Analysis

Upper Tribunal decision in Greene King: tax and accounting

SPEED READ **The Upper Tribunal has upheld the First-tier Tribunal's (FTT's) decision in *Greene King*. Planning designed to obtain a deduction with no taxable receipt was held to have failed. While the law has changed significantly since the transactions occurred, the case provides a useful example of HMRC successfully challenging a taxpayer's accounting treatment in order to defeat tax planning, and the Upper Tribunal was unwilling to overturn the FTT's consideration of expert evidence in this regard. The case needs to be seen in the context of the wider ongoing debate on the relationship between accounting and tax when it comes to the taxation of debt. In particular, it upholds the principle that there can be more than one GAAP-compliant way to account for a transaction.**

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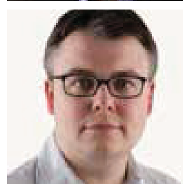

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In 2012, the Greene King group lost a case before the FTT in relation to some tax planning (*Greene King PLC and another v HMRC* [2012] UKFTT 385 (TC)). The aim of the arrangements had been to achieve a tax deduction for intra-group interest payments payable by a Greene King group company, with no offsetting taxable receipt elsewhere in the group.

The FTT struck down the tax planning, finding that it generated a taxable receipt (and created the potential for the Greene King group to be taxed twice). The taxpayer appealed, and the Upper Tribunal reached the same overall outcome as the FTT (*Greene King PLC and another v HMRC* [2014] UKUT 0178 (TCC)).

Background

Greene King PLC (PLC) was owed £300m by its wholly owned subsidiary Greene King Brewing and Retailing Ltd (GKBR) under interest bearing loan stock.

In 2003, PLC assigned the right to receive interest (but not the right to repayment of the principal) to another group company, Greene King Acquisitions Ltd (GKA). In consideration for that assignment, GKA issued preference shares with a nominal value of £1.5m to PLC.

The taxpayer argued that the effect of the assignment was that:

- GKBR continued to be entitled to a tax deduction in respect of its interest payments under the loan stock (this was not disputed);
- PLC was required for accounting purposes to continue to recognise the loan stock in its accounts at a value of £300m; and
- GKA carried the £19m difference between the net present value of its right to receive interest (£20.5m) and the nominal value of the preference shares (£1.5m) to its share premium account, which meant that under the loan relationship rules as they then were (specifically FA 1996 s 84(2)(a)), it was not taxable on that amount.

The FTT found the key question was whether PLC's accounting was compliant with generally accepted accounting principles (GAAP). This involved consideration of paras 23 and 71 of Financial Reporting Standard 5 (FRS 5) which deals with occasions when a creditor should derecognise assets.

Had the right to interest been transferred by PLC to a third party, PLC would have been required to derecognise the £20.5m difference between the £300m nominal value of the loan stock and its £279.5m market value following the assignment, accreting the £20.5m back into account over the lifetime of the loan stock (thus giving rise to taxable profit in the profit and loss account). The taxpayer argued that this treatment was not required in its case, as the assignment was intra-group and the reduction in the value of the loan for PLC was offset by a rise in the value of PLC's shareholding in GKA.

Having heard evidence from accounting experts on both sides, the FTT preferred HMRC's expert evidence and concluded that PLC's accounting was not GAAP compliant. It found that PLC ought to have derecognised and accreted the £20.5m.

The FTT went on to consider the position of GKA. It found that whether or not GKA had a loan relationship with GKBR following the assignment, the payments received by GKA did not arise from that relationship and so were outside the loan relationship regime, with the result that FA 1996 s 84(2)(a) did not apply to exempt the payments from tax in GKA. The FTT acknowledged that the consequence of this could be double taxation. However, it was unsympathetic, given the aim had been to achieve an unmatched deduction.

Upper Tribunal decision

The main challenge for the taxpayer was to overturn a finding of fact that had been reached by the FTT after hearing expert evidence on behalf of each party.

The taxpayer put forward a number of arguments as to why it was appropriate for the first instance decision to be revisited. It argued that the FTT had failed to take into account that there could be more than one GAAP compliant accounting method, with PLC's approach being a permissible alternative. However, the Upper Tribunal gave this argument short shrift, and found that the FTT had concluded

that there was in this case only one GAAP compliant accounting method (para 37).

The Upper Tribunal found that the FTT had reached its conclusion by weighing the expert evidence it had heard and preferring the evidence of HMRC's expert to that of PLC's. That being so, the taxpayer needed to show that either HMRC's expert evidence, or the text of FRS 5, did not justify the FTT's decision. The Upper Tribunal found that the taxpayer had not achieved this, and held that the FTT was entitled to find that derecognition was required.

