Case No: C3/2003/1094

Neutral Citation Number EWCA Civ 1221
IN THE SUPREME COURT OF JUDICATURE
COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM CHANCERY DIVISION
(Mr Justice Peter Smith)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 21st August 2003

Before :

LORD PHILLIPS OF WORTH MATRAVERS, M.R.
LORD JUSTICE WALLER
and
LORD JUSTICE CARNWATH

Between :

BLACKBURN (H.M. INSPECTOR OF TAXES)	**Appellant**
- and -	
KEELING	**Respondent**

Mr David Ewart (instructed by Solicitor for Inland Revenue) for the Appellant
Mr Giles Goodfellow QC (instructed by Gregory Rowcliffe Milners) for the Respondent

Hearing dates : 30th to 31st July 2003

JUDGMENT : APPROVED BY THE COURT FOR HANDING DOWN (SUBJECT TO EDITORIAL CORRECTIONS)

Lord Justice Carnwath:

Introduction

1. This appeal concerns a decision of the General Commissioners given in August 2002 that the taxpayer's PAYE coding in the year 2002/3 should have reflected an underwriting loss of £425,390.00, expected to be declared in May 2003. The relevant facts appear from the case stated by the Commissioners. The main points are as follows.

2. The taxpayer is a Name in various Lloyd's Syndicates. A syndicate is an "annual joint venture". Each individual name is entitled to a predetermined share of any profits or losses. Although a syndicate writes business for one year, it normally reinsures itself with a successor syndicate, and each member of the reinsured syndicate has the right to participate in the business of the successor syndicate. The resulting right to participate in a chain of syndicates is known as "syndicate capacity". Profits and losses of the syndicate are attributed to names in accordance with their share of syndicate capacity.

3. Syndicates trade from 1 January to 31 December in each year ("the underwriting year") and each such year is regarded as a single venture for the year. To enable liabilities to be quantified more accurately, the business accounts remain open for a further two years, although forecasts are provided at regular intervals. Thus, the accounts for the underwriting year 2000 were left open until 31 December 2002, and the profit or loss for that year was declared in May 2003.

4. In February 2002 the taxpayer claimed loss relief under section 380(1)(b) of the Taxes Act (see below), based on the loss expected to be declared in May 2003; and he requested that it be set against his pension income for 2002/3 (taxable under Schedule E), by amendment of his PAYE code for that year. The Inspector disallowed the claim to relief, and refused to amend the PAYE code.

5. The Commissioners allowed the taxpayer's appeal in respect of the PAYE code, on the ground that, under section 203(7) of the Taxes Act he was entitled to claim "provisional relief relating to losses which are reasonably established to have been incurred". (His appeal against refusal of the claim to relief under section 380 had been withdrawn, the Revenue having indicated that they would not treat this as prejudicing his case in respect of the PAYE code). The judge dismissed the Revenue's appeal, principally relying on paragraph 7(2)(f) of the PAYE regulations.

6. There is no dispute that the amount of the trading loss greatly exceeded the taxpayer's pension income for 2002/03. It is also common ground that section 380(1)(b) would in due course allow a claim for relief for that trading loss. The issue is whether this can be set against his income for 2002/3 through his PAYE code for that year.

7. The Revenue's contentions before us (as helpfully summarised by Mr Goodfellow for the taxpayer) are as follows:-

   i) He cannot be treated as sustaining any loss in his underwriting trade until the end of 2003 and so no account could be taken of such trading losses in setting his PAYE coding for 2002/03 ("the no trading loss point").

   ii) Even if he could be treated as having sustained or as sufficiently likely to sustain some trading loss so as to be entitled to relief under Section 380, his actual or prospective entitlement to such relief was not relevant to setting his PAYE code for 2002/03 because by virtue of TMA Schedule 1B such relief did not alter his liability to income tax for 2002/03 (Schedule 1B).

The latter was a new point before the judge, which he permitted to be raised on terms as to costs.

