Notes for Guidance on Pension Scheme Loans

Regulations permit loans to be made from Investment Regulated Occupational Pension Schemes (also known as Small Self- Administered Schemes (SSAS)).

The aim of these notes is to assist Pension Scheme Trustees with making loans, to ensure that transactions are handled correctly & any problems avoided. Not all loans are straightforward & it is advisable to discuss plans with Astute Trustee Services Ltd before proceeding. Please read & follow the guidelines below.

General Principles

HM Revenue & Customs allow Investment Regulated Occupational Pension Schemes to make loans only if they are genuine investments which must be prudent, secure & on a commercial basis.

Loans can be made to sponsoring companies of the pension scheme, or to genuine third party companies or individuals. If to a company, they must be trading companies & for trading purposes.

Loans cannot be made to the following parties:-

1. Scheme members & their relatives or connected parties
2. Companies controlled by scheme members &/or their relatives & business associates which do **NOT** participate in the pension scheme.
3. Partnerships in which scheme members &/or their relatives are partners.

HMRevenue & Customs have a very broad definition of a connected party as set out in Section 839 of the Taxes Act. This basically involves the following:

- A wife, husband or relative
- A wife or husband of a relative
- A trustee connected with a settlor
- A business partner, wife, husband or relative of a business partner
- One company controlling another, or two companies being controlled by the same person (either with or without other connected persons)

If you are in any doubt, please contact Astute Trustee Services Ltd.

Scheme Trustees must act in the best interests of the scheme members in their capacity as scheme members & not as directors or shareholders. HM Revenue & Customs guidelines state that loans must not be made:-

a) Solely to keep an ailing business afloat

b) To employers who are technically insolvent

Trustees must also take all available legal steps to enforce the repayment of a loan, if an employer breaches the conditions of the loan agreement (i.e. fails to pay interest &/or capital on the due date), ceases to carry on business or becomes insolvent. There must be no preferential treatment given to a sponsoring employer of the pension scheme when enforcing the collection of a debt, even if this involves the company being placed into liquidation.

Astute Trustee services Ltd must be able to demonstrate by evidence that the pension scheme trustees are doing the same as any commercial lender would do in similar circumstances. We will therefore require independent expert corroboration in these situations (eg from the company's accountant).

In cases where loan capital & interest remain unpaid, this may be treated by HM Revenue & Customs as an "Unauthorised payment" on which tax of at least 55% is payable (40% by the company & 15% by the pension fund). If the outstanding amount represents more than 25% of the total fund value, this tax charge increases to 70%.

Purpose

i. The loan must be made to benefit the borrower's business & a precise reason for the loan must be given. As much detail as possible should be provided at the outset to avoid any problems with HM Revenue & Customs

ii. Loans from the scheme cannot be used to benefit the scheme members, eg to pay directors' remuneration

iii. The amount & term of the loan should be consistent with the purpose. If the loan is for purchase of stock, full details of the stock must be given & invoices & receipts must be kept as HM Revenue & Customs may ask to see invoices to support the purpose given.

iv. Examples of permitted reasons for loans are:
   - Purchase of stock / machinery / commercial vehicles
   - Expenditure on new premises
   - Extensions to or refurbishment of existing premises
   - Launching a new product

v. Loans are not permitted for the purpose of purchasing residential property or tangible moveable property e.g. art, antiques, stamps, fine wine, vintage cars etc.

Amount

The maximum amount which may be lent by a pension scheme (or combined loans if loans have been made previously) is 50% of the net market value of the pension fund. This includes fund shares of members in receipt of income withdrawal from the fund.

The 50% limit is applied at the time the loan is made, & will not be re-tested at a later date if the value of the fund has fallen.

If a loan exceeds 50% of the net fund value at the time it is granted, the excess is treated as an "Unauthorised Payment" on which tax of at least 55% is payable (40% by the company & 15% by the pension fund). If the excess amount represents more than 25% of the total fund value, this tax charge increases to 70%.

Interest Rate

The pension scheme must charge interest on the loan of at least 1% above the average of the base lending rates of the following 4 high street banks:

- Barclays Bank PLC
- National Westminster Bank PLC
- HSBC
- Lloyds TSB

The average is rounded up to the nearest 0.25%.

This rate is published on the HM Revenue & Customs website:

http://www.hmrc.gov.uk/rates/interest-ctsa.htm

(this is inclusive of the 1% above base rate figure).

The interest can be fixed throughout the loan at the applicable rate on the date the loan is granted.

If the interest rate does not satisfy these requirements, an Unauthorised Payment applies, which is taxed as set out above.

Term

The maximum term of a loan is five years. The loan capital & interest must be repaid by the end of the term. If a loan exceeds the five year period & is not formally rolled over (see below), then an Unauthorised Payment will apply with consequent tax charges.

Repayment

Loans must be repaid in equal instalments of capital & interest on at least an annual basis, so that the loan is fully repaid by the end of the term. The frequency of payment can be monthly, quarterly, half yearly or annually.

Security

A loan must be secured throughout its full term by the pension scheme have a **first** legal charge over an asset owned by the borrowing company or some other person, which is of at least equal value to the loan capital **AND** interest payments due during its term.

There must be no other charge over the asset being used as security which takes priority over the charge made by the pension scheme.

The asset used for security must not be a "taxable investment" (such as residential property) which would lead to heavy tax charges on the pension scheme should it have to invoke the legal charge.

It will therefore be necessary firstly to provide us with an independent open market valuation of the asset to be used as security, & secondly for the pension scheme Trustees to appoint a solicitor to act on their behalf to produce a suitable Legal Charge. A draft must be provided to Astute Trustee Services Ltd for approval before the Loan Agreement is produced & the loan is granted.

A replacement security can be provided during the term of the loan, which must have a value of at least the remaining capital & interest due.

Should a sponsoring company or connected person do anything which reduces the value of the security, an Unauthorised Payment is deemed to have been made.

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