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DIRECTORS' LOAN ACCOUNTS EXPLAINED

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- Tax Efficient Ways To Extract Cash From Your Company;
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- Tax-efficient Business Exit Strategies; and
- Cash Basis For Landlords.

About this Guide

This guide explains some of the planning opportunities and pitfalls associated with the use of directors' loan accounts.

1 Nature of a director's loan account

Key points

- A director's loan account is a mechanism of keeping track of the transactions between the director and his or her personal or family company.
- Borrowing money from the company can be a cheap source of finance.
- Tax consequences may arise if the account is overdrawn.
- Interest can be paid if the account is in credit.

Transactions between a director and his or her personal or family company are common and a director's loan account is simply an account for recording the transactions that occur between the two.

Typical transactions that may be found on a director's loan account include:

- a loan by the director to the company;
- a loan from the company to the director;
- salary payments credited to the account;
- dividend payments credited to the account;
- bonus payments credited to the account;
- personal bills paid by the company on the director's behalf;
- company bills paid by the director on the company's behalf; and
- shares issued on incorporation but not paid for.

At the end of the year, the account will be in credit if the money owed by the company to the director exceeds that which the director owes to the company. However, if the net result is that the director owes money to the company, the account will be overdrawn.

Tax implications may arise if the company is a close company and the account is overdrawn at the end of the accounting period. These are explained further in section 5.

A benefits-in-kind charge may also arise if the outstanding balance exceeds more than £10,000 at any point in the tax year. This is explored in section 7.

Where a director has lent money to the company and interest is paid on that loan, the company may need to deduct tax at the basic rate from the interest paid and pay it over to HMRC. This is discussed further in section 10.

Practical tip

A director's loan account is a useful way of keeping track of the transactions between the director and the company. It is important to ensure that all transactions are recorded.

Beware – Tax implications may arise if the account is overdrawn.

2 Overdrawn director's loan account

Key points

- If the director's loan account is overdrawn, this is in effect a loan to the director by the company.
- If the company is a close company and a participator (either the director or another participator) has a loan from the company, there may be tax implications to consider.
- If the loan account is overdrawn at the year-end, the company *needs* to tell HMRC about it.
- If the loan is still outstanding (fully or partially) nine months and one day after the year-end, a tax charge ('section 455 tax') arises on the company on the overdrawn balance.
- A benefits-in-kind charge may also arise if the loan balance exceeds £10,000 at any point in the tax year.
- Anti-avoidance provisions apply.

A director's loan account is overdrawn if the money owed to the company by the director is more than the money that the company owes the director.

Example 1: Overdrawn director's loan account

David is a director of his family company. In the year to 31 March 2021, the following transactions are showing on the director's loan account in the company's books

	DR		CR
1/12/20: Loan to David	10,000	31/12/20: Dividend	5,000
25/2/21: Personal expenses paid by company on David's behalf	500		
		Balance c/f	5,500
	10,500		10,500

At the year-end, the account is overdrawn. David owes the company £5,500. This constitutes a director's loan. It will appear as a debtor in the company's balance sheet.

Where the director's account is overdrawn at the end of the accounting period, this is equivalent to a loan to the director by the company and, depending on whether or not the overdrawn amount is cleared before the corporation tax due date (nine months and one day after the year-end), it may trigger a section 455 tax charge on the company. A benefits-in-kind tax charge may also arise if the loan balance is more than £10,000 at any point in the tax year (see section 7).

If the director is a participator and the loan that has not been paid back in full within nine months and one day of the accounting period, and the company is a close company, the company must pay a tax charge (a section 455 charge) on the outstanding amount of the loan at that date (see section 5).

A section 455 charge will also arise on any outstanding balance of a loan to person who is not a director but is a participator in a close company which has not been fully repaid nine months and one day after the end of the accounting period in which it was made.

For the meaning of 'participator' and 'close company', see section 3 and for the meaning of 'loan', see section 4.

2.1 Overdrawn account repaid by corporation tax due date

If the director is a participator and the director's account is overdrawn at the end of the year but the overdrawn balance is repaid by the normal due date for payment of corporation tax, i.e. nine months and one day after the end of the accounting period, there is no section 455 tax to pay (but be aware of the anti-avoidance provisions that may apply (for which see section 9)).

However, you will need to tell HMRC about the overdrawn loan account when you file your corporation tax return and you will need to disclose the amount by which the loan account was overdrawn at the end of the accounting period.

It should be noted that the rules apply to loans to 'participators' in close companies – the recipient of the loan does not need to be a director but must be a participator for the provisions to apply. Most directors of close companies are 'participators'; however, a loan to a director who is not a participator falls outside scope of the rules. For the meaning of 'participator' and 'close company', see section 3.

There may also be a benefit-in-kind tax charge to pay on the loan if the loan balance exceeds £10,000 at any point in the tax year. The benefit-in-kind charge is discussed in section 7.

Example 2: Overdrawn account repaid by corporation tax due date

Ruth is a director of and participator in her family company. The company is close. It prepares accounts to 31 December each year.

On 1 September 2020, Ruth borrows £8,000 from the company. She repays the loan on 16 April 2021.

The loan is still outstanding at the end of the accounting period in which it was made (i.e. on 31 December 2020). However, it is repaid before 1 October 2021 (the normal due date for payment of corporation tax, nine months and one day after the end of the accounting period).

As it has been repaid before the corporation tax due date, there is no section 455 tax to pay. However, when completing her company tax return, Ruth must tell HMRC (on form CT600A) about the loan and the balance at the year-end.

As the loan balance is less than £10,000 at all times, there is no benefit-in-kind tax charge to pay.