[2018] UKFTT 735 (TC)

TC06868

Appeal number: TC/2017/06379

CAPITAL GAINS TAX – s253(4) of TCGA 1992 – whether payments made under a guarantee of qualifying loans – no – they were made under an indemnity – appeal dismissed

FIRST-TIER TRIBUNAL
TAX CHAMBER

RON DENNIS CBE **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE & CUSTOMS **Respondents**

TRIBUNAL: JUDGE JONATHAN RICHARDS

Sitting in public at Taylor House, Rosebery Avenue, London on 9-10 October 2018 and having considered additional written submissions from the parties dated 29 November 2018 and 30 November 2018 respectively

Philip Ridgway, instructed by Blick Rothenberg for the Appellant

Jeremy Schryber, Officer of HM Revenue & Customs, for the Respondents

DECISION

1. The Appellant, Mr Dennis, is appealing against two closure notices that HMRC issued on 2 December 2016 at the end of enquiries into his 2007-08 and 2008-09 tax returns. Very broadly, the appeal involves the question whether a payment that Mr Dennis made was under a "guarantee of a loan" so as to give rise to an allowable loss under the provisions of s253 of the Taxation of Chargeable Gains Act 1992 ("TCGA 1992"). On conclusion of their enquiries, HMRC determined that the payments were not under such a guarantee. They therefore amended Mr Dennis's return for 2007-08 so as to reduce the allowable losses that he had claimed to suffer in that year. They then amended his return for 2008-09 in which he claimed to carry forward allowable losses against chargeable gains that he had made. Mr Dennis appeals the conclusions of both closure notices.

Facts

2. The relevant facts were largely agreed and a Statement of Agreed Facts was made available to me. Neither party relied on witness evidence, though they had agreed a bundle of relevant documents and both made submissions by reference to that bundle. The relevant facts are as set out at [3] to [22] below.

The capital structure of the Company and the Shareholders' Agreement

3. In 1998, Mr Dennis entered into a joint venture with TAG Group Holdings SA ("TAG Holdings"), a third party company, to develop and manufacture high quality electronic audio and audio-visual equipment. The joint venture vehicle was TAG McLaren Audio Ltd (the "Company"), a company incorporated in England and Wales.

4. Mr Dennis and TAG Holdings made their respective series of investments in the Company by way of loan and by subscription for ordinary shares and preference shares. Some of the amounts that were initially advanced by way of loan were subsequently converted into preference shares.

5. The investments that Mr Dennis and TAG Holdings made in the Company are summarised in the following table:

Investment	**Amount invested by TAG Holdings (£)**	**Amount invested by Mr Dennis (£)**
Ordinary shares	73,339	48,893
Preference shares	11,985,664	3,995,221
Loans[1]	3,053,251	1,017,750
Total	15,112,254	5,061,864

[1] The parties agreed that these are "qualifying loans" for the purposes of s253 of TCGA 1992.

6. TAG Holdings' ordinary shares in the Company were 'A' ordinary shares of £1 each. Mr Dennis's ordinary shares were 'B' ordinary shares of £1 each. As is customary for shares in joint venture companies, the 'A' ordinary shares and 'B' ordinary shares were separate classes of share but in all material respects ranked pari passu and carried identical rights. Both the 'A' ordinary shares and the 'B' ordinary shares carried one vote per share on a vote by way of poll at a general meeting. Both classes of ordinary share were issued at par, with no share premium, and therefore, the table at [5] sets out both the amount invested in ordinary shares and the number of ordinary shares held by TAG Holdings and Mr Dennis respectively.

7. Similarly, TAG Holdings held 'A' preference shares and Mr Dennis held 'B' preference shares of nominal value £1 each. These were separate classes of share as a matter of company law, but their rights were in all material respects identical. The preference shares carried a right, on a return of capital or on a winding up, to the payment of the capital paid up on them (£1 per share) but carried no further right to participate in assets of the Company. The preference shares also carried a preferential right to a fixed, cumulative dividend. Like the ordinary shares, the preference shares were issued at par with no share premium and so the table at [5] records both the amount invested in preference shares and the number of preference shares held by Mr Dennis and TAG Holdings.

8. The preference shares did not carry voting rights except in limited circumstances. Article 4.2.3 of the Company's Articles of Association provided as follows:

> The holders of the Preference Shares shall … not be entitled to vote, either in person or by proxy, at any general meeting by virtue or in respect of their holding of Preference Shares, unless the business of the meeting is or includes the consideration of a resolution for winding-up the Company or a resolution varying or abrogating any of the rights or restrictions attached to the Preference Shares (in which case the holders of the Preference Shares shall be entitled to vote only on such resolution).

Where entitled to vote, holders of preference shares were entitled to one vote per preference share held.

9. As the table demonstrates, there was a mismatch, between investors' voting rights (conferred by ordinary shares in the Company) and their general economic investment in the Company. The 73,339 ordinary shares that TAG Holdings owned gave it control of 60% of votes that could be cast at general meetings of the company[2]. However, it had provided 75% of the finance by way of preference shares and 75% of the finance by way of loan.

10. Mr Dennis and JAG Holdings entered into a Shareholders' Agreement on 26 July 2001 (the "Shareholders' Agreement"). Recital (C) of the Shareholders' Agreement recited that:

[2] Apart from on resolutions on which holders of preference shares were entitled to vote.

> Each of the Parties enters into this Agreement to regulate their holding of shares in the Company in consideration of each of the other Parties entering into this Agreement and accepting the terms, undertakings and covenants contained herein.

11. Clause 6 of the Shareholders' Agreement was headed "Finance". Pursuant to Clause 6.1 of the Shareholders' Agreement, Mr Dennis and TAG Holdings agreed to subscribe for preference shares.

