Bunting v HMRC: claiming capital loss relief

OMB



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We look at case which examines the timing of a claim for a capital loss following a loan to a trader becoming irrecoverable.

Key Points

What is the issue?

Mr Bunting advanced a substantial loan (over £3 million) to fund his business. As the business began to fail due to depreciating stock values, the company took steps toward liquidation, and £2.2 million of the loan was exchanged for additional ordinary shares (with the intent of realising a capital loss).

What does it mean to me?

When HMRC challenged the income tax loss claim, Mr Bunting made a protective claim under the Taxation of Chargeable Gains Act 1992 s 253 regarding a capital loss on the irrecoverable loan. As there was no outstanding loan meeting the criteria for being irrecoverable at the time the claim was made, the Upper Tribunal allowed HMRC's appeal, denying the capital loss relief.

What can I take away?

Tax advisers should ensure that claims under s 253(3) are made in a timely manner, especially when exchanging an irrecoverable loan for other assets of little or no value, as a delay in claiming could jeopardise the availability of capital loss relief.

Although debts are generally disregarded assets for the purposes of the capital gains tax legislation, this is subject to some exceptions. In particular, the Taxation of Chargeable Gains Act 1992 s 253 provides that a loss suffered on a loan to a trader can be treated as an allowable loss for capital gains tax purposes, thereby providing some limited relief if the taxpayer has any gains against which to offset that loss.

The application of those rules was the subject of a recent decision of the Upper Tribunal, *HMRC v Bunting* [2025] UKUT 96 (TCC).

The facts of the case

The taxpayer, Mr Bunting, set up a company in the early 2000s to trade in sports history books and memorabilia. The company issued a single £1 share at par. In order to fund the company's initial activities, Mr Bunting advanced a loan to the company in excess of £3 million.

Although the company was initially successful, the stock it had acquired was depreciating in value (contrary to Mr Bunting's hopes and expectations) and the business was becoming unsustainable. As a result, various steps were taken in early 2013 which then led to the company being put into liquidation.

In particular, Mr Bunting and the company entered into an agreement on 31 January 2013. In relation to £2.2 million of the loan, it was agreed that the company would issue a further 2.2 million ordinary £1 shares in exchange for Mr Bunting giving the company a full discharge for that part of the loan. The apparent purpose of that

transaction was to create a capital loss on the shares, which would then be allowed as an income tax loss under s 131 of the Income Tax Act 2007.

What appears to be the balance of the loan was satisfied by the transfer of certain assets by the company to Mr Bunting.

When HMRC initially challenged the income tax claim in respect of the £2.2 million loss, Mr Bunting then made a protective claim under s 253 on 29 February 2016. That too was the subject of an HMRC enquiry and subsequently refused by HMRC. That refusal was then appealed against and the appeal was duly notified to the First-tier Tribunal.

In the meantime, Mr Bunting conceded that he was not entitled to the income tax loss relief he had sought. This is because the new shares, whilst of negligible value, had never 'become' of negligible value. This meant that there was no capital loss available for set off against income. Therefore, the only issue for the First-tier Tribunal was whether capital loss relief was available in relation to the loss Mr Bunting had incurred on his failed loan to the company.

The First-tier Tribunal allowed Mr Bunting's appeal. HMRC then appealed against the First-tier Tribunal's decision to the Upper Tribunal.

The Upper Tribunal's decision

The case came before Mrs Justice Joanna Smith and Judge Nicholas Aleksander.

They noted that Mr Bunting's loan to the company satisfied the conditions in s 253(1) to be a qualifying loan for the purposes of the loans to traders rules. In particular, the loan was for money to be used wholly for the borrower's trade (not being a trade which consists of or includes the lending of money), the borrower was UK-resident and the debt was not a debt on a security.

The Upper Tribunal also noted that, immediately before 31 January 2013, the loan had become irrecoverable and therefore the full amount of the loan was 'outstanding'. It was also agreed by the parties that the balance of the loan that was satisfied with the transfer of other assets did not qualify for any loss relief.

The focus on the Upper Tribunal's analysis was on the procedural mechanics of making a claim. Section 253(3) provides that a taxpayer may proceed to treat an

allowable loss as having arisen in the following circumstances:

‘Where a person who has made a qualifying loan makes a claim and at that time:

a) any outstanding amount of the principal of the loan has become irrecoverable…’

The dispute was centred on the words ‘at that time’ which was 29 February 2016, the date on which the claim was made.

It was accepted that the claim would have been valid had it been made just before 31 January 2013. The question was whether the events on that date precluded a later claim from being made.

The Upper Tribunal decided that the words ‘outstanding’ and ‘irrecoverable’ had to be given their ordinary meaning. In particular, they considered that, following the conversion of some of the loan on 31 January 2013, that part of the loan could no longer be considered to be outstanding. The Upper Tribunal said that there was no outstanding loan at the date of the claim and therefore no part of the loan qualified for relief.

