

On Appeal from The Court of Appeal

BETWEEN:

THE COMMISSIONERS FOR HIS MAJESTY’S REVENUE AND CUSTOMS

Appellants

- and -

SCOTTISHPOWER (SCPL) LIMITED

SCOTTISHPOWER RENEWABLES (UK) LIMITED

SCOTTISHPOWER (DCL) LIMITED

SCOTTISHPOWER ENERGY RETAIL LIMITED

Respondents

RESPONDENTS’ WRITTEN CASE

INTRODUCTION

- 1.1 Common sense demands, and the law both accepts and requires, that a trader who, as happened here, makes a mistake in the conduct of the trade is able to deduct the cost of making amends for the error, which is what the Redress Payments do. There is a broad measure of agreement between the parties. Indeed, this much is agreed in the Statement of Agreed Facts and Issues at §§63 and 59:

- 1.1.1 the opening words of the Corporation Tax Act 2009¹ s46(1) set out a **Rule**;
 - 1.1.2 the Rule is that the profits of a trade (profits of the kind with which this case is concerned)

“must be calculated in accordance with generally accepted accounting practice.”
 - 1.1.3 the Rule is mandatory;
 - 1.1.4 the deduction of the Redress Payments in calculating the Respondents’ profits was in accordance with and required by the Rule; and
 - 1.1.5 as appears from the **tailpiece** to s.46(1), the Rule may only be abrogated where an adjustment is required or authorised by law in calculating profits for the purposes of corporation tax.
- 1.2.1 The acts or omissions which led to the Redress Payments involved breaches of the conditions incorporated in the Respondents’ licenses to supply or generate electricity and so were akin to breaches of contract or to tortious acts rather than to breaches of a statute or statutory instrument.
 - 1.2.2 The bulk of those acts or omissions were “practically almost unavoidable”, “were part of the activity of SPERL’s trade”, “were done for the purpose of earning income from that trade” and the Redress Payments were paid pursuant to Settlement Agreements which SPERL “chose” to enter into for trading purposes – see Statement of Agreed Facts and Issues at §§47 and 53-55.

¹ The Corporation Tax Act 2009 is here sometimes referred to as **CTA 2009**. References to s.46 are to s.46 of the CTA 2009.

- 1.2.3 In the bright light of those findings and that choice, a deduction for the Redress Payments is to be expected: a taxpayer has the right to expect that it can deduct the costs (direct or indirect) of things done for the purpose of earning income from its trade.
- 1.2.4 It is striking that, if the Settlement Agreements had been entered into without the involvement of a regulator, a claim that, on these facts, the Redress Payments were not deductible would or, at least, should have been regarded as nonsensical and impossible.
- 1.2.5 But, nonetheless, HMRC put forward the claim that payments, made as a result of things which were practically almost unavoidable and done for the purpose of earning income from the trade, are non-deductible. That does not sound right and it can only be right if the Rule is abrogated.
- 1.2.6 The circumstances in which the Rule is abrogated are limited.
- 1.2.7 HMRC say it is abrogated here. Their argument is based on the involvement of a regulator, so one of the questions here is whether payments, which would be deductible if no regulator were involved, become non-deductible because the regulator is involved. That seems implausible.
- 1.2.8 HMRC seek to support their argument on the basis of two cases, *IRC v von Glehn* (1920) 12 TC 232 and *McKnight v Sheppard* [1999] STC 669, in neither of which were there facts remotely like those identified at paragraphs 1.2.1 and 1.2.2 above so that, for the reasons explained later, the decisions in those cases cannot determine the outcome of this case.
- 1.2.9 And if the arguments based on those cases don't work, HMRC make a comparison between cases governed by the *ex turpi causa* principle, many of which deal with the consequences of unlawful killing, and the regulatory breaches which occurred here, a comparison which is inappropriate. The question "what is the taxpayer's taxable profit?" does not respond to the type of analysis which is appropriate where a Court is asked to lend its aid to enforce an illegal act. The Respondents are not asking this Court to do that.
- 1.3.1 There is no authority which, on a proper application of the doctrine of precedent, even comes close to suggesting that payments with the characteristics set out at paragraphs

1.2.1 and 1.2.2 above, which do not engage the criminal law and which are not imposed as penalties are non-deductible: certainly, understood properly, the cases mentioned at paragraphs 1.2.8 and 1.2.9 do not suggest that.

