Analysis

Ball UK Holdings: approaching accounting disputes

Speed read

We have seen many more disputes involving accounting evidence over the past few years than ever before. This case debunks a number of assumptions about how both HMRC and the tribunal approach these disputes. HMRC does not always instruct its own employees as its expert witnesses. The fact that an approach has been audited by one of the 'Big Four' accountancy firms, or is even supported by all of them, is not enough. The tribunal is far more interested in a clear and logical analysis of the standards themselves, and the quality of the analysis presented by your expert will be crucial.

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We have seen very many cases concerning questions of accounting over the past few years. I have counted 12 since the beginning of 2015, more than in the previous ten years put together. This is probably because of the changes made to the loan relationship and derivative contract rules in 2005, and in particular because accounting has taken a preeminent position since then in determining taxable profits. Many of these cases involved structures that were designed to generate a tax benefit that did nothing more than reflect a debit in the accounts.

In the recent case of *Ball UK Holdings v HMRC* [2017] UKFTT 457 (reported in *Tax Journal*, 30 June 2017), the accounting question is a simple one: should the appellant have prepared its statutory accounts in US dollars or in pounds sterling? That turned on whether the taxpayer applied FRS 23 correctly. Avoidance was allegedly involved, but let's not focus on that: it may have affected the outcome; then again, it may not. The case is interesting because of HMRC's choice of expert witness, and also because of the comments made by the tribunal about how it should approach accounting evidence.

HMRC's expert witness

Generally, HMRC instructs one of its own employees as expert witness on accounting matters. It has done so for years. Here, however, HMRC instructed David Chopping, who is the head of Moore Stephens' Audit Technical Department, and of the ICAEW's Technical and Practical Auditing Committee.

This is not the first time this has happened. Chopping has been instructed by HMRC at least twice before: recently in *Smith and Nephew Overseas Ltd v HMRC* [2017] UKFTT 151 (TC); and a few years earlier in *Fidex v HMRC* [2013] UKFTT 212 (TC).

Still, out of over 25 cases involving expert accounting evidence heard over the past 15 years, as far as I am aware these are the only three occasions in which HMRC has not instructed one of its own employees to act as expert witness on accounting issues.

What does this mean? It is generally assumed that HMRC will always instruct one of its own employees in relation to an accounting dispute. Rightly or wrongly, there has also been an assumption that a tribunal would generally prefer the evidence of one of the Big Four firms over an HMRC employee.

I hesitate to predict a change in approach. That said, it must be the case that advisers need to treat HMRC using external accounting expertise in the future as at least a realistic prospect. It could become the norm.

What does it mean to be GAAP compliant?

The first question addressed by the tribunal was whether a taxpayer has to prove it applied GAAP correctly, or merely that it had adopted a reasonable interpretation. This is a highly relevant question, and the answer is instructive.

The application of GAAP is not, and has never been, black and white. I am told time and time again that the exercise of drawing up accounts is one of judgment. The judgment is to be exercised by the management of the company, not by the auditors; and management can do no more than prepare accounts on the basis of a reasonable interpretation of the relevant standards.

Further, the courts have accepted that where a number of GAAP compliant approaches can be taken, a taxpayer is free to adopt any of them (see *Johnston v Britannia Airways* [1994] STC 763 and, more recently, *Versteegh Ltd v HMRC* [2013] UKFTT 642 (TC)).

In this case, the appellant argued that it followed from all of the above that in preparing GAAP compliant accounts, a taxpayer merely had to adopt an interpretation of the accounting that was reasonable. Each interpretation that is reasonable would be GAAP compliant.

The tribunal disagreed. It drew a distinction between interpreting the standard, which must be done correctly, and applying that interpretation to a given set of facts, which involves judgment and so does permit a number of reasonable approaches.

Of course, in practice there may be some doubt about the correct interpretation of a given standard. If there is, the expert must give his or her opinion to the tribunal on the merits of each possible interpretation. It is then the job of the tribunal to decide, on the balance of probabilities, which of those interpretations is correct. It is not enough for an expert merely to say whether a given interpretation is reasonable: a reasonable interpretation may be found on the balance of probabilities not to be correct.

The expert must instead explain why he or she considers that that his or her interpretation is correct.

The 'Big Four'

My practical experience has for a long time been that both taxpayers and advisers have assumed that HMRC would find it difficult to win a dispute on an accounting point against an expert from one of the Big Four firms of accountants.

Greene King v HMRC [2012] UKFTT 385 (TC) is the case that first suggested that this might not always be the case. The tribunal found for HMRC, even though the appellants' accounts had been audited by one of the Big Four. However, on a closer reading it is apparent that the audit partner was not an expert witness, he was a witness of fact. This is an important distinction, and quite rightly the tribunal acknowledged that his evidence concerned 'what was done,

and why it was done', rather than whether it was GAAP compliant. The appellant's expert witness was a director employed by another firm outside of the Big Four.

