[2012] UKFTT 385 (TC)

TC02069

Appeal numbers TC/2010/02176
TC/2010/04041

CORPORATION TAX — accounting treatment of intra-group transactions — loan relationship provisions — FA 1996, Part IV, Ch II— whether accounting treatment adopted GAAP compliant — no — FRS 5, 18 — interest strip — whether principal should be partially de-recognised in creditor's accounts — yes — whether receipts of stripped interest within FA 1996 s 84(1)(b) — no — whether FA 1996 s 84(2)(a) applies — no — appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

GREENE KING plc
GREENE KING ACQUISITIONS LIMITED **Appellants**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

Tribunal: Judge Colin Bishopp
Judge Alison McKenna

Sitting in public in London on 17 to 20 October 2011

Mr Jonathan Peacock QC and Mr Michael Ripley, counsel, instructed by Reynolds Porter Chamberlain for the Appellants

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

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DECISION

Introduction

1. This is an appeal against two notices of amendment, issued by HMRC on 6 January 2010, relating to the corporation tax returns of the appellants, Greene King plc ("PLC") and Greene King Acquisitions Ltd ("GKA"), a wholly-owned subsidiary of PLC, for the periods ending 30 April 2003 and 30 April 2004.

2. The appeal finds its origins in two transactions, which took place on 31 January 2003 and 5 September 2003 respectively, whereby PLC provided financing to GKA by exchanging the right to receive the interest due to PLC, on loan stock issued by another of its wholly-owned subsidiaries, for preference shares issued by GKA. The dispute between the parties centres on the correct accounting treatment of the transactions and the application to them of the loan relationship provisions in Part IV, Chapter II, of the Finance Act 1996 ("the 1996 Act"); these provisions have since been re-written to the Corporation Tax Act 2009, but as they were still in force at the relevant time, we shall refer in this decision to the original provisions. HMRC's case is, in essence, that the accounting treatment of the transactions adopted by PLC and GKA was incorrect and led to an under-declaration of profit in their accounts. The disputed amendments were designed to bring into tax the profits which, HMRC say, that accounting treatment was intended to, but does not, remove from tax.

3. Before us, PLC and GKA were represented by Mr Jonathan Peacock QC and Mr Michael Ripley, counsel, and HMRC by Mr David Milne QC. The parties had agreed the essential facts but we heard the oral evidence of two witnesses of fact, Mr Bryndon Webb who is the Greene King group's tax controller, and Mr Les Clifford, a partner in the firm of chartered accountants, Ernst & Young, responsible for the Greene King group's audit, who provided more detail about the circumstances in which the group entered into the transactions, and about their accounting treatment. We also had the expert evidence of Mr David Parish ACA, employed by RSM Tenon as a director of its audit, tax and advisory division, for the appellants, and of Mr Mark Chandler FCA, who is employed by HMRC as an advisory accountant.

4. In the customary way, the experts had agreed a joint statement of those matters on which they were agreed and of those on which they had been unable to agree. We shall come to those matters later. At this stage we think it appropriate to record that we heard some cross-examination and submissions about their respective qualifications and standing which we did not find greatly helpful. We merely observe that we are satisfied that both gave opinion evidence which it was within their competence to give and, for the avoidance of any doubt there might be, that Mr Chandler's employment by HMRC does not compromise the independence of his views.

The agreed facts

5. The parties' agreed statement of facts, with some amendment, paraphrasing and expansion, is as follows:

(1) The Greene King group is based in Bury St Edmunds, Suffolk and its principal activities are operating managed, tenanted and leased public houses, brewing beer, and wholesaling beers, wines, spirits and soft drinks.

(2) The relevant transactions took place between three companies of the group:

- PLC, which is the UK parent company of the group;
- Greene King Brewing and Retailing Limited ("GKBR"), a wholly owned subsidiary of PLC; and
- GKA, a wholly owned subsidiary of Beards of Sussex Group Limited, itself a wholly owned subsidiary of PLC. GKA was originally called Beards of Sussex Limited but changed to its current name on 10 February 2003. We shall refer to it as GKA in respect of events both before and after its change of name.

(3) The first transaction giving rise to the present dispute between the parties in this appeal (in reality a sequence of transactions, but for simplicity referred to throughout this decision as "the first transaction") was as follows:

(a) On 20 October 2000, PLC lent £300 million to GKBR. On the same day GKBR created unsecured loan stock with a nominal value of £300 million, all of which was issued to PLC as security for the loan.

(b) At all times material to this decision PLC was the sole holder of all the loan stock.

(c) At the time of issue, the terms of the loan stock were that it was to be redeemed on 4 May 2004, and in the meantime that it bore interest at a floating rate which equated to LIBOR plus 1%, payable six monthly in arrears on 4 May and 4 November until redemption. There was an option to repay the loan and redeem the stock early.

(d) On 31 January 2003, the terms of the loan were amended by agreement of PLC and GKBR. The interest rate was altered to a fixed rate of 4.75%, but the interest remained payable on the same dates. The option to redeem the stock early was removed.

(e) On the same day, PLC assigned to GKA its right to receive the interest on the loan stock (including interest accrued but not then due for payment), in consideration for which GKA issued to PLC 1.5 million £1 preference shares in itself. The right to receive repayment of the loan principal remained with PLC.

(f) The preference shares carried the right to a special dividend, defined as an initial dividend of 65 pence per share to be declared on 14 February 2003, and thereafter the right to a 5% annual dividend.

(g) PLC immediately gave notice to GKBR of the assignment and directed GKBR to make future interest payments to GKA.

(h) On 14 February 2003, the special dividend of 65 pence per share, amounting in all to £975,000, was declared by GKA. The dividend was to be paid on 2 May 2003, and it was duly paid on that date.

(i) On 4 May 2003 GKBR paid interest of £7,066,438 on the loan to GKA.

(j) Three future payments of interest on the loan were due following the assignment and before redemption:

4 May 2003 – £7,066,438

4 November 2003 – £7,183,561; and

4 May 2004 – £7,066,438;

Total: £21,316,437.

(k) The net present value (or NPV) of the three future interest payments, as at 31 January 2003, was calculated to be £20,548,372, using a discount rate of 5%. That value is not a matter of dispute.

(4) The second transaction (again, a sequence but referred to throughout this decision as "the second transaction") was as follows:

(a) Between 1997 and 2003 PLC lent a total of £290 million to GKBR. In return, GKBR issued £125 million discounted unsecured loan stock on 2 May 1997, and entered into two inter-company loan agreements: for £105 million on 10 December 2001 (reduced to £30 million on 7 January 2003) and for £60 million on 28 February 2003.

(b) At all times material to this decision PLC was the sole holder of the loan stock, and remained the creditor under the loan agreements.

(c) The terms of the loan stock, as they had been amended by deed of variation of 30 April 1999, provided that it was repayable on 4 May 2004 (with an option to redeem early) and that it bore interest at a floating rate of six months LIBOR plus a margin of 1%. The interest was payable six monthly in arrears on 4 May and 4 November until redemption. The same interest rates were prescribed by the loan agreements. The inter-company loans were repayable on demand.

(d) On 5 September 2003, the interest rates were amended to a fixed rate of 4.25% but the interest remained payable on the same dates. The option for the borrower to pay off the loans early was removed.

(e) On the same day, PLC assigned to GKA the rights to the future interest payments on the loan stock and the agreements, in consideration for which GKA issued to PLC one million £1 A preference shares in itself. The right to receive repayment of the principal of the three loans remained with PLC.

(f) The A preference shares carried the right to a special dividend of 65 pence per share, such dividend to be declared on 12 September 2003, and the right to receive an annual preferential dividend of 5%.

(g) PLC immediately gave notice to GKBR of the assignment and directed GKBR to make future interest payments to GKA.

(h) On 12 September 2003, the special dividend of 65 pence per share, amounting in all to £650,000, was declared by GKA. The dividend was to be paid on 4 November 2003, and it was duly paid on that date.

5 (i) Two future payments of interest on the loans were due following the assignment and before redemption:

4 November 2003 - £4,818,120.55; and

4 May 2004 - £4,531,198.63;

Total: £9,349,319.18.

10 (j) The net present value of the two future payments, as at 5 September 2003, was £9,184,786.88, using a discount rate of 4.5%.

(5) PLC made up its accounts to 4 May 2003 and 2 May 2004. Following the first assignment of the right to receive interest (which took place on 31
15 January 2003 and therefore in the accounting period ended 4 May 2003), PLC continued to recognise the loan principal of £300 million in its accounts.

(6) GKA also made its accounts up to 4 May 2003 and 2 May 2004. After the first assignment (of 31 January 2003) to it of the interest strip (*ie* the
20 right to receive the interest on the loan from PLC to GKBR) and its issuing of preference shares to PLC, GKA:

- recorded the right as a receivable from GKBR in its balance sheet at its net present value;
- credited the nominal value of the preference shares as a non-
25 equity capital instrument; and
- credited to share premium account the difference between the net present value of the interest strip and the nominal value of the preference shares issued.

Payments received following the assignment were credited against the
30 balance sheet receivable, with the excess of the amounts actually received over the original net present value taken to the profit and loss account.

(7) GKBR also made up its accounts to 4 May 2003 and 2 May 2004. The assignment of interest did not give rise to any changes in the accounting adopted by GKBR in respect of the recognition of the loan principal as a
35 liability or the payments of interest on the loan, which were debited to its profit and loss account.

(8) Sub-paragraphs (5) to (7) above also apply, with necessary modifications, to the accounting treatment adopted in consequence of the second transaction.

