Close company loans to participators: HMRC update guidance on exclusion from bed and breakfast provision

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The May 2014 issue of *Tax Adviser* included a feature titled ‘Over the edge’ which looked at the treatment in HMRC’s Company Taxation Manual of the exclusion from the FA 2013 provisions relating to bed and breakfasting arrangements in respect of loans to participators. The article concluded that the guidance should be amended to fully reflect HMRC’s view of the law as it applies to certain common methods by which loans to participators might be repaid. We now report on the revised guidance published by HMRC in March 2015.

The new wording of CTM61642 reads:

‘CTA 2010 s 464C(6)

This legislation does not apply where the repayment itself gives rise to a charge to income tax on the participator or associate to whom the original loan was made. This could happen, for example, where the loan is repaid by means of a dividend credited to the loan account which is included as income on the recipient’s tax return, or where a bonus is paid which is subjected to PAYE/NIC before being credited to the loan account. It would not apply, for example, to a payment of rent from the company to the participator because this is not itself income that gives rise to a tax charge but rather it is a constituent part of the eventual calculation of profits from a rental business.

‘Where money actually leaves the company (for example, the dividend or bonus is paid out in cash before being reintroduced into the company and credited to the loan account), then, regardless of whether income tax is chargeable on the dividend etc when paid, this is not within the exemption in CTA 2010 s 464C(6) as it is not the repayment itself which is giving rise to the income tax charge. When the money leaves the company it loses its identity as a relevant repayment.

‘Furthermore, to qualify for the exception the repayment must come from the same company source. Thus where a participator receives a dividend from a separate company and pays the cash into the company that has made him a loan; that will not qualify as a repayment that bears income tax within this exception.’

This significant revision means that the published guidance is now in line with what we have understood since June 2013 to be HMRC’s narrow interpretation of the legislation. Before the revision, CTM61642 gave an incomplete picture of HMRC’s thinking. That thinking was demonstrated in the explanatory note to Finance Bill 2013 published on 6 June 2013, which stated:

‘Subsection 464C(6) applies to disregard any repayments which give rise to an income tax charge from consideration by this section. This means that the majority of dividends and remuneration presented purely as book entries can be ignored when applying s 464C.’

By contrast, CTA 2010 s 464C(6) itself states:

‘This section does not apply in relation to a repayment which gives rise to a charge to income tax on the participator or associate by reference to whom the loan, advance or benefit was a chargeable payment.’

Much turns on the meaning of the phrase ‘a repayment which gives rise to a charge to income tax’.

In correspondence with HMRC, the CIOT and ATT have maintained that there is nothing in the phrase to confine the exclusion to repayment transactions that consist of book entries. We have also questioned the authority for apparently confining the exclusion to payments of dividends and remuneration and asked whether it should similarly apply to other payments from a company to a participator, for example in respect of rent or royalties. There could also be a case for regarding loan interest as within the scope of the exclusion.

Partly in response to the points that we had raised, HMRC decided (as a temporary measure designed to enable publication of the guidance on the remainder of the FA 2013 changes) to publish brief guidance on the exclusion. HMRC advised us that amended guidance that reflected the full HMRC view of the limits of the exclusion would be published as soon as possible. As indicated in ‘Over the edge’, the February 2014 version of CTM61642 did not therefore spell out the restrictions which HMRC consider the statutory provision to impose.

The March 2015 revision in HMRC’s manual is accordingly welcome confirmation of their (albeit) unwelcome and narrow interpretation of the legislation. Although readers of the guidance may wish to question whether HMRC’s narrow interpretation is correct, they will at least know the limited circumstances when HMRC see the exclusion applying and be in a position to advise clients in the light of that understanding.

It remains to be seen how a tribunal or court might interpret the phrase ‘a repayment which gives rise to a charge to income tax’. Any member who encounters a loan account situation where HMRC are contesting the availability of the s 464C(6) exclusion by reference to the meaning of the phrase is welcome to alert us to the matter.