[2018] UKUT 236 (TCC)

Appeal number: UT/2017/0096

CGT – tax years 2006/07 and 2007/08 – corresponding deficiency relief under s. 539 ITTOIA 2005 – whether available to reduce rates of tax on chargeable gains when no income – construction and effect of ss. 4 and 6(2) TCGA 1992

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

ANDREW SCOTT	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

TRIBUNAL: MR JUSTICE NUGEE
JUDGE NICHOLAS ALEKSANDER

Sitting in public at the Rolls Building, London EC4A 1NL on 27 June 2018

Michael Furness QC and Michael Firth, instructed by P E Shirley Ltd, for the Appellant

Simon Pritchard, instructed by the General Counsel and Solicitor for HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This is an appeal by Mr Andrew Scott from a decision (**"the Decision"**) of the First-tier Tribunal (Judge Ashley Greenbank) (**"the FTT"**) dated 4 May 2017, the Respondents being the Commissioners for Her Majesty's Revenue and Customs (**"HMRC"**). The Decision is reported as *Scott v HMRC* [2017] UKFTT 0385 (TC), and references below to numbers in square brackets are, unless otherwise apparent, references to paragraphs of the Decision. Permission to appeal was granted by Judge Greenbank in the FTT on 21 July 2017.

2. The appeal concerns the correct taxation of capital gains, and specifically the operation of provisions in relation to a relief called "corresponding deficiency relief' (**"CDR"**) which has the effect of reducing the rate of capital gains tax (**"CGT"**) from higher rate to basic rate in certain circumstances. The particular question is whether Mr Scott's capital gains for the tax years 2006/07 and 2007/08 are taxable at a rate of 40%, as HMRC decided and the FTT held, or at 20% as Mr Scott contends.

3. Before the FTT a number of points were argued, but on appeal to us there is only one issue. This is whether the FTT were right to accept an argument put forward by HMRC which was labelled the "negative income argument".

The facts

4. The facts were not in dispute before the FTT, and the FTT included a Statement of Agreed Facts as Appendix 1 to the Decision.

5. We were not taken through any of the detailed calculations, as the amounts of tax that are the subject of the appeal are not in dispute. The argument before us proceeded on the question of principle and by reference to simplified examples rather than by reference to the specific facts applicable to Mr Scott.

6. For the purposes of this decision it is sufficient to refer to the extract from Mr Scott's Grounds of Appeal to the FTT, cited in the Decision at [13] as follows:

> "The appeal relates to the rate of capital gains tax that should be applied to the Appellant's capital gains for the 2006/07 and 2007/08 tax years. In these years, the Appellant had claims for CDR under section 539 ITTOIA which exceeded both his income and capital gains. There is no dispute between the parties over the quantum of the capital gains or the amount of CDR. The sole dispute concerns how section 4 TCGA 1992 should determine the rate of tax to be charged on the gains. The Appellant claims that the capital gains should be charged at the 20% rate of capital gains tax. HMRC initially through their computer systems assessed the gains at 20%, but much later into their enquiries decided the gains should be assessed at the 40% rate. There is no factual dispute between the parties and the matter for the Tribunal is the statutory interpretation of section 4 after taking into

account section 6(2) TCGA 1992. The Appellant's chargeable gains for 2006/07 and 2007/08 were £8,844,541 and £14,713,593."

7. As appears from this extract, one point formerly relied on by Mr Scott was that HMRC themselves had initially decided the gains should be taxed at 20%. On the basis of that he both sought to bring a claim for judicial review (for which he was refused permission – see the Decision at [14]) and argued before the FTT that HMRC could not enquire into its own calculations. His argument on this point (labelled *"the procedural issue"* in the Decision) failed before the FTT (see at [137] to [185]) and he has not sought to pursue it before us. We therefore say no more about this aspect of the history.

Legislative background – the legislation in 1988

8. We were taken by Mr Furness QC (who appeared with Mr Firth for Mr Scott) to the legislative background, starting with s. 98 of the Finance Act 1988 (**"FA 1988"**). By the time of the tax years in question this section had been replaced by provisions in the Taxation of Chargeable Gains Act 1992 (**"TCGA 1992"**), and we are conscious that the general principle is that courts and tribunals should construe legislation as it stands without conducting an investigation into its historical antecedents, but Mr Furness showed us s. 98 FA 1988 on the basis that its terms are rather simpler than the later legislation and were a useful introduction to the questions. We will adopt the same course although we do not think we ultimately have to construe any of the 1988 legislation and do not propose to do so.

9. s. 98 was one of a group of sections (ss. 98 to 103) which were headed *"Unification of rates of tax on income and capital gains"*. Its terms were as follows:

"**98. Rates of capital gains tax.**

(1) Subject to the provisions of this section and sections 99 and 100 below, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be equivalent to the basic rate of income tax for the year.

(2) If income tax is chargeable at the higher rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the

> basic rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts)."

10. We did not detect any dispute between the parties as to how this provision applied in the ordinary case (that is where the taxpayer did not have any CDR or similar relief available). We can illustrate it by some simple examples in which we have assumed, as the parties did throughout their arguments, that the basic rate limit was £40,000, with the result that a taxpayer would pay income tax at a basic rate of 20% on the first £40,000 of his taxable income, and at a higher rate of 40% on any excess. These and subsequent examples also ignore the effect of income tax personal allowances and the CGT annual allowance.

11. As appears from the section, s. 98 dealt with three different situations:

(1) The default position under s. 98(1) was that capital gains were taxed at the basic rate. If a taxpayer's taxable income and chargeable gains, taken together, were under the basic rate limit, that was the provision which applied. Thus a taxpayer with income of £30,000 and chargeable gains of £5,000 would pay tax at the basic rate on both income and gains as follows:

Income

Charged at basic rate	£30,000

Capital Gains

Charged at basic rate	£ 5,000

(2) If a taxpayer's income was over the basic rate limit so that he was paying higher rate on any part of his income, the effect of s. 98(2) was that any gains would also be taxed at the higher rate. A taxpayer with income of £50,000 and gains of £5,000 would therefore pay tax at the following rates:

Income

Charged at basic rate	£40,000
Charged at higher rate	£10,000

Capital Gains

Charged at higher rate	£ 5,000

(3) That left the position where the taxpayer's income was under the basic rate limit, but his income and capital gains taken together were over the basic rate limit. This was dealt with by s. 98(3), the effect of which was to allow the taxpayer to use the remainder of his basic rate band (the *"unused part of his basic rate band"*) for the first slice of his

gains, which would therefore be taxed at the basic rate, with any excess taxed at the higher rate.