The law

8. Special provision is made, by the Finance Act 1993 Part II Chapter III, for taxation of Lloyd's underwriters. Income tax on profits arising from a member's underwriting business is charged on the profits of the year of assessment (s 171). Section 172(1) provides that "for all the purposes of the Income Taxes Acts" the profits or losses in any year of assessment are "taken to be" -

> "(a) in the case of profits or losses arising directly from his membership of one or more syndicates, those of any previous year or years which are declared in the corresponding underwriting year;
>
> (b)...
>
> (c) in the case of other profits or losses, those derived from payments received or made in the corresponding underwriting year"

By section 184(1) "underwriting year" means the calendar year; and, by (2)(a):

> "an underwriting year and a year of assessment shall be deemed to correspond to each other if the underwriting year ends in the year of assessment"

9. Thus, the underwriting year 2003 ends in the year of assessment 2003/4, and therefore "corresponds" to that year of assessment. Accordingly, losses declared in May 2003, and other losses derived from payments made up to the end of the underwriting year 2003, regardless of their derivation, are "taken to be" losses "in" the year of assessment 2003/4.

10. Under the general law, the relevant provisions are in the Income and Corporation Taxes Act 1988 ("the Taxes Act"), and regulations made under it, and the Taxes Management Act 1970 ("TMA"). Of the Taxes Act, it is necessary only to refer to the provisions governing relief for losses, and those relating to PAYE.

11. As to the former, Section 380 (1) provides:-

> "(1) Where in any year of assessment any person sustains a loss in any trade, profession, vocation or employment carried on by him either solely or in partnership, he may, by notice given within twelve months from the 31 January next following that year make a claim for relief from income tax on -
>
> (a) so much of his income for that year as is equal to the amount of the loss or, where it is less than that amount, the whole of that income; or
>
> (b) so much of his income for the last preceding year as is equal to that amount or, where it is less than that amount, the whole of that income;
>
> but relief shall not be given for the loss or the same part of the loss both under paragraph (a) and under paragraph (b) above."

Losses for this purpose are computed in the same manner as profits under Schedule D (s 382(3)).

12. Taken with s 172 of the 1993 Act, section 380(1)(b) has the effect that losses declared in May 2003, being losses in the tax year 2003/4, may be subject to a claim for relief, which (subject to the Schedule 1B point) may be used in respect of income for 2003/4 or 2002/3.

13. Read literally it might be thought that the section does not allow such a claim to be made before the end of January 2005 (that is, January "next following" the end of the tax year 2003/4). However, the Revenue does not take that position. In effect, it reads "within twelve months", in s 380(1), as meaning "before the end of twelve months". (Not surprisingly, the taxpayer does not quarrel with that interpretation, and we see no reason to question it.) On the Revenue's interpretation, however, the claim for the losses declared in May 2003 cannot be made before the end of the underwriting year, that is December 2003, which is when the losses for that year are crystallised.

14. Turning to the Taxes Management Act 1970 ("TMA"), section 42 provides for the making of claims for relief. By subsection (1A) the claim must be for a quantified amount; and, by subsection (2) it must be made by inclusion in a tax return, if it could be so included. However, by subsection (3), neither (1A) or (2) applies to a claim which falls to be taken into account by deduction or repayment under the PAYE system. Subsection (11A) provides for "claims involving two or more years of

assessment" (which includes claims under Taxes Act s 380); schedule 1B has effect as respects such claims.

15. Paragraph 2 of schedule 1B deals with loss relief. It provides:-

> "2(1) This paragraph applies where a person makes a claim requiring relief for a loss incurred or treated as incurred, or a payment made, in one year of assessment ("the later year") to be given in an earlier year of assessment ("the earlier year").
>
> (2) Section 42(2) of this Act shall not apply in relation to the claim.
>
> (3) The claim shall relate to the later year.
>
> (4) Subject to sub-paragraph (5) below, the claim shall be for an amount equal to the difference between -
>
> (a) the amount in which the person is chargeable to tax for the earlier year ("amount A"); and
> (b) the amount in which he would be so chargeable on the assumption that effect could be, and were, given to the claim in relation to that year ("amount B").
>
> (5) Where effect has been given to one or more associated claims, amounts A and B above shall each be determined on the assumption that effect could have been, and had been, given to the associated claim or claims in relation to the earlier year.
>
> (6) Effect shall be given to the claim in relation to the later year, whether by repayment or set-off, or by an increase in the aggregate amount given by Section 59 B (1) (b) of this Act *[relating to payments made on account of tax]* or otherwise.
>
> (7) ... "

16. This elaborate deeming provision has the effect (so far as it applies) that, where under section 380(1)(b) loss relief is claimed on income in the preceding year, the claim nonetheless "relates" to the later year (para 2(3)). The amount of the claim is computed using the formula in paragraph 2(4), based on the income in the previous year; but it does not affect the tax position in the earlier year (para 2(3)). It gives rise to a "free-standing credit" (in the Revenue's language) which can be used in any of the ways set out in paragraph 2(6).

