

*CORPORATION TAX – chargeable gains – group of companies – ultimate disposal in 1990 of shares the value of which had been materially reduced by two depreciatory transactions within the group – allowable loss accruing on the ultimate disposal – reduction of allowable loss having regard to the depreciatory transactions - whether just and reasonable to further reduce allowable loss by the equivalent of the indexation allowance from the dates of the depreciatory transactions to the date of the ultimate disposal – yes – appeal dismissed – TA 1970 s 280(4) and (5)*

**THE SPECIAL COMMISSIONERS**

**WHITEHALL ELECTRIC INVESTMENTS LIMITED**

- and -

**J F OWEN  
(H M INSPECTOR OF TAXES)**

**Appel**

**Responden**

**SPECIAL COMMISSIONER: DR NUALA BRICE**

**Sitting in London on 6 March 2002**

**Felicity Cullen of Counsel, instructed by Freshfields Bruckhaus Deringer Solicitors, for the Appellant**

**David Ewart of Counsel, instructed by the Solicitor of Inland Revenue, for the Respondent**

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## **DECISION**

### **The appeal**

1. Whitehall Electric Investments Limited (the Appellant) appeals against an assessment to corporation tax in respect of chargeable gains made on a disposal dated 18 November 1996 (the 1996 disposal). The assessment was raised because the Inland Revenue were of the view that losses carried forward relating to a disposal on 10 December 1990 (the ultimate disposal) were not sufficient to offset the gains made on the 1996 disposal. In particular, the Inland Revenue were of the view that, when the allowable loss on the ultimate disposal was reduced, having regard to two previous depreciatory transactions (in 1987 and 1988), it was just and reasonable to make a further reduction of an amount equivalent to the indexation allowance between the dates of the depreciatory transactions and the ultimate disposal.

## The legislation

2. At the time of the ultimate disposal the legislation relating to the reduction of losses attributable to depreciatory transactions was contained in section 280 of the Income and Corporation Taxes Act 1970 (the 1970 Act). The relevant parts provided:

### **"Losses attributable to depreciatory transactions**

#### **Transactions in a group**

**280(1) This section has effect as respect a disposal of shares in, or securities of, a company (in this section referred to as an "ultimate disposal") if the value of the shares or securities has been materially reduced by a depreciatory transaction effected on or after 6 April 1965; and for this purpose "depreciatory transaction" means-**

**(a) any disposal of assets at other than market value by one member of a group of companies to another, ...**

**(4) If the person making the ultimate disposal is, or has at any time been, a member of the group of companies referred to in subsections (1) and (2) above, any allowable loss accruing on the disposal shall be reduced to such extent as appears to the inspector, or on appeal the Commissioners concerned, to be just and reasonable having regard to the depreciatory transaction: ...**

**(5) The inspector or the Commissioners shall make the decision under subsection (4) above on the footing that the allowable loss ought not to reflect any diminution in the value of the company's assets which was attributable to a depreciatory transaction, but allowance may be made for any other transaction on or after 6 April 1965 which has enhanced the value of the company's assets and depreciated the value of the assets of any other member of the group."**

## The issues

3. In 1990 the Appellant disposed of the whole of the issued share capital of a company called Sir Isaac Pitman Limited (Pitman). This was the ultimate disposal within the meaning of section 280(1). It was agreed that the value of the shares in Pitman had been materially reduced by two depreciatory transactions, effected in 1987 and 1988 respectively, where the assets of Pitman had been disposed of at other than market value by one member of a group of companies to another. It was also agreed that, at the time of the 1987 and 1988 depreciatory transactions, the diminutions in the value of the assets of Pitman amounted to £2,846,000 and £366,740 respectively, making a total of £3,212,740. It was further agreed that the values of the shares in Pitman were reduced by the depreciatory transactions by the same amounts.

4. The Appellant argued that the allowable loss on the ultimate disposal of the shares in Pitman should be reduced by an amount of £3,212,740 as that was the

amount of the diminution in the value of Pitman's assets which was attributable to the two depreciatory transactions within the meaning of section 280(5). The Inland Revenue, however, argued that it was just and reasonable, within the meaning of section 280(4), that the allowable loss on the ultimate disposal should be further reduced by an additional amount of £923,569, which was the amount equal to the indexation allowance on the amounts of £2,846,000 and £366,740 respectively, between the dates of the 1987 and 1988 depreciatory transactions and the ultimate disposal; thus the Inland Revenue argued that the allowable loss accruing on the ultimate disposal should be reduced by a total of £4,136,309.

