A guide to Loan Account

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Introduction to Directors Loan Account

What is a Director's Loan?

If you are the director or participator of a Limited Company and you withdraw money from the company without registering it as a dividend or salary, you have technically received the money as a director's loan. This money is not yours and belongs to the company.

This guide sets out in detail how directors' loans work and explains the Corporation and Income tax implications for you and your company. It also explains how you should record the details of any directors' loans you have taken and what you need to do to inform HM Revenue and Customs of your Limited Company's Director's Loan Account.

How Director's Loan Accounts Work

The record of flows of money lent between a company director and the company itself is known as the Director's Loan Account. Money passed from the director to the company is classed as a credit on the account, while money passed from the company to the director which is not salary, dividends or expense reimbursement is classed as a debit.

The overall balance of transfers between the company and the director (ie the net position once all transfers in each direction have been accounted for) is the overall Director's Loan position. If the company bank account has received more money from the director than the director has received from the company (excluding salary and dividends) then the Director's Loan Account is in credit overall. If the company bank account has received less money from the director than the director has received from the company, the Director's Loan Account is in debit – or overdrawn.

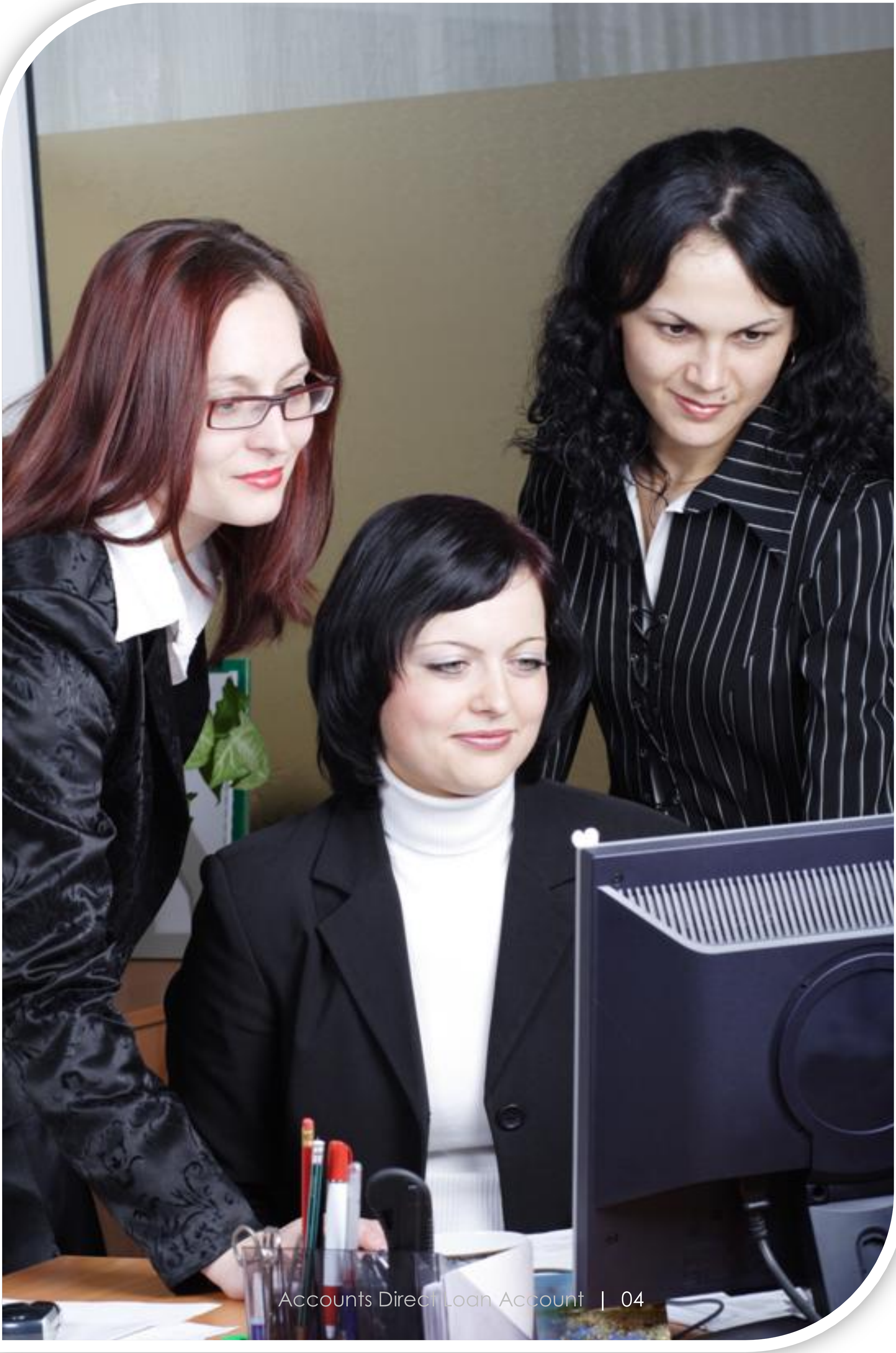
If the account has a net balance of zero, there are no implications for your Tax Return, but debit balance (overdrawn director's loan account) may have tax implications. Note that because it is simply an assessment of the balance of flows between the director and the company, the

Director's Loan Account exists whether or not you have specifically set one up in the company's books.

