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Director-shareholder loan account issues

The coronavirus (COVID-19) pandemic has taken its toll on business, with far-reaching consequences for companies that once flourished. Now, as these companies focus on survival, they may find traditional remuneration methods are unavailable. As a result, the loan account may remain outstanding this year. Here, we consider how the position can best be dealt with, and look at the tax consequences of the options involved.

SAMPLE

Loans or advances from a company can take a variety of forms. Sometimes director-shareholders borrow a specific amount outright as a short-term loan. More often it's the informal transactions between a director-shareholder and the company, such as cash withdrawals to meet personal expenditure, or personal expenses directly paid by the company, that create borrowing. Where, overall, a director has borrowed more from the company than they have lent to it, the director's loan account is said to be 'overdrawn'. Such balances are usually cleared a few months after the year end when profits have been determined, by voting a dividend or paying a bonus.

Corporation tax charge

Where a loan is made by the company to a director who is also a shareholder in the company, there can be corporation tax implications for the company. The area is governed by what are called the 'loans to participators' rules. These mean that a corporation tax charge arises if a close company makes a loan to a participator, or an associate of a participator, if the loan is unpaid nine months after the end of the accounting period. Most family companies fall into the category of close companies.

Definitions

- *Close company: a company controlled by five or fewer participators, or by any number of participators who are directors*
- *Participator: someone who owns share capital or voting rights in the company. Can also extend more widely to someone who is able to direct that company income or assets be applied for their benefit*
- *Associate of participator: this includes a relative, such as spouse/civil partner, parent, child or sibling.*

Excluded from this charge are loans to a close company director or employee where these don't exceed £15,000, and where the borrower works full time for the company, but does not have a material interest (broadly 5% or more) in the company.

If the director-shareholder repays the loan balance within nine months of the end of the accounting period, there is no charge on the company. Where such a loan is not settled within this window, the company is required to make a payment equal to 32.5% of the loan to HMRC. This is often referred to as a s455 tax charge.

There are various strategies to clear the loan account and avoid the s455 charge crystallising, which would routinely be adopted when trading conditions are favourable. We outline these in this factsheet, and discuss alternatives possibly better suited to the current business climate.

Paying dividends

For many family companies, crediting a dividend to the loan account is the route of choice to deal with an overdrawn loan account. But dividends can only be paid out of profits available for the purpose, and this is a prime consideration this year.

Even if profits are available to pay a dividend, it may not always be prudent to do so in current circumstances. This could be the case if, for example, there are significant repayment obligations, such as COVID-19 business loans or repayments of outstanding VAT to HMRC.

If there are not sufficient retained profits out of which to pay a dividend, any dividend would be unlawful. Recipient shareholders can be liable to repay unlawful dividends to the company where they know or have reasonable grounds to believe that they are

unlawful. In addition, directors may be held personally liable for the amount paid. There are also tax consequences to the payment of unlawful dividends if they are not repaid to the company. HMRC is likely to treat the amount as a loan to the shareholder, and thus potentially within scope of a s455 charge.

Paying a bonus

The use of a bonus to clear an outstanding balance on a director's loan account is another traditional strategy. Where there are not the reserves to pay a dividend, this may be an option. A bonus stands to be taxed as employment income. From the company perspective, this is deductible for corporation tax purposes. It can thus be used to reduce taxable profits or generate a loss.

But there are corresponding costs, both for the company and the director. Employer Class 1 national insurance contributions (NICs) are one of them. The director too may face a cost in terms of income tax and NIC liability. The exact equation ... whether there is employment allowance a... employer contributions, and what sc... directors' remuneration before e... further point is that the loan ... that the net pay is enough ... therefore be an expensi... to the danger of a lo... there is any possibi... tax and NICs goin... personally liabl...

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An overdrawn l... funds. However, ... this option this yea... a director can take o... no tax charge arises on ... providing a further loan sh... facility. We would recommend ... here, as complex anti-avoidance ... such arrangements.

Leaving a loan outstandi...

A final option to consider is leaving the loan balance outstanding at the year end and paying the s455 charge. The tax is included within the corporation tax self assessment system, the company reporting loans outstanding to participators at the year end in the company tax return. The tax is due and payable when corporation tax for the period would normally be paid. The financial implications for the company of such a payment will need to be considered.

The charge is temporary, in that when the loan is paid or written off by the company, the s455 tax will be refunded. This, however, doesn't happen immediately. Relief for the repayment is not until nine months and one day after the end of the accounting period in which the loan is repaid.

This may be a necessary option for directors and the company to consider in current circumstances, and we would be pleased to advise further on the claims procedure and time limits involved.

Example

A company has a 31 December year end. A loan is made to a shareholder in the 2020 accounting period and is not repaid by 1 October 2021. The company must pay s455 tax by 1 October 2021. If the loan is repaid in 2022, the tax relating to the loan would not be due for repayment until 1 October 2023.

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... s455 charge, a loan to a ... be treated as a taxable ... individual concerned ... nterest-free, or the ...% for 2020/21: ... s more than ... beneficial ... culated ... The ... enefit.

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If business begins to improve so that th... changed significantly for the better since th... accounts, it may be possible to justify a dividend based on interim accounts. Where there has been a period of strong trading, such accounts could be prepared in the next few months, and we should be happy to advise on the potential of this route.

Please contact us for further information and advice.

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