40 6. As we have indicated, the dispute between the parties centres on the correct accounting treatment of those arrangements; there is rather less disagreement about the tax consequences which follow once the correct treatment has been established. It is common ground that the accounting treatment to be adopted in any case is dictated in part by legislation, in part by recognised accounting
45 standards, and in part by professional judgment. The recognised accounting standards are known as Financial Reporting Standards, or FRS, which are issued

by the Accounting Standards Board. They provide guidance on the accounting treatment of particular types of transactions, on the presentation in accounts of assets and liabilities, and on similar matters, and are universally recognised as the standards to be followed within the United Kingdom. There are several such standards, usually identified as FRS 1, FRS 2 and so on, and they are often collectively referred to as Generally Accepted Accounting Practice or GAAP, or (in order to distinguish them from standards in use elsewhere) UK GAAP. We shall examine the relevant legislation and standards later; before doing so it is necessary to say a little more about the background to the dispute, and to identify the issues which arise.

Mr Webb's evidence

7. Mr Webb gave us some further information about the group, and the circumstances in which it entered into the transactions. He is currently employed by the Greene King group as its tax controller, but his position at the relevant time was its tax and treasury manager, in which role he was required, for example, to ensure that there was a match between the group's debt profile and its income, and that external finance was obtained as cheaply as possible. Neither of these is a consideration in this case.

8. His evidence was, rather, directed to the group's need of funding for expansion, which was achieved by acquisition rather than by organic growth. Historically, acquisitions had been made of smaller but nevertheless substantial companies carrying on the same kind of business; their businesses then became an integral part of GKBR's business. In the course of a reconstruction in 1997, GKBR had become the group's main operating company, while PLC owned the properties from which trade was carried on, charging rent to GKBR. The first loan of £125 million, referred to at para 5(4)(a) above, came into existence in the course of the reconstruction. In 2000, however, the board decided that the 1997 arrangement was too cumbersome: the properties were transferred to GKBR and PLC became merely a holding company. It was the transfer of the properties which led to the £300 million loan referred to at para 5(3)(a) above. We should add that HMRC accept that the loan was made for ordinary commercial reasons.

9. The loans of £105 million and £60 million, also mentioned at para 5(4)(a) above, were made to enable GKBR to acquire the assets of two companies. HMRC do not dispute that the money was put to that purpose, nor do they contend that these loans too were anything other than ordinary intra-group arrangements.

10. By about 2002, Mr Webb said, the group was beginning to find that the opportunities for growth by the acquisition of fairly large companies were reducing, and in order to continue expanding it was forced to acquire much smaller companies, some with only one public house. The decision was made in January 2003 that GKA, rather than GKBR, would become the acquisition vehicle, and that it would also operate the acquired businesses for a short period after acquisition—hitherto acquired businesses had been immediately integrated into GKBR. GKA had itself been acquired, with its immediate parent company, in 1998. It had been effectively dormant since May 2002 although it retained some reserves.

11. At about the same time Ernst & Young, who were the group's principal accounting advisers and auditors, identified to the board an intra-group financing arrangement, essentially that adopted for the first and second transactions. Mr Webb's evidence was that the arrangement was thought to be a suitable means by which PLC could make funds available to GKA, in order that it could continue to implement the group's expansion plans. The arrangement was attractive to PLC, which adopted it in respect of the first transaction on 31 January 2003 (see para 5(3)(d) above). Mr Webb's evidence was that finance provided by PLC to GKA, by means of the assignment to it of the interest stream receivable from GKBR, had indeed been used for the acquisition of several pubs, and there is no dispute that GKA received net funds which were available for acquisitions.

12. We need at this point to embark on a short digression. Mr Milne suggested to Mr Webb, by reference to various contemporaneous emails, that each of the transactions, far from being an efficient means by which PLC could continue to do what it had been doing for many years (that is, provide acquisition finance to its subsidiaries) was in truth no more than a tax saving device, one moreover in which Ernst & Young was to share, by taking a percentage of the tax saved by its adoption. It was, he said, "a scheme for making what would otherwise be taxable income vanish into thin air". We have no real doubt that the perceived tax saving was the predominant purpose of the transactions: the appellants acknowledged that they used a marketed scheme, one feature of which, as Ernst & Young's presentation to prospective clients showed, was that "it provides a borrowing company within the Group an interest deduction on its finance without the lender being taxed on this interest".

13. Mr Webb did not claim that the steps in the transactions undertaken in 2003 represented a more effective means by which PLC could provide funds for its subsidiary than a simple loan, and he accepted, even if rather reluctantly, both that the special dividends had no commercial purpose and that GKA became the vehicle for future acquisitions as an integral part of the scheme, and not for separate commercially-driven reasons. In addition Mr Clifford, in the opinion to which we shall later come, made the point that

> "The … transaction looked at in isolation is not on arm's length terms. No company would rationally sell a valuable future interest stream for a consideration of such little comparative value, unless it already had control of the transferee such that it could benefit indirectly from the value of the income stream."

14. However, HMRC have not hitherto advanced arguments that the transactions fail in their purpose for these reasons. At para 5 of the statement of case they say:

> "The object of the scheme was to achieve the position whereby a debit is generated in GKBR in respect of the payment of the interest flow to GKA, whereas no corresponding credits would be imputed to GKA (as recipient) or PLC (as assignee)."

15. This paragraph encapsulates the thrust of HMRC's case about the intended result of the arrangements, namely that one group company receives tax relief on payments it makes to another group company, while the recipient is not charged to tax on the receipt. As we have indicated, that is precisely what Ernst & Young

offered when presenting the scheme to prospective clients. Mr Milne put it in this way in his skeleton argument:

> "[The] transactions were structured in the curious way they were (considering that GKA could have been funded to make its acquisitions by simple interest-free loan) in order to attempt to take advantage of a perceived loophole in the loan relationships legislation so as to achieve a tax mismatch within the Greene King group. If the scheme were to succeed, GKBR would be entitled to a deduction (for corporation tax purposes) of over £21m for interest paid on an intergroup loan, without any company in the group being chargeable on the corresponding receipt."

16. The statement of case goes on to argue, however, that the arrangement does not succeed in that purpose, not because it is an abuse, or falls foul of anti-avoidance provisions, but because it does not, as a matter of law and accounting practice, have the intended result. The same approach was adopted in the correspondence which led to the disputed notices of amendment (even though the transactions were described by HMRC in that correspondence as "artificial") and, despite the extract we have set out, in Mr Milne's skeleton argument. In those circumstances we do not think it necessary or appropriate to dwell further on the appellants' motives, nor to consider whether or not the transactions were abusive. Nevertheless, the admitted purpose of the transactions is not a factor which can be ignored entirely. It was of particular importance in relation to Mr Clifford's role, to which we shall come later.

The issues

17. The issues between the parties which arise from the agreed facts were identified by Mr Peacock in his skeleton argument. As formulated in respect of the first transaction, and with some re-phrasing, they are:

> Issue 1: Whether PLC should have accounted in its individual (or "solus") accounts for an additional £1.5 million (representing the nominal value of the preference shares received as consideration for the interest strip) as taxable profit in the year ending 4 May 2003.
>
> Issue 2: Whether PLC is taxable under s 84(2) of the 1996 Act (see para 39 below) on £20,453,476 (the aggregate of the sums referred to in the closure notices) as a loan relationship credit. We are not required to decide whether the taxable amount, assuming it is taxable, has been correctly calculated.
>
> Issue 3: Whether GKA has a loan relationship with GKBR as result of the first transaction.
>
> Issue 4: Whether s 84(2)(a) applies to the credits in GKA's accounts arising from the receipt of interest.

18. The issues arising from the second transaction are identical, save for differences in the amounts and, since there is no other difference between the two transactions which is material to the outcome of the appeal, the parties concentrated on an analysis of the first transaction; we shall do likewise.

19. HMRC's position in relation to issue 1, almost to the start of the hearing, was that PLC should have brought the £1.5 million into taxable profit, but Mr

Chandler took the contrary view and it was agreed between the parties before the hearing began that the answer to that issue was "no". We thus do not need to address it, nor do we need to investigate the differing reasons for the agreed answer in order to determine the remainder of the appeal, though we will shall make some brief comments below (see para 50). Issue 2 became the main focus of argument. Some matters of dispute relevant to issues 3 and 4 were also resolved between the parties, leaving only some residual though nonetheless significant matters for determination.

20. The critical question it is necessary to answer in order to decide issue 2 is whether, as HMRC contend, PLC should have partially de-recognised the principal outstanding (in the case of the first transaction, £300 million) by discounting it by the NPV of the interest strip (£20,548,372, the figure mentioned at para 5(3)(a) above), and should then have accreted that value progressively, by the same aggregate amount, over the period remaining before redemption, bringing the accretions into profit and, correspondingly, tax. We interpose, parenthetically, that the NPV of the interest strip and the amount by which the principal should be de-recognised (if HMRC are correct in principle) are not necessarily identical, but we are not required to deal with that point. The appellants say that partial de-recognition was not merely not required but not permissible, and that HMRC's position is fundamentally flawed because, had the interest strip been exchanged for cash, HMRC's proposed accounting method would bring the same sum into tax twice.

21. Before coming to the rules which dictate their accounting treatment it is, we think, appropriate to say rather more about the genesis of the transactions, and the process by which the accounting treatment actually adopted was determined.

