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Taxflash

Changes to the taxation of loans from your company

LOAN AND BEHOLDEN (TO HMRC)

The Finance Bill 2013 (FB13) introduced some important changes to the rules on the taxation of loans made by close companies to their participators, which took effect from Budget Day (20 March 2013).

THE RULES

A 'close company' is broadly defined as one controlled by 5 or fewer shareholders, or by its directors, and a 'participator' broadly encompasses the shareholders, and loan creditors, plus associates, typically close family of the same.

Such loans are exposed to two main taxing provisions, being:

i) an income tax charge on the loan recipient, if no/low interest is charged on the loan; and

ii) a charge on the company, known as a s.455 charge.

The s.455 charge is a levy of 25% of any loan balance outstanding at the company's year end, and remaining outstanding 9 months and 1 day after the year end date. The charge is repayable to the company once the loan balance to which it relates has been repaid.

The FB13 changes have tightened up the rules in relation to the s.455 charge in three main areas:

1) Bed and breakfasting

This term describes the practice whereby participators avoid the s.455 charge by repaying what would be chargeable loan balances and, shortly afterwards, drawing new loans. Repeating the exercise year after year typically meant that no original balance remained chargeable even when the reality of the situation was that a loan existed for (say) 49 weeks of every year.

The new rules introduce two counteractions to the practice;

30 day rule: for repayments and re-withdrawals in excess of £5,000. Where the gap between the two is less than 30 days, the repayment will be matched to the new withdrawal, leaving the original loan treated as outstanding, and so exposed to the charge.

Intention based rule: which is similar in principle, but is not time limited and is much more subjective. Applying to amounts in excess of £15,000, repayments are matched to withdrawals, leaving original loans exposed to the charge, where the intention to re-withdraw existed at the point of repayment.

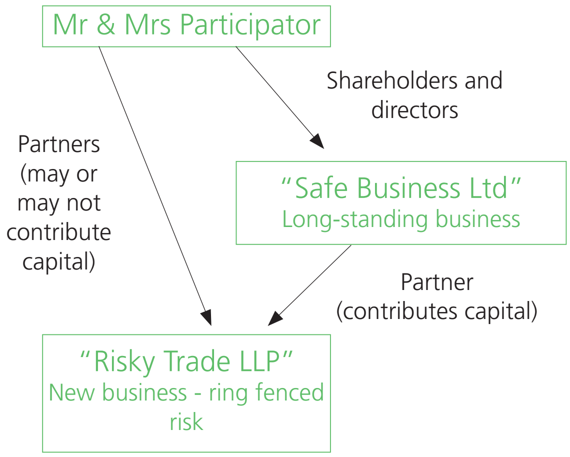
Happily, under both rules, a 'repayment' does not include anything which creates an income tax charge. So where dividends/salaries/bonuses are voted after the year end, it is still possible to treat these as repayments of the old loan, and the drawing of monies as new loans. Thus the s.455 charge will continue to be avoidable in many circumstances.

2) Loans via intermediaries

Perhaps the most troublesome of the new rules, this change targets close companies deemed to be making loans to participators via structures such as partnerships or trusts.

This change will impact on perfectly legitimate business structures, for example where a company and one or more of its participators set up a Limited Liability Partnership (LLP) to carry on a new trade/business. The motivation for setting up a new entity is often to ring-fence the risks of the new business from the assets of the old one, and it is usually necessary for the existing (limited company) business to inject funds to provide working capital.

Regardless of a commercially sensible motivation for these ventures, and without the participator drawing any monies out of the new (LLP) business, the working capital loan will now be treated as a loan chargeable to s.455.



3) Transfers of value, other than loans

The third and final change targets arrangements where value is extracted from the company in some way other than the making of a loan. The HMRC guidance suggests that the arrangements being targeted are similar to the loans via intermediaries, but rather than the company making loans to the LLP, for example, it transfers the value by not withdrawing its share of the LLP profits. This leaves those undrawn profits available for the participator to draw on.

A subtle distinction between items 2 and 3 is that the s.455 charge on transfers of value appears only to arise if the participator draws the monies in question out of the partnership (ie. if they withdraw more than their share of the profits) whereas the charge on loans arises without regard to the behaviour of the participator.

Some top tips for business owners:

- **Review your business structure** – the timeframe for the charge means you should have time to re-arrange your affairs should it be necessary.
- **Keep records** - you should get into the habit of recording the purpose and reason for transactions, as a contemporary record.
- **Time your income carefully** – as above, voting dividends or salary/bonuses will still be treated as a repayment.
- **Protect existing loans** – existing arrangements where working capital loans have been made should not be affected. Avoid repaying loans advanced before 20 March 2013 unless you know that it will not become necessary to re-lend the money, as the new transaction could be caught.
- **Monitor any s.455 charge paid** – experience tells us that HMRC struggle to properly administer s.455 charges, often neglecting to repay the charge following repayment of the loan. The recoverable amount should be carried on the company balance sheet, and its repayment chased once the necessary tax return has been sent to HMRC

For further information on the changes to the taxation of loans or to arrange a meeting to discuss your specific circumstances please contact your usual UHY partner.