[2021] UKFTT 160 (TC)

TC08129

CORPORATION TAX – deferred revenue expenditure had been incurred in the course of carrying on a property business and formed part of the cost of the property in the Appellant's accounts – on the sale of the property, the difference between the sale proceeds and the cost of the asset (in this case, nil because the two amounts were the same) was required by generally-accepted accounting practice to be accounted for in the Appellant's profit and loss account – did that accounting treatment mean that the deferred revenue expenditure had not been brought into account as a debit in calculating the Appellant's accounting profits in the financial year in which the sale occurred? – no – even if the deferred revenue expenditure had been so brought into account, should relief for the deferred revenue expenditure be denied on the basis that the sale did not take place in the course of the property business because it gave rise solely to a capital receipt? – no – appeal allowed in principle

FIRST-TIER TRIBUNAL
TAX CHAMBER

Appeal number: TC/2018/05365

BETWEEN

WEST BURTON PROPERTY LIMITED **Appellant**

-and-

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

TRIBUNAL: JUDGE TONY BEARE

The hearing took place on 19 April 2021 to 23 April 2021 (inclusive). The form of the hearing was V (video) and the hearing was held on the Teams video platform. A face-to-face hearing was not held because of the pandemic. The documents to which I was referred for the purposes of the hearing were a documents bundle of 2056 pages, a supplemental documents bundle of 37 pages and an authorities bundle of 432 pages.

Prior notice of the hearing had been published on the gov.uk website, with information about how representatives of the media or members of the public could apply to join the hearing remotely in order to observe the proceedings. Although the platform on which the hearing was held was changed from the First-tier Tribunal's own video platform to the Teams video platform at short notice because of technical difficulties with the former, members of the public were able to discover that that was the case and apply to join the hearing on the replacement platform had they so wished. As such, the hearing was held in public.

Mr Malcolm Gammie QC, instructed by Enyo Law LLP for the Appellant

Mr Jonathan Bremner QC and Ms Barbara Belgrano, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

INTRODUCTION

1. This decision relates to an appeal against a closure notice which was issued by the Respondents on 26 July 2018 in relation to the Appellant's corporation tax self-assessment return for the accounting period ending 16 November 2011. The relevant statutory accounts of the Appellant in relation to this accounting period were the accounts for the financial year of the Appellant ending 31 December 2011.

2. The Appellant's principal activity during the accounting period in question was the ownership and leasing of West Burton coal-fired power station, a 2000MW coal-fired power station which began exporting power to the National Grid in 1967 (the "Power Station").

THE FACTS

3. The parties have agreed the following facts:

(1) Since 30 December 2001, the Appellant has been a wholly-owned indirect subsidiary of a company now known as EDF Energy Limited ("EDF"), which is the holding company of a UK energy business;

Purchase of the company now known as EDF Energy (Thermal Generation) Limited ("Power Ltd") from TXU Europe Limited

(2) EDF acquired Power Ltd from TXU Europe Limited, a U.K. subsidiary of the U.S.-based TXU Corporation, on 30 December 2001. At that time, the Power Station was owned by the Appellant and the Appellant was a wholly-owned subsidiary of Power Ltd. EDF Energy did not hold any interest in the Power Station prior to its acquisition of Power Ltd;

(3) on 19 November 2001, prior to EDF's ownership, the Appellant granted a lease to Power Ltd to enable Power Ltd to operate the Power Station. The term of the lease was ten years less one day; and

Sale of the Power Station by the Appellant to Power Ltd

(4) on 16 November 2011, shortly before the expiry of the lease, the freehold interest in the Power Station, together with all associated fixed property, plant and equipment, was sold by the Appellant to Power Ltd. In connection with the sale, Power Ltd also took on the benefit and burden of any existing contracts and other commitments relating to the Power Station and assumed responsibility for any liabilities incurred following the sale.

4. The consideration for the sale described in paragraph 3(4) above was equal to the net book value of the assets in question (which is to say, the total cost of the assets in question less accumulated depreciation). The net book value was approximately £244 million (a total cost of approximately £698 million less accumulated depreciation of approximately £454 million). As the sale took place at net book value, the sale gave rise to neither a profit nor a loss for accounting purposes and, consequently, the Appellant's profit and loss account for the financial year ending 31 December 2011 did not show a profit or loss in respect of the sale.

5. The net book value of the Power Station at the time of the sale included approximately £65 million of unamortised deferred revenue expenditure, or "DRE". The DRE arose as follows. In common with the owners of other coal-fired power stations, the Appellant incurred costs in maintaining the Power Station. Although those costs were revenue in nature – in that they related to the maintenance of the Power Station and not its modification or improvement – the costs incurred in each financial year were initially capitalised in the Appellant's accounts

for the financial year in which they were incurred and then amortised over four years. The Appellant incurred approximately £156.5 million of DRE in aggregate over the 10 years in which it owned the Power Station. Of that £156.5 million, approximately £91.5 million was depreciated in the profit and loss account of the Appellant in the financial years preceding the financial year ending 31 December 2011, with the result that, at the time when the sale of the Power Station to Power Ltd took place, approximately £65 million of the DRE remained undepreciated in the profit and loss account of the Appellant.

THE NATURE OF THE DISPUTE

6. It is common ground that:

(1) prior to its disposal of the Power Station, the Appellant carried on a "UK property business", as defined in Section 205 of the Corporation Tax Act 2009 (the "CTA 2009"), (and, hence, a "property business", as defined in Section 204(1) of the CTA 2009) and the Power Station was a capital asset which was used in the course of that business;

(2) the Appellant was liable to corporation tax on the taxable profits of its property business pursuant to Section 209 of the CTA 2009;

(3) those taxable profits were to be determined in accordance with the provisions of Sections 210 et seq. of the CTA 2009;

(4) in broad terms, this meant that the taxable profits of the Appellant's property business were required to be determined in the same way as if the property business had been a trade, which is to say, by reference to certain specified provisions in Part 3 of the CTA 2009 incorporated by reference into Chapter 3 of Part 4 of the CTA 2009 by Section 210 of the CTA 2009;

(5) in the context of the present decision, the key provisions so incorporated by reference were:

(a) Section 46 of the CTA 2009, which specifies that the taxable profits of a trade are to be calculated in accordance with generally-accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes;

(b) Section 48 of the CTA 2009, which specifies that, in the context of the calculation of the taxable profits of a trade, references in the Corporation Tax Acts to receipts and expenses are to items brought into account as credits or debits in calculating profits;

(c) Section 53 of the CTA 2009, which specifies that, in calculating the taxable profits of a trade, no deduction is allowed for items of a capital nature; and

(d) Section 93 of the CTA 2009, which specifies that items of a capital nature must not be brought into account as receipts in calculating the taxable profits of a trade;

(6) this dispute relates to the deductibility, in calculating the taxable profits of the Appellant's property business for its accounting period ending 16 November 2011, of the approximately £65 million of DRE which remained undepreciated in the profit and loss account of the Appellant at the time of sale and therefore formed part of the net book value at which the Power Station was held in the balance sheet of the Appellant at that time;

(7) that DRE was revenue and not capital expenditure. Indeed, the Respondents have accepted that the approximately £91.5 million of DRE which was depreciated in the profit and loss account of the Appellant in the financial years preceding the financial year

ending 31 December 2011 was deductible in computing the taxable profits of the Appellant in the accounting periods corresponding to those financial years; and

(8) the sale of the Power Station was taken into account in preparing the profit and loss account of the Appellant in respect of the financial year ending 31 December 2011 (and was not disregarded in preparing that account) but a nil amount was recorded in respect of the sale in the profit and loss account because the sale proceeds were equal to the net book value of the Power Station at the time of the sale.

7. The Respondents have challenged the deductibility of that DRE on two distinct grounds, as follows:

(1) first, they say that the sale of the Power Station was a transaction which fell outside the scope of the Appellant's property business and therefore, even if the sale meant that the DRE was brought into account as a debit in calculating the profits which were shown in the profit and loss account of the Appellant for the financial year ending 31 December 2011, the DRE cannot be taken into account in calculating the taxable profits of the property business. This question ("Issue 1") is the first question that I need to determine in this decision; and

(2) secondly, they say that, in any event, even if they are wrong in relation to Issue 1, since the DRE was not brought into account as a debit in calculating the profits which were shown in the profit and loss account of the Appellant for the financial year ending 31 December 2011, there is no basis on which the Appellant is entitled to claim a deduction in respect of that DRE in computing the taxable profits of its property business in its accounting period ending 16 November 2011. This question ("Issue 2") is the second question that I need to determine in this decision, assuming that I find in favour of the Appellant in relation to Issue 1.

8. It will be apparent that, in order for the Appellant to succeed in its appeal, it has to succeed in relation to both issues. The Respondents have to succeed in relation to only one of the issues in order to prevail.

9. The parties have agreed that this decision should merely deal with the issues described above as a matter of principle. If I decide both of the issues in favour of the Appellant, then there will need to be further discussion between the parties in relation to whether or not the precise amount of the unamortised DRE which the Appellant has claimed to deduct in its accounting period ending 16 November 2011 is correct but that is not something which I need to address in this decision.

THE LEGISLATION

10. The following provisions in the CTA 2009 are relevant to this decision:

"Chapter 3 Trade Profits: Basic Rules

46 Generally accepted accounting practice

(1) The profits of a trade must be calculated in accordance with generally accepted accounting practice, subject to any adjustment required or authorised by law in calculating profits for corporation tax purposes.

(2) This does not—

(a) require a company to comply with the requirements of the Companies Act 2006 (c. 46) or subordinate legislation made under that Act except as to the basis of calculation, or

(b) impose any requirements as to audit or disclosure….

47 Losses calculated on same basis as profits

(1) The same rules apply for corporation tax purposes in calculating losses of a trade as apply in calculating profits.

(2) This is subject to any express provision to the contrary.

48 Receipts and expenses

(1) In the Corporation Tax Acts, in the context of the calculation of the profits of a trade, references to receipts and expenses are to any items brought into account as credits or debits in calculating the profits.

(2) It follows that references in that context to receipts or expenses do not imply that an amount has actually been received or paid.

(3) This section is subject to any express provision to the contrary….

Chapter 4 Trade Profits: Rules Restricting Deductions

53 Capital expenditure

(1) In calculating the profits of a trade, no deduction is allowed for items of a capital nature.

(2) Subsection (1) is subject to provision to the contrary in the Corporation Tax Acts…

Chapter 6 Trade Profits: Receipts

Capital receipts

93 Capital receipts

(1) Items of a capital nature must not be brought into account as receipts in calculating the profits of a trade.

(2) But this does not apply to items which, as a result of any provision of the Corporation Tax Acts, are brought into account as receipts in calculating the profits of the trade.

Part 4

Property Income

Chapter 1

Introduction

202 Overview of Part

(1) Chapter 2 contains definitions relevant to the application of the Part.

(2) Chapter 3 applies the charge to corporation tax on income to the profits of a UK property business or an overseas property business and contains basic rules about the calculation of the profits of such a property business.

(3) Chapter 4 provides for certain amounts of a capital nature to be brought into account as receipts in calculating the profits of a property business.

(4) Chapter 5 contains additional rules about the calculation of the profits of a property business….

Chapter 2

Property Businesses

Introduction

203 Overview of Chapter

(1) This Chapter explains for the purposes of this Act what is meant by—

(a) a company's UK property business (see section 205), and

(b) a company's overseas property business (see section 206).

