

Loans

Take control of your pension



Loans are only acceptable if they are genuine investments of a pension scheme. They should be prudent, secure and on a commercial basis.

A. Loans to Members

Although a loan to a member, or former member is possible it is always treated as an unauthorised payment equal to the amount of the loan. Similarly a loan to a person connected to the member is treated as an unauthorised payment to the member unless the connected person is also a scheme member. Such tax treatment is likely to preclude the scheme making a loan to such individuals.

B. Loans to Unassociated Third Party

Loans may be made to an unassociated third party (i.e. not connected to members or sponsoring employers). Such loans are normally on an arms length basis at a market rate.

C. Loan to Employer

It should be noted that a loan to a sponsoring employer can only be made from an employer sponsored registered pension scheme (i.e. normally an occupational scheme). It would not be possible for such a loan to be made from a SIPP. Where a loan is made by a registered pension scheme that is not an occupational scheme to an employer who is connected to the member this will result in a tax charge on the member.

Loans to employers, other than in the form of bonds issued on the open market, must comply with each of the five key tests opposite:

i. be secured as a first charge on assets that are at least equal to the loan. Subsequent falls in the value of the security are permitted, provided these are not the result of actions taken by the employer or connected persons. The charge must take priority over any other charge on the assets.

ii. have an interest rate equal to the average of the base lending rates of the following companies, plus 1%:

- The Bank of Scotland
- Barclays Bank Plc
- HSBC Bank Plc
- Lloyds TSB Bank Plc
- National Westminster Bank Plc, and
- The Royal Bank of Scotland Plc

Where the average is a multiple of 0.25%, that will be the rate. Where it is not such a multiple the average should be rounded up to the next multiple of 0.25%. This calculation is undertaken on the "reference date" (i.e. the 12th working day of the month preceding the "operative date"). For this purpose the "operative date" will be the 6th working day of the month concerned and the rate so calculated will apply for a month. It appears that a recalculation of the rate will be required for each subsequent month of the term of the loan.

A scheme may make a loan at a fixed rate of interest as long as that interest rate is at least the rate specified at the time the loan is advanced. As long as the terms of the loan remain unchanged there will be no requirement to alter the interest charged on the loan during its life.

iii. not last for more than 5 years. The total amount owing (including interest) must be repaid by the loan repayment date.

iv. be no more than 50% of the market value of scheme assets as at the date the money is loaned by the employer.

v. be repaid by equal instalments of capital and interest for each complete year of the loan. Where there are amounts owing on the 5th anniversary there is only one opportunity for schemes to roll over a loan and only then for a maximum extension period of 5 years. This allows a loan to be extended where the sponsoring employer is having genuine difficulties making repayments without having to find replacement security for the loan if the original security has fallen in value.

Where the above terms are not complied with the loan will be seen as an "unauthorised employer payment", which if large enough could result in HMRC withdrawing the registration of the scheme. The unauthorised payment is calculated separately for each one of the five tests failed. However, to avoid double charging, if the loan fails on more than one of the tests the unauthorised payment will be the greatest amount calculated in respect of all of the failed tests. In any event the payment must not exceed the amount of the loan when it was made.

Any guarantee of a loan, made by a registered pension scheme to

- a sponsoring employer, or
- a member of the scheme, or
- a person who is connected to the sponsoring employer or the member

is treated as a loan and is subject to the same requirements above as set out for a loan. The amount of the loan will be equal to the amount guaranteed by the scheme.

D. Pre A-Day Loans

Where an occupational pension scheme made a loan to a sponsoring employer before 6 April 2006, the existing loan is not subject to the new rules provided

- the occupational scheme has become a registered pension scheme
- there is no alteration in the repayment terms of the loan after 5 April 2006
- the repayment date of the loan (capital and interest) is after 6 April 2006

If on or after 6 April 2006 there is a change in the repayment terms, any amount arising (including interest) will be subject to the new rules.

A postponement of the repayment date will not be treated as a change in repayment terms if

- there is an amount outstanding on the date which the amount should have been paid
- the rollover does not exceed 5 years
- there has been no previous rollover on or after 6 April 2006
- there are no other changes to the repayment terms of the original loan

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