

Interest on loans to defray money applied for certain purposes

Part 36-00-19

This document should be read in conjunction with section 840A of the Taxes Consolidation Act 1997 ('TCA').

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1 Introduction

Section 840A restricts the ability of certain companies (referred to as “investing companies” in this section) to claim a deduction for interest payable on certain connected party borrowings to fund the acquisition of certain assets from other group companies.

In general, section 840A provides that in computing the amount of the profits or gains to be charged to corporation tax under Schedule D, no deduction is available for investing companies in respect of any interest payable on loans—

- for the acquisition of assets from a company connected with the investing company,
- where the loan is made to the investing company by a person who is connected with the investing company.

For the purposes of section 840A, section 10 TCA 1997 is applied to establish whether persons are connected. Consequently, “control”, as used for determining connected person, is to be construed in accordance with section 432¹.

Section 840A(2)(b) provides that interest on any form of refinancing such a loan is similarly not deductible.

¹ Guidance on the meaning of “control” is provided in Tax and Duty Manuals Part [01-00-05](#) 'Meaning of “control” in certain contexts' and Part [13-01-02](#) 'Close Companies: Interpretation and General'.

The operation of section 840A is illustrated in figure 1 below:

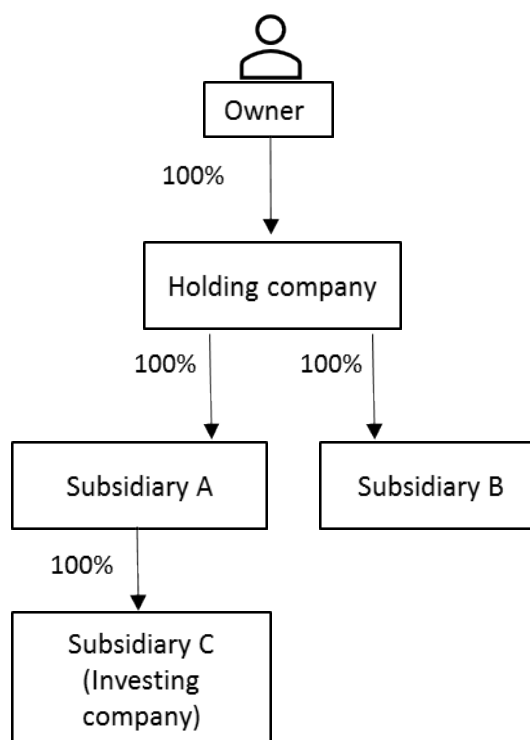


Figure 1: Diagram illustrating group scenario.

Section 840A generally prevents Subsidiary C—

- from deducting interest on a loan from:
 - Owner,
 - Holding Company,
 - Subsidiary A, and/or
 - Subsidiary B,
- where the loan is used to finance the acquisition of an asset from:
 - Holding Company,
 - Subsidiary A, and/or
 - Subsidiary B.

This is the case as the loan would be from a connected person for the purposes of acquiring an asset from a connected company.

2 Definitions

2.1 Assets

For the purposes of section 840A, “asset” means any asset other than—

- (a) intellectual property that qualifies for capital allowances, i.e., specified intangible assets as defined in section 291A(2)², and
- (b) an asset acquired as trading stock within the meaning of section 89.

Section 89 provides that “trading stock” means, property of any description, whether real or personal, which is either -

- property such as is sold in the ordinary course of the trade would be so sold if it were mature or if its manufacture, preparation or construction were complete, or
- materials such as are used in the manufacture, preparation or construction of property such as is sold in the ordinary course of that trade.

Furthermore, trading stock includes any services, article or material which, if the trade were a profession, would be treated as work in progress of the profession for the purposes of section 90³.

2.2 Loan

A “loan” for the purposes of section 840A includes a promissory note and any other agreement or arrangement having similar effect.

3 Scope of the provision

Section 840A(2) refers to computing the amount of the profits or gains to be charged to corporation tax under Schedule D.

