



Appeal number
FTC/46/2010

Corporation Tax – intangible fixed assets – goodwill – Finance Act 2002 Schedule 29 – taxpayer purchased business and internally generated goodwill from associated company after commencement date – whether internally generated goodwill within definition in para 4(2) – whether goodwill created by taxpayer after commencement date within para 118(1)(a)

**UPPER TRIBUNAL
TAX AND CHANCERY CHAMBER**

GREENBANK HOLIDAYS LIMITED

Appellant

- and -

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

Respondents

Tribunal: The Hon Mr Justice Arnold

Sitting in public in London on 4 April 2011

Francis Fitzpatrick, instructed by Reynolds Porter Chamberlain LLP, for the Appellant

**Christopher Tidmarsh QC and Nicola Shaw, instructed by HMRC Solicitor's Office, for
the Respondents**

MR JUSTICE ARNOLD:

Introduction

1. This is an appeal by Greenbank Holidays Ltd from a decision of the First-Tier Tribunal (Tax) (Sir Stephen Oliver QC and Mark Buffery FCA) (“the Tribunal”) dated 8 March 2010 [2010] UKFTT 109 (TC) by which the Tribunal dismissed Greenbank’s appeal against an amendment by HMRC pursuant to paragraph 34 of Schedule 18 to the Finance Act 1998 to Greenbank’s corporation tax return for the accounting period ending on 30 September 2003. The effect of the amendment was to disallow a deduction claimed by Greenbank in respect of goodwill purchased by Greenbank from Keyline Continental Ltd (“Keyline”), an associated company, on 30 September 2003 (“the Goodwill”). Greenbank elected to write down the cost of the Goodwill at an annual fixed rate of 4% pursuant to paragraphs 10 and 11 of Schedule 29 to the Finance Act 2002. HMRC disallowed the deduction on the ground that the Goodwill was created before the commencement date of Schedule 29, namely 1 April 2002.

The facts

2. There is no dispute as to the facts, which are set out in paragraphs 6-9 of the Tribunal’s decision. They may be summarised as follows. Both Greenbank and Keyline were members of the same group of companies. By an agreement dated 30 September 2003 Keyline sold its business (save for certain excepted assets) to Greenbank for just over £46.6 million. Greenbank’s accounts for the year ending 30 September 2003 showed, in accordance with generally accepted accounting practice, an entry for “goodwill” on the balance sheet of just over £37.1 million. This is the Goodwill in issue. The value ascribed to the Goodwill reflected the difference between the purchase price of £46.6 million and the value of the net identifiable assets of the business acquired by Greenbank from Keyline. By contrast, no matching or related entry for goodwill appeared in Keyline’s accounts for the period prior to the sale.

The relevant provisions of Schedule 29

3. Schedule 29 to the Finance Act 2002, “Gains and losses of a company from intangible fixed assets”, was introduced as a new corporation tax code for intangible fixed assets. In essence, the code brought the tax treatment of intangible fixed assets into line with the manner in which such items were treated in a company’s accounts and treated gains in respect of them as income for corporation tax purposes.
4. The relevant provisions of Schedule 29 as they stood at the material time were as follows:

“PART 1

INTRODUCTION

...

Intangible assets

- 2.(1) In this Schedule 'intangible asset' has the meaning it has for accounting purposes.

...

Intangible fixed assets

3.

...

- (3) Unless otherwise indicated, the provisions of this Schedule apply to an intangible fixed asset whether or not it is capitalised in the company's accounts.

...

Goodwill

- 4.(1) Except as otherwise indicated, the provisions of this Schedule apply to goodwill as to an intangible fixed asset.

- (2) In this Schedule 'goodwill' has the meaning it has for accounting purposes.

....

PART 14

COMMENCEMENT AND TRANSITIONAL PROVISIONS

Commencement date

- 117.(1) The commencement date for the purposes of this Schedule is 1 April 2002.

....

Application of Schedule to assets created or acquired after commencement

- 118.(1) Except as otherwise expressly provided, the provisions of this Schedule apply only to intangible fixed assets of a company ('the company') that—

- (a) are created by the company after commencement, or

- (b) are acquired by the company after commencement from a person who at the time of the acquisition is not a related party in relation to the company, or
- (c) are acquired by the company after commencement from a person who at the time of the acquisition is a related party in relation to the company in the cases specified in sub-paragraph (2).

As to when assets are regarded as created or acquired, see paragraphs 120 to 125.

....

Assets regarded as created or acquired when expenditure incurred

120.(1) This paragraph has effect for the purposes of paragraph 118 (application of Schedule to assets created or acquired after commencement) and applies to all intangible assets except those to which paragraph 121 or 122 applies (certain internally-generated assets).

