DIRECTORS' LOAN ACCOUNTS EXPLAINED

2020/21

Sarah Bradford

taxinsider
BUSINESS

Contents

About Sarah Bradford......5
About This Guide......5
1. Nature Of A Director's Loan Account......6
2. Overdrawn Director's Loan Account......7
2.1 Overdrawn Account Repaid Within Nine Months And One Day Of End Of AP......8
2.2 Overdrawn Account Still Outstanding Nine Months And One Day After End Of AP......8
2.3 Overdrawn During The Year......9
3. What Is A Close Company......9
3.1 Who Is A Participator?......9
3.2 Why Does It Matter?......10
4. Meaning Of 'Loan'......10
4.1 What Is Not A Loan?......11
4.1.1 Unpaid Share Capital......11
4.1.2 Supply Of Goods And Services......11
4.1.3 Small Loans......11
4.1.4 Loans In The Ordinary Course Of Business......12
4.1.5 Amounts On Which Income Tax Is Paid......13
4.1.6 Loans To A Charitable Trust......13
4.2 Indirect Loans......13
5. The Section 455 Charge......14
5.1 Nature Of The Section 455 Tax Charge......14
5.2 Amount Of The Section 455 Tax......14
5.3 Payment Of The Tax......15
5.4 A Temporary Tax......16
5.5 Timing The Loan Repayment......17
5.6 Choosing Which Loans to Clear First......17
5.7 Claiming A Section 455 Tax Repayment......18
5.8 Giving Effect To A Section 455 Tax Repayment......19
6. Clearing An Overdrawn Director's Loan Account......20
6.1 Introducing Funds......21
6.2 Declaring A Dividend......22
6.3 Paying A Salary......24
6.4 Paying A Bonus......25
6.5 Writing Off The Loan......26
7. Benefits-In-Kind Charge......27
7.1 No Charge On Loans Less Than £10,000......27
7.2 Other Exemptions......28
7.3 Tax Charge On Cheap Loans......28
7.4 Class 1A Charge......31
7.5 Reporting The Benefit......31
8. Tax Planning Opportunities......31
8.1 Enjoy An Interest-Free Loan Tax-Free For Up To 21 Months......31
8.2 A Cheap Source Of Finance......32
8.3 Clear The Loan To Avoid A Section 455 Charge......33
8.4 Choose The Lowest Tax Rate......33
8.5 Consider Cash Flow......36
8.6 Choose Which Loan Is Repaid......36

9. Anti-Avoidance......37
9.1 The Bed And Breakfast Trap......38
9.2 The 30-Day Rule......38
9.3 The Intentions And Arrangements Rule......39
9.4 Arrangements Conferring A Benefit On A Participator......40
10. Account In Credit......41
11. Toolkit......41

'Directors' Loan Accounts Explained' – First published April 2016, second edition November 2017, third edition December 2018 and fourth edition April 2020.

Copyright

The right of Sarah Bradford and Tax Insider Ltd to be identified as the authors of this guide.

© 2020 Tax Insider Ltd

Disclaimer: This 'Tax Insider' guide is produced for general guidance only, and professional advice should be sought before any decision is made. Individual circumstances can vary and therefore no responsibility can be accepted by the contributors or the publisher, Tax Insider Ltd, for any action taken, or any decision made to refrain from action, by any readers of this guide. All rights reserved. No part of this guide may be reproduced or transmitted in any form or by any means. To the fullest extent permitted by law, the contributors and Tax Insider Ltd do not accept liability for any direct, indirect, special, consequential or other losses or damages of whatsoever kind arising from using this guide.

About Sarah Bradford

Sarah Bradford BA (Hons) FCA CTA (Fellow) is a director of Writetax Ltd, a company providing technical writing services on tax and National Insurance, and also of its sister company, Writetax Consultancy Services Ltd.

She is also a senior writer for Tax Insider, Business Tax Insider and Property Tax Insider, and the author of the following guides:

- The cash basis for landlords;
- IR35 – Tax Tips for Contractors;
- Year-end tax planning for businesses
- Tax-efficient ways to extract cash from your company; and
- Business exit strategies.

All of these guides are available for purchase from www.taxinsider.co.uk.

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 2020, the following transactions are showing on the director's loan account in the company's books

	DR		CR
1/12/19: Loan to David	10,000	31/12/19: Dividend	5,000
25/2/20: 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 company is a close company (see Section 3), in the event that a director who is a participator (or another participator) has a loan that has not been paid back within nine months and one day of the accounting period, the company must pay a tax charge (a section 455 charge) on the outstanding value of the loan at that date (see Section 5). The meaning of 'participator' and 'close company' is discussed in Section 3 and the meaning of 'loan' is discussed in Section 4.

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).