company which, in pursuance of a notice under Section 22 (1) *of the Finance Act,* 1937, *paid Profits Tax amounting to* £209,437 *in respect of its own and the Respondent Company's profits for the chargeable accounting period ended* 31*st December,* 1950. *If notice under Section* 22 *had not been given, the Profits Tax payable by the principal company would have been* £131,742, *and the Profits Tax payable by the Respondent Company would have been* £191,420.

This last amount was paid by the Respondent Company to the principal company, purporting to be by way of reimbursement of Profits Tax which by virtue of the notice having been given was payable by that company. The companies then jointly made an election under Section 38 (3), *Finance Act,* 1947, *and the Respondent Company claimed that, by virtue of this election, the full amount paid* (£191,420) *by it to the principal company should be treated, for Income Tax purposes, as Profits Tax payable in respect of the profits of the Respondent Company.*

Assessments to Income Tax under Case I *of Schedule D were made on the Respondent Company on the basis that only* £77,695 (*the difference between* £209,437 *and* £131,742) *could be regarded as "by way of reimbursement of profits tax which by virtue of the notice having been given is payable by" the principal company within the meaning of Section* 38 (3), *Finance Act,* 1947, *and, accordingly, only that amount was allowable as a deduction in computing the Respondent Company's profits for Income Tax purposes. The Respondent Company's appeals against these assessments were upheld by the Special Commissioners and the Crown demanded a Case.*

Held, *that the amount of Profits Tax payable by the principal company by virtue of the notice was the additional liability imposed by the notice.*

[1] Reported (C.A.) [1955] 1 W.L.R. 277; 99 S.J. 203; [1955] 1 All E.R. 633; 219 L.T.Jo. 143; (H.L.) [1956] 1 W.L.R. 391; 100 S.J. 282; [1956] 1 All E.R. 828; 221 L.T.Jo. 190.

CASE

Stated under the Income Tax Act, 1952, Section 64, by the Commissioners for the Special Purposes of the Income Tax Acts for the opinion of the Chancery Division of the High Court of Justice.

At a meeting of the Commissioners for the Special Purposes of the Income Tax Acts held on 23rd June, 1953, Chloride Batteries, Ltd. (hereinafter called " the Respondent "), appealed against assessments to Income Tax made upon it under Case I of Schedule D, Income Tax Act, 1918, as under :—

Year	Amount of assessment
1949–50	£175,000 less £12,000 capital allowances
1950–51	£1,050,000 less £50,000 capital allowances
1951–52	£700.000 less £19,000 capital allowances

on the grounds that in computing the profits and gains of the Respondent for the purposes of the said assessments a deduction of £191,420 was allowable in respect of a like amount paid by the Respondent to Chloride Electrical Storage Co., Ltd. (hereinafter called " the principal company "), such amount purporting to be paid by way of reimbursement of Profits Tax within the meaning of Section 38 (3) of the Finance Act, 1947.

2. At the hearing of the appeal we found the following facts admitted and agreed between the parties.

(i) The Respondent commenced business on 1st January, 1950, as a manufacturer of storage batteries.

(ii) Throughout the period relevant to this appeal the Respondent was a wholly-owned subsidiary of the principal company.

(iii) The Respondent made up its first accounts for the calendar year to 31st December, 1950, which thus constituted or included the basis periods for the years of assessment under appeal. The assessable profits for that year amounted to the sum of £832,023, subject to adjustment in respect of a payment made to the principal company as hereinafter appeareth.

(iv) The principal company gave notice in writing to the Commissioners of Inland Revenue within the period prescribed by the Finance Act, 1937, Section 22 (1), requiring that the provisions of Sub-section (2) of the said Section 22 should apply to the Respondent. In consequence, Profits Tax became payable by the principal company in respect of its own and the Respondent's profits and was assessed at £209,437. 12*s*., which sum was duly paid by the principal company. The amount which the principal company would have had to pay by way of Profits Tax had the aforesaid notice not been given would have been £131,742 8*s*. It was admitted by H.M. Inspector that the difference between the said two sums, viz. £77,695 4*s*., fell to be treated as an amount paid by way of reimbursement of Profits Tax within the meaning of the Finance Act, 1947, Section 38 (3) (*b*), and was accordingly deductible in computing the profits and gains of the Respondent for the purposes of the said assessment.

(v) The Respondent paid to the principal company the sum of £191,420, which purported to be, within the meaning of the Finance Act, 1947, Section 38 (3) (*b*), an amount by way of reimbursement of Profits Tax which by virtue of the notice having been given as aforesaid was payable by the principal company. £191.420 was calculated by the Respondent to be the amount which the Respondent would have

had to pay by way of Profits Tax had notice not been given by the principal company under the provisions of the Finance Act, 1937, Section 22 (1).

(vi) The principal company and the Respondent jointly elected by notice in writing to the Commissioners of Inland Revenue within the period prescribed by the Finance Act, 1947, Section 38 (3) (*c*), that the amount of £191,420 so paid by the Respondent to the principal company should for all the purposes of the Income Tax Acts be treated as provided for in the Finance Act, 1947, Section 38 (3), paragraphs (i) and (ii), i.e., as regards the Respondent as an amount of Profits Tax payable in respect of the profits arising in the chargeable accounting period of twelve months to 31st December, 1950.

3. It was contended on behalf of the Respondent

(i) that the amount of Profits Tax which, by virtue of the notice under the provisions of Section 22 of the Finance Act, 1937, having been given to the Commissioners of Inland Revenue, was payable by the principal company, was £209,437 12*s.*;

(ii) that the whole of the aforementioned sum of £191,420 paid by the Respondent to the principal company was, within the meaning of the Finance Act, 1947, Section 38 (3) (*b*), an amount paid by way of reimbursement of Profits Tax which, by virtue of the notice hereinbefore referred to given by the principal company, was payable by the principal company; and that in consequence the whole of the said sum of £191,420 was by virtue of Section 25 of the Finance Act, 1937, properly allowable as a deduction in computing the profits and gains of the Respondent for the purpose of assessment to Income Tax under Case I of Schedule D, Income Tax Act, 1918;

(iii) that the appeal should be allowed.

4. It was contended on behalf of the Appellant

(i) that the sum which fell to be treated as paid by the Respondent to the principal company within the meaning of the Finance Act, 1947, Section 38 (3) (*b*), as an amount paid by way of reimbursement of Profits Tax, was limited to the said sum of £77,695 4*s.*;

(ii) that, in consequence, the said sum of £77,695 4*s.* and no more was properly allowable as a deduction in computing the profits and gains of the Respondent under Case I of Schedule D, Income Tax Act, 1918, for Income Tax purposes;

(iii) that the assessments should acordingly be adjusted as follows:—

1949–50 increased to £188,582 less capital allowances £12,218.
1950–51 reduced to £754,328 less capital allowances £39,917.
1951–52 increased to £754,328 less capital allowances £19,173.

5. We, the Commissioners who heard the appeal, gave our decision in the following terms:—

This is an appeal by Chloride Batteries, Ltd., hereinafter referred to as "the Appellant", against assessments to Income Tax as follows:—

1949–50 £175,000 less £12,000 capital allowances.
1950–51 £1,050,000 less £50,000 capital allowances.
1951–52 £700,000 less £19,000 capital allowances.

