Neutral Citation Number: [2018] EWCA Civ 2075

Case No: A3/2017/1070

IN THE COURT OF APPEAL (CIVIL DIVISION)
ON APPEAL FROM THE UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)
[2017] UKUT 0068 (TCC)

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 05/10/2018

Before :

LORD JUSTICE HENDERSON
LADY JUSTICE ASPLIN
and
LORD KITCHIN

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Between:

GDF SUEZ TEESSIDE LIMITED	**Appellant**
- and -	
THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS	**Respondents**

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- -

Mr Julian Ghosh QC, Mr Richard Boulton QC and Mr Charles Bradley (instructed by **Slaughter and May**) for the **Appellant**
Mr David Milne QC, Ms Elizabeth Wilson and Mr Ben Elliott (instructed by the **General Counsel and Solicitor to HMRC**) for the **Respondents**

Hearing dates: 30 April and 1 and 2 May 2018

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Approved Judgment

Lord Justice Henderson:

Introduction

1. This case concerns a tax avoidance scheme by which the appellant taxpayer, then called Teesside Power Limited ("TPL") and subsequently renamed GDF Suez Teesside Limited, sought to reduce its potential liability to United Kingdom corporation tax ("CT") in respect of contingent and unrealised, but nevertheless very valuable, claims which it had against certain companies in the insolvent Enron Group. When the relevant transactions were entered into, between December 2006 and March 2007, the open market value of the unrealised claims is agreed to have been approximately £200 million, but in accordance with UK generally accepted accounting practice (or "GAAP") the claims still had a carrying value of nil in TPL's accounts. Accordingly, if nothing were done, TPL would in principle become liable to CT on profits equivalent to the full amount of the sums received as and when the claims were realised.

2. On advice from Ernst & Young LLP ("EY"), who devised the scheme and were also TPL's auditors, TPL hoped to escape this potential liability by the simple expedient of transferring the relevant claims to a newly-incorporated and wholly-owned Jersey subsidiary, called Teesside Recoveries and Investments Limited ("TRAIL"), in consideration for the issue by TRAIL to TPL of equivalent numbers of fully paid ordinary shares in TRAIL representing the fair value of the claims. There were three transfers in all, two of which took place on 5 December 2006 and the third on 2 March 2007. Thus TPL exchanged its beneficial ownership of the claims for beneficial ownership of the corresponding shares in TRAIL, and TPL now had indirect (shareholder) control, through its ownership of TRAIL, instead of direct (managerial) control in its own right, over the future realisation or utilisation of the claims.

3. Throughout these proceedings, it has been common ground that the claims gave rise to "loan relationships" within the meaning of the taxation regime governing corporate loan relationships which was first enacted in Chapter II of Part IV of the Finance Act 1996 ("FA 1996"). The loan relationship legislation has been substantially amended on a number of occasions since its introduction, and we are concerned with the code as it stood in the tax year 2006/07, including (as I shall explain) important amendments made by the Finance Act 2004 ("FA 2004") and (with effect from 19 July 2006) by the Finance Act 2006 ("FA 2006").

4. The scheme was designed on the basis that the transfer of the claims by TPL to TRAIL would not give rise to any "credits" which, in accordance with UK GAAP, would have to be taken into account in computing the profits and gains arising to TPL in its two relevant accounting periods (the first of which ended on 5 December 2006, and the second of which ran from 6 December 2006 to 30 September 2007). In other words, the intention was that the transfers would not generate any taxable credits in the hands of TPL, and that the shares in TRAIL would have a carrying value of nil in TPL's accounts in the same way as the claims for which they had been exchanged.

5. On the other hand, it is agreed that the position of TRAIL was different from that of TPL, in that TRAIL acquired assets which did not represent anything it had previously owned, and provided full consideration for those assets by the issue of corresponding

numbers of its own shares at par. Thus the base value of the claims in the hands of TRAIL was their market value of approximately £200 million, and TRAIL would in principle subsequently realise a profit from the claims only if and to the extent that realisations exceeded that base value. As a company registered and resident for tax purposes in Jersey, TRAIL was not itself liable to CT; but it was a "controlled foreign company" (or "CFC") within the meaning of the UK tax legislation dealing with CFCs, and as such its future profits (if any) were liable to be attributed to TPL and taxed in the UK accordingly. The critical difference from the status quo, however, was that only profits arising from realisations in excess of the £200 million base value could be "brought home" in this way and taxed in the hands of TPL. So the overall effect of the scheme, if it worked, was that the £200 million would fall permanently outside the net of CT, because (a) the transfers of the claims to TRAIL gave rise to no loan relationship credits in the hands of TPL, and (b) any subsequent profits realised by TRAIL from the claims would be taxable under the CFC legislation only to the extent that they exceeded the £200 million base value.

6. Similarly, if TRAIL were subsequently to pay up distributable profits by way of dividend to TPL, it could only do so to the extent that it had accounting profits in excess of the base value which were available for distribution under Jersey company law (which the parties were content to assume was the same for all material purposes as English company law), and TPL would again be taxable on only that amount.

7. In the event, TRAIL subsequently received sums totalling approximately £243 million in respect of the claims, between April 2007 and May 2008. TRAIL never held any assets other than the claims, and the proceeds from their realisation were for the most part lent back to TPL on an unsecured and interest free basis. We were informed by leading counsel for HMRC, Mr David Milne QC, that no charge under the CFC legislation was made on TPL in respect of the profit element of £43 million realised by TRAIL, because the equivalent sum was in fact paid up by TRAIL to TPL by way of dividend and was taxable in the hands of TPL on that basis. On 3 July 2008, the directors and shareholders of TRAIL passed a special resolution to wind up the company. The sole purpose for which it had been brought into existence had been accomplished.

8. At this point, it may be helpful to quote the description of the scheme provided by EY when they notified it to HMRC on 8 December 2006 under the "Disclosure of Tax Avoidance Schemes" (or "DOTAS") rules introduced by section 308 of FA 2004, as follows:

> "These arrangements enable a UK company ("UKCo") to indirectly realise the value of an existing asset which has no carrying value under UK GAAP (such as potential proceeds under a claim under litigation or an insolvency process) without triggering an immediate tax charge, by transferring it to a foreign subsidiary ("FSub") in exchange for an issue of new shares. FSub may subsequently realise value from the asset. Any profit so arising may give rise to a liability to corporation tax through the operation of the UK controlled foreign company ("CFC") rules, but in calculating the gain, the effective base cost of the asset will have been stepped up to market value at the time of transfer.

Under UK GAAP, the nature of the asset is such that it is not recognised as an asset in the books of UKCo. Further, no realised profit would arise on transfer of the assets to FSub solely in return for the issue of newly-issued shares. The prior history and documentation surrounding the asset is such that it is considered to be a loan relationship. Accordingly, as under UK GAAP no credits to the profit and loss account arise from the transfer, no credits should be brought into account under the loan relationships provisions.

On acquisition of the asset, FSub would record the asset in its books at its fair value at the date of transfer, to be matched by share capital. Where FSub is a CFC, the profits potentially subject to an apportionment on a future realisation of the asset under the operation of the loan relationships regime should be restricted to the excess of the net proceeds over that amount.

UKCo should obtain a capital gains base cost in the new shares in FSub equal to the open market value of the asset on the transfer date."

9. The DOTAS disclosure went on to explain how the expected tax advantage would arise:

"This planning is specific to certain assets with somewhat unusual characteristics and should result in reduced taxation on the realisation of the assets as compared to simply awaiting realisation. The key characteristics of such an asset are as follows.

- It has a value, albeit one that cannot be readily or reliably ascertained.
- It falls to be treated as a loan relationship because of the existence of a money debt and documentation issued to represent the rights of the creditor.
- It is not recognised as an asset under UK GAAP, for instance as a result of uncertainty regarding the amounts that might ultimately be collected and their timing.

The transfer of such an asset by UKCo to the newly formed FSub in exchange for the issue of new shares by FSub is a "related transaction". No credit is recognised in the accounts, in accordance with UK GAAP, because no profit is realised in the form of cash or other assets the ultimate realisation of which cannot be assessed with reasonable certainty (paragraph 28 FRS 18). Accordingly, no amount is taken into account under the loan relationships provisions as a profit on a related transaction.

…"

10. In due course, after TPL had submitted its tax returns and computations for the two accounting periods, HMRC opened enquiries into the returns which resulted in the issue of closure notices on the footing that loan relationship credits should be brought into account on the dates when the claims were transferred to TRAIL, in the sum of £194,899,838 for the first period and £5,154,631 for the second period. Following an internal review, which confirmed HMRC's position, TPL appealed against the closure notices to the First-tier Tribunal ("the FTT") (Judge Rachel Short and Mr Nigel Collard) which heard the appeal over three days in April 2015. The issues before the FTT were these:

    a) Was the accounting treatment adopted by TPL in respect of the transfer of the claims permissible in accordance with UK GAAP at the material time?

    b) Would any (and if so what) alternative accounting treatment have been available in respect of the transfer and permissible in accordance with UK GAAP?

    c) If more than one UK GAAP-compliant accounting treatment was available, was TPL required by section 84(1) of FA 1996 to bring debits and credits into account for CT purposes in accordance with one (and if so which) of those alternative treatments?

    d) If the only UK GAAP-compliant accounting treatment available was the one adopted by TPL, was TPL nevertheless required by section 84(1) to bring debits and credits into account otherwise than by reference to the accounts, and if so, how were such debits and credits to be determined?

11. The fourth issue turned, in particular, on the scope and meaning of the words "fairly represent" in section 84(1) of FA 1996, which in its then current form provided that:

> "The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, when taken together, fairly represent, for the accounting period in question –
>
> (a) all profits, gains and losses of the company, including those of a capital nature, which (disregarding interest and any charges or expenses) arise to the company from its loan relationships and related transactions; and
>
> (b) all interest under the company's loan relationships and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions."

