



Directors' Loan Accounts Toolkit

2011-12 Company Tax Returns

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Introduction

Tax agents and advisers play an important role in helping their clients to get their tax returns correct. This toolkit is aimed at helping and supporting tax agents and advisers by providing guidance on the errors we find commonly occur in relation to directors' loan accounts. It may also be helpful to anyone who is completing a Company Tax Return.

This toolkit is applicable for financial years commencing 1 April 2011 for Company Tax Returns. Its use is entirely voluntary.

The content of this toolkit is based on our view of how tax law should be applied. Its application to specific cases will depend on the law at the relevant time and on the precise facts.

For further information on using this toolkit and reasonable care under our penalty system see **Toolkits to help reduce errors - essential information**.

References are made throughout this toolkit to **S455** and **S458 Corporation Tax Act 2010** which replaced S419 and S419(4) Income and Corporation Taxes Act 1988 respectively for periods beginning on or after 1 April 2010.

For guidance on matters not dealt with in this toolkit you should refer to our Company Taxation Manual (CTM):

hmrc.gov.uk/manuals/ctmanual/index.htm

Areas of risk within directors' loan accounts

A company may not deduct expenditure in computing their taxable profits unless it is incurred wholly and exclusively for the purposes of the trade. See **S54 Corporation Tax Act 2009**.

As companies are separate legal entities that stand apart from their directors and shareholders they do not incur personal expenses. However many companies, particularly 'close' companies, pay for personal expenses of the directors.

It is important to note that where payments, either made to or incurred on behalf of a director, do not form part of their remuneration package these amounts may not be an allowable company expense. In such circumstances it may be appropriate for these items to be set against the director's loan account. Establishing whether a payment forms part of a director's remuneration package can be complex.

For further guidance on our view of this area see **Enquiry Manual (EM) EM8505**.

This toolkit broadly covers expenses that do not form part of a director's remuneration package. Where a company makes payments on behalf of a director which forms part of their remuneration package please refer to the relevant guidance contained within **Employment Income Manual (EIM)**.

For further information on errors that we find commonly occur in relation to expenses and benefits from employment see **Expenses and Benefits from Employment Toolkit**.

Areas of risk within director's loan accounts fall broadly into the following categories:

Review of accounts

It is important that any personal expenditure incurred by the director and paid by the company is allocated correctly. Where the expenditure forms part of the remuneration package it will be an allowable expense of the company and the appropriate employment taxes should be paid. Where the expenditure does not form part of the remuneration package the relevant amount should normally be debited to the director's loan account.

A review of particular accounts headings may identify directors' personal expenditure that has not yet been allocated appropriately. Transactions should normally be recorded as they occur and a detailed transaction history maintained, so that it is possible to identify the director's loan account balance on any given date.

Section 455 tax

Where a close company makes a loan or advances money to an individual who is either:

- a participator in the company
- an associate of a participator

then, unless the loan or advance was made in the ordinary course of the close company's business and that business includes the lending of money, or relief under **S458 Corporation Tax Act 2010** is due the close company is due to pay tax under **S455 Corporation Tax Act 2010**. S455 applies only if the company is a close company at the time the loan or advance is made.

Where tax has been paid in earlier years under S419 Income and Corporation Taxes Act 1988 any relief due should be claimed under S419(4).

A participator is any person having a share or interest in the capital or income of the company. Commonly loans or advances are made to directors of close companies (who are also participators) through their loan accounts. Where an individual participator's or director's loan account is overdrawn this should be reviewed to consider whether the company is liable to pay S455 tax.

Record keeping

Good record keeping is essential. Poorly kept records can mean that information provided is not accurate. This may result in non-business expenditure incurred by the directors being incorrectly recorded or misposted in the business records and claimed in error as an allowable expense. Conversely, justifiable business expenditure incurred by the directors may not be claimed or claimed inaccurately. Consequently directors' loan account balances may be incorrect resulting in S455 tax being underpaid or S458/S419(4) relief not claimed at the appropriate time.

For further information see **Directors' loan accounts and Corporation Tax explained**.

For further information on general record keeping for companies see **Records for Corporation Tax**.

Using links within this document

[Blue underlined text](#) are links within this document.

Green bold text are hyperlinks to external documents on the internet (access to the internet is necessary to view these).

