HOUSE OF LORDS SESSION 2005–06
[2006] UKHL 4
on appeal from[2003] EWCA Civ 1849

OPINIONS

OF THE LORDS OF APPEAL

FOR JUDGMENT IN THE CAUSE

Pirelli Cable Holding NV and others (Respondents)
v.
Her Majesty's Commissioners of Inland Revenue (Appellants)

Appellate Committee

Lord Nicholls of Birkenhead
Lord Hope of Craighead
Lord Scott of Foscote
Lord Walker of Gestingthorpe
Lord Brown of Eaton-under-Heywood

Counsel

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Respondents:
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David Cavender
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LORD NICHOLLS OF BIRKENHEAD

My Lords,

1. The primary issue on this appeal concerns the application of two double taxation conventions in circumstances not envisaged when they were made. The problem arises from the unforeseen impact of Community law on the partial 'imputation' system of corporation tax operated within the United Kingdom between 1973 and 1999. This system was introduced by the Finance Act 1972 as a means of avoiding the perceived double taxation of distributed profits, once in the hands of the company and again in the hands of its shareholders. The central principle of the new taxation scheme was that part of the corporation tax paid by a company was 'imputed' to its shareholders by giving them an appropriate tax credit. The means adopted for this purpose was that a company was required to pay a tax on its dividends known as advance corporation tax, or ACT in short, and its shareholders were given a corresponding tax credit. Nowhere did the legislation state that liability to pay ACT was a precondition of entitlement to a tax credit. But this unspoken linkage lay at the heart of the scheme, and the legislation was drawn in a form which achieved this result. This linkage is central to the first issue raised by this appeal.

2. In broad outline the legislation provided as follows. Where a company resident in the United Kingdom paid a dividend to its shareholders it became liable to pay ACT in respect of the dividend. ACT was set against the company's liability to 'mainstream' corporation tax. A recipient of the dividend, if resident in the United Kingdom, became entitled to a tax credit. The amount of the tax credit corresponded to the current rate of ACT. In the case of an individual a tax credit was utilised primarily as a credit against his income tax. Any excess was paid to the individual. Where the recipient of the dividend

was a company the amount of the dividend plus the amount of the tax credit constituted franked investment income. This could be used to frank dividends paid by the company so the company would not be liable to ACT on its dividends: see sections 14, 231 and 238-241 of the Income and Corporation Taxes Act 1988, or ICTA 1988 in short.

3. This basic scheme was subject to an important exception. Special provision was made for dividends paid by one company to another company in the same group. These companies could jointly make a group income election under section 247 ICTA 1988. A group income election had a twofold effect, reflecting the linkage between payment of ACT and entitlement to a tax credit. Dividends paid by a subsidiary to its parent while the election was in force, conveniently described as 'election dividends', did not trigger liability to pay. Nor did their receipt trigger entitlement to a tax credit. So election dividends did not constitute franked investment income of the parent. They constituted, in the language of the legislation, 'group income' of the receiving company: hence the description 'group income election'.

4. On the face of the legislation the right to make a group income election was expressly confined to cases where both companies were resident in the United Kingdom. In March 2001 the Court of Justice of the European Communities ruled that affording groups of companies the right to make a group income election where they were resident in the United Kingdom but denying them that right where the parent companies were not resident in the United Kingdom was contrary to article 52 (now article 43) of the EC Treaty providing for freedom of establishment: Joined Cases C-397/98 and C-410/98 *Metallgesellschaft Ltd and Hoechst AG v Commissioners of Inland Revenue* [2000] ECR I-1727. The court held that the claimant companies in these cases were entitled to compensation for loss of the use of the money paid as ACT between the date of payment and the date when the ACT was used by being set off against the subsidiary company's mainstream corporation tax liabilities.

5. This ruling had a widespread effect in practice. Shortly stated, the effect of this decision was that wherever group companies had been denied the opportunity to make a group income election, the United Kingdom government became liable to compensate them for the loss they suffered if the denial was an infringement of article 43 of the EC Treaty as interpreted by the court in the *Hoechst* decision.

6. Not surprisingly, many groups of companies sought to take advantage of this ruling. The present appeal concerns the assessment of

compensation payable to one such group, the Pirelli group, chosen as a test case in one category of claims within a group litigation order. For the purposes of this appeal the detailed facts, summarised in the speech of my noble and learned friend Lord Scott of Foscote, are not material. The essential facts are that dividends were paid by a subsidiary company resident in the United Kingdom to parent companies resident in Italy or the Netherlands. Group income election was not available, because the parent companies were not resident in the United Kingdom. So ACT was paid by the subsidiary company in respect of the dividends. For the same reason the parent companies were not entitled to tax credits under section 231 ICTA 1988. But under double taxation conventions made by this country with Italy and the Netherlands the parent companies became entitled to tax credits of a reduced amount calculated as set out in those conventions. I shall call these 'convention tax credits'.

The first question

7. In the present case the first question arising on the assessment of compensation is this. If the United Kingdom legislation had permitted parent companies resident in other member states of the European Community to make a group election, and if an election had been made in respect of the dividends in question, would the parent companies have been entitled to payment of the convention tax credits they in fact received under the double taxation conventions? If they would have been so entitled then no deduction should be made in respect of these tax credits when calculating the compensation. If, however, the parent companies would not have been so entitled, then in principle – and subject to the other issues raised on this appeal – due allowance should be made in respect of these tax credits when calculating the compensation. Due allowance should be made because, in this event, the convention tax credits received by the parent companies comprise financial benefits they would not have received had the group been able to make a group income election and had the group duly done so.

8. Whether the parent companies would have been entitled to convention tax credits in this hypothetical circumstance depends upon the proper interpretation of the relevant double taxation conventions. The two conventions are the Netherlands Convention of 7 November 1980 (S I 1980/1961) and the Italian Convention of 21 October 1988 (S I 1990/2590). Both conventions have effect in United Kingdom law pursuant to Orders in Council made under section 788 ICTA 1988.

9. In all respects material on the present issue the two conventions are in similar form. For convenience I will refer only to the Netherlands convention. The relevant provision in the Netherlands convention is article 10(3). This was applicable as long as an individual resident in the United Kingdom was entitled to a tax credit in respect of dividends paid by a company resident in the United Kingdom. Article 10(3)(c) entitled a company resident in the Netherlands which received dividends from a company resident in the United Kingdom to a tax credit calculated and payable as follows:

> '.. a tax credit equal to one half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received those dividends, and to the payment of any excess of that tax credit over its liability to tax in the United Kingdom.'

'Tax credit' in this subparagraph has the same meaning as in ICTA 1988: see article 3(2) of the convention. Entitlement to a convention tax credit was subject to tax at a rate not exceeding 5% on the total amount of the dividend and the tax credit: article 10(3)(a)(ii). Nothing turns on this additional provision.

10. The first point to note is that, as would be expected, article 10(3)(c) accords with the scheme of the underlying legislation whereby entitlement to a tax credit marched hand-in-hand with liability to pay ACT. Article 10(3)(c) did not, in terms, exclude election dividends from its scope. But this was not necessary. On the face of the legislation a parent company resident in the Netherlands could not make a group income election. By definition, an election dividend was payable only to a company resident in the United Kingdom. So, on the face of the legislation, there could be no question of a Netherlands resident company ever being in a position to claim a convention tax credit on a dividend whose payment did not attract ACT.

11. This analysis of article 10(3)(c) accords with the intended purpose of the Netherlands convention as stated in section 788. The object of section 788 is to enable effect to be given to arrangements made with the governments of other countries 'with a view to affording relief from double taxation'. Section 788(3) provides that, notwithstanding anything in any enactment, arrangements such as the Netherlands convention shall have effect in relation to income tax and corporation tax:

> ‘in so far as they provide …
>
> (d) for conferring on persons not resident in the United Kingdom the right to a tax credit under section 231 in respect of qualifying distributions made to them by companies which are so resident.’

In section 231(1) entitlement to a tax credit was expressed to be subject to section 247. The effect of section 247 was to exclude an election dividend from entitlement to a tax credit under section 231 and from attracting liability to ACT under section 14(1) as a qualifying distribution.

12. So much is clear. The question before the House, however, requires one to inhabit a new and different world, a world where an election dividend may be paid to a non-resident company. How is article 10 to be read and understood in this new world? If article 10 is to be read literally I would agree with Park J and the Court of Appeal that a Netherlands resident parent would be entitled to a convention tax credit on an election dividend. That is the effect of the literal interpretation of article 10. But is this the proper interpretation?

13. Article 10, like all documents, must be interpreted purposively. So, in answering these questions it is important to have in mind how they come to arise at all. They arise from the explosive effect of Community law on a prime feature of the legislation regarding groups of companies. On its face section 247 precluded non-resident parent companies from making a group income election. The Netherlands convention was drafted and agreed on this basis. But this residence limitation, in its application to companies resident in member states of the European Community, was negated by the *Hoechst* decision. Consequent upon this decision section 247 fell to be applied in a circumstance for which it was not designed. This had a knock-on effect on the application of article 10 of the Netherlands convention. The further effect was that article 10 fell to be applied in a circumstance for which it too was not designed, namely, that a Netherlands resident company could receive a dividend which had not attracted payment of ACT.