- 1.3.2 Since that is so, there is no obvious way of denying the deduction for the Redress Payments and to do so leads to a commercially absurd result. HMRC have not come up with anything plausible but, rather, with something perhaps based on the requirement for harmony in the law, which, if accepted, would not only deny a trader a deduction for damages incurred in the ordinary course of a trade but which would also create a disharmony by treating payments agreed with a regulator to be payable as Redress Payments as having character different from their agreed character. The law ought not to allow that.
- 1.3.3 A further objection to the approach adopted by HMRC in this case is that, because these terms are used in *von Glehn* and in *McKnight*, it focusses excessively on the concepts of penalties and punishment which are not relevantly found in the Tax Acts and for which focus there is, on a proper application of the doctrine of precedent, no authority. The focus of the statute is on the Rule and on the tailpiece.
- 1.4.1 The effect of the Rule is that the determination of profits is, first, a matter of accounting practice.
- 1.4.2 That is how it should be. The concept of profits is not a play toy for lawyers: it is an inherently commercial matter, a point made with great clarity in *IRC v Whimster* 12 TC 813 at 823 and relatively recently reinforced both by the enactment of the Rule, originally by FA 1998 s.42 and now by CTA 2009 s.46 and by the decision of this Court in *NCL Investments Ltd v HMRC* [2022] 1 WLR 1829.
- 1.4.3 Profits and nothing else are the subject matter of the charge to tax on companies – see CTA 2009 s1(1)(a); 2(1) and (2); they are the root of the corporation tax tree. The Rule makes it necessary to deduct the Redress Payments to calculate a figure which can be correctly described as a profit.
- 1.5.1 Nonetheless, HMRC say that there is a relevant exception to the Rule so that the Redress Payments are not deductible.

- 1.5.2 The exceptions to the Rule are provided for by, and only by, the tailpiece.
- 1.6.1 The tailpiece provides that the calculation of trading profits in accordance with generally accepted accounting practice is:
- “subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes.”
- 1.6.2 The adjustments provided for by the tailpiece are exceptions from the Rule: they are, accordingly, inevitably exceptional and not normal: their purpose is not to allow easy escape from the general and mandating power of the Rule but to ensure that the Rule is observed unless there is a clear reason for departing from it.
- 1.7 The claim, which is not made in this case by the Respondents but by HMRC, is that the Redress Payments should be added back to the Respondents’ profits – see Statement of Agreed Facts and Issues at §64.
- 1.8.1 The add back can only be done if it is an adjustment “required or authorised by law in calculating profits for corporation tax purposes”: unless that is the case, s.46(1) does not allow the add back and doing so would break the Rule.
- 1.8.2 Only those adjustments which pass a two-factor authentication test may be made: first, only adjustments “required or authorised by law” may be made and then, secondly, only if they are required or authorised “in calculating profits for corporation tax purposes”.
- 1.8.3 An adjustment which is required by law is one which, in the appropriate circumstances, must be made: CTA 2009 s.54, which prohibits a deduction for expenses not incurred wholly and exclusively for the purposes of the trade and CTA 2009 s.1304 which prohibits a deduction for payments the making of which constitute a criminal offence, are examples of provisions which *require* an adjustment to be made if the profits have been computed without proper regard to the prohibition.
- 1.8.4 The deduction of capital allowances granted on a claim under the Capital Allowances Act 2001 is an example of an adjustment which is *authorised* but not required.
- 1.9.1 Where it is claimed that profits calculated in accordance with generally accepted accounting practice are to be adjusted in accordance with the tailpiece, it is necessary

to identify what requires or authorises the adjustment which is claimed: the requirement or authorisation may, in theory, be found in case law or it may be found in statute law.

1.9.2 Although judge-made rules about how profits are to be calculated may exist, it is difficult to see how they could apply specifically “in calculating profits for corporation tax purposes” as required by the tailpiece, nor is it easy to see how such a rule could be created without the Courts trespassing on the law-making functions of Parliament and that is especially so in relation to adjustments which are authorised rather than required by law. The concept of an authorised adjustment implies the ability to make a choice. But how can a Court (as distinct from the legislature) grant a taxpayer (or the tax authority) a fiscal choice? That is an exclusively legislative function.

