Revenue and Customs Commissioners v English Holdings (BVI) Ltd

[2017] UKUT 842 (TCC)

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

ROSE J (P) AND JUDGE HERRINGTON

17, 18 OCTOBER, 14 DECEMBER 2017

Loss relief – Claim – Validity – Income tax – Separate trades – Taxpayer company registered in British Virgin Islands – Taxpayer making losses through permanent establishment in UK that if profitable would have been chargeable to corporation tax – Taxpayer making profits not through permanent establishment chargeable to income tax – Whether taxpayer entitled to set loss relief for corporation tax loss against income tax liability – Income Tax Act 2007, s 64 – Corporation Tax Act 2009, s 3.

The taxpayer was a company registered in the British Virgin Islands and was not resident in the United Kingdom. At the relevant time, it had a permanent establishment ('PE') in the UK through which it carried on the activity of trading in land situated in the UK ('the PE trade'). If it had made profits on the PE trade, the taxpayer would have been chargeable to corporation tax on those profits. However, in the year to 31 March 2011, the PE trade made a loss of over £2m. In addition to that trade, the taxpayer owned various investment properties in the UK on which it earned rental income ('the letting business'). The letting business was not carried out through a PE and so any profits were chargeable to income tax. In the tax year ended 5 April 2010, the letting business made profits of over £1m. The Revenue and Customs Commissioners ('HMRC') considered that that resulted in an income tax liability of just over £200,000. The taxpayer sought to set off its loss arising out of the trading activities in the year to 31 March 2011 against its profits on its non-PE trading activities arising in the previous year. HMRC rejected the taxpayer's claim in a closure notice. The First-tier Tribunal ('FTT') allowed the taxpayer's appeal, holding that, on a literal reading of s 64[a] of the Income Tax Act 2007 ('ITA 2007'), theoretically a taxpayer could set off against its general income a loss incurred in a trade which, if profitable, would have been subject to corporation tax. The FTT also rejected HMRC's submission that a purposive reading of the statutory provisions was necessary in order to respect the separation between the corporation tax regime and the income tax regime. It held that it was not obvious that Parliament intended that taxpayers in the unusual position of having two income streams, one subject to corporation tax and one subject to income tax, should not be able to set a corporation tax loss against an income tax profit. Ordinary taxpayers were able to set losses arising in one trade against profits arising in other trades, if both trades fell within the corporation tax regime or if they both fell within the income tax regime. HMRC appealed. The Upper Tribunal considered whether s 64 ITA 2007 allowed the taxpayer to make a claim for trade loss relief against the general income coming from the

a Section 64 ITA 2007, so far as material, is set out at [26], below.

letting business by offsetting the loss made in the PE trade. HMRC contended that s 3[b] of the Corporation Tax Act 2009 ('CTA 2009') had the broad effect of separating the corporation tax regime from the income tax regime so that where a trade was within the corporation tax regime then its profits and losses were dealt with exclusively under that regime and could not fall within the income tax regime either for the purpose of being taxed as income if the trade made a profit or for the purpose of claiming loss relief if the trade made a loss. HMRC argued therefore that the extent to which a loss arising from a trade which was within the charge to corporation tax could be offset against income was limited to the uses expressly allowed by the Corporation Tax Acts.

Held – On the proper construction of the relevant provisions of the Income Tax Acts and the Corporation Tax Acts, the taxpayer was entitled, pursuant to s 64 ITA 2007, to set off against the profits from its letting business the loss incurred in its PE trade, even though the profits of the letting business were within the charge to income tax and, if it had earned profits in that PE trade, those profits would have been chargeable to corporation tax. There was nothing in ITA 2007 s 64 which limited the trade in which the loss was made to a trade which, if profitable, was chargeable to income tax. CTA 2009 s 3 only disapplied those provisions of the Income Tax Acts which applied to the income of a non-resident company where the income was within its chargeable profits, as defined in the CTA 2009. There was no general principle that different taxes had to be interpreted so as to be mutually exclusive in terms of their scope of potential application. The interaction between different taxes depended on what Parliament expressly legislated for. There was no clear reason why Parliament should have intended to prevent a company, which was in the anomalous position of having two businesses, one subject to income tax and one subject to corporation tax, from being able to set a corporation tax loss off against general income. A purposive interpretation therefore favoured set-off. HMRC's appeal would accordingly be dismissed (see [61], [65], [67]–[69], [140], below).

Notes

For relief for trading losses: current year profits, see Simon's Taxes D1.1104.

For the Income Tax Act 2007, s 64, see the Yellow Tax Handbook 2015–16, Part 1b, p 1141.

For the Corporation Tax Act 2009, s 3, see the Yellow Tax Handbook 2015–16, Part 1b, p 2188.

Cases referred to

Blanckaert v Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen (Case C-512/03) EU:C:2005:516, [2005] STC 1574, [2005] ECR I-7685, ECJ.

Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften (Case C-386/04) EU:C:2006:568, [2008] STC 1439, [2006] ECR I-8203, ECJ.

Européenne et Luxembourgeoise d'investissements SA v Directeur général des impôts (Case C-451/05) EU:C:2007:594, [2008] STC 1762, [2007] ECR I-8251, ECJ.

Finanzamt Ulm v Wagner-Raith (Case C-560/13) EU:C:2015:347, ECJ.

Holböck v Finanzamt Salzburg-Land (Case C-157/05) EU:C:2007:297, [2008] STC 92, [2007] ECR I-4051, ECJ.

b Section 3 CTA 2009, so far as material, is set out at [6], below.

Missionswerk Werner Heukelbach eV v Belgium (Case C-25/10) EU:C:2011:65, [2011] STC 985, ECJ. a

Prunus SARL v Polonium SA (Case C-384/09) EU:C:2011:276, [2011] STC 1392, [2011] ECR I-3319, ECJ.

Routier v Revenue and Customs Comrs [2017] EWCA Civ 1584.

Sanz de Lera, Criminal proceedings against (Joined cases C-163/94, C-165/94, and C-250/94) EU:C:1995:451, [1995] ECR I-4821, ECJ. b

Schröder v Finanzamt Hameln (Case C-450/09) EU:C:2011:198, [2011] STC 1248, [2011] ECR I-2497, ECJ.

Test Claimants in the FII Group Litigation v Inland Revenue Comrs (Case C-446/04) EU:C:2006:774, [2007] STC 326, [2006] ECR I-11753, [2012] 2 AC 436, ECJ.

Test Claimants in the FII Group Litigation v Revenue and Customs Comrs (Case C-35/11) EU:C:2012:9876, [2013] STC 612, [2013] Ch 431, ECJ. c

Trigg v Revenue and Customs Comrs [2016] UKUT 165 (TCC), [2016] STC 1310.

Trummer, Proceedings brought by (Case C-222/97) EU:C:1999:143, [1999] ECR I-1661, ECJ.

Welte v Finanzamt Velbert (Case C-181/12) EU:C:2013:662, [2014] 2 CMLR 415, ECJ. d

Westdeutsche Landesbank Girozentrale v Stefan (Case C-464/98) EU:C:2001:9, [2001] ECR I-173, ECJ.

X BV v Staatssecretaris van Financiën (Joined cases C-24/12 and C-27/12) EU:C:2014:1385, [2014] STC 2394, ECJ.

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Appeal

The Revenue and Customs Commissioners ('HMRC') appealed against the decision of the First-tier Tribunal (Judge Mosedale) dated 20 June 2016 ([2016] UKFTT 436 (TC), [2017] SFTD 20) allowing the appeal of the taxpayer, English Holdings (BVI) Ltd, against a closure notice issued by HMRC refusing the taxpayer's claim for loss relief pursuant to s 64 of the Income Tax Act 2007. f The facts are set out in the decision.

David Yates (instructed by the *Solicitor for Revenue and Customs*) for HMRC.
Michael Firth (instructed by *Brian White Ltd*) for English Holdings.
The tribunal took time for consideration. g

14 December 2017. The following decision was released.

ROSE J (P) AND JUDGE HERRINGTON.

[**1**] This is an appeal brought by the appellants, the Revenue and Customs h Commissioners ('HMRC'), against the decision of the First-tier Tribunal ('FTT') (Judge Mosedale) dated 20 June 2016 ([2016] UKFTT 436 (TC), [2017] SFTD 20). In that decision Judge Mosedale allowed the appeal of the respondent ('English Holdings') against a closure notice that had refused English Holdings' claim for loss relief under s 64 of the Income Tax Act 2007. The appeal raises an issue about the interrelation of corporation tax and j income tax in respect of a non-UK resident company where part of the company's business falls within the corporation tax regime and part of its business falls within the income tax regime. Judge Mosedale gave permission to appeal in a decision dated 6 September 2016.

[**2**] The facts are as set out in the FTT's judgment and were not in dispute.

(1) English Holdings is a company registered in the British Virgin Islands and is not resident in the UK.

(2) At the relevant time, it had a permanent establishment ('PE') in the UK through which it carried on the activity of trading in land situated in the United Kingdom ('the PE trade'). If it had made profits on the PE trade, English Holdings would have been chargeable to corporation tax on those profits. In the year to 31 March 2011, the PE trade made a loss of over £2m.

(3) In addition to that trade, English Holdings owned a number of investment properties in the UK on which it earned rental income ('the letting business'). This letting business was not carried out through a PE and so any profits were chargeable to income tax. In the tax year ended 5 April 2010 the letting business made profits of over £1m which HMRC consider resulted in an income tax liability of just over £200,000.

[**3**] The issue in this appeal is the apparently straightforward one of whether English Holdings is able to set off the loss incurred in the PE trade against the profits arising from the letting business with the effect of cancelling the income tax that would otherwise be charged on the letting business profits. English Holdings say that there is no reason why they should not be able to do so and Judge Mosedale agreed. HMRC argue that it is clear from the relevant legislation that the corporation tax and income tax regimes are intended to be separate so that losses incurred under one regime cannot be used to offset profits subject to the other.

THE RELEVANT STATUTORY PROVISIONS

[**4**] The provisions governing the imposition of the charge to corporation tax and the charge to income tax are spread over a number of different statutes. For income tax, the main statute is the Income Tax Act 2007 ('ITA 2007'). Section 1 ITA 2007 helpfully sets out an overview of the Income Tax Acts. For our purposes, these are the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') which deals with, amongst other things, the taxation of employment income; the Income Tax (Trading and Other Income) Act 2005 ('ITTOIA') which deals with the taxation of trading income and property income; and the ITA 2007 itself which deals largely with the mechanics of the imposition of the charge.

[**5**] For corporation tax, there are two main statutes, the Corporation Tax Act 2009 ('CTA 2009') and the Corporation Tax Act 2010 ('CTA 2010'). The CTA 2009 contains basic provisions including the imposition of the charge to corporation tax on the income and chargeable gains of companies, referred to collectively as 'profits'. The CTA 2010 deals with the calculation of the corporation tax charge chargeable on a company's profits, in particular the rates at which corporation tax is charged and how to ascertain the amount of profits to which the rates of tax are applied. It also makes provision for relief for trade losses and for losses from property businesses.

[**6**] As a matter of general principle the corporation tax and income tax regimes are separate. The separation is effected by s 3 CTA 2009. Section 3 is heralded by s 1(1)(b) CTA 2009 which provides that ss 3 and 4 CTA 2009 deal with 'the exclusion of income and chargeable gains subject to corporation tax from income tax and capital gains tax'. Section 3 CTA 2009 itself provides:

'3. Exclusion of charge to income tax

(1) The provisions of the Income Tax Acts relating to the charge to income tax do not apply to income of a company if—

(a) the company is UK resident; or

(b) the company is not UK resident and the income is within its chargeable profits as defined by section 19.'