The Ernst & Young presentation

22. As we have said, the transactions were entered into as a marketed scheme, known as "Project Sussex", devised by Ernst & Young. Among the documents produced to us were copies of a presentation by Ernst & Young to prospective purchasers of the scheme. It included the following passages:

> **"Accounting**
>
> - We shall assume that prior to stripping the coupons [PLC] has accrued interest on the loan to the value of £1.2m, and the market value of the coupon stripped is £22.6m.
> - [GKBR]
>   - [GKBR] will show the loan as a liability in its balance sheet and will credit its Profit & Loss Account with the interest accrued during the accounting period.
> - [PLC]
>   - [PLC] will accrue interest on the Loan prior to the date of the assignment. The interest will be credited to the Profit & Loss account.
>   - The value of the Loan should be impaired in [PLC's] accounts after it has assigned to [GKA] the right to receive 1.5 years of interest payments. However it is not uncommon practice in the UK for

companies not to perform an impairment review in respect of inter-company loans.

- If the Loan is impaired, it will accrete the value of the Loan to £300m over the 1.5 year period, with corresponding credits being taken to the Profit & Loss Account.
- The preference share that [PLC] receives as consideration for assigning the interest will not be accounted for except as a revaluation as it has already effectively been recognised in the carrying value of the loan or reflected in the accretion up to £300m. [PLC's] assets do not exceed £300m.

- [GKA]
  - [GKA] will show the payments that it will be entitled to receive from [GKBR] over the next 1.5 years as an asset in its balance sheet at its fair value (£22.6m).
  - [GKA] will show an increase in shareholders' funds equal to the fair value of the consideration received (£22.6m). As a matter of company law, [GKA] will be required to show the preference share on the basis of its nominal value of (£1.2m) and the balance of the consideration (£21.4m) will be taken to the share premium account.
  - The aggregate value of the interest payments will be £23.81m. The difference between this figure and the fair value of £22.6 m (£1.21m) will be treated as interest by the investor, which it will credit to its Profit and Loss Account at a constant rate over the 1.5 year period.
  - On each occasion [GKBR] makes a payment to [GKA] the payment will be split between interest and a repayment of capital. The value of the asset shown in [GKA's] accounts will fall over the 1.5 year period to zero.

Taxation

- [GKBR]
  - [GKBR] will be able to claim relief on an accruals basis for the payment of interest in respect of the Loan. This deduction should be unaffected by the assignment of that interest from [PLC] to [GKA].
- [PLC]
  - [PLC] has a Loan Relationship with [GKBR] before and after the assignment of the interest.
  - The provisions of para 12 Sch 9 FA 1996 do not apply because [GKA] does not replace [PLC] as a party to the loan relationship.
  - [PLC] is taxed on an amount equal to the accounting value given to the Preference Share at the time of the assignment as a profit on a related transaction (£1.2m).
- [GKA]
  - [GKA] is a party to a loan relationship in its own right, represented by the rights to interest. [GKA] should bring into account its profit as a profit from a loan relationship rather than as interest; there is no interest under this loan relationship.

- [GKA] should bring into account a profit of £1.21m in respect of its loan relationship, on which it should be taxed on an accruals basis over the term of the loan as it accretes the value of the asset from £22.6m up to £23.81 m.

5 - [GKA] should not have to bring, into account for tax purposes the £21.4m that is mandatorily taken to its share premium account."

23. The figures given above differ slightly from those identified in the agreed facts, but the differences are not material. The remarks made in relation to GKBR are uncontroversial. Those made under "accounting", in particular the second and 10 third indents, in relation to PLC go to the core of issue 2, while those relating to GKA are relevant to issue 4. Some of the remarks under "taxation" are uncontroversial, but others are relevant to issue 3 and are not agreed. We shall return to the areas of controversy in due course.

Mr Clifford's evidence

15 24. At the time of the transactions, Mr Clifford was Ernst & Young's audit engagement partner for PLC and its subsidiaries and, therefore, ultimately responsible for the truth and accuracy of the auditors' opinion which appeared in the group companies' published accounts, and which he signed on behalf of Ernst & Young. In addition, and because of PLC's recognition of the true underlying 20 purpose of the transactions (that is, as a means, if it succeeded, of generating relief for the payments of interest made without a corresponding liability to tax on the receipts), he was asked to prepare an opinion (see para 27 below) about their correct accounting treatment before PLC and GKA entered into them. He gave evidence as a witness of fact, and we accordingly treat what he told us as evidence 25 of what was done, and why it was done, rather than as evidence of the correctness of the manner in which the transactions were treated within the relevant companies' accounts.

25. Before coming to the substance of his evidence we need to deal with a preliminary matter. Mr Clifford rejected Mr Milne's suggestion that his views 30 were coloured by his being a partner in the same firm which had devised, and was marketing, a tax avoidance scheme. There was at that time, he said, no legal or ethical impediment to a single firm both advising and auditing a group such as Greene King. Mr Clifford made the points that he had taken no part whatever in the planning of the scheme, that he was obliged, as an auditor, to take an 35 independent view, that any failure on his part to do so could lead to disciplinary proceedings, and that both a technical reviewer and another partner, neither of whom had any relationship of his own with the Greene King group, had reviewed his work before it was released.

26. Although it would be remarkable if Mr Clifford had been able to put out of 40 his mind altogether the fact that his own firm was the architect of the scheme, we are satisfied from his evidence that he did examine the accounting requirements which flowed from it objectively, and that the opinions given in advance of its implementation by PLC, GKA and GKBR, and in the group's audited accounts, were not coloured as Mr Milne suggested. That is not to say, however, that he was 45 right.

27. In January 2003, Mr Clifford and a team of other Ernst & Young personnel prepared an opinion, for the Greene King board, advising on the proper accounting treatment of what was then still a proposed assignment and share issue. He told us that his main task was to consider the various possible ways in which the companies could properly account for the transactions. In the consolidated group accounts they would, as he put it, "eliminate", meaning effectively cancel each other out; what was required was a method by which the individual companies could treat them in their own, solus, accounts. He took into consideration, in particular, the requirements of FRS 4 (relating to capital instruments), FRS 5 (entitled Reporting the Substance of Transactions), and Sch 4 to the Companies Act 1985, and decided upon what he described in his witness statement as "a method that recognises no impairment in the underlying value of the loan receivable on day one", rejecting the other possible methods which he thought might have been appropriate, namely partial de-recognition and capital contribution.

28. As we have indicated, HMRC argue, among other things, that Mr Clifford's choice between these methods was wrong, and that partial de-recognition was the only appropriate method. It is in consequence necessary to consider Mr Clifford's reasons for favouring one possible method over the others as one of the factors to be taken into account: although we do not treat Mr Clifford as an expert, it is nevertheless essentially his judgment (or, to be precise, the judgment of the team he led in producing the opinion which preceded the transactions) which is in issue. In his witness statement he put the reason for favouring what he had described as a non-impairment method in this way:

> "It was considered that there would be no overall change in the carrying value of PLC's assets because a reduction in the value of the loan would be offset by an enhancement in the value of investment in its subsidiaries, *ie* the value of the loan to GKBR would be reduced on 'disposing' of the interest rights but this would be economically balanced by the increase in the value of the equity in [GKA] as PLC would be able to control the benefits arising from the income stream.
>
> Maintaining consistency with the accounting practice adopted by PLC for other intra-group loans at this time; as such non-interest bearing loans of an intra-group nature were not routinely written down within the Greene King group unless there was an indication of a permanent impairment in the recoverable amount. It was considered that the £300 million receivable under this transaction would be fully recoverable at the end of the loan term. As set out in paragraph 1 of FRS 18 'the objective of the FRS is to ensure that for all material items an entity adopts the accounting policies most appropriate for the purpose of giving a true and fair view'. The standard further addresses the need for 'comparability' in paragraph 30 which supports the need for consistency with group practice.
>
> Based on the above it was considered that there would be no economic disposal by PLC as there would be no significant change in PLC's rights to the benefits or exposure to risks (FRS 5, paragraph 70) taking into account the commercial effect of the transaction in practice (FRS 5, paragraph 75)."

29. Later in his witness statement he expanded upon his reasons for rejecting partial de-recognition:

> "The partial de-recognition method does not, in my view, adequately take into account the intra-group context of the transaction. In particular, I do not consider that FRS 5 requires partial de-recognition in circumstances where the commercial effect for PLC in substance is not significant and where PLC's rights to benefits and exposure to risks are substantively unchanged. I have noted that HMRC itself says [in the correspondence between the parties] that from an accounting perspective, PLC had not suffered any loss, merely a change in the nature of the assets that it holds, thus acknowledging the practical effect of the transaction."

30. Thus Mr Clifford concluded that there was no justification for impairing the loan in PLC's accounts because, in summary, while the character of the group companies' respective rights and obligations changed, PLC's overall position was, in net terms, unaffected, and there was no reason to think that the loan would not be repaid in full and on time. His distinction of this case from an arm's length transaction in which, as he accepted, partial de-recognition would be the technically correct accounting treatment, by virtue of the fact that this was an intra-group transaction with no significant risk attached to it, broadly reflects what is said in the second indent under "accounting", in relation to PLC, in the extract from Ernst & Young's presentation reproduced at para 22 above. The validity or otherwise of this distinction is of great importance in the determination of issue 2, and we shall return to it.

