BETWEEN/

90TACD2022

[redacted]

Appellant

V

REVENUE COMMISSIONERS

Respondents

DETERMINATION

Introduction

1. This is an appeal against corporation tax assessments raised by the Respondents on 28 November 2017, which relate to the accounting periods ending 31 December 2011, 31 December 2012 and 31 December 2013. The assessments total €301,106.

2. A number of sums, classified as loans in the Appellant's financial accounts were paid to Mr. [redacted] (deceased) formerly a director of the company. The total balance of these loans (hereafter 'the loan') was €3,108,211 as at the year ending 31 December 2011, 31 December 2012 and 31 December 2013.

3. No issue arises in relation to the four year time limit for raising assessments in section 959AA TCA 1997, as corporation tax returns in respect of 2011 and 2012 were filed in December 2013.

4. The assessments were raised in accordance with sections 438 and 239 of the Taxes Consolidation Act 1997, as amended ('TCA 1997'). Section 438 TCA 1997 provides that where a close company (whose business does not include the making of loans) makes a loan or gives an advance to a participator or an associate of a participator, the company is to be assessed to income tax at the standard rate on the grossed up amount of the loan or advance for the year of assessment in which the loan or advance is made. The section also provides that a close company is to be regarded as making a loan to any person who incurs a debt to the company.

Background

5. The Appellant company was incorporated in [redacted] and Mr. [redacted] (deceased) was a director until [redacted] 201[redacted]. The Appellant carried on the trade of property development and construction. It is not in dispute that the director Mr. [redacted] was a participator and that the Appellant company was a close company.

6. The Appellant made a number of loans to Mr. [redacted] director. The loans totalled €3,108,211 as at 31 December 2011, 31 December 2012 and 31 December 2013.

7. Interest was accrued in the financial accounts of the Appellant company on the loans made to Mr. [redacted] however, the interest was not paid. The accounts contain provision for bad debt in respect of the interest accrued but not paid. Although a bad debt provision was made in respect of the outstanding interest, these sums were not written off. The sums form part of the debtor's figures in the accounts and remain recognised in the accounts as monies owed by the director to the company. The sums accrued and for which provision was made are as follows; €388,526 in respect of the year end 31 December 2011, €388,526 in respect of the year end 31 December 2012 and €349,674 in respect of the year end 31 December 2013.

8. A notification of revenue audit issued to the Appellant on 22 October, 2015. The audit covered the years 2010 to 2014 inclusive and the scope of the audit was '*all relevant taxes and duties'.*

9. During the audit, it was established that Mr. [redacted] had incurred debts to the Appellant company from the year 2007 onwards. The financial statements of the

company recorded these debts as a debit balance in the director's loan account for each year ('the loan').

10. The loan was repaid to the company in November 2013 on foot of a restructuring agreement involving several companies of which Mr. [redacted] was a shareholder and director. Under this restructuring agreement Mr. [redacted] transferred his shareholding in [redacted] Ltd., which had a value of €5,072,000, to [redacted] Ltd. in exchange for [redacted] Ltd. issuing him 'A' ordinary shares and redeemable preference shares with a similar value. [redacted] Ltd. issued 3,972,000 'A' ordinary shares of €1 each and 1,100,000 redeemable preference shares at €1 each to Mr. [redacted] Mr. [redacted] then transferred 3,108,211 'A' ordinary shares to the Appellant company in settlement of his director's loan account.

11. The issue then arose as to whether the benefit in kind ('BIK') provisions of section 122 TCA 1997, in relation to preferential loans had been applied to the debit balances on the director's loan account of Mr. [redacted] for the years 2010 to 2011. Mr. [redacted] Form 11 for year ended 2010 returned a taxable benefit in relation to BIK on a '*director's loan'* of €540,801.

