Appeal number: UT/2015/0163

CORPORATION TAX — avoidance scheme — transfer of contingent, unrecognised, claim against third party to subsidiary in exchange for shares — subsidiary recognising value of asset despite contingency but parent not recognising shares — whether accounting GAAP-compliant — yes — loan relationship rules — whether FA 1996 s 84(1) engaged — yes — recognised value of asset to be brought into account as credit in parent's corporation tax computation —appeal dismissed

PROCEDURE — opening of enquiry — whether error in identification of accounting period invalidates enquiry — no, if intention clear

UPPER TRIBUNAL (TAX AND CHANCERY CHAMBER)

GDF SUEZ TEESSIDE LIMITED
(Formerly TEESSIDE POWER LIMITED) **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

TRIBUNAL: MR JUSTICE NEWEY
JUDGE COLIN BISHOPP

Sitting in public in London on 24, 25 and 28 November 2016

Mr Jonathan Peacock QC and Mr Richard Boulton QC, instructed by Slaughter and May, for the Appellant

Mr David Milne QC and Miss Elizabeth Wilson, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. This case concerns the effectiveness of a tax avoidance scheme of which the appellant, Teesside Power Limited ("TPL", now renamed "GDF Suez Teesside Limited"), made use in 2006-2007. HM Revenue and Customs ("HMRC") contend that the scheme did not achieve its aim and, on this basis, issued closure notices assessing TPL to tax on profits of some £200 million. TPL appealed to the First-tier Tribunal ("the FTT"), but in a decision ("the Decision") released on 11 August 2015 the FTT (Judge Rachel Short and Mr Nigel Collard) ruled in favour of HMRC. TPL now appeals against the Decision.

2. TPL's liability to tax is said to have arisen under the provisions relating to "loan relationships" to be found in the Finance Act 1996 ("FA 1996"). The dispute between the parties turns on whether amounts fell to be brought into account for the purpose of Chapter II of Part IV of FA 1996 on the transfer by TPL of certain claims it held to a wholly-owned subsidiary. Among other things, the case raises issues as to the meaning and implications of the words "fairly represent" in section 84(1) of FA 1996.

Basic facts

3. From 1993, TPL owned and operated a power station at Redcar and Cleveland. It entered into "off-take" agreements with Enron Capital Trade Resources Limited ("ECTRL") and Enrici Power Marketing Limited ("Enrici"), each of which was part of the Enron group of companies, under which ECTRL and Enrici contracted to buy the majority of the output of the power station. Enron Corporation ("EC") guaranteed ECTRL's and Enrici's obligations.

4. As is well known, the Enron group collapsed. In 2001, EC filed for relief under Chapter 11 of the United States Bankruptcy Code and ECTRL went into administration. Administrators were appointed in respect of Enrici on 12 January 2006 and the company went into creditors' voluntary liquidation on 21 December of that year.

5. 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 admitted a liability to TPL of £360,767,273 (plus interest) in a settlement deed ("the ECTRL Claim"). In November 2006, EC and the administrators of ECTRL issued letters recognising the extent of TPL's claims against the companies. In February 2007, Enrici's administrators accepted that that company owed TPL £101,071,188 ("the Enrici Claim"). We will refer to the Enron Claim, the ECTRL Claim and the Enrici Claim together as "the Claims".

6. By 5 December 2006, TPL had received cash distributions in respect of the Enron Claim of, in aggregate, some £120 million plus shares in Portland General Electric ("Portland") worth about £14 million. These 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. Corporation tax was paid on the amounts received.

7. On 1 December 2006, TPL established a wholly-owned subsidiary, Teesside Recoveries and Investments Limited ("TRAIL"), which was incorporated and tax-resident in Jersey. For the purposes of United Kingdom corporation tax, it was a "controlled foreign company".

8. On 5 December 2006, TPL assigned to TRAIL:

   (a) Its rights in relation to its proofs of claim against EC which had been recognised by the United States Bankruptcy Court (i.e. 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 93,799,491 ordinary shares in TRAIL.

9. On 2 March 2007, 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.

10. The fair value of each of the Claims assigned was equal to the fair value of the shares in TRAIL issued in consideration for it. In a memorandum dated 5 December 2006, Carval Investors LLC ("Carval") had valued the Enron and ECTRL Claims at, respectively, $199,698,461 (equating to 22 cents per dollar or £101,100,347) and £93,799,491 (or 26 pence per pound) (this was an arm's length, third party valuation). A paper headed "Review of Enron Estate Payment Position" that appears to have been prepared on 22 November 2006 and presented to TPL's board concluded, however:

> "Whilst information is available to creditors on the Enron Corp and ECTRL claims, this information demonstrates that there remain significant uncertainties regarding the value of unliquidated assets, the final level of disputed claims and therefore the amount creditors will receive in distributions from the respective estates. In the case of Enrici, the only information relates to the Enron Europe Limited estate and hence, TPL is uncertain about how much it will receive as a creditor of Enrici."

11. The transfer of the Enron and ECTRL Claims was notified to HMRC on 8 December 2006 under the "Disclosure of tax avoidance schemes" (or "DOTAS") rules. The notification summarised the arrangements in these terms:

> "These arrangements enable a UK company … 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 … 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."

12. TRAIL subsequently received sums amounting in all to £243,149,027 in respect of the Claims. EC's administrators distributed a total of £60,911,081 between April 2007 and January 2008 as well as making a further distribution of shares in Portland with a value of £3,972,128. In July 2007, there was a distribution of £84,114,434 from ECTRL's administrators and a distribution of £2,547,582 from Enrici's liquidators followed in November 2007. Between March and May of 2008, TRAIL realised £91,486,556 from sale of the Claims. It also received £117,076 by way of dividends from Portland.

13. TPL's financial statements for the period to 5 December 2006, which received an unqualified audit opinion from Ernst & Young LLP, did not attribute any value to either its shares in TRAIL or the claims against EC and ECTRL which were assigned to TRAIL in return for such shares. Notes to the statements explained:

> "The investment in TRAIL is stated at the cost of £nil, being the carrying value of the claims transferred to TRAIL at the date of the transfer"; and
>
> "Due to the nature of the bankruptcy and administration proceedings, the claims against Enron Corp and ECTRL have been accounted for as contingent assets. There remains considerable uncertainty over the timing and amounts of further distributions to be determined by Enron Corp and the ECTRL administrators, and consequently no further amounts were recognised in the financial statement. On the date the company transferred its interests in the claims to TRAIL, the carrying value of the claims by the company prior to the transfers was nil."

14. TPL's financial statements for the period 6 December 2006 to 30 September 2007, in respect of which Ernst & Young also gave an unqualified audit

opinion, referred to the transfer of the Enrici Claim (in March 2007) as well as that of the Enron and ECTRL Claims. A note stated:

> "The shareholdings received in connection with the claims transferred together with the 2 subscriber shares represent 100% of the issued share capital of [TRAIL]. The investment in TRAIL is stated at the cost of £nil, being the carrying value of the claims transferred to TRAIL at the date of the transfer."

15. In contrast, the Claims were treated as having substantial value in TRAIL's accounts. A note to TRAIL's financial statements for the year ended 30 November 2007 records:

> "The claims receivable are stated at their recoverable value. Unrealised gains are recognised within the profit and loss account."

16. On 3 July 2008, TRAIL was put into liquidation. It had previously lent the proceeds of the Claims, which were its only assets, to TPL on an unsecured and interest-free basis.

17. On 1 August 2013, HMRC issued closure notices assessing TPL to tax. The closure notices amended TPL's corporation tax returns for the periods from 1 January 2006 to 5 December 2006 and from 6 December 2006 to 30 September 2007. TPL was said to have made a profit of £194,899,838 in the 2005-2006 period and a profit of £5,154,631 in the 2006-2007 period "in respect of the DOTAS notified arrangement whereby [TPL] transferred claims against the Enron group to a newly created subsidiary in Jersey, [TRAIL], in exchange for new shares issued in TRAIL". The closure notices proceeded on the basis that the "agreed consideration for the transactions entered into between TPL and TRAIL" should have been reflected in TPL's financial statements.

18. On 25 November 2013, TPL filed a notice of appeal with the FTT.

19. The way in which TRAIL treated its shares and the Claims is not at issue between the parties. The dispute between them relates exclusively to the tax and accounting position adopted by TPL.

The legislative framework

20. As its heading indicates, Chapter II of Part IV of FA 1996 is concerned with "loan relationships". It is common ground that the Enron, Enrici and ECTRL Claims gave rise to "loan relationships" within the meaning of FA 1996.

21. During the period relevant to this case, section 80(1) of FA 1996 stated that, for the purposes of corporation tax, all profits and gains arising to a company from its loan relationships were to be chargeable to tax as income in

accordance with Chapter II of Part IV. The point was reinforced by section 80(5), which provided:

> "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."

22. Section 82 of FA 1996 dealt with the "Method of bringing amounts into account". Section 82(1) stated:

> "For the purposes of corporation tax—
>
> (a) the profits and gains arising from the loan relationships of a company, and
>
> (b) any deficit 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."

