[2018] UKFTT 287 (TC)

TC06517

Appeal number: TC/2015/03059 &TC/2015/04240 & TC/2015/06537 & TC/2015/03836
TC/2015/03061 & TC/2015/03062
TC/2015/03099 & TC/2015/04488
TC/2015/03100 & TC/2015/04241 & TC/2015/03838

INCOME TAX– close company – directors' loan waiver scheme - whether release of debt for purposes of s415 ITTOIA tax charge – no – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

(1) ESPRIT LOGISTICS MANAGEMENT LIMITED **Appellants**
(2) MR GRAHAM DIXON
(3) OCUK LIMITED (FORMERLY ESNET LIMITED)
(4) MICHON LIMITED
(5) RIPPLE DEVELOPMENTS LIMITED
(6) MR DAVID WOLFENDEN

- and -

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

TRIBUNAL: JUDGE SWAMI RAGHAVAN

Sitting in public at Taylor House, London on 17-19, and 22-26 January 2018

Michael Jones, counsel for the Appellants instructed by RPC

Akash Nawbatt QC and Kate Balmer, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

1. The appeals covered by this decision concern the income tax and corporation tax treatment of a scheme which involved releases of loan balances on the director's loan account of close companies. There are four sets of appeals, two of which involve only the close company (OcUK Limted and Michon Limited) and two which involve both the close company and one of its directors (Esprit Logistics Management Limited and its director Mr Graham Dixon, and Ripple Developments Limited and its director Mr David Wolfenden).

2. The documentation underlying the arrangements followed a very similar format. A board minute explained the company's wish to release sums owing by the director by way of a bonus for the director's services to the company. A deed was accordingly executed setting out the sums released. The company paid NICs but not employment income tax on the released amounts and deducted the sums released from its taxable profits.

3. In brief, the appellants argue the amounts released were taxable in the hands of the directors under s415 Income Tax (Trading and other Income) Act 2005 ("ITTOIA") at the dividend ordinary rate, rather than taxable as HMRC contend as employment income under Part 2 of the Income Tax (Earnings and Pensions) Act 2003 ("ITEPA"). HMRC argue the waiver of the loan, was, in reality, a reward for the directors' services. They say s415 ITTOIA is not in issue, and in any case construed purposively, does not apply to the facts viewed realistically and commercially. The loan waiver was simply the mechanism for the delivery of a performance based bonus by way of set-off. Alternatively, HMRC argue, that even there were such a "release" for s415 purposes, then s415 ITTOIA does not have priority over the charge to employment income under Part 2 of ITEPA. The appellants say the legislation clearly accords the ITTOIA charge priority over the ITEPA charge. They concede however that if s415 ITTOIA does not apply, or that if they wrong in arguing the ITTOIA charge took priority over the ITEPA charge, then the sums would be taxable under s62 ITEPA.

4. As regards corporation tax, HMRC say that if, contrary to their primary case, the sums are *not* chargeable as employment income, then the sums are not deductible by the companies; arguing the loan was not a "loan relationship" of the company (s81 Finance Act 1996 and s302 Corporation Taxes Act 2009), or that if it were, the debits brought into account by the company should be nil (paragraph 11 of Schedule 9 Finance Act 1996 and s444 Corporation Tax Act 2009).

5. The appeals concern determinations under regulation 80 of the Income Tax (PAYE) Regulations 2003 ("Regulation 80 Determinations") and corporation tax closure notices ("Corporation Tax Closure Notices") issued variously by HMRC against the appellants in the tax years 2006/07 to 2009/10. The specific years and amounts in issue are detailed below.

6. *Esprit appeals*: (i) a Regulation 80 Determination of 4 October 2011, in the sum of £114,840.60; (Esprit Logistics Management Ltd also appeals a corporation tax Discovery Assessment issued under paragraphs 41 to 46 of Schedule 18 Finance Act 1998 (appeal reference TC/2015/06537). The issue of the validity of that assessment has been stayed pending the outcome of this hearing pursuant to tribunal directions of 19 June 2017. (ii) A Corporation Tax Closure Notice for the year ended 30 September 2009 dated 19 August 2014. Mr Dixon also appeals a Section 9A TMA enquiry closure notice of 7 August 2014.

7. *OcUK appeals*: (i) a Regulation 80 Determination, dated 1 February 2011, for the tax year 2006/07 in the amount of £1,193,744.40; and (ii) a Corporation Tax Closure Notice, dated 21 August 2014, for the tax year 2006/07.

8. *Michon* appeals: (i) a Regulation 80 Determination, dated 1 February 2011, for the tax year 2006/07 in the amount of £114,338.40; and (ii) a Corporation Tax Closure notice, dated 27 March 2014, in respect of the tax year 2007.

9. *Ripple* appeals: (i) a Regulation 80 Determination dated 4 October 2011 in the sum of £60,836.70 for the tax year 2007/08; and (ii) a Corporation Tax Closure Notice, for the tax year 2007, dated 1 August 2014. Mr Wolfenden also appeals a Section 9A TMA enquiry closure notice for the tax year ended 5 April 2008 dated 5 August 2014.

10. The tribunal heard evidence from a number of appellant company directors, each of whom had served witness statements in advance exhibiting various documents such as directors loan account details, board minutes and correspondence which included letters of advice from the scheme structurer. The witnesses were called in the following order Jeff Michon and Tony Michon (Michon Limited), David Wolfenden (Ripple Developments Limited), Mark Proudfoot (OcUK Limited) and Graham Dixon (Esprit Logistics Management Limited). While I was satisfied that each of the witnesses gave their recollections honestly, given the length of time that had passed since the relevant events, some aspects of those recollections, as will be seen when various contested issues of fact are discussed later, were not reliable or were accorded less weight.

Law

11. I gratefully adopt, with some minor modifications, the explanation of the relevant statutory provisions which the parties had set out in their skeleton arguments.

Income Tax

ITTOIA

12. The five Parts of ITTOIA bring into charge to tax "trading income", "property income", "savings and investment income" and "certain miscellaneous income". Part 4 of ITTOIA deals with the taxation of "Savings and Investment Income" and charges tax on income such as interest, dividends, gains from annuities and insurance. Under Chapter 6 of Part 4 there is a charge to income tax on the release of loans to the

participator of a close company. The charge to tax is found in s415 ITTOIA, which relevantly provides as follows:

> "**415 Charge to tax under Chapter 6**
>
> (1) Income tax is charged if—
>
> (a) a company is or has been assessed or is liable to be assessed undersection 419 of ICTA (loans to participators in close companies etc.) in respect of a loan or advance, and
>
> (b) the company releases or writes off the whole or part of the debt in respect of the loan or advance.
>
> …
>
> (5) Expressions used in this Chapter have the same meanings as if they were in section 419 of ICTA."

13. The terms "close company" and "participator" are defined in Part XI, Chapter 1 (ss414 to 418) of the Income tax and Corporation Taxes Act 1988 ("ICTA"). Broadly speaking, a "close company" is one under the control of five or fewer participators and their associates or of directors who are participators and their associates. There is no dispute in these appeals that the corporate appellants were, at all relevant times, "close companies", or that the directors in question were all "participators" in their respective companies.

14. There is case law, *Collins v Addies (Inspector of Taxes)* [1992] STC 746, on the interpretation of the predecessor provision to s415 ITTOIA, which the parties referred to extensively in their respective submissions and which I come on to discuss later in this decision.

15. Under s416 ITTOIA, the amount charged is the amount released or written off, grossed up by reference to the dividend ordinary rate for that year; and under s417, ITTOIA, the person liable for any tax charged under the Chapter is the person to whom the loan or advance was made. That person is treated as having paid income tax at the dividend ordinary rate on the amount charged: s421 ITTOIA. The amount is charged as dividend income and taxed at the dividend ordinary rate: ss14 and 19 Income Tax Act 2007.

Background and Findings of Fact

16. Each of the appeals relate to a remuneration planning scheme promoted by Tenon Limited and/or Premier Strategies Limited ("PSL") which was known as the "loan waiver scheme". Tenon Limited subsequently became known as Premier Strategies (PSL). Depending on the time period in issue the documents and evidence referred to one or other of the two names but nothing turns on that distinction. The scheme implementation followed the same pattern in each appeal. For convenience this decision sets out the terms of the documents in relation to Michon Ltd, whose directors were the first I heard evidence from, in more detail. The common scheme document extracts in the other appeals are not replicated in the same level of detail, but they followed the

same format and the findings accordingly only focus on the main points of difference as regards e.g. differences in specific dates and amounts.

Michon Ltd

Background

17. The business of the company, which was founded by Jeff Michon, was to provide creative design and marketing services predominantly to large corporate firms and small and medium-sized enterprises. At all material times, Jeff Michon was the Managing Director of Michon Limited and his brother Tony Michon was the Creative Director. In his role as Managing Director, Jeff Michon had oversight of the whole company, but his main responsibilities were the finances and management of the business. As the Creative Director of the company Tony Michon was ultimately responsible for ensuring the quality of the creative services provided by the company to enable them to maintain existing contracts and win new business. The business decisions, for example any decisions concerning the company finances, were always discussed and made jointly by them. The company's business was originally established by Jeff as a sole trader in 1982. Tony Michon joined him approximately four years later, first on a freelance basis and later, in 2001, as an employee. In 1998 the business was incorporated as a limited company with the registered name of Michon Design Limited. It changed its name to Michon Limited in 2001. At the time of incorporation, Jeff Michon's wife, Lorraine Michon, was the company secretary. Later, in August 2002, Lorraine Michon became a director of the company.

