Bean Counters
Accounting for your Success

Directors Loan Accounts

If you have just started up a limited company, the Directors' Loan Account can be one of the trickiest concepts to get your head around. But I promise you it's not impossible. It is necessary in understanding how you relate to your company and more importantly, how you get your hands on your profits.

What isn't a Directors' Loan?

The Directors' Loan Account is not a real bank account. The company may have a business bank account and you may have a personal bank account, but these are both different from a Directors' Loan Account.

What is a Directors' Loan?

The Directors' Loan Account is a virtual account that exists only in your accounting records to record of the flow of money between you as an individual and the limited company. Unlike a sole trader, when you set up a limited company, the company is separate from you as an individual therefore money earned by the company belongs to the company and not to the individual. However, there are ways you can take money out of the business and the Directors' Loan Account keeps track of this.

Putting Money into Directors' Loan Account

There might be times when the company cash flow needs a helping hand from a Directors' personal funds, when the Director introduces personal funds to the business this is a loan to the business. If, for example, the Director was to introduce £5,000 of his or her personal money into the company bank account, then £5,000 would be recorded in the Directors' Loan Account as being owed back to the Director

Another way to introduce money to the company would be if the Director were to purchase items for the company with their personal funds, this is considered a loan to the company and the value of the items would be recorded in the Directors' Loan Account as money owed to back to the Director. A Director doesn't, however, need to be spending money to be making a loan to the business. If the Director is paid a salary through payroll they may opt not to take this if cash flow is tight, when this happens the Director has, in effect, lent their salary to the business and the value of the salary payments would be recorded in the Directors' Loan Account as money owed to back to that Director..

It is important to remember is that the Director can take back the money in his or her Directors' Loan Account at any time, provided the company has sufficient funds. When a Director lends money to the company, they are a creditor to the business and, like any other creditor, can take repayment of their loan. Please note that if the Director is repaying a loan made to the business then they will not have to pay tax on the money; Tax only become relevant when taking profit over and above what has been lent to the business, these are known as dividends.

Taking Money Out of a Limited Company

Money can be taken out of the company in one of a number of ways, via Directors Remuneration (salary), as a dividend on the profit, or to pay back a loan that has been made. Money can also be withdrawn that is not a loan repayment, wage or dividend, when this happens the Director is borrowing from the company this is also recorded in the Directors' Loan Account. This can take the form of personal spending from the business bank account, withdrawing cash for personal use or transferring money to a personal bank account.

Many Directors borrow from the business during the year and then settle at the year-end by paying themselves dividends to clear off what they have borrowed. This is totally fine, but there are a few things to bear in mind.

Things to watch out For

More than £10,000

If the Directors' Loan Account is overdrawn by more than £10,000 then it is classed as a benefit in kind because the Director concerned is in receipt of a loan without paying any interest. When this happens, it must be declared on the Director's personal tax return (SA100) and income tax is payable that is equal to HMRC's notional interest rate. In order to avoid this, you can pay interest to your company on your Directors' Loan Account that is equal to or over the HMRC rate.

Dividends get paid after tax

Many people get caught out by this and end up without enough profit left over after tax to fully clear the Directors' Loan Account with dividends. Unfortunately, if the Director does end up with an overdrawn Directors' Loan Account this will need to be declared on the Corporation Tax Return (CT600) and some additional tax may e due.

If, however, the overdrawn amount is repaid within 9 months and 1 day of the accounting year end then there is no tax to pay. The outstanding loan amount does still need to be declared on the CT600. There is a caveat to this however, HMRC have now got wise to Directors paying off the loan just before the 9 months and 1-day deadline only to take it straight back out again the next day (what is known as bed and breakfasting). If the amount repaid is then withdrawn within 30 days, it is considered that the loan has not been repaid.

If the loan isn't settled within 9 months and 1 day of the accounting year end this will need to be declared on the CT600 and the company will have to pay tax on the loan amount.