31. It will be observed that the declaration and payment of a special dividend (of £975,000 in the context of the first transaction) do not feature in Ernst & Young's presentation, and we did not learn what was the purpose of the dividend, save that it was regarded as part of the consideration (the remainder being the preference shares) for the interest strip. The received dividend was treated in PLC's accounts as a realised profit, and there is no disagreement between the parties on that treatment. Mr Clifford took the view that the allotment of the preference shares had no immediate impact on PLC as it was reflected, or included, in the unimpaired carrying value of the £300 million loan; adding the value of the preference shares to that unimpaired value would result in an over-statement of realised profits.

32. The treatment in GKA's accounts of the share premium arising from the issue of the preference shares was, Mr Clifford believed, dictated by FRS 4 and s 130 of the Companies Act 1985, which required the net proceeds to be allocated to shareholders' funds: he said that his understanding at the time was that s 132 of that Act (with which we deal at para 41 below) did not apply to the transaction. The definition of "net proceeds" he followed was that in FRS 4, namely the "fair value of the consideration received on the issue of a capital instrument after deduction of issue costs", the issue costs in this case being negligible. The accounting treatment Mr Clifford proposed was to recognise an asset at the net present value of the income stream (see para 5(3)(a) above) and to treat as the premium the excess of that sum over the nominal value of the shares. The asset was amortised to nil over the period of the loan as the payments of interest were received. This treatment, too, reflects the approach proposed in Ernst & Young's presentation. Whether or not this treatment was correct depends upon our answer to issue 4.

The relevant legislation

33. The appropriate starting point is s 226 of the Companies Act 1985 (as substituted by the Companies Act 1989, and also since repealed and replaced), which imposed on the directors of a company the duty to prepare accounts, including a balance sheet and a profit and loss account (together referred to in the Act as the company's "individual accounts"), for each of the company's accounting periods (usually a year). The form and content of the accounts were prescribed by Sch 4 of the Act, which imposed a large number of individual detailed requirements. The overriding obligation, however, was to prepare accounts which gave a "true and fair view"; and s 226(4) and (5) amplified that requirement:

> "(4) Where compliance with the provisions of [Sch 4], and the other provisions of this Act as to the matters to be included in a company's individual accounts or in the notes to those accounts, would not be sufficient to give a true and fair view, the necessary additional information shall be given in the accounts or in a note to them.
>
> (5) If in special circumstances compliance with any of those provisions is inconsistent with the requirement to give a true and fair view, the directors shall 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 shall be given in a note to the accounts."

34. Despite the detail of the rules set out in Sch 4, they amounted to no more than a framework, whose interpretation and application were left to accounting practice, itself governed by the recognised standards of UK GAAP. In essence, Sch 4 prescribed what must be recorded, but with limited exceptions did not prescribe how the amounts to be recorded were to be determined; and in some respects alternative approaches were permitted. The FRS provided guidance, often amounting to prescription, about those matters. There were, however, other legislative provisions of relevance here.

35. It is common ground that the loan relationship provisions to which we have referred above apply to the transactions. The principal charging provision was s 80 of the 1996 Act which, so far as material to this decision, provided that:

> "(1) For the purposes of corporation tax all profits and gains arising to a company from its loan relationships shall be chargeable to tax as income in accordance with this Chapter.
>
> (2) To the extent that a company is a party to a loan relationship for the purposes of a trade carried on by the company, profits and gains arising from the relationship shall be brought into account in computing the profits of the trade.
>
> (3) Profits and gains arising from a loan relationship of a company that are not brought into account under subsection (2) above shall be brought into account as profits and gains chargeable to tax under Case III of Schedule D.…
>
> (5) 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."

36. Thus subsections (2) and (3) together brought into charge all profits and gains arising from a loan relationship, and merely provided for differential treatment of those derived respectively from trading and non-trading activities. Later provisions of Chapter II, to which we shall come, supplied rules about the determination of the profits and gains which were chargeable in accordance with s 80. Mr Peacock placed some emphasis on sub-s (5), making the point that, with limited exceptions not material here, the loan relationship provisions amounted to an exclusive code.

37. What is meant by a loan relationship was spelt out by s 81:

"(1) Subject to the following provisions of this section, a company has a loan relationship for the purposes of the Corporation Tax Acts wherever—

(a) the company stands (whether by reference to a security or otherwise) in the position of a creditor or debtor as respects any money debt; and

(b) that debt is one arising from a transaction for the lending of money;

and references to a loan relationship and to a company's being a party to a loan relationship shall be construed accordingly.…

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

(5) For the purposes of this Chapter—

(a) references to payments or interest under a loan relationship are references to payments or interest made or payable in pursuance of any of the rights or liabilities under that relationship; and

(b) references to rights or liabilities under a loan relationship are references to any of the rights or liabilities under the agreement or arrangements by virtue of which that relationship subsists;

and those rights or liabilities shall be taken to include the rights or liabilities attached to any security which, being a security issued in relation to the money debt in question, is a security representing that relationship."

38. There is no dispute that PLC and GKBR were in a loan relationship within the meaning of that section. As we shall indicate, it is not so clear, and is before us as issue 3, whether one consequence of the transactions was the creation of a loan relationship between GKBR and GKA.

39. Sections 82 and 83 of the 1996 Act are of no relevance in this case, but s 84(1) and (2) are of some importance. They provided that:

"(1) The credits and debits to be brought into account in the case of any company in respect of its loan relationships shall be the sums which, 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; and

(b) all interest under the company's loan relationships and all charges and expenses incurred by the company under or for the purposes of its loan relationships and related transactions.

(2) The reference in subsection (1) above to the profits, gains and losses arising to a company—

(a) does not include a reference to any amounts required to be transferred to the company's share premium account; but

(b) does include a reference to any profits, gains or losses which, in accordance with generally accepted accounting practice, are carried to or sustained by any other reserve maintained by the company."

40. A central feature of the appellants' argument is that s 84(2)(a) was engaged, while sub-s (2)(b) was not, since no other reserve came into play. The significance of this point is that, if the appellants are right, amounts required to be transferred to GKA's share premium account (in this case by reason of s 130 of the Companies Act 1985, to which we come next) did not fall within the s 80 charge. HMRC agree that s 84(2)(b) was not engaged, but say that sub-s (2)(a) was irrelevant, because of the combined effect of ss 130 and 132 of the 1985 Act. The essence of the dispute on this issue is that while the parties agree that, at first sight, s 130 applied to the creation and issue of the preference shares (see paras 5(3)(e) and 5(4)(e) above), the respondents argue that its application was immediately excluded by s 132. The appellants say that s 132 cannot apply. Those provisions too have since been repealed and replaced, but were in force at the relevant time. Section 130 of the 1985 Act, so far as material, provided that:

"(1) If a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account called 'the share premium account'.…

(4) Sections 131 and 132 below give relief from the requirements of this section, and in those sections references to the issuing company are to the company issuing shares as above mentioned."

41. Section 131 is of no present relevance. Section 132 (which was entitled "Relief in respect of group reconstructions") read:

"(1) This section applies where the issuing company—

(a) is a wholly-owned subsidiary of another company ('the holding company'), and

(b) allots shares to the holding company or to another wholly-owned subsidiary of the holding company in consideration for the transfer to the issuing company of assets other than cash, being assets of any company ('the transferor company') which is a member of the group of companies which comprises the holding company and all its wholly owned subsidiaries.

(2) Where the shares in the issuing company allotted in consideration for the transfer are issued at a premium, the issuing company is not required by section 130 to transfer any amount in excess of the minimum premium value to the share premium account."

42. The following subsections provided a mechanism for determining the "minimum premium value", but we do not think it necessary to explore them as we are required only to reach a decision in principle on this point. Although, as we shall explain, the parties did not agree on the point, for present purposes we can assume that Mr Clifford's approach (of taking the difference between the net present value of the interest strip and the nominal value of the shares, therefore approximately £19 million) was correct. If the appellants are right, that £19 million was required to be transferred to the share premium account and, by virtue of s 84(2)(a), escaped taxation. HMRC contend that s 132 nullified the obligation which there would otherwise have been to make that transfer, and the £19 million correspondingly formed part of GKA's taxable profit. We deal with this issue at para 85 below.

43. Section 85 of the 1996 Act was entitled "Authorised accounting methods". Only sub-ss (1) and (2) are relevant to this appeal. They provided, in respect of the accounts drawn up to 4 May 2003—there were, for present purposes inconsequential, changes for the following year—that:

"(1) Subject to the following provisions of this Chapter, the alternative accounting methods that are authorised for the purposes of this Chapter are—

(a) an accruals basis of accounting; and

(b) a mark to market basis of accounting under which any loan relationship to which that basis is applied is brought into account in each accounting period at a fair value.

(2) An accounting method applied in any case shall be treated as authorised for the purposes of this Chapter only if—

(a) subject to paragraphs (b) to (c) below, it is in conformity with generally accepted accounting practice to use that method in that case;

(b) it contains proper provision for allocating payments under a loan relationship, or arising as a result of a related transaction, to accounting periods;

(bb) it contains proper provision for determining exchange gains and losses from loan relationships for accounting periods; and

(c) where it is an accruals basis of accounting, it does not contain any provision (other than provision in respect of exchange losses or provision comprised in authorised arrangements for bad debt) that gives debits by reference to the valuation at different times of any asset representing a loan relationship."

44. Section 87(2) makes it clear that the only permitted basis of accounting where (as here) the parties have a connection is an accruals basis, and a mark to market basis would in any event be impractical. Subsection (2) did not otherwise, we think, in reality restrict the choice of accounting method unduly, since the

requirements it imposed are similar to those imposed by UK GAAP. For completeness however we should mention that s 86(3) added a further qualification:

> "(3) If a basis of accounting which is or equates with an authorised accounting method is used as respects any loan relationship of a company in a company's statutory accounts, then the method which is to be used for the purposes of this Chapter as respects that relationship for the accounting period, or part of a period, for which that basis is used in those accounts shall be—
>
> (a) where the basis used in those accounts is an authorised accounting method, that method; and
>
> (b) where it is not, the authorised accounting method with which it equates …."

