# CHAPTER 12

# LOAN RELATIONSHIPS

## 12.1 Definition

A loan relationship is **any transaction involving** the **borrowing or lending of money**. For a loan relationship to exist there must be a transaction for the lending of money. CTA 2009, s.302

This will include **interest received** on **bank accounts**, interest received on **loan stock** or debentures or even interest paid to the company by the government on a tax repayment.

The loan relationship rules also cover **interest paid** by a company – for example; interest on a **bank overdraft**, debenture interest paid to loan stockholders or **interest on a loan** taken out by the company to buy a new building or to purchase trading stock.

We can conclude from the above that what we need is a **money debt** that has arisen from the lending of money. Thus if a company was to sell some shares but did not immediately receive the cash, we do not necessarily have a money debt. There is a debt - however, it arises from the selling of the shares and not from the lending of money. Money debts **include non-sterling** currency. CTA 2009, s.303

Where an instrument is drawn up to evidence the money debt, there will be a transaction for the lending of money.

Debts arising in relation to shares in the company (for example, non-payment of dividends) do not give rise to loan relationships. CTA 2009, s.303(4)

Although instruments related to equity interests do not come within the rules, loans where the rate of interest varies according to the level of profits of a company do come within the rules. These are normally called "ratchet loans".

The definition of a loan relationship includes mandatory convertibles. These arise where a debt is issued that can only be settled by the issue of shares in a company.

**Example 1**

**Which of the following constitute a loan relationship?**

a) Debentures in a company

b) Government gilts

c) Bank deposit account

d) Bank overdraft

e) Debtors ledger

f) Loan to an employee

## 12.2 Debits and credits

CTA 2009, s.306 -312

Debits and credits on loan relationships follow the accounting treatment, i.e. the profit and loss account definition, in that **debits are expenses and credits are income.** The **amounts put through the profit and loss account** or income statement in accordance with UK generally accepted accounting practice or international accounting standards, are the amounts that are tax deductible (if expenses) or that are taxable (if income). This includes amounts recognised:

- in the company's statement of recognised gains and losses or statement of changes in equity, or
- in any other statement of items brought into account in computing the company's profits and losses for that period.

The amounts put through the profit and loss account and other statements for accounting purposes are interest **receivable** and interest **payable**. It includes prior year adjustments but not the corrections of fundamental errors.

In the case of a fundamental error the company should amend the return for the earlier period.

It is not just interest that comes within the loan relationship rules. **All debits and credits in relation to the debt liability** are taxed under the rules.

**Example 2**

**Which of the following are eligible for tax relief under the loan relationship rules?**

a) Interest payable

b) Early redemption penalties

c) Bank arrangement fees

d) Amounts written off loans (bad debts)

e) Loss on disposal of loan stock

## 12.3 Trading v non-trading

CTA 2009, s.297

A company can be either a debtor (borrower) or a creditor (lender) in terms of a loan relationship. In either case the tax treatment is determined by looking at whether the loan relationship is **trade or non-trade**.

Looking at the position where the company is the borrower, we ask "why did the company borrow the money"?

A **trading purpose** is defined as a loan taken out for the purposes of the trade. Generally speaking, this is where the **funds are used to generate income** which is **taxed as trade profits**. An example could be a loan to buy stock used in the trade.

The loan equally may have been entered into for a **non-trading purpose**. This is where the **funds are used to generate income** which is **not taxed as trade profit**. A good example of this could be a loan taken out to buy units in a unit trust, which generates investment income rather than trading income.

### Example 3

**Classify the following loans between trading and non-trading:**

a) Loan to buy a factory

b) Loan to buy rental premises

c) Loan to buy shares on the stock market

d) Loan to buy shares in a trading subsidiary company

e) Funds lent to a subsidiary for the purpose of its trade.

When we look at loans where the company is the creditor, we define trade and non-trade slightly differently. This time we ask was the lending of the money done as an integral part of the company's trade? Here the answer will only be "yes" in the case of banks and financial institutions.