(2) Both those sections need to be read with—

(a) section 207 (which explains what is meant by generating income from land), ….

204 Meaning of "property business"

(1) In this Act "property business" means a UK property business or an overseas property business.

(2) References in this Act to a property business are to a property business so far as any profits of the business are chargeable to tax under Chapter 3 (as to which see, in particular, the rules about territorial scope in section 5).

(3) Accordingly, nothing in Chapter 4 or 5 is to be read as treating an amount as a receipt of a property business if the profits concerned would not be chargeable to tax under Chapter 3.

Basic meaning of UK and overseas property business

205 UK property business

A company's UK property business consists of—

(a) every business which the company carries on for generating income from land in the United Kingdom, and

(b) every transaction which the company enters into for that purpose otherwise than in the course of such a business.

206 Overseas property business

A company's overseas property business consists of—

(a) every business which the company carries on for generating income from land outside the United Kingdom, and

(b) every transaction which the company enters into for that purpose otherwise than in the course of such a business.

Generating income from land

207 Meaning of "generating income from land"

(1) In this Chapter "generating income from land" means exploiting an estate, interest or right in or over land as a source of rents or other receipts.

(2) "Rents" includes payments by a tenant for work to maintain or repair leased premises which the lease does not require the tenant to carry out.

(3) "Other receipts" includes—

(a) payments in respect of a licence to occupy or otherwise use land,

(b) payments in respect of the exercise of any other right over land, and

(c) rentcharges and other annual payments reserved in respect of, or charged on or issuing out of, land….

Chapter 3

Profits of Property Businesses: Basic Rules

Charge to tax on profits of a property business

209 Charge to tax on profits of a property business

The charge to corporation tax on income applies to the profits of a property business.

Calculation of profits

210 Profits of a property business: application of trading income rules

(1) The profits of a property business are calculated in the same way as the profits of a trade.

(2) But the provisions of Part 3 (trading income) which apply as a result of subsection (1) are limited to the following—

In Chapter 3 (basic rules)—

section 46	generally accepted accounting practice
section 47	losses calculated on same basis as profits
section 48	receipts and expenses…

In Chapter 4 (rules restricting deductions)—

section 53	capital expenditure…

In Chapter 6 (receipts)—

section 93	capital receipts…

212 Items treated as receipts and expenses

The rules for calculating the profits of a property business need to be read with—

(a) the provisions of CAA 2001 which treat allowances as expenses of a property business,

(b) the provisions of CAA 2001 which treat charges as receipts of a property business, and…

Chapter 4

Profits of Property Businesses : Lease Premiums etc

Introduction

215 Overview of Chapter

(1) This Chapter provides for certain amounts (which would otherwise generally be amounts of a capital nature) to be brought into account as receipts in calculating the profits of a property business.

(2) The amounts relate to short-term leases in the case of—

section 217 (lease premiums),

section 218 (amount treated as lease premium where work required),

section 220 (sums payable for surrender of lease), and

section 222 (assignments for profit of lease granted at undervalue).

(3) The amounts relate to any lease in the case of—

section 219 (sums payable instead of rent), and

section 221 (sums payable for variation or waiver of terms of lease).

(4) The amounts relate to the sale of any estate or interest in land in the case of—

section 224 (sales with right to reconveyance), and

section 225 (sale and leaseback transactions).

(5) This Chapter also permits certain deductions in calculating the profits of property businesses carried on by tenants under certain leases (see sections 231 and 232).

216 Meaning of "short-term lease"

In this Chapter "short-term lease" means a lease whose effective duration is 50 years or less.

Amounts treated as receipts: leases

217 Lease premiums

(1) This section applies if a premium is required to be paid—

(a) under a short-term lease, or

(b) otherwise under the terms subject to which a short-term lease is granted.

(2) The company to which the premium is due is treated as—

(a) entering into a transaction mentioned in section 205 (if the land to which the lease relates is in the United Kingdom) or section 206 (if that land is outside the United Kingdom), and

(b) receiving the amount calculated under subsections (4) and (5) as a result of that transaction.

(3) That amount is brought into account as a receipt in calculating the profits of the property business which consists of or includes that transaction for the accounting period in which the lease is granted.

(4) The amount of the receipt is given by the formula—

Px 50 – Y50

where—

P is the premium, and

Y is the number of complete periods of 12 months (other than the first) comprised in the effective duration of the lease.

(5) But, if the rule in section 228 (the additional calculation rule) applies, the amount given by the formula in subsection (4) is reduced by the amount calculated in accordance with section 228."

THE EVIDENCE AND FINDINGS OF FACT

Introduction

11. The evidence for the appeal took the form of the various documents set out in the documents bundle and the supplemental documents bundle, together with the witness evidence of Mr Richie Bingham - the head of tax at EDF - and the expert accounting witnesses for the parties – Mr Peter Hogarth of PricewaterhouseCoopers for the Appellant and Mr Mark Vickers, of the Respondents, for the Respondents.

12. The documents bundle included a statement of principles for financial reporting published by the Accounting Standards Board (the "ASB") in December 1999 (the "SoP") and various financial reporting standards ("FRSs" and, each, an "FRS"). The parts of the SoP and the FRSs which are relevant to this decision are set out in the Appendix to this decision.

13. Whilst the witness evidence was voluminous, my conclusions were that only a small part of it was ultimately of significance to my decision. In particular, although the accounting experts disagreed on the significance of the SoP to generally accepted accounting practice and how some of the language used in the SoP and the FRSs should be construed, they were in agreement in relation to the material facts which I consider to be relevant to my decision, as I outline in paragraph 17 below.

Mr Bingham

14. Mr Bingham provided evidence on the factual background to the appeal, some of which I have already described above in setting out the salient facts. For present purposes, I would note only that he said as follows:

(1) the DRE which was the subject of this appeal involved maintenance and did not modify or improve the Power Station. It was therefore classified as revenue in nature;

(2) under generally-accepted accounting practice:

(a) that expenditure was capitalised in the accounts of the Appellant and then amortised in the profit and loss account in each financial year; and

(b) the balance of the expenditure was then taken into account as part of the net book value on the disposal of the Power Station;

(3) the effect of the above was that the expenditure was reflected in the profit and loss account of the Appellant over a period which was aligned with the period in which the Appellant earned its income from the Power Station;

(4) since the consideration for the sale of the Power Station was the net book value of the Power Station, including the DRE, one consequence of the sale was that the Appellant was made whole in respect of that expenditure;

(5) prior to the financial year ending 31 December 2011, the Respondents had not challenged the deductions claimed by the Appellant in respect of the depreciation of the DRE in calculating the taxable profits of its property business; and

(6) the sale of the Power Station by the Appellant to Power Ltd had been made in order to simplify the group structure and align ownership of the Power Station with the operation of the Power Station.

15. The Respondents have not sought to challenge any of the above evidence and I therefore adopt the statements made above as findings of fact for the purposes of this decision.

The accounting experts

Findings of fact – common ground

16. Turning then to the evidence of the accounting experts, both experts agreed, and I therefore adopt as findings of fact for the purposes of this decision, that:

(1) under generally-accepted accounting practice, the accounts of a company were required to be prepared in accordance with the requirements of law and various accounting standards;

(2) in the context of the present appeal, the two most relevant accounting standards were:

(a) FRS 15, "Tangible Fixed Assets", which was the relevant accounting standard that set out the requirements in respect of the recognition, measurement, presentation and disclosure of tangible fixed assets, including the capitalisation of subsequent expenditure, depreciation and disposal; and

(b) FRS 3, "Reporting Financial Performance", which also contained relevant guidance on the recognition, measurement, presentation and disclosure of profits and losses on the disposal of fixed assets;

(3) the profit and loss account and balance sheet of the Appellant in respect of its financial year ending 31 December 2011 had been prepared in accordance with generally-accepted accounting practice and therefore in accordance with the requirements of law and the FRSs mentioned above;

(4) the SoP did not have the status of an accounting standard but the SoP set out principles which the ASB believed should underlie the preparation and presentation of financial statements;

(5) although FRS 3 had been published some years before the SoP was published, the ASB had acknowledged that FRS 3 drew on the principles of good presentation described in the SoP and that FRS 3 and the SoP did not conflict with one another;

(6) both FRS 15 and FRS 3 required that the profit or loss on the disposal of a tangible fixed asset be accounted for as the difference between the sale proceeds and the asset's carrying value (which is to say, cost less accumulated depreciation);

(7) the book-keeping entries to determine that profit and loss were recorded in an account. Those entries involved crediting the relevant account with the sale proceeds and debiting the relevant account with the net book value of the Power Station at the time of the sale. The net amount reflecting that credit and debit in the book-keeping account was then recorded in the profit and loss account. In this case, the net amount was nil, of course, as the Power Station had been sold at its net book value. However, the same approach would have been adopted even if the Power Station had been sold for £1 million more or less than its net book value. In the former case, the book-keeping entries would have involved crediting the relevant account with the sale proceeds and debiting the relevant account with the net book value and the £1 million difference would then have been recognised as a credit in the profit and loss account. In the latter case, the book-keeping entries would have been the same and the £1 million loss would then have been recognised as a debit in the profit and loss account;

(8) as the profit and loss account and balance sheet of the Appellant in respect of its financial year ending 31 December 2011 had been prepared in accordance with generally-accepted accounting practice (and therefore in accordance with the requirements of law and the FRSs mentioned above), there was no credit or debit in the profit and loss account itself in respect of the sale of the Power Station even though that event – ie the sale – had been recognised and accounted for in the profit and loss account;

(9) the books referred to in paragraph 16(7) above were not part of the profit and loss account or balance sheet for the financial year in question. Instead, they stood outside the accounts for the relevant financial year and did not themselves need to comply with the requirements of law and the FRSs; and

(10) the accounting treatment of sales of tangible fixed assets described above was distinguishable from the accounting treatment of sales of stock. In the latter case, the gross sales proceeds were shown as a credit in the profit and loss account and the gross cost was shown as a debit in the profit and loss account. Thus, the transaction in question was recorded in the profit and loss account on a gross basis, in contrast to the net basis applicable to disposals of tangible fixed assets described above.

17. The above findings of fact, which are based on the common views of both experts, are the only facts that I consider to be necessary in order for me to be able to deal with the issues in this appeal. This is because the accounting treatment adopted by the Appellant is not relevant to Issue 1 and, so far as Issue 2 is concerned, my task is solely to consider whether, in the light of the facts described above, each of the sale proceeds and the net book value of the Power Station at the time of the sale - which is to say, the gross amounts used to calculate the net amount which appeared in respect of the sale in the profit and loss account of the Appellant for the relevant financial year - were "items brought into account as credits or debits in calculating the profits [of the Appellant's trade in the financial year in question]" (see Section 48 of the CTA 2009). That is a question of law for me to determine. For reasons which will become

clear in due course, I think that the above facts are sufficient for me to reach a conclusion in relation to that question of law.

"***Recognised" and "accounted for"***

18. I should add that, although the views of the experts on the question of statutory construction described above are ultimately irrelevant, neither expert did in fact set out his views on that question, as stated. This is because, slightly to my surprise, neither expert was expressly instructed to provide a view on how the language used in Section 48 of the CTA 2009 applied to the facts in this case. Instead, Mr Hogarth was merely instructed to comment generally on the accounting treatment of the sale of the Power Station under generally-accepted accounting practice whilst Mr Vickers was instructed to opine on how disposals of tangible fixed assets should be "recognised" or "accounted for" under generally-accepted accounting practice. Thus, in giving their evidence, the experts crossed swords on the question of whether the gross amounts could be said to have been "recognised" or "accounted for" in the profit and loss account for the relevant financial year. They did not address the specific question of whether the gross amounts were "brought into account…in calculating the profits" which were shown in the profit and loss account.