14. So where does this leave article 10(3)(c)? In my view no one could suppose that in the new world ushered in by the *Hoechst* decision a group with a Netherlands resident parent could elect to avoid payment of ACT by making a group income election pursuant to the *Hoechst*

ruling and, at the same time, remain entitled to a tax credit under the Netherlands double taxation convention. That would be to entitle a company resident overseas to a convention tax credit where a company resident in this country was not entitled to a tax credit. That would put a Netherlands resident parent in a better position than a United Kingdom resident parent. That would fly in the face of the stated purpose of article 10(3)(c), namely, to entitle a Netherlands resident parent to part ('one half') of the tax credit to which a United Kingdom resident would have been entitled had he received the dividend.

15. An interpretation of article 10 having this effect would comprise such a gross and obvious departure from the evident purpose of article 10(3)(c), and from a fundamental feature of the tax credit scheme on which article 10(3)(c) is superimposed, that in my view article 10(3)(c) cannot be so read. The Netherlands convention assumes that the dividend whose receipt attracts a convention tax credit will also have attracted liability to ACT. That is an assumption implicit in article 10(3)(c). When interpreting article 10(3)(c) in the post-*Hoechst* world effect should be given to this implicit assumption. Article 10(3)(c) is to be read as not applying to election dividends.

16. Accordingly, on the first issue raised on this appeal I would declare that if the U K- resident subsidiary of a parent resident in another member state of the European Union had paid a dividend to its parent while a group income election was in force the parent would not have been entitled to a tax credit in respect of the dividend under double taxation conventions in the form of the Netherlands and Italian conventions.

The second question

17. The Pirelli group have another string to their bow. Mr Aaronson QC submitted that, even so, when assessing the compensation payable to a U K-resident subsidiary for the wrongful denial of an opportunity to exclude payment of ACT by making a group income election, no account should be taken of the convention tax credits received by the overseas parent companies. Even though (on this footing) the parent companies were not entitled to these tax credits and the consequential payments, these should be left out of account because a subsidiary and its parent are separate legal entities. The harm suffered in consequence of the breach of Community law was suffered by the United Kingdom

subsidiary, whereas the countervailing advantages were enjoyed by the parent companies.

18. I have to say I find this argument of Pirelli no more attractive than their submission on the first question. Here again, Pirelli are seeking to have the best of both worlds. The outcome for which they contend is so artificial that it cannot be right.

19. A group income election is a *group* election. A group income election cannot be made by a subsidiary alone. It is an election made jointly by the subsidiary paying the dividend and the parent receiving the dividend. By making such an election both companies seek the fiscal consequences of making the election. One consequence is that by making the election the subsidiary will obtain the advantage of not paying ACT in respect of the relevant dividend. Another consequence is that the subsidiary will obtain this advantage at the cost of depriving the parent of a tax credit in respect of the dividend. These two fiscal consequences are inextricably linked. You cannot have one without the other. That is why the election has to be made jointly. The advantage to the paying subsidiary comes at a price to the recipient parent.

20. Accordingly the loss sustained by the subsidiary cannot fairly be assessed in isolation. The commercial reality is that by not having the opportunity to make a group income election the group lost the opportunity to take advantage of a fiscal package: a package which affected the parent in one way and its subsidiary in a different way. In calculating the loss suffered by the group, that is, the parent and the subsidiary, regard must be had to both elements in the package. The effect on the parent must be considered as well as the effect on the subsidiary. The subsidiary lost the use of the money paid as ACT. In some instances, where the ACT was not set off against its mainstream corporation tax, the subsidiary lost the money altogether. But this cannot be treated as the amount of compensation payable by the Commissioners of Inland Revenue without also taking into account any adverse consequence a group income election would have had on the parent. By the same token, assessment of the compensation must take into account any countervailing fiscal benefit received by the parent which would not have been available had a group income election been made.

21. Pirelli sought to side-step this difficulty by presenting their claim as a claim by the subsidiary alone. But this difference in presentation

cannot make any material difference in the outcome. A group income election cannot be made, or continued in force, by a subsidiary acting alone. Pirelli cannot, by presenting their claim in this way, alter the fundamental nature of the wrong for which compensation has become payable, namely, the loss of an opportunity for the parent and the subsidiary jointly to take advantage of a single fiscal package having different effects on the parent and the subsidiary.

22. It is for this reason that assessment of the group's overall loss, rather than the loss of the subsidiary alone, does not involve departure from the basic principle of company law that a parent company and its subsidiary are separate legal entities. Assessment of the overall loss represents the only fair way to assess the amount of loss suffered where a subsidiary and its parent have been denied the opportunity jointly to obtain a single package of this nature.

23. Assessment of the compensation now in issue is not exclusively a matter for the domestic law of the United Kingdom. Assessment of the compensation has a Community law dimension because the compensation is payable for breach of an EC Treaty obligation. But this feature does not disturb the conclusion expressed above. I can see nothing in the above analysis which offends the Community law principles of equivalence and effectiveness.

24. Pirelli, however, raised a different point of Community law. The European Court of Justice has held that in certain circumstances the need to ensure cohesion of a member state's tax system may justify rules liable to restrict fundamental freedoms. This principle has been applied where a direct link existed, in the case of one and the same taxpayer, between the grant of a tax advantage and the offsetting of that advantage by a fiscal levy, both of which related to the same tax: *Bachmann v Belgium* [1992] ECR I-249 and *Commission v Belgium* [1992] ECR I-305. The precise limits of this principle remain to be explored. But the European Court has declined to apply the principle where the link between the taxes in question comprised the grant of a tax exemption to shareholders resident in the Netherlands in respect of dividends received by them and taxation of the profits of companies in another member state. They were 'two separate taxes levied on different taxpayers': *Staatssecretaris van Financiën v BGM Verkooijen* [2000] ECR I-4071, 4132, paras 56-58.

25. Pirelli sought to apply this limitation on the scope of the 'tax cohesion' principle by analogy in the present case. They sought, further, a reference to Luxembourg if their submission on this point did not find favour. I am unable to accept either submission. Pirelli's argument breaks down at the very outset. The suggested analogy is misconceived. The grounds on which a restriction on a fundamental freedom may be justified say nothing about the principles applicable in assessing compensation for breach of a Treaty freedom. Assessment of compensation is primarily a matter for the domestic legal system of each member state, provided always that the principles of equivalence and effectiveness are duly observed.

26. Accordingly, I would hold in answer to the second question that the amount of the convention tax credits received by the Dutch and Italian parent companies is to be taken into account in calculating the compensation payable for the breach of article 43 of the EC Treaty. Essentially what is to be taken into account is the value of the benefits thus obtained. Depending on the circumstances a notional rate of interest on the amounts paid may properly be regarded as an element of the value obtained. But this is a matter to be evaluated in the context of the facts of the particular claims.

The third question

27. The third question is of a different character. It arises out of the terms of Council Directive 90/435 EEC of 23 July 1990, known as the 'Parent/Subsidiary Directive'. On this I have nothing to add to the observations of Lord Scott of Foscote. The terms of articles 5.1 and 7.1 of the directive, coupled with the decision of the European Court of Justice in *Océ van der Grinten NV v Inland Revenue Commissioners* [2003] STC 1248, make plain that ACT is not prohibited by the directive. This is acte clair. I would not refer a question to the European Court of Justice as sought by Pirelli.

28. For these reasons, and those set out in the speeches of my noble and learned friends Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe, I would allow this appeal and remit the proceedings to Park J to decide the unresolved factual question whether, had group income election been available to the Pirelli group, the group would have elected to have the United Kingdom subsidiaries pay the dividends in question free of ACT or, instead, would have chosen that the United Kingdom subsidiaries should pay the dividends outside group

income elections, thus enabling the overseas parents to receive convention tax credits.

LORD HOPE OF CRAIGHEAD

My Lords,

29. I have had the advantage of reading in draft the speeches of my noble and learned friends Lord Nicholls of Birkenhead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. I agree with them, and for substantially the same reasons as they have given I too would allow the appeal and make the order which has been proposed by Lord Nicholls. But we are differing from judges in the courts below whose opinions in revenue matters have always commanded the greatest respect. So I should like to add these brief remarks to explain why I have reached the same conclusion as my noble and learned friends have done.

30. The issues which we have been asked to decide are (1) whether, if a group income election had been made under section 247(1) of the Income and Corporation Taxes Act 1988 ("ICTA 1988"), the three EU parent companies would have been entitled to a tax credit under the relevant Double Taxation Agreement ("DTA") ("the election issue") on the dividends paid to them as group income by their UK subsidiaries; (2) whether, if that question is answered in the negative, the tax credits which were received by the EU parent companies under the relevant DTA should be brought into account in assessing the compensation payable to the UK subsidiaries for the breach of article 52 of the EC Treaty (now article 43 EC) because the tax advantage of a group income election was not made available where the parent company was not resident in the UK ("the assessment issue"); and (3) whether ACT is a withholding tax within the meaning of article 5.1 of Council Directive 90/435/EEC ("the Parent/Subsidiary Directive"). I would give the answers "no" to the first question, "yes" to the second question and "no" to the third question, holding the answer to the third question to be *acte clair*.

The election issue

31. The answer to the question raised by the election issue is to be found in arrangements for double taxation relief that were created for companies not resident in the United Kingdom by sections 788(3)(d), 231(1) and 247(2) ICTA 1988. These arrangements have to be seen in the context of the system which Lord Scott has described for giving tax credits to a parent company resident in the UK in respect of distributions made to it on which its UK subsidiary had paid Advance Corporation Tax ("ACT") under section 14(1) ICTA 1988. I have listed the sections of the ICTA 1988 in that order because taking them in that order reveals most clearly the question of statutory construction on which the answer to the issue depends. In my opinion it is to the domestic legislation, and not only to the relevant DTA, that one must look for the answer. For the reasons that I shall give, and in agreement with Lord Scott, I think that the legislation provides the answer which is contended for by the revenue.