Accordingly, the provision is not confined to profits of any trade or profession i.e. those under Schedule D Case I/II. The provision extends to other sources of income that are taxed under different cases of Schedule D.

A practical example of the scope would be rental income, i.e. Schedule D Case V income. Where a connected party loan is used to fund the acquisition of a property from another connected company, a deduction for such interest (which might otherwise have been deductible by way of section 97) is, in general, not available in calculating the amount of rent subject to tax.

4 Interest on a loan to acquire a trade

Section 840A(3) provides that where—

- a loan from a connected person is used by a company to acquire a trade from a connected company, and
- the profits or gains of the trade carried on by that connected company was not within the charge to corporation tax prior to its acquisition,

then interest on that loan may be deducted in computing the acquiring company’s profits. The amount of deductible interest on the loan cannot exceed the amount of

² Refer to Tax and Duty Manual [09-05-05](#) ‘Capital allowances for intangible assets’.

³ Section 90 TCA 1997 concerns the ‘Valuation of work in progress at discontinuance of profession’.

the profits or gains of the acquired trade which are chargeable to tax under Case I of Schedule D.

Where only part of a trade is acquired, section 840A(4) treats the acquisition as if that part of the trade were itself a separate trade.

Where the company begins to carry on an acquired trade (or part thereof) as its own trade, the acquired trade (or part thereof) is treated as a separate trade for the purposes of determining the limit to which interest can be deducted. The profits of that trade should be apportioned on a just and reasonable basis in order to determine the profits or gains of the separate trade.

The amount of profits or gains apportioned to the separate trade cannot exceed the amount which would be attributed to a distinct and separate company engaged in those activities if it were both—

- independent of, and
- dealing at arm's length with,

the investing company.

5 Exclusions from the general rule

There are a number of exclusions from the general rule. Where such exclusions apply, the investing company should, subject to any applicable rules for interest deductibility, be able to deduct interest payable on loans from connected persons which are used to acquire assets from connected companies.

5.1 Leased assets

Where a loan from a connected person to an investing company is used by the investing company to acquire an asset—

- that is to be leased out by the investing company for an accounting period in the course of a trade of leasing, and
- which prior to its acquisition was not in use for the purposes of a trade carried on by a company within the charge to corporation tax,

subsection (6) provides that subsection (2) will not restrict deductibility on the interest payable in computing the leasing company's profits, up to the amount of profits or gains of the leasing trade attributable to the acquired asset.

In order to determine the profits or gains of a trade attributable to the acquired asset, the expenses and receipts of that trade require any necessary apportionment.

5.2 On-lending activities

5.2.1 Sole business of lending

Subsection (7)(a) provides that the interest restriction in section 840A does not apply to interest payable by an investing company to a company where the sole business

of the connected company is the on-lending of monies from third-party sources to the investing company.

For example, if the activities of Subsidiary B in [Figure 1](#) were wholly related to acquiring external financing to on-lend to Subsidiary C to acquire assets from Subsidiary A, a deduction for interest payable by Subsidiary C to Subsidiary B would not be restricted by section 840A.

5.2.2 Qualifying financing companies

Subsection(7)(b) provides that the section does not apply to interest payable by an investing company to a 'qualifying financing company' within the meaning of the section 76E⁴.

5.3 Securitisation activities

Subsection (8) provides that the section does not apply to interest payable by a qualifying company, within the meaning of section 110⁵.

6 Schemes or arrangements for the making of loans

Subsection (9) provides that a loan made as part of, or in connection with, a scheme or arrangement whereby:

- a connected person loans or provides funds to an unconnected person, (whether directly or indirectly), and
- that unconnected person then makes a loan to the investing company,

is treated as having been made by a connected person to the investing company.

⁴ Guidance on 'Interest Relief for Qualifying Finance Companies (QFCs)' is contained in [TDM 04-05-07](#).

⁵ Guidance on 'qualifying company' within the meaning of section 110 is contained in [TDM 04-09-01](#).