5. Thus the issues for determination in the appeal were:

(1) whether the amount of the reduction in the allowable loss on the ultimate disposal was limited to the amount by which the assets in Pitman had been diminished in value by the two depreciatory transactions within the meaning of section 280(5), namely £3,212,740 (as argued by the Appellant); or

(2) whether it was just and reasonable within section 280(4) to make a further reduction of an amount equal to the indexation allowance on the values of the depreciatory transactions between the dates of the depreciatory transactions and the ultimate disposal, making a total reduction of £4,136,309 (as argued by the Inland Revenue).

### **The evidence**

6. A blue bundle of documents was produced which included an agreed statement of facts which was referred to at the hearing. The bundle also contained copies of certain correspondence between the parties most of which was not referred to at the hearing.

### **The facts**

7. From the evidence before me I find the following facts.

8. The Appellant was at all material times a wholly owned subsidiary of Pearson Plc (Pearson). Pearson also had another wholly owned subsidiary called Longman Group Limited (Longman). Longman had a wholly owned subsidiary called Longman Group UK Limited (Longman UK).

9. On 28 June 1985 Longman acquired the whole of the issued share capital of Pitman from an unconnected third party for the sum of £12,204,253. Pitman's activities included the carrying on of a publishing business and the holding of 20% of the shares in Ibis Mailing Group Limited (Ibis).

10. In January 1987 Pitman transferred the assets of its publishing business to Longman UK at book value (the 1987 depreciatory transaction). The book value of these assets was £2,846,000 below their market value and therefore the 1987 depreciatory transaction diminished the value of Pitman's assets (within the meaning of section 280(5)) by an amount of £2,846,000. The parties agreed that the value of the shares in Pitman were materially reduced (within the meaning of section 280(1)) by the same amount.

11. In September 1988 Pitman transferred its shares in Ibis to Longman at book value (the 1988 depreciatory transaction). The book value of the shares of Ibis was £366,740 below the market value and therefore the 1988 depreciatory transaction diminished the value of Pitman's assets (within the meaning of section 280(5)) by an amount of £366,740. The parties agreed that the value of the shares in Pitman were materially reduced (within the meaning of section 280(1)) by the same amount.

12. On 6 December 1990 the Appellant acquired from Longman the whole of the issued share capital of Pitman. Section 273 of the 1970 Act provided that, where a member of a group of companies disposed of an asset to another member of the group, the consideration was of such an amount as to secure neither a gain nor a loss. Thus the Appellant's base cost of the acquisition of the shares in Pitman was the same as the cost in 1985 to Longman, namely £12,204,253. On 10 December 1990 the indexation allowance on that amount was £4,405,735 making a total of £16,609,988.

13. On 10 December 1990 the Appellant disposed of the whole of the issued share capital of Pitman to an unconnected third party for £6,419,156 (the ultimate disposal). The incidental costs were £189,794. Thus the initial calculation of the allowable loss on the ultimate disposal was:

Sale proceeds £ 6,419,156

Less incidental costs £ 189,794

Net sale proceeds £ 6,229,362

Less deemed base cost including indexation £16,609,988

Allowable loss £10,380,626.

14. Under the provisions of section 280(4) and (5) of the 1970 Act the allowable loss of £10,380,626 has to be reduced having regard to the 1987 and the 1988 depreciatory transactions.

15. On 18 November 1996 the Appellant realised a chargeable gain on the disposal of another asset (the 1996 disposal) and wished to bring forward the allowable losses on the ultimate disposal. The Appellant claimed that the allowable losses on the ultimate disposal were sufficient to offset against the chargeable gains on the 1996 disposal. However, the Inland Revenue were of the view that the allowable losses on the ultimate disposal were not sufficient to offset the chargeable gains on the 1996 disposal with the result that there remained a chargeable gain of £850,855 not offset by carried forward losses. Accordingly the Inland Revenue assessed the Appellant to corporation tax in respect of gains of £850,835 and it is against that assessment that the Appellant appeals.