18. On incorporation Tony and Jeff Michon were appointed as the two directors and shareholders. The directors of the company were remunerated predominantly by way of salaries (which included bonuses) and dividends.

Director's Loan account

19. On incorporation in 1998, the assets of the business were transferred to the company. This included fixtures, debtors and work in progress as well as funds in the bank. This was done by crediting the directors' respective loan accounts. Over the following years, as the company began to generate more funds, Jeff and Tony Michon took the opportunity to withdraw money from their director's loan accounts or occasionally charge private expenditure to this. The director's loan accounts operated in the manner of a current account or running account between the directors and the company.

20. For several years Jeff Michon's loan account remained in credit. From at least 2004 onwards, Michon Limited credited the directors' loan accounts in respect of various amounts. For example, in January 2006 Jeff Michon and Tony Michon were both awarded a bonus of £100,000 gross by the company. The net sum of £59,000 each, after deduction of PAYE, was credited to their directors' loan accounts by way of a book entry. Sums owed to Jeff and Tony Michon for mileage and to Jeff Michon for rent of the company premises were similarly credited to the directors' loan accounts. In late 2005/early 2006 the director's loan account became overdrawn. Tony Michon also

made several drawings by way of the loan account during a six-month period from December 2005 to June 2006 each making two significant drawings from their respective loan accounts, £75,000 in December 2005 and £60,000 in May 2006. As the business grew, in or around 2003/2004, Jeff and Tony tried to find somewhere suitable that they could buy and refurbish as they needed more space. This took some time. The funds borrowed in December 2005 were to enable Jeff and Tony Michon to bid at an auction on a property. Neither of them were able to recall details in relation to the May 2006 withdrawal. The circumstances surrounding the drawing of £60,000 in May 2006 and in particular whether the sum was drawn after they received advice from Tenon, as HMRC argue in furtherance of their submission regarding the non-availability of the corporation tax deduction, is a matter of contention. At all times, Jeff and Tony Michon relied on and followed the advice they had been given in connection with the loan waiver. The issue of when the first meeting took place is considered further below.

21. The entries on Jeff Michon's loan account with the company for the period 2004 to 2007 show both cash drawings and borrowings which arose as a result of the company making a payment to a third party on Jeff Michon's behalf. By June 2006, his director's loan account had an overdrawn balance of £149,670.95.

22. The entries on Tony Michon's director's loan account show that by July 2006, he had an overdrawn balance of £132,743.60.

Remuneration planning and advice

23. As the appellants acknowledge, and HMRC emphasise, taking account that there was little contemporaneous documentary evidence, neither Jeff Michon's nor Tony Michon's evidence of events in 2006 was particularly clear given the passage of time. HMRC add that, to the extent the Michons suggested their first meeting with Tenon/PSL was later than May 2006, their evidence was plainly unreliable.

24. The potential period in which the first meeting with Tenon took place may be narrowed down to the period between February/March 2006, when the Michons first identified a suitable property (the Old School Rooms) and 26 June 2006 when Tenon/PSL wrote to Jeff Michon stating:

> "We have discussed in some detail the different ways in which the Company, having decided to award you and Tony in respect of your services for the year ended 31 January 2007, could provide you with sufficient funds to repay your overdrawn loan accounts. The Company have decided that the most cost efficient way of doing this is to release the loan accounts in satisfaction of your bonuses for the year. The purpose of this letter is to set out some of the taxation and legal issues associated with these releases…"

25. The appellants highlight the following from Jeff Michon's evidence:

(1) Once the Michons had identified the Old School Rooms, they approached their accountants, Newby Castleman, to seek advice, although this was not immediately after they had found the Old School Rooms. They were initially

interested in a number of properties, including the Old School Rooms, and there was a period of some months between them finding the Old School Rooms and the decision to proceed to try to purchase it. The property required permission for a change of use from residential to commercial, which permission Jeff Michon recalled had been sought in July 2006. This, the appellants argue, was consistent with an entry dated 27 April 2006 in the director's loan account in respect of expenditure incurred by the company on the directors' behalf for *"*Planning & legal costs re new premises*"*, which Tony Michon described as *"*preliminary work*"* undertaken before the decision to proceed with attempting to purchase the property.

(2) At this point, Tony and Jeff Michon decided to take extended mortgages on their individual residential properties of approximately £300k-£350k each. This was to ensure they had sufficient funds to proceed. However, they were aware that there were funds in the company which would assist. They discussed this with Brian Buck, their accountant at Newby Castleman**.**

(3) It was Mr Buck who had recommended Jeff and Tony Michon to use Tenon, although Jeff cannot remember exactly when that was save that it was around the time they identified the Old School Rooms as a property they wanted to purchase; this was around June or July 2006. This, it is suggested, was broadly consistent with the timing of a letter of advice from PSL dated 28 June 2006, which referred to earlier discussions – Jeff Michon's evidence was that the process involving Tenon/PSL happened fairly quickly and that there was not long between their initial meeting and the drawing up of the relevant paperwork.

(4) At their initial meeting with Tenon the possibility of the waiver of director's loans was brought to their attention as a tax efficient way of releasing the funds to repay their extended mortgages and finance the refurbishment of the Old School Rooms.

(5) They only met with Tenon on a couple of occasions. The first was the initial meeting where the loan waiver proposal was discussed, and the second was to sign the relevant paperwork.

26. As far as Tony Michon can remember, Brian Buck and PSL met with them to talk through some of the different options around how they could effectively raise the funds to assist with the property purchase and they settled on the loan waiver agreement. Tony could not clearly recall when he and Jeff first met with Tenon, but it was possibly at some point before 2 May 2006 (but after December 2005).

27. HMRC emphasise the following features from the evidence:

(1) The advice Jeff Michon and Tony Michon sought from Tenon/PSL was advice about the most tax efficient way of "releasing" - i.e. extracting - funds from the company to finance their new property purchase. The only extraction of funds in 2006 were two withdrawals of £60,000 by each of the appellants on 2 May 2006. HMRC argue those drawings must, therefore, have been made pursuant to Tenon's /PSL's advice. Neither of the appellants could present any other explanation for those withdrawals.

(2) The documentary evidence and large parts of the Michons' evidence pointed towards the advice being given beforehand. Tenon's letter of 28 June began "we have discussed in some detail…". Such discussions, which included several meetings, must have been ongoing for some time and, HMRC say, prior to 2 May 2006. Jeff Michon said in his witness statement that his accountant Brian Buck first introduced him to Tenon "around the same time that we identified the Old School Rooms as the property we wished to purchase", which was in "February/March" 2006. Tony Michon also expressly agreed in cross-examination that the advice from Tenon was given "after December 2005 but before 2 May 2006" and that the £60,000 was taken out "pursuant to the loan waiver planning" as explained by Tenon.

Was Tenon/PSL loan waiver advice given before 2 May 2006 or after?

28. In reaching my conclusion on this issue I noted the following points in particular.

29. Jeff Michon's recollections that the advice was not given until later were anchored to the time period around which planning permission had been sought and when the decision to take extended mortgages had been made. The timing of those events was, however, itself based on recollection and recollections made without the benefit of any supporting documents. Jeff Michon's recall around the May 2006 withdrawal was confused, in that in cross-examination he initially maintained the purpose was for an auction bid (which was the stated purpose for the December 2005 withdrawal). It must also be taken into account that both planning permission and mortgage applications are typically ongoing processes in relation to which, when a person recollects them a number of years later, they might be some understandable ambiguity over what particular point in the process the recollection related to. The suggestion that the Tenon advice was given later in June 2006 was also at odds with Jeff Michon's recollection that advice was taken at about the same time as the Old School Rooms was identified as a property which according to his initial answers was around February/March 2006. As regards the 27 April 2006 entry in the director's loan account for planning and legal costs, even taking into account that it was not known whether such fees were in respect of invoices rendered or whether they were advance payments the entry appears to me more consistent with the investigations taking place earlier than late June than not.

30. Tony Michon's recollection, in response to a suggestion in cross-examination that the advice led to the withdrawals of £75,000 in December 2005 and £60,000 in May 2006, was as follows:

> "Those discussions, if I remember correctly came after that. So I think the initial £75,000 was always taken out as – so that we could respond quickly to properties as they were coming on to the market, with a view to then paying it back asap. It was then brought to our attention that this could actually be used to raise the funds and in an effective way and that was brought to our attention later. I'm not sure exactly when. I know it was in between the two drawings."

31. This evidence came across to me as less equivocal than his other recollections and may, in my view, be given more weight. Furthermore, the recollection of timing was linked in his mind to the rationale for why the amount was drawn, a topic which seems to me to be more susceptible to reliable recollection over the passage of time than specific dates.