The accounting standards

45. The most important of the FRS in this case is FRS 5, entitled "Reporting the substance of transactions". Mr Peacock drew our attention to the comment which appears in its introductory paragraphs that

> "The FRS … will mainly affect those more complex transactions whose substance may not be readily apparent. The true commercial effect of such transactions may not be adequately expressed by their legal form and, where this is the case, it will not be sufficient to account for them merely by recording that form.
>
> Transactions requiring particularly careful analysis will often include features such as—
>
> … a transaction is linked with others in such a way that the commercial effect can be understood only by considering the series as a whole…."

46. Two of the substantive paragraphs of FRS 5 are of particular importance in this case. Paragraph 23 provides that

> "Paragraphs 21 and 22 deal with most transactions affecting items previously recognised as assets. In other cases where there is a significant change in the entity's rights to benefits and exposure to risks but the provisions of paragraph 22 are not met, the description or monetary amount relating to an asset should, where necessary, be changed and a liability recognised for any obligations to transfer benefits that are assumed. These cases arise where the transaction takes one or more of the following forms:
>
> (a) a transfer of only part of the item in question;
>
> (b) a transfer of only part of the item in question;
>
> (c) a transfer of all of the item for all of its life but where the entity retains some significant right to benefits or exposure to risk."

47. Paragraphs 21 and 22 do not have any relevance in this case. The second passage of importance is para 71:

> "Transfer of part of an item that generates benefits may occur in one of two ways. The most straightforward is where a proportionate share of the item is transferred. For example, a loan transfer might transfer a proportionate share of a loan (including rights to receive both interest and principal), such that

all future cash flows, profits and losses arising on the loan are shared by the transferee and transferor in fixed proportions. A second, less straightforward way of transferring a part of an item arises where the item comprises rights to two or more separate benefit streams, each with its own risks. A part of the item will be transferred where all significant rights to one or more of those benefit streams and associated exposure to risks are transferred whilst all significant rights to the other(s) are retained. An example would be a 'strip' of an interest-bearing loan into rights to two or more different cash flow streams that are payable on different dates (for instance 'interest' and 'principal'), with the entity retaining rights to only one of those streams (for instance 'principal'). In both these cases, the entity would cease to recognise the part of the original asset that has been transferred by the transaction, but would continue to recognise the remainder. A change in the description of the asset might also be required."

48. There was also reference to the requirements of FRS 18, whose purpose is identified succinctly in its introduction:

"The objective of this FRS is to ensure that for all material items:

(a) an entity adopts the accounting policies most appropriate to its particular circumstances for the purpose of giving a true and fair view;

(b) the accounting policies adopted are reviewed regularly to ensure that they remain appropriate, and are changed when a new policy becomes more appropriate to the entity's particular circumstances; and

(c) sufficient information is disclosed in the financial statements to enable users to understand the accounting policies adopted and how they have been implemented."

49. Although some references were made to other parts of UK GAAP, and to various explanatory notes and guidance published by the "Big Four" accountancy practices, we do not think it necessary to set them out, save to the limited extent we do so below. We repeat, for ease of understanding, that the critical point, in relation to issue 2, is whether the combined effect of paras 23 and 71 of FRS 5 is to require PLC to de-recognise the capital value of the loan principal in part, as HMRC contend; or, as the appellants maintain, their effect is to require PLC to produce accounts which do not contain any element of de-recognition.

Issue 1

50. As we have already said, the parties agreed shortly before the hearing began that the £1.5 million nominal value of the preference shares issued by GKA to PLC did not represent a realised profit in PLC's hands. Mr Parish and Mr Chandler arrived at that answer by quite different routes, and each doubted the other's reasoning. In particular, Mr Chandler did not accept that the accounting treatment actually adopted (of treating the £1.5 million as an increase in the value of PLC's investment in GKA, while taking no account of what Mr Chandler viewed as the transfer of value to GKA at PLC's expense) was correct. It is not, however, necessary for us to deal with their differences on this point, save to observe that they were marked, which lends some support to Mr Peacock's argument that there is room for divergent views about the correct accounting treatment of some transactions.

Issue 2

The expert evidence

51. The experts' joint statement is lengthy, and much of what it contains is set out elsewhere in this decision. We can, therefore, summarise much of it. The experts identified four discrete issues, in a slightly different form from that we have set out at para 17 above; how the preference share income should be recognised; whether or not PLC should have partially de-recognised the loan; whether or not PLC should have accreted the loan (in what follows, as elsewhere, we deal only with the first transaction) from about £280 million to £300 million between 31 January 2003 (when the interest strip took place) and 4 May 2004 (the due date for redemption of the loan), on a constant rate of return basis, while crediting the interest receivable to its profit and loss account over the same period; and the manner in which the share premium should be recognised in GKA.

52. The main battleground was, as it is in the appeal itself, whether or not the loan should have been partially de-recognised. It was common ground between the experts that, had the transfer of the interest strip been between unconnected parties, it would ordinarily have been appropriate for its value to be de-recognised in accordance with FRS 5, paras 23 and 71, in order that the financial statements gave a true and fair view.

53. Mr Parish argued that this was not so in the case of an intra-group transaction such as this. It is, he said, necessary to consider the commercial substance of a transaction and, in the case of intra-group transactions, this may require a different accounting treatment to be adopted from that which would be used if the parties were at arm's length. PLC's historic accounting policy had been for fixed asset investments in subsidiary companies to be valued at cost, less any provision for permanent impairment in value. He considered that de-recognition of the value of the interest strip was not required under UK GAAP as there was no disposal of an asset that was required to be accounted for separately, nor any permanent impairment. Therefore, in his opinion, the relevant question was whether there had been any impairment in the overall value of PLC's investment in GKBR following the transfer of the right to interest. From the perspective of PLC, the loan stock was non-interest bearing after assignment of the interest strip, and it was appropriate for that loan to be accounted for in the same manner as any other intra-group loans upon which PLC did not receive a direct economic return, that is at redemption value. Thus the application of FRS 5, paras 23 and 71, should be modified, he said, so as to reflect the fact that, overall, there was no change in PLC's position. There was no risk which it was necessary to reflect in its accounts that PLC would not receive payment in full of the outstanding principal, and thus no warrant for impairing its value. He relied too on application note E15 to FRS 5 which, so far as material, reads:

> "Whilst the commercial effect of any particular transaction should be assessed taking into account all its aspects and implications, the presence of all of the following indicates that the lender has not retained significant benefits and risks, and de-recognition is appropriate:
>
> (a) the transaction takes place at an arm's length price for an outright sale;

(b) the transaction is for a fixed amount of consideration and there is no recourse whatsoever, either implicit or explicit, to the lender for losses from whatever cause …

(c) the lender will not benefit or suffer in any way if the loans perform better or worse than expected …

Where any of these three features is not present, this indicates that the lender has retained benefits and risks relating to the loan and, unless these are insignificant, either a separate presentation or a linked presentation should be adopted."

54. The effect of this note, Mr Parish said, was that de-recognition, though apparently a requirement of paras 23 and 71, was excluded because not all of the features identified were present. His position was that partial de-recognition was incorrect because it would not reflect the fact that PLC had the right to payment of the principal, and it would therefore not provide a true and fair view. In his opinion, GAAP required PLC to reflect the full value of the principal in its solus accounts since they would otherwise give the misleading impression that PLC was not entitled, as overall it was, to the full beneficial interest in that principal. PLC had thus produced GAAP-compliant accounts, and Ernst & Young had correctly given those accounts an unqualified auditor's opinion.

55. Mr Chandler took the contrary position. He pointed out that FRS 5 does not discriminate in any way, in paras 23 and 71, between intra-group and arm's length transactions. Thus unless there was compelling reason to the contrary—and there was none here— the partial de-recognition demanded by para 71 was mandatory. He accepted Mr Peacock's point that it was customary, and GAAP-compliant, for a parent company to record a non-interest bearing loan (as, from PLC's perspective, the loan was once the interest had been stripped) at its face value but, he said, that treatment reflected the fact that such loans were almost invariably repayable on demand, even if there was an understanding that immediate payment would not be required in practice. That was not the case here; the loan was not repayable for (at the time of the strip) about 15 months and it was necessary to reflect that fact by partial de-recognition. It was not a case of impairment—he accepted that the risk of non-payment was so small that it could be ignored—but one in which it was necessary to reflect the present value of a future payment, and to accrete that value, over time, as the date for payment approached. The accretions had to be taken to PLC's profit and loss account.

56. He pointed out that three of the "Big Four" accountancy firms had published guidance to the same effect (the fourth having apparently published no guidance on the point). It is entirely in accordance with the substance of the transaction to de-recognise the interest strip in PLC, since as a matter of fact, the interest strip was transferred. The cash flows in respect of the interest strip were transferred to GKA, and GKA received them. The loan was not interest free, albeit principal and interest were due to different companies, and it was inappropriate to treat it as if it were. Indeed, GKBR and GKA both recognised that the loan was interest-bearing, and accounted for it accordingly. It is true that the requirements of an accounting standard can be overridden (that is, in this case, that FRS para 71 might be ignored), but this course is permissible only when the "true and fair" requirement

of the Companies Act made it necessary. No such necessity was identifiable in this case.

