TC01907

Appeal number TC2011/06588

Loan interest. Associated company. Material interest.

FIRST-TIER TRIBUNAL
TAX

ANTONI NOWOSIELSKI **Appellant**

- and -

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

TRIBUNAL: GERAINT JONES Q. C. (JUDGE)
JAMES MIDGLEY ESQ (MEMBER)

Sitting in public at 45 Bedford Square, London WC1 on 12 March 2012.

Mr. Pinchin for the Appellant

Mrs Durkin, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

1. By its letter dated 01 February 2011 the respondent raised additional assessments to income tax against the appellant in respect of each of the tax years 2004/2005, 2005/2006 and 2006/2007. The total of the additional tax assessed was £1,893.32p. The appellant sought a review of the assessments but by its letter dated 22 July 2011 the respondent maintained that the additional assessments were correct. The appellant has appealed.

2. The additional assessments arose in the following way. The appellant is a director of and a shareholder in the company Andrew Pinchin Architects Limited. He holds 50 out of the 100 issued shares in that company, with 49 he held by Mr Pinchin and one by Mrs Pinchin. The appellant is also a director of Vanfame Limited, but he does not hold any shares in that company. The shares in that company are held by Mr & Mrs Pinchin. There are 120,000 allotted shares with Mr Pinchin holding 60,001 shares and his wife holding 59,999 shares.

3. Vanfame Limited develops real property. Sometime in 2005 it experienced cash flow problems and so the appellant agreed to lend the company £100,000. To raise that sum of money he mortgaged his house (or increased the mortgage on his house) with HSBC plc. He had to pay the bank interest on that borrowed money at a rate that varied from time to time. Vanfame Limited reimbursed the appellant in respect of that interest by paying him a sum of £400 per calendar month, which equated, more or less, to the interest that he paid to the bank. The figures are such that the appellant did not make any profit in respect of the money that he lent to the company because he had to service the cost of borrowing from the bank.

4. The appellant disclosed the receipt of interest from Vanfame Limited and sought to neutralise the effect of that receipt by claiming tax relief in respect of the interest that he had paid to the bank in respect of the borrowed £100,000. The respondent has taken the stance that although the appellant must pay tax on the interest received, he is not entitled to tax relief on the interest paid because, it is argued, the appellant can only obtain such relief if the two companies mentioned above are "associated companies" and the appellant has a "material interests" in respect of the borrower company. Thus, we turn our attention to sections 360A and 416 Income and Corporation Taxes Act 1988.

5. We should record that by its letter dated 3 December 2010 the Respondent accepted and admitted that the two companies referred to above were, within the meaning of the relevant legislation, associated companies. At the hearing before us the respondent sought to resile from that position.

6. We find as a fact that the two above-mentioned companies were at all material times associated companies within the meaning of section 416 of the 1988 Act. We arrive at that conclusion because it is clear from perusing the relevant shareholdings that Vanfame Limited is controlled by Mr Pinchin in that he has a controlling shareholding. Initially the position in respect of Andrew Pinchin Architects Limited (“APA”) seemed less clear and could potentially turn upon where the casting vote at any shareholders meeting might lie. However, during the

course of the hearing we considered accounting documents in respect of APA. Their reliability and accuracy was not disputed by the respondent.

7. The Formatted Trial Balance of APA for the year ended 31 March 2007 (which contains the like figures from 2006) demonstrates that at the end of that financial year there were total assets of £15,939 which had risen from £8262 in March 2006. Mr Pinchin was owed £48,643 on his director's loan account for the year ended March 2007, up from £5789 in the year ended March 2006. The same document does not deal specifically with the year ended March 2005, but it does show that for that year there was a deficit of £2893. In our judgement it is a proper inference to draw that in that year Mr Pinchin was equally entitled to receive the *"greater part of"* the net assets of the company upon winding up, especially as by reason of his shareholding he was already entitled to 49% of any surplus after all creditors had been paid.

8. Section 416(2)(c) of the 1988 Act provides that where, upon the winding up of the company, a person is entitled to receive "*the greater part of the assets of the company, which would then be available for distribution among the participators*", that person will have a controlling interest in that company. The accounting documents plainly show that Mr Pinchin had such an entitlement for the year ended March 2006 and March 2007. That is because, taking the year ended March 2006, his loan account stood at £5789 against total distributable assets of £8262. In respect of the year ended March 2007, he would have been entitled to receive the whole of the distributable assets given that they were only £15,939, whereas he was then owed £48,643.

9. As we are satisfied that the two companies mentioned above were, within the meaning of section 416, associated companies we take the view that HMRC was correct to make the admission in its letter of 3 December 2010 and that when it sought to resile from that position at the hearing before us, that was an inappropriate stance to take.

10. The next issue is whether the appellant had a "material interest" in Vanfame Limited, within the meaning of section 360 of the 1988 Act.

11. When we refer to section 360 of the 1988 Act we can record that for the purpose of section 360(1)(b) it was accepted by the respondent that the £100,000 had been lent to Vanfame Limited for its normal commercial purposes. If the appellant is to succeed he must also satisfy the conditions that appear in sections 360(2) or (3) of the 1988 Act. His case has been put on the basis that he does have a "material interest" in Vanfame Limited. The expression "material interest" is defined in section 360A of the 1988 Act and, for present purposes, this appeal revolves around section 360A(1)(b). The argument is that the appellant possessed a right which would, in the event of the winding up of the company, give him an entitlement to receive more than 5% of the assets which would then be available for distribution amongst the participators.

12. Section 360A(1)(b) is not devoid of difficulty. It provides that a person has a "material interest" in a company if he *"possesses, or is entitled to acquire, such rights as would, in the event of the winding up of the company or in any other circumstances, give an entitlement to receive more than 5% of the assets which would then be available for distribution among the participators."* It gives rise to this difficulty. The provision might be properly construed as meaning that a person has a "material interest" if, upon liquidation, he is entitled to receive more than 5% of the assets which, but for prior claims, would be available for distribution amongst the

participators. Alternatively, the provision might be properly construed as meaning that the person has a "material interest" only if , after all the company's liabilities have been settled, he is entitled to receive more than 5% of the assets distributable amongst the several participators in the company. On that analysis it would exclude a person with 5% or less of the shareholding in a company.

13. Although we need not resolve that matter of construction it seems to us that the first approach is the correct one, given the definition of “participator” and “loan creditor” in section 417 of the 1988 Act. Section 417 of the 1988 Act provides definitions of "participator" and "loan creditor". Section 417(1)(b) specifically provides that a loan creditor is a participator. In short, a "loan creditor" is a creditor in respect of a debt incurred by the company for money borrowed or capital assets acquired by the company. There can be no doubt that the appellant was, so far as Vanfame Limited is concerned, a loan creditor. Accordingly, he was a participator. Therefore it follows that he had a "material interest" in the company quite regardless of which way section 360A(1)(b) is to be construed, given that he was owed £100,000, giving him a right to far more than 5% upon winding up.

14. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

Decision.

Appeal allowed.
The appellant is entitled to relief against the interest payments made by him to HSBC plc in respect of monies lent by him to Vanfame Limited.
The amended assessments dated 01 February 2011 are set aside.

TRIBUNAL JUDGE
RELEASE DATE: 22 March 2012