



Michaelmas Term

[2026] UKSC 35

On appeal from: [2025] EWCA Civ 3

JUDGMENT

**ScottishPower (SCPL) Limited and others
(Respondents) v Commissioners for His Majesty's
Revenue and Customs (Appellant)**

before

Lord Reed, President

Lord Stephens

Lady Rose

Lady Simler

Lord Doherty

JUDGMENT GIVEN ON

21 October 2026

Heard on 18 and 19 May 2026

Appellant
David Ewart KC
Thomas Chacko
(Instructed by HMRC Legal)

*Respondents – ScottishPower (SCPL) Limited; ScottishPower Renewables (UK) Limited;
ScottishPower (DCL) Limited; ScottishPower Energy Retail Limited*
David Goldberg KC
Laura Inglis
(Instructed by Linklaters LLP)

LADY ROSE AND LORD DOHERTY (with whom Lord Reed, Lord Stephens and Lady Simler agree):

1. Introduction

1. The issue in this appeal is whether the Respondents (“ScottishPower”) are entitled, when calculating the profits of their trade for the purpose of the charge to corporation tax, to deduct the sum of about £28 million (“the Redress Payments”) which was paid out to various customers and charities pursuant to settlement agreements made between the Fourth Respondent (“SPERL”) and the energy regulator, the Gas and Electricity Markets Authority (“GEMA”).

2. SPERL was, at all relevant times, the holder of gas and electricity supply licences. The other three Respondents were holders of electricity generation licences. The agreements which required SPERL to make the Redress Payments brought to an end four investigations into ScottishPower carried out by GEMA and the Office of Gas and Electricity Markets (“Ofgem”). Ofgem carries out the day-to-day work of GEMA and investigates matters on GEMA’s behalf. Ofgem found that SPERL had committed serious breaches of several of the licence conditions to which it was subject as a regulated gas and electricity provider, and of the Electricity and Gas (Community Energy Savings Programme) Order 2009 (SI 2009/1905). Pursuant to an intercompany agreement, some of the Redress Payments were borne by the other Respondents.

3. GEMA initially told SPERL that it intended to impose fines as punishment for the breaches, under the powers that GEMA has to impose penalties on regulated persons under section 27A of the Electricity Act 1989 (the “Electricity Act”) and under the corresponding provision of the Gas Act 1986: see section 30A. Those provisions were introduced by the Utilities Act 2000. It is common ground that if GEMA had fined SPERL £28 million, the fine would not be deductible from turnover as an expense when computing profits for the purpose of calculating corporation tax. But ScottishPower argue that GEMA did not impose any significant fine. Instead, SPERL and GEMA agreed that if SPERL made the Redress Payments and took other steps to improve its performance in the future, a nominal fine of £1 would be imposed under each settlement. The Redress Payments were therefore not penalties or fines and, ScottishPower argue, they fall within the definition of deductible expenses.

4. In order to determine the appeal we are required to consider why penalties imposed on a taxpayer are not deductible expenses when computing trading profits; and whether the Redress Payments should also not be deductible.

2. The legislation

(a) The Corporation Tax Act 2009

5. Corporation tax is charged on the profits, that is the income and chargeable gains, of companies: see section 2 of the Corporation Tax Act 2009 (“CTA 2009”). The charge to corporation tax on income applies to the profits of a trade (section 35). Sections 46(1) and 54(1)(a) of the CTA 2009 provide:

“46 Generally accepted accounting practice

(1) The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes. ...

54 Expenses not wholly and exclusively for trade and unconnected losses

(1) In calculating the profits of a trade, no deduction is allowed for—

(a) expenses not incurred wholly and exclusively for the purposes of the trade, ...”

(b) The Electricity Act 1989

6. Section 3A of the Electricity Act, inserted by the Utilities Act 2000 (section 13), provides that the principal objective of GEMA in carrying out their functions under Part I of the Act is to protect the interests of existing and future consumers in relation to electricity conveyed by distribution or transmission systems. Section 4 provides that it is a criminal offence for a person to supply electricity to any premises without a licence, subject to certain exceptions not relevant here. A supply licence can be granted by GEMA under section 6(1)(d) and according to section 7, a licence may include such conditions as may appear to the grantor to be requisite or expedient having regard to the duties imposed. According to section 8A, a licence to supply electricity incorporates by reference every standard licence condition (“SLC”) as set out in section 33(1) of the Utilities Act 2000.

7. The Electricity Act confers various powers on the Secretary of State and GEMA to make orders and regulations. Under section 39, GEMA may, with the consent of the Secretary of State, make regulations prescribing such standards of performance for the supply of electricity, so far as affecting customers or potential customers, “as in the Authority’s opinion ought to be achieved in individual cases”. According to section 39(3), if a supplier fails to meet the prescribed standard “he shall make to any person who is affected by the failure and is of a prescribed description such compensation as may be determined by or under the regulations”. The making of such compensation does not prejudice any other remedy that may be available in respect of the act or omission which constituted that failure: section 39(4).

8. GEMA is responsible for enforcing the licence conditions and other standards. Section 25 provides that where GEMA is satisfied that a regulated person is contravening or is likely to contravene any relevant condition or requirement whether imposed under the Electricity Act or by provisions elsewhere (as listed in Schedule 6A), it shall by final order make such provision as is requisite for the purpose of securing compliance.

9. For our purposes, the relevant obligations imposed on SPERL are the following:

(a) Condition 25 of the SLCs of both the electricity and gas supply licences. This stipulates, amongst other things, that sale representatives must not use misleading or otherwise inappropriate sales techniques when selling or marketing to domestic customers. Representatives must only recommend tariffs that are appropriate to that customer’s characteristics and/or preferences.

(b) Conditions relating to complaints handling. These are imposed by the licence and by the Gas and Electricity (Consumer Complaints Handling Standards) Regulations 2008 (SI 2008/1898).

(c) Condition 27.2A of the SLCs. This requires that the differences in the terms and conditions between different payment methods should reflect the relative costs of the different methods.

(d) Article 14(1) of the Electricity and Gas (Community Energy Savings Programme) Order 2009. This requires suppliers to achieve carbon emissions reduction by promoting specified actions to domestic energy users in areas of low income.

10. Section 26 of the Electricity Act sets out detailed procedural requirements before an order can be made. The procedures include not only giving notice and an opportunity to make representations to the regulated person but also publishing a notice of the

proposal to make the order so as to bring it to the attention of persons likely to be affected by the matters to which the notice relates.

11. If the regulated person is aggrieved by the making of the order and wishes to argue that it was not within the powers conferred by section 25, or that the correct procedure was not followed, it may apply to the High Court in England and Wales or to the Court of Session in Scotland under section 27 for the order to be quashed. Section 27(3) provides that the validity of an order “shall not be questioned by any legal proceedings whatever” other than proceedings under that section.

12. Section 27A, inserted by the Utilities Act 2000, deals with penalties. It provides that where GEMA is satisfied that a regulated person has contravened or is contravening any relevant condition or has failed or is failing to achieve any standard of performance prescribed under section 39, GEMA may impose a penalty of such amount as is reasonable in all the circumstances of the case. There is a procedure set out in subsection (3) for GEMA to follow before imposing a penalty, and when a notice of penalty is given, it must be published in such manner as is appropriate to bring it to the attention of persons likely to be affected by it. Any sums received by GEMA by way of penalty are paid into the Consolidated Fund: section 27A(10).

13. GEMA is also required by section 27B to publish a statement of policy with respect to the imposition of penalties and the determination of their amount. A regulated person who is aggrieved by the imposition of a penalty or by its amount can appeal to the court under section 27E on limited grounds set out in subsection (4). There is a maximum amount of penalty and compensation ordered to be paid, set by section 27O at 10 per cent of turnover.

