The Personal Tax Planning Review

SECTION 419 INCOME AND CORPORATION TAXES ACT 1988

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Introductory

These comments on s.419 of the Income and Corporation Taxes Act 1988 are prompted by a (said to be an "official") view that if a participator receives a "loan or advance" from a close company, but at the same time a larger amount is owed by the company to the participator, there can be assessment under s.419 ICTA 1988 on the amount owed by the participator without reference to (or credit for) the amount owed to him. The better view is that this depends on the nature of the transactions.

S.419(1) and (2) - The Charge to Tax

By sub-section (1) "... where a close company ... makes any loan or advances any money to an individual who is a participator in the company ... there shall be assessed on and recoverable from the company, as if it were an amount of corporation tax chargeable on the company for the accounting period in which the loan or advance is made, an amount equal to such proportion of the amount of the loan or advance as corresponds to the rate of advance corporation tax in force for the financial year in which the loan or advance is made."

If a taxpayer had a current account credit balance with a close company but received a loan repayable over a period, the alleged Revenue view would appear to be correct because notwithstanding that the participator was in credit with the company that participator had nevertheless received a loan of £X upon which the section would bite.

The same considerations would apply if there were an advance as opposed to a loan.

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Loan or Advance

Consideration of the distinction between loan and advance is beyond the scope of relatively short comments. The moneylending legislation clearly demonstrated that there are many forms of credit arrangement which are neither loan nor advance. For present purposes, and very, very broadly, it may be said that there is a loan when money is paid over to a person and an advance when paid out for his benefit at his request. For further consideration see, for instance, *London Financial Association v Kelk* [1884] 26 ChD 107 at 136; *Bronester Limited v Priddle* [1961] 3 AER 471 CA; on "makes a loan or advances any money" see *Potts Executors v IRC* [1951] AC 443; [1951] 1 AER 76; 32 TC 211 HL; on "credit for unpaid balance of purchase money" neither a loan nor, it is thought, an advance, see *Ramsden v IRC* (1957) 37 TC 619; and as to misappropriated funds (neither a loan nor advance) see *Stevens v Pittas* [1983] STC 576.

As the Act covers either activity, and by sub-section (2) includes other credit arrangements as such further consideration of the distinction would be unproductive.

Extension to Include Debt

By the said sub-section (2) the cases in which a close company is to be regarded as making a loan to any person also include a case where:

(1) that person incurs a debt to the close company; or

(2) a debt from that person to a third party is assigned to a close company;

when the close company will be regarded as making a loan of an amount equal to the debt.

What is meant by 'debt' and 'incurring'? In most cases liability will be clear but there will be circumstances of doubt: what of a property company whose participator surveyor receives a rent or other payment due from a tenant as nominee for and for onward transmission to the company? Does he incur a debt? Doubtful circumstances may not often arise but the possibility is mentioned to emphasise that each case must be considered on its merits.

"Debt" may here mean something recoverable by an action for debt (see *Ogdens Limited v Weinberg* (1906) 95 LT 567 at 567, HL). In the absence of precision in the arrangements, a test to determine whether when a participator also owes money to a close company the company can be assessed without "credit" for the debt owing may depend upon the participator's right to set off, albeit, and strictly, there are two separate debts. If there is an actual loan or advance within the meaning of sub-section (1) the "official" view may be correct, but if the Revenue

wish to rely upon the extended meanings in sub-section (2) then, in the absence of special agreement as to the debts, in determining the amount on which the company can be assessed it may well be that there should be deduction for a set-off.

Well advised participators who enter into these transactions with close companies will be careful to show whether the amount due to them is to be treated as being repaid or as left outstanding as the case may be.

Excluded Transactions

By s.420 certain loans or advances are not subject to the charge:

(a) a loan made by a close company in the ordinary course of business which includes the lending of money;

(b) a debt incurred for the supply of goods or services by a close company in the ordinary course of its trade or business unless the credit given exceeds 6 months or is longer than that normally given to the company's customer;

(c) a loan to an employee or director of a close company or of an associated company if:

(i) the borrower works full-time for the close company or one of its associated companies;

(ii) the borrower does not have a material interest in the close company or any of its associated companies; and

(iii) the amount of the borrower's total indebtedness does not exceed £15,000.

A person has a material interest in a company if he, either on his own or with one or more associates, or if any associate of his with or without such other associates,

(i) is the beneficial owner of, or able directly or through the medium of other companies, or by any other indirect means, to control more than 5% of the company's ordinary share capital; or

(ii) in the case of a close company, would [or could] be entitled on a winding-up to receive more than 5% of the assets available for distribution among participators.

(see s.420(2), applying s.168(11)).

Anti-avoidance

Sub-section (5) applies where, under arrangements made by any person otherwise than in the ordinary course of a business carried on by him:

(a) a close company makes a loan or advance which, apart from that sub-section, does not give rise to any charge on the company under sub-section (1) ..., and

(b) some person other than the close company makes a payment or transfers property to, or releases or satisfies (in whole or in part) a liability of, an individual who is a participator in the company or an associate of the participator,

when, unless in respect of the matter referred to in (b) above there falls to be included in the total income of the participator or associate an amount not less than the loan or advance, the section will apply as if a loan or advance had been made to that participator.

A clear purpose is to assess back-to-back and other similar avoidance devices.

Relief

Where a company has made a loan or advance and the same is subsequently repaid the company is entitled to relief by way of discharge or repayment of the tax charged in respect of the loan (or the part repaid) (s.419(4)). Before 19th March 1986 the section provided for relief only where the loan was repaid after the company had been assessed, with consequent uncertainty if repayment preceded assessment. The position was clarified in 1986. As at now there is assessment and relief is given regardless of whether all or part of the loan has been repaid at the time the assessment is raised (s.491(3), (4)).