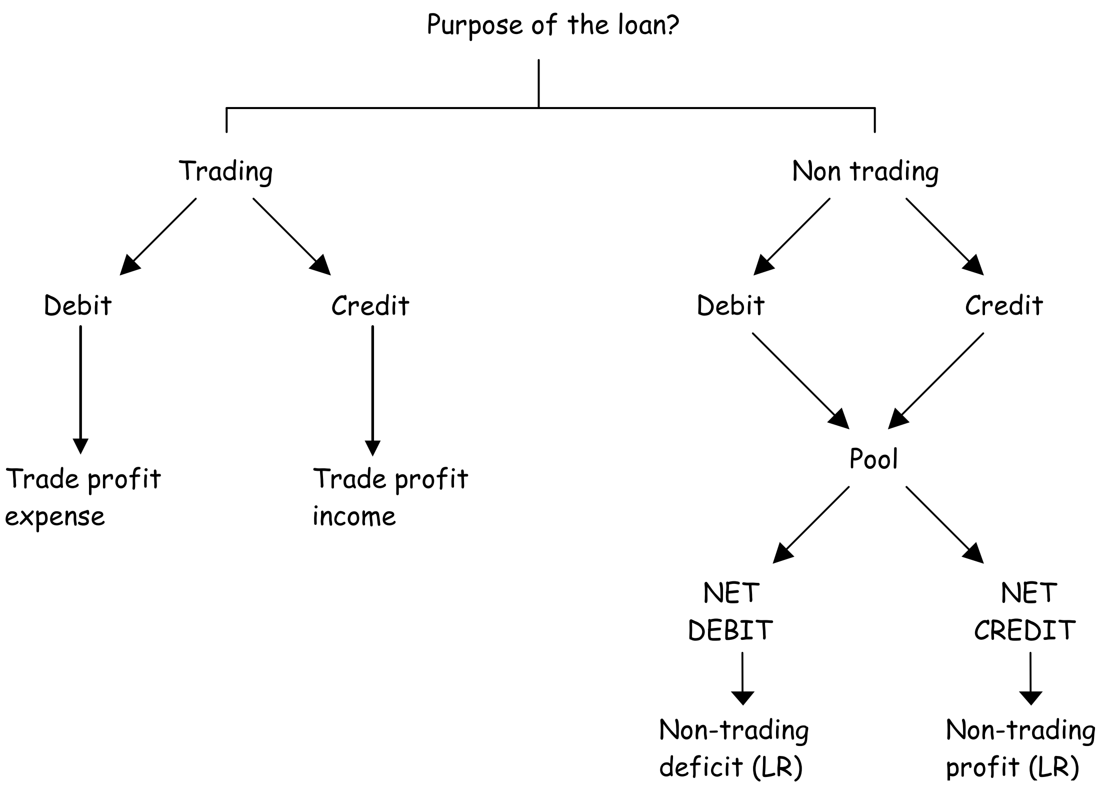
### Example 4

Soria Ltd borrows £10,000,000 from a bank on 1 March 2010 for trade purposes. Interest of 5.75% is payable quarterly in arrears. The fees for arranging the loan came to £75,000 and were payable in full on 1 March 2010 when the documentation for the 5 year loan was put in place.

**Calculate the amount of corporation tax deduction available for the loan in respect of Soria Ltd's year ended 30 September 2010.**

## 12.4 Tax treatment

This can best be summarised by a flowchart:




## 12.5 LR deficits loss relief

The rules for relief for non-trading deficits (LR) (or "LR deficits") are very similar to the rules relating to trading losses, which will be covered in a later chapter. CTA 2009, s.456 -463

In summary a LR deficit loss can be used as follows:

1. Relief is allowed in the **current year against total profits** (which are the income and gains of the company before deducting qualifying charitable donations); CTA 2009, s.459(1)(a)

2. There is a carry back provision, whereby the LR deficit loss can be **carried back one year** and set **against non-trading profits (LR)** in the previous accounting period; CTA 2009, s.459(1)(b)