32. Section 788(3)(d) ICTA 1988 gave domestic effect to the arrangements specified in a DTA for conferring on non-resident companies such as the EU parent companies "the right to a tax credit under section 231 in respect of qualifying distributions made to them" by companies which were resident in the United Kingdom. The expression "tax credit" is defined in section 832(1) as meaning a tax credit under section 231. So it is to the provisions of that section that one must go in the first instance to see what the right was that was being referred to in section 788(3)(d).

33. Section 231(1) provided that, where a company resident in the United Kingdom made a qualifying distribution and the person receiving the distribution was another such company, the recipient of the distribution was to be entitled to a tax credit equal to such proportion of the amount or value of that distribution as corresponded to the rate of ACT in force for the financial year in which the distribution was made. But the opening words of that subsection stated that it was subject to sections 95(1)(b) and 247. Section 95(1)(b), which applied where a company purchased its own shares from a dealer, is not in point in this case. But section 247 is very much in point. It is that section, and in particular section 247(2), that creates the difficulty for the Pirelli companies.

34. Section 247(1) ICTA enabled an election ("a group income election") to be made not to account for ACT in two situations that might arise within a group of companies all of whose members were resident in the United Kingdom. The first is the one that would have applied to this case, had all the companies within the Pirelli group had been so resident. It was where the paying company was a 51 per cent subsidiary of the receiving company or of another UK resident company of which the receiving company was a 51 per cent subsidiary. In that situation the receiving company and the paying company could jointly elect that ACT was not to be payable on the dividends which the parent received from the paying company.

35. The consequences of such an election, so long as it was in force, were two-fold. First, ACT was not payable under section 14(1) ICTA 1988 on the election dividends. Secondly, the income represented by the amount of the election dividends was not franked investment income (that is to say, franked as having borne ACT) in the hands of the recipient company, but was to be treated in the ordinary way as group income of the receiving company. This meant that income of this description did not qualify for a tax credit under section 231. As section 247(2) puts it, the election dividends "shall be excluded from sections 14(1) and 231". The payment of ACT was not enacted as a condition that had to be fulfilled before a shareholder could become entitled to a tax credit, as Park J was right to point out: [2003] STC 250, para 36. But the link between these two provisions – imposing the liability to ACT and giving the right to the tax credit – could not have been more clearly expressed.

36. The reason for the exclusion, in the domestic context, of the right to a tax credit under section 231 was simple. A group income election dividend was a dividend on which no ACT was payable. The purpose of section 231 was to provide the receiving company with a tax credit equivalent in amount to the ACT payable on the dividend. The tax credit was designed to avoid tax having to be paid twice on the same dividend when tax was paid on its profits by the parent company. As no ACT was payable in the case of a group income election dividend, there was nothing against which credit needed to be given to the recipient company. There was no risk of tax being paid twice in respect of the amount distributed to the parent, so there was no need of a tax credit to avoid that result.

37. It has to be borne in mind, of course, that ACT was a tax payable by the paying company. It was not a tax on profits in the hands of the

recipient. Receipt of distributions that had borne ACT could arise in circumstances where, due to such features as capital allowances, the paying company did not have sufficient profits at the end of its relevant accounting period to give rise to a liability to mainstream corporation tax. This was frequently the case, as Park J explains in his judgment in para 61. But the tax credit was always given, and given only, where the company making the qualifying distribution in respect of which it was given was liable under section 14(1) of ICTA 1988 to payment of ACT on an amount equal to the amount or value of the distribution. As Mr Glick QC for the revenue put it, it was the payment of the ACT that made the giving of the tax credit to the recipient necessary.

38. Park J said in paras 38-41 that the answer to the election issue was to be found in the DTA and that section 788(3)(d), which referred only to section 231 and made no mention of section 247(2), had to be read consonant to the Treaty. The Court of Appeal adopted the same approach: [2004] STC 130, para 46. Mr Aaronson QC for the Pirelli companies urged your Lordships to take the same view. If this argument was right its effect would be that section 247(2) had the effect already mentioned in the domestic context but did not qualify the entitlement to relief from double taxation provided for by the DTA. But I do not think that this approach fits either with the clear language of section 231 itself, or with the system which the tax credit mentioned in that section was designed for.

39. It seems to me that there is no escape from the fact that it is section 231 that section 788(3)(d) uses to identify the relief that is to be given in accordance with the DTA by way of a relief under the domestic system to the non-resident companies. It was the domestic system, not the Treaty, that defined the extent of that relief. According to its own terms section 231 had to be read subject to section 247. And the giving of a tax credit for qualifying distributions only became necessary because qualifying distributions were distributions on the making of which the paying company was liable to ACT. Reading these two provisions together, it is clear that the prerequisite for the giving of a tax credit was the making of a qualifying distribution which was liable to ACT. A group income election extinguished that liability and with it the right to the tax credit that was the counterpart of the liability. It follows that, if the same system had been available to them and a group election had been made, no ACT would have been payable on the distributions to the EU parent companies. So there would have been no entitlement to a tax credit with respect to those distributions under section 788(3)(d). I would answer the question raised by this issue in favour of the revenue.

The assessment issue

40. The assessment issue raises an entirely different point. The argument for the Pirelli companies is that the harm of having to pay the ACT and of losing the cash flow advantage that a group income election would have given them was suffered by the UK subsidiary only, not by the parent which received the advantage of the tax credit paid to it under section 788(3)(d). So the amount of the compensation to be paid to the subsidiary should be assessed without bringing the tax credit received by the parent companies into account. To this the answer for the revenue is that section 247(1) gave the right to make a group income election to both the parent and to the subsidiary jointly. It was an election which was available to them which would only have been made where it was in their joint interests to make it, and in the event of a joint election the tax credit would not have been payable. So the group should be treated as a single unit for the purpose of assessing the amount of the compensation payable in order to give effect to the judgment of the European Court of Justice. Park J said in para 48 that this was a huge and unjustifiable step, as it ignored the separate corporate identities of the respective companies.

41. I do not think that the revenue's approach falls into the trap of ignoring the companies' separate identities. What it does is to look at them instead as members of the group. I agree with Lord Scott that the relevant harm was the harm that the group suffered by reason of the breach of the parent companies' right to freedom of establishment under article 52 of the Treaty. The breach deprived the group of the benefit of a joint election which, if there had been no breach, would have been available under section 247(1) ICTA 1988 for the benefit of the group as a whole. It would have been exercisable by the paying and the recipient members of the group jointly. It is the joint nature of the exercise that makes it appropriate to look at the group as whole when the compensation is being assessed rather than the effect of the breach on each company taken in isolation.

42. In *Metallgesellschaft Ltd v Inland Revenue Commissioners* (Joined Cases C-397 and 410/98) [2001] Ch 620, para 88 the European Court stressed that in an action for restitution the principal sum due was none other than the amount of interest which would have been generated by the sum use of which was lost as a result of the premature levy of the tax. In para 89 it said that article 52 of the Treaty entitled a subsidiary resident in the UK and/or its parent company having its seat in another member state to obtain interest on the ACT paid by the subsidiary

during the period between the payment of the ACT and the date on which the mainstream corporation tax became payable. Elaborating on this point in para 96, the court said that article 52 of the Treaty required that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they had sustained as a result of being deprived of the entitlement to a tax regime that allowed them to avoid the obligation on the subsidiary to pay ACT in respect of dividends paid to the parent company.

43. The language that the European Court uses in these and the other passages in the judgment referred to by Lord Scott shows that the loss for which an effective legal remedy is to be made available is the loss which was sustained by the subsidiaries and their parent companies as members of a group. This is because the taxation regime which was denied to them was a regime that was available to a group under the domestic system. The effect of the breach of article 52 which denied the opportunity to opt for that regime to the Pirelli companies cannot be assessed without looking at both sides of that regime – at the differences that it would have made to the receiving companies within the same group as well as to those companies that were paying the dividends. Decisions as to whether to opt for that regime, which had to be made by these companies jointly, were always made by reference to what was in the best interests of the group looked at as whole. It would be artificial, and therefore wrong, to look only to the effect on the subsidiaries that opting for that regime would have had without having regard to its effect on the parent companies within the same group also.

44. Mr Glick QC for the Revenue accepted that a common law claim against the parent companies for repayment of the tax credits would fail because they were not paid to the parent companies under a mistake. But he submitted that it was nevertheless open to the revenue to rely on the amount of the tax credits given to the parents to reduce or extinguish its liability to the subsidiaries in the same group. In my opinion reparation for the breach of article 52 of the Treaty for the loss that was sustained by the group in this case, as explained by the European Court's judgment, permits this approach. I would answer this question too in favour of the revenue.

The withholding tax issue

45. The third issue is whether ACT was contrary to EC law on the ground that it was a withholding tax within the meaning of the Parent/Subsidiary Directive. As Park J pointed out in para 61, it only needs to be addressed if both of the two previous questions are answered in favour of the revenue. Both of those questions were answered both by him and by the Court of Appeal against the revenue, so it was not necessary for them to deal with it. As we are in favour of the revenue on both points we must do so.