23. Section 84 of FA 1996 was concerned with the "Debits and credits brought into account". Section 84(1) was in these terms:

> "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 relationship and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions."

24. Section 85A of FA 1996 referred to computation on the basis of "generally accepted accounting practice" (or "GAAP"). Section 85A(1) provided:

> "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."

As regards a company other than one preparing accounts in accordance with "international accounting standards", the expression "generally accepted accounting practice" was defined in section 50 of the Finance Act 2004 to mean:

> "generally accepted accounting practice with respect to accounts of UK companies … that are intended to give a true and fair view".

25. Finally, section 85B(1) of FA 1996 stated as follows:

> "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."

The Decision

26. It was TPL's case before the FTT that nil credits were required to be brought into account under section 84(1) FA 1996 (read with sections 85A and 85B) in respect of the transfer of the Claims to TRAIL. HMRC, however, contended that credits in the amount of £200,054,469 should be brought into account.

27. The FTT was asked to consider four issues:

(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? (Issue 1)

(b) Would there have been available any alternative accounting treatments in respect of the transfer which would have been permissible in accordance with UK GAAP, and if so what were those treatments? (Issue 2)

(c) If, following on from Issues 1 and 2, more than one UK GAAP-compliant accounting treatment was available, was TPL required by section 84(1) FA 1996 to bring debits and credits into account for corporation tax purposes in accordance with one of those alternative accounting treatments in particular (and if so which one)? (Issue 3)

(d) If, following on from Issues 1 and 2, the only UK GAAP-compliant accounting treatment available was the one adopted by TPL, was TPL required by section 84(1) FA 1996 to bring debits and credits into account for corporation tax purposes in respect of the transfer otherwise than by reference to UK GAAP-compliant accounts, and if so how are such debits and credits to be determined? (Issue 4)

28. The FTT determined Issues 1-3 in favour of TPL, but Issue 4 in favour of HMRC. More specifically, it held:

(a) As to Issue 1, that TPL's accounts were GAAP-compliant (see paragraph 134 of the Decision). The FTT went on:

"Our view is that the Tribunal should be slow to upset accounts which have been given audit sign off as GAAP compliant accounts. We have concluded that Mr Wild's expert evidence to the Tribunal [i.e. the evidence of Mr Kenneth Wild, who was called by TPL] should be accepted and that the relevant accounting principles have been correctly applied by TPL to produce a GAAP compliant set of accounts for the disputed accounting periods";

(b) As to Issues 2 and 3, that no alternative set of GAAP-compliant accounts was available. The FTT said (in paragraph 140 of the Decision):

"On the basis of Ms Baird's evidence [i.e. the evidence of Ms Eileen Baird, whom HMRC called to give expert evidence] we do not believe HMRC have made a convincing case. In particular; Ms Baird's approach did not sufficiently answer the FRS 5 requirement for the recognition of the substance of a transaction and did seem to be forcing a credit into TPL's STRGL [i.e. statement of total recognised gains and losses] where none would naturally appear on the transfer of the Claims. This is reflected by E&Y's view in their audit letter that this was … an 'unusual' approach. Nor did Ms Baird satisfactorily explain why the Claims should not be transferred to TRAIL at their nil (or non-existent) book cost"; and

(c) As to Issue 4, that "£200 million of profit should be recognised in TPL for the accounting periods when the Claims were transferred to TRAIL despite the fact no profit was recognised for accounting purposes" (paragraph 153 of the Decision). In the FTT's view, "on any realistic commercial approach to this transaction, these Claims were monetised when they were exchanged for shares in TRAIL" (paragraph 151 of the Decision).

29. On the strength of its conclusion on Issue 4, the FTT dismissed TPL's appeal.

The scope of the appeal

Accounting questions

30. With permission from the FTT, TPL appealed against the Decision on the basis that the FTT's conclusion on Issue 4 was erroneous. In a response dated 7 December 2015, HMRC said that it opposed the appeal and relied on "the same grounds as they relied upon before the First-tier Tribunal". The response continued (in paragraph 5):

> "In summary:
>
> (1)[TPL's] accounts are not GAAP-compliant (contrary to FTT 134). This case concerns a tax avoidance scheme for the sale of loan relationships on 5 December 2006 and 2 March 2007 for an issue of shares agreed to be worth a total of £200,054,469. The correct accounting would reflect the sale consideration received for the loan relationships in [TPL's] accounts, and would recognise an unrealised gain in the Statement of total recognised gains and losses (the STRGL). By virtue of section 85A(2) Finance Act 1996 total sums of £200,054,469 should be brought into account as a loan relationship credit of £200,054,469 (being £194,899,838 for the period ended 5 December 2006, and £5,154,631 for the period ended 30 September 2007).
>
> (2)Further or alternatively, whether or not [TPL's] accounts are GAAP-compliant total sums of £200,054,469 must be brought into account as a loan relationship credit of £194,899,838 for the period ended 5 December 2006, and £5,154,631 for the period ended 30 September 2007. These are the sums which 'fairly represent' the profit which arose to [TPL] from selling the loan relationships for an issue of shares agreed to be worth a total £200,054,469: section 84 Finance Act 1996."

31. The next paragraph of the response stated:

> "For the avoidance of doubt, it is not necessary on [HMRC's] case to make a finding as to whether the accounting treatment proposed by [HMRC] is GAAP-compliant. However, to the extent that the Upper Tribunal considers that it requires a decision on this issue in order to decide the case, [HMRC] will invite the Upper Tribunal to make a

> finding that the accounting treatment proposed by [HMRC] is GAAP-compliant."

32. On the footing that HMRC had not appealed against the FTT's conclusions on Issues 1-3 (i.e. the accounting questions), the skeleton argument filed on behalf of TPL on 2 November 2016 addressed only Issue 4 and the new argument mentioned in paragraphs 45 to 47 below. However, HMRC's skeleton argument, filed on 9 November, included the contention that TPL's accounts were not GAAP-compliant for reasons set out in an annex. "In finding to the contrary," the skeleton argument said, "the FTT thus erred in law (insofar as it is finding of law) and/or erred in law in the *Edwards v Bairstow* sense (insofar as it is a finding of fact)".

33. Mr Jonathan Peacock QC, who appeared with Mr Richard Boulton QC for TPL, argued that it is not open to HMRC to challenge the FTT's conclusions on Issues 1-3. Where, he said, a party wishes to disagree with something that the FTT has decided, he must file a notice of appeal or, failing that, at least identify in a response the points of law on which he relies. Here, he maintained, HMRC did neither. In contrast, Mr David Milne QC, who appeared with Miss Elizabeth Wilson for HMRC, contended that HMRC are entitled to dispute the FTT's views on Issues 1-3. They had, he submitted, to do no more than specify in their response the grounds on which they relied, and that they did.

34. We were referred in this context to the Tribunals, Courts and Enforcement Act 2007 ("TCEA 2007") and the Tribunal Procedure (Upper Tribunal) Rules 2008 ("the 2008 Rules"). Section 11 of TCEA 2007 confers a right to appeal to the Upper Tribunal, with permission, on a "point of law arising from a decision made by the First-tier Tribunal". Where permission to appeal is sought from the Upper Tribunal, the application for permission must include "the grounds on which the appellant relies" (rule 21(4)(e) of the 2008 Rules), and a notice of appeal provided to the Upper Tribunal in accordance with rule 23 of the 2008 Rules is required to contain the same information (rule 23(3)).

35. Rule 24 of the 2008 Rules provides for a "Response to the notice of appeal". Rule 24(1A) states that, subject to any direction given by the Upper Tribunal, a respondent "may provide a response to a notice of appeal". Any such response must, by virtue of rule 24(3)(e), state:

> "the grounds on which the respondent relies, including (in the case of an appeal against the decision of another tribunal) any grounds on which the respondent was unsuccessful in the proceedings which are the subject of the appeal, but intends to rely in the appeal".

36. It is to be noted that an appellant and a respondent who puts in a response to a notice of appeal are alike to give the "grounds" relied on.

37. In *Acornwood LLP v HMRC* [2016] UKUT 361 (TCC), Nugee J considered (albeit obiter) whether the fact that rule 24(1A) of the 2008 Rules states that a respondent "may" provide a response to a notice of appeal means that he is under no obligation to do so even if he wishes to rely on reasons other than those on which the FTT based its decision. He concluded (in paragraph 107):

> "… I do think that if a respondent wishes to rely on any grounds in support of his opposition to an appeal (other than simply relying on the decision which is being appealed) then he should say so; and if he fails to say so, and fails to obtain an extension of time, then the consequence is that he cannot run such arguments on the appeal without the permission of the tribunal."

38. In our view, HMRC were not obliged either to file a notice of appeal or to obtain permission to appeal. Having regard to the terms of rule 24 of the 2008 Rules, all that HMRC were required to do was give "the grounds on which [they] relied", including "any grounds on which [they] were unsuccessful" in the FTT but on which they "intended[ed] to rely in the appeal". Neither the 2008 Rules nor TCEA 2007 imposes any obligation on a party who has won in the FTT to file a notice of appeal or to obtain permission to advance points which the FTT rejected.

