

## **Employment related loans –practical issues (Lecture B1269 – 15.55 minutes)**

*A recap on the basics....*

When an employer makes a loan to an employee which is either interest-free or which is made at a rate of interest which is lower than the HMRC official rate (currently 2%), the employee is in receipt of a taxable benefit.

The amount of the benefit is disclosable on form P11D and is liable to employer-only Class 1 A NICs.

There is no voluntary payrolling option for beneficial loans (although tax is often collected on beneficial loans via the employee's tax code).

There is no benefit charge if the aggregate of all employment-related loans outstanding at any time in the tax year does not exceed £10,000. This is the provision which takes public transport season ticket loans etc out of the charge to tax. Where the £10,000 threshold is exceeded, the taxable benefit is calculated on the entire loan (and not just on the excess of the loan over £10,000).

A director's loan account will therefore trigger a benefit charge if the balance exceeds £10,000 at some point in the tax year.

If the borrower is a shareholder in a close company but is neither an employee nor director, there is no benefit charge on the shareholder. Instead, the amount which would otherwise be taxed as a benefit is treated as a dividend. S.455 tax will also then be an issue.

With all this in mind, here are a few practical points on employment-related loans of which you should be made aware....

### *Interest payments by employees*

Amounts "make good" by the employee for the provision of the loan (being payments of interest) will reduce the value of the benefit, so loans made at or above the official rate will not give rise to a charge (although they would still normally need to be disclosed on the P11D).

Interest paid by the employees should be under an obligation that existed during that year (as HMRC do not regard voluntary payments as "interest").

It should be noted here that there is a general deadline of 6 July after the end of the tax year if "making good" payments are to reduce a taxable benefit, but this deadline does not apply to beneficial loans. As long as the interest is "for a year of assessment" and is paid at some point (even if rolled up and added to the loan), it will be deductible.

Loans which roll-up the interest at the HMRC official rate should therefore be tax-free. However, HMRC argue that Class 1A NIC is due on the full cash equivalent of the benefit if the interest is not paid by the Class 1A payment deadline (which is 19/22 July depending on whether the business files electronically or not). This means that the cash equivalent of the benefit would be reduced for income tax purposes but not for NIC.

### *Close company loans*

S.455 CTA 2010 (“loans to participators”) must also be considered as there is no rule which precludes a S.455 charge where the cash equivalent of the loan is taxed as a benefit.

A loan to a director / shareholder of a close company will therefore be potentially chargeable to income tax under the ITEPA 2003 benefits code as well as having a 32.5% S.455 charge (albeit that the S.455 tax will be refunded when the loan is repaid or written off).

### *The £10,000 exemption*

The £10,000 exemption applies per employer (or group of employers) and does not apply per person. So an employee with two jobs could have two separate £10,000 loans, neither of which would give rise to a taxable benefit.

This also means that in a “husband and wife” company, both can take advantage of the exemption and have a £10,000 loan without triggering a taxable benefit. However, a couple of points must be borne in mind here:

- 1) The loan must be made by reason of their own employment and not by reason of that of their spouse / civil partner. So there is no problem in doubling-up the exemption where both spouses / civil partners are employees and/or directors. But if one spouse (say W) is the only director and her husband / civil partner (H) has no involvement in the company, then a loan to H would be treated as assessable on W and effectively added to her loan for taxable benefit purposes.
- 2) Even if exemption is secured for income tax, the loans are likely to be subject to S.455 tax as the £15,000 exemption for close company loans does not apply if the shareholder has a material interest in the company (being 5% including holdings of associates).

### *Loans written off*

The default position is that the write-off of the loan is treated as employment income of an amount equal to the amount written off. There is no £10,000 exemption here, so a write-off charge will still arise on small loans which may have been exempt from the loan benefit charge.

The amount written-off is not PAYE income but is instead reportable via the P11D.

However, the amount written-off is subject to Class 1 NIC (not Class 1A) which means an NIC charge arises for the employee as well as the employer. The amount written off must therefore be put through payroll as earnings chargeable to NIC (but not income tax).

A CT deduction is available for the amount written off (being in the nature of remuneration).

If the loan is written off as a result of an employee’s death, there is no tax charge.

If an employee is made redundant and the loan is written off by the employer as part of the redundancy package, the full amount of the released loan is taxable as earnings. The £30,000 exemption does not apply. In such cases it would be preferable for the employer to repay the loan in advance of any redundancy settlement being agreed and for the employer to then make a higher ex-gratia redundancy payment (which would qualify for the £30,000 exemption). Clearly these two events should not be linked.

Where a loan is made by a close company to an employee who is also a shareholder, the write-off of the loan is treated as dividend income. This is because S.189 ITEPA 2003 gives priority to the distribution treatment. There is therefore no P11D reporting and no CT deduction. The dividend allowance would be available.

Where a close company loan to an employee / shareholder is written-off, there is no similar provision to S.189 in the NIC regulations. This creates a mismatch between the income tax rules (which tax the loan write-off as a dividend) and the NIC rules which still treat the amount written off as earnings.

In this case the amount written off must be put through payroll as earnings for Class 1 NIC (employer's and employee's) and is accordingly added NICable pay in that pay period (but is not included as taxable pay).

It may be possible to argue that the loan was made to the individual specifically in his capacity as a shareholder (which would then avoid the charge to Class 1 NIC). If this argument is to have any legs, HMRC would expect to see this having been properly documented and minuted at shareholder meetings at the time the loan was made. It is not therefore the sort of argument one could run in hindsight.

Where a loan is written off, any S.455 tax which was paid when the loan was advanced will be repaid.

#### *PAYE & NIC issues for loan write-offs*

If a loan is written off, Class 1 NIC is due and must be accounted for via payroll. For employees the charge will either be at 12% or 2% depending on the level of their general earnings in the pay period.

If the employee's NIC on the amount written-off exceeds their net pay in that pay period, the net pay is reduced to nil.

The employer will make the full Class 1 primary NIC payment to HMRC and the employee then has to make good the excess NIC within 90 days.

If the employee fails to do so, the amount which the employer fails to recover is treated as a taxable benefit and is entered on the P11D for the tax year in which that 90th day falls. The unrecovered amount is earnings for Class 1 NIC in the pay period in which the 90th day falls (again treated as NICable pay for payroll purposes but not taxable pay).

*Contributed by Steve Sanders*