Powell v HMRC: Director's loan novation

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We look at a case which considers the consequences of a director’s loan moving from a subsidiary to its parent company.

Key Points

What is the issue?

The case of *Powell v HMRC* examined whether transferring a director’s loan from a subsidiary to its parent company amounted to a ‘release’ of the debt, triggering an income tax charge under ITTOIA 2005 s 415. What appeared to be a straightforward creditor substitution became a complex question of whether a loan had been repaid or merely reclassified.

What does it mean to me?

The tribunal ruled that, even where valuable consideration was given, a novation could still constitute a taxable release if the creditor company had not actually received repayment. This significantly broadens HMRC's reach over participator loans.

What can I take away?

Companies should approach director loan restructurings with caution and seek early tax advice to avoid inadvertently triggering a deemed dividend under s 415. Any intra-group loan novation should be carefully documented and structured to demonstrate genuine repayment rather than release.

This article concerns the recent case of *Powell v HMRC* [2025] UKFTT 528 (TC). As the tribunal itself stated at the beginning of its decision, the issue to be considered was 'a discrete and seemingly simple one'. However, as is often the case with tax disputes, the resolution turned out to be far more complex than originally anticipated.

The facts of the case

Mr Powell had for many years been the director and sole shareholder of a company, Thermoline Limited (Thermoline). On 2 July 2020, a share-for-share exchange took place with another company, Property Holding SW Limited (PHSW), making PHSW the sole shareholder of Thermoline. Mr Powell was a director and the sole shareholder of PHSW.

Between Mr Powell and Thermoline, there was an increasing balance owing to the company on a director's loan account. At 31 March 2020, Mr Powell owed Thermoline just over £309,000. By the end of the calendar year, that balance had increased by more than £200,000. Thermoline prepared its accounts to 31 March each year.

On 16 March 2021 (but backdated to 31 December 2020), a deed of novation was entered into by Mr Powell and the two companies. The effect of the deed was to transfer the debt so that it was owed to PHSW, rather than to Thermoline.

The relevant legislation and prior case law

It was beyond doubt that Thermoline was a close company and that Mr Powell was a participator in the company. Accordingly, the loan was covered by the rules in Corporation Tax Act 2010 s 455. Furthermore, at least as far as the company's year ended 31 March 2020 was concerned, the company had accordingly accounted for corporation tax in relation to the amount owed to it by Mr Powell.

The issue in this case was whether the arrangement in March 2021 meant that a tax charge was triggered under Income Tax (Trading and Other Income) Act (ITTOIA) 2005 ss 415 and 416. Those provisions are engaged when there is a close company loan to a participator under the section 455 rules. In such cases, if 'the company releases or writes off the whole or part of the debt in respect of the loan or advance', the amount released or written off is then charged to income tax as if it were dividend income received by the participator.

These provisions had previously been considered in the case of *Collins v Addies (HM Inspector of Taxes)* which proceeded to the Court of Appeal ([1992] STC 746). That was a case where two participator/directors together owed a close company a total of £79,000. By way of an agreement between them, the company and a third shareholder (Mr Brent), it was agreed that Mr Brent would take on £68,000 of the debt and the two others would pay Mr Brent £11,000; Mr Brent would then repay that sum to the company. The Special Commissioner and the higher courts in that case had to consider whether the transaction amounted to a release of the debt that the two participators owed the company.

The courts took the view that there was a clear distinction between a debt being released and a debt being repaid. (Such a distinction is evidenced by the fact that the Corporation Tax Act 2010 s 458 – which forms a part of the same code as s 455 – uses repayment and release as distinct events.) Thus, what is now section 415 must apply to transactions that amount to a release but not a repayment of the loan. Applying the distinction to the facts of that case, the courts in *Collins* held that there had been no repayment of the remaining £68,000 loan. Instead, the company had released the obligations of the original two debtors and replaced them with a debt from Mr Brent. At the High Court, the situation was contrasted with one where Mr Brent had simply paid off the £68,000 owed by the other two participators.