1.10 The general expectation is, accordingly, that adjustments to profits will have a statutory basis – see *NCL Investments Ltd v HMRC* [2022] 1 WLR 1829; *Morgan v Tate & Lyle* [1953] Ch. 601 at 627 per Jenkins LJ; and, as the Court of Appeal said in this case, any judge-made rule must be clear – see *SCPL v HMRC* [2025] STC 227 at [58]:

“...a rule which denies a deduction for expenses that are not only incurred in the course of trading activities but are taken into account in calculating profits in accordance with generally accepted accounting practice will generally be expected to be statutory rather than “judge-made”. Any rule which does not have an express statutory basis needs to be clear in its effect”.

It is inherently improbable that the law will authorise a Court to adjust the profits on some form of discretionary basis. It is still less likely that the law will allow HMRC to adjust profits on that sort of basis.

1.11 The argument for HMRC in this case seeks to introduce, in one form or another, a moral or discretionary or public policy element, in that it appears to make the allowance of a deduction dependent on the approval, by the relevant Court or Tribunal, of the way in which the taxpayer has conducted its trade.

1.12.1 That is a serious error: whatever the rule about adjustments is, it must allow the trader to deduct the actual costs of running the trade, and those actual costs must include damages paid or payable for breaching a contract entered into in the course of a trade,

tortious damages for wrongs done in the course of a trade, and payments which recognise regulatory breaches occurring in the course of a trade – compare *The Herald and Weekly Times v Federal Commissioner of Taxation* (1932) 48 CLR 113. That is particularly so where, as here, the outgoings in issue have the characteristics identified at paragraphs 1.2.1 and 1.2.2 above.

1.12.2 Indeed, unless that is so, what is being taxed cannot possibly be regarded as a profit and tax would be imposed without any statutory authority on an artificial figure which has no relationship to commercial reality.

1.12.3 That, of course, is what HMRC are trying to do here: they are seeking to tax the Respondents on more than their commercial profit; the attempt should not succeed and cannot succeed unless HMRC are able to point to something which authorises or requires the adding back of the Redress Payments.

1.13 HMRC’s claim that this case falls within the tailpiece, a claim which attacks the ability of a taxpayer to deduct payments like the Redress Payments, which have been correctly deducted in computing profits in accordance with generally accepted accounting practice, may, broadly, be made on one of two grounds, neither of which should succeed.

1.14.1 The first ground of attack may, in appropriate cases, be statutory, based on the wholly and exclusively rule enacted by CTA 2009 s.54.

1.14.2 But, while such an attack might, in principle, be made and, indeed, is attempted by HMRC at paragraphs 76 to 126 of their written case, there is no basis for it in this case because no deduction is being sought for any expenditure which had a dual purpose – see Statement of Agreed Facts and Issues at §§53-59. The acts or inactions that gave rise to the Redress Payments were part of the activity of SPERL’s trade and were done for the purpose of earning income from that trade. In face of that unchallenged – indeed, agreed – finding of fact, read together with the FTT’s similarly unchallenged findings at [2022] UKFTT 41 (TC) at [170]-[172], that the Redress Payments were incurred wholly and exclusively for the purposes of the trade, there is no basis for any argument that this is a case where duality of purpose denies a deduction for a payment. There is only one purpose and it is trading. The fact that that is so is reinforced by the agreement

of the parties, at §54 of the Statement of Agreed Facts and Issues, that SPERL **chose** to enter into the Settlement Agreements under which the Redress Payments were made for the trading purposes there set out, which emphasises that, in this case, as may not be so in cases involving imposed penalties, the settlements agreed were a matter of trading choice by the Respondents.

1.14.3 Nor is this a case where it can be claimed that the Redress Payments were made out of profits once earned: the FTT's findings show that the payments were made to earn, not after earning, the profits – see, in particular [2022] UKFTT 41 (TC) [112] and [161]-[162].

1.14.4 The second ground of attack is that some form of judge-made public policy bar precludes the deduction of the Redress Payments.

1.14.5 That is the basis on which HMRC's main attack on the deductibility of the Redress Payments is now mounted. But there is no authority to support such an unprincipled claim and to introduce any element of uncertainty into the tax system by reference to public policy would be bad for that system.

1.14.6 It is for HMRC to tax the profits of a trade, but it is not for HMRC or for anyone other than the owner to say how the trade is to be run; and the issue of whether an expenditure is morally good or bad is irrelevant to the computation of profits.

1.14.7 The surest guide to the determination of a profit is generally accepted accounting practice. Nonetheless, HMRC claim that the Respondents should be taxed on the basis of a profit calculated without deducting the Redress Payments and so on the basis of a profit not calculated in accordance with generally accepted accounting practice. That claim is unsound, unsupported by authority, and wrong.