3. LR deficits are available for **group relief** by allowing the loss to be transferred to a fellow 75% group company. These rules will be covered in detail in a later chapter; or CTA 2010, s.99

4. **Carry forward** the LR deficit, and set it **against future non-trading profits**. This is basically any income and gains in the future year, except that which qualifies for loss relief under s.37 CTA 2010. The company will have **two years to make a claim not to have the deficit set off against non-trading profit** in the succeeding accounting period. CTA 2009, s.457

It should be appreciated that all of these claims are **independent** and we can make a current year claim before we carry back or make a group relief claim whenever we want to, etc.

In the claim, we must **specify the amount that we wish to relieve** and therefore, it does gives us flexibility to use part of the loss in say, the current year and part of it by say group relief, if that is what we want to do.

## 12.6 Connected parties

CTA 2009, s.348-349

Where the parties are connected, the **only accounting basis** that can be used is the **amortised cost** basis.

If companies become connected and fair value accounting was previously used for the LR, a debit will be brought in to the extent that the fair value of the LR exceeds the amortised cost and a credit where the fair value is less than the amortised cost. CTA 2009, s.350

A company is connected with another person for an accounting period if that person is a company and, at any time in that accounting period, one of the companies had control of the other or both were under the control of the same person. CTA 2009, s.466

For this purpose control of a company means the power of a person to secure that the affairs of the company are conducted in accordance with his wishes: CTA 2009, s.472

- by means of holding shares or the possession of voting power (in the company or any other company); or
- by virtue of powers conferred by the articles of association or any other document.

Powers held by a company by virtue of a holding of shares are ignored if the shares are held as trading stock, unless they are assets of an insurance company's long-term insurance fund.

## 12.7 Late interest

Normally, a company can get relief for interest payable. As mentioned already, by interest "payable" we are referring to the amounts recognised in the accounts which are normally prepared on the accruals basis. Therefore, as a general rule, a company does not have to have physically made the interest payment to get relief for it.

However, where the parties to a loan relationship are **connected** and the interest is **not paid within 12 months of the end of the accounting period,** a debit for that interest **will not be allowed** until it has been **paid**. This is only the case where, very importantly, the **creditor** (lender) is **not within the charge to corporation tax** in respect of the loan - for example where the creditor is an overseas company (which is resident in a non-qualifying territory) or is a participator in a close company. (Close companies are covered in a later chapter.) CTA 2009, s.373 CTA 2009, s.375

**Illustration 1**

Participator
Mr B

Mr B lent money to A Ltd

Annual interest payable to Mr B is £10,000

A Ltd
Close company
Y/e 31 December 2010

If A Ltd pays the £10,000 interest to Mr B on 1 July 2011, the company will receive tax relief on the accruals basis as normal, in its year ended 31 December 2010. This is because the interest is paid less than 12 months after the end of the chargeable accounting period.

However if A Ltd does not pay the interest until 1 July 2012, the company will only receive tax relief in the period of payment, being the year ended 31 December 2012, because the interest is paid more than 12 months after the end of the chargeable accounting period.
For accounting periods beginning **on or after 1 April 2009**, where the creditor is a company, the loan interest will only be allowed on a paid basis where the company **is resident in a non-qualifying territory** or **effectively managed in a non-taxing non-qualifying territory**. CTA 2009, s.374(1a)

A non-qualifying territory for these purposes is essentially a territory where there is **not** a Double tax treaty which includes a non discrimination clause. This definition of a non-qualifying territory is the **same as for transfer pricing** and we will look at this in more detail in the chapter on transfer pricing in the overseas manual.

Residence is defined as `liable to tax by reason of domicile, residence, or place of management'.

Therefore, for accounting periods beginning on or after 1 April 2009, the paid basis will **only** apply where the creditor company is resident in a small number of these non-qualifying territories.