46. The wording of article 5.1 does not provide a clear answer to the problem. But it comes close to doing this, as it provides that profits which a subsidiary distributes to its parent shall be exempt from withholding tax. The wording of this paragraph suggests that the exemption applies where the taxable person from whom the tax is being withheld is the parent company to whom the profits are being distributed. That is how the concept of withholding tax was explained in *Ministério Público and Fazenda Pública v Epson Europe BV* (Case C375/98) 2000 ECR 1-4243, where the European Court said that a tax was a withholding tax where it was a tax on the parent company's dividend income, not a tax on the profits of the subsidiary: see paras 23 and 24. ACT did not fall within that description, as under section 239 of ICTA it was a tax payable by the subsidiary which was to be set against the subsidiary's liability to mainstream corporation tax. So it was a tax on the profits, if any, of the subsidiary, not those of the parent company. This is made clear by the fact that income of the parent by way of distributions made by its subsidiary under deduction of ACT entitled the parent to a tax credit under section 231 equal in amount to the tax payable by the subsidiary as ACT. Article 7.1 however seems to me to put the matter beyond doubt. It provides that the term "withholding tax" does not cover an advance payment of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company. ACT answers to this description.

47. In *Athinaiki Zithopiia v Elleniko Dimosio* (Case C-294/99) [2002] STC 559 it was argued to the European Court that article 5 did not apply because the tax in question was a tax on the profits of the subsidiary to its parent company within the meaning of article 7.1. In para 29 of its judgment this argument was rejected on the ground that it related to income which was taxed only in the event of a distribution of dividends and up to the limit of the dividends paid. This description seems to me to indicate that the reason why the taxation was held not to fall within

article 7.1 was that it was a tax on the parent's income as holder of the shares which entitled it to payment of the dividends, not on the income of the subsidiary. This interpretation of that decision is confirmed by what the European Court said in *Océ van der Grinten NV v Inland Revenue Commissioners* (Case C-58/01) [2003] STC 1248, para 47 where, treating the matter as having been settled by its decisions in the *Epson* and *Athinaiki* cases, the court made it clear that a withholding tax is a tax on the income from the shares on which the dividend is paid and where the holder of the shares is the taxable person from whom the tax is withheld.

48. It is true, as Park J pointed out in para 61, that ACT could only be said to be an advance payment of tax payable by the subsidiary if its profits were sufficiently large at the end of the accounting period to attract mainstream corporation tax. If this was not the case – and it often was not the case – it could not be said to be an advance payment of tax that was ultimately to be borne by the subsidiary. But this not the criterion to which article 7.1 as interpreted by the European Court addresses itself. The essence of a withholding tax within the meaning of article 5.1 as explained by article 7.1 is that it is a tax on the income of the parent company. The court's own jurisprudence makes it clear that ACT was not a withholding tax for the purposes of the Parent/Subsidiary Directive.

LORD SCOTT OF FOSCOTE

My Lords,

Introduction

49. The problem that your Lordships must resolve on this appeal is produced by a combination of four things. First, the Finance Act 1972 introduced advanced corporation tax (ACT) to our tax system. The charging provision, originally section 84(1) of the 1972 Act, became section 14(1) of the Income and Corporation Taxes Act, 1988. It required a company which made a "qualifying distribution" (typically the payment of a dividend) to its shareholders to pay ACT to the Revenue. The ACT (described in section 14(1) as "an amount of corporation tax) was made payable on an amount equal to the amount or value of the distribution and at the rate at which income tax at the basic

rate was charged. The ACT was not deducted from the dividend paid to the shareholder (as had been the case with Schedule F income tax: see the explanation given by Peter Gibson LJ in paragraphs 5 and 6 of the judgment of the Court of Appeal) but instead the ACT attributable to each dividend was "imputed" to the shareholder to whom the dividend was payable and, if the shareholder was resident in the UK, the shareholder generally became entitled to receive from the Revenue a tax credit equal to the amount of the ACT (see s.231(1) of the 1998 Act). The shareholder was then taxable on the aggregate of the dividend and the tax credit. As for the company that had paid the ACT, that company was entitled to set the ACT against its liability to mainstream corporation tax.

50. The second contributory factor was the availability of group income elections. Provision for these elections was made by section 247(1) of the 1988 Act. Where both a subsidiary company and its parent company were resident in the UK they were permitted by section 247(1) to make a joint election that the sub-section should apply to the dividends paid by the subsidiary to the parent. Then, so long as the election remained in force, ACT would not be payable in respect of those dividends and the parent company would not receive a corresponding tax credit.

51. The right to receive tax credits pursuant to section 231(1) of the 1988 Act did not apply to recipients of dividends who were not resident in the UK. But the liability of companies to pay ACT when dividends were paid arose regardless of the place of residence of the shareholder. The position of non-resident shareholders was catered for, to the extent that it was catered for at all, under double-taxation agreements entered into between the UK and other states. Some of these double-taxation agreements contained provision for tax credits to be given by the Revenue to foreign shareholders in a UK resident company which had paid dividends and, accordingly, also paid ACT. The amount of the tax credits to which the foreign shareholders were to become entitled and the conditions on which entitlement to the tax credits depended were agreed by negotiation between the UK and the state in question and were spelt out in the double-taxation agreements. Not all double-taxation agreements contained provisions enabling the foreign shareholders to claim tax credits but, relevantly for present purposes, the double-taxation agreements between the UK and the Netherlands and the UK and Italy did. The agreements themselves did not *ipso facto* become enforceable in our domestic law but section 788 of the 1988 Act gave them that enforceability. Sub-section (1) of section 788 declared that

> "If Her Majesty by Order in Council declares that arrangements specified in the Order have been made with the government of any territory outside the United Kingdom with a view to affording relief from double taxation …
>
> and that it is expedient that those arrangements should have effect, then those arrangements shall have effect in accordance with sub-section (3) below"

and sub-section (3) says that

> "Subject to the provisions of this Part, the arrangements shall, notwithstanding anything in any enactment, have effect in relation to income tax and corporation tax in so far as they provide - ……
>
> (d) for conferring on persons not resident in the United Kingdom the right to a tax credit under section 231 in respect of qualifying distributions made to them by companies which are so resident."

52. The third factor contributing to the problem which your Lordships must resolve is that the double taxation agreement (the 'DTA') between the UK and the Netherlands, and that between the UK and Italy, provided, under Article 10(3)(c), that a Netherlands/Italian company that had received a dividend from a UK subsidiary should (subject to certain qualifications which are irrelevant for present purposes) -

> "… be entitled to a tax credit equal to one half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received those dividends, and to the payment of any excess of that tax credit over its liability to tax in the United Kingdom" (see Netherlands: Convention of 7 November 1980: SI 1980/1961 and Italy: Convention of 21 October 1988: SI 1990/2590)

For the sake of completeness I should add that Article 10(3)(b) of each DTA provided for tax credits to be given to individual shareholders resident in the Netherlands or Italy.

53. The final event which has created the problem is the judgment given on 8 March 2001 by the European Court of Justice in two cases, heard together, *Metallgesellschaft Ltd v Inland Revenue* and *Hoechst AG v Inland Revenue* [2001] Ch. 620. The European Court of Justice was responding to requests for rulings on the question whether the denial by section 247(1) of the 1988 Act to companies of other member states and their UK subsidiaries of the right to make a group income election, and thereby to enable the subsidiaries to avoid payment of ACT in respect of dividends paid to their parents, while affording that right to UK companies and their UK subsidiaries, was consistent with Community law (see the formulation of the issue in paragraph 35 of the Court's judgment).

54. The Court noted (in paragraph 44) that the ACT/group income election statutory provisions gave the subsidiary of a UK parent

> "… a cashflow advantage inasmuch as it retains the sums which it would otherwise have had to pay by way of advance corporation tax until such time as mainstream corporation tax becomes payable … " (see also para.54).

The Court concluded that it was contrary to Article 52 of the Treaty (now Article 43) for this tax advantage to be made available where the parent company was resident in the UK but to be denied where the parent company was resident in some other member state.

55. Having reached the conclusion to which I have referred, the Court then had to consider what remedy the companies which had been denied the right to make group income elections should be entitled to. The Court's conclusion on this question is set out in paragraph 96 of the judgment and, having regard to some of the submissions addressed to your Lordships, I think it important to set out in terms what the Court said:

> "… where a subsidiary resident in one member state has been obliged to pay advance corporation tax in respect of dividends paid to its parent company having its seat in another member state even though, in similar circumstances, the subsidiaries of parent companies resident in the first member state were entitled to opt for a taxation regime that allowed them to avoid that obligation,

> article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained and from which the authorities of the member state concerned have benefited as a result of the advance payment of tax by the subsidiaries."

It is to be noticed that the European Court referred to the financial loss sustained by and the legal remedy that had to be afforded to "resident subsidiaries and their non-resident parent companies."

The issues in this appeal

56. Following the European Court's judgment there were, not surprisingly, claims for compensation by a number of foreign companies and their UK subsidiaries. Having regard to the number of cases and to the many common issues that were raised by these cases a Group Litigation Order was made. The GLO identified a number of common issues, one of which was the effect, if any, that the receipt by a foreign parent company of a tax credit should have on the compensation to which its UK subsidiary was entitled. That is the core issue which your Lordships must now resolve. There are, however, sub-issues.