19. In my view, the concept of "recognition" or being "accounted for" in a profit and loss account is not the same as the concept of being "brought into account as [a credit or debit] in calculating the profits [shown in that profit and loss account]". This is because, notwithstanding the conclusion which I reach in paragraphs 24 and 25 below, I consider that the phrase "brought into account….in calculating the profits [shown in a profit and loss account]" is more apt than the words "recognition" and "accounted for" to include amounts which have been taken into account in the calculations underlying an item appearing in the profit and loss account. As such, I think that it is perfectly possible to conclude that an item has been brought into account as a credit or debit in calculating the profits shown in a profit and loss account even though it has not been "recognised" or "accounted for" in the profit and loss account. Nevertheless, for completeness, as I had the benefit of hearing the evidence of the experts on this question in my capacity as the fact-finding tribunal, I will briefly summarise the views of the experts on that issue and then set out, as a finding of fact, my own conclusion on the issue.

The views of the experts

20. Unsurprisingly, Mr Hogarth, the Appellant's expert, was of the view that the gross amounts were so "recognised" or "accounted for" whereas Mr Vickers, the Respondents' expert, considered that only the net amount – in this case, nil – was so "recognised" or "accounted for".

21. In the view of Mr Hogarth:

(1) the phrase "accounted for" was not defined in the FRSs although it appeared frequently within them;

(2) in some cases, the phrase was used to describe a broad accounting approach – for example where paragraph 42 of FRS 1 referred to various types of contract being "accounted for" as a hedge or paragraph 13 of FRS 6 referred to the fact that a group reconstruction might be "accounted for" by using merger accounting;

(3) in other cases, the phrase was used to describe the time at which a particular item appeared or should appear in the accounts – for example, paragraph 38 of FRS 6 stated that it was effective for business combinations first "accounted for" after a certain date, and paragraph 95 of FRS 15 stated that a change in the estimated residual value of a tangible fixed asset should be "accounted for" prospectively;

(4) the phrase "accounted for" could also be construed in a third sense, consistent with paragraph 4 of FRS 18, of describing the process whereby a transaction or other event should be recognised, measured or presented in the accounts;

(5) in his view, the phrase "accounted for" in paragraph 21 of FRS 3 and paragraph 72 of FRS 15 was referring to when the profit or loss arising on the sale of a tangible fixed asset should be shown in the profit and loss account (the period in which the sale took place), how that profit or loss should be measured (the difference between the sale proceeds and the net book value) and how that profit and loss should be presented. In so doing, the relevant paragraphs were saying that the gross amounts which went to make up the net amount of the profit or loss should be both "recognised" and "accounted for" in the profit and loss account, even though they were not "presented" in that account;

(6) although the SoP did not have the status of an FRS or the requirements of law, and was therefore subservient to both of those when it came to preparing accounts:

> (a) it provided a frame of reference and a statement of high-level principles which helped the ASB either to develop new FRSs or to review existing FRSs; and
>
> (b) where the FRSs and the law were silent on a subject, it was appropriate to consider what the SoP had to say on the subject;

(7) paragraphs 7.9 to 7.11 of the SoP dealt with the presentation of financial information and contrasted the different treatment accorded to sales of stock as compared to sales of fixed assets. The language used in those paragraphs, when read together with paragraph 4.41 of the SoP, made it clear that, although it was best to present the profit or loss arising on the sale of a fixed asset on a net basis (because disclosing the gross components was not likely to be useful for an assessment of either future results or the effects of past transactions or events), the net amount reflected the two underlying gross amounts which were used to calculate the net amount, both of which were therefore being "recognised" and "accounted for" by virtue of that presentation. In other words, just as in the case of a sale of stock, the sale of a fixed asset gave rise to the recognition of two gross amounts. The only difference between the two distinct categories of asset was that the sale of a fixed asset was required to be presented on a net basis whilst the sale of stock was required to be presented on a gross basis. The difference was therefore one of presentation and not "recognition" or being "accounted for";

(8) the treatment described in paragraph 21(7) above could be seen in the extract from a leading accounting textbook – paragraph 21.14 of Frank Wood's Business Accounting, Volume 1, 14th Edition ("Frank Wood") – in the supplemental bundle. That showed that the net amount which was presented in the profit and loss account was the result of a calculation involving the gross amounts and that therefore the gross amounts were being "recognised" and "accounted for" when the net amount was shown in the profit and loss account;

(9) in this regard, it was instructive to consider the way in which FRS 12 applied in circumstances where an asset was lost or destroyed and it subsequently became clear that an entitlement to insurance proceeds in respect of the loss arose. In that case, if the loss/destruction occurred in a different financial year from the one in which the entitlement to insurance proceeds became virtually certain, then the two events - the loss/destruction of the asset and the entitlement to insurance proceeds –were shown on a gross basis in the profit and loss account for each of the relevant financial years. In contrast, if the two events both occurred in the same financial year, then it was possible to present the two gross amounts reflecting those two separate events as a single net amount in the profit and loss account for the financial year in question, even though both of those gross amounts were being recognised within that net amount; and

(10) in summary, Mr Hogarth distinguished between, on the one hand, "presentation" and, on the other hand, "recognition" and being "accounted for". He said that, whilst only the net amount was required to be "presented" in the profit and loss account, what was being "recognised" and "accounted for" in so doing were the gross amounts comprised within that net amount.

22. In contrast, Mr Vickers was of the view that the only amount "recognised" or "accounted for" in the profit and loss account was the net amount reflecting the two gross amounts. He said that:

(1) paragraph 72 of FRS 15 was clear on its face that the amount to be "accounted for" in relation to the sale of a fixed asset was the net amount comprising the difference between the sale proceeds and the book value of the fixed asset. The words "accounted for" in that context meant the same as "recognised" and therefore the paragraph should be construed as saying that only the net amount and not the elements used to calculate that net amount were being "recognised" and "accounted for" in the profit and loss account;

(2) paragraph 35 of Appendix IV to FRS 15 supported that interpretation as it stated that "FRS 3 requires gains and losses on disposal to be recognised in the profit and loss account in the period in which the disposal took place, calculated as the difference between carrying amounts and the net sale proceeds". It therefore distinguished between the amounts taken into account in the calculation and the amount actually "recognised" in the profit and loss account;

(3) similarly, the language used in the introduction to chapter 5 of the SoP stated that "[the] term "recognised" was being used in the SoP to mean depicting an item both in words and by a monetary amount". This also supported the proposition that what was "recognised" in the profit and loss account was only the amount which actually appeared in that account and not the elements which were taken into account in calculating that amount;

(4) further support for that interpretation could also be found in the terms of paragraphs 17.27 to 17.30 of FRS 102, which referred to "recognising" the gain or loss arising from the disposal of an asset and "determining" that gain or loss by reference to the difference between the sale proceeds and the carrying value of the asset. Although that FRS was published some time after the events which were the subject of this dispute, it was expressed in similar terms to the terms of paragraph 72 of FRS 15 apart from using the word "recognise" instead of "accounted for". As such, it was indicative of the fact that the two phrases should be regarded as being synonymous;

(5) he accepted that the profit or loss arising on the sale of a fixed asset was calculated in the same way as the profit or loss arising on the sale of stock but said that, in the former case, only the net amount of the profit or loss was "recognised" or "accounted for" whereas, in the latter case, the gross amounts making up the profit or loss arising on the sale of stock were so "recognised" or "accounted for". Thus, he did not agree with Mr Hogarth that, in both cases, the amounts "recognised" and "accounted for" were the gross amounts. He said that this conclusion was supported by the fact that paragraph 21 of FRS 3 and paragraph 72 of FRS 15 stipulated that, in the case of the sale of a fixed asset, only the net amount reflecting the difference between the two gross amounts should appear in the profit and loss account. He also noted that the language used in paragraph 4.40 of the SoP supported this view. That provision referred to "revenue" and "expenses" – which would include the gross amounts attributable to a sale of stock – and then went on to refer to the gains and losses arising from disposals of fixed assets;

(6) on the sale of a tangible fixed asset, the asset was derecognised in the balance sheet and the asset representing the receipt of the sales proceeds – for example, the cash sales proceeds – was recognised in the balance sheet. Thus, the sale proceeds and the cost of the asset in question were balance sheet items and only the net profit or loss (if any) arising on the sale was recognised in the profit or loss account. The excerpt from Frank Wood referred to in paragraph 21(8) above was indicative of that fact as the first three accounting entries in that excerpt were all related to the balance sheet and only the final one related to the profit and loss account;

(7) the analogy proffered by Mr Hogarth in paragraph 21(9) above of comparing the accounting treatment in this case to the accounting treatment required by FRS 12 on the loss/destruction of an asset and the receipt of insurance proceeds was a false one because, in the case of a loss/destruction and the receipt of insurance proceeds, there were two events – namely, on the one hand, the loss/destruction and, on the other hand, the entitlement to the insurance proceeds – and indeed those two events were accounted for separately and on a gross basis in circumstances where the entitlement to the insurance proceeds became sufficiently certain only in a later financial year from the financial year in which the loss/destruction occurred. In contrast, in this case, there was only a single event – namely, the sale; and

(8) in summary, Mr Vickers said that the language used in paragraph 21 of FRS 3 and paragraph 72 of FRS 15 was doing more than simply prescribing what should be "presented" in the profit and loss account. Instead, it was prescribing what should be "recognised" or "accounted for" in that account.

23. There was also some discussion between the parties and the experts as to whether note 7 to the Appellant's accounts for the financial year ending 31 December 2011 – which referred to the DRE's being "written off to profit and loss account" – was an accurate description of what had occurred. However, on the basis that the experts were agreed that the notes to accounts could not compensate for, or change, what actually appeared in the accounts themselves and that what was "recognised" or "accounted for" in the accounts was to be identified solely by reference to the application of the FRSs and the requirements of law, I do not consider that that debate advances in any way the question which is the subject of this section of my decision.

Findings of fact – "recognised" or "accounted for"

24. After listening to the rival submissions of both experts and both parties on this issue, I can understand why, based on the language used in the SoP and the relevant FRSs, Mr Vickers reached the view that only the net amount reflecting the two gross amounts was "recognised" or "accounted for" in the profit and loss account for the financial year in question. However, I have decided that I prefer the view of Mr Hogarth on this issue for the following reasons:

(1) first, I think that, on a point such as this, it is inappropriate to construe the language used in the SoP and the FRSs as if those documents were statutes. There is no indication that the ASB, in preparing the relevant documents, had in mind the sort of fine distinction which is currently in issue between the parties for the simple reason that that distinction was irrelevant to the matters with which the ASB was concerned in preparing the relevant documents;

(2) secondly, it is in my view a misnomer to assume that, simply because an FRS refers to the "recognition" in the profit and loss account of a particular amount or that a particular amount must be "accounted for", that automatically means that only that amount has been "recognised" and "accounted for" in the profit and loss account and that the same cannot also be true of the gross amounts which have been used to calculate that amount. There is nothing either express or implied to that effect in the terms of the relevant FRSs; and

(3) that brings me on to the final point which is that, somewhat prefiguring my conclusion of law in relation to Issue 2 below, regardless of the semantic points on which Mr Vickers and the Respondents sought to rely in relation to the SoP and the FRSs, it seems to me to be very hard to say that, in "recognising" or "accounting for" the nil net amount in respect of the sale in the profit and loss account in this case, the Appellant was not, in so doing, also "recognising" or "accounting for" the two gross amounts which were necessarily used in order to determine that nil net amount. It was "recognising" the two gross amounts in the profit and loss account because "recognising" the nil net amount necessarily entailed "recognising" the constituent elements making up the nil net amount in that account and it was "accounting for" the gross amounts in the profit and loss account because those amounts were the two components in the calculation of the nil net amount which was "accounted for" in that account. It could therefore hardly "recognise" or "account for" the nil net amount without also "recognising" or "accounting for" the gross amounts comprising that nil net amount.

