Planning for tax results

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The author discusses the issue of tax planning following the recent case of MJP Media Services Ltd v Revenue and Customs Commissioners *[2010] UKFTT 298 (TC); [2010] S.F.T.D. 1083.*

The facts of the recent First Tier Tax Tribunal case of *MJP Media Services Ltd v Revenue and Customs Commissioners* [2010] UKFTT 298 (TC); [2010] S.F.T.D. 1083, do not greatly matter. The point is that if you do not plan for the tax treatment you want to get, and do not document your transactions accordingly, you cannot expect to get it.

To keep the facts to a minimum: MJP was a wholly owned subsidiary of Aegis Plc, a company listed on the main London Stock Exchange. Over the course of a year or so, MJP claimed to have paid a number of debts that were due by Aegis to third parties outside the group. This was reflected in the accounts between Aegis and MJP by recording the amounts paid as being owed by Aegis to MJP. Just before the end of an accounting year, MJP waived approximately £6 million of the total thus due to it by Aegis. It claimed a deduction of this amount from its profits for corporation tax purposes, pursuant to the loan relationships rules (at the material time, in the Finance Act 1996, but now in Pt 5 of the Corporation Tax Act 2009; there is no material difference between the two (see in particular s.302(1)(b) of the 2009 Act)).

Two points arose. First, was the payment by MJP of debts due by Aegis a "transaction for the lending of money"? Second, if so, did the waiver of part of the debt due by Aegis to MJP entitle MJP to a deduction from its profits?

The First Tier Tax Tribunal answered the second question in the negative. This is beyond the scope of this article. Strictly, it is in any event *obiter*. The tribunal recognised this. It is *obiter* because before this second question arose MJP had to prove that the transaction between it and Aegis was a, "transaction for the lending of money". On the evidence available to it, and on the basis of the House of Lords' decision in *Potts' Executors v Inland Revenue Commissioners* [1951] A.C. 443; [1951] 1 All E.R. 76, the tribunal held that that there was no such transaction. MJP therefore could not claim a deduction from its profits, regardless of how the question as to whether a partial waiver counted was answered.

As regards the evidence, MJP did not call as a witness any of their employees who had actually been involved in the transactions; and the lack of direct documentary evidence made it difficult for the tribunal to decide what payments MJP had actually made and to whom.

But assuming that MJP had paid third parties debts owed by Aegis, there was no adequate documentation showing the relationship between Aegis and MJP in respect of those payments. There were simply payments by MJP to third parties whom Aegis had owed money, the consequence of these payments being that Aegis came to owe MJP the amounts MJP had paid out.

Did these payments constitute "transactions for the lending of money" by MJP to Aegis?

On one approach, they could be regarded as loans by MJP to Aegis. There was no economic difference between what actually happened and what would have happened if, for example, formal loan documentation had been concluded, and MJP had made the payments to the third parties, or indeed if MJP had paid the relevant amounts to Aegis and Aegis had then paid them on to its creditors.

But in *Potts' Executors*, the House of Lords had had to consider whether payments made by a company to the creditors of its governing director were paid by the company to the director and, if so, whether they had been paid to him "by way of loan" (s.40(5)(a)(i) of the Finance Act 1938). Whenever the company made such a payment, an entry was made in its accounts debiting the amount to the director's current account (styled "director's account" in its books) with the company. So the director came to owe the company the amounts it had paid out for the director.

Lord Simonds said (at [1951] A.C., p.454): "The question is not what the transactions between the [director] and the company in substance were but whether they fell within the fair meaning of the section." He continued (at p.455): "I am not, in the construction of [a taxing] statute, entitled to say that, because the legal or business result is the same whether on the one hand I borrow money from the company and with it make certain payments, or on the other hand the company at my request makes certain payments on my implied promise to repay, therefore it is immaterial what words are in the statute if that result is attained." He then concluded (albeit without a great deal of further explanation) that the transactions did not constitute the payment of money by the company to the director "by way of loan".