57. Some of the facts that give rise to the issues are actual. Some must be assumed. The actual facts are as follows –

- (i) Two of the respondents, Pirelli Cable Holding NV ('Pirelli Cable') and Pirelli Tyre Holding NV ('Pirelli Tyre') were resident in the Netherlands and one of the respondents, Pirelli SpA, was resident in Italy.
- (ii) The respondents Pirelli UK plc ('the UK Holding Company') and Pirelli General plc ('the UK Subsidiary') were resident in the UK;
- (iii) the UK Holding Company owned all the shares in the UK Subsidiary and Pirelli Tyre, Pirelli Cable and Pirelli SpA each owned 33? per cent of the issued ordinary shares of the UK Holding Company.

(iv) Over the period 14 July 1995 to about 20 April 1999 Pirelli Tyre, Pirelli Cable and Pirelli SpA could, if they had been UK resident companies, have made a group income election in respect of all dividends declared by the UK Holding Company.

(v) The UK Holding Company therefore became liable to pay ACT on each occasion in the relevant period that it paid dividends to its three parent companies and it paid ACT accordingly. On two occasions ACT was paid by the UK Subsidiary in respect of dividends it paid to the UK Holding Company. The UK Holding Company subsequently paid dividends of the same amount to its three parent companies but in doing so incurred no additional ACT liability because the dividends it paid were "franked" payments equal to the "franked investment income" it had received from the UK Subsidiary (see s.241(1) of the 1988 Act). Nothing turns on this and it is simpler, for present purposes, to treat all ACT as if paid by the UK Holding Company. And

(vi) In respect of all these dividends the three parent companies received from the Revenue tax credits pursuant to the DTAs between the UK and Netherlands or the UK and Italy, the net amount of which was 6.875 per cent of the value of the dividends.

The assumed facts are that over the whole of the relevant period a group income election *would* have been made by each of the three parent companies if it had been open to them to do so. This is an issue of fact yet to be resolved if it becomes necessary to resolve it.

58. The two main issues are, therefore, these –

(i) If the UK Holding Company had paid the dividends to its three parent companies while a group income election was in place, and thereby avoided liability to pay ACT in respect of those dividends, would the three parent companies nonetheless have been entitled to the tax credits that they received pursuant to the relevant DTA?

(ii) If the parent companies would not have been entitled to tax credits had the dividends been paid

> by the UK Holding Company without incurring any liability to ACT, should the tax credits in fact received by the parents be brought into account in calculating the compensation payable for the breach of Article 52 that, the European Court held, had been committed?

59. There is another issue, namely, whether ACT constituted a withholding tax within the meaning of Article 5.1 of Council Directive 90/435/EEC of 23 July 1990 ("the Parent/Subsidiary Directive") and, if so, whether it fell within the exception set out in Article 7.1 of that Directive, and whether that question should be referred to the European Court for a ruling. I will leave any further explanation of this issue until later.

The first main issue

60. Both Park J and the Court of Appeal concluded, for substantially the same reasons, that even on the hypothesis that the Pirelli respondents had been entitled to make and had jointly made a group income election under section 247(1), so that the UK Holding Company in paying their dividends would have incurred no liability to pay and would not have paid ACT, nonetheless the parent companies would still have been entitled to tax credits pursuant to Article 10(3)(c) of the respective DTAs. The essential reasoning behind this conclusion, strongly supported by Mr Aaronson QC in his written and oral submissions to your Lordships, was that each DTA was the product of negotiation between the UK and the Netherlands or Italy (as the case may be), represented a give-and-take bargain between the negotiating states and should be applied according to its own internal provisions without regard to what might be thought to be the policy underlying the tax regime regarding ACT and tax credits.

61. Thus, Park J said that "… the question ultimately turns on the construction of the relevant provisions of art.10 in the two DTAs …" (para.35), that "Article 10, read with s.788(3) …. lays down the conditions which have to be fulfilled …" for entitlement to tax credits and, in paragraph 38, that the Pirelli parent companies

> "… complied with every specific condition [for entitlement to tax credits], and would have done whether

> the Pirelli UK dividends were paid to it as group income or not."

62. And the Court of Appeal judgment, in paragraph 45, said that

> "The impression that the provisions of the DTAs are intended to be exhaustive for prescribing the circumstances in which the right to a tax credit under s.231 in respect of qualifying distributions made by a UK-resident company is conferred on a non-resident is strongly confirmed by consideration of the Italy and Netherlands DTAs themselves. They are extremely detailed, and although they are substantially similar they are not identical … The DTAs contain their own formulas for calculating the amount of tax credit that is allowed, different from the amount of the tax credit available to a UK-resident shareholder, albeit expressed by reference to what a UK-resident shareholder would have received by way of tax credit. They contain their own conditions governing entitlement to the tax credit in particular amounts."

63. My Lords, I am in respectful agreement with Park J and the Court of Appeal that the issue depends upon the construction of article 10(3)(c) of the DTAs but I do not agree that that provision, or the DTA provisions as a whole, are "exhaustive", if the use of that adjective is intended to mean that the correct meaning and effect of the DTA provisions can be ascertained simply by reading the provisions themselves.

64. Let me stay with article 10(3)(c), under which a Netherlands, or Italian, resident company can claim "one half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received those dividends." There are two points to be made about this language. First, there is no definition anywhere in these DTAs of the expression "tax credit". But article 3(2) of each DTA says that -

> "As regards the application of the Convention by one of the States any term not defined therein shall, unless the context otherwise requires, have the meaning which it has under the law of that State concerning the taxes to which the Convention applies."

65. The expression "tax credit" is defined in section 832(1) of the 1988 Act as "a tax credit under section 231" and the same wording is to be found in section 788(3)(d). So that is the meaning to be attributed to the expression "tax credit" in article 10(3)(c). Re-writing article 10(3)(c), the Netherlands or Italian company is to be entitled to "one half of the tax credit under section 231 of the 1988 Act to which an individual resident in the United Kingdom would have been entitled if he had received those dividends."

66. Section 231(1) says that

> "Subject to section … 247 … where a company resident in the United Kingdom makes a qualifying distribution and the person receiving the distribution is another such company or a person resident in the United Kingdom, not being a company, the recipient of the distribution shall be entitled to a tax credit …"

And section 247(2) says that where a group income election under subsection (1) is in force -

> "… the election dividends shall be excluded from sections 14(1) and 231 and accordingly are not included in references to franked payments made by the paying company or the franked investment income of the receiving company but are in the Corporation Tax Acts referred to as 'group income' of the receiving company."

67. It follows, in my opinion, from section 231(1) and section 247(2) that where a group income election is in force and dividends are paid by a UK company a section 231 tax credit cannot be claimed by the recipient of the dividends. The language of section 231(1) and section 247(2) bars such a claim. The language of article 10(3)(c) involves, therefore, a contradiction. The entitlement to a section 231 tax credit of a Pirelli parent company that received dividends that had been paid under a group income election is said by article 10(3)(c) to depend upon the entitlement to a section 231 tax credit of a UK-resident individual "had he received *those dividends*" (emphasis added). But "those dividends" would be dividends paid under a group income election and, therefore, in respect of which no ACT was payable or paid and no entitlement to a section 231 tax credit could arise. But an individual

could not have received any such dividends. Only a company could receive dividends paid under a group income election. In order, therefore, to apply the hypothesis prescribed by article 10(3)(c), either the individual must be taken to have received dividends of a character different from those received by the Pirelli parent company, i.e. the individual must be supposed to have received dividends *not* paid under a group income election and in respect of which ACT *had* been paid, or, alternatively, the individual must be attributed for the purpose of the article 10(3)(c) hypothesis with the ability to receive dividends paid under a section 247 group income election.

68. Each of these solutions is somewhat unsatisfactory because each involves an element of unreality. But some degree of unreality in trying to apply the article 10(3)(c) condition is, perhaps, inevitable if one bears in mind that those who negotiated the terms of the DTAs and those, if different, who drafted article 10(3)(c) could not have had in mind that the provision would subsequently need to be applied to a hypothetical situation in which it has to be supposed that group income elections have been made by UK subsidiaries and their other member state parent companies, that dividends have been paid by the subsidiaries to the parent companies without incurring any ACT liability and that the parent companies that have received these dividends have then claimed section 231 tax credits. For my part I prefer the second of the two possible solutions which seems to me to do less violence than the other to the language of article 10(3)(c). There is no doubt about the character of the dividends assumed to have been received by the Pirelli parent companies and in respect of which it is to be assumed that they claimed tax credits. They are dividends assumed to have been paid under a group income election jointly made by the subsidiaries and the parents. The reference in article 10(3)(c) to "those dividends" that the hypothetical individual is to be taken to have received should be, it seems to me, dividends of the same assumed character. So the individual must be attributed with the ability to receive dividends of that character. If that is the right approach to the article 10(3)(c) hypothesis, the individual who had received dividends of that character would not have been entitled to a section 231 tax credit and, consequently, nor would the Pirelli parent companies. The alternative appears to me to involve overlooking the statutory definition of "tax credit" as a "tax credit under section 231" and attributing to the individual, and thence to the Pirelli companies, the right to a tax credit that an application of section 231 would reject.

69. I disagree, therefore, with the conclusion reached by Park J and the Court of Appeal on the first issue, the so-called "election" issue.