(4) *"Basic rate band"* is not a statutorily defined term, but s. 98(4) explains what is meant by the *"unused part of an individual's basic rate band"*, namely the amount by which the *"basic rate limit"* (which *is* a defined term – in the example assumed to be £40,000) exceeds his *"total income (as reduced by any deductions made in accordance with the Income Tax Acts)."* In the ordinary case this gives rise to no difficulty, and a taxpayer with £30,000 income and £15,000 chargeable gains would pay tax at the following rates:

Income

Charged at basic rate		£30,000

Capital Gains

Unused part of basic rate band	£40,000 – £30,000 £10,000	
Charged at basic rate		£10,000
Charged at higher rate		£ 5,000

12. *"Total income"* was defined in s. 835 of the Income and Corporation Taxes Act (**"ICTA 1988"**) for the purposes of the Income Tax Acts as meaning *"the total income of [the individual] from all sources estimated in accordance with the provisions of the Income Tax Acts"* – in other words the total of all the income on which an individual was *prima facie* chargeable to income tax (s. 98(4) forms part of the Income Tax Acts for these purposes). Mr Furness accepted that the reference to *"deductions made in accordance with the Income Tax Acts"* was a reference to deductions by way of reliefs and allowances from total income to find the taxpayer's taxable income. He also accepted that in the ordinary case deductions by way of reliefs and allowances could reduce the taxpayer's income to nil, but could not reduce it below nil. If for example a taxpayer had income of £30,000, reliefs of £25,000 and a personal allowance of £10,000, his taxable income would be nil, not -£5,000. You cannot pay tax by reference to a negative number and if the total deductions available to you exceed your income, the effect is to reduce your income to nil for tax purposes, not to give you a negative income for tax purposes. Mr Furness therefore accepted that for the purposes of the calculation required by s. 98(4) the figure for *"total income (as reduced by any deductions made in accordance with the Income Tax Acts)"* could not in the ordinary case be less than zero; and hence that the figure for the *"unused part of his basic rate band"* could not exceed the basic rate limit (£40,000 in the example). (We add that Mr Furness mentioned in passing the case of *Martin* (that is *HMRC v Martin* [2014] UKUT 0429 (TCC)) where a taxpayer

was found (as a result of a claw-back of a bonus paid in a prior year) to have negative earnings arising from employment, which gave rise to a loss that could be used as a relief; but, as Mr Furness accepted, it was not a case where the taxpayer's taxable income was reduced to below zero, and he did not suggest that the decision was of any assistance.)

13. So far we have considered the effect of s. 98 in the ordinary case, that is where the taxpayer did not have any CDR or other similar relief available to him. CDR was then governed by s. 549 ICTA 1988. This provided as follows:

> "**549. Certain deficiencies allowable as deductions.**
>
> (1) Subject to subsection (2) below, where such an excess as is mentioned in section 541(1)(a) or (b) or 543(1)(a)—
>
> (a) would be treated as a gain arising in connection with a policy or contract, and
>
> (b) would form part of an individual's total income for the year of assessment in which the final year ends,
>
> a corresponding deficiency occurring at the end of the final year shall be allowable as a deduction from his total income for that year of assessment, so far as it does not exceed the total amount treated as a gain by virtue of section 541(1)(d) or 543(1)(c) on the previous happenings of chargeable events.
>
> (2) Except where the deficiency mentioned in subsection (1) above occurs in connection with a contract for a life annuity made after 26th March 1974, the deduction allowable under that subsection shall be made only for the purposes of ascertaining the individual's excess liability, that is to say, the excess (if any) of his liability to income tax over what it would be if all income tax were chargeable at the basic rate to the exclusion of any higher rate.
>
> (3) In this section "final year" has the same meaning as in section 546.

(This is the form of the section as originally enacted; there had in fact been some minor amendments by the time FA 1988 was enacted but they do not affect the position and we do not need to set them out).

14. This is one of a group of sections dealing with the taxation of life insurance policies. The detail of these provisions is unimportant: all that needs to be understood is that a policy can give rise to gains which form part of a taxpayer's total income; and that if there is a deficiency in the final year of the policy, that is available as a deduction from income (provided that it does not exceed the previous amounts treated as gains): this is the effect of s. 549(1). The deduction is not however a deduction from income for all purposes, but only for the purposes of calculating the taxpayer's *"excess liability"*, that is his liability for higher rate income tax: this is the effect of s. 549(2). It is not

therefore a relief against all income tax, but a relief against higher rate income tax. As Mr Pritchard, who appeared for HMRC, pointed out, this means that it would not be one of the *"deductions made in accordance with the Income Tax Acts"* referred to in s. 98(4), as this referred to deductions which reduced a taxpayer's income generally.

15. Mr Pritchard also pointed out that s. 549 ICTA 1988 is only concerned with a deduction for the purposes of income tax and not for the purposes of CGT. Indeed he said that s. 549 pre-dated s. 98 FA 1988, and that if CDR had been intended to operate as a relief not only against income but also against CGT, one would have expected that to be provided for in the legislation dealing with CGT (then the Capital Gains Tax Act 1979), and not solely in ICTA 1988 which dealt with income and corporation tax. We were not told when the provision in s. 549 ICTA 1988 was first enacted (although from the reference in s. 549(2) it seems quite probable that it dates back to 1974) but we accept that it must have pre-dated s. 98 FA 1988 and that until ss. 98-103 FA 1988 were enacted s. 549 had nothing to do with CGT but only with relief against higher rate income tax.

16. s. 102 FA 1988 however made special provision for CDR, and a number of other cases where relief was also given against higher rate income tax. So far as material it provided as follows:

> "**102. Other special cases.**
>
> …
>
> (2) Where for any year of assessment—
>
> (a) by virtue of section 427(4) of the Taxes Act 1988 (apportionment of close company income) an amount is deemed not to form part of a person's income for the purposes of excess liability,
>
> (b) by virtue of section 549(2) of that Act (gains under life policy or life annuity contract) a deduction of an amount is made from a person's total income for those purposes,
>
> (c) by virtue of section 683(1) or 684(1) of that Act an amount of a person's income is treated as not being his income for those purposes, or
>
> (d) by virtue of section 699(1) of that Act (income accruing before death) the residuary income of an estate is treated as reduced so as to reduce a person's income by any amount for the purposes of excess liability,
>
> section 98(4) above shall have effect as if his income for the year were reduced by that amount."

17. It can be seen that each of the cases listed in s. 102(2) was one where relief

was given against excess liability (that is, higher rate income tax) by treating a person's income as reduced for that purpose, although the drafting used to achieve this result was not precisely the same, referring variously to an amount being deemed not to form part of his income, an amount being treated as not being his income, an amount being deducted, or his income being reduced.

18. There is no dispute between the parties as to the combined effect of s. 549 ICTA 1988 and s. 102(2) FA 1988 in the case where a taxpayer's CDR was less than his total income. Taking first a case where a taxpayer had income and CDR but no chargeable gains, for example income of £100,000 and CDR of £35,000, he would pay tax as follows (this is Mr Furness's Example 1):

Example 1

Income

For basic rate purposes	£100,000
For higher rate purposes	£100,000 –
	£ 35,000
	£ 65,000

Charged at higher rate	
(£65,000 less basic rate limit of £40,000)	£ 25,000
Charged at basic rate	£ 75,000

The practical effect is the same as if the basic rate band had been extended by the amount of the CDR (£40,000 + £35,000 = £75,000), although it should be noted that this is not what the statutory provisions did. What they did was to deem the taxpayer's income to be reduced for higher rate income tax purposes.