17. As for the PAYE scheme, the statutory basis for the regulations is in section 203. Subsection (1) provides:-

> "On the making of any payment of or on account of any income assessable to income tax under Schedule E income tax shall subject to and in accordance with regulations made by the Board under this section, be deducted or repaid by the person making the payment notwithstanding that when the payment is made no assessment has been made in respect of the income and notwithstanding that the income is in whole or in part income for some year of assessment other than the year during which the payment is made."

18. Two familiar and important features of the PAYE machinery are the "Tax tables" and the "PAYE code". Tax tables are prepared by the Revenue and issued to employers, showing the amount to be deducted on each pay day to achieve the correct overall deduction of tax over the year, by reference to the PAYE code for the particular employee. (In this context, "employer" is defined so as to include anyone paying income taxable under Schedule E, such as the taxpayer's pension in this case.) The tax tables are largely mechanistic. The individual circumstances of the taxpayer, including the allowances and reliefs to which he is entitled, are reflected in his PAYE code, determined by the inspector, and subject to appeal by the employee. In considering the statutory provisions, it is important to keep in mind that the PAYE code is itself part of the tax tables (see the PAYE regulations, reg 2(1) below).

19. Section 203(2) requires the Board to make regulations with respect to the assessment, charge, collection and recovery of tax under Schedule E; the regulations "have effect notwithstanding anything in the Income Tax Acts" (defined by s 831(1)(b) to mean "the enactments relating to income tax"). They are to include provision for payment of Schedule E income to be made subject to deduction of tax "calculated by reference to tax tables..." (s 203(2)(a)).

20. By subsection (6), the tax tables are to be constructed so as to ensure as far as possible that the "total income tax" payable for the year is deducted from income paid in that year. By subsection (7):-

> "In subsection (6) above reference to the total income tax payable for the year shall be construed as references to the total income tax estimated to be payable for the year in respect of the income in question, subject to a provisional deduction for allowances and reliefs and subject also, if necessary, to an adjustment for amounts overpaid or remaining unpaid on account of income tax in respect of income assessable under Schedule E for any previous year ".

21. The relevant regulations are the Income Tax (Employment) Regulations 1993 (SI 1993/744) ("the PAYE regulations").

22. The employer is required on any payment to deduct tax calculated by reference to the employee's "cumulative emoluments" and "cumulative free emoluments" (reg 14).

"Emoluments" are the full amount of income to be taken into account in assessing liability under Schedule E; "free emoluments" are

> "the appropriate amount of any emoluments of the employee which qualify for relief from income tax" (reg 2(1).

Under regulation 6, every employer upon making any payment of emoluments to any employee is obliged to deduct or repay tax in accordance with the appropriate code. The concept of the "code" is explained by regulation 2(1), which defines it as

> "any part of the tax tables in which all the amounts of free emoluments... for any period have been calculated on the basis of the same total amount for the whole year..."

23. Regulation 7 is central to the argument in this case. It provides:-

> "(1) The appropriate code shall be determined by the Inspector who for that purpose may have regard to any of the matters specified in paragraph (2).
>
> (2) The matters specified in this paragraph are;
>
> (a) subject to paragraph (3) the reliefs from income tax to which the employee is entitled for the year in which the code is determined, so far as his title to those reliefs has been established at the time of the determination.
>
> (aa) where the code is determined before the beginning of the year for which it is to have effect any proposed alteration or alterations in the rates for that year of any of the reliefs referred to in sub-paragraph (a)
>
> (b)... (e)...
>
> (f) such other adjustments as may be necessary to secure that so far as possible the tax in respect of the employee's emoluments for the year for which the code is to have effect shall be deducted from the emoluments paid during that year.
>
> (3) Where the code is determined before the beginning of the year for which it is to have effect, the inspector shall disregard any relief such as is referred to in paragraph (2)(a) if he is not satisfied that the employee will be entitled to it for that year."

24. Regulation 9 provides for two circumstances where there need be no actual code. The first is where the inspector determines that tax is to be deducted at the higher rate from the whole of any emoluments (reg.9(1)). The second, conversely, is where he

determines that no tax is to be deducted from any emoluments, for example because the emoluments will be taken into account in a Schedule D assessment. In either case the appeal and other provisions apply as though a code had been determined (reg 9(3)).

