bostockwhite

chartered accountants and business advisers

Cabourn House Station Street Bingham Nottinghamshire NG13 8AQ

Tel:01949 838838 Fax:01949 831174

Email: tony@bostockwhite.com
samantha@bostockwhite.com
simon@bostockwhite.com

www.bostockwhite.com

Neither a borrower or lender be

This Briefing summarises the tax implications of shareholders borrowing from or lending to an owner managed company. There is new tax law to contend with particularly if loans are being taken by an individual directly or indirectly from a company.

Loans from the company

The tax issues for the company

If a close company makes a loan to a participator, (for example, most shareholders in unquoted companies), the company must make a payment of corporation tax to HMRC if the loan is not repaid within nine months of the end of the accounting period. The amount of the corporation tax, often referred to as 's455 tax', is 25% of the loan. This tax is included within the corporate tax self-assessment system and the company must also report the loans still outstanding at the accounting period end in the tax return.

If the loan is repaid after the company has paid over the tax, then the s455 tax will be repaid but not until nine months and one day after the end of the accounting period in which the loan is repaid. This means that the company may have to wait some time for it to be repaid.

A loan includes advances, such as a current account that many shareholders may have with the company, when the shareholder is also a director of the company. A loan to an 'associate' of a shareholder, such as a relative, is also included as if the loan had been made to the shareholder.

Example

A company makes accounts to 31 December annually. A loan made to a shareholder in the 2011 accounting period was not repaid by 1 October 2012. The company must pay the s455 tax by 1 October 2012. If the loan is repaid at any time in, say, 2013 the tax relating to that loan would not be due for repayment until 1 October 2014.

Tax issues for the shareholder

The making of the loan may have tax consequences for the shareholder who is also a director of the company. An income tax charge will arise if the interest paid on the loan (if any) is less than the interest at HMRC's official rate. In most cases, National Insurance Contributions (NIC) of 13.8% will be due from the company on the benefit assessable on the director.

Recent changes to the s455 tax charge – repayments not treated as repayments of the original loan

A shareholder may organise his finances such that he repays a loan or advance made by the company to him just before the end of the nine month period so no tax charge arises on the company. Shortly afterwards the company provides another loan to the shareholder. In substance the shareholder has continual use of the money from the company but the company does not suffer the s455 tax that would otherwise arise.

HMRC have been concerned about this and certain other arrangements for some time. Whilst not necessarily accepting that all such arrangements work, HMRC want to ensure that some of the arrangements are definitely caught by the tax.

The new law which consists of two new rules applies to repayments of loans on or after 20 March 2013.

The first is a 30 day rule. This applies for loans of £5,000 or more. If at least £5,000 is repaid to the company and within 30 days new loans or advances of £5,000 or more are made to the shareholder (or an associate), the old loan is effectively treated as if it has not been repaid. As a consequence s455 tax may become due.

The second is an arrangements rule. The first rule could be avoided by waiting 31 days before the company advances further funds to the shareholder. The second rule applies where:

- the outstanding amount from the shareholder is £15,000 or more
- at the time the loan is repaid by the shareholder, arrangements had been made to make a new withdrawal with the effect of replacing some or all of the amount repaid and
- a new payment is made to the shareholder or an associate under the arrangements of £5,000 or more.

The effect where the rule applies is that either s455 tax is still due or any repayment of s455 tax will be restricted by 25% of the lower of the amount repaid and the new payment.

Example

Taylor Ltd lends a shareholder £20,000 which is still outstanding at the end of the accounting period. 35 days before the s455 tax becomes due and payable, the shareholder receives a further £25,000 payment from the company. The original £20,000 is repaid using £20,000 of the £25,000 new loan.

It is likely in this situation that the repayment of £20,000 would be treated as a repayment of £20,000 of the new £25,000 loan so the original loan would be treated as not repaid and so the s455 tax would become due and payable.

What should be done by the company and shareholder so that the s455 tax does not arise?

If loans or advances on a current account are made to a shareholder, the amounts need to be cleared within nine months of the end of the accounting period in which these amounts arose. This can be achieved by:

- the shareholder repaying the loan by making a payment in cash but if further amounts are subsequently borrowed from the company, HMRC may have scope for applying the new rules so that the old loan is not treated as repaid or
- the company declaring a dividend or granting a bonus which is equal to the amount outstanding. HMRC have confirmed that the dividend or bonus will remove the s455 tax liability as these amounts are chargeable to income tax in the hands of the shareholder.

Example

Bernard is the sole shareholder and director of Extra Ltd. He withdraws £2,000 a month from his current account with the company so that by the end of the company's accounting period which ends on 31 December 2013, he owes the company £24,000. The current account continues to increase by £2,000 a month in 2014. In June 2014 a dividend is declared which is £24,000.