19. Taking next the case where the taxpayer had both income and chargeable gains as well as CDR, for example income of £50,000, gains of £50,000 and CDR of £35,000 (this is Mr Furness's Example 2):

Example 2

Income

For basic rate purposes	£ 50,000
For higher rate purposes	£ 50,000 –
	£ 35,000
	£ 15,000

Charged at basic rate	£ 50,000

Gains

Total income for s. 98(4) purposes	£ 15,000	
Unused part of basic rate band	£ 40,000 –	
	£ 15,000	
	£ 25,000	
Charged at basic rate		£ 25,000
Charged at higher rate		£ 25,000

Again the practical effect is as if the basic rate limit had been increased by the amount of CDR from £40,000 to £75,000; but another way of putting it (which more closely tracks the statutory language) is that the taxpayer has only used £15,000 of his basic rate band of £40,000 for income tax (because s. 549 has reduced his income to £15,000 for this purpose) and that means he still has £25,000 of his basic rate band unused which is available to be used for CGT.

20. Mr Furness pointed out that the outcome for the taxpayer is the same as in Example 1: in each case he pays tax at 20% on a total amount of £75,000, and 40% on the remaining £25,000, regardless of whether he has £100,000 of income or £50,000 of income and £50,000 of gains.

21. That result is not disputed in an example like this where the taxpayer has income which exceeds the amount of CDR available to him. But the issue which divides the parties is what the position would be if the taxpayer's income is less than the amount of CDR available to him.

22. We do not propose to consider this issue by reference to the wording of the legislation as it stood in 1988, namely FA 1988 and ICTA 1988. By the time of the first tax year in question (2006/07) the relevant provisions had been re-enacted and amended, and it is clearly appropriate for us to consider the issue on the wording of the statutory provisions as they stood for that year. For the second tax year (2007/08) the legislation was amended again, partly as a result of the Income Tax Act 2007 (**"ITA 2007"**), part of the project to rewrite the tax law, which first applied to the tax year 2007/08.

Tax year 2006/07

23. By the tax year 2006/07 what had been s. 98 and s. 102(2) FA 1988 had been re-enacted as ss. 4 and 6(2) TCGA 1992, and what had been s. 549 ICTA 1988 had been re-enacted as s. 539 of the Income Tax (Trading and Other Income) Act 2005 (**"ITTOIA 2005"**).

24. s. 4 TCGA 1992 provided as follows:

"**4. Rates of capital gains tax.**

(1) Subject to the provisions of this section, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be

equivalent to the lower rate of income tax for the year.

(1AA) The rate of capital gains tax in respect of gains accruing to—

(a) the trustees of a settlement, or

(b) the personal representatives of a deceased person,

in a year of assessment shall be equivalent to the rate which for that year is the rate applicable to trusts under section 686 of the Taxes Act.

(1AB) If (after allowing for any deductions in accordance with the Income Tax Acts) an individual has no income for a year of assessment or his total income for the year is less than the starting rate limit, then-

(a) if the amount on which he is chargeable to capital gains tax does not exceed the unused part of his starting rate band, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the starting rate;

(b) if the amount on which he is chargeable to capital gains tax exceeds the unused part of his starting rate band, the rate of capital gains tax in respect of such gains accruing to him in the year as correspond to the unused part shall be equivalent to the starting rate.

(1AC) The references in subsection (1AB) above to the unused part of an individual's starting rate band are to the amount by which the starting rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts).

(2) If income tax is chargeable at the higher rate or the dividend upper rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate or the dividend upper rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the basic rate limit exceeds his total income (as reduced by any deductions made in accordance with the Income Tax Acts)."

Save for the complications caused by the introduction of new rates such as the rate applicable to trusts, the starting rate and the dividend upper rate, and the change of terminology from basic rate to lower rate (still charged at 20%), this closely followed s. 98 FA 1988.

25. s. 6(2) TCGA 1992 provided as follows:

> "**6. Other special cases.**
>
> (2) Where for any year of assessment—
>
> (a) by virtue of section 539 of ITTOIA 2005 (gains from contracts for life insurance etc) a deduction of an amount is made from a person's total income for the purposes of extra liability, or
>
> (c) by virtue of section 669(1) and (2) of ITTOIA 2005 (reduction in residuary income: inheritance tax on accrued income) the residuary income of an estate is treated as reduced so as to reduce a person's income by any amount for those purposes,
>
> section 4(4) shall have effect as if his income for the year were reduced by that amount."

Save that the special cases had by then been reduced from four to two, this closely followed s. 102(2) FA 1988.

26. s. 539 ITTOIA 2005 provided as follows:

> "**539 Relief for deficiencies**
>
> (1) A deficiency from a policy or contract arising on a chargeable event is allowable as a deduction from an individual's total income for a tax year if, had a gain arisen instead on that event–
>
> (a) the individual would have been liable to income tax on the gain for that year, or
>
> (b) the individual would have been so liable apart from the requirement in section 465(1) that the individual must be UK resident in the tax year in which the gain arises.
>
> (2) See section 540 for the cases in which such a deficiency is treated as arising, section 541 for how the deficiency is calculated and section 469(5) for the apportionment of deficiencies in cases where two or more persons are interested in a policy or contract.
>
> (3) Subsection (1) only applies for the purpose of determining the individual's extra liability.
>
> (4) For this purpose, an individual's extra liability is the amount by which the individual's liability to income tax exceeds the amount it would be on the assumptions specified in subsections (5) and (6).
>
> (5) It is assumed that income charged to tax at the higher rate is charged–
>
> (a) in the case of income within section 1A(1A)(c) of ICTA (income charged at the lower rate instead of the basic rate), at the lower

rate, and

(b) in any other case, at the basic rate.

(6) It is assumed that income charged to tax at the dividend upper rate is charged at the dividend ordinary rate."

27. It is now possible to address the arguments. We can do so by reference to Mr Furness's Example 3, which is that of a taxpayer who has income of £0, CDR of £35,000 and chargeable gains of £100,000. On Mr Furness's interpretation of the legislation such a taxpayer would pay tax as follows:

Example 3A

Income		£ 0
Gains		
Total income for s. 98(4) purposes	£ 0 – £ 35,000 (£ 35,000)	
Unused part of basic rate band	£ 40,000 – (£ 35,000) £ 75,000	
Charged at basic rate		£ 75,000
Charged at higher rate		£ 25,000

28. By contrast on Mr Pritchard's interpretation, such a taxpayer would pay tax as follows:

Example 3B

Income		£ 0
Gains		
Total income for s. 98(4) purposes	£ 0	
Unused part of basic rate band	£ 40,000 – £ 0 £ 40,000	
Charged at basic rate		£ 40,000
Charged at higher rate		£ 60,000

29. We have no hesitation in preferring Mr Pritchard's interpretation, and will now set out why.

30. It can be seen from the rival calculations that the difference between them is this. Mr Furness submits that the wording at the end of s. 6(2) TCGA 1992 (*"section 4(4) shall have effect as if his income for the year were reduced by that amount"*) required one to subtract the amount of the CDR from the taxpayer's income, and if the amount of CDR was larger than the amount of income, the result was a negative figure. He said that s. 4(4) TCGA 1992, when read with s. 6(2) TCGA 1992, was simply an arithmetical formula. In effect (although he did not put it in quite these terms) his submission was that in a case where a taxpayer had available CDR, the effect of s. 4(4) TCGA 1992 could be represented as:

UP = BRL – TI

(where UP is the unused part of the basic rate band, BRL is the basic rate limit, and TI is total income for s. 4(4) purposes); and the effect of s. 6(2) TCGA 1992 as:

TI = I – D

(where I is income and D is the amount of the deficiency available to the taxpayer). That means that the combined effect of s. 4(4) and s. 6(2) TCGA 1992 is:

UP = BRL – (I – D).