12. By its decision released on 11 August 2015 ("the FTT Decision"), the FTT found in favour of TPL that its accounts complied with GAAP, that there was no alternative

accounting treatment which would also have complied, and that HMRC were obliged to accept those accounts. On the other hand, the FTT decided issue (d) in favour of HMRC, holding that the accounting treatment did not in the circumstances fairly represent TPL's profits in the two periods and that £200 million of profit should be recognised in TPL as a consequence of the transfer of the claims. Accordingly, TPL's appeal was dismissed.

13. TPL then appealed to the Upper Tribunal (Newey J and Judge Colin Bishopp), which heard the appeal over three days in November 2016 and released its decision ("the UT Decision") on 17 February 2017. The Upper Tribunal reached the same conclusion as the FTT, holding that HMRC's challenges to the FTT's conclusions on the three accounting issues all failed, but that section 84(1) required TPL to bring into account for tax purposes a sum representing the value of the shares allotted to it by TRAIL in exchange for the transfer of the claims.

14. TPL now appeals to this court, with permission granted by the Upper Tribunal. By a respondent's notice, HMRC seek to renew their challenge to the conclusions of the FTT on the accounting issues as being erroneous in law.

15. HMRC have throughout been represented by Mr Milne QC, leading Ms Elizabeth Wilson (and, in this court, Mr Ben Elliott). TPL was represented before the two Tribunals by Mr Jonathan Peacock QC and Mr Richard Boulton QC, but on the appeal to this court Mr Julian Ghosh QC has replaced Mr Peacock, while Mr Charles Bradley has been added to the team of counsel. We heard three full days of legal argument from Mr Ghosh, Mr Boulton and Mr Milne. The division of labour between Mr Ghosh and Mr Boulton was that the former dealt with issues of tax law and construction of the relevant legislation, while the latter dealt with the accountancy and company law issues.

The factual background

16. The basic facts are relatively simple, and not in dispute. They are clearly set out in the decisions below. What follows is a summary, mainly based on the UT Decision at [3] to [19].

17. From 1993, TPL owned and operated a power station at Redcar and Cleveland, in Teesside. TPL's business included selling electricity on a wholesale basis to customers such as Enron Corporation and British Energy. Under "off-take" agreements entered into with Enron Capital Trade Resources Limited ("ECTRL") and Enrici Power Marketing Limited ("Enrici"), each of which was part of the Enron group of companies, TPL contracted to sell the majority of the output of the power station to those companies. The obligations of ECTRL and Enrici under the agreements were guaranteed by Enron Corporation ("EC").

18. Following the collapse of the Enron group, in late 2001 EC filed for relief under Chapter 11 of the United States Bankruptcy Code and ECTRL went into administration in the UK. In January 2006, Enrici also went into administration in the UK, followed by a creditors' voluntary liquidation in December of that year.

19. TPL had very substantial claims against the Enron group. In 2005, a US Bankruptcy Court allowed TPL's proofs of claim totalling $907,720,278 against EC ("the Enron Claim") and ECTRL entered into a settlement deed which admitted a liability to TPL

of £360,767,273 plus interest ("the ECTRL Claim"). In November 2006, EC and the administrators of ECTRL issued letters recognising the extent of TPL's claims against those companies. In February 2007, the administrators of Enrici accepted that Enrici owed TPL £101,071,188 ("the Enrici Claim"). I will follow the Tribunals in referring to the Enron Claim, the ECTRL Claim and the Enrici Claim together as "the Claims".

20. By 5 December 2006, TPL had received cash distributions in respect of the Enron Claim totalling some £120 million, plus shares in a company called Portland General Electric ("Portland") worth about £14 million. These receipts were recognised as exceptional items in the profit and loss account in TPL's financial statements for the periods ended 31 December 2005 and 5 December 2006. CT was duly paid on the amounts received, and as I have already explained CT would have continued to be payable on subsequent receipts in the same way if TPL had not entered into the scheme.

21. TPL received no distributions in respect of the ECTRL and Enrici Claims during its two accounting periods which ended on 5 December 2006.

22. On 1 December 2006, TPL established TRAIL in Jersey.

23. In a memorandum addressed to the board of directors of TRAIL dated 5 December 2006, Carval Investors LLC valued the Enron and ECTRL Claims at, respectively, $199,698,461 (equivalent to 22 cents per dollar, or £101,100,347) and £93,799,491 (equivalent to 26 pence in the pound). It appears to be common ground that this was an arm's length, third party valuation, even though the director who signed the memorandum on behalf of Carval was also a director of TRAIL. The memorandum explained that a secondary market for Enron claims had developed over the years, as a result of which it was possible to estimate the fair value of Enron claims based on the indicative bids and offers of potential buyers and brokers. There was also a secondary market for claims against ECTRL. Nevertheless, there was still "significant uncertainty regarding the future recovery values", there were numerous unresolved issues in both insolvent estates, and experience suggested that it was "not uncommon to see bankruptcies such as these (particularly in the UK) drag on for a considerable period".

24. The memorandum did not include a valuation of the Enrici Claim, but in a separate paper headed "Review of Enron Estate Payment Position", which appears to have been prepared on 22 November 2006 and presented to TPL's board, it was noted that almost no progress had been made since Enrici had entered administration in January 2006, and that it was "almost impossible to form a view on when and how much will be distributed from the Enrici Estate".

25. On 5 December 2006, TPL assigned to TRAIL (a) its rights in relation to the Enron Claim in consideration for the issue to TPL of 101,100,347 ordinary shares in TRAIL, and (b) its rights under the settlement deed with ECTRL (i.e. the ECTRL Claim) in consideration for the issue to TPL of a further 93,799,491 ordinary shares in TRAIL. The third assignment took place on 2 March 2007, when TPL assigned to TRAIL its rights in respect of the Enrici Claim in consideration for the issue to TPL of 5,154,631 ordinary shares in TRAIL.

26. TRAIL subsequently received a total of £243,149,027 in respect of the Claims, on various dates between April 2007 and May 2008. The details are set out in the FTT Decision at [18]. The sums included distributions from the estates of all three

companies, shares in and dividends from Portland, and the proceeds of sale of the residual Claims in March and May 2008.

27. TPL's financial statements for the period to 5 December 2006 did not attribute any value to its shares in TRAIL, or to the claims against EC and ECTRL which had been assigned to TRAIL. Notes to the statements explained that the investment in TRAIL was stated at a cost of nil, being the carrying value of the claims transferred to TRAIL at the date of the transfer, and that the assigned claims had been accounted for as contingent assets, with no further value recognised in respect of them because of the continuing uncertainty over the timing and amounts of further distributions. The financial statements received an unqualified audit opinion from EY.

28. TPL's financial statements for the following period to 30 September 2007 dealt in a similar way with the transfer of the Enrici Claim in March 2007, and again received an unqualified audit opinion from EY.

29. By contrast, the Claims were treated as having substantial value in TRAIL's accounts for the year ended 30 November 2007. The balance sheet showed net assets of £245,046,825, including a "loan receivable" of £132,999,000 in respect of realisations which had been lent up by TRAIL to TPL, and a figure of £108,051,120 for "claims receivable". A note recorded that the claims receivable were stated at their recoverable value, while unrealised gains were recognised within the profit and loss account. In their audit opinion, EY said that the statements gave "a true and fair view, in accordance with United Kingdom Accounting Standards, of the state of the company's affairs as at 30 November 2007", and had been properly prepared in accordance with the Companies (Jersey) Law 1991.

30. On 3 July 2008, as I have already recorded, TRAIL was put into liquidation. By then, it had fully liquidated the Claims and either lent or distributed the proceeds to TPL.

The loan relationship legislation

31. As Lord Walker of Gestingthorpe JSC explained in DCC Holdings (UK) Limited v Revenue and Customs Commissioners [2010] UKSC 58, [2011] 1 WLR 44, at [7]:

> "Chapter II of Part IV of FA 1996 effected a fundamental change in the taxation of loan interest for the purposes of corporation tax (but not for the purposes of income tax). The changes were aimed at bringing the tax treatment of all interest onto an authorised basis of accounting (in many cases… an accruals basis), and went far beyond mere counteraction of tax avoidance. They involved a new head of charge for corporation tax purposes…"

In the account which follows, I shall unless otherwise stated refer to the relevant legislation as it stood when the Claims were assigned by TPL to TRAIL in December 2006 and March 2007.

32. Chapter II of Part IV of FA 1996 is introduced by section 80, subsection (1) of which states that:

> "For the purposes of corporation tax all profits and gains arising to a company from its loan relationships shall be chargeable to tax as income in accordance with this Chapter."

33. "Loan relationships" are then defined by section 81. The primary definition, in section 81(1), covers cases in which "the company stands… in the position of a creditor or debtor as respects any money debt", and "that debt is one arising from a transaction for the lending of money." For present purposes, however, the relevant provision is section 81(3), which says that:

> "… where an instrument is issued by any person for the purpose of representing security for, or the rights of a creditor in respect of, any money debt then (whatever the circumstances of the issue of the instrument) that debt shall be taken for the purposes of this Chapter to be a debt arising from a transaction for the lending of money."

It is common ground that each of the Claims gave rise to a loan relationship by virtue of section 81(3), even though the original agreements between TPL and the Enron companies did not involve the lending of money in any normal sense.

34. The exclusivity of the loan relationship regime is reinforced by section 80(5), which states that:

> "Subject to any express provision to the contrary, the amounts which in the case of any company are brought into account in accordance with this Chapter as respects any matter shall be the only amounts brought into account for the purposes of corporation tax as respects that matter."

35. Section 82 is headed "Method of bringing amounts into account", and subsection (1) states that:

> "For the purposes of corporation tax –
>
> (a) the profits and gains arising from the loan relationships of a company, and
>
> (b) any deficit of on a company's loan relationships,
>
> shall be computed in accordance with this section using the credits and debits given for the accounting period in question by the following provisions of this Chapter."

