



Qualifying loan interest relief: changes

Who is likely to be affected?

This measure makes two changes. The first change will affect individual taxpayers paying interest on loans to invest in companies in the European Economic Area (EEA), apart from companies resident in the UK. The second change is consequential and will have no effect on the availability of qualifying loan interest relief.

General description of the measure

The measure will extend the income tax relief for interest paid on loans to invest in certain UK companies to interest on loans to invest in such companies in the wider EEA.

Policy objective

The material change ensures that the rules for this relief comply with EU law.

Background to the measure

This measure has not been previously announced and has not been the subject of consultation.

Detailed proposal

Operative date

This measure will have effect for interest paid on or after 6 April 2014.

Current law

Chapter 1 of Part 8 of the Income Tax Act 2007 (ITA) provides for income tax relief for payments of interest on loans for particular purposes. These include loans to buy an interest in a 'close company'. The definition of a 'close company' is in Chapter 2 of Part 10 of the Corporation Tax Act 2010 (CTA 2010) and section 442(a) CTA 2010 excludes non-UK resident companies from being 'close'. The relief is not available for interest on a loan to buy an interest in a 'close investment-holding company' as defined at section 34 CTA 2010.

Relief is also available for interest paid on a loan to buy an interest in an employee-controlled company. One of the conditions for this relief is that the company is UK resident.

Proposed revisions

Legislation will be introduced in Finance Bill 2014. The relief for investment in close companies is extended to include companies resident in an EEA state other than the UK which would be close if they were UK resident. The relief for investment in employee-controlled companies is also extended to include companies resident in an EEA state other than the UK.

At the same time a new section, section 393A, is being added. This includes the definition of 'close investment-holding company' which is currently at section 34 CTA 2010, but is shortly to be repealed as a result of the adoption of a single rate of corporation tax for companies (other than those with oil and gas ring fence profits) from financial year 2015. It makes no change to the application of the rules for qualifying loan interest relief.

Summary of impacts

Exchequer impact (£m)	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
	-	nil	-15	-10	-10	-10
	The Office for Budget Responsibility has included these numbers in its forecast.					
Economic impact	The measure is not expected to have any significant economic impacts.					
Impact on individuals and households	<p>The first change affects UK taxpayers borrowing money to invest in close companies and employee-controlled companies in the EEA, apart from the UK. This is only thought to impact on a small number of individuals (fewer than 10,000) who will be eligible to claim relief on these investments.</p> <p>The second change will have no effect on individuals and households.</p>					
Equalities impacts	No impacts based on race, gender, disability or other equality groups are anticipated.					
Impact on business including civil society organisations	The first change only affects individual taxpayers and the second change will have no material effect. This measure is expected to have no impact on businesses and civil society organisations.					
Operational impact (£m) (HMRC or other)	The first change proposed will result in some extra handling costs for HM Revenue & Customs, but these are expected to be negligible. The second change will have no operational impact.					
Other impacts	Other impacts have been considered and none have been identified.					

Monitoring and evaluation

This measure will be monitored through information collected from tax returns and through communication with affected taxpayer groups

Further advice

If you have any questions about this change, please contact Judith Diamond on 03000 585712 (email: judith.diamond@hmrc.gsi.gov.uk).

1 Relief for loan interest: loan to buy interest in close company

- (1) Chapter 1 of Part 8 of ITA 2007 (relief for interest payments) is amended as follows.
- (2) In section 392 (loan to buy interest in close company), in subsection (4) –
 - (a) after “section 393 –” insert –

“close company” includes a company which –

 - (a) is resident in an EEA state other than the United Kingdom, and
 - (b) if it were UK resident, would be a close company,”
 - (b) in the definition of “close investment-holding company”, for “section 34 of CTA 2010” substitute “section 393A”.
- (3) After section 393 insert –

“393A Close investment-holding companies

- (1) For the purposes of sections 392 and 393, a close company (“the candidate company”) is a close investment-holding company in an accounting period unless throughout the period it exists wholly or mainly for one or more of the permitted purposes set out in subsection (2).

There is an exception to this rule in subsection (5).
- (2) The candidate company exists for a permitted purpose so far as it exists –
 - (a) for the purpose of carrying on a trade or trades on a commercial basis,
 - (b) for the purpose of making investments in land, or estates or interests in land, in cases where the land is, or is intended to be, let commercially (see subsection (3)),
 - (c) for the purpose of holding shares in and securities of, or making loans to, one or more companies each of which –
 - (i) is a qualifying company, or
 - (ii) falls within subsection (4),
 - (d) for the purpose of co-ordinating the administration of two or more qualifying companies,
 - (e) for the purpose of the making of investments as mentioned in paragraph (b) –
 - (i) by one or more qualifying companies, or
 - (ii) by a company which has control of the candidate company, or
 - (f) for the purpose of a trade or trades carried on on a commercial basis –