Putting in the figures for BRL, I and D then gives the following:

UP = £40,000 – (£0 – £35,000)

which as a matter of simple arithmetic leads to the conclusion:

UP = £75,000.

31. But this argument depends on s. 6(2) TCGA 1992 requiring the total amount of the deficiency to be subtracted from the taxpayer's income in order to find the figure for total income for the purposes of s. 4(4). This is not what s. 6(2) says. What s. 6(2) says is that s. 4(4) shall have effect as if his income for the year were reduced *"by that amount"*. That must be a reference back to the amount referred to in s. 6(2)(a), which applies where by virtue of s. 539 ITTOIA 2005 *"a deduction of an amount is made from a person's total income for the purposes of extra liability."* That takes one to s. 539 which in s. 539(1) says that a deficiency is *"allowable as a deduction"* from an individual's total income, and in s. 539(3) says that that only applies for the purpose of determining the individual's extra liability.

32. Mr Furness accepted, as we have recorded above, that in the ordinary case of reliefs and allowances which were available as deductions from income, the amount deducted could not exceed the amount of income, or in other words that reliefs and allowances could reduce a taxpayer's income to nil, but could

not reduce a taxpayer's income to below nil or to a negative figure: see paragraph 12 above. We have been unable to see any reason why it should be any different with the relief given by s. 539 ITTOIA 2005. The effect of s. 539 is that CDR is available to the taxpayer to be used as a deduction from his income, but we do not see why in this case, any more than in any other case where an allowance or relief is available to a taxpayer, that deduction can be used to reduce his income below zero. The only relevant difference between the relief given by s. 539 and other reliefs is that the s. 539 relief only applies for the purposes of determining higher rate income tax liability, and we cannot see that that justifies such a difference of treatment. In our judgment therefore, if a taxpayer has income of £10,000 and CDR available to him of £35,000, the effect of s. 539(1) is to permit £10,000 of the CDR to be used as a deduction from his income so that his income is reduced to nil for the purposes of calculating his higher rate income tax liability. It is not to permit the whole £35,000 to be deducted from his income so that his income is reduced to -£25,000 for the purposes of computing his liability to higher rate income tax. That would be inconsistent with the general principle, accepted by Mr Furness, that deductions by way of reliefs and allowances cannot ordinarily reduce a taxpayer's income below zero. If they cannot do that, we cannot see any justification for the proposition that s. 539 can reduce a taxpayer's income below zero for the purposes of liability to higher rate income tax. There is certainly nothing in the statutory language of s. 539 compelling, or even suggesting, that result.

33. In the light of that conclusion, it seems to us to inevitably follow from the language of s. 6(2) TCGA 1992 that the amount by which the taxpayer's income is to be reduced for the purposes of s. 4(4) TCGA 1992 is similarly limited. Thus in the example we have just given of the taxpayer with income of £10,000 and available CDR of £35,000, the amount of the deduction that is made from his income by virtue of s. 539 is not £35,000 but £10,000, and that is therefore the amount referred to in s. 6(2)(a) TCGA 1992 (*"where ... by virtue of section 539 of ITTOIA 2005… a deduction of an amount is made"*), and hence that is also the amount referred to in the concluding words of s. 6(2) (*"as if his income were reduced by that amount"*).

34. Similarly in Mr Furness's Example 3, although the taxpayer has CDR available of £35,000, the deduction made under s. 539(1) is nil (because he has nil income and it cannot be reduced under s. 539 below nil); the reference in s. 6(2)(a) TCGA 1992 to *"a deduction of an amount"* is also nil, as that is the amount deducted under s. 539(1); and the reference to his income being reduced *"by that amount"* is also a reference to a nil amount. Or indeed one could more simply say that s. 6(2) has no application because there is no deduction of any amount under s. 539 ITTOIA 2005 at all.

35. The effect of this interpretation is that the amount deducted under s. 539 can never be greater than the taxpayer's income, and hence that the figure to be used for the taxpayer's total income in s. 4(4) can never be less than nil, or a negative figure. That means that the *"unused part of his basic rate band"* in

s. 4(3) TCGA 1992 can never be greater than the amount of the basic rate limit (£40,000 in the example). In other words, the effect of s. 4(3) and (4) is to allow the taxpayer to use for CGT purposes any part of his basic rate band that has not been used for income tax purposes; and the effect of s. 6(2) TCGA 1992 is to leave out of account for this purpose any income not brought into account for higher rate income tax purposes. It is not to extend the basic rate band by adding the amount of CDR to the basic rate limit. The practical effect is that however large the amount of CDR available to a taxpayer, and however small his income, he cannot use the CDR to avoid paying tax on all chargeable gains in excess of the basic rate limit (£40,000). In the words of the FTT at [93]-[98]:

> "93 Many of the examples that Mr Firth put to the Tribunal in the course of argument showed the effect of CDR as if it operated as an extension of the basic rate band. Mr Firth says that this extension of the basic rate band is consistent with the way in which calculations for the application of CDR have been performed by HMRC. That is not the way in which the legislation governing CDR works. The relevant CDR provisions – in section 539 ITTOIA — require a comparison of liabilities arising on a calculation of total income for the purposes of basic rate liability and separate calculation of total income for the purposes of liability at higher rates on different assumptions. A calculation performed simply by extending the basic rate limit by the amount of CDR may provide a suitable short-cut to the amount of the resulting income tax liability in most cases. But it does not reflect the manner in which the relief is given on the terms of the legislation.
>
> 94 Furthermore, if that approach is extended to the provisions governing rates of CGT, the effect is to give relief for an income tax relief to reduce tax on capital gains. That would be a major step and I cannot discern such a broad purpose from the scheme of the Act. As Mr Pritchard pointed out, the legislation does not provide for a perfect integration of income tax and CGT. If it were to be so, the legislation would allow for reliefs from income tax to reduce capital gains and vice versa. It does not do that.
>
> 95 In the context of CDR, Mr Firth says that his is the only interpretation that gives full effect to the purpose of the legislation, namely to tax capital gains at the same marginal rate. It is the only interpretation on which the next £1 of income or £1 of gain will be taxed in the same way. But that is not the case for income or gains which might otherwise be absorbed by unused losses or reliefs taken into account in computing total income or the amount which is subject to CGT. There no reason to make a special case for CDR being available to reduce tax on capital gains.
>
> 96 In my view, the purpose of section 6(2) is more limited. It is not to turn an income tax relief into a relief which can be used to reduce CGT. The aims of section 6(2) are to identify the calculation of total income that is relevant (given that there are two possible calculations) and to ensure that the effect of section 4 does not deprive the taxpayer of the

> benefit of the basic rate threshold in a case in which CDR is claimed. Without section 6(2), if the amount of CDR exceeds the amount of income which is subject to tax at higher rates, then capital gains would potentially be taxed at higher rates even if there would have been additional capacity within the basic rate threshold.
>
> 97 Mr Firth can rightly say that all that this is doing is ensuring that the next £1 of gain is taxed in the same way as the next £1 of income up to the amount of the basic rate limit. That is true, but to my mind the extension of the argument to, in effect, convert an income tax relief into a relief from CGT goes beyond the natural meaning of the words.
>
> 98 Nor do I think that this is an absurd result. The effect is to preserve the benefit of the basic rate limit in a case where CDR applies. Without it, the taxpayer could effectively lose the benefit of the basic rate limit. The basic rate limit is an integral part of the rate structure and these provisions are about tax rates."