32. While I agree with the appellants' point, that it does not follow from the fact that Tenon's/ PSL's advice was about tax efficient release of funds to fund a property purchase, that the £60,000 drawing must therefore have been made pursuant to the advice, it is nevertheless a factor, particularly when Tony Michon's evidence is taken account of, which points towards the advice having been given beforehand. Viewing the evidence in the round, and weighing up Tony Michon's evidence which provided an explanation for the withdrawal against Jeff Michon's evidence which did not, I conclude it is more likely than not that the first meeting with Tenon in relation to the loan waiver scheme took place before the 2 May 2006 withdrawal.

Implementation

33. As is clear from the terms of a letter from PSL to the directors dated 28 June 2006, which referred to the company "…having decided to award [Jeff and Tony Michon] in respect of [their] services", the directors of Michon Limited decided to award Jeff Michon and Tony Michon a bonus for their services in the year ended 31 January 2007 some time prior to 28 June 2006. The sum of £150,000 was set aside to reward Jeff Michon and another sum of £133,000 was set aside to reward Tony Michon in respect of their services to the company during that year.

34. The Board meeting took place on 3 July 2006. The Minutes of the Board of Michon Limited which were dated 3 July 2006 recorded Jeff Michon and Tony Michon, (directors), and Lorraine Michon, Director / Company Secretary as present. (Both parties to these appeals readily accept that they emphasise different aspects of the minutes and in accordance with their suggestion it is convenient to set the minutes out in full).

> "1. The meeting was held to discuss arrangements for bonuses for the year ended 31 January 2007.
>
> 2. The Board noted that a sum of £150,000 had been set aside to reward Mr JP Michon, whilst another sum of £133,000 had been set aside to reward Mr T Michon in respect of their services to the company during the year ended 31 January 2007.
>
> 3. Further discussions then took place regarding the form that the awards should take. The Board noted during those discussions that the loan accounts of Mr JP Michon and Mr T Michon were overdrawn to the sums of £149,670.95 and £132,743.60 respectively. It was therefore decided that the company should reward Mr JP Michon and Mr T Michon with sufficient net funds to enable them to repay their Directors loan accounts. These rewards would be made to Mr JP Michon and Mr T Michon in respect of their services as the key employees in the business during the year ended 31 January 2007.

> 4. Mr J Michon reported that there had been discussions with their accountants, and Premier Strategies Limited, in order to determine the most cost efficient way of providing them with the necessary net funds. The purpose of these discussions was to determine the way in which the required remuneration could be delivered at the lowest cost to the company.
>
> 5. The Board therefore considered the most appropriate way in which the bonus could be made.
>
> 6. Mr J Michon referred to his recent discussions with Premier Strategies Limited and tabled a calculation that showed that the release of their loan accounts would be the most cost efficient delivery mechanism. After discussion of the merits of this structure it was agreed that the bonus for the year would be delivered by way of formal release of the loan accounts of Mr JP Michon and Mr T Michon.
>
> 7. Mr J Michon informed the Board that he would ensure the releases were properly documented and was given full authority to affect the release of the loan accounts of Mr JP Michon and Mr T Michon in satisfaction of their bonuses for the year ended 31 January 2007.
>
> 8. The board noted that the company was, and would remain, solvent following this transaction and resolved that no alternative to the loan release, cash or otherwise, would be made available to Mr JP Michon and Mr T Michon in respect of their services to Michon Limited.
>
> 9. There being no further business the meeting closed at 430pm 3rd July 2006."

35. Each of the attendees signed the board minutes.

36. On 3 July 2006 a letter addressed to Jeff Michon was executed as a deed by the company (Tony and Lorraine Michon). The letter stated:

> "We refer to the sum of £149,670.95 (the "Amount") which was owed by you to the Company. We hereby:-
>
> 1. release you from any liability to repay the Amount to the Company;
>
> 2. acknowledge that the Company has no claim or right of action of any kind against you in relation to the Amount; and
>
> 3. to the extent that any such claim or right of action exists or may exist, irrevocably waive such claim and release you from any liability whatsoever in respect of such claim or right of action."

37. The same day the company passed a written resolution describing the arrangements that the company was entering into with Jeff and Tony Michon as directors:

> "The arrangements are for the release by the Company of a debt in the sum of £149,670.95 due to the Company from Mr JP Michon and a debt in the sum of £132,743.60 due to the Company by Mr T Michon."

38. The company credited the sum of the bonus onto each director's loan account.

39. The loan waiver was recorded in the company's profit and loss accounts under "wages and salaries". Note A7 "Loan account release" recorded:

> "On 3 July 2006 Michon Limited released £149,671 of the loan of Mr J P Michon, and £132,744 of the loan account of Mr T Michon in satisfaction of their bonuses for the year. The amount of the loan released has been treated as earnings for National Insurance purposes.".

40. Tony Michon disclosed to HMRC in his 2007 tax return the release of his loan as a Non-Qualifying Distribution, in the year ended 5 April 2007 in respect of the loan release of £132,743.60.

41. In the company's tax return for the year ended 31 January 2007, the release of the directors' loan accounts was detailed in supplementary pages, headed "Loans to participators by close companies Form CT600A". The company claimed a deduction in respect of the sums of the indebtedness released.

42. The release of Jeff Michon's loan account and Tony Michon's loan account was referred to in the notes to the company's financial statements for the year ended 31 January 2007, at note 10 'transactions with directors'.

Esprit Logistics Management Limited

Background

43. Mr Dixon was the founder of Esprit Logistics Management Limited ("Esprit"), which was formed in September 2006. He and his wife have been the two sole directors at all material times. Mr Dixon's background was in road haulage, both as a driver and then in managing his own haulage business with a small fleet of lorries. Mr Dixon has been the Managing Director from its inception until the day it ceased trading in 2011. This role involved overall management of the day-to-day running of the business – payroll, finances, business development and HR.

44. The shares in the company have always been owed by Mr Dixon and his wife, although the ratio has varied over time until eventually it was held 50:50 between the two. Prior to the incorporation of Esprit, Mr Dixon used an accountant in Rawtenstall to deal with his affairs. But Mr Dixon felt that the affairs of the new company would be too complicated for that accountant to deal with and so, on recommendation, he engaged RSM Tenon to advise Esprit. In or around 2007 or 2008, Tenon became the sole accountants dealing with both Mr Dixon's personal affairs and those of Esprit until 2010, with Mark Conboy as his main contact. During that time Tenon dealt with various aspects of the affairs of Mr Dixon and Esprit, including corporate and personal tax matters.

45. In 2007 Mr Dixon and his wife planned to sell Esprit and emigrate to France, where his elderly mother lived. Despite attempts by Tenon to find a buyer for the company, no sale materialised and Mr Dixon became disillusioned with Tenon. He therefore changed accountants and engaged a firm called Hardy & Co in or around 2011.

The Director's Loan Account

46. Mr Dixon and his wife, as directors of Esprit, were permitted to draw on the company funds. They paid themselves a minimal salary and then paid out regular dividends. NICs were paid on these sums.

47. Mr Dixon made regular monthly drawings of differing sums on the company funds from late 2007 onwards. The director's loan account operated in the manner of a current account or running account between the directors and the company. Esprit made book entry credits on the director's loan account of certain sums to its director, Mr Dixon. For example, on 1 November 2007 Mr Dixon was awarded a dividend of £40,000. The sum of £40,000, was credited to his director's loan account. On 1 March 2008, a dividend of £25,000 was credited to his director's loan account.

Remuneration planning/ advice

48. In late 2008 or early 2009, Mr Dixon and his fiancée had a meeting with Tenon to discuss and review Esprit's accounts. Mr Dixon was concerned that the company may be "overpaying tax" and wanted to ensure any tax allowances were being properly utilised.

49. On 21 May 2009, Tenon sent a letter of advice to Mr Dixon regarding the loan waiver scheme. The proposals were either: (i) do nothing and let the balance increase over time; (ii) pay a bonus to clear the balance; (iii) payment of a dividend to clear the balance; (iv) a loan write-off through ELM's profit and loss account as director's salary.

50. During this meeting, Tenon suggested ways to deal with the director's loan account balance. This was followed by a letter dated 21 May 2009, in which Tenon outlined the loan waiver proposal.

51. On 23 June 2009, Mr Dixon received a further letter of advice and a formal engagement letter from Tenon.

52. Some time prior to 23 June 2009, the directors of Esprit decided to award Mr Dixon a bonus for his services to the company in the years ended 30 September 2008 and 30 September 2009. The sum of £155,000 was set aside to reward Mr Dixon in respect of his services to the company during those years.

53. After a gradual build up, by mid-2009 his director's loan account had an overdrawn balance of £305,785. In anticipation of the sale of the company, Mr Dixon and his wife withdrew various amounts from the loan account to enable them to put down a deposit on property in France and also to provide a deposit on a small apartment in the UK for the couple to use as a bolt-hole.

54. Following the advice received from Tenon, they decided to proceed with the loan waiver. Tenon then dealt with all the procedural aspects, and provided them with the necessary paperwork to implement the loan waiver. At all times, Mr Dixon and the company relied on and followed the advice he had been given in connection with the loan waiver.

