



Close Company Loans to Participators (Loophole Closures)

Technical Note

20 March 2013

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Foreword

On 20 March 2013, the Government announced that it will be introducing legislation that amends and extends the rules governing the taxation of close company loans to their participators, with effect from that date. The legislation will counter certain types of arrangements which seek to avoid the charge to tax arising under s455 Corporation Tax Act 2010.

Legislation will be published in Finance Bill 2013 on 28 March 2013. This document provides technical detail on the circumstances and manner in which the proposed legislation will operate. All references are to Corporation Tax Act 2010 unless otherwise stated.

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Further information on this measure is available on the Budget 2013 pages of the HMRC website and the Finance Bill 2013 pages of the HM Treasury website, including a Tax Information and Impact Note. An Explanatory Note will be published alongside the Finance Bill.

Chapter 1 - Introduction

1. On 20 March 2013, the Government announced its intention to introduce legislation in Finance Bill 2013 to counter arrangements under which close companies seek to avoid the charge to tax under section 455. Legislation will be published in Finance Bill 2013 on 28 March 2013 and will have effect from Budget day (20 March 2013).
2. The Government also announced its intention to undertake a wider review of the loans to participators regime. A consultation paper relating to this wider review will be published later this year.
3. The UK corporate tax regime imposes a tax charge (known as “section 455 tax”) in certain circumstances on close companies¹. The purpose of the charge is to deter close companies from transferring value from the company to individuals who have an interest or shares in the company (participators) in ways which are not chargeable to tax as remuneration or dividends.
4. The current rules governing close company loans to their participators are found in Chapter 3 of Part 10 of the Corporation Tax Act 2010.
5. Broadly, the charge operates as follows:
 - Section 455 provides that the charge arises when a close company makes a loan or advance of money to an individual who is a participator or an associate of a participator in the close company during an accounting period. The charge is equivalent to 25 per cent of the amount of the loan or advance.
 - Section 458 provides for relief in the case of a repayment or release of the loan. If the loan or advance of money is repaid to the company, between the end of the accounting period and the due and payable date (i.e. within nine months of the end of the accounting period), relief is automatic and the tax never becomes

due and payable. If the close company has paid section 455 tax on a loan and the loan is later repaid, the close company can claim a repayment of the tax paid on that loan.

- Section 459 contains rules whereby the loan is treated as having been made to the participator under arrangements involving another person.
- Part 4, Chapter 6 ITTOIA 2005 contains rules whereby an income tax charge arises on the person to whom a loan was made if the company releases or writes off the loan.

6. HMRC has seen a number of arrangements which seek to avoid the section 455 tax charge. Many of these arrangements are tacked on to wider avoidance arrangements which have the principal purpose of avoiding income tax or National Insurance contributions.
7. Therefore, the Government is moving to counter three types of arrangements which some close companies and their participators have entered into which seek to circumvent the current legislation.
8. Firstly, some close companies have made loans to their participators via certain types of intermediary to seek to avoid the section 455 tax charge. The amendments put beyond doubt that loans or advances via intermediaries will be specifically within the section 455 tax charge. For detail see Chapter 2 below.
9. Secondly, some close companies have transferred value to their participators (either directly or indirectly) in forms which are not loans or advances of money. Section 455 tax applies to loans or advances of money. The new rules will extend the remit of the current rules to cover any untaxed extractions of value from close companies which end up in the hands of their participators (or their associates) save for certain exceptions. For detail see Chapter 3 below.

¹ “Close company” is defined in s439 and broadly means companies with five or fewer participators or any number of participators who are directors

10. Thirdly, some close companies have sought to exploit the rules which provide relief for section 455 tax where the loan is repaid to the company. Known as “bed and breakfasting” by some, the term is used generally to cover arrangements in which a loan from the close company to the participator is repaid prior to the point in time when the 455 charge would have arisen, only for the close company to make a new loan to the participator shortly afterwards. The new rules contain specific avoidance provisions to deny the relief in such cases. For detail see Chapter 4 below.