14. Sections 27G to 27N were inserted into the Act by the Energy Act 2013 and came into force in February 2014. Those sections make express provision for the making of consumer redress orders where GEMA is satisfied that a regulated person has contravened a relevant condition or requirement. That was not the power used by GEMA in the present case. Nonetheless it is accepted that GEMA has the power to enter into the kinds of agreements which included the obligation to make the Redress Payments.

(c) The statement of policy

15. On 6 November 2014, in compliance with its obligation under section 27B of the Electricity Act, GEMA published its Statement of Policy With Respect to Financial Penalties and Consumer Redress (“the Penalties Policy”). It contains the following relevant statements:

(a) When determining a reasonable penalty GEMA will have regard to the level of any redress ordered and/or any redress which is being or has been provided: para 1.5.

(b) GEMA is clear that regulated persons should not benefit financially from any contravention or failure and that financial penalties should act as a significant deterrent to future non-compliance. GEMA will therefore normally seek to ensure that any financial penalty significantly exceeds the gain to the regulated person and the detriment caused to consumers whether individually or as a group affected by the contravention or failure: para 2.4

(c) GEMA will consider any remedial measures that have been put in place but may still impose a financial penalty significantly in excess of the gain or detriment even where the gain or detriment has been mitigated in full. This may be necessary in order to deter non-compliance and provide appropriate encouragement for all regulated persons to comply with their obligations: para 2.5.

(d) Factors to be considered include whether the contravention was deliberate or reckless, and whether the regulated person has a record of previous contraventions: para 4.1.

16. The Penalties Policy also sets out in more detail the process to be followed before a penalty is imposed. GEMA will first calculate the detriment to consumers and the gain to the regulated person where it is practicable to quantify it: paras 5.6 and 5.7. It will then assess the seriousness of the contravention, consider aggravating or mitigating factors and then consider an adjustment for deterrence. GEMA may make such an adjustment where it considers that the penal element of the penalty would be insufficient to deter the regulated person or others from contravening in future: para 5.21.

17. Step 5 of the process set out in the Penalties Policy deals with discounts for settlement. Paragraph 5.23 states that GEMA may offer the regulated person the opportunity to settle the case. The Penalties Policy refers to Ofgem's Enforcement Guidelines (published on 12 September 2014 and updated since then) where the settlement process is set out. Those Guidelines make clear that to settle a case, a company under investigation must be prepared to admit to the breaches that have occurred and that the settlement will lead to a finding of breach. The company will also be expected to agree not to challenge or appeal any finding of breach, penalty or consumer redress order that is agreed to as part of the settlement: paras 5.4 and 5.5.

18. Early settlement has advantages for GEMA, including saving resources for GEMA and the regulated person and getting compensation to consumers sooner. The Penalties Policy says:

“5.24 The Authority therefore considers that in many cases it is likely to be in the interests of consumers for a regulated person to be offered the chance to resolve matters through settlement. In recognition of the benefits of such agreements, the Authority will reduce the penal element of the overall financial liability to be imposed on the regulated person. Such discounts will not apply to any gain and/or detriment that has been identified by the Authority.”

19. It states that the size of the discount will reflect the stage of the process at which agreement is reached, ranging from 30 per cent in the early settlement window, which opens when the draft penalty notice and press notice are served on the company and usually closes after 28 days (see para 5.26 of the Penalties Policy read with para 5.16 of the Ofgem Enforcement Guidelines) to 10 per cent in the late settlement window which opens on expiry of the period for making written representations on the Statement of Case served on the regulated person.

20. Settlement is not entirely at the discretion of the Ofgem case team. The case team is provided with a mandate by the Settlement Committee which comprises two members of GEMA’s Enforcement Decision Panel and a partner of Ofgem. If the case is not settled, then it will be decided by three members drawn from the Enforcement Decision Panel the members of which are GEMA employees who are independent from the case team: para 6.14.

21. On 14 December 2015, Ofgem published guidance on the allocation of voluntary redress payments with the aim of making more transparent the way that such payments are allocated. The payments are made if the party under investigation accepts the case against it and decides not to exercise its right to contest the matter in front of a panel of decision makers. Under Ofgem’s current practice described in the guidance, the company must propose suitable charities, organisations or projects to support. Wherever possible, there should be a link between the breach(es) and the types of beneficiaries. The guidance states that: “A company should not gain benefit, financial or other, from voluntary redress. For example, a company should not derive positive publicity from voluntary redress payments, and voluntary redress payments must be truly additional to any charitable donations made, or expected to be made by that company.”

3. The investigations and settlement agreements

(a) Mis-selling and marketing

22. SLC 25 imposes obligations on energy suppliers in relation to marketing activities. In particular, it regulates doorstep marketing sales. 40% of SPERL’s sales arose from

doorstep marketing. Ofgem investigated SPERL's compliance with SLC 25 and concluded that SPERL did not have robust arrangements in place for training in relation to, and the monitoring of, doorstep sales and telesales. As a result, misleading information had been provided to customers. SPERL accepted that it had breached SLC 25. However, it did not initially agree with Ofgem as to the seriousness of the breach or the quantum of harm caused to consumers. Ofgem suggested a significant penalty and negotiations followed. In the correspondence between ScottishPower and Ofgem leading up to the agreement ScottishPower stated that their understanding was that payments would be made "in lieu of financial penalty" and they asked Ofgem to consider levying no formal penalty at all which Ofgem refused to do.

23. On 10 October 2013 SPERL and GEMA entered into a settlement agreement under the terms of which:

- (a) SPERL agreed to pay £7.5 million to vulnerable customers, identified through SPERL's 2012 Warm Homes Discount scheme;
- (b) SPERL agreed to set aside £1 million to make compensation payments to customers affected by mis-selling;
- (c) SPERL agreed that any money not paid out of the £8.5 million allocated under the two headings above would be paid to ScottishPower Energy People Trust ("SPEPT"), a charitable trust which supported people affected by fuel poverty and over which SPERL had no control; and
- (d) GEMA imposed a £1 penalty on SPERL.

24. Pursuant to the settlement agreement GEMA published a formal Notice of Decision on 4 December 2013. This stated that GEMA found that SPERL was in breach of SLC 25; that the breaches had been admitted by SPERL; and that, while there was no evidence that the contraventions had been deliberate or wilful, they could not be regarded as inadvertent or accidental. The notice also set out factors relevant to the level of the penalty. These included GEMA's views as to the seriousness of the breaches, the duration of the breaches, the degree of harm experienced by customers, and the financial gain made by SPERL as a result of sales tactics in breach of SLC 25.

25. The Notice of Decision stated that the breaches warranted a "significant penalty" but, having regard to SPERL's agreement to pay £8.5 million to consumers, the steps SPERL had taken to put things right and its agreement to settle the investigations, GEMA proposed a penalty of £1. It also stated that the penalty would have been higher if SPERL

had not: agreed a settlement, admitted the breaches, agreed to make payments of £8.5 million to benefit consumers, and taken steps to ensure future compliance.

(b) The costs reflectivity investigation and settlement

26. SLC 27.2A requires that differences in the terms and conditions between different payment methods should reflect their relative costs. This was extremely important to prevent detriment to customers, in particular to vulnerable groups.