[**7**] Section 4 CTA 2009 makes similar provision in respect of capital gains tax.

[**8**] The treatment of non-UK resident companies so far as corporation tax is concerned is dealt with further in s 5 CTA 2009 which specifies the territorial scope of the charge. This provides:

> **'5. Territorial scope of charge**
>
> (1) A UK resident company is chargeable to corporation tax on all its profits wherever arising.
>
> (2) A non-UK resident company is within the charge to corporation tax only if it carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom.
>
> (3) A non-UK resident company which carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom is chargeable to corporation tax on all its profits wherever arising that are chargeable profits as defined in section 19 (profits attributable to its permanent establishment in the United Kingdom).
>
> (4) Subsections (1) and (3) are subject to any exceptions provided for by the Corporation Tax Acts.'

[**9**] Detailed provisions for when a company is treated as resident in the United Kingdom are set out in Ch 3 of Pt 2 of the CTA 2009.

[**10**] Both ss 3 and 5 CTA 2009 refer forward to s 19 CTA 2009 as the section which specifies which of a non-UK resident company's profits are chargeable to corporation tax when the non-UK resident company carries on a trade in the United Kingdom through a permanent establishment here. Section 19 CTA 2009 provides:

> **'19. Chargeable profits**
>
> (1) This section applies if a non-UK resident company carries on a trade in the United Kingdom through a permanent establishment in the United Kingdom.
>
> (2) The company's chargeable profits are its profits that are—
>
> (a) of a type mentioned in subsection (3), and
>
> (b) attributable to the permanent establishment in accordance with sections 20 to 32.
>
> (3) The types of profits referred to in subsection (2)(a) are—
>
> (a) trading income arising directly or indirectly through or from the establishment,
>
> (b) income from property or rights used by, or held by or for, the establishment, and
>
> (c) chargeable gains falling within section 10B of TCGA 1992 (non-resident company with United Kingdom permanent establishment)—
>
> (i) as a result of assets being used in or for the purposes of the trade carried on by the company through the establishment, or
>
> (ii) as a result of assets being used or held for the purposes of the establishment or being acquired for use by or for the purposes of the establishment.'

[**11**] Sections 20 to 32 CTA 2009 then set out detailed rules for the purpose of determining the amount of profits of a non-UK resident company that are 'attributable' to a permanent establishment in the UK for the purpose of s 19(2)(b) CTA 2009. These provisions rely on the 'separate enterprise principle' described in s 21, broadly that the profits of the non-UK resident company attributable to the permanent establishment are those that the establishment would have made if it were a distinct and separate enterprise.

[**12**] Section 8 CTA 2009 provides for how corporation tax is charged and assessed, namely by reference to accounting periods. The provision imposing the charge to corporation tax on trading income is s 35 CTA 2009. This provides that the charge to corporation tax on income applies to the profits of the trade. Chapter 3 in Pt 3 of CTA 2009 sets out the basic rules for the calculation of trade profits. Section 46(1) CTA 2009 provides that the profits of a trade must be calculated in accordance with generally accepted accounting practice subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes. Section 47 CTA 2009 then provides:

> **'47. Losses calculated on same basis as profits**
> (1) The same rules apply for corporation tax purposes in calculating losses of a trade as apply in calculating profits.
> (2) This is subject to any express provision to the contrary.'

[**13**] The treatment of losses for corporation tax purposes is dealt with in CTA 2010. Loss relief is covered by Pt 4 of that Act. Section 36 CTA 2010 introduces Ch 2 as the Chapter which provides relief against a company's total profits of an accounting period for a loss made by the company in a trade in that or a subsequent accounting period. Section 36(3) CTA 2010 provides:

> '(3) In this Chapter references to a company carrying on a trade are references to the company carrying on the trade so as to be within the charge to corporation tax in relation to the trade.'

[**14**] Section 37 CTA 2010 provides for relief of trade losses against total profits. It applies if, in an accounting period, a company carrying on a trade makes a loss in the trade. The company may make a claim for relief for the loss by deducting the loss from the company's total profits of the accounting period in which the loss is made. If the company's claim so requires, the loss can also be set off against profits in previous accounting periods so far as they fall wholly or partly within the period of 12 months ending immediately before the loss-making period begins. There are some restrictions on the ability of the company to claim loss relief under s 37 CTA 2010. For example, the company may not make a claim if during the loss-making period it carried on the trade wholly outside the United Kingdom: see s 37(5) CTA 2010. The company's claim must generally be made within two years after the end of the loss-making period: see s 37(7) CTA 2010.

[**15**] As is apparent from these provisions, the trade loss suffered by the company can be set against the profits of the company earned by a different trade carried on by the same company in the same accounting period, as they form part of the company's 'total profits'. Trade losses can also be carried forward to future years if the loss has not in whole or in part been relieved by a claim under s 37: see s 45 CTA 2010. The unrelieved loss is carried forward to subsequent accounting periods so long as the company continues to carry on the trade. However, the carrying forward of the trade loss relief is limited to

reducing future profits of the previously loss-making trade. Section 45(5) provides that references to the profits of a trade are references to profits of the trade chargeable to corporation tax.

[**16**] Corporation tax losses can be used in other ways as well. For example, they can be surrendered under Ch 2 of Pt 5 of the CTA 2010 so that the loss can be used by another company in the same corporate group to set against that other company's profits.

[**17**] The charge to income tax on trading income is dealt with in Pt 2 of ITTOIA. Section 3 ITTOIA, giving an overview of Pt 2, provides in sub-s (4) that the charges under that Part apply to non-UK residents as well as UK residents but this is subject to later sections which provide that charges on non-UK residents apply only to their UK income.

[**18**] The main charging provision for income tax on trading profits is s 5 ITTOIA which provides that income tax is charged on the profits of a trade, profession or vocation. According to s 6 ITTOIA, profits of a trade arising to a UK resident are chargeable to tax wherever the trade is carried on. However, profits of the trade arising to a non-UK resident are chargeable to income tax only if they arise from a trade carried on wholly or partly in the United Kingdom. Section 268 ITTOIA provides that income tax is charged on the profits of a property business. The territorial scope of that charge to income tax is set out in s 269 ITTOIA. Again, a UK resident is subject to income tax on the profits of an overseas property business but a non-UK resident is only chargeable to income tax on the profits of a UK-based property business.

[**19**] Section 7 ITTOIA provides that income tax is charged under Ch 2 of Pt 2 of ITTOIA on the profits of a tax year, which are the profits of the 'basis period' for the tax year. Rules identifying the basis period for a tax year are set out in Ch 15 of Pt 2 of ITTOIA.

[**20**] Section 18 ITTOIA applies if a company starts or ceases to be within the charge to income tax under Ch 2 in respect of a trade. The company is treated for the purposes of Pt 2 of ITTOIA as starting to carry on the trade when it starts to be within the charge to income tax and it is treated as permanently ceasing to carry on the trade when it ceases to be within the charge.

[**21**] ITTOIA also deals with how the profits of a trade must be calculated. Thus, s 25 ITTOIA provides that the profits of the trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for income tax purposes. Section 26 ITTOIA provides that the same rules apply for income tax purposes in calculating losses of the trade as apply in calculating profits, subject to any express provision to the contrary.

[**22**] The ITA 2007 deals with a large number of specific points about the charge to income tax. Section 5 ITA 2007 records the exclusion from the charge to income tax in relation to certain income of the company. It provides:

> **'5. Income tax and companies**
> Section 3 of CTA 2009 disapplies the provisions of the Income Tax Acts relating to the charge to income tax in relation to income of a company … if—
> (a) the company is UK resident; or
> (b) the company is non-UK resident and the income is within its chargeable profits as defined by section 19 of that Act (profits attributable to its permanent establishment in the United Kingdom).'

[**23**] Loss relief for income tax is covered by Pt 4 of ITA 2007. The overview of Pt 4 is provided in s 59 ITA 2007:

'59. Overview of Part

(1) This Part provides for income tax relief for—

(a) losses in a trade, profession or vocation (and certain post-cessation payments and events) (see Chapters 2 and 3),

(b) losses in a UK property business or overseas property business (and, in the case of a UK property business, certain post-cessation payments and events) (see Chapter 4),

(c) losses in an employment or office (see Chapter 5),

(d) losses on a disposal of certain shares (see Chapter 6), and

(e) losses in certain miscellaneous transactions (see Chapter 7).

(2) This Part needs to be read with Chapter 3 of Part 2 (calculation of income tax liability).

(3) For rules about the calculation of losses for the purposes of this Part, see—

(a) section 26 of ITTOIA 2005 (losses of a trade, profession or vocation calculated on same basis as profits),

(b) section 272 of ITTOIA 2005 (which applies section 26 of that Act, so that losses of a UK property business or overseas property business are calculated on the same basis as profits),

(c) section 11 of ITEPA 2003 (calculation of "net taxable earnings"), and

(d) section 872 of ITTOIA 2005 (losses from miscellaneous transactions calculated on same basis as miscellaneous income).'

[**24**] Chapter 2 of Part 4 of ITA 2007 provides for relief for trade losses. Section 60 ITA 2007 gives an overview of the Chapter. Section 60(4) ITA 2007 defines 'sideways relief' as including trade loss relief against general income. Where a trade is carried on by a person otherwise than as a partner in a firm, any reference to the person making a loss in the trade in a tax year is to the person making a loss in the trade in the basis period for the tax year.

[**25**] Section 63 ITA 2007 ensures that there is no double counting of losses:

'63. Prohibition against double counting

If relief is given under any provision of this Chapter for a loss or part of a loss, relief is not to be given for—

(a) the same loss, or

(b) the same part of the loss,

under any other provision of this Chapter or of the Income Tax Acts.'

[**26**] Section 64 ITA 2007 is the key provision on which English Holdings rely. Under the heading 'Trade loss relief against general income' it states:

'64. Deduction of losses from general income

(1) A person may make a claim for trade loss relief against general income if the person—

(a) carries on a trade in a tax year, and

(b) makes a loss in the trade in the tax year ("the loss making year").'

[**27**] Other subsections of s 64 ITA 2007 deal with in which years the loss can be used to gain relief and cross-refer to other sections containing other provisions about loss relief. Thus, where a person has two trades which are within the charge to income tax there is no doubt that the person can set a loss

made in one trade against general income from other sources subject to various restrictions, for example for trades which are not run on a commercial basis or if the trade is hobby farming or market gardening.

THE ISSUES IN THE APPEAL

[**28**] It was common ground that English Holdings' PE trade is within the charge to corporation tax by reason of s 5(2) CTA 2009. That means that because of s 5(3) CTA 2009 it is chargeable to corporation tax on all its profits wherever arising that are chargeable profits as defined in s 19 CTA 2009 as being attributable to that permanent establishment. The profits of the letting business are chargeable to income tax pursuant to s 268 and s 269 ITTOIA because it is a property business carried on in the UK otherwise than through a permanent establishment and so chargeable to income tax even though English Holdings is a non-UK resident.

[**29**] We should say at the outset that this case was not presented by HMRC as a tax avoidance case. Mr Yates, appearing for HMRC, referred to the fact that at the relevant time, income tax rates were slightly lower than corporation tax rates, so that there was an advantage to English Holdings in not carrying on the letting business through the permanent establishment and placing it within the income tax regime. But it is not suggested that this was some deliberate choice on English Holdings' part designed to minimise tax in an artificial way.

