

Capital loss relief for loan guarantee? (Lecture P1178 – 29.02 minutes)

When someone pays up under the terms of a loan guarantee, it is possible to make a claim for a capital loss, but only if all the conditions in S253 TCGA 1992 have been satisfied. This can be illustrated by the different outcomes in the recent First-Tier Tribunal cases of:

- *Dennis v HMRC* (2018); and
- *Hunt v HMRC* (2019).

Hitherto, in order to qualify for relief under S253 TCGA 1992, the loan had to be to a borrower who:

- was resident in the UK; and
- used the money wholly for trading purposes (or to set up a trade provided that trading actually started).

Relief is only available if there is no reasonable prospect of the loan ever being repaid and, where claimed, S253 TCGA 1992 allows the lender to write the loss off against his chargeable gains. The rules cover both individual and corporate lenders, but the claimant and the borrower must not be spouses, civil partners or members of the same 75% group. Legislation will be introduced in FA 2020 to extend this relief, with effect from 24 January 2019, to borrowers who are resident outside the UK.

The section also applies to a guarantor of a qualifying loan. The guarantor must have made a payment under the guarantee to the lender or to a co-guarantor and he will then be treated as if an allowable loss equal to the amount of his payment had accrued to him on the date when that payment was made. One commentator has confirmed that the word 'guarantee' covers 'the case where a person's property is charged as security for a qualifying loan – it does not include an indemnity which creates a primary liability'.

Dennis v HMRC (2018)

In 1998, the taxpayer (D) entered into a joint venture agreement with a company called TAG Group Holdings SA (TAG) to develop and manufacture high quality electronic audio and audio-visual equipment. The joint venture vehicle was a UK-incorporated company (TAG McLaren Audio Ltd). D and TAG made their respective series of investments in the joint venture vehicle by way of loan and by subscription for ordinary shares (which carried votes) and preference shares (which did not). Some of the amounts which were initially advanced as a loan were later converted into preference shares. Their aggregate investment was substantial:

- D put in over £5,000,000; and
- TAG invested more than £15,000,000.

Clause 10.3 of the joint venture agreement envisaged the situation where the joint venture vehicle was wound up and the investors failed to recover their full investment so that there was a shortfall. In that case, the overall shortfall had to be apportioned in accordance with the investors' respective voting entitlements and the parties undertook to make balancing payments between themselves to bring each one's share of the economic loss to that proportion.

TAG McLaren Audio Ltd did not meet its financial targets and so, on 4 July 2005, the company went into a members' voluntary liquidation. By virtue of Clause 10.3 (see above), TAG made a claim against D which was eventually settled at £3,000,000. This sum was paid over on 23 April 2007. D claimed £3,000,000 as an allowable loss under S253 TCGA 1992 and offset it against his chargeable gains for 2007/08.

HMRC argued that nearly all of D's loss of £3,000,000 related to an investment in ordinary and preference shares in the joint venture vehicle, for which he could not claim relief under S253 TCGA 1992 given that the section only applies to loans. Accordingly, it did not represent an eligible payment under a guarantee, although HMRC were prepared to concede an allowable loss of just over £490,000. This approach of denying relief was contested by D and the case hinged on whether Clause 10.3 amounted to a loan guarantee. If it did not, then no relief was, strictly speaking, available.

In legal terms, a guarantee is a specific form of indemnity, i.e. an arrangement whereby one person can look to another to satisfy their losses. A guarantee must always consist of a written agreement between three parties:

1. a guarantor;
2. who agrees to meet the financial obligations of the principal (or debtor);
3. to the creditor.

There are two particular characteristics which were important in this case:

1. the principle of coextensiveness (there is no liability on the part of a guarantor if the underlying obligation is void or unenforceable or if the obligation ceases to exist); and
2. the right of subrogation (once a guarantor has made payments under the agreement, he has the right to pursue the principal for this expenditure).

D's obligations under Clause 10.3 only arose once TAG McLaren Audio Ltd's obligations to TAG had ceased to be in any way enforceable. As the judge remarked:

'Since (D) could not make full payment under Clause 10.3 until the last distribution in the company's liquidation has been made, (D) could never have any meaningful right of subrogation against the (joint venture vehicle).'

The conclusion was therefore that, while Clause 10.3 was clearly a form of indemnity, it was not a guarantee.

D lost his appeal. Arguably, he came off better than he might have expected to, in view of the fact that HMRC had already conceded the £490,000 loss – since there was no guarantee, this relief should not, in all strictness, have been given.

Hunt v HMRC (2019)

In contrast to the Dennis case, the taxpayer (H) in *Hunt v HMRC (2019)* had made a payment under what everyone agreed was a valid loan guarantee. The questions here revolved around the trading status of the company which received the loan.

H was a 22% shareholder in Altala Ltd (Altala), a company set up to establish a health lottery with the specific aim of supporting the NHS. He issued a guarantee, via a nominee company, for Altala's £17,500,000 loan facility with Barclays Bank plc.

Following significant set-up activity which took place over 2007 and 2008, Altala failed to obtain a lottery management operating licence from the Gambling Commission. On 4 December 2009, Altala went into administration and, on 13 January 2010, its assets were sold to Health Lottery Ltd which successfully launched what became known as 'The Health Lottery' in October 2011 with, in the words of the case report, 'all the distinguishable features established by Altala including the logo, advertising campaign and IT systems and infrastructure'.

By this stage, the bank had recalled their debt and H's nominee company had paid the £17,500,000. H claimed an allowable loss under S253 TCGA 1992. HMRC agreed that H had made a payment of slightly more than the specified sum in pursuance of his guarantee, that this had become irrecoverable and that the loan had been used by Altala for the purposes of setting up a trade. However, HMRC contended that Altala had never actually traded. If there was no trade, HMRC said that there could be no relief. In support of this argument, HMRC pointed to the fact that no Gambling Commission licence had been obtained at the time when Altala went into administration. A consequence of this was that the company could not legally trade as a lottery manager.

The judge looked at the activities which Altala had undertaken in anticipation of obtaining a licence. These included:

- the production of play cards;
- agreements with payment handlers and retailers;
- advertising and marketing;
- establishing a customer contact centre;
- setting up a suitable IT infrastructure;
- the acquisition of lottery ball machines; and
- taking out prize insurance.

It was significant that Altala's successor used most of Altala's groundwork and assets for the successful launch of the new lottery. In other words, Altala had put virtually everything in place bar the Gambling Commission licence.

The judge then referred to the leading case on this matter (*Mansell v HMRC (2006)*) where the following comments were made:

‘A trade commences when the taxpayer, having a specific idea in mind of his intended profit-making activities and having set up his business, begins operational activities – and, by operational activities, I mean dealing with third parties immediately and directly related to the supplies to be made which it is hoped will give rise to the expected profits and which involve the trader putting money at risk.’

On this basis, he considered that Altala did engage in operational activities in relation to which it incurred a financial risk. The company had done enough to be treated as trading and so H’s appeal was allowed in full.

Contributed by Robert Jamieson