[2016] UKUT 0320 (TCC)

Tribunal ref: UT/2015/0083

CORPORATION TAX — acquisition of company with accrued losses by company carrying on similar trade — whether acquirer entitled to set losses against income of enlarged group — ICTA ss 337, 343, 393 — losses to be set only against income of predecessor's trade — appeal allowed

UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Appellants**

- and -

LEEKES LIMITED **Respondent**

Tribunal: Hon Mr Justice Roth
Judge Colin Bishopp

Sitting in public in London on 4 May 2016

Ms Elizabeth Wilson, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the appellants

Mr Nikhil Mehta, counsel, instructed by Deloitte LLP, for the respondent

DECISION

Introduction

1. The respondent to this appeal, Leekes Ltd ("Leekes"), carries on retail trade from department stores. Before November 2009 it traded from four such stores, three in Wales and one in Wiltshire. On 18 November 2009 it acquired the entire issued share capital of Coles of Bilston Ltd ("Coles") for £1. Coles carried on a similar trade from three stores and a distribution centre in the West Midlands. On the following day Coles' business was hived up to Leekes, and Coles became dormant. Leekes rebranded the former Coles stores, and it continued to trade from all of the stores until August 2013 when one of the former Coles stores was closed, leaving Leekes with a total of six stores.

2. Coles had been making trading losses for some time, and at the date of its acquisition its accumulated losses amounted to about £3 million. Leekes maintains that it is entitled to obtain relief for those losses by setting them off against the income of the enlarged business, and in its corporation tax return for the year to 31 March 2010 it set about £1.7 million of the losses against its income for the year, reducing its taxable profit to nil. The return also showed that it was intended that the balance of Coles' accumulated losses should be carried forward for utilisation in a similar fashion in future years.

3. The present appellants ("HMRC") opened an enquiry into the return and on 17 September 2013 they issued a closure notice disallowing the claim for relief. That conclusion was upheld on review, and Leekes appealed to the First-tier Tribunal ("the F-tT"). HMRC's reason for rejecting the claim, reflected in their case before the F-tT, was that Leekes could set Coles' accumulated losses only against any income generated by what was formerly Coles' business. If HMRC are correct, no relief was available in the relevant year because that part of the enlarged business taken over by Leekes from Coles remained unprofitable.

4. The F-tT (Judge Short and Mr Dee) decided that Leekes was right, and that it was entitled to the relief it had claimed. HMRC now appeal to this tribunal with permission granted by Judge Short.

The legislation

5. The relevant legislation at the date of the acquisition (it has since been re-written to the Corporation Tax Act 2010) was to be found in the Income and Corporation Taxes Act 1988 ("ICTA"). The starting point is s 337(1):

> "Where a company begins or ceases—
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> (a) to carry on a trade, or
>
> (b) to be within the charge to corporation tax in respect of a trade, the company's income shall be computed for the purposes of corporation tax as if that were the commencement or, as the case may be, the discontinuance of the trade, whether or not the trade is in fact commenced or discontinued."

6. If the matter rested there, Leekes would have no right to any relief for Coles' losses. However, ICTA provided for the transfer of potential loss relief from one

company to another in certain circumstances. It is common ground that the relevant provision in this case is s 343. Those subsections which applied in a case of this kind were as follows:

> "(1) Where, on a company ('the predecessor') ceasing to carry on a trade, another company ('the successor') begins to carry it on, and—
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> (a) on or at any time within two years after that event the trade or an interest amounting to not less than a three-fourths share in it belongs to the same persons as the trade or such an interest belonged to at some time within a year before that event; and
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> (b) the trade is not, within the period taken for the comparison under paragraph (a) above, carried on otherwise than by a company which is within the charge to tax in respect of it;
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> then the Corporation Tax Acts shall have effect subject to subsections (2) to (6) below.
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> In paragraphs (a) and (b) above references to the trade shall apply also to any other trade of which the activities comprise the activities of the first mentioned trade.
>
> …
>
> (3) … the successor shall be entitled to relief under section 393(1), as for a loss sustained by the successor in carrying on the trade, for any amount for which the predecessor would have been entitled to relief if it had continued to carry on the trade."