### **The arguments of the Appellant**

16. For the Appellant Miss Cullen agreed that the allowable loss of £10,380,626 on the ultimate disposal should be reduced by the amounts of £2,846,000 and £366,740, that is, by a total of £3,212,740. That was the amount, she said, by which the values of the assets in Pitman were diminished as result of the 1987 and the 1988 depreciatory transactions. However, she argued that there should

be no further reduction by an amount equal to the indexation allowance on the amounts of the depreciable transactions between the dates of those transactions and the date of the ultimate disposal.

17. Miss Cullen first referred to section 280(4) and argued that the "just and reasonable" discretion given by that subsection was not wide because that would not comply with the general principle that the law (and especially tax law) should be certain and also because that would not give due effect to the provisions of section 280(5) which described how the discretion should be exercised. The discretion in section 208(4) was meant to apply to matters such as difficulties in valuation.

18. Referring next to section 280(5) Miss Cullen went on to argue that it was that subsection which governed the exercise of the discretion; that provision was mandatory and also, by the use of the definite article in the phrase "the footing" excluded any other footing. She argued that the words "any diminution in value of the company's assets which *was* attributable to a depreciable transaction" was the only test to be applied. In particular she relied upon the word "was" as indicating that it was the diminution in value immediately after the depreciable transaction which was relevant and that later diminutions in value were not relevant. The assets disposed of by a depreciable transaction could diminish or increase in value after the transaction but many years later it might be impossible to trace them and establish their new values.

19. Miss Cullen relied upon the scheme of the legislation. She argued that section 280 was first enacted in 1968 before the enactment of the indexation allowance in 1982; thus when section 280 was enacted Parliament could not have intended the indexation of values under section 280(4) and she relied upon *Hadley v Perks* [1866] 1 QB 444 at 457. Further, the indexation provisions were very detailed but contained no reference to section 280. It was also relevant that the statutory indexation allowance was calculated by reference to the base cost of an asset and the period of ownership after 1 April 1982; however, in this appeal, the Inland Revenue were arguing for an indexation equivalent by reference to the diminution in the value of the total assets of a company for a period which started with the disposal of an asset and ended with the disposal of shares. Finally, the application of the retail prices index might not be relevant to particular assets which had diminished in value.

20. Miss Cullen distinguished *Tesco Plc v Crimmin* [1997] STC 981 ChD as, in that appeal, the depreciable transaction took place only two days before the ultimate disposal and so it was not in issue (as in this appeal) that there should be any indexation of the diminution in value between the date of the depreciable transaction and the date of the ultimate disposal. However Miss Cullen relied upon *Tesco v Crimmin* as authority for the views that: in section 280(5) the words "allowable loss" meant the indexed loss; that the word "reflect" meant "attributable to"; and that the purpose of section 280 was to negate the use of a depreciable transaction to produce allowable losses. She argued that the approach adopted by the Inland Revenue went further than that. Miss Cullen finally argued that the purpose of the indexation allowance was to reduce gains by a factor for inflation but in a depreciable transaction the diminution in value took place once and for all at the time of the depreciable transaction and it would not be appropriate to apply the indexation allowance (or its equivalent) in those circumstances.

### **The arguments of the Inland Revenue**

21. For the Inland Revenue Mr Ewart argued that the allowable loss on the ultimate disposal should be reduced by a total of £4,136,309. This, he said, was made up of the sum of £3,212,740 agreed by the Appellant and a further sum of £923,569 which was an amount equal to the indexation allowance on the sum of £3,212,740 (which was treated as a notional base cost for that purpose) between the dates of the two depreciatory transactions and the ultimate disposal. He relied upon *Tesco v Crimmin* at 993h as authority for the view that the intended role of section 280 was to prevent allowable losses being produced by depreciatory transactions.

22. On the subject of section 280(4) Mr Ewart argued that the reference to what was just and reasonable was not limited to matters such as valuation because the whole legislation assumed that it was always possible to find the true market value of an asset or shares, not a "just and reasonable" value. The aim of section 280(4) was to put the taxpayer in the position in which it would have been if there had been no depreciatory transaction and that was why a discretion was given to the Inspector and the Special Commissioners. When applying section 280(4) it was the allowable loss on the ultimate disposal of the shares which had to be reduced and that was not necessarily the same as the reduction in the value of the assets mentioned in section 280(5). It was relevant that in this appeal the initial computation of the allowable losses on the ultimate disposal of the shares included the application of the indexation allowance to the base cost of the shares. That had had the result of reducing the gain (i.e. increasing the loss) on the ultimate disposal of the shares. It followed that it would be just and reasonable to increase the amount of the depreciatory transactions by the equivalent of the indexation allowance to take account of inflation from the dates of the depreciatory transactions to the date of the ultimate disposal. He relied upon paragraph 40 of the judgment of Lord Hoffman in *Macniven v Westmoreland Investments Limited* [2001] STC 237 as authority for the view that a "real" amount was one which had been adjusted for inflation. He referred to *Holdings Limited v Money* [1995] STC (SCD) 347 at 350a where a similar provision was held to permit account to be taken of economic factors and inflation on a just and reasonable basis.