39. Where the respondent to an appeal lost in the FTT on, say, points of statutory interpretation, it may well suffice for him to say that he relies on the same grounds that he relied on before the FTT. Something to that effect may identify the arguments adequately to satisfy the rule 24 requirement to state "grounds on which the respondent was unsuccessful in the proceedings which are the subject of the appeal, but intends to rely in the appeal". For the respondent to rehearse in his response to the notice of appeal the arguments on which he failed in the FTT might merely add verbiage needlessly.

40. The position seems to us, however, to be different where a respondent wishes to challenge a finding of fact that the FTT made or its assessment of expert evidence. The grounds on which a respondent might hope to overturn such a finding will necessarily differ from those it put forward before the FTT. At least normally, therefore, a response giving "the grounds on which the respondent relies" should do more than just state that the respondent relies on the same grounds that he relied on before the FTT.

41. That conclusion seems to us to be supported by the decision of the Court of Appeal in *Georgiou v Customs & Excise Commissioners* [1996] STC 463. In that case, which involved an appeal from the Value Added Tax Tribunal, Evans LJ (with whom Saville and Morritt LJJ agreed) said (at 476):

> "[T]he nature of the factual inquiry which an appellate court can and does undertake in a proper case is essentially different from the decision-making process which is undertaken by the tribunal of fact.

> The question is not, has the party upon whom rests the burden of proof established on the balance of probabilities the facts upon which he relies, but, was there evidence before the tribunal which was sufficient to support the finding which it made? In other words, was the finding one which the tribunal was entitled to make? Clearly, if there was no evidence, or the evidence was to the contrary effect, the tribunal was not so entitled.
>
> It follows, in my judgment, that for a question of law to arise in the circumstances, the appellant must first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and, fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make. What is not permitted, in my view, is a roving selection of evidence coupled with a general assertion that the tribunal's conclusion was against the weight of the evidence and was therefore wrong."

42. The role of the Upper Tribunal is thus "essentially different" from that of the FTT as regards issues of fact and, we would add, the assessment of expert evidence. A challenge to a finding on such a matter must accordingly be advanced on a basis other than that the FTT should, on balance, have preferred the view that it in fact rejected. On appeal, the person wishing to impugn the finding (whether as an appellant or a respondent) has to show why, having regard in particular to the guidance to be found in *Edwards v Bairstow* [1956] AC 14, the FTT was not *entitled* to make the relevant finding. The passage from *Georgiou* that we have quoted indicates that the challenger should "first identify the finding which is challenged; secondly, show that it is significant in relation to the conclusion; thirdly, identify the evidence, if any, which was relevant to that finding; and, fourthly, show that that finding, on the basis of that evidence, was one which the tribunal was not entitled to make". At all events, the "grounds" given in the notice of appeal or response to it (as the case may be) will have to go beyond the points put forward before the FTT.

43. In the present case, HMRC's response to the notice of appeal did not attempt to explain how the FTT's conclusions on Issues 1-3 could be set aside on an *Edwards v Bairstow* basis. Paragraph 5 of the response added nothing of significance to the general statement that HMRC relied on "the same grounds as they relied upon before the First-tier Tribunal", and those grounds could not of themselves suffice to justify us in overturning a finding of fact or assessment of expert evidence. That means, as it appears to us, that HMRC cannot pursue Issues 1-3 without our permission.

44. With a degree of hesitation, however, we have concluded that we should grant such permission. It seems to us that, in the particular circumstances, permission can be given without unfairness to TPL. While HMRC's response to the notice of appeal was, in our view, deficient, their skeleton argument will

have given TPL notice that they proposed to argue that, in relation to the accounting issues, the FTT "erred in law (insofar as it is a finding of law) and/or erred in law in the *Edwards v Bairstow* sense (insofar as it is a finding of fact)", and TPL was able to address the issues in detail in a reply skeleton argument of 16 November 2016. The points were also aired during oral argument. It would appear that TPL would have been no better off if HMRC had spelt out in its response the "grounds" on which it has subsequently sought to impugn the FTT's conclusions on the accounting questions.

The "Mabbutt" argument

45. In August 2016, TPL applied for permission to amend its grounds of appeal to include a further and alternative ground of appeal, namely, that "the purported closure notice issued by HMRC to TPL for the period ended 5 December 2006 has no standing as there was no valid enquiry into the corporation tax return of TPL for that period". TPL's argument is that the notice of enquiry it received was fundamentally flawed because it referred to a return for the "Year Ended 31 December 2006" when there was no such return and that there can, accordingly, be no valid enquiry into TPL's return for the period ended 5 December 2006. TPL was prompted to raise the point, which it did not run before the FTT, by the decision of a differently-constituted FTT in *Mabbutt v HMRC* [2016] UKFTT 306 (TC). We shall refer to the point as "Issue 5".

46. HMRC argued that TPL should not be allowed to introduce Issue 5. The point could, they submitted, have been taken in the FTT, but TPL did not do so. No new facts having emerged, permission to amend the notice of appeal should be refused. HMRC relied in support of their contentions on *Jones v MBNA International Bank* [2000] EWCA Civ 514, where the Court of Appeal declined to permit new points to be taken on appeal. May LJ said (at paragraph 52):

> "Civil trials are conducted on the basis that the court decides the factual and legal issues which the parties bring before the court. Normally each party should bring before the court the whole relevant case that he wishes to advance. He may choose to confine his claim or defence to some only of the theoretical ways in which the case might be put. If he does so, the court will decide the issues which are raised and normally will not decide issues which are not raised. Normally a party cannot raise in subsequent proceedings claims or issues which could and should have been raised in the first proceedings. Equally, a party cannot, in my judgment, normally seek to appeal a trial judge's decision on the basis that a claim, which could have been brought before the trial judge, but was not, would have succeeded if it had been so brought. The justice of this as a general principle is, in my view, obvious. It is not merely a matter of efficiency, expediency and cost, but of substantial justice. Parties to litigation are entitled to know where they stand. The parties are entitled, and the court requires, to

> know what the issues are. Upon this depends a variety of decisions, including, by the parties, what evidence to call, how much effort and money it is appropriate to invest in the case, and generally how to conduct the case; and, by the court, what case management and administrative decisions and directions to make and give, and the substantive decisions in the case itself. Litigation should be resolved once and for all, and it is not, generally speaking, just if a party who successfully contested a case advanced on one basis should be expected to face on appeal, not a challenge to the original decision, but a new case advanced on a different basis. There may be exceptional cases in which the court would not apply the general principle which I have expressed. But in my view this is not such a case."

47. However, the Court of Appeal allowed new points to be taken in, for example, *Miskovic v Secretary of State for Work and Pensions* [2011] EWCA Civ 16, [2011] 2 CMLR 20 and *Wright v Lewis Silkin LLP* [2016] EWCA Civ 1308. In any case, on balance it seems to us that TPL should be granted permission to amend. It was prompted to raise the point by a decision (viz. *Mabbutt v HMRC*) which post-dates the hearing before the FTT in the present case. The point, moreover, is essentially one of law and requires no evidence beyond that which was before the FTT and is available to us. In all the circumstances, it seems to us to be just, and not unfair to HMRC, to allow TPL to raise the issue in the context of the present appeal and that we should exercise our discretion to allow the proposed amendment.

Conclusion

48. In the light of what we have said above, we need to consider Issues 1-3 and 5 as well as Issue 4.

The accounting questions (Issues 1-3)

49. Issues 1-3 can conveniently be considered together.

50. Each party adduced expert evidence on accounting matters. Mr Wild, who was called by TPL, expressed the view that the accounting treatment that TPL adopted in respect of the transfer of the Claims to TRAIL fully complied with UK GAAP and that there was no other permissible accounting treatment. In contrast, Ms Baird, whom HMRC called, considered that TPL's approach did not accord with GAAP. In her opinion, 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 assignment agreements. Since, she said, the gains on disposal of the Claims were unrealised, they should have been accounted for in TPL's statement of total recognised gains and losses (or "STRGL").

51. The experts referred to several Financial Reporting Standards issued by the Accounting Standards Board (now Financial Reporting Council). The first of these to be issued, FRS 3, dealt (as its title indicates) with "Reporting Financial Performance" and introduced the STRGL. FRS 3 included this:

> "The range of important components of financial performance which the FRS requires reporting entities to highlight would often be incomplete if it stopped short at the profit and loss account, since certain gains and losses are specifically permitted or required by law or an accounting standard to be taken directly to reserves. An example is an unrealised gain, such as a revaluation surplus on fixed assets. It is necessary to consider all gains and losses recognised in a period when assessing the financial performance of a reporting entity during that period. Accordingly, the FRS requires, as a primary statement, a statement of total recognised gains and losses to show the extent to which shareholders' funds have increased or decreased from all the various gains and losses recognised in the period."