Implementation

55. At a board meeting held on 26 June 2009, the company resolved to release Mr Dixon's loan account by way of reward for his services to the company in the two years to 30 September 2009.

56. The board minutes were in the same form as for Michon Limited except that the details regarding the sums and relevant years were different. Also at point 6 instead of referring to recent discussions with Premier Strategies Limited, the minute referred to recent discussion with Tenon Limited. The minutes recorded a sum £155,000 had been set aside to reward Mr Dixon for services during the year ended 30 September 2008 and that his loan account was overdrawn by £305,785. The board's resolution related to provision of bonus for the two years ended 30 September 2009.

57. The board minutes, Deed of Waiver and the company's written resolution were all dated 26 June 2009.

58. Tenon prepared the financial statements for Esprit for the years ended 30 September 2008 and 30 September 2009 and also Esprit's corporation tax computations for the periods ending 30 September 2008 and 30 September 2009, and Mr Dixon's self-assessment tax return for the 2009/10 tax year. He included the release of the loan in it in the sum of £339,761 as a "non-qualifying distribution" and paid tax of £78,437.02 in respect of it. Mr Dixon notes that the figure shown in his return is higher than the sum released, but does not know why this is. (His representative suggest that the £339,761 figure is likely to be the figure of £305,785 grossed up at the prevailing dividend ordinary rate (since £339,761 = £305,785/0.9).

59. To the best of Mr Dixon's knowledge, NICs was also paid in respect of the loan release, with all tax sums due, as advised by Tenon, being paid in full and on time

OcUK Limited (formerly Esnet Limited)

Background

60. Mr Mark Proudfoot is the former Managing Director of OcUK Limited (previously known as Esnet Limited). In 1999, Mr Proudfoot decided to set up a limited company to sell "overclocked" central processing units (more commonly referred to as "CPUs"). "Overclocking" a CPU means taking steps to make the CPU run at higher processing speeds. The company was incorporated in 1999 under the name Esnet Limited. Mr Proudfoot became a director of the company in 2000 and remained as such until the Esnet Group was sold in 2011. His wife Claire was also appointed as a director of the company following the departure of Mr Peter Radford as director in 2003.

61. DPC Accountants, who were the company's accountants dealt with all the financial aspects of the company. Whilst Mr Proudfoot was involved in all financial decisions of the company, it did not have a financial director and so Mr Proudfoot was heavily led by David Griffiths, who was the main contact at DPC. The company grew to become highly successful, but in 2007 Mr Proudfoot and his wife decided to sell the Esnet Group because running the business was very stressful**.** The group was eventually

sold in 2011. After the sale, the name of the Company was changed to OcUK Limited. Mr Proudfoot is not now involved with the business.

The Director's Loan Account

62. As a director of the company, Mr Proudfoot was primarily remunerated through the payment of dividends, and in some years a small salary. He was also permitted to draw on company funds by way of loan**.** The director's loan account operated in the manner of a current account or running account between the director and the company. Mr Proudfoot does not recall when his director's loan account was opened, however it was following advice from DPC.

63. The loan account was not used by Mr Proudfoot to make regular drawings. In 2006 Mr Proudfoot was advised by DPC to draw money from the loan account because the company accounts had not been finalised and he was therefore unable lawfully to draw a dividend. The loan account shows that there were two significant drawings by Mr Proudfoot, one for £40,351 in April 2006 and one for £3,000,000 on 15 June 2006. Mr Proudfoot cannot recall what the former sum was used for, but the latter sum was used to purchase a property in Devon in the summer of 2006.

64. On 18 September 2006 Mr Proudfoot was awarded a dividend of £515,000 by a group company. The sum of £515,000, was credited to his director's loan account. By 29 September 2006, his director's loan account had an overdrawn balance of £2,515,680.

Remuneration planning /advice

65. David Griffiths of DPC introduced Mr Proudfoot to Marc Edmond at Tenon Limited (later known as PSL), in or around 2004. This was in relation to other tax planning schemes discussed with Mr Proudfoot in the period between 2004 and 2007.

66. In the summer of 2006 Mr Griffiths, Mr Proudfoot and his wife met with Mr Edmond at DPC's offices and he explained the release of director's loans and how they were taxed, advising that it was tax-efficient. On 31 July 2006 PSL issued an engagement letter to the company.

67. It is a matter of dispute as to whether Mr Proudfoot received advice from PSL on the loan waiver scheme before the date the £3million was drawn (15 June 2006).

68. The appellants argue it can be inferred from the 31 July 2006 letter that the meeting with Mr Edmonds took place on or shortly before that date. HMRC pointed to a letter from Tenon to HMRC dated 10 October 2011 from Tenon, which stated:

> "No discussions between [PSL] and [OcUK] took place concerning the loan release before the engagement letter was issued on 16 June 2006".

69. However, it appears no engagement letter of that date was provided by Tenon; neither party to these proceedings was able to find a copy. On the balance of probabilities, given the date of the copy of the engagement letter that was in evidence,

I find as the appellant invites me to, that the reference to the "16 June 2006" date was a mistake.

70. HMRC invite the Tribunal to find that Mr Proudfoot received advice from PSL in relation to the loan waiver scheme on or before 15 June 2006. The whole basis of the loan waiver scheme was that it required a "balance outstanding on the loan account". Since early 2005, Mr Proudfoot's loan account had generally been in credit with very little withdrawal activity. However, on 15 June 2006 Mr Proudfoot then suddenly withdrew a substantial sum of £3,000,000. This had the effect of taking his director's loan account £3,030,680 overdrawn, sufficient to cover his 2007 bonus of £3,000,000. The 15 June 2006 withdrawal must, therefore, HMRC argue, have been made pursuant to PSL's advice and with the intention of operating the loan waiver scheme.

71. Mr Proudfoot's recollection was that he first received the advice in relation to the loan waiver scheme only after the 15 June 2006 drawing. Taking account the length of time that had since passed, I am unable to accord any significant weight to that recollection however. I agree with HMRC's suggestion that, even if PSL were not formally engaged in June 2006, it is likely that they provided informal advice to Mr Proudfoot about the loan waiver scheme at or around that time. That is because Mr Proudfoot was introduced to PSL/Tenon in 2004. He then participated in at least one or two other PSL's/Tenon's tax schemes between 2004 and 2006.

72. It seems to me improbable, taking account of that backdrop, the significant amount of drawing involved, the lack of any other similar amounts having been advanced in this fashion previously, that Mr Proudfoot would have withdrawn £3million without getting advice beforehand, and that given Tenon/PSL's previous involvement in advising on matters of tax-efficiency, that they would not similarly be involved in the advice that was given. In my view, there is little that can be inferred from Tenon's 10 October 2011 letter which suggested that no discussions had taken place before the engagement letter. The date of the engagement letter mentioned (16 June 2006), as I have found earlier, was mistaken, no witness was available to speak to the letter, and the tribunal was not provided with any supporting evidence, for instance in the way of PSL's record keeping, from which to understand the basis upon which Tenon's claim, that no discussions had taken place, was made. As regards the significance of the date (31 July 2006) of the engagement letter which was produced, it is quite possible that the need to formally confirm the engagement promptly following initial discussions was perceived to be less pressing with an existing client than with a new one. I therefore agree with HMRC that it is more likely than not that the loan waiver scheme would have come up during the meetings Mr Proudfoot had with Tenon in relation to other schemes prior to 15 June 2006.

73. On 25 September 2006, PSL outlined the loan release to Mr Proudfoot. Acting on the advice received from PSL and the discussions Mr Proudfoot had with Mr Griffith at DPC, he decided to proceed with the loan release. He trusted Mr Griffith and had no reason to doubt his advice. Premier Strategies dealt with all the procedural aspects and DPC provided Mr Proudfoot with the necessary paperwork to implement the release. At all times, Mr Proudfoot relied on and followed the advice he had been given in connection with the loan waiver.

Implementation

74. At a board meeting held on 29 September 2006, the company resolved to release Mr Proudfoot's loan account by way of reward for his services to the company for the year ended 30 April 2007. The board minutes were in the same form as for Michon Limited save for the different financial year and sums involved. The sum awarded (for Mr Proudfoot's services during the year to 30 April 2007 and the amount by which the loan account was overdrawn was noted as £3 million (although as a matter of fact this was incorrect because as from 18 September 2006 onwards Mr Proudfoot's director's loan account was only overdrawn in the sum of £2,515,680 because of the dividend which had been credited).

75. The board minutes, deed of release and company resolution were all dated 29 September 2006. DPC prepared the company accounts and corporation tax computations. The loan waiver was recorded in the company's profit and loss accounts, under wages. It was also put through payroll as a National Insurance only event.

Ripple Developments Limited and Mr David Wolfenden

Background

76. Mr David Wolfenden is the Managing Director of Ripple Developments Limited ("Ripple"), a retail display and interiors specialist providing design, manufacturing and installation services.

77. Mr Wolfenden joined Ripple as a Commercial Manager in July 1982 and was appointed as a director in the second year of his employment. In 1984, after acquiring Nigel Wolfenden's shares, he advanced to the role of Sales Director, before becoming the Managing Director in 1990, a position he has held since. In his role as Managing Director, he is responsible for the general management and strategic development of the business. At the relevant times he was a 94% shareholder, the balance being held by his wife. In 2005 the company changed its name to Ripple Group Limited; it changed to its current name in 2008.

