

Debts and Capital Gains Tax

i **Contacts**

Please phone:

- the number printed on page TR 1 of your tax return
- the SA Helpline on **0845 9000 444**
- the SA Orderline on **0845 9000 404** for helpsheets

or go to

www.hmrc.gov.uk

This helpsheet explains:

- how debts are dealt with for Capital Gains Tax purposes
- how you may be able to claim an allowable loss if a loan you have made to a trader cannot be repaid
- how you may be able to claim an allowable loss if you have guaranteed a loan to a trader which cannot be repaid and have to pay up under the guarantee.

This helpsheet only explains the basic rules as they apply in simple cases. In more complex cases you may need to obtain professional advice. If you are in any doubt about your circumstances you should ask your tax adviser.

We will also be pleased to help and provide any forms you may need.

You can also consult our Capital Gains Manual, which explains the rules in more detail, at **www.hmrc.gov.uk**

This helpsheet will help you fill in the *Capital gains summary* pages of your tax return.

What is debt?

A debt exists whenever money is owed to someone else. A debt is an asset in the hands of the creditor or lender. That asset will be disposed of when the debt is repaid or if the lender sells or transfers the debt. But there are only a limited number of circumstances in which such a disposal gives rise to a chargeable gain or allowable loss.

In the hands of the debtor or borrower a debt is not an asset but a liability. Capital Gains Tax is concerned with the disposal of assets, not liabilities. Therefore a borrower will not make a chargeable gain or allowable loss from the disposal of a debt.

How are debts dealt with for Capital Gains Tax purposes?

For Capital Gains Tax purposes, debts can be divided into three broad categories.

Simple debts

A simple debt is a straightforward loan or amount owing by one person to another. Simple debts are not chargeable assets in the hands of the original lender. But you may be able to claim a loss if a loan you have made to a trader cannot be repaid. Please see the section headed 'Losses on loans to traders' on page 2.

It is possible to buy debts. A debt will be a chargeable asset if you are not the original lender. But a loss on the disposal of a simple debt, by a person who is not the original lender, may not be allowable for Capital Gains Tax purposes. Ask us or your tax adviser for details.

Securities

Securities are more formal loans made to companies. Securities are chargeable assets in the hands of the original lender. But many securities are

exempt from Capital Gains Tax because they are qualifying corporate bonds (QCBs). If you buy or subscribe for listed securities, your broker or the company should be able to tell you whether they are QCBs. There are also published lists showing which listed securities are QCBs. We have copies of these lists.

If you acquired the QCB on a company share reorganisation or takeover, there may be a chargeable gain or allowable loss on its disposal.

You can find more information in Helpsheet 285 *Share reorganisations, company takeovers and Capital Gains Tax* in the section on company takeovers and Capital Gains Tax.

Loans made to unlisted companies may also be securities and QCBs. This can be a complex subject; ask us or your tax adviser for help.

Gilt-edged securities

Gilt-edged securities, or 'gilts', are UK Government securities issued by the Treasury. Gilts are exempt from Capital Gains Tax.

Losses on loans to traders

If you make a loan to a trader you may be able to claim an allowable loss if the loan cannot be repaid. The loan must have been used wholly for trade purposes and have become irrecoverable. You cannot claim if the borrower was your spouse or civil partner either when the loan was made or subsequently.

Example 1

You lend £30,000 to your brother to start a bicycle shop. After trading successfully for a number of years, the business fails. £5,000 of the loan is repaid to you but £25,000 is irrecoverable. You can claim an allowable loss of £25,000.

If you claim the relief, you will be taxable on any amounts of the loan subsequently repaid.

Example 2

Continuing Example 1, two years after you make the claim your brother is able to repay £10,000. You are treated as having made a capital gain of £10,000 in the tax year in which the £10,000 is repaid.

What loans qualify?

To qualify for relief the loan must be to a borrower who:

- is resident in the UK, and
- uses the money wholly for the purposes of a trade, or
- uses the money to set up a trade, as long as they start trading.

A trade includes a profession or vocation, but does not include money-lending. If the loan is made to a company, that company can pass the money to another company in the same group to be used in that other company's trade.

Loans may include credit balances on a director's loan account but not ordinary trade debts. Exceptionally, trade debts may qualify for relief if there is a specific agreement to extend the period of credit beyond what is customary for the trade concerned. But you cannot claim an allowable loss if you have claimed the bad debt as a trading expense.

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The loan must not be a security (see ‘How are debts dealt with for Capital Gains Tax purposes?’ on page 1). If the loan is a security but not a QCB, the ordinary rules of Capital Gains Tax will allow you to claim an allowable loss if the loan becomes worthless. If the loan is a QCB, and was made before 17 March 1998, you may be able to claim a separate relief. Ask us for details.

What does ‘irrecoverable’ mean?

Relief is only due if the loan has become irrecoverable. This does not mean merely that the borrower cannot repay the loan at the date you make the claim. You have to show that there was no reasonable prospect of the loan ever being repaid. If the borrower continues to trade this test is unlikely to be satisfied.