52. FRS 5 had the title "Reporting the Substance of Transactions" and "require[d] an entity's financial statements to report the substance of the transactions into which it has entered". "The commercial effect of the entity's transactions, and any resulting assets, liabilities, gains or losses, should," FRS 5 stated, "be faithfully represented in its financial statements."

53. The objective of FRS 12, with the title "Provisions, Contingent Liabilities and Contingent Assets", was "to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount". FRS 12 stipulated that an "entity should not recognise a contingent asset" and defined "contingent asset" to refer to "a possible asset arising from past events whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control". FRS 12 explained:

> "Contingent assets are not recognised in financial statements because it could result in the recognition of profit that may never be realised. However, when the realisation of the profit is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate."

54. There was reference in the evidence, too, to the Statement of Principles for Financial Reporting. This set out "the principles that the Accounting Standards Board believes should underlie the preparation and presentation of general purpose financial statements", while "not contain[ing] requirements on how financial statements should be prepared or presented" and not being an

accounting standard "nor [having] a status equivalent to an accounting standard". The Statement of Principles included these passages:

> "An asset or liability that is being measured using the historical cost basis will be recognised initially at transaction cost or, if an event other than a transaction is involved, at its fair value at the time it was acquired or assumed. The transaction cost of an asset acquired or liability assumed is the fair value of the consideration given or received in exchange for that asset or liability" and
>
> "It can generally be assumed that, in the absence of evidence to the contrary, a transaction has been carried out at fair value. In such circumstances, the transaction cost involved can be determined by reference to the fair value of either the asset (or liability) acquired or the consideration paid (or received); whichever fair value is easiest to measure will usually be used."

55. Mr Wild said, among other things, the following:

(a) Prior to their transfer to TRAIL, the Claims were treated as contingent assets and so, having regard to FRS 12, should not have been recognised at all in TPL's accounts;

(b) So far as TPL was concerned, TRAIL was merely a "wrapper" for the items transferred. TPL remained exposed to the risks and rewards of the Claims;

(c) As moving an item from being owned directly by a company to being owned by its wholly-owned subsidiary simply moves its control of that item from direct to indirect, the item should not be restated for accounting purposes. In other words, it should be carried, applying FRS 5, at its previous carrying value (or nil if it was previously unrecognised);

(d) An analogy can be drawn with a company undertaking research which proves successful. If, when the research moves to a product development phase, a new subsidiary is established to exploit the product, the benefit of the research is passed into the subsidiary (possibly in return for the issue of shares). The subsidiary is not uplifted by the market value of the research;

(e) Given its relative standing, it would not be appropriate to treat the Statement of Principles as authority for adopting an accounting treatment contrary to a requirement in a standard or to generally accepted practice;

(f) The analysis favoured by HMRC ignores the economic realities behind the transfer of the Claims and would lead to the preparation of potentially misleading accounts that would fail to give a true and fair view of TPL's developments and state of affairs. The accounting treatment proposed by Ms Baird "sidesteps the prohibition on recognising contingent assets (FRS 12, paragraph 31) and leads to '*the recognition of profit that may never be realised*', which is precisely what FRS 12 is designed to prevent (FRS 12, paragraph 33)". It would render FRS 12 toothless if a company could simply drop its contingent assets (the value of which it is prohibited from recognising) into a new wholly-owned subsidiary and record its investment at fair value;

(g) FRS 3 deals with presentation and disclosure, not whether there is a gain to be recognised. If TPL should have recognised a gain, its accounts will necessarily have been defective and it matters not whether the gain should have been taken to the profit and loss account, the STRGL or somewhere else. On the basis, however, that no gain fell to be recognised, there was nothing to include in the STRGL.

56. Mr Wild summarised his views in these terms:

> "TPL had a number of contingent assets which, despite having become valuable (in that they could be sold for a considerable amount) were, correctly under UK GAAP, not recognised in its accounts. It then established a simple wrapper, in the form of a wholly owned subsidiary with minimal assets, and placed these contingent assets within that wrapper. As such, in accounting terms nothing had really changed from TPL's point of view as a result of the Assignment Transaction: it had no more and no less control of the items transferred, and the risks and rewards associated with those items after the Assignment Transaction were in substance no different from TPL's perspective than before the Assignment Transaction."

57. For her part, Ms Baird said, among other things, the following:

(a) An investment in ordinary shares, such as those TPL acquired in TRAIL in exchange for the Claims, is not a "possible asset" within FRS 12's definition of "contingent asset", but an actual one which must be recognised in the holder's financial statements;

(b) The value of the shares in TRAIL fell to be measured by reference to the value of the consideration given for them. Thus, the Statement of Principles, for example, explains that an asset arising from a transaction carried out at fair value will be measured on initial recognition at its transaction cost, which will be the fair value of the consideration given in exchange for the asset;

(c) Since the consideration for the shares in TRAIL was agreed at £200,054,469, TPL should have recognised the investment in its accounts at this amount;

(d) It is not correct to say that the transfer of the Claims to TRAIL had no economic impact on TPL. TPL "exchanged something with a very uncertain value for something which had an agreed fixed value";

(e) The fact that TPL's gain was unrealised did not prevent its recognition in its financial statements. While a profit and loss account should include only realised gains and losses for the accounting period, a STRGL should include all gains and losses whether realised or not.

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. More specifically, it accepted Mr Wild's "analysis that in accordance with FRS 12 contingent assets have a nil value at inception and should not be re-valued until they are realised in the form of cash, including by an unrealised gain in STRGL" (paragraph 135 of the Decision); that Mr Wild's "approach is in line with the substance requirements of FRS 5 and the prudence concept underlying FRS 12" (paragraph 136); that "FRS 5 does allow the accounting to ignore the intervention of a 100% subsidiary and take account of the fact [that] TPL remained exposed, if only indirectly to the value of the Claims" (paragraph 136); and that "it is a valid starting point for the valuation of the claims to take their book value at inception and add to that their book value on transfer (by reference to FRS 12 and [Urgent Issues Task Force] 31)" (paragraph 137).

60. It is HMRC's case that the FTT erred in a variety of respects in relation to the accounting questions. As well as suggesting that TPL's accounts did not comply with a specific provision in the Companies Act 1985 (a point to which we shall come in a moment), Mr Milne submitted that the FTT went wrong in its assessment of the implications for the present case of accounting standards and the Statement of Principles. It was said, for example, that the FTT erred in law both by disregarding guidance in the Statement of Principles and in finding that FRS 5 allowed "the intervention of a 100% owned subsidiary" to be disregarded in the accounts of its parent. The FTT's "key errors" included, it was said, accepting the "erroneous" view of Mr Wild that "nothing had changed" following the assignment of the Claims and ignoring the position of TRAIL.

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.

62. There remains to be considered the submission that TPL's accounts were not GAAP-compliant because they failed to accord with a provision of the Companies Act 1985 ("CA 1985") relating to company accounts.

63. During the relevant period, section 226 of CA 1985 imposed on a company's directors a duty to prepare accounts for the company for each of its financial years, and section 226A stipulated that such accounts were to comprise a balance sheet and profit and loss account, each of which was to give a "true and fair view" (see section 226A(2)). Section 226A(3) stated that a company's accounts "must comply with the provisions of Schedule 4 as to the form and content of the balance sheet and profit and loss account and additional information to be provided by way of notes to the accounts", but section 226A(5) explained:

> "If in special circumstances compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors must depart from that provision to the extent necessary to give a true and fair view."

Particulars of any such departure, the reasons for it and its effect were to be given in a note to the accounts.

64. Mr Milne focused on paragraph 17 of schedule 4 to CA 1985, which provided in a section dealing with "Historical cost accounting rules" that, subject to exceptions that are not material, "the amount to be included in respect of any fixed asset shall be its purchase price or production cost". The expression "purchase price" was defined in section 262 of the Act in this way:

> "'*purchase price'*, in relation to an asset of a company or any raw materials or consumables used in the production of such an asset, includes any consideration (whether in cash or otherwise) given by the company in respect of that asset or those materials or consumables, as the case may be".

65. Mr Milne maintained that, in the circumstances, the shares in TRAIL that TPL acquired in 2006-2007 represented a fixed asset, that their "purchase price" therefore had to be included in TPL's accounts, that the "purchase price" included the "consideration (whether in cash or otherwise) given by the

company" in respect of the shares and that it can be seen that consideration of £200,054,469 was given. Mr Milne accepted that the £200,054,469 need not have featured in TPL's profit and loss account but said that it should have been reflected in the company's STRGL.

66. Mr Milne's submissions on this point, were they correct, could have far-reaching implications. If the FTT was right to accept Mr Wild's view that the accounting treatment that TPL adopted was the only one compatible with accounting standards, Mr Milne's arguments would imply a conflict between those standards and Companies Act requirements.

