March 2020		
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Loans to participators

1. Introduction

A tax charge – under CTA 2010, s. 455 - may be imposed on a close company where it makes a loan to a participator.

In this module we will look at four areas:

- the scope of the rules;
- how the charge is calculated, including how relief is given when the loan is repaid or released;
- how to deal with the charge in the company's tax return, including how to claim a repayment of tax; and
- the consequences for the company and for the participator where the loan is written off.

For detailed guidance on the rules applying in these areas, see In-Depth at 779-500ff..

Please note that we will not cover the separate but similar charge – under s. 464A - on arrangements which confer a benefit on a participator. See In-Depth at 779-700ff..

2. The scope of the rules

2.1 Overview

The rules apply where a close company makes a loan or advances money to one of the following:

- an individual, where that individual is either a participator in the close company (P) or an associate of P;
- a company, where that company:
  - receives a loan or advance in a fiduciary or representative company; and
  - is P or an associate of P;
- the trustees of a settlement, where at least one of the trustees or actual or potential beneficiaries is P or an associate of P; and
- a partnership (including an LLP), where at least one of the partners is an individual who is P or an associate of individual who is P,

in circumstances where none of the following exceptions applies:

- the company carries on a business of lending money;
- the loan is made to the trustees of a charitable trust; and
- the loan is a low-value loan to an employee - see 2.3.

Anti-avoidance provisions apply to prevent arrangements being entered into to avoid a charge to tax under the loans to participators rules. These target indirect loans and loans made by a company which is controlled by a close company. These provisions are not considered here; see In-Depth at 779-530 and 779-535.

2.2 Key terms

Brief definitions of some key terms are provided here; click on the links to In-Depth for detailed guidance.

A UK resident company is a **close company** if it is controlled by either 5 or fewer participators or by any number of participators who are directors. The term ‘control’ is widely drafted and includes where a person has more than 50% of the company’s share capital. For the purpose of determining control, a participator is deemed to hold rights and powers held by her or her associates. See In-Depth at 779-200ff..

A person who has a share or interest in the capital or income of the company is a **participator** in respect of that company. See In-Depth at 779-010.

The main category of **associate** is the participator’s relatives, being his/her spouse or civil partner; siblings; parents & grandparents and children & grandchildren. See In-Depth at 779-030.

The term ‘**makes a loan or advances money**’ includes informal loans; for example, where a company meets the personal expenditure of a shareholder/director, crediting the amount to the person’s loan account. HMRC’s position is that where a person has more than one account, the balances should be considered in isolation; debit and credit balances should not be netted off.

A debt which arises because the person has bought goods or services from the company on credit will not normally constitute a loan or advance for these purposes, providing the terms of the credit are commercial.

HMRC now accept that unpaid share capital does not give rise to a loan for these purposes.

2.3 Exception for low-value loans

The loans to participators rules do not apply where:

1. the person to whom the loan or advance is made (the borrower) is a director or employee of a close company or an associated company of that company;
2. the borrower works full time for the company (or an associated company). HMRC’s guidance (at CTM 61540) is that, for this purpose, full-time working is not less than three-quarters of the normal working hours of the company;

3. the borrower does not have a material interest in the company (or an associated company). A person has a material interest in a company if they hold 5% or more of its share capital. In determining if this is the case, we must bring in shares held by the person's associates; and
4. the aggregate amount of the loan/advance and any other outstanding loans/advances made to the borrower by the close company (or an associated company) does not exceed £15,000.

Example

A close company makes the loans below to an individual. Tests 1-3 above are met at all times.

01/01/2019: £3,000;

01/10/2019: £5,000 (balance £8,000);

01/02/2020: £2,000 (balance £10,000); and

01/07/2020: £8,000 (balance £18,000).

The charge to tax under s. 455 applies with regard to the £8,000 borrowed on 01/07/2020 as at this point, the total amount advanced exceeds £15,000.

See In-Depth at 779-546 for detailed guidance on this exception.

3. Calculating the charge

3.1 Overview

Where the rules do apply with regard to an amount, that amount is charged to tax – referred to as 's. 455 tax' - on the close company at the rate of 32.5% (25% for loans made before 1 April 2016). The due date for paying the tax is 9 months and 1 day from the end of the accounting period in which the loan/advance was made.

Relief is given where all or part of the loan is repaid by the borrower or is released/written off by the company. The manner in which relief is given is determined by when the repayment is made/the loan is released, as set out in the table below. Note: Special rules apply in respect of 'bed and breakfast-type' repayments; see 3.3.

Timing of repayment/release	**Manner in which relief is given**
Before the end of the accounting period in which the loan is made	The amount repaid/released is deducted in arriving at the amount to be charged to s. 455 tax (ie only the amount outstanding at the year end is chargeable to tax)*.

After the end of the accounting period and before the due date	The charge is reduced by an amount equivalent to 32.5% of the amount repaid/released. In other words, the final tax charge is restricted to 32.5% of the amount outstanding immediately before the due date.
On or after the due date	In this case, the repayment/release is made after the tax has been paid to HMRC. The company is entitled to a repayment, equal to 32.5% of the amount repaid/released. This is given 9 months from the end of the accounting period in which the repayment was made/the loan was released.