27. Ofgem's investigation into SPERL's compliance with SLC 27.2A concluded that it did not have robust procedures in place to justify its price differentials because it did not have a sufficiently robust view of the relative cost of the different payment methods. SPERL eventually accepted that it had breached SLC 27.2A. Negotiations between SPERL and Ofgem followed. On 17 January 2014 Ofgem wrote to SPERL encouraging settlement of the investigation and indicating that lower penalties would be imposed for early settlement, and stating that failure to reach a settlement by 14 March 2014 would "likely result in a higher penalty". On 27 February 2014 Ofgem extended this period to 16 April 2014. Internal Scottish Power correspondence records the progress of discussions over the amount to be paid. An email of 11 March 2014 recites that "if this were to be contested – they would be looking for a fine of £2.5m."

28. On 15 May 2014 SPERL and GEMA entered into a settlement agreement the terms of which resulted in the following action:

(a) GEMA issued a Notice of Decision dated 3 July 2014, stating that SPERL had breached SLC 27.2A but that there was no evidence that there were "deliberate actions in relation to the breach";

(b) SPERL agreed to pay £750,000 to Energy Best Deal Extra, a public awareness campaign run by Citizens Advice; and

(c) GEMA imposed a £1 penalty on SPERL.

29. GEMA's Notice of Decision stated that "the Authority considers it appropriate to impose a financial penalty on [SPERL] of £1". It noted that this penalty was a lower figure than would have been imposed if SPERL had not been willing to engage in the settlement process, had not admitted liability and had not made a payment of £750,000 to Energy Best Deal Extra.

(c) The energy saving CESP Order investigation and settlement

30. This investigation involved all four Respondents. The Electricity and Gas (Community Energy Saving Programme) Order 2009 (the “CESP Order”) required electricity generators and suppliers to achieve reductions in carbon emissions by promoting energy saving actions to domestic customers in low income areas. These were specified in terms of reductions in CO₂ emissions. Each of the Respondents was set a target, and SPERL carried out the delivery of the obligation on behalf of all of them. Pursuant to an inter-company agreement, each accepted part of the cost of such delivery.

31. SPERL outsourced the greater part of these obligations to Carillion but Carillion failed to meet the prescribed targets. As a result, all of the Respondents failed to meet the targets. In May 2013 Ofgem opened an investigation into the Respondents’ compliance with the CESP Order.

32. On 6 November 2014 Ofgem sent the Respondents a without prejudice letter. In a section of the letter headed “Penalty policy on early resolution”, Ofgem set out how an early settlement would attract discounts at differing levels depending on the date of settlement in comparison to a penalty of £3,600,000 which would be sought if the case were contested.

33. On 4 December 2014 SPERL and GEMA entered into a settlement agreement under the terms of which:

(a) GEMA issued a Notice of Decision which stated that SPERL had breached the Order and that GEMA intended to charge a £1 penalty. The Notice of Decision did not suggest that the breach was deliberate and referred to mitigating activity undertaken by SPERL;

(b) £2.4 million would be paid by the Respondents (and another company which has since left the group) to SPEPT; and

(c) GEMA imposed a £1 penalty on SPERL.

(d) The complaints handling investigation and settlement

34. SLC 25C requires suppliers to take reasonable steps to achieve matters such as fair, accurate and prompt behaviour. SLC 27 requires that bills be sent out within 6 months and errors be corrected speedily. The Gas and Electricity (Consumer Complaints

Handling Standards) Regulations 2008 (the “CHRs”) deal with complaints handling standards and procedures and are relevant conditions or requirements applicable to SPERL for the purpose of enforcement by Ofgem pursuant to section 25 of the Electricity Act.

35. In November 2014 Ofgem opened an investigation into SPERL’s compliance with these requirements. SPERL agreed that it had breached its obligations. Before the negotiations with Ofgem had even started, SPERL had written off some £8 million of consumers’ bills in recognition that it had breached its duties and in recognition of consumer harm. SPERL had had problems with billing and complaints handling which arose from the implementation of a new unified computer system in place of some 80 old systems. This was a major task involving some 5 million customer accounts. Ofgem noted that complex projects such as this were “challenging” but considered that SPERL had not done enough to identify and mitigate risks.

36. On 23 March 2015 Ofgem sent SPERL a without prejudice letter which, in a section of it under the heading “Penalty policy on early resolution” mentioned an initial penalty figure of £23 million and set out various discounts for early settlement, including a discount to £18 million if a settlement was reached by 5pm on 25 April 2016. The letter then expressed a view as to whom payments might be made.

37. On 25 April 2016 SPERL and GEMA entered into a settlement agreement pursuant to which:

(a) GEMA issued a Notice of Decision stating that SPERL had contravened some of the conditions and requirements, i.e. SLC 25C, SLC 27.17 and various of the CHRs. The Notice of Decision stated that the breaches were not trivial, but GEMA considered that SPERL had not sought to breach the requirements;

(b) SPERL admitted the breaches and agreed to make £18 million of “consumer redress payments” of which:

(i) compensation of up to £15 million would go to priority or Warm Homes Discount “Qualifying Customers” whose bills had been issued more than 6 weeks late or who had made a relevant complaint. Each would receive between £50 and £150; and

(ii) £3 million plus any of the £15 million which was unused would be paid to charities to be agreed within the next 2 months (and if not agreed to the Treasury via the Consolidated Fund);

(c) GEMA imposed a £1 penalty on SPERL.

38. ScottishPower duly made payments in accordance with all four agreed settlements. The question arising on this appeal is whether or not those payments are allowable deductions because they fall within section 54(1)(a) of the CTA 2009.

4. The caselaw on section 54(1)(a)'s predecessor provisions

39. Where an item of expenditure has more than one purpose, each purpose must have been for the purposes of the trade if the expense is to be deductible under section 54(1)(a). The authorities make it clear that the taxpayer's conscious purpose may not be determinative. When the facts are examined objectively it may be evident that there is another purpose. Where there is a duality of purposes each purpose must be for the purposes of the trade. In this regard it is sufficient to mention three of the leading authorities.

40. An early but much cited case on the purpose test is the decision of the House of Lords in *Strong & Co of Romsey v Woodfield* [1906] AC 448, 5 TC 215 ("*Strong v Woodfield*") and in particular the speech of Lord Davey. The case concerned whether a brewery company which owned and operated an inn could deduct damages and costs paid to a customer of the inn who was injured by a falling chimney, an accident caused by negligent maintenance of the property by employees of the company. The company sought to deduct the damages and costs in the computation of its profits. The relevant section of the Income Tax Act 1842 provided that losses could only be deducted if they were wholly and exclusively laid out or expended for the purposes of the trade: see the speech of Lord Loreburn LC at 452. Lord Loreburn said that losses cannot be deducted "if they are mainly incidental to some other vocation or fall on the trader in some character other than that of trader". He held that the loss was not deductible and Lord Macnaghten agreed, it seems because the loss fell on the company in its character as a property owner rather than as a trader. Lord Davey, in a passage that was quoted in the later cases, stressed that the purpose test required something more than a simple link between the trade and the expenditure: (p 453)

"I think that the payment of these damages was not money expended 'for the purpose of the trade.' These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, &c. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits."

41. In *Mallalieu v Drummond (Inspector of Taxes)* [1983] 2 AC 861 (“*Mallalieu*”) the House of Lords considered whether the appellant’s expenditure on dark clothing to wear at work as a barrister and for related events was deductible. It held that the evidence of her conscious professional purpose or motive did not displace the inference that there was another subconscious non-professional purpose. Lord Brightman stated at p 875:

“... it is inescapable that one object, though not a conscious motive, was the provision of the clothing that she needed as a human being. I reject the notion that the object of a taxpayer is inevitably limited to the particular conscious motive in mind at the moment of expenditure. Of course the motive of which the taxpayer is conscious is of a vital significance, but it is not inevitably the only object which the commissioners are entitled to find to exist. In my opinion the commissioners were not only entitled to reach the conclusion that the taxpayer’s object was both to serve the purposes of her profession and also to serve her personal purposes, but I myself would have found it impossible to reach any other conclusion.”