12. Clause 6.2 provided that, save as otherwise provided in the Shareholders' Agreement:

> All further requirements of the Company exceeding its own resources from time to time shall be procured so far as possible by borrowing other than from Shareholders.

13. Clause 6.3 of the Shareholders' Agreement provided as follows:

> 6.3 Save as provided above, no Shareholder undertakes to provide any loan or share capital to the Company … nor to give any guarantee, security or indemnity in respect of any of the liabilities or obligations of the Company….

14. Clause 10.3 of the Shareholders' Agreement ("Clause 10.3") contained a provision consequent on the "mismatch" referred to at [9] above. Since the meaning and effect of Clause 10.3 is at the heart of the issues arising in this appeal, I set it out in full:

> 10.3 To the extent that any of the Shareholders do not receive satisfaction in full in the winding-up of the Company of all sums due or to fall due to them, then the aggregate shortfall between all sums due or to fall due to the Shareholders and all amounts actually recovered by the Shareholders (whether by direct payment or the exercise of any right of set-off or otherwise) shall be calculated and apportioned between the Shareholders in the Relevant Proportion at that time and payment shall be made between the Shareholders to ensure that each Shareholder bears its respective share of the aggregate amount of such shortfall.

15. The definition of "Relevant Proportion" for the purposes of the Shareholders' Agreement was:

> "Relevant Proportion" means in relation to a Shareholder, the proportion which the voting rights attaching to the Shares of that Shareholder bears to the total voting rights of the Shares in issue at that time.

The definition of "Shares" embraced all classes of share in issue from time to time and so included both ordinary shares and preference shares in the Company.

The winding-up of the Company

16. The Company developed several retail products. However, lower than expected demand and difficult market conditions led Mr Dennis and TAG Holdings to agree not to pursue the venture further. The decision was taken to cease developing new products in July 2003, although products that had been introduced to the market continued to be available as did warranty, repair and helpdesk support services.

17. The Company entered liquidation on 4 July 2005. Immediately prior to the winding-up, the respective investments of Mr Dennis and TAG Holdings in the Company were as set out in the table at [5] above. As part of the winding-up process, both Mr Dennis and TAG Holdings agreed to subordinate their debt claims against the Company to those of other unsecured creditors. As a result, the Company was solvent at the time of winding up and so the winding-up took effect as a members' voluntary winding up accompanied by a declaration of solvency. TAG Holdings received payments in the winding-up of the Company totalling £525,200 and Mr Dennis received £150,072.

18. The losses that the shareholders suffered in the winding-up of the Company are summarised in the following table:

	TAG Holdings	**Mr Dennis**
Amount invested (£)[3]	15,112,254	5,061,864
Amount recovered in liquidation	(525,200)	(150,072)
Shortfall	14,857,054	4,911,792
Total shortfall of TAG Holdings and Mr Dennis	£19,498,846	
Amount of shortfall if that shortfall had been shared between TAG Holdings and Mr Dennis in 60:40 ratio	£11,699,308	7,799,538

19. Following the winding-up of the Company, TAG Holdings made a claim for £3.8m against Mr Dennis under Clause 10.3. That claim related to the proportion of the sums unrecovered by TAG Holdings and included an amount of some £800,000 in respect of interest. Mr Dennis accepted that he was obliged to make a rebalancing payment to TAG Holdings under Clause 10.3 but agreed with TAG Holdings that interest should not be due. Mr Dennis and TAG Holdings agreed to settle at an amount of £3m and Mr Dennis paid that amount to TAG Holdings on 23 April 2007.

Mr Dennis's tax returns and HMRC's enquiries into them

20. In his self-assessment return for the 2007-08 tax year, Mr Dennis made a claim for an allowable loss of £3m which he considered arose under s253(4) of the Taxation of Chargeable Gains Act 1992 as a result of the payment he had made to TAG Holdings. In his self-assessment return for the 2008-09 tax year, Mr Dennis claimed to set that

[3] See table at [5] above

allowable loss off against other gains that he had made in that tax year and claimed a repayment of tax for the 2008-09 tax year.

21. On 29 September 2009 and 21 February 2010 respectively, HMRC opened enquiries into Mr Dennis's tax returns for 2007-08 and 2008-09. HMRC refused to make the repayment of tax that Mr Dennis had claimed.

22. In a letter to Mr Dennis's advisers, Blick Rothenberg dated 12 October 2016, HMRC accepted that some loss was allowable but that it was limited to £403,407 on the stated principle that relief for equity losses could not be allowed. On 2 December 2016, HMRC issued closure notices relating to both tax years in dispute setting out their conclusion that the allowable loss was just £403,407. Mr Dennis made in-time appeals to HMRC against these conclusions and, on 25 July 2017, HMRC sent Mr Dennis the conclusions of their internal review (which concluded that no allowable loss was available). Mr Dennis notified his appeal to the Tribunal on 15 August 2017, within applicable time limits.