12. In relation to the years 2011 to 2013, correspondence was received from the tax agent [redacted], dated 22nd July 2016, point 14 of which stated that '*BIK was not applied to the outstanding director's loan accounts as interest was charged on 13.5% on all loans outstanding'.*

13. The financial statements of the Appellant company posted interest charged on the outstanding director's loan to a nominal account titled '*other debtors*'. The interest charged was not paid by Mr. [redacted] and a provision for bad debt of the same amount is reflected in the accounts for each year.

Legislation

Section 438 TCA 1997 – Loans to participators

(1)(a)Subject to this section, where a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any

loan or advances any money to an individual who is a participator in the company or an associate of a participator, the company shall be deemed for the purposes of this section to have paid in the year of assessment in which the loan or advance is made an annual payment of an amount which, after deduction of income tax at the standard rate for the year of assessment in which the loan or advance is made, is equal to the amount of the loan or advance.

(b)Section 239 shall apply for the purposes of the charge, assessment and recovery of the tax referred to in paragraph (a).

(c)The annual payment referred to in paragraph (a) shall not be a charge on the company's income within the meaning of section 243.

(2)For the purposes of this section, the cases in which a close company is to be regarded as making a loan to any person shall include a case where –

(a) that person incurs a debt to the close company, or

(b) a debt due from that person to a third person is assigned to the close company,

and in such a case the close company shall be regarded as making a loan of an amount equal to the debt; but paragraph (a) shall not apply to a debt incurred for the supply by the close company of goods or services in the ordinary course of its trade or business unless the period of credit given exceeds 6 months or is longer than that normally given to the company's customers.

Section 239 – Income tax on payments by resident companies

*(1)In this section, "*relevant payment*" means –*

(a)any payment from which income tax is deductible and to which subsections (3) to (5) of section 238 apply, and

(b)any amount which under section 438 is deemed to be an annual payment.

(2)This section shall apply for the purpose of regulating the time and manner in which companies resident in the State –

(a)are to account for and pay income tax in respect of relevant payments, and

(b)are to be repaid income tax in respect of payments received by them.

(3) ….. etc.

Submissions

Appellant's submissions

14. The Appellant submitted that acts which are ultra vires the powers of a company are void *ab initio*, citing *Ashbury Railway Carriage and Iron Company Limited v Riche* [1874-80] All ER Rep Ext 2219. The Appellant's position was that the initial loan taken by Mr. [redacted] from the Appellant company was in breach of company law and was *ultra vires* the powers of the company. The Appellant submitted that the loan was not simply tainted by illegality but was rooted in illegality.

15. The Appellant contended that the loan made to Mr. [redacted] was void *ab initio* by virtue of being *ultra vires* the Appellant's memorandum of association and by extension, accounting entries of accrued interest and subsequent write offs of same, based on the said arrangement, had no standing in law and therefore did not fall within the charge to tax. The Appellant submitted '*given that the appellant had no right to make such payments and was clearly prohibited from doing so under Irish company law, such a course of action on its part was ultra vires and therefore, void ab initio*.'

16. The Appellant submitted that the interest charged by the company did not constitute a '*debt*' within the meaning of section 438(2) TCA 1997, and that the director did not incur a debt to the Appellant company pursuant to this provision.

Respondents' submissions

17. The Respondents submitted that section 438 TCA 1997, applied to the interest charged by the Appellant company to Mr. [redacted] which was not paid by him.

18. The Respondents submitted that Mr. [redacted] incurred a debt to the company for each year 2011 to 2013 with this debt being reflected as a '*director's loan'* in the financial statements of the company. Interest was charged at 13.5% on the loan and

was posted to '*other debtors'* in the nominal account. The Respondents submitted that the unpaid interest constituted a debt incurred by Mr. [redacted] to the company and was subject to the provisions of section 438 TCA 1997.

19. The Respondents submitted that the issue of whether the original loan was *ultra vires* the powers of the company was not relevant to the question of whether the interest charged constituted a debt incurred within the meaning of section 438(2) TCA 1997.