The appellants' submissions

57. Mr Peacock's starting point was that if PLC's statutory accounts were drawn up in accordance with GAAP, there is no legitimate basis on which the respondents can substitute their own preferred accounting method for what PLC actually did: in other words, an acceptable accounting method cannot be rejected and replaced simply because it results in a lower tax yield than the respondents think is appropriate. We record this argument for completeness since Mr Milne did not demur, acknowledging that if we were persuaded that the accounting method adopted was GAAP-compliant, we must determine the appeal in favour of the appellants.

58. Mr Peacock also made the point that if HMRC were to succeed on issue 2, we would need to be satisfied that Mr Clifford and his team, as well as Mr Parish, were all wrong in thinking that the method used was GAAP-compliant. The fact that they thought it was compliant was, in itself, good reason for concluding that there was at least scope for alternative acceptable methods, and the appellants' choice between those acceptable methods could not be challenged. However, he went rather further by contending that the method adopted was not merely one of several acceptable methods, but the one most appropriate.

59. His argument depended on a number of propositions, all supported by paragraphs of FRS 5. We need not deal with many of the points in detail, since they are uncontroversial. It is, indeed, axiomatic that an entity must report the substance of its transactions; that regard must be had to the true commercial effect of a transaction; that a linked series of transactions should be looked at as a whole; that regard should be had to increases or decreases in existing assets or liabilities; and that the test for de-recognition is whether there has been a significant change in the entity's rights to benefits and exposure to risks. It is also undisputed that if there is no significant change in rights or risks there should be no de-recognition, whereas if there is a transfer of all rights and risks there should be full de-recognition of the asset. It follows that where there is a significant change in rights and risks but no full transfer, consideration needs to be given to partial de-recognition: this is the effect of FRS 5 para 23, set out above. What is "significant" should be judged by reference to likely benefits and risks.

60. Three other propositions were, however, the subject of some debate. Mr Peacock, supported by some comments made by Mr Parish as he gave his evidence, argued that regard must be had to "moral risk", which will be present where the transferor feels obliged to fund losses arising on the loans concerned (here the interest payments). De-recognition of a loan is only appropriate if the transferor retains no significant benefits and no significant risks; in other words only when it has divested itself entirely of the loan. This will be so if there is a transaction at an arm's length price for an outright sale, the consideration is for a fixed amount without recourse to the transferor and the transferor will not benefit or suffer in any way from the performance of the loans: see application note E15, set out above. Where any of these three features is not present, a method other than partial de-recognition must be adopted.

61. Mr Chandler had accepted that, in order to determine whether partial de-recognition is appropriate, it is necessary to look at all the features of a transaction. Those in issue here were not arm's length transactions, and made commercial sense only if viewed in their intra-group context. Both risks and rewards must be transferred in practice; if they are retained by, or in any way could revert to, the transferor then, Mr Peacock argued, partial de-recognition is inappropriate. FRS 5, para 23, merely provides for the standard practice, which ordinarily applies where part of an asset is transferred for all of its life; it does not lay down an inflexible rule which must be followed irrespective of the surrounding circumstances. The experts agree that FRS 5, para 23, is engaged when there has been a significant change in the transferor's rights to benefits and exposure to risks, and that whether a change is "significant" for these purposes is to be judged by commercial and practical, rather than legal or formalistic, criteria. Here, PLC retained all the practical and commercial benefits and risks in respect of the interest by virtue of its being, even if indirectly, the holder of the entire shareholding in GKA. It is common ground that the transactions had the effect of increasing the value of GKA, while there was no economic change in PLC. The reality therefore is that PLC's position was unchanged; thus there was no justification for de-recognising the loan principal in its accounts.

62. Mr Chandler's opinion that PLC has confused consolidated group accounts with solus company accounts is incorrect (and immaterial), said Mr Peacock, since both experts agree that the consolidated accounting position is not relevant. It is necessary, rather, to examine the value of the investments in PLC's solus accounts, and to determine the commercial effect of the transaction, which was to increase the value of those investments. Mr Chandler's approach, Mr Peacock argued, is based on his perception that the transactions in reality effected no change, because they were intra-group loans between companies all controlled by PLC. Crucially, he said that when examining those rights which have a commercial impact for the purposes of FRS 5, a transfer between parent and wholly-owned subsidiary is not significant. But that approach, Mr Peacock emphasised, was inconsistent with his acceptance of the proposition that the intra-group transfer of an asset has a real economic consequence. There was further inconsistency between his acceptance of the proposition that the intra-group nature of the transactions is relevant to their accounting treatment, while ignoring it when applying FRS 5. By contrast, Mr Parish did not argue for a departure from FRS 5, but for consideration of the question whether its terms apply to the present case.

63. The essential question is a simple one: whether the accounting treatment actually adopted (and, moreover, audited by Ernst & Young) was GAAP-compliant. Mr Parish concluded that it was. Even if Mr Chandler were able to produce an alternative GAAP-compliant method, it did not follow that the method actually used was wrong. However, Mr Chandler had not produced an appropriate alternative method, since his approach did not work. He had ignored the indicators in application note E15, which he had treated as no more than typical features rather than, as they were, determining factors, and had disregarded the fact that none was present here. Instead, the test he had applied was whether PLC controlled the interest strip; yet the FRS 5 test for partial de-recognition has nothing to do with control. He also relied on the fact that it would make no sense

for both GKA and PLC to recognise the same asset. But that analysis is fundamentally flawed, since PLC and GKA did not recognise the same asset: PLC held a loan which had not been partially de-recognised and GKA held certain rights to interest.

64. It follows that in the present case de-recognition of part of the original loan (*ie* the right to interest) was not appropriate because there has been no significant change in PLC's rights and risks in relation to that right to interest. If one were to look at the substance and true commercial effect of the transaction as a whole, while bearing in mind that PLC and GKA were associated companies and the former was funding the latter in order that it could make acquisitions on behalf of the group, it would be seen that:

(1) PLC retained the right to control GKBR (both as a shareholder and under the terms of the loan stock);

(2) PLC retained the right, through its voting power as stockholder, to change the terms of the loan stock so as to capitalise interest and require it to be repaid as principal on redemption;

(3) PLC retained the "moral" risk in relation to GKA since the latter was its wholly-owned subsidiary, and was the group's acquisition vehicle;

(4) PLC's transfer of the right to interest to GKA was matched by an increase in the value of its existing asset in the form of the ordinary shares in the intermediate company which owned the ordinary shares in GKA;

(5) There was no transaction at an arm's length price for an outright sale;

(6) There was no consideration for a fixed amount without recourse to the transferor, since all that PLC received was preference shares in a company in which it already owned the ordinary shares; and

(7) PLC continued, through its ordinary shares, to benefit and suffer from the performance of the loans.

65. The consequences if the loan were to be de-recognised were problematic. This was apparent from Mr Chandler's agreement that the accounting treatment which HMRC had suggested before he was instructed was not GAAP-compliant, a further illustration of the appellants' case that there was room for differing opinions about the correct GAAP-compliant treatment of the transactions. De-recognition would result in a credit in PLC's accounts of £20.5m. The corresponding debit would be partly to the assets received in consideration for the strip, but there would be a substantial debit remaining. In the circumstances of an arm's length transaction it would have been appropriate to use the remaining debit to recognise a loss. But the experts agree that this would not be appropriate in this case. Mr Chandler thought that it should be treated as a capital contribution in PLC's accounts, relying on guidance published by the "Big Four" accountants, while Mr Parish pointed out that the only reference to capital contributions in the accounting standards is in FRS 4, and that standard relates only to the recipient's accounts. In fact, the guidance relied on by Mr Chandler—published, ironically, by Ernst & Young—states that it is possible for the transferor to record a loss. All

these factors pointed to the conclusion that it could not properly be said that PLC's chosen method was inappropriate.

HMRC's submissions

66. The core of the respondents' case (on issues 2, 3 and 4) is set out at para 16 of the statement of case (which Mr Milne drafted), and he adopted it as part of his argument:

> "The Respondent argues that PLC is taxable under section 84(2) of the Finance Act 1996 on [£20,453,476] as a loan relationship credit in accordance with the accruals basis of accounting, as follows:
>
> - The loan from PLC to GKBR was recognised in the accounts with a book value of £300m.
> - Economically, the loan represents the right to receive future interest payments and the right to receive the £300m on redemption (4 May 2004).
> - As of the date of assignment of the rights to future interest payments (31 January 2003):
>   - The right to the future interest had a fair value of say (for illustrative purposes) £20m.
>   - The right to the repayment of £300m on redemption therefore had a fair value of say £280m.
>
>   Normally no distinction is made between these two parts and a single 'loan' is recognised in the books.
> - FRS 5 requires the substance of transactions to be recognised in financial statements, and para 71 of FRS 5 (at the material time) considers how to account for a transfer of part of an item (*eg* an asset). It discusses the accounting with the example of a transfer of rights to interest on a loan without transferring the rights to the principal (a so-called 'interest strip'), and requires that the reporting entity should cease to recognise the part of the original asset that has been transferred by the transaction, but continue to recognise the remainder.
> - So, instead of the £300m loan on its balance sheet, the company should continue to recognise only the right to the principal on its balance sheet, with a book value and historic cost of £280m. The company should no longer recognise the right to future interest receipts with a book value and historic cost of £20m. This right has been assigned to the indirect subsidiary, GKA and so is no longer recognised by PLC.
> - The right to principal is economically identical to a zero coupon bond issued for £280m and redeemed for £300m and the standard accounting is to accrete the £280m to £300m over the period to redemption so as to recognise 'interest' at a constant rate of return.
> - The accretion from £280m to £300m will be recognised in the accounts of PLC over the course of the period between assignment of the interest rights to GKA (31 January 2003) of the

> loan and repayment of the principal to PLC (4 May 2004). This gives rise to loan relationship credits for the purposes of section 84(2) of the Finance Act 1996 in the amount of [£20,453,476]."