25. Thus, although I remain of the view that the phrase "brought into account….in calculating the profits [shown in a profit and loss account]" is more apt than the words "recognition" and "accounted for" to include amounts which have been taken into account in the calculations underlying an item appearing in the profit and loss account, I have ultimately concluded that, on the facts of this case, the outcome is the same and those underlying amounts were also "recognised" and "accounted for". I therefore find as a fact that, in stipulating, in relation to the disposal of an asset, that the net amount reflecting the difference between the sale proceeds and the net book value should be "recognised" or "accounted for" in the profit and loss account, FRS 3 and FRS 15 were implicitly also stipulating that those gross amounts should be "recognised" or "accounted for" in that account. Having said that, as I have noted above, I believe that this issue is of no relevance to my conclusions in relation to either of the two issues which are the subject of this appeal.

DISCUSSION

Introduction

26. In my view, the Appellant's positions on both of the issues involved in this dispute are correct as a matter of law. Despite Mr Bremner's considerable forensic skill, he has not persuaded me that the construction of the tax legislation which has been proposed by the Respondents in this case is correct in law. Moreover, I believe that were the outcome for which the Respondents are contending in this appeal to be adopted, that would:

(1) produce an unfair tax result for the Appellant; and

(2) be contrary to the system for calculating the profits of a trade or property business which has operated perfectly well for a considerable period of time.

27. In summary, my view is that, in terms of the principles involved in this case, and leaving aside for the moment the precise number, the Appellant was entitled to claim a deduction for the unamortised DRE in calculating its profits for corporation tax purposes in its accounting period ending 16 November 2011 and that its appeal should therefore be upheld.

28. In the rest of this section of the decision, I will outline, in relation to each of the grounds on which the Respondents have sought to avoid that outcome:

(1) the arguments made by the Respondents in relation to the issue in question; and

(2) my conclusions in relation to that issue and my reasons for reaching those conclusions, including my reasons for disagreeing with the submissions of the Respondents in relation to that issue.

29. I will then conclude with some observations on why I believe that the conclusions I have reached give rise to a fair outcome for the Appellant and are entirely consistent with the manner

in which the particular aspect of the tax system to which the appeal relates has operated and, in my view, should continue to operate.

Issue 1

The Respondents' submissions in relation to Issue 1

30. The first challenge which the Respondents have made to the Appellant's claim to deduct the DRE in calculating the taxable profits of its property business is that the sale of the Power Station was a transaction which occurred other than in the course of the Appellant's property business and that therefore any accounting debit or credit to which the sale gave rise cannot form part of the calculation of the taxable profits of that property business.

31. More particularly, the Respondents submitted as follows:

(1) Section 204(1) of the CTA 2009 defined a "property business" as a "UK property business" or an "overseas property business". In this case, it was common ground that the leasing of the Power Station by the Appellant meant that the Appellant was carrying on a "UK property business";

(2) Section 205 of the CTA 2009 defined a company's "UK property business" as consisting of every business which the company carried on for generating income from land in the UK, and every transaction which the company entered into for that purpose other than in the course of such a business;

(3) Section 207(1) of the CTA 2009 defined the phrase "generating income from land" as "exploiting an estate, interest or right in or over land as a source of rents or other receipts";

(4) Section 209 of the CTA 2009 provided that "[the] charge to corporation tax on income" applied to the profits of a property business and Section 210 of the CTA 2009 provided that the taxable profits of a property business were to be calculated in the same way as the taxable profits of a trade although only certain provisions of Part 3 of the CTA 2009 were to be taken into account for this purpose;

(5) the way in which Section 210 of the CTA 2009 operated meant that, in applying the specified provisions in Part 3 of the CTA 2009 in the context of calculating the taxable profits of a property business, one should read each reference in those provisions to a trade as a reference to a property business. As a result, it was the taxable profits of a property business which were required to be calculated in accordance with generally-accepted accounting practice (subject to adjustments required or authorised by law) by Section 46 of the CTA 2009 and it was in the context of calculating the taxable profits of a property business that references in the Corporation Tax Acts to receipts and expenses should be construed as items brought into account as credits and debits in the calculation of those taxable profits;

(6) it followed from the above that an item which was brought into account as a credit or debit in calculating the profits shown in a profit and loss account was not within the scope of Sections 46 and 48 of the CTA 2009 and therefore could not fall to be taken into account in calculating the taxable profits of a property business if it was attributable to a transaction that was not carried out in the course of the property business, as defined;

(7) the sale of a property for a capital sum did not concern the exploitation of land as a source of rent or other receipts because it did not involve making use of the land in order to generate rent or other receipts. That language covered the act of putting land to use – or "exploiting" the land - to generate rent or other receipts. It did not extend to an outright sale of land for a capital sum. The latter did not involve putting land to use and was therefore the polar opposite of the language used in Section 207 of the CTA 2009;

(8) in addition, the proceeds of such a sale were obviously not rent and nor were they an "other receipt", because it was clear that the rent or other receipts to which Section 207 of the CTA 2009 referred were only those of an income nature. This followed from the fact that:

(a) Section 209 of the CTA 2009 specified that the profits of a property business were subject to the charge to corporation tax "on income"; and

(b) Section 204(2) of the CTA 2009 specified that references in the Act to a "property business" were to a property business "so far as any profits of the business are chargeable to tax under Chapter 3 [of Part 4 of the Act]" and Section 209 of the CTA 2009 was part of that chapter;

(9) it followed that not only was the sale of a property for a capital sum incapable of giving rise to the existence of a property business in and of itself but that, even where there was a pre-existing property business (as was the case here), the sale of the property which had been used in the property business for a capital sum could not be regarded as a transaction taking place in the course of the property business for the purposes of Section 207 of the CTA 2009;

(10) in the present case, since the proceeds of the sale of the Power Station were neither rent nor an "other receipt", the sale of the Power Station could not be a transaction which was carried out in the course of the Appellant's property business;

(11) consequently, no amount which was brought into account as a credit or debit in calculating the profits shown in the Appellant's profit and loss account as a result of the sale could feature in the computation of the taxable profit or loss of the property business;

(12) the above conclusion was not contradicted by the fact that the sale of a property could have capital allowances consequences such that the sale could give rise to items which fell to be treated as expenses or receipts of the property business. This was because Section 212 of the CTA 2009 expressly incorporated those items, by reference, in the computation of the taxable profits of the property business. The same was true in relation to lease premiums which gave rise to items which fell to be included in the computation of the taxable profits of the property business under Section 217 of the CTA 2009 and other equivalent provisions in Chapter 4 of Part 4 of the CTA 2009. The provisions in Chapter 4 of Part 4 of the CTA 2009 were particularly instructive in that each relevant provision adopted a two-stage process. First, it expressly required the taxpayer to be treated as having entered into the transaction in the course of a property business for the purposes of Section 205 (or, as the case may be, Section 206) of the CTA 2009 and, then, it stipulated that the taxpayer should be treated as receiving a specified amount as a result of the transaction. The existence of the first stage was indicative of the fact that the concept of a property business was limited to transactions giving rise to income; and

(13) similarly, the above conclusion was not contradicted by the exclusion in Section 93 of the CTA 2009 from the calculation of the taxable profits of a property business for capital receipts. It might well be the case that the conclusion meant that there was only a relatively limited residual role for Section 93 of the CTA 2009 to perform but the provision was by no means redundant. For example, it might operate to exclude from the scope of the property business tax computation the part of a lease premium which was not to be treated as income by virtue of Section 217 of the CTA 2009 and other equivalent provisions in Chapter 4 of Part 4 of the CTA 2009.

Conclusion in relation to Issue 1

32. There are two reasons why I do not agree with the Respondents' submissions in relation to Issue 1.

Transactions to be included in calculating the taxable profits of a property business

33. The first is that I believe that:

(1) the Respondents have adopted an overly-narrow approach to identifying the transactions which fall to be taken into account in calculating the taxable profits of a property business; and

(2) contrary to their submissions, the sale by the Appellant of the Power Station was a transaction which fell to be taken into account in calculating the taxable profits of the Appellant's property business. This is because that sale was the disposal of the main capital asset which was used in carrying on that business.

34. Before I elaborate on that conclusion, I should start by saying that I am inclined to agree with the Respondents that, in order for a property-owning company to be carrying on a property business in the first place, the company needs to be carrying on a business of exploiting the property to derive items of an income nature and that, subject to the application of Chapter 4 of Part 4 of the CTA 2009 (as to which, see below), it is not carrying on a property business if its purpose is instead to derive from the property only items of a capital nature. I have reached this view in part because the definition of both "UK property business" and "overseas property business" refer to "generating <u>income</u> from land" but, more importantly, because the definition of the latter term in Section 207 of the CTA 2009 uses language which suggests to me that it is directed at receipts of an income nature and not receipts of a capital nature.

35. I say that because that provision refers to "exploiting…land as a source of rents or other receipts" and, in my view:

(1) the word "exploiting" and the word "source" are both words which tend to be used in the context of income items and not capital items; and

(2) "rents" are always income in nature and therefore, construing the term "other receipts" in the light of the *eiusdem generis* rule, the reference to "rents" imparts an income flavour to the phrase "other receipts".

36. In this context, I do not think that Section 207(3) of the CTA 2009 – which gives a definition of the phrase "other receipts" – is determinative of the position, not least because it is an inclusive definition, but I would observe that the three categories of "other receipts" expressly mentioned in that definition again have an income flavour – see, in particular, the reference to "rentcharges and other annual payments" in Section 207(3)(c) of the CTA 2009.

37. In his submissions at the hearing, Mr Gammie said that the language in Section 207 of the CTA 2009 was also apt to include items of a capital nature. In this regard, he relied on the judgment of Sir Nicolas Browne-Wilkinson V-C in *McClure (Inspector of Taxes) v Petre* [1988] STC ("*McClure*"). In *McClure*, which was a case in relation to the old Schedule A, the question at issue was whether certain lump sum payments received by a property owner in return for licensing the property were subject to income tax as being "annual profits or gains arising in respect of…other receipts arising…from, or by virtue of, his ownership of an estate… in… land" for the purposes of Section 67(1) of the Income and Corporation Taxes Act 1970 (the "ICTA 1970"). It was held that, although it was common ground between the parties that the lump sums fell within the words "other receipts arising…from, or by virtue of, his ownership of an estate… in… land", the sums in question were not "annual profits or gains" because they were of a capital and not an income nature. As such, they fell outside the ambit of the provision.

38. Mr Gammie said that *McClure* was therefore authority for the proposition that the phrase "other receipts" included capital recipts as well as income receipts.