42. In the subsequent case of *MacKinlay v Arthur Young McClelland Moores & Co* [1990] 2 AC 239 the issue was whether a partnership which wanted partners to move to different offices for business reasons could deduct the cost of arranging and furnishing their houses when they moved. The House of Lords held that it could not. In so far as the expenditure benefited the partners it was not for the purposes of the trade. Lord Oliver of Aylmerton observed at p 255G–H:

“The question in each case is what was the object to be served by the disbursement or expense? As was pointed out by Lord Brightman in *Mallalieu*’s case, this cannot be answered simply by evidence of what the payer says that he intended to achieve. Some results are so inevitably and inextricably involved in particular activities they cannot but be said to be a purpose of the activity. Miss Mallalieu’s restrained and sober garb inevitably served and cannot but have been intended to serve the purpose of preserving warmth and decency and her purpose in buying cannot but have been, in part at least, to serve that purpose whether she consciously thought about it or not.”

5. The case law on why penalties are not deductible

43. A consideration of the case law on the non-deductibility of penalties can begin with *Inland Revenue Commissioners v Warnes & Co* [1919] 2 KB 444 (“*Warnes*”). The

defendant company was subject to a penalty for failing to take care to ensure that a consignment of oil shipped by them to Norway did not fall into enemy hands during the First World War. A penalty of £2,000 was ordered by the court after the parties reached a settlement, that sum to cover the costs of the Crown. This is described in the report at p 445 as a “mitigated penalty” consented to by the taxpayer on the basis that “all imputations as to the respondents’ moral culpability” were withdrawn and that it was made clear to the public that there had been no deliberate infringement by the company, only carelessness. The question later arose whether the penalty sum, together with the costs incurred by the company in defending proceedings brought by the Attorney General, was deductible in arriving at the profits of the trade or business. In a short judgment, Rowlatt J held those sums were not deductible. They were not losses connected with or arising out of a trade. He acknowledged that it was difficult to “frame any formula which shall describe” such a loss but he was sure that this was not such a loss, because to qualify for deduction a loss must be “contemplatable and in the nature of a commercial loss” (p 452). His sentiment to the effect that it is difficult to say *why it is not* deductible but that it certainly *is not* deductible is echoed in the statements of later judges who have also struggled to light upon a rationale to explain the conclusion that they have had no hesitation in reaching.

44. In 1920, less than a year after *Warnes*, the issue came before the Court of Appeal in *Inland Revenue Commissioners v Alexander von Glehn & Co Ltd* [1920] 2 KB 553 (“*von Glehn*”). That also concerned a penalty that was imposed following the settlement of court action brought by the Attorney General to recover penalties said to be due because the taxpayer had exported goods to Russia without making the necessary declaration as to the ultimate destination of the goods. The taxpayer sought to deduct both the sum of £3,000 and its costs of defending the proceedings.

45. The Court of Appeal approved Rowlatt J’s judgment in *Warnes*. The taxpayer argued that they were in effect being penalised twice – once by having to pay the penalty and once by not being able to deduct it from profit and so paying more tax. Lord Sterndale MR referred to various rules on the computation of profits for a trade including Rule 1 which provided that sums were not deductible “not being money wholly and exclusively laid out or expended for the purposes of such trade...” (p 563). Having considered various rules which might be relevant to determine the issue, he held as follows: (p 565)

“I prefer to decide the case upon Rule 1, which applies to profits of trades and also to professions, employments, or vocations. I think that the payment of these damages was not money expended ‘for the purpose of the trade.’ These words are used in other rules, and appear to me to mean for the purpose of enabling a person to carry on and earn profits in the trade, etc. I think the disbursements permitted are such as are made for that purpose. It is not enough that the disbursement is made in

the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade.”

46. In the case before him, he said, the business could perfectly well be carried on without any infraction of the law. The penalty was imposed because of an infraction of the law, and it was not a disbursement or expense which was laid out or expended for the purpose of such trade. Nor was it a sum paid on account of a loss connected with or arising out of such trade: p 565. The company had committed a breach of the law and for that they were fined: (p 566)

“That, as it seems to me, was not a loss connected with the business, but was a fine imposed upon the company personally, so far as a company can be considered to be a person, for a breach of the law which it had committed. It is perhaps a little difficult to put the distinction into very exact language, but there seems to me to be a difference between a commercial loss in trading and a penalty imposed upon a person or a company for a breach of the law which they have committed in that trading.”

47. Warrington LJ first made clear that the question whether the amount was deductible or not must be determined by the rules regulating the assessment of income tax and not by rules regulating what may be allowed in the preparation of the company’s profit and loss accounts: p 567. He also addressed whether the deductions were wholly and exclusively laid out or expended for the purposes of the trade. He cited the passage from Lord Davey’s speech in *Strong v Woodifield* and held that the penalty was not one laid out or expended wholly and exclusively for the purposes of trade: p 569–570.

“Now it cannot be said that this disbursement was made in any way for the purpose of the trade or for the purpose of earning the profits of the trade. It was made, ... because the individuals who were conducting the trade had not from any moral obliquity but had unfortunately been guilty of an infraction of the law.”

48. Warrington LJ also recorded that the taxpayer had submitted that deductibility was a question of fact and had been decided in the taxpayer’s favour by the Commissioners. He rejected that argument: (p 570)

“In my opinion that is a misapprehension, first, of what is a question of fact and what is a question of law, and also of the real finding of the Commissioners. It seems to me that whether

or not a particular sum is, according to the true construction of the Income Tax Acts, a sum which is to be deducted from the gross amount of a man's profits is a question of law, but it has to be decided of course upon the facts which are found by the tribunal to whom the ascertainment of the facts is intrusted. But whether that sum is deductible or not is a question of law, and I think the Commissioners have so treated it in the present case."

The Commissioners, he said, had found the facts as to what happened but they had not purported to express their finding that the sums were deductible as a finding of fact.

49. Scrutton LJ also echoed the difficulty of putting into words the reasoning behind what he thought was the obvious answer; that the sums were not deductible: "But as Lord Macnaghten once said in the House of Lords, the clearer a proposition is the more difficult it often is to find authority in support of it; and when one comes to state the reasons why that obvious answer should be given perhaps it is not so easy as saying 'Of course he cannot.'" (p 571). He cited the statement of Lord Davey in *Strong v Woodfield* and concluded that the penalty and legal costs were not paid for the purpose of earning the profits but were "unfortunate incidents which followed after the profits had been earned" (p 572).

50. We pause to note that both "penalties" held not to be deductible in *Warnes* and *von Glehn* were in fact payable as the result of a consent order made following the settlement of proceedings brought by the Attorney General. Indeed, under the settlement in *von Glehn* there appears to have been no actual finding that the alleged infringements had taken place since the £3000 was paid "upon terms of the record being withdrawn": see p 555 of the law report. Lord Sterndale also records that at the hearing it was agreed that the taxpayer had no defence under the provision, but that there was no judgment recorded against the appellants. They submitted to pay the £3000: p 562. It does not appear to have been argued in either case that the payments were therefore voluntary in some way. They were treated as penalties just as if they had been imposed after the Attorney's success in the proceedings.

