

## Basic loan relationship principles

**(Lecture B1098 – 18.56 minutes)**

### *Scope of loan relationship legislation*

The meaning of a 'loan relationship' (LR) is widely defined in s302, CTA 2009 and covers:

- money debts for the lending of money (e.g. financing loans); or
- money debts evidenced by an instrument issued for the purpose of evidencing the lender's security (e.g. loan notes issued to a corporate vendor on a takeover).

Related LR transactions involving the disposal or acquisition of rights or liabilities under a LR are also included.

Broadly, 'money debts' are those which can be settled by:

- the payment of money (including foreign currency);
- the issue/transfer of shares; or
- by the transfer of rights to the settlement of another money debt (s303, CTA 2009).

Examples of items typically covered by the LR rules are:

- bank borrowing and deposits;
- directors loan accounts;
- shareholder and loans; and
- third party borrowing and lending.

Deferred consideration for the sale of a capital asset (such as shares) will not fall within the LR rules, unless a loan note is issued evidencing the debt (although the deferred consideration will normally fall within the relevant non-lending LR rules (see below)).

Shares and convertible debt held on capital account (where there is a reasonable likelihood at the outset that the right to convert into ordinary shares will be exercised) remains a chargeable asset within the capital gains regime (although interest received thereon will generally be taxed on an accruals basis within the LR regime).

### *Extension to non-monetary debts*

Where there is no lending of money, there is unlikely to be a LR – for example, where consideration for the sale of services or goods is left outstanding, or deferred consideration for the sale of a capital asset, such as shares (except where a loan note is issued).

However, non-monetary debts are treated as non-lending relationships and are covered by the LR rules (s478 CTA 2009) for certain purposes only, which are:

- Interest;
- Foreign currency exchange (Forex) differences (see s483 CTA 2009);
- Impairment losses;
- Release of debts;
- Discounts.

Notably, this means that the LR impairment loss and the debt release rules will now operate for simple trade debts with connected companies.

#### *Deemed QCB rule*

Any debt treated as a LR is deemed to be a Qualifying Corporate Bond (QCB) for a corporate holder. This effectively takes profits from corporate LRs out of the gains regime (since QCBs are exempt assets for capital gains purposes)

#### *Accounts-based regime*

Under the LR regime, the tax treatment of 'debt-related' expenses, losses and profits/credits is broadly based on the amounts included in the company's GAAP compliant accounts, subject to various statutory provisions which require a different tax treatment for certain items. LR debits and credits are relieved and taxed as income items (so the traditional 'capital' v revenue' distinction is ignored).

Companies must include in their corporation tax computations all debits and credits relating to its LRs, including forex differences (s307 CTA 2009)

The debits and credits brought into account must include all amounts on which the company's profit for the relevant corporation tax accounting period (CTAP) is based. S308 CTA 2009 provides that the relevant amounts are picked-up from items passing through a company's:

- income statement for the period;
- other comprehensive income (OCI);
- share premium account.

This requirement is subject to a number of special statutory overrides.

#### *Trade and non-trade LR debits and credits*

All LR and LR-related forex debits and credits must be analysed between trade and non-trade items.

Debits and credits (and forex arising on trading related loans) are included within the company's tax-adjusted trading results. Interest and other expenses/losses charged on loans borrowed for a trading purpose are deductible as a trading expense.

Interest credited on trading account is included as a trading receipt. This is only likely to apply to banks and financial traders. Non-financial trading companies do not normally make loans for the purposes of their trade.

Interest incurred and receivable, together with other LR debits and credits relating to non-trade borrowing and lending must be pooled (together with any non-trade LR forex) to produce either a non-trading credit or non-trading deficit for the period.

#### *Relief for non-trading debits*

A non-trading loan relationship (LR) deficit can be relieved in the following ways:

- surrender by way of group relief (without having to offset it against the surrendering company's profits first) (s457 (2)(a), CTA 2009);
- by set-off against the total profits of the same accounting period (which is referred to in the statute as the deficit period); and
- by carry-back and set-off against non-trading loan relationship profits arising in the previous 12 months.

Furthermore, post-31 March 2017 non-trading deficits can be offset against its future total profits (including trading profits, rental income, investment income, capital gains and so on) and the total profits of fellow group companies. This offset is subject to the £5 million 'annual allowance' restriction rules. In contrast, pre-1 April 2017 non-trading deficits could only be carried forward and offset against the company's future non-trading profits (i.e. all profits except trading profits). The same offset rules apply where these pre-1 April 2017 LR deficits are carried forward against post-31 March 2017 non-trading profits (except that they will be subject to the £5 million annual allowance restriction).

Companies can use their post-31 March 2007 non-trade LR deficits in priority to any pre-1 April 2007 deficits.

*Contributed by Peter Rayney*