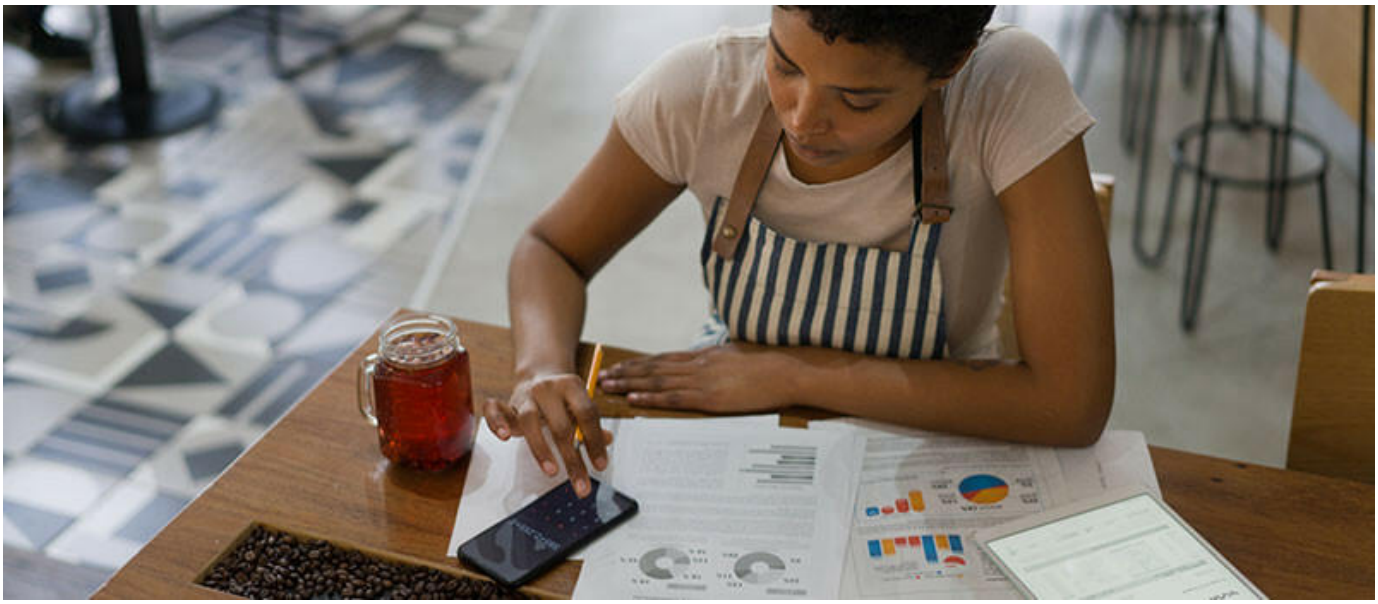
Loans to participators: charge on upstream loans

OMB



21 August 2024

The CIOT's Owner Managed Business technical committee has written to HMRC about CTA 2010 s 459, which members have told us is causing some issues in due diligence on commercial share acquisitions, typically in buyout scenarios where a company lends cash to its parent company, referred to as 'upstream loans'.

Where a loan to a participator in a close company remains outstanding nine months after the balance sheet date, the company making the loan is required to make a payment to HMRC equivalent to33.75% of the loan outstanding at the nine-month stage (CTA 2010 s 455). This tax liability is well understood and uncontroversial. However, the s 455 charge is extended (by CTA 2010 s 459) to other situations where there is a loan, such as certain tax avoidance scenarios where the charge would otherwise be avoided – perhaps by making the loan to an intermediary who then loans the money on to the participator. Our submission highlights how this can cause problems in uncontroversial commercial situations where no tax avoidance is involved.

In a typical management buy-out scenario, the management team will form Bid Co that will purchase the shares of Target and issue shares and loan notes as consideration to the vendor shareholders. The purchase will often be financed out of current and future resources of Target. One approach is for Target to lend funds to Bid Co by making an upstream loan, allowing Bid Co to repay some of the debt. This can cause problems, as s 459 may technically apply to such transactions. However, in our view this is not a scenario that the loans to participators legislation should catch and we do not believe it is within the policy aims of the legislation either, as we explain in our submission. We suggest that some further relieving provisions might help to prevent a charge applying where, in our view, it ought not to apply.

We also note that HMRC's guidance (CTM615501 at tinyurl.com/532s8u45) indicates that they take a 'strict application' of s 459. Whilst we have not in practice seen HMRC take the point, we highlight that the risk of s 459 applying on a strict technical reading is being raised more frequently on tax due diligence when companies are later sold. This introduces an element of uncertainty of tax treatment into commercial transactions on share acquisitions and is potentially preventing transactions from completing.

We are interested in hearing from CIOT members who have encountered issues with this in practice – please contact technical@ciot.org.uk.

In our submission, we say that we are interested in HMRC's views on the issue and in discussing possible options with them, such as an amendment to HMRC's manuals or a change in the legislation.

The full CIOT submission can be found here: www.tax.org.uk/ref1334. We will also be publishing HMRC's response on our website when we receive it.

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