ANALYSIS

20. Pursuant to the provisions of section 438 TCA 1997, where a close company (whose business does not include the making of loans) makes a loan or an advance to a participator, the company will be assessed to income tax at the standard rate on the grossed up equivalent of the loan or advance made by the close company. Income tax deducted forms part of the company's corporation tax liability and must be included on the company's corporation tax return.

21. The provisions of section 438 TCA 1997 provide;

(1)(a)Subject to this section, where a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator in the company or an associate of a participator, the company shall be deemed for the purposes of this section to have paid in the year of assessment in which the loan or advance is made an annual payment of an amount which, after deduction of income tax at the standard rate for the year of assessment in which the loan or advance is made, is equal to the amount of the loan or advance.

(b)Section 239 shall apply for the purposes of the charge, assessment and recovery of the tax referred to in paragraph (a).

(c)The annual payment referred to in paragraph (a) shall not be a charge on the company's income within the meaning of section 243.

(2)For the purposes of this section, the cases in which a close company is to be regarded as making a loan to any person shall include a case where –

(a) that person incurs a debt to the close company, or

(b) a debt due from that person to a third person is assigned to the close company,

and in such a case the close company shall be regarded as making a loan of an amount equal to the debt; but paragraph (a) shall not apply to a debt incurred for the supply by the close company of goods or services in the ordinary course of its trade or business unless the period of credit given exceeds 6 months or is longer than that normally given to the company's customers.

22. As is clear from the wording of subsection (2), section 438 is not solely concerned with the making of a loan or an advance by a company but also expressly includes the incurring of a debt by a participator to the close company.

23. The Appellant submitted that the interest arose in relation to a loan which was itself *ultra vires* the powers of the company and void *ab initio* and as a result, in view of the Appellant, the interest had no standing in law and was not subject to the provisions of section 438 TCA 1997

24. The Respondents' position was that the interest owed to the company was a debt incurred in accordance with the provisions of section 438(2) TCA 1997 and that the debt was taxable in accordance with the provisions thereof.

Case Law

25. In support of its position, the Appellant relied on the UK authority of *Stephens v Pittas* [1983] STC 576, 56 TC 722.

26. In *Stephens v Pittas*, the director of the company misappropriated sums of money, proper to the company, for his own use. Mr. Pittas failed to record the sums of money in the company's books and records and the accounts much understated the company's receipts and its profits for corporation tax. The monies misappropriated should have been shown as receipts of the company in its tax returns but were not. Assessments were raised against the company on the basis that these sums took the form of a loan to the director.

27. Assessments were raised for five consecutive years commencing 1966-1967. The first three years of assessments were based upon the un-amended provisions of section 75 of the Finance Act 1965 which provided:

'Where after the end of the year 1965-66 a close company, otherwise than in the ordinary course of a business carried on by it which includes the lending of money, makes any loan or advances any money to an individual who is a participator in the company or an associate of a participator, there shall be assessed on and recoverable from the company, as if it were an amount of income tax chargeable on the company, an amount equal to income tax on the grossed up equivalent of the loan or advance.'

28. Subsection (2) continues:

'Where, after a company has paid the amount assessed on it under subsection (1) above in respect of any loan or advance, the loan or advance or any part of it is repaid to the company, the amount paid by the company or a proportionate part of it shall be repaid."

29. Subsection (3) begins:

'Where a company is assessed or liable to be assessed under this section in respect of a loan or advance, and releases or writes off the whole or part of the debt in respect of it, the person to whom it was made shall be treated for purposes of surtax as having then received an amount of income equal to the grossed up equivalent of the amount so released or written off.'

30. Section 75 of the UK Finance Act 1965 was amended by the Finance Act 1969 as follows;

'(1) For the purposes of section 75 of the Finance Act 1965 the cases in which a close company is to be regarded as making a loan to any person include a case where - (a) that person incurs a debt to the close company, or (b) a debt due from that person to a third party is assigned to the close company, and then the close company shall be regarded as making a loan of an amount equal to the debt.'