- (2) An intangible asset to which this paragraph applies is regarded as created or acquired after commencement to the extent that expenditure on its creation or acquisition is incurred after commencement.

As to whether expenditure on the creation or acquisition of the asset was incurred after commencement, see paragraphs 123 to 125.

...

Internally-generated goodwill: whether created before or after commencement

121. For the purposes of paragraph 118 (application of Schedule to assets created or acquired after commencement) internally-generated goodwill is regarded as created before (and not after) commencement if the business in question was carried on at any time before commencement by the company or a related party.

...

Expenditure on acquisition treated as incurred when recognised for accounting purposes

123(1) For the purposes of paragraph 120 (assets regarded as created or acquired when expenditure incurred) the general rule is that expenditure on the acquisition of an asset is treated as incurred when it is recognised for accounting purposes.

“For accounting purposes”

5. A number of the provisions in Schedule 29, including paragraphs 2(1) and 4(2), include the phrase “for accounting purposes”. This expression was defined by section 832 of the Income and Corporation Taxes Act 1988 (as amended by section 103(1) of the Finance Act 2002) as meaning (unless the context otherwise required) “for the purposes of accounts drawn up in accordance with generally accepted accounting practice”. “Generally accepted accounting practice” was defined by section 836A of the 1988 Act as meaning (unless the context otherwise required) “generally accepted accounting practice with respect to accounts of UK companies that are intended to give a true and fair view”.

Generally accepted accounting practice (“GAAP”)

6. At the material time, Fourth Council Directive 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies laid down certain requirements for annual accounts. Article 8 provided that Member States shall prescribe one or both of the layouts prescribed by Articles 9 and 10 for the presentation of the balance sheet. Both Article 9 and Article 10 included “Goodwill, to the extent that it was acquired for valuable consideration” amongst fixed intangible assets.
7. These provisions were implemented by Part VII and Schedule 4 of the Companies Act 1985. Section 226(3) provided that a company’s accounts “shall comply with the provisions of Schedule 4 as to the form and content of the balance sheet”. Schedule 4 prescribed two formats. Both formats included “Goodwill” amongst fixed intangible assets. The notes to the balance sheet formats specified that “Amounts representing goodwill shall only be included to the extent that the goodwill was acquired for valuable consideration”. Paragraph 36A provided that in the notes to the accounts, “It shall be stated whether the accounts have been prepared in accordance with applicable accounting standards...”. Section 256(1) defined “accounting standards” as meaning “statements of standard accounting practice issued by such body or bodies as may be prescribed by regulations”.
8. The Accounting Standards (Prescribed Body) Regulations 1990, SI 1990/1667, prescribed the Accounting Standards Board Ltd for the purposes of section 256(1) of the 1985 Act.
9. Financial Reporting Standard 10 (“FRS10”), “Goodwill and Intangible Assets”, was issued by the Accounting Standards Board Ltd in 1997. It included the following definitions in paragraph 2:

“Intangible assets:-

Non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody or legal rights.

An identifiable asset is defined by companies legislation as one that can be disposed of separately without disposing of a business of the entity. If an asset can be disposed of only as a part of the revenue-earning activity to which it contributes, it is regarded as indistinguishable from the goodwill relating to that activity and is accounted for as such.

...

Purchased goodwill:-

The difference between the cost of an acquired entity and the aggregate of the fair values of that entity's identifiable assets and liabilities. Positive goodwill arises when the acquisition cost exceeds the aggregate fair values of the identifiable assets and liabilities. Negative goodwill arises when the aggregate fair values of the identifiable assets and liabilities exceed the acquisition cost."

10. It is common ground that goodwill does not fall within the definition of "intangible asset" in FRS10 since it cannot be disposed of separately from the business of the entity.

11. FRS10 contained the following Statements of Standard Accounting Practice:

"Goodwill

7. Positive purchased goodwill should be capitalised and classified as an asset on the balance sheet.

8. Internally generated goodwill should not be capitalised.

Intangible assets

9. An intangible asset purchased separately from a business should be capitalised at its cost.

10. An intangible asset acquired as part of the acquisition of a business should be capitalised separately from the goodwill if its value can be measured reliably on initial recognition.

...

13. If its value cannot be measured reliably, an intangible asset acquired as part of the acquisition of a business should be subsumed within the amount of the purchase price attributed to goodwill.