51. Next, we come to *Herald and Weekly Times v Federal Commission of Taxation* (1932) 48 CLR 113 (HCA) ("*Herald and Weekly Times*"), a decision of the High Court of Australia. That case did not concern penalties; rather the sums in dispute were paid as compensation, either before or after judgment, to people who had claimed damages in respect of libels alleged to have been published in the taxpayer's newspapers. They also included the costs of contesting the claims or of obtaining advice about them. Gavan Duffy CJ and Dixon J in a joint judgment noted at p 117 that in order for the sum to be deductible, it was necessary to show both that it was a revenue outgoing "actually incurred in gaining or producing the assessable income" and also that it was "wholly and

exclusively laid out or expended for the production of assessable income”. They also noted (p 117) that the lower court had:

“... assumed that to a greater or less degree it is an inevitable consequence of the conduct of an evening newspaper that actionable wrongs should at times be committed, and that in other cases claims will be made based upon allegations that such wrongs have been committed, sometimes without foundation.”

52. The High Court stated that none of the libels was published with any other object in view than the sale of the newspaper. The expenditure flowed (p 118) “as a necessary or a natural consequence from the inclusion of the alleged defamatory matter in the newspaper and its publication.” The joint judgment distinguished *von Glehn* on the basis that (p 120):

“The penalty is imposed as a punishment of the offender considered as a responsible person owing obedience to the law. Its nature severs it from the expenses of trading. It is inflicted on the offender as a personal deterrent, and it is not incurred by him in his character of trader.”

53. Rich J agreed that publication of the newspaper was at the same time the source of income and the cause of liability so that the necessary connection existed between the carrying on of the business and the expenditure. McTiernan J said that the question whether the expenditure was incurred wholly and exclusively must be decided as a matter of fact in each case. The judge’s finding that the expenditure was an unavoidable consequence of carrying on the business of printing and publishing the appellant’s newspaper should have been conclusive of the question whether the money was wholly and exclusively laid out or expended by the appellant to get its income.

54. It may be observed that *Herald and Weekly Times* has been distinguished more than it has been applied. In *Fairrie v Hall* [1947] 2 All ER 141 where the taxpayer sought to deduct damages and costs incurred for having maliciously libelled a commercial rival, Macnaghten J held that it would be “preposterous” if the taxpayer were allowed to deduct these sums from his assessment.

55. More recently and closer to home, *Herald and Weekly Times* was relied on before the First-tier Tribunal (Tax Chamber) in *G4S Cash Solutions (UK) Ltd v Revenue and Customs Commissioners* [2016] UKFTT 239 (TC); [2016] STI 2207. That concerned whether parking fines totalling over £300,000 paid by a company engaged in delivering cash to and collecting cash from customers’ premises were deductible. The company

argued that it was essential for them to park their vans as close to the premises as possible to ensure the safety of their staff, the customers, bystanders and anyone else who might be caught up in any problem that arose. The tribunal accepted at para 142 that the incurring of parking fines was connected with the taxpayer's trade but they concluded that their incurrence was not for the purpose of the trade. The fines were not paid for the purposes of the trade but because the taxpayer had a statutory liability to pay them: para 238.

56. The principal more recent authority on this issue is *McKnight v Sheppard* (1999) 71 TC 419 ("*McKnight*"). This case, and in particular Lord Hoffmann's analysis of the reasoning in *von Glehn*, was the focus of detailed submissions before us. Mr Sheppard was a stockbroker found guilty by the Stock Exchange Council's Disciplinary Committee of four charges of gross misconduct. He was suspended from practice. His appeal to an Appeals Committee was allowed in part but two findings of gross misconduct were upheld. The suspension was replaced by fines totalling £50,000. He incurred legal fees of about £200,000 in connection with the disciplinary proceedings and appeal. The special commissioner held that the legal fees were expended wholly and exclusively for the purposes of Mr Sheppard's trade and so were deductible but the fines were not. The High Court (Lightman J) [1996] STC 627 held that neither was deductible. Mr Sheppard appealed to the Court of Appeal only in respect of the legal fees and did not challenge further the non-deductibility of the penalty. The Court of Appeal (Nourse, Potter and Mummery LJ) allowed Mr Sheppard's appeal, holding that the fees were deductible because they were wholly and exclusively expended for the purposes of his trade and not precluded from deduction by the relevant legislative provisions: [1997] STC 846.

57. The House of Lords dismissed the Crown's appeal: [1999] 1 WLR 1333. Lord Hoffmann, with whom Lord Mackay of Clashfern, Lord Clyde, Lord Hutton and Lord Hobhouse agreed, summarised the question simply as whether the legal costs were money wholly and exclusively laid out or expended for the purposes of the trade. The special commissioner had found as a fact that the taxpayer's exclusive purpose in laying out the legal costs was to preserve his trade which would have been destroyed by expulsion or suspension from the Stock Exchange. The Crown argued before the House that the taxpayer had had two purposes: to preserve his trade but also to preserve his personal reputation. This, however, was contrary to the findings of the special commissioner that, although the taxpayer had been concerned about his reputation, that was not the purpose for which the money was spent.

58. Lord Hoffmann referred to Lord Brightman's speech in *Mallalieu* emphasising that the important consideration is the purpose or object of the taxpayer in spending the money, not on any unavoidable effect or benefit accruing to the taxpayer as a result.

59. The Crown's other point was that there was no sufficient connection between the fees and the earning of profits, relying on *von Glehn*. Lord Hoffmann did not doubt that

the decision in *von Glehn* was correct. He rejected the reasoning of Scrutton LJ that the penalties were incurred “after the profits had been earned” since that simply restated the conclusion that they could not be deducted in the calculation of the profits rather than providing a reason for that conclusion: p 1337F.

60. Lord Hoffmann said that the Court of Appeal in *von Glehn* had accepted that the penalty “was incurred in the course of the company’s trade”. He inferred from this that there must have been something in the nature of the expense which prevented it from being deductible. He went on: (p 1337H–1338A)

“I think with great respect that the Court of Appeal had difficulty in identifying exactly what this was because they were looking in the wrong place. They hoped to find the answer in the broad general principles of what counts as an allowable deduction. But the reason in my opinion is much more specific and relates to the particular character of a fine or penalty. Its purpose is to punish the taxpayer and a court may easily conclude that the legislative policy would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of tax. This, I think, is what Lord Sterndale M.R. meant when he said that the fine was imposed ‘upon the company personally.’”

61. Lord Hoffmann concluded that the courts below had been right in not allowing the fines to be deducted. But once it was appreciated that the non-deductibility of the fines “depends upon the nature of the expenditure and the specific policy of the rule under which it became payable” the same did not necessarily apply to the legal costs. There was no reason of policy prohibiting the deduction of those damages in the earlier case and nor, he held, was there any policy prohibiting the deduction of fees by Mr Sheppard. On the contrary, non-deductibility of fees for resisting disciplinary proceedings would amount to an additional penalty for which the regulatory scheme did not provide.

62. *McKnight* does not cast doubt on the principle that penalties are not deductible. The case was about the legal fees incurred not the penalties themselves, and Lord Hoffmann made clear that he thought the decisions of the courts below in that case upholding the Revenue’s disallowance of the penalties was correct. But ScottishPower in the present appeal seek to uphold the Court of Appeal’s reasoning to the effect that the principle on which deductibility is precluded for penalties is a particular policy reason underlying the legislation creating the penalty. They maintain that this policy applies regardless of whether the penalty might otherwise properly be regarded as having been incurred wholly and exclusively for the purpose of the taxpayer’s business. They argue as regards the Redress Payments that they too are incurred wholly and exclusively for the

purpose of their trade but that there is no policy requiring their disallowance as there would be if they had been penalties.