23. On the subject of section 280(5) Mr Ewart argued that the language of the subsection was the language of guidance and not of prescription. The subsection gave guidance as to the exercise of the discretion in section 280(4). It did not say that the allowable loss *should be* reduced by the diminution in value of the company's assets attributable to a depreciatory transaction; just that the reduction should be made "on the footing" that the allowable loss should not "reflect" that diminution. It left open the door to other reductions. If the Appellant were right then the provisions of section 280(4) would be otiose. He also argued that subsection (5) did not say that the allowable loss should not reflect the depreciatory transaction; what it said was that the allowable loss should not reflect the diminution in value of the company's assets attributable to the depreciatory transaction. It would be possible for the value of a company's assets to increase after a depreciatory transaction but section 280(4) only provided that a loss could be reduced; it did not provide that a gain could be imposed.

24. By way of clarification Mr Ewart stated what he was not arguing. First, he was not arguing that there should be an extra-statutory application of the indexation allowance to section 280; what he was arguing was that there should be a just and reasonable adjustment to take account of inflation and that this should be by reference to the retail prices index (which was also how the indexation allowance was calculated). Secondly, he was not arguing that the indexation allowance provisions changed section 280 or the construction of section 280. He accepted

that one could only take account of subsequent statutory provisions if the original were ambiguous. However, he argued that although an indexation allowance did not exist when section 280 was enacted, the "just and reasonable" provisions in section 280(4) were sufficiently flexible to take into account the fact that losses were now adjusted for inflation. Although Mr Ewart referred to *Cape Brandy Syndicate v Inland Revenue Commissioners* [1920] 1 KB 64 at 64 and 70, he argued that it was not apposite in the present appeal. Thirdly, Mr Ewart said that he was not arguing that the retail prices index should be applied to the diminution in the value of the assets of Pitman but he was arguing that it should be applied to the diminution in the value of the shares as it was the allowable losses on the ultimate disposal of the shares which was being reduced. (Although in this appeal it had been agreed that the diminution in the value of the shares was the same as the diminution in the value of the assets that would not always be the case.)

### **Reasons for decision**

25. I have not found this decision to be without difficulty. The arguments of both parties were very persuasive. I have to interpret the meaning of the phrase "just and reasonable" which is itself imprecise and which was contained in legislation which was enacted many years before the enactment of the legislation about the indexation allowance. Further, there are no authorities directly on this point to give guidance. I have therefore approached the arguments of the parties by first considering the plain words of section 280 (which does not mention the indexation allowance). I then consider the wider statutory framework including that relating to the indexation allowance. And finally I consider the authorities to see what principles they establish.

#### *Section 280*

26. Section 280 applies to groups of companies and was first enacted in 1968. (The indexation allowance provisions were first enacted in 1982). Section 280(1) provides that the section applies where there is an ultimate disposal of shares whose value has been reduced by a previous depreciatory transaction. A "depreciatory transaction" is defined as a disposal of assets at less than market value. Thus the section applies to an ultimate disposal of shares if the value of the shares has been reduced by a previous disposal of assets at less than market value. These provisions, therefore, are the necessary conditions for the application of the section but do not themselves state what is to happen on the ultimate disposal.

27. Of course, if a company disposes of any of its assets at less than market value that is likely to lead to a reduction in the value of its shares. That means that, other things being equal, if assets have been disposed of at less than market value then there will be a loss on the subsequent disposal of the shares.