14. An internally developed intangible asset may be capitalised only if it has a readily ascertainable value."

The expert evidence

12. Both Greenbank and HMRC adduced expert evidence before the Tribunal, Greenbank from Professor David Cairns OBE and HMRC from Matthew Blake. The experts prepared a Joint Statement setting out matters on which they agreed and on which they disagreed. Both experts were cross-examined. As the Tribunal recorded in its decision, the following matters were common ground between the experts:
- i) Some assets that may exist in a commercial or legal sense are not recognised on the balance sheet as assets in accounts drawn up under GAAP.
 - ii) Goodwill is the difference between the value of a business and the fair value of its identifiable net assets.
 - iii) On the purchase of a business, the purchaser's accounts recognise the difference between the purchase price and the fair value of the identifiable assets and liabilities that have been purchased as goodwill on the balance sheet. This is called "purchased goodwill" in the accountancy literature.
 - iv) For the purposes of both the Companies Act 1985 and FRS10, "goodwill" comprises both "purchased goodwill" and "internally generated goodwill". "Internally generated goodwill" is goodwill other than "purchased goodwill".
 - v) "Internally generated goodwill" is prohibited from being recognised on the balance sheet under GAAP.

Summary of Greenbank's contentions

13. Greenbank's primary case is that the definition of "goodwill" in paragraph 4(2) of Schedule 29 does not include internally generated goodwill. On this basis, Greenbank contends that Keyline had no goodwill within the meaning of paragraph 4(2), and that the Goodwill was created by Greenbank after 1 April 2002 within paragraph 118(1)(a) when Greenbank purchased the business of Keyline and recognised the Goodwill in its balance sheet. Greenbank's alternative case is that, even if the definition of "goodwill" in paragraph 4(2) includes internally generated goodwill, the Goodwill held by Greenbank and recognised in its accounts was purchased goodwill which was a different asset to the internally generated goodwill previously held by Keyline.

The Tribunal's decision

14. The Tribunal decided that: (i) the definition of "goodwill" in paragraph 4(2) included internally generated goodwill; and (ii) the Goodwill was created by Keyline before commencement and acquired by Greenbank, not created by Greenbank after commencement.

The appeal

15. Greenbank contends that the Tribunal erred in law on both points. It also challenges the Tribunal's handling of the expert evidence.

First issue: does "goodwill" include internally generated goodwill?

16. If the definition of "for accounting purposes" contained in section 832 of the 1988 Act and the definition of "generally accepted accounting practice" contained in section 836A of the 1988 Act are plugged into the definition of "goodwill" contained in paragraph 4(2) of Schedule 29, the full definition of "goodwill" is as follows:

"In this Schedule 'goodwill' has the meaning it has for the purposes of accounts drawn up in accordance with generally accepted accounting practice with respect to accounts of UK companies that are intended to give a true and fair view."

17. Counsel for Greenbank submitted that, on the true construction of this definition, "goodwill" was what was shown as goodwill in accounts drawn up in accordance with GAAP i.e. the finished product of the accounting process. Since GAAP only permits purchased goodwill to be recognised in such accounts, "goodwill" is restricted to purchased goodwill and does not extend to internally generally goodwill. Counsel for HMRC submitted that "goodwill" was what was treated as goodwill when drawing up accounts in accordance with GAAP i.e. during the process of preparing the accounts. Since GAAP recognises the existence of internally generated goodwill, albeit that it does not permit it to be capitalised as an asset on the balance sheet, "goodwill" includes internally generated goodwill as well as purchased goodwill.
18. Greenbank's construction emphasises the words "drawn up" in the definition, whereas HMRC's construction emphasises the words "for the purposes of". As a matter purely of language, it seems to me that both constructions are tenable. I agree with HMRC and the Tribunal, however, that HMRC's construction is the correct one for the following reasons.
19. First, although I regard Greenbank's construction as linguistically possible, HMRC's construction seems to me to be the more natural way in which to read the definition. On HMRC's construction, "goodwill" has a straightforward meaning which embraces any goodwill which an accountant would recognise as such whether or not it is capitalised on the balance sheet. On Greenbank's case the definition in paragraph 4(2) contains a trap for the unwary, since it is only when the definition is expanded that the potential significance of the words "drawn up" becomes apparent. Furthermore, on Greenbank's case the effect of those words is to restrict the definition to purchased goodwill. But if the draftsman had intended to say that goodwill meant purchased goodwill, it would have been much simpler to say so in terms.
20. Secondly, it is common ground and trite law that Schedule 29 should be construed as a whole so that, as far as possible, the various provisions make sense together. In my judgment HMRC's construction is consistent with other

provisions in Schedule 29, namely paragraphs 3(3) and 121, whereas Greenbank's is not.

