

Loans to participators and Collins v Addies (Lecture B1298 – 16.22 minutes)

HMRC have recently produced new guidelines on the repayment rules for participator loans, explaining how they plan to proceed in the future with regard to these arrangements.

Everyone knows about loans to participators. If a close company makes a loan to a participator which is outstanding more than nine months after the end of the accounting period in which it was made, the company must make a payment to HMRC equal to 32.5% (rising to 33.75% for loans made on or after 6 April 2022) of the amount of the loan (S455 CTA 2010). This money remains in HMRC's hands until the loan is repaid.

In Para CTM61602 of the Company Taxation Manual, HMRC comment that they are finding 'an increasing number of cases' where loans and overdrawn directors' loan accounts (DLAs) are said to have been paid back, but in fact all that has happened is the movement of the debtor balances around a series of group or associated companies, with the original lender never actually being repaid.

Using the decision in *Collins v Addies* (1992), HMRC, who won the case before both the Court of Appeal and the High Court, argue that 'the substitution of a fresh debtor (for the original debtor) does not constitute repayment'.

In the High Court hearing, Millett J concluded:

'While payment by a third party on behalf of the debtor, or payment in kind by the debtor himself or by a third party, accepted in full discharge of the debt may well constitute repayment or satisfaction and not a release for the purpose of (the relevant legislation), I do not consider that the substitution of a fresh promise to pay by a third party can be similarly treated. A promise to pay by a new debtor constitutes valuable consideration and may properly be accepted by the company in substitution of the debt of the original obligee, but as a matter of ordinary usage it would not be regarded as payment. It seems to me that there is a clear distinction to be drawn between a novation, which involves the release of one debt and the substitution of another, and all other forms of payment or satisfaction under which the debt is actually repaid with no outstanding obligation on any party in respect of the debt or any similar sum.'

In contract law, novation is the replacement of one of the parties in a two-party agreement with a third party, with all three parties consenting. HMRC say that the release of a loan by way of novation does not represent repayment and so no relief is allowed under S458 CTA 2010. This sounds fair enough, except that S458 CTA 2010 now specifically refers to the repayment or release of a loan (which earlier versions of the section did not). Accordingly, a release by way of a novation should entitle the company to relief. The speaker suggests that this part of the loan to participator legislation needs to be reworded.

In addition, in Para CTM61602 HMRC express their concern about the increasing frequency with which repayments of close company loans are said to have been affected by circular or recycling arrangements.

They provide the following example:

A shareholder wholly owns Company A which in turn wholly owns Company B.

In the accounting period to 31 March 2019, the shareholder withdraws £2,000,000 from Company A. Just before the date (which falls) nine months after the end of the accounting period in which he borrowed the funds, e.g. on 28 December 2019, he borrows enough from Company B to repay Company A the amount outstanding at the end of its accounting period to 31 March 2019 (i.e. £2,000,000).

His overdrawn DLA in Company A is therefore cleared, but his DLA in Company B is now overdrawn to the tune of £2,000,000. He continues to draw funds from Company B throughout the accounting period to 31 March 2020 and owes £6,000,000 by the end of that accounting period.

On 23 December 2020, the shareholder borrows £6,000,000 from Company A to repay the amount outstanding in Company B at the end of 31 March 2020.

This clears the 2020 DLA in Company B and creates an overdrawn balance on the DLA in Company A in the accounting period to 31 March 2021.

This process continues in the accounting period to 31 March 2021 such that, at the end of that accounting period, the shareholder owes Company A £15,000,000. The same process is repeated.

Clearly, the shareholder continues to hold an increasing amount of company funds from a combination of Company A and Company B, on which he has paid no income tax and on which it would seem that no S455 CTA 2010 charge arises.

However, HMRC consider that, looking at the legislation as a whole and its purpose, there is no repayment here – rather S455 CTA 2010 should apply to the increasing amounts withdrawn from the companies.

Therefore, £2,000,000 should be charged to S455 CTA 2010 on Company A in the accounting period to 31 March 2019, £4,000,000 on Company B in the accounting period to 31 March 2020 and £9,000,000 on Company A in the accounting period to 31 March 2021.

Ploys of this sort deserve to be challenged, given that the reality of the situation is obvious. However, HMRC's rationale for their line of attack as set out in the penultimate paragraph of (g) above hardly seems adequate as a technical challenge. Indeed, it is difficult to say that the loan from Company A has not been repaid if a genuine repayment has been made. But, in that case, could not S464A or S464C CTA 2010 apply? Why do HMRC appear reluctant to use these last two anti-avoidance sections which were brought in as recently as FA 2013? Are we likely to see further legislation being introduced in order to strengthen HMRC's hand?

Contributed by Robert Jamieson