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HMRC services for customers with particular needs

Checklist for directors' loan accounts

Yes No N/A

Review of accounts

- 1 Have [expense headings](#) which could include non-business expenditure paid to or on behalf of directors been reviewed to identify any non-business elements?
- 2 Have any [payments made to or on behalf of the directors](#) as part of their remuneration package been treated as employment income and all relevant employment taxes operated?
- 3 Has any [personal expenditure of the directors](#) that does not form part of their remuneration package been charged to the directors' loan accounts as appropriate?
- 4 Have any [relevant credits to the directors' loan accounts](#) been calculated correctly?
- 5 Have all transactions relevant to the directors' loan accounts been [posted contemporaneously](#)?

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Section 455 tax

- 6 If a [director's or participator's loan account is overdrawn](#), has the company paid tax under S455 Corporation Tax Act 2010 where appropriate?
- 7 If a loan made to a director or participator has been repaid has the [relief](#) been claimed in the correct year?
- 8 Where an overdrawn loan account has been repaid, has the [same or similar amount been withdrawn](#) in the subsequent period?
- 9 Have all loans made to directors or participators been [considered separately](#) where appropriate?
- 10 If any loans made to directors or participators have been [repaid by way of bonus or dividends](#), have these been credited correctly?
- 11 Have any [released or written off loans](#) made to directors or participators been treated correctly?

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Explanation and mitigation of risks

Review of accounts

1. Have expense headings which could include non-business expenditure paid to or on behalf of directors been reviewed to identify any non-business elements?

Risk

A company may not correctly distinguish non-business transactions such as payments made to or on behalf of the directors (directors' personal expenditure) from business transactions. This may result in non-business expenditure being charged in the profit and loss account instead of to the directors' loan accounts or directors' benefits not being properly returned on form P11D.

Mitigation

A review of the draft profit and loss account may identify account headings where there is an unusual variation or where, based on past experience and knowledge of the business, directors' personal expenditure may be included.

Such account headings may include motor expenses, repairs and renewals, travel and subsistence, sundry expenses and so on. A detailed analysis of these may identify amounts which are paid by the company and which are more properly chargeable to the directors.

Ensure that relevant accounts are analysed and that any directors' personal expenditure is charged to the appropriate director's loan account or included in the payroll records and/or returned on form P11D as appropriate.

Explanation

Only revenue expenditure incurred wholly and exclusively for the purposes of the company's trade may be claimed as a deduction. Payments made towards the directors' personal expenditure are not allowable as deductions from profits, unless they form part of a director's remuneration package. If so, then relevant employment taxes should be operated or a form P11D should be completed detailing the value of the expenses and benefits as appropriate. See [Q2](#).

For further guidance on benefits see [EIM21000+](#).

For payments not forming part of the director's remuneration package see [Q3](#).

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2. Have any payments made to or on behalf of the directors as part of their remuneration package been treated as employment income and all relevant employment taxes operated?

Risk

Payments made to or on behalf of directors or their family or household that are contractual, rewards for work done or are payments for future work are normally considered to be employment income. Employment income includes earnings, amounts treated as earnings, for example benefits and certain other payments. See [explanation](#).

If such payments are posted to the director's loan account when they are in fact part of the remuneration package this can result in an underpayment of tax and National Insurance contributions (NICs) and an incorrect loan account balance.

Mitigation

Consider the payments made to or on behalf of the director or members of their family or household. Those that constitute employment income, including benefits etc should be subject to tax and NICs and/or returned on form P11D appropriately.

If the payments are not charged as earnings, because they do not have a monetary value or cannot be converted to cash they may be chargeable to tax under the benefits code. In these circumstances the benefit should be included on form P11D. It is important to note that National Insurance contributions (NICs) will be due on most benefits.

Payments that legitimately form part of the director's remuneration package are taxable as employment income and will therefore be an allowable expense of the company.

For further guidance on NICs see **National Insurance Manual (NIM) NIM02010+**.

Explanation

Before there is a charge to tax on employment income there must be an office or employment, for instance as a company director. Employment income consists of three types of income:

- earnings including wages, salaries, fees or bonuses defined in **S62 Income Tax (Earnings and Pensions) Act 2003**
- any amount treated as earnings including expenses, benefits and other payments such as sick pay
- any amount that counts as employment income, including termination payments and share options

Subject to minor exceptions, any benefit provided for the members of the family or household of a director is treated as if it were provided for the director personally. Family or household covers the director's:

- spouse
- children and their spouses
- parents
- servants, dependants and guests
- registered civil partner

For further information regarding payments that should be treated as earnings see **EIM00513**.

