

## Part 06-02-03 - Matters to be treated as distributions

### Interest on Certain Loans

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*Section 130* of the TCA 1997 sets out the meaning of the term “distribution” for the purposes of the Corporation Tax Acts. Broadly, a **distribution** is any dividend or other distribution out of the assets of a company in respect of shares in the company. The scope of the definition is widened to include a variety of other payments which are treated as distributions. A distribution is not deductible in calculating a company’s income. It is regarded as a distribution out of the company’s income rather than an expense in earning that income.

One of the categories of payment which is treated as a distribution is **interest paid** by a company on a loan if the level of interest on the loan depends on the results of the company’s business. This is designed to prevent what are in reality equity investments being disguised by companies as loans in order to obtain an interest deduction.

A type of loan - referred to as a **ratchet loan** - which has been developed for commercial reasons has a link between the level of interest on the loan and the borrowing company’s profitability. However, the link is that a lower interest rate applies when the borrower’s results improve (because the lender’s risk thereby reduces) and a higher interest rate applies when the borrower’s results disimprove. Nevertheless, as the level of interest on the loan is linked to the borrowing company’s profitability, the interest is technically “caught” by *section 130* and treated as a distribution.

As these loans are commercial in nature and are not a mechanism to disguise an equity investment as a loan, the interest on them should not be recharacterised as a distribution.