67. The transaction amounted to a disposal by PLC of part of its loan receivable from GKBR to GKA. The recoverability of the loan was in no way affected and, Mr Milne added, it is therefore incorrect to argue, as the appellants appear to do, that the loan may have been impaired; the notion of "impairment", meaning a reduction in the recoverable amount of an asset below its "carrying amount", is irrelevant. By the same token, it is incorrect to argue that the loan may have been devalued or is required subsequently to be revalued; the notion of "revaluation" is likewise irrelevant. There is a clear distinction between a loan that may (in part or in full) not be recovered, and one of which part has been disposed of; the appropriate accounting treatment of each is different.

68. The loan receivable comprised rights to two separate benefit streams: the right to repayment of the principal (£300m); and the right to interest as it became payable, worth about £21m. The aggregate rights, to receive £321m, were stated at their historic cost of £300m (coincidentally roughly equal to their net present value, or NPV), as a loan receivable in PLC's balance sheet. However, this loan, like any other interest-bearing loan, comprised those two distinct elements. Both experts agreed that this was correct in principle.

69. Immediately prior to the assignment of the interest, the cost of the loan related to those two parts, one representing the principal element and the other the interest element. The most straightforward way to allocate the cost between the two parts is to look at the relative values of the components: approximately £280m and £20m, while bearing in mind that this approach constitutes an allocation of cost and does not amount to a valuation of the two parts. Immediately after the interest strip, therefore, the loan receivable should have been carried at that discounted amount, £280m, being the cost, or carrying value, of the part retained.

70. The process of subsequent interest accretion accrues the £20m difference between the cost of the part retained and the cash receivable on repayment over the remaining term of the loan. While that value is the same as the NPV of the interest strip, it is nonetheless a different thing. The £20m recognised over the remainder of the loan is the difference between the cost of the part retained and the amount ultimately received on repayment. Over the period between assignment of the right to interest and redemption of the principal (at £300m), the accretion from £280m to £300m should be recognised in the accounts of PLC, which on the actual facts of the case gives rise to loan relationship credits of £20,453,476. Mr Milne added that if no assignment had taken place, PLC would have received a total of £321m, consisting of £300m principal and £21m interest. That interest would necessarily have been brought into account in accordance with s 84(1)(b).

Discussion

71. It seems to us that the flaw in Mr Clifford's reasoning, as it is set out in the extract from his witness statement reproduced at para 28 above, and as we have further described it in para 30, is that it fails to deal separately with the capital

value of the loan and the value of PLC's investment in GKA, but instead simply sets one off against the other in order to reach the conclusion that no adjustment is required. It is perfectly true that, as Mr Clifford put it, "there would be no overall change in the carrying value of PLC's assets"—plainly there would not, for the reasons he gave—but that truth does not affect the value of the loan, considered as a single asset. It is in our view axiomatic that a present right to receive a sum at a future date must have a value less than the amount which is to be received, and that that value is to be determined by conventional discounting principles. Indeed, Mr Clifford's own observation that "the value of the loan to GKBR would be reduced on 'disposing' of the interest rights" shows that he was of the same view himself. It is nothing to the point that PLC had near certainty that the £300 million, in the case of the first transaction, would be paid in full; had it been otherwise the present value of the payment would be less still, but for the quite different reason that payment was not certain.

72. In short, both Mr Clifford and Mr Parish have, in our judgment, failed properly to distinguish between impairment on grounds of doubtful recoverability and discounting because of time lapse before payment, and they have failed to recognise that, although PLC's overall position is unchanged, the value of the loan has been diminished in exchange for an augmentation elsewhere. The passages we have set out from Ernst & Young's presentation (see para 22 above), and in particular the second and third indents relating to PLC under "accounting", too, show a confusion between impairment and de-recognition.

73. We are accordingly satisfied that full recognition of the loan does not accurately reflect PLC's own position, disregarding that of its subsidiaries. One has only to ask whether PLC could hope, on the date of the assignment of the interest strip, to secure an arm's length sale of the benefit of the loan remaining in its hands (that is, without interest over the remaining period before redemption) for £300 million to see that the answer is obviously not. A true and fair value of the asset on that date is therefore, as HMRC say, a discounted value which accretes to the full £300 million as redemption approaches.

74. We agree too with Mr Chandler and Mr Milne that there is no ground on which a departure from the terms of paras 23 and 71 of FRS 5 is warranted; on the contrary, we consider they are directly in point. From the moment of the assignment, PLC no longer had the right to receive the interest; it had instead a more valuable subsidiary. It is irrelevant that this was not an arm's length transaction or that PLC could have undone the assignment at any time; accounts must reflect the position as it is, and not as it might be. For these reasons we perceive no need, as the appellants contend, to reflect the fact that PLC's overall position is unchanged by declining to de-recognise part of the loan. The reality of the transaction is properly reflected by partial de-recognition of the loan, and an addition to the value of PLC's investment in its subsidiaries. That being so, a departure from FRS 5 is not justified, and it follows that the accounting treatment of the transactions adopted by PLC is not GAAP-compliant. Thus HMRC are right to argue that partial de-recognition was required by UK GAAP, that PLC was obliged to bring the accretion from the NPV of the capital sum on the date of the assignment of the interest strip until redemption into taxable profit, and that issue 2 must accordingly be determined in HMRC's favour.

Issue 3

75. It became apparent to us as the hearing progressed that there is no need to answer issue 3 as it is put, and for its own sake. The real question is a little more complicated, and is whether the interest received by GKA following the strip arises from a loan relationship of GKA. We do, however, need to address the nature of a loan relationship in order to provide an answer. It is convenient to deal with HMRC's submissions in relation to this point first.

HMRC's submissions

76. HMRC's central point is that the loan relationship in respect of the £300 million loan stock issued by GKBR to PLC remained between GKBR and PLC at all relevant times, and it remained PLC's creditor relationship despite the assignment from PLC to GKA of the right to receive interest on that loan. Consequently, the "interest" which, as a result of that assignment, was paid by GKBR to GKA is not within s 84(l)(b): it is not interest under a loan relationship of GKA, but interest under a loan relationship between GKBR (as debtor) and PLC (as creditor). Mr Milne relied on the observation of Lawrence Collins LJ in *Revenue and Customs Commissioners v Bank of Ireland Britain Holdings Ltd* [2008] STC 398 at [47] that

> "Receipt, of itself, is not a determinant of any possible tax liability. An assignee of the right to receive interest (without assignment of the loan relationship) would not be taxable on the amount of that interest under the loan relationship provisions because he has no relevant loan relationship."

77. Thus the interest is not a profit or gain arising to GKA from its loan relationship and is not "interest under the company's loan relationships" within the meaning of s 84(1)(b). It follows that Chapter 13 of Part IV has no application to it, and that it is taxable in the hands of GKA as income under general principles. The result is the same whether or not it is correct that, once interest was accruing under the loan stock but was not yet payable, that accrued interest represented a new "debt" owing from GKBR to GKA, and thus created a new loan relationship between GKBR and GKA. Any credit of that interest in GKA's accounts did not represent a profit arising to GKA from its loan relationships—it is the principal of the loan relationship itself or, as Ernst & Young themselves said in material produced in connection with the promotion of the scheme, "the rights of the interest form the corpus of [GKA's] loan relationship and do not arise under its loan relationship". The respondents say that, equally, the interest is not a profit arising from GKA's loan relationship, and so does not fall within section 84. But for the assignment, the interest would obviously have been a profit arising to PLC from the loan stock; it still arises from the loan stock (which remains an element of PLC's loan relationship with GKBR) even after the assignment, but now comes into profit in GKA's hands.

The appellants' submissions

78. Mr Peacock's essential argument was that the answer is obvious: all the requirements of s 81(1) of the 1996 Act are met and there is consequently no room for doubt that GKA had a loan relationship with GKBR as a result of the transactions. GKA stood as creditor in respect of a money debt, that is the

obligation imposed on GKBR to pay the interest as it fell due to GKA; and that obligation arose from a transaction for the lending of money. Nothing more was required. In particular, there is no requirement that the creditor should be the original lender, or the debtor the original borrower.

79. HMRC's contrary case, based on the argument that GKA had not purchased debt, but rights to a future interest stream, and that GKA did not become a creditor, or GKBR a debtor, in respect of any interest until the interest payment date is, he said, misconceived. It disregards the fact that under the loan relationship between GKBR and PLC there were a number of anticipated payments: six-monthly interest payments and repayment of the principal. From the creditor's perspective a debt is essentially the right to receive payment at a future date, and GKA reflected that right in its balance sheet. The interest payments (which in the hands of GKA represented the consideration for the share issue) in themselves represented a part of the original debt between GKBR and PLC. GKA was a creditor of GKBR in respect of amounts outstanding before their respective payment dates, and those amounts were reflected as assets in its balance sheet.