We agree.

36. This interpretation also has the merit that it gives to the words *"unused part of his basic rate band"* in s. 4(3) TCGA 1992 a meaning which is its natural meaning. Mr Furness relies on the fact that *"basic rate band"* is not itself a statutorily defined term, and that to find out what the whole phrase means one has to look at s. 4(4), which is simply a means of introducing an arithmetical formula. It is however a general principle that where a statute uses a defined expression, be it a word or a phrase, the ordinary meaning of the defined expression is part of the material that can be used as an aid to interpretation. We were not in fact taken to any authority for this proposition but neither counsel dissented from it and it is well established. As Mr Pritchard mentioned, it was endorsed by the House of Lords in *Oxfordshire County Council v Oxford City Council* [2006] UKHL 25 (see at [38] per Lord Hoffmann (*"in construing a definition, one does not ignore the ordinary meaning of the word which Parliament has chosen to define"*) and at [82] per Lord Scott, approving a statement in *Bennion, Statutory Interpretation* that *"its dictionary meaning is likely to exercise some influence over the way the definition will be understood by the court"* and referring to statements in previous House of Lords cases). See also the subsequent statements of Lord Hoffmann in *Birmingham City Council v Walker* [2007] UKHL 22 at [11] (*"the ordinary meaning of the word is part of the material which can be used to construe the definition"*) and *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38 at [17] where in relation to the analogous question of contractual interpretation he said:

> "The words used as labels are seldom arbitrary. They are usually chosen as a distillation of the meaning or purpose of a concept intended to be more precisely stated in the definition. In such cases the language of the defined expression may help to elucidate ambiguities in the definition or other parts of the agreement."

37. Mr Furness accepted that *"basic rate band"* had an ordinary colloquial meaning, namely that band or slice of income which is taxed at the basic rate. In the assumed example, it would be the band from £0 to £40,000 (ignoring the complications of starting rate). Given that that is the natural meaning of *"basic rate band"*, we agree with Mr Pritchard that the natural meaning of *"unused part of his basic rate band"* is that part of the available band of £0 to £40,000 which has not been used for income tax purposes and so can be used for CGT purposes. The interpretation which he has put forward and which we have accepted is consistent with this natural meaning: the *"unused part of his basic rate band"* on this view can never exceed £40,000. On Mr Furness's interpretation, it will exceed £40,000 whenever the available CDR is greater than the taxpayer's income, and indeed in Mr Scott's case would be some £20m. We agree with Mr Pritchard that that puts a most unnatural meaning on the phrase. As the FTT put it at [91]-[92]:

> "91 As an initial point, the "income" of a person that is referred to in the final words of section 6(2) is the "total income" of that person as referred to in section 4(4). Total income is the amount of income on which an individual pays income tax and by implication cannot be negative.
>
> 92 That interpretation, in my view, is supported by the wording of section 4(4) which refers to the "unused part" of the basic rate band being "the amount by which an individual's basic rate limit exceeds total income". If Mr Firth's interpretation is correct and total income after the application of section 6(2) can be negative, the effect is that the "unused part of the basic rate limit" can exceed the amount of the actual basic rate band itself. Once again, that is not a natural reading and there is nothing in the remainder of the provisions of the Act to support it."

Again we agree.

38. Mr Furness has a series of criticisms of the FTT's Decision. We should deal with them briefly although none of them affects the conclusion we have come to.

39. In relation to [91] he said that he accepted that total income could not be negative, but this was to mischaracterise his argument, which was that s. 6(2) TCGA 1992 was just a formula. That might produce a negative *figure* for insertion into s. 4(4) TCGA 1992, but that was not negative *income*, still less negative *total income*. It seems to us however that it is a drawback of Mr Furness's interpretation that it can produce a negative figure for s. 4(4) purposes when s. 4(4) refers to *"total income (as reduced by any deductions made in accordance with the Income Tax Acts)"* and, as Mr Furness accepted, this could not in the ordinary case (where there was no CDR or other higher rate relief and s. 6(2) did not apply) be reduced below zero. In the ordinary case therefore *"total income (as reduced...)"* in s. 4(4) does mean the taxpayer's taxable income and cannot be negative. We do not see anything in

s. 6(2) which suggests that where there is CDR available it should be given a different meaning.

40. In relation to [92] Mr Furness accepted that it was a consequence of his argument that the *"unused part of his basic rate band"* could exceed the ordinary or popular concept of *"basic rate band"* but that was simply a consequence of the mandatory calculation required by s. 6(2) TCGA 1992. We have already addressed this point above.

41. In relation to [93] Mr Furness said that his argument was not about how CDR worked for its own code (under s. 539 ITTOIA 2005) but about how it fed into the calculation required by s. 4(4) TCGA 1992. But as we have sought to demonstrate above, s. 6(2) TCGA 1992 does require one to identify the amount of the deduction under s. 539 ITTOIA 2005, and if the amount of that deduction is limited to the amount of the taxpayer's income, as in our view it is, that does affect the amount that s. 6(2) requires to be fed into s. 4(4) TCGA 1992.

42. In relation to [94] Mr Furness said that on any view the whole object of the exercise *was* to allow income tax relief (namely CDR) to be used to reduce the tax on chargeable gains. We agree, but we do not think this is an answer to the point made by the FTT that what the legislation does not do is integrate the taxation of income and chargeable gains or provide generally that income tax reliefs are available against CGT; what it does is to ensure that s. 4 TCGA 1992 does not deprive the taxpayer of the benefit of the basic rate band in a case in which CDR is claimed.

43. In relation to the last sentence of [95] Mr Furness said that Parliament did intend to make CDR a special case (see the heading to s. 6 TCGA 1992 *"Other special cases"*). Again that does not seem to us to be an answer to the point that what Parliament did in s. 6 was indeed to make special provision for the case of CDR, but it did not do so by simply providing (as it could have done) that CDR was available as a relief against higher rate on both income and chargeable gains. Instead what it did was more limited.

44. In relation to [96]-[98] Mr Furness said that the rather limited purpose of the legislation identified by the FTT did not fulfil the statutory purpose of unifying the tax rates on income and chargeable gains. We agree that the general purpose of s. 4 TCGA 1992 was to unify the rates of income tax and CGT, as can be seen from the way in which it works in the ordinary case (and as was reflected in the heading to ss. 98 to 103 FA 1988 when these provisions were first enacted). But we do not think that this general aim can control the interpretation of s. 6(2) TCGA 1992: that is to be found primarily by construing the words, not by appeals to the general policy underlying the provisions.

45. We therefore reject Mr Furness's criticisms of the Decision in relation to 2006/07.

46. Mr Furness had one further submission, although he did not put it at the forefront of his argument, which was based on what the Chancellor of the Exchequer, Mr Nigel Lawson, said in his Budget speech to the House of Commons on 15 March 1988. We deal with this point below but will say now that it has not persuaded us to adopt any different interpretation of the legislation applicable to 2006/07.

