HMRC - OT22006 - Qualifying Loans

CTA10\S286(2) allows a deduction against ring fence profits for loan relationship debits to the extent that the loan relationship is in respect of ‘money borrowed’ that has been ‘used to meet’ expenditure incurred by the company on oil extraction activities or on acquiring oil rights, other than from a connected party.

Exchange gains and losses

For accounting periods beginning after 30 September 2002, similar provisions apply to loan relationship debits that result from exchange losses (ICTA88\S494(2)(c)(ii) now CTA10\S286(4)). These can be deducted from ring fence profits only to the extent they arise on money debts on which interest payments would be allowed as ring fence deductions.

Exchange gains arising in similar circumstances are treated as loan relationship credits and included in the ring fence profits (CTA10\S287).

Money Borrowed

Debts can exist without there being money borrowed and, as CTA10\S286 allows loan relationship debits in respect only of money borrowed, no deduction is allowed for interest paid otherwise than in respect of money borrowed.

This is relevant where interest is charged on unpaid interest.

For example, for a company involved in one development but with little or no production there may be a large negative cash flow. This will probably mean that the company will not have cash available to pay interest. If interest is merely charged to the account so that the account balance increases as a result of the interest then HMRC consider that the increase in the debt arising from the charging of unpaid interest is not money borrowed. As this is not money borrowed then compound interest charged on that part of the balance will not be within CTA10\S286.

If the interest is paid as a result of a further borrowing of money being used to pay the interest HMRC would argue that the money borrowed was not “used to meet expenditure incurred by the company in carrying on oil extraction activities …” but that it was used to pay interest, which is not qualifying expenditure under CTA10\S286.

Used to meet

In looking at how money has been ‘used’, the starting point is the premise that money is fungible. Taking the Concise Oxford Dictionary definition of ‘fungible’

that can serve for, or be replaced by, another answering to the same definition,

This means that any £1 is as good as any other £1, or any $1 is the same as any other $1. Thus, the fact that money borrowed is put into a separate account from which funds are drawn to meet expenditure incurred by the company in carrying on oil extraction activities does not necessarily, in HMRC’s view, mean that it passes the S286 test if there are other accounts available to the company out of which money is used for other purposes. It may be necessary to look at all money used in a period and all uses to which money is put in that period and apply uses to usage proportionately.

No underlying debt: CTA10\S286(4)

In certain circumstances, loan relationships are deemed to exist where there is a money debt but no lending of money (see CTA09\S478 +, formerly FA96\S100). Examples of this are trade interest and redetermination interest. Interest debits arising on this type of money debt are allowable against ring fence profits where money has not been borrowed but a loan relationship is deemed to exist under CTA09\S478 + . However, CTA10\S286(4) allows such debits only if the underlying cause of the interest satisfies CTA10\S286(2) i.e. a Ring Fence purpose.

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