31. The amended version of section 75 of the Finance Act 1965 applied to the tax years of assessment 1969-1970 and 1970-1971. Accordingly, the company did not pursue an appeal against those assessments as stated as follows at page 14 of the judgment;

'The advisers of the Respondent feel unable to deny that the result of Mr. Pittas's conversion of the company's money in the present case was that he incurred a debt to the company, and accordingly the appeal against the assessments under s 75 for the years of assessment 1969-70 and 1970-71 has not been proceeded with;…'

32. The wording of section 438(2) TCA 1997 is almost identical to the wording of the English provision insofar as it applied from 1969 onwards. The wording of sub-section (a) of the UK provision is identical to subsection 2(a) of section 438 as the subsection provides: '*that person incurs a debt to the close company, or*'.

33. In this judgment Goulding J. observed that the Special Commissioners had concluded that the misappropriation of the company's funds did not come within the description of '*loan'* or '*advance'* as contained in the relevant UK provision, section 75. To this he stated:

'I do not feel so sure. If it could truly be said that the company paid the money in question to Mr. Pittas, then I think it might be possible to say that the company had advanced money to him even if the payments were illegal under the Companies Acts or a fraud on the minority shareholder; but I do not find it necessary to express any decided view either way on that point.'

34. Thus it can be seen from the judgment, that Goulding J. countenanced the possibility that payments made by the company to Mr. Pittas which were illegal under the Companies Acts, might nonetheless fall within the meaning of '*loan or advances*' in section 75 if it could be shown that the company had paid them.

35. Goulding J. considered the crucial question to be whether the company had paid the money to Mr. Pittas, stating; *'Did the company pay the money in question to Mr. Pittas? He undoubtedly took it from the company's till or from the company's debtors but did the company pay it to him?'* The question turned on whether there was consent or consensus between Mr. Pittas and the company in relation to payment of the monies. The Court concluded that there was no consent nor was there consensus. In this regard, Goulding J. upheld the finding of the Special Commissioners that: *'There can have been no consensus between the company and Mr. Pittas in those circumstances, and in our view it is not possible to regard those sums as loans or as advances by the company to Mr. Pittas.'* He stated that: *' … an outright misappropriation of a company's*

money cannot be treated as the act of the company except possibly if all the corporators of a solvent company consent to it.'

36. He concluded that: *'.. in my view the company cannot be said, in the circumstances found by the Commissioners, have made an advance or a loan to Mr. Pittas'.*

37. In relation to the assessments for 1966-1967, 1967-1968 and 1968-1969 it was held that, in the absence of any consensus between Pittas and the company, the misappropriation of the company's money could not amount to a loan or an advance by the company for the purposes of section 75 of the Finance Act 1965.

38. The Appellant company placed considerable reliance on *Stephens v Pittas* however, there are a number of fundamental differences between the *Pittas* case and the facts and circumstances of this appeal herein.

39. In *Pittas*, the director misappropriated company funds without consent or consensus from the company. The sums misappropriated by the director in *Pittas* were not reflected in the books and records of the company whereas, in this appeal both the loans and the interest on those loans were accounted for in the books and records of the Appellant company. The financial statements of the Appellant recorded the original loans as a debit balance in the director's loan account for each of the years 2010 to 2013. The interest charged on the outstanding director's loan balances was posted to a nominal account titled '*other debtors'*. The interest charged was not paid and a provision for bad debt of the same amount is reflected in the accounts for each year.

40. In addition to reflecting the loans and loan interest in the company accounts, correspondence from the Appellant's tax agent dated 22 July, 2016 confirmed on behalf of the company, that interest was charged in respect of the loans. That letter provided:

> *'We refer to your correspondence of 27th June 2016 in relation to out above mentioned clients and enclose herewith the following;*
>
> *Copies of Directors Loan Accounts for all companies for the years ended 31st December 2010 to 2013*

Copies of the nominal 'Other Debtors' for all companies for the years ended 31st December 2010 to 2013 which shows the interest on the various directors loans. We also attach a copy of the bad debt provision account.