The error which I think was made can be identified in paragraphs 37 and 38 of Park J's judgment. In paragraph 37 he sets out in sub-paragraphs (i) to (v) the article 10(3)(c) conditions that, in his view, the Pirelli parent companies had to satisfy in order to claim tax credits. I respectfully agree that these conditions must all be satisfied and were satisfied. The judge then moves to his conclusion which he sets out in sub-paragraph (vi)

> "(vi) If the foregoing conditions were satisfied, as they were, Pirelli SpA was entitled to tax credits equal to half the tax credits to which a United Kingdom resident individual would have been entitled."

In my opinion, however, the judge omitted an additional condition that had to be satisfied, namely, that a UK-resident individual who had received the dividends received by Pirelli SpA (i.e. "those dividends") would have been entitled to section 231 tax credits. This, in my opinion, is the critical condition.

70. In paragraph 38, second sentence, Park J said that:

> "Pirelli SpA complied with every specific condition, and *would have done so whether the Pirelli UK dividends were paid to it as group income or not*." (emphasis added)

Not so, in my respectful opinion. The judge's conclusion overlooks the article 10(3)(c) requirement that the hypothetical UK resident individual must be taken to have received "those dividends", that is to say, the dividends paid to Pirelli SpA under a group income election. In that hypothetical event the omitted condition would not be satisfied. The UK-resident individual would not have been entitled to a section 231 tax credit; nor, therefore, would Pirelli SpA.

71. The Court of Appeal apparently did not accept that references to "tax credit" in article 10 of the two double taxation agreements meant "tax credit under section 231" (see paragraphs 46 to 48). But the section 832(1) definition is essential in order to give a meaning to "tax credit" in article 10, for the term is nowhere else defined and article 3(2) expressly imports domestic law definitions for terms not defined in the DTAs themselves. The Court of Appeal say, in paragraph 48, that "the

reference [in s.788(3)(d)] to s.231 was necessary in order to cause the tax credit to be aggregated with the distribution in respect of which the tax credit is conferred and so to be rendered chargeable to tax under para.2 of Sch.F". That is no doubt true but does not, in my opinion, justify writing the definition out of the DTAs. Article 10 in express terms hinged a Netherlands/Italian parent company's right to a tax credit to the entitlement that a UK resident individual would have had to a tax credit if he had received the dividends that the foreign parent company had received. That being so I do not, for my part, find it at all surprising that specific provisions in domestic legislation restricting in specified circumstances the right to a tax credit should govern the availability of a tax credit under article 10. Be that as it may, the only tax credit available, at least in this area of tax law, is a tax credit under section 231. There is no such thing as an article 10(3)(c) tax credit that is not a "tax credit under section 231".

72. In my opinion, therefore, and in agreement with my noble and learned friend Lord Walker of Gestingthorpe, on the true construction of article 10(3)(c) the Pirelli parent companies would not have been entitled to tax credits in respect of dividends paid to them by the UK Holding Company as group income under a section 247(1) group income election and, therefore, without incurring any liability to pay ACT.

The second issue

73. So what are the consequences of that conclusion for the compensation claims made by the Pirelli respondents? Both Park J and the Court of Appeal treated this second issue as one which depended upon whether the separate corporate identity of the UK Holding Company, which had paid the ACT, could be ignored. There were references to *Salomon v Salomon & Co* [1897] AC 22 and to the remarks about a single economic unit or lifting the corporate veil in such cases as *DHN Food Distributors Ltd v Tower Hamlets London BC* [1976] 1 WLR 852, *Adams v Cape Industries* [1990] Ch.433 and *Ord v Belhaven Pubs Ltd* [1998] 2 BCLC 447. Park J held, and the Court of Appeal agreed, that compensation payable to the Pirelli subsidiaries was not to be reduced by reference to the value of the tax credits received by the Pirelli parent companies.

74. It must, for the purposes of this second issue, be accepted that if section 247 group income elections had been able to be made and had

been made by the Pirelli companies and if dividends had been paid to the Pirelli parent companies by the UK Holding Company while the elections were in force, the UK Holding Company would not have paid ACT and the Pirelli parent companies would not have been entitled to tax credits.

75. The answer to this issue does not, in my opinion, depend upon whether the corporate veil can be lifted or whether the Pirelli companies should for compensation purposes be treated as a single economic unit. The answer requires as a start that the nature of the wrong for which compensation is payable be identified.

76. The European Court of Justice held that the ACT/group income election tax regime imposed an unwarranted restriction on the freedom of establishment guaranteed by article 52 of the Treaty and hence was a breach of that article. The rights conferred by article 52 are described in paragraph 41 of the judgment:

> "Article 52 of the Treaty constitutes one of the fundamental provisions of Community law and has been directly applicable in the member states since the end of the transitional period. Under that provision, freedom of establishment for nationals of one member state within the territory of another member state includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected. The abolition of restrictions on freedom of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any member state established in the territory of another member state."

And in paragraph 42

> "Freedom of establishment thus defined includes, pursuant to article 58 of the Treaty, the right of companies or firms formed in accordance with the law of a member state … to pursue their activities in the member state concerned through a branch or agency … With regard to companies, it should be noted in this context that it is their corporate

> seat … that serves as the connecting factor with the legal system of a particular state, like nationality in the case of natural persons …. Acceptance of the proposition that the member state in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its seat is situated in another member state would thus deprive article 52 of all meaning. … ”

77. It is important, in my opinion, to notice two things from these passages. First, the right to freedom of establishment conferred by article 52 is the right of a company (or an individual) with its seat in one member state to establish itself in another member state. Unwarranted restrictions imposed by the latter member state on the branch or agency or subsidiary company by means of which the parent company is seeking to establish itself in that member state is plainly a breach of the article 52 right to freedom of establishment of that parent company. It is more difficult to describe an infringement of article 52 rights brought about by unwarranted restrictions being placed by a member state on the subsidiary of a parent company that has its seat in another member state as a breach of article 52 rights of the subsidiary. It is, surely, strictly speaking, the parent company's right to freedom of establishment that is interfered with.

78. Secondly, the language of these passages shows that a company in one member state and its branch, or its agency, or its subsidiary, in another member state are regarded as a group. The subsidiary, unlike the branch or an agency, will have separate legal identity from that of the parent company but there is no suggestion that this makes any difference.

79. It is entirely consistent and natural, therefore, that when the European Court discusses the remedies to be made available for an infringement of article 52 rights it treats the parent companies, whose rights have been infringed, and the subsidiaries, on whom the unwarranted restrictions have been placed, as a group.

Thus

(i) paragraph 77 refers to the situation where –

"… a subsidiary resident in the member state concerned and its parent company having its seat in another member state have been wrongfully deprived of the benefit of a taxation regime which would have enabled the subsidiary to pay dividends to its parent company without having to pay advance corporation tax …"

(ii) paragraph 96 concludes that

"… article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained and from which the authorities of the member state concerned have benefited as a result of the advance payment of tax by the subsidiaries."

(iii) paragraphs 98 and 107 refer to a claim for compensation

"… brought … by a resident subsidiary and its non-resident parent company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary …"

(iv) in paragraph 2 of the court's ruling (p 668), the Court says that

"… article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained …"

and (v) in paragraph 3 of the ruling there is a similar reference.

It is true that in the passages to which I have referred the European Court was responding to questions which had been referred to it by the national court and that the formulation of the responses may have owed something to the nature of the questions. But the questions, set out in paragraph 13 of the Opinion of the Advocate General, do not require the explicit responses that the Court's responses appear to me to constitute in making clear that the compensation claims could be put forward by the subsidiaries and parent companies as a group to recover the loss that they, the group, had suffered in consequence of the article 52 infringements.

80. The correct analysis, in my opinion, is that the article 52 infringements of which the Pirelli respondents complain were

infringements of the Pirelli parent companies' rights to freedom of establishment in the United Kingdom, that the primary measure of the loss thus caused was the financial detriment to their UK subsidiary caused by its liability to pay ACT but its inability to make group income elections, but that the benefit of the tax credits that the Pirelli parent companies would not have received but for the article 52 infringements should be brought into account. Logically, as it seems to me, the compensation should be compensation to the group for the detriment suffered by the group. Compensation that concentrates on the financial detriment of the subsidiary and ignores the financial benefit of the parent seems to me to overlook the nature of the article 52 infringement. The identity of the recipient or recipients of the compensation payable for the loss suffered by the group can be left to be decided by the group, but cannot, in my opinion, affect the quantum of the compensation.

81. Park J, in paragraph 45 of his judgment, said that the Revenue's problem, in arguing that countervailing advantages to the Pirelli parent companies should be balanced against the disadvantage of the UK Holding Company having had to pay ACT soon after paying dividends to the Pirelli parent companies, was that the harm suffered in consequence of the breach of Community law was suffered by the United Kingdom subsidiaries whereas the countervailing advantages were enjoyed by the Pirelli parent companies. The Court of Appeal, in paragraph 53 of its judgment, repeated with approval Park J's point. But the point overlooks, in my opinion, the nature of an article 52 infringement. ACT was not held to be an unlawful tax. What was unlawful was interfering with the Pirelli parent companies' article 52 freedom of establishment by denying their subsidiaries a facility (the ability to avoid ACT by making a group income election) available to UK-resident parent companies' subsidiaries. The charge which was found proved was discrimination against other member state parent companies which had established UK subsidiaries and in favour of UK parent companies with UK subsidiaries. The relevant harm, which took the form of financial detriment to the UK subsidiary, was harm to the group brought about by a breach of the parent companies' article 52 freedom of establishment.