Under general principles of law, loans are treated as being repaid first unless another order is agreed. The accumulated current account balance at 31 December 2013 is therefore treated as cleared by the dividend and thus no s455 tax is due from the company on 1 October 2014.

It is essential however that the amounts are cleared properly and, in the case of a dividend, in compliance with company law. This is where we can help you to ensure that s455 tax is not payable.

Recent changes to the s455 tax charge – use of a partnership or a trust

HMRC has seen an increase in the number of shareholders who, in HMRC's view, have had the benefit of money from a company but without a s455 charge applying to the company. New law has been introduced which:

- makes certain that s455 tax arises where a close company makes a loan to a partnership and an individual is a shareholder in the company and a partner in the partnership
- ensures s455 tax arises where there is a loan to the trustees of a settlement in which at least one trustee or beneficiary (or potential beneficiary) is a shareholder in the close company making the loan.

A common example of a partnership scenario which may be affected by the legislation is a 'mixed' partnership in which a partnership carries on the main trade, a company is a partner in the partnership along with individuals, and the individuals are shareholders in the company. The company is entitled to a share of profits which will be subject to corporation tax usually at a lower rate than the marginal rate of tax of partners who are individuals. If loans are made by the company to the partnership and there is an individual partner who is also a shareholder in the close company, the loan is chargeable to s455 tax on the company.

What if the company does not withdraw its profit share but an individual partner draws an amount exceeding his profit share (i.e. drawing on funds available as the company has not withdrawn its profit share)? This may not be caught by a s455 charge on the basis that a loan or advance has not been made by the company to the partnership. So, further legislation is introduced to catch such arrangements. A new tax charge (which is equivalent in its effect to s455) catches tax avoidance arrangements, to which a close company is party, under which a benefit is directly or indirectly conferred on an individual, who is a participator in the close company or an associate of such a participator.

Example

X, an individual, is a participator in a close company (C Ltd). C Ltd and X are partners in a partnership. Under the partnership agreement, 80% of the profits are allocated to C Ltd and charged on C Ltd at the corporation tax rate of 20%.

C Ltd leaves its profits undrawn on capital account in the partnership and X draws on them.

There is a benefit conferred on X because X has received funds from C Ltd, a company in which X is a participator and there was no s455 charge on C Ltd and no income tax charge on X. If the funds had been transferred directly from C Ltd to X, they would have been chargeable to income tax (if transferred as remuneration or a dividend) or s455 (if they were transferred as a loan).

Loan releases

If the company decides to release the shareholder from repaying the loan (i.e. loan write off), the shareholder is assessed on the amount released as though it were dividend income, as opposed to earned income. The effective tax rates are therefore the same as if a dividend had been paid to the shareholder. For example, a 40% higher rate taxpayer would pay 25% effective additional tax on the deemed dividend income.

Although from a tax viewpoint the income is not assessed as earned income, HMRC generally consider the deemed dividend to be subject to Class 1 employer and employee NIC if the individual is a director or employee of the company.

The impact of NIC means that it is preferable to pay a real dividend to enable the loan to be cleared. As there are a number of points to consider, please talk to us before a decision is made.

For the company, a release of the loan will be treated as if the shareholder has repaid the loan and thus the company will be entitled to a repayment of any s455 tax paid.

Loans to the company

If the company is in need of additional funds the shareholder may wish to lend money to the company. It will generally be tax efficient to charge interest as a means of extracting money from the company in a tax efficient way.

Interest charged at a commercial rate will generally be tax deductible for the company.

In the hands of the shareholder, the income will be taxable as savings income. No NIC will be due even if the shareholder is a director as NIC only applies to earned income. This will benefit both the employer and employee.

What if the shareholder is taking on personal loans to on-lend to the company? There may be a number of reasons why such a route is taken rather than the company being directly provided with finance from a bank. For example, the individual may be able to provide better security for the loan compared to a new company with no obvious collateral or track record.

The shareholder in this instance needs to ensure that:

- tax relief is available to the individual on the interest which depends on certain qualifying conditions, the detail of which we can advise you on
- relief will be available for any capital loss suffered if the company is unable to repay the loan from the shareholder.

Other main points to appreciate here are:

- the finance received by the individual must be a loan rather than an overdraft or use of a credit card
- interest relief is given as a deduction from total income of the individual. Where there is a significant amount of interest paid there may be restrictions on the amount of interest that can be deducted from income
- to obtain capital loss relief the company must have used the monies from the loan provided by the individual for the purposes of its trade.

In some cases, it may be preferable to invest the monies borrowed as further share capital rather than as a loan but this requires consideration of different qualifying conditions not covered here. Please talk to us if you are considering providing finance to, or obtaining loans from, a company so we can advise on the alternative options available.