39. I do not agree with Mr Gammie's submission on this. Leaving aside the fact that Sir Nicolas Browne-Wilkinson V-C did not specifically address the question of whether the capital

sums in *McClure* fell within the ambit of the words "other receipts" but merely observed that there was no dispute between the parties in relation to that question, it is important to note that the language in Section 67 of the ICTA 1970 was very different from the language in Section 207 of the CTA 2009 which I am now considering. In particular, whereas the former referred to other receipts "arising from, or by virtue of," the ownership of land, the latter refers to "exploiting" land as a "source" of other receipts. The latter language is much more indicative that the charge is limited to receipts of an income nature than is the former language.

40. I therefore agree with the Respondents that, subject to the application of Chapter 4 of Part 4 of the CTA 2009 – an area which I address in further detail in paragraphs 46 and 51 below - a company which exploits a property to generate only receipts of a capital nature and not receipts of an income nature would not be regarded as carrying on a property business because those capital receipts would not be regarded as "rent or other receipts" for the purposes of Section 207(1) of the CTA 2009.

41. However, the fact that there can be no property business without there being an exploitation of land as a source of income receipts does not of itself mean that, once a property business exists because that condition is satisfied, a transaction which would naturally fall to be regarded as taking place in the course of that business but which does not give rise to a receipt of an income nature cannot be taken into account in computing the taxable profits of that business. Those are two completely different questions.

42. It is common ground in this case that:

(1) the Appellant did in fact carry on a property business when it leased the Power Station to Power Ltd in return for a rent; and

(2) the Power Station was therefore a capital asset of the Appellant which the Appellant was using in the course of that property business while it held the Power Station and continued to receive the rent.

43. However, the Respondents contend that, although the Power Station was a capital asset of the property business while it continued to be held by the Appellant, the sale of the Power Station was not a transaction which should be taken into account in computing the taxable profits of that business because it did not give rise to a receipt of an income nature.

44. I do not agree with that submission. To my mind, it elides two quite distinct concepts, which is to say, on the one hand, the description of the activity which must exist before it can be said that there is a property business (on the basis of the definitions in Sections 205 to 207 of the CTA 2009) – which was the source of the taxable profits - and, on the other hand, the calculation of the taxable profits to which that property business gave rise. Chapter 3 of Part 4 of the CTA 2009 outlines how the taxable profits of a property business are to be calculated once it has been determined that a property business exists. In that context, leaving aside for the moment the exclusion for capital receipts set out in Section 93 of the CTA 2009, it seems inconceivable to me that the taxable profits of the property business would not fall to be determined by taking into account both the acquisition and the disposal of the property which has been the main asset of that business.

45. In this respect, the position is identical to that pertaining where a capital asset has been used in the course of a trade. In that case, the taxable profits of the trade fall to be calculated in accordance with the rules set out in Part 3 of the CTA 2009. The disposal of the capital asset is taken into account for that purpose, although the proceeds of disposal are of course excluded from the computation of the trading profits by Section 93 of the CTA 2009. In both cases, the exclusion in Section 93 of the CTA 2009 does not mean that the transaction giving rise to the receipt is to be disregarded in calculating the taxable profits of the property business or trade, as the case may be. It simply means that the particular capital receipt is to be excluded in calculating those taxable profits. Indeed, the very existence of the exclusion seems to me to

support the conclusion that the transaction itself should be taken into account in calculating the taxable profits of the property business or trade as, were that not to be the case, the exclusion would have very little, if any, purpose.

46. In his submissions, Mr Bremner said that the existence of Section 93 of the CTA 2009 might be explained by the fact that, were it not for the inclusion of that provision, the capital element of a short lease premium (and of other amounts which are subject to the provisions in Chapter 4 of Part 4 of the CTA 2009) might otherwise fall to be taken into account in computing the profits of the property business. However, leaving aside the fact that this reasoning does not explain the existence of the section in the context of calculating the profits of a trade, it seems to me to be inconsistent with the fact that each of the deeming provisions in Chapter 4 of Part 4 of the CTA 2009 expressly says that only the deemed income element calculated in accordance with the relevant provision is to be included in the taxable profits of the property business – see, for example, the language used in Section 217(2)(b) of the CTA 2009. I am therefore not persuaded that the existence of Section 93 of the CTA 2009 can be explained on those grounds.

47. The Respondents have relied in this context on the language used in two provisions – Section 209 of the CTA 2009, which specifies that the taxable profits of a property business are "subject to the charge to corporation tax on income", and Section 204(2) of the CTA 2009, which specifies that references in the Act to a property business are to a property business "so far as any profits of the business are chargeable to tax under Chapter 3 [of Part 4 of the Act]".

48. I do not consider that either of these provisions supports the Respondents' position.

49. The former section is simply making it clear that the taxable profits of a property business, once calculated, are to be subject to corporation tax as income. It says nothing about the nature of the items which are to be included in the calculation of those taxable profits. As it happens, capital items are excluded from the calculation of those taxable profits but that is because Sections 53 and 93 of the CTA 2009 expressly say so. It is not because Section 209 of the CTA 2009 provides that the taxable profits of a property business are subject to the charge to corporation tax on income.

50. In relation to the latter section, I would note the following:

(1) the language on which the Respondents rely in Section 204(2) of the CTA 2009 is followed by the words "(as to which see, in particular, the rules about territorial scope in section 5)". Section 5 of the CTA 2009 is the provision which makes clear the territorial scope of corporation tax and, in particular, the fact that a non-UK resident company which is not carrying on a trade in the UK through a permanent establishment is not subject to that tax. There are other provisions in the Corporation Tax Acts apart from Section 5 of the CTA 2009 which have the effect of excluding a company from the scope of the charge to corporation tax under Chapter 3 of Part 4 of the CTA 2009 - see, for example, the exclusion from corporation tax in Section 6 of the CTA 2009 for profits received in a fiduciary capacity and the exclusion from corporation tax in Section 984 of the Corporation Tax Act 2010 for local authorities;

(2) Section 204(2) of the CTA 2009 is then followed by Section 204(3) of the CTA 2009 which provides as follows:

"Accordingly, nothing in Chapter 4 or 5 is to be read as treating an amount as a receipt of a property business if the profits concerned would not be chargeable to tax under Chapter 3";

(3) Chapters 4 and 5 contain various provisions which specify that certain transactions which might not otherwise fall to be regarded as giving rise to, or as taking place within the course of, a property business:

(a) should be treated as transactions mentioned within Sections 205 or 206 of the CTA 2009 - and hence as part of a property business; and

(b) should be treated as giving rise to an amount of income calculated in accordance with the relevant provision –

see, for example, Sections 217(2)(a) and (b), 219(2)(a) and (b), 220(2)(a) and (b), 221(2)(a) and (b), 222(2)(a) and (b), 224(2)(a) and (b), 225(3)(a) and (b) and 250(2)(a) and (b) of the CTA 2009;

(4) in each case, the first of the relevant sections is necessary to make it clear that, even if the transaction in question would not generally be treated as giving rise to, or as taking place within the course of, a property business, it should be treated as so doing;

(5) in my view, it follows from the above that the language in Section 204(2) of the CTA 2009 should be construed as saying no more than that a person who is outside the scope of the charge to corporation tax under Chapter 3 of Part 4 of the CTA 2009 – for example, but not exclusively, by virtue of Section 5 of the CTA 2009 - remains in that position despite any suggestion to the contrary in Part 4 of the CTA 2009 and, in particular, the deeming language in Chapters 4 and 5 of Part 4 of the CTA 2009. I do not think that it can possibly have the meaning for which the Respondents contend – of delineating the scope of a property business by reference to those profits of the business which are chargeable to tax in accordance with Chapter 3 of Part 4 of the CTA 2009 - because that would render Section 204(2) of the CTA 2009 and Chapter 3 of Part 4 of the CTA 2009 entirely circular; and

(6) support for my conclusion can be found in the equivalent provisions for income tax purposes (Sections 263(4) and 263(5) of the Income Tax (Trading and Other Income) Act 2005 (the "ITTOIA")). Tellingly in my view, those provisions refer only to an overseas property business (and consequently the jurisdictional limitation in Section 269 of the ITTOIA so far as it applies to such a business) and make no reference to a UK property business. If the Respondents' interpretation of Section 204(2) of the CTA 2009 were to be correct, then the equivalent income tax provisions would have referred to both categories of property business.

51. For completeness, I should say that I do not believe that the deeming set out in the first part of each of the relevant provisions in Chapter 4 of Part 4 of the CTA 2009 demonstrates that the conclusion which I have reached in paragraphs 41 to 50 above is wrong and that transactions which do not give rise to items of an income nature cannot be taken into account in computing the taxable profits of a property business. This is because, in the case of many of the provisions, such as Section 217 of the CTA 2009 itself, the capital receipt which is the subject of the relevant provision is all that arises in respect of the property as a result of the transaction in question. Accordingly, as I have noted in paragraphs 34 to 40 above, were it not for the deeming provision, the company might not be treated as carrying on a property business with the property in question at all. For instance, but for the deeming in Section 217(2)(a) of the CTA 2009, a company which sought to benefit from its property solely by way of granting short leases in return for premiums would not be carrying on a property business in relation to that property at all.

52. In summary, I believe that the Respondents have erred in this case by failing to distinguish between, on the one hand, the circumstances which are required to exist in order for there to be a property business and, on the other hand, the identification of the transactions which should be taken into account in calculating the taxable profits of that business once it has been established that that business does exist. Again, to adopt the analogy of a taxpayer carrying on a trade, I think that it would generally be accepted that, despite the fact that the acquisition and disposal of a capital asset which is used in the course of a trade give rise to

expenditure and receipts of a capital nature, those transactions are nevertheless carried out in the course of carrying on the trade and are therefore to be taken into account (albeit subject to the rules in relation to capital expenditure and capital receipts) in calculating the profits of the trade. In each case, one needs to separate the identification of the activity – whether that be the exploitation of land as a source of rents or other receipts or the activity of selling items of stock in the course of a trade – from the transactions which are to be taken into account in calculating the taxable profits from that activity because they take place in the course of carrying on that activity. And, in my view, acquisitions and disposals of capital assets which have been used, whilst held, to carry on the relevant activity should be taken into account in calculating the taxable profits arising from that activity and regarded as taking place in the course of that activity.

53. Based on my conclusion above, the transaction comprising the sale of the Power Station was a transaction which should properly be taken into account in calculating the taxable profits arising from the Appellant's property business and therefore the items which were brought into account as credits and debits in calculating the profits shown in the Appellants profit and loss as a consequence of that transaction were capable of being taken into account in the calculation of the taxable profits of the property business, subject only to the provisions listed in Section 210(2) of the CTA 2009, of which Sections 53 and 93 of the CTA 2009 are the most relevant in the present context.

Identifying the transaction which gave rise to the DRE

54. However, even if the view which I have reached in paragraphs 33 to 53 above is wrong, there is a second, quite separate, reason why I consider that the Appellant is entitled to succeed in relation to Issue 1. This is that the DRE in question was quite plainly incurred by the Appellant for the purpose of maintaining and overhauling the Power Station in the period in which the Appellant was leasing the Power Station to Power Ltd. As the DRE was revenue expenditure incurred by the Appellant in the course of carrying on the property business, the Appellant was entitled to relief for that DRE if and when the DRE was brought into account as a debit in calculating the profits shown in the Appellant's profit and loss account and that was the case even if the transaction which triggered the DRE's being so reflected was a transaction occurring other than in the course of carrying on the property business.