It is agreed that these assessments are estimates and that the sole point for our determination is whether the sum of £191,420 paid by the

Appellant to Chloride Electrical Storage Co., Ltd., hereinafter referred to as "the principal company", in the circumstances hereinafter referred to, is a proper deduction in computing the profits of the Appellant under Case I of Schedule D for the years of assessment in question, or whether the said amount should be restricted to a sum of £77,695.

(2) There is no dispute as to the facts of this case. The Appellant is a wholly-owned subsidiary company of the principal company. It commenced business on 1st January, 1950, and made up its first accounts to 31st December, 1950. The principal company gave notice under the provisions of the Finance Act, 1937, Section 22 (1), to the Commissioners of Inland Revenue and accordingly the profits of the Appellant fall to be treated for Profits Tax purposes as if they were profits arising in the corresponding chargeable accounting period of the trade or business carried on by the principal company. On this basis the principal company paid Profits Tax amounting to £209,437 on the group profits. Subsequently the Appellant paid to the principal company the aforementioned sum of £191,420, and the principal company and the Appellant jointly elected by notice in writing to the Commissioners of Inland Revenue within the prescribed time limit under the provisions of the Finance Act, 1947, Section 38 (3) (*c*), to have the amount so paid by the Appellant to the principal company treated for all the purposes of the Income Tax Acts in the manner provided in paragraphs (i) and (ii) of the said Section 38 (3), i.e., as regards the Appellant, as

> "an amount of profits tax payable in respect of its profits arising in the chargeable accounting period . . . corresponding to the chargeable accounting period to which the payment relates",

namely, the year to 31st December, 1950, and in consequence an allowable deduction in computing the profits of the Appellant for Income Tax purposes under Case I of Schedule D. The said sum of £191,420 was in fact equal to the amount which the Appellant would have had to pay by way of Profits Tax if the principal company had not served notice on the Commissioners of Inland Revenue under the Finance Act, 1937, Section 22 (1).

(3) It is contended for the Appellant that the said sum of £191,420 so paid to the principal company was an amount by way of reimbursement within the meaning of the Finance Act, 1947, Section 38 (3) (*b*). It is said that the expression

> "profits tax which by virtue of the notice having been given is payable"

in the said Section 38 (3) (*b*) means the Profits Tax payable by the principal company in respect of its own and the Appellant Company's profits which fall to be assessed together by reason of the notice given under the Finance Act, 1937, Section 22 (1); that it is irrelevant to consider what the Profits Tax payable by each company would have been had notice not been given by the principal company under the said Section 22 (1); and that the only limitation on the amount which must be regarded as paid by way of reimbursement by the Appellant to the principal company within the meaning of the said Section 38 (3) (*b*) is that implied by the use of the word "reimbursement" itself, so that no more than the actual amount disbursed can be reimbursed.

(4) For the Crown it is admitted that some part of the aforementioned sum of £191,420 falls to be treated as a reimbursement within the meaning of the Finance Act, 1947, Section 38 (3) (*b*), but it is contended that the part of the said sum which must be so regarded is limited to £77,695, being the difference between the Profits Tax actually paid by the principal company and the amount which would have been payable by the principal company had notice not been given under the Finance Act, 1937, Section 22 (1). It is said that the omission of the definite article before the words "profits tax" in the said Section 38 (3) (*b*) points to a distinction between the Profits Tax which would have been payable by the principal company in respect of its own profits and Profits Tax payable by the principal company in respect of both its own and its subsidiary's profits by virtue of the notice having been given under the said Section 22 (1); that to ignore this distinction is to deprive the adjectival phrase "which by virtue of the notice having been given is payable" of any meaning; and that the said Section 38 (3) (*b*) must therefore be read as if the word "additional" were inserted before the words "profits tax".

(5) In our view the provisions of a taxing Statute must be strictly construed, and if the particular provisions with which we have to deal are capable of interpretation and application in the form in which they were passed by the Legislature it is not permissible to insert or delete words or phrases in order to achieve a different interpretation. In our opinion the said Section 38 (3) (*b*) is capable of bearing, and does bear, the interpretation contended for by the Appellant and which presents no difficulty in application.

The appeal therefore succeeds and in accordance with figures previously agreed between the parties we adjust the assessments as follows:—

1949–50 £160,151 less capital allowances £12,218
1950–51 £640,603 less capital allowances £39,917
1951–52 £640,603 less capital allowances £19,173.

6. Immediately after the communication to the Appellant of our determination of the appeal, dissatisfaction therewith as being erroneous in point of law was expressed to us on his behalf and in due course we were required to state a Case for the opinion of the High Court in pursuance of the Income Tax Act, 1952, Section 64, which Case we have stated and do sign accordingly.

7. The point of law for the opinion of the High Court is whether, on the facts found by us and set forth in paragraph 2 hereof, our determination of the appeal as stated in paragraph 5 above was correct in law.

Norman F. Rowe, } Commissioners for the Special Purposes
W. E. Bradley, } of the Income Tax Acts.

Turnstile House,
94-99, High Holborn,
London, W.C.1,
5th January, 1954.

The case came before Upjohn, J., in the Chancery Division on 21st and 22nd October, 1954, when judgment was given against the Crown, with costs.

Mr. J. Millard Tucker, Q.C., Mr. J. H. Stamp and Sir Reginald Hills appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. H. Major Allen for the Company.

Upjohn, J.—The Respondent in this case, Chloride Batteries, Ltd., is and was at all material times a wholly-owned subsidiary of the Chloride Electrical Storage Co., Ltd., which I will call " the principal company ".

The principal company, exercising the right given to it by Section 22 of the Finance Act, 1937, gave a notice to the Commissioners of Inland Revenue requiring that the provisions of Sub-section (2) of that Section should apply. The result of giving that notice is clear and not in dispute, namely, that for the purpose of the Profits Tax, as it is now called, the profits of the subsidiary company have to be treated for the purposes of the Act as the profits of the principal company. Therefore, the Respondent having made substantial profits during the years in question, those profits are treated as the profits of the principal company and not of the Respondent for the purposes of Profits Tax.

The whole question I have to determine arises upon the true construction of Section 38 (3) of the Finance Act, 1947, which makes provision for the case where a subsidiary company reimburses the principal company for the Profits Tax payable and paid by the principal company where a notice under Section 22 is in force. The Sub-section is in these terms:

> " Where—(*a*) such a notice as aforesaid is in force ; "

—that is, a notice under Section 22—now comes an important sub-paragraph,

> " and (*b*) the subsidiary to which the notice relates pays to the principal company an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable by that company for any chargeable accounting period ending after the thirty-first day of December, nineteen hundred and forty-six ; and (*c*) the principal company and the subsidiary jointly so elect by notice in writing given to the Commissioners of Inland Revenue within six months from the end of that chargeable accounting period or such longer time as those Commissioners may in any case allow, the amount so paid, and any amount so paid in relation to a subsequent chargeable accounting period, by the subsidiary to the principal company shall for all the purposes of the Income Tax Acts be treated—(i) as regards the subsidiary, as an amount of profits tax payable in respect of its profits arising in the chargeable accounting period of the subsidiary corresponding to the chargeable accounting period to which the payment relates ; and (ii) as regards the principal company, as reducing the amount of the profits tax payable by the principal company for the chargeable accounting period to which the payment relates."