Legislative provisions

23. Section 253 of TCGA 1992 provides as follows:

> **253 Relief for loans to traders**
>
> (1) In this section "a qualifying loan" means a loan in the case of which—
>
> (a) the money lent is used by the borrower wholly for the purposes of a trade carried on by him, not being a trade which consists of or includes the lending of money, and
>
> (b) the borrower is resident in the United Kingdom, and
>
> (c) the borrower's debt is not a debt on a security as defined in section 132;
>
> and for the purposes of paragraph (a) above money used by the borrower for setting up a trade which is subsequently carried on by him shall be treated as used for the purposes of that trade.
>
> …
>
> (4) Where a person who has guaranteed the repayment of a loan which is, or but for subsection (1)(c) above would be, a qualifying loan makes a claim and at that time—
>
> (a) any outstanding amount of, or of interest in respect of, the principal of the loan has become irrecoverable from the borrower, and
>
> (b) the claimant has made a payment under the guarantee (whether to the lender or a co-guarantor) in respect of that amount, and
>
> (c) the claimant has not assigned any right to recover that amount which has accrued to him (whether by operation of law or otherwise) in consequence of his having made the payment, and

> (d) the lender and the borrower were not each other's spouses or civil partners, or companies in the same group, when the loan was made or at any subsequent time and the claimant and the borrower were not each other's spouses or civil partners, and the claimant and the lender were not companies in the same group, when the guarantee was given or at any subsequent time,
>
> this Act shall have effect as if an allowable loss had accrued to the claimant when the payment was made; and the loss shall be equal to the payment made by him in respect of the amount mentioned in paragraph (a) above less any contribution payable to him by any co-guarantor in respect of the payment so made.

The issues arising in this appeal

24. By the time of the hearing, Mr Dennis accepted that he is not entitled to the full allowable loss of £3m that he claimed. However, Mr Ridgway argues that Mr Dennis is entitled to an allowable loss of £2,528,250 which he calculates as follows:

> (1) The aggregate shortfall for the purposes of Clause 10.3 was £19,498,846 (see the table at [18]).
>
> (2) TAG Holdings's "Relevant Proportion" for the purposes of Clause 10.3 was 60% (because TAG Holdings's ordinary shares conferred 60% of the voting rights that could be cast on resolutions generally). Mr Dennis's Relevant Proportion was 40%.
>
> (3) TAG Holdings's actual shortfall was £14,587,504. If it had suffered only 60%, its Relevant Proportion, of that shortfall, its shortfall would have been £11,699,308 (see the table at [18]). It followed that Clause 10.3 required Mr Dennis to make a payment to TAG Holdings of the difference between these two sums (which was £2,887,747).
>
> (4) Mr Dennis actually paid £3m and may, therefore, have paid more to TAG Holdings than was strictly required. However, that can happen when disputes are compromised and nothing turns on this point for the purposes of this appeal. Mr Dennis paid at least £2,887,747 to TAG Holdings under the guarantee in Clause 10.3.
>
> (5) The payment of £525,200 by the liquidator to TAG Holdings was partial repayment of the Company's most senior obligations owed to TAG Holdings (i.e. its loans rather than its ordinary or preference share capital). It follows that, following the payment by the liquidator, TAG Holdings had not received payment of £2,528,250 of loans to the Company. The payment that Mr Dennis made to TAG Holdings should be treated as making good first the shortfall that TAG Holdings had suffered in respect of its loans with any balance being attributed to the shortfall on equity.
>
> (6) Therefore, the first £2,528,520 of the payment that Mr Dennis made under the guarantee should be treated as being in respect of the Company's qualifying loans and thus generates an allowable loss under s253(4) of TCGA 1992. Mr Dennis accepted that the balance of the payment was

attributable to equity in the Company and so did not contribute to any allowable loss.

25. The parties were broadly agreed that there were three relevant issues.

26. The first issue (which I will call the "Guarantee Issue") is whether Clause 10.3 of the Shareholders' Agreement involved Mr Dennis giving a guarantee of a qualifying loan. It was common ground that, if Mr Dennis fails on the Guarantee Issue, s253(4) of TCGA 1992 is not engaged and he is not entitled to any allowable loss whatever the outcome of the other two issues described below.

27. The second issue (which I will call the "Relevant Proportion Issue") related to the meaning of the term "Relevant Proportion" in Clause 10.3 of the Shareholders' Agreeement. The parties' positions on this issue were as follows:

> (1) As noted at [24(2)], Mr Dennis's position was that TAG Holdings's "Relevant Proportion" was 60% (because it held 60% of the ordinary shares which were the only shares carrying voting rights on resolutions generally). That calculation of "Relevant Proportion" underpinned his calculation of the amount of allowable loss to which he was entitled outlined at [24] above.
>
> (2) HMRC do not accept that TAG Holdings's "Relevant Proportion" should be established only by reference to voting rights on the ordinary shares in the Company. They argue that voting rights attaching to the Company's preference shares should also be taken into account. Taking into account voting rights on the preference shares, they calculate TAG Holdings's "Relevant Proportion" as being at or around 75%[4]. Therefore, HMRC submit that TAG Holdings had not suffered more than its Relevant Proportion of the shortfall (as its shortfall was £14,587,054 out of a total shortfall of £19,498,846 or around 73.1%). It follows, in HMRC's submission that even if Clause 10.3 amounted to a guarantee of a loan, Mr Dennis made a payment that he was not obliged to make and so none of that payment made "under" that guarantee.

28. The third issue (which I will refer to as the "Apportionment Issue") arises only if Mr Dennis succeeds on both the Guarantee Issue and the Relevant Proportion Issue. In that case, the question is how much of the payment that Mr Dennis made to TAG Holdings should be treated as being "under a guarantee of a [qualifying loan]" (which is treated as an allowable loss), and how much should be treated as being made in respect of the Company's preference shares and ordinary shares (which does not give rise to an allowable loss). The parties' respective positions on this issue were as follows:

---

[4] There was a total of 122,232 ordinary shares and 15,980,885 preference shares. Where they carried voting rights, both ordinary shares and preference shares carried one vote per share. TAG Holdings held 12,059,003 shares (both ordinary shares and preference shares) out of a total issued share capital of 15,980,885 shares. Therefore, on Dr Schryber's submissions, the "Relevant Proportion" of TAG Holdings was 75.5% and Mr Dennis's "Relevant Proportion" was 24.5%

(1) Mr Dennis considers that £2,528,250 of the payment was made "under a guarantee of a [qualifying loan]" and therefore that is the amount of allowable loss to which he is entitled.