36. The debits and credits to be brought into account are then specified by section 84, which provides that:

> "(1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, when taken together, fairly represent, for the accounting period in question –
>
> (a) all profits, gains and losses of the company, including those of a capital nature, which (disregarding interest and any charges or expenses) arise to the company from its loan relationships and related transactions; and
>
> (b) all interest under the company's loan relationships and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.
>
> …
>
> (5) In this Chapter "related transaction", in relation to a loan relationship, means any disposal or acquisition (in whole or in part) of rights or liabilities under that relationship.
>
> (6) The cases where there shall be taken for the purposes of subsection (5) above to be a disposal and acquisition of rights or liabilities under a loan relationship shall include those where such rights or liabilities are transferred… by any sale, gift, exchange, surrender, redemption or release.
>
> (7) Schedule 9 to this Act contains further provisions as to the debits and credits to be brought into account for the purposes of this Chapter."

It is common ground that the assignments of the Claims were "related transactions" within the meaning of section 84(5), from which it follows that the credits and debits to be brought into account by TPL under section 84(1) are those which "when taken together, fairly represent" all profits, gains and losses which arose to TPL from both the Claims and the assignments of them to TRAIL.

37. It is also important to note that, until the amendments effected by FA 2004, the words "when taken together, fairly represent" were preceded by "in accordance with an authorised accounting method and", so that the subsection read:

> "The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, *in accordance with an authorised accounting method and* when taken together, fairly represent, for the accounting period in question…" (emphasis supplied).

Thus the requirement that the credits and debits should "fairly represent" the profits etc. arising to the company from its loan relationships and related transactions was, until the 2004 amendments took effect on 1 January 2005, expressly linked to a further requirement that they should do so "in accordance with an authorised accounting method". That link was expressly removed in 2004, and one of the key issues which we

have to decide is whether the scope of the words "fairly represent" was thereby enlarged or otherwise altered.

38. The 2004 amendments also introduced important changes in the prescribed methods of accounting that were to be used for the purposes of the Chapter. As originally enacted, section 85 provided that two alternative accounting methods were authorised: an accruals basis of accounting, and a mark to market basis (under which any loan relationship to which that basis was applied is brought into account in each accounting period at a fair value). As a result of the 2004 amendments, these requirements were replaced by sections 85A and 85B, the general effect of which was to require the computation of debits and credits to be performed in accordance with UK GAAP. So far as material, and incorporating the further amendment to section 85A(1) in 2006 to which I refer below, those sections provide that:

> "**85A Computation in accordance with generally accepted accounting practice**
>
> (1) Subject to the provisions of this Chapter (including, in particular, section 84(1)), the amounts to be brought into account by a company for any period for the purposes of this Chapter are those that, in accordance with generally accepted accounting practice, are recognised in determining the company's profit or loss for the period.
>
> (2) If a company does not draw up accounts in accordance with generally accepted accounting practice ("correct accounts") –
>
> (a) the provisions of this Chapter apply as if correct accounts had been drawn up, and
>
> (b) the amounts referred to in this Chapter as being recognised for accounting purposes are those that would have been recognised if correct accounts had been drawn up.
>
> …
>
> **85B Amounts recognised in determining company's profit or loss**
>
> (1) Any reference in this Chapter to an amount being recognised in determining a company's profit or loss for a period is to an amount being recognised for accounting purposes –
>
> (a) in the company's profit and loss account or income statement,
>
> (b) in the company's statement of recognised gains and losses or statement of changes in equity, or

(c) in any other statement of items brought into account in computing the company's profits and losses for that period.

…"

39. "Generally accepted accounting practice" is defined for the purposes of the Tax Acts by section 50 of FA 2004. Unless a company prepares its accounts in accordance with "international accounting standards", the expression means "UK generally accepted accounting practice", which in turn means "generally accepted accounting practice with respect to accounts of UK companies… that are intended to give a true and fair view": see section 50(1) and (4)(a).

The 2006 amendment to section 85A(1)

40. Schedule 6 to FA 2006, headed "Avoidance involving financial arrangements", introduced a number of amendments with the explicit purpose of countering tax avoidance. Section 76, in the body of the Act, incorporated the schedule with these words:

> "Schedule 6 (which makes provision in relation to tax avoidance involving financial arrangements) has effect."

The 24 paragraphs of schedule 6 dealt with various subjects, but paragraphs 10 to 19 were devoted to the loan relationships legislation. They included paragraph 11, which was in the following terms:

> "*Loan relationships: computation in accordance with generally accepted accounting practice*
>
> (1) Section 85A of FA 1996 (computation in accordance with generally accepted accounting practice) is amended as follows.
>
> (2) In subsection (1) (amounts to be brought into account are those recognised in determining company's profit or loss) after "Subject to the provisions of this Chapter" insert "(including, in particular, section 84 (1))"."

The amendment took effect from 19 July 2006, the date on which FA 2006 received the Royal Assent.

41. So it was that the introductory words of section 85A(1) ("Subject to the provisions of this Chapter") were reinforced by the addition of an express reference to section 84(1), which, as we have seen, had itself been amended in 2004 and contains the requirement that the credits and debits to be brought into account in respect of a company's loan relationships "shall be the sums which, when taken together, fairly represent, for the accounting period in question" all profits, gains and losses of the company which arise to it "from its loan relationships and related transactions".

42. At first sight, this is a rather puzzling amendment. Why did Parliament think it appropriate to single out section 84(1) as a provision of Chapter II to which the

computation rule in section 85A(1) was subject, when it was already included in the words “the provisions of this Chapter” at the start of section 85A(1)? From one point of view, this was merely a statement of the obvious. Yet it must be assumed that Parliament had a more specific purpose in mind, and did not intend merely to enact a tautology. Furthermore, given the context of the amendment in the anti-avoidance provisions contained in schedule 6 to FA 2006, Parliament’s purpose must in some way have been to help counter tax avoidance through abuse of the loan relationship legislation.

43. If the amendment is viewed in this light, I would be inclined to infer that Parliament’s purpose must have been to make it clear that the “fairly represent” requirement in section 84(1) is a separate and potentially overriding condition which has to be satisfied, once the initial computation in accordance with UK GAAP has been performed. The enquiry under section 84(1), in its post-2004 form, is different from, and wider than, the link with UK GAAP mandated by section 85A(1), in at least two respects. First, section 84(1) requires regard to be had to any related transactions as well as to the relevant loan relationship itself. Thus, in the present case, the focus is widened from the application of UK GAAP to the position of TPL viewed in isolation, and regard must also be had to the effect of the assignments of the Claims to TRAIL. Secondly, the requirement to “fairly represent” the profits, gains and losses arising to the company will not necessarily be answered by saying that they are recognised in accordance with UK GAAP, because section 84(1) would then add nothing of substance to section 85A(1), and there would be no point in making the latter provision expressly subject to the former.

44. This interpretation of the 2006 amendment to section 85A(1) is supported, in my judgment, by the Explanatory Note to clause 76 and schedule 6 of the Finance (No.2) Bill 2006, which became section 76 and schedule 6 of FA 2006. The summary in paragraph 1 of the Explanatory Note said that:

> “This clause and Schedule close a number of loopholes and block a number of avoidance schemes disclosed under Part 7 Finance Act (“FA”) 2004 and elsewhere. They all exploit legislation relating to financial products and arrangements of the types for which disclosure of schemes is required.”

Examples were then given of the “main categories of affected schemes”, including several relating to loan relationships. The examples do not, of course, include the present scheme, because it was not disclosed under the DOTAS rules until December 2006.

45. The explanation for what became paragraph 11 of schedule 6 (then paragraph 5 of the Bill) stated (in paragraph 57) that its purpose was “to make it absolutely clear” that section 85A(1) of FA 1996 was “subject to section 84(1) of that Act.” The background to the amendment was then described as follows:

> “58. Section 85A FA 1996 was inserted in FA 1996 by paragraph 3 Schedule 10 to FA 2004 replacing the concepts of “authorised accounting methods” by provisions explaining that the amounts of credits and debits are recognised for tax when they are recognised for accounting purposes in various parts of the

> accounts. Subsection (1) provides that the amounts to be brought into account by a company for the purposes of Chapter 2 Part 4 FA 1996 are those that, in accordance with generally accepted accounting practice, are recognised in determining the company's profit or loss for the period. The section is however expressed to be subject to the provisions of Chapter 2 Part 4.
>
> 59. Section 84 FA 1996 provides the basic computational rules for the loan relationships regime. Subsection (1) requires that the debits and credits to be brought into account by a company in respect of its loan relationships shall be the sums which when taken together fairly represent, for the accounting period in question, all profits, gains and losses (including interest) arising to the company from its loan relationships and related transactions. Certain commentators have argued that section 85A is the last word on what amounts are taken into account, subject to specifically expressed tax adjustments. The addition to section 85A(1) made by paragraph 5(1) puts the issue beyond doubt so that it is clear that the "fairly represents" rule does override the accounting treatment".

46. The status of Explanatory Notes, and the extent to which it is permissible to have regard to them in construing a statute, were considered by Lord Steyn in R (Westminster City Council) v National Asylum Support Service [2002] UKHL 38, [2002] 1 WLR 2956, at [2] to [6]. He explained that since 1999 Explanatory Notes have been published in conjunction with the majority of public Bills introduced in either House of Parliament by a Government minister. He observed, at [4], that:

> "The texts of such notes are prepared by the Government department responsible for the legislation. The Explanatory Notes do not form part of the Bill, are not endorsed by Parliament and cannot be amended by Parliament. The notes are intended to be neutral in political tone: they aim to explain the effect of the text and not to justify it. The purpose is to help the reader to get his bearings and to ease the task of assimilating the law."