For accounting periods beginning **before 1 April 2009,** the paid basis was more likely to apply **to late interest payments**. Under the old rules, relief for interest payments under the paid basis applied to **all** connected overseas creditors where the interest was **not paid within 12 months of the end of the accounting period.**

This old rule was suspended in relation to companies on 28 July 2008. Thus for returns submitted after this date, companies could choose whether to apply the old rules.

A company may **elect,** in its corporation tax return for the first accounting period beginning on or after 1 April 2009, for the current rule **not to have effect** for that period. By making the election, relief for late interest payments to all connected overseas creditors continues only to be allowed on a paid basis as under the old legislation. Companies may want to make the election as the timing of relief on a paid basis may be advantageous to them.

No election may be made for an accounting period ending after 31 March 2011. FA 2009, Sch 20

The election must be made in the corporation tax return for the accounting period in relation to which the election is to have effect.

There is an extended definition of **'connected'** for these purposes. In particular, a participator lending money to a close company is deemed to be connected to that company. CTA 2009, s.375

This extended definition does not include loans to a close company which is itself a collective investment scheme (CIS) and is small or medium, or where the creditor is a limited partnership which is a CIS. Certain limited partnerships are designated CISs for these purposes.

## Example 5

**When is interest deductible on a <u>paid</u> basis?**

a) If the interest remains unpaid 12 months after the year end; or

b) Where the borrower and lender are connected; or

c) Where the lender is not chargeable to corporation tax and is resident in a non-qualifying territory; or

d) Where all of the above apply.

## 12.8 Bad debt relief – impairment losses

Bad debts are recorded in a company's accounts as "impairment losses". Tax relief is obtained for such impairment losses simply by the tax treatment following the accounting treatment.

If bad debt relief is given, the debtor will bring in a corresponding credit with the following exceptions: CTA 2009, s.322

(i) Where the release is part of a statutory insolvency agreement;

(ii) Where the companies are connected;

(iii) Where the releasing company is in insolvent liquidation as set down by s357 CTA 2009 and immediately before the liquidation the parties were connected, but are not connected following the liquidation;

(iv) Where the parties are not connected and the debtor company is in insolvent liquidation;

(v) Where the release is not a release of relevant rights (post 9 November 2009) and is in consideration of any entitlement to the shares formed as part of the ordinary share capital of the debtor company (see next chapter).

Relevant rights are rights acquired in circumstances which, save for the application of certain exclusions, would have resulted in a deemed release under s361 CTA 2009 (see 12A.9 and 12A.10 below).

The rules apply to part releases as well as full releases.

Where companies are connected at any time in an accounting period, the creditor company cannot bring in debits relating to amounts written off a loan relationship. CTA 2009, s.354

**Illustration 2**

A Ltd and B Ltd set up a joint venture with C Ltd. A Ltd owns 49% and B Ltd owns 51%. To start C Ltd off, both companies lend it £1 million. Unfortunately, C Ltd cannot repay the loan and both A Ltd and B Ltd have to write off the loans that they have made. As far as A Ltd is concerned, this will be a non trading debit, and therefore deductible in arriving at A Ltd's corporation tax profit.

On the other side, however, the amount will be taxable on C Ltd, but in all eventuality, it is unlikely that any tax will be paid, because C Ltd is making losses.

That is all very well for A Ltd, because it gets its tax relief and the corporation tax bill is reduced. However, B Ltd's position is different. B Ltd and C Ltd are connected, because B Ltd controls C Ltd. As a result, the write off of the loan has no effect for tax purposes. Therefore, the write off is **not deductible by B Ltd** and is not taxable within C Ltd.

There are two exceptions to this rule for connected party loans;

i. When there is a forgiveness of debt for equity and no connection existed before the equity was issued. In which case a debit is allowed in the accounting period of the issue only and only in relation to the debt equity swap; and CTA 2009, s.356

ii. When the creditor is in insolvent liquidation. CTA 2009, s.357

Where the companies are connected and the creditor company sells the loan relationship to an unconnected third party, the rules adjust any loss (or profit) on disposal. This prevents a creditor from getting any bad debt relief it was previously denied because of the connection, by instead bringing in the loss on disposal. This rule also applies where the companies are connected and the creditor unconditionally releases a debt in full. CTA 2009, s.352

This is because the creditor ceases to be party to that loan relationship – it has effectively disposed of the loan relationship.