28. Section 280(4) provides that any allowable loss accruing on the ultimate disposal of the shares is to be reduced "to such extent as appears to be just and reasonable having regard to the depreciatory transaction". Pausing there, it is clear that the reduction not only has to be just and reasonable but must also have regard to the depreciatory transaction (and only to the depreciatory transaction). It will be recalled that the depreciatory transaction was the previous disposal of assets at less than market value. So, the allowable loss on the ultimate disposal of the shares has to be reduced to such extent as is just and reasonable having regard to the previous disposal of assets at less than market value. This provision also makes it clear, as argued by Mr Ewart, that one is looking at the allowable loss on the ultimate disposal of the shares when deciding

what is a just and reasonable reduction. In my view that is relevant in this appeal as it is at the time of the ultimate disposal of the shares that that one has to decide what is a just and reasonable deduction.

29. When enacted the "just and reasonable" test was required because a disposal of assets at less than market value will, in most cases, lead to a reduction in the value of a company's shares but there will not always be an exact co-relation between the amount of the undervalue of the assets and the amount of the reduction in value of the shares. (Although it was agreed in this appeal that the values of the shares were reduced by the same amounts as the assets were undervalued on their disposal, that will not always be the case.) As enacted, therefore, the purpose of the "just and reasonable" provision was to decide the amount by which the value of the shares was reduced having regard to the previous depreciatory transactions under which the assets were disposed of at an undervalue.

30. Section 280(5) contains further provisions as to how the allowable loss on the ultimate disposal of the shares is to be reduced. It is mandatory and provides that the decision *shall* be made in accordance with the subsection. It has to be made on one (and only one) stated footing. That is, that the allowable loss on the ultimate disposal of the shares must not reflect any diminution in the value of the company's assets which *was* attributable to a previous disposal of assets at an undervalue (and to nothing else).

31. Pausing there, it is clear that any computation under section 280 is to be made at the time of the ultimate disposal of the shares. It is the allowable loss on the ultimate disposal of the shares which is being calculated and reduced having regard to the (previous) depreciatory transaction. By definition, the depreciatory transaction takes place before the ultimate disposal and there could be a substantial interval between the two.

32. Two separate questions then arise. The first concerns the application of the indexation allowance to the value of the depreciatory transaction between the date of the depreciatory transaction and the date of the ultimate disposal and that is in issue in this appeal. I consider that question later within the context of the statutory provisions applicable to the indexation allowance. The second question (which was mentioned in argument by Miss Cullen) concerns the effect of a change in the market value of an asset the subject of a depreciatory transaction between the date of the depreciatory transaction and the date of the ultimate disposal. That question is not in issue in this appeal but is relevant because the possibility of a change in market values must have been present in the mind of the legislature when section 280 was enacted (although clearly the indexation allowance was not so present).

33. The question then arises as to whether, when valuing the shares on the ultimate disposal, one should take into account only the diminution in the value of the company's assets as at the date of the depreciatory transaction or whether one should also have regard to changes in the value of the asset between the date of the depreciatory transaction and the date of the ultimate disposal. For example, suppose that there is a depreciatory transaction in year 1 under which a particular asset is disposed of for no consideration when its market value was £500,000. At the date of the ultimate disposal of the shares in year 5 the market value of that asset could have doubled or halved and, if the asset had not been disposed of, that new value would be reflected in the value of the company's shares at the date of the ultimate disposal. Is therefore the allowable loss on the ultimate disposal of the shares to reflect the diminution in the value of the



company's assets as at year 1, namely, as at the date of the depreciatory transaction (£500,000) or the diminution in value of the company's shares as at year 5, namely, the date of the ultimate disposal (£1,000,000 or £250,000)?

34. In my view the use of the word "was" in section 280(5) makes it clear that the diminution in value is that at the date of the depreciatory transaction and not at the date of the ultimate disposal. Otherwise, the subsection would have referred to "any diminution in value of the company's assets attributable to a depreciatory transaction".

33. The alternative proposal might be unworkable. Where an ultimate disposal of shares takes place many years after a depreciatory transaction has diminished the value of a company's assets, it might be impossible to trace the assets disposed of by the depreciatory transaction and to identify whether their value had been reduced, increase or maintained in the interval.

34. The conclusion therefore is that the diminution in value referred to in section 280(5) is the diminution in value of the company's assets as at the date of the depreciatory transaction. If no regard is to be paid to subsequent fluctuations in the value of the assets forming part of the depreciatory transaction that might lead to the tentative conclusion that no regard should be paid to subsequent inflation either. However, that is the view reached on the plain words of section 280 alone. Since that section was enacted the indexation allowance has changed the way in which the initial computation of the allowable loss on the ultimate disposal has to be made. The question thus arises as to whether it would be just and reasonable to have regard to that factor when deciding on the amount of the reduction to the allowable loss which should be made having regard to the depreciatory transaction. In order to reach a view on that question I now consider the wider statutory framework

### ***The statutory framework***

35. Three sets of statutory provisions were relevant at the time of the ultimate disposal. The first were the provisions about losses attributable to depreciatory transactions which appeared in section 280 of the 1970 Act. These have already been considered.