47. Lord Steyn continued, at [5]:

> "The question is whether in aid of the interpretation of a statute the court may take into account the Explanatory Notes and, if so, to what extent. The starting point is that language in all legal texts conveys meaning according to the circumstances in which it was used. It follows that the context must always be identified and considered before the process of construction or during it. It is therefore wrong to say that the court may only resort to evidence of the contextual scene when an ambiguity has arisen… In so far as the Explanatory Notes cast light on the objective

> setting or contextual scene of the statute, and the mischief at which it is aimed, such materials are therefore always admissible aids to construction. They may be admitted for what logical value they have. Used for this purpose Explanatory Notes will sometimes be more informative and valuable than reports of the Law Commission or advisory committees, Government green or white papers, and the like. After all, the connection of Explanatory Notes with the shape of the proposed legislation is closer than pre-parliamentary aids which in principle are already treated as admissible…"

48. At [6], Lord Steyn added this salutory warning:

> "What is impermissible is to treat the wishes and desires of the Government about the scope of the statutory language as reflecting the will of Parliament. The aims of the Government in respect of the meaning of clauses as revealed in Explanatory Notes cannot be attributed to Parliament. The object is to see what is the intention expressed by the words enacted."

49. The observations of Lord Steyn in the <u>National Asylum Service</u> case were not commented upon by the other members of the court, but he returned to the same theme, more briefly, in <u>R (S) v Chief Constable of the South Yorkshire Police</u> [2004] UKHL 39, [2004] 1 WLR 2196, at [4], in a speech with the reasoning of which Lord Rodger of Earlsferry, Lord Carswell and Lord Brown of Eaton-under-Heywood all agreed: see [63], [80] and [85]. Lord Steyn there said:

> "Explanatory notes are not endorsed by Parliament. On the other hand, in so far as they cast light on the setting of a statute, and the mischief at which it is aimed, they are admissible in aid of construction of the statute. After all, they may potentially contain much more immediate and valuable material that other aids regularly used by the courts, such as Law Commission Reports, Government Committee reports, Green Papers and so forth."

See too <u>Tarlochan Singh Flora v Wakom (Heathrow) Limited</u> [2006] EWCA Civ 1103, at [15] to [17] per Brooke LJ.

50. With the benefit of this guidance, I think it is permissible to take account of the Explanatory Notes which I have quoted in identifying the anti-avoidance purpose of the 2006 amendment to section 85A(1) and the mischief at which it was aimed, namely making it absolutely clear that the "fairly represent" rule in section 84(1) takes priority over, and may override, the accounting treatment mandated by section 85A(1). As I have explained, these are inferences which I would anyway be disposed to draw in the absence of the Explanatory Notes, and I emphasise that in the present case I regard the value of the Explanatory Notes as no more than confirmatory. I also recognise that the final two sentences of paragraph 59 of the Notes are not admissible to the extent that they reflect the wishes and desires of the Government about the scope and effect of the amendment; but that recognition does not in my view invalidate the inference to be

drawn from Parliament's decision to single out section 84(1) as a provision to which section 85A(1) is expressly made subject.

The accounting issues: the decisions of the FTT and the Upper Tribunal

51. I propose at this stage to deal briefly with the accounting issues, which both Tribunals have decided in favour of TPL. They are fully and clearly discussed by the Upper Tribunal in paragraphs [49] to [73] of the UT Decision, which is reported at [2017] STC 1622.

52. The FTT had the benefit of expert accounting evidence on both sides. TPL's expert was Mr Kenneth Wild OBE, who was a fellow of the ICAEW and formerly head of Deloitte's financial reporting technical department and a member of the UK Accounting Standards Board. The FTT found him to be "a knowledgeable witness with extensive experience of both accounting theory and practice acquired through many years of employment as a technical accounting expert": see the FTT Decision at [51]. HMRC's expert was Ms Eileen Patricia Baird, who was a member (she too is now a fellow) of the ICAEW and had been employed as an accountant by HMRC since 2009. Mr Wild's opinion, which the FTT accepted, was that the accounting treatment adopted by TPL in respect of the transfer of the Claims to TRAIL fully complied with UK GAAP, and that there was no other permissible accounting treatment. Ms Baird, on the other hand, considered that TPL's approach did not accord with GAAP. In her view, TPL should have accounted for the shares that it acquired in TRAIL at a cost equal to the consideration of £200,054,469 specified in the assignments. Since the gains on disposal of the Claims were unrealised, it was her opinion that they should have been accounted for in TPL's statement of total recognised gains and losses (or "STRGL" for short): see the UT Decision at [50].

53. As the Upper Tribunal went on to explain, the STRGL was introduced by Financial Reporting Standard ("FRS") 3, which dealt with "Reporting Financial Performance". Other relevant Standards included FRS 5, entitled "Reporting the Substance of Transactions", which required "an entity's financial statements to report the substance of the transactions into which it has entered", and FRS 12, entitled "Provisions, Contingent Liabilities and Contingent Assets", one of the purposes of which was to ensure that contingent assets should not be recognised until they were either realised or the realisation of a profit from them was "virtually certain".

54. The Upper Tribunal then summarised salient features of the evidence of Mr Wild and Ms Baird, before reaching these conclusions:

> "58. It should be stressed that it was common ground that, at all times prior to their transfer to TRAIL, the Claims could not properly be recognised in TPL's accounts because they were "contingent assets".
>
> 59. The FTT preferred Mr Wild's evidence [*details of which were then given*].
>
> 60. It is HMRC's case that the FTT erred in a variety of respects in relation to the accounting questions [*again, details were then given*].

> 61. In our view, however, there can be no question of our overturning the FTT's conclusions on these matters. This is not a case in which it can be said that there was no evidence to support a finding: the FTT's conclusions reflected evidence given by Mr Wild. Further, having been head of the technical department at Deloitte for many years, a member of the Accounting Standards Board and chairman of a committee that worked on a precursor to FRS 5, Mr Wild was very well-qualified to give expert evidence on the issues, rather more so in fact than Ms Baird. Mr Wild's evidence cannot, moreover, be characterised as obviously wrong: to the contrary, Mr Wild provided cogent explanations for his views and related them to accounting standards and other materials. Finally, the FTT, unlike us, had the benefit of seeing Mr Wild and Ms Baird give oral evidence over an extended period."

55. The Upper Tribunal then went on to consider HMRC's submission that TPL's accounts were not GAAP-compliant because they contravened a provision of the Companies Act 1985 ("CA 1985") relating to company accounts. The relevant provision was contained in paragraph 17 of schedule 4 to CA 1985, which (put shortly) required "the amount to be included in respect of any fixed asset" to be "its purchase price or production cost", with "purchase price" defined in section 262 of that Act as including "any consideration (whether in cash or otherwise) given by the company in respect of that asset". The argument advanced for HMRC by Mr Milne was that the shares in TRAIL that TPL acquired represented a fixed asset, so their "purchase price" had to be included in TPL's accounts; and the "purchase price" had to include the consideration of some £200 million given for the shares. This sum need not have featured in TPL's profit and loss account, said Mr Milne, but it should have been reflected in the company's STRGL.

56. After pointing out that these submissions, if correct, could have far-reaching implications, because they would imply a conflict between the relevant accounting standards and the requirements of CA 1985, the Upper Tribunal referred to what they described as a "highly influential opinion written by Mr Leonard Hoffmann QC and Miss Mary Arden (as they then were) in September 1983", where the authors said that "the courts will treat compliance with accepted accounting principles as prima facie evidence that the accounts are true and fair". The Upper Tribunal also referred to some judicial endorsements of those views, and to Parliamentary recognition of accounting standards, as well as to Mr Wild's evidence on the question, before concluding as follows:

> "71. As discussed above, we consider that the FTT was entitled to conclude, as it did, that TPL's financial statements complied with accounting standards and that no alternative accounting treatment would have been consistent with those standards. That being so, it seems to us that the financial statements must be taken to have given a "true and fair view" in accordance with section 226A of CA 1985. Were paragraph 17 of schedule 4 to the Act to be incompatible with the accounting treatment, the paragraph would, in our view, have to yield to the overriding

> need for accounts to give a "true and fair view" (as to which, see section 226A(5)).
>
> 72. However, we do not think that paragraph 17 of schedule 4 to CA 1985 should be interpreted in such a way as to give rise to a conflict with accounting standards. Neither the expression "purchase price" nor the word "consideration" (by reference to which "purchase price" is defined in CA 1985) is unambiguous in its application to the facts of the present case. It appears to us that, where a company acquires shares in a subsidiary in return for contingent assets that could not properly be recognised in the parent's accounts, with the result that accounting standards require the parent to attribute no value to the shares (as the FTT found to be the case with TPL), the cost to the parent (or, in the words of paragraph 17 of schedule 4 to CA 1985, "purchase price") can and should be taken to be nil."

TPL's appeal: the effect of section 84(1) of FA 1996

57. Despite its success on the accounting issues, TPL failed on the fourth issue (which raised the question of the effect of section 84(1) of FA 1996) before both Tribunals. It is therefore convenient to begin by considering TPL's appeal on this issue.