Director's Loan Account

78. The shareholding directors are remunerated by means of salaries and dividends; they are also permitted to draw on company funds. The company books recorded the individual loan accounts and the drawings and credits that were made. The director's loan accounts operated in the manner of a current account or running account between the directors and the company.

79. Mr Wolfenden's director's loan account had existed for some time, but did not become operational until the early 2000s. From this point onwards, following advice he received from Ripple's accountants, he made regular monthly drawings of approximately £5,000 - £8,000 on each occasion. He was in the habit of paying his PAYE contributions into his loan account and making regular monthly drawings. The entries show both cash drawings and borrowings which arose as a result of the company making a payment to a third party on Mr Wolfenden's behalf. Every month in 2005-

2007, Mr Wolfenden was paid a salary from the company. The net salary figure, after deduction of PAYE, was credited to his director's loan accounts by way of a book entry. Similarly, sums owed to Mr Wolfenden for mileage and as dividend payments from the company were credited to the director's loan account.

80. Mr Wolfenden made significant drawings of £20,000 in December 2005, £16,000 in December 2006, and £69,000 on 19 December 2007. He believes that the drawings in December 2005 and December 2006 were to fund refurbishment expenditure on his house, in preparation for sale. In December 2007, his director's loan account had an overdrawn balance of £150,008.

Remuneration planning / advice

81. Prior to June 2007, Ripple had been advised by an accountant named Mr John Gillibrand of Unity Chartered Accountants. In June 2007, Unity Chartered Accountants was acquired by RSM Tenon but Mr Gillibrand continued to advise Ripple.

82. In November 2007, Mr Wolfenden spoke to Mr Gillibrand about "the balance on my director's loan account" and "wanted to understand what would be the best method of drawing the net funds from Ripple in an amount which was sufficient to enable the loan account to go back into credit". Mr Gillibrand introduced Mr Wolfenden to Paul Draper of Tenon who provided "advice in connection with remuneration planning for the year ended 31 December 2007". This included a meeting at which Paul Draper discussed the options available to the company and "brought the possibility of a waiver of directors' loans to our attention".

83. On 13 December 2007, Tenon provided a letter of advice by email with illustrations of various remuneration options which included detailed advice about the loan waiver scheme and draft calculations. Mr Wolfenden understood from his discussions that the loan write-off was an accepted practice and HMRC approved. Mr Wolfenden discussed this with his colleagues and consequently decided to proceed with the loan waiver.

84. On 19 December 2007, Mr Wolfenden received a further letter of advice from Tenon. The letter stated that "having decided to award you in respect of your services" the company had decided to "release the loan account in satisfaction of your bonus for the year". At or around the same time, the sum of £150,008 was "set aside" to reward Mr Wolfenden in respect of his services to the company during that year.

85. The same day, Mr Wolfenden then withdrew £69,000 on his loan account. That drawing was made at a time when Mr Wolfenden knew the company were going to implement the loan waiver scheme and had sought advice from Tenon about the most tax efficient way of drawing funds from the company. The drawing of £69,000 was made pursuant to Tenon's advice, to bring the loan account overdrawn to a sufficient sum (£150,007.91) to correlate with the performance related bonus of £150,008 Mr Wolfenden was to be awarded by the company the next day.

Implementation

86. Following Tenon's directions, Mr Wolfenden called a meeting of the Board of Directors which took place on 20 December 2007, to formally discuss the loan write-off. Tenon provided paperwork which the board used to guide the meeting and record minutes as necessary, and sent a letter to Mr Wolfenden setting out the tax and legal issues the day before. At all times, Mr Wolfenden relied on and followed the advice he had been given in connection with the loan waiver.

87. The board meeting was attended by three directors including Mr Wolfenden and the company secretary. The minutes were in the same form as Esprit (the discussions recorded were with Tenon Limited) except that the time at which the meeting closed was not completed. The sum awarded (for services during the year ended 31 December 2007) and the amount overdrawn was £150,008. The Board meeting minutes, deed of release and company resolution were all dated 20 December 2007.

88. The withdrawal of £69,000 on 19 December 2007 clearly took place after advice in relation to the loan waiver scheme had been given to Mr Wolfenden.

89. Tenon prepared the company's tax return and financial statements for the year ended 31 December 2007. In the company's tax return for the year ended 31 January 2007, the release of Mr Wolfenden's loan account was detailed in the supplementary pages, headed "Loans to participators by close companies". The release of the loan account was also referred to in the notes to the company's financial statement at note 14 'transactions with directors'. In his tax return for the year ended 5 April 2008 Mr Wolfenden disclosed the release of his loan to HMRC. The loan waiver was recorded in the company's profit and loss account as wages. It was also put through payroll as a National Insurance only event.

Extent and order of issues for determination

90. There was some disagreement between the parties as to the proper extent and ordering of the issues for determination, which it is necessary to address at the outset. HMRC's starting point is their argument that the so-called waiver of the loan was, in reality, simply a reward for the director's services and chargeable as employment income (within the meaning of s62 ITEPA) under s9 ITEPA. The scheme of arrangements was the mechanism for the delivery of bonuses which were taxable as employment income. It was not necessary to consider other charging provisions. The appellants maintain the starting point is nevertheless to consider whether s415 ITTOIA applies, as they argue, because there was a "release" of the director's loan and then consider whether, as they maintain, s415 ITTOIA has priority over the charge to income tax under ITEPA. The appellants accept the release is capable of falling within the definition of earnings in s62 ITEPA. However, the difficulty highlighted by the appellants with HMRC's starting point is that it assumes either s415 ITTOIA has no application or that, if the ITTOIA charge does apply, that ITEPA nevertheless takes priority or otherwise excludes s415 ITTOIA.

91. Having reflected on the parties' arguments it was not clear to me what further basis there was, over and above the arguments around statutory priority as between

ITEPA and the s415 ITTOIA charge (that would only need to be addressed if s415 was found to be applicable on the facts), for HMRC's submission, that if the payment was earnings under s62 ITEPA, no other charge was relevant. Noting the concession made by the appellant I agree that the appropriate starting point is to consider the s415 ITTOIA issue. I should also record that further to the parties' request, the decision on the various issues is to be given in principle, and that no determination was sought, at this stage, in relation to whether, if an employment income charge was in issue, the relevant amounts were subject to PAYE.

Whether s415 ITTOIA applies?

92. As already mentioned, there is no dispute that the corporate appellants were at all the relevant times close companies or that the directors in question were all participators in their respective companies. It was also not in contention that the corporate appellants made loans to those participators so as to make them assessed or liable to be assessed under section 419 ITTOIA.

93. The case put forward by Mr Jones on behalf of the appellants is straightforward. He argues the s415 charge is a sui generis charge which applies when certain conditions are fulfilled, namely when the loan referred to is released by the company. The term "release" bears its ordinary meaning. In each case the deed of release unambiguously provided that the company would release the director from any liability to repay the full amount to the company.

94. On behalf of HMRC, Mr Nawbatt argues that, viewed realistically and commercially, the arrangements do not involve a "release" within the meaning of the legislation construed purposively. A "release" means the close company agrees to release a director from his or her obligation to repay the director's loan without the debt being repaid. If the parties exchange something of equal value there will be no release but rather a set-off. The obligation has ceased to exist as the debt has been repaid and there is no obligation for the debtor to be released from.

95. The term "release", as it appeared in the predecessor legislation to s415 was considered in *Collins v Addies* where the taxpayers were directors and shareholders of a close company who were indebted to the company. Under the terms of a sale of shares to a fellow director, that director (Mr Brent) was obliged to deliver a deed under which the company released the taxpayer directors from their liability up to £68,000 in consideration of the substitution of Mr Brent for the taxpayer directors as debtor to the company in that amount. In other words the debt owing to the company was novated. The Revenue raised assessments under predecessor provisions to s415 (s287 of the Income and Corporation Taxes Act 1970). The issue was whether the novation of a debt constituted a "release" as the Revenue maintained. The Special Commissioners rejected the appellant's argument that the novation was not a release, as did the High Court on appeal. The Court of Appeal unanimously upheld the High Court's decision.

96. In the High Court, Millet J analysed the underlying purpose of the provision as follows:

> "In my judgment, the true analysis of s 287 is that it is linked for this purpose with s 233 which exempts the original loan from being a distribution and thus being taxable in the participator's hands only because it is made for full consideration consisting of the obligation to repay. As long as that obligation to repay subsists the exemption from tax likewise subsists. If the obligation to repay should come to an end by payment of the debt then clearly there should be no tax charge; the distribution would be nullified by the repayment. If on the other hand it should come to an end by release so that the obligation is terminated without repayment, a balancing charge or payment of the deferred charge on the distribution should be raised. That is the essential relationship between s 287(1) and the other provisions relating to participators in close companies and distributions to them."