Of course, the facts of the *Collins* and *Powell* cases were different inasmuch as the former involved a change of debtor, whereas the latter involved a change of creditor.

The First-tier Tribunal's decision

The case came before Tribunal Judge Amanda Brown KC (shortly before she was appointed President of the Tax Chamber) and Member Gill Hunter.

The tribunal carefully examined the terms of the deed of novation in order to determine, on a step-by-step basis, what actually happened. In particular, counsel for Mr Powell argued that Thermoline had given up its right to recover the money from Mr Powell by accepting, instead, a debt of the same value from PHSW. As valuable consideration was being given to Thermoline, this was not simply a case of Mr Powell's debt to the company being released but a case of it being repaid.

The tribunal was prepared to accept the interpretation of the facts put forward on Mr Powell's behalf but continued to say that this was not determinative of the issues that it had to decide. Instead, the tribunal had to continue to determine how ITTOIA 2005 s 415 applied to the case 'despite the conclusion that there is valuable consideration for a creditor to creditor novation and consequent release of the Appellant [i.e. Mr Powell] from his loan relationship with Thermoline'.

In particular, the tribunal concluded that there can be a taxable release, even in cases where there is valuable consideration in a contractual sense. In the tribunal's decision, what is critical is to ask whether the creditor company actually receives its money (in which case a repayment has occurred) or is still left being owed the sums due.

As Thermoline had not been repaid (and merely found itself with a different debtor), the tribunal concluded that the arrangement amounted to a release in the taxable sense. As a result, section 415 was held to apply and the appeal was dismissed.

Commentary

As the tribunal said, this was a seemingly simple case that was significantly more complex than first appeared. In many ways, I can understand how the tribunal reached its decision. Thermoline's balance sheet was no different before and after the novation – it was still owed over £500,000. On the other hand, Mr Powell no longer owed the company that money and, therefore, in a sense he had been released from the debt to the company without there being any payment by him (or on his behalf) to Thermoline. By adopting the language of *Collins*, this was a release without a repayment and therefore it fell within the scope of section 415.

However, if one focuses on Mr Powell himself (and, perhaps, given that section 415 concerns the taxation of individuals and not the taxation of companies), the case can be viewed differently. Mr Powell owed one company a significant sum of money on one day and then owed another company (the first company's parent) the same significant sum of money on the next day. In other words, he was no better or worse off. In those circumstances, he could justifiably be surprised to learn that that switch of creditor has landed him with a deemed dividend (taxable) of over £500,000.

The *Collins* case described the purpose of section 415 to be to ensure that a tax charge arises on a participator in situations where the participator's 'obligation to repay [a debt] should come to an end by release so that the obligation is terminated without repayment'. Or, as HMRC suggested in this case, the purpose of ITTOIA 2005 s 415 as an anti-avoidance provision is to prevent the extraction of value from a close company by a participator without the payment of income tax.

The case is fundamentally different, however, from *Collins* as the participators in that case were able to release themselves from any obligation to pay the £68,000 they collectively owed the company: it makes clear sense that they should be taxed on that windfall. By applying the wording of the courts which was based on the facts of the *Collins* case, it is at least arguable that the purpose of the legislation has been wrongly construed in the present case. It does not seem to me to be a huge stretch to say that, in this case, the debt ***was*** repaid to Thermoline (albeit by the substitution of a new debt to the company owed by PHSW). Accordingly, the factual matrix that the tribunal was prepared to accept might turn out to be of critical importance.

Given the amounts at stake, I was not surprised to see that the Upper Tribunal will consider this case. Although I would be hard-pushed to predict the outcome, it is to be hoped that the Upper Tribunal's decision (potentially in the summer of 2026) will create some greater certainty.

What to do next

Until further clarity is obtained, companies contemplating restructuring should take extra care to avoid additional income tax charges being incurred in relation to loans to participators, particularly if the participator ends up owing the same amount to the group of companies as was owed prior to the reorganisation.