(1) The reasoning of the FTT and the Upper Tribunal

(a) The decision of the FTT

58. The FTT dealt with this issue at [144] to [164] of the FTT Decision.

59. The FTT began its discussion as follows:

> "144. At its heart, despite the extensive citation of technical accounting literature to us, our view is that this is an appeal less about the technical application of accounting principles and more about how far accounting principles can be taken as the basis of a taxing statute and in particular whether they can be taken so far as to result in potential profits being taken outside the UK tax net altogether.
>
> 145. In terms of the statutory approach, that question is whether or not there is implicit or explicit in s 84 a concept of "fairness" by reference to taxable profits which can override a set of accounts which are in accordance with UK GAAP and which produce a "true and fair" accounting view of a company's profits.
>
> 146. It is not in dispute that at the relevant time s 84 included a two stage process, which implies some recognition that accounting profits might not reflect a fair view of a company's profits. Counter to what was said by Mr Peacock, there is nothing

> on the face of [*the*] legislation to suggest that this fairness is referable only to the allocation or attribution of profits.
>
> 147. Mr Peacock's approach produced a hermetically sealed version of s 84 into which only accounting profits were allowed. We view this as too restricted an approach even to legislation which takes as its starting point the accounting profits of a company…"

60. The FTT then referred, at [149], to the acceptance by TPL that one purpose of "the fair representation rule" in section 84(1) was properly to allocate profits on a timing basis to the correct period. The FTT commented that this reflected the requirements of FRS 12, and was "based on the accounting concept of prudence which will always tend to defer the recognition of profits." The FTT continued, in a passage which encapsulates their view of the case:

> "150. Mr Wild saw the world through a wholly accounting perspective, he said; "*I don't know anything about tax. I don't think tax should have any effect on good accounting*". We do not agree that this is a sufficient view of the world when that world has in view a transaction which has been structured to ensure that profits are deferred for tax purposes by relying on accounting rules. S 84(1) provides for an override of the credits and debits produced by an acceptable accounting method if that method has failed to fairly represent profits. Mr Wild was concerned that applying FRS 5 in the manner suggested by Ms Baird gave carte blanche to companies to inflate profits by transferring assets with unrealised value to subsidiaries and trigger a recognised profit. That might well be true for accounting purposes. However the converse is true for tax purposes; Mr Wild's approach allows companies to transfer assets with unrealised value to subsidiaries and avoid triggering a taxable profit. The analogous tax transaction to the transfer of intellectual property rights with an uncertain value between group companies referred to by Mr Wild, is the transfer of assets pregnant with gain between members of a group of companies one of which is outside the UK tax net before the gain is realised.
>
> 151. Our view is that on any realistic commercial approach to this transaction, these Claims were monetised when they were exchanged for shares in TRAIL. We do not accept [*TPL's*] distinctions between an exchange and a sale for these purposes; TPL no longer directly owned the assets and had received something else in exchange. That might not be a sale, but it is a disposal for good consideration, to which the principles in *Stanton v Drayton* should apply.
>
> 152. We know that there was value in the Claims in December 2006 and March 2007 and that valuation took account of the likelihood of payment; it priced in the contingency of receipt. The valuation given to the Enron and ECTRL Claims by Carval

> was their non-contingent value and represented the current realisable value of those claims. We were told that the Enrici Claim had been valued in the same way.
>
> 153. Following this logic we have concluded that £200 million of profit should be recognised in TPL for the accounting periods when the Claims were transferred to TRAIL despite the fact that no profit was recognised for accounting purposes…"

61. This approach, in the FTT's view, built on TPL's acceptance that section 84(1) could be used for the proper allocation of profits between accounting periods, because its effect was to accelerate credits which would otherwise be recognised in a later accounting period: see [154]. "To take any other approach", said the FTT (ibid), "would remove the ability of s 84(1) to adjust credits and debits to give a fair representation of profits."

62. The FTT was also unimpressed by the submission that moving away from GAAP would leave "the Tribunal without the ability to quantify profits". It said, at [155]:

> "Prior to the legislative move towards the primacy of accounting profits as a basis for tax the courts were perfectly capable of identifying a profit and particularly the time at which a profit should be treated as arising for tax purposes. In this case we do not have to look far to find the correct non-contingent valuation of the Claims, it is stated in the Carval approach to valuation which was accepted by the parties."

63. In the final part of its discussion, the FTT looked at the picture more broadly and examined the impact of FRS 5 in ascertaining the substance of a transaction. It commented, at [158], that "FRS 5 contains a strong subjective element, as made clear by the very different view of the substance of the transaction taken by Ms Baird and Mr Wild." The FTT added, at [159]:

> "While accepting Mr Wild's application of FRS 5 in this instance we have concerns about allowing the application of a subjective accounting principle to be relied on in the context of a DOTAS reported transaction. We are not convinced that FRS 5's perspective of substance, looking at economic substance over and above commercial legal form should be allowed to predominate for tax purposes in this kind of transaction…"

64. The FTT then said, at [161]:

> "Our view is that TPL's profits for tax purposes should treat the non-contingent valuation of the shares received by it on the assignment of each of the Claims as profit arising on the transfer

> of the Claims in order to give a fair representation of TPL's profits for the two relevant accounting periods."

(b) The decision of the Upper Tribunal

65. After summarising the FTT's decision at [74] to [76] of the UT Decision, and reciting at some length the arguments addressed to them by Mr Peacock for TPL and by Mr Milne for HMRC, the Upper Tribunal stated their conclusions at [99] to [107]. They began their discussion by agreeing with Mr Peacock that section 84(1) "does not import some overarching requirement of "fairness", allowing a Court or Tribunal to impose its own perception of the right result." They said that the FTT had not fallen into this trap, and referred to [161] of the FTT Decision where the purpose of section 84(1) had correctly been identified as the fair representation of TPL's profits for tax purposes. In relation to the solution adopted by the FTT, the Upper Tribunal said at [99]:

> "We do not see that as the application of an imprecisely articulated fairness test, but as an adjustment which fairly – meaning as accurately as reasonably possible – reflects economic reality and which adopts, moreover, the value TPL itself had placed on the shares it received. That conclusion does not, however, answer the question whether the adjustment was one open to the FTT."

66. The Upper Tribunal continued:

> "100. Mr Peacock's argument that it was not depends substantially upon the proposition that once the FTT had determined that TPL had made no accounting profit it was not open to it to bring in some other notional profit from elsewhere. That argument has three limbs. The first is that no amount which might represent some notional profit, or credit, can be found in TPL's accounts. In our judgment that part of the argument must fail. As Mr Milne, in our view correctly, pointed out there is no limitation in section 84(1) on the source of the sums which may be brought into account, nor are the profits, gains or losses to which sub-paragraph (a) refers restricted to those which might be recognised by GAAP-compliant accounts. This limb of the argument might have been sustainable by reference to the earlier version of section 84(1) (see paragraph 95 above) but is in our view unsustainable by reference to the version in force at the time with which we are concerned. Indeed, it seems to us that the amendment was designed to ensure that the application of section 84(1) was unequivocally not confined to sums identifiable by reference to a company's accounts.
>
> 101. The second limb of the argument is that section 84(1) is designed to deal with cases in which there is a mismatch between a tax period and the company's accounts, or where an apportionment between loan relationship gains and other types

> of income is required. We do not consider that a natural reading of the subsection and, in particular, the phrase "for the accounting period in question". All that phrase signifies, as we see it, is that the section 84(1) exercise must be undertaken for each accounting period, but as corporation tax attaches to separate accounting periods there is nothing remarkable in that. The exercise may permit the kinds of apportionment, by time or derivation, to which Mr Peacock referred, but we do not see in the terms of the subsection any intention on the part of the draftsman to limit it in that way. Moreover, had it been his intention it would have been simple to say so.
>
> 102. The third limb of the argument is that, as a matter of fact, TPL did not make any profit when it exchanged the Claims for shares, since the two assets were of equal value, whatever that value might have been. At first sight Mr Peacock is on stronger ground in this limb since the experts were agreed that TPL did not realise a profit in that exchange. The question, however, is not merely whether TPL realised a profit, but whether it made a profit or a gain within the scope of section 84(1). It is to be noted that the subsection uses both words, plainly intending them to have different meanings."

67. In the view of the Upper Tribunal, it was unnecessary to look beyond the decision of the Supreme Court in the <u>DCC Holdings</u> case in order to resolve the issue. They reasoned as follows:

> "103. … In that case [*i.e. DCC Holdings*] the taxpayer attempted to manipulate the deeming provisions relating to repos in the hope of procuring a mismatch between economic reality and the tax treatment of the transactions in which it engaged. Here, as the description of the scheme set out in the DOTAS notification… makes clear, TPL has attempted to exploit accounting rules for the same purpose, in the process of generating a mismatch between economic reality and the accounting treatment of it. Like Schrödinger's cat, the Claims were dead and unrecognised in TPL, while simultaneously alive and well in TRAIL. That, as we see it, is the kind of asymmetry which section 84(1) is designed to correct.
>
> 104. The passage from the judgment of Lord Walker on which Mr Milne relied… seems to us to provide the answer here as it did there. Earlier in his judgment Lord Walker had considered three possible symmetrical solutions… Here the choice is a little different, but the principles seem to us to be the same. One can view the economic reality of what TPL and TRAIL did in either of two ways. The first is that TPL transferred to TRAIL assets (the Claims) of contingent, and correspondingly (by application of GAAP) unrecognisable value. As Mr Peacock correctly said, the asset did not change its character on transfer, and economically nothing changed. Thus symmetrical treatment

could have been achieved by the non-recognition of the asset by TRAIL, for tax though not necessarily accounting reasons. But that is not what TPL did. It chose to ascribe a recognisable value to the Claims once they had been transferred to TRAIL, but induced asymmetry by not recognising its now valuable subsidiary.

105. Although it did not put it in quite this way, in essence the FTT applied section 84(1) to that asymmetry in reaching its conclusion that TPL had made a gain which, for tax purposes, must be brought into account. It is, in our view, difficult to see how its conclusion does any more than reflect the fact, whatever its accounts might show, that following the transfer TPL had a subsidiary which, by recognising the Claims at their Carval valuation, had bestowed on itself a substantial positive balance sheet. We agree with Mr Milne that the value of the subsidiary must be reflected in the value of the shares held by TPL – there was a surplus in TRAIL potentially available for distribution for shareholders. It is not realistic for TPL to claim that, because it was not compelled to recognise the shares in its accounts, they must be treated for all purposes as effectively worthless. Although the amount which would eventually be received for the Claims could not be predicted with certainty, they had a value, reflected in the existence of a market for them. The shares could have found a buyer had TPL chosen to sell.