(2) HMRC consider that, only £490,694 of the payment that Mr Dennis made can be regarded as being "under a guarantee of a [qualifying loan]". Therefore, even if Mr Dennis succeeds on both the Guarantee Issue and the Relevant Proportion Issue, HMRC argue that his entitlement to an allowable loss should be restricted to this amount.

The Guarantee Issue

Whether Clause 10.3 amounted to a "guarantee" at all

29. Halsbury's Laws of England state that:

> A guarantee is an accessory contract by which the promisor undertakes to be answerable to the promise for the debt, default or miscarriage of another person, whose primary liability to the promise must exist or be contemplated.

30. A guarantee therefore involves three parties: first the surety or guarantor, second the principal or debtor and third the creditor.

31. Section 4 of the Statute of Frauds 1677 provides that a contract of guarantee is not enforceable unless it is in writing. Partly because of that requirement, the law draws a distinction between contracts of indemnity (which may be enforceable if not in writing) and contracts of guarantee (which are not enforceable if not in writing). The distinction between a "guarantee" and an "indemnity" is not an absolute one because, as Smith LJ noted in *Anthony Pitts and others v Andrew Jones* [2007] EWCA Civ 1031 at [21] a contract of guarantee is a type of indemnity (since the term "indemnity" is referring only to the right of one party to look to another to satisfy his losses). However, there is an important distinction between contracts of guarantee and contracts of indemnity that are not guarantees (which I will refer to simply as "contracts of indemnity" in the discussion that follows). The Seventh Edition of the Law of Guarantees, authored by the Honourable Mrs Justice Andrews DBE and Richard Millett QC explains this distinction as follows:

> It follows from the secondary nature of the [guarantee] obligation that the guarantor is generally only liable to the same extent that the principal is liable to the creditor, and that there is no liability on the part of the guarantor if the underlying obligation is void or unenforceable, or if that obligation ceases to exist. This is known as the "principle of co-extensiveness".

32. By contrast, under a contract of indemnity, the surety can be liable even if the creditor is not. At 3-013 of the Law of Guarantees, the authors comment on situations where there is a lack of co-extensiveness as follows:

> If the liability of the surety is greater than that of the principal, the contract is an indemnity and falls outside s4 [of the Statute of Frauds 1677]…
>
> Similarly, if the surety agrees to pay regardless of whether the principal is liable, or in circumstances in which there is considerable doubt as to the principal's liability, he is not undertaking to pay in respect of the 'debt, default or miscarriage of another'. Accordingly, if it is clear from the nature of the contract that it was entered into specifically to safeguard against the possibility that the principal would not be liable to the creditor, the contract does not fall within [s4 of the Statute of Frauds 1677]: *Lakeman v Mounstephen* (1874) L.R 7 H.L. 17

33. Section 253(4) of TCGA 1992 apply only where a person has "guaranteed" a qualifying loan and apply only to payments made under that guarantee. Parliament has not provided for payments under indemnities generally to fall within s253(4) and I consider that Mr Ridgway was right to accept during the hearing that, even applying doctrines of "purposive" interpretation, the reference to "guarantees" in s253(4) should not be taken to extend to indemnities generally. I therefore accept Mr Ridgway's submissions that, since Parliament has chosen to use the word "guarantee" which bears a particular meaning in general law, it intended that general law meaning to apply for the purposes of s253(4). Support for that interpretation comes from *Bennion on Statutory Interpretation* Fifth Edition in Section 366, relevant parts of which are as follows:

> *Free-standing terms*: A free-standing legal technical term is one that stands on its own feet without the need for any definition. It has a legal meaning which exists for all purposes, not just for those of a particular enactment. This general meaning may exist at statute or at common law. Thus *highway* is defined at common law whereas *highway maintainable at the public expense* is defined generally by statute…
>
> Unless the contrary intention appears, Parliament is taken, when using a free-standing legal term, to intend that its meaning shall correspond to the legal meaning assigned to it generally.

34. For the reasons set out at [35] to [45] below, I do not consider that the "principle of co-extensiveness" is satisfied. It follows that I consider Clause 10.3 amounts to an indemnity, but not a guarantee.

35. Before Clause 10.3 can apply, it must be the case that "the Shareholders do not receive satisfaction in full in the winding-up of the Company of all sums due or to fall due to them". Therefore, Clause 10.3 can only apply after (a) the Company has entered winding-up and (b) all distributions in the winding-up of the Company have been made. In particular, Clause 10.3 does not envisage that an initial payment is made at the time of the first distribution in the liquidation of the Company with adjusting payments being made if, and when, subsequent liquidation distributions are made. On the contrary, Clause 10.3 envisages a single payment being once <u>all</u> distributions in the winding-up have been made.

36. Once all distributions have been made in the Company's liquidation, the Company may still exist as it may take a little time between the making of the final distribution and the formal dissolution of the Company. However, once the final distribution is made, there could be no realistic prospect of the shareholders having any further recourse against the Company. Since a liability under Clause 10.3 can only be crystallised at a point in time at which there is no prospect of the shareholders having recourse to the Company, it follows that Clause 10.3 is not a "guarantee" as the "principle of co-extensiveness" is not engaged.

