Personnel Today

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How to offer loans to employees

By **James Green** on 10 Jun 2014 in **Staff Loans**

The cost of a rail season ticket is often loaned to employees

Many employers offer loans to their employees, but this practice can throw up some unexpected pitfalls of which employers should be aware. James Green, senior associate lawyer at Burges Salmon LLP, offers some guidance.

Q. Can I offer an interest-free loan to an employee?

Employee loans for season tickets are frequently made on a low-cost or interest-free basis. However, if the amount to be loaned is greater than £10,000, then the loan will be taxable as a benefit in kind. Class 1A employer's national insurance contributions are also payable.

Q. We plan to charge our employee interest on their loan. Is this permitted?

An employer can charge interest for a loan made to an employee. However, you need to tread carefully as some types of loan may be caught by the Consumer Credit Act 1974 (CCA). Although an employee is not a consumer in the ordinary sense of the word, a loan made by an employer to an employee will be caught by the CCA even if its business does not ordinarily

involve providing consumer credit. The CCA also catches not just straightforward cash loans, but also certain types of credit agreement such as deferred payment share plans.

A loan will be exempt from the CCA in certain circumstances, the most common of which is if the rate of interest does not exceed 1% above the base rate of certain banks. Interest-free season ticket loans will therefore be exempt.

If the loan is not exempt, the loan agreement will be a “regulated agreement” for the purposes of the CCA. The effect of this is that before the agreement is signed, the employer must provide the employee with a list of certain pre-contract information in standard form, including an explanation of the credit arrangement, to enable the employee to assess whether the agreement is suitable.

The agreement itself must contain certain key terms, including a 14-day withdrawal period. There is also a requirement to provide an annual statement of account. These requirements mean that you will need specialist documentation and the arrangements used for standard interest-free loans, eg season-ticket loans, will not be suitable.

It is essential that an employer complies with the requirements of this regime. If it does not, the loan agreement will be unenforceable, unless the consent of the court is obtained.

Q. Do we need a consumer credit licence to make loans under regulated agreements?

If your business is providing credit to consumers under regulated agreements, then you will need a consumer credit licence.

That requirement does not apply if an employer makes only occasional loans to employees using regulated agreements. However, if you plan to offer these types of loans to a large number of employees, perhaps as part of an employee share plan, then it may be a prudent step to obtain this licence.

It is a criminal offence to carry out a consumer credit business without the appropriate licence, so there is a strong incentive to get this right.

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How are employee loans treated for tax and NI purposes?

How can an employer ensure that an employee will repay a loan if he or she leaves the organisation before the loan is cleared?

Q. Does it matter what the loan is being used for?

Generally, an employer is free to make loans to employees for any purpose, and low cost or interest-free loans are commonly offered as an employee benefit.

However, issues may arise if a company lends money to enable employees to acquire shares in that company or a group company. This is known as “financial assistance”.

If the loans are made by a public company, then this financial assistance is unlawful unless it falls within certain limited exceptions. If the loan is made by a private company, this will generally be permitted, unless it is for the purpose of acquiring shares in its parent company where that parent company is a public company.

Q. We plan to make a loan to a director. Will any issues arise?

Loans to directors require shareholder approval in advance under the Companies Act 2006. If that consent is not obtained, then the loans are voidable, although may be affirmed by shareholders after the event. There are some exceptions, notably for loans of under £10,000.

Q. We plan to make a loan to one of our shareholders. Is there anything we need to consider?

There is a possibility that a tax charge will arise if the loan is made to a participator (broadly speaking, a shareholder of the company) by a close company. A close company is controlled by five or fewer participators or by its directors.

If a loan is made by a close company to a participator, then a corporation tax charge equal to 25% of the loan will arise, unless certain limited exceptions apply.

About James Green

James Green is a senior associate lawyer at Burges Salmon LLP.