Loan to Sponsoring Employer

SSAS

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Notes on an Authorised Loan to a Sponsoring Employer

These notes are intended to summarise the lending criteria laid down in the Finance Act 2004 (as far as it relates to a 'sponsoring employer'*), and are based upon our interpretation of the relevant legislation and HM Revenue & Customs (HMRC) guidance at the time of issue. Whilst great care has been taken in preparing these notes it should be appreciated that only the Courts can authoritatively interpret the law, and accordingly we cannot accept responsibility for any reliance placed on its contents.

**Sponsoring employer (section 150(6) Finance Act 2004), in relation to any registered occupational pension scheme (including a SSAS), means any employer, to or in respect of any or all of whose employees (which includes directors) the scheme has, or is capable of having, effect so as to provide benefits.*

HMRC have advised us of its interpretation of this definition as follows: "...whether or not a particular employer is a person who is, or has been, a sponsoring employer for the purpose of a registered pension scheme (that is an occupational pension scheme) will be a matter that would need to be considered on the facts and circumstances of the employer and the pension scheme concerned but I hope the following will help.

Whilst the provisions of a particular registered pension scheme might be very wide in terms of the employers that could participate in that scheme that should not mean that any employer would then be a sponsoring employer in relation to that scheme. To determine whether or not a particular employer would be a sponsoring employer it would seem reasonable to require that employer to have an involvement with that scheme in such a way that there is a link between the employees of that employer, the benefits being provided under the scheme for those employees and the employment those employees have with that employer.

For example, employer who has established its own pension scheme to provide benefits for its employees is likely to be a sponsoring employer. Similarly, if another employer was to participate in that same scheme in order for that scheme to provide benefits the employees of that employer as well, that 'participating employer' is likely to be a sponsoring employer as well.

Alternatively, if an employer has never had any involvement with a particular pension scheme, such as it does not nor never has participated in the scheme, that employer is unlikely to be a sponsoring employer."

General Requirement

In its online Pension Tax Manual HMRC states that all loans are only acceptable if they are genuine investments of pension schemes and that they should be prudent, secure and on a commercial basis.

Key Legislative Requirements

Before proceeding with a loan to a sponsoring employer, the SSAS Trustees must make themselves familiar with the following five key prescribed requirements for the loan to qualify as an **authorised employer loan**:

- Maximum amount of loan.
- Security of 'adequate value'.
- Term of loan.
- Repayment terms.
- Interest rate.

The criteria for each of these are laid out below. Failure to meet any one of these tests will result in an unauthorised payment charge being levied against the sponsoring employer and also a Scheme Sanction Charge being levied against the Scheme Administrator.

NB: A Loan Agreement is a legal contract which should be drafted by a duly qualified solicitor that has been appointed to advise the Trustees in accordance with Section 47 of the Pensions Act 1995.

Similarly, the security given by the borrower must be formally documented by Deed. EBS Pensions Limited (EBS) is not qualified to assist in the preparation of such a document.

Notes on Key Requirements

1. **Maximum amount of loan**

   The loan, when aggregated with any outstanding loans to sponsoring employers, should not exceed 50% of the net market value of the scheme assets immediately before the loan is made.

   Loans should only be made where all members of the Scheme are also trustees and the trustees are required to make investment decisions unanimously.

   Any loan above this limit will give rise to an unauthorised payments tax charge on the sponsoring employer of 40% of the excess amount.

   The Scheme Administrator will also be liable to a scheme sanction charge of up to 40% of the excess.

2. **Security**

   Security must be provided throughout the full term as a first charge on any asset(s) – i.e. it takes priority over any other charge over the asset(s) – either owned by the sponsoring employer, or some other person, and the asset(s) is (are) of adequate value. This means that at the time the charge is given the market value of the asset(s) must be at least equal to the face value of the loan including interest to the end of the term.

