help & information

employer loans & repayment problems

background

A unique feature of Small Self-Administered Scheme (SSAS) is the ability of the Trustees to grant a loan to the Sponsoring Employer from the pension scheme.

There are various reasons for doing so:

- The company may be looking for finance to fund short-term or longer-term plans, and the pension scheme will, via its Members and Trustees, usually have considerable understanding of those plans;

- The loan is repayable to the pension scheme, rather than to a third party such as a Bank or Building Society;

- Repayment terms are generally in the control of the Trustees, including interest rates, which can lead to somewhat more flexibility than might be offered by third parties.

required loan terms

When a pension scheme lends money to the employer, it is subject to five specific conditions:

- The maximum loan allowed is 50% of the value of a pension scheme. So, if a pension scheme is worth £200,000, then a loan of up to £100,000 can be granted.

- The interest rate must be at least 1% above bank base rate. Higher interest can be charged, so it is sometimes a balance between making the loan attractive to both parties.

- The maximum term is 5 years. At the end of that timescale, if there are loan monies still outstanding, a rollover of a further 5 years can be agreed.

- The loan must be repaid in equal annual instalments of capital and interest. Monthly and quarterly payments are allowed, provided the overall annual amount each year is equal.

- The loan must be secured as a first charge on assets that are equal to the loan plus interest. So, if the loan was £100,000, and the total interest due over the term was £7,500, security of £107,500 must be offered.

  Security can take different forms, ranging from property to assets and does not need to be owned by the company.

payment arrears and loan issues

HM Revenue & Customs recognises that loans don't always operate as expected, for various reasons. Companies will get into financial difficulty, and there may be a requirement for a certain level of negotiation as regards the repayment of the loan in those circumstances.

As the loan is between the pension scheme and the 'Sponsoring Employer', HMRC will always expect any deviation from the loan agreement to be agreed on commercial terms. In the normal course of events, this would usually mean requesting independent confirmation from accountants, for example, to provide evidence that the company is unable to meet the repayments for genuine reasons and agreeing an action plan going forward.

If the loan is unable to be repaid at the end of the term, HMRC allows it to be 'rolled over' on similar terms for another period – so, a five year loan can be rolled over for a further five years, for example.

unauthorised payments

Individuals familiar with pension schemes will understand that where HMRC deems a transaction between connected parties (such as a pension scheme and the Sponsoring Employer) to be uncommercial, it is deemed to be an Unauthorised Payment. An Unauthorised payment would then lead to a severe tax penalty being imposed on the pension scheme and the company.

In the case of an Employer loan, failure to make a repayment on time is not automatically classed as an Unauthorised Payment. There are, broadly, two scenarios where an Unauthorised Payment can occur:

- Where the loan was not set up properly in the first place. So, for example, the loan agreement did not require equal payments each year, or there was no security for the loan;

- Where the loan is not repaid and the Trustees do (or did) not take appropriate action.

Accordingly, where an employer is unable to make a repayment on time, Trustees of pension schemes should not automatically consider that they will be faced with an Unauthorised Payment charge.

coronavirus & the current environment

The present environment is unprecedented given the impact that the Coronavirus is having on the economy generally. This impact is being felt by all manner of industries and commercial enterprises, large and small. Cashflow will inevitably be affected for many, meaning Employers will potentially struggle to make loan repayments to pension scheme.

Loan agreements would not allow Employers to withhold or delay payments. Nor would they allow pension schemes to offer any concessions from the minimum requirements set out by HMRC (as that would breach the initial requirements of being able to make the loan).

Trustees are therefore likely to be in a difficult position where they know that the terms of the loan agreement provide little flexibility, but the Employer (which they are likely involved with) may require that flexibility.

what can pension schemes do?

The Trustees cannot simply vary the terms of the loan agreement, but they can afford the Employer some flexibility. There are, however, a number of important considerations:

- The Employer should try to detail the challenges that they are facing. Although this is likely to be a very sensitive matter, as much detail as possible should be provided so that it is held as a record.

- Consideration needs to be given as to whether the Trustees should get specific independent validation of any problems that an Employer has. This might be relevant in more extreme cases where it is anticipated that there could be a substantial delay in making repayments.

- Any variation should be documented carefully. This needs to be careful not to amend the terms of the loan agreement which might then place the loan into an area where an Unauthorised Payment could occur. It is more likely to be recording an understanding of when repayments may commence, and when the position will be reviewed.

- Trustees need to be clear that they are not allowing a waiving of the loan repayment in its entirety. The loan repayments would need to be deferred and collected at a future date when the economic situation has improved.

- The period of deferral needs to be considered. A short period without payment combined with a regular review might be preferable to a long period of deferral where there are no records kept of how the situation changes.

- Trustees need to consider the position of their security and plan accordingly especially where the loan is secured against company assets. In the worst-case scenario, the Trustees need to ensure they lodge their position with any Administrator appointed to the Employer.

- Additionally, the Trustees need to balance providing flexibility to an Employer against the commercial impact on its own position. If a pension scheme is relying on loan repayments to pay retirement benefits, for example, then regular reviews of the position might be vital.

- There might be opportunity, for example, to allow a gradual return to full loan repayments which could ease the cashflow of the pension scheme, and also allow the Employer continued breathing space to return to profitability.

- Trustees need to bear in mind the make-up of their pension scheme. There may be Trustees who are no longer part of the Employer who may not be willing to allow as much flexibility as the Employer desires. It is important that Trustees meet and discuss and agree a sensible course of action in such circumstances.

What should Sponsoring Employers not do?

Employers should not simply stop repaying loans without communicating with the Trustees. This is vitally important, as long-term failure to make repayments without reason can be both classed as an Unauthorised Payment, and also trigger provisions in the loan agreement to pursue the security.

Where pension scheme members act in both capacities (both as the Trustees and the Employer) there may be an assumption that a given course of action (i.e. stopping loan repayments) is commercially in the interests of both parties.

The likelihood is that this may well be the case, but it is still important to document what is happening. In future years, pension scheme Trustees do not want to be challenged by HM Revenue & Customs to evidence why they conceded any relaxation for loans especially for a connected party.

Where can I obtain further information or help?

Odyssey Pensions has a wealth of expertise relating to pension scheme loan transactions and operations.

We can discuss particular situations with clients and help devise strategies, or comment on proposals, that will try to ensure that loans remain within the relevant pension rules. We can assist in documenting the variations being considered, and also help with the ongoing reviews of any concessions.

We also have access to a number of professional, specialist law firms that can provide additional support and assistance.