Accordingly, HMRC’s appeal was allowed.

Commentary

This is a case where I have found the legal arguments to be finely balanced. Indeed, my view as to the correct outcome has alternated several times during the writing of this article. However, on balance, I do think that the Upper Tribunal has reached the wrong decision.

As the Upper Tribunal acknowledged, the purpose of s 253 is to encourage non-banks to make loans to traders and this was a case where the £2.2 million would have qualified for relief had the claim been made before 31 January 2013.

The Upper Tribunal reached its decision, however, by concluding that the purpose of the legislation should not override the plain meaning of the statutory words. I agree entirely with that sentiment. However, I am not sure that the First-tier Tribunal’s decision actually contradicted the plain meaning of the legislation.

For me, the critical point is that paragraph (a) in s 253(3) uses the perfect tense ('has become irrecoverable'). If it were important to focus on the status of the loan at the time of the claim, then Parliament could simply say 'is irrecoverable'. If the wording were such, then I would more readily accept that the phrase 'any outstanding amount of the principal of the loan [is] irrecoverable' would require the relevant part of the loan to be outstanding as at the time of the claim. However, as it stands, I see that the condition merely requires that, looking back from the date of the claim, there is a point in time when that part of the loan had become irrecoverable.

The use of the perfect tense also, in my mind, implies that that part of loan remains irrecoverable, rather than covering a case where the loan was once irrecoverable but subsequently became recoverable again. Indeed, I read the word 'irrecoverable' as being a state that, once it exists, is likely to remain the case and so there is little risk of a claim being made on a loan which was (but later ceased to be) irrecoverable. In any event, s 253(6) ensures that in any exceptional case where a later recovery is made (fully or partially), a corresponding capital gain is treated as having arisen.

What seems to have scuppered Mr Bunting's case (if the Upper Tribunal were right) is the fact that he was able to exchange the loan for something else, being the additional shares in the company. However, had the shares been worth anything, then that would militate against the loan being irrecoverable. What happened is that Mr Bunting exchanged one worthless asset for another. (And, indeed, it was the fact that the shares were worthless that prevented them from giving rise to an allowable loss in their own right and, thereby, preventing Mr Bunting from qualifying for relief against his income tax.)

Had Mr Bunting made his claim on 30 January 2013 and then carried on with the exchange on the following day, he would have been entitled to the capital loss relief. (The income tax relief claim would still have failed for the same reason; this being that the shares did not 'become' of negligible value – they were always of negligible value.) Did Parliament really intend the availability of the loss relief to depend on the precise timing of the claim in this way?

What reinforces my view is comparison with the wording of s 253(3) as it stood before the changes made by the Finance Act 1996. Those changes, which coincided with the introduction of Self Assessment, were one of several that year which were

intended to codify some extra-statutory concessions.

In this instance, Parliament wanted to confirm that taxpayers could backdate the crystallisation of the capital loss by up to two years and this is provided for by the insertion of s 253(3A).

It did so by the use of the words ‘at that time’ in sub-s (3) and ‘an earlier time’ in sub-s (3A). Indeed, reading sub-ss (3) and (3A) together suggests that Parliament was doing no more than ensuring that the loan had become irrecoverable by the time that the claim was made; and that the loss can be treated as arising at any time in the previous two years, provided also that the loan had become irrecoverable by that earlier time. Most importantly, the pre-1996 wording did not include the words ‘at that time’, which lies at the heart of the Upper Tribunal’s decision.

Given the fact that the statutory changes were intended to codify a concession, it is considered unlikely that Parliament would have also wanted to restrict the availability of the relief.

A further clue as to the limited effect intended to be given to the words ‘at that time’ can be found in s 253(3)(c).

When this is read alongside the opening words of the sub-section, we see that one condition for the relief to be given is:

‘Where a person who has made a qualifying loan makes a claim and at that time:

c) the claimant and the borrower were not each other’s spouses or civil partners … when the loan was made or at any subsequent time…’

That phraseology is distinctly odd and suggests to me that the words ‘at that time’ were not intended to introduce a requirement that the loan continues to be extant at the time of the claim but were merely a device to separate those claims which were to be given effect immediately (sub-s (3)) from those which were to be given retrospective effect (sub-s (3A)).

The Upper Tribunal took some comfort from the wording of s 253(3)(b). I do not wish to disagree with anything that the Upper Tribunal said about that paragraph because I do not see it contradicting my own preferred analysis.

What to do next

It will be interesting to see if an application is made to take this case to the Court of Appeal. If so, I will certainly follow the outcome closely.

In the meantime, tax advisers should endeavour to ensure that timely claims are made under s 253(3) in any case where it is proposed to convert the irrecoverable loan into another worthless asset.

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