63. The reappraisal in *McKnight* of the reasoning in *von Glehn* was considered by the Upper Tribunal (Tax and Chancery Chamber) (Warren J and Judge Sinfield) in *McLaren Racing Ltd v Revenue and Customs Commissioners* [2014] UKUT 269 (TCC); [2014] STC 2417. That case concerned a sum which was clearly imposed as a penalty on the well-known Formula 1 racing team for breach of a code imposed by the relevant governing body for the conduct of motor racing events. McLaren's chief designer had wrongly obtained and used confidential design information about the car of a rival team. The tribunal said that before considering whether the penalty was not allowable as an expense, they had to decide what McLaren's trade was. They held that the cheating for which McLaren had been fined was not part of its trade: para 61. They rejected a *Herald and Weekly Times* type argument that it was "an occupational hazard" and hence unavoidable that employees might sometimes overstep the mark and act in a way that put McLaren in breach of the rules: para 62.

64. The tribunal then turned to Lord Hoffmann's analysis in *McKnight* in which he had made clear he agreed with the lower courts that the penalty in that case was not deductible (though he held that the legal expenses were deductible). They held that the penalty in this case was clearly designed to punish McLaren: "it could hardly be maintained that exclusion from the championship would be other than a punishment; the payment of a large fine to avoid that punishment can only be seen, we consider, as acceptance of an alternative punishment" (para 70). They summarised their conclusion that the penalty was not deductible on the basis that it was not an expense of carrying out an activity in the course of a trade; it did not have the sole purpose of preserving the trade so was not wholly and exclusively laid out for that purpose, and even if the sole purpose had been to preserve the trade, the nature of the penalty was such as to prevent its deductibility.

6. The decisions below

65. The First-tier Tribunal (Judge Hellier and John Woodman) issued their decision on 4 February 2022: [2022] UKFTT 41 (TC); [2022] SFTD 576. At para 30 the tribunal recorded some useful information about Ofgem's practice. They found that from about 2010, Ofgem's approach changed from imposing penalties to seeking settlement agreements involving substantial consumer redress payments coupled with a nominal penalty. Thus in 2010 some £15 million of penalties were imposed with no redress payments and in 2019 the penalties imposed were some £2 million but redress payments were some £50 million. This change, the tribunal noted, was reflected in a number of statements made by Ofgem after 2010 where it stated that redress payments would be of greater benefit to consumers than the imposition of a penalty. The tribunal also said that the process of settlement of an investigation "involved hard fought negotiation: there were

generally differing views as to whether there had been breaches, which customers had been affected and the detriment (if any) suffered by them” (para 34).

66. The tribunal said that SPERL had not been compelled to make a settlement agreement by force of law or physically. But in each case it chose to make a settlement to avoid the risks inherent in litigation, the possible adverse effects on its reputation of a large penalty and the diversion of management time in bringing the investigation to a close or litigating the penalty. Further, the tribunal found at para 137 that in each case had the payment not been agreed, it is likely that even after any appeal, a penalty of the same order of magnitude as the settlement amount would have been borne: “In this sense we regard the settlements to have been made in place of what might have been imposed and so to have avoided a penalty larger than £1.”: para 138.

67. The tribunal described the four investigations and how they were resolved and then discussed the case law on the deductibility of a penalty. Having considered Lord Hoffmann’s reasoning in *McKnight*, they concluded that “there is a rule of statutory interpretation which requires the disallowance of the expense of a penalty if it has been imposed to punish the taxpayer and does not compensate another person”: para 80.

68. They also thought it was clear that GEMA intended the obligations to make the Redress Payments to be punishments: para 134. That meant that the same public policy which denied the deduction for a penalty also denied a deduction for punishing non-compensatory payments which arise from a breach of statutory conditions and which are made in avoiding a larger penalty under the aegis of the body which would have imposed such a penalty.

69. The tribunal went on to consider whether any of the Redress Payments were compensatory. Most of them they held were not compensatory but the £554,013 paid to customers affected by mis-selling by way of cheque or credits was compensation. The payments were “akin to damages for breach of a tortious obligation not to mislead them”: see paras 147–150.

70. The tribunal then moved to discuss whether the compensatory payments were incurred wholly and exclusively for the purposes of the trade. They concluded at paras 171 and 172 that the expense of the compensatory Redress Payments (that is to say the £554,013) was incurred wholly and exclusively for the purposes of the trade and further if they were wrong to conclude that policy reasons precluded the deductibility of the other payments, then those payments also fell within section 54. They therefore allowed the appeal in relation to the £554,013 but dismissed it in relation to the other payments.

71. Both HMRC and ScottishPower appealed to the Upper Tribunal (Miles J and Judge Raghavan) which delivered its judgment on 5 September 2023: [2023] UKUT 218 (TCC); [2023] STC 1579.

72. The Upper Tribunal analysed the case law in detail. They considered the taxpayers' argument that the non-deductibility of penalties arose from an "adjustment required or authorised by law in calculating profits for corporation tax purposes" within the meaning of section 46(1) CTA 2009. They rejected the submission that this was what was decided in *McKnight* and said that the issue in *McKnight* was whether the payment was "for the purposes of the trade" under section 130(a) of the Income and Corporation Taxes Act 1970 (which was the predecessor to section 54 CTA 2009): para 51. They said:

"Lord Hoffmann [in *McKnight*] did not take himself to be creating some kind of extra-statutory, judge-made rule of law. He was simply engaged in the orthodox, conventional, task of construing the material part of the statute (s.130(a)) and applying it to the relevant facts. Nor did Lord Hoffmann suggest that this interpretation of s.130(a) involved an exception to the established rule about profits being calculated by reference to accounting principles. The treatment to be given to penalties (as falling outside s.130(a)) is not a matter of calculation; the principle is that payments of penalties are not within s.130(a) at all."

73. They held that Mr Goldberg KC's submissions about the formal features of the Redress Payments would favour form over substance. They therefore held that the tribunal had erred in distinguishing between punitive payments and compensatory ones – the focus should have remained on whether overall the payments bore the necessary punitive character. Where, as here, the payments were "part of an overall package" a global assessment of all the circumstances was necessary. The tribunal had been entitled to conclude that the agreements were entered into under the threat of penalties far greater than £1 and were properly to be characterised as being made in place of penalties and having the character of penalties.

74. Turning to HMRC's appeal, the Upper Tribunal noted that HMRC did not dispute the tribunal's finding that the £554,013 "was in a sense compensatory": para 95. But they concluded that that sum was part of the full package negotiated as part of an overall deal. They therefore allowed HMRC's appeal holding that none of the Redress Payments was deductible.

75. The Court of Appeal [2025] EWCA Civ 3; [2025] 1 WLR 2225 allowed ScottishPower's appeal and held that all of the Redress Payments were deductible. Falk

LJ gave the main judgment with which Snowden and Zacaroli LJ agreed. The Court of Appeal's analysis focused on which party was right as to the principle established by the House of Lords in *McKnight*.

76. Falk LJ held that the Court of Appeal's decision in *von Glehn* established that a penalty or fine incurred under a statutory regime such as the one considered in that case was not deductible in computing trading profits, even where it was incurred in the course of trading activities. In *McKnight*, Lord Hoffmann had explained this in terms of the "legislative policy" otherwise being diluted, because the taxpayer would be "allowed to share the burden with the rest of the community" by a tax deduction (para 49). The legislative policy to which he referred could only be the legislation under which the fine or penalty was imposed. It was not straightforward, she said, to interpret section 54(1)(a) as encapsulating that principle (para 50). The focus of section 54(1)(a) is usually the taxpayer's purpose or object in incurring the expenditure not the character or nature of the payment. She recognised that there were two possible ways to resolve this. The first was to construe section 54(1)(a) so that expenditure to meet fines or penalties is simply not to be regarded as incurred "for the purposes of the trade". There was support for that in *von Glehn* and it might explain *Herald and Weekly Times*.