7. Since they were relied on heavily in the argument for Leekes, it is appropriate also to set out s 343(8) and (9), which provided as follows:

> "(8) Where, on a company ceasing to carry on a trade, another company begins to carry on the activities of the trade as part of its trade, then that part of the trade carried on by the successor shall be treated for the purposes of this section as a separate trade, if the effect of so treating it is that subsection (1) … above has effect on that event in relation to that separate trade; and where, on a company ceasing to carry on part of a trade, another company begins to carry on the activities of that part as its trade or part of its trade, the predecessor shall for purposes of this section be treated as having carried on that part of its trade as a separate trade if the effect of so treating it is that subsection (1) … above has effect on that event in relation to that separate trade.
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> (9) Where under subsection (8) above any activities of a company's trade fall, on the company ceasing or beginning to carry them on, to be treated as a separate trade, such apportionments of receipts, expenses, assets or liabilities shall be made as may be just.…"

8. The title of s 343 is "Company reconstructions without a change of ownership" and, at first sight, it may seem surprising that it applies to a case such as this. It is, however, agreed by the parties that, because of the one-day interval between Leekes' acquisition of the shares and the hiving up of the business, the requirements of sub-s (1)(a) are met, and that accordingly Coles is to be treated as the predecessor and Leekes as the successor for the purposes of the section. What the parties do not agree upon is the meaning of sub-s (3). That meaning is coloured by the terms of s 393(1), to which sub-s (3) referred. So far as material it was as follows:

> "Where in any accounting period a company carrying on a trade incurs a loss in the trade, the loss shall be set off for the purposes of corporation tax against any trading income from the trade in succeeding accounting periods; and (so long as the company continues to trade) its trading income from the trade in any succeeding accounting period shall then be treated as reduced by the amount of the loss, or by so much of that amount as cannot be relieved under this subsection …".

9. In other words, in the case of a company which carried on a trade without interruption, a loss in one year could be carried forward and set against income derived from the same, or materially the same, trade in later years until it was exhausted. The combined effect of s 343(3) and s 393(1) was to put a successor company, such as Leekes, in substantially the same position as a company carrying on a trade without interruption.

The F-tT's decision

10. At [17] and [20] the F-tT identified the issue before them as one of statutory interpretation, namely whether the terms of s 343(3) required Leekes to undertake what the parties had referred to as "streaming" of the post-acquisition income of the combined trade. The parties' positions, consistently with what had gone before, were in straightforward opposition: HMRC argued that it was obligatory to identify separately the income derived from the former Coles' business and the income derived from Leekes' continued trade in order that the pre-acquisition losses could be set against the former, while Leekes argued that there was no legislative basis for such an exercise.

11. At [40] the F-tT said that they preferred Leekes' arguments for three reasons, which they summarised as follows: that there was no requirement in sub-s (3) for streaming; that HMRC's interpretation of the section imported practical difficulties of application; and that Leekes' approach was "more closely aligned to commercial reality".

12. The decision records that Mr Nikhil Mehta, who appeared for Leekes before the F-tT and before us, advanced two hypotheses—the trade hypothesis and the quantum hypothesis as he termed them—to support his argument that there was no proper basis upon which sub-s (3) could be interpreted in the manner for which HMRC argued. At [49] the F-tT indicated that they agreed that s 343(3) "involves at least two hypotheses", and spent several paragraphs considering them by reference to what the F-tT recognised was only indirect judicial authority on the interpretation of s 343(3); the cases to which they referred nevertheless threw some, even if oblique, light on the question. They appear to have been much influenced by the observation of Sir Wilfrid Greene MR, in *Briton Ferry Steel Co Ltd v Barry* 23 TC 414 at 429, that "the reality of the matter is that, as from the date of such an acquisition [similar to the acquisition here], there is one business and one business only"; and by the comment of Millett J in *Falmer Jeans Ltd v Rodin* 63 TC 55 at 70, [1990] STC 270 at 281 to the effect that sub-s (1) "does not require the successor to begin to carry on the trade which it has acquired as a separate trade".