106. Mr Peacock complained that the FTT's conclusion accelerated a tax liability, by ascribing to TPL a gain for tax purposes at a time earlier than it could be said it had realised an economic gain. We do not find that a particularly attractive argument against the background of a scheme designed to ensure that the economic gain was not taxed at all, but even leaving the lack of attraction to one side we do not consider the argument has any merit. As we have said, TRAIL could have treated the Claims as a contingent asset, not to be recognised in its accounts for tax purposes. Instead, by recognising a value to the Claims in its accounts, TRAIL has crystallised a gain within the scope of section 84(1). We do not see how TPL can legitimately complain about acceleration it has brought on itself.

107. For those reasons TPL's appeal on Issue 4 is dismissed."

(2) Submissions

(a) The submissions of TPL

68. In their skeleton argument in support of the appeal, counsel for TPL provide a helpful outline of TPL's case. Somewhat simplified, it runs as follows:

(1) TPL's assignment of the Claims to TRAIL did not yield any commercial profit in TPL's hands, because the value of the consideration shares issued by TRAIL was equal to the fair value of the Claims.

(2) Nor did TPL realise an accounting profit on the assignment, because it did not realise a commercial profit. Since the nature of the Claims remained unaltered after the assignment, and the only consideration received by TPL was in the form of shares issued by TRAIL, there is no way in which TPL's profits (whether accounting or otherwise) could have been increased.

(3) As the FTT found and the Upper Tribunal upheld, there was no other method of accounting for the assignment of the Claims, so far as TPL was concerned.

(4) Section 84(1) of FA 1996 cannot be construed or applied so as to override a company's accounts, nor does it admit of a reading which creates taxable credits and debits where none exist as a matter of GAAP.

(5) Further, to construe section 84(1) as a provision which overrides GAAP has no foundation in principle, because any such application of the section would inevitably be imprecise and arbitrary.

(6) Such a construction and application of section 84(1) would also be contrary to the scheme of the loan relationship provisions, and would in particular conflict with section 85A(2) (which provides for the imposition of "correct accounts" where the actual accounts do not comply with GAAP) and with the adjustment provisions contained in schedule 9.

(7) The Upper Tribunal wrongly ignored the binding decision of the Court of Appeal in Greene King PLC v HMRC [2016] EWCA Civ 782, [2017] 4 WLR 190, which holds that section 84(1) cannot be interpreted or applied so as to override a company accounts, and thus conclusively decides the issue in favour of TPL.

(8) The legislative history of the loan relationship provisions, and section 84 in particular, shows that section 84(1) cannot ever have been intended to override a company's GAAP-compliant accounts by reference to some sort of unspecified economic reality, particularly as TPL made no profit or gain of any description on the assignments.

(9) Finally, had TRAIL been resident for tax purposes in the UK, it would have been taxable in respect of any profit in respect of the Claims. The only reason TRAIL was not so taxable is because TRAIL was not UK tax resident. An attack on TPL to compensate HMRC for HMRC's inability to tax TRAIL is unprincipled and impermissible.

69. In relation to the loan relationship legislation, TPL makes two main points. The first is that what counsel call "the "fairly represents" mechanism" in section 84(1) has an "attribution function", and is designed to ensure that the relevant credits and debits, once identified, relate only to credits and debits which arise from the company's loan relationships during the accounting period in question. This mechanism would be needed, it is said, if (for example) a company made a profit from a sale of both loan relationships and shares, or if a company has an accounting period of more than twelve

months which has to be sub-divided for tax purposes: see sections 8(3), 12 and 834(1) of the Income and Corporation Taxes Act 1988.

70. The second point is that there are express provisions in the legislation which do adjust a company's accounts. They are set out in schedule 9 to FA 1996, which is headed "Loan relationships: special computational provisions". So, for example, paragraph 10 of schedule 9 excludes any "loss" from a company's loan relationship computation, to the extent that the loss is "referable to a time when the [*loan relationship*] was not subject to United Kingdom taxation…"; while paragraph 11 of the schedule adjusts credits and debits in respect of a non-arm's length related transaction onto an arm's length basis. This latter provision is particularly telling, submits TPL, because it shows that Parliament did not consider that any adjustment was required, for loan relationship purposes, of the debits and credits arising on the assignment of a loan relationship where, as in the present case, the assignment was on an arm's length basis. Furthermore, it is said, paragraph 11 of schedule 9 would be redundant if the "fairly represents" mechanism has the meaning for which HMRC contend, because it would have been pointless to substitute arm's length terms for non-arm's length terms if even arm's length terms were capable of being overridden by section 84(1)(a).

71. Our attention was also drawn to paragraph 11B of schedule 9, introduced by the Finance Act 2008, which in broad terms taxes profits on an assignment of a loan relationship if the assignment is informed by a "tax avoidance" purpose. This provision was not in force at the relevant times, but according to TPL it provides another example of an adjustment provision which would be redundant if section 84(1) has the overriding effect identified by the Tribunals below.

72. Turning to authority, TPL places considerable reliance on the decision of this court in Greene King which was handed down on 27 July 2016, a few months before the Upper Tribunal hearing in the present case in November 2016. Greene King concerned another loan relationship tax avoidance scheme devised and marketed by EY. The facts were far removed from the scheme with which we are concerned, although the artificial series of transactions designed by EY did include the assignment by the parent company of a group to a subsidiary of the parent's entitlement to receive the future interest under a loan, in consideration for which the subsidiary issued £1.5 million of preference shares to the parent. For present purposes, the relevant ground of appeal was ground 4, whereby the parent submitted that the accretion back to it of £20.5 million (representing the net present value of the future interest payments under the loan) fell to be excluded from section 84(1)(a) in any event because it did not "fairly represent" profit as required by the wording of that subsection: see the judgment of Sir Terence Etherton C (with whom Patten and Sales LJJ agreed) at [71].

73. Counsel for the taxpayers relied upon the judgment of Moses LJ in the Court of Appeal in DCC Holdings [2009] EWCA Civ 1165, [2010] STC 80, where he said at [63]:

> "Section 84(1) is the machinery by which all interest under DCC's loan relationships is brought into account. The section poses a second statutory question, namely whether any particular sum when taken together with the other sums which fall to be brought into account fairly represents all the interest including that which is the mere product of statutory fiction. That question is different and additional to the first question, whether the sums

> are in accordance with an accruals basis of accounting. The introduction of that distinct additional question suggests the possibility but, I accept, not the necessity of some process of adjustment. It suggests that there may be some room for adjustment of the sums which would otherwise be given by the application of an authorised accounting method, or, at the very least suggests that in some cases the identification process in section 84(1) will not merely be resolved by an authorised accounting method."

74. It is essential to note at this point that the version of section 84(1) which was considered by Moses LJ in DCC Holdings, and by the Court Appeal in Greene King, was the version as it stood *before* the amendments made by FA 2004. At that date, it will be recalled, the statutory wording referred to "the sums which, in accordance with an authorised accounting method and when taken together, fairly represent, for the accounting period in question…". It was in relation to that statutory wording that the Chancellor in Greene King rejected the submission for the taxpayers advanced by John Gardiner QC, as follows:

> "72. Mr Gardiner described the "fairly represent" requirement as a "sanity check" for the accounting to be overridden where there is no real or commercial profit from a loan relationship
>
> [*Mr Gardiner's submissions were then set out*]
>
> 76. I do not accept that analysis of Mr Gardiner. In the first place, it is to be noted that in *DCC Holding (UK) Limited v Revenue and Customs Comrs* in the Supreme Court… Lord Walker JSC, with whom the other Justices agreed, said at para 35 that he doubted Moses LJ's analysis of section 84(1) as containing two criteria, one of which was required to yield to the other. Lord Walker considered that the words in section 84(1) had to be construed as a composite whole.
>
> 77. Secondly, no evidence was given by [*two of the taxpayers' witnesses*] to support Mr Gardiner's analysis. Their evidence was that it was incorrect to de-recognise part of the loan for accounting purposes, and they did not go on to give evidence of the consequences, as suggested by Mr Gardiner, if they were wrong on that point. In effect, Mr Gardiner had to advance his analysis as a matter of law. I do not consider that [*the parent*] can do so. What is in issue is the fair representation of credits and debits in accordance with "an authorised accounting method" for the purposes of section 84(1). There is no scope for some other method set by the court itself."

75. Returning to the present case, TPL submits that Greene King is still binding authority on the meaning of "fairly represent" in section 84(1), even though that case was concerned with the pre-2004 wording of the section, because the subsequent excision of the phrase "in accordance with an authorised accounting method" from section 84(1) was replaced by the enactment of sections 85A and 85B requiring computation in accordance with GAAP. Nothing of substance had changed by reason of FA 2004, as the Explanatory Notes to the relevant changes in FA 2004 make clear.

76. In oral argument, Mr Ghosh submitted to us that if the mere removal of the words "in accordance with an authorised accounting method" from section 84(1) had changed the scope and meaning of the "fairly represent" requirement in the way contended for by HMRC, so that it became a form of economic override, that would be "the most massive side wind in legislative history."

77. A further point upon which TPL places much emphasis is the submission, articulated in various ways, that HMRC's real complaint in this case is about the non-resident tax status of TRAIL. Had TRAIL been tax resident in the UK, TRAIL would have been taxable on any profit subsequently realised in respect of the Claims, and it would not have had the benefit of a £200 million base cost in computing that profit. This follows from paragraph 12 of schedule 9, which so far as material provides that:

> "(1) … this paragraph applies where, as a result of –
>
> (a) a related transaction between two companies that are –
>
> (i) members of the same group, and
>
> (ii) within the charge to corporation tax in respect of that transaction,
>
> …
>
> one of those companies ("the transferee company") directly or indirectly replaces the other ("the transferor company") as a party to a loan relationship.
>
> (2) For the purpose of determining the credits and debits to be brought into account for the purposes of this Chapter in respect of the loan relationship –
>
> (a) for the accounting period in which the transaction or, as the case may be, the first of the series of transactions takes place, the transferor company shall be treated as having entered into that transaction for a consideration equal to the notional carrying value of the asset or liability representing the relationship; and
>
> (b) for any accounting period in which it is a party to the relationship, the transferee company shall be treated as if it had acquired the asset or liability representing the relationship for a consideration equal to the notional carrying value of the asset or liability.