   It is likely that a **floating charge** over the sponsoring employer's assets would satisfy this requirement notwithstanding that in the event of the sponsoring employer going into receivership, administration or liquidation, there are likely to be preferential debts such as employee wages, tax and VAT. The Trustees should take legal advice to ensure the security documents provide for the floating charge to automatically convert to a fixed charge in specified circumstances.

   In the event the SSAS Trustees do not have a first charge or the value of their security is less than the minimum required an unauthorised payment charge of 40% of the loan (plus interest) will be levied on the sponsoring employer. The Scheme Administrator will also be liable to a scheme sanction charge of 40% of the loan (including interest).

   It should not be a problem if, at any time after the security is given, the market value of the asset(s) reduces to less than the amount of the outstanding loan and interest provided the reduction in value is not attributable to any step taken by the sponsoring employer or a person connected with the sponsoring employer.

   Where the security is changed the value of the replacement security must be at least equal to the lower of the market value of the replaced asset(s), or the outstanding loan amount including interest.

   Where the replacement security is inadequate, an unauthorised payment charge of 40% of the shortfall amount will be levied on the sponsoring employer, and the Scheme Administrator will also be liable to a scheme sanction charge of up to 40% of the shortfall amount.

   Please be aware that HMRC consider that if the security given includes 'taxable property'* (i.e. residential property and/or tangible moveable assets) it will create an interest in taxable property. This would constitute an unauthorised payment and would mean that both the Scheme Administrator and the SSAS members would be liable for tax charges under the 'taxable property' rules. However, this charge would be in relation to the amount of the consideration given for the interest, which may only be the amount of any fees or costs in connection with the acquisition of the interest. Therefore it is possible to avoid this by arranging for the sponsoring employer to meet all such fees and costs (but you should take advice on this).

   If the employer subsequently defaults on the loan, the SSAS Trustees may call in the charge. Enforcement of a charge over property could lead to the SSAS Trustees obtaining additional rights, such as a right of occupation. This acquisition of a further interest in the taxable property will create an unauthorised payment based on the market value of the taxable property and give rise to tax charges on the Scheme Administrator and the SSAS members.

   *Details of the 'taxable property' rules are available on request.

3. Term of loan

The repayment period must be no longer than five years. The total owed plus interest must be repaid by the loan repayment date.

Where the loan exceeds the five-year period, or the terms are altered to give effect to a longer than five-year term and the roll over provisions to not apply, an unauthorised payment charge (at 40%) will be calculated as follows:

$$\frac{\underline{[(DLRP/DFY) \times 100]} - 100 \times AO}{100}$$

where DRPL = total days from date loan taken to date loan repaid
DFY = total days from date loan taken until five years after that date
AO = amount owing (including interest) at beginning of loan or where terms of loan altered

'Rollover' - In the event of genuine difficulties in making repayments and there being an amount of capital or interest outstanding at the end of the loan period, the loan can be extended and the repayment date postponed for a further five-year period starting from the standard repayment date.

A loan may be rolled over only once and the roll over will not be treated as a new loan. Existing security may continue even if this is less than the face value of the loan. Any increase in the loan will be treated as a new loan. The 50% limit will only be re-tested in the event of a new loan.

4. Repayment terms

Loans must be repaid in equal instalments of capital and interest for each complete year of the loan which must be the specified repayment plan in the Loan Agreement. A 'loan year' begins on the date the loan is made and ends on the last day of the following twelve-month period. If a loan is for less than a year then the incomplete year is treated as a final year of the loan.

For each loan year the minimum capital and interest repayments are referred to as 'the required amount' and calculated as follows:

$$([L + TIP] \div TLY) \times NLY$$

where L = loan
TIP = total interest payable
TLY = total number of loan years
NLY = number of loan years in period

Any shortfall in the required amount during any loan period will result in an unauthorised payment tax charge. This will be calculated by reference to the largest shortfall which occurs during any twelve-month loan period. Again, the tax rate on the sponsoring employer is 40% of the unauthorised payment.

The Scheme Administrator will also be liable to a scheme sanction charge of up to 40% of the unauthorised payment.