Chapter 2 – Amendment covering loans via intermediaries

11. Currently, the charge under section 455 applies where a loan or advance is made to a “relevant person” (section 455(1)). “Relevant person” is defined to include only individuals and companies receiving a loan or advance in a fiduciary or representative capacity (section 455(6)). HMRC have seen close companies using both partnerships (including limited liability partnerships (or LLPs)) and trusts in structures which seek to avoid the section 455 tax charge.

Avoidance involving LLPs and other partnerships

Current application of the legislation

12. When close companies make loans to partnerships in which all the partners are individuals, if one of the partners is a participator (or an associate of a participator) one can look through the partnership and say there is a loan to individuals (who are “relevant persons” under section 455(6)(a)) and therefore that section 455(1) applies.

13. However, some close companies have sought to argue that, where loans are made to partnerships in which the partners are not all individuals (e.g. where a company is acting as a partner), this would not be caught by section 455(1) because it would not be a loan to a relevant person, namely individuals. The partnership used may be any type of partnership, for example: a general partnership, a Limited Partnership (either English or Scottish) or a LLP.

14. In these cases, the avoidance uses a structure whereby at least one of the partners will be an individual and at least one a company. For example, the partnership may comprise at least one individual (M) who participates (or is an associate of an individual who is a participator) in a close company (CC Ltd). M and CC Ltd are then both also partners in a partnership.

Amendments to the legislation

15. Part 10 will be amended so that in certain cases where a close company makes a loan to a LLP or other partnership, in which there is partner who is relevant person and a participator in the close company (or an associate who is a relevant person and a participator in the close company) the company will be subject to a tax charge of 25 per cent on the amount of the loan or advance.
16. Relief for the tax will be available if the loan is repaid and will operate automatically if the loan is repaid by the due and payable date (as described in paragraph 4 above).
17. There will be appropriate exceptions to this charge to tax, including where loans are made in the ordinary course of a money lending business.
18. In relevant cases, where loans are released or written off, an income tax charge will arise in a corresponding way to the current ITTOIA 2005 provision.

Avoidance involving trustees

Current application of the legislation

19. HMRC consider that loans and advances of money from close companies to trustees are chargeable under section 455 in a number of circumstances, including, for example where:
 - some assets held in the trust are shares in the close company and the trustees are therefore participators through that holding, or
 - the loan is to trustees who are associates of a participator, e.g. where the participator is a settlor, or
 - the loan is to trustees who are all relevant persons (i.e. individuals or companies acting in a fiduciary or representative capacity) and each of them is also a participator or an associate of a participator (whether or not the trust holds company shares).

Amendments to the legislation

20. However, to provide clarity in line with the case for partnerships, amendments to Part 10 will explicitly charge loans from close companies to the trustees of a settlement where one or more of the trustees or actual or potential beneficiaries is a relevant person who is a participator in the company or an associate of such a participator and which are outstanding at the end of the accounting period and not repaid by the due and payable date.

21. As with the new rules for partnerships, relief will be available where the loan is repaid and apply automatically if the loan is repaid before the due and payable date (as described in paragraph 4 above), there will be appropriate exceptions, including where loans are made in the ordinary course of a money lending business, and there will be an income tax charge where a loan is released or written off.

Chapter 3 – Extension of the rules to cover other extractions of value

Current application of the legislation

22. Some close companies are using arrangements similar to the structures described above but instead of providing loans to intermediaries the close companies are seeking to transfer value to their participators in other ways.
23. Chapter 3 of Part 10 CTA imposes a charge to tax in connection with “loans or advances” by close companies to relevant persons.
24. Some close companies and their participators have sought to circumvent the section 455 tax charge by transferring value to individuals who are participators (or an associate of a participator) using arrangements similar to the structures used in the loans via intermediaries avoidance described above. The extractions of value from the close company which are then provided to the participator they argue are neither chargeable to tax as remuneration or dividends, nor loans or advances of money.
25. For example, an individual (M) participates in a close company (CC Ltd) and together they form a partnership (a LLP or any other partnership). Typically the profits arising in the partnership are allocated, under the partnership agreement, to the corporate partner, namely CC Ltd. Where CC Ltd leaves the profits undrawn on capital account in the partnership or where CC Ltd draws the profits and then pays them back to the partnership as a capital contribution, some have sought to argue that M would be able to draw on these capital amounts without CC Ltd being subject to a charge under s455.