1.15.1 Of course, there may, sometimes, be scope for argument about whether what has led to an outgoing is truly within the scope of the trade. But the findings of the FTT leave no room for doubt about that here. What happened here was plainly within the scope of the trade – see Statement of Agreed Facts and Issues §§38, 47, and 53-59.

1.15.2 This is not a case where the taxpayer has done something which quite obviously has nothing to do with the trade and then claimed a deduction for the expenditure incurred

in doing that non trading thing: this case is, for example, nothing like *McLaren Racing* [2014] UKUT 269 (TCC) where the thing which caused the disputed expenditure was not remotely part of the trade.

- 1.16.1 The non-statutory judge-made ground of attack considered above is sometimes bolstered when the item which it is claimed may be deducted is a penalty, and the question of whether it makes any difference to the question of deductibility if the payment is a penalty or not is considered below.
- 1.16.2 The point to grasp here is that the Redress Payments were expressly and deliberately not penalties of a kind recognised by any statute as penalties and it is agreed that they were not statutory penalties – see Statement of Agreed Facts and Issues at §64. It follows that the question of how penalties fit into the principles of deductibility does not arise in this case; see also *SCPL v HMRC* [2025] STC 227 at [65]. This is not, as HMRC assert it is in paragraph 46 of their written case, a matter of labelling. The Redress Payments were substantively and not merely formally different from the penalties which could have been, but which were not, imposed on the Respondents.
- 1.16.3 It is to be observed that if the Redress Payments can be described as penalties (as the FTT thought they could be) so can damages awarded in a tort case or a breach of contract case. The point is that concentration on the concept of penalty in the abstract goes too far because it denies a deduction for anything which can be described as a penalty regardless of what it actually is and so will deny a deduction for expenses which should be deductible.
- 1.16.4 Similarly, the Redress Payments were not in lieu of a penalty: the regulator decided to pursue Redress Payments, not penalties, and where the regulator has done that, there is no penalty for the Redress Payment to be in lieu of; there is just a Redress Payment with its own particular character. The Court of Appeal was right to say in this case that the taxpayer must be taxed on the basis of what he actually did and not on the basis of what might have happened - see *SCPL v HMRC* [2025] STC 227 at [59]-[64].
- 1.17 The Respondents say that that is the end of the matter: they are to be taxed on their accounting profits; there is nothing which allows the profits to be adjusted and, in

particular, there is no statutory or judge-made rule which prohibits the deduction or authorises or requires the add back of the Redress Payments.

1.18.1 The conclusion that the Redress Payments should be deducted in computing the taxable profits of the Respondents accords with the evident policy of the UK tax code. Some tax codes, for example, restrict the trading expenditure which may be deducted to that which is necessary, or to that which satisfies certain policy criteria.

1.18.2 But the UK has wisely adopted a liberal approach to the deduction of trading expenditure and to deny a deduction for payments which have the characteristics of the Redress Payments is to flout the evident purpose of the legislature.

HMRC'S ARGUMENT

2.1 HMRC, on the other hand, say that no deduction is permitted for the Redress Payments, so that the Redress Payments must be added back with the result that the Respondents are taxed on their accounting profits plus the Redress Payments.

2.2.1 The question which HMRC's claim raises is whether, in calculating profits for corporation tax purposes, an adjustment, adding back the Redress Payments, is required or authorised by law.

2.2.2 They say there is something which requires the Redress Payments to be added back to profits. But apart from their unsatisfactory attempt to bring the case within CTA 2009 s.54(1)(a), which ignores the agreed and found facts, they do not point to any statutory provision which requires or authorises the adding back of the Redress Payments. Nor do they point to any case which has facts remotely similar to the facts of this case in which a deduction has been denied for payments which, like the Redress Payments, have the characteristics identified at 1.2.1 and 1.2.2 above and which were paid under Settlement Agreements which the taxpayer chose to enter into for trading purposes.

2.2.3 So what is the rule for which HMRC argue? Where does it come from? What are the limits? Does it have anything to do with the involvement of a regulator? If so, how far does the regulator have to intervene in the running of the trade before the rule applies? It is possible that a trader would make payments similar to the Redress Payments to consumers without any intervention from a regulator at all (as occurred in this case –

see Statement of Agreed Facts and Issues at §46). How does HMRC's proposed rule work then? Would HMRC's rule apply if there were no £1 penalty in the Settlement Agreements but only an agreement to pay the Redress Payments? In what way do the Redress Payments differ from damages and why should damages be deductible while the Redress Payments are not? HMRC have no answer to these questions.