37. Mr Ridgway argued against the conclusion set out at [36] by submitting that whenever a company is subject to insolvent liquidation, a claim against a guarantor of that company's obligations can only be known for certain once the final distribution has been made. He argued as follows:

> (1) The "rule against double proof" explained at paragraph 25 of the judgment of Lloyd LJ in *Cattles plc v Welcome Financial Services Limited and others* [2010] EWCA Civ 599 meant that, if a guarantor wished to prove in the company's insolvency in respect of sums paid under the guarantee (under its rights of subrogation), it needed to pay the creditor the full amount guaranteed before the payment of the liquidation distribution.
>
> (2) A guarantor who chose to pay before the liquidation distribution would be able to prove in the liquidation (under its rights of subrogation), but those rights could be presumed to be worthless (since an insolvent company would be no more able to pay the guarantor than it would the creditor).
>
> (3) A guarantor who made no payment before the liquidation distribution would only have to pay the creditor the difference between what the creditor received from the company in the liquidation and the principal amount of the guaranteed obligation. That difference could only be ascertained once the final distribution had been made, exactly the same position that arises under Clause 10.3.
>
> (4) Prior to the dissolution of the Company, TAG Holdings had rights against both the Company and against Mr Dennis under Clause 10.3. The fact that the rights against the Company were worthless meant that TAG Holdings chose to claim against Mr Dennis, exactly the same position that would arise under a guarantee.

38. I am by no means convinced that the "rule against double proof", which deals with the circumstances in which someone can prove in an insolvent liability, has much bearing on the question whether, as a matter of construction, Clause 10.3 amounts to a "guarantee" or a more general indemnity. Nor do I accept that Mr Ridgway's comparisons with a guarantee are made out. If Mr Dennis had "guaranteed" loans to the Company then, as soon as the Company defaulted on those loans (for any reason), and following satisfaction of any conditions to the guarantee, TAG Holdings would have had rights against both the Company and Mr Dennis. In such a case, TAG Holdings could choose whether it would seek recovery from Mr

Dennis or from the Company. Indeed it is precisely because of the existence of that choice that the "rule against double proof" exists[5]. However, under Clause 10.3, TAG Holdings had no such choice. Only when the Company paid TAG Holdings everything it possibly could, such that no further payment from the Company was possible, would TAG Holdings have any ability to require payment from Mr Dennis. The rights of TAG Holdings against the Company and Mr Dennis were therefore sequential, not co-extensive.

39. Mr Ridgway referred to *In re Fitzgeorge ex parte Robson* [1905] 1 KB 462 as authority for the proposition that there could still be a "guarantee" of an obligation owed by a company even where that company had ceased to exist on dissolution. In that case A guaranteed B the regular payment of interest payable on a debenture of a company. Some time afterwards the company went into liquidation and was dissolved. Subsequently A became bankrupt. The High Court held that, even though the company had been dissolved, B was entitled to prove in A's bankruptcy for the estimated value of future interest that would have been payable by the company. That decision was briefly considered without adverse comment by the Court of Appeal in *Ali Shipping Corporation v Jugobanka D.D Beograd and Jugobanka Split* [1997] EWCA Civ 2705.

40. However, I do not consider *Fitzgeorge* compels the conclusion that Clause 10.3 is a "guarantee". *Fitzgeorge* was not concerned with the question of whether A's promise to B should be categorised as a "guarantee" or as an "indemnity". Rather, it was concerned with B's right to claim in A's bankruptcy for amounts owed. In any event, A's obligations in *Fitzgeorge* were co-extensive with those of the company: if prior to the company's dissolution, it had defaulted on its obligations, B could have claimed on the guarantee in relation to the company's obligations that would still be extant at that point. *Fitzgeorge* and *Ali Shipping Corporation* demonstrate that the mere fact that the debtor company is subsequently dissolved does not of itself frustrate the contract of guarantee. But this appeal does not involve a mere coincidental subsequent dissolution of the debtor. On the contrary, the very terms of Clause 10.3 mean that no liability under Clause 10.3 can be crystallised until a point in time at which a shareholder no longer has any meaningful right to claim against the Company in respect of the obligation said to be "guaranteed".

41. At the hearing, Mr Ridgway also canvassed examples where it is thought that the liquidator has made a final distribution in the liquidation, and the parties set about deciding whether a payment from Mr Dennis to TAG Holdings (or vice versa) is required under Clause 10.3. However, before the Company is finally dissolved, its liquidator discovers previously unknown assets that are available to meet the Company's liabilities to its shareholders. At that point, he submitted, the Company would still owe liabilities to its shareholders and rights under Clause 10.3 would be

[5] If a company's creditor obtains payment from the company's guarantor then the guarantor acquires a right of subrogation against the company. That right of subrogation is a contingent liability of the company (because it arises only if the creditor obtains payment from the guarantor). The "rule against double proof" deals with problems that would otherwise arise if the creditor proved in a liquidation for the company's actual liability and the guarantor proved for the contingent liability.

co-extensive with the Company's obligations demonstrating the principle of co-extensiveness is met.

42. I cannot, however, accept that submission. First, it contains a logical fallacy. Clause 10.3 can only be operated after the final distribution in the Company's liquidation has been made. Yet Mr Ridgway's example involved Clause 10.3 being applied before this point (at a time when it is thought, wrongly, that the final distribution has been made). Mr Ridgway argued that Clause 10.3 could apply on such a "provisional" basis and, if further sums were discovered, the aggregate shortfall would need to be recalculated with credit being given. However, Clause 10.3 simply contains no mechanism for provisional payments to be made and adjusted. Nor is there any need to imply such a mechanism as Clause 10.3 can work perfectly sensibly provided it is applied at a point when it is certain, not merely thought, that the Company has made all payments possible to its creditors and shareholders.

