Nuts and bolts

An online family meeting generates a discussion on the tax implications of withdrawals from a close company. Nicole Neville provides a DIY guide to the main elements.

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My brother Derek and I are 'zooming'. Six months ago, that would have conjured up images of the two of us speeding along in a fast car. Now, that couldn't be further from the truth. We are each sitting in armchairs in our respective homes catching up on recent events.

Derek is his usual bombastic self. 'I hate to wrench you away from your box set binge, but I wanted to share my good news with you. Despite all this economic uncertainty, my company is more than measuring up to expectation. Profits are at an all-time high. This is certainly helping to raise my spirit level.'

> "If a close company makes a loan to a shareholder, the company has to pay tax on this amount under CTA 2010, s 455."

The DIY business

Derek is the managing director and 50% shareholder in Derek's DIY Ltd (DDIY). He set up the company with his friend, Dudley, who is the other 50% shareholder. Dudley is not an employee or director of the company.

'I am so glad that last year we laid strong foundations in setting up our online business. We have been able to build on this through this pandemic. So many people are taking the opportunity to catch up on all the odd jobs they never previously got around to doing. And they are going online and buying their equipment from us. Our revenue has never been this high. It's as though we've released a blockage.'

Yes, my brother really does talk like this; it can be a little abrasive at times.

He continues: 'When this is all over, I am going to take an extra £50,000 cash from DDIY and finally get around to building that extension to my house.'

I am amazed: 'Wow, that is taking DIY to the limit. Are you sure you can do all that yourself?'

'Don't be ridiculous,' he retorts. 'That's why I need to wait for this pandemic to be over, why would I do it myself when I can get contractors to do it for me?'

Hmm... why would Derek, director of Derek's DIY Ltd attempt to do any DIY?

A close company

'Well, maybe I can offer some constructive advice?' I suggest. 'DDIY is a close company. A close company is one which is resident in the UK and is controlled either by five or fewer shareholders, or by any number of directors who are also shareholders.'

'Agreed,' says Derek. 'DDIY is controlled by two shareholders, me and Dudley.'

Derek has not always been the sharpest tool in the box, but he is doing well so far.

'Well, if a close company makes a loan to a shareholder, the company has to pay tax on this amount under CTA 2010, s 455,' I explain.

I thought my brother was about to blow a fuse. 'What are you talking about? I am just taking cash out of my company, surely I am entitled to do that?' Derek responds impatiently.

I explain calmly: 'Let's drill down into the issue. As a director, you are entitled to your salary from DDIY. As a shareholder, you are entitled to dividends from it. If you take any extra cash out of the company that is considered a loan and there are special rules on loans made by close companies to shareholders.'

Key points

- If withdrawals from company are not treated as salary or dividends they could be a loan.
- Liability under CTA 2010, s 455 is payable nine months and one day after the company year end.
- The tax liability calculated at 32.5% of the loan is payable on the normal corporation tax payment date.
- Anti-avoidance legislation will catch repayments and replacement borrowing.
- A loan write-off is treated as employment earnings for National Insurance purposes.
- Benefits in kind provided to a shareholder who is not an employee would be treated as a dividend.

Liability on loans

'If, in the company's year end 31 December 2020, you withdraw £50,000, then DDIY will have to pay s 455 tax on its normal due date for corporation tax; in other words, nine months and one day after the end of the accounting period. So that would be 1 October 2021.'

'And how much is this tax?' asks Derek.

'The tax is 32.5% of the loan outstanding at the due date. So, if you have not repaid any of the £50,000 loan by 1 October 2021, then DDIY will have to pay s 455 tax of £16,250 being £50,000 at 32.5%,' I reply.

'But when you do repay the loan, the s 455 tax will be refunded to the company. So if, for example, you repay the loan on 1 December 2021, the repayment is made in the company's year end 31 December 2021. The s 455 tax will be refunded within nine months and one day from the end of that accounting period; in other words, by 1 October 2022.'

Derek's expression becomes thoughtful and he is unusually quiet for a minute. I start to worry we have lost connection. Then Derek jumps up and bellows: 'I've nailed it! This is what I will do: take a loan of £50,000 from DDIY during its year end 31 December 2020. Then, I will find the money to repay the loan on 30 September 2021, just before the due date for the s 455 tax.

'That way there will be no loan outstanding on 1 October 2021 so DDIY will not have any s 455 tax to pay. But, on 2 October 2021, I will take a new £50,000 loan from the company. I will have only lost the use of the money for a few days, but DDIY will not have to pay any s 455 tax.'

Anti-avoidance

'I hate to throw a spanner in the works, but unfortunately there is some anti-avoidance legislation designed to counteract this,' I reply.

'If within any period of 30 days of making a repayment of at least £5,000 of a close company loan, the shareholder borrows a total of £5,000 or more from the company in a subsequent accounting period, the repayment is treated as a repayment of the subsequent loan, not the original one.

'This means that the repayment on 30 September 2021 is not treated as a repayment of the original loan but a repayment of the loan DDIY will make to you on 2 October 2021. So all of the original loan is outstanding at 1 October 2021 meaning the company will still have to pay s 455 tax.'