Certain expenses may require to be returned on form P11D although the director may subsequently make a claim under **S336 Income Tax (Earnings and Pensions) Act 2003** for expenses wholly, exclusively and necessarily incurred in the performance of their duties. To avoid the submission of details of routine expenses and benefits that would clearly involve no further tax liability, the company may prefer to consider applying for a dispensation.

For further information on dispensations see **Booklet 480 Chapter 2**.

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3. Has any personal expenditure of the directors that does not form part of their remuneration package been charged to the directors' loan accounts as appropriate?

Risk

If the company makes payments to, or on behalf of, the directors for their personal bills, and these payments do not form part of their remuneration package, these should normally be charged to the appropriate director's loan account. For example, payment of personal bills including credit cards, personal expenses paid by company credit card and personal entertaining, such as of the director's family or friends, should not be overlooked.

If these payments are not charged to the appropriate director's loan account the loan account balance will be incorrect.

Mitigation

Identify any payments the company has made to or on behalf of the directors that do not form part of their remuneration package. Ensure these costs are charged to the appropriate loan account and not the company profit and loss account.

Establishing whether a payment forms part of a director's remuneration package can be complex. For further guidance on our view of this area see [EM8505](#).

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4. Have any relevant credits to the directors' loan accounts been calculated correctly?

Risk

Directors' bonuses, dividends and salaries etc may be credited to the directors' loan accounts. Where such credits are made to the loan account the amount or timing of the credit may be incorrect, for example a director's bonus should only be credited when paid or deemed to be paid. PAYE and NICs should be operated on earnings at the same time and therefore only the net amount should be credited to the loan account.

Where there are credits for other items, such as use of the director's home or business expenses paid personally, it is important to ensure that the amount reflects the actual or apportioned expense. If not the loan account balance may be incorrect.

Mitigation

Consider any amounts credited to the directors' loan accounts and ensure that these are for the correct amount and have been posted at the correct time.

Where items such as use of home are included there may be employment income implications. For further information see [Expenses and benefits A to Z](#).

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5. Have all transactions relevant to the directors' loan accounts been posted contemporaneously?

Risk

If transactions are not posted at the time they occur, for example if they are only posted at the year end, an overdrawn balance during the year may be overlooked. Overdrawn loan accounts may constitute a beneficial loan which should be returned on form P11D. If beneficial loans are not returned on form P11D, this can result in an underpayment of tax by the director.

Tax may also be chargeable on the company under [S455 Corporation Tax Act 2010](#). See [Q6+](#).

Mitigation

Transactions should normally be recorded as they occur and a detailed transaction history maintained, so that it is possible to identify the director's loan account balance on any given date. Where a contemporaneous record has not been kept consider whether the loan account should be redrawn to identify if it has been overdrawn at any point during the year. Where a director's loan account is overdrawn at any point during the year consider whether there is a beneficial loan and ensure the benefit is returned on form P11D. Also consider whether tax under S455 applies. See [Q6+](#).

Class 1A NICs will also be payable on the P11D benefit and should be reported on form P11D(b).

Explanation

A beneficial loan is chargeable if, at any time during the tax year, the total balance outstanding is more than £5,000. Loans with a balance of less than £5,000 throughout the whole year do not give rise to a chargeable benefit. The £5,000 limit does not apply for S455 purposes.

Exceptions from S455 are detailed in [S456 Corporation Tax Act 2010](#).

A director obtains a benefit by reason of their employment when they or members of their family or household are provided with a cheap or interest free loan. The director is generally taxable on the difference between interest at the relevant official rate and any interest paid.

For further guidance on beneficial loans see [Booklet 480 Chapter 17](#) and Q3 in the Expenses and Benefits from Employment Toolkit

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Section 455 tax

6. If a director's or participator's loan account is overdrawn, has the company paid tax under S455 Corporation Tax Act 2010 where appropriate?