Amendments to the legislation

26. New rules will be introduced which will apply if there are any arrangements under which value is extracted from a close company and the benefit is (directly or indirectly) conferred on an individual who is a participator in the close company, or an individual

who is an associate of a participator. If the amount is not subject to a section 455 charge or otherwise chargeable as income, there will be a tax charge of 25 per cent of the value extracted.

27. Relief from the charge will be available if the value is returned to the close company and no consideration is given for that return of value. The relief will operate automatically if the value is returned by the due and payable date for the section 455 tax.
28. Provision equivalent to sections 460 and 461 will apply to the new rules.

Chapter 4 – Anti-avoidance provision relating to relief

Current application of the legislation

29. The regime which governs the taxation of loans made by close companies to their participators has relief rules. Section 458 broadly provides that:

- if the loan is repaid by the due and payable date, the section 455 tax charge never becomes due and payable; and
- close companies may claim a repayment from HMRC for any, or a proportionate part of any, section 455 tax paid on a loan if the loan or advance (or any part of it) is repaid to the company.

30. Relief is given in recognition that Chapter 3 is a deterrent to untaxed extractions of value from close companies. So, if the funds are returned to the company (or extracted in a chargeable form such as a dividend), there is no longer an untaxed extraction so the relief would ensure that the company is not subject to the charge to tax under section 455.

31. Some participators and close companies have sought to exploit these rules in the following ways:

- some loans are repaid by the accounting period end date or in the nine months between the end of the accounting period and the due and payable date to prevent the section 455 charge becoming due and payable. The participator then very shortly after the repayment, redraws the money (or a greater amount) either through a loan or advance of money from the close company or through an extraction of value as described in Chapter [3] of this Technical Note. The participator has therefore only lost the use of the money for a very short period, and in many cases never intended the repayment to be lasting.
- other loans are repaid after section 455 tax has been paid on them so that a repayment relief claim can be made. Again, the participator then very shortly afterwards redraws the money with the same result i.e. the participator still has the funds but has also reclaimed the tax.

32. This is colloquially known as “bed and breakfast”.

Amendments to the legislation

33. New provisions (the “30 day rule”) will be introduced into Part 10 which deny the relief if within a 30 day period repayments of more than £5,000 are made to the close company in respect of amounts (either a loan or advance of money from the close company or through an extraction of value as described in Chapter 3 of this Technical Note) which have given rise to a charge to tax under Part 10 and amounts are then redrawn either through a loan or advance of money from the close company or through an extraction of value as described in Chapter 3 of this Technical Note.

34. In addition, even if the 30 day rule does not apply to deny relief, relief will be denied if there are amounts (loans, advances of money from the close company or through an extraction of value) outstanding amounting to at least £15,000 and at the time of a repayment there are arrangements, or an intention, to redraw an amount, either through a loan or advance of money from the close company or through an extraction of value as described in Chapter 3 of this Technical Note and an amount is subsequently redrawn.

Loans from close companies to their participators

Who is likely to be affected?

This measure affects close companies¹ (and in some cases their participators²) which make loans or transfer value to their participators in certain ways, including those who have made payments via an intermediary such as a partnership or trust.

General description of the measure

To tackle avoidance of the tax charge (known as s455 tax) on loans from close companies to their participators, the Government has introduced three changes to the rules:

- to put beyond doubt that loans to various intermediaries are within the scope of the charge;
- transfers of value (other than loans) are brought within the scope of the charge when arrangements mean there is also a corresponding receipt of value by the participator; and,
- the repayment rules are reinforced so relief is only given for genuine repayments.