67. The relationship between accounting standards and Companies Act requirements was discussed in a highly influential opinion written by Mr Leonard Hoffmann QC and Miss Mary Arden (as they then were) in September 1983. The authors said (in paragraphs 8-9):

> "In the end, … the question of whether accounts give a true and fair view in compliance with the Companies Acts must be decided by a judge. But the courts look for guidance on this question to the ordinary practices of professional accountants. This is not merely because accounts are expressed in a language which judges find difficult to understand. This may sometimes be true but it is a minor reason for the importance which the courts attach to evidence of accountancy practice. The important reason is inherent in the nature of the 'true and fair' concept. Accounts will not be true and fair unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are addressed. On this question, accountants can express an informed opinion on what, in current circumstances, it is thought that accounts should reasonably contain. But they can do more than that. The readership of accounts will consist of businessmen, investors, bankers and so forth, as well as professional accountants. But the expectations of the readers will have been moulded by the practices of accountants because by [and] large they will expect [to] get what they ordinarily get and that in turn will depend upon the normal practices of accountants.
>
> For these reasons, the courts will treat compliance with accepted accounting principles as prima facie evidence that the accounts are true and fair."

68. These views received some judicial endorsement in *Lloyd Cheyham & Co Ltd v Littlejohn & Co* [1987] BCLC 303. Woolf J there accepted (at 313):

> "While [Statements of Standard Accounting Practice (i.e. forerunners of Financial Reporting Standards)] are not conclusive, so that a departure from their terms necessarily involves a breach of the duty of care, and they are not as the explanatory foreword makes clear, rigid

> rules, they are very strong evidence as to what is the proper standard which should be adopted and unless there is some justification, a departure from this will be regarded as constituting a breach of duty. It appears to me important that this should be the position because third parties in reading the accounts are entitled to assume that they have been drawn up in accordance with the approved practice unless there is some indication in the accounts which clearly state that this is not the case."

In *Macquarie Internationale Investments Ltd v Glencore UK Ltd (No 2)* [2011] 1 BCLC 561, Jackson LJ observed (at paragraph 52) that the Courts had "treated compliance with published professional standards as strong evidence that the accounts in question did present a true and fair view" in a number of decisions subsequent to the opinion of Mr Hoffmann and Miss Arden.

69. Accounting standards have also received some Parliamentary recognition. Section 256 of CA 1985, as inserted into the Act by the Companies Act 1989, made provision for grants to be given to bodies concerned with issuing such standards or investigating departures from them. Moreover, a new paragraph 36A of schedule 4 to the Act required notes to financial statements to state "whether the accounts have been prepared in accordance with applicable accounting standards" and to give "particulars of any material departure from those standards and the reasons for it".

70. On the subject of the requirement in paragraph 17 of schedule 4 to CA 1985 to include the "purchase price or production cost" of a fixed asset, Mr Wild said this:

> "Although the Companies Act uses the term '*purchase price*', the majority of the accounting literature (including the accounting standards) generally uses the word '*cost*' rather than '*purchase price*' to describe the carrying value of items such as fixed assets. In doing so the literature seeks to capture what has become a relatively sophisticated accounting concept, which goes beyond the simple purchase of an item for cash. However, the description '*purchase price*' is often used in the more basic literature, such as the Companies Act, to specify the same principle. In practice the terms are interchangeable and are frequently used as alternatives. Such use of '*cost*' as the basic concept notwithstanding the fact that the Companies Act prescribes the use of '*purchase price*' is not seen as a departure from the Companies Act. Rather it is seen as a development of a Companies Act concept, as discussed in the 1983 Hoffmann & Arden legal opinion."

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.

73. In all the circumstances, HMRC's challenge to the FTT's conclusions on Issues 1-3 fails.

The effect of FA 1996 section 84(1) (Issue 4)

The FTT's decision

74. As we have indicated, the FTT concluded that the effect of section 84(1) in the circumstances of this case was to override the GAAP-compliant accounting treatment of the transactions. Its perception of the underlying purpose of the subsection was set out at [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."

75. That approach led to its conclusions, reproduced at paragraph 28(c) above, that the Claims were "monetised" on transfer to TRAIL, and that they had a value, as provided by Carval and recognised by TRAIL, and which section 84(1) compelled TPL, too, to recognise for tax purposes even if it was not required to do so for accounting purposes. At [157] it recorded Mr Wild's evidence that TPL had merely "wrapped" assets which it held directly into its 100% subsidiary and that, in economic terms, nothing had changed, but rejected that approach at [161]:

> "… we have concluded that in this instance the UK GAAP compliant accounts of TPL do not give a fair representation of the profits arising to TPL from this transaction and in particular that the economic substance approach of FRS 5 should not override the requirement of s 84(1) that the profits from this transaction, the assignment of the Claims for their non-contingent £200 million value, for this entity, TPL, not the wider group, should be fairly represented. 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."

76. At [162] the FTT mentioned Mr Peacock's argument, based on an observation of Knox J in *Johnston v Britannia Airways Ltd* [1994] STC 763 at 782 to the effect that the Courts are "slow to accept that accounts prepared in accordance with accepted principles of commercial accounting are not adequate for tax purposes", that they should similarly be slow to "ignore accounting profits generated by the principles of commercial accounting"—that is, to treat TPL as having made a profit which was not recognised in its accounts. It rejected the argument:

> "Our response to that is that in the normal case the accounting measure of profits will give a fair view of a company's taxable profits. This is not the normal case; this is a structured transaction in which accounting rules have been used in order to both defer and potentially remove profits from the UK tax net."

TPL's arguments

77. TPL's attack on the FTT's reasoning and conclusions began from the purpose behind the introduction of the loan relationship rules in 1996. The aim was to provide a comprehensive code, based on the accounts drawn up by the companies concerned, provided that the accounts satisfied the relevant accounting standards. That was made clear in a Treasury summary, released with the Explanatory Notes for the Finance Bill 1996, which stated that "So far as possible, the rules are designed to fit in with how companies draw up computations in their statutory accounts …Whenever possible companies will be allowed to follow what is done in their accounts." The Explanatory Note to what is now section 84 said that "This Clause provides that debits and credits from loan relationships are to reflect all profits and losses, interest and

allowable expenses arising from the relationship or the acquisition or disposal of it: all calculated in accordance with an authorised accounting method". As this Tribunal said in *Spritebeam & others v Revenue and Customs Commissioners* [2015] UKUT 75 (TCC), [2015] STC 1222 at [40], "tax follows the accounting method".

78. The process of determining what is to be taxed, Mr Peacock said, has three stages. The first, derived from section 85A(1), is the identification of the amounts recognised in determining the company's profit or loss for the relevant accounting period in accordance with GAAP. Those accounts will, necessarily, give a "true and fair view", because that is a fundamental requirement not only of section 226 of CA 1985 but also of FRS 5. The second stage is the identification of the debits and credits to be brought into account, being the sums which, when taken together, fairly represent for the accounting period in question the company's profits, gains and losses arising to it from its loan relationships and related transactions. That stage is derived from section 84(1) and is a statutory rather than accounting requirement. The third stage, for which section 82(1) provides, is the calculation of the "profits and gains" arising from the loan relationships of the company, which then form a part of its tax computation. The key to the process, which has been present since the loan relationship rules were first enacted in 1996, and despite changes of detail to the rules, is the phrase "fairly represent".

79. It was clear, Mr Peacock continued, that TPL's accounts for the relevant periods showed no amount in respect of the Claims or the assignments. Thus the question is whether, despite the absence of a "profit" in the GAAP-compliant accounts or of any identifiable "amounts" from which section 84(1) credits or debits could come, TPL is to bring into the calculation at the third stage a "credit" which fairly represents a profit or gain arising to it from its loan relationships or related transactions. There were, he said, two reasons why the answer was "no".

80. The first was that the assignments gave rise to no profit or gain, and there was correspondingly no "sum" within the meaning of section 84(1) which could "fairly represent" that non-existent profit or gain. There was nothing in section 84(1) which permitted or required the creation of an accounting profit (or any other type of profit) in order that a credit could also be created to "fairly represent" that supposed profit. In any event, it was impossible to see how the transfer of an asset by a company to a wholly owned subsidiary in return for an issue of shares could be said to give rise to a profit or gain of any sort; at most the company, here TPL, exchanged one asset for another asset of equal value.

81. The second reason was that in finding that there was some profit which engaged section 84(1) the FTT failed to respect its own earlier conclusions. Those relevant to this issue were that FRS 5 is concerned with the substance of a transaction, reflecting its commercial effect; that (as Mr Wild had said and

the FTT accepted) there was no accounting profit in TPL on the transfers of the Claims; that any profits derived from the Claims would be recognised by TPL when TRAIL distributed its profits or TPL disposed of the shares; that contingent assets such as the Claims should not be re-valued until they are realised in cash; and that the proper interpretation of FRS 5 showed that TPL remained exposed to changes in the value of the Claims. The FTT disregarded those conclusions in finding at [144] that there were "potential profits", or at [150] that profits had been "deferred" or "removed". It was nothing to the point that Carval had placed a value on the Claims. The fact of a valuation said nothing about profit, and it did not change the value of the asset in question; it merely showed that there might be a profit at some time in the future. The FTT's own conclusions should have led it to the further conclusion that section 84(1) was not engaged.