43. Second, Mr Ridgway's situation is not that with which Clause 10.3 is, read objectively, concerned. Clause 10.3 is not concerned with hypothetical situations where a liquidator discovers previously unknown assets after making what was thought to be a final distribution. Rather, Clause 10.3 read objectively is seeking to allocate the risk of the Company not paying shareholders everything due to them in a winding up. Only once all sums have been paid in the Company's winding-up can Clause 10.3 be applied. The whole architecture of Clause 10.3 demonstrates that it is not concerned with a situation where obligations of the Company and of Mr Dennis (or TAG Holdings) exist in parallel.

44. There is a further, related, reason why Clause 10.3 does not amount to a guarantee. If Clause 10.3 were a guarantee then Mr Dennis, as the person making a payment under that guarantee, would under equitable principles be entitled to a right of subrogation or contribution against the Company as soon as he made all payments due under it.[6] However, since Mr Dennis could not make full payment under Clause 10.3 until the last distribution in the Company's liquidation has been made, Mr Dennis could never have any meaningful right of subrogation against the Company. This could be interpreted as Mr Dennis having impliedly waived his right of subrogation (as there is no express waiver of any such rights). However, since the parties have adopted a form of contract that is inconsistent with any meaningful right of subrogation arising, and since a right of subrogation is a normal incident of a contract of guarantee, I regard it as more natural to conclude that the absence of any meaningful right of subrogation is a strong indication that Clause 10.3 is not a guarantee at all.

45. As I have noted above, Mr Ridgway submitted that the situation set out at [44] was true of guarantees generally since rights of subrogation will typically be worthless. I do not agree. First, rights of subrogation do not always fall to be exercised in situations of insolvency. For example, if Mr Dennis had given a

[6] I recognise that, under the "rule against double proof", Mr Dennis could not prove in the Company's liquidation in respect of his rights of subrogation unless he made payment in full under the guarantee prior to the date of the liquidation distribution.

"straightforward" guarantee of the Company's debts, the Company might fail to pay those debts on the due date because of cash flow problems prompting the creditors to look to Mr Dennis for payment. Provided he made such payment, Mr Dennis would acquire rights of subrogation that would enable him to put the Company into liquidation. If the Company, despite its cash flow problems, had valuable assets, a sale of those assets in a liquidation might enable the Company to pay Mr Dennis in full even though it did not pay its creditor anything. Even if the Company were insolvent, it might still be able to pay some percentage of its liabilities and therefore, if he gave a guarantee, Mr Dennis's rights of subrogation might result in him receiving some payment in a liquidation of the Company. There is, therefore, a contrast between Clause 10.3 (which could never give Mr Dennis any meaningful right of subrogation) and a "guarantee" that would offer Mr Dennis the prospect of valuable rights of subrogation.

46. The failure to satisfy the "principle of co-extensiveness" and the absence of any meaningful rights of subrogation are the two primary reasons why I have concluded that Clause 10.3 gives rise to an indemnity, and not a guarantee. I can therefore deal briefly with other arguments that Dr Schryber made on this issue[7].

47. Dr Scrhyber submitted that Clause 10.3 should be characterised as a "loss-sharing arrangement" and not a guarantee. However, I agree with Mr Ridgway, that this is simply an argument about labels. Many guarantee arrangements could be described as "loss-sharing arrangements" as they involve the guarantor suffering, or sharing, a loss that would otherwise be suffered by a creditor on default of a debtor.

48. Dr Schryber also submitted that loan guarantees are not normally made in circumstances whereby two lenders lend to the same borrower and guarantee each other's loans. However, I do not consider that the legal question whether Clause 10.3 amounts to a guarantee or not can be answered by considering whether it is "normal" or not. Conceptually, Clause 10.3 could involve the provision of a guarantee that is atypical.

49. Dr Schryber also relied on Clause 6.3 of the Shareholders' Agreement referred to at [13] above. He argued that Clause 6.3 amounted to a "prohibition" on giving guarantees. Moreover, since Clause 6.3 did not provide any saving for Clause 10.3, it demonstrated that the parties to the Shareholders' Agreement did not consider Clause 10.3 to involve the provision of any guarantee.

50. I agree with Mr Ridgway that it is overstating matters to describe Clause 6.3 as a "prohibition" on giving guarantees. Rather, viewed objectively, Clause 6.3, sitting as it does in a section of that agreement dealing with "Finance", is simply recording the parties' agreement that, having agreed to provide the finance set out in Clause 6 and in the Shareholders' Agreement generally, the shareholders could not be required to provide guarantees of borrowings that the Company took out. That was sensible. If

[7] I do not consider that the fact that a claim under Clause 10.3 is for part only of the shortfall of itself prevents Clause 10.3 from being a guarantee since it seems to me that a person can guarantee part only of an obligation (and Dr Schryber did not argue to the contrary).

Mr Dennis (or TAG Holdings), having provided all finance to the Company required by the Shareholders' agreement was suddenly confronted with a demand for a guarantee of a loan by a third party, Mr Dennis (or TAG Holdings) might legitimately feel that they were being asked to assume financial risk that had not been agreed. The purpose of Clause 6.3 viewed objectively was to clarify that neither party could be required to assume such additional risk. The form of Clause 6.3 perhaps gives rise to a (weak) inference that the parties did not regard Clause 10.3 as involving the provision of a guarantee as otherwise they might have, in Clause 6.3, included a specific cross-reference to Clause 10.3. However, at most that sheds some light on what the parties thought of Clause 10.3. It says little, if anything, as to the true legal effect of Clause 10.3.

Whether Clause 10.3 amounted to a "guarantee of a loan"

51. Since I have concluded that Clause 10.3 did not amount to a "guarantee" at all, this issue does not need to be considered. However, since the parties both made arguments on this issue, I will address them briefly.