The position before that Act was this. Under Section 25 of the 1937 Act, the amount of Profits Tax is a deduction for the purposes of computing Income Tax. So, where the principal company has given a notice and has paid the Profits Tax on the profits of a subsidiary company, it may deduct the tax so paid for the purposes of its Income Tax. If the subsidiary company subsequently reimbursed any part of the tax so paid, that was a domestic matter between the principal and the subsidiary company which gave no rise to any claim by the subsidiary company to be allowed to bring in the amount so paid by it to the principal company as a deduction for Income Tax purposes.

(Upjohn, J.)

Section 38 altered all that. When Parliament enacted the 1947 Act, bearing in mind that the distributive profits tax was introduced for the first time—and that was at a high rate—it no doubt seemed right and proper that, where the subsidiary company did in fact reimburse part of the Profits Tax paid by the principal company, it should be allowed to bring that amount so paid by it into its accounts, and that it should be allowed as a deduction for Income Tax purposes the amount so paid. Of course, in that event, a corresponding deduction in the amount brought in by the principal company as a deduction for Income Tax would also have to be made. That was the broad scheme of the Section which I have read.

The difficulty which arises in this case is as follows. Notice under Section 22 having been given, Profits Tax was assessed upon the principal company at £209,000. If no notice had been given, the profits of the subsidiary Company, the Respondent, would not have been added to the principal company's profits, and, in that event, the Profits Tax for the relevant period of the principal company would have been £132,000. The difference, therefore, between the sum that it had to pay and the sum that it would have had to pay if no notice had been given was £77,000. Again, if no notice had been given and the subsidiary Company, the Respondent, had been assessed, as it would have been, to Profits Tax, the amount it would have had to pay was £191,000. I am informed that the difference is due to this. If the Respondent had been separately assessed, it would have had to pay at a much higher rate because it distributed part of its profits to the principal company. That accounts for the fact that, had no notice been given, the principal company and the Respondent between them would have had to pay a much larger sum by way of Profits Tax for the relevant period. The contention of the Crown is that the maximum that the Respondent may be allowed to bring into account for the purposes of its Income Tax is the sum of £77,000 which I have already mentioned.

The contention of the Respondent is that it could, so far as it is a matter of construction of the Act, if it cared to, pay or reimburse to the principal company the whole of the tax which it has paid, that is to say, £209,000. It does not in fact claim to be allowed to make that payment and bring it into its accounts for the purposes of Income Tax. It only seeks to be allowed to bring in the amount which it would have had to pay if no notice had been given, and that is £191,000; for it submits on perfectly general principles—having nothing whatever to do with Income Tax liability —that that is the maximum amount which it appeared to the directors of the subsidiary Company they ought to pay in all the circumstances of the case to the principal company. The question is: Which of those two contentions is right?

It depends on a very few words in Section 38 (3) (*b*). The Crown submits that the amount to be allowed is "an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable", which is to be arrived at in this way: You deduct the amount you would have had to pay from the amount which you did pay, and so you arrive at the maximum sum of £77,000. It is said that the sum paid by virtue of the notice is not the whole sum which you have to pay, because part of that sum is paid out of the profits of the principal company and is paid not by virtue of the notice but by virtue of the liability under Section 19 of the 1937 Act, that being the charging Section to Profits Tax. Therefore, it is only correct to say that it is the balance that is payable by virtue of the notice. The Crown points out that, if the argument of the subject be right, then no meaning is being given to

the words " which by virtue of the notice having been given is payable ", and they could be struck out without affecting the meaning of the Section. Secondly, it is submitted by the Crown that, even if the meaning of the Section literally be that submitted by the Respondent, then the context demands that it should be read in the way contended for by the Crown, otherwise it is suggested that many anomalies will arise. For instance, it is said that, if the contention of the subject is right, a subsidiary company which has made a loss could pay the whole of the Profits Tax payable by the principal. It is said that would be absurd, because, if that payment were made by the subsidiary company, it could not bring any part of it into account for the purposes of Income Tax for the simple reason that it had no profits. That is perfectly true. On the other hand, one can think of a case where a company might be a subsidiary company having much cash and might find it worth while in certain circumstances to make the payment, although it could not turn that payment to any fiscal advantage to itself.

The contention of the subject is that it is not necessary to give effect to every word in a Section, and that there can be only one answer given to the question, what is the amount of Profits Tax payable by virtue of the notice, and that is the whole tax, because it is submitted that the giving of a notice under Section 22 does not have the effect of creating two taxes which the company has to pay. The effect of that notice is merely to add to the profits of the principal company the profits made by the subsidiary company, and upon that total one tax is payable and that is the tax payable by virtue of the notice which has been given. It is said that is the literal meaning of the Section, and that is the meaning that it ought to bear.

The point, as I have said, is a very short one. The Commissioners, in a careful judgment, came to the conclusion that the contention of the Respondent was correct. I agree with them. I think there can be only one answer to this question. The Profits Tax payable by virtue of the notice having been given is the whole Profits Tax. I do not think the Section is concerned with limiting in any way the amount of tax which any subsidiary company may be reimbursing its principal. Of course, in the aggregate, there cannot be any reimbursement by subsidiary companies which exceeds the total amount of tax payable by the principal company. Subject to that, I do not think the Crown can spell out of this Section, as a matter of construction, any limitation upon the amount which any subsidiary company may reimburse the principal company. That question has to be determined not by reference to Income Tax law but by reference to the general law. The directors of subsidiary companies will have to consider many things no doubt before they come to the conclusion as to what is the right and proper reimbursement in any given year to make to the principal company. When they have come to a conclusion as a result of exercising their functions as directors, that amount is to be allowed for the purposes of the Income Tax Act.

I agree with the Commissioners in thinking that the Crown's contention really comes to this, that the Section ought to read as though there was a reference to the additional tax which the principal company has to pay by virtue of giving the notice. If those words had been in, it would have been very different, but that is what the Crown is seeking to say—that it is only the additional tax which the principal company has to pay which may be reimbursed by the subsidiary. Well, those words are not there.

The appeal must be dismissed with costs.

The Crown having appealed against the above decision, the case came before the Court of Appeal (Sir Raymond Evershed, M.R., and Jenkins and Morris, L.JJ.) on 17th and 18th February, 1955, when judgment was given unanimously in favour of the Crown, with costs.

Mr. J. Millard Tucker, Q.C., Mr. J. H. Stamp and Sir Reginald Hills appeared as Counsel for the Crown, and Mr. F. Heyworth Talbot, Q.C., and Mr. H. Major Allen for the Company.

Sir Raymond Evershed, M.R.—As Upjohn, J., observed, the question in this appeal is in very truth a short one. It turns upon the meaning of parts of two Sections relating to Profits Tax, although as will later appear the actual question between Crown and taxpayer relates to Income Tax. The two Sections are Section 22 of the Finance Act, 1937, which imposed, *sub nomine* the National Defence Contribution, what is now called Profits Tax, and Section 38 of the Finance Act, 1947, which in many substantial (but for the purposes of this case not material) respects amended the Act originally passed.