Derek is dejected: 'That sounds like a bit of a wrench.' But he then asks, hopefully: 'Could I get around the problem if I were to wait more than 30 days after the repayment before DDIY makes me a new loan?'

'I'm afraid not. The anti-avoidance legislation taps into this situation as well. If there is a loan outstanding of £15,000 or more and, at the time of the repayment, there are arrangements or an intention to take out a new loan of £5,000 or more; then, as before, the repayment is treated as a repayment of the subsequent loan, not the original loan.

'So even if you waited more than 30 days before taking another loan from the company you will be trapped by these rules because your intention was to have the company make you this second loan.'

'Thanks, you have certainly hammered the point home,' Derek replies despondently.

> "Even if you waited more than 30 days before taking another loan from the company you will be trapped by these rules."

Loan write-off

Derek is thoughtful once more. And then in a somewhat more subdued manner says: 'Let me level with you sis, I am not sure I will ever repay this £50,000. Does that mean that the company will never get a refund for this s 455 tax? That sounds a bit hardcore.'

'Well if a close company releases or writes off the loan it will receive a refund of the s 455 tax in the same way as if you repaid the loan. So, if DDIY releases you from the obligation to repay the loan on 1 December 2021, the s 455 tax will be refunded by 1 October 2022.'

'That's not too bad – just a cashflow issue for the company. Whether I repay the loan, or the company writes it off, DDIY will get a refund of the s 455 tax,' Derek replies.

'Yes – but we need to drill down further,' I respond.

'If the loan, or part of it, is written off, you will be treated as receiving a dividend equal to that amount.

'The date of receipt of the dividend will be the date the amount is written off. If the loan is written off on 1 December

Close company loans

Tax implications for close company making a loan to a shareholder

Corporation tax	• S 455 tax on any loan outstanding at the due date. • S 455 tax refunded if loan is repaid or written off. • No deduction for company if loan written off.
Income tax	• Taxable benefit for shareholder if the loan is interest free. • Dividend taxed on shareholder if the loan is written off.
National Insurance	• Class 1 contributions due if loan to employee shareholder is written off.

2021, you will be treated as receiving a dividend of £50,000 in the tax year 2021-22 and you will have to pay the income tax through self assessment.

'And I am afraid the write-off is not a deductible expense for the company.'

> "Since you are an employee, the write-off is treated as employment earnings for National Insurance purposes."

National Insurance

Derek is downcast and slumps in his chair; but I decide to keep powering through and continue.

'Since you are an employee of DDIY, the write-off is treated as employment earnings for National Insurance purposes. So you will be subject to class 1 contributions at 12% or 2% of the amount written off depending on your level of salary.

'The company itself will then pay class 1 secondary contributions at 13.8%. On the plus side, the National Insurance paid by the company is a deductible expense.'

Taxable benefit

'I am afraid there are more tax consequences. If the loan from DDIY is interest free, you are receiving a taxable benefit from the company which must be reported on your P11D.

'Let's assume the loan is made on 1 December 2020 and is waived on 1 December 2021 and the official rate of interest is 2.25% throughout.

'Then for the tax year 2020-21, we look at the period 1 December 2020 to 5 April 2021, which is about four months, so therefore the taxable benefit will be £375, calculated as:

Planning point

Watch out for loans repaid to a close company. Related tax under CTA 2010, s 455 should be refunded to the company within nine months and one day from the end of the accounting period.

£50,000 × 2.25% × 4/12 months = £375

'For the next tax year, 2021-22, we look at the period 6 April 2021 to 1 December 2021, which is about eight months. For this year the taxable benefit will be £750, calculated as:

£50,000 × 2.25% × 8/12 months = £750.'

'I never saw that coming!' says Derek. 'So many tax implications as a result of me simply taking cash out of my close company.'

Then, after a few minutes of typing, Derek shares his laptop screen with me displaying an impressive table – see ***Close company loans*** alongside.

Derek continues: 'This has been super helpful. Can I bolt on one more question please? I presume that if the company provides Dudley (who is my co-shareholder) with a company car there will be no tax implications. After all, Dudley is not a director or employee of the company so he cannot be taxed on this as an employment benefit, can he?'

I reply: 'If Dudley was an employee or director of DDIY, any benefits he receives would be subject to income tax as part of his employment income. But just because he is a shareholder rather than a director or an employee, he will not avoid an income tax charge all together. The benefit is treated as if it were a dividend paid to him by the company. We would need to calculate the cash value of the company car using the employment income rules and this is taxed on him as a dividend in the appropriate tax year.

'As far as the company is concerned, no deduction is available for the cost of providing the car. So capital allowances cannot be deducted.'

Zooming off

Derek is disappointed. But he is never dispirited for long.

'Thanks for all your help and advice sis. This has been a riveting conversation. I'll let you get back to your box set.' And before I can say goodbye, the host, Derek, has ended the Zoom meeting. Ah well, that's Derek for you.

And so over to *Taxation* readers. By recounting my Zoom call with Derek, I have taught you some of the nuts and bolts of the rules on close companies. Now you have the tools in your toolkit, you should be able to attempt a question on this topic and be able to do it yourself. ●

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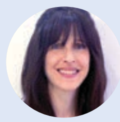

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