

# LOANS TO EMPLOYEES: CONSUMER CREDIT ACT IMPLICATIONS

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## EMPLOYMENT

Many companies offer loans to their employees. Loans (on better terms than from a bank) may be used as a stand alone incentive or to enable employees to pay for shares under an employee share scheme. When making such loans some care is required to avoid falling foul of the provisions of the UK's Consumer Credit Act (the Act).

### OFFENCE AND PENALTIES

Carrying on a consumer credit business without a licence is a criminal offence. Penalties include fines of up to £5,000 and, potentially, two years in prison. In addition, an unlicensed creditor requires the consent of the court to enforce a consumer credit agreement which was made in the course of a consumer credit business. Unfortunately for employer companies, the definition of consumer credit business is wider than one might expect. These provisions of the Act may apply even where the company's business does not normally involve the provision of credit facilities and the only loans it makes are those provided to employees as a benefit. However, no offence is committed provided that loans are made only occasionally.

### EXEMPTIONS

Even if one is not carrying on consumer credit business because the provision of loans is a one-off or infrequent event, various other provisions of the Act may still apply. These regulate, for example, the form and substance of the agreement and may provide for cancellation rights and limitations on security and enforcement.

Fortunately, there are a number of exemptions which may be available and which have the result of taking agreements outside the ambit of the Act.

### Agreements with high-net-worth debtors

There is an exemption for loans to high-net-worth individuals. For these purposes, a high-net-worth individual is someone with an after tax income of not less than £150,000 in the previous financial year or net assets (excluding primary residence, life or endowment policies and pension arrangements) with a total value of not less than £500,000. This exemption is only available if the amount being advanced is in excess of £60,260. The exemption requires a statement of high-net-worth in relation to the previous financial year (meaning the period of one year ending on 31 March) to be signed by a qualified accountant. The format of the statement must comply exactly with the form in the regulations – for example, a letter from an accountant stating that an individual's net assets are over £500,000 is not sufficient. The loan agreement must also include a declaration by the employee in exactly the form prescribed by the regulations.

### Low interest rate agreements

There will usually be an exemption where a loan is offered interest free (or with interest at a rate which is no more than 1 per cent above the base rate of certain major banks) to employees by their employer as an incident of their employment. In order to be eligible for this exemption, the loan cannot have restrictions placed on the use to which the funds provided under it can be put. In short, if the loan must be used for a specific purpose this exemption is unlikely to apply.

At present, any loans provided under this exemption will be beneficial loans for tax purposes, meaning that income tax and national insurance will be payable, charged annually on the difference between the interest which would have been accrued at the HMRC official rate, currently 4 per cent, and any interest actually incurred. The employer will need to ensure this is accounted for correctly on the P11D.

### Interest free loans with limited numbers of repayments

Certain types of agreement will fall within an exemption where: (i) the total number of repayments to be made by the debtor does not exceed four; (ii) the repayments to be made by the debtor must be made within 12 months of the date of the loan; and (iii) the credit is provided without interest or any other charge.

### Business agreements over £25,000

An exemption is available for credit agreements over £25,000 entered into by the debtor "wholly or predominantly for the purposes of a business carried on or intended to be carried on by him". In order to create a presumption that the agreement qualifies for this exemption, the loan agreement must include a declaration by the debtor in the form prescribed by the legislation. However, the presumption in favour of the exemption can be rebutted if the creditor, or anyone acting on his behalf, knows that the debtor is not acting in the course of a business. The requirement for the loan to be provided for the purposes of a business carried on by the debtor means this exemption will not generally apply in the case of loans to employees.

#### WHAT IF NONE OF THE EXEMPTIONS APPLY?

The more material issues are as follows.

- ◆ Carrying on consumer credit business without a licence is an offence. The provision of loans to employees is considered to be consumer credit business. However, where a person only provides consumer credit “occasionally”, they are not considered to be carrying on consumer credit business and therefore do not need a licence. The meaning of the word “occasionally” is, unhelpfully, not defined. The provision of a one-off loan is unlikely to be an offence and loans made to a few senior executives are unlikely to cause problems. However, the position is less clear where such loans are made once to a whole workforce or on a regular (e.g. annual) basis. Where loans are provided more than occasionally (and no exemptions apply), the employer will have to apply to the OFT for a consumer credit licence.
- ◆ The loan agreement will have to comply with various requirements as to form and content, failing which it will only be enforceable with the consent of the court. It is possible that consent would not be given.
- ◆ Before the agreement is entered into, the debtor will have to be given certain specified consumer credit information and a 14 day withdrawal period.
- ◆ The debtor must be given an annual statement of account in a prescribed form.

#### CONTACT DETAILS

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