Risk

Where a close company makes a loan or advance to an individual who is a participator in the company or an associate of a participator (normally the directors and their relatives), the close company is due to pay tax under [S455 Corporation Tax Act 2010](#). If S455 tax is not paid on the overdrawn amount this can result in an underpayment of tax.

Exceptions from S455 are detailed in [S456 Corporation Tax Act 2010](#).

Mitigation

Once all appropriate adjustments have been made to the directors' or participators' loan accounts, review the loan account balances at the end of the accounting period. If the loan accounts are overdrawn at the end of the accounting period calculate the S455 tax due and include the amount due with any Corporation Tax payable. S455 tax is due nine months and one day after the end of the accounting period in which the liability arises. See [S455\(3\) Corporation Tax Act 2010](#).

However where the whole or part of a loan or advance is repaid, released or written off, the company is entitled to relief from the tax chargeable under S455 or a proportionate part of it. Where the loan is repaid, released or written off within nine months of the end of the accounting period relief is due immediately. The S455 tax and relevant S458 relief should be included and claimed on the relevant Company Tax Return. See [Q7](#) regarding the date relief is otherwise due.

Explanation

Loans made on beneficial terms to a participator, or an associate of a participator, who is a director or an employee, may also give rise to liability on the individual under the earnings from employment provisions in addition to any charge on the company under S455. See [Q5](#).

For further guidance see [EIM26101](#).

For further guidance on associates of participators see [CTM60150](#).

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7. If a loan made to a director or participator has been repaid has the relief been claimed in the correct year?

Risk

If a loan is repaid more than nine months following the end of the accounting period, relief under **S458 Corporation Tax Act 2010** is not due until nine months after the end of the accounting period in which the loan is repaid. If the date of payment is not properly identified relief could be claimed in the wrong accounting period and the Company Tax Return may be incorrectly completed.

Where tax has been paid in earlier years under S419 Income and Corporation Taxes Act 1988 any relief due should be claimed under S419(4).

Mitigation

Identify the date the loan is repaid. If the loan was repaid more than nine months after the end of the accounting period in which the loan was made ensure the relief is not claimed until nine months after the end of the appropriate accounting period.

For further guidance on S458 relief see **EM8560**.

Explanation

A claim for relief under S458/S419(4) has to be made within four years from the end of the financial year in which the loan is repaid, released or written off. The company can claim relief whether or not it is a close company at the time of the repayment etc of the loan.

Example

Director A is a full time working director of a close company with a material interest in the company. His loan account is overdrawn by £10,000.

The company's accounting period ends on 31 March 2012. Director A repays £3,000 on 31 July 2012 and the remaining £7,000 on 10 January 2013. The first repayment is within nine months of the end of the accounting period and therefore relief can be claimed on the Company Tax Return for the accounting period ending 31 March 2012. The second repayment is more than nine months after the end of the accounting period and falls within the accounting period ending 31 March 2013.

- S455 tax is due on £10,000 on 1 January 2013
- S458 relief is due on £3,000 on 1 January 2013
- S458 relief is due on £7,000 on 1 January 2014

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8. Where an overdrawn loan account has been repaid, has the same or similar amount been withdrawn in the subsequent period?

Risk

If the repayment of the loan account is a temporary arrangement, for example the loan account is repaid by the director or participator at the end of the accounting period (or at the point nine months after the end of the accounting period), and the same or a similar amount is redrawn shortly thereafter, then tax under **S455 Corporation Tax Act 2010** may still be due.

Mitigation

Establish whether the loan account is overdrawn at the end of the accounting period. Identify whether the loan has been repaid. If the loan has been repaid but a similar sum withdrawn soon after consider whether the book entries reflect the actual underlying transactions. If there is no evidence that the loan has in fact been repaid, S455 tax is due. Ensure S455 tax is paid appropriately and S458 relief is not claimed.

Even where the entries do reflect the underlying transactions, depending on the facts, S455 tax can still apply.

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9. Have all loans made to directors or participators been considered separately where appropriate?

Risk

Normally each director or participator has a separate loan account, indeed each director or participator may have more than one account. Where there are separate accounts for individual loans/indebtedness each account should be considered separately for S455 purposes even where the loans are to the same director or participator. If accounts are aggregated inappropriately this can result in an underpayment of S455 tax.

The position however is different if the facts show that there is genuinely a joint account. It would though be unusual to find two directors operating a genuine joint account unless they are husband and wife or otherwise closely related individuals.