The taxpayer put forward various other arguments. It argued that even if derecognition was the correct accounting treatment, it did not automatically follow that the consequence was accretion back of the £20.5m. The Upper Tribunal agreed that the FTT had erred in failing to consider this, even though it had been considered by the expert witnesses. However, on examining the relevant evidence, the Upper Tribunal found that accretion back was the correct approach.

The taxpayer went on to argue that even if accretion back was the correct approach, the £20.5m would not be 'realised profit' for accounting purposes, and so could not be taken to profit and loss. Again, the Upper Tribunal agreed that the FTT had failed to consider this, but went on to conclude from the earlier expert evidence that the £20.5m would be realised profit to be taken to profit and loss account.

Finally, the taxpayer ran a series of arguments that, even if the £20.5m was required to be taken to profit and loss account, it did not follow that it should be treated as profit within the loan relationships code. Again, the Upper Tribunal agreed that the FTT had failed to deal with a number of these points, although on considering them the Upper Tribunal rejected them all, with the result that it upheld the result that PLC was taxable on the £20.5m accretion back.

The Upper Tribunal briefly considered whether the position was affected by the requirement in FA 1996 s 84 (now CTA 2009 s 307(3)) that the credits and debits to be brought into account under the loan relationships code shall be those which 'fairly represent' profits, gains and losses, etc. As the Upper Tribunal acknowledged, Moses and Rix LJJ in the Court of Appeal in *DCC Holdings (UK) Ltd v HMRC* [2009] EWCA Civ 1165 had suggested that the 'fairly represents' requirement was 'a sort of statutory override' to the accounts, but this formed no part of Lord Walker's Supreme Court judgment ([2010] UKSC 58). The Upper Tribunal shied away from engaging deeply on this point, but found that were 'fairly represents' to comprise an override, the result would be that the £20.5m fairly represented a profit on the loan stock.

The Upper Tribunal then went on to consider the FTT's findings as regards GKA. The Upper Tribunal differed from the FTT by directly considering the question of whether there was a loan relationship between GKA and GKBR. It found that while the relationship between GKA and GKBR involved a debt, it did not involve a transaction for the lending of money and therefore was not a loan relationship. The Upper Tribunal declined to make any more general findings about the wider taxation consequences of the situation for GKA.

Where does this leave us?

The Upper Tribunal's decision upholds the principle that there can be more than one GAAP compliant method of accounting for a transaction (although, in this case, the FTT had determined only one method was acceptable). This principle was important in *Versteegh Ltd and others v HMRC* [2013] UKFTT 642 (TC), where the FTT found that there was more than one GAAP compliant method of accounting and HMRC's accounting challenge therefore failed. This sets a high bar for HMRC; it needs to show not only that its preferred approach is GAAP compliant, but also that the taxpayer's approach is not.

The Upper Tribunal's decision does not take the debate on the meaning of 'fairly represents' much further forward. The Upper Tribunal did not engage deeply with it, and given that the focus of FRS 5 is on the substance of financial transactions, it is doubtful whether it would have added much in any case. HMRC is understood still to consider that the 'fairly represents' criterion can operate as an accounting override, although the ongoing consultation on modernising the taxation of loan relationships indicates nervousness on its part. Much of the focus of that consultation has been on giving HMRC more latitude to depart from accounts in certain cases, and while the idea of a non-specific accounting override has been discarded, a 'regime-wide avoidance rule' will be introduced instead (HMRC's technical note of 8 April 2014). Will the combination of the difficulty in challenging taxpayers' accounts, doubts over 'fairly represents', and the introduction of a regime-wide avoidance rule make HMRC's approach in *Greene King* something of a rarity? It remains to be seen.

All of that is little comfort for Greene King. Despite the taxpayer's best efforts, and some gaps in the FTT's reasoning, the Upper Tribunal ultimately was not prepared to overturn the FTT's consideration of the expert evidence. This reiterates that interpreting accounting standards is an issue of fact, just as any other non-legal issue would be, and that the courts are expected to be able to choose between alternative views presented by experts, just as they would be in any other non-legal area where expert evidence is given. This therefore involves the judiciary having to come to terms with accounting concepts – no matter how unpalatable that may seem.

After the FTT's decision, a number of commentators remarked that the decision appeared to give rise to double taxation for the Greene King group, although in fact the FTT found only that the loan relationships regime did not apply to GKA's receipts and made no findings as to whether they would be taxable on any other basis. The Upper Tribunal was more forthright in refusing to consider questions beyond the application of the loan relationship rules, so we are no clearer on whether or not Greene King will be taxed twice as a result of this transaction. ■

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Cases: *Greene King v HMRC* (29.4.14)

Cases: *Versteegh Ltd and Others v HMRC* (13.11.13)

Tax and accounts: lessons from *Versteegh* and *Greene King* (Angela Savin, 4.4.14)

The FTT decision in *Greene King*: law, accounting and tax (Paul Miller, 9.8.12)