Overdrawn director's loan accounts

In a personal or family company, the lines between the directors as individuals and the company are often blurred – the director may lend money to the company when cashflow is tight and the company may lend money to the director or pay personal bills on the director's behalf. Transactions between the director and the company are tracked via the director's account.

If the director's account is overdrawn at the end of the accounting period (such that the director owes the company money) and the company is close, there are tax consequences to consider. Broadly, a close company is one that is controlled by five or fewer shareholders (participators).

Potential tax charge

A tax charge arises on the company if the director's loan account is overdrawn at the end of the accounting period and remains overdrawn nine months and one day after the end of that accounting period. This is the date on which corporation tax for the accounting period is due. The overdrawn amount constitutes a loan to the director from the company

The tax charge (known as the 'section 455 charge' after the section of the Corporation Tax Act 2010 which imposes the charge) is 32.5% of the amount of the loan. The rate of section 455 tax is the same as the higher dividend rate.

The tax is paid with, but is not the same as, the corporation tax for the period.

Example

Nigel is the director of his personal company N Ltd. Accounts are prepared to 31 March each year.

On 31 March 2018, Nigel's director's loan account is overdrawn by £20,000. The account remains overdrawn on 1 January 2019 (the date on which corporation tax for the period is due).

The company must pay section 455 tax of £6,500 (£20,000 @ 32.5%).

Avoiding the charge

Even if the loan account was overdrawn at the end of the accounting period, the section 455 charge can be avoided if the loan is cleared by the corporation tax due date of nine months and one day after the end of the period. This can be done in various ways:

- the director can pay funds into the company to clear the loan;
- the company can declare a dividend to clear the loan balance;
- the director's salary can be credited to the account to clear the loan balance;
- the company can pay a bonus to clear the loan balance.

It should be noted that with the exception of the director introducing funds into the company, the other options will trigger their own tax bills.

Clearing the loan may not always be the best option – it may be preferable to pay the section 455 tax instead. This will be the case if the tax on the dividend or bonus credited to the account to clear the loan is more than the section 455 tax.

A temporary tax

Section 455 tax is a temporary tax in that it is repayable nine months and one day after the end of the tax year in which the loan is cleared.

Anti-avoidance provisions

It should be noted that anti-avoidance rules apply to prevent the director clearing the loan shortly before the section 455 trigger date, only to re-borrow the funds shortly thereafter