[**30**] The first issue that arises in this case is whether s 64 ITA 2007 allows English Holdings to make a claim for trade loss relief against the general income coming from the letting business by offsetting the loss made in the PE trade. HMRC contend that s 3 CTA 2009 has the broad effect of separating the corporation tax regime from the income tax regime so that where a trade is within the corporation tax regime then its profits and losses are dealt with exclusively under the corporation tax regime and cannot fall within the income tax regime either for the purpose of being taxed as income if the trade makes a profit or for the purpose of claiming loss relief if the trade makes a loss. HMRC argue therefore that the extent to which a loss arising from a trade which is within the charge to corporation tax can be offset against income is limited to the uses expressly allowed by the Corporation Tax Acts. English Holdings say that there is no reason either in the wording of the statute or as a matter of policy or common sense why they should not be able to set off the PE trade loss against the letting business profit. They contend that the effect of s 3 CTA 2009 is narrow because its effect is limited to preventing the profits arising from a trade which fall to be taxed under the corporation tax regime from also being treated as income under the income tax regime. The section has no effect on the application of the provisions in the Income Tax Acts concerning losses.

[**31**] English Holdings have a further line of argument if we find against them on the statutory construction point. If HMRC are correct and the legislation does prevent English Holdings from setting off the loss from the PE trade against the income from letting business, then that is only because English Holdings are non-UK resident. If English Holdings were UK resident then the letting business would be taxed under the corporation tax regime because a UK resident company is chargeable to corporation tax on all its profits wherever arising: see s 5(1) CTA 2009. This disadvantageous treatment amounts to a restriction on the free movement of capital contrary to art 63 of the Treaty on the Functioning of the European Union ('TFEU'). English Holdings submit that the restriction must therefore be disapplied so as to allow

a them to deduct the loss from the PE trade against the rental business profits. HMRC rely on various arguments to counter English Holdings' claim to any EU based right to set the restriction aside.

THE FTT'S DECISION

[**32**] Judge Mosedale identified the principal issue between the parties as
b whether s 3 CTA 2009 should be construed as only disapplying those provisions of the Income Tax Acts which relate to the imposition of the charge to income tax on profits or whether it disapplies all the provisions relating to the application of the income tax regime, including those provisions relating to losses. She held that the natural meaning of the words was more limited in
c scope than HMRC submitted and affected only those provisions of the Income Tax Acts which dealt with the taxation of income, not those that dealt with the treatment of losses. In English Holdings' case, there was no such income because the PE trade had made a loss. She therefore held at para [20] of the decision that a literal reading of s 64 ITA 2007 meant that English Holdings would succeed and that in theory a taxpayer could set off against its general
d income a loss incurred in a trade which, if profitable, would have been subject to corporation tax.

[**33**] Judge Mosedale then rejected the submission that it was impossible to calculate the trade loss because various key provisions which needed to be applied in order to carry out that calculation were disapplied by s 3 CTA 2009. We consider the arguments put to her in more detail below.

e [**34**] Judge Mosedale also rejected HMRC's submission that a purposive reading of the statutory provisions was necessary in order to respect the separation between the corporation tax regime and the income tax regime. She went on to hold at para [52] of the decision that in any event, it was not obvious to her that Parliament intended that taxpayers in the unusual position of having two income streams, one subject to corporation tax and one subject
f to income tax, should not be able to set a corporation tax loss against an income tax profit. Ordinary taxpayers are able to set losses arising in one trade against profits arising in other trades, if both trades fall within the corporation tax regime or if they both fall within the income tax regime.

[**35**] Having concluded that the appeal against the assessment should be
g allowed Judge Mosedale did not go on to consider the submissions on EU law.

DISCUSSION ON THE DOMESTIC LAW

[**36**] The difficulty facing us, as it faced the FTT, is in articulating precisely how one would have to read s 3 CTA 2009 in order for it to achieve the result for which HMRC contend.

h [**37**] The first step in construing the provision is to determine the literal meaning of the words. HMRC argued before the FTT, as they argued before us, that the reference in s 3 CTA 2009 to 'provisions of the Income Tax Acts relating to the charge to income tax' would naturally include not only the profits taxing provisions but also the loss relieving provisions. The disapplication effected by s 3 CTA 2009 must therefore extend to s 64 ITA 2007.
j The FTT accepted that that was correct but held that it did not help HMRC's case. That is because the problem for HMRC arose not from those words in s 3 CTA 2009 but from the fact that the disapplication of the provisions of the Income Tax Acts is limited by s 3 CTA 2009 first to the 'income of a company' in the opening words of s 3(1) and then to 'the income' of the company in s 3(1)(b) CTA 2009. The disapplication of the income tax provisions was

therefore limited to the situation where there was income—either any income where the company is a UK resident or income within its chargeable profits as defined by s 19 CTA 2009 if the company is not UK resident.

[**38**] We agree with Judge Mosedale that the literal meaning is the meaning for which English Holdings contend—namely that the effect of the section is limited to disapplying the provisions of the Income Tax Acts that impose a charge on the income of a company where that income is within the charge to corporation tax.

[**39**] Two alternative possibilities were put forward by Mr Yates. The first was that the reference to 'income' in both places where it occurs in s 3(1) CTA 2009 should be read as meaning in effect, 'the result of the corporation tax trade in that accounting year, whether an income or a loss'. The second was that it should be read as referring not to the income from the trade but to the activity of the trade itself.

[**40**] There are a number of problems with this. First, 'income' is referred to in s 2(2) CTA 2009 as one of the elements of the term 'profits' as used in that Part. It would be odd for 'income' in s 2(2) to be treated as meaning either an income or loss, because a loss is clearly not an element in the company's profits. As Mr Firth submitted, the word 'profit' cannot include a loss because they are opposites. Given that 'profit' does not include a loss and so 'income' as used in s 2(2) CTA 2009 cannot include a loss, it is difficult to see how the term 'income' used in s 3(1) can be construed as including a loss.

[**41**] Similarly, s 3(1)(b) contemplates the 'income' being within the company's chargeable profits as defined by s 19 CTA 2009. Section 19 clearly regards trading income arising through the non-UK resident's permanent establishment as being one of the 'type of profits' that are chargeable to corporation tax. Again, it is difficult to make sense of s 19 if the word 'income' is read as possibly meaning something other than a positive figure and as encompassing a loss.

[**42**] The second problem is that although Mr Yates argued that the draftsman used the concepts of 'income of a company' interchangeably with the concept of the 'activity of a company' or the concept of the 'outcome of the trading activity, whether positive or negative', this is in fact not so.

[**43**] HMRC rely on s 47 CTA 2009 as supporting their contention that both profits and losses arising from a corporation tax trade must be governed by the same rules. Since the profits of the trade are subject only to the corporation tax rules, similarly losses from the trade can be used only in accordance with the corporation tax rules. We do not accept that s 47 can bear the weight HMRC seek to place on it. The purpose of the section is simply to make it clear that the rules for calculating the profit of a trade set out in that and later Chapters are to be used for calculating losses if the trade has been unsuccessful. This does not say anything about the provisions which govern the use of the loss once it has been calculated according to those rules.

[**44**] Further, we consider it would have been easy for the draftsman to devise a provision which clearly achieved the goal which HMRC say is achieved by s 3 CTA 2009. Section 1009 ITA 2007 was drawn to our attention part way through the hearing. That section, headed 'Sources of income within the charge to income tax or corporation tax', provides that in the Income Tax Acts a source of income is within the charge to income tax or corporation tax if that tax either is chargeable on the income arising from it *or would be so chargeable if there were any income arising from it*. References to a person or income being within the charge to income tax or corporation tax are to be read in the same

way. The equivalent provision for corporation tax purposes is s 1167 CTA 2010. That provides that in the Corporation Tax Acts, a source of income is within the charge to corporation tax or income tax if that tax either is chargeable on the income arising from it *or would be so chargeable if there were any income arising from it*, and references to a person or income being within the charge to corporation tax or income tax are to be read in the same way. The existence of these mirroring provisions undermines HMRC's basic argument on the construction of s 3 CTA 2009. It provides an easy way for the draftsman to have achieved the result which HMRC argues the existing wording does achieve. But the draftsman did not do so.

[**45**] We cannot accept HMRC's submission that because s 1009 ITA 2007 clarifies the meaning of s 18 ITTOIA, and s 1167 CTA 2010 clarifies the meaning of s 41 CTA 2009, that the draftsman of s 3 CTA 2009 and s 5 ITA 2007 must have meant the same thing.

[**46**] Moreover, we note that there is no provision in s 64 ITA 2007 equivalent to s 36(3) CTA 2010. The draftsman could have expressly restricted the trade losses which can be set against general income to losses incurred in a trade which is within the charge to income tax. There are other instances in the Income Tax Acts where Parliament expressly limits the availability of sideways relief for losses. See for example, s 95 ITA 2007 which provides that where a person makes a loss in a trade carried on wholly outside the United Kingdom sideways relief for that loss is available only against qualifying foreign income. Again, the draftsman of s 3 CTA 2009 did not include any such provision.

DOES THE NARROW CONSTRUCTION LEAD TO ABSURD OR IMPRACTICAL RESULTS?

[**47**] To overcome the literal meaning of the words of s 64 ITA 2007, HMRC rely on two different although related strands of argument. The first strand is to point out various absurd or impractical results that they say flow from English Holdings' construction, as upheld by the FTT. These show that Parliament cannot possibly have intended that s 3 CTA 2009 be construed as effecting only a limited disapplication of the provisions of the Income Tax Acts because the provisions under both the tax regimes are not set up in a way which accommodates a taxpayer in English Holdings' position setting off a corporation tax trade loss against general income within the charge to income tax.

[**48**] The second strand is to assert that the tribunal should adopt a purposive construction of s 3 CTA 2009 to give effect to the purpose at which HMRC say the section was aimed, namely the complete separation of the corporation tax and income tax regimes. HMRC contend that their interpretation would achieve that purpose whereas English Holdings' muddies the position by allowing a corporation tax loss to migrate in whole or in part into the income tax box—and perhaps even back again.

Calculation of the loss

[**49**] The first of the obstacles which HMRC say are created by following through with the literal interpretation of s 3 CTA 2009 is how the value of the loss to be deducted from general income can be computed. HMRC submit that the structure of the legislation assumes that it is not possible to set off a loss from a trade within the corporation tax regime against general income under the income tax regime. Section 26 ITTOIA provides that the rules to be applied in calculating losses of a trade for income tax purposes are the same rules that

are used for calculating a profit. This means that in order for a trading loss to be set against general income under s 64 ITA 2007, it has to be a trading loss that has been calculated using the income tax rules and not using the corporation tax rules. HMRC accept that at the time the predecessor provisions from which these sections are derived were enacted, there were few differences between the way that corporation tax losses were calculated and the way that income tax losses were calculated. There has been a greater divergence since then, but even at the time they were enacted there were distinctions, for example the application of the preceding year basis for taxation of trades under the income tax regime. HMRC say that the loss that English Holdings has incurred in the PE trade is a loss that was calculated using the corporation tax rules not the income tax rules. The effect of s 26 ITTOIA is that that is not a loss that can be set off against income tax because s 26 ITTOIA is disapplied by s 3 CTA 2009.

[**50**] English Holdings accept that s 26 ITTOIA does mean that a loss has to be calculated according to the income tax rules in order for that loss then to be set off against general income pursuant to s 64 ITA 2007.