52. Dr Schryber submitted that Clause 10.3 did not refer to any specific loan, or indeed to loans at all. It contained no words of apportionment designed to allocate payments under Clause 10.3 as between loans or other obligations of the Company. In those circumstances he submitted that, even if it is a guarantee, it is not a "guarantee of a loan" and so s253 of TCGA 1992 does not apply. He amplified by that argument by submitting that Clause 10.3 appeared in a shareholders' agreement whose evident purpose, as set out in Recital (C) was to regulate the holdings of shares in the Company, not to provide guarantees of loans.

53. I do not accept that submission. If, contrary to my view, Clause 10.3 is a "guarantee", I would conclude that it is a guarantee of all the Company's obligations. The parties would have been well aware that some of those obligations arose in respect of loans that the shareholders had made to the Company. Indeed, Schedule 5 of the agreement itemised loans that the shareholders had made to the Company and Clause 2 of the Shareholders' Agreement envisaged that while part of those loans would be set off against the shareholders' obligations to subscribe for preference shares, some of those loans would remain due. Therefore, if Clause 10.3 was a guarantee, at least in part it took effect as a guarantee of loans.

54. That conclusion is not affected by absence of contractual provisions apportioning payments under the guarantee as between loans and other obligations. For tax purposes, it clearly matters whether payments were made under a guarantee of a loan since only such payments give rise to an allowable loss under s253 of TCGA 1992. However, the Shareholders' Agreement was not concerned with tax issues: it was concerned with allocating losses that would arise if the Company failed to discharge its obligations. Therefore, the absence of an apportionment mechanism sheds little light on whether Clause 10.3 took effect as a guarantee of a loan.

55. It seemed to me, during the hearing, that there was a construction of Clause 10.3 that meant that, if it were a guarantee, it could only take effect as a guarantee of loans.

Clause 10.3 is focusing on the difference between "all sums due or to fall due" to shareholders and amounts actually paid to them in a winding-up. Both parties were proceeding on the basis that amounts paid up on ordinary and preference shares were "sums due or to fall due" and that accordingly, if the Company did not repay equity in full on a winding up there could a claim under Clause 10.3. I was not myself entirely convinced on this issue. It seems to me possible that, since the Company was not able to pay in full the shareholders' prior ranking loans in its winding-up, amounts paid up in respect of equity never became "due" and never fell due since equity, by its very nature, only becomes due and payable in a winding-up once debt-holders have been paid in full. If that were the correct interpretation, a shortfall on equity could not give rise to a claim under Clause 10.3. However, at the hearing, both parties were agreed that a shortfall on equity was within the scope of Clause 10.3 and, since that was their position, I will not make findings that are contrary to it.

Overall conclusion on the Guarantee Issue

56. Since Clause 10.3 is an indemnity, and not a guarantee, Mr Dennis has not succeeded on the Guarantee Issue.

The Relevant Proportion Issue

57. Since Mr Dennis has not succeeded on the Guarantee Issue, his appeal has failed and there is no need for me to consider the Relevant Proportion Issue. However, since I heard full argument on that issue, I will set out brief conclusions on it.

58. In short, I prefer Mr Ridgway's submissions on the Relevant Proportion Issue. The Shareholders' Agreement could have been more clearly drafted. However, as I have noted at [35] above, the relevant time for calculating any payment due under Clause 10.3 is after the final distribution in the Company's liquidation is made. It follows that the "Relevant Proportions" have to be ascertained at that time and I do not accept Dr Schryber's argument that the "relevant time" is the date of the resolution to wind up the Company (or that the votes that holders of preference shares had on such a resolution fell to be taken into account in determining the "Relevant Proportion").

59. As noted above, the preference shares carried no voting rights except on (i) a resolution to wind up the Company, (ii) a resolution to reduce capital or (iii) a resolution varying or abrogating the rights or restrictions attaching to the preference shares. There could be no possibility of resolutions of the kinds set out at (i) or (ii) being proposed once the final distribution in the winding up is made. It is difficult to envisage a realistic situation in which a resolution of the kind at (iii) above might be proposed at that point.

60. Of course, after the final distribution in the winding-up of the Company, it is difficult to envisage a realistic scenario in which even the holders of ordinary shares could be given the opportunity to vote on a shareholder resolution. However, the parties could scarcely intend that both parties' "Relevant Proportions" were nil. Rather, Clause 10.3 and the definition of "Relevant Proportion" has to be given a

practical and common-sense interpretation. The shareholders in the Company realised that TAG Holdings had contributed some 75% of the finance to the Company, but had only 60% of the voting rights on most resolutions except the specific resolutions set out at [8] on which holders of preference shares could vote. But for Clause 10.3, if the Company was unable to meet its liabilities in full in a winding-up, TAG Holdings would bear the cost of 75% of the shortfall and Mr Dennis would bear 25% of it. The shareholders clearly wanted to alter that outcome and the only sensible interpretation of Clause 10.3 is that they thought the parties should make adjusting payments as necessary to ensure that TAG Holdings bore only 60% of the loss and Mr Dennis bore 40%. It would make no sense if the (contingent) voting rights attaching to the preference shares were included in the calculation of "Relevant Proportions" since, as the calculation in footnote 4 to paragraph [27] demonstrates, that would not result in a materially different allocation of the loss than would arise if there had been no Clause 10.3.

The Apportionment Issue

61. Given my conclusion on the Guarantee Issue, the Apportionment Issue does not need to be addressed. However, since I heard argument on it, I will do so briefly.