55. Putting this another way, the correct measure of the taxable profits of the Appellant's property business could be calculated only by taking into account both the income which the Appellant derived from exploiting the Power Station and the expenditure which the Appellant incurred in order to derive that income, in each case to the extent that the relevant income and expenditure was brought into account as a credit or debit in calculating the profits shown in the Appellant's profit and loss account. The DRE was expenditure which fell within the above description in that it was expenditure which the Appellant incurred in order to derive the rental income from Power Ltd. Thus, if the DRE were to be excluded from the computation of the taxable profits of the property business, notwithstanding the fact that it was brought into account as a debit in calculating the profits shown in the Appellant's profit and loss account, then those taxable profits would be being over-stated.

56. Putting it yet a third way, the event which can most appropriately be described as the true cause of the DRE's being brought into account as a debit in calculating the profits shown in the Appellant's profit and loss account (assuming it was so brought into account – as to which, see Issue 2 below) was not the sale of the Power Station but was instead the incurring of the DRE. The latter definitely occurred in the course of carrying on the property business regardless of one's views on whether the sale of the Power Station was an event which should be taken into account in computing the taxable profits of the property business. Whilst the sale was the trigger for the DRE's being brought into account as a debit in calculating the profits shown in the Appellant's profit and loss account (assuming it was so brought into account),

the reason why the DRE was incurred in the first place was to keep the Power Station fit for purpose during the period in which the Appellant carried on the property business so that the Appellant could continue to receive rent from the Power Station and therefore the debit in respect of the DRE should be regarded as being attributable to its being incurred in the first place and not to the sale, as such.

Outcome in relation to Issue 1

57. For the above reasons, I consider that the Appellant is entitled to succeed in relation to Issue 1.

Issue 2

58. I turn now to address Issue 2.

The Respondents' submissions in relation to Issue 2

59. The Respondents submitted that, even if they were wrong in saying that an item brought into account as a debit in calculating the profits shown in the Appellant's profit and loss account in connection with the sale of the Power Station was not permitted to be taken into account in calculating the taxable profits of the Appellant's property business, no item was in fact so brought into account in the Appellant's profit and loss account for the financial year ending 31 December 2011. This was for the following reasons:

(1) Section 46 of the CTA 2009 (as incorporated into Part 4 of the CTA 2009 by Section 210 of the CTA 2009) required that the taxable profits of the property business had to be calculated in accordance with generally-accepted accounting practice, subject to any adjustment required or authorised by law;

(2) it was common ground that the profit and loss account for the financial year ending 31 December 2011had been prepared in accordance with generally-accepted accounting practice;

(3) Section 48 of the CTA 2009 (again, as incorporated into Part 4 of the CTA 2009 by Section 210 of the CTA 2009) provided that, in the Corporation Tax Acts, in the context of the calculation of the taxable profits of the property business, references to receipts and expenses were to "any items brought into account as credits or debits in calculating the profits";

(4) no debit in respect of the DRE had been brought into account in calculating the profits in this case because:

(a) the accounting experts were *ad idem* in saying that the only amount which appeared in the profit and loss account in respect of the sale of the Power Station was the difference between the sale proceeds and the net book value of the Power Station;

(b) although the sale proceeds and the net book value had been brought into account in the underlying books of the Appellant, that was neither here nor there because the books themselves were not part of the accounts; and

(c) in any event, the entries in the books, to the extent that they related to the derecognition of the Power Station and the recognition of the sale proceeds (in this case, in the form of the liabilities assumed by Power Ltd as purchaser) were balance sheet matters and not profit and loss account matters. Only the difference, if any, between those two items was recognised in the profit and loss account, and there was no such difference in the present case;

(5) the above conclusion meant that there was no amount which was brought into account as a credit or debit in calculating the profits shown in the profit and loss account to which an adjustment that was required or authorised by law could be made; and

(6) this approach had nothing to do with the fact that, in this case, the two amounts – that is to say, the sale proceeds and the net book value of the Power Station – were equal. The same analysis would apply even if the sale had given rise to a profit or a loss. In that event, on the assumption that the Respondents were wrong in relation to Issue 1:

(a) if the sale of the Power Station had given rise to a profit, then the credit for that profit appearing in the profit and loss account would have fallen to be excluded from the calculation of the taxable profits of the property business by Section 93 of the CTA 2009. That exclusion would have been the sole adjustment required by law; and

(b) conversely, if the sale of the Power Station had instead given rise to a loss, then the debit for that loss appearing in the profit and loss account would have been a permissible deduction to the extent that it related to the DRE but would have fallen to be excluded from the calculation of the taxable profits of the property business by Section 53 of the CTA 2009 to the extent that it related to the capital expenditure on the Power Station. The latter would have been the sole adjustment required by law.

60. The Respondents submitted that their conclusion to the effect that no amount in respect of the sale proceeds or the DRE had been brought into account as a credit or debit in calculating the profits shown in the profit and loss account and that therefore no adjustment was required by law to the profits appearing in that account was supported by two decisions – the decision of the Court of Appeal in *NCL Investments Limited v The Commissioners for Her Majesty's Revenue and Customs* [2020] EWCA Civ 663 ("*NCL*") and the decision of the House of Lords in *The Commissioners for Her Majesty's Revenue and Customs v William Grant & Sons Distillers Limited and Small (Inspector of Taxes) v Mars UK Limited* [2007] UKHL 15 ("*William Grant*"), noting that the former decision was currently under appeal to the Supreme Court.

61. In the view of the Respondents, *NCL* established that the only receipts and expenses which fell to be taken into account for tax purposes pursuant to Sections 46 and 48 of the CTA 2009 were the items of income and expenditure which were "recognised" or "accounted for" in the profit and loss account. The case involved other issues as well but its relevance to this appeal lay in the fact that the starting point for any calculation of the taxable profits of a trade – and, by extrapolation, the taxable profits of a property business – was to identify the credits and debits which had been recognised in the profit and loss account. In this case neither a credit nor a debit had been recognised in the profit and loss account in respect of the sale of the Power Station.

62. The Respondents referred to two first instance decisions which they said had made the same point. In *Jenners Princes Street Edinburgh Limited v Inland Revenue Commissioners* [1998] STC(SCD) 196 ("*Jenners*"), the Special Commissioners had held that a taxpayer was entitled to deduct a provision which appeared in its accounts in respect of repairs to its premises on the basis that the amount of the provision had been "actually expended". In *Turners (Soham) Limited v The Commissioners for Her Majesty's Revenue and Customs* [2019] UKFTT 131 (TC) ("*Turners*"), the First-tier Tribunal had held that, in the absence of any requirement of law which authorised or required a deduction for tax purposes, a taxpayer was not entitled to a deduction for any expense which had not been debited in the profit and loss account. Each of those cases therefore exemplified the fact that, subject to any requirement or authorisation by law, the deductibility of an item depended on its appearing as a debit in the profit and loss account.

63. The Respondents added that the decision in *William Grant* reinforced the conclusion that, subject to any requirement or authorisation by law, only amounts actually "recognised" or "accounted for" in the profit and loss account could be taken into account in calculating the

taxable profits of a trade or, by extension, a property business. This was because *William Grant* made it apparent that calculations which were anterior to a figure which appeared in the profit and loss account were of no relevance in this context and that the mere fact that an amount featured as part of those calculations was insufficient to mean that the relevant amount was being "recognised" or "accounted for".

64. *William Grant* related to the treatment in the accounts of capital asset depreciation which, as a capital item, was required to be disregarded when it came to calculating the taxable profits of the trade. In the case of the appellants in that case, the aggregate capital asset depreciation had two components – part A was the depreciation that related to stock which was sold in the financial year in question or that related to assets which had not been used for the production of stock and part B was the depreciation that related to stock which was not sold in the financial year in question. The appellants had deducted part A in their respective profit and loss accounts and had carried part B forward as part of the cost of the unsold stock. The notes to the accounts made it clear that part A had been calculated by taking the aggregate depreciation and then deducting part B, which led the Respondents in that case to argue that the amount to be added back in calculating the taxable profits of the trade was the aggregate depreciation and not merely part A. The Respondents in this appeal submitted that, in rejecting that proposition, the House of Lords had held that only part A was to be added back because only part A had been debited in the relevant profit and loss account and that the fact that part B was taken into account in determining part A was irrelevant.

65. Finally, the Respondents pointed out that, in any event, the Appellant had not borne the economic cost of the DRE because the relevant expenditure had been reimbursed by Power Ltd as a result of the DRE's being taken into account in the calculation of the consideration for the sale of the Power Station.

Conclusion in relation to Issue 2

66. My conclusion in relation to Issue 2 is that the Respondents are wrong to say that the sale proceeds and the DRE in this case were not "items brought into account as credits or debits in calculating the profits" shown in the profit and loss account. In my view, they have reached that incorrect conclusion by adopting too narrow a construction of the term in quotation marks above.

67. It is common ground that, when the nil amount was reflected in the profit and loss account in respect of the sale of the Power Station, that nil amount was calculated by deducting the net book value of the Power Station from the sale proceeds. If nothing else, the entries in the books of the Appellant demonstrate that that is how the nil amount was determined. In my view, it follows inexorably from that fact that the sale proceeds were brought into account as a credit in calculating the profits shown in the profit and loss account and that, similarly, the net book value of the Power Station was brought into account as a debit in calculating those profits. The fact that the credit and debit in question appeared only in the books of the Appellant and did not appear in the profit and loss account itself is of no moment in this context because I can see nothing in the language used in Sections 46 and 48 of the CTA 2009 which compels the conclusion that the only credits and debits which may be taken into account for this purpose are those credits and debits which appear in the profit and loss account itself. All that matters is that the relevant item has been brought into account as a credit or debit in calculating the profits. In that regard, in this case, if the sale proceeds had been a smaller amount, then the profits of the financial year in which the sale occurred would have been lower and, if the net book value had been a smaller amount, then the profits of the financial year in which the sale occurred would have been greater. On the basis of those facts, if one were to ask oneself whether the sale proceeds have been brought into account as a credit in calculating the Appellant's profits in respect of the relevant financial year and whether the net book value has been brought into account as a debit in calculating the

Appellant's profits in respect of the relevant financial year, there would be only one logical answer, which is that they have.

68. There is nothing either express or implied in the language of Sections 46 and 48 of the CTA 2009 which limits the items to be treated as having been brought into account as credits and debits in calculating the profits shown in the profit and loss account to the items actually set out in the profit and loss account. An item which has increased or reduced those profits because it featured as a credit or debit in the calculation of an amount set out in the profit and loss account is just as much brought into account as a credit or debit in calculating the profits as an item which appears as a credit or debit on the face of the profit and loss account. The Respondents accept that this is the case when it comes to aggregating, within the profit and loss account, the credits and debits arising from a number of different events and transactions but for some reason they fail to extend that same logic to a case such as the present one, where the credit and debit comprising the single composite item which appears in the profit and loss account both arose from the same event or transaction. I can see no difference between the two circumstances, whether in terms of principle or in terms of the impact on the calculation of profits or losses.

