

The recent UK case of MJP Media Services Ltd v HMRC has highlighted the importance of ensuring that payments claiming to be loans must be made directly to the debtor for them to use as necessary and that, if challenged, taxpayers must retain and be able to produce sufficient evidence to support its case. As this article will show, payments to third parties may seem like the expedient way to settle debts, with the taxpayer then accounting for them as loans, but such practice will not necessarily make them loans.

MJP Media Services Limited (“MJP”) was a wholly-owned subsidiary of Carat International (“Carat”), which was owned by Aegis plc (“Aegis”). Between 2001 and 2004, four transactions took place, resulting in Aegis owing MJP £6,815,366. Between 1st January and 26th March 2004, the parties signed a document stating that MJP had loaned Aegis the sum of £6,815,366, at an interest rate of 1% above the base rate. The document was undated but stated to be made “effective from 1st January 2004”. On 26th March 2004, the parties signed a deed of waiver, under which MJP waived the sum of £6,704,000, leaving an amount outstanding, after accrued interest, of £189,976.

In its 2004 corporation tax calculation, MJP claimed a deduction of the waived amount, which was rejected by HMRC. MJP appealed to the Tax Chamber of the First-tier Tribunal (the “First-tier”). The First-tier dismissed the appeal, finding that, in the absence of direct payments by MJP to Aegis, the payments had been made to Aegis’s creditors.

For a company to have a loan relationship, there must be a money debt owed and that debt must arise either from a “transaction for the lending of money” (section 302(1)(b), Corporation Tax Act 2009 (“CTA2009”)) or an instrument must be issued to represent security for, or rights of a creditor in respect of, the debt, such as a loan note. The First-tier held that this was not a “transaction for the lending of money”, despite what had been shown in the group’s accounts.

MJP appealed to the Finance and Tax Chamber of the Upper Tribunal (the “Tribunal”). They argued firstly that it was not open on the evidence for the First-tier to find that MJP had not proved that it had made cash payments to Aegis. Secondly, even if the payments were made to third parties on behalf of Aegis, that was sufficient to constitute “transactions for the lending of money”. MJP argued that if parties to a transaction agree that such debts should be treated as a loan, it should be respected as such. They further argued that, in accordance with section 476(1) of the CTA 2009, wherein a loan is defined as any advance of money, payments made by it on behalf of Aegis were advances of money and, therefore, loans.

The Tribunal rejected all of the arguments. On the first, it held that parties cannot make a transaction fit a description which the facts do not fit simply by saying it does.

On the other arguments, the Tribunal felt that they lacked proper factual foundation. The Tribunal did not accept the argument that, if the transactions did not comprise cash payments from MJP to Aegis, then they had to be payments by MJP on behalf of Aegis. This argument had not been put to the First-tier Tribunal, no such evidence had been produced and the Tribunal felt that this was not the only possibility. The Tribunal found that, in one transaction, Carat had assigned to MJP the debt owed to Carat by Aegis in exchange for MJP writing off the debt it was owed by Carat. In the case of the other transactions, without evidence to confirm its assertion of a loan, it was possible that MJP had contracted with and paid a third party to obtain services the benefit of which was passed on to Aegis, with Aegis agreeing to repay MJP, but leaving that money outstanding as an inter-company debt.

In the circumstances, the Tribunal felt it unnecessary to deal with the issue of law raised in MJP’s third argument and their appeal was dismissed.

There are lessons to be learned from this case: firstly, unless it walks like a duck, quacks like a duck and looks like a duck, saying it's a duck won't make it so. Companies have to structure their loans correctly if they are to be considered loans by HMRC. A payment to a third party does not automatically become a loan if all the circumstances do not make it fit. To make a transaction a loan, it should be structured as a loan to the debtor, who can then go on to use it as necessary.

Secondly, the Tribunal made clear the importance of producing and retaining proper transactional records. It is a requirement that all companies keep bank statements for six years for VAT purposes. MJP had destroyed records in November 2009, six years after the final transaction had taken place, even though HMRC had opened the investigation in 2006. The Tribunal asserted that MJP should have appreciated the need to produce records once the investigation was opened and retained them until its conclusion.

However, an important point to note about this case is that the Tribunal dealt with the particular facts and never really tested them against the law. This case focuses more on the importance of good record-keeping for evidence than casting more light on the legal position. This would most likely mean that, presented with proper evidence, a tribunal would then have to go on and deal with the question of law, an opportunity which appears to have been missed here.

As for advisers and officers, particularly those working on off-shore structures, when acceptable arrangements are put in place, every effort should be made to ensure that proper record-keeping is in place, so that it is not made so easy to challenge those arrangements.

Taxpayers and advisers should heed these warnings, as it could prove costly to ignore them.

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