The provisions in s352 CTA 2009 work by comparing the:

- debits and credits that would have been brought into account under LR rules if there had been no disposal, and
- the actual debits and credits brought into account under LR rules.

For debits, the amount to be brought in is the smaller of the assumed or actual debit.

For credits, the amount to be brought in is the larger of the assumed or actual credit.

**Illustration 3**

Breen Ltd makes a loan of £35,000 to its subsidiary, Moor Ltd, repayable in 5 years. In year 1, Breen Ltd writes £7,000 off the loan as bad. In Year 2 it sells the loan to an unconnected company, Doon Ltd, for £25,000.

*Actual debits*

In Year 1 the bad debt of £7,000 is disallowed under s354(2) CTA 2009. Debit nil.

In Year 2 the loss of £3,000 is a potential debit under LR rules.

*Assumed debits (as if no disposal)*

In Year 1 the bad debt of £7000 is disallowed under s354(2) CTA 2009. Debit nil.

In Year 2 we assume no disposal, so debit nil.

The assumed debit is smaller than the actual debit, so the amount to be brought is nil.

## 12.9 Release of connected companies debt

CTA 2009, s.358

Where a liability under a debtor relationship between connected parties is released generally no credits are brought into account on the part of the debtor (s.358), and no debits are brought into account on the part of the creditor (s.354).

However, where such a liability is released under circumstances which fall within the deemed release provisions (ss.361-362 CTA 2009, see 12A.10 below), or, post 14 October 2009, which is a release of "relevant rights" of the debtor company, then the debtor company is required to bring a credit into account.

"Relevant rights" means rights of a creditor company that were acquired in circumstances that would have resulted in a deemed release under s.361 (below), save for the application of the corporate rescue exception or the debt-for-debt exception; or such rights which were acquired by another company and then transferred by way of assignment to the creditor company.

This is an anti-avoidance provision to prevent connected parties from circumventing the deemed release rules by 'buying back' debt which has benefitted from the corporate rescue or debt-for-debt exemptions, and subsequently releasing such debt.

The amount the debtor company is required to bring into account on the release of such relevant rights is:

(a) the amount of the discount received on acquisition, less

(b) the sum of any credits brought into account in respect of that amount (currently or previously) by the creditor company.

In addition it should be noted that no debit is to be brought into account in respect of the release or writing off a loan made to a participator of a close company where such loan has given rise to a charge to tax under s.455 CTA 2010, with effect from 24 March 2010. CTA 2009, s.321A

## 12.10 Deemed release of liability on impaired debt becoming held by a connected party

CTA 2009, s.361

CTA 2009, s.362

Whilst the basic rule under s.358 above is that no credit arises on the debtor company where a connected party liability is released, there are two exceptions with regard to a 'deemed release' of such a debt under either s.361 or s.362.

Whilst there is no actual release of the debt by the creditor company, these sections provide that there is a 'deemed release' of the debt where it is impaired and has been acquired by a connected party in two circumstances. Where these sections apply the debtor company must bring into account a credit with regard to the 'deemed release' of the debt.

*Deemed release – s.361*

CTA 2009, s.361

A deemed release occurs where a company connected with the debtor acquires debt from a third party and the carrying amount of the debt exceeds the amount paid for its release.

For acquisitions on or after 14 October 2009 there are three exceptions to this rule: the corporate rescue exception; the debt-for-debt exception; and the equity-for-debt exception.

CTA 2009, s.361A

The **corporate rescue exception** applies where the acquisition is at arm's length, there has been a change in the ownership of the debtor company during the period one year before and 60 days post the date of acquisition, and it is reasonable to assume that:

(i) but for the change in ownership, the company would have become insolvent (within one year of the change of ownership), and

(ii) but for the change in ownership, the acquisition would not have been made.