……..

BIK was not applied to the outstanding directors loan accounts as interest was charged at 13.5% on all loans outstanding (see 'other debtors' nominal in point 2 above).'

41. As is clear from the final paragraph of the letter, the company through its agent represented that a benefit-in-kind ('BIK') was not charged on the loan for the relevant tax years of assessment because interest was in fact charged in respect of the loan.

42. The *Pittas* case proceeded on the un-amended version of the UK legislation. That un-amended provision (section 75 of the UK Finance Act 1965) imposed a charge to tax on the company only where the company had either loaned or advanced money to the participator.

43. Notably, the company did not pursue the assessments raised under the amended version of the legislation which expanded the remit of section 75 to include a situation where a person incurs a debt to the close company. On page 14 of the *Pittas* case, the judgment provides: *'The advisers of the Respondent feel unable to deny that the result of Mr. Pittas's conversion of the company's money in the present case was that he incurred a debt to the company, and accordingly the appeal against the assessments under s 75 for the years of assessment 1969-70 and 1970-71 has not been proceeded with;'*

44. However the provision in Irish legislation, section 438 TCA 1997, is analogous to the amended version of section 75 in the *Pittas* case. The relevant subsection is subsection (2) which expressly provides:

(2)For the purposes of this section, the cases in which a close company is to be regarded as making a loan to any person shall include a case where –

(a) that person ***incurs a debt*** *to the close company, ….*

[emphasis added]

45. Thus the applicable legislation in *Stephens v Pittas* was the un-amended version of section 75 of the Finance Act 1965 (equivalent to section 438(1) TCA 1997) which taxed a loan or advance to a participator. The appeal in relation to the assessments which were raised after the amended version of the UK legislation (equivalent to section 438(2) TCA 1997) was enacted, which expanded the provision to include a debt incurred to the close company, was not pursued.

46. In its accounts, interest was accrued in respect of the loans and the company thereby acknowledged that it charged Mr. [redacted] interest on those loans and that interest was reflected as a debt due by Mr. [redacted] to the company notwithstanding the repayment of the underlying loans. The interest was not paid by Mr. [redacted] and the accounts contain provision for bad debts in respect of the interest accrued but not paid.

47. The Respondents submitted that section 438(2) TCA 1997 extends to a situation where a director incurs a debt to the company. The Respondents submitted that the interest owed and unpaid came within the charge to tax in accordance with the provisions of section 438(2) TCA 1997. The provisions of section 438 TCA 1997, in this appeal have been applied to the interest arising on the loans as reflected in the accounts of the company.

48. The original loan has been repaid in full and this is not in dispute. The Appellant accounted for the loan and for the interest due in respect of the loan through its financial accounts and in correspondence from its tax agent. The situation was otherwise in the *Pittas* case where the monies taken from the company were not accounted for in the company's books and records. In the Appellant's accounts, the interest has been charged and is represented as a debt owing from the director, Mr. [redacted] Based on the entries in the books and records of the company, including the charging of interest by the company in respect of the loan, together with the correspondence on behalf of the Appellant dated 22 July 2016, I am satisfied that there was consensus between the director and the company in this case in respect of both the interest and the underlying loan.

49. It is alleged, on behalf of the Appellant, that the loans were contrary to company law, were *ultra vires* the powers of the company and were void *ab initio*. The question which arises then is whether (assuming the loans were *ultra vires* the powers of the company) the director, Mr. [redacted] did or did not '*incur a debt*' to the close company in respect of the interest arising on those loans within the meaning of section 438(2) TCA 1997.