The brief effect, so far as relevant, of these two Sections (and I shall later have to refer more particularly to their language) is this. They related to the case of what are called in the Acts principal and subsidiary companies. It is a well-known feature of trading companies that you may have, and frequently do have, companies controlled, sometimes wholly controlled, by what is more generally, I think, called a parent company. It is to that kind of case that the phrase " principal and subsidiary companies " relates, and I need not take time by referring to those parts of the Section which define what constitutes principal or subsidiary companies as the case may be; for in this case it is not in dispute that the Respondent, the taxpayer company, Chloride Batteries, Ltd., is a subsidiary company within the meaning of those Sections, the principal or parent company relevant for consideration being another company called the Chloride Electrical Storage Co., Ltd.

The broad purpose of the two Sections which I have mentioned was first to enable a principal company, if it so chose, to serve a notice (and, as has been observed, once served its effect continued indefinitely and it was not apparently capable of being recalled) upon the Commissioners of Inland Revenue assuming to itself all the Profits Tax which might be properly leviable both upon itself and upon its subsidiary. Thereupon, so far as the Commissioners of Inland Revenue are concerned, they look exclusively to the principal or parent company, and for the purposes of assessment the profits from the trade or business of the subsidiary are treated as part of the profits of the trade or business of the principal; and, similarly, if the subsidiary suffered a trading loss the loss would be taken into account in computing the principal company's liability.

But the effect was not limited to such an assumption by the principal company of the Profits Tax liability for itself and the subsidiary. For by the second Section which I have mentioned, Section 38 of the Finance Act, 1947, it was possible for the subsidiary then to make a payment " by way of reimbursement " to the principal company, and if it did so and the principal and the subsidiary jointly elected and communicated that election in writing to the Commissioners, then for Income Tax purposes there was a consequential adjustment of the respective liabilities of principal and subsidiary; for at that time (though I think it is not so now) Profits

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Tax paid by a company was a legitimate deduction for Income Tax purposes.

The present case has arisen because all those options, so to speak, have in this case been exercised. Here the Chloride Electrical Storage Co., Ltd., sent the requisite notice under the 1937 Act, and thereby assumed to itself exclusively the Profits Tax liability both in respect of its own and in respect of the subsidiary's, the Respondent Company's, businesses. The Respondent Company then paid a sum, or a series of sums (for there is more than one accountable year in question), to its principal company, and as a consequence the question is now before the Court of the resultant deduction which the subsidiary claims to make for Income Tax purposes by virtue of having made those payments.

It so happens that if the contentions of the Respondent Company are right they can in the circumstances of the case get a very considerable advantage by way of Income Tax relief, and that circumstance arises mainly from the fact that the subsidiary company, the Respondent here, began its business on 1st January, 1950, and beyond question, for Income Tax purposes, deductions of this kind or of other corresponding kinds serve a very useful purpose extending over more than two years during the infancy of such a company.

The fact that if the Respondent Company is right it will financially be able to benefit very considerably is plainly irrelevant for the purposes in view. I will, however, state as respects one year, for that will suffice for present purposes, what the figures are, since reference to them will, I think, serve to illustrate the points as my judgment proceeds. For the year of which I speak, which was the first year of the taxpayer company's life, the total amount of Profits Tax which became leviable in respect of the joint enterprises of principal and subsidiary was the not inconsiderable sum of £209,000. The Profits Tax which the principal company would have been liable to pay, had there not been what Mr. Heyworth Talbot called this amalgamation of profits for tax purposes, would have been £132,000, £77,000 less than the first total I mentioned. But there is this complication which has to be stated to make what follows clear. If there had been no notice served and if the subsidiary company, the present Respondent Company, had been left accordingly to pay its own Profits Tax in respect of its own trading profits, it would have paid a good deal more than £77,000 because it would have had to pay at a much higher rate. Why that was so I need not pause to explain, but the difference depends upon the fact that under the scheme of the Profits Tax there are variations in rate. The tax was then particularly designed to discourage distribution, but when there was an amalgamation and a distribution by a subsidiary to a principal it did not, so to speak, count as a distribution. The figure—and this is the important matter—which the subsidiary company would have paid, if left, as I say, to its own devices, would have been £191,000, much more than £77,000.

What the Company here alleges is that the option given by the joint effect of these Sections to the subsidiary, or the subsidiary and the principal working in collaboration, is for the subsidiary to reimburse the entire sum of Profits Tax which the principal, in the events which have happened, has been called upon to pay, to wit, £209,000, and then you can bring that sum into its, the subsidiary's, accounts as an Income Tax deduction.

On the other side the Crown say: No; upon a proper interpretation of the relevant parts of the Sections all that the subsidiary can pay over by way of reimbursement, the most they can so pay, is the amount of additional tax

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which fell upon the shoulders of the principal company when and because it had assumed this liability, namely, £77,000. It is the fact that the sum which the subsidiary Company paid over and claims to bring into its Income Tax account was not £209,000 but £191,000. The reason for that figure being paid, as I understand it, is that those responsible thought that the fairest sum as between parent and subsidiary and the commercially correct figure to pay over was a figure which represented what the subsidiary's liability would have been in respect of Profits Tax had it not been for the notice served by the parent company. But the fact that they paid £191,000 and not £209,000 is for the purposes of argument irrelevant, and must not be allowed to affect it. Put another way, there is no case for saying that, if there be a limit upon what the subsidiary can reimburse, the limit is represented, not by the added obligation imposed upon the principal, but by the obligation from which the subsidiary was saved. Those are the essential facts in the case.

I must now refer to the terms of the two Sections so far as they are relevant. Let me say that I gladly omit from my reading parts of those Sections which were used quite properly to illustrate the argument but which reflect the more complicated provisions of Profits Tax, namely, those parts concerning differential rates; because on the view I take I do not think they really bear upon the question we have to decide. As Upjohn, J., said, and as I have already observed, the point is—and it remains—a short one. Section 22 (1) of the 1937 Act provides that a principal company, as there defined, may by notice in writing given to the Commissioners of Inland Revenue, before a certain date related to any chargeable accounting period of the subsidiary

> "require that the provisions of subsection (2) . . . shall apply to the subsidiary as respects that period and all subsequent chargeable accounting periods throughout which it"

—that is, the subsidiary—

> "continues to be a subsidiary of the principal company".

I can pass over the proviso and go to Sub-section (2) which explains how the notice shall take effect. Again I need not read all of it; this suffices.

> "Where such a notice is given, the profits or losses arising in any chargeable accounting period to which the notice relates from the trade or business carried on by the subsidiary shall be treated . . . as if they were profits or losses arising in the corresponding chargeable accounting period from the trad or business carried on by the principal company."

If the matter stopped there, there would be, at any rate in this case, no problem at all. The notice having been given, there would have been for Profits Tax purposes an amalgamation—I use again Mr. Heyworth Talbot's word—of the profits or losses of both principal and subsidiary, and the charge for tax would be on the amalgam.

Section 38 of the 1947 Act, however, introduced this further option. I can confine myself to Sub-section (3) which reads:

> "Where—(*a*) such a notice as aforesaid is in force"

—and that means, by reference to Sub-section (1), where a notice under Section 22 (1) of the Finance Act, 1937, is in force—

> "and (*b*) the subsidiary to which the notice relates pays to the principal company an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable by that company for any chargeable accounting period"

ending after a known date;

> "and (*c*) the principal company and the subsidiary jointly so elect by notice in writing given to the Commissioners of Inland Revenue"

within a certain period, then

> "the amount so paid."