25. Regulation 11 allows the taxpayer to appeal to the General Commissioners against the inspector's determination of the code. On such an appeal, the Commissioners –

> "shall determine the appropriate code having regard to the same matters as the inspector may have regard to when the appropriate code is determined by him."(reg 11(5))

The judgment below

26. Peter Smith J summarised the respective contentions before him, as follows:

> "Mr Ewart contends that the reference to the reliefs under 7(2)(a) shows that the Inspector can only give effect to reliefs when they properly arise in the relevant tax year. That he says effectively referred back to the procedure in this case for the loss relief claim. A loss relief claim he submits can only be made in accordance with section 380 and will fall to be considered in the second year as specified by schedule 1B paragraph 2 (3) TMA 1970 as set out above. As this cannot arise until after the accounts for the underwriting year have been declared i.e. May next, no claim can be submitted and the Inspector cannot take into account any claim of a future loss which is not yet presently claimable....
>
> Mr Goodfellow submits that the PAYE regime is a provisional assessment procedure. It would be quite wrong for the Inspector to ignore the obvious facts in this case. The obvious facts are that ultimately the Respondent will not have any tax liability when all reliefs are ultimately taken into account...."

27. He concluded in favour of the taxpayer:-

> "I see no objection in principle to the Code being determined on a provisional basis in the light of the information available to the Inspector when he determines the code. Although subparagraph (a) refers to a relief to which the employee is entitled for the year, I do not see that as meaning that the Inspector does not have the ability to take into account a future entitlement which will ultimately affect the relevant tax year and to my mind he can do that under subparagraph (f). That is a sweeper clause entitling the Inspector to take into account all matters known to him at the time he prepares the code to arrive at the fairest and most realistic code that is likely to be the

> nearest to the true tax position of the taxpayer when the taxpayer's affairs for that tax year are finally worked out. It seems to me that the PAYE code should operate both ways. Primarily of course it operates in favour of the Government in that the Government is enabled to collect in advance tax which otherwise it could not claim until the year end. I do not see why the Government should not also submit to the counter position namely that if the reality in any given case is that there is likely to be no tax paid the Code should be amended accordingly."

28. Mr Ewart complains that he did not in terms deal with the Revenue's alternative argument. However, I understand that this was intended to be covered by the last part of his judgment where he said:

> "... It does seem to me that the regime under the regulations is self-contained. That is why in section 203 it is stated that it applies not withstanding any provision in the Taxes Act.
>
> Therefore although I accept that the method of recovery of loss relief is as set out in the provisions helpfully referred to above by Mr Ewart that does not have any impact on an ability to treat the loss differently under the PAYE regime if it is appropriate so to do."

Thus, in the judge's view, the provisions of TMA, directed to recovery of loss relief, could not be relied on to alter the PAYE rules.

No trading loss

29. Dealing with the Revenue's first submission, it is necessary to begin by considering the nature of the right to the relief claimed; and then to see how it is applied in the PAYE system.

30. The starting-point is section 380, which confers the right to relief. That is triggered where the taxpayer "sustains a loss" in any year of assessment. To find out what that entails, in the case of a Lloyd's underwriting business, one has to look to the 1993 Act. From that it is clear that losses declared in May 2003, along with other profits or losses in the underwriting year 2003, are "sustained" in the year of assessment 2003/4. That loss may be used (subject to the Schedule 1B point), on a claim made for that purpose, to give relief from income tax in either 2003/4 itself, or in the preceding year 2002/3.

31. From this analysis, it seems to me quite clear that in February 2002, when the claim was made, and in July 2002, when the Commissioners considered the matter, there was as yet no right to the relief, since the losses had not yet been "sustained". For this

purpose, it is unnecessary to decide whether the right arose in May 2003, when the losses were declared, or at the end of the underwriting year, as the Revenue argues (although the latter view is consistent with the general approach, explained in *Jones (HMIT) –v- O'Brien* (1988) 60 TC 706, 714H-715A). On any view they were not "sustained" before May 2003. It is also clear that the right to make a claim for relief from income tax, on so much of his income as is equal to the loss sustained in 2003/4, has nothing to do with the fact that those losses were derived from events before the tax year 2003/4. It is simply a statutory right given by section 380, on the basis of losses sustained in 2003/4.

32. Turning to the PAYE scheme, the obvious reference-point is regulation 7(2)(a), which deals specifically with the treatment of reliefs from income tax. Under this paragraph attention is directed to reliefs to which the employee is "entitled for the year", so far as "his title" has been "established" at the time of the determination. Whether title has been established, can only be decided by looking at the provisions which confer the right to relief. As I have said, it seems clear to me, from these provisions, that the right or title was not established at the time of the determination, because the losses had not then been "sustained". It is clear, therefore, in my view, that paragraph (a) does not assist the taxpayer.