50. The Appellant contended that because the loan was *ultra vires* the powers of the company and void *ab initio*, the interest in respect of the loan had no legal standing and there could be no debt incurred within the meaning of section 438(2) TCA 1997. The Respondent submitted that even if the loan was *ultra vires*, there was nonetheless a debt incurred by the director to the company both in relation to the original loan and in relation to the interest on that loan for the relevant accounting periods.

Statutory interpretation

51. The original loan of €3,108,211 was repaid to the company in November 2013, on foot of a restructuring agreement involving several companies of which Mr. [redacted] was a shareholder and director. The assessments in this appeal relate to the interest on that loan for the relevant tax years of assessment 2011, 2012 and 2013.

52. The Appellant submitted that the interest arose in relation to a loan which was itself *ultra vires* the powers of the company and void *ab initio* and as a result, the interest had no standing in law and could not be subject to the provisions of section 438 TCA 1997. The Appellant submitted that there was an absence in Irish tax law of a specific statutory provision to bring within the scope of section 438 TCA 1997, payments taken or paid to a participator which were unlawful under Irish company law and which were void *ab initio*.

53. To incur a change to tax, a taxpayer must come clearly within the scope of a tax charging provision. The Appellant cited *O'Coindealbhain v Gannon* 111 ITR 484 and in particular the dicta of Barrington J. namely; *'The principles of legal interpretation to be applied to the construction of Revenue statutes are well established. It is a general principle that to be liable to tax the citizen must come clearly within the words of the charge to tax - '*

54. In the recent Supreme Court case of *Bookfinders Ltd. v The Revenue Commissioners* [2020] IESC 60, the principles governing statutory interpretation were comprehensively reviewed. Leading the judgment of the Court, O'Donnell J. as he then was, stated at paragraph 39: *'It is worth emphasising that the starting point of any exercise in statutory interpretation is, and must be, the language of the particular statute rather than any pre-determined theory of statutory interpretation*.'

55. The Court at paragraph 53 of the judgment quoted and approved the judgment of McKechnie J. in the Supreme Court case of *Dunnes Stores v the Revenue Commissioners* [2019] IESC 50 including *inter alia*, the following paragraphs:

> *'63. As has been said time and time again, the focus of all interpretive exercises is to find out what the legislature meant: or as it is put, what is the will of Parliament. If the words used are plain and their meaning self-evident, then save for compelling reasons to be found within the instrument as a whole, the ordinary, basic and natural meaning of those words should prevail. "The words themselves alone do in such cases best declare the intention of the law maker" (Craies on Statutory Interpretation (7th Ed.) Sweet &Maxwell, 1971 at pg. 71). In conducting this approach "…it is natural to inquire what is the subject matter with respect to which they are used and the object in view" Direct United States Cable Company v. Anglo – American Telegraph Company [1877] 2 App. Cas 394. Such will inform the meaning of the words, phrases or provisions in question. McCann Limited v. O'Culachain (Inspector of Taxes) [1986] 1 I.R. 196, per McCarthy J. at 201. Therefore, even with this approach, context is critical: both immediate and proximate, certainly within the Act as a whole, but in some circumstances perhaps even further than that.*
>
> *64. Where however the meaning is not clear, but rather is imprecise or ambiguous, further rules of construction come into play. Those rules are numerous both as to their existence, their scope and their application. It can be very difficult to try and identify a common thread which can both coherently and intelligibly explain why, in any given case one particular rule rather than another has been applied, and why in a similar case the opposite has also occurred. Aside from this however, the aim, even when invoking secondary aids to interpretation, remains exactly the same as that with the more direct*

approach, which is, insofar as possible, to identify the will and intention of Parliament.

65. When recourse to the literal approach is not sufficient, it is clear that regard to a purposeful interpretation is permissible. There are many aspects to such method of construction: one of which is where two or more meanings are reasonably open, then that which best reflects the object and purpose of the enactment should prevail. It is presumed that such an interpretation is that intended by the lawmaker.'