—and I read this just to make the point that this notice like the other, if given, is given for good and all so long as the relationship continues—

> "and any amount so paid in relation to a subsequent chargeable accounting period, by the subsidiary to the principal company shall for all the purposes of the Income Tax Acts be treated—(i) as regards the subsidiary, as an amount of profits tax payable in respect of its profits arising in the chargeable accounting period of the subsidiary corresponding to the chargeable accounting period to which the payment relates; and (ii) as regards the principal company, as reducing the amount of the profits tax payable by the principal company for the chargeable accounting period to which the payment relates."

The effect for present purposes of those paragraphs (i) and (ii) is that as regards the subsidiary with which we are concerned the amount so paid by way of reimbursement is treated for Income Tax purposes as a deduction. That is all I need read of the Statutes.

The whole question turns on these few words,

> "an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable by that company"

—not an involved formula; on the face of it simple enough; but beyond a peradventure it has given rise to a sharp distinction between the views taken on either side.

Put quite simply, it is said by the taxpayer that the phrase "profits tax which by virtue of the notice having been given is payable by that company" means the total resultant figure for which the principal company is liable since the notice has been given. I will try to use language which is clearly expressive of the point, but it can be most clearly stated by saying, in this case, simply £209,000. That, it is said, is the Profits Tax payable by that company by virtue of the notice, because that is the sum which, the notice having been given, the principal company is now bound to pay; and if the notice had not been given some quite different and much smaller sum, namely £132,000, would have been exigible.

On the other side, it is said for the Crown: No; the Profits Tax which is payable by the principal company "by virtue of the notice" means that part of the total obligation which is exclusively referable to, and derives its force from, the notice as distinct from the obligations to which by virtue of the other Sections of the Act the principal company in any event, notice or no notice, would have been liable.

The Special Commissioners and Upjohn, J., favoured the view for which Mr. Heyworth Talbot has contended. I feel, let me say at once, diffident in expressing a view contrary to that which commended itself to them, but I am bound to say that, having given the matter my best attention, the meaning which those words give to me, to which they give rise in my mind, is the contrary meaning, the meaning for which the Crown contends. Perhaps it is right to say, as Mr. Heyworth Talbot said, that this should not be regarded as a matter of first impression; and indeed, after listening to argument carefully presented in this Court for a day, the first impression has perhaps faded a little away. But in the end—and I shall try to give reasons in support of that view—the question is, having read those words, which are straightforward words in the English language, what to the reader (who is in this case myself) do they mean? Presumably the draftsman had quite a clear idea of what he meant when he drafted the paragraph. If anybody had suggested that they were equivocal the doubt could have been resolved in the simplest possible way. If he had wanted to make clear

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beyond any doubt that the intention was in conformity with Mr. Heyworth Talbot's view he would, I should have thought, have said: an amount by way of reimbursement of the *total* profits tax which, etc. If he wanted to make quite certain that it was the Crown's view which would be regarded as intended he would have said something to the effect: by way of reimbursement of the *additional* profits tax, etc. But he has not said either of those things. For myself I do not think that to conclude in the Crown's favour involves reading in words any more than the view in favour of Mr. Heyworth Talbot would involve reading in words. But they are not there; we cannot supply them. What we have to do is to say what the words which are there do mean.

Upjohn, J., at the end of his judgment said that he had agreed with the Commissioners. He said(1):

> "I think there can be only one answer to this question. *The* Profits Tax payable by virtue of the notice having been given is the whole Profits Tax."

I am sorry to say I cannot accept that view. I emphasised, when I read that sentence, that Upjohn, J., had put in the definite article. Let me read the vital words with the definite article in: Where the subsidiary to which the notice relates pays to the principal company an amount by way of reimbursements of *the* profits tax which by virtue of the notice having been given is payable by that company, etc. I do not say that this is conclusive by any means, but I confess that, if the definite article had been in, I should have been at least more inclined to think that "*the* profits tax which by virtue of the notice" might have meant the whole, final, total sum; and when you get in paragraph (ii) below (which I read) just that phrase "the profits tax payable by the principal company", it does mean the total sum so paid. And it will be noticed that the words "by virtue of the notice" do not occur in that paragraph. But in the paragraph which we have to construe the definite article is absent—"an amount by way of reimbursement of profits tax which by virtue of the notice," etc. I follow the point that, since the subsidiary is not bound to reimburse the whole or indeed anything, it might have been desirable, if the definite article had been in, or if it had clearly been the total sum which was referred to in the vital sentence, instead of saying "by way of reimbursement", to have said: in or towards reimbursement. It is idle speculation to try to guess how this sentence was built up; but the fact is that the phrase "profits tax" is used without the definite article. As I have said, I think that is a small point favourable to the view which I entertain. But more substantial I think is this: as a matter of strict English, if the question be asked: What is the amount of Profits Tax payable by the principal company by virtue of the notice having been given? surely the answer is: That amount of Profits Tax the obligation to pay which the notice, and only the notice, brought about. As I have said, in the absence of the notice the principal company would have been liable to pay £132,000. What the notice did as regards its liability to Profits Tax was to impose the additional obligation of £77,000.

I asked Mr. Heyworth Talbot whether it was a fair paraphrase to say that the question which this vital sentence raises may be put thus: How much of the obligation for Profits Tax is attributable to the giving of the notice? Mr. Heyworth Talbot agreed that those words fairly pose the question. I ask then: How much *was* attributable to the giving of the notice? I do not think it is true to say that the whole sum was so attributable. It is quite right to say that the final figure was arrived at because the notice had been

(1) *See* page 363 *ante*.

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given; and had it not been for the notice, not that figure but some other figure would have been arrived at. But still, of the £209,000, £132,000 was an obligation wholly independent of the giving of the notice. To that view of the matter I think considerable support is lent by the use of the word "payable". I have read it so often that I hesitate to do so again, but it will be remembered that the tax in question (that is, the subject-matter which may be reimbursed) is Profits Tax which is *payable* and not which has been paid. In other words, the use of the word "payable" introduces the conception of obligation and, as I think, does justify the formulation of the question I have just put—how much of the obligation is attributable to the giving of the notice?

Then, finally, I think that if you start by having clearly in mind what is the notice—if, in other words, instead of paragraph (*a*) you take the necessary language from Section 22 of the 1937 Act—again you are assisted towards the conclusion which I have mentioned. What is the notice? How would it read? Where a principal company has given a notice applicable to a subsidiary and requiring that the profits or losses arising in any accountable period from the trade or business of the subsidiary shall be treated as if they were profits or losses arising from the trade or business of the principal company, and the subsidiary to which the notice relates—and so on. The form and character of the notice is a notice by a principal requiring that for a limited purpose, namely, ascertaining Profits Tax, the business profits or losses of the subsidiary shall be treated as the principal's. What the notice, then, has done in this case is that it has increased for the purpose of Profits Tax, by the amount of the subsidiary's trading profit, the subject-matter to be taxed in the principal's hands.