- (i) by one or more qualifying companies, or
 - (ii) by a company which has control of the candidate company.
- (3) For the purposes of subsection (2)(b), any letting of land is taken to be commercial unless the land is let to –
 - (a) a person connected with the candidate company (“a connected person”), or
 - (b) a person who is –
 - (i) the spouse or civil partner of a connected person,
 - (ii) a relative of a connected person, or the spouse or civil partner of a relative of a connected person,
 - (iii) the relative of the spouse or civil partner of a connected person, or
 - (iv) the spouse or civil partner of a relative of a spouse or civil partner of the connected person.
- (4) A company falls within this subsection (see subsection (2)(c)(ii)) if –
 - (a) it is under the control of the candidate company or of a company which has control of the candidate company, and
 - (b) it exists wholly or mainly for the purpose of holding shares in or securities of, or of making loans to, one or more qualifying companies.
- (5) If a company is wound up and was not a close investment-holding company in the accounting period that ends (by virtue of section 12(2) of CTA 2009) immediately before the winding up starts, the company is not treated for the purposes of sections 392 and 393 as being a close investment-holding company in the subsequent accounting period.
- (6) In this section “qualifying company” means a company which –
 - (a) is under the control of the candidate company or of a company which has control of the candidate company, and
 - (b) exists wholly or mainly for either or both of the purposes mentioned in subsection (2)(a) and (b).
- (7) In this section –
 - “accounting period” has the meaning given by section 1119 of CTA 2010,
 - “close company” includes a company which –
 - (a) is resident in an EEA state other than the United Kingdom, and
 - (b) if it were UK resident, would be a close company,
 - “control” has the meaning given by section 450 of CTA 2010, and
 - “relative” means brother, sister, ancestor or lineal descendant.”
- (4) Accordingly –
 - (a) in section 383(2)(c), after “close company” insert “etc”,
 - (b) in the italic heading before section 392, after “*close company*” insert “*etc*”;
 - (c) in the heading of section 392, after “**close company**” insert “**etc**”.
- (5) The amendments made by this section have effect in relation to interest paid in the tax year 2014-15 or any subsequent tax year.

2 Relief for loan interest: loan to buy interest in employee-controlled company

- (1) In section 397 of ITA 2007 (eligibility requirements for interest on loans within section 396), for subsection (2)(a) substitute –
 - “(a) an unquoted company that is resident in the United Kingdom or another EEA state and is not resident outside the European Economic Area, and”.
- (2) The amendment made by this section has effect in relation to interest paid in the tax year 2014-15 or any subsequent tax year.

EXPLANATORY NOTE

RELIEF FOR LOAN INTEREST: LOAN TO BUY INTEREST IN CLOSE COMPANY

SUMMARY

1. Clause X extends the income tax relief for interest paid on loans to buy an interest in a close company to interest paid by individuals investing in companies which are resident in the European Economic Area (EEA) and would be 'close' if they were resident in the United Kingdom.
2. The measure also adds a new section containing the definition of a 'close investment-holding company'.

DETAILS OF THE CLAUSE

3. Subsection 1 introduces changes to Chapter 1 of Part 8 of the Income Tax Act 2007 (ITA 2007).
4. Subsection 2(a) provides that a 'close company' for the purposes of sections 392 and 393 ITA 2007 includes a company which is resident in an EEA state other than the United Kingdom.
5. Subsection 2(b) changes the reference to the legislation containing the definition of 'close investment-holding company' from section 34 of the Corporation Tax Act 2010 (CTA 2010) to section 393A ITA 2007.
6. Subsection 3 adds new section 393A to ITA 2007. This contains the definition of 'close investment-holding company' that is currently at section 34 CTA 2010.

BACKGROUND NOTE

7. A company is defined as 'close' in Corporation Act 2010 (CTA 2010) if it is controlled by five or fewer participators or any number of directors who are participators, or if more than half the company's assets would be distributed to five or fewer participators or to any number of directors in a winding up. Section 442 CTA 2010 provides that a company is not treated as a close company if it is not UK resident.
8. The change to the definition of a close company for the purposes of this relief has been made to ensure that the legislation is compatible with EU law.

9. The addition of the definition of ‘close investment-holding company’ is made because section 34 CTA 2010 is to be repealed as a result of the adoption of a single rate of corporation tax for companies (other than those with oil and gas ring fence profits) from Financial Year 2015.

10. If you have any questions about this change, or comments on the legislation, please contact Judith Diamond on 03000 585712 (email: judith.diamond@hmrc.gsi.gov.uk).

EXPLANATORY NOTE

RELIEF FOR LOAN INTEREST: LOAN TO BUY INTEREST IN EMPLOYEE-CONTROLLED COMPANY

SUMMARY

1. Clause X extends the income tax relief for interest paid on loans to buy an interest in an employee-controlled company to interest paid by individuals investing in such companies, wherever they are resident in the European Economic Area (EEA).

DETAILS OF THE CLAUSE

2. Subsection 1 replaces subsection 397(2)(a) Income Tax Act 2007 with a new subsection. This provides that interest may be relieved on loans to acquire an interest in unquoted companies that are resident in the United Kingdom or another EEA State and are not resident outside the EEA.

BACKGROUND NOTE

3. This change has been made to ensure that the legislation is compatible with EU law.

4. If you have any questions about this change, or comments on the legislation, please contact Judith Diamond on 03000 586712 (email: judith.diamond@hmrc.gsi.gov.uk).