13. From those observations they reached the conclusion, at [44], that "the trade of [the] original company has disappeared", and rejected the notion that the successor's original trade and that acquired from the predecessor should be treated as identifiable parts of the combined whole on the basis that it was incapable of reconciliation with that starting point. They returned to this topic at [55], where they referred to the practical

difficulties, as they saw them, of identifying the separate income stream derived from the acquired trade so as to allow for s 343(3) to be applied in the manner for which HMRC argued. They observed at [56] that although in this case it was relatively simple to ascribe the income of the enlarged business to its constituent parts, "[i]n many instances a succession will mean a loss of identity for the acquired trade … and the legislation needs to be able to provide a sensible answer in those circumstances".

14. At [45] they addressed HMRC's argument about the survival of the acquired trade, derived from further remarks of Sir Wilfrid Greene MR in *Bell v National Provincial Bank of England Ltd* 5 TC 1. In that case a large bank took over the entire undertaking of a smaller bank, and the question was whether there was a succession within the meaning of the law as it was in force at the time. At p 10 the Master of the Rolls drew a distinction between the position in which the successor had acquired a business in order to reduce competition by its extinction, in which case there would not be a succession in the statutory sense, and the position, in that case as in this, in which the successor acquired a business in order "to carry it on exactly as it had been carried on before, except of course that the accounts and profits did merge into the main business" of the acquiring bank. The F-tT did not, however, consider that the case (which related in any event to a rather different question) assisted HMRC; and for similar reasons they indicated that they derived little help from *Falmer Jeans* or *Laycock v Freeman, Hardy and Willis Ltd* 22 TC 288, on both of which HMRC had relied, because they related to successions to something less than or different from the predecessor's trade.

15. Instead, they preferred an approach drawn from the judgment of Upjohn LJ in *Aviation & Shipping Co Ltd v Murray* 39 TC 595. In that case, a ship-owning company acquired two ships, subject to existing time charters, from its wholly-owned subsidiary. The two ships represented the subsidiary's entire fleet. A few weeks later the ships were sold and replaced, and the time charters were transferred to the replacement ships. The question was whether the subsidiary's trade had ceased on the acquisition of the ships by the parent, or alternatively on the sale of the two ships or, instead, the subsidiary's trade had merged with that of the parent, and had continued. In deciding that the correct view was the last of those possibilities Upjohn LJ, at p 607, rejected the "mountain of fictions" on which the arguments of cessation were based and said that "It seems to me that you must look … at the reality of the whole matter." All the parent had done was to change the stock-in-trade of the trade it had taken over, to which it had succeeded and which it continued to carry on.

16. The F-tT's decision also records that Mr Mehta argued that no requirement of streaming could be implied because of the contrast between s 343(3), of application to this case, and s 343(8) and (9), which dealt with succession to the *activities* of a trade (as opposed to the trade as such).

17. The important feature identified by Mr Mehta was that sub-s (8) imposed a requirement that the continued trading activities of the predecessor be treated as a notionally distinct trade (the "streaming"), and sub-s (9) provided for the implementation of this requirement by a just apportionment, in order that the predecessor's accrued losses carried forward could be set only against the income of that notional trade and not the successor's trade as a whole. Mr Mehta submitted that the absence of corresponding provisions in sub-ss (1) and (3) was deliberate, and an

indication that it was intended that in a case such as this the successor should be able to set losses carried forward from the predecessor against the profits of the combined business.

18. At [29] the F-tT recorded the contrary argument of HMRC, represented before the F-tT and before us by Ms Elizabeth Wilson, that an express requirement of streaming was unnecessary because it was plain from the wording of the section that the trade to which sub-s (3) referred could be only the predecessor's trade. They examined the argument in the following paragraphs, but when they returned to this area of disagreement at [58] they described it as a "second order" argument. They accepted that it did not necessarily follow from the fact that streaming was required when the old and the new trade differed (a sub-s (8) case) that it was not required when they were the same (a sub-s (1) case), but at [59] stated that if streaming was to be required in a sub-s (1) situation they would expect the requirement to be explicit. They therefore considered that this difference between the two parts of the section was a further reason for concluding that Leekes' approach was to be preferred. Accordingly they allowed the appeal.

The parties' arguments

19. Ms Wilson argued that the F-tT had committed an error which undermined their reasoning. At [22] they outlined Mr Mehta's trade hypothesis, in the course of which they observed that "the successor should be treated as having incurred the losses in question". That error led the F-tT to the further incorrect proposition at [51]: "any subsequent entitlement to losses under s 393 can only be an entitlement of" the combined trade. That was not what the legislation provided. It did not treat the successor as having sustained the losses; rather, it enabled the successor to obtain relief, but it did so only in a prescribed manner.