It is against that background that the subsidiary pays to the principal a sum "by way of reimbursement of profits tax which by virtue of the notice" which I have just read is payable by the principal. I think the vital sentence in that context shows that the notice is one by virtue of which for Profits Tax purposes an added burden is imposed upon the principal. What other purpose, indeed, have the words "which by virtue of the notice", etc., served? If the answer is otherwise, it seems to me rather strange. The principal is given power by notice to assume to itself the whole of the Profits Tax, both its own and its subsidiary's. There is no corresponding option which would entitle it to place upon the subsidiary the whole Profits Tax of itself and the subsidiary. Yet, if the taxpayer's argument is right, the subsequent option has the oblique effect of transferring to the subsidiary for Income Tax purposes the higher Profits Tax obligation of both of them put together. That seems to me an effect out of keeping with the general tenor of the Sections and the rights conferred. For those reasons my reading of the vital words is not the reading which commended itself to the learned Judge.

If I am wrong, at the very least, as it seems to me, there is a real ambiguity. I do not mean an ambiguity which arises because Counsel on one side and the other have contended for different meanings, but a real doubt of what the sentence does mean. If that is so then the Court is entitled to consider the general scope of the Act, and I have just given a reason for thinking that Mr. Heyworth Talbot's view is out of keeping with my understanding of the scope of the Section.

It is legitimate also to consider the anomalous results to which I think Mr. Heyworth Talbot's view would lead. I do not propose to elaborate this matter. Nor do I doubt that when regard is had to the differential rates, to the ingenuity of mankind and the infinite variety of circumstances of life,

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on any view of it peculiar results may sometimes arise, not the less so because these options once exercised cannot be recalled. But we have been dealing with the case of a parent with one child, and, as Mr. Millard Tucker rightly pointed out, not only may a company commonly have more than one subsidiary but the Sections themselves show that a plurality of subsidiaries is contemplated. I think Mr. Millard Tucker is entitled to say this. If Mr. Heyworth Talbot's view is right and notices have been given in respect of two or three subsidiary companies, then what are the rights *inter se* of each of them? Each *prima facie* is entitled to repay the whole joint Profits Tax for the whole group. The effect of that of course would be a greater benefit to the parent company than obviously it was entitled to receive. Mr. Heyworth Talbot's answer was this: The right to make payments is expressed " by way of reimbursement ", and if I undertake to reimburse another for the expenses he has incurred in some particular connection, then once he has had from me the amount he has expended he cannot be further reimbursed in respect of those same expenses. I am not quite sure that that is necessarily so, but it is a very great deal to get out of those four words " by way of reimbursement " if the general argument is right. On any view it seems to me that as the years roll by it might create very difficult problems of priority between the subsidiaries, who was going to pay, to get in first, to reimburse the parent and gain the best advantage from the Income Tax provisions, assuming of course that the right to make the deduction has continued. I think Mr. Millard Tucker has made good his point that the view contended for by the Respondent produces anomalies, and obviously does so as soon as you consider the case of a plurality of subsidiaries.

Mr. Heyworth Talbot said: Take the case where a company, a subsidiary, makes a loss. To put it into figures makes it more simple. The parent makes a profit of £1,000 ; a subsidiary makes a loss of £500. Notice has been given, and the result is to reduce the business profits for the purpose of Profits Tax from £1,000 to £500. Assuming tax at the rate of 10 per cent. the tax would be reduced from £100 to £50. What, said Mr. Heyworth Talbot, on the Crown's view, would be the amount which, within the terms of the vital sentence " of profits tax which by virtue of the notice having been given ", would be payable by the principal company? Mr. Heyworth Talbot contended that the answer must be in that case £50, and if that was so all else followed. I think with Mr. Millard Tucker that the answer in those circumstances is nil. The result of the notice produced no obligation to Profits Tax on the parent company. What it in fact did was to relieve the principal company of part of the obligation which it would otherwise have had to bear.

It has been said so many times that on matters of construction over-elaboration may not be useful but that in the end it is a question of interpreting fairly and according to ordinary English sense the words used. I feel already that my judgment has been overlong, but from the great respect which I bear to the learned Judge and out of regard for the careful arguments put before us I have tried to justify the view which I confess has clearly formed itself in my own mind. For the reasons I have stated I would allow the appeal.

Jenkins, L.J.—I agree that this appeal should be allowed. I only venture to add a few observations of my own because we are differing both from the Special Commissioners and from the learned Judge.

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The case resolves itself into the question what does Section 38 (3) (*b*) of the Finance Act, 1947, mean by

> " profits tax which by virtue of the notice having been given is payable by that company ",

that is to say the principal company. It is to be observed that the expression is not simply " profits tax payable by that company ", but it is " profits tax which by virtue of the notice having been given " is so payable. What Profits Tax can answer the description of being payable by the principal company by virtue of the notice? Surely only such Profits Tax as is payable by the principal company by reason of the notice having been given, and which would not have been payable by the principal company if the notice had not been given. That seems to me to be the natural and inescapable meaning of the language used.

I think that conclusion is reinforced if one reads into Section 38 (3) (*b*) of the Finance Act, 1947, the effect of the notice referred to in Section 22 of the 1937 Act. It is a notice, to put it shortly, that the profits or losses of the subsidiary are to be treated as profits or losses of the principal company. If the effect of the notice is thus read into Sub-section (3) (*b*) it seems to me to be reasonably plain that the Profits Tax in this context which answers the description of being payable by the principal company by virtue of the notice is so much of the total Profits Tax payable by the principal company as is payable by that company by virtue of the fact that the profits of the subsidiary company are added to its own profits for the purpose of ascertaining its liability to Profits Tax. Accordingly, in my view, the relevant payment for the purposes of Section 38 in this case must consist, as contended for the Crown, of the £77,000, representing the increase brought about by the Section 22 notice in the total amount of tax payable by the principal company.

The short point of construction admits of no great elaboration, but I would call attention to this. The argument for the Respondent Company is to the effect that the Profits Tax payable by virtue of the notice is the whole of the Profits Tax payable by the principal company on the combined profits of principal and subsidiary. For the reasons I have endeavoured to state I think that is a wrong construction ; but by way of reinforcement of this view it is not without significance that, whereas the reference in Sub-section (3) (*b*) is to " profits tax which by virtue of the notice having been given is payable by " the principal company and so on, when one comes to paragraph (ii) of Sub-section (3), which states the effect on the tax position of the principal company of the payment by way of reimbursement, one finds this expression,

> " as regards the principal company, as reducing the amount of the profits tax payable by the principal company for the chargeable accounting period to which the payment relates."

That is the expression used in the Section to denote the whole of the Profits Tax liability of the principal company. I venture to think that, when the different and qualified expression " profits tax which by virtue of the notice having been given is payable " and so on is used in Sub-section (3) (*b*), it is used because the reference is not to the whole of the Profits Tax payable by the principal company but only to that part of the total Profits Tax payable by the principal company which is payable by that company by virtue of the notice.

Accordingly, in my view and as a matter of construction, after paying the best attention I can to the careful arguments presented, I think the Crown's contention is right.

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I will not pursue the arguments which were directed to the anomalies which it was said might arise one way or another whichever construction of the words is adopted. I will content myself by saying that it seems to me that on the whole the possible anomalies instanced by Mr. Tucker were more surprising than those suggested on the other side; but I prefer to found myself on the construction of the relevant Sections and, having construed them, I agree with my Lord that this appeal should be allowed.