62. Mr Ridgway's essential argument was that the order of distribution in the Company's liquidation involved payments being made first made to secured creditors, second to unsecured creditors, thirdly to holders of preference shares and finally to holders of ordinary shares. Therefore, the total payment under Clause 10.3 should be treated as being made first in respect of the most senior of the Company's obligations (its qualifying loans) so as to mirror the order in which payments were made in the Company's liquidation. On that interpretation, it does not matter whether the payment "under" Clause 10.3 was the full £3m that Mr Dennis actually paid or the figure of £2,887,747 produced by the calculation set out at [24(3)]. On either basis the first £2,528,520 of the payment should be treated as attributable to the Company's qualifying the loans. Mr Ridgway conceded that the balance of the payment (whatever its amount) was not made "under" a guarantee of a qualifying loan and so does not give rise to an allowable loss under s253 of TCGA 1992.

63. Clause 10.3 requires the following calculations to be made:

> (1) First, it is necessary to calculate the "shortfall" that Mr Dennis and TAG Holdings actually suffered following the liquidation of the Company. Given the parties' agreement that shortfalls on equity are within the scope of Clause 10.3 (see [55] above), this shortfall is an aggregate comprising both a shortfall on (senior-ranking) debt and a shortfall on equity. Clause 10.3 does not require this aggregate shortfall to be calculated by reference to the priority of payments in a liquidation. Indeed, if the equity claims ranked senior to debt claims on a winding-up, the calculation of the aggregate shortfall would be the same.
>
> (2) It is then necessary to compare both parties' shortfall with the shortfall they would have suffered if they had shared that shortfall in the ratio 60:40

(as a consequence of my conclusion on the Relevant Proportion Issue). That calculation also requires no consideration of the priority of payments in a liquidation.

(3) In this case, TAG Holdings was suffering more than 60% of the aggregate shortfall. Therefore, a payment was due from Mr Dennis of an amount necessary to ensure that, taking into account that payment, the parties were sharing the aggregate shortfall in the ratio of 60:40. Again, the calculation of the payment relates in no way to the priority of payments in a liquidation.

64. Since the calculation of the amount due under Clause 10.3 does not either expressly or by implication reference the priority of payments due on a winding up, I reject Mr Ridgway's core submission that the first £2,528,520 of the payment that Mr Dennis made necessarily related to the Company's loans and so was made "under a guarantee" of a qualifying loan.

65. The parties are agreed that some of the payments under Clause 10.3 relate to the Company's obligations under "qualifying loans" and some relate to obligations that are not "qualifying loans". Therefore, even though I have rejected Mr Ridgway's core submission, if Clause 10.3 is a "guarantee" of a qualifying loan, it is still necessary to apportion the single payment that Mr Dennis made into an amount made "under a guarantee of a qualifying loan" (which gives rise to an allowable loss under s253 of TCGA 1992) and a residual amount (which does not give rise to an allowable loss). Section 52(4) of TCGA 1992, which provides so far as relevant as follows, is relevant to that issue:

> **52 Supplemental**
>
> …(4) For the purposes of the computation of the gain, any necessary apportionments shall be made of any consideration or of any expenditure and the method of apportionment adopted shall, subject to the express provision of this Chapter, be just and reasonable.

66. Section 253(4) of TCGA 1992 treats so much of a payment under a guarantee of a qualifying loan as is in respect of outstanding interest or principal on that loan as an allowable loss. Section 253(4) does not expressly refer to "expenditure", but since the amount of loss arising under s253(4) is determined by reference to a "payment" made, I consider that the loss is determined by reference to "expenditure". Since s16 of TCGA 1992 provides for losses to be computed in the same way as gains, I consider that the conditions of s52(4) of TCGA 1992 are met with the result that the amount of the payment that is made "under a guarantee of a qualifying loan" should be determined following a "just and reasonable apportionment"[8].

[8] Strictly, s16 of TCGA 1992 applies to the determination of "a loss accruing on a disposal of an asset" whereas the allowable loss arising under s253(4) does not arise on any disposal. However, construed purposively, I believe that s52(4) should apply to the determination of a loss under s253(4) in the same way as the determination of other gains and losses. Even if s52(4) does not apply in this case, I still consider that any apportionment should be performed on a just and reasonable basis as I do not

67. The core of Dr Schryber's argument on the Apportionment Issue was that TAG Holdings's shortfall in respect of qualifying loans was £2,528,520 and Mr Dennis's shortfall was £867,678. The total shortfall in respect of qualifying loans was therefore £3,395,928. To bring TAG Holdings's shortfall on qualifying loans down to just 60% of the total (i.e. £2,037,557), Mr Dennis would need to make a payment of £490,693 to TAG Holdings. Therefore, in his submission, just £490,693 of the payment that Mr Dennis made was, even if made under a guarantee of a qualifying loan, attributable to qualifying loans on a just and reasonable apportionment.

68. As I have noted, Mr Ridgway's submissions on this issue focused on his argument at [62], which I have rejected. He did not put forward any other alternative to Dr Schryber's approach or suggest that there was a better way of apportioning sums on a "just and reasonable" basis. I consider that Dr Schryber's approach is both just and reasonable. It follows that HMRC succeed on the Apportionment Issue with the result that, even if Mr Dennis was entitled to an allowable loss in respect of the payment he made to TAG Holdings, that loss was limited to £490,693.

Disposition

69. Mr Dennis's appeal is dismissed.

70. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

JONATHAN RICHARDS

TRIBUNAL JUDGE
RELEASE DATE: 14 DECEMBER 2018

(Amended under the "slip rule" in Rule 37 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009 on 28 January 2019, but these amendments do not affect the release date of the decision).

consider Parliament can have intended the apportionment to be approached on a basis that is either unjust or unreasonable.