82. The FTT had, moreover, attached a meaning to the phrase "fairly represent", as it was used in section 84(1), which it was not intended to bear, by ignoring its context. The phrase which should be considered is not "fairly represent" alone, but "fairly represent, for the accounting period in question": it is, and can be seen to be, a provision designed to ensure that profits and gains derived from loan relationships are taxed in the period to which they are proper, and not a provision requiring a company to identify and bring into its tax computation some profit which is not recognised, and not required to be recognised, in its accounts. It caters for a case in which a company's tax accounting period and the period for which its accounts are drawn up do not coincide, and also for those circumstances in which income is in part derived from a loan relationship and in part from some other source. The example Mr Peacock gave was of a receipt of interest in excess of a reasonable commercial rate; the excess would be treated as a distribution and taxed pursuant to a different regime. The FTT had recognised this purpose of section 84(1) at [110], but had then disregarded it.

83. That section 84(1) does not go any further, and in particular does not require a taxpayer to identify some other or additional sum to be added to its chargeable profits by reference to some wider notion of "fairness", was wholly consistent, Mr Peacock said, with the approach of the majority of the Court of Appeal and with the unanimous Supreme Court in *DCC Holdings (UK) Ltd v Revenue and Customs Commissioners* [2009] EWCA Civ 1165, [2010] STC 80 and [2010] UKSC 58, [2011] STC 326 respectively. In that case the taxpayer company entered into repo arrangements by which (to take the aggregated and averaged figures used in the case for simplicity) the taxpayer bought gilts from a bank for £812 million, selling them back, 18½ days later, for £785 million. It received a coupon of £28.8 million, representing six months' interest, on the last day of the 18½ day period and retained that payment. Interest apportioned over the 18½ days would have amounted to £2.9 million. The taxpayer made an economic and accounting profit of £1.8 million, but it claimed to have suffered a loss of £27 million for tax purposes on the basis that, by virtue of various statutory provisions applicable to repos and not of relevance to this

case, the taxpayer was to be treated as if it had paid (even though it had not in fact paid) a "deemed manufactured dividend" equivalent to the coupon to the bank, as interest on the loan. It did not bring the £28.8 million it had in fact received into its accounts on the basis that it was not required by the applicable accounting standards to do so. HMRC amended the taxpayer's return in order to bring the receipt of the £28.8 million into its tax computation. The question was whether section 84(1) applied in such a case and, if it did, what was its effect.

84. On the company's appeal the Special Commissioner decided that the company was a party to a loan relationship, that the accountancy evidence led to the conclusion that no debit would have been brought into its profit and loss account in respect of the £28.8 million manufactured dividend with the result that the sum which fairly represented the interest was nil, and that in bringing the debits and credits relating to the transaction into account a nil debit should be made. Norris J in the High Court allowed the company's appeal, with some reluctance, but the Court of Appeal, by a majority (Moses and Rix LJJ, Rimer LJ dissenting on some but not all points), concluded that by application of section 84(1) the correct answer was a symmetrical credit of £28·8 million matched by a debit of the same amount. The Supreme Court unanimously upheld the approach of the majority, that is that a symmetrical outcome was required, but differed in the manner in which that was to be achieved. The premise of its judgment was that the relevant provisions were intended to ensure that a company was taxed on a repo as if it had made a secured loan at interest, and that the coupon was taxed as income of the bank, whether it reached the bank directly, or in the form of a representative payment, or not at all. Statutory hypotheses were not, however, to be taken further than was warranted, and section 84(1) was to be applied with an eye on the real world. The taxpayer was required, therefore, to bring the amount it had actually received into account.

85. The primary message to emerge from *DCC Holdings*, and despite the outcome in the particular circumstances of the case, said Mr Peacock, is that while one might need to pay regard to the real world there is no overarching requirement of fairness. So much is apparent from what Moses LJ said, with characteristic élan, at [53]:

> "Neither [counsel for the taxpayer] nor Norris J found any statutory justification for wafting a magician's wand, scattering the stardust of fairness over the sums brought into account by s 84(1) … Lord Hoffmann would have described such an approach as 'spooky jurisprudence' (*Norglen Ltd (in liquidation) v Reeds Rains Prudential Ltd; Circuit Systems Ltd (in liquidation) v Zuken-Redac (UK) Ltd* [1998] 1 All ER 218 at 226–227, [1999] 2 AC 1 at 14)."

86. If Parliament intended to build into the loan relationships code some kind of statutory override which could, in some situations, require the substitution for tax purposes of a "profit" or "loss", not derived from the taxpayer's accounts,

in place of the amounts that are so determined, one would expect some clear indication to that effect, coupled with guidance on the manner in which the substitute amounts are to be determined; but such features are absent from section 84(1). It is, Mr Peacock said, entirely unclear how a Tribunal or Court might go about determining the quantum and timing of credits whose amount is said (for the purposes of section 84(1)) fairly to represent a profit which arises from a taxpayer's loan relationships, when no such profit appears in its GAAP-compliant accounts. That was a critical factor in the reasoning of the Chancellor in *Greene King plc v HMRC* [2016] EWCA Civ 782 at [77]:

> "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."

87. Although the FTT correctly identified the scope of Issue 4, Mr Peacock continued, it asked itself the wrong question. The question the FTT thought it had to address is identified in the heading to [144], which is "Do TPL's accounts represent a fair view of profits?" The test, however, is not whether there is some profit that ought to be fairly represented in TPL's accounts; it is, rather, "what are the debits and credits to be brought into account for tax purposes for the accounting period in question?" The starting point for that enquiry is the accounts which, in this case, revealed no relevant profit. The question posed by section 84(1) is whether, despite the accounts, it is necessary to determine the credits and debits to be brought into account for tax purposes by reference to some other standard. The FTT's error was to superimpose some vague and unarticulated concept of fairness, for which there is no warrant. What the Chancellor said in *Greene King* at [77], quoted above, showed that this was quite the wrong approach. The FTT seems to have been influenced by its perception that this was a tax avoidance, or tax planning scheme; but that is an irrelevant consideration for the purposes of section 84(1), which has nothing to say about motive. Similarly, it characterised the relevant accounting principles as subjective, and treated that characterisation as a justification for the application of section 84(1). That was an impermissible approach which, if adopted, would undermine the manifest intention of Parliament that loan relationships should be taxed by reference to GAAP-compliant accounts—the more so where, as here, the FTT had itself determined that there was only one GAAP-compliant method, the method adopted by TPL, for accounting for these transactions.

88. Although the FTT accepted that what it found to be the correct accounting treatment of the transactions revealed no profit derived from the transfer of the Claims, it nevertheless wrongly concluded that there was some "profit", not recognised for accounting purposes, of £200 million because, as it put it at [151], on a "realistic commercial approach" the Claims were "monetised" on exchange for the shares in TRAIL. It also acknowledged, at [153], that this approach would lead to the "profit" being recognised earlier than would otherwise have been the case, but provided no explanation of the reasons why recognition of the supposed profit should be accelerated in that way. There

was no basis on which the FTT could utilise its own "realistic commercial" view of the transactions as a basis for taxation, and the proposition on which that view was founded was itself flawed: the Claims were not "monetised" on the transfer to TRAIL, but simply exchanged for ordinary, unquoted, shares in TPL's wholly-owned subsidiary. Such shares could not be regarded as cash or equivalent to cash. Indeed, the experts agreed on that point: although they put it in different terms they both accepted that there had been no realisation of a gain. The FTT's conclusion that the Claims had been "monetised" was, therefore, contrary to the evidence. It was also inconsistent with the reality that TPL was, in economic terms, in precisely the same position after each transaction as it was before, with the sole difference that it held its contingent asset indirectly rather than directly. It was difficult to see how a difference of that kind could lead to any kind of profit or gain.

89. At [156] the FTT embarked on an examination of what it called "the wider picture", justifying its doing so by the proposition, at [159], that "tax tends not to look at the economic characterisation of a transaction and will usually respect the legal form of entities and impose tax on an entity by entity basis even in group situations". It was that proposition which led to the conclusion at [161] (set out at paragraph 75 above) that £200 million should be brought into account as a credit. It was based, Mr Peacock said, on a misunderstanding of what was said by Sir Thomas Bingham MR in *Gallagher v Jones* [1993] STC 537. At that time there was no statutory reliance on GAAP-compliant accounts as the basis for taxation. The FTT observed that the authorities "stress the primacy of profits generated by principles of commercial accounting [but] do contain caveats that the profits generated must not be 'inconsistent with the true facts or otherwise inapt to determine the true profits or losses of the business'"; the internal quotation being drawn from the judgment of the Master of the Rolls. The error, Mr Peacock said, was that what the Master of the Rolls contemplated in that observation is that the principles contained within an applicable accounting standard may in certain circumstances be inapt to determine profits, and not that the accounting profits may not give a fair view of a company's taxable profits.

90. The purpose of FRS 5, Mr Peacock continued, was to ensure that the commercial effect of transactions was properly reflected in a company's accounts, but the commercial effect did not differ in some way from the economic effect and substance which, as the FTT had accepted, was correctly recorded in TPL's accounts. In addition, as Mr Wild explained and the FTT accepted at [136], FRS 5 does not ignore the separate legal identity of companies but here requires that TPL should account for the substantive effect of the transfer on the basis that, through its ownership of shares in TRAIL, it is still indirectly exposed to the risks and rewards of the Claims.

