

Repayment of participator loan (Lecture B1259 – 12.56 minutes)

On 16 December 2020, the GAAR Advisory Panel gave a unanimous opinion in connection with an arrangement involving the repayment of a close company participator loan. They were asked to determine whether the entering into and carrying out of the transactions in question represented a reasonable course of action in relation to the relevant tax provisions, having regard to all the circumstances.

HMRC had referred the case to the Panel in a letter dated 31 July 2020. At the same time, they wrote to the company and their advisers, informing them of the referral to the Panel and inviting them to make representations within the 21-day timescale allowed. In the event, no representations were made.

Before dealing with the Panel's decision, it will be helpful to set out the background to the case:

- A property dealing company (P) was incorporated in 2008. Initially, the single issued share was held by an individual (Mr X).
- On 3 June 2011, P issued a further 500,000 shares which were held as follows:
 - 375,000 by Mr X; and
 - 125,000 by two other companies.
- On 12 August 2015, one of those companies transferred its 100,000 shares to Mr X so that he held just over 95% of P's share capital.
- P's corporation tax return for the year ended 31 December 2014 showed that Mr X had an overdrawn loan account balance of nearly £1,600,000. It was stated that this amount had been repaid to P before 1 October 2015 so that no liability to tax arose under S455 CTA 2010.
- The dispute with HMRC revolved around the repayment of this loan balance and whether the repayment was effective for the purposes of ensuring that there was no charge under S455 CTA 2010 (as supplemented by Ss464A – 464D CTA 2010).

The scheme was designed to prevent a participator loan charge arising on a balance owed to a close company by a shareholder.

Mr X who owed the debt to P incorporated a second company in Guernsey (Newco) with an initial share capital of 1,000 shares of £1 each. These shares were fully paid up.

Newco then arranged a further issue of 1,999,000 shares of £1 each but did not make a call on these shares. However, Mr X personally guaranteed that he would meet that call when it was made.

To begin with, Newco's shares were held by two nominee companies on behalf of Mr X, but, on 25 September 2015, the shares were transferred to P in satisfaction of the outstanding loan. P accepted the transfer as a repayment of the loan balance. Thus, the participator loan was technically repaid before a S455 CTA 2010 charge could arise. The result was that Mr X had a positive balance on his account with P.

This planning ploy was not approved by the Panel. They said:

‘We start by noting that there is nothing contrived or abnormal *per se* about paying back an outstanding loan before the nine-month deadline in order to avoid the need to pay over the S455 CTA 2010 charge. The legislation clearly contemplates that repayments may be made in time and so avoid the need to pay over the potential tax.

What needs to be considered is the way in which the repayment was effected. In our view, the arrangements as a whole are contrived and abnormal and appear to us to serve no purpose other than to seek to avoid the S455 CTA 2010 tax charge,

There are, in particular, a number of features of the arrangements which strike us as particularly contrived or abnormal:

1. The use of a separate company needs to be considered. Involving another company does not, in our view, necessarily make the step contrived or abnormal. But causing a new company to be incorporated does appear contrived in the context we see here. The new company we are concerned with in these arrangements has no commercial purpose or substance.
2. A key part of the arrangement is the way the share capital of Newco was set up. To issue an additional near £2,000,000 share capital and leave it uncalled does seem to us abnormal. The lack of any economic substance in terms of funding is an indicator of contrived arrangements,
3. The retained obligation, namely the agreement for (Mr X) to remain liable to pay a call on the new shares, does seem to be a contrived step, given the amounts involved and that this relates to a new company (which) as yet has no trading record. The way that value is generated in Newco seems to us to be contrived.
4. The paying back of the loan by way of transfer of the shares needs to be considered. We do not see anything objectionable in a taxpayer transferring assets to a company to satisfy a debt: that is contemplated by the legislation. But here the asset being transferred has been specifically created for the purpose of enabling the transfer to be made and the debt satisfied. Instead of a debt due on loan account, (Mr X) is left with a potential liability for the uncalled share capital. The net result for (P) is that it is still (through its inactive subsidiary) owed the money from (Mr X). This seems to us to be effected by contrived steps.

We also have to note that the transactions were proposed as a set of steps in a letter from (Mr X's) advisers on 16 September 2015 and were completed by the taxpayers on 25 September 2015, as planned in the 16 September 2015 proposal. We are bound to conclude that the arrangements, by being put in place in such a short timescale yet apparently creating value of £2,000,000, were contrived.

We also note that Newco's substance seems to depend on its providing consultancy services to its sole shareholder (Mr X) in return for the individual granting Newco an option to acquire an annuity. We do not have any evidence of any services or this option being exercised (and HMRC say in correspondence that Newco has never traded), but, in any event, it seems to us that the arrangements are also contrived. There is no evidence of the £2,000,000 capital being required for the services (or being called).'

It would appear that the arrangements were seeking to take advantage of the decision in *RKW Ltd v HMRC (2014)*. This was a First-Tier Tribunal case which held that uncalled share capital does not constitute a debt. Unfortunately for the taxpayers in this instance, they were ineffective. The Panel concluded that the overall scheme was not a reasonable course of action to take.

Contributed by Robert Jamieson