33. Accordingly, if the relief is to be taken into account, it must be by virtue of some other provision of the PAYE scheme. There are three possibilities:

i) Section 203(6) and (7), which impose the general requirement for the tax tables (which include the code) to be designed to secure that "the total income tax" payable for the year is deducted under PAYE for the year; and which define "total income tax" in this context as the estimated income tax for the year, subject to "a provisional deduction for allowances and reliefs…";

ii) Paragraph 7(2)(f) of the regulations, which the judge described as a "sweeper clause", allowing adjustments necessary to secure that the tax in respect of emoluments for the year is deducted from emoluments paid during the year;

iii) A residual discretion under regulation 7, implied by the use of the word "may" in 7(1).

As has been seen, the Commissioners found in favour of the taxpayer under the first; the judge favoured the second.

34. Like the Commissioners and the judge, I have some sympathy with the taxpayer's contention. Certainly, it seems arguably contrary to the spirit of the PAYE system that tax should be deducted from his pension in 2002/3, when everyone knows that he will in due course be entitled to claim loss relief far greater than the tax liability. On the other hand, it has to be borne in mind that, if a profit rather than a loss had been

declared in May 2003, there would have been no question of any tax being paid on it before the end of that year.

35. In any event, these considerations do not permit us to depart from the statutory provisions. The insuperable difficulty with any of the three possibilities is that they nullify the effect of paragraph (a). There would be no purpose in a specific provision, restricting reliefs to those to which title has been established, if it can be overridden by a general discretion to make a provisional deduction at an earlier time.

36. It is also easy to understand why paragraph (a) was limited in this way. Although the likely scale of the losses was clear in this case, one can envisage many cases, not confined to Lloyd's underwriters, where a similar argument could be advanced, in circumstances where the likely amount of the losses is far less certain. If in all such cases the inspector and the Commissioners were given a free hand to make provisional allowances for prospective losses, it would add a further layer of complication and uncertainty to the already complex task of preparing PAYE codes.

37. Mr Goodfellow relies on the analogy with interest relief. It is common ground that, where a qualifying loan is taken out during the year, with interest payable monthly, the code will in practice be adjusted for the whole year, as soon as the first payment is made, even though technically the "entitlement" to relief on the later instalments only arises when they are paid. Whether or not this procedure is strictly correct, it makes obvious sense, in order to avoid multiple adjustments. The important distinction, however, is that, assuming payments continue, the entitlement will arise in the relevant year of assessment. It provides no assistance for a case, such as the present, where the right will not arise until after that year.

38. Accordingly, in my view, the Revenue is entitled to succeed on the first point.

No effect under TMA Schedule 1B

39. This conclusion makes it unnecessary to reach a final view on the alternative point. The Revenue's contention, in summary, is that even if there were a power to make provisional adjustments, it could only be in respect of reliefs relating to the year in question. Schedule 1B makes clear that this relief, even if used in respect of the tax for the earlier year, does not "relate" to that year, and does not affect the tax position in that year. Paragraph 2(6) of the Schedule provides in terms that it "shall" be given effect in relation to the later year.

40. Mr Goodfellow submits that Schedule 1B is no more than part of the machinery for assessing and collecting tax; and that it cannot detract from his rights under the PAYE system, which is to have effect "notwithstanding anything in the Income Taxes Acts". He further submits that, on analysis, schedule 1B is part of provisions made necessary by the self-assessment system, and it has no relevance to the separate PAYE code. For example, he notes that paragraph 2(2) (which disapplies section 42(2)) can have no

relevance to PAYE, since that provision has already been excluded by section 42(3). He also seeks to explain the deeming provision in schedule 1B, by reference to the special time-limits applicable to self-assessment. For example, TMA section 9ZA prohibits amendment of a return more than twelve months after the filing date. Where relief under section 380(1)(b) is applied to an earlier year, it is treated as "relating" to the later year, so that the claim can still be made up to 12 months from the January following that year (as permitted by s 380(1)).

41. I see some force in these arguments. However, it is unnecessary to decide the question, and I prefer to rest my conclusion on the first point.

Conclusion

42. I would allow the appeal and restore the inspector's determination of the code.

Lord Justice Waller

43. I agree.

Lord Phillips of Worth Matravers, MR

44. I also agree that the appeal should be allowed for the reasons given by Carnwath LJ.