91. If, as the FTT found, there was only one GAAP-compliant method of accounting for the transfer, that should have been the end of the matter: section 84(1) requires TPL to be taxed only by reference to debits and credits

derived from its accounts. The accounts reflected the commercial reality that TPL made no gain or profit when it exchanged the Claims for shares, as the experts agreed, but would do so only when the Claims were converted into cash. The FTT had simply invented a non-existent credit in order to arrive at what it evidently considered a fair result, but had not explained the basis for that invention.

HMRC's arguments

92. Mr Milne's first point was that it is necessary to have regard to the opening provision of the loan relationship rules, section 80 of FA 1996. Subsection (1) provided that "all profits and gains arising to a company from its loan relationships shall be chargeable to tax". The purpose of the rules is therefore clear. Section 84 provides a means of determining what are the sums—the credits and debits—which represent the gains and, if appropriate, the losses which are to be brought into account. The process to be followed is, first, to bring into account the amounts which have been recognised by the company in its GAAP-compliant accounts (or, where there are no such accounts, the amounts which would be recognised by GAAP-compliant accounts). That is what sections 85A and 85B mandate. The second step, mandated by section 84(1), is to evaluate those amounts in order to check whether they are "sums which fairly represent" the profits, gains, losses, interest, charges and expenses which are listed in subsection (1)(a) and (b).

93. It is quite clear from its own wording, and from the statement in section 85A(1) that it is "[s]ubject to the provisions of this Chapter (including, in particular, section 84(1)", Mr Milne said, that section 84(1) contains an overarching requirement. If the draftsman had intended that GAAP-compliant accounts should be respected, without more, he could easily have said so. It was, rather, a necessary inference from the existence of section 84(1) that it was apt to override GAAP-compliant accounts in an appropriate case, that is if it is necessary in order to achieve a fair representation of the profits and gains a company had received. It could be seen as a "longstop" provision designed to ensure that profits and gains which ought to be taxed did not fall out of the net.

94. The FTT's reasoning respected the scheme of the rules. It determined that there was a disposal of each of the Claims, for which the consideration was an issue of shares with an agreed fair market value totalling £200 million. The shares were not issued at a discount under either English or Jersey company law, and must therefore be taken to have been issued at their fair value. The FTT was right to conclude that TPL had made a gain, whether or not it was recognised in its accounts, equivalent to the value of the shares it had received. The value of the shares clearly represented a credit of the kind to which the loan relationship rules refer.

95. Far from supporting TPL's case, what was said in *DCC Holdings* is consistent with HMRC's position. It was important to bear in mind that the wording of

section 84(1) at that time was a little different: it stated that the credits and debits to be brought into account shall be "the sums which, in accordance with an authorised accounting method and 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 …". Significantly, the words "in accordance with an authorised accounting method and when taken together" were repealed with effect from 2005. But even the former wording, as the majority in the Court of Appeal and the Supreme Court held, did impose a "fair representation" test. As we have mentioned, the majority in the Court of Appeal decided upon symmetrical credits and debits of £28.8 million; in the process of his reasoning Moses LJ rejected, at [51], the possible alternative of symmetrical credits and debits of £2.9 million. The proper approach was explained by Lord Walker:

> "[43] [Counsel for DCC] submitted that para [51] of Moses LJ's judgment was a complete answer to the Revenue's reliance (as its first fall-back position) on DCC being treated, under s 84(1), as having a debit of an apportioned sum of £2.9m. He submitted that this position was unacceptable because it involved £25.9m (the balance of the deemed manufactured interest) as having simply vanished into the ether. I do not see that as a convincing argument. Under s 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 s 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. The spare £25.9m may vanish into the ether as a hypothetical sum, but £25.9m is (or would be but for its non-residence) taxable in the hands of the Bank ….
>
> [44] In short, I consider that the majority of the Court of Appeal were right to see the overwhelming need for a symmetrical solution: that is the essential statutory function of the deemed flows of income … it seems to me that the correct answer is that on the accruals basis mandated by s 84(1) … both the credit and the debit should be £2.9m—the former by a simple process of time-apportionment of the coupon, the latter by a corresponding time-apportionment of DCC's notional payment representative of the coupon, so that only 18½ days out of the 182½ days' deemed manufactured interest (very slightly more than one-tenth, producing the figure of £2.9m as an apportioned part of £28.8m) is brought into account as a debit."

96. In a straightforward case, all things being equal, the fair representation test would almost always be satisfied by GAAP-compliant accounts. But one could

imagine, said Mr Milne, a situation in which two GAAP-compliant methods are available, one of which produces a mismatch, for example that a seller is not required to recognise sale consideration, while the buyer does so. The seller adopts the method which appears to deliver the mismatch in the hope of a tax advantage. In such a case, the "fairly represents" override might well require the seller to bring into account as a loan relationship credit the sums given by the alternative GAAP-compliant method which, had it been adopted instead, would not lead to a mismatch. If instead the company has adopted the only possible GAAP-compliant method, but it has structured its transaction so as to exploit (for tax) that particular GAAP-compliant accountancy treatment, the existence of the tax advantage may be strong evidence that the accountancy treatment, GAAP-compliant though it may be, does not "fairly represent" the profits and gains which arise to the company from its loan relationships. Here, as the FTT said at [135], the accounting produced "odd results"—that is, the recognition by TRAIL of an asset, while its parent treated the value of its TRAIL shares as nil—requiring the accountants to "squar[e] a circle", and that led to the FTT's correct observation, at [162], that this was a structured transaction designed to ensure that its GAAP-compliant accounts did not fairly represent TPL's profits and gains.

97. The plain reality in this case, Mr Milne said, was that TPL obtained shares (not issued at a discount) with a par value of £200 million from a "related transaction". That is a "profit" within the scope of section 84(1). There was no warrant, as TPL argued, for restricting the application of the subsection to cases where the accounting and tax periods did not coincide, or where a profit needed to be segregated in order to reflect loan relationship and other income. Moreover, TPL could not shelter behind the Explanatory Notes: those to the Finance Act 2004, which introduced the new section 85A, stated that its application is "subject still to the requirement that the credits and debits must fairly represent the profits and losses made."

98. It was quite wrong to say, as TPL did, that the FTT asked itself the wrong question, or misunderstood the facts. It found, correctly, that the Claims were assigned for shares issued at par value, matching their fair value, by a subsidiary and that the transaction was structured in this way to exploit for tax a proposed accountancy treatment of contingent assets: that is precisely how the DOTAS disclosure (see paragraph 11 above) described it. In that context, the FTT was entitled to find that the transactions "monetised" the loan relationship; that the scheme was intended to exploit the statutory link between accountancy profit and taxable profit and accordingly fell squarely within the mischief of the section 84 override; and that the accountancy treatment devised to deal with the transaction, even if it was GAAP-compliant, had produced an unnatural and uncommercial result. It was a clear example of a case in which section 84(1) was designed to apply.

Discussion and conclusions

99. We agree 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. We are not aware that such an interpretation of the subsection has ever found any judicial support and we do not detect that the FTT fell into the trap of adjusting the transactions on that rather nebulous basis. The critical paragraph of its decision, in respect of this point, is [161], in which it correctly identifies as the purpose of section 84(1), applied to this case, the fair representation of TPL's profits, for tax purposes, and went on to conclude that they should include "the non-contingent valuation of the shares received by it on the assignment of each of the Claims". 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.

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.

103. In our judgment it is unnecessary to look beyond *DCC Holdings* for the resolution of this issue. In that case 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 (see paragraph 11 above) makes clear, TPL has attempted to exploit accounting rules for the same purpose, in the process 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, set out at paragraph 95 above, seems to us to provide the answer here as it did there. Earlier in his judgment Lord Walker had considered three possible symmetrical solutions: a credit of £28.8 million matched by a debit of the same amount; a credit of nil matched by a debit of nil; and the answer at which he arrived, an apportioned credit of £2.9 million matched by a debit of the same amount. 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.

The "*Mabbutt*" argument (Issue 5)

108. As the *Mabbutt* argument was not before it the FTT made no findings of fact of relevance to it, but they are of limited compass and can be readily gleaned from the documents. On 22 August 2007 HMRC wrote to TPL. The heading to the letter referred to "Year Ended 31 December 2006", and the purpose of the letter was to acknowledge receipt of TPL's recently submitted corporation tax return "for the above period" and to inform it that HMRC were opening an enquiry. TPL had not, of course, made a return for that period; its return related to the period ended 5 December 2006. The error was promptly spotted. On 28 September 2007 Ernst & Young wrote to HMRC to acknowledge the letter and to indicate that they had been instructed to deal with the enquiry on TPL's behalf. Their letter mentioned, without taking any point about it, that the period had been incorrectly identified in HMRC's earlier letter. Thereafter the correspondence on both sides, including the closure notice, identified the relevant period correctly. Mr Peacock accepted that the error was easily identified, that it was nothing more than a simple clerical slip, and that neither TPL nor Ernst & Young had been misled.