47. For the reasons we have given we propose to dismiss the appeal in relation to the tax year 2006/07.

2007/08

48. For 2007/08 the relevant statutory provisions were further amended. The version of s. 4 TCGA 1992 as so amended provided as follows:

> "**4. Rates of capital gains tax.**
>
> (1) Subject to the provisions of this section, the rate of capital gains tax in respect of gains accruing to a person in a year of assessment shall be equivalent to the savings rate of income tax for the year.
>
> (1AA) The rate of capital gains tax in respect of gains accruing to—
>
> (a) the trustees of a settlement, or
>
> (b) the personal representatives of a deceased person,
>
> in a year of assessment shall be equivalent to the rate which for that year is the trust rate.
>
> (1AB) If an individual has no Step 3 income for a year of assessment or the individual's Step 3 income for the year is less than the starting rate limit, then-
>
> (a) if the amount on which he is chargeable to capital gains tax does not exceed the unused part of his starting rate band, the rate of capital gains tax in respect of gains accruing to him in the year shall be equivalent to the starting rate;
>
> (b) if the amount on which he is chargeable to capital gains tax exceeds the unused part of his starting rate band, the rate of capital gains tax in respect of such gains accruing to him in the year as correspond to the unused part shall be equivalent to the starting rate.
>
> (1AC) The references in subsection (1AB) above to the unused part of an individual's starting rate band are to the amount by which the starting rate limit exceeds the individual's Step 3 income.
>
> (2) If income tax is chargeable at the higher rate or the dividend upper rate in respect of any part of the income of an individual for a year of assessment, the rate of capital gains tax in respect of gains accruing to

him in the year shall be equivalent to the higher rate.

(3) If no income tax is chargeable at the higher rate or the dividend upper rate in respect of the income of an individual for a year of assessment, but the amount on which he is chargeable to capital gains tax exceeds the unused part of his basic rate band, the rate of capital gains tax on the excess shall be equivalent to the higher rate of income tax for the year.

(4) The reference in subsection (3) above to the unused part of an individual's basic rate band is a reference to the amount by which the basic rate limit exceeds the individual's Step 3 income.

(5) For the purposes of this section the "Step 3 income" of an individual means the individual's net income less allowances deducted at Step 3 of the calculation in section 23 of ITA 2007 for the purpose of calculating the individual's income tax liability.

(6) Section 989 of ITA 2007 (the definitions) applies for the purposes of this section as it applies for income tax purposes."

49. s. 6(2) TCGA 1992 as amended provided as follows:

"**6. Other special cases.**

(2) Where for any year of assessment—

(a) by virtue of section 539 of ITTOIA 2005 (gains from contracts for life insurance etc) a person is entitled to relief by reference to the amount of a deficiency, or

(c) by virtue of section 669(1) and (2) of ITTOIA 2005 (reduction in residuary income: inheritance tax on accrued income) the residuary income of an estate is treated as reduced so as to reduce a person's income by any amount for the purposes of extra liability,

section 4(4) shall have effect as if the person's Step 3 income for the year were reduced by the amount of the deficiency or (as the case may be) the amount mentioned in paragraph (c)."

50. s. 539 ITTOIA 2005 as amended provided as follows:

"**539 Relief for deficiencies**

(1) An individual is entitled to a tax reduction for a tax year in which a deficiency arises from a policy or contract on a chargeable event if–

(a) the condition in subsection (2) is met,

(b) the individual would (apart from this section) be liable to income tax at the higher rate or the dividend upper rate (or both) for the tax year, and

(c) the individual makes a claim.

(2) The condition is that, if a gain had arisen instead on the chargeable event–

(a) the individual would have been liable to income tax on the gain for the year, or

(b) the individual would have been so liable apart from the requirement in section 465(1) that the individual must be UK resident in the tax year in which the gain arises.

(3) The tax reduction is given effect at Step 6 of the calculation in section 23 of ITA 2007.

(4) See section 540 for the cases in which a deficiency is treated as arising from a policy or contract on a chargeable event, section 541 for how the deficiency is calculated and section 469(5) for the apportionment of deficiencies in cases where two or more persons are interested in a policy or contract.

(5) The amount of the tax reduction is calculated as follows.

Step 1

Attribute to the amount of the deficiency an amount of the individual's income for the tax year which is liable at the dividend upper rate, so far as is possible.

Step 2

If there is an amount of the deficiency remaining after Step 1, attribute to the remaining amount of the deficiency an amount of the individual's savings income for the tax year which is liable at the higher rate, so far as is possible.

Step 3

If there is an amount of the deficiency remaining after Step 2, attribute to the remaining amount of the deficiency an amount of the individual's other income for the tax year which is liable at the higher rate, so far as is possible.

Step 4

Calculate the amount of the individual's preliminary income tax liability for the tax year (see subsection (6)).

Step 5

Calculate the amount of the individual's preliminary income tax liability for the tax year again, on these assumptions–

Assume that any income attributed to the deficiency at Step 1 is liable at the dividend ordinary rate.

Assume that any income attributed to the deficiency at Step 2 is liable at the savings rate.

Assume that any income attributed to the deficiency at Step 3 is liable at the basic rate.

Step 6

Deduct the amount found at Step 5 from the amount found at Step 4.

The result is the amount of the tax reduction.

(6) The individual's preliminary income tax liability is the amount found by calculating the individual's income tax liability in accordance with section 23 of ITA 2007, ignoring Steps 6 and 7 of that calculation."

51. Each of these provisions refers to the calculation in s. 23 ITA 2007. This provided as follows:

"**23 The calculation of income tax liability**

To find the liability of a person ("the taxpayer") to income tax for a tax year, take the following steps.

Step 1

Identify the amounts of income on which the taxpayer is charged to income tax for the tax year.

The sum of those amounts is "total income".

Each of those amounts is a "component" of total income.

Step 2

Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year.

See section 25 for further provision about the deduction of those reliefs.

The sum of the amounts of the components left after this step is "net income".

Step 3

Deduct from the amounts of the components left after Step 2 any allowances to which the taxpayer is entitled for the tax year under Chapter 2 of Part 3 of this Act or section 257 or 265 of ICTA (individuals: personal allowance and blind person's allowance).

See section 25 for further provision about the deduction of those allowances.

Step 4

Calculate tax at each applicable rate on the amounts of the components left after Step 3.

See Chapter 2 of this Part for the rates at which income tax is charged and the income charged at particular rates.

If the taxpayer is a trustee, see also Chapters 3 to 6 and 10 of Part 9 (special rules about settlements and trustees) for further provision about the income charged at particular rates.

Step 5

Add together the amounts of tax calculated at Step 4.

Step 6

Deduct from the amount of tax calculated at Step 5 any tax reductions to which the taxpayer is entitled for the tax year under a provision listed in relation to the taxpayer in section 26.

See sections 27 to 29 for further provision about the deduction of those tax reductions.

Step 7

Add to the amount of tax left after Step 6 any amounts of tax for which the taxpayer is liable for the tax year under any provision listed in relation to the taxpayer in section 30.

The result is the taxpayer's liability to income tax for the tax year."

52. s. 23 ITA 2007 cross-refers to s. 25 ITA 2007. This provided as follows:

"**25 Reliefs and allowances deductible at Steps 2 and 3: supplementary**

(1) This section supplements the provisions about reliefs and allowances in Steps 2 and 3 of the calculation in section 23.

(2) At Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax.