69. I also do not agree with the dichotomy which the Respondents have sought to draw in this context between credits and debits in the balance sheet and credits and debits brought into account in calculating the profits shown in the profit and loss account. The two accounts are dealing with completely different things – the balance sheet sets out the assets and liabilities of the relevant company at a particular point in time whereas the profit and loss account sets out the profits or losses of the relevant company over a particular period of time. The fact that, when an asset is the subject of a disposal, the asset is required to be derecognised in the balance sheet and the proceeds of sale are required to be recognised in the balance sheet tells one nothing about the items which are to be brought into account as credits and debits in calculating the profits shown in the profit and loss account in respect of the disposal. Even on the Respondents' own analysis, in circumstances where the proceeds of a sale exceed the cost of the asset which is the subject of the sale, the part of the sale proceeds which exceeds the cost of the asset in question is required to be shown in both the balance sheet (along with the rest of the sale proceeds, as a newly-recognised asset,) and in the profit and loss account (as the profit on the disposal). So there is clearly no reason in principle why the same item cannot both be reflected in the balance sheet and brought into account as a credit or debit in calculating the profits shown in the profit and loss account.

70. Turning then to the first of the cases which the Respondents claimed supported their position, the ratio of the relevant part of the decision in *NCL* was that a debit appearing in the profit and loss account which did not reflect any past or prospective outgoing from the taxpayer in question could still be said to be an expense incurred by the taxpayer for the purposes of Part 3 of the CTA 2009. The decision was therefore addressing the question of whether a debit which appeared in the profit and loss account of a taxpayer but which did not reflect an actual payment could nevertheless be said to be an expense incurred by the taxpayer. That is a completely different point from the one which falls to be addressed in this appeal, which is how the items which have been brought into account as credits and debits in calculating the profits of a taxpayer are to be identified. The same can be said of the decision in *Jenners*, which concerned a similar question – on that occasion, an accounting debit for a provision in relation to a payment which had not been made in the same financial year as that to which the debit related.

71. *Turners* is also of no assistance in the present appeal but for a different reason. Unlike *NCL* and *Jenners*, *Turners* did not relate to the question of whether an amount which was brought into account as a debit in calculating the profits but which either was never going to be paid or was not paid in the same financial year as that in which the debit was brought into account could be said to be expended. Instead, it related to whether there was an express

provision in the legislation which could be construed as authorising a deduction for an amount which had not been brought into account as a debit in calculating the profits. However, again, it did not address the question of how the items which had been so brought into account should be identified.

72. It follows from the above conclusion that I see no relevance to the present appeal of the decisions in *NCL*, *Jenners* or *Turners*. None of those cases was dealing with the question which is at the heart of the present appeal – namely, the extent to which a receipt or expense which has had an impact on the profits appearing in the profit and loss account (in the sense that those profits would have been smaller or larger but for being affected by the relevant item) but which has not appeared as a distinct item in the profit and loss account itself can be said to have been brought into account as a credit or debit in calculating those profits. I have no doubt that it can be said to have done so and that the contrary conclusion would involve adopting an unnecessarily restricted approach to the construction of Sections 46 and 48 of the CTA 2009. This is not a case where the taxpayer is seeking relief for an expense which has not depleted its commercial profits and, in doing so, is seeking to rely on some express or implied requirement of law. Instead, the taxpayer is, quite properly, seeking relief for expenditure which has depleted its profits for the simple reason that an amount appearing in the profit and loss account is lower than it would have been had the expenditure not been taken into account in calculating that amount.

73. In his submissions, Mr Bremner said repeatedly that, in this case, the sale proceeds had not increased the profits appearing in the profit and loss account and the DRE had not depleted those profits. I could not disagree more. In my view, that is exactly what they did, albeit that they did not appear as gross items of credit and debit in the profit and loss account.

74. Turning then to the Respondents' reliance on *William Grant*, I consider that this is based on a profound misreading of the relevant decision. In *William Grant*, the only part of the depreciation which appeared as a debit in the relevant profit and loss account and therefore depleted the profits of the relevant appellant was the part A depreciation. The part B depreciation was not something which was taken into account as a debit in calculating the profits shown in the profit and loss account at all. Instead, pursuant to the applicable accounting standards – paragraph 77 of FRS 15 and paragraphs 17 and 20 of Statement of Standard Accounting Practice 9 - the part B depreciation:

(1) did not need to be debited to the profit and loss account at all; and

(2) could instead be carried forward as part of the unsold stocks.

75. The Respondents' position in *William Grant* was that both parts should be treated as having been debited to the profit and loss account and then an amount equal to the part B depreciation should be treated as having been credited to the profit and loss account. The House of Lords held that there was no basis for that submission because the relevant accounting standards said expressly that the part B depreciation did not need to be debited to the profit and loss account in the first place.

76. It may therefore be seen that, by its decision, the House of Lords did not set out some general principle to the effect that an amount taken into account in the calculation of an item appearing in the profit and loss account but not itself actually shown as an item in the profit and loss account could not be taken into account when it came to making the necessary adjustments for tax purposes. All that it did was hold that, where generally-accepted accounting practice stipulates that an item is not be debited in calculating the profits appearing in the profit and loss account, then there is no basis for assuming that that item has been so debited and then cancelled out by an equal and opposite credit.

77. The position in this appeal could not be more different. Here, both the sale proceeds and the DRE were items which affected the profits appearing in the profit and loss account. I

therefore consider that the House of Lords in *William Grant* would have had no difficulty in concluding that, in this case, the items were "brought into account as credits or debits in calculating the profits".

78. In summary, I consider that, when the nil amount was recognised in the Appellant's profit and loss account in respect of the sale of the Power Station, that involved bringing into account in the calculation of the Appellant's profits for the relevant financial year a credit in respect of the sale proceeds and a debit in respect of the net book value of the Power Station. The credit was then required to be disregarded in calculating the taxable profits of the Appellant's property business by Section 93 of the CTA 2009. In addition, the debit in respect of the net book value of the Power Station, to the extent that it related to the capital expenditure which had been incurred by the Appellant on the Power Station, was required to be disregarded in calculating the taxable profits of the Appellant's property business by Section 53 of the CTA 2009. Both of those adjustments were adjustments required by law as mentioned in Section 46 of the CTA 2009. The two adjustments meant that only the debit in respect of the DRE which was a component of the calculation described above remained to be taken into account in calculating the taxable profits of the Appellant's property business.

79. As for the Respondents' point that the Appellant did not bear the economic cost of the DRE because the sale consideration included an amount which was calculated by reference to the DRE, I believe that this is also mistaken. It confuses two entirely separate things - on the one hand, a capital receipt on the sale of the Power Station and, on the other hand, revenue expenditure incurred by the Appellant in the course of carrying on the property business before the sale. Those two things are entirely distinct for tax purposes. From the technical perspective, the answer in this case cannot possibly be affected by whether or not the consideration happened to reimburse the Appellant for the DRE in question. The principles to be applied would be the same even if the sale proceeds had been insufficient to cover the DRE. Moreover, there are numerous situations where a seller is able to achieve higher capital proceeds on the sale of an asset because it has incurred revenue expenditure in maintaining the asset in question prior to the sale and this quite rightly is disregarded in addressing the question of whether the revenue expenditure has been brought into account as a debit in calculating the profits shown in the profit and loss account. Once it is accepted that expenditure has a revenue nature, the deductibility of that revenue expenditure does not turn on whether or not the expenditure in question was reimbursed through the receipt of the capital proceeds of a sale.

80. I would add that this is a totally different question from the one addressed by the Upper Tribunal in *Ingenious Games LLP and others v The Commissioners for Her Majesty's Revenue and Customs* [2019] UKUT 226 (TCC), where the taxpayers had entered into a non-recourse borrowing to finance 70 of the 100 which each of them had provided for the production of films and the Upper Tribunal held (on an obiter basis) that the 70 had not in any meaningful sense really been incurred. In this case, there can be no doubt that the DRE was actually incurred by the Appellant when it bore the cost of the overhauls and maintenance in question and that did not change merely because the Appellant was subsequently able to sell the Power Station for a capital sum which happened to enable it to recoup the cost of the DRE in question. I do not think that the Respondents intended this point as a serious challenge to the deductibility of the DRE in this case but, to the extent that they did, I do not accept it.

Additional observations

Introduction

81. The above analysis explains why, in my view, the Appellant is entitled to succeed in its appeal as a matter of law.

82. However, for completeness, I think it is important to add that the conclusions I have reached above in relation to the law are, in my opinion, also ones which:

(1) give rise to the fair result so far as the Appellant is concerned; and

(2) enable the tax system so far as it pertains to this area of the law to operate effectively and appropriately.

Fairness

83. My starting point in this regard is to note that, given that the taxable profits of a taxpayer in carrying on a property business are required to be calculated in accordance with the accounts of the relevant taxpayer, it is axiomatic that revenue expenditure which the taxpayer has incurred in carrying on the property business and which has depleted the profits shown in its profit and loss account should be deductible in computing those taxable profits. Any other answer would mean that the taxpayer would be being denied relief for expenses of a revenue nature which have been reflected in, and have depleted, the aggregate profits that have been shown in the accounts of the relevant taxpayer over the financial years in which it has carried on the property business and that result cannot conceivably be right or fair.

84. Despite their assertion that the DRE in this case was not "recognised" or "accounted for" in the profit and loss account of the Appellant in respect of its financial year ending 31 December 2011, both the Respondents and their expert, Mr Vickers, readily accepted that the nil profit which was shown in that account reflected, or was the outcome of, a debit in the Appellant's books in respect of that DRE and an equal and opposite credit in the Appellant's books in respect of the sale proceeds. Thus, it is common ground that the profits of the Appellant in respect of that financial year were depleted by the DRE or, to put it another way, that the profits of the Appellant in respect of that financial year would have been higher if the amount of the sale proceeds had remained the same and the DRE had not been incurred. As that was the case, it would, in my view, be wholly inappropriate for the taxable profits of the Appellant's property business to be calculated without taking into account a deduction for the DRE.

85. Following on from that point, I think it is helpful to compare two taxpayers, each of which adopts a different accounting treatment for maintenance expenditure of a revenue nature which it incurs in the course of carrying on a property business. Let us assume for this purpose that, in each case:

(1) a property was acquired for 100 on the first day of a financial year and was sold on the final day of the financial year for 110;

(2) during the course of the financial year, the taxpayer in question incurred 10 on expenditure of a revenue nature in maintaining the property; and

(3) in one case, the taxpayer chose to treat the expenditure of 10 as an expense in its profit and loss account whereas, in the other case, the taxpayer chose to capitalise the expenditure of 10.

86. In the first case described above, the profit and loss account in respect of the relevant financial year would show an expense of 10 and a profit on sale of 10 – and thus a nil net profit overall - whilst, in the second case described above, the profit and loss account in respect of the relevant financial year would show no expense and a profit of nil in respect of the sale – and thus also a nil net profit overall. In both cases, therefore, the relevant taxpayer would have recorded the same nil net profit overall and that nil net profit would have reflected (in that it would have been higher by 10 but for) the revenue expenditure of 10. Logic suggests that, in the context of an accounts-based calculation which excludes capital receipts from its scope, the taxable profits of the property business should be the same in both cases. However, if the Respondents' analysis were to be correct, the taxpayer in the first case would make a loss in respect of the property business of 10 whereas the taxpayer in the second case would make neither a profit nor a loss in respect of the property business. That is neither equitable nor logical.

87. Another way of testing the fairness of my conclusion is to consider the position over the whole life of a property which is used in the course of a property business but has multiple owners. In that case, each purchaser is unable to claim a deduction for any part of its purchase price because that constitutes a capital expense of its property business for which relief is denied by Section 53 of the CTA 2009. Thus, to the extent that that purchase price reflects the fact that the property has been properly maintained by the seller through incurring DRE such as overhaul and maintenance costs, the failure of the seller to obtain relief for the DRE would mean that no person obtained relief for it. That result seems contrary to principle because one would expect that, over the life of a property, all revenue expenditure should qualify for relief in the hands of one or other of the property owners.