The loan must have become irrecoverable. Relief will not be due if the loan was irrecoverable when it was made. If you make a claim shortly after making the loan, this may cast doubt on whether the loan was ever recoverable.

The loan must not have become irrecoverable as a result of the terms of the loan or some act or omission by the lender.

How is the relief given?

The relief is given by treating the amount outstanding of the loan principal as an allowable loss. Normally, you cannot claim that only part of the amount outstanding on a loan has become irrecoverable. But you can make a claim if:

- the borrower has been placed in bankruptcy, receivership or liquidation, and
- the receiver or liquidator has announced an anticipated dividend for unsecured debts and has indicated that no further dividends are likely.

Example 3

You have lent £12,000 to a company. Having repaid you only £2,000, the company goes into liquidation. The liquidators say they hope to make a payment of 20p in the pound to unsecured creditors but there will be no further payments. You may claim an allowable loss of £8,000.

How to make a claim

Are there any time limits?

After the loan has become irrecoverable there is no time limit in which to make the claim. The loss will arise:

- at the time you make the claim or, if you want,
- at an earlier time you specify when you make your claim that falls in either of the two previous tax years, provided all the necessary conditions for relief are satisfied at the date you make the claim and at the earlier time.

So, if you make a claim during the tax year 2012–13, any loss will arise in 2012–13. Alternatively, you can ask for the loss at an earlier time specified in your claim that falls during 2010–11 or 2011–12, provided all the necessary conditions for relief were also satisfied at that earlier time.

If you want to make a claim for 2012–13, write to us giving details of your claim.

If you want to make a claim for 2011–12 in your tax return for 2011–12, you should put ‘X’ in box 34 on page CG 2 and provide details of the claim (including details of the earlier time at which relief is sought) in the ‘Any other information’ box, box 36, or in your computations, providing a clear statement that this relief is being claimed. Include the loss in box 6 on page CG 1 of your *Capital gains summary* pages.

During the tax year 2012–13 you can also ask for the loss to be given at a time falling in 2010–11 by amending your 2010–11 tax return on or before 31 January 2013. If you decide to ask for the carry back to 2010–11 at some time between 1 February 2013 and 5 April 2013 you will have to send us a separate notice.

What happens if you recover the loan?

If you recover any amount for which you have claimed relief the amount you receive is treated as a chargeable gain. The chargeable gain arises in the tax year the payment is received and at the time of recovery. If you received any such payments in 2011–12 the amount should be added to other chargeable gains and entered in box 3 or 5 and in box 31 of the *Capital gains summary* pages.

Relief for payments made under guarantees given on behalf of traders

Instead of making a loan to a trader yourself you may act as guarantor for a loan. If the loan, or the interest on it, becomes irrecoverable and you have to pay up under your guarantee, you may claim an allowable loss. The relief will be reduced by any amounts payable by co-guarantors. The conditions for relief are very similar to those which apply to losses on loans to traders.

Example 4

Your brother borrows £20,000 from the bank to set up a bicycle shop. You provide a personal guarantee for the loan. After a period of trading successfully the business fails. The loan cannot be repaid. The bank calls on you to pay £20,000 under the guarantee. You can claim an allowable loss of £20,000 in the year the payment is made.

What are the conditions for relief?

The guarantee must be made for a loan which satisfies all the conditions set out under ‘What loans qualify?’ on page 2. The only difference is that relief can be given for a guarantee of a loan which is a security.

Some part of the loan or the interest on the loan must be outstanding at the date of the guarantee payment. This amount must be irrecoverable from the borrower.

The borrower and lender must not have been spouses or civil partners either when the loan was made or subsequently. And you and the borrower must not have been spouses or civil partners either when you gave the guarantee or subsequently.

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How is the relief calculated?

The amount you pay under the guarantee will be treated as an allowable loss. But the amount of relief will be limited if you are entitled to receive any payments from co-guarantors. This restriction is not limited to amounts you actually receive from co-guarantors. However, you must take account of their ability to pay. If a co-guarantor is unable to make a payment, the liability of the other guarantors will be increased accordingly. If you think this restriction applies, you should ask us or your tax adviser for advice. On the other hand, you can claim relief for amounts you have to pay as a co-guarantor.

How to make a claim

The appropriate proportion of the payment is treated as an allowable loss for the year in which the payment is made.

If you made a guarantee payment in 2011–12, you should put ‘X’ in box 34 on page CG 2 and provide details of the claim in the ‘Any other information’ box, box 36, or in your computations providing a clear statement that this relief is being claimed. Include the loss in box 6 on page CG 1 of your *Capital gains summary* pages.

The claim has to be made within four years of the end of the tax year in which you make the payment under the guarantee.

If, after you have made a claim, you recover any amount of the loan or interest, or any part of the guarantee payment, the amount you receive is treated as a chargeable gain. The chargeable gain arises in the year the payment is received and at the time of receipt. If you have received such a payment in 2011–12, the amount should be included with any other gains and entered in box 3 or 5 and in box 31 of the *Capital gains summary* pages.

These notes are for guidance only and reflect the position at the time of writing. They do not affect any rights of appeal. Any subsequent amendments to these notes can be found at www.hmrc.gov.uk