> For the purposes of this sub-paragraph, the notional carrying value is the amount that would have been the carrying value of the asset or liability in the accounts of the transferor company if a period of account had ended immediately before the date when the company ceased to be a party to the loan relationship."

In other words, says TPL, by virtue of paragraph 12, had TRAIL been UK tax resident, it would have been deemed to acquire the Claims at a nil accounting value, and would thus have been taxable on the entirety of its future receipts in respect of the Claims. This shows that any alleged "asymmetry" arises not because of TPL's accounting practice, but by reason of TRAIL being outside the scope of CT.

78. In his oral submissions, Mr Ghosh was very critical of the decisions of both Tribunals. He described the FTT's view "that on any realistic commercial approach to this transaction, these claims were monetised when they were exchanged for shares in TRAIL" (at [151] of the FTT Decision) as unintelligible. Nothing of substance had changed when the Claims were assigned to TRAIL, and in no sense were they converted into money as they would have been on a sale to an outside purchaser. On a sale, TPL would have given up ownership of the Claims and received money instead. On ordinary principles, a profit would have crystallised and would have been recognised accordingly. By contrast, the effect of the assignments was merely that TPL exchanged its rights in respect of the Claims for shares in TRAIL. TPL remained fully exposed to future fluctuations in the value of the Claims, albeit indirectly rather than directly; but neither commercially, nor as a matter of accounting, had any profit crystallised. The position was in substance no different than if TPL had simply made a gift of the Claims to TRAIL.

79. As for the UT Decision, Mr Ghosh submitted that it was fundamentally flawed, both in its endorsement of the FTT Decision and in the Upper Tribunal's own additional observations and reasoning. Mr Ghosh emphasised the exclusivity of the loan relationship provisions, and the absence of any statutory guidance or criteria by reference to which the "fairly represent" requirement should be applied if it were decoupled from GAAP. Further, the Upper Tribunal's search for a symmetrical solution, based on the approach of the Supreme Court in <u>DCC Holdings</u>, was mistaken in principle, because the only asymmetry in the present case was caused by TRAIL's non-UK tax residence. The Upper Tribunal's view, at [105] of the UT Decision, that TPL had somehow made a gain which had to be brought into account for tax purposes, because TRAIL, by recognising the Claims at their Carval valuation, "had bestowed on itself a substantial positive balance sheet" was, in his submission, incomprehensible. TPL made neither a profit nor a loss as a result of a transactions, and the reason why the Claims had a positive value in TRAIL's balance sheet was that they were valuable assets which TRAIL had not previously owned, and in consideration for which it had issued shares at par to TPL.

(b) The submissions of HMRC

80. On the construction of section 84, HMRC submit that following the amendment to section 85A(1) made by FA 2006, if not before, the "fairly represent" requirement does indeed potentially override the accounting treatment mandated by sections 85A and 85B. It follows that, in order to ascertain the credits or debits to be brought into account for a period, section 84 requires the company to do two things. First, it must bring into

account the amounts which have been recognised by the company in its GAAP-compliant account, whether in the profit and loss account or in the STRGL. Alternatively, where there are no such accounts, the company must bring into account the amounts which would be recognised by GAAP-compliant accounts. This is the effect of sections 85A and 85B. Secondly, the company must then evaluate the amounts thus brought into account, in order to check whether they are "sums which fairly represent" the profits, gains and losses, and the interest charges and expenses, as set out in section 84(1)(a) and (b). HMRC submit that this is the clear effect of the words used in section 84(1), read together with sections 85A and 85B; and it gives full effect to the opening words of section 85A(1) as amended. In particular, it would make no sense to interpret section 84 as merely re-imposing a requirement which should already be satisfied by GAAP-compliant accounts.

81. Furthermore, say HMRC, this interpretation accords with the clear legislative policy of Chapter II. Precisely because it contains a comprehensive and exclusive code charging to tax all profits, gains and losses arising to a company from its loan relationships and related transactions, one would expect to find a "longstop" or "failsafe" provision which has the effect that significant profits arising to a company from its loan relationships do not vanish or fall out of charge to tax. In this connection, Parliament would have been aware that there can often be more than one correct accounting treatment for a transaction, and that a taxpayer might seek to exploit a GAAP-compliant accounting method in order to avoid tax. Parliament would not have intended to make CT on loan relationships voluntary. Any possible doubt on this score is dispelled by the Explanatory Notes to the relevant 2006 amendment.

82. HMRC go on to submit that, properly understood, DCC Holdings supports their interpretation of section 84. That case was concerned with sections 84(1) and 85 as originally enacted, when the "fairly represent" requirement was tied to an authorised accounting method. Even when the legislation was in that form, however, the substantive importance of the fair representation test was recognised by Lord Walker in his judgment at [43] and [44]. In particular, Lord Walker said at [43] (with emphasis supplied):

> "Under section 84(1) the concern is to identify the sums, whether credits or debits, in respect of all DCC's loan relationships, actual or hypothetical, which "in accordance with an authorised accounting method [the accruals basis] and when taken together, fairly represent…(b) all interest under the company's loan relationships… If the credit from an actual relationship under which DCC is a creditor is a time-apportioned sum, the debit under a hypothetical relationship under which DCC is a debtor making a payment representative of interest must also be a time-apportioned sum, with the apportionment carried out in the same way. The language of section 84(1) is in my view amply wide enough to enable that to be done, *and unless it is done, the subsection's requirement of fair representation cannot be satisfied*."

Furthermore, say HMRC, although Lord Walker may have doubted what Moses and Rix LJJ said in the Court of Appeal about "fairly represent" being a second stage test (see [2010] STC 80 at [63] to [72] per Moses LJ, and [97] and [108] per Rix LJ), it is

now clear that what Moses and Rix LJJ said is correct in relation to the amended version of section 84(1) to which sections 85A and 85B are expressly made subject.

83. The point may be tested, submits Mr Milne, by supposing a case where two or more GAAP-compliant methods are available, one of which produces a mismatch (or asymmetry) so that consideration which is agreed to have been paid on a sale of rights under a loan relationship is recognised by the buyer but not the seller. The seller adopts the accounting method which appears to deliver the mismatch, in the hope of obtaining a tax advantage. In such a case, consideration of the sums which "fairly represent" the profits and gains arising to the company may well require the seller to bring into account as a loan relationship credit the amount given by the alternative GAAP-compliant method, because it alone satisfies section 84(1). Such an approach would be entirely consistent with authorities such as Johnston v Britannia Airways [1994] STC 763, which establish the general proposition that in the ordinary case both HMRC and the taxpayer are bound by whatever choice of GAAP-compliant accounting is adopted by the taxpayer, precisely because the loan relationship code has a statutory override which HMRC are free to invoke.

84. If the argument is right thus far, HMRC go on to submit that if there is only one GAAP-compliant method which is available, but the company appears to have structured its transaction so as to exploit that method for tax purposes, the existence of the tax advantage (especially if notified under DOTAS) will be persuasive evidence that the method in question, even though GAAP-compliant, does not "fairly represent" the profits and gains which arise to the company from its loan relationships and related transactions.

85. As to the objection that such an interpretation is unworkable and unprincipled, because Parliament has not spelt out an alternative method of computing profit, HMRC submit that there is nothing arbitrary or fictional about the exercise on the facts of the present case. TPL obtained shares (agreed not to have been issued at a discount) with a par value of approximately £200 million from a "related transaction". That is a "profit" within the meaning of section 84(1). (It would also be an accounting profit, if we were to find, in disagreement with the Tribunals below, that the accounting treatment proposed by HMRC's expert was also GAAP-compliant: the case would then be one of the type discussed at [83] above).

(3) Discussion and conclusions

86. In evaluating these submissions, it is logical to begin with the construction of section 84(1). Are HMRC correct to say that the "fairly represent" requirement is an overriding provision which permits consideration of wider criteria than GAAP, or does it merely have the limited attribution function for which TPL contends?

87. I begin by observing that we must construe the section as it stood in 2006/07, in the context of the loan relationship legislation as a whole including the amendment to section 85A(1) introduced by FA 2006 with effect from 19 July 2006. The relevant principle is stated as follows in Bennion on Statutory Interpretation, 7th Edition, at section 6.7 on page 201:

> "(1) Where an Act makes textual amendments to an earlier Act the intention is usually to produce a revised text that may be construed as whole.
>
> (2) The original wording, however, may be used as an aid to interpreting the meaning of words that are unaltered."

The authors then comment that "[t]he fact Parliament has chosen to legislate by making textual amendments to another Act is a strong indication that the revised text of the amended Act is intended to be construed as a whole for the future." The authority cited for that proposition is Inco Europe Limited v First Choice Distribution (a firm) [1999] 1 All ER 820, where Hobhouse LJ said, at 823:

> "In general terms, it is undoubtedly correct that the effect of an amendment to a statute should be ascertained by construing the amended statute. Thus, what is to be looked at is the amended statute itself as if it were a free-standing piece of legislation and its meaning and effect ascertained by an examination of the language of that statute. However in certain circumstances it may be necessary to look at the amending statute as well… The expression of the relevant parliamentary intention is the *amending* Act. It is the amending Act which is the operative provision and which alters the law from that which it had been before."