(3) Subsection (2) is subject to–

[there are then listed a large number of sections of ITA 2007 and other

Acts]

and any other provision of the Income Tax Acts under which reliefs or allowances deductible at Step 2 or 3 are not permitted to be deducted from particular components of income or are required to be deducted from particular components of income or in a different order.

(4) A relief or allowance may be deducted at Step 2 or 3 only so far as there is sufficient income from which to deduct it.

(5) In deciding whether there is sufficient income from which to deduct a relief or allowance, reliefs and allowances already deducted at Step 2 or 3 must be taken into account.

(6) Nothing in Step 2 or 3 is to be read as permitting a relief or allowance to be deducted more than once."

53. We can now come to the arguments on this amended legislation. We start with a strong disposition to find that it has the same practical effect as the previous iteration of the legislation. This is for three reasons:

(1) Neither counsel invited us to reach a different conclusion on the two tax years. On the contrary, it was common ground between them that there is no relevant difference between the two years.

(2) Although the amendments to the legislation for 2007/08 were quite extensive, they were effected under s. 1027 and sch 1 ITA 2007, and clearly were drafting amendments to bring these provisions into line with ITA 2007. As already mentioned this was part of the project to rewrite the tax law, and we can we think take judicial notice that the purpose of this project was to restate the law in more accessible language rather than to effect substantive amendments to the law. Indeed the preamble to ITA 2007 describes it as:

> "An Act to restate, with minor changes, certain enactments relating to income tax; and for connected purposes."

It is of course possible that in the process of restating the law the draftsman has inadvertently effected a substantive change in it, but we approach the interpretation of the legislation on the assumption that it was not intended to do so. Mr Furness accepted that in construing the versions of ss. 4 and 6 TCGA 1992 and s. 539 ITTOIA 2005 in force for 2007/08 the tribunal could properly look at the previous versions of the same sections in order to resolve any ambiguities in the drafting.

(3) Much of the relevant statutory language is left unchanged. Most noticeably s. 4(3) TCGA 1992, which is where one finds the reference to *"the unused part of his basic rate band"*, is in identical terms to what it was for 2006/07. It would we think be a very surprising result if it had a radically different meaning in 2007/08 to what it had had in

2006/07 when the language itself was the same, and there is no hint in s. 4 itself that there was any intention to make any change of substance at all.

54. Mr Pritchard however accepted that the simple argument which we accepted in relation to 2006/07 was not available to him, or at any rate was nothing like as strong. This is because whereas for 2006/07 s. 6(2) TCGA 1992 referred to the taxpayer's income for the year being *"reduced by that amount"* (that is by the amount of the deduction under s. 539 ITTOIA 2005), the equivalent provision in force for 2007/08 refers instead to the taxpayer's step 3 income being *"reduced by the amount of the deficiency"*. Mr Furness submitted that that referred to the amount of CDR available to the taxpayer, regardless of whether it exceeded the taxpayer's income or not. Taken by itself, there is clearly some force in that, as Mr Pritchard effectively accepted.

55. Nevertheless we have come to the conclusion that Mr Furness's argument must be rejected in relation to 2007/08 as well, for the following reasons.

56. First, as we have said, we have a strong disposition to find that the legislation has the same effect as the previous iteration did.

57. Second, we have accepted above that for 2006/07 the *"unused part of his basic rate band"* bore its natural meaning, that is that part of the band or slice of income between £0 and the basic rate limit (£40,000) that had not been used by the taxpayer for income tax purposes, and that the effect of the legislation as it then stood was that this could not itself be more than the basic rate limit (£40,000). We think that it should if at all possible be given the same meaning for 2007/08. That can only be done by rejecting Mr Furness's interpretation.

58. Third, it is not difficult to interpret s. 6(2) TCGA 1992 in a way consistent with the way it worked in 2006/07. As amended it requires the taxpayer's Step 3 income to be *"reduced by the amount of the deficiency"*. We will assume that Mr Furness is right that *"the amount of the deficiency"* is the whole of the CDR available to the taxpayer. Nevertheless it is an essential part of Mr Furness's argument that if the taxpayer's Step 3 income is £0, and the CDR £35,000, the resulting figure to be used for the purposes of s. 4(4) TCGA 1992 is a negative figure, namely -£35,000. That might have been so if s. 6(2) had contained an algebraic formula requiring the amount of CDR to be subtracted from the amount of the taxpayer's Step 3 income. But that is not what it says: what it says is that the taxpayer's Step 3 income shall be *"reduced"* by the amount of the deficiency. We accept Mr Pritchard's submission that that can be interpreted as meaning that if the available CDR exceeds the taxpayer's income, the income is reduced to nil, but not below nil. That means that the Step 3 income which s. 6(2) requires to be used for the purposes of s. 4(4) TCGA 1992 can never be less than nil, and hence that the *"unused part of the basic rate band"* can never exceed the basic rate limit of £40,000.

59. That seems to us to be a perfectly sensible and natural interpretation of the language of s. 6(2) TCGA 1992, and given the desirability of interpreting it in such a way as not to effect a substantive change from the way the legislation worked in 2006/07, we consider that it is the interpretation that should be adopted.

60. It also seems to us to be consistent with the general way in which deductions from income for tax purposes work: it is noticeable that s. 25(4) ITA 2007 now provides expressly that:

> "A relief or allowance may be deducted at Step 2 or 3 only so far as there is sufficient income from which to deduct it."

That simply makes explicit what Mr Furness accepted was the general position anyway, as indeed the Explanatory Notes to s. 25 ITA 2007 say. These include (at paragraph 110) the following:

> "Some, but not all, of the source provisions contain the rule that income cannot be reduced below nil, but even where not explicitly mentioned, it has always been the accepted practice that a deduction can only be made from income to the extent that there is income to absorb the deduction. The position is now explicit for all income deductions."

61. Given this general principle, we see nothing surprising in an interpretation of s. 6(2) TCGA 1992 which means that the amount of available CDR can be used to reduce the taxpayer's Step 3 income only to the extent that there is income available to absorb it; and cannot be used to reduce the income to a negative figure.

62. That conclusion makes it unnecessary to consider if Mr Furness is in fact right that the *"amount of the deficiency"* in s. 6(2) TCGA 1992 means the whole amount of the CDR available to the taxpayer. Although there is obvious force in that contention, it is not the only possible interpretation. The words *"the amount of the deficiency"* in the concluding words of s. 6(2) must we think refer back to the words in s. 6(2)(a) which refer to the taxpayer being *"entitled to relief by reference to the amount of a deficiency"*. Suppose a case in which the taxpayer has income of £100,000 and CDR of £150,000. This entitles the taxpayer to relief by way of an income tax reduction under s. 539(1) ITTOIA 2005. The calculations set out in Steps 1 to 6 of s. 539(5) show that the only amount of CDR which can be used for that purpose is £100,000 because the way the relief is given is by attributing the taxpayer's income (at Steps 1 to 3) to successive slices of the deficiency. As Mr Furness accepted, for income tax purposes if you have no further income against which to use the CDR, the benefit of the excess is wasted.

63. In these circumstances it seems to us to be a possible interpretation of s. 6(2)(a) TCGA 1992 that the reference to *"the amount of a deficiency"* (by reference to which relief is given) is not a reference to the whole of the CDR available to the taxpayer (£150,000) but to so much of the deficiency as is the

amount by reference to which relief is given, which will necessarily be limited to the amount of the taxpayer's income (£100,000). If that is right, then it is also possible to interpret the second reference to *"the amount of the deficiency"* in the concluding words in s. 6(2) in the same way.

