Tell me more about Directors' Loan Accounts

Directors Loan Accounts

In the ordinary course of events, it is a normal occurrence for owner-managers (OM) of small and medium size businesses to be owed monies by their own companies.

These monies are, in accountancy terms, known as directors' loan or current accounts (DLA) and can arise in a variety of ways.

IMPORTANT - The information below is for general guidance only so we recommend you speak to us before you sign any leasing contracts so that we can tailor our advice to your particular circumstances.

Very often, owner managers may need to inject monies into their companies as seed corn capital or, as dictated by cash-flow requirements.

It is not always appropriate or desirable to issue further shares in smaller companies and the intention may be to repay these monies when funds permit and, as a general principle, it is not the best idea for business owners to be creditors of their own businesses.

Alternatively, monies can be credited to directors' loan accounts for a variety of reasons such as undrawn dividends, undrawn remuneration or non-reimbursed expenses and allowances.

Tax planning opportunity (with care)

Directors' current accounts can sometimes create tax-planning opportunities however, it is perfectly possible to pay interest on these balances provided that the rate of interest is at a proper commercial rate. As these loans tend to be unsecured, an acceptable rate may be considerably greater than on a secured commercial loan.

In these circumstances, paying interest can form part of an OM's personal tax and annual remuneration planning depending of course, on other personal circumstances.

A basic rate taxpayer can earn £1,000 interest per annum tax free and a higher taxpayer £500. However, in certain circumstances, it is possible to receive up to £5,000 or even more interest tax free. This is separate from interest that may arise in specific tax-free products such as ISA's.

Interest paid by a company is tax deductible for the company as long as it is an acceptable commercial rate so a rare potential win-win situation.

Deduction at source

It should be noted that, when a company pays interest to an individual, there is a legal obligation to deduct basic rate tax at source at 20% and remit the tax to HMRC on a quarterly basis.

Mr A wishes to pay £2,000 interest on his director's loan account.

£400 must be remitted to HMRC by the company and then £1,600 can be paid to Mr A or credited to his loan account.