CTA 2009, s.361B

The **debt-for-debt exception** applies if the acquisition is an arm's length transaction and either:

(i) The rights acquired are represented by a security (the "old security"), the consideration given consists only of a new security (under which the purchaser is the debtor), and the new security has the same nominal value as the old security and (at acquisition) has substantially the same market value; or

(ii) The rights acquired are represented by an asset other than a security (the "old unsecured loan"), the consideration given consists of a new similar asset with the purchaser as a debtor, and the terms of the new unsecured loan are substantially the same as the old unsecured loan.

CTA 2009, s.361C

The **equity-for-debt exception** applies if the transaction is at arm's length and the consideration given by the purchaser, Company 'C', consists only of:

(a) shares forming part of the ordinary share capital of C;

(b) shares forming part of the ordinary share capital of a company connected with C; or

(c) an entitlement to shares within (a) or (b) above.

There are transitional provisions with regard to the application of s361A, B and C in respect of acquisitions made during the transitional period, or where the agreement for the acquisition was entered into before 14 October 2009.

The exceptions above have been introduced to allow genuine corporate rescues to take place without giving rise to a credit on the debtor company under the deemed release rules.

However, as noted at 12A.9, anti-avoidance provisions have also been introduced to prevent these exceptions being used to circumvent the deemed release rules as they should properly apply to connected party transactions.

*Deemed release – s.362* CTA 2009, s.362

Pursuant to the provisions of s.362 there is a deemed release of an impaired debt where the creditor is not connected with the debtor, but becomes connected when the carrying amount of the debt would have been amended for impairment.

*Credit to be brought into account*

In each of s.361 and s.362 a release is deemed to take place. The release in the case of s.361 (where none of the exceptions apply) is of the difference between the carrying value in the debtor's accounts and the amount paid, and in the case of s.362 the amount of the adjustment that would be required for impairment.

This rule prevents the debtor from taking advantage of the connected party rules and ensures that a credit for the effective release of the loan is brought in.

**Illustration 4**

Marco Ltd has a loan from a bank of £800k. The bank agrees to sell the loan to Reloj Ltd for £620k which includes £20k in respect of accrued interest. Marco Ltd and Reloj Ltd are both 100% subsidiaries of Time Ltd.

Marco Ltd accounts for the loan on an amortised cost basis. Thus it will be showing a liability of £800k in its balance sheet. Marco Ltd and Reloj Ltd are connected for the purposes of s361. Reloj Ltd has paid £600k (£620k- £20k) for the loan relationship.

The provisions of s361 mean that Marco Ltd, the debtor company, must bring in a credit of £200k (£800k- £600k).

If in a future period the debt is repaid in full Marco Ltd will be allowed to bring in a debit of £200k and Reloj Ltd will recognise a gain of this amount.

## 12.11 Impairment and cessation of connection

A connection between companies may cease whilst a debt is still in existence, for example if the debtor company is sold out of the group.

The creditor company cannot bring in any debits that relate to earlier write-downs in the accounts that were **not** relieved because of s354. CTA 2009, s.355

A company does not have to bring a credit into account for reversal of an impairment loss that has been disallowed because the companies are connected.

## 12.12 Impairment losses and consortium relief

Where there is a consortium the companies will not always be connected for the purposes of loan relationships. As a result relief for impairment losses will be available to consortium members.

If relief has been allowed for impairment losses to a consortium member or group member via a link company, then there will be a restriction on the consortium relief that can be claimed.

The rules apply where the lender is a company that is either:

- a member of a consortium that owns a consortium company; or
- a fellow group company of a consortium member;

and the borrower is

- the consortium company; or
- if where the consortium company is a holding company, then a subsidiary of that company.

The amount of consortium relief that can be claimed is reduced by the debits already allowed in earlier accounting periods for impairment against the loan.

If a claim is made for both impairment of the loan and consortium relief in the same accounting period, then the claim for impairment loss will be reduced by the consortium relief claimed.

Where consortium relief is claimed before an impairment loss, it is effectively carried forward to reduce impairment debits in later periods.