21. Paragraph 3(3) expressly says that the provisions of the Schedule apply to an intangible fixed asset *whether or not* it is capitalised in the company's accounts. This makes it clear that, when paragraph 2(1) defines "intangible asset" as having the meaning it has "for accounting purposes", it does not exclude assets which are not capitalised in the company's accounts. Paragraph 4(1) provides that (except where otherwise indicated) the provisions of the Schedule apply to goodwill in the same way as to an intangible fixed asset. This implies that the definition of goodwill in paragraph 4(2) does not exclude goodwill which is not capitalised in the company's accounts i.e. internally generated goodwill. Counsel for Greenbank argued that paragraph 3(3) would be otiose unless paragraph 2(1) was interpreted in the same way as Greenbank construes paragraph 4(2) i.e. as restricted to intangible assets which are recognised in the accounts when drawn up in accordance with GAAP. On that interpretation of paragraph 2(1), intangible assets which are not capitalised in the accounts because they cannot reliably be valued would fall outside the definition in paragraph 2(1), but would be caught by paragraph 3(3). By contrast, he argued, if paragraph 2(1) were interpreted as extending to intangible assets which would be recognised as such during the process of drawing up the accounts, paragraph 3(3) would be unnecessary. I do not accept that argument. It is well established that arguments from redundancy are rarely compelling as a basis for statutory interpretation: see e.g. *Omar Parks Ltd v Elkington* [1992] 1 WLR 1270 at 1273 and *Walker v Centaur Clothes Ltd* [2000] 1 WLR 799 at 805. In the present case, I consider that paragraph 3(3) is a classic confirmatory provision which makes the position clear even though it would probably be inferred anyway.
22. Paragraph 121 is even clearer. This explicitly deals with internally generated goodwill. It follows that paragraph 121 necessarily proceeds on the basis that internally generated goodwill is within the definition of goodwill in paragraph 4(2). Counsel for Greenbank argued that to interpret paragraph 4(2) by reference to paragraph 121 would be to allow the tail to wag the dog, since paragraph 4(2) is a general definition for the purposes of the whole Schedule whereas paragraph 121 is a minor commencement provision. I do not accept that argument. Greenbank's construction of paragraph 4(2) would mean that paragraph 121 would have no application and had been included in error. Counsel for Greenbank tried to rebut that in two ways. First, he argued that paragraph 121 confirmed that internally generated goodwill was not within Schedule 29. I cannot accept that. Not only is that not what paragraph 121 says, but also it cannot apply at all if "goodwill" does not include internally generated goodwill in the first place. Secondly, he argued that paragraph 121 catered for the possibility that FRS10 might be changed to allow internally generated goodwill to be recognised on the balance sheet. Again, I cannot accept that. Schedule 29 was designed to align the tax treatment of goodwill with existing GAAP, not some speculative future change in GAAP. Paragraph 121 is clearly designed to address the temporal issue discussed in paragraph 28 below. In my view that is a strong indication that Greenbank's construction is wrong.

23. Thirdly, I consider that HMRC's construction is supported by the Companies Act 1985, FRS10 and the expert evidence. It is clear from these that goodwill consists of purchased goodwill and internally generated goodwill. The only difference between them is that purchased goodwill is capitalised in the balance sheet, whereas internally generated goodwill is not. As is common ground, the rationale for this is that purchased goodwill has an objective measure of its value, namely the surplus of the purchase price which a purchaser has agreed to pay for the business over the identifiable net assets of that business, whereas the valuation of internally generated goodwill by a company is subjective. Given that, as is also common ground, the purpose of Schedule 29 was to align the corporation tax treatment of intangible fixed assets and goodwill with the accounting treatment, one would expect Schedule 29 to deal with both. On Greenbank's case, however, Schedule 29 contains a lacuna since it does not deal with internally generated goodwill even though paragraph 121 suggests that it does. Again, this indicates that Greenbank's construction is wrong.
24. Fourthly, Greenbank's construction has the consequence, and is designed to have the consequence, that goodwill is created by the act of purchasing it. In my view that is not merely wrong as a matter of construction of Schedule 29 for the reasons given below, but also offensive to common sense. This is another indication that Greenbank's approach to these provisions is flawed.

Second issue: did Greenbank create the Goodwill?