Policy objective

The measure will protect the Exchequer from loss of revenue through use of perceived loopholes in the existing rules to avoid the tax charge on close company loans to their participators. This supports the Government's objective of a fair tax system.

Background to the measure

The Government announced this measure on 20 March 2013.

Detailed proposal

Operative date

The measure will have effect on and after 20 March 2013.

Current law

The rules governing the charge on loans from close companies to their participators are found at Chapter 3 of Part 10 Corporation Tax Act 2010 (CTA 2010). The purpose of the s455 tax charge is to deter companies from making untaxed loans to their participators rather than paying remuneration or dividends which are chargeable as income.

The charge is on the close company at a rate of 25 per cent of any amounts outstanding nine months after the end of the accounting period. The close company must have made the loan or advance to participators who are individuals (subject to certain limited exceptions) during the accounting period.

¹ A close company is a company which is controlled by five or fewer participators or any number of directors who are participators.

² Broadly, a participator is a person who has a share or interest in a company.

Loans from close companies to partnerships in which all the partners are individuals and at least one of the partners is a participator in the close company are also caught by the s455 tax charge.

There are exemptions from the charge for debts incurred in the ordinary course of a money lending business; for goods or services provided on normal credit terms; and certain loans to employees and directors which do not exceed £15,000.

The close company can claim relief for any s455 tax if the loan is repaid to the company. Chapter 3 CTA 2010 also contains provisions to prevent avoidance, for example, through the use of indirect loans and insertions of a non-close company into the structure.

Avoidance arrangements

Arrangements have sought to use perceived loopholes in the legislation by making loans and other payments to participators via intermediaries such as Limited Liability Partnerships (LLPs), partnerships and trusts in which the close company and at least one participator in the close company are members, partners or trustees.

Other arrangements seek to prevent the tax charge becoming due and payable with a repayment of the loan before the end of the nine month period which is very shortly followed by a withdrawal of a 'new' loan on similar terms.

Proposed revisions

Legislation will be introduced in Finance Bill 2013 to apply the s455 tax charge to any loans from close companies to participators made via partnerships (including LLPs) in which the close company and at least one partner/member is a relevant person who is a participator (or associate of a participator). Part 10 CTA 2010 will be amended to ensure that there will be appropriate exceptions and relief from the charge. Similar provisions will apply to certain trustees.

Where there is an extraction of value from a close company and the value is transferred to a participator, there will be a 25 per cent tax charge on the close company on the amount of the payment to the participator. Part 10 CTA 2010 will be amended to ensure that there will be exceptions to the charge, and relief if the value transferred is returned to the close company.

The repayment provisions are amended to deny the relief, subject to de minimis limits, where repayments and re-drawings are made within a short period of time of each other, or there are arrangements (or there is an intention) to make further chargeable payments at the time the repayment is made (and there are subsequent re-drawings).

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18
	nil	+65	+75	+70	+60
	<p>These figures are set out in Table 2.1 of Budget 2013 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside the Budget.</p> <p>This measure supports the Exchequer in its commitment to protect revenue.</p>				
Economic impact	The measure is not expected to have any significant economic impacts.				
Impact on individuals and households	This measure will have an impact on some individuals as an income tax charge arises when any chargeable loan is released or written off by the close company lender.				
Equalities impacts	The Government does not collect data on characteristics of individuals who are close company participators.				
Impact on business including civil society organisations	This measure addresses avoidance of tax charge (known as s455 tax) on loans from close companies to their participators. These schemes constitute an unfair advantage and in removing that there will be no impact on the normal commercial transactions of businesses and civil society organisations.				
Operational impact (£m) (HMRC or other)	The operational impact of this measure is expected to be negligible.				
Other impacts	Other impacts have been considered and none have been identified.				

Monitoring and evaluation

This measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Ellen Milner on 020 7147 3961 (email: ellen.milner@hmrc.gsi.gov.uk).