[**51**] This was a point that was made to Judge Mosedale and it was rejected in paras [24]–[27] of her decision. She held that there is nothing to stop English Holdings from recalculating the results of the PE trade for the relevant year applying the income tax calculation rules to see if the trade still results in a loss and then, if it does, setting that loss against general income. This is so even if the actual loss figure arrived at is different from the loss figure that would be available for relief wholly within the corporation tax regime.

[**52**] We agree with Judge Mosedale that s 3 CTA 2009 (together with s 5 ITA 2007) does not disapply s 26 ITTOIA. Section 26 ITTOIA is not a provision which applies to income; it is a provision that applies to losses. We hold that the effect of s 3 CTA 2009 is that s 26 ITTOIA is not disapplied in so far as losses are concerned, even losses of a trade which would have been within s 19 CTA 2009 if profitable. It is therefore possible for English Holdings, if they so wish, to recalculate the loss made by the PE trade using the income tax calculation rules in order then to set the loss off against general income under s 64 ITA 2007.

[**53**] This does raise the theoretical possibility that the different rules for computing losses would generate a completely different result such that the same trading year could give rise to a loss under the corporation tax rules but a profit under the income tax rules. The parties did not give any indication as to whether this is in fact ever likely to happen. English Holdings accept that in those circumstances there would not be a loss to set off against its general income because of the application of s 26 ITTOIA. However, the apparent profit would not be taxable under the income tax regime because of the operation of s 3 CTA 2009. Mr Firth submitted and we agree that the wording of s 3 is general and prevents double taxation of income regardless of whether that income figure is the result of a computation in accordance with the corporation tax rules or in accordance with the income tax rules. Similarly, there is no reason to limit the reference to income in s 19(3)(b) CTA 2009 (as cross-referred to in s 3(1)(b) CTA 2009) to trading income computed according to the corporation tax rules.

Double counting of loss

[**54**] The second obstacle which HMRC assert arises from English Holdings' construction as upheld by the FTT, is the problem with potential double

counting of the loss. Section 63 ITA 2007 prevents the same loss being used more than once but it only prohibits double relief being given 'under any other provision of this Chapter or of the Income Tax Acts'. It does not on its face prohibit relief being given under the Corporation Tax Acts. Judge Mosedale recognised the problem created by this provision and was unable to identify a solution. Mr Firth also accepted that there was no easy answer to this point, suggesting that it might be argued, if a taxpayer in English Holdings' position tried to obtain double tax relief, that s 63 ITA 2007 should be given a purposive construction for example by arguing that a 'loss' ceased to be a 'loss' once it had been set against income.

[**55**] We raised at the hearing the point that on the facts of this case the PE trade loss greatly exceeded the letting business profits and might well do so even if one recalculated the PE trade loss using the income tax computation rules. Did English Holdings contend that they could use the rest of the loss to offset against some other corporation tax profit if for example, English Holdings had had another trade through its permanent establishment which had made a corporation tax profit? Mr Firth submitted that there was no reason why not.

[**56**] We recognise that if this is true there must be a lacuna in the legislation because one would expect to see some machinery describing how this is to be done. However, Mr Yates fairly accepted that this argument was not enough, by itself, for HMRC to win the day on the construction point. Even if we were to conclude that English Holdings' construction of s 3 CTA 2009 created difficulties because it generates a claim for loss relief which is not properly accommodated by the statutory provisions, that is not a good reason to rewrite s 3 CTA 2009 to the extent that it would need to be rewritten for HMRC to succeed.

Basis periods

[**57**] The third obstacle to English Holdings' construction highlighted by HMRC is the difficulty with identifying a basis period for the loss for income tax purposes. The problem arises in the following way. Section 64 ITA 2007 is in Ch 2 of Pt 4 of that Act. Section 61(2) in the same Chapter provides that for the purposes of Ch 2 'any reference to the person making a loss in the trade … in a tax year is to the person making a loss in the trade … in the basis period for the tax year'. Basis periods are dealt with in Ch 15 of Pt 2 of ITTOIA. Section 198 ITTOIA sets out the general rule which is that the basis period in a tax year is the period of 12 months ending with the accounting date in that year. The term 'accounting date' is defined in the preceding section, s 197 ITTOIA, as meaning the date in the tax year to which accounts are drawn up. There are then a number of different rules that displace the general rule as set out in eight different sections later in the Chapter.

[**58**] HMRC argue that it is extremely doubtful that Parliament intended there to be a basis period for a trade such as English Holdings' PE trade which never fell with the income tax regime but is a trade which is subject to the charge to corporation tax. English Holdings argue there is no problem here. The company drew up accounts for the PE trade up to 31 March each year. None of the special rules about basis periods listed in s 198(2) ITTOIA applies, so the general rule should apply. This means that the basis period for the tax year for the purposes of s 61(2) ITA 2007 is the period of 12 months ending with 31 March in that tax year.

[**59**] HMRC in turn counter by saying that it is not so simple. They refer to s 18 ITTOIA which applies if a company starts or ceases to be within the charge to income tax in respect of a trade. HMRC argue that the effect of English Holdings' construction is that the PE trade starts to be within the charge to income tax in a year in which it makes a trading loss because in such a year s 3 CTA 2009 does not operate to take it outside the income tax regime. HMRC therefore raise the unpalatable prospect that English Holdings' PE trade might enter and leave the charge to income tax as its trading fortunes fluctuate over the years, with all the attendant problems that would arise from the application of the various statutory provisions dealing with the commencement or cessation of a trade. Mr Yates submitted that the Income Tax Acts plainly do not contemplate that a company starts to be subject to the charge to income tax when it makes a loss on a corporation tax trade. Rather the legislation contemplates the company carrying forward loss relief. That would not be possible if the company left the charge as soon as it made a loss.

[**60**] We agree with Judge Mosedale that s 18 ITTOIA does not create this problem. As the judge commented, the PE trade is not stopping or starting but carries on from year to year. The fact that it may not generate a profit subject to corporation tax in any given year does not mean that it starts to be within the charge to income tax in that year. Section 1009 ITA 2007 and s 1167 CTA 2010 make it clear that for the purposes of s 18 ITTOIA, the PE trade does not start to be within the charge to income tax if it makes a loss because it would not be within the charge to income tax if income arose from it.

[**61**] We have considered all the difficulties raised by HMRC as to awkwardness of applying the statutory provisions to the circumstances in which English Holdings find themselves. We recognise that the dispute between the parties in this case appears to arise because Parliament failed to accommodate within the legislation the implications of the fact that it had legislated that some income of a company still falls to be dealt with under the income tax regime rather than the corporation tax regime. Parliament created this situation which is an important exception to the rule that HMRC urged upon us that the two regimes should be separate. In our judgment, the difficulty of making the provisions work sensibly cannot undermine the fundamental argument put forward by English Holdings that:

(1) there is nothing in s 64 ITA 2007 which limits the trade in which the loss is made to a trade which, if profitable, is chargeable to income tax; and

(2) s 3 CTA 2009 only disapplies those provisions of the Income Tax Acts which apply to the income of a non-resident company where the income is within its chargeable profits as defined by s 19 CTA 2009.

PURPOSIVE CONSTRUCTION

[**62**] HMRC argue that their construction gives effect to the purpose behind s 3 CTA 2009 namely to separate the corporation tax and income tax regimes.

[**63**] The role of purposive construction has been described by the Upper Tribunal in *Trigg v Revenue and Customs Comrs* [2016] UKUT 165 (TCC), [2016] STC 1310. The principles set out there are as follows:

(1) The move away from literal interpretation and to the purposive approach entails regard being had to the context and scheme of the relevant Act as a whole. It should be assumed that a statutory provision has some purpose, but that purpose must be found in the words of the statute itself. The court must not infer a purpose without a proper foundation for doing so.

(2) When determining purpose, the tribunal may have regard to the background and context of the provisions at issue.

(3) The application of purposive construction does not mean that the literal meaning of the statutory language is to be ignored. It will often be—indeed it must be so in the vast majority of cases—that the purpose of a statutory provision which is discerned from the words of the statute will be the same as the literal meaning of those words. The will of Parliament finds its expression in the statutory language.

(4) It is not the case that merely because legislation is closely-articulated, or prescriptive in nature, it is somehow less susceptible to a purposive construction. That may be the conclusion that follows from construing a particular provision purposively, but it is not in itself an inhibition on such construction.

(5) The task for the courts and tribunals, in all cases, is to construe the statutory language of a particular provision in its context and having regard to the scheme of the legislation as a whole in order to ascertain and give effect to its purpose.

(6) Whatever underlying purpose may be identified, it is not the task of the tribunal to import a different meaning to the provision in question from that which can properly be attributed to it, merely because of a perception that such a meaning would better suit the purpose so identified. That would be an exercise in rectification and not construction.

[**64**] Mr Yates's broad submission is that looking at the scheme of the corporation tax legislation and the income tax legislation as a whole, it is clear that they are intended to be mutually exclusive. That is the purpose of s 3 CTA 2009 and s 5 ITA 2007. Mr Yates also pointed to the provisions in Ch 4 of Pt 2 of CTA 2009 which identify the profits attributed to a permanent establishment in the United Kingdom. Those provisions seek to treat the establishment as a separate enterprise, showing, he submitted, that the losses generated by that enterprise are to be dealt with separately from any other taxable business carried on in the United Kingdom by the non-UK resident company outside that permanent establishment.

[**65**] The difficulty with that submission is that, as this case shows, the separation is not absolute. Further, ss 967 and 968 CTA 2010 allow UK resident and non-UK resident companies to set off against corporation tax any income tax that has been deducted from a payment that it receives. There are therefore instances where Parliament treats a company as subject to income tax rather than corporation tax on its profits and where Parliament allows a deduction of income tax paid to be offset against a corporation tax liability. We accept Mr Firth's submission that there is no general principle that different taxes must be interpreted so as to be mutually exclusive in terms of their scope of potential application. The interaction between different taxes depends on what Parliament expressly legislates for.

[**66**] Mr Firth also took us to the Explanatory Notes for s 3 CTA 2009. We agree that, in so far as they are relevant, they support English Holdings' construction of the section. They state that the purpose of the section 'ensures that income of the company within the charge to corporation tax is not chargeable to income tax as well as corporation tax'. It does not say that this section is intended to bring about the complete separation of the two regimes.

[**67**] Finally we agree with Judge Mosedale's conclusion in para [52] of her judgment that there is no clear reason why Parliament should have intended to

prevent a company which is in the anomalous position of having two businesses, one subject to income tax and one subject to corporation tax from being able to set a corporation tax loss off against general income.

[**68**] We therefore reject HMRC's submission that a purposive construction can be adopted here to prevent such a set-off.

[**69**] We therefore conclude that Judge Mosedale was right to prefer the construction of the legislation for which English Holdings contend and we uphold the FTT's conclusion as to the domestic construction of the relevant statutory provisions.

THE EU LAW ISSUES

[**70**] In the light of our findings on the domestic law issues, the question as to whether the domestic legislation imposed a restriction on English Holdings' rights to free movement of capital under the TFEU does not arise. However, in case this case goes further, we will scope out the arguments that were put forward by the parties and our observations on those arguments.

The relevant provisions of EU law

[**71**] Article 63 of the TFEU provides:

> 'Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.'

It is thus unusual in conferring rights on people in third countries as well as on people in other member states.