20. The prescribed manner appeared in s 343(3), which limited the relief to the "amount for which the predecessor would have been entitled to relief had it continued to carry on the trade". It is plain, Ms Wilson continued, that the "trade" mentioned here must be the predecessor's trade, and that the provision could not be read as if the trade was the combined trade of the successor, since the predecessor could never have set off losses incurred by it in its own trade against profits earned by the successor's trade, in which it had never had an interest and which it could not have carried on. There is no need for any mention in sub-s (3) of streaming, because it is implicit in the words used that the relief is available only by reference to the income of the predecessor's continued trade.

21. The contrast between sub-s (3) and sub-s (8), in which streaming is explicitly mentioned, was explained by Millett J in *Falmer Jeans* at p 71 as a legislative reversal of the decision in *Laycock v Freeman, Hardy and Willis*. There, the taxpayer company was a retailer of boots and shoes which it bought, wholesale, from independent suppliers and from two wholly-owned subsidiaries. The two subsidiaries were placed in liquidation, whereupon the taxpayer acquired all of their assets and continued to manufacture boots and shoes from the same factories using the same staff, selling the goods in its shops as before. The Court of Appeal concluded that the subsidiaries' businesses had ceased on transfer of their assets to the taxpayer. Now, because of s 343, that would not be the case. The effect of the section is the same whether there is a

succession within sub-s (1) or an acquisition within sub-s (8): it is to entitle the successor to the relief to which the predecessor would have been entitled, but no more.

22. It is nothing to the point, Ms Wilson added, that following the succession there might be a single trade: a taxpayer in the position of Leekes would need to keep records of the income of the trade to which it had succeeded, but it would know in advance that it had the potential for relief and it could take appropriate steps to ensure that the necessary record-keeping was feasible. Even if, in some cases, segregation might be difficult, the difficulty could not amount to a basis upon which the statutory scheme should be disregarded. In this case, the task of segregation plainly did not present any great difficulty. It is notable, she said, that this is the first case to reach the courts or tribunals since the introduction of the predecessor legislation by the Finance Act 1965. Since the form of corporate acquisition and restructuring that occurred in the present case is by no means uncommon, this strongly suggests that in practice the legislation has not led to any insuperable difficulties.

23. Similarly, the F-tT's preference for what it termed "commercial reality" was not a basis upon which the statutory words could be overridden. It was difficult to see what could be the policy justification for allowing Leekes to take the benefit of relief, in respect of Coles' accrued losses, which Coles itself could not have taken.

24. Mr Mehta's response was broadly based on the hypotheses he had advanced before the F-tT. The first was that the loss was to be treated as having been sustained by the successor, rather than the predecessor, in carrying on the trade; the second is that the amount of the loss is the amount for which the predecessor would have been entitled to relief had it continued to carry on the trade. The first hypothesis, he said, was necessary in order to enable the successor to carry forward a loss which it did not itself suffer while the second fixed the extent of the entitlement. The F-tT had correctly concluded that Leekes' entitlement to losses was the same as that of Coles, that is the entire £3 million, while its ability to use the losses depended on the amount of the profits of the enlarged trade. Once it is accepted that Leekes has acquired the entitlement to the relief there is nothing objectionable or contrary to principle in its doing so by reference to the profits of the combined trade.

25. The reason why sub-s (8) did, but sub-s (3) did not, require streaming lay in the use in the former of the word "activities". Subsection (3) related to the transfer of a trade, whereas sub-s (8) related to the transfer of something which, following transfer, can no longer be identified as a trade carried on by a predecessor company. He gave the example of the acquisition by a wholesaler of a manufacturing business of which the wholesaler had formerly been the principal customer. The merged trade would consist of the manufacture of goods for the benefit of the wholesaler, which would then proceed to sell them, and the effect is that the wholesaler has taken over the manufacturing functions as activities of its trade. The ability of the manufacturer to make profits has disappeared because the successor cannot profit by manufacturing goods and supplying them to itself. The purpose of sub-s (8) is to compel the wholesaler to treat its manufacturing activity as a separate trade for the purposes of claiming loss relief. It is because that deemed separate trade is dependent on a statutory fiction that the restriction of the loss relief has been imposed.