82. I would, therefore, allow the Revenue's appeal on this issue too.

The withholding tax issue

83. The Parent and Subsidiary Directive recited that it was necessary, in order to ensure fiscal neutrality, that the profits which a subsidiary distributed to its parent company be exempt from withholding tax. Accordingly, article 1.1 of the Directive required each member state of the EU to apply the Directive to

> "… distributions of profits by companies of that State to companies of other Member States of which they are subsidiaries."

and article 5.1 of the Directive said that -

> "profits which a subsidiary distributes to its parent company shall … be exempt from withholding tax …"

84. The Pirelli respondents contend that ACT constituted a withholding tax. If that is correct ACT would have been an unlawful tax, at least in its application to UK subsidiaries of parent companies of other member states. It would then follow that exactions of ACT from these subsidiaries would have been unlawful exactions and the subsidiaries that had paid ACT would, *prima facie*, be entitled to re-imbursement of that which had been unlawfully demanded of them. This, I think, is common ground. No question would arise of any countervailing advantage obtained by the parent companies unless in an action brought by the Revenue against the parent companies for re-imbursement of the value of the tax credits as having been provided under a mistake of law. The possibilities of such a claim need not be pursued here.

85. However, article 7.1 of the Directive says that -

> "The term 'withholding tax' as used in this Directive shall not cover an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company …"

Article 7.1 would appear to rule out any claim that ACT constituted a withholding tax for the purposes of the Directive. Moreover, the European Court and the Advocate General in the *Metallgesellschaft* and *Hoechst* case made a number of references to ACT in terms which bring ACT within the article 7.1 exemption. In paragraph 22 of his Opinion, Advocate General Fennelly said that

> "It is clear that advance corporation tax is nothing other than an advance payment of mainstream corporation tax"

and the Court, in paragraph 6 of the judgment, said -

> "It is important to bear in mind that advance corporation tax is not a sum withheld on a dividend, which is paid in full, but is rather corporation tax borne by the company distributing dividends, paid in advance and set off against the mainstream corporation tax payable in respect of each accounting period".

If the point rested there it would be plain, and *acte clair*, that ACT was not a withholding tax.

86. But the Pirelli respondents rely on certain passages in other European Court judgments which they submit make it arguable that ACT is indeed a withholding tax and that the point should be referred to the European Court for a definitive ruling.

87. Article 7.1 said that an advance payment of corporation tax was not a withholding tax, but did not go on to say what was. Conceptually a "withholding tax" is a tax levied on the recipient of a payment and is an amount withheld from the recipient. Park J, in paragraph 59 of his judgment said that he would not regard ACT "as being conceptually a withholding tax." He explained

> "If a United Kingdom company declared a dividend of 100 to its shareholders it paid them 100, not 100 less an amount withheld out of it on account of the tax on the dividend."

88. The obvious conclusion that ACT was not a withholding tax is said to be called into question by the European Court's judgment in *Athinaiki Zithopiia v Elliniko Dimosio* [2001] ECR I-6797. In its judgment the Court commented that

> " … the chargeable event for the taxation … is the payment of dividends. In addition, the amount of tax is directly related to the size of the distribution." (para.28).

The same could be said of ACT. But in paragraph 29 the Court said this -

> "Contrary to the submissions of the Greek Government, the taxation cannot be treated like an advance payment or prepayment (précompte) of corporation tax to the Member State of the subsidiary which is made in connection with a distribution of profits to its parent company, within the meaning of Article 7(1) of the Directive. The taxation relates to income which is taxed only in the event of a distribution of dividends and up to the limit of the dividends paid".

It cannot be said of ACT that ACT "relates to income which is taxed only in the event of a distribution of dividends". ACT is treated as an advance payment of corporation tax which is assessed on the company's profits whether or not the profits are distributed as dividends.

89. However, following the judgment of Park J, but before the hearing in the Court of Appeal, the European Court returned to the question of what constituted a withholding tax. The case was *2 Fp van der Grinten NV v Inland Revenue Commissioners* [2003] STC 1248 where, at paragraph 47 of its judgment, the Court referred to the *Athinaiki* case (and the *Epson Europe* case) as establishing that

> " … any tax on income received in the State in which dividends are distributed is a withholding tax on distributed profits for the purposes of art.5(1) of the directive where the chargeable event for the tax is the payment of dividends or of any other income from shares,

> the taxable amount is the income from those shares and the taxable person is the holder of the shares …"

ACT is not a tax charged on the shareholders. It does not qualify as a withholding tax under the description of a withholding tax given in the *2 Fp* case.

90. In my opinion, the terms of article 7.1 of the Directive coupled with the explanation of the nature of a withholding tax given in *2 Fp* and the remarks about ACT by the Advocate General and the European Court in the *Metallgesellschaft* and *Hoechst* case establish, so that the point is *acte clair*, that ACT falls within the article 7.1 exception and is not a withholding tax.

Conclusion

91. For these reasons, and those set out in the opinions of my noble and learned friends Lord Nicholls of Birkenhead, Lord Hope of Craighead and Lord Walker of Gestingthorpe, I would allow this appeal, set aside paragraphs 1 and 2 of the order made by Park J on 22 January 2003 and remit the case to Park J to decide the unresolved factual question referred to by Lord Nicholls in para 28 of his opinion. The respondents must pay the costs of the appeal to the Court of Appeal and to this House.

LORD WALKER OF GESTINGTHORPE

My Lords,

92. I have had the advantage of reading in draft the opinions of my noble and learned friends Lord Nicholls of Birkenhead, Lord Hope of Craighead and Lord Scott of Foscote and I gratefully adopt Lord Scott's summary of the facts. I agree with the reasoning and conclusions in these opinions. But in view of the importance of the matter, and because we are differing from the courts below, I add some comments of my own on what has been called the election issue.

93. Your Lordships are concerned with two double taxation agreements ("DTAs") entered into by the United Kingdom, one in 1980

with the Netherlands and the other in 1988 with Italy. On what has been called the election issue the provisions of the DTAs can assist the respondents, at any rate in the national courts, only if and so far as those provisions have been incorporated into the domestic tax law of the United Kingdom. That is the effect of the words "in so far as they provide" in section 788(3) of the Income and Corporation Taxes Act 1988 ("the 1988 Act"): see *R v IRC ex parte Commerzbank AG* [1991] STC 271 (Divisional Court); *NEC Semi-Conductors Ltd v IRC* [2004] STC 489 (Park J). The correct starting point for any examination of the position under domestic tax law is therefore the relevant paragraph of section 788(3) following the words "in so far as they provide", that is,

> "(d) for conferring on persons not resident in the United Kingdom the right to a tax credit under section 231 in respect of qualifying distributions made to them by companies which are so resident."

94. It is a striking feature of section 788(3)(d) that it is expressed in precise and technical language (in contrast to the three preceding paragraphs, which are expressed in more general, and largely non-technical, language). What is to be conferred is "a tax credit under section 231" (which is in any case, under section 832(1) of the 1988 Act, the meaning of "tax credit") and it is to be conferred "in respect of qualifying distributions" made by companies resident in the United Kingdom. Any Dutch or Italian businessman encountering these expressions in (say) 1995 would, unless he happened to be a tax expert himself, have had to seek advice as to their meaning from someone who was expert in the intricacies of United Kingdom corporation tax. This need would not be diminished by the strong overriding language used earlier in section 788(3) ("notwithstanding anything in any enactment"), since paragraph (d) is spelling out what the content of the overriding provisions is to be.

95. The inquiring businessman would have been told that a tax credit under section 231 was the only significant tax credit known to the imputation system of corporation tax introduced into the United Kingdom in 1973. (His adviser might, at the risk of confusion, have added that under section 239 of the 1988 Act payment of advance corporation tax ("ACT") gives the paying company a credit in respect of mainstream corporation tax ("MCT"), but that this is normally spoken of in terms of set-off rather than credit; and that there could also be a specialised type of tax credit under section 441A of the 1988 Act, but that that complication could be ignored.)

96. The adviser would perhaps also have gone on to say that the basic structure of section 231 (as it then stood) was to be found in the first three subsections. Subsection (1) laid down the basic condition for the grant of the tax credit, that is, a qualifying distribution made (usually in the form of a dividend) by a company resident in the United Kingdom to a shareholder resident in the United Kingdom. It also laid down the amount of the tax credit: it was to be a proportion of the amount of the distribution corresponding to the rate of ACT (so that if the rate of ACT was 25%, the credit would be one-quarter of the amount of the distribution). Subsection (2) dealt with certain rare cases in which a corporate shareholder resident in the United Kingdom would be entitled to payment of the tax credit; the adviser probably would have told his client to disregard subsection (2) as an unimportant exception to the general rules about franked investment income (to be found in Part VI, Chapter V of the 1988 Act). Subsection (3) dealt with the much more common situation in which there was a right to payment of the tax credit, that is when the dividend was paid to a non-corporate shareholder resident in the United Kingdom, (typically an individual, but possibly a body of trustees of a pension scheme, a charity or some other type of trust) and the shareholder was not liable to pay income tax, or paid it at a relatively low rate. Those were the salient characteristics of a tax credit under section 231.