56. On the authority of *Bookfinders*, I am satisfied that the approach to be taken in relation to the interpretation of the expression '*incurs a debt*' in section 438(2) TCA 1997, is a literal interpretative approach. I am satisfied that the wording of section 438 TCA 1997, is both clear and unambiguous and that the expression '*incurs a debt to the close company*' in section 438(2) is to be afforded its ordinary and natural meaning.

57. Accordingly, it falls to be considered whether, on the undisputed facts of this case, the director, Mr. [redacted] a participator in the close company, incurred a debt to the company in respect of interest charged on the original loan.

58. First of all, I am satisfied that the director, Mr. [redacted] incurred a debt to the company within the meaning of section 438(2) TCA 1997, for the accounting periods ended 2011, 2012 and 2013 in relation to the original loan of €3,108,211 with this debt being reflected in the '*director's loan'* account in the financial statements of the company. Interest was charged by the company on this debt and the interest charged was posted to an '*other debtors*' nominal account. The original loan/debt was repaid in November 2013.

59. The director had the use and benefit of the sum of €3,108,211 for approximately three years in circumstances where he paid no interest on the loan although interest was charged. I am satisfied that Mr. [redacted] incurred a debt within the meaning of section 438(2) TCA 1997 in respect of both the original loan and the interest charged by the company on that loan. The existence of these debts is evidenced by;

- the existence of the director's loan account of Mr. [redacted] as prepared by the Appellant company, for each tax year of assessment.

- the fact that Mr. [redacted] repaid the original loan by means of a restructuring arrangement in November 2013 involving several companies of which he was a director. This restructuring arrangement was put in place to repay the debt due to the company.
- the fact that interest was charged to Mr. [redacted] on the original loan as evidenced in the Appellant's nominal accounts.
- the fact that the interest charged was not paid by Mr. [redacted] and the interest remains reflected in the accounts of the Appellant company as a debt owed by Mr. [redacted] for the relevant accounting periods.
- the acknowledgment of the Appellant company, through its agent, in correspondence dated 22 July 2016, that '*BIK was not applied to the outstanding director's loan accounts as interest was charged on 13.5% on all loans outstanding'.*

60. The status of the original loan for company law purposes and the question of whether it was *ultra vires* the powers of the company is not in my view a relevant consideration for the purposes of this analysis because even if the loan was *ultra vires*, the director nonetheless incurred a debt to the company in accordance with section 438(2) TCA 1997, in respect of the original loan (reflected in the 'director's loan' account in the financial statements). Before the original debt was repaid, interest was charged by the company on that debt and the interest was marked in the financial statements as a debt due to the company for the accounting periods ending 31 December 2011, 31 December 2012 and 31 December 2013.

61. I am satisfied that the Appellant falls within the charge to tax on a plain and literal interpretation of section 438 TCA 1997, on the basis that the interest constituted a debt incurred to the company to which the provisions of section 438(2) TCA 1997 apply.

Additional cases cited

62. The Appellant cited a number of authorities in addition to the *Pittas* case, which are considered as follows;

63. The UK case of *Baker v HMRC* [2013] UKFTT 394 (TC), addressed the question of whether amounts paid (in cash and in kind) to a director/shareholder of a private

company in satisfaction of a purported purchase of own shares by that company were taxable as distributions in the hands of the recipient notwithstanding the failure to observe the requirements of the Companies Act in respect of such a purchase.

64. In that case, the Tribunal found that the legal basis of the transfer of cash or assets would need to be taken into account in any consideration of whether a distribution might have occurred under section 209(4) of the Income and Corporation Taxes Act 1988 ('ICTA') (paragraph 65). The Tribunal held that the company's acquisition of its own shares and the corresponding obligation to pay for them were both void.