[**72**] On the morning of the first day of the hearing before us, the Court of Appeal handed down its judgment in *Routier v Revenue and Customs Comrs* [2017] EWCA Civ 1584. That case concerned the status of Jersey, a Crown Dependency, vis-à-vis the United Kingdom. The court held that Jersey is a third country for the purposes of the free movement of capital provisions: see para [49] of the judgment. HMRC accepted for the purposes of the hearing before us that the position of the British Virgin Islands could not be distinguished from that of Jersey on the basis of the Court of Appeal's reasoning. We therefore proceeded on the basis that the British Virgin Islands, where English Holdings is incorporated, is a third country for the purposes of art 63, notwithstanding its status as a British Overseas Territory and that a company incorporated in the British Virgin Islands can rely on the principle of free movement of capital to strike down a legislative restriction on that freedom in an appropriate case.

[**73**] Paragraph 1 of art 64 TFEU contains an exemption from the provisions of art 63. So far as relevant it provides:

> 'The provisions of Article 63 shall be without prejudice to the application to third countries of any restrictions which exist on 31 December 1993 under national or Union law adopted in respect of the movement of capital to or from third countries involving direct investment—including in real estate—establishment, the provision of financial services or the admission of securities to capital markets …'

[**74**] This provision is relevant because, as we shall see, HMRC contend that in so far as there is a restriction in the domestic legislation that restriction existed prior to 31 December 1993 and it is a restriction involving direct investment in real estate.

[**75**] Prior to the coming into force of arts 63 and 64 TFEU free movement of capital was protected pursuant to the terms of Council Directive 88/361/EEC (for the implementation of art 67 of the Treaty) (OJ 1988 L178 p 5) ('the Capital Directive') which provided directly effective rights. Annex 1 to the Capital Directive contained a Nomenclature which set out various classifications of capital movements. Although the Capital Directive is no longer in force, having been replaced by the provisions now found in arts 63 and 64 TFEU, it is generally accepted by the Court of Justice of the European Union ('CJEU') that the Nomenclature remains relevant for the purpose of identifying the types of capital movement that are protected by art 63. The Nomenclature specifically lists a number of capital movements under the heading 'I-DIRECT INVESTMENTS', which include the establishment and extension of branches and the participation in new or existing undertakings with a view to establishing or maintaining lasting economic links. Under the heading 'II-INVESTMENTS IN REAL ESTATE (not included under I)' investments in real estate on national territory by non-residents is included.

[**76**] The Nomenclature also contains Explanatory Notes as to the meaning of 'Direct Investments' as follows:

> 'Investments of all kinds by natural persons or commercial, industrial or financial undertakings, and which serve to establish or to maintain lasting and direct links between the person providing the capital and the entrepreneur to whom or the undertaking to which the capital is made available in order to carry on an economic activity. This concept must therefore be understood in its widest sense.
>
> The undertakings mentioned under I-1 of the Nomenclature include legally independent undertakings (wholly-owned subsidiaries) and branches.
>
> As regards those undertakings mentioned under I-2 of the Nomenclature which have the status of companies limited by shares, there is participation in the nature of direct investment where the block of shares held by a natural person of another undertaking or any other holder enables the shareholder, either pursuant to the provisions of national laws relating to companies limited by shares or otherwise, to participate effectively in the management of the company or in its control.
>
> Long-term loans of a participating nature, mentioned under I-3 of the Nomenclature, means loans for a period of more than five years which are made for the purpose of establishing or maintaining lasting economic links. The main examples which may be cited are loans granted by a company to its subsidiaries or to companies in which it has a share and loans linked with a profit-sharing arrangement. Loans granted by financial institutions with a view to establishing or maintaining lasting economic links are also included under this heading.'

[**77**] The Nomenclature also contains an Explanatory Note as to the meaning of 'Investments in real estate' as follows:

> 'Purchases of buildings and land and the construction of buildings by private persons for gain or personal use. This category also includes rights of usufruct, easements and building rights.'

[**78**] As we shall see, one of the EU law issues is whether, if there is a restriction, it is to be regarded as a restriction on freedom of establishment rather than a restriction on the free movement of capital. Article 49 TFEU

prohibits restrictions on the freedom of establishment of nationals of a member state in the territory of another member state. The prohibition also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any member state established in the territory of any member state. But this provision, in contrast to art 63, does not extend the benefit of the freedom to third countries.

[**79**] There are provisions in the TFEU dealing with its application to overseas countries and territories which are associated with a member state ('OCTs'). Most of the Treaty does not apply to OCTs but art 203 permits the Council to lay down provisions as regards the detailed rules and procedure for the Association of OCTs with the EU.

[**80**] There is a specific Council Decision of 27 November 2001 dealing with the association of overseas countries and territories with the EU (the 'OCT Decision') which was made pursuant to the powers set out in art 203. Article 47 of the OCT Decision so far as relevant deals with currency payments and capital movements in the following terms:

> '1. Without prejudice to paragraph 2:
> (a) Member States and the OCT authorities shall impose no restrictions on any payments in freely convertible currency on the current account of balance of payments between residents of the Community and of the OCTs;
> (b) with regard to transactions on the capital account of balance of payments, the Member States and the OCT authorities shall impose no restrictions on the free movement of capital for direct investments in companies formed in accordance with the laws of the host Member State, country or territory and to ensure that the assets formed by such investment and any profit stemming therefrom can be realised and repatriated.
> 2. …'

THE EU LAW ISSUES ON THIS APPEAL

[**81**] English Holdings contends that in so far as the domestic law provisions prevent it setting off the losses it incurred in the PE trade against the profits arising from the letting business then those provisions amount to a restriction on the free movement of capital between the British Virgin Islands and the EU. It contends that the domestic legislation creates such a restriction because it treats a company incorporated in the British Virgin Islands less favourably than a UK resident company, the latter being liable only to be taxed on its income pursuant to the provisions of the Corporation Tax Acts which would allow the set-off.

[**82**] It is clear from the authorities that the payment of rental income is a movement of capital. In *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* (Case C-386/04) EU:C:2006:568, [2008] STC 1439, [2006] ECR I-8203 the issue before the CJEU was whether rental income received by a charitable foundation not established in Germany, which would have been exempt from corporation tax if received by a charitable foundation established in Germany, was covered by the free movement of capital protection. The court said at paras 23 and 24 of its judgment:

> '23. It is not disputed that the foundation, whose seat is in Italy, has commercial property in Munich which it lets. Among the capital

> a movements listed in Annex I to Directive 88/361, under heading II entitled "Investments in real estate", are investments in real estate on national territory by non-residents.
>
> 24. It follows that free movement of capital covers both the ownership and administration of such property and it is not therefore necessary to consider whether the foundation acts as a provider of services.'

b [**83**] *Schröder v Finanzamt Hameln* (Case C-450/09) EU:C:2011:198, [2011] STC 1248, [2011] ECR I-2497 is authority for the proposition that less favourable tax treatment reserved for non-residents alone might deter them from acquiring or retaining immovable property situated in a member state and would therefore amount to a restriction on the free movement of capital. The court said:

> c '31. With regard to the legislation at issue in the main proceedings, a natural person who is not domiciled or habitually resident in Germany is, according to para 49 of the EStG, liable to income tax in that member state in respect of income derived from the letting of immovable property situated in Germany. In contrast to resident taxpayers, a non-resident taxpayer may not, under para 50 of the EStG, deduct from that income an
> d annuity, such as that paid by Mr Schröder to his mother in the context of the anticipated succession inter vivos, as special expenditure within the meaning of para 10(1)(1a) of the EStG.
>
> 32. Less favourable tax treatment reserved for non-residents alone might deter them from acquiring or retaining immovable property situated in
> e Germany (see, by analogy, *Blanckaert v Inspecteur van de Belastingdienst/ Particulieren/Ondernemingen buitenland te Heerlen* (Case C-512/03) [2005] STC 1574, [2005] ECR I-7685, para 39). It might also deter German residents from naming, as beneficiaries of an anticipated succession inter vivos, persons resident in a member state other than the Federal Republic of Germany (see, by analogy, [*Missionswerk Werner Heukelbach eV v Belgium*
> f (Case C-25/10) EU:C:2011:65, [2011] STC 985] (para 25)).
>
> 33. Such legislation constitutes, therefore, a restriction on the free movement of capital which is prohibited, in principle, by art 63 TFEU.'

[**84**] HMRC did not appear to dispute these propositions. They contend that the prohibition on restrictions on the free movement of capital in art 63 TFEU does not apply in this case on three different grounds:

g (1) Any question of EU law is governed exclusively by art 47 of the OCT Decision in the sense that if a restriction is not prohibited by art 47 of the OCT Decision then there is no need to consider whether it is prohibited by art 63 TFEU. Article 47 only prohibits a very limited class of restrictions and the present restriction does not fall within that class of prohibited
h restrictions.

(2) English Holdings' complaint is in relation to legislation primarily concerned with freedom of establishment rather than the free movement of capital. Sections 5 and 19 CTA 2009, in the context of non-resident companies, concern the situation where a trade is carried on in the UK via a permanent establishment and it is these provisions which mean that
j English Holdings cannot offset losses sustained in its PE trade in one year against its letting business income received in earlier years. The complaint could be expressed as being either (i) the fact that the PE trade is brought within the territorial scope of the corporation tax regime or (ii) the narrowness of the application of s 19 CTA 2009 in deciding what income is to be attributed to the permanent establishment.

(3) There was no breach of EU law since HMRC are entitled to rely on art 64 TFEU.

[**85**] In summary, English Holdings' answer to those arguments is as follows:

(1) The authorities demonstrate that the OCT Decision does not exclude the operation of art 63 TFEU in circumstances not covered by the scope of the OCT Decision. English Holdings can therefore take advantage of the TFEU provisions.

(2) English Holdings is being denied a relief that would allow it to pay less tax on its letting business income. That is solely a freedom of capital issue.

(3) HMRC cannot rely on art 64 for three reasons. First, because the relevant domestic legislation was not specifically adopted in respect of the movement of capital to or from third countries and the restriction does not arise from legislation adopted for such purposes. Secondly, the restriction does not fall within the concept of a restriction on 'direct investment'. Finally, the separation of corporation tax and income tax codes was not a restriction that existed before 1994.

[**86**] English Holdings have one further argument relating to EU law if any doubt was entertained in relation to the above issues. It contends that the UK courts and tribunals have a duty (as a matter of ordinary statutory interpretation) to interpret domestic legislation dealing with the same subject matter consistently with international treaty obligations where that is reasonably possible. Therefore, even if art 64 applied vis-à-vis third countries, it cannot apply vis-à-vis other member states and therefore in order for the UK legislation to be compatible with EU law, ITA 2007 must be interpreted as permitting the offset of UK trading losses against UK rental income of non-residents. HMRC object that this would not be a conforming interpretation because it would go beyond the minimum necessary to achieve compatibility with EU law.

[**87**] We shall take each of the issues set out above in turn.

The OCT Decision

[**88**] We were referred to a number of authorities relevant to the issue whether a company established in an OCT can rely on the Treaty provisions if it generally falls within the scope of the OCT Decision.

[**89**] The first authority is *Prunus SARL v Polonium SA* (Case C-384/09) EU:C:2011:276, [2011] STC 1392, [2011] ECR I-3319. That case concerned a French tax on immovable property situated in France when the property was owned, directly or indirectly, by legal persons. An exemption from that tax was granted to legal persons whose seat of management was in France, in an EU member state or in a country or territory that had concluded a tax information agreement with France. Legal persons interposed between the person subject to the tax on the property were jointly and severally liable for the tax.

[**90**] Prunus, a company established in France, was owned by a company established in Luxembourg, which in turn was owned by two companies established in the British Virgin Islands. Therefore, the British Virgin Islands companies were subject to the tax and the intermediate holding companies were jointly and severally liable for the tax in respect of the relevant years, 1998 to 2002.

