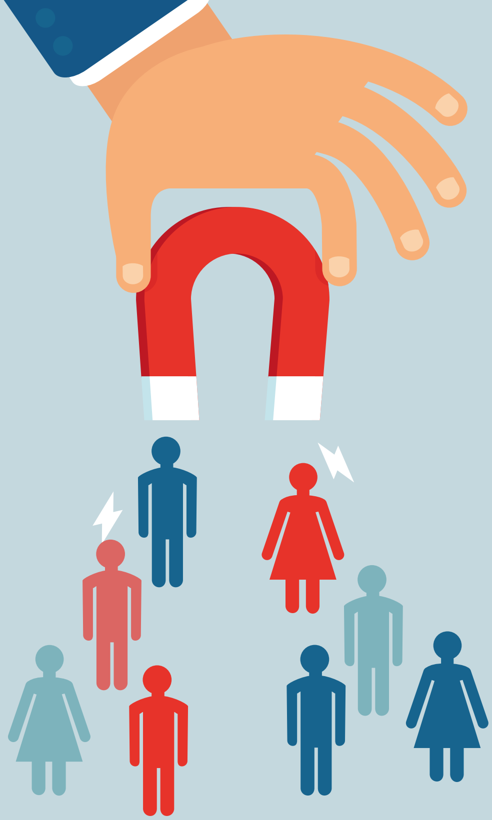

A beautiful relationship

Your tax colleagues are vital to your success as a treasurer. Doug Williamson explains how to charm both them and your examiner with your knowledge of a key treasury and tax transaction

Many corporate groups combine senior treasury and tax responsibilities in positions such as director of treasury and tax, or tax and treasury manager. In these roles, you will have tax responsibilities and tax specialists reporting to you. So understanding tax and the tax treatment of treasury transactions will be essential for you to fulfil these senior roles.

Treasurers need to understand not only the accounting for key treasury transactions, but also the resulting tax implications. Tax has a huge impact on the cash flows of the business. For this reason, the tax treatment of treasury transactions is a frequently examined topic.

A very important tax and treasury transaction is the tax treatment of loans, which are defined for UK tax purposes as 'loan relationships'.

Loan relationships

A loan relationship exists where a company holds or owes a debt as a result of lending or borrowing money.

Loan relationships are categorised into trading loans and non-trading loans.

Trading loans and borrowings

A trading loan is when a company borrows or lends money for the purpose of its trade.

For a non-financial company, most borrowing will be for trading purposes, but any lending will normally be non-trading.

The tax treatment of trading loans is generally more favourable for the taxpayer, compared with non-trading loans. This is mainly to do with the ways in which gains and losses may be offset with more flexibility in relation to trading items.

Loan relationships for a non-financial company

	Lending money	Borrowing money
Trading loans	–	(ii) Most borrowings
Non-trading loans	(i) All lending	(iii) Borrowing to buy share investments

(i) If a non-financial company lends money, then this is as a non-trading loan for UK tax purposes. Only banks and finance houses whose trade includes lending money make trading loans.

(ii) When a non-financial company borrows money, then most borrowings will be for the purpose of its trade.

(iii) The only general exception is where the loan is taken out to buy an investment, such as shares in another company.

A recent exam question asked about loan relationships from the perspective of a non-financial trading company.

What's it worth?

Worth Ltd ('Worth') is a UK-resident trading company. The company made the following transactions in its year to 31 March 2014.

Worth made a £75,000 loan to Kingston Ltd, an unconnected company. Kingston Ltd paid interest of £2,000 to Worth, but Kingston Ltd subsequently went into liquidation. The liquidator has confirmed that Worth will receive only £15,000 of its loan back.

Required: Explain the tax treatment of these transactions.

Corporate Tax, April 2014 Q4 extracts

Six steps to relationship success

Six simple steps will unlock this question and similar ones:

(1) Trade or non-trade?
(2) Are we connected?
(3) Identify credits
(4) Identify deficits
(5) Set off credits against deficits
(6) Tax or tax relieve

Let's apply each of these steps, in turn.

(1) Trade or non-trade?

Worth is a non-financial company. Lending money is not part of Worth's trade. This means that Worth's loan to Kingston is a non-trading loan relationship.

(2) Are we connected?

Special tax rules apply if the lender and the borrower are connected with one another.

In this case, Worth and Kingston are not connected, so the normal tax rules (as set out below) will therefore apply.

> **Credits and deficits**
>
> "Many candidates demonstrated confusion in identifying which items would be loan relationship credits and which would be loan relationship deficits."
>
> *Examiner's report, Corporate Tax, April 2014*

Loan relationship credits and deficits (or debits) for tax purposes are similar to the amounts credited as income, or debited as expenses, in the financial statements.

Credits	Deficits (debits)
✓ Interest income ✓ Other gains	✓ Interest payable ✓ Capital losses ✓ Other losses

(3) Identifying Worth's credits

The interest income of £2,000 that Worth received from Kingston is a credit. This is a non-trading loan relationship credit, because it arises from a non-trading loan.

(4) Worth's deficits

Worth has suffered a capital loss on this loan. Worth advanced £75,000 to Kingston, but Worth will only receive £15,000 of this amount back.

The loss of capital or principal is:
£75,000 advanced *less* £15,000 received back
= £60,000 loss.

This is a non-trading loan relationship deficit. Again, this is a non-trading item, because it arises from the non-trading loan to Kingston.

(5) Set off credits against deficits

Non-trading credits and non-trading deficits of the same year are automatically set off against each other to reach a single net figure. Applying this rule to Worth:

£60,000 deficit
less £2,000 credit
= £58,000 net deficit.

(6) Tax or tax relieve

Under modern UK tax rules, Worth will enjoy tax relief on the net non-trading deficit of £58,000. The most common use is to offset it against the company's taxable total profits for the year, reducing tax immediately for the current year.

> **Concise answer**
>
> (1) W is not a financial company, so the loan to K is a non-trading loan relationship.
> (2) W & K are not connected, so the normal tax rules apply.
> (3) The £2,000 interest received is a taxable, non-trading loan relationship credit.
> (4) The partial loss of the principal is a non-trading loan relationship deficit of:
> £75,000 – £15,000 = £60,000.
> (5) The net non-trading deficit is:
> £60,000 – £2,000 = £58,000.
> (6) This £58,000 may be offset against W's taxable total profits for the year.

The examiner noted that students struggled with this question, and went on to explain why these important topics will continue to appear in the future.

> **What goes around comes around**
>
> "Where there was a loan relationship, this should be identified as trading or non-trading and the tax treatment explained.
>
> "Candidates appeared unsure of how to treat these transactions and were answering with general knowledge rather than any particular tax rules. This is particularly disappointing when these items relate to treasury transactions. The examiner believes this to be a crucial part of the syllabus and will continue to examine it in future."
>
> *Examiner's report, April 2014*

Tax benefits

Understanding tax and building good relationships with tax colleagues are all-important. Tangible benefits include improving your company's tax cash flows, passing your ACT exams and increasing your employability for senior treasury roles.

HELP FOR ACT STUDENTS

Download previous articles from this series and other useful study information from the Exam Tips area of the student site at study.treasurers.org/examtips

Doug Williamson FCT is a finance tutor who enjoys slicing complex problems into tasty, bite-sized pieces