5. Interest rate

A commercial rate of interest must be applied to the loan. The minimum interest rate laid down in SI Regulation 2005/3449 is 1% above the average of the base lending rates of the following six banks:

Bank of Scotland
Barclays
HSBC
Lloyds TSB
National Westminster
Royal Bank of Scotland

The average rate obtained should be rounded up to the nearest ¼%.

Where the minimum interest rate is not charged an unauthorised payment charge (at 40%) will apply. The charge will be made on the amount owing based on the percentage that the interest rate applied to the loan is less than the official rate using the formula:

$$\frac{100 - [(IR/PIR) \times 100]}{100} \times AO$$

where	IR	= Interest rate payable
	PIR	= Prescribed Interest Rate
	AO	= amount of loan outstanding (excluding interest)

Additional Notes

1. **'Taxable property' rules and purpose of the loan**
   The Finance Act 2006, which came into force from 6th April 2006 and imposes severe tax charges on a SSAS that invests directly or indirectly in 'taxable property', i.e. residential property and tangible moveable property such as plants & machinery, cars, jewellery, wine, antiques, etc.

   A loan to an employer to fund the acquisition of 'taxable property' could therefore have unintended and unwelcome tax implications for SSAS Trustees **unless** it satisfies the following conditions:

   a. The loan is an authorised employer loan made by a pension scheme to or in respect of a sponsoring employer;
   b. The interest in the property is acquired so that the property may be used for the purposes of a trade, profession or vocation carried on by the sponsoring employer or for the purposes of the sponsoring employer's administration or management; and
   c. After the acquisition, the property is not occupied or used by a member of the pension scheme or a person connected with such a member.

2. **Unauthorised loans**
   A loan from a SSAS to a person (which includes individuals and companies) who is connected with a SSAS member and is not a sponsoring employer will constitute an 'unauthorised payment' to the member and both the member and the SSAS will be liable for tax charges.

   This document is based on EBS Pensions Limited's interpretation of pension tax law, existing law, HM Revenue & Customs' published guidance as at the date of this document and proposed changes to pension tax legislation, all of which may be subject to change. While we believe this interpretation to be correct, EBS Pensions Limited can give no guarantee in this respect.

   This document is solely for information purposes and should not be construed as investment or financial advice. Individuals should seek such advice from their own professional advisers.

   The tax treatment of pensions depends on individual circumstances and may be subject to change in future.

Loan Agreement Requirements

The loan agreement should as a minimum contain the following:

a. NAME OF REGISTERED PENSION SCHEME .... (the 'Scheme')

b. NAME OF SPONSORING EMPLOYER.. (the ''Borrower')

c. AMOUNT OF THE LOAN - (see Note 1 above) £........... (figures) .... (words)

d. SECURITY GIVEN BY BORROWER - (see Note 2 above) ....
NB: Any security given by the borrower must be formally documented by deed. This security must be in place before any monies are released.

e. DATE FROM WHICH LOAN IS TO START ....DATE OF REPAYMENT.................(five years maximum term) (see Note 3 above)

f. REPAYMENT BASIS - All loans must be repaid in equal instalments of capital and interest for each complete year (see Note 4 above).

g. INTEREST - Interest is due at a rate of ....% (see Note 5 above)

h. ATTESTATION TO BE SIGNED BY
Each Trustee
The Sponsoring Employer

There will be other issues which the trustees may wish to consider including within the loan agreement, including:

- An option for the loan to be repaid by the Borrower prior to the Repayment date;
- An undertaking that the Borrower shall be liable to compensate the trustees for action by him that results in a tax charge on the trustees, or Scheme Administrator;
- That the loan period may be rolled over and the conditions which apply;
- That the security given will have priority over any other that might be in existence;
- There have been no arrears in payment of any outstanding loans to the Scheme and that in relation to the loan the Borrower's financial situation is healthy and that the loan is a prudent investment of the trustees.

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