64. Having identified the argument we do not propose to decide it, partly because as we have already said we do not need to, and partly because we received very limited submissions on this point. We are content to rest our decision on the point that s. 6(2) does not permit the taxpayer's Step 3 income to be reduced below nil even if the amount of CDR available to the taxpayer exceeds his Step 3 income. On this basis we propose to dismiss the appeal in relation to the tax year 2007/08 as well.

Mr Lawson's Budget speech

65. That leaves Mr Furness's reliance on Mr Lawson's Budget speech on 15 March 1988. Having said that with the existing position, with capital gains taxed at 30% for everybody, some taxpayers paid a lower rate than on their income and some a higher rate, he proposed a fundamental reform which he described as follows:

> "Subject to the new base date, capital gains will continue to be worked out as now, with the present exemptions and reliefs. But the indexed gain will be taxed at the income tax rate that would apply if it were the taxpayer's marginal slice of income. In other words, I propose in future to apply the same rate of tax to income and capital gains alike."

Mr Furness's submission was that that was admissible as an aid to construction of the legislation first enacted in ss. 98 and 102 FA 1988 and hence of ss. 4 and 6 TCGA 1992.

66. We can deal with this point quite shortly. There is in fact a question whether the FTT intended to grant permission to appeal on this point, but we do not propose to consider this – we will assume that Mr Furness has the requisite permission. Nevertheless it seems to us that on orthodox principles statements by Ministers to the House of Commons as to the intended effect of legislation can usually only be admitted on a question of construction if they can be brought within the principle of *Pepper v Hart* [1993] AC 593. That case imposed narrow conditions for the admissibility of such statements, summarised by Lord Bingham in *R v Secretary of State for the Environment, Transport and the Regions, ex p Spath Holme Ltd* [2001] 2 AC 349 at 391C as follows:

> "In *Pepper v Hart* the House (Lord Mackay of Clashfern LC dissenting) relaxed the general rule which had been understood to preclude reference in the courts of this country to statements made in Parliament for the purpose of construing a statutory provision. In his leading speech, with which all in the majority concurred, Lord Browne-Wilkinson made plain that such reference was permissible only where (a) legislation was ambiguous or

> obscure, or led to an absurdity; (b) the material relied on consisted of one or more statements by a minister or other promoter of the Bill together, if necessary, with such other parliamentary material as might be necessary to understand such statements and their effect; and (c) the effect of such statements was clear (see pp 640b, 631d, 634d). In my opinion, each of these conditions is critical to the majority decision."

He later said (at 392D) that:

> "I think it important that the conditions laid down by the House in *Pepper v Hart* should be strictly insisted upon."

67. We do not consider that the comments in Mr Lawson's Budget speech meet the strict conditions laid down in *Pepper v Hart*. First, we do not think the first condition is met. The legislation which Mr Lawson in due course introduced (that is ss. 98 to 103 FA 1988) was not in our view ambiguous or obscure or led to an absurdity. The wording of s. 102(2) FA 1988 was in material respects similar to the wording of s. 6(2) TCGA 1992 as it stood for the tax year 2006/07, which we have found clear and unambiguous. It is true that we have not found the later iteration of s. 6(2) TCGA 1992 as it stood for the tax year 2007/08 so clear, but Mr Lawson's speech in 1988 had of course nothing to say about that.

68. Second, we are very doubtful if the second condition is met. *Pepper v Hart* permits reference to statements by the promoter of a bill. But at the time of his Budget speech, Mr Lawson was not introducing a Bill before the House. As we understand the Parliamentary procedure, the Budget debate is not a debate on draft legislation before the House, but is a debate on HM Treasury's "Red Book". It is only at a later stage that a Finance Bill is laid before the House. No doubt Mr Lawson was the promoter of the Finance Bill, and if he had repeated his statements when introducing the Finance Bill, they would no doubt have been statements made by the promoter of the bill, but the same is not we think true of statements made at an earlier stage in the Budget debate.

69. Third, and in any event, we do not consider that the third condition is met. Mr Lawson's statement as to the purpose behind the new legislation, namely to tax income and capital gains at the same rate, is a very general statement of the rationale for the legislation. It does not we think say any more than could be understood from reading ss. 98 to 103 (together with the heading to that group of sections). Mr Lawson said nothing about the interaction between CDR and the new provisions, or how what became s. 102 FA 1988 was intended to work. That can be contrasted with the facts in *Pepper v Hart* itself where what was striking was that the Minister, when debating the relevant Bill in Parliament, had given explicit assurances directed to the very question which later became the subject matter of litigation. One can see that, for example, in the speech of Lord Browne-Wilkinson at 635A, where he refers to a few cases in which:

> "it may emerge that the very question was considered by Parliament in

> passing the legislation."

Similarly, Lord Oliver at 620D said that the relaxation was permissible:

> "only where the expression of a legislative intention is genuinely ambiguous or obscure or where a literal or *prima facie* construction leads to a manifest absurdity and where a difficulty can be resolved by a clear statement directed to the matter in issue."

In the present case there is nothing in Mr Lawson's speech which could be said to be directed at the very question in issue in this appeal.

70. Mr Furness referred us to *HMRC v EB Central Services Ltd* [2008] EWCA Civ 486 where at [36] Mummery LJ said this:

> "At this point it is relevant to consider the legislative history, as set out in the judgment of Dyson LJ, and the preparatory legislative materials. They are relied on directly in construing the provisions of Group 8 of Schedule 8, as can be done in cases which satisfy the requirements laid down in *Pepper v. Hart* [1993] AC 593. In this instance the materials have been introduced not to construe the legislation, but to establish the fact that the purpose of the relevant national amending legislation was to make national law compatible with the Directive."

We think it likely from the context that there is a "not" missing in the second sentence, and that what Mummery LJ meant to say was:

> "They are [not] relied on directly in construing the provisions of Group 8 of Schedule 8, as can be done in cases which satisfy the requirements laid down in *Pepper v. Hart* [1993] AC 593."

That seems to us to make more sense: Mummery LJ was we think contrasting the case where statements in Parliament are directly relevant to construction of statutory provisions, and the case before them where statements were relied on simply to establish that the legislation was intended to implement a European Directive.

71. Mr Furness relied on this as showing that statements in Parliament are admissible to show the general purpose of legislation. We do not need to decide whether he is right about that. As we have already said, the general purpose of the legislation in ss. 98 to 103 FA 1988 is not in doubt: it was to assimilate or unify the rates of tax charged on income and chargeable gains. But that cannot answer the specific question that arises in this appeal which is whether CDR is available to reduce the tax rate payable on chargeable gains even if the available CDR exceeds a taxpayer's income. That is a very specific question which we consider can only be answered by construing the wording of the legislation as it has stood from time to time, and not by appeal to the general legislative intent behind it. In those circumstances we do not find Mr Lawson's remarks in his budget speech of any assistance in resolving this appeal.

Conclusion

72. For the reasons we have given we dismiss the appeal both in relation to the 2006/07 tax year and in relation to the 2007/08 tax year.

MR JUSTICE NUGEE

JUDGE NICHOLAS ALEKSANDER

RELEASE DATE: 17 July 2017