Greene King PLC and Greene King Acquisitions Ltd v the Commissioners for Her Majesty's Revenue and Customs (2016 EWCA Civ 782)

The Court of Appeal has partially upheld the taxpayer's appeal in a lead case in respect of an intra-group financing arrangement, effectively continuing to deny the intended benefit but overturning an additional downside for the taxpayer which followed from the findings of the First-tier Tribunal (FTT). The case involved the treatment of an intra-group assignment of the right to receive interest from a loan in exchange for an issue of preference shares. It was intended that the borrower would obtain relief for the cost of borrowing but neither the original lender nor the transferee would be materially taxed on the corresponding income.

The result of the decisions at both the FTT and the Upper Tribunal (UT) was that there was a downside for the taxpayer from the arrangement in that not only was the transferred interest income found to in substance remain taxable on the transferor but there was an additional charge on the transferee. The Court of Appeal has confirmed that the scheme is ineffective but removed the additional charge.

The Court of Appeal also approved the recent FTT decision in the *Stagecoach Group plc* case which denied relief for the debit related to the derecognition of part of a loan relationship asset. The accounting here was to credit a loan and debit the carrying value of a share investment in a subsidiary and the FTT decided the debit was not deductible. The Court of Appeal approval may influence other cases which involve claims from debits arising from the derecognition of loan relationships and derivative contracts which we understand are pending.

Although the scheme itself is now of limited interest because of subsequent developments, such as the rules to counter intra-group mismatches from loan relationships, the decision is potentially of wider significance. This is because, in addition to approving the analysis in the *Stagecoach* decision, the Court of Appeal held that:

- a transferred right to receive interest was a loan relationship; and
- if a loan relationship is transferred in exchange for an issue of shares resulting in an amount recognised in share premium then this amount represents a potentially taxable profit.

Factual background

The arrangement was undertaken twice in 2003 and is illustrated by the first transaction.

Greene King plc (PLC) had made a £300m intra-group loan to Greene King Brewing and Retailing Ltd (GKBR). PLC assigned the right to receive three fixed interest payments (totalling £21.3m) to Greene King Acquisitions Limited (GKA) in exchange for an issue of 1.5m £1 preference shares. GKA subsequently received all interest on the loan.

Accounting treatment in the statutory accounts

PLC continued to recognise the £300m loan principal in its accounts.

GKA recorded the interest receivable asset in its accounts at its £20.5m net present value, credited £1.5m to preference share capital with the £19m excess being credited to share premium account. Subsequently, interest receipts were partly (£0.8m) credited to the profit and loss account with the balance (£20.5m) being credited to the balance sheet receivable.

Intended tax effect and finding of the Court of Appeal

It was intended that PLC would no longer be taxable on the interest receivable and GKA would only be taxed on the £0.8m profit and loss credits, leaving £20.5m as untaxed.

The Court of Appeal considered appeals for the taxpayer in relation to the tax treatment in the transferee (GKA) finding for the taxpayer and in relation to the transferor (PLC) finding for HMRC. The outcome is that the scheme was unsuccessful but there was no downside.

Tax treatment in the transferee (GKA)

The FTT and the UT had both held that the interest receipts by GKA from GKBR would not be dealt with under the loan relationship code, as not arising from a loan relationship to which GKA was party. In the case of the FTT this was because the receipts were to be regarded as arising (only) under the original loan relationship between PLC and GKBR, and in the case of the UT because it did not accept that GKA was party to any loan relationship with GKBR which the receipts could be said to arise from. This meant that the receipts fell to be taxed on GKA under general principles, creating a risk that in substance both GKA and PLC would be taxable on the same income if the planning failed.

Rejecting this conclusion, two issues were decided by the Court of Appeal in relation to the transferee.

Was there a loan relationship between GKA (transferee) and GKBR (borrower), following the assignment of the right to interest (paragraphs 41 to 50)?

The Court of Appeal decided that GKA had a loan relationship arising from the right to receive future interest payments.