[**91**] The Advocate General in *Prunus* rejected a submission by France that the legal arrangements applicable to OCTs constitute an autonomous body of

rules which are 'impervious to any influence from the Treaties': see para 33 of his opinion. The Advocate General's reasoning was as follows (emphasis in the original):

> '34. However, that interpretation fails in the light of a literal reading of art 355 TFEU. The article begins by stating that, "[i]n addition to the provisions of Article 52 [TEU]", "[t]he special arrangements for association set out in Part Four" are to apply to OCTs. The term "in addition" indicates that European Union law applies to the member states and that, where OCTs are concerned, *additional* special arrangements apply. Naturally, those arrangements must be taken into account and they operate as a lex specialis, thereby replacing the general provisions of the Treaty; that, however, does not convert them into an autonomous body of rules, immune to any influence from primary law.
>
> 35. It is not only the textual argument which militates against the full autonomy of the provisions of European Union law applicable to OCTs but also the practical consequences of an interpretation like the one set out above. If autonomous legislation existed which was applicable to OCTs and was separate from the rest of European Union law, that would mean that, in the event of legislative silence, OCTs would be left on their own in a kind of legal limbo, and might even run the risk of third countries being entitled to benefit from more advantageous treatment than OCTs despite the close ties which the latter have with the Union. That last factor calls for particular vigilance when the general provisions of the Treaty refer to third countries. It is in such cases that OCTs, because they do not formally come within the ambit of either member states or third countries, run the risk of being the victims of interpretations which are, at the very least, risky.
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> 36. To avoid that outcome, the court has been very pragmatic in its case law when dealing with the nature of OCTs and their classification as third countries or territories which are *associated with* (but not *members of*) the European Union.'

[**92**] The Advocate General therefore then dealt with the question as to whether art 63 TFEU could apply notwithstanding the fact that art 47 of the OCT Decision did not deal with restrictions on freedom of capital other than in respect of direct investments in companies. His opinion was that this did not mean that art 63 was excluded in other respects:

> '53. The first aspect to be borne in mind is the wording of the decisions of 1991 and 2001. As concerns Decision 91/482, the fact that movements of capital are confined strictly to foreign exchange transactions permits the assertion that a situation of the kind at issue does not fall within the scope of that decision. The reply is rather more complex in relation to Decision 2001/822, art 47 of which does not restrict its subject-matter to a specific activity and instead refers expressly to "direct investments" in the context of "transactions on the capital account of balance of payments". As I already stated at point 50 of this opinion, art 47 refers to direct investments made in companies established in OCTs, thereby restricting its scope to capital flows from member states to OCTs. Therefore, it is appropriate to conclude that the two decisions do not cover a situation like the one in the instant case, because their provisions refer to activities or capital flows other than the ones at issue.
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> 54. The fact that the decisions are silent with regard to a case such as the one under scrutiny does not necessarily mean that European Union law

has exhausted its function. As stated in points 31 to 39 of this opinion, the law applicable to OCTs is not an autonomous body of rules which is immune to the influence of the general provisions of the Treaties. On the contrary, once it has been confirmed that the specific provisions are not applicable to a particular case, it is necessary to ascertain, having regard to the objectives of Part Four of the TFEU, whether it is appropriate to rely on a provision of the Treaty which concerns third countries. In the case before the court, it is a matter of ascertaining whether art 63 TFEU is a provision which, in the light of art 198 TFEU et seq, is applicable to a national measure which restricts the free movement of capital from an OCT to the Union.

55. As I have previously pointed out, art 63 TFEU enshrines the free movement of capital, stipulating that the provision takes effect not only as between member states but also in relation to third countries. Accordingly, the free movement of capital also precludes, somewhat exceptionally in comparison with the other freedoms, national measures which impede the exit and entry of capital to and from third countries. On the basis of that special feature, it is my view that, interpreted in the light of art 198 TFEU et seq, art 63 TFEU is applicable to OCTs.

56. An interpretation of the free movement of capital as a regime which extends outside the European Union inevitably entails an interpretation of that freedom which is susceptible to universalisation. The opening-up of capital markets does not occur in a fragmented fashion but rather with a general purpose aimed at fulfilling well-known objectives which have already been described. The view that this freedom is not applicable to OCTs contradicts the very spirit underlying the current wording of art 63 TFEU, as it introduces a notable exception which, in any event, must be expressly provided for.

57. In addition, the aims which underpin the special arrangements for OCTs, specifically their economic and social development, would be called into question if the European Union were to allow the entry of capital originating in member states into OCTs while severely curtailing the entry of capital originating in OCTs. The promotion of economic and social development, together with the establishment of "close economic relations" between OCTs and the European Union cannot be reconciled with a free movement of capital which excludes OCTs while embracing all third countries. The ties which bind OCTs to the European Union are such that they justify arrangements for association which consolidate economic relations between the two territories. Those arrangements may, in some circumstances, entail the adoption of restrictive measures, which will, on occasions, be counteracted by other provisions. However, that is a balancing exercise which must be performed by Decision 2001/822 in particular, in addition to all the acts which preceded it. In the event of silence, a general freedom laid down in the Treaty, which, in very specific terms, is applicable to all third countries without exception, must be construed as applying equally to OCTs.'

[**93**] The reasoning in the judgment of the CJEU in *Prunus* deals primarily with the other issue in the case, namely the question as to whether the conditions for the carve-out in art 64 TFEU were satisfied in respect of the restriction alleged. The court referred at para 29 of its judgment to the principle that the general provisions of the TFEU do not apply to OCTs and

that OCTs benefit from the provisions of EU law in a similar manner to the member states only when EU law expressly provides that OCTs and member states are to be treated in such a manner. Having observed at para 30 that the Treaty did not contain any express reference to movements of capital between member states and OCTs, the court concluded at para 31 of *Prunus* that OCTs benefit from the liberalisation of the movement of capital provided for in art 63 TFEU in their capacity as non-member states. In other words, the CJEU concluded that art 63 applied to OCTs in exactly the same way as it applied to third countries.

[**94**] On that basis, in our view, the CJEU's reasoning impliedly accepts that art 47 of the OCT Decision does not affect the position and does not provide an exclusive code for OCTs in the field of freedom of movement of capital. However, Mr Yates submits that in other cases the CJEU came to the opposite conclusion and that we should refer the question to the CJEU.

[**95**] Mr Yates relies on *X BV v Staatssecretaris van Financiën* (Joined cases C-24/12 and C-27/12) EU:C:2014:1385, [2014] STC 2394 ('*X BV*'). That case concerned a Dutch withholding tax on payments of dividends to 100% parent companies resident in the Netherlands Antilles, the latter territory being an OCT. A similar dividend paid to a Dutch resident company would have been exempted from that tax. The question referred to the CJEU was whether the EU rules on the free movement of capital, now contained in art 63, had to be interpreted as precluding a measure of a member state which was likely to hinder movement of capital between that member state and its own OCT.

[**96**] In the event, the CJEU did not decide the case by reference to art 47(1)(b) of the OCT Decision. It held that the measure at issue was intended to prevent excessive capital flow towards the Netherlands Antilles and to counter the appeal of that OCT as a tax haven. It therefore came under the tax carve-out clause contained in art 55(2) of the OCT Decision.

[**97**] At para 35 of his opinion in *X BV*, the Advocate General quoted with approval the Advocate General's opinion at para 57 of *Prunus* that 'in the event of silence' a general freedom laid down in the Treaty which is applicable to all third countries must be construed as applying equally to OCTs.

[**98**] In its judgment in *X BV*, the CJEU made no reference to the Advocate General's opinion. We accept that its reasoning at paras 47–50 could be read as indicating that art 47(1) of the OCT Decision is exhaustive of the position regarding restrictions on payment and on movement of capital between the EU and OCTs. The court said:

> '47. As regards the OCT Decision, adopted by the Council on the basis of art 187 EC to implement the arrangements for association, it states, in art 47(1), what restrictions on payment and on movements of capital are prohibited between the European Union and OCTs.
>
> 48. By referring to balance of payments and by prohibiting, first, all restrictions on payments in freely convertible currency on the current account of that balance and, second, restrictions on the movement of capital linked to investments in companies and which concern transactions on the capital account of that balance, art 47(1) of the OCT Decision has a particularly wide scope, close to the scope of art 56 EC in the relations between member states and third countries (see, to that effect and concerning art 63 TFEU, *Prunus*, paras 29 to 31).
>
> 49. Consequently, by prohibiting, inter alia, restrictions on the acquisition of shares in companies and the repatriation of profits stemming therefrom,

art 47(1)(b) of the OCT Decision prohibits, among others, restrictions on the payment of dividends between the European Union and OCTs, along the lines of the prohibition of such measures set out in art 56 EC as regards, inter alia, relations between member states and third countries.

50. However, having regard to the case law cited at para 45, above and to the fact that neither Part Four of the EC Treaty nor the OCT Decision, adopted pursuant to that part of the treaty, expressly refer to art 56 EC, it is necessary to examine the question referred from the point of view of art 47(1) of the OCT Decision and to verify whether the scope of that provision is clarified or circumscribed by other rules of the special arrangements applying to the EU-OCT association.'

[**99**] Having therefore concluded that prima facie the restriction was not permitted by the terms of art 47(1) of the OCT Decision, the court justified the restriction by reference to art 55(2) of the OCT Decision which permitted the adoption and enforcement of any measure aimed at preventing the avoidance of taxes. The court therefore concluded at para 54 of its judgment:

'54. It follows from the foregoing, and without there being a need to examine the question as to what extent the rules of European Union law applicable to the relations between the European Union and OCTs apply between a member state and its own OCT, that the answer to the first question is that European Union law must be interpreted as not precluding a tax measure of a member state which restricts movements of capital between that member state and its own OCT whilst pursuing the objective of combating tax avoidance in an effective and proportionate manner.'

[**100**] We observe that this case involved an investment by a parent company in its 100% subsidiary, the situation which according to the Nomenclature referred to at para [76], above is to be classified as a 'direct investment'. Therefore, there was no question that art 47(1) of the OCT Decision was prima facie applicable and would have applied but for the application of the tax carve-out in art 55. The case therefore says nothing about the position where the investment concerned is not a direct investment in a company.

[**101**] In *Finanzamt Ulm v Wagner-Raith* (Case C-560/13) EU:C:2015:347, the Advocate General made reference to the applicability of the provisions regarding the free movement of capital to OCTs and to the decisions in both *Prunus* and *X BV* as follows:

'44. Although Part Four of the successive Treaties does not contain any provision relating to the free movement of capital, the court has nevertheless not inferred from this that such provisions were not applicable to OCTs. Since that freedom also extends to third countries, it would have been at the very least incongruous if entities benefiting from special association arrangements intended to establish close economic relations with the European Union could not benefit from a freedom specifically extended to all third countries. That is why, in its judgment in *Prunus*, concerning the taxation of direct investments made in France by a company established in the British Virgin Islands, the court held that OCTs benefit from the liberalisation of the movement of capital provided for in Article 63 TFEU in their capacity as third countries, even though, in my opinion, it would have been more correct to say that OCTs benefit from a liberalisation of the movement of capital *equivalent* to that afforded to third countries, taking into account the *sui generis* nature of their status.

a 45. Thus, as regards the classification of a national measure as constituting a restriction on movements of capital between Member States and OCTs, the court's assessment in the judgment in *Prunus* (EU:C:2011:276), which extends the application of Article 63 TFEU to OCTs, is valid in so far as no specific provision, at the very least equivalent in scope to Article 63 TFEU, governs those movements.

b 46. There was no such provision during the period that elapsed between the entry into force of the Maastricht Treaty—that is to say, the liberalisation in principle of free movements of capital in relation to third countries too, as provided for in Article 73b of the EC Treaty—and 2 December 2001, since the Council did not adopt any decision under Part Four of the EC Treaty prescribing a free movement of capital regime
c between Member States and OCTs that was equivalent to that applicable to third countries. However, 2 December 2001 marks the entry into force of Council Decision 2001/822/EC of 27 November 2001 on the association of the overseas countries and territories with the European Community ("the OCT Decision"), Article 47(1) of which was recently regarded by the
d court in its judgment in [*X BV*] as having a particularly broad scope similar to that of Article 56 EC in the relations between Member States and third countries.'