- 3.1 There are, no doubt, certain sums which are not deductible in computing profits for tax purposes because a statute prohibits their deduction: the most familiar of these provisions are to be found in CTA 2009 ss.53 to 60A and ss.1288 to 1305A and, of those, the two most commonly encountered possibilities are s.53, prohibiting the deduction of capital expenditure and s.54, prohibiting the deduction of expenses not incurred wholly and exclusively for the purposes of the trade.
- 3.2 However, the deductions made in this case for the Redress Payments are not prohibited by anything in that familiar list and, apart from HMRC's attempt to bring the matter within CTA 2009 s.54(1)(a) in their written case here, no suggestion has been made that they are.
- 3.3 In particular, the Statement of Agreed Facts and Issues shows that the Redress Payments were incurred wholly and exclusively for the purposes of the taxpayer's trade and, as to the vast bulk of them, were the result of acts not only in the course of the trade but also done for the purpose of earning income from that trade and practically almost unavoidable – see Statement of Agreed Facts and Issues at §§38, 47 and 55, and see also the FTT's Decision [2022] UKFTT 41 (TC) at [171]-[172]. There is no scope here for finding, on an objective basis, an unspoken subjective basis for the payment: the facts found by the FTT are comprehensive and clear and leave room only for the conclusion that the Redress Payments were incurred wholly and exclusively for the purposes of the trade.
- 4.1 Accordingly, HMRC's attempt here is to include, in calculating the profits of the taxpayer's trade, outgoings which were incurred by things done or omitted to be done in running the trade and which were practically almost unavoidable.
- 4.2 That would be a strange result: it would make no commercial sense.

- 4.3.1 Indeed, once it is recognised that, as a matter of fact, the Redress Payments were incurred wholly and exclusively for the purposes of the taxpayer's trade, and had the other characteristics identified at 3.3 above, it follows that deduction of the Redress Payments is not and cannot be prohibited by the familiar wholly and exclusively rule enacted by s.54 of the Corporation Tax Act 2009.
- 4.3.2 In particular on the facts of this case, which show that the need to make the Redress Payments is deeply rooted in the actual trading activities of the Respondents (see Statement of Agreed Facts and Issues at §§53-56), no argument that the payments are made after the earning of profits so that they cannot be made wholly and exclusively for the purposes of the trade is possible: it is inconsistent with the facts found. It is not possible in this case to argue that the activities which led to the Redress Payments were not undertaken by the Respondents in their capacity as traders.
- 4.3.4 Another argument which can be ruled out is that the purpose of the regulator in entering into the Settlement Agreement is relevant: the Court of Appeal was right for the right reasons in holding that the purpose of the taxpayer and not the regulator is relevant here – see *SCPL v HMRC* [2025] STC 227 at [72]-[73].
- 4.3.5 There is no room for an argument hinted at in some cases, that the wholly and exclusively rule has both a factual and a legal aspect, so that some payments in fact made wholly and exclusively for the purposes of a trade are, in law, not made for those purposes. Whether or not – in some cases – the rule may be double-aspected with a factual and a legal element, there is, on the findings of fact made in this case, no possible legal aspect to the test which could preclude deductibility: there is certainly no principle which allows payments which (like the Redress Payments) were in fact lawfully made and wholly and exclusively for the purposes of the trade to be regarded as not so made.
- 4.4.1 Where, then, is there to be found a rule that requires or authorises an adjustment to profits to be made by adding back to profits payments like the Redress Payments?
- 4.4.2 The answer is that no such rule is to be found because there is none: the judicial creation of a rule like that impinges on the role of Parliament and is impermissible as a matter of law; it would also be a commercial nonsense inimical to the sensible working of any tax system.

