

BIM45700 - tracked changes comparison

February 2026 version compared with post-July 2026 version

Comparison basis: February 2026 text is the original. Deletions and insertions are recorded as true Word tracked changes. Formatting, webpage navigation and print artefacts have been omitted so the comparison focuses on substantive guidance.

BIM45700 - Specific deductions - interest: Withdrawal of capital from a business

This chapter applies for Income Tax purposes to the computation of trade profits and property income. References in the text to a 'business' should therefore be taken to include both trades and property businesses. The chapter does not apply for Corporation Tax purposes, where there are separate rules in the loan relationships legislation (see CFM30000).

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.~~

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.

Example 1

~~Daphne talks to their bank manager about how well the trade is doing and the manager agrees to increase the business overdraft facility by £10,000. Daphne increases the level cash drawings from the trade by £1,000 a month, so is withdrawing part of the capital as well as the profits being earned by the business. The capital account does not become overdrawn. The interest payable on the increased overdraft is an allowable deduction.~~

Mr P wants to substantially increase the stock levels in his business. He approaches the bank and provides details of his growing business. The bank agree to increase the business overdraft facility by £10,000. Mr P then uses most of the facility to purchase more stock, but also uses some of the available overdraft facility to help purchase a new private car. The identifiable proportion of the interest relating to the amount used to purchase new stock is an allowable deduction but the interest relating to the proportion used to purchase the new car is not an allowable deduction.

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 the rental business shows: Mortgage £80,000; Property at market value £375,000; Capital account £295,000. Maddie renegotiates the mortgage on the flat to convert it to a buy to let mortgage and borrows a further £125,000. They withdraws 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; 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.

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.

Example 3

Blake has taken over the family business, which is a small firm manufacturing plastic dinosaur toys. It does reasonably well, making a profit of £45,000 a year. The factory unit was built 20 years ago at a cost of £150,000 and stands near the centre of town. Blake has it revalued and negotiates with the bank to increase the business loan facility, secured on the factory. Part of the drawings of £150,000 are used to buy a holiday home in Spain. Balance sheet figures included: Bank loan £200,000; Revaluation reserve £150,000; Trade creditors £20,000; Capital account B/F £55,000; Profit for year £45,000; Drawings £150,000; C/F £(50,000). Although the bank loan is secured on the factory and is shown as a trading liability in the accounts, part of the money has been used to fund drawings in excess of the capital and the profits. The fact that part of the drawings were used to buy a property in Spain does not determine the tax treatment. An interest restriction is due because the drawings were in excess of the profits of the trade available for drawing and the capital Blake had in the business. A tax computation adjustment is required to add back interest on £40,000. This figure is arrived at as follows. The effect of depreciation on plant and machinery needs to be taken into account, as does the funding provided by trade creditors. So the assets which have been funded by the bank loan are the factory cost £150,000, plant and machinery cost £20,000, and trade debtors of £10,000, less the trade creditors of £20,000 = £160,000. As the total loan is £200,000 and only £160,000 has been used for the purposes of the trade then interest on £40,000 of the loan is not allowable as a trading deduction. Looking at it another way Blake's capital account is overdrawn by £50,000. But the accumulated profits have been reduced by depreciation of £10,000, which is a non-cash item. The drawings exceeded the accumulated profits of the trade (before taking into account depreciation) by £40,000, which must have been funded by the increase in the bank loan. In this example the revaluation of the premises is shown as a separate revaluation reserve on the balance sheet. But it could have been treated within the capital account, to increase the proprietor's capital account balance. This would not affect the restriction of the loan interest. The capital account would be in credit by £100,000, but this would have to be adjusted by reference to depreciation and revaluation. There is more guidance on overdrawn capital accounts at BIM45705 onwards.

Mr X has taken over the family business which is a small firm manufacturing plastic dinosaur toys. It does reasonably well making a profit of £45,000 a year. The factory unit was built 20 years ago at a cost of £150,000 and is owned outright by Mr X. Mr X has the property revalued and is able to secure loan funding of £150,000 against the property. On obtaining the loan finance Mr X uses £75,000 to expand the product lines of the business and £75,000 is immediately withdrawn to fund a holiday home in Spain. Although the bank loan is secured on the factory and is shown as a trading liability in the accounts, part of the money has

been used for a non-business purpose and therefore it is reasonable to seek further information to understand if an interest restriction is required. In assessing what, if any, amount of the loan and the interest thereon has a non-business purpose consideration would need to be given to the purpose(s) of Mr X at the time he obtained the funding, as well as amounts that may have been capable of withdrawal from the business absent the loan funding. Further advice is provided at BIM45705.