HM Revenue and Customs may ask to review your company's Director's Loan Account to check that you are paying the correct Corporation Tax. This means you must keep a careful and timely record of all transfers between your company and its director(s). If your company has more than one director who takes, or makes, director's loans, you must keep a separate record of each director's transfers so that a Director's Loan Account is available for each director of the company.

Types of transfer that can be classed as a director's loan

- Any cash transfer from the company's bank account to a director's bank account which is not registered as a salary, dividend or expense reimbursement.
- Money borrowed from the company for any personal use
- Items a director has claimed as expenses which are in fact for personal use



How Directors Loan Affect Corporation Tax

Only directors' loans which are not repaid to the company at the end of the company's Corporation Tax accounting period need to be disclosed on the Company tax return to HM Revenue and Customs.

Any debit balance on the Director's Loan Account that is outstanding when the accounting period finishes may increase your company's Corporation Tax liability, depending on when the loan is eventually repaid.

The following three scenarios illustrate the implications.

Scenario 1:

You repay all director's loan to the company before the accounting period ends

If you clear any overdrawn balance in your Director's Loan Account before your company's Corporation Tax accounting period finishes, you pay no Corporation Tax on the loan and you do not need to inform HM Revenue and Customs of the loan.

> For example, your company's accounting period runs from 1 April 2008 to 31 March 2009, and you pay off your director's loan account on 30 March 2009. You don't need to include any information about this loan on your Company Tax Return.

Scenario 2:

You repay the loans within nine months and one day of the accounting period end date

If your company's Director's Loan Account is overdrawn when your company's Corporation Tax accounting period ends but you repay the loans within nine months and one day of the period end date, you pay no Corporation Tax on the loan, but you must declare the loan to HM Revenue and Customs on your company tax return.

For example, your accounting period runs from 1 April 2008 to 31 March 2009. You pay off your director's loan account on 30 September 2009. You need to include information about this loan on your Company Tax Return but you will not need to pay any tax on the loan.

Scenario 3:

You don't repay a director's loan within nine months and one day of the accounting period end date

If you do not repay a director's loan within nine months and one day of the accounting period end date, you must declare the loan to HM Revenue and Customs on your company tax return, and your company must pay Corporation Tax on the loan, at a rate of 25%.

For example, your company's accounting period runs from 1 April 2008 to 31 March 2009. Your director's loan account is overdrawn by £10,000 on 1 January 2010. You need to include information about this loan on your Company Tax Return. You should add £2,500 (£10,000 x 25 per cent) to how much Corporation Tax you must pay.

HM Revenue and Customs will also charge interest on the unpaid amount – dated from nine months and one day from the end of the accounting period to the date on which the tax is paid or the director's loan is repaid, whichever is earlier. The interest is non-refundable.

You cannot appeal against the company's additional tax liability due to a director's loan because the loan will be included on your company's self tax return. It is also not possible to postpone collection of the tax.

Reclaiming Corporation Tax after Your Director's Loan Has Been Repaid

The corporation tax pain on the overdrawn director's loan can be claimed back depending when the director's loan has been paid off?

A company can reclaim any corporation tax pain on director's loan within 9 months after the end of accounting period in which the director's loan was repaid. The claim must be made within four years after the end of accounting period in which the director's loan was paid off.

Example

- ***Your company's accounting period ended on 31 March 2008.***
- ***Your company paid Corporation Tax of £2,500 on a £10,000 loan that was still outstanding on 1 January 2009.***
- ***You repay this loan in full to your company on 1 March 2011 (financial year ending 31 March 2011).***

You can reclaim this Corporation Tax any time after 31 December 2011. Your claim must be made by 31 March 2015.

Benefit In Kind

If the balance of your Director's Loan account is more than £5,000 overdrawn (i.e., you owe the company more than this amount), HM Revenue and Customs will consider that you are enjoying a benefit in kind from the company and you will pay a charge on this. No benefit in kind charge would apply if you paid interest on the loan at the official HMRC rate (currently 4%). As well as increasing the amount you need to repay, paying interest on the loan could increase your company's taxable profits.

Going back to the example above, the company has overdrawn director's loan account balance of £10,000. The company can either charge interest of 4% or above on 10.000 and add it to the companies profile and increase the director's overdrawn account by the interest amount or treat as benefit in kind for the director. In case of benefit in kind the interest (10,000*.04=400) will be disclosed on director's P11D and will be subject to income tax of 20% if the director already has other income to cover the personal allowance which is £7474.

It is advised to pay interest on the overdrawn director's loan as the treatment of benefit in kind can be administratively complex.

Overdrawn Directors Loan Account

HM Revenue and Customs will carefully inspect the Director's Loan Account and determine whether the payments constitute a loan or a salary. If you regularly take cash from the business without declaring them as dividends, or if you take them as dividends without the company having made enough profits to declare a dividend, HM Revenue and Customs may decide that the money is in fact a salary. In this case, HMRC may force you to pay Income Tax and National Insurance contributions on the money.

For this reason, Accounts Direct advises that you do not allow the Director's Loan Account to remain overdrawn beyond the company's tax accounting period.