In order for there to be a loan relationship, there must be a debt, that debt must be a money debt (which relates to the way in which the debt is settled) and the debt must have arisen from the lending of money,

Counsel for HMRC, David Milne QC, had argued that the right to receive three instalments of interest on fixed dates was, at the time it was assigned to GKDA, not a debt but merely a chose in action. The Court of Appeal, agreeing with the UT, found that there was a debt at that time albeit the debt was payable in the future. It was said that this "is consistent with the intention … that the loan relationship code embraced a wide category of corporate debt, which would not in ordinary legal or trade terms be categorised as a loan" (paragraph 46). Unlike the UT, however, the Court of Appeal held that this debt between GKA and GKBR should be regarded as "arising from a transaction for the lending of money", arguing that no legislative purpose or policy had been identified which would justify a departure from the literal meaning of this phrase.

Having held that there was a loan relationship between GKA and GKBR, the Court of Appeal did not explicitly go on to address the view of the FTT that the fact the interest arose the original loan relationship between PLC and GKBR precluded it arising under any new loan relationship between GKA and GKBR. It is implicit in the overall approach of the Court, however, that it preferred the UT's view that the receipts should not be regarded as precluded from arising under the new loan relationship in this way.

Was GKA (transferee) taxable on more than the £0.8m credits recognised in its profit and loss account (paragraphs 51 to 59 and 86 to 89)?

The Court of Appeal did consider whether the £19m credited to share premium was a profit from a loan relationship, departing from the views of both parties in concluding that it was. On the facts of this particular case the profit was nonetheless excluded from the charge to tax by a provision applying at that time to amounts which were required to be taken to share premium account, but this unexpected outcome may have broader implications for other cases.

It was noted that it "is received wisdom that an amount paid to a company by way of share premium is a profit in the hands of the company" (paragraph 88). Counsel for the taxpayer, John Gardiner QC, and David Milne QC for HMRC had agreed that if an amount taken to share premium account represented a profit this was not taxable under the loan relationship rules because it did not arise to GKA *from* its loan relationships. However, Sir Terence Etherton (see paragraphs 51 to 59) and Lord Justice Sales (see paragraphs 86 to 89) disagreed, arguing that this profit could not be distinguished from the amounts recognised in the profit and loss account in respect of the excess of the actual receipts over the asset booked at inception.

This is a surprising decision and potentially has implications for commercial transactions, perhaps where debt is purchased from a third party in exchange for an issue of shares. For example, there is an exception from the deemed release rules (in section 361C CTA 2009) where debt is purchased at a discount to face value for consideration consisting only of certain shares. Whilst the relief ensures that there is no deemed taxable release in the borrower, there could be a taxable profit in the acquiring company if share premium is recognised. Since the FTT decision, this has been a concern but HMRC have granted clearance that the amount taken to share premium account is not taxable. Following the Court of Appeal decision, such transactions will need to be considered carefully, if relevant taking account of the changes applying to the taxation of loan relationships for accounting periods beginning on or after 1 January 2016.

Treatment in the transferor (PLC)

Four issues were considered in relation to the transferor.

The FTT and UT had found that, in its accounts, PLC should have derecognised £20.5m of the carrying value of the loan asset and then accreted the asset back up to the face value over the period to redemption, with the accretion credits being recognised in the profit and loss account and taxed.

The Court of Appeal found the following in relation to PLC, as the transferor of the right to receive the three interest payments in the future:

- The FTT had provided adequate reasoning to support the conclusion that part of the loan should be derecognised in the accounts for PLC (paragraph 67);

- The accretion of the loan asset back up to £300m represented a realised profit for PLC (paragraph 69);
- The accretion credits fairly represented a profit from the £300m loan (paragraphs 76 and 77);
- The provision which allows relief for a loan relationship debit taken to the carrying value of a fixed capital asset (now section 320 CTA 2009), did not apply here to allow relief for the debit which should have been taken to the carrying value of PLC's subsidiary with derecognition accounting. In coming to this conclusion, the Court of Appeal approved the recent FTT decision in the Stagecoach Group plc case ([2016] UKFTT 0120) where, in different factual circumstances, the accounting was to credit a loan and debit the carrying value of a share investment in a subsidiary (paragraph 83).

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