*Strictly, the tax charge should be considered each time that a loan is made; however, in practice it is only necessary to consider loans/advances that are outstanding at the end of the accounting period (see HMRC's guidance at CTM 61510).

In all cases, the relief must be claimed.

3.2 Detailed example

A Ltd, which prepares its accounts to 31 December, made a loan of £40,000 to Mr A on 1 March 2018. Mr A repaid the loan as follows:

Date	Amount repaid	Balance Outstanding
1 October 2018	£8,000	£32,000
1 April 2019	£6,000	£26,000
1 November 2019	£12,000	£14,000
1 February 2020	£14,000	Nil

Relief for the amounts repaid is given as follows:

Year ended 31 December 2018:

Amount advanced during period	£40,000
Less, amount repaid before the year end	(£8,000)
Less, amount repaid before the due date	(£6,000)
Balance	£26,000
S. 455 tax (£26,000 at 32.5%)	£8,450
Due date for payment	01/10/2019

Year ended 31 December 2019:

Amount repaid during the period and not taken into account earlier	£12,000
Repayment due (at 32.5%)	£3,900
Due date for repayment	30/09/2020

Year ended 31 December 2020:

Amount repaid during the period	£14,000
Repayment due (at 32.5%)	£4,550
Due date for repayment	30/09/2021

Memo: s. 455 tax paid and repaid

Year ended 31 December 2018	£8,450
Year ended 31 December 2019	(£3,900)
Year ended 31 December 2020	(£4,550)
Balance	Nil

3.3 Bed and breakfasting

Legislation is in place to prevent companies and participators from benefiting from 'bed and breakfast-type' arrangements, being where a loan is repaid in order to avoid a charge under the loans to participators rules only for another loan to be made shortly afterwards.

The legislation takes the form of two restrictions, as follows:

- restriction 1, applying where a new loan is taken out within 30 days of the repayment of an earlier loan, subject to a de minimis of £5,000. In-Depth at 779-572; and

- restriction 2, applying where arrangements are in place for a loan to be made, subject to a de minimis of £15,000. See In-Depth at 779-574.

Neither restriction can apply where the repayment gives rise to an income tax charge for the participator. A good example of this is where a dividend or bonus (after tax and NI) is credited to the participator's loan account.

HMRC take the view (at CTM 61642) that the following repayments would **not** qualify as repayments giving rise to an income charge for this purpose:

- the payment of rent to the participator by the company. Reason given: “this is not itself income that gives rise to a tax charge but rather it is a constituent part of the eventual calculation of profits from a rental business”; and

- where a dividend or bonus is paid in cash and the funds are reintroduced into the company to settle the loan. Reason given: “it is not the repayment itself which is giving rise to the income tax charge”.

4. Administration

4.1 Reporting the loan

A loan made during the period should be declared in supplementary pages CT600A to the company’s tax return.

4.2 Claiming relief for repayments

The deadline for claiming relief on the repayment/release of a loan is 4 years from the end of the financial year in which the repayment/release took place. The mechanics of how to claim relief depend on when the repayment/release took place relative to: (1) the accounting period during which the loan was made; and (2) the due date for the tax payable under s. 455 for that period, as summarised below:

Timing of repayment/release	Manner in which the claim is made
Before the end of the accounting period	Relief is given implicitly in calculating the balance outstanding at the end of the period. Complete box A1 of supplementary pages CT600A.
After the end of the accounting period and before the due date	By completing section 2 of supplementary pages CT600A to the company’s tax return.
After the due date	By completing form LP2 on Gov.UK (https://bit.ly/3aKQdrh). Where there has been a significant delay in submitting the return for the accounting period it may be possible to claim relief by completing section 3 of CT600A.

5. Consequences of a write-off

5.1 Consequences for the company

The first consequence to be aware of is that the close company may benefit from a reduction in its liability to tax under CTA 2010, s. 455, or be entitled to a repayment of s. 455 tax paid earlier. This is considered in section 3.

The second consequence is that, where the company recognises a debit in its Profit and Loss account in respect of the release or write-off, CTA 2009, s. 321A applies to deny the company tax relief for the amount of the debit. This is considered in detail in In-Depth at 717-240.

Finally, where the participator is on the payroll, the amount written off is earnings for NICs purposes and so will give rise to a NICs liability for the company and for the individual (see 5.2), to be accounted for through the PAYE system.

5.2 Consequences for the participator

The amount written-off or released is charged to income tax as dividend income of the individual.

Where the individual is an employee of the company:

- it is generally accepted that the amount written off should be brought into account in calculating the individual's Class 1 NICs liability; and
- there is a potential charge to income tax as employment income under ITEPA 2003, s. 188. However, the charge to tax as dividend income is given priority over the charge to tax as employment income by ITEPA 2003, s. 189.

Where the loan is written off/released after the death of the individual, the amount written off is added to the income of the person from whom the debt was due at the time of its release.

Where the loan is written off/released while the person is temporarily non-resident, the amount written off is treated for these purposes as if it had been written off in the period of return.

Special rules apply in the case of a partnership (see In-Depth at 779-620) and a trustee (779-630).