77. The alternative explanation was that the rule established in *von Glehn* should now be regarded as an adjustment required by law within section 46(1) CTA 2009. That, she concluded, was the better analysis: para 51. The judgment in *NCL Investments Ltd v Revenue and Customs Commissioners* [2022] UKSC 9; [2022] 1 WLR 1829 recognised at para 29 that such an adjustment could arise as a "judge-made rule" which adjusts properly computed accounting profits. By enacting section 46, Parliament recognised that restrictions may exist which do not have an express statutory basis and are instead found to exist by case law: para 54

"In this case the principle established by *von Glehn*, many years before either s.46 or its statutory predecessor (s.42 of the Finance Act 1998) was enacted, may be regarded as a recognition by the courts that when computing profits for tax purposes an adjustment must be made to prevent a deduction being obtained for fines or penalties imposed by a statutory regime, notwithstanding that the expenditure would otherwise be taken into account in determining profits in accordance with generally accepted accounting principles. An adjustment is required because otherwise the 'legislative policy [of the penalty regime] would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of tax'."

78. Falk LJ held that there were no considerations of policy which required that a principle that prohibits the deduction of penalties must extend to payments which are not in fact penalties and such a conclusion could be seen as going beyond the proper role of the judiciary: para 61. She expressed concern about the lack of clarity that an extension of the principle would create. She rejected the policy imperative of ensuring that there was no difference between the tax treatment of penalties and alternative forms of redress and affirmed that, in any event, it would properly be for Parliament and not for the courts to develop such a rule: para 64.

7. Are the Redress Payments deductible?

79. The Court of Appeal's conclusion followed from the following steps:

(a) They understood *von Glehn* and *McKnight* as deciding that even though penalties are wholly and exclusively incurred for the purposes of the trade (within the meaning, now, of section 54(1)(a)), they are still not deductible.

(b) That must be because of some judge-made rule which requires or authorises an adjustment to be made in calculating profits for corporation tax purposes within the meaning of section 46(1).

(c) That judge-made rule is different from the general principles governing the scope of section 54(1)(a) because it depends on the purpose of the legislation which empowers the regulator to impose the penalty, whereas the application of the test in section 54(1)(a) generally depends on the purpose of the taxpayer in making the payment.

(d) Since that is a judge-made rule, it must be construed narrowly and should not be extended by judicial decision to sums which are not strictly penalties; that is a matter for legislation.

(a) Why are penalties not deductible?

80. We start by making clear that our consideration of *McKnight* in the following paragraphs extends only to the discussion in that case as to why penalties are not deductible. The question of whether legal fees or other expenses incurred in resisting disciplinary proceedings are deductible is not raised in the present appeal.

81. It is clear on the authorities that penalties are not deductible. In our view it is also clear that the reason they are not deductible is that they are not incurred for the purposes of the trade. They represent expenditure of a very different nature. They are punishments imposed because of wrongs which the taxpayer has committed. Their object is to punish the offender and to deter him and others from engaging in such behaviour. The taxpayer's object in paying the penalty is not to carry on the trade, but to answer for his breach. In our judgment that is tolerably clear from the judgments of the Court of Appeal in *von Glehn*. No doubt it would have been possible for those judgments to have explained the point more clearly, but we think that Lord Hoffmann overstated the position when he described them as being "curiously inarticulate about why the fine was not money expended for the purposes of the trade" (*McKnight* at p 1337C). Lord Sterndale MR distinguished between losses connected to the business and fines imposed on the taxpayer "personally" (p 566). Similarly, Warrington LJ contrasted a commercial loss incurred by the business with a sum which "the persons conducting the trade have had to pay because in conducting it they have so acted as to render themselves liable to this penalty." (p 569).

82. All three judges were at pains to stress that although they accepted that the penalty was paid *in the course of* the taxpayer's trade, that was not enough for it to be treated as made *for the purpose of* that trade: see the passages cited in paras 45 to 49 above from the judgments of Lord Sterndale MR, Warrington LJ and Scrutton LJ. In that, they relied on the statement of Lord Davey in *Strong v Woodifield* (p 453) that "It is not enough that the disbursement is made in the course of, or arises out of, or is connected with, the trade, or is made out of the profits of the trade. It must be made for the purpose of earning the profits". The nature of the disbursement in *Von Glehn* was such that it was not made for the purpose of earning profits. Moreover, we would be reluctant to dismiss any of the formulations discussed by the Court of Appeal in *von Glehn* as never being likely to be helpful in ascertaining whether an expense is for the purposes of the trade. As cases since then have shown, while no single test is likely to be of help in every case, depending upon the facts, one or other of them may be helpful.

83. In any case, *McKnight* confirms that it is the nature of penalties which results in expenditure to meet them not being for the purposes of the trade. In other words, as a matter of construction of section 130(a) of the 1970 Act, and now of section 54(1)(a) of the CTA 2009, expenditure made on penalties is not expenditure incurred for the purposes of the trade.

84. At pp 1337H–1338A Lord Hoffmann observed in relation to the particular character of a fine or penalty:

"Its purpose is to punish the taxpayer and a court may easily conclude that the legislative policy would be diluted if the taxpayer were allowed to share the burden with the rest of the community by a deduction for the purposes of tax. This, I think,

is what Lord Sterndale MR meant when he said that the fine was imposed ‘upon the company personally.’”

85. It was the reference to policy in this passage which led the Court of Appeal in the present case to conclude that the basis for the non-deductibility of penalties was a judge-made rule which applied even though the payments were properly regarded as made for the purposes of the trade. In our judgment, that was a misreading of Lord Hoffmann’s reasoning. His reference to dilution of punishment simply pointed to a likely consequence if penalties were to be deductible. There is no doubt that Lord Hoffmann proceeded on the basis that the correct construction of section 130(a) of the 1970 Act was that expenditure on penalties was not money laid out or expended for the purposes of the trade. That was because of their nature. He was not introducing or relying upon any policy-based, judge-made rule.

86. We do not accept that there is any inconsistency between that construction and the authorities that focus on the purpose of the taxpayer when applying the test in section 54(1)(a). The intention of the legislature in conferring power to impose a penalty as part of a regulatory regime and the intention of the regulator in imposing a penalty in a particular case may be relevant to the later question of whether a payment is in the nature of a penalty. But it does not affect the purpose of the taxpayer in making the payment. That purpose is to satisfy a legal obligation which arises usually under statute to punish the taxpayer for infringing rules which bind him in the conduct of his trade. That is the taxpayer’s purpose in making the payment and it is that purpose which, on the true construction of section 54(1)(a), is not a purpose of the trade.

87. There are policy reasons which support construing section 54(1)(a) as excluding penalties. As Lord Hoffmann recognised, one of them is that it would be unfair to the public for the taxpayer to be able to share the financial burden of the penalty with them, or, to put it another way, that it would dilute the effect of the penalty if it was not subject to tax. We do not agree that an appropriate response to this would be for the regulator to consider grossing up the amount of the redress payment to counteract the effect of the more beneficial tax treatment: see Falk LJ’s suggestion in para 63. Aside from the question whether that would be a relevant factor in public law terms for a regulator to take into account to increase the payment, it would be difficult for a regulator to anticipate either how the taxpayer would ultimately treat the payment in its accounts, or how HMRC would respond to it.