97. The High Court's judgment went on to set out that the term "release" was not limited to gratuitous releases and drew a clear distinction between novation (release of one debt and substitution of another) and all other forms of payment or satisfaction under which the debt was actually repaid:

> "…In my judgment, ss 286 and 287 draw a clear distinction between the release or writing off of the debt on the one hand and its repayment or satisfaction on the other. 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 these sections, 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. In my judgment 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 treated as repaid with no outstanding obligation on any party in respect of the debt or any similar sum."

98. In the Court of Appeal (Nourse, Glidewell and Stocker LJJ) the Court of Appeal also confirmed releases were not limited to gratuitous releases. Nourse LJ rejected the appellant's argument that it was illogical to accept both that a novation was a release and the Revenue's concession that a release would cover accord and satisfaction:

> "…The Crown's basic proposition with which I agree is that "release" does not include any transaction which either consists of or amounts to a repayment of the loan even if the transaction, when viewed in isolation, might be said to have the effect of releasing the debtor from his obligation to repay the loan. The reason for that limitation is that the repayment of the loan, or the acceptance by the company of something equivalent to it, effectively enables it to recover its money, in which event there is no justification for imposing a liability to tax on the participator. The limitation has nothing to do with gratuitousness, moreover it is not one which excludes a novation being a transaction which does not enable the company to recover its money."

99. He dismissed the appeal for substantially the same reasons as those relied on by Millet J. Glidewell LJ agreed with Nourse LJ's reasons adding that not only did certain clauses in the deed refer to the transaction as a "release" of the taxpayer's liability to repay the company but that in ordinary English usage "release" was an accurate word to describe what was being done. Stocker LJ agreed with both Glidewell and Nourse LLJ's judgments.

Interpretation of s415

100. There is no real disagreement between the parties around the basic propositions do be drawn from the case. The term "release" did not cover repayment or satisfaction of the loan. The term was not confined to gratuitous releases or releases for less than full consideration. A novation did not amount to repayment or satisfaction. What the parties differ on however is the extent to which a purpose may be drawn from the provision, and in how the provision applies to the particular facts of the appeals in question.

Differing views of purpose

101. For the appellants, Mr Jones argues s419 is very specific sui generis provision which applies where terms of charge are met. It does not tax distributions nor does it treat a transaction as if it were a distribution. Section 415 was a provision "concerned only with the character of the particular transaction" (as described by Moses LJ at [55] in *PA Holdings*)and it was difficult to discern much of a purpose from words of the provision. In *Collins v Addies* it was the form of the transaction (novation) which was crucial and the fact the novation involved release of the old debt under s415 even though the substance was that debt did not really change. The case confirmed that "release" took its ordinary meaning, which in essence was to let the borrower off the obligation to repay.

102. Mr Nawbatt, for HMRC submits, that construing s415 purposively, and taking account of how *Collins v Addies* dealt with the predecessor provisions, the purpose of s415 was to impose a charge where the director / shareholder has been advanced money he or she had not repaid. The section was plainly not intended to apply where the loan discharged by repayment or satisfaction. If there was an exchange of equal value then there was satisfaction by set off as if both sums had actually been paid in full rather than release.

Relevance of Set-off principles

103. In *Spargo's case* (1873)L.R. 8 Ch.App 407, which HMRC referred to, Mallis LJ stated the principle as follows:

> "Nothing is clearer than if the parties account with each other, and sums are stated to be due on one side, and sums to an equal amount due on the other side on that account, and those accounts settled by both parties, it is exactly the same thing as if the sums due on both sides had been paid. Indeed, it is a general rule of law, that in every case where a transaction

> resolves itself with paying money by A to B, and then handing it back again by B to A, if the parties meet together and agree to set one demand against the other, they need not go through the form and ceremony of handing the money backwards and forwards."

104. The appellants submit HMRC cannot establish the ingredients for set-off which requires mutual debts legally owing; on the facts the director had no contractual entitlement to bonus. HMRC's case was flawed because it sought to charge tax on what the company could have paid, whereas tax was charged on what actually did happen.

105. HMRC submit, it is not necessary for there to be any contractual entitlement (pre-existing or otherwise) for the set-off principles to apply. They refer to Lord Hodge's comments in *RFC 2012 Plc (the Rangers Football Club Plc) v Advocate General for Scotland* [2017] UKSC at [66] where he explained that the fact that the employees had no contractual entitlement to the bonuses, and the bonuses were voluntary on the part of the employer, was irrelevant to the bonuses in that case falling within the relevant tax charge as emoluments or earnings so long as the money was given in respect of the employee's work as an employee.

106. HMRC maintain the general rule stated in *Spargos* above is not dependent on there being any sum due but in any case the board minutes resulted in the requisite obligation. In any event, HMRC's case did not need to rely on the principle in *Spargos* because, when viewing the facts realistically and looking at substance, it must have been the case that the tax treatment was the same between (using the OcUK facts as an example) £3 million being transferred to Mr Proudfoot's bank account, which the director then used to pay money into director's loan account, and the situation where company did not go through the ceremony of handing money back and forth.

Arguments on facts

107. The appellants emphasise the question of whether there was a "release" is a legal question which involves determining the legal effect of the documents the parties entered into. The views of how the parties thought the documents operated were therefore irrelevant. The relevant documentation (board minutes, resolution, deed of release) show in each case the company decided to reward the directors for their services to it during the year by way of release of the director's outstanding indebtedness. In each case the deed unambiguously provided that company would release the director from any liability to repay the full amount to the company and acknowledged that the company had no claim or right of action of any kind. At no stage did the directors have any entitlement to a cash sum in the same amount which could be used to set off against the outstanding loans. Reading the board minutes as a whole they decided the bonus would be delivered by way of a formal release of the loan account. The form of wording of the deeds was similar to the wording in the deeds in *Collins v Addies*. The appellants accept the release was not wholly gratuitous because it was made in recognition of past services. But, that did not matter as it was clear that "releases" for the purposes of s415 were not confined to gratuitous releases.

108. Referring back to the core of Nourse LJ's reasoning and the purpose underlying the provision of considering whether the company has recovered its money HMRC

submit the deed cannot be looked at in isolation. The credit of the sum of bonus enabled the company to recover the monies advanced. That was a key distinction between *Collins v Addies* where the debt subsisted, albeit the debt had been novated to the purchaser.

Discussion

109. As neatly encapsulated by the House of Lords in *BMBF v Mawson* [2004] UKHL 51 at [32] the underlying question to be tackled is:

> "… whether the relevant provision of statute, upon its true construction, applies to the facts as found"

110. As clarified in the paragraph from which that excerpt is taken, it does not matter whether the tribunal starts by construing the statute first and then looks at the facts or the other way round. In this case I address the parties' competing submissions on how the provision in s415 should be interpreted first.

111. While it must be uncontroversial that the s415 charge only applies when the conditions mentioned within it are fulfilled, the precise scope of how those conditions should be interpreted will be informed by the ordinary meaning of the words used as properly understood in their statutory context. That task of interpretation has previously been carried out by the higher courts. Having considered the substantially similar predecessor sections, both the High Court and Court of Appeal in *Collins v Addies* were able to discern and articulate a purpose for the provision. I therefore reject the appellants' argument that it is difficult to extract a purpose from the provisions "concerned only with character of transaction" per Moses LJ in *HMRC v PA Holdings* [2012] STC 582 and that the charging provisions are in essence "form-driven". Moses LJ had stated at [56]

> "In such cases, *[referring to BMBF and TowerMCashback]* on a proper construction of the statutory provisions in issue no purpose can be discerned other than to bring within their application a transaction which, on a realistic appraisal, falls within their scope. On a proper construction, it makes no difference whether the transaction was part of a series of transactions or part of a composite transaction or not."

112. While I agree with the appellants that the question of whether there has, on the facts, been a "release" is a legal question involving analysis of the legal effect of deeds entered into it is not so confined. As is clear from the terms of Nourse LJ's reasoning in *Collins* (at [98] above), which acknowledged that, even if the transaction "when viewed in isolation" might have the effect of releasing the debtor from his obligation to repay the loan, this did not mean there was a "release" if the transaction nevertheless amounted to a repayment of the loan. Mr Nawbatt, for HMRC, drew attention to the expansive way in which Nourse LJ put his reasoning in referring to a transaction which "consists of or amounts to a repayment…". The judge's analysis also referred, not just to repayment of the loan, but also to "the acceptance by the company of something equivalent to it" and to the fact that such repayment or acceptance "effectively" enabled the company to recover its money which meant there was no justification for imposing liability to tax on the participator. While it must be recognised, and HMRC certainly

do not suggest otherwise, that these references, as terms in a judgment, ought not to be examined as if they were a statute, they do serve to illustrate that, once the purpose of the provision is taken account of, that the exclusion of repayment and satisfaction transactions from the scope of "release" is not to be viewed restrictively or formalistically but should also encompass transactions which amount in substance to repayment or satisfaction.

113. Regarding the particular issues surrounding the relevance of set-off, there is no reason to suppose that where two mutually enforceable legal obligations to pay amounts due, are set off against each other that that would not amount as payment or satisfaction of the amounts outstanding. But, as can be seen from the parties' respective arguments they disagree on whether such mutually enforceable obligations emerge on the facts of these appeals and on the consequences if such obligations cannot be found.