25. Greenbank contends that it created the Goodwill when it purchased the Goodwill on 30 September 2003, i.e. after 1 April 2002, and thus falls within paragraph 118(1)(a). As noted above, it advances this contention on two alternative bases. The first is that internally generated goodwill is not within the definition of "goodwill" in paragraph 4(2). On this basis, Greenbank says that the Goodwill came into existence for the purposes of Schedule 29 when it was recognised as purchased goodwill in Greenbank's accounts. The second basis is that the Goodwill, being purchased goodwill, was a different asset to the internally generated goodwill owned by Keyline. Again, Greenbank says that it created the Goodwill by recognising it in its accounts. I do not accept either argument for the following reasons.
26. First, it is common ground that, immediately prior to 30 September 2003, Keyline owned internally generated goodwill which was not recognised in its accounts. In my judgment it is manifest that what happened on 30 September 2003 was that Keyline sold and Greenbank purchased that goodwill i.e. the Goodwill. Because it was purchased by Greenbank, it was properly capitalised in Greenbank's accounts. But that was simply the accounting treatment of the Goodwill in accordance with GAAP. That accounting treatment did not mean that the Goodwill either came into existence for the first time or that it was a different asset to the goodwill owned by Keyline.
27. Secondly, counsel for Greenbank relied on paragraph 120(2) as supporting Greenbank's argument. This provides that what counsel described as the "general rule" is that an intangible asset is regarded as created or acquired after commencement to the extent that expenditure on its creation or

acquisition is incurred after commencement. Counsel argued that Greenbank purchased the Goodwill after commencement, hence the expenditure on the creation (on Greenbank's primary case) or the acquisition (on Greenbank's alternative case) of that asset was after commencement. I do not accept that argument. Paragraph 120(2) refers to paragraphs 123 to 125 for determining whether expenditure is incurred after commencement; but counsel for Greenbank accepted that on Greenbank's primary case none of those paragraphs was applicable. Although paragraph 123(1) would be applicable on Greenbank's alternative case, it does not support the proposition that what Greenbank acquired was a different asset to the asset sold by Keyline, but rather contradicts it. In any event, paragraph 120(1) expressly provides that paragraph 120 does not apply to intangible assets to which paragraph 121 applies.

28. Thirdly, I agree with HMRC and the Tribunal that it is clear that the position with regard to the internally generated goodwill created by Keyline is governed by paragraph 121. This provides that internally generated goodwill is regarded as created before commencement if the business in question was carried on at any time before commencement by the company or a related party. There is no dispute that the business was carried on by a related party, namely Keyline, before commencement. It follows that the internally generated goodwill is to be treated as created before commencement. Indeed, I consider that the whole point of paragraph 121 is to deal with cases, such as the present, where some of the internally generated goodwill was created before 1 April 2002 and some after that date.

The 2009 amendment

29. Counsel for Greenbank pointed out that the definition of "goodwill" had been amended in 2009 to address the issue which arose in the present case. Schedule 29 was repealed and replaced by Part 8 of the Corporation Tax Act 2009. The definition of "goodwill" in section 715(3) of that Act, which replicated the definition in paragraph 4(2) of Schedule 29, was then amended by section 70 of the Finance Act 2009 to add the parenthesis "(and includes internally-generated goodwill)". Counsel argued that, if (contrary to Greenbank's case) the definition of "goodwill" in paragraph 4(2) was ambiguous, then it was legitimate to construe it by reference to the amended legislation, relying on the principle stated and applied by the Privy Council in *Commissioners of Inland Revenue v Hang Seng Bank Ltd* [1991] AC 306 at 323-324.
30. I do not accept this argument. I do not regard paragraph 4(2) as sufficiently ambiguous to make this principle of construction applicable. Even if it were applicable, I do not accept that the amendment proceeds on the basis that the definition contained in paragraph 4(2) excludes internally generated goodwill. To my mind, it is a confirmatory amendment.

The expert evidence

31. Finally, Greenbank attacks the Tribunal's handling of the expert evidence on two grounds. First, counsel for Greenbank submitted that the Tribunal had

rejected Professor Cairns' opinion expressed in paragraph 3.4 of the Joint Statement that, for the purposes of accounts drawn up in accordance with GAAP, goodwill meant purchased goodwill without giving any, or any sufficient reasons, for doing so. I disagree. It is clear that Professor Cairns interpreted "for the purposes of accounts drawn up in accordance with [GAAP]" in the same way as Greenbank. The Tribunal gave perfectly clear and cogent reasons for rejecting that construction.

32. Secondly, counsel for Greenbank complained that the Tribunal had wrongly prevented him from cross-examining Mr Blake as to his reasons for expressing the contrary opinion in paragraph 3.5 of the Joint Statement. In my judgment the Tribunal was perfectly correct to do so. This issue is one of construction, and hence one of law.

Conclusion

33. For the reasons given above, which are essentially the same as those given by the Tribunal, the appeal is dismissed.

Mr Justice Arnold

Release Date: 11 April 2011