So *Greene King* was not a case where HMRC won an accounting dispute 'against' one of the Big Four. *Ball UK Holdings Ltd* is such a case. The appellant's position looked about as good as it might get: the accounts were audited by one Big Four firm; the appellant instructed not one but two partners from another Big Four firm as expert witnesses; and there was also a report prepared by a third Big Four firm agreeing with the appellant's position.

The tribunal accepted that all of these accountants had agreed with the appellant. It nevertheless preferred Chopping's evidence, concluding that just because a number of accountants take one view of an accounting standard does not make it GAAP.

The point to note is that the tribunal was willing to prefer HMRC's expert evidence, notwithstanding the apparent support for the appellant's approach from three of the Big Four.

This may well be because the expert witnesses were both from only one of those firms. The tribunal did not infer anything about the correctness of their expert evidence from the fact that the appellant's accounts had been audited by another firm and approved by an accounting opinion from a third. In the absence of cross-examination by the tribunal of the audit partner and of the author of the accounting opinion, this meant nothing more than that two other individuals agreed with the expert evidence. This does not make general acceptance. The tribunal inferred very little therefore from the audit and the existence of the accounting opinion.

Instead, the case simply turned on whether the tribunal preferred the evidence of HMRC's expert (the head of Moore Stephens LLP's Audit Technical Department and of the ICAEW's Technical and Practical Auditing Committee) or the appellant's experts (lead of the KPMG accounting advisory services team and an IASB practice fellow). Each of the experts was clearly highly regarded in their profession. As such, all the tribunal could do was evaluate the evidence presented to them on its merits.

An analytical approach

The tribunal took little from the position taken by one of the appellant's experts that his interpretation was GAAP because it had been adopted by all of the Big Four. The expert supported this position by reference to the Big Four manuals.

The tribunal conceded (at para 161) that the Big Four manuals could be helpful:

'where the meaning of an aspect of an FRS is unclear, the generally accepted interpretation of that part of the FRS may be apparent from the Big Four manuals, particularly if they are consistent with each other on the point. Nevertheless, where the FRS is clear, the Big Four manuals do not override it'.

However, rather than simply relying on the Big Four manuals, the tribunal was clearly looking for analytical evidence justifying the interpretation taken primarily by reference to the words of the relevant standards, supported by the context, the spirit and purpose of the standards, and the background notes and basis of conclusions.

HMRC's expert evidence was accepted because this was the approach taken by its expert.

Using more than one expert

So what does all of the above mean? The decision suggests that by far and away the most important evidence that an appellant can lead is the analysis of its expert. The support offered by the fact that accounts have been audited, that they are approved in a separately commissioned report or that they are consistent with the Big Four manuals is limited.

Should a taxpayer therefore instruct multiple experts? Here, the appellant instructed two KPMG partners. One was an expert in FRS 23 and the other in IAS 21. This case was about FRS 23, which is a UK accounting standard. FRS 23 is, however, the UK implementation of IAS 21, which is an international accounting standard. FRS 23 is intended to be interpreted and applied consistently with IAS 21, hence the two experts.

> It is the quality of the analysis that will be most important, and not the number of accountants (however reputable) who agree with it

The two experts dealt with largely the same issue and this created an interesting backdrop. The experts agreed, then disagreed and then agreed again. One was explicitly asked whether or not he might find it difficult to disagree with one of his partners in public. He said not. Still, all of this seemed to cast some doubt about the evidence led. Contradictions will inevitably be the danger with having more than one expert.

It is also debatable whether multiple experts would help. One thing to take from this decision is that it is the quality of the analysis that will be most important, and not the number of accountants (however reputable) who agree with it.

What does this mean?

Tax advisers should not assume that accounting advice from one of the Big Four firms cannot be challenged by HMRC.

Here, the appellant's accounting was supported by three of the Big Four firms. Generally, one would have thought that such a position would be unassailable. This case goes to show that it may not be.

If you do not understand or are not persuaded by the accounting advice you have received, do not be surprised if you cannot persuade HMRC that it is correct.

The same goes for litigation. Disputes about accounting will be heard by a tribunal judge at the First-tier Tribunal, one or all of whom will be a tax professional like you. The best way to stress test your expert's evidence is to keep testing it until you understand it and are persuaded by it.

Managing your expert will be key: it will be important to make it clear from the outset that his or her role is to give an opinion on what is the correct way to interpret the standards. The opinion should be analytical by reference to the standards themselves and their supporting notes.

Evidence of what the Big Four manuals say, and of the approach generally taken by accountants, will be helpful to some extent, but evidence of this nature should not supplant the analysis. ■

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- *Greene King*: loan relationships and accounting issues (Heather Self, 4.8.16)
- Practical steps to prepare for new UK GAAP (Stephanie Hurst & Alycia Spitzmueller, 26.7.13)