(b) Are the Redress Payments akin to penalties and so not deductible?

88. Having decided that penalties are not deductible because they are not incurred “for the purposes of the trade” within the meaning of section 54(1)(a), we turn to the key

question which is whether the Redress Payments are to be treated in the same way as penalties or not.

89. On this point the findings of the tribunal were clear and inevitable. ScottishPower describe the Redress Payments as voluntary. We do not accept that characterisation of the Redress Payments. It is true that SPERL was not compelled to enter into the settlement agreements. But it is also clear that if it had not done so, it would have faced fines of the same or similar amounts. The finding of the tribunal on this point was as follows: (para 137)

“137. ... No penalty (other than £1) was actually imposed and the penalty Ofgem said it would charge in the absence of settlement would be subject to appeal and could end up being lower. But it seems to us that in each case had a payment not been agreed it is likely that, even after any appeal, a penalty of the same order of magnitude as the settlement amount would have been borne because it seems unlikely, in view of Ofgem’s attitude and the way the witnesses described SPERL’s aims in settlement, that SPERL would have settled if it had been given robust advice that only a very much smaller sum would have been successfully imposed.

138. In this sense we regard the settlements to have been made in place of what might have been imposed and so to have avoided a penalty larger than £1.”

90. That observation also indicates the counterintuitive result that would arise if Redress Payments were treated differently from penalties. A regulated person caught ‘bang to rights’ is more likely to agree to settle quickly once advised that there is no hope of disputing the existence of a breach. A regulated person whose alleged infringement is more borderline may prefer to force GEMA to impose a penalty which can then be challenged on appeal rather than settle since, as we have described, this involves admitting the breach and giving up the right to challenge GEMA’s decision: see para 17 above. It would be unfair for the former to be able to deduct the payments from tax whereas the latter cannot. We do not accept the criticism that this is assessing on the basis of what did not happen rather than what did happen. It is simply confirming that, as a matter of substance rather than form, the Redress Payments actually paid here are akin to penalties and are governed by the same principles.

91. We also reject ScottishPower’s submission to the effect that the Redress Payments are not like penalties but are instead akin to payments made by a taxpayer by way of compensation to a counterparty for the taxpayer’s breach of contract. The contract here,

they say, is the licence that is granted by GEMA to SPERL to enable them lawfully to supply electricity.

92. We observe first that the energy saving breach was not of a licence condition but of a statutory instrument. But it is important to address the principle as regards breaches of the licence conditions.

93. The licence conditions are not, in our judgment, like a contract, they are more like a statutory obligation. This is not a private law remedy and was not intended to restore the counterparties to the individual electricity supply contracts or GEMA to the position they would have been in but for the breach. The settlement negotiated by Ofgem with SPERL was approved by GEMA's Settlement Committee and recorded in decision notices published by GEMA. Those decision notices establish the direct link between the Redress Payments and the penalty that would have been imposed if the Redress Payments had not been agreed and paid. They recorded:

- (a) that breaches of the relevant obligations had been found by GEMA.
- (b) that GEMA had decided that it was appropriate to impose a financial penalty in the particular investigation and in some cases that it warranted a significant penalty.
- (c) that GEMA had considered all the circumstances of the case in deciding the level of the financial penalty as required by the Penalties Policy, including the importance of deterrence and of incentivising compliance with the conditions.
- (d) whether GEMA found that SPERL had gained financially or otherwise from the breaches either by winning customers away from competitors by their unfair practices or by not devoting sufficient company resources to compliance procedures.

94. We have no doubt that the Redress Payments are sufficiently akin to penalties for it to be clear, on the basis of the case law we have discussed earlier, that they were not expenditure incurred for the purposes of ScottishPower's trade within the meaning of section 54(1)(a). Like the payments made in *Warnes* and *von Glehn* (as to which see para 50 above), they were made to avoid the imposition of substantial penalties. The fact that, as Mr Goldberg pointed out, the money goes to recipients selected by GEMA rather than to the Consolidated Fund to which penalties are paid does not change the nature of the payments. Nor does it matter that under generally accepted accounting practice they would be included as expenses in ScottishPower's accounts: see the qualification

contained in section 46(1) and the observation of Warrington LJ in *von Glehn* at p 567 (referred to at para 47 above).

95. Falk LJ raised the difficulty of distinguishing between the Redress Payments and other expenditure incurred by SPERL to bring itself into compliance with the rules it had infringed and, for example, to anticipate the results of the investigation by taking steps to resolve its customer service issues: see paras 68 and 69. However, the questions said to arise about the deductibility of such expenditure would arise just as much if the result of the investigation had been the straightforward imposition of penalties, if SPERL had not ultimately been able to reach a settlement with GEMA. Everyone accepts that such penalties would not be deductible. There may be cases where there is a difficult dividing line to draw between sums expended at the close of the investigation and sums expended to pre-empt or appease the regulator at an earlier stage. HMRC will make its own assessment as to which side of the line the expenditure lies and, if necessary, the tribunal will determine any challenge. But this case is not such a case – no one has suggested that there is any difficulty in identifying the value of the Redress Payments set out in Ofgem’s decision notices or distinguishing them from other expenditure incurred by ScottishPower to put matters right.

96. ScottishPower rely on *Herald and Weekly Times* to argue that the tribunal found that some of the breaches were practically unavoidable. At para 164, the tribunal said that not all the failures were wholly unavoidable; but they recognised that the very act of carrying on a business puts a taxpayer at risk of mistakes being made in conducting that business. They acknowledged that to be true, in particular, in respect of the complaints handling and billing investigation. By appointing reputable, able consultants and managing the process of transition to the new system slowly, they thought SPERL had taken reasonable steps to avoid difficulties: “The problems arose in part at least from the (in)actions of others. Where those others were reputable consultants they may reasonably be described as almost unavoidable.”: para 166.

97. *Herald and Weekly Times* was not concerned with penalties or redress payments imposed under a regulatory regime but with tortious damages. Whatever may be its continued relevance to the deductibility of defamation damages, it has no place in assessing whether penalties or redress payments are tax deductible. The GEMA decision notices considered various factors tending to increase or decrease the level of the penalty including the involvement of senior management, or whether the breach or possibility of breach would have been apparent to a diligent licensee. Factors tending to reduce the level of penalty were whether the contravention was trivial in nature and “evidence that the contravention or failure was genuinely accidental or inadvertent”. SPERL’s culpability has therefore already been factored into the arriving at the amount of the Redress Payments, and it is not appropriate for it to play any role in determining whether those Payments should now be excluded from corporation tax.

98. As we are of the view that a consequence of the nature of the Redress Payments is that they were not incurred for the purposes of the trade we do not need to consider the issue of duality of purpose.

99. Finally, we agree with the Upper Tribunal's decision, allowing HMRC's appeal on this point, that it is not right to treat the £554,013 payment in respect of consumers directly affected by the mis-selling infringements differently from the other sums. That sum was not, in our judgment, akin to damages for breach of a tortious obligation but was as much a punishment for breaches of the conditions as the other sums. We agree with the Upper Tribunal's description of the £554,013 payment as part of the package negotiated as an overall deal. As the Upper Tribunal said: (para 99)

“The full package had, in line with the FTT's findings in relation to the other payments, been put together under the threat of penalty and was (just as much as the other parts of the package) paid in lieu of a penalty - in the sense that it was arrived at under the regulatory auspices and would have been imposed if the deal was not done.”

8. Conclusion

100. We would therefore allow HMRC's appeal and restore the decision of the Upper Tribunal.