Morris, L.J.—I am of the same opinion. The construction contended for by the Respondents is one which in my judgment might result if the words of Section 38 (3) (*b*) of the Finance Act, 1947, were: the subsidiary to which the notice relates pays to the principal company an amount by way of reimbursement of profits tax payable by that company. But the words which by such a reading are omitted are, in my judgment, words which have significance and meaning. I refer to the words

> " which by virtue of the notice having been given is ".

With the inclusion of those words an enquiry is denoted to determine what Profits Tax is payable by the principal company " by virtue of the notice having been given ". This in turn suggests an enquiry as to what the position would have been if no notice had been given, and what the position is " the notice having been given ". If no notice had been given, then on the figures in this case the Profits Tax payable by the principal company would have been £132.000. The notice having been given, the Profits Tax payable was £209,000. What then is the Profits Tax which by virtue of the notice having been given was payable by the principal company? In my judgment it was the difference between the two. If there is to be payment of " an amount by way of reimbursement of profits tax " which is payable " by virtue of the notice having been given " the amount referred to is, in my judgment, the amount of any resulting additional tax.

The notion of paying " an amount by way of reimbursement " suggests to my mind a measure of responsibility for that which is to be reimbursed. The principal company would have had, unless a notice was given, a liability to pay £132.000 by way of Profits Tax. But when a notice was given liability to that extent did not owe its origin to the giving of the notice and was not payable by virtue of the notice having been given. But the amount of the resulting additional liability would be by virtue of the notice having been given.

Mr. Millard Tucker.—I ask that the appeal should be allowed, with costs here and below, and that the case should be remitted to the Special Commissioners to adjust the assessments in accordance with the judgment of this Court.

Sir Raymond Evershed, M.R.—That must be right.

Mr. F. Heyworth Talbot.—Indeed, I agree that that be the Order following upon your Lordships' judgment.

I am instructed to ask for leave to appeal to the House of Lords. I base my application upon the difference in judicial opinion in this case and upon the nature—may I venture to suggest the difficult nature—of the point involved.

Sir Raymond Evershed, M.R.—And a lively hope of success! What do you say, Mr. Millard Tucker?

Mr. Millard Tucker.—I am not instructed to put forward any objection.

(*The Court conferred.*)

Sir Raymond Evershed, M.R.—Yes, we will give you leave.

The Company having appealed against the above decision, the case came before the House of Lords (Viscount Simonds and Lords Reid, Radcliffe and Somervell of Harrow) on 27th February, 1956, when judgment was reserved. On 26th March, 1956, judgment was given unanimously in favour of the Crown, with costs.

Sir Andrew Clarke, Q.C., Mr. F. Heyworth Talbot, Q.C., and Mr. H. Major Allen appeared as Counsel for the Company, and Sir James Millard Tucker, Q.C., Sir Reginald Hills and Mr. E. B. Stamp for the Crown.

Viscount Simonds.—My Lords, the Appellant Company is a subsidiary of another company called Chloride Electrical Storage Co., Ltd., which I will refer to as "the principal company". For the purpose of the Acts which I must examine, a company is the subsidiary of another company if the latter holds 75 per cent. or more of its shares. But in fact the principal company held all the shares of the Appellant Company.

The appeal arises upon three assessments to Income Tax made upon the Appellant Company for the years 1949–50, 1950–51 and 1951–52 under Case I of Schedule D of the Income Tax Act, 1918, in respect of the profits arising from its trade.

The matter in dispute is whether a payment of £191,420 made by the Appellant Company to the principal company was a deductible outgoing in computing the profits of the Appellant Company for the purpose of Income Tax or whether only £77,695 of that amount was so deductible. The answer to this question depends on the true construction of a very few words in the Finance Act, 1947, but it is necessary first to look at the Finance Act, 1937, by which Profits Tax (then called National Defence Contribution) was first imposed.

This tax, which I will continue to call Profits Tax, was, by Section 19 of the Finance Act, 1937, imposed on the profits arising in each accounting period from the trades or businesses therein described. During the relevant chargeable accounting period the Appellant and the principal company each carried on a trade falling within the charging provisions and each had profits arising from its trade. This enabled them to take advantage of the provision to which I now refer.

By Section 22 of the Act it was enacted as follows:

> "22.—(1) Where a body corporate resident in the United Kingdom is a subsidiary of another body corporate so resident (hereafter in this section referred to as 'the principal company') the principal company may, by notice in writing given to the Commissioners of Inland Revenue before the expiration of any chargeable accounting period of the subsidiary or within two months thereafter, require that the provisions of subsection (2) of this section shall apply to the subsidiary as respects that period and all subsequent chargeable accounting periods throughout which it continues to be a subsidiary of the principal company: . . . (2) Where such a notice is given, the profits or losses arising in any chargeable accounting period to which the notice relates from the trade or business carried on by the subsidiary shall be treated, for the

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> purpose of the provisions of this Act relating to the national defence contribution . . . as if they were profits or losses arising in the corresponding chargeable accounting period from the trade or business carried on by the principal company. . . ."

By Section 25 (1) of the same Act it was provided that the amount of Profits Tax payable in respect of the profits arising from a trade or business in a chargeable accounting period should be allowed to be deducted as an expense in computing for the purpose of Income Tax the profits and gains arising from that trade or business in that period.

The Finance Act, 1947, introduced important changes into the law. With one of them, a change of great practical importance, by which the rate of tax was made to vary according to whether profits were or were not distributed by way of dividend, your Lordships are not concerned. I mention it only to explain that the sum of £191,420, which I mentioned at the beginning of this speech, is the sum which the Appellant Company would have paid by way of Profits Tax if the notice under Section 22 of the Act of 1937 had not been given.

Section 38 of the Act of 1947, to which I now refer, is the material Section. The relevant parts of it are as follows:

> "38.—(1) Where a notice under subsection (1) of section twenty-two of the Finance Act, 1937 (which relates to subsidiary companies) is in force— . . . (3) Where—(*a*) such a notice as aforesaid is in force; and (*b*) the subsidiary to which the notice relates pays to the principal company *an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable by that company* for any chargeable accounting period ending after the thirty-first day of December, nineteen hundred and forty-six; and (*c*) the principal company and the subsidiary jointly so elect by notice in writing given to the Commissioners of Inland Revenue within six months from the end of that chargeable accounting period or such longer time as those Commissioners may in any case allow, the amount so paid, and any amount so paid in relation to a subsequent chargeable accounting period, by the subsidiary to the principal company shall for all the purposes of the Income Tax Acts be treated—(i) as regards the subsidiary, as an amount of profits tax payable in respect of its profits arising in the chargeable accounting period of the subsidiary corresponding to the chargeable accounting period to which the payment relates; and (ii) as regards the principal company, as reducing the amount of the profits tax payable by the principal company for the chargeable accounting period to which the payment relates. . . . (6) This section shall be construed as one with the said section twenty-two."

I have italicised the important words upon whose construction the issue depends. But before considering them I will state the material facts, which are undisputed.