109. His argument, rather, was that the letter opening the enquiry failed to comply with the requirements of paragraph 24 of schedule 18 to the Finance Act 1998, as it has been interpreted by the Tribunal and the Courts. The relevant part of paragraph 24 is sub-paragraph (1), which is as follows:

> "An officer of Revenue and Customs may enquire into a company tax return if they give notice to the company of their intention to do so ('notice of enquiry') within the time allowed."

110. The question whether the period to which a document relates has to be correctly identified was considered by the Court of Appeal in *Baylis v Gregory* (reported as *Craven v White, IRC v Bowater Property Developments Ltd, Baylis v Gregory* [1989] 1 AC 398). The appeals were later to proceed to the House of Lords, but not on this point. The relevant inspector instructed a subordinate to issue an assessment for the tax year 1975-76; by mistake the subordinate made and notified an assessment expressed to be for 1974-75. When the mistake was realised the assessment was vacated, although the taxpayer was not told that it had been vacated. The questions, identified by Slade LJ at 434, were whether, notwithstanding its vacation, the assessment had any legal effect at all, and whether, if so, it could be treated as a valid assessment for the year 1975-76 by virtue of section 114 of the Taxes Management Act 1970 ("TMA") or for some other reason. Section 114 is as follows:

> **"(**1) An assessment or determination, warrant or other proceeding which purports to be made in pursuance of any provision of the Taxes Acts shall not be quashed, or deemed to be void or voidable, for want of form, or be affected by reason of a mistake, defect or omission therein, if the same is in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts, and if the person or property charged or intended to be charged or affected thereby is designated therein according to common intent and understanding.
>
> (2) An assessment or determination shall not be impeached or affected—
>
> (a) by reason of a mistake therein as to—
>
> (i) the name or surname of a person liable, or
>
> (ii) the description of any profits or property, or
>
> (iii) the amount of the tax charged, or
>
> (b) by reason of any variance between the notice and the assessment or determination."

111. At 436 Slade LJ recorded that the taxpayer's advisers realised immediately they received the notification of the assessment that the reference to 1974-75 was an error, and that 1975-76 had been intended, but said that, leaving section 114 to one side, it was nevertheless impossible to regard the assessment as one made for 1975-76. He accepted the argument of counsel for the taxpayer that the identification of the correct year of assessment was critical, and said at 438 that section 114 was not apt to overcome so fundamental an error. Mr Peacock accepted that there was no particular form by which an enquiry must be opened but argued that the correct identification of the relevant period was as critical to an enquiry as to an assessment. By way of analogy he referred us to the decision of Judge Berner, sitting in the FTT, in *Sokoya v Revenue and Customs Commissioners* [2009] UKFTT 163 (TC), where HMRC had

incorrectly stated, in a letter to the taxpayer, that he must comply with an information notice within 30 days of receipt, rather than within 30 days of a determination by a Special Commissioner. The judge accepted that, in the circumstances of the case, the taxpayer had not been misled, but nevertheless took the view that the error in stating the date for compliance was fatal, and that the notice was invalid.

112. The error in *Mabbutt* itself was similar: HMRC opened, or purported to open, an enquiry into the taxpayer's return for "the year ending 6 April 2009". Again, the taxpayer and his advisers knew perfectly well what was intended but the judge concluded that the error in the date was nevertheless fatal, because an enquiry had to be opened into a period which existed, and was accurately identified.

113. Miss Wilson emphasised, in response, the lack of any formality in the procedure for the opening of an enquiry: the only requirement is that the taxpayer should be informed of it. In *R (Spring Salmon and Seafood Ltd) v Inland Revenue Commissioners* [2004] STC 444 at [32] Lady Smith, sitting in the Outer House, pointed out that there was not even any requirement of writing, and that (as in that case) a notice given to one of a company's offices, but not its registered office, was valid. A similar conclusion was reached by Cranston J in *R (Sword Services Ltd) v Revenue and Customs Commissioners* [2016] 4 WLR 113; at [71] he observed that "There is no particular form prescribed for a notice of enquiry and so long as the taxpayer knows of HMRC's decision to conduct an enquiry that is sufficient."

114. In *Portland Gas Storage Ltd v Revenue and Customs Commissioners* [2014] UKUT 0270 (TCC) this Tribunal was required to consider whether, as the taxpayer maintained, HMRC had opened an enquiry; HMRC's position was that they had not done so. The relevant statutory provision in that case (which concerned stamp duty land tax) was paragraph 12 of schedule 10 to the Finance Act 2003 which, like the applicable provision here, imposed no requirements of form. The taxpayer submitted a return relating to the grant of a lease, and paid the appropriate duty. Some time later the terms of the lease were amended in a manner which, had the amendments been effective from the outset, would have led to a substantially lower amount of tax. The taxpayer thereupon sought to amend its return, and the question was whether it was out of time to do so. In the course of correspondence an HMRC officer wrote that he was "seeking advice from our policy team regarding the time limit …", and the Tribunal decided that was sufficient to open an enquiry. As it said at [48]:

> "… a communication should be regarded as giving notice of an intention to enquire provided the intended effect is reasonably ascertainable by the person to whom it is directed. In our view Portland would clearly ascertain from HMRC's letter that there was an intention to enquire further into the return …"

115. Here, said Miss Wilson, it was quite obvious what was intended: HMRC's letter of 22 August 2007 acknowledged TPL's return and, despite the error in describing the period to which it related, there could have been no doubt that the letter referred to that return, and not some other, non-existent, return. Ernst & Young had quite clearly understood what was meant and, entirely sensibly and consistently with what happens in the real world, had not taken any point on the error. It was accepted in the statement of agreed facts that an enquiry had been opened, and it had not occurred to anyone until *Mabbutt* was decided that an error of this kind was of any significance at all. The error of the Tribunal in that case was to look first at section 114 of TMA, rather than to construe the letter in its context. In that case too it should have been obvious to the recipient of the letter that it contained an inconsequential clerical mistake. In the different but nevertheless comparable context of a notice to terminate a lease the House of Lords decided, in *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, that an error in a notice served by the tenant to terminate a lease, which referred to 12 January when the applicable break day was 13 January, did not invalidate the notice. The error here, said Miss Wilson, was of a similar character.

116. In our judgment Miss Wilson is right, and broadly for the reasons she gave. The essence of the reasoning of the majority in *Mannai v Eagle Star* was that, in the case of an error of form, what mattered was what the recipient would understand from the communication in question when it was objectively construed. As Lord Hoffmann put it at 774, the landlord "will reject as too improbable the possibility that the tenant meant that unless he could terminate on 12 January, he did not want to terminate at all. He will therefore understand the notice to mean that the tenant wants to terminate on the date on which … he may do so, ie 13 January."

117. The position here, in our view, is much the same. The recipient of HMRC's letter cannot reasonably have understood it to mean that the writer had no wish to enquire into the return which had been made, but wanted to enquire instead into some other, hitherto unmade, return. On the contrary, despite the error there is no arguable ambiguity about what was meant: the writer intended to enquire into the return whose receipt he was acknowledging. Ernst & Young plainly understood that to be the message. The requirement that the taxpayer be informed of the opening of an enquiry was accordingly met and for that reason, in our view, this issue can be resolved without resort to section 114. If such resort is nevertheless necessary it seems to us clear that, despite the error, the letter was "in substance and effect in conformity with or according to the intent and meaning of the Taxes Acts", as section 114(1) puts it, and its defect is cured.

118. We do not consider that what was said in *Baylis v Gregory* or in *Sokoya* leads to a different conclusion. The former concerned the validity of a formal demand, for which there is a prescriptive statutory framework, by which a taxpayer is made liable, subject to appeal, to make a payment to the state. One can well

understand why protection of the taxpayer demands formality and complete absence of ambiguity in such a case. The latter concerned a penal provision: the taxpayer was said to be liable to a penalty for his alleged failure to comply with an information notice by a date which had been incorrectly identified. In other words, he was said to be liable to a penalty for failing to do something which he could not lawfully have been required to do; moreover, it is well established that in a penal context any ambiguity must be construed in favour of the person penalised. We see no true parallel between those cases and this.

119. We therefore reject this ground of appeal, and conclude that HMRC had opened a valid enquiry. In so far as the FTT came to a different conclusion in *Mabbutt*, we respectfully disagree.

Summary of conclusions

120. We are satisfied that the FTT was right to conclude that the accounting treatment adopted by TPL was GAAP-compliant. HMRC's appeal against that part of the Decision is therefore dismissed.

121. We are also satisfied that the FTT was right to conclude that section 84(1) of FA 1996 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 to TRAIL of the Claims.

122. The error in the identification of the relevant accounting period in the letter sent by HMRC in order to open an enquiry into TPL's relevant return does not invalidate the enquiry.

123. TPL's appeal is therefore dismissed.

Mr Justice Newey **Judge Colin Bishopp**

RELEASE DATE: 17 February 2017