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Understanding Director Loan Accounts

A guide for Company Directors

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What is a Director Loan Account ("DLA")?

A DLA is a record in your company's books that tracks money you, as a director, either lend to or borrow from your company. It's a way of keeping track of any funds that move between you and the company outside of your usual salary, dividends, or expense reimbursements.

How does it work?

- Money lent to the company: If you personally pay for company expenses or inject additional funds into the business, these amounts are credited to your DLA. The company owes you this money, which can be repaid later.
- Money taken from the company: If you withdraw money from the company that isn't salary, dividend, or an expense reimbursement, this is debited from your DLA. Effectively, you owe the company this money until it is repaid.

Wages, drawings and dividends

Monies paid to a director under an employment contract and which are reported through the company's payroll scheme are wages/salary. Wages would not typically feature on a DLA unless the wages were unpaid, in which case they could be a credit on the DLA.

Monies withdrawn which are not wages, or repayment of business expenses, will be classified as drawings. It's these amounts that will be added to a DLA which could leave it in an overdrawn position.

Where the director is also a shareholder, it's common for them to take money out of the company as drawings rather than salary as part of tax planning. Whilst the regular drawings will create a temporary overdrawn DLA position, company profits can subsequently be used to declare and pay dividends to shareholders which can then be offset against the DLA.

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How will I know if I have a DLA already?

- Accounting records: Check your accounting software for a director loan account ledger.
- Financial accounts: The DLA may be listed under creditors or debtors, depending on the status of the DLA.
- Ask your accountant.

Impact of insolvency

- The impact of insolvency can be significant, as it's likely to mean the company is no longer generating profits and any retained profits may have been eroded too. In these circumstances, the company wouldn't be able to declare dividends which can be used to offset against the drawings already taken, leaving the director with an overdrawn DLA. If the company is then forced into an insolvent process, the director would be required to repay the balance of their DLA.
- It is not possible to reclassify prior drawings as salary ahead of an insolvency event. Any attempt to do so would most certainly be considered as misconduct and challenged. The misconduct could have further implications, such as disqualification.
- It's crucial for directors to be aware of the company finances and understand how their drawings compare with the level of projected profits. If there is any doubt, the director could look to protect their position by taking future payments as wages (so long as the salary wouldn't be deemed excessive for the role performed). Whilst this can be more costly for the company overall, it may be necessary for the director to avoid exposing themselves to personal liability.
- Alternatively, the director could stop drawing any funds from the company altogether.
- If you have a credit balance on your DLA you equally need to be mindful about making repayments. Any repayments during the preceding 2 years to insolvency could be deemed a preference and potentially overturned.

Example

Mr Smith is the sole director and shareholder of a company.

Mr Smith works out that he needs £3,000 a month to meet his personal living costs. On advice of his accountant, Mr Smith draws a wage of £1,000 per month and the additional £2,000 is debited to his DLA. By the end of the company's financial year the director's DLA is overdrawn by £24,000.

Once the annual accounts are finalised, it transpires the company made £30,000 profit. These profits are subsequently used to declare and pay a dividend of £24,000 to Mr Smith as the sole shareholder. Mr Smith would receive a credit to his DLA of £24,000, reducing his DLA to nil.

The director continues with the same level of drawings for the following financial year. Once the accounts are prepared at the end of that year it transpires that the company made a loss of £40,000, due to some bad debts and a downturn in trade. Accordingly, the company is not able to declare a dividend to shareholders.

The company trades for a further three months but, due to increased trading losses, mounting creditor pressure and severe cashflow problems, the director seeks advice from an Insolvency Practitioner. Mr Smith concludes that he has no option but to cease trading and place the company into liquidation.

At the date of insolvency, Mr Smith's DLA was £30,000 overdrawn (15 x £2,000).

In this scenario, Mr Smith may have been able to reduce his exposure by increasing the level of his wage and reducing/stopping the non-salary drawings. The sooner that he could have done this the better.

Key points to remember

- All transactions must be properly documented and recorded in the company's accounts.
- If your director loan account is overdrawn at the end of the company's financial year, there may be tax implications for both you and the company.
- Repayments to or from the director loan account should be made promptly to avoid unnecessary tax charges or penalties.
- Consult your accountant or financial advisor for guidance on managing your director loan account effectively.

Further information

If you have any questions or need advice regarding director loan accounts, please speak to our team or consult your accountant.

This flyer is designed to give you a quick overview. For a detailed discussion tailored to your company's circumstances, let's arrange a meeting.

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