

CGT loss relief for loans (Lecture P1444 – 13.08 minutes)

The First-Tier Tribunal decision in *Bunting v HMRC (2024)* highlights a potential trap in connection with loss relief claims where money lent to a trading company becomes irrecoverable. Sadly, in recent years, this has been a common situation.

The appellant (B) had enjoyed a successful career as a banker. Outside his work, he had a keen interest in sports history and memorabilia.

In the early 2000s, B decided to establish a business dealing in sports history books and memorabilia. This was always intended to be a *bona fide* trading operation. Accordingly, in July 2004, Rectory Sports Ltd was incorporated. B's wife was the sole shareholder and director, given that, at the time, B worked for Goldman Sachs who did not approve of employees holding external directorships. The company was capitalised with a single £1 ordinary share.

The company's activities were funded by B who invested nearly £3.5 million by way of a series of unsecured non-interest-bearing loans. This arrangement represented money lent to Rectory Sports Ltd which was used by the company for the purpose of its trade in books and memorabilia. It was not a debt on a security.

Initially, the company invested heavily in the acquisition of stock. It opened premises in Surrey and hired specialist staff to deal with the trade. For the first few years, the business was successful, but, by 2012, it had become clear to B and his wife that the stock held was going down in value instead of appreciating and that the company's target market was falling away. In other words, the business was becoming unsustainable.

In January 2013, B and the company entered into an agreement for the capitalisation of £2,200,000 of B's loans. Pursuant to that agreement, Rectory Sports Ltd issued 2,200,000 £1 ordinary shares to B in consideration for the appellant agreeing 'fully and irrevocably' to release and discharge the company from any claims or demands which B might have against it.

This capitalisation issue was undertaken for the purpose of enabling B to make an income tax share loss claim under S131 ITA 2007 on the basis that his shares had become of negligible value.

Two months later, the parties entered into a further agreement for the release and discharge of the remaining loans. Liquidation of the company followed and, in January 2014, B made a share loss claim in his 2012/13 self-assessment tax return.

During the enquiry which followed, B eventually accepted that, because the shares were of no value at the time when they were issued, they had not 'become of negligible value' so that he had no entitlement to his share loss claim. In the meantime, he made what the case report described as 'a protective claim to capital losses in respect of the losses arising in connection with the discharge of the capitalised proportion of (his loans)'. This was under s.253 TCGA 1992. HMRC treated the claim for capital losses as one made outside a tax return (the period for amending the 2012/13 tax return having expired).

In February 2017, HMRC started a new enquiry into the validity of B's capital loss claim. That enquiry was closed with a refusal of the claim in September 2022. This was on the basis that the loan was discharged by the issue of the shares so that, at the date of the capital loss claim, there was no 'amount outstanding' as required by s.253(3) TCGA 1992.

HMRC accepted that B could of course have made the capital loss claim before his share subscription, but unfortunately he did not do so.

One expert commentator remarked:

‘HMRC also observed that he had received property (i.e. the shares) in satisfaction of the debt and (the confusingly similar) s.251(3) TCGA 1992 therefore disqualified the loan from relief.’

But how serious was B’s tax problem?

Ultimately, the case turned on the correct interpretation of s.253(3) TCGA 1992. This subsection provides that an allowable loss will arise for CGT purposes where ‘a person who has made a qualifying loan makes a claim and at that time . . . any outstanding amount of the principal of the loan has become irrecoverable’.

The legislation defines ‘a qualifying loan’ as a loan where:

- ‘(i) the money lent is used by the borrower wholly for the purposes of a trade carried on by him, not being a trade which consists of or includes the lending of money; and
- (ii) if the loan is made before 24 January 2019, the borrower is resident in the UK; and
- (iii) the borrower’s debt is not a debt on a security.’

In the context of (i) above, money used by the borrower for setting up a trade which is subsequently carried on by him is treated as used for the purposes of that trade.

It seems clear that B’s loans met these criteria:

- (i) the money lent was used by Rectory Sports Ltd for the purposes of its trade;
- (ii) the company was UK-resident; and
- (iii) the company’s indebtedness did not represent a debt on a security.

The First-Tier Tribunal decided that the words (‘any outstanding amount of the principal of the loan has become irrecoverable’ – see above) merely means that the debt must be unpaid, regardless of whether or not, as someone has pointed out, ‘there was any continuing right of enforcement’. The debt had not been settled and so the test in s.253(3) TCGA 1992 was met.

On HMRC’s argument about s.251(3) TCGA 1992, the judges were equally sympathetic to B. The taxing authorities’ contention was dismissed on the ground that the shares received in satisfaction of the debt were worthless so that no valuable consideration had been received. This meant that the loans were *not* disqualified from relief.

As a result, B’s capital loss claim was successful, but, in the speaker’s view, an appeal by HMRC to the Upper Tribunal is quite likely.

Contributed by Robert Jamieson