Mitigation

Ensure each loan and each loan account balance is considered separately and S455 tax calculated on each overdrawn balance.

Explanation

It may be that, for commercial or other purposes, certain transactions are kept separate and this is achieved by the use of distinct loan accounts, even for the same director or participator. One account may be secured, the other unsecured; one account may bear interest, the other may be interest free; and so on. If, for whatever reasons, the parties choose to keep the various forms of indebtedness separate, then liability under S455 will arise if the director or participator is indebted to the company on any account. This will also normally apply where the accounts are held by different persons.

Separate accounts should not be aggregated or 'netted off' for S455 purposes. **S455 Corporation Tax Act 2010** imposes a charge to tax when the close company makes a loan or advances money, that is, the company is liable on the full amount of a loan or advance, irrespective of whether the same director or participator has a credit balance on another account with that company.

Book entries that reflect the facts that a credit balance is used to repay a debit balance, may be made but this is not the same as saying the two accounts can be 'netted off'. In which case the S455 liability is on the full amount of the debit balance and relief is available under S458/S419(4), see **CTM61605** onwards. In this scenario, the date of repayment for S458/S419(4) purposes is the date the book entries are made.

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10. If any loans made to directors or participators have been repaid by way of bonus or dividends, have these been credited correctly?

Risk

Where a loan has been repaid by way of a bonus or dividend it is important to identify the date the bonus or dividend was paid and that the transaction is recorded at the correct date. If the date of the payment of the bonus or dividend is not properly identified this may result in underpayment of tax under **S455 Corporation Tax Act 2010** or relief being claimed when not due. The date of repayment will affect whether there is a charge under S455 or when any S458/S419(4) relief is due. This may not necessarily be the same date as the date of payment (for other tax purposes) of the bonus or the dividend.

The bonus or dividend should be credited net of any employment taxes.

Mitigation

When a loan has been repaid, particularly by way of a bonus or dividend voted at the end of the year, establish the actual date of payment. Ensure that the bonus or dividend is not credited to the loan account before the date of payment, which may differ from the date that the bonus or dividend is voted or provided for in the accounts which is often the accounting date. If the loan account remains overdrawn at the accounting date S455 tax is due. The date of payment will also affect the date S458/S419(4) relief may be due.

Example

Director B, is a full time working director of a close company with a material interest in the company. He has an overdrawn loan account of £10,000.

The company's accounting period end is 31 December 2010.

At the AGM on 31 October 2011 a director's bonus of £15,000 is voted, the net bonus is credited to Director B's loan account the same day.

The bonus is therefore paid on 31 October 2011 and PAYE/NICs are due on that date.

S455 tax is due on the overdrawn balance of £10,000 at 31 December and payable on 1 October 2011.

S458 relief is due the following October (1 October 2012) as the loan account was not repaid until more than nine months after the accounting period end.

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11. Have any released or written off loans made to directors or participators been treated correctly?

Risk

Where a loan or indebtedness has been released or written off, then relief under **S458 Corporation Tax Act 2010** or S419(4) of Income and Corporation Taxes Act 1988 will be due to the company as in [Q7](#). However there may also be a charge under **S415 Income Tax (Trading and Other Income) Act 2005** on the director or participator. If so, they will be treated as being in receipt of income which has been taxed at the dividend ordinary rate. In addition, National Insurance contributions (NICs) will normally be due on the amount released or written off.

Mitigation

Consider whether any loans etc have been released or written off and whether **S415 Income Tax (Trading and Other Income) Act 2005** will impose a charge on the director or participator as dividend income. Where loans have been released or written off company claims to relief under S458/S419(4) can be made accordingly.

For further guidance see **CTM61630**.

For Income Tax purposes the amount released or written off should normally be included on the director's Self Assessment tax return. For NICs purposes the amount released or written off should normally be treated as earnings liable for Class 1 NICs.

Where the director is not a participator the treatment can be complex, a charge to tax will arise either under **S62 Income Tax (Earnings and Pensions) Act 2003** as earnings or as a benefit under **S188 Income Tax (Earnings and Pensions) Act 2003**.

For further guidance see **EIM01490** and **EIM21740+**.

For the NICs treatment of any loans released or written off see **NIM12020**.

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