JAMES HAY
PARTNERSHIP

Notes for Guidance on Loans from Occupational Pension Schemes (SSAS Only)

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 and any problems avoided. Not all loans are straightforward and it is advisable to discuss plans with James Hay Partnership before proceeding. Please read and 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 and on a commercial basis.

HM Revenue & Customs rules state that 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 and for trading purposes.

Loans cannot be made to the following parties:-

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

Please also note that James Hay Partnership will also **not** make loans available to the following parties:

- Individuals
- Sole traders
- Partnerships with 3 or fewer partners.

HM Revenue & 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 is 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 consult James Hay Partnership.

Scheme Trustees must act in the best interests of the scheme members in their capacity as scheme members and not as directors and 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 and/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.

James Hay Partnership 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 (for example from the company's accountant).

In cases where loan capital and interest remain unpaid, this may be treated by the Revenue as an "Unauthorised Payment" on which tax of at least 55% is payable (40% by the company and 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 and 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 the Revenue.
ii) Loans from the scheme cannot be used to benefit the scheme members, for example, to pay directors' remuneration.
iii) The amount and the 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 and invoices and receipts must be kept as the Revenue may ask to see invoices to support the purpose given.
iv) Examples of permitted reasons for loans are: purchase of stock/machinery/commercial vehicles, or 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, and 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 and 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 6 high street banks:

1. Bank of Scotland
2. Barclays
3. HSBC
4. Lloyds TSB
5. National Westminster
6. Royal Bank of Scotland

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 term of 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 and interest must be repaid by the end of the term. If a loan exceeds the five year period and 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 and 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 having 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, and 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 James Hay Partnership for approval before the loan Agreement is produced and 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 and 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. Similarly, if the requirements for security are not met, an Unauthorised Payment is deemed to have been made.

However, should the value of the security fall during the term of the loan for a reason outside the control of the sponsoring company or connected persons (e.g. due to market forces), there will not be an Unauthorised Payment.

Rollovers

Where an employer is having genuine difficulties making loan repayments and there is an amount of capital or interest outstanding at the end of the loan period, the loan can be extended or "rolled-over" for a further period of up to five years starting from the original repayment date.

A loan may only be rolled-over once. Under no circumstances can it be rolled-over more than this.

Any existing security may continue as this is a rollover rather than a new loan, and the 50% limit will not be re-tested.

Please remember the comments above regarding the trustees being required to pursue non payment of loan capital and interest.

Commerciality / Solvency

The Revenue will not regard as 'commercial' a loan made to a company where:-

a) the company is already in arrears with repayments of interest and/or capital on an existing loan from the pension scheme.

b) the company is in arrears with rent on a property leased from the scheme.

c) the company owes any other funds to the scheme.

d) The reason for making the loan is to keep an ailing business afloat or to an employer who is technically insolvent.

The Revenue are particularly concerned about injudicious or risky loans being made to employers, which are contrary to Trustees' primary duty of safeguarding scheme funds. James Hay Partnership therefore require a letter from the company's accountant/auditor,

confirming that in their opinion the investment is a suitable one for the Trustees and that capital and interest are capable of repayment on the due dates.

Administration

The terms and conditions of the loan must be properly documented. James Hay Partnership will prepare a suitable Loan Agreement, which must be signed by a Director of the company or all partners (if loaned to a partnership) and all scheme members/trustees, together with a draft Letter of Request in which the Directors will be required to set out full details of the purpose of the loan.

The loan agreement provides for immediate repayment of the loan if the borrower is in breach of the terms.

Pre A Day Loans

Existing loans already in place before 6th April 2006 (A Day) can continue on their original terms. Any rollovers must however comply with the new requirements outlined in these guidelines.

Fees

James Hay Partnership's standard fee for the work involved with arranging a loan is £250 plus VAT. However, if our guidelines are not followed, this usually results in additional administration. James Hay Partnership reserves the right to charge an extra fee, on an hourly basis, in respect of any additional work.

For those who wish to proceed with a loan from their pension scheme, the first step is to complete James Hay Partnership's questionnaire and return it with a letter from the company's auditor confirming the company's solvency and a professional valuation of the security being granted for the loan.

These guidelines are based on our understanding of current law and HM Revenue & Customs practice, which are subject to alteration.

James Hay Partnership is the trading name of James Hay Insurance Company Limited (JHIC) (registered in Jersey number 77318); IPS Pensions Limited (IPS) (registered in England number 2601833); James Hay Administration Company Limited (JHAC) (registered in England number 4068398); James Hay Pension Trustees Limited (JHPT) (registered in England number 1435887); James Hay Wrap Managers Limited (JHWM) (registered in England number 4773695); James Hay Wrap Nominee Company Limited (JHWNC) (registered in England number 7259308); PAL Trustees Limited (PAL) (registered in England number 1666419); Santhouse Pensioneer Trustee Company Limited (SPTCL) (registered in England number 1670940); Sarum Trustees Limited (SarumTL) (registered in England number 1003681); Sealgrove Trustees Limited (STL) (registered in England number 1444964); The IPS Partnership Plc (IPS Plc) (registered in England number 1458445); Union Pension Trustees Limited (UPT) (registered in England number 2634371) and Union Pensions Trustees (London) Limited (UPTL) (registered in England number 1739546). JHIC has its registered office at 15 Union Street, St Helier, Jersey, JE2 3RF. IPS, JHAC, JHPT, JHWM, JHWNC, SPTCL, SarumTL and IPS Plc have their registered office at Trinity House, Buckingway Business Park, Anderson Road, Swavesey, Cambs CB24 4UQ. PAL, STL and UPT have their registered office at Dunn's House, St Paul's Road, Salisbury, SP2 7BF. UPTL has its registered office at Boundary House, 91-93 Charterhouse Street, London, EC1M 6HR. JHIC is regulated by the Jersey Financial Services Commission and JHAC, JHWM, IPS and IPS Plc are authorised and regulated by the Financial Services Authority. The provision of Small Self Administered Schemes (SSAS) and trustee and/or administration services for SSAS are not regulated by the FSA. Therefore, IPS and IPS Plc are not regulated by the FSA in relation to these schemes or services.(02/13)

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