65. The Tribunal held that in the circumstances of the case, there was no distribution in accordance with the provisions of section 209(2)(b) of the ICTA. The Tribunal held that the purchase by the company of its own shares was void, that the Appellant was under an obligation to return the monies and assets received and that the receipt of such monies and assets was not capable of amounting to a distribution under section 209 ICTA.

66. This authority turned on specific provisions of UK company law and tax law relating to the meaning of distributions and the taxation thereof.

67. This appeal herein does not relate to a distribution and to whether a distribution is taxable but to the question of whether a debt was incurred in accordance with the provisions of section 438 TCA 1997. Section 438(2) asks whether the participator has incurred a debt to the close company. The language used in section 438(2) namely, whether a person '*incurs a debt*' to the close company, is sufficiently broad to encompass the debt arising in this appeal.

68. The case of *Taylor & Son v Barnett Trading Co*. [1953] 1 All ER 843, concerned a contract for the sale of steak at a price which was in excess of the maximum price permitted by emergency legislation. The contract was illegal, the defendants failed to deliver the goods and the plaintiffs were awarded damages through an arbitration process. The Court held that the award of damages was to be set aside on the basis that the contract was illegal. The Appellant also cited the authority of *Quinn v IBRC Limited* [2015] IESC, considered whether the security provided in respect of certain loans was capable of being enforced. In that case it was found that the security in those cases could be enforced notwithstanding their connection to illegal contracts. I

do not consider either of these authorities to be directly relevant to the question in this appeal which concerns the application of section 438 TCA 1997.

69. In *Baker v Potter* [2004] EWHC 1422, a loan was made to the Respondent in breach of his fiduciary duty as a director on the basis that it constituted a breach of section 330 of the UK Companies Act 1985, and also because the loan was not made on commercial terms or for any proper corporate purpose but was made purely to benefit Mr. Potter. The Court held that Mr. Potter held the monies as a constructive trustee for the company. However, *Baker v Potter* was not a tax case and did not deal with the implications of the loan in a tax context.

Conclusion

70. The question to be addressed in this appeal is whether the interest charged on a loan to the director, Mr. [redacted] a participator in the Appellant close company, is taxable in accordance with the provisions of section 438 TCA 1997.

71. Pursuant to section 438(2) TCA 1997, the close company is regarded as making a loan where a person '*incurs a debt*' to the close company.

72. The approach to be adopted in identifying the meaning of the words '*incurs a debt*' in section 438 TCA 1997, is a literal interpretative approach in accordance with the Supreme Court authority of *Bookfinders Ltd. v The Revenue Commissioners.* I am satisfied that the wording of section 438 TCA 1997, is both clear an unambiguous and that section 438(2) taxes a close company where a person incurs a debt to the close company.

73. The interest charged to Mr. [redacted] by the company has always been recognised by the company, was recorded in the company's accounts and has been acknowledged by the company in correspondence to the Respondents.

74. The status of the original loan for company law purposes and the question of whether it was *ultra vires* the powers of the company is not in my view a relevant consideration for the purposes of this analysis because even if the loan was *ultra vires*, the director nonetheless incurred a debt to the company in accordance with section 438(2) TCA 1997, in respect of the original loan (reflected in the 'director's loan' account in the

financial statements). Before the original debt was repaid, interest was charged by the company in relation to that debt and the interest was marked in the financial statements as a debt due to the company for the accounting periods ending 31 December 2011, 31 December 2012 and 31 December 2013.

75. I am satisfied that the Appellant falls within the charge to tax on a plain and literal interpretation of section 438 TCA 1997, on the basis that the interest constituted a debt incurred to the company to which the provisions of section 438(2) TCA 1997 apply.

Determination

76. Accordingly, I determine that the assessments raised by the Respondents on 28 November 2017, totalling €301,106, which relate to the accounting periods ending 31 December 2011, 2012 and 2013 shall stand.

77. This appeal is determined in accordance with section 949AK TCA 1997.

This determination has not been appealed

COMMISSIONER LORNA GALLAGHER

29th day of April 2022