Brush up on your knowledge of director loan accounts

1. **What is a director loan account (DLA)?**
   DLA is an account on the company financial records that reports all transactions between the director and the company. Amounts due to the director from the company should be recorded in the company's books as a creditor while the amounts due from the director to the company should be recorded as a debtor.

2. **Is it only transactions with the directors that need to be recorded?**
   No, if the company is a close company any 'private' payments made by the company to director's family, friends, business partner or any person associated with the director may need to be recorded. Also, an overdrawn director loan account cannot be avoided by lending money to a person connected with the director. A close company is one that is controlled by five or fewer participators or by any numbers of participators if those participators are the directors of the company.

3. **Is it an overdrawn DLA illegal?**
   No, Companies Act 2006 has removed the general prohibition on a company making loans to directors. The rule has been replaced by the requirement to obtain prior shareholder approval. There are few exemptions when members' approval is not required. As a general rule for loans of more than £10,000 shareholder approval must be given beforehand. Often a director is also a controlling shareholder so the approval is more a formality rather than a legal issue.

4. **Can an overdrawn DLA be offset?**
   There might be situation where the company has two directors (i.e. husband and wife) and one director owes money to the company, while the other is owed money. In order to be able to offset these balances, the directors must formally agree in writing (and proper documentation should be kept) before any offsetting takes place.

5. **Does a benefit in kind arise on an overdrawn DLA?**
   If the loan is greater than £5,000 a benefit in kind will arise on the cash equivalent of the amount of interest that would be payable at the official rate. Benefit in kind will not arise if the loan does not exceed £5,000 or the director is paying interest on the loan at the rate recommended by HMRC. The cash equivalent is usually calculated using the average method unless the daily method provides a significant higher cash benefit. The average method works well when the balance in the DLA does not fluctuate during the year.

6. **Are there any other tax implications on an overdrawn DLA?**
   If the DLA remains overdrawn nine months after the company accounting period, section 455 Corporation Tax Act 2010 (s455 CTA 2010) provides for a tax charge at the rate of 25% on the lower of the amount outstanding at the year end and nine months after the year end. This amount is payable even if the company is making a loss and there is no corporation tax due. Tax payable under section 455 is a temporary tax and it is repayable to the company by HMRC nine months after the

end of the accounting period in which the loan was repaid. Once the loan is repaid the tax effect is nil; however, the time lag between the loan being repaid and tax being refunded can place a significant strain on the company's cash flow.

S 455 applies not only to a director's loan account but to a loan to a participator of a close company. HMRC defines a participator as a person who has a share or 'interest' in a company.

7. **Are there any exemptions to the charge under for s455 CTA 2010?**
   Section 455 does not apply to:
   - A loan made in the ordinary course of a business carried on by a company if the business includes the lending of money.
   - A debt incurred for the supply by a close company of goods and services in the ordinary course of its trade unless the credit given exceeds six months or is longer than normally given to the company's customers.
   - A loan made to a director or employee of a close company if the amount does not exceed £15,000, the borrower works full time for the company and the borrower does not have a material interest in the company. A person has a material interest in a company for this purpose if together with any associate he or she is able to control more than 5% of ordinary share capital.
8. **What are the accounting disclosure requirements?**
   Companies Act 2006 section 413 provides for disclosure of the details of any advance or credit granted by the company to its directors. The details required are the amount of the loan granted during the year, an indication of the interest rate, its main condition and any amount repaid or written off. In the notes to the accounts must also be stated the total amount of the loan and the total amount of interest charged. Disclosure for transaction with the directors is also required under FRS 8 Related party disclosure.
9. **Can a DLA be written off?**
   The company can write off a loan given to the director. The loan must be formally waived as the liability will technically remain if the company just agrees not to collect the outstanding balance.

   The amount written off is treated under Income Tax (Trading and other Income) Act 2005 as a deemed dividend. Because it is a deemed dividend there is no requirement for the company to have available profits for distribution and the dividend does not need to be paid to all shareholders of a particular class of shares. However, an important feature of a loan being written off is that in most cases HMRC will argue that writing off a loan comes under the definition of 'emoluments from an office or employment' and as a result will seek to collect Class 1 NIC from the company.

   The amount of loan written off will have to be included in the director's self-assessment tax return on a specific box on the 'additional information' pages. For income tax purposes the amount is treated as dividend with the usual tax credit.

   The company will not receive corporation tax relief on the amount of the loan written off.

10. **What are the consequences on the overdrawn DLA if the company goes into liquidation?**
    The liquidator can demand that director repays the amount owed to the company in order to pay the company's creditors. The liquidator can take legal action against the director or even make him bankrupt.

In conclusion, when the director borrows money from the company, good record keeping is essential to ensure the right taxes are paid. The director should be aware that if too much money is borrowed and the company is unable to pay its creditors, the company might be forced into liquidation and the liquidator can take legal action against him to recover the debt.

To find out how Handley Evans & Co can help you make use of dividends as a tax efficient way of rewarding yourself from your company contact us

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