- 4.4.3 Similarly, there is no basis for recognising a rule which prohibits deduction of payments like the Redress Payment: the statutory rules do not apply to deny a deduction for the Redress Payments, and there is nothing in the case law which lays a foundation for such a rule.
- 4.5 Nonetheless, in an attempt to find a basis for a rule which is intended to preclude a deduction for expenditure which springs from the essential conduct of the trade, HMRC focus on *McKnight v Sheppard* [1999] STC 669 and argue that it expressed or created a rule that punishment could not be deducted.
- 4.6 In raising that argument, HMRC are misusing and abusing the doctrine of precedent. No doubt, the concept of punishment was mentioned in *McKnight*, but the case did not and could not decide anything about the deductibility of punishments because that issue was not before the Court and the Court heard no argument on it – see *Finzi v Jamaican Redevelopment Foundation Inc* [2024] 1 WLR 541 at [60] to [62].
- 4.7 Although obviously of some interest in this case, *McKnight* did not and could not establish any principle affecting the deductibility of the Redress Payments: it was about something else altogether – legal expenses - and can be of no more than peripheral interest in this case.
- 4.8 Since that is so, *McKnight* does not provide any basis for saying that there is a rule that punishments which were, as a matter of fact, incurred wholly and exclusively for the purposes of a trade are non-deductible.
- 4.9 It is accordingly necessary for HMRC to look elsewhere and they turn to the concept of penalty.
- 5.1.1 The Respondents accept that there is a principle which prohibits the deduction of fines and penalties when imposed under a statute imposing a sanction for breach of the law. The Respondents also accept and, indeed, assert, that that principle comes from *von Glehn* [1920] KB 553 where the taxpayer accepted a penalty. This is why the Respondents never sought to deduct the £1 penalties imposed in this case – see Statement of Agreed Facts and Issues at §59.

- 5.1.2 There is room for some debate as to the foundations of the principle. On one view, it is simply an aspect of the wholly and exclusively test, so that a statutory penalty which is imposed against the will of the payer, as distinct from being chosen and agreed, can never be incurred wholly and exclusively for the purposes of the trade in question. But in many cases it is apparent that, in fact, a taxpayer has incurred a penalty for the purposes of the trade and it is not satisfactory to rely on the wholly and exclusively test for the non-deductibility of penalties. That is especially so in this case where it is an agreed fact that the Respondents chose to enter into the Settlement Agreement for the trading reasons set out in the Statement of Agreed Facts and Issues at §§53 and 54.
- 5.1.3 A better explanation for the non-deductibility of penalties is that there is a principle of our law that a punishment inflicted by a criminal court is personal to the offender and so outside the scope of his trading activity. Where a person has suffered a punishment personal to them for some illegal activity, the civil courts will not entertain an action by the offender to recover an indemnity against the consequences of that punishment – see *Askey v Golden Wine Co Ltd* [1948] 2 All ER 35 at 38 C-D. As Lord Atkin put it in *Beresford v Royal Insurance Co Ltd* [1938] AC 586 at 596:
- “no system of jurisprudence can with reason include amongst the rights which it enforces rights directly resulting to the person asserting them from the crime of that person.”
- 5.2.1 The scope of this principle has not been fully determined. In *Sheppard v McKnight* and in *Maclaren* it was assumed that it could extend to sanctions imposed by a regulatory scheme or a contractual scheme but, if the true basis of the principle about non-deductibility is as set out above, it is not clear that it extends to non-statutory sanctions.
- 5.2.2 Certainly *von Glehn* itself was a case in which the sanction involved was created by statute so that, on a proper application of the principle of *stare decisis*, the only binding force of the case is in relation to unlawful conduct involving a statutory sanction. The Court of Appeal rightly recognised that – see *SCPL v HMRC* [2025] STC 227 at [49], [54].
- 5.3.1 But no matter what the true scope of the rule is, it has no application in this case: the Redress Payments were wholly civil in character without being in any way a substitute

for some criminal sanction. They were not penalties of any kind but, by obvious and deliberate decision of the regulator, were payments of a different character and were expressly distinguished as such in the regulator's Notices of Decision.

- 5.3.2 Where a regulator has power to impose penalties, but makes a deliberate choice not to impose them and, instead, agrees that payments will be made to consumers or potential consumers or charities, what happens is a voluntary payment which is akin to contractual or tortious damages and cannot be equated for any purpose to a penalty even if it can, in a broad way, be described as one; nor can it be treated as a penalty on the basis that it is in lieu of a penalty. It is not in lieu of a penalty. There is no penalty: there is something else – an agreed payment which cannot sensibly be distinguished from contractual or tortious damages which are or should be plainly deductible.
- 5.3.3 This is not a matter of labelling: the Redress Payments were substantively and procedurally different from any penalty which Ofgem might have imposed and they were different not only because Ofgem wanted them to be different, but because the Respondents wanted them to be different too.
- 5.3.4 Nor can it be said that the Redress Payments diverted funds away from the Consolidated Fund to consumers: there was nothing to divert; the Redress Payments did not go to the Consolidated Fund because they did not belong there. For HMRC to deny a deduction for the Redress Payments on the basis of an argument that they can be regarded as some kind of penalty is to recharacterise the payment the taxpayer actually made without any authority giving them the right to do that and to impose a double sanction on the trader when the regulator has chosen not to do that – compare *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267 at 292. HMRC do not have a magic wand with which to turn what is expressly not a penalty into a penalty – compare *SCPL v HMRC* [2025] STC 227 at [60]-[64]. Nor do they have the ability to impose a double sanction where the regulator has decided not to do that.
- 5.4.1 At paragraph 131 of their written case, HMRC suggest that allowing a deduction for the Redress Payments would amount to an impermissible “sharing” of a punishment with taxpayers and would enable ScottishPower to retain a benefit derived from wrongdoing. That is wrong.