[**102**] In our view, what is being said at paras 44 and 45 of this opinion is that because OCTs have the benefit of art 63, if there is a national measure which constitutes a restriction on the movements of capital between member states
e and OCTs then art 63 will prevail unless there is a specific provision elsewhere, which is at least equivalent in scope to art 63 and which governs those movements of capital. At para 46, the Advocate General refers to the fact that there were no such provisions between the coming into force of the Maastricht Treaty and 2 December 2001, because there was no decision establishing a free
f movement of capital regime between member states and OCTs. In *Prunus*, three of the years to which the issue in that case related fell within that period. The Advocate General then refers to *X BV* and the fact that art 47 of the OCT Decision and that the CJEU had regarded that provision as having 'a particularly broad scope' similar to that of what is now art 63 as that provision applies between member states and third countries. These passages were not
g referred to at all by the CJEU in its judgment in *Wagner Raith*.

[**103**] Summing up all this case law, in our view, *Prunus* is clear authority for the proposition that art 63 TFEU is to be interpreted as applying to OCTs, in respect of three of the years to which the judgment related which were before art 47 of the OCT Decision came into force. The OCT Decision was in force
h for the last of those years and the CJEU was clearly aware of that because the Advocate General made reference to it at paras 49 and 53 of his opinion. Of course, art 47(1) only makes reference to restrictions on direct investment in a company, whereas *Prunus* was dealing with investments in real estate. It is also clear from para 34 of the Advocate General's opinion in that case, as set out at para [91], above that any special provisions applying to OCTs should be
j regarded as *additional* to other provisions of EU law which applied to OCTs, such as was found to be the situation in this case, art 63.

[**104**] In contrast, *X BV* was a case involving direct investment in a company, and therefore the provisions of art 47(1)(b) were directly on point. It is entirely consistent with the reasoning of the Advocate General at para 34 of his opinion in *Prunus* that in those circumstances, those provisions operate as a lex specialis

and replace the general provisions of the Treaty. In our view, para 47 of the CJEU's judgment in *X BV*, which refers to art 47(1) of the OCT Decision as stating what restrictions on movements of capital between the EU and OCTs are prohibited and para 48 of the judgment, which refers to that provision having a particularly wide scope, 'close to that' what is now art 63 must be read as only applying to those capital movements which are within the scope of the wording in art 47(1), namely direct investment in a company. Further, the references at para 50 of the judgment to the question being determined by reference to art 47 of the OCT Decision (rather than what is now art 63 TFEU) must likewise be read in the same way.

[**105**] Therefore, we reject Mr Yates's submission that the two decisions are inconsistent with each other. Further, we do not read the passages from the Advocate General's opinion in *Wagner Raith* set out at para [101], above as seeking to reconcile any inconsistency between the two cases. As we read those passages, the Advocate General was referring to the fact that art 47(1) of the OCT Decision did introduce a provision that excluded the application of what is now art 63 TFEU but, as he made clear at para 45, art 63 continued to be valid 'in so far as no specific provision, at the very least equivalent in scope to Article 63' governed the movements in question. As we have seen, art 47(1) of the OCT Decision was not equivalent in scope because it did not cover the entire ground that is covered by art 63 since the former provision only relates to direct investment in a company.

[**106**] We therefore reject Mr Yates's submission that the matter does not appear to be acte clair. In our view on the basis of the clear authority in *Prunus*, art 63 TFEU is applicable and had it been necessary to resolve the issue we would have concluded with complete confidence that the relevant provisions of domestic law amounted to a restriction on the free movement of capital which is prohibited by that provision. Consequently, in our view there would be no need to refer the matter to the CJEU.

The prevailing freedom

[**107**] It is clearly possible that domestic legislation can be held to fall within the scope of more than one of the freedoms of movement established by TFEU. In this case the question arises as to whether in so far as the domestic legislation contains a restriction on rights given by the Treaty, that restriction is to be regarded as a restriction on the freedom of establishment or a restriction on the free movement of capital.

[**108**] Guidance on how to approach this issue was given by the CJEU in *Test Claimants in the FII Group Litigation v Revenue and Customs Comrs* (Case C-35/11) EU:C:2012:9876, [2013] STC 612, [2013] Ch 431 (at paras 90–103). This guidance makes it clear that when deciding whether national legislation falls within the scope of one or other of the freedoms of movement, the purpose of the legislation concerned must be taken into consideration. Therefore, national legislation intended to apply only to shareholdings which enable the holder to exert a definite influence on a company's decisions and to determine its activities falls within the scope of art 49 TFEU on the freedom of establishment. On the other hand, national legislation which applied to shareholdings acquired solely with the intention of making a financial investment without any intention to influence the management control of the undertaking must be examined exclusively in light of the free movement of capital: see paras 90–92 of the judgment. Where the legislation in question applies to both situations, so that it cannot be determined from its purpose

whether it falls predominantly within the scope of art 49 or art 63, the court must take account of the facts of the case in point in order to determine whether the situation falls in the scope of one or other of those provisions: see paras 93–94 of the judgment. In other words, the court must examine by reference to the facts whether the situation falls predominantly within one freedom or the other, and the predominant freedom will prevail.

[**109**] In this case therefore, the question is whether the restriction affects English Holdings' permanent establishment in the UK through which it conducts its trading activities, an activity that falls within the scope of the freedom of establishment, (although as an entity established in a third country English Holdings has no right of establishment under art 49) or whether, on the other hand, it affects its investment in real estate from which it derives rental income, an activity that falls within the scope of the right to free movement of capital.

[**110**] Mr Yates submits that ss 5 and 19 CTA 2009 are obviously provisions that relate to freedom of establishment, namely the permanent establishment that English Holdings has set up in order to carry on its trading activities in the United Kingdom. He submits that the restriction which is complained of is a restriction which makes the establishment of a trade less attractive by only allowing trading losses to be used as against other income or profits that come within s 19 CTA 2009. For that reason, he submits that only freedom of establishment is relevant here. The restriction on the free movement of capital which results from not allowing such losses to be set against investment income not attributable to the permanent establishment is purely consequential. He submits that this is a case where the legislation was intended to apply solely to a permanent establishment and therefore it was not permissible to go any further and look at the facts.

[**111**] Mr Firth submits that the situation in this case is solely a free movement of capital issue for the following reasons.

[**112**] First, English Holdings' investment in real estate and receipt of rental income, to which the free movement of capital provisions certainly apply are not within the scope of the freedom of establishment. It is the income tax rules relating to the payment of tax on that letting income that English Holdings challenges. It is being denied a relief that would allow it to pay less tax on its letting income. That is solely a free movement of capital issue.

[**113**] Second, and in any event, the predominant freedom principle applies where a restriction on one and the same activity gives rise to both a restriction on the free movement of capital and on the freedom of establishment. But the predominant freedom principle does not apply, Mr Firth submits, where the same legislative provision is liable to restrict two separate activities, one of which is solely covered by the free movement of capital (receipt of letting income) and the other of which is covered by the freedom of establishment (property trade).

[**114**] Mr Firth submits that in so far as HMRC are able to demonstrate a restriction on the freedom of establishment by reference to the location of English Holdings' property trade, that is a restriction on a different activity from English Holdings' receipt of income from the letting business and does not preclude its reliance on the free movement of capital in relation to its receipt of letting income.

[**115**] We prefer Mr Firth's submissions on this issue. We cannot discern from the legislation that it was intended to impose a restriction on the freedom of establishment any more than it was intended to impose a restriction on a

non-resident company exercising its right to the free movement of capital by treating it less favourably than a UK resident company. The structure of the legislation is to impose income tax on a non-resident company which derives income from property in the United Kingdom. Under the legislation, that is taxed on a different basis from any income that the company derives from a trade carried on through a permanent establishment. Therefore, the structure of the legislation is to treat income derived from an activity which has the benefit of the freedom of movement of capital provisions of art 63 differently from income derived from a trade carried on through a permanent establishment which falls within the scope of art 49.

[**116**] Consequently, we hold that Mr Firth is right in his analysis that the predominant freedom principle does not apply in this situation because the two activities must be regarded as separate for the purpose of the application of the freedoms concerned. Therefore, even if HMRC are right to say that there is a restriction on the freedom of establishment because of the inability of English Holdings to set off its trading losses against its letting business income, that does not preclude its reliance on the free movement of capital provision in relation to its receipt of letting income.

Article 64 TFEU

[**117**] We have held that art 63 TFEU is relevant in the present circumstances where the relevant restriction is not prohibited by art 47 of the OCT Decision. We must therefore go on to consider whether HMRC are right to submit that they can rely on art 64 TFEU to uphold the validity of the restriction. There are three elements to art 64 which have to be satisfied:

(1) the measure in question must have been adopted in respect of the movement of capital to or from third countries;

(2) the measure must be one 'involving direct investment—including in real estate—establishment, the provision of financial services or the admission of securities to capital markets'; and

(3) the measure must have existed prior to 1994.

[**118**] As regards the first element, Mr Firth submits that the provision must be construed strictly and art 64 can only validate a restriction that is imposed in respect of the movement of capital to or from third countries. It does not apply in the present case because the restriction here is imposed provided that the taxpayer is not resident in the UK—it applies whether the taxpayer is resident in another EU member state or in a third country. He relies on the following passage at para 44 of the CJEU's judgment in *Criminal proceedings against Sanz de Lera* (Joined cases C-163/94, C-165/94, and C-250/94) EU:C:1995:451, [1995] ECR I-4821 as supporting this proposition:

> '44. The exception provided for in Article 73c(1) of the Treaty concerning the application to non-member countries of the restrictions existing on 31 December 1993 under national law or Community law regarding the capital movements listed in it to or from non-member countries is precisely worded, with the result that no latitude is granted to the Member States or the Community legislature regarding either the date of applicability of the restrictions or the categories of capital movements which may be subject to restrictions.'

[**119**] However, Mr Yates counters this by relying on a number of cases where the CJEU had found that generally worded tax provisions which resulted in different tax treatment for residents were capable of benefiting from the exemption provided by art 64.

[**120**] In particular, in *Holböck v Finanzamt Salzburg-Land* (Case C-157/05) EU:C:2007:297, [2008] STC 92, [2007] ECR I-4051 the CJEU considered the terms of Austrian income tax legislation pursuant to which profit distributions by domestic companies which were made to a natural person resident in Austria were taxed at a reduced rate whereas profit distributions by foreign limited liability companies which were made to a natural person resident in Austria was subject to tax at the full rate. The court held at paras 36–38 of its judgment that a less favourable tax treatment of foreign-sourced dividends came within the scope of the prohibition on free movement of capital. But since it was a restriction that existed on 31 December 1993 the free movement provisions did not preclude the application of the Austrian legislation in this particular case in respect of dividends paid by foreign companies. Mr Yates observes that the Austrian legislation was not in its terms specifically targeted at direct investment by investors from third countries.