36. The second were the provisions about the computation of gains and losses which appeared in Part II Chapter II sections 28 and 29 of the Capital Gains Tax Act 1979 (the 1979 Act). Sections 28 and 29 defined gains and losses.

37. The third set of statutory provisions were found in section 86 and paragraph 2 of Schedule 13 of the Finance Act 1982 (the 1982 Act) (as respects gains) as amended by the Finance Act 1985 (the 1985 Act) (to apply to losses). The relevant parts of section 86 of the 1982 Act, as amended by the 1985 Act, provided:

#### **" 86 Indexation allowance on certain disposals**

##### **(1) This section applies to any disposal of an asset-**

**(a) ... if the disposal is by a company, on or after 1 April 1982 ..**

##### **(2) In relation to a disposal to which this section applies-**

**(a) "the unindexed gain or loss" means the amount of the gain or loss on the disposal computed in accordance with Chapter II of Part II of the [1979 Act] ...**

**(4) The following provisions of this Chapter have effect to provide for an allowance (in those provisions referred to as "the indexation allowance") which, on a disposal to which this section applies, is to be set against the unindexed gain or, as the case may be, added to the unindexed loss so as to give the gain or loss for the purposes of the [1979 Act] as follows-**

**(a) if there is an unindexed gain, the indexation allowance shall be deducted from the gain and, if the allowance exceeds the unindexed gain, the excess shall constitute a loss;**

**(b) if there is an unindexed loss, the indexation allowance shall be added to it so as to increase the loss; and**

**(c) if the unindexed gain or loss is nil, there shall be a loss equal to the indexation allowance."**

38. Thus it is clear that the indexation allowance reduces a gain or increases a loss. There is nothing in the indexation allowance provisions about depreciatory transactions. It is no doubt for this reason that the Inland Revenue did not argue that they should apply to depreciatory transactions. The Inland Revenue's argument was that the allowable loss on the ultimate disposal of the shares should not only be reduced by the diminution in the value of a company's assets attributable to a depreciatory transactions but should be yet further reduced by an amount equal to the indexation allowance on the value of the depreciatory transaction between the date of the depreciatory transaction and the ultimate disposal under the "just and reasonable" provision in section 280(4).

39. On the one hand it could be argued (as did Miss Cullen) that the indexation provisions are detailed and specific. When they were enacted section 280 already existed. If Parliament had intended them to apply to depreciatory transactions than that could have been stated specifically. As it did not do so, to apply them, even in the way suggested by the Inland Revenue, would be to read words into section 280(4) and (5) which are not there. On the other hand it could be argued (as did Mr Ewart) that section 280(4) requires such reduction (to the allowable loss on the ultimate disposal) to be made as is fair and reasonable having regard to the depreciatory transactions. It was not possible to ignore the fact that, in computing the gain or loss on the ultimate disposal of the shares, the base cost of the shares had been indexed as a result of the statutory provisions relating to the indexation allowance. Thus the indexation allowance had already increased the allowable loss. It was therefore just and reasonable, when reducing the allowable loss having regard to the depreciatory transactions, to further reduce the allowable loss by an amount to represent inflation.

40. In order to put this argument into the context of section 280 I now return to look at that section with the indexation provisions in mind. Section 280(4) requires a reduction to be made in the amount of the allowable losses on the

ultimate disposal of the shares such as is just and reasonable "having regard to the depreciatory transaction". One must bear in mind that the calculation is being made at the time of the ultimate disposal of the shares and on that ultimate disposal the base cost of the shares has been increased by the indexation allowance, thus increasing the allowable losses. The indexation allowance has been applied to the full value of the base cost of the shares for the full period of time (since 1982) during which the shares were held. However, during part of that period of time, as a result of the depreciatory transactions, the Appellant (and its predecessor in the group) did not in fact hold the full value of the shares but a value reduced by the depreciatory transactions. That would indicate that, when having regard to the depreciatory transactions as required by section 280(4), one should also have regard to the fact that the depreciatory transactions reduced the values of the shares, upon which the full indexation allowance was later given as if the full value of the shares had been held up to the date of the ultimate disposal. That would lead to the conclusion that it would be just and reasonable to adjust the values of the depreciatory transactions to take account of inflation.