97. On being told this much about a tax credit under section 231 the foreign client might have objected that it was dealing with a purely domestic situation (a United Kingdom company paying a dividend to a United Kingdom shareholder), so how could such a credit benefit him? The adviser would have replied with some confidence that the whole point of section 788 (3)(d) was to confer on a non-resident, through a DTA, a right which was, under section 231, conferred on residents, and that this residence requirement was necessarily and obviously overridden in the parallel universe of the DTA. The adviser might also have added, with little less confidence, that the quantification of the tax credit in section 231(1) was also liable to be overridden, and was in practice very likely to be overridden, by arrangements negotiated under section 788 between Her Majesty's Government and the Dutch or Italian Government. Neither side would wish its fisc to have to pay out to non-resident shareholders more cash than it had to, and the amount of the credit under the DTA would depend on hard bargaining rather than on any transparent principle. In the present case the negotiated formula produces, on an assumed ACT rate of 25%, the rather awkward figure of 6.875% (explained in paragraph 24 of the judgment of Park J [2003] STC 250, 262, para 24).

98. So (the client might have said, recapitulating his understanding of the advice) the shareholder's residence requirement in section 231(1) is to be disregarded, and the quantum of the tax credit under section 231(1) cannot be relied on; are there any other characteristics of "a tax credit under section 231" about which advice is needed? The adviser would then have drawn attention to the only other obvious technicality in section 231(1), the need for the shareholder to receive a "qualifying distribution." He would have explained that that expression meant, in practice, a dividend, and that under the imputation system the payment of a dividend was closely associated with the payment (within a maximum period of fifteen weeks) of an amount of ACT (see section 14 of and schedule 13 to the 1988 Act). He might have added that this was however subject to section 247 (Dividends etc paid by one member of a group to another), to which both section 14 and section 231 are expressly made subject. Where a group income election ("GIE") under section 247 was in force, the dividends paid under it ("election dividends") did not give rise to an obligation for payment of ACT but were (under section 247(2)) to be "excluded from sections 14(1) and 231." In other words, they were not to count as qualifying distributions triggering a liability to pay ACT, nor as qualifying distributions giving the right to a tax credit.

99. The Dutch or Italian client would no doubt have evinced particular interest at this point; it was because his company had a subsidiary resident in the United Kingdom that he was interested in how the DTAs work. If this imaginary consultation had taken place in 1995, the adviser (unless very prescient and knowledgeable about the EU treaties) would have hastened to reassure his client that he need not worry about section 247, because a GIE was available only between companies resident in the United Kingdom. The question "What if a Dutch (or Italian) parent company and its UK subsidiary joined in making a GIE and dividends were paid under it, without ACT?" would have been regarded as a stupid question. But the momentous decision of the Court of Justice of the European Communities in the *Hoechst* case (the combined cases of *Metallgesellschaft Ltd v IRC* and *Hoechst AG v IRC* [2001] STC 452) has since made it a meaningful and highly pertinent question.

100. That is the heart of the so-called election issue, which is the first issue in this appeal. Is it an essential characteristic of "a tax credit under section 231" that it is conditional on a qualifying distribution in respect of which ACT is payable (so that if the company paying the dividend is not liable to pay ACT, there is no tax credit for the shareholder)? Or is the liability to pay ACT simply a practical necessity in the domestic

context of a United Kingdom shareholder obtaining a tax credit on the payment of a dividend by a United Kingdom company, but not a prerequisite (because of the "notwithstanding anything in any enactment" rubric) when the concept of "a tax credit under section 231" is transferred to the international context (or parallel universe) of the DTAs?

101. Park J had little difficulty in deciding that there was no requirement for ACT to be payable. He said of section 231(1) (at para 36),

> "There is no requirement there or anywhere else that ACT must have been paid, or at least must be payable. It is probably true that the draftsman in 1972 assumed that, in any case where a recipient of a dividend would be entitled to a tax credit under the predecessor of section 231(1), there would have been a liability on the part of the paying company, or of one or more lower tier companies, to pay ACT in amounts which would match the amount of the tax credit. Further, in all circumstances which the draftsman could realistically have anticipated at the time, his assumption would have been correct. It remains the case, however, that the policy considerations which influenced the architects of the imputation system and the assumptions which the draftsman probably made were nowhere enacted as conditions which had to be fulfilled before a shareholder could be entitled to a tax credit."

The judge repeated the same point (at para 38) in relation to article 10 of the DTAs. After summarising submissions made by Mr Glick QC (for the Revenue) as to sections 231 and 247 he set out his comment very pithily (at para 40): So what?

102. The Court of Appeal (Peter Gibson and Laws LJJ and Sir Martin Nourse) upheld the judge's conclusion, and again seem to have had little difficulty in doing so. The core reasoning is in paras 46 and 47 of the judgment of the Court delivered by Peter Gibson LJ:

> "Given the elaborately detailed nature of the DTAs and their purpose of relieving double taxation, we would find it very surprising if specific provisions limiting the

> conferring of tax credits in the domestic tax legislation so as to exclude it in particular circumstances were intended to govern the availability of tax credits to a non-resident. Is it really to be supposed that every statutory qualification enacted from time to time in the UK fiscal legislation to the availability of a tax credit under section 231 qualifies the entitlement conferred by the DTA to the limited relief of double taxation by the tax credit as provided for in the DTA? We think not.
>
> Moreover, section 247(2), which forms the linchpin of Mr Glick's argument, is not in fact purporting to affect the meaning of 'tax credit' in UK tax law. It is merely limiting the circumstances in which a tax credit under section 231 will be granted."

103. I have found this issue much less easy. It is to my mind a short but very difficult point of statutory construction. The unanimous view of the very experienced judges in the courts below commands great respect. But in the end I have come to the conclusion, differing most reluctantly from the courts below, that they reached the wrong conclusion because they did not give enough weight to two factors. One is that in applying the DTAs it is necessary to look, not only at their terms, but also at the language of section 788(3)(d), which uses a technical expression of domestic tax law, "qualifying distribution." The other is that the clear scheme of the 1988 Act is that the payment of a dividend should be accompanied by a payment of ATC if a tax credit is to come into existence, and if exceptionally (because of a GIE) the payment of a dividend is not accompanied by a payment of ACT, the dividend would not give rise to a tax credit, because of section 247(2). Section 247(2) does not directly affect the meaning of "tax credit", but it does to my mind affect the meaning of "qualifying distribution"; a dividend paid under a GIE is in terms excluded from section 14(1), and section 231 is in terms made to take effect subject to section 247.

104. These processes of exclusion and subjection are no doubt not strictly a matter of definition (although the types and purposes of statutory definitions are manifold: see Bennion, *Statutory Interpretation*, 4th ed. pp 479 ff). But they are a fundamental element of how a tax credit under section 247 was intended to work under the imputation system. A thunderbolt from Luxembourg, in the form of the decision in *Hoechst*, has shown that under EU law the statutory scheme was flawed, and has been flawed since its inception in 1973. There is no answer which resolves all the difficulties. But in those circumstances your Lordships should in my opinion adopt a construction which best accords

with the original scheme of the 1988 Act, flawed though it is now seen to be, rather than abandoning the attempt to find any sort of purposive construction.

105. In his printed case Mr Aaronson QC (for the respondent Pirelli companies) acknowledged (para 38) that if commonsense or plain justice required it, the Revenue might be able to justify what he has called a selective reading of sections 231 and 247. The requirements of justice are not easy to discern in the world of cross-border taxation of multinationals, but I think that commonsense does point in favour of the Revenue's appeal. The evident purpose of section 788(3)(d) and of article 10 of the DTAs is to give a tax credit (of a certain sort) to a non-resident shareholder who receives a dividend from a United Kingdom company. It is central to the concept of the United Kingdom granting a tax credit to the shareholder in respect of a dividend that some United Kingdom tax should have been paid (or at least payable) in respect of that dividend. It would be an abuse of language, and contrary to commonsense, to speak of granting a tax credit when no such tax has been paid. Moreover the DTAs would not then, in this sort of situation, be relieving double taxation. It is the respondents, to my mind, who seek to adopt a selective reading of the relevant provisions of the 1988 Act by ignoring a central feature of the statutory scheme, that liability to pay ACT is a concomitant of a qualifying distribution.

106. Mr Aaronson relied on the well-known presumption that Parliament does not intend to act in breach of public international law, including the treaty obligations of the United Kingdom. I would accept the submission (made by Mr Glick in his reply) that that principle does not assist the respondents, since section 788 (like its statutory antecedents) is a general enabling provision capable of incorporating an indefinite number of bilateral arrangements (that is, DTAs) into our domestic tax law, but only for the purposes specified in subsection (3), and within the scope of those purposes (see *R v IRC ex parte Commerzbank AG* [1991] STC 271 and *NEC Semi-Conductors Ltd v IRC* [2004] STC 489, to which I have already referred). If section 788(3)(d) is clear and unambiguous, its meaning cannot be altered by the text of any particular DTA: see *Salomon v Customs and Excise* [1967] 2 QB 116, 143.

107. For these reasons I would resolve the election issue in favour of the Revenue. In agreement with the reasoning of Lord Nicholls, Lord Hope and Lord Scott I would also decide the assessment issue and the

withholding tax issue in favour of the Revenue. I would therefore allow the appeal and make the order that Lord Scott proposes.

LORD BROWN OF EATON-UNDER-HEYWOOD

My Lords,

108. I have had the advantage of reading in draft the opinions of my noble and learned friends, Lord Nicholls of Birkenhead, Lord Hope of Craighead, Lord Scott of Foscote and Lord Walker of Gestingthorpe. For the reasons they give, with which I entirely agree, I too would allow the appeal and make the order proposed.