The Appellant Company commenced business on 1st January, 1950, as a manufacturer of storage batteries and made up its first accounts to 31st December, 1950, which thus constituted or included the basis period for the years of assessment under appeal. The principal company duly gave notice pursuant to Section 22 (1) of the 1937 Act requiring that Sub-section (2) of that Section should apply to the Appellant Company. Therefore, Profits Tax became payable by the principal company in respect of its own and the Appellant Company's profits. This tax was assessed at £209,437 12*s*. If the notice had not been given, the principal company would have had to pay the sum of £131,742 8*s*. by way of tax on its own profits only, a difference of £77,695 4*s*. Taking advantage of Section 38 (3) (*b*), which I have set out, and purporting to do so by way of reimbursement as therein mentioned, the Appellant Company paid to the principal company the sum of £191,420 (that sum being calculated in the way I have already described), and then under Section 38 (3) (*c*) the principal company and the Appellant

Company jointly elected that the sum should, for all the purposes of the Income Tax Acts, be treated as provided for in paragraphs (i) and (ii) of Section 38 (3), or, in other words, that as regards the Appellant Company it should be treated as the amount of Profits Tax payable in respect of the profits arising in the chargeable accounting period of twelve months to 31st December, 1950. The Revenue authorities did not accept the view that £191,420 or any larger sum than £77,695 could be reimbursed to the principal company by the Appellant Company and assessed the latter Company to Income Tax accordingly. From these assessments the Appellant Company appealed to the Commissioners for the Special Purposes of the Income Tax Acts, who allowed their appeal. From their determination the Respondent, the Inspector of Taxes, appealed by way of Case Stated to the High Court, Upjohn, J., who upheld their determination. From his Order the Respondent appealed to the Court of Appeal, which allowed the appeal. From their Order the Appellant Company brings this appeal.

I state again the short question in this case. What is the meaning of the words

> "an amount by way of reimbursement of profits tax which by virtue of the notice having been given is payable by that company"

where they occur in Section 38 (3) (*b*) of the Act?

The notice to which reference is made is the notice given under Section 22 of the Act of 1937, and I do not dissent from the contention of the Appellant Company that the effect of that notice was to create a single liability in the principal company in respect of Profits Tax. It was a single liability computed on the aggregate of its own and the Appellant Company's profits. Nor would I dispute that in the judgments of the Master of the Rolls and Jenkins, L.J., there are to be found expressions which suggest that after the notice the principal company became subject to two separate liabilities, the one in respect of its own profits, the other an additional one in respect of the Appellant Company's profits. But these are, I think, verbal criticisms only and do not affect the substance of their reasoning, with which I find myself in complete agreement.

The structure of Section 38 (3) is not to be disregarded. It does not purpose to authorise any payment by a subsidiary to a principal company. But it provides that, where certain conditions are satisfied, including a payment by a subsidiary to a principal company, then certain results for tax purposes shall follow. It assumes that such a payment is authorised by the general law. This throws some light upon the construction of the vital words; for a subsidiary company may have as many as 25 per cent. minority shareholders and it may have trade and other creditors. I do not understand how, under the general law, a subsidiary could by way of reimbursement pay to a principal company a sum which it, the subsidiary, was never liable to pay. Learned Counsel urged that it was purely a domestic arrangement between the two companies how much one should pay the other, but this argument ignores the position of minority shareholders and creditors and it ignores, too, the salient fact that, while the payment may be a domestic arrangement, the purpose of the Section is to give to that payment certain consequences for tax purposes. It is with this background that the material words must be considered.

It is possible, too, that some light may be thrown on the problem by the use of the word "reimbursement". It suggests to me, as it did to Morris, L.J., that the sum paid by the subsidiary company was one for which the principal company would not, but for the notice, have become

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liable. This consideration leads me at once to the ground upon which, in effect, the Court of Appeal decided against the Appellant Company.

> "What Profits Tax",

they ask,

> "can answer the description of being payable by the principal company by virtue of the notice?"

I take the answer of Jenkins, L.J.(1):

> "Surely only such Profits Tax as is payable by the principal company by reason of the notice having been given, and which would not have been payable by the principal company if the notice had not been given."

This he describes as the natural and inescapable meaning of the language used. I agree with him.

The principal company paid £209,437 12*s*. Profits Tax in respect of the relevant accounting period. Notice or no notice, it incurred a liability to pay Profits Tax under Section 19 of the Act of 1937. If there had been no notice, its liability would have been £131,742 8*s*. As a result of the notice its liability was £209,437 12*s*. What amount of Profits Tax became payable "by virtue of the notice"? No other sum than the difference between those amounts, namely, £77,695. Even here there is in the last analysis a misstatement. For it is not by virtue of any notice that liability to tax arises. The liability arises under the Act. But the quantum of liability both as between the subsidiary and principal company and as between the companies and the Revenue authorities may be affected by the notice. It is therefore legitimate, though not entirely accurate, to speak of Profits Tax "which by virtue of the notice having been given is payable". It is at least true that, *quoad* the profits of the subsidiary company, the liability of the principal company arises from Section 19 of the Act of 1937 combined with the notice under Section 22. It would be untrue to speak of the liability of the principal company in respect of its own profits as arising from a notice. That liability arose under the Act alone, though the quantum might be affected by a notice. It would be increased if the subsidiary company made a profit or reduced if it made a loss. This latter possibility may throw some light on the relevant words. For it would, as it appears to me, be plain nonsense to speak of the subsidiary company paying an amount by way of reimbursement of Profits Tax which by virtue of the notice having been given is payable by the principal company, when the only result of the notice was to reduce the amount of tax so payable.

For these reasons, which are intended only to supplement those of the Court of Appeal, with which, as I have said, I am in full agreement, I am of opinion that this appeal should be dismissed with costs.

Lord Reid.—My Lords, I agree.

Lord Radcliffe.—My Lords, I am in full agreement with what has fallen from my noble and learned friend on the Woolsack.

I, too, think that the decision of the Court of Appeal was correct. The point is a very short one and it does not need elaboration from me. I would like to make it plain, however, that I do not regard a construction of Section 38 (3) of the Finance Act, 1947, which limits the Appellant Company's deduction for Income Tax purposes to £77,695 as a construction which introduces into Sub-section (3) (*b*) any words not already there. On the

(1) *See* page 371 *ante*.

contrary, I think that this construction offers the only tenable meaning of the words used.

Even though the tax enactments in question relate to "group" assessments and to inter-company transfers of money from a subsidiary (though not necessarily a wholly-owned subsidiary) to a principal company, the payment by the subsidiary which we are supposed to envisage cannot just be a transfer to the principal of as much cash as it may need to make good whatever it has had to pay in satisfaction of its own liability for Profits Tax as a whole. It must be a payment to the principal of some amount which the giving of the notice under Section 22 (1) of the Finance Act, 1937, has made it reasonable and fair that the one company should pay over to the other. Against this background the words "reimbursement" and "by virtue of the notice" acquire an obvious significance, and in my opinion they limit the ranking amount to such an amount as that by which the Profits Tax bill of the principal company has been increased in consequence of the notice.

Lord Somervell of Harrow.—My Lords, I agree with the opinion delivered by my noble and learned friend on the Woolsack and have nothing I wish to add to it.

Questions put:

That the Order appealed from be reversed.

The Not Contents have it.

That the Order appealed from be affirmed and the appeal dismissed with costs.

The Contents have it.

[Solicitors:—Solicitor of Inland Revenue; Simpson, North, Harley & Co., for Marsh, Pearson & Green, Manchester.]

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