[**121**] In *Wagner-Raith*, the CJEU considered the terms of German tax legislation which provided that the tax treatment of distributions from investment funds differed according to how co-operative the investment fund was in sharing information as regards the fund and its unit holders with the German authorities. Consequently, a German unit holder who held units in a Cayman Islands investment fund was treated less favourably from the tax point of view than a unit holder who held units in a German investment fund. The Advocate General observed at para 75 of his opinion that there was nothing to suggest that member states' tax legislation was excluded from the scope of the freedom of capital provisions or the exemption in art 64, referring to *Holböck* in that regard. The CJEU followed that opinion at para 41 of its judgment.

[**122**] We accept Mr Yates's submissions that these authorities demonstrate that for art 64 to apply it is not necessary for the domestic legislation in question to be specifically targeted in its terms at third countries. We note that in neither of the cases we have mentioned above was *Sanz de Lera* referred to. We see nothing in the passage that we have quoted from that judgment which gives any support to Mr Firth's submissions in the light of the other cases that we were referred to.

[**123**] We therefore conclude on this point that the relevant provisions of domestic legislation in this case satisfy the first requirement for benefiting from the exemption in art 64 TFEU.

[**124**] As regards the second element, Mr Firth submits that the restriction does not fall within the concept of 'direct investment'. He referred us to the following explanation that the CJEU gave to the meaning of that term at paras 180–181 of its judgment in *Test Claimants in the FII Group Litigation v Inland Revenue Comrs* (Case C-446/04) EU:C:2006:774, [2007] STC 326, [2006] ECR I-11753:

> '180. The same indicative value must be given to that nomenclature in interpreting the concept of direct investment. The first section of that nomenclature, entitled "Direct investments" includes the establishment and extension of branches or new undertakings belonging solely to the person providing the capital and the acquisition in full of existing undertakings, participation in new or existing undertakings with a view to

> establishing or maintaining lasting economic links, long-term loans with a view to establishing or maintaining lasting economic links, and reinvestment of profits with a view to maintaining lasting economic links.
>
> 181. As that list and the relative explanatory notes show, the concept of direct investments concerns investments of any kind undertaken by natural or legal persons and which serve to establish or maintain lasting and direct links between the persons providing the capital and the undertakings to which that capital is made available in order to carry out an economic activity.'

[**125**] It is clear, Mr Firth submits, that when art 64 refers to 'direct investment' as including investment in real estate, not all investment in real estate is caught. The distinction between the two is that 'direct' investment in real estate means the acquisition of real property for the pursuit of entrepreneurial purposes (for example, an office or a factory to be used as such by the investor). He submits that acquisition to hold as a financial investment is not direct investment.

[**126**] Mr Firth submits that this conclusion is confirmed by the distinction drawn in Directive 88/361/EEC between 'Heading I: Direct Investments', and 'Heading II: Investments in Real Estate not included under Heading I'—thus there is a category of investment in real estate that is not direct investment. Furthermore, Mr Firth refers to the explanatory notes to the Directive, which we have set out at para [76], above, and which explain that 'direct investment' means investment for entrepreneurial purposes.

[**127**] Mr Firth also relies on the fact that these explanatory notes confirm that investing in real estate for gain constitutes investment in real estate. This is demonstrated, in his submission, by the CJEU's judgment in *Walter Stauffer*, which we have referred to at para [82], above. That case concerned a commercial property owned by an Italian established charitable foundation from which it did not carry on any business but merely obtained rental income. At paras 23 and 24 the ECJ found that the rental income was covered by Heading II, rather than Heading I, which would have applied if it was direct investment.

[**128**] In contrast, Mr Yates submits that whether a real estate investment falls within Heading I as a direct investment or within Heading II is determined by whether the property concerned is a personal holding or a commercial investment. Mr Yates relies on a number of cases in support of that submission as follows. In *Welte v Finanzamt Velbert* (Case C-181/12) EU:C:2013:662, [2014] 2 CMLR 415 the CJEU considered the application of the free movement of capital provisions to circumstances where a national of a third country who had inherited a house from her parents in Germany had received a smaller tax-free allowance against the value of the estate than would have been available to a German resident. The court considered whether the inheritance of the house constituted a form of acquisition of real estate which can be equated to investment in real estate and thus benefited from the free movement of capital provisions.

[**129**] The court in *Welte* said this about the concepts of 'direct investments' and 'investments in real estate' as those terms are used in Heading I and Heading II:

> '32. While those concepts are not defined in the Treaty, it is apparent from the list in heading I and the explanatory notes to it, whose indicative value has already been acknowledged by the Court, that the concept of

direct investment concerns investments by natural or legal persons which serve to establish or maintain lasting and direct links between the person providing the capital and the company to which that capital is made available in order to carry out an economic activity (see, to that effect, [*Holböck v Finanzamt Salzburg-Land* (Case C-157/05) EU:C:2007:297, [2008] STC 92, [2007] ECR I-4051, paras 34 and 35 and the case law cited]).

33. It is apparent from the very title of heading II of Annex I to Directive 88/361 that the "investments in real estate" referred to in that heading do not include the direct investments referred to in heading I of that Annex.

34. In those circumstances it must be held that, as pointed out by the A.G. at point AG55 of his Opinion, art.57(1) EC, in referring to "direct investment—including in real estate", concerns only investments in real estate that constitute direct investments coming under heading I of Annex I to Directive 88/361.

35. By contrast, investments in real estate of a "patrimonial" nature, such as that at issue in the main proceedings concerning the house of the parents of the deceased, made for private purposes unconnected with the carrying out of an economic activity do not fall within the scope of art.57(1) EC.'

[**130**] As Mr Yates submits, the court distinguishes between property acquired for private purposes and property acquired for purposes connected with the carrying out of an economic activity. It does not, however, appear to us that the case deals specifically with what constitutes an investment falling within Heading I as opposed to one falling within Heading II. The fact that a property acquired in the rather unusual circumstances in *Welte* fell within Heading II and not Heading I does not mean that all investments in real estate other than of this very limited kind fall within Heading I.

[**131**] However, Mr Yates submits that *Prunus* establishes the proposition that *any* property exploited commercially is to be regarded as a direct investment. He referred to para 44 of the Advocate General's opinion in *Prunus*, where the Advocate General dealt with the question as to whether the investment by Prunus was covered by the freedom of establishment. The Advocate General said ([2011] STC 1392):

'44. Naturally, it should be pointed out that the dividing line between the two freedoms is vague and there is even some overlapping. However, in the instant case, it is perfectly clear that freedom of establishment is not applicable, at least in the light of the facts presented in the proceedings. As the court has previously acknowledged, in order for the provisions relating to the right of establishment to apply, it is in principle necessary to have a permanent presence in the host member state and, where immovable property is purchased and held, that property should be actively managed. It cannot be denied that Prunus is controlled by Polonium and, in turn by Lovett and Grebell, and it is a legal person which, according to the order for reference, has a permanent presence on French territory. However, all the information available to the court in this case indicates that ownership of the immovable properties, which forms the taxable event giving rise to the tax at issue, constitutes a direct investment in immovable property. The immovable properties concerned are, therefore, being commercially exploited without, according to the order, any material activity being carried out in connection with the operations of the holding companies.

> Therefore, this is a case of a direct investment in which control over Prunus is an instrumental means of achieving the free movement of capital; in other words, an investment.'

[**132**] At para 60 of his opinion, the Advocate General refers to the 'direct investment' requirement laid down in art 64 and in a footnote says:

> 'EC Council Directive 88/361 of 24 June 1988 for the implementation of Article 67 of the Treaty (OJ 1988 L 177, p 5) defines direct investments in real estate as "[p]urchases of buildings and land and the construction of buildings by private persons for gain or personal use. This category also includes rights of usufruct, easements and building rights". That definition has interpretative value for the purposes of defining the term "direct investment in real estate" in the context of the free movement of capital, as the court has confirmed on a number of occasions (see *Proceedings brought by Trummer* (Case C-222/97) [1999] ECR I-1661, para 21; *Westdeutsche Landesbank Girozentrale v Stefan* (Case C-464/98) [2001] ECR I-173, para 5; *Centro di Musicologia Walter Stauffer v Finanzamt München für Körperschaften* (Case C-386/04) [2008] STC 1439, [2006] ECR I-8203, para 22; and [*Européenne et Luxembourgeoise d'investissements SA v Directeur général des impôts* (Case C-451/05) EU:C:2007:594, [2008] STC 1762, [2007] ECR I-8251], paras 33 and 34).'

[**133**] Mr Yates submits that in this footnote the Advocate General equated the reference to 'direct investment—including in real estate' to include the entirety of Heading II.

[**134**] We do not accept that submission. The definition that the Advocate General referred to is not part of the definition of 'direct investments' but is a stand alone definition of what is meant by 'investments in real estate'. The Advocate General does not appear to be saying anything about which investments in real estate fall within Heading I as opposed to Heading II. It would therefore appear that the reference to 'direct' in the second line of the footnote is made in error.

[**135**] There was no reference either to this footnote or to para 44 of the Advocate General's opinion in the judgment of the court in *Prunus*. It is therefore not clear what evidence was before the Advocate General that led him to conclude that the investment in real estate made by Prunus was a direct investment. It does not appear that the court itself expressed any view as to whether the investments made by Prunus were to be regarded as direct investments. The court focused rather on whether the restriction concerned existed on 31 December 1993.

[**136**] We therefore agree with Mr Firth that the cases cited by Mr Yates are not authority for his submission that all investments in real estate which are made for commercial purposes are direct investments. It does not appear to us that the judgments in those cases have addressed that point. However, in our view *Walter Stauffer* is clear authority that a financial investment in real estate, such as the one made in that case in a property from which the investor did not carry on an economic activity, is to be regarded as falling within the scope of Heading II rather than Heading I.

[**137**] Having reached that conclusion as to the law, there is however a difficulty in applying this case law to the facts of the present case. There are no findings of fact in the FTT's judgment about the extent of the property held by English Holdings, the nature of that property and the way in which it is

a exploited commercially. All we know is that the lettings business is not carried out in the United Kingdom through a permanent establishment and that it generated an annual profit of over £1m. If the point had arisen for decision, we would have had to consider whether we had enough information to enable us to determine the 'direct investment' point or whether we would have needed to supplement that information by some means in order to arrive at a decision.

b [**138**] As regards the third element, our conclusion on the 'direct investment' point means that it is unnecessary for us to determine this point. It does not however, appear to us that there is any material difference between the provisions of the relevant provisions as they existed as at 31 December 1993 in the Income and Corporation Taxes Act 1988 and the provisions that replaced c them in CTA 2009 and ITA 2007.

Conforming construction

[**139**] Our conclusion on all the other EU law issues in favour of English Holdings means that it is not necessary for us to determine the issue we have described in para [86], above.

d

CONCLUSION

[**140**] For the reasons set out above, we dismiss HMRC's appeal against the ruling of Judge Mosedale. We hold that on the proper construction of the relevant provisions of the Income Tax Acts and the Corporation Tax Acts, English Holdings is entitled, pursuant to s 64 ITA 2007, to set off against the e profits from its letting business the loss incurred in its PE trade, even though the profits of the letting business are within the charge to income tax and, if it had earned profits in that PE trade, those profits would have been chargeable to corporation tax.

[**141**] Finally, we would like to thank Mr Yates and Mr Firth for their helpful submissions which navigated us through this complicated case.

f

Appeal dismissed.

Katie Green Barrister.