114. As the appellants point out, and HMRC do not disagree, the facts do not disclose any contractual entitlement to bonus on the part of the company to the director. While HMRC refer to Lord Hodge's comments in *Rangers* regarding the irrelevance of contractual rights, the appellants are correct in their argument that the treatment of such non-contractual arrangements for employment remuneration tax purposes does not mean those arrangements are treated as legal obligations as a matter of general law. Nor is it apparent, what the basis is in law, for treating a statement in made in a board minute as creating any such legal right as a matter of general law (as opposed to, for instance for the purpose of applying employment tax charging provisions).

115. But, a conclusion that set-off, in the sense which involves mutually enforceable legal obligations, does not apply is not fatal to HMRC's case. As discussed above, the interpretation of "release" and the exclusion of repayment and satisfaction transactions is informed by the underlying purpose of looking to see whether the company recovered its money and therefore encompasses transactions which amount to or are equivalent to repayment or satisfaction of the loan. It is clear from *Collins v Addies* that there is no bar to non-gratuitous transactions being considered as a "release". Novation is one such example where value is given in the form of the substitution of a fresh promise by a third party. However, it does not follow that, because a transaction is non-gratuitous, (and not also described as being made in payment or satisfaction), that it is prevented from amounting to payment or satisfaction so that it is not then in turn a "release". Whether a transaction amounts to such a release will involve looking not just at the deed of release but also at the particular facts and circumstances which surround the transaction.

116. These include the Board minutes which I have considered in full (and which are set out at [34] above). As was apparent from the parties' submissions, support for their respective cases can be found by highlighting particular excerpts. The appellant's case is that reading the board minutes as a whole the board decided the bonus would be delivered by way of a formal release of the loan account. While that description is fair, as far is goes, it is incomplete so far as an analysis of whether there was a "release" for the purposes of s415 is concerned, and the question of whether there was something which amounted to repayment or satisfaction of the loan. The board minutes capture each company's intention, having decided to set sums aside, which were matched by

indebtedness to the company, to reward their directors for their services. The intention of the reward was expressed to be to reward the director(s) "with sufficient net funds to enable them to repay" their Director's loan accounts. The purpose of the discussions with Premier / Tenon was reported as being to provide those net funds (i.e. the net funds to repay the loans) at the lowest cost to the company. Authority was given to affect the release of the loan accounts of the director(s) "in satisfaction of their bonuses" for the relevant year.

117. Reading the board minutes as whole, together with the deed of release, they reflect, as HMRC argued, that there was an exchange of equal value: the company wanted to award the directors sums so they could pay off their loans, but instead of handing over the money only for it to be handed back to make the repayment, the company reduced the director's indebtedness. These facts points towards the transaction amounting to repayment or satisfaction of the loan even if, because of the lack of a contractual entitlement, there was not a set-off of mutually enforceable legal obligations. The facts do fall into a scenario where the company "recovers its money" (in that bonus amounts that the company had indicated it would give no longer needed to be given, and therefore that such bonus commitments could be regarded as satisfied). The deed of release cannot be viewed in isolation as explained above and furthermore I agree with Mr Nawbatt's point that if the deed was intended to operate as a true release of obligation, it might then be expected that there would have been a separate payment of bonus that the company had decided to pay and set aside (in circumstances where the company had decided the directors' services had merited performance bonuses in that sum).

118. On the facts of each of the appeals the transaction which took place between the company and the director amounted to a repayment of the relevant loan. I therefore conclude the appellant companies did not release the loans for the purposes of the s415 ITTOIA charge.

119. The appellants concede that, if the s415 charge does not apply, the sums are taxable under s62 ITEPA. That concession was rightly made in my view. Although some of the general observations Mr Jones made on behalf of the appellants were correct in principle they did not further their case on the facts. The appellants point out the director's understanding of the arrangements they were entering was not determinative of the legal consequences of the transaction. Similarly they highlight that the fact an amount is described as a credit or a debit on a director's loan account is not determinative of whether the underlying transaction amounted to payment or to indebtedness being increased. However, in each appeal, the fact was, that sums were set aside on account of a reward for services in advance of the board meeting which matched the indebtedness to the company. The sums were then credited which reduced the indebtedness owed to the company commensurately (and in the case OcUK went further and resulted in a credit balance of £484,320). Although the company was not contractually obliged to credit the account, when it did so, this did amount to a payment of remuneration which was subject not only to NICs as is accepted, but to tax under s62 ITEPA too. In this case the director's understanding that, rather than being paid a cash bonus the director was being paid a bonus by having their loan account credited, was reflective of the reality. Similarly, the earlier debits on the loan account did in fact

correspond to increases in indebtedness, and the subsequent credits did correspond to payments of bonus. In summary the companies decided the directors should receive a bonus and delivered the bonus by reducing the indebtedness of the company.

120. Pursuant to the parties' request the decision is made in principle and makes no determination on whether any obligation in relation to PAYE arose in relation to the amounts of earnings. The remaining issues (whether if both s415 and ITEPA apply, which has priority, and whether, if s415 did apply the appellants were entitled to a claim a corporation tax deduction) do not need to be determined. I outline the parties' main arguments on those points and my views on those briefly in case they assist on any subsequent appeal.

Whether s415 ITTOIA has priority over Part 2 ITEPA.

121. The appellants' case, that a charge under s415 ITTOIA (which is in Chapter 6 Part 4 of ITTOIA) has priority over a charge under Part 2 of ITEPA rests on an exclusion in s366 ITTOIA which, so far as relevant provides (emphasis added):

> "**366 Provisions which must be given priority over Part 4**…
>
> (3) Any income, so far as it falls within—
>
> (a) any Chapter of this Part other than Chapter 3 or 6, and
>
> (b) Part 2, 9 or 10 of ITEPA 2003 (employment income, pension income or social security income), is dealt with under the relevant Part of ITEPA 2003."

122. HMRC maintain that, even if s415 and ITEPA apply, then s9 ITEPA is a stand-alone charge which means it is not necessary to consider other charging provisions. The fact s9 ITEPA is a stand-alone charge and that there is no requirement to consider any other charging provisions is consistent with the position set out by the Court of Appeal in *PA Holdings* (at [62]-[65]). It cannot have been Parliament's intention that s415 would have priority over s9 where a loan is waived as a means of rewarding performance. Section 366 does not specify the position in relation to Chapters 3 and 6 and does not require those Chapters to be given priority over ITEPA. No statutory intention to give Chapter 6 of Part 4 of ITTOIA priority over Part 2 of ITEPA can be read into s366. The overlap between the loan release provisions in s415 of ITTOIA and the employment-related loan release provisions in s188 ITEPA provide a clear rationale for excluding Chapter 6 from the mandatory requirement to give priority to ITEPA. Section 188 does the much the same as s415 but applies to employees rather than participators in close companies. There is clear potential for a double charge as recognised in s189 ITEPA with s415 taking statutory priority. Furthermore Para 1461 of the explanatory notes is consistent with the overlap that was in consideration being s188. That paragraph states:

> "In the source legislation there is a potential charge under section 421 of ICTA (which is rewritten in Chapter 6 of Part 4 of this Act (release of loan to a participator in a close company) and section 188 of ITEPA. Section 189 of ITEPA gives priority to section 421

> of ICTA. Section 189 of ITEPA will continue to assign priority to the charge in Chapter 6 of Part 4 of this Act."

123. As regards *PA Holdings* the appellants point out that case was concerned with, and confined to, a mutually exclusive schedular system of taxation which as noted by Moses LJ in *PA Holdings* at [26] was "radically altered" by the introduction of the Tax Law Rewrite. Furthermore that case was considering a section which was not in the same terms as s366(3) ITTOIA.

124. Were it necessary to decide to issue, I would not be satisfied HMRC's case demonstrated why it was the ITEPA provisions had priority despite the Chapter references in s366 which suggested otherwise. As the appellants highlight, no statutory provision or authority was put forward which supported the argument for priority; it could just as well be said that s415 was a stand-alone charge meaning that no other charge needed to be considered. The words of s366 clearly envisage the ITEPA priority provisions do not extend to the chapter which the s415 charge inhabits. The fact a rationale on one particular basis (the s188 overlap) can be found which is also mentioned in explanatory notes for the provision does not mean the words of the priority provision exclusion, which on their face extend to all of Chapter 6, should thereby be read more restrictively. While it must be accepted the intention of Tax Law Rewrite provisions was not to change the substance of the law, whether that was the effect would need to be examined by looking at the particular provisions. The provision from which s366 was drawn (s20(2) ICTA) similarly provided for priority of the (Schedule F) charge under s421 (which was the predecessor to Chapter 6 of Part 4 of ITTOIA). In any case an intention not to change the substance of the law would not stop such provisions nevertheless having such an inadvertent effect, if that was how they had to be interpreted applying the normal principles of construction to the language used in the new legislative scheme. I note that to the extent the explanatory notes for the provision are of assistance they suggest that s366 was meant to set out the precise scope of ITEPA's priority. Para 1459 of the Explanatory notes set out:

> "*Subsection 3* [referring to s366] ensures that ITEPA takes priority over Part 4 of this Act except for the charging provisions in Chapter 3 of Part 4 of this Act (dividends etc. from UK resident companies) and Chapter 6 of Part 4 of this Act (release of loan to participator in a close company). This reflects the priority that ITEPA has over Schedule D in the source legislation. It is based on section 18(1)(b) of ICTA and Schedule D Cases III(a) and VI of ICTA."