88. As I have already explained, the purpose of the 2006 amendment to section 85A(1), which was introduced as part of a package of anti-tax avoidance measures, must have been to make it clear, for the avoidance of any doubt which might otherwise have arisen, that the fair representation requirement in section 84(1) was a separate and overriding condition which had to be satisfied in computing the credits and debits to be brought into account by a company in respect of its loan relationships.

89. The fact that it was an overriding requirement (whatever its precise content may have been) is clear from the express subjection of section 85A(1) to the provisions of section 84(1). The fact that it was also a separate requirement is apparent for at least two different reasons.

90. First, section 84(1) expressly requires consideration of the profits, gains and losses (and the interest, charges and expenses) which arise to the company for the accounting period in question "from its loan relationships *and related transactions*" (my emphasis), whereas the focus of sections 85A and 85B is exclusively on the amounts to be brought into account by the company itself, in accordance with either GAAP or substituted "correct accounts". Thus section 84(1) requires a synoptic view to be taken of each relevant loan relationship in conjunction with "any disposal or acquisition (in whole or in part) of rights or liabilities under that relationship" (that being the definition of "related transaction" in section 84(5)). There is no equivalent of this wider focus to be found in sections 85A and 85B.

91. Secondly, there would have been little point in expressly making section 85A(1) subject to section 84(1) if Parliament had intended that the fair representation requirement should always be assessed by reference to the same accounting criteria as those

mandated by sections 85A and 85B. The scope of the requirement was doubtless more limited before the 2004 amendments to section 84(1), because it then formed part of a single composite test which had to be applied "in accordance with an authorised accounting method"; but even then, as the observations of Lord Walker in DCC Holdings make clear, the words "fairly represent" had a distinct role to play as part of the overall assessment. That role can only have been enhanced when the link to an authorised accounting method was removed in 2004, leaving fair representation alone as the governing concept.

92. I am also wholly unpersuaded by TPL's submission that the requirement had only a limited attribution function. No support for giving such a meagre content to the requirement may be found in the wording of the section itself, or in the authorities. Indeed, such an interpretation would appear to be in conflict with the approach adopted both by Lord Walker, and by Moses and Rix LJJ, in DCC Holdings. It would also rob the 2006 amendment to section 85A(1) of any significant content, and reduce it to a mere statement of the obvious in a context where Parliament was deliberately introducing a package of anti-avoidance measures. Finally, the attribution functions relied upon by TPL are in my view anyway implicit in the provisions of sections 85A and 85B themselves, and therefore did not need to be the subject of separate provision.

93. The objection that Parliament would have formulated specific guidance on the application of the fair representation test, if it was intended to be an overriding requirement of a substantive nature, is at first sight more compelling, particularly when it is remembered that the test was until 2004 explicitly linked to "an authorised accounting method". Nevertheless, I do not think that the objection is well-founded, although it was persuasively advanced by Mr Ghosh. The concept of fairness is central both to the development and application of accounting standards, and to any process of judicial appraisal by a court or tribunal. In itself, the concept needs no elucidation, but rather provides a touchstone which is well suited to application by accountants, lawyers and judges, bringing their professional experience and expertise to bear in widely differing factual contexts.

94. Moreover, as Mr Milne pointed out, basic concepts such as profit or gain have traditionally not been the subject of detailed statutory provision in UK tax law, but have rather been left to the courts to develop, subject to specific statutory intervention from time to time. Thus, for example, the charge to income tax under Schedule D on the profits of a trade was for well over a century unencumbered with statutory definitions, and it was left to the courts to develop the applicable principles in computing profits for tax purposes. As a specific example of this process, Mr Milne referred to the rule in Sharkey v Wernher (1955) 36 TC 275, [1956] AC 58, where the House of Lords decided that when a trader appropriates an item of trading stock for personal use or consumption, the transaction must be accounted for at market value in the books of the trade. In preferring this solution to bringing the transaction into account at cost value, Lord Radcliffe said, at 84 to 85, that market value "gives a fairer measure of assessable trading profit" and was "better economics". Similarly, in my judgment, an assessment of the kind required by section 84(1) is one which courts and tribunals are well qualified to perform without further specific statutory guidance. Accounting standards and practice will of course always be central to the exercise, but they are not conclusive, particularly where "related transactions" are in issue.

95. Furthermore, as so often, the proof of the pudding is in the eating of it. It is notable that in the present case neither Tribunal felt any conceptual difficulty in applying the test to the facts, and concluding that it required the accounting treatment of the assignments in the books of TPL to be overridden.

96. Once the overriding nature of the fair representation test is recognised, the remainder of the analysis seems to me to fall into place without difficulty. Looking in the round at each Claim and the assignment of it by TPL to TRAIL in return for shares in TRAIL of equivalent value, I see no difficulty in concluding that a profit or gain of a capital nature thereby arose to TPL from the disposal of the Claim, and that such profit or gain can only be fairly represented by a loan relationship credit in the hands of TPL equal to the value of the Claim at the date of the disposal. In this way, the profit or gain is brought into charge to tax at the same value as is recognised for accounting purposes in the hands of TRAIL, and a symmetrical outcome is assured. The alternative treatment, based solely on the GAAP-compliant treatment of the transactions in the books of TPL, would not "fairly represent" the profit or gain arising to TPL because it would lead to the value received by TPL in return for the Claims falling out of any charge to tax at all in the hands of either TPL or (by virtue of its non-UK tax resident status) TRAIL. Parliament could not rationally have intended such an outcome, and application of the fair representation test is in my opinion the appropriate means by which it is prevented.

97. On any view, the assignment of each Claim by TPL involved the disposal of a valuable asset by TPL for a consideration in money's worth in the form of shares in TRAIL. Whether the disposal is properly to be characterised as a sale or an exchange or an assignment for valuable consideration does not seem to me to matter. The important point is that TPL disposed of one asset (the Claim) in return for another asset (shares in TRAIL of equivalent value). The disposal may not (on the findings of the FTT, upheld by the Upper Tribunal) have involved a realisation of the Claims which had to be recognised in accordance with GAAP; but the distinction between a sale of the Claims for money, which would admittedly have amounted to a realisation for accounting purposes, and a disposal for money's worth, which apparently would not, is at best a fine one. In each case, the asset disposed of passes from the ownership of TPL to a third party, and in each case equivalent value is received in return. Further, although the Claims remained under the indirect control of TPL, through its ownership of TRAIL, the legal structure through which that control was exercised was completely different, as were the methods by which TPL could obtain the economic benefits of the Claims in the future (whether by sale of the shares in TRAIL, or by receipt of dividends out of TRAIL's distributable profits, or on a liquidation of TRAIL). Taking all these matters into account, TPL can in my view fairly be regarded as having made a profit or gain on the disposals, even if it was not a profit or gain which UK GAAP required to be recognised.

98. In my view, an analysis along these lines is what the FTT must have had in mind when they described the Claims as having been "monetised when they were exchanged for shares in TRAIL". I see nothing wrong with such a description, provided that it is so understood.

99. Nor am I deflected from this conclusion by TPL's arguments that HMRC's real complaint is about the non-resident status of TRAIL, and that the scheme could not have succeeded if TRAIL were UK-resident because of the operation of paragraph 12 of schedule 9 to FA 1996. In the first place, it is the position of TPL with which we are

primarily concerned, and the computation of the credits arising from its loan relationships in the shape of the Claims. Secondly, since as a matter of commercial reality TPL disposed of the Claims in return for shares of equivalent value, the relevant question is how the value arising to TPL from that transaction should be fairly represented under section 84(1). It is at this stage that the accounting treatment of the transactions in the books of TRAIL becomes relevant, together with the need for a symmetrical solution in order to prevent tax avoidance. Thirdly, the fact that paragraph 12 of schedule 9 would effectively have countered the scheme if TRAIL were a UK-resident subsidiary seems to me to tell against, not in favour of, TPL's argument. It shows that, in a purely domestic context, Parliament did not intend related transactions between companies that are members of the same group to affect the taxability of accrued but unrealised profits or gains referable to the relevant loan relationship. Consistently with that policy, Parliament cannot have intended that the transfer of a loan relationship to a non-UK tax resident subsidiary should lead to the accrued value of the loan relationship at the date of the transfer falling out of charge to tax in the hands of either the transferor or the transferee. That objective is achieved if the transferee is UK-resident and takes over the transferor's carrying value. Such a solution is not available if the transferee is non-resident and outside the charge to CT, but Parliament must have intended that a similar result should if possible be achieved by other means.

100. For all these reasons, I consider that the FTT and the Upper Tribunal were correct to conclude that the credits which had to be brought into account by TPL in respect of the Claims in the two relevant accounting periods were the sums shown as the value of the consideration shares in the assignments, and not a nil amount. Although my reasoning is not entirely the same as that of the two Tribunals, I consider that in substance they came to the right conclusion on this issue, and (if the other members of the court agree) that TPL's appeal must therefore be dismissed.

The accounting issues

101. The conclusion which I have reached on the section 84(1) issue means that it is unnecessary to give further consideration to the accounting issues and the contentions raised by HMRC in their respondent's notice. Since an appeal to this court from the Upper Tribunal lies only on questions of law, HMRC would face obvious difficulties in seeking to overturn the conclusions of both Tribunals on what are to a large extent questions of fact and the evaluation of expert evidence. Mr Milne was of course fully alive to this difficulty, and he valiantly sought to persuade us that at least some clear errors of law could be identified in the reasoning and approach of the Upper Tribunal to the accounting issues. Without formally deciding the matter, I will content myself with saying that, in my judgment, none of the arguments advanced by HMRC came close to persuading me that any material error of law could be identified in the Upper Tribunal's treatment of the accounting issues.

Overall conclusion

102. Accordingly, for the reasons which I have given, I would dismiss the appeal.

Asplin LJ:

103. I agree

Lord Kitchin:

104. I also agree.