80. HMRC's argument, Mr Peacock added, appears to confuse two concepts: the existence of an outstanding debt, and the debt falling due. For example, the lending of money gives rise to a creditor-debtor relationship, irrespective of when the debt is due. Taxing the receipt of an interest strip within the provisions for loan relationships accords with the purpose of the legislation, that is to provide a single code for corporate debt, replacing the variety of other rules and ensuring that all amounts previously taxed as interest fall within this code. The respondents' approach was not merely wrong but unprincipled since, if it was right, it would expose PLC to tax on the accretion to the de-recognised principal and at the same time expose GKA to tax on the interest, essentially the same sum.

81. The *Bank of Ireland* judgment was not in point, since it was given in the context of a case concerning the treatment of deemed interest on a deemed loan under the repo legislation, which differed from that in issue here, and was not directed to the present situation. The observation had no wider significance and could not be applied by analogy to this case.

Discussion

82. We agree with Mr Peacock that the observation of Lawrence Collins LJ in the *Bank of Ireland* case is not directly relevant. Perusal of the judgment shows that the legislative provisions in issue, though related in their purpose to those we must consider, differ in material respects. We do not, therefore, consider that an observation (as it was) about the interpretation of s 730A(6) of the Income and Corporation Taxes Act 1988 binds us in the construction of s 81, which was not mentioned at all in the judgment. It does not, however, follow that HMRC are wrong; and in our view the remainder of Mr Milne's argument is sound.

83. There are two elements identified in paras (a) and (b) of s 81(1): there must be a relationship of creditor and debtor, and the debt must arise from a transaction for the lending of money. In the ordinary case, where the creditor was the lender and the debtor was the borrower, those requirements pose no difficulty of interpretation. It seems to us, too, that there is no great difficulty when the entire

benefit, or burden, of the relationship is assigned: the assignee stands within the shoes of the assignor. Here, however, GKA did not stand in PLC's shoes. It had not lent money, and it had no right to the payment of the capital sum. The creditor remained PLC, which chose to require GKBR to pay the interest due to it, instead, to GKA. Plainly the loan relationship between PLC and GKBR subsisted, and we agree with Mr Milne that the interest arose from *that* loan relationship. Thus even if there was a loan relationship between GKA and GKBR (and it is unnecessary for us to decide the point), the interest did not arise under it. Mr Milne is consequently right to argue that the sums received by GKA did not fall within s 84(1)(b); the requirement that the interest should arise under *GKA*'s loan relationships is not met.

84. We are unimpressed with Mr Peacock's argument that our conclusions on issues 2 and 3 might lead to double taxation. As we have said, the transactions were a device for ensuring that relief for payment was not matched by taxation of the receipt; and the appellants have no evident difficulty with that outcome. It does not seem to us that they can legitimately complain if the scheme fails in its purpose and instead results in their paying tax twice.

Issue 4

85. It follows from our conclusion in respect of issue 3 that issue 4 is, as HMRC contend, irrelevant. Nevertheless, in case we should be found elsewhere to be wrong, it is appropriate to offer an answer.

The appellants' submissions

86. As we indicated above (see para 40), the appellant's case is that s 84(2)(a) of the 1996 Act is engaged. Mr Peacock's argument is that the requirement imposed by s 130 of the 1985 Act of the transfer to share premium account of the minimum premium value is crucial to the company law concept of capital maintenance for the benefit of creditors. Although a company such as GKA may enjoy the advantage of the relief provided by s 84(2)(a), a key consequence of exchanging rights under a loan relationship for preference shares, he says, is that any premium arising must be credited to a non-distributable reserve. Mr Milne's argument (that GKA was not required to transfer any amounts to the share premium account by virtue of the relieving provisions in s 132) is wrong, he says, because s 132 is not in point in a case such as this.

87. First, the title of that section, "Relief in respect of group reconstructions", is to be regarded as an aid to construction: see *DPP v Schildkamp* [1971] AC 1. It is plain from its title that the section was not intended to apply to transactions which are not undertaken in the course of a reconstruction. It is plain that the draftsman never intended that company reconstruction relief would apply to transactions such as those in issue here, which did not involve any sort of reconstruction. Second, it is apparent from the use within the section of "assets" in the plural that it applies only to those reconstructions which entail the transfer of a number of assets within a group, and not the assignment of a single asset, as here. Moreover, there are considerable obstacles in the way of applying the statutory calculation of the minimum premium value in such situations. In particular, whereas the appellants contend that the "cost" of such an asset can be readily identified in the

present case, in other cases, an undertaking to pay cash (whether in the form of interest from a third party or otherwise) may not have an identifiable cost other than cash from the transferor company in consideration for the share issue. Section 738(2) of the Companies Act 1985 makes it perfectly clear that shares are deemed to be paid up or allotted for cash where the consideration is an undertaking to pay cash at a future date. This is precisely the consideration received by GKA.

HMRC's submissions

88. Mr Milne's argument was that s 130 was designed to apply to swaps of debt for equity, in which a company which is struggling to pay its debts enters into an arrangement with its creditors by which, to settle its liabilities (that is, escape from its loan relationships), it issues shares which are worth less than the amount owed. It thus makes a nominal "profit" which, absent legislative provision to the contrary, falls within section 84(1)(a). But, by virtue of s 130, that "profit" is required to be transferred to the company's share premium account: the company has issued its shares at a premium equal to the difference between the amount of the debt and the nominal value of the shares. The purpose of section 84(2)(a) is to take that "profit" out of the charge to tax. Mr Peacock, we should add, agreed with that description.

89. GKA, however, did not have an existing loan relationship: it issued preference shares in order to acquire the right to receive future payments, rather than to settle a liability. The "profit" did not arise from the disposal of a loan relationship as it would in the paradigm case within s 130. The profit arose because GKA acquired an asset (the right to the interest stream) that was worth more than the shares given in exchange. The Commissioners nevertheless accept that it follows that the shares were issued at a premium, and that, leaving s 132 to one side, s 130 required GKA to transfer a sum equal to the amount of that premium to its share premium account.

90. What is in issue here, however, is not the treatment of the credit arising on the issue of the preference shares, but the treatment of the subsequent receipt of the payments made by GKBR. There is nothing in s 130 (or elsewhere), Mr Milne said, which requires that interest to be transferred, on receipt, to GKA's share premium account; and that is an unsurprising result, since it is not the purpose of s 84(2)(a) to relieve such receipts. Moreover, GKA did not transfer the receipts to its share premium account; instead it created an asset account, consisting of the value of the future interest receipts, and as they were received it set them against the asset account. That treatment, said Mr Milne, was consistent with the Commissioners' case that s 132 (despite Mr Peacock's observations about its purpose) was relevant: shares were allotted to the issuer's 100% parent company in consideration for the transfer to the issuer of assets other than cash, in this case the right to future payments. Thus if s 130 applied at all, the effect of s 132 was that only the minimum premium value had to be transferred.

91. We should add, for completeness, that Mr Milne also argued that the application of subsections of s 132 we have not set out above dealing with the determination of the minimum premium value to the facts of this case lead to the conclusion that, even if he was wrong on his other points, the amount which GKA

was required to transfer to its share premium account was nil. Mr Peacock did not agree, but as this is essentially an arithmetical argument we do not think it necessary to deal with the point in the light of our remaining conclusions.

Discussion

5 92. In our judgment Mr Milne's first argument is correct and for the reasons he advanced: s 130 can have no application to the receipts from GKBR. But even if that is wrong, we also agree with him that s 132 limits the obligation to effect a transfer to GKA's share premium account.

93. We can see the force of Mr Peacock's point that s 132 was designed to deal
10 with reconstructions, and that these transactions did not amount to reconstructions in the ordinary sense of that word, but if its provisions nevertheless clearly cover such arrangements, we see no basis on which we can disregard them. Despite the title of the section, it seems to us that it does cover the present arrangements exactly. We do not accept Mr Peacock's argument that we should treat the use of
15 the word "assets" as an indication that only multiple assets were in contemplation. That might well be the usual position; but ordinary canons of statutory construction require the plural to be treated as including the singular, and we see no warrant for excluding those rules here. Our conclusion on this issue, therefore, is that s 84(2)(a) does not apply to the receipts either in full or, if we are wrong in
20 our first conclusion on this issue, applies only to an amount equal to the minimum premium value.

Conclusions

94. We determine the issues identified at para 17 above, in respect of the first transaction, as follows:

25 Issue 1: PLC should not account for the value of the preference shares received as consideration for the interest strip as taxable profit in the year ending 4 May 2003 (this was the parties' agreed position).

Issue 2: PLC was required by UK GAAP to de-recognise the loan
30 principal, to the extent necessary to reflect its current value at the date of the assignment, and to bring a sum equivalent to the difference between the amount so determined and its face value into profit over the remaining period before redemption. We do not determine whether the amount by which the principal should
35 have been de-recognised and the NPV of the interest strip at the date of the assignment are identical, but leave the parties to agree on that point, or to return for further argument should that be necessary.

Issue 3: We do not determine this issue in quite the manner in which it is
40 set out above. Whether or not GKA had a loan relationship with GKBR, which we do not need to decide, the payments received by GKA did not arise from that relationship and did not fall within s 84(1)(b).

Issue 4: Section 130 of the Companies Act 1985 did not require GKA to transfer the premium received on the issue of the preference shares to its share premium account. Moreover, s 84(2)(a) does not apply to the payments received by GKA. Alternatively, it applies only an amount equivalent to the minimum premium value.

95. The appeal is accordingly dismissed.

96. This document contains full reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier 45 Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

Colin Bishopp

Tribunal Judge

Alison McKenna

Tribunal Judge

Release Date: 14 June 2012