Corporate Tax Deduction

Whether loans made to director were "loan relationships" for purposes of s81 FA 1996 and s302 CTA 2009.

125. The relevant provisions were helpfully covered in the parties' skeleton arguments and I set them out in the Annex to this decision.

126. HMRC's case on this point is made only in relation to three of the sums drawn by the appellants (Michon Ltd: 2 May 2006, Ripple Developments Ltd: 19 December 2007 and OcUK Limited: 15 June 2006). HMRC contended, and I have now accepted on the evidence, that these amounts were drawn after the PSL/Tenon advice was given. The significance, it is argued, is that they were made pursuant to the loan waiver scheme, and in the knowledge the board meeting would take place and the transaction entered into. There was a lack of requisite common intention to repay necessary for a loan. In any case applying a purposive approach Parliament cannot have intended that increases in indebtedness in the circumstances of the contemplated transactions could result in a deduction from profits for employment income.

127. The appellants maintain the loans were "loan relationships". The companies stood as creditors. The loan waiver was a "related transaction" in respect of which the companies were the entitled to debits for Corporation Tax purposes. There was evidence the witnesses understood monies showing as due on accounts were borrowed and had to be repaid which was not challenged. As to HMRC's arguments on purposive interpretation these were misconceived because i) the deduction was not for employment income, it was claimed under the loan relationship provisions. ii) The directors were not being taxed as though they received a dividend, the sums were not distributions or deemed distributions. The tax charge was stand-alone tax charge which attracted the dividend rate. iii) There was nothing in legislation which implies symmetry which HMRC argues for in contrast for example with EBT contributions and corresponding deductions where it was specifically required that there had to be a taxable receipt in order for there to be a deduction.

128. Were it necessary to decide the issue, I would find the grounds advanced by HMRC in relation to the particular drawings would not justify refusal of the corporate tax deduction. In reaching that conclusion, the evidence of what the director understood would not assist. The question was the objective one of common intention and (reflecting the extract from *Chitty on Contracts, 39-258* I was referred to) whether the company lent or agreed to lend a sum of money to another in consideration of a promise express or implied to repay that sum on demand. The common intention appeared to me to implement the loan waiver scheme and therefore for the company to lend money in exchange for the director promising to repay it so that there would then be a loan capable of release in accordance with the scheme. Nor, was it apparent from the face of the legislation referred to, why the purposive construction HMRC argue for had to be taken so as to exclude the transactions.

129. HMRC further argue however that even if there were a loan relationship, the amounts (and this argument would apply to all of the debts in issue (not just the ones given after the Tenon/ PS loan waiver scheme advice) arose from a transaction that would not have occurred if the parties were at arm's length and accordingly fall foul of the arm's length provisions s444 CTA 2009 (para 11 Schedule 9 FA 1999) with the result that the corporation tax debit is reduced to nil. The directors who controlled the company and those who were lent the money which was subsequently released were the same people. This issue only arises if there was no release (and therefore no consideration in return). If nothing was provided in return then this was not a transaction at arm's length.

130. The appellants' response is that something was provided in return. The waiver was a form of reward for services, the company was getting value in return for the release in the same way as if it had paid a discretionary bonus even if the legal form was different.

131. It is not necessary however to reconcile how a discretionary bonus would be treated. On the facts of these appeals, in a scenario where there was shown to be a release, and therefore nothing which amounted to repayment or satisfaction of the debt I cannot see, as HMRC's case highlights, that there is then any room to argue that the waiver was given in return for something. Parties dealing at arm's length would not have entered into the transaction without getting something in return. In the event I was wrong in my conclusion that there was no release, it would therefore follow that the debits brought into account by the company should be reduced to nil and the corporation tax deduction disallowed.

Conclusion

132. The decision which is given in principle is that on the facts of these appeals, there was no release of loan by the close company appellants for the purposes of s415 ITTOIA. As indicated above, this decision does not address the question of liability to PAYE. If agreement cannot be reached on that issue or on the quantum of the relevant determinations and assessments under appeal then the parties may revert to the tribunal for further directions.

133. 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

SWAMI RAGHAVAN
TRIBUNAL JUDGE

RELEASE DATE: 31 May 2018

Annex

Provisions relevant to Corporation Tax Deduction issue

For accounting periods ending before 1 April 2009, the taxation of company loan relationships was dealt with under Chapter II of Part IV of FA 1996. With effect for accounting periods ending on or after that date, those provisions were re-written to Parts 5 and 6 of CTA 2009.

Section 292 provides an "Overview" to that Part, which states:

> "292 Overview of Part
>
> (1) This Part sets out how profits and deficits arising to a company from its loan relationships are brought into account for corporation tax purposes.
>
> (2) For the meaning of "loan relationship" see section 302 and Part 6 (relationships treated as loan relationships etc).
>
> (3) For how such profits and deficits are calculated and brought into account, see—
>
> …
>
> (b) section 297 (trading credits and debits to be brought into account under Part 3),
>
> …"

Section 295 sets out the "General rule" for profits arising from loan relationships:

> "**295 General rule: profits arising from loan relationships chargeable as income**
>
> (1)The general rule for corporation tax purposes is that all profits arising to a company from its loan relationships are chargeable to tax as income in accordance with this Part.
>
> (2)But see section 465 (exclusion of distributions except in tax avoidance cases)."

Section 296 deals with profits and deficits and section 297 with trading credits and debits. Chapter 2 contains "Basic definitions". Section 302 then contains the following definitions:

"Loan relationship" is defined in s.81, FA 1996 (ss.302, 303 CTA 2009), which relevantly provides:

> **81 Meaning of "loan relationship" etc**
>
> (1) Subject to the following provisions of this section, a company has a loan relationship for the purposes of the Corporation Tax Acts wherever—
>
> (a) the company stands (whether by reference to a security or otherwise) in the position of a creditor or debtor as respects any money debt; and
>
> (b) that debt is one arising from a transaction for the lending of money;

and references to a loan relationship and to a company's being a party to a loan relationship shall be construed accordingly.

(2) For the purposes of this Chapter a money debt is a debt which is, or has at any time been, one that falls, or that may at the option of the debtor or of the creditor fall, to be settled—

(a) by the payment of money;

(b) by the transfer of a right to settlement under a debt which is itself a money debt, or

(c) by the issue or transfer of any shares in any company, disregarding any other option exercisable by either party.

…

(5) For the purposes of this Chapter—

(a) references to payments or interest under a loan relationship are references to payments or interest made or payable in pursuance of any of the rights or liabilities under that relationship; and

(b) references to rights or liabilities under a loan relationship are references to any of the rights or liabilities under the agreement or arrangements by virtue of which that relationship subsists; and those rights or liabilities shall be taken to include the rights or liabilities attached to any security which, being a security issued in relation to the money debt in question, is a security representing that relationship.

…"

Section 303 defines a "money debt" and "transaction for the lending of money" as follows:

"**303 "Money debt"**

(1)For the purposes of this Part a money debt is a debt which—

(a) falls to be settled—

(i) by the payment of money,

(ii) by the transfer of a right to settlement under a debt which is itself a money debt, or

(iii) by the issue or transfer of any share in any company,

(b) has at any time fallen to be so settled, or

(c) may at the option of the debtor or the creditor fall to be so settled.

(2)For the purposes of subsection (1) any option exercisable by either party to settle the debt in any other way than is mentioned in subsection (1)(a) is ignored.

(3)A money debt is a debt arising from a transaction for the lending of money for the purposes of this Part if an instrument is issued by any person for the purpose of representing—

(a)security for the debt, or

(b)the rights of a creditor in respect of the debt.

> (4)A debt does not arise from a transaction for the lending of money for the purposes of this Part so far as it arises from rights conferred by shares in a company.
>
> …"

"related transaction" is defined in s.84(5) (s304 CTA 2009) as *"any disposal or acquisition (in whole or in part) of rights or liabilities under that relationship"*; and the extinguishment of rights under a loan relationship by surrender or release of the same is expressly included as a case where there is taken to be a disposal of such rights for these purposes: see s.84(6) (s304 CTA 2009).

Schedule 9 to FA 1996 contains certain *"special computational provisions"* for the purposes of s.84 (s.84(7)). One such provision, relevant to the current appeals is paragraph 11 of Schedule 9 (s444, CTA 2009), which relevantly provides:

> "(1) Where —
>
> (a) debits or credits in respect of a loan relationship of a company fall to be brought into account for the purposes of this Chapter in respect of a related transaction,
>
> (b) that transaction is not a transaction at arm's length, the debits or credits to be brought into account shall be determined on the assumption that the transaction was entered into on the terms on which it would have been entered into between independent persons.

An *"independent person"* is defined as a *"knowledgeable and willing party dealing at arm's length"*: s.103(1) FA 1996 (s444(2) CTA 2009).