Lord Normand concluded that the payments had not been made to the director at all, and therefore the question of whether they were paid "by way of loan" did not arise (see p.458). But in an expressly *obiter* passage, Lord Normand continued (at p.458): "There is a real distinction between a loan to A to enable him to pay his creditors and a payment to A's creditors made for the purpose of discharging his debts. It is a distinction recognised and taken advantage of both by commercial men and by others." The payments were accordingly not made "by way of loan" in any event.

On the basis of the House of Lords' decision in *Potts*, in *MJP* the First Tier Tribunal held that the term, "a transaction for the lending of money", in the loan relationships provisions in Finance Act 1996 did not encompass a payment to a third party to discharge another's debt, even if that other came under an obligation to reimburse the paying party (at p.1097). But this was in the context of an absence of documentation identifying the relationships between MJP, Aegis, and the creditors paid.

There has been some discussion about the First Tier Tribunal's conclusion by commentators. Jonathan Peacock, QC, in "MJP Media Services and loan relationships" [2010] *Tax Journal*, Issue 1046, p.18, is clearly correct in his view that, "the FTT's decision that discharging debts can never amount to a loan (and thus a loan relationship) is open to serious question; indeed, the better view is that it can be" (at p.19). This leads to the point of this contribution.

The fact pattern of A owing a debt to B that is paid by C with the effect that A thereafter owes the money to C is common to a number of legal structures.

What one might call the default position, where there is no agreement between any of the parties, is not entirely clear. If C's payment extinguishes A's debt to B (and it is thought that in general this is the effect in Scots law), then A comes under an obligation, in unjustified enrichment, to reimburse C. This is not a loan by C to A, regardless of how A's debt to B arose in the first place. But if C's payment does not discharge A's debt (the most likely position in English law), then A still owes B the money, and C may or may not have a right to recover his payment from B. Again, there is no loan by C to A. See generally MacQueen, "Payment of another's debt", in Johnston & Zimmermann, *Unjustified Enrichment: Key Issues in Comparative Perspective* (2002), p.458.

But the parties can agree something different. For example, the arrangement might involve B assigning to C the debt due by A to B. A's only involvement is receiving intimation of the assignation. Clearly, the assignation does not in itself constitute a "transaction for the lending of money" by C to A. But A's obligation to C may fall within the loan relationship rules, if the initial transaction between A and B was itself a loan by B to A. This is recognised by the First Tier Tribunal in *MJP*: see p.1097. But if the initial transaction between A and B is not one for the lending of money, then the obligation subsequently owed by A to C will not fall within the loan relationship rules either.

However, in all cases it is possible for the parties to agree, in advance, that C shall make a loan to A. Even if, pursuant to the parties' agreement, the funds flow directly from C to B, this clearly does not call in question the characterisation of the relationship between A and C as a "transaction for the lending of money". In other words, once C has agreed to lend the money to A, it does not matter whether the funds flow from C to A and then on to B, or directly from C to B. The relationship between A and C counts as a loan relationship.

Of course, this leads to the question of evidence. As Adam Craggs has pointed out, in "Preparation is everything" [2010] *Taxation*, No.4279, p.10, if one is to succeed at tribunal (and this must always be the aim of tax planning) one must draw up and retain the appropriate documentary evidence. Accordingly, if A and C want to achieve the result that C, in paying A's debt to B, is to be regarded as making a loan to A, it is necessary (i) to draw up and have executed a loan agreement between C and A; and (ii) to retain that loan agreement. If, for some reason, the parties desire that the money should flow directly from C to B, the loan agreement should expressly allow for this possibility.

In terms of practicality, in a group situation such as that in MJP it may also be possible to draw up a facility letter in effect allowing, for example, payments by a trading subsidiary of debts due by a holding company to count as loans by the subsidiary to the parent. The terms of such a facility letter would, however, require careful consideration.

But there is no reason to regard the decision in *MJP* as closing the door on an argument that payment of another's debt constitutes a loan by the payer to that other. All that is necessary is proper planning.