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7 October 2026

HMRC
Small Business and Trading Income Policy and Property Income teams
Business Profits, Business Assets and International

Via email:

Dear

Withdrawal of capital from a business: Change to HMRC's manual BIM45700

We are writing to request that HMRC clarify uncertainties arising from changes to HMRC's Business Income Manual at BIM45700.

On 1 July 2026, HMRC changed their guidance at [BIM45700](#) relating to deduction of interest costs and the withdrawal of capital from a business. A tracked version of the changes made is attached as an appendix.

The 'change note' for 1 July 2026 for this page refers only to 'Amendments to provide clearer context for the examples and remove unnecessary numerical calculations' without further clarification or rationale for the changes.

The paragraph headed 'S34 Income Tax (Trading and Other Income) Act 2005' has changed as shown below:

[Previous guidance](#) ('pre-July guidance')

S34 Income Tax (Trading and Other Income) Act 2005

A proprietor of a business may withdraw the profits of the business and the capital they have introduced to the business, even though substitute funding then has to be provided by interest bearing loans. The interest payable on the loans is an allowable deduction. This is on the basis that the purpose of the additional borrowing is to provide working capital for the business. There will, though, be an interest restriction if the proprietor's capital account becomes overdrawn, see [BIM45705](#) onwards. (Our underlining)

[Current guidance](#) ('post July guidance')

S34 Income Tax (Trading and Other Income) Act 2005

A proprietor of a business may withdraw the profits of the business and the capital they have introduced to the business, even though subsequent funding may then have to be provided by interest bearing loans. However, simply exchanging existing capital for loan finance does not on its own satisfy the wholly and exclusively test provided by S34. The interest payable on the loans is an allowable deduction where the borrowing is used for business expenditure or acquisition of assets used in the business. (Our underlining)

The pre-July guidance also contained more numerical examples and focused on whether withdrawals exceeded profits and capital, using the capital account and balance-sheet analysis to quantify any interest restriction. The post July guidance concentrates only on the purpose and actual use of the borrowing.

This is illustrated by comparing the pre and post July versions of example 2 at BIM45700:

Pre-July version of BIM45700 - Example 2

Maddie owns a flat in central London, which was bought ten years ago for £125,000. There is a mortgage of £80,000 on the property. Maddie has been offered a job in Holland and is moving there to live and work, but intends to come back to the UK at some time. Maddie decides to keep the flat and rent it out while away. The London flat now has a market value of £375,000.

The opening balance sheet of his rental business shows:

Mortgage	£80,000	Property at market value	£375,000
Capital account	£295,000		

Maddie renegotiates his mortgage on the flat to convert it to a buy to let mortgage and borrows a further £125,000. They withdraws (sic) the £125,000, which is then used to buy a flat in Rotterdam.

The balance sheet at the end of Year 1 shows:

Mortgage		£205,000	Property at market value	£375,000
Capital account	B/F	£295,000		
	Less Drawings	£125,000		
	C/F	£170,000		

Although Maddie has withdrawn capital from the business, the interest on the mortgage loan is allowable in full because it is funding the transfer of the property to the business at its open market value at the time the business started. The capital account is not overdrawn. (Our underlining)

Post July guidance - Example 2

Mrs H owns a house in London that she rents out to students as part of her UK property business. She leaves her current employment to take up a new job in Paris. Mrs H increases her mortgage on the property she rents out and uses the additional funds raised to purchase her new private residence in Paris. As the funds are used to buy a new

private asset the interest on the new remortgage is not an allowable deduction in the property business. (Our underlining).

Uncertainties

The changes to the manual page give rise to uncertainties for property and trading businesses including partnerships in respect of HMRC's new approach and, to the extent there is a change in practice, what this means for the treatment of returns completed in reliance¹ on the pre-July guidance.

Pre-July example 2 shows that interest on a loan raised to allow the business owner to withdraw capital could qualify for relief, provided the owner's capital does not become overdrawn as a result. HMRC therefore appeared to accept that this scenario meets the wholly and exclusively test in ITTOIA 2005 section 34. There is no balance sheet detailing the movement on the capital account in the post-July 2026 example 2. It is therefore not known whether the funds raised exceed capital invested in the business.

Questions

1. The change note is brief and uninformative. It does not indicate what calculations are unnecessary or why. Please could HMRC clarify whether the capital account is overdrawn or not is relevant to HMRC's current interpretation of the wholly and exclusively test to finance costs arising from mortgaging and re-mortgaging.
2. Please would HMRC confirm their current view of the treatment of loan interest for a taxpayer in the same scenario as Maddie (the pre-July example 2) in which the interest is treated as deductible.
3. If taxpayers have relied on example 2 in the pre-July guidance to treat interest as deductible, would HMRC's current view that loan interest is restricted or non-deductible apply only to interest arising on or after 1 July 2026, or also to mortgages and re-mortgaging entered into before that date?
4. What steps are being taken to alert taxpayers and their advisers to the change to the guidance beyond the change note and to indicate any action HMRC may expect to be taken in respect of returns made in reliance on the previous position?

At the recent Self-Employed Stakeholder Forum on 23 September HMRC indicated that some form of notification will be included in the October Agent Update. That will be helpful. However, any change to HMRC's longstanding interpretation will need much wider publicity and clarification on the points raised above at questions 1-3.

5. Please would HMRC ensure that the examples at BIM45700 are consistent with general guidance on GOV.UK: [Work out your rental income when you let property](#) to avoid confusion. Expanding the general guidance on GOV.UK to clarify the position should also reach a wider audience than the manual changes.

¹HMRC's guidance: [How HMRC advice and information can help you](#) includes the following paragraph:

If advice and information changes

HMRC have a duty to collect the correct amount of tax as required by the law as it applies at the time.

Advice is also based on the understanding of the law at the time it is given. If this is changed by the courts, we must collect the correct amount of tax as required by the new understanding of the law.

This may mean that HMRC can no longer be bound by advice, information or guidance it has previously given. We may decide not to apply the new understanding retrospectively and may only apply it moving forward instead.

We would be grateful if HMRC would address these questions and clarify their position - ideally in publicly available guidance - to explain the technical rationale for HMRC's change of guidance. If helpful, the CIOT would publish any clarification or response, with HMRC's agreement.

We propose publishing this letter on our website with addressee names redacted.

Yours sincerely

Caroline Fleet

Vice-chair, Property Taxes Committee

The Chartered Institute of Taxation

The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.