41. It is then necessary to consider whether this conclusion accords with the words of section 280(5). In my view it does. It ensures that the allowable loss on the ultimate disposal of the shares does not reflect any diminution in value of the company's assets which was attributable to the depreciatory transaction. If the adjustment were not made then the allowable loss on the ultimate disposal of the shares would not adequately reflect the diminution of assets which were attributable to the depreciatory transactions as the allowable loss on the ultimate disposal would include the indexation allowance up to the date of the ultimate disposal on that part of the base cost of the shares which represented assets previously disposed of in the depreciatory transactions.

42. Thus the wider statutory framework supports the view that it would be just and reasonable to reduce the allowable loss on the ultimate disposal of the shares by an amount equal to the indexation allowance on the amounts of the depreciatory transactions between the dates of the depreciatory transactions and the date of the ultimate disposal. In my view this conclusion does not require any words to be read into section 280 that are not there. It just gives the ordinary, everyday meaning to the phrase "just and reasonable".

44. Having reached that conclusion I now turn to consider the authorities cited by the parties to see what principles they establish.

#### *The authorities*

45 In *Tesco v Crimmin* (1997) the issue also concerned the way in which the indexation allowance was applied to the reduction of allowable losses on an ultimate disposal of shares having regard to a previous depreciatory transaction. The appellant argued that the indexation allowance had nothing to do with the depreciatory transaction; accordingly, the unindexed loss should first be reduced by the depreciatory transaction after which the indexation allowance could be used to restore a loss. The Inland Revenue argued that it was the indexed loss which had to be reduced by the depreciatory transaction. The Vice-Chancellor held at 993f that the section 280 machinery had to be applied to the allowable loss and that was the indexed allowable loss (and not the unindexed loss); the indexed allowable loss had to be ascertained and section 280 applied to it.

46. Although *Tesco v Crimmin* does not concern the issue in this appeal it was relied upon by Mr Ewart at 993h as authority for the view that the intended role

of section 280 was to prevent allowable losses being produced by depreciatory transactions. At that stage in his judgment the Vice-Chancellor was addressing the point that section 280 only operated to reduce allowable losses and not to increase gains or turn losses into gains and was dealing with an argument of the appellant that the result he proposed might lead to taxpayer companies being deprived of the indexation allowance. He said:

"Mr Park [for the appellant] protested that the view I have expressed would have the result that taxpayer companies might find themselves deprived by s 280 of the benefit of the indexation allowance. In some cases I agree that that might be so. But an indexation allowance is neutral as to whether the end result is a chargeable gain of a reduced amount, a gain/loss of nil, or an allowable loss of an increased amount. It is only in the last of these eventualities that s 280 may come into play. But if s 280 does come into play it must be allowed its intended role, namely, to prevent allowable losses being produced by depreciatory transactions. If a depreciatory transaction does not go so far as to produce an unindexed allowable loss but simply eliminates or reduces a potential unindexed gain, and on a subsequent disposal the indexation allowance produces an allowable loss where pre-indexation there would be none, s 280, in reducing or eliminating that indexed allowable loss, is discharging, in my opinion, the proper role for which the legislature intended it, namely, in negating the use of depreciatory transactions to produce allowable losses."

47. This passage makes it clear that the indexation allowance applies only to the base cost of the shares at the date of the ultimate disposal. If that creates allowable losses so that s 280 applies then that is the purpose of the section. However, the passage is not authority for the view that a further indexation should be applied to the disposal of the assets in the depreciatory transaction and so I have not relied upon it in this appeal.

48. Mr Ewart relied upon paragraph 40 of the judgment of Lord Hoffman in *Macniven v Westmorland* as authority for the view that a "real" amount was one which had been adjusted for inflation. In paragraph 40 Lord Hoffman said:

"The speeches in *Ramsay* and subsequent cases contain numerous references to the "real" nature of the transaction and to what happens in the "real" world. These expressions are illuminating in their context, but you have to be careful about the sense in which they are being used. Otherwise you land in all kinds of unnecessary philosophical difficulties about the nature of reality and, in particular, about how a transaction can be said not to be a "sham" and yet be "disregarded" for the purpose of deciding what happened in "the real world". The point to hold onto is that something may be real for one purpose but not for another. When people speak of something being a "real" something, they mean that it falls within some concept which they have in mind, by contrast with something else which might have been thought to do so, but does not. When an economist says that real incomes have fallen, he is not intending to contrast real incomes with imaginary incomes. The contrast is specifically between incomes which have been adjusted for inflation and those which have not. In order to

know what he means by "real", one must first identify the concept (inflation adjustment) by reference to which he is using the word."