88. The specific facts of this case are complicated by the fact that the Appellant's purchaser, Power Ltd, in addition to acquiring the Power Station on the no gain/no loss basis required by Section 171 of the Taxation of Chargeable Gains Act 1992 (the "TCGA"), did not itself lease out the Power Station and therefore the Power Station was not used in the course of a property business in its hands. Nevertheless, there was still no basis on which, as purchaser, Power Ltd would have been entitled to claim any relief for the DRE and so the general point made in paragraph 87 above remains valid.

89. On the subject of chargeable gains, I should add that, as revenue expenditure on maintaining an asset falls outside the various categories of expenditure set out in Section 38 of the TCGA which qualify as base cost on the disposal of a chargeable asset, the consequence of the Respondents' position in this case is that the DRE would qualify for no relief for tax purposes at all.

The tax system

90. Finally, I should observe that the conclusion I have reached above is entirely compatible with the system for calculating the taxable profits of a trade which has operated in the UK for many years. In contrast, were the submissions of the Respondents in this appeal to succeed, that would drive a coach and horses through that system and render it incapable of functioning effectively and appropriately. There are of course many provisions in the tax legislation which require or authorise adjustments to be made to the profits of a trader in order to determine the taxable profits of the trader's trade. Two of the most significant are the ones relating to capital receipts and capital expenses which are relevant to this appeal. For example, it is standard practice in calculating the taxable profits of a trade to start with the profits and then write back accounting depreciation and deduct capital allowances.

91. The exclusion of capital items from the calculation of the taxable profits of a trade creates a capital/income divide for tax purposes which does not exist for accounting purposes. As a result, I expect that it would not be uncommon for the profit and loss account of a trader to include a single amount which reflects the net of a capital item and an income item, as opposed to including both of the constituent items on a gross basis. That is what has occurred in this case. On this particular occasion, where the constituent items involved a receipt of a capital nature and an expense of a revenue nature, the Respondents' position clearly benefits them. But there might well be circumstances where the constituent items are a receipt of a revenue nature and an expense of a capital nature and I cannot help wondering whether the Respondents would have been quite so assiduous in adopting the position which they have taken in this appeal had that been the fact pattern in this case. Be that as it may, for the reasons which I have set out above, I consider that the Respondents' position in this case is not only unsound as a matter of law but would, if adopted, give rise to an unfair result for the Appellant and cause potentially significant upheaval in relation to this aspect of UK taxation regime more generally.

Outcome in relation to Issue 2

92. For the above reasons, I consider that the Appellant is entitled to succeed in relation to Issue 2.

CONCLUSION

93. For the reasons set out in this decision, I uphold the Appellant's appeal in principle. That disposes of the appeal, subject to the agreement of the parties in relation to the quantum of the DRE which is deductible. Should the parties fail to reach agreement on the figures, I will address that issue at that stage.

94. For the record, I should say that I mean no disrespect to Mr Gammie by including in the paragraphs above so few references to his submissions. I have taken that approach only because to have done so would unnecessarily have prolonged this decision. I am grateful to him for those submissions and, as he will see from the conclusions I have reached, with the exception of the point made in paragraphs 37 to 40 above in relation to the decision in *McClure*, I agree with those submissions in their entirety.

RIGHT TO APPLY FOR PERMISSION TO APPEAL

95. This document contains full findings of fact and 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 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.

TONY BEARE
TRIBUNAL JUDGE

RELEASE DATE: 18 MAY 2021

APPENDIX
RELEVANT PROVISIONS IN THE SOP AND FRSS

THE SoP

"4.40 The terms 'gains' and 'losses' therefore include items that are often referred to as 'revenue' and 'expenses', as well as gains and losses arising from, for example, the disposal of fixed assets and the remeasurement of assets and liabilities.

Offsetting gains and losses

4.41 Some transactions give rise to a gain (or a loss) that is the net of two amounts: the revenue or income arising from the transaction and the expenses or costs incurred in generating that revenue. For example, the profit that arises on selling an item of stock is the difference between the sale proceeds and the cost of the item sold. For the purpose of the Statement, the sale proceeds and cost of the item sold are separate items—the former being a gain and the latter a loss. Whether such gains and losses are shown separately in the financial statements is a presentation issue and is considered in Chapter 7….

CHAPTER 5:

RECOGNITION IN FINANCIAL STATEMENTS

When the reporting entity undertakes a transaction or when some other relevant event occurs, the effect of that transaction or event on the elements of financial statements will need to be recognised in the financial statements if certain criteria are met. This chapter considers that recognition process.

PRINCIPLES

• If a transaction or other event has created a new asset or liability or added to an existing asset or liability, that effect will be recognised* if:

(a) sufficient evidence exists that the new asset or liability has been created or that there has been an addition to an existing asset or liability; and

(b) the new asset or liability or the addition to the existing asset or liability can be measured at a monetary amount with sufficient reliability.

In a transaction involving the provision of services or goods for a net gain, the recognition criteria described above will be met on the occurrence of the critical event in the operating cycle involved.

An asset or liability will be wholly or partly derecognised† if:

(a) sufficient evidence exists that a transaction or other past event has eliminated◊ all or part of a previously recognised asset or liability; or

(b) although the item continues to be an asset or a liability, the criteria for recognition are no longer met.

* The term ‘recognised’ is used in the Statement to mean depicting an item both in words and by a monetary amount and including that amount in the primary financial statement totals.
† The term ‘derecognised’ is used in the Statement to mean that an item ceases to be recognised.
◊ To simplify the text, the word ‘eliminated’ is used in this chapter in place of the phrase ‘consumed, transferred, disposed of, expired, settled or extinguished’.

….

GOOD PRESENTATION

Statement of financial performance

7.9 The financial performance of a reporting entity is made up of components that exhibit differing characteristics in terms of, for example, nature, cause, function, relative continuity or recurrence, stability, risk, predictability and reliability. All these components are relevant to an assessment of financial performance and therefore need to be reported on in the statement of financial performance, although their individual characteristics mean that some will carry more weight in some assessments of financial performance than others.

7.10 Information on financial performance needs to be presented in a way that focuses attention on these components and on their key characteristics. Therefore, although it is not of fundamental importance whether one or more than one performance statement is provided, the presentation—including the headings used and the items that appear under each heading—is important. Good presentation of financial performance information typically involves:

(a) recognising only gains and losses in the statement of financial performance.

(b) classifying components by reference to a combination of function (such as production, selling and administrative) and of the nature of the item (such as employment costs, interest payable and amounts written off investments).

(c) distinguishing amounts that are affected in different ways by changes in economic conditions or business activity (for example, by providing segmental information or by presenting income from continuing and discontinued operations as separate components).

(d) identifying separately:

(i) items that are unusual in amount or incidence judged by the experience of previous periods or expectations of the future.

(ii) items that have special characteristics, such as financing costs and taxation.

(iii) items that are related primarily to the profits of future, rather than current, accounting periods, such as some research and development expenditure.

7.11 Gains and losses are generally not offset in presenting information on financial performance. For example, as explained in Chapter 4, if a transaction involves both a receipt and a cost (as is the case, for example, when an item of stock is sold), the transaction will usually be best presented by showing the gain (the receipt) separately from the loss (the cost). However, gains and losses will be offset if:

(a) they relate to the same event or circumstance; and

(b) disclosing the gross components is not likely to be useful for an assessment of either future results or the effects of past transactions and events.

For example, if a profit is made on the disposal of a fixed asset, that profit is usually best presented by showing it as a gain rather than by showing the sales proceeds as a gain separately from the depreciated cost of the asset."

FRS 1

"42 When a futures contract, forward contract, option contract or swap contract is accounted for as a hedge, the cash flows of the contract should be reported under the same standard heading as the transaction that is the subject of the hedge."

FRS 3

"21 The profit or loss on the disposal of an asset should be accounted for in the profit and loss account of the period in which the disposal occurs as the difference between the net sale proceeds and the net carrying amount, whether carried at historical cost (less any provisions made) or at a valuation."

FRS 6

"13 A group reconstruction may be accounted for by using merger accounting, even though there is no business combination meeting the definition of a merger, provided:

(a) the use of merger accounting is not prohibited by companies legislation; [6 Sch 10, of the Regulations]

(b) the ultimate shareholders remain the same, and the rights of each such shareholder, relative to the others, are unchanged; and

(c) no minority's interest in the net assets of the group is altered by the transfer….

38 The accounting practices set out in the FRS should be regarded as standard in respect of business combinations first accounted for in financial statements relating to accounting periods commencing on or after 23 December 1994. Earlier adoption is encouraged but not required."

FRS 12

"Reimbursements

56 Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised only when it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement should not exceed the amount of the provision.

57 In the profit and loss account, the expense relating to a provision may be presented net of the amount recognised for a reimbursement."

FRS 15

"72 The profit or loss on the disposal of a tangible fixed asset should be accounted for in the profit and loss account of the period in which the disposal occurs as the difference between the

net sale proceeds and the carrying amount, whether carried at historical cost (less any provisions made) or at a valuation. Profits or losses on the disposal of fixed assets should be shown in accordance with FRS 3 Reporting Financial Performance….

Depreciation

Depreciable amount

77 The depreciable amount of a tangible fixed asset should be allocated on a systematic basis over its useful economic life. The depreciation method used should reflect as fairly as possible the pattern in which the asset's economic benefits are consumed by the entity. The depreciation charge for each period should be recognised as an expense in the profit and loss account unless it is permitted to be included in the carrying amount of another asset….

95 Where the residual value is material it should be reviewed at the end of each reporting period to take account of reasonably expected technological changes based on prices prevailing at the date of acquisition (or revaluation). A change in its estimated residual value should be accounted for prospectively over the asset's remaining useful economic life, except to the extent that the asset has been impaired at the balance sheet date….

APPENDIX IV – The development of the FRS

Reporting gains and losses on disposal

35 FRS 3 requires gains and losses on disposal to be recognised in the profit and loss account in the period in which the disposal took place, calculated as the difference between carrying amount and the net sale proceeds. This treatment of gains and losses on disposals is inconsistent with the treatment of gains and losses on revaluation. For example, a revaluation gain would be recognised in the statement of total recognised gains and losses, whereas a subsequent gain on disposal would be recognised in the profit and loss account, even though both gains were due to the same factors (ie rising market prices)."

FRS 18

"The following definitions shall apply in the FRS and in particular in the Statement of Standard Accounting Practice set out in bold type.

Accounting policies:-

Those principles, bases, conventions, rules and practices applied by an entity that specify how the effects of transactions and other events are to be reflected in its financial statements through

(i) recognising,
(ii) selecting measurement bases for, and
(iii) presenting

assets , liabilities, gains, losses and changes to shareholders' funds….

Accounting policies define the process whereby transactions and other events are reflected in financial statements. For example, an accounting policy for a particular type of expenditure may specify whether an asset or a loss is to be recognised; the basis on which it is to be measured; and where in the profit and loss account or balance sheet it is to be presented…."

FRS 102

“Derecognition

17.27 An entity shall derecognise an item of property, plant and equipment:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

17.28 An entity shall recognise the gain or loss on the derecognition of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 20 Leases requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.

17.29 In determining the date of disposal of an item, an entity shall apply the criteria in Section 23 *Revenue* for recognising revenue from the sale of goods. Section 20 applies to disposal by a sale and leaseback.
17.30 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item….”