Any reversal of impaired amounts will be adjusted to take account of the debits disallowed.

When looking at bad debt debits, the rules take into account all loans made to the consortium company by any group members, not just the consortium member.

In arriving at the total amount of group relief claimed, include all amounts claimed from the consortium company by any group company, not just the consortium member.

**Illustration 5**

M Ltd holds 30% of CC Ltd. M Ltd has made a loan of £1,000,000 to CC Ltd. CC Ltd has been experiencing problems for many years and to date £250,000 of the loan has been written off.

In the period to 31 March 2011, M Ltd makes a consortium relief claim for losses of £300,000 from CC Ltd. The losses under the consortium claim will be reduced to £50,000 to take account of the bad debt relief previously given.

## 12.13 Continuity of treatment within groups

CTA 2009, s.336

There are special rules where loan relationships **are transferred within a group**. It does not matter whether the relationship is with a third party or intra-group the rules will still apply.

A group for these purposes is a group as defined for capital gains purposes and this definition is covered in a later chapter.

The transferor is treated as having transferred the loan relationship for a consideration equal to the notional carrying value of the loan relationship. The transferee is treated as acquiring the loan relationship at its notional carrying value.

The notional carrying value is the amount the loan relationship would have been standing at if accounts were drawn up for the transferor immediately before the transfer. The notional carrying value is as defined above. CTA 2009, s.340(6)

If the LR is valued at fair value in the accounts then this value is used at the transfer date.

**Illustration 6**

X Ltd holds £250,000 debentures in Y Ltd. The debentures were issued on 1 January 2008 paying interest at 5%. On 30 June 2010 X Ltd transferors the debentures to W Ltd (its 100% subsidiary) for £242,000. X Ltd and W Ltd have September year ends. Y Ltd has a December year end. The debentures are classed as held to maturity assets. The debentures are to be redeemed on 31 December 2012.

The transfer will take place at the carrying value of the asset in the accounts of X Ltd. As the asset is held at amortised cost and no impairment has taken place this will be £250,000.

In the year to 30 September 2010 X Ltd will show interest income of £9,375. W Ltd will acquire the debentures for £250,000 and show interest of £3,125 in the year to 30 September 2010.

## 12.14 Transferee leaving company after replacing transferor in loan relationship

CTA 2009, s.345

For a transferee leaving a capital gains group there are special rules.

The loan relationship is treated as being assigned and then immediately reacquired for its fair value at that date.

This rule only applies if, as a result, a credit would be brought in or the loan is in a hedging relationship with a derivative contract which has also previously been transferred intra group. (It effectively allows there to be equal and opposite exit charges and exit losses on the two items which are hedging each other).
There is an exception for exempt distributions under s1075 CTA 2010.

**Illustration 7**

Continuing the illustration above, assume that W Ltd was sold by X Ltd on 31 December 2010 when the fair value of the debentures was £257,000.

(Note: if the fair value had been less than £250,000 then Condition 1 would have been failed, meaning that there would be no deemed disposal / re-acquisition and no exit "loss" would arise).

The loan is treated as if it really had been sold and re-acquired for £257,000. If this had been the case then, on an amortised cost basis, W Ltd would have to amortise the premium of £7,000 (£257,000 purchase price less £250,000 redemption value) over the remaining 2 years of the debentures.

This would mean that a charge of £2,625 would be made to P&L account for the remaining 9 months to 30 September 2011, £3,500 for the year to 30 September 2012 and £875 for the year to 30 September 2013. These notional charges (debits) would not appear in the company's real accounts, but for tax purposes we have to pretend they exist.

## 12A.15 Loans for an unallowable purpose

CTA 2009, s.441

Where, in an accounting period, a company's loan relationship has an unallowable purpose, the debits attributable to the unallowable purpose and any credits relating to exchange gains must be excluded from the loan relationship computation.

Where the debits relate to more than one purpose, a just and reasonable apportionment is to be made.

