

Loans to directors and participators

Introduction

If you are a company director or 'participator' and take money out of your company that's not a salary or a dividend - over and above any money you have put in – you are classed as having received the benefit of a director's loan. HM Revenue & Customs (HMRC) defines a participator as a person who has a share or 'interest' in a company. A participator is usually a shareholder who could also be a director. HMRC see this as an issue as in any other circumstances you would be charged loan interest until the amount is repaid or you would have to pay tax on this amount.

Corporation tax (s419 tax)

If your director's loan account is overdrawn, your company must pay tax on any amount you have not repaid within nine months after the end of your Corporation Tax accounting period. Whether your company has to tell HMRC that your director's loan exists - and pay tax on the outstanding loan amount - depends on when the loan is repaid.

If you pay off your director's loan in full by the last day of your company's Corporation Tax accounting period, your company does not pay Corporation Tax on the loan and you don't need to tell HMRC about the loan on your Company Tax Return.

If your director's loan account is overdrawn after the last day of your company's Corporation Tax accounting period, but you repay it in full within nine months, your company does not pay tax on the loan but you must include details of that loan in your Company Tax Return.

If your director's loan account is not paid off in full within nine months after the end of your company's accounting period, you must include details of the loan in your Company Tax Return and your company must pay Corporation Tax on the loan. The current tax rate for director's loans is 25 per cent of the outstanding loan.

When you repay a director's loan on which your company has paid Corporation Tax, the company can reclaim that amount of Corporation Tax paid. Depending when in the company's financial year repayment is made it can take from 9 to 21 months to recover this tax from HMRC.

Income tax and national insurance

If your director's loan account is overdrawn by more than £5,000 at any time during a tax year there are income tax and national insurance implications for you and for the company. The loan is classed as a 'benefit in kind', with the result that income tax is payable by you and Class 1a national insurance is payable by the company. The loan should also be reported on forms P11D and P11D(b). The benefit in kind is the notional interest that would have been paid on the loan calculated using HMRC's Official rate of interest (4.75% from 1.3.2009 and 4% from 6.4.2010). Unlike the corporation tax referred to above, the income tax and national insurance are not refunded when the loan is repaid. It is possible to eliminate a benefit in kind charge and national insurance liability by paying to the company interest on the loan at or above the Revenue's Official rate of interest.

Companies Act

Under the Companies Act 1985 certain loans to directors and participators were prohibited. They are now permitted under the Companies Act 2006 provided that they are formally approved by a resolution of the members of the company.

There are a few exceptions where formal approval is not required:

- for small loans as long as the total value of such loans to any director and any person connected to him does not exceed £10,000 and;
- for small credit transactions as long as the total value of such credit transactions does not exceed £15,000.