49. I do not read this paragraph as being authority for the view that a real amount is one which has been adjusted for inflation. All it states is that when an economist speaks of real incomes he means incomes which have been adjusted for inflation. The paragraph emphasises that the nature of reality depends upon the context within which the concept is used. It warns against the extrapolation of one meaning of reality into another context. However, even if it could be said generally that a "real" amount is one which has been adjusted for inflation that would not assist the Inland Revenue in this appeal because the word "real" does not appear in section 280. I have therefore not relied upon this authority either.

50. Mr Ewart also relied upon *Holdings v Money* (1995) which concerned the application of paragraph 3 of Schedule 11 of the Finance Act 1988 (the 1988 Act) which restricted the indexation allowance on certain disposals of shares in groups and associated companies. Paragraph 3 provided:

**"3 (1) This paragraph applies-**

**(a) where there is a disposal by a company of-**

**(i) a holding of redeemable preference shares of another company, if the two companies are linked companies before the disposal.**

**(2) Where this paragraph applies, any indexation allowance which, apart from this paragraph, would be due on the disposal shall be reduced by such amount as appears to the inspector, or on appeal the Commissioners concerned, to be just and reasonable."**

51. In that appeal in 1978 and 1980 a subsidiary issued 14.5m 6% non-cumulative redeemable preference shares to its parent. The 6% rate was a commercial rate which took account of anticipated inflation. There was a re-organisation in 1982 when the subsidiary became a subsidiary of the appellant who then held the non-redeemable preference shares which were then valued at £1 each. In 1988 the appellant redeemed 10m of the shares for £10M and claimed an indexation allowance of £2.93M. The Inland Revenue took the view that it was just and reasonable under paragraph 3 to reduce the indexation allowance to nil on the ground that, as inflation had been taken into account when fixing the rate of interest, the appellant had already been compensated for any loss attributable to inflation during the period that it held the shares. The Special Commissioners agreed and, dismissing the appeal, held that, as the redemption of the shares did not result in any economic loss overall to the group of companies to which the appellant and the subsidiary belonged, it was difficult to see how the indexation allowance could be justified.

52. That decision is not of direct relevance in this appeal because of three significant differences between the words of section 280(4) and the words of paragraph 3 of Schedule 11 of the 1988 Act. First, section 280 does not refer to the indexation allowance whereas paragraph 3 does. Secondly, in section 280(4) the words "just and reasonable" are immediately followed by the words "having regard to the depreciatory transaction" and by section 280(5); there is no such

qualification in paragraph 3. And finally paragraph 3 applies on the disposal by a company of its shares and concerns the statutory indexation allowance due on that disposal whereas section 280(4) and (5) concern the reduction to be made to take account of a depreciatory transaction.

53. Having said that, however, the decision is of interest because the Special Commissioners reached their view on what was just and reasonable having regard to the overall economic loss to the group of companies to which the appellant and the subsidiary belonged. I have reached a view in the present appeal having regard to the fact that the allowable loss on the ultimate disposal of the shares is calculated with the application of the statutory indexation allowance for the full period of ownership to the full base cost of the shares. Accordingly, it is just and reasonable to have regard to the fact that, as a result of the depreciatory transactions, the full value of the shares was not in fact held for the full period of time and to make a reduction accordingly.

### **Decision**

54. My decision on the issues for determination in the appeal is that the amount of the reduction in the allowable loss on the ultimate disposal is not limited to the amount by which the assets (and the shares) in Pitman had been diminished in value by the two depreciatory transactions, namely £3,212,740 (as argued by the Appellant) but that there should be a further reduction of an amount equal to the indexation allowance on the values of the depreciatory transactions between the dates of the depreciatory transactions and the ultimate disposal.

55. The appeal is, therefore, dismissed.

**DR NUALA BRICE**

**SPECIAL COMMISSIONER**

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