Two classes of unallowable purpose are set out in the legislation: CTA 2009, s.442

(i) the loan is in relation to any part of the company's **activities which are not within the charge to corporation tax;** or

(ii) the main purpose of the loan is **tax avoidance**.

Tax avoidance is defined as securing a tax advantage. This is a very wide definition as set down by s1139 of CTA 2010. CTA 2009, s.476

The test is the purpose of the loan relationship in the accounting period so a loan relationship may have a business purpose when a company enters into it but have an unallowable purpose at a later date.

HMRC give the following examples of when a loan may be held for an unallowable purpose:

- where the UK branch of a non-UK resident company pays interest on a loan being used to fund activities of the company unconnected with the UK branch; or

- a golf club raising a loan to finance construction of a new club house. The interest expense would have to be apportioned into allowable and non-allowable parts according to the club's taxable income from non-members and non-taxable income from members.

Whether tax avoidance is one of the main purposes will be a question of fact. The rules can cover situations where money is borrowed to enter a tax avoidance scheme, although the borrowing of money is not part of the scheme.

## 12.16 Money debts etc not arising from the lending of money

CTA 2009, s.479

Where there is a money debt which arises from a transaction which is not for the lending of money and the money debt is one:

(a) on which interest is payable to or by the company; or

(b) in relation to which exchange gains or losses arise to the company; or

(c) in respect of which a payment would fall to be brought into account for the purposes of corporation tax as a receipt of a trade, UK property business or overseas property business and in relation to which an impairment loss (or reversal) arises to the company; or

(d) a debt in relation to which a relevant deduction has been allowed to the company and which is released;

**there is deemed to be a loan relationship,** but the only debits or credits to be brought in are those relating to the matters stated above.

In (d) above "relevant deduction" means a deduction allowed in calculating the profits of a trade, UK property business or overseas property business.

FA 2009 inserted (d) above to correct a drafting error in previous legislation. It applies to all releases on or after 22 April 2009.

The amendment works by applying the loan relationships rules to the debtor as well as to the creditor.

The one change affecting debt releases between **unconnected** companies is that, where the debtor is carrying on a UK property business, the profit will now be brought into account as a non-trading loan relationships credit, rather than as property income.

Interest payable/receivable under the Tax Acts is to be treated as a non-trading debit or credit. CTA 2009, s.482(1)

## 12.17 Company ceasing to be UK resident

Where a company ceases to be UK resident on or after 17 March 2004, it is treated as **having made a deemed disposal of all its loan relationships at fair value.** CTA 2009, s.333

**Answer 1**

**All but the debtors ledger (e)** – this is not a loan relationship as it has not arisen through the lending of money but through the company selling goods or providing services to a customer.

**Answer 2**

**All items are tax deductible** as they are all amounts put through the accounts relating to a loan.

**Answer 3**

(a) The loan taken out to buy the factory is a **trading loan**, providing the factory is used by the company for the purpose of its trade.

(b) The loan taken out to buy rented premises generates UK property business income, therefore, as this is not trade profit, it is a **non-trading loan**.

(c) The loan taken out to buy shares on the stock market produces dividend income, again this is not trade profit, so is a **non-trading loan**.

(d) Equally the loan taken out to buy shares in the trading subsidiary, is also a **non-trading loan** because, again these shares will generate dividend income. It doesn't matter what the subsidiary actually does, what is important is that we are buying shares and shares do not generate trading income (unless the company is a share dealing company).

(e) The loan taken out to lend money to a subsidiary for the purposes of its trade is again a **non-trading loan**, because the loan is not taken out to fund the trade of the lending company. This of course is on the assumption that the lending company is not a bank.

**Answer 4**

The deduction available will be:

| | £ |
|---|---|
| Interest payable | |
| £10,000,000 x 5.75% x 7/12 | 335,417 |
| Loan arrangement fees | |
| £75,000 x 1/5 x 7/12 | 8,750 |
| Total deduction allowed in arriving at trade profits | 344,167 |

**Answer 5**

The answer is **(d)**