- 5.4.2 First, no benefit remains once the Redress Payments are made.
- 5.4.3 HMRC’s argument incorrectly assumes that ScottishPower retains some benefit unless the payment is disallowed for tax. If Ofgem identifies a gain of £100 and requires a Redress Payment of £100, the gain is entirely extinguished by the payment itself. There is no retained profit. A deduction in computing taxable profits therefore does not “subsidize” a benefit: it reflects commercial reality. If, by contrast, the Redress Payment must be added back, ScottishPower would suffer an additional fiscal loss – something neither contemplated nor intended by the regulator.
- 5.4.4 Secondly, HMRC conflate compensatory payments with punitive sanctions.
- 5.4.5 The flaw arises from treating any regulatory settlement as a punitive sanction personal to the taxpayer. That is incompatible with the agreed facts and with Ofgem’s Notices of Decision. Ofgem explicitly chose *not* to impose statutory penalties and instead required civil payments of a type which can be described as compensatory. These are not “in lieu” of penalties and cannot be characterised as punishment in any legally relevant sense. The principles governing the non-deductibility of criminal or quasi-criminal penalties are therefore inapplicable.
- 5.4.6 Thirdly, deductibility does not undermine regulatory objectives.
- 5.4.7 There is no disharmony between allowing deductibility and the regulator’s aims. Ofgem sought restitution. It would create disharmony – not resolve it – to deny deductibility and thereby impose a fiscal penalty where the regulator has deliberately chosen not to impose one.
- 5.4.8 Fourthly, HMRC’s public policy concern is misplaced.
- 5.4.9 The tailpiece only permits adjustments to profits where “required or authorised by law”. There is no statutory or judge-made principle denying deduction for compensatory civil payments of this kind. Nor is there any logical basis for implying a public policy limitation which precludes the deduction of redress payment but not damages. We no doubt must forgive those who trespass against us, but it does not mean that they did less wrong than the Respondents in this case. HMRC’s assertion that deductibility would result in the sharing of a punishment is a policy argument unsupported by authority and

inconsistent with the factual findings that the payments were incurred wholly and exclusively for trading purposes.

- 5.5 An issue which does not arise in this case is what happens when some form of civil penalty is incurred. Parking “fines” are a good example. Where a parking charge is incurred as a result of parking on private land in the course of a trade there would seem to be no good reason for denying the deductibility of the charge and that remains so even if the charge is called a penalty. Similarly, most local authorities imposing a penalty charge notice for parking in a restricted area are not imposing anything which is akin to a criminal sanction and, again, there would not seem to be any good reason for denying a deduction for sums paid in satisfaction of penalty charge notices imposed by a private parking contractor.
- 5.6 It is submitted that any principle said to be derived from *von Glehn* is accurately and precisely confined to cases with facts similar to *von Glehn* so that, whatever the principle is, it does not extend beyond statutory sanctions.
- 6.1 Recent authority has gone some way to emphasise the desire for all aspects of the legal system to be harmonious with each other (see *Hall v Hebert* [1993] 2 SCR 159), but this is difficult in tax cases, since tax law is no longer regarded as a seamless garment but as a patchwork (see *RFC 2012 Plc v Advocate General for Scotland* [2017] 1 W.L.R 2767 at [10]).
- 6.2 There is, furthermore, no disharmony between what the regulator has done to secure the making of the Redress Payments and the requirement that HMRC recognise that they cannot undo the deduction for the Redress Payments taken in the taxpayers’ accounts in accordance with generally accepted accounting practice. It would, or might be, different if the regulator had imposed the Redress Payments as a penalty and the regulator were, in doing that, exercising power in relation to criminal or quasi criminal activity because, in that case, the taxpayer would be asking a civil arm of the state system (HMRC) to ameliorate the penalty imposed by another arm, the regulator. But nothing like that has happened or is happening here: the issue of disharmony cannot arise where the actions of all parties fall, as they do here, in the civil realm. The Respondents here are not seeking a deduction for a wrong which they have done; they

are seeking a deduction for payments made to recognise and to make up for those wrongs.