26. There is no need for a fiction in a case such as this, where the trade which the successor has acquired remains identifiable. The reality, Mr Mehta said, is that the same

trade is carried on by the successor but on an enlarged basis. Real losses have been carried forward and they should be available to be set off against the real profits of the enlarged trade. In the absence of any express indication to the contrary in sub-s (3), there was no basis upon which the restriction for which HMRC argued could be inferred. On the contrary, if streaming were implicit in sub-s (3), it is difficult to see why the draftsman considered it necessary to include the same requirement explicitly in sub-s (8).

27. In his skeleton argument, Mr Mehta dealt with the history of the case-law, making the point that most of the cases dealt with the meaning of succession and with provisions relating to the tax charge, whereas s 343 relates to relief. We agree with Mr Mehta that, for that reason, little assistance is provided by the previous authorities and we therefore have not thought it necessary to discuss those cases in any detail. What we have already said on the topic is, we think, sufficient.

Discussion

28. Although, on first reading, s 343(3) may appear somewhat obscure, we are satisfied that, when analysed in its context, there is no real room for doubt about its correct interpretation. It represents an exception to the finality of s 337, without which the potential relief in respect of accumulated losses would be forfeited on cessation of the trade by the predecessor. We agree, however, with Ms Wilson that its purpose is not to put the successor in a better position than that in which the predecessor would have found itself had it carried on the trade, but to transfer the potential for relief, without change, to the successor in a case falling within sub-s (1).

29. It is in our view clear that "the trade" to which sub-s (3) refers is the same trade as that to which sub-s (1) refers; there is nothing in the wording of the section to suggest that the draftsman intended to refer in sub-s (1) to the predecessor's trade but in sub-s (3) was contemplating the enlarged trade of the successor. We do not see how the subsection can be interpreted in any other way. As Ms Wilson, in our judgment rightly, argued, the predecessor could not have carried on the enlarged trade but only its own, smaller, trade and it is only by reference to the profits, if any, of that trade that it would have been entitled to relief for accumulated losses. Thus we agree with her that the draftsman has not included any provision for streaming because it is unnecessary to do so. The reason why the requirement of streaming is included within sub-s (8) is that that subsection contemplates a different situation, in which a successor has taken over only the activities of another's trade—implying, in some cases, that only part of the predecessor's trade may have been taken over—and has merged those activities with his own trade. In a case of that kind, there is not necessarily any trade of the predecessor which can be discretely identified as continuing and a deeming provision is therefore required to treat the trading activities as a notional trade: see the explanation given by Millett J in *Falmer Jeans*.

30. We do not accept Mr Mehta's argument that s 343 gives rise to two hypotheses, an argument which, we think, set the F-tT on the wrong track. There is nothing hypothetical about the amount, or quantum, for which relief is available: it is, as sub-s (3) makes clear, the "amount for which the predecessor would have been entitled to relief". We also see no need for a trade hypothesis when the meaning of the subsection is, as we have concluded, clear; but it is probably this argument which led the F-tT to the observation, at [44] that "[t]he basic premise of the relieving provision in s 343(1)

(combined with s 337) is that if one company ceases to carry on a trade and another begins to carry it on, the trade of the original company has disappeared"; and, from it, and the absence of an express streaming provision in sub-s (3), to the conclusion that relief is available by reference to the income of the enlarged trade.

31. We disagree with the F-tT in its view about the relevance of the commercial reality of a succession of the kind with which we are concerned or, indeed, a succession in which it is less easy to identify the predecessor's trade as a discrete part of the enlarged whole. First, we accept Ms Wilson's point that it is not permissible to disregard the words of a statute because of a perception of practical difficulty. Moreover, as she pointed out, the difficulty can be avoided or minimised by careful record-keeping. Secondly, the policy reasons behind the restriction of the successor to relief only in those circumstances in which relief would have been available to the predecessor are obvious: if it were otherwise there would be ample opportunity for abuse.

Disposition

32. Accordingly, HMRC's appeal is allowed. The F-tT's decision is set aside and the conclusion of the closure notice is restored.

Hon Mr Justice Roth

Judge Colin Bishopp

Upper Tribunal Judges
Release date: 12 July 2016