- 7.1 On the analysis so far, there is nothing which authorises or requires any adjustment to the taxpayers' profits as they calculated them with a deduction for the Redress Payments; and that is not surprising because the common sense answer to the issue in this case is that the taxpayers should be able to deduct the Redress Payments: they are a normal business expense.
- 8.1 The agreed issue in this case is whether the Redress Payments can be added back to correctly computed profits and given that, for the reasons just given, *McKnight v Sheppard* does not govern this case and given also that there is no law requiring or authorising the add back when calculating the Respondents' profits for corporation tax purposes, HMRC's primary case falls away.
- 8.2 HMRC's next argument is that prohibition of a deduction for the Redress Payments is a consequence of the *ex turpi causa* principle: that a person cannot rely on their own turpitude to bring or defend a claim.
- 8.3 But that cannot be right. First, there is no turpitude here: the breach which occurred here, which is an almost unavoidable breach of a licence condition is a breach of a private civil obligation and is not turpitude – see *Les Laboratoires Servier v Apotex Inc* [2015] AC 430 at [28].
- 8.7 Secondly, even if there were turpitude here, the *ex turpi causa* principle applies only as a defence to a claim by the person alleged to have done the turpitudinous thing. Here, the taxpayers are not seeking to use their supposedly turpitudinous acts as the basis for a claim or as a defence to a claim. At this stage of the proceedings, the Respondents are not claiming a deduction for the Redress Payments. Those have been deducted as of right in the calculation of profits in accordance with generally accepted accounting practice. The question now is not whether they can be deducted but whether they should be added back, and that can be seen from the Agreed Issues – see Statement of Agreed Facts and Issues at §64. The person here making the claim (which is to add back, to the taxpayers' profits, the Redress Payments) is HMRC and in that context there is no scope for either party to rely on the *ex turpi causa* principle: the taxpayers are not relying on

it because they are not making any claim and HMRC cannot rely on it because they are not seeking to defend against a turpitudinous claim; rather, they are the ones making a claim.

8.8 Thirdly, the *ex turpi causa* principle applies only where not to apply it would allow disharmony between two legal systems – see *Les Laboratoires Servier v Apotex Inc* [2015] AC 430 at [23]-[25].

8.9 But there is no disharmony here: if the regulator had imposed a penalty on the taxpayer, disharmony might have existed. The question of whether the rule which denies a deduction for criminal or quasi criminal penalties applied to civil penalties would then arise and would need to be decided. But where, as here, there was no penalty inherent in the Redress Payments and no one for the taxpayer is trying to say that there was a penalty, both sides, the regulator and the taxpayer, are acting alike and there is no disharmony.

9. The Respondents' arguments may be summarised as follows:

(1) The Redress Payments here in issue are properly deductible for corporation tax purposes. They were deducted in accordance with generally accepted accounting practice, and HMRC have been unable to identify any adjustment required or authorised by law that enables the Redress Payments to be added back when calculating the Respondents' profits for purposes of corporation tax. In particular:

(a) it is apparent from the Statement of Agreed Facts and Issues and the FTT's Decision that the Redress Payments were incurred wholly and exclusively for the purposes of the Respondents' trade; nor is there any statutory provision prohibiting their deduction.

(b) there is no judge-made rule precluding the deduction of the Redress Payments and the establishment of such a rule would trespass on the legislative function of Parliament.

(2) The judge-made rule against the deduction of statutory penalties has no application here: the Redress Payments were expressly and deliberately not statutory penalties;

neither were they in lieu of penalties and, even if they can be described as penalties, they are not the sort of thing referred to in authorities as being non-deductible on the ground that they are penalties.

- (3) The *ex turpi causa* principle likewise has no application here. Not only is there no turpitude in the present case, but the Respondents are not seeking to use their own supposedly turpitudinous conduct as the basis for or as a defence to any claim. They properly deducted the Redress Payment in accordance with generally accepted accounting practice, and it is HMRC that are claiming the right to add those payments back in (so as to tax the Respondents on what is not in fact a profit). Finally, the deduction of the Redress Payments does not create any disharmony in the legal system which the *ex turpi causa* principle is needed to resolve.

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