

DLA repayments – nature and timing (Lecture B1443 – 12.57 minutes)

Background

There are various potential tax consequences where a director's loan account becomes overdrawn. For example, there is a possible tax charge on a close company under the 'loans to participators' provisions (in CTA 2010, s 455); if the participator is a director or employee, there is a possible benefit-in-kind charge under the beneficial loan rules (in ITEPA 2003, s 175); and if the loan account is released or written off, there's generally an income tax charge on the participator (under CTA 2010, s 415), and a repayment of any corresponding tax charge for the company on the loan (under CTA 2010, s 458).

It's all in the timing

The timing of overdrawn directors' loan account credits, repayments, or any release or writing-off of the loan account is equally significant for several tax reasons. For example, the timing will determine the date of payment or repayment of any loans to participator charge for the close company; also, the tax year in which a beneficial loan income tax charge for the director is reduced or ceases altogether; and the tax year in which the repayment, release or writing-off of the loan account is taxable on the participator.

(a) Earnings

There are tax rules to determine when cash earnings are treated as having been received for employment income purposes (in ITEPA 2003, s 18(1)), and different but broadly similar rules to determine when a payment of income is treated as made for PAYE purposes (in ITEPA 2003, s 686(1)). HMRC accepts (following *Garforth v Newsmith Stainless Ltd*, ChD 1978, 52 TC 522) that crediting an account in the employer's books represents 'payment' for these tax purposes (see HMRC's Employment Income Manual at EIM42270).

In many owner-managed and family companies, directors often draw money from the company during the year, which is debited to their loan account and repaid at the end of the year by crediting earnings voted or declared post-year end. Until then, in the absence of specific evidence to the contrary, the amounts drawn do not actually belong to the director.

Those in-year drawings aren't payments on account of earnings for the purpose of the tax rules which determine when earnings are treated as having been received for employment income and PAYE purposes (see EIM42280).

(b) Dividends

Commonly, an overdrawn loan account of a director shareholder is cleared or reduced by crediting a dividend from the company to the loan account. However, care is needed to ensure that company law requirements are satisfied. For example, the dividend should be properly voted, paid, and formally documented by minutes, dividend vouchers, etc. It's also important to appreciate when a dividend is treated as paid.

A company's articles often distinguish between final and interim dividends, by providing that final dividends may be declared by the company in general meeting, and interim dividends may be paid by the directors from time to time. A final dividend which has been properly declared and which doesn't specify a date for payment creates an immediately enforceable debt. On the other hand, an

interim dividend can be varied or rescinded at any time before payment and may therefore only be regarded as due and payable when it's actually paid (*Potel v CIR* (1971) 46 TC 958).

HMRC's view is that payment of an interim dividend isn't made until a right to draw on the dividend exists, which is generally when the appropriate entries are made in the company's books. If the interim dividend entries aren't made until the annual accounts are prepared, and this takes place after the end of the accounting period in which the directors resolved that an interim dividend be paid, the due and payable date will be in the later accounting period rather than the earlier one. This could mean, for example, that an overdrawn director's loan account isn't repaid as early as the company expected.

(c) General repayments

HMRC will not necessarily object to director's loan account repayments via book entries, if those entries reflect the underlying reality of a transaction and are properly recorded in the company's books. But a repayment by book entry will normally be treated as taking place at the date the book entry is made; and in HMRC's view it is only on that date that the relief on loans to participators (in CTA 2010, s 458) is due (see CTM61600).

Which debt?

Many director shareholders will have a single directors' loan account with the company, into which any loans from the company will normally be paid. HMRC's guidance on loans to participators (in the Company Taxation Manual at CTM61600) states that where there are multiple loans or advances on a single loan account, the parties involved (i.e., the participator and/or the company) can specify against which debt they want to set the repayment. Where the debt is not specified, HMRC will generally set the repayment against the earliest debt first, following the rule in *Clayton's Case* [1816] 1 Mer 572. The rule in that case generally applies when a debtor has a 'running account' with a creditor (e.g., a bank account). In such situations, a payment will be allocated against the earliest debt first.

On the other hand, where a debtor makes a payment to a creditor in respect of a specific debt, the debtor may appropriate the money how they please. However, if the debtor does not make any appropriation, the right of appropriation devolves on the creditor. This treatment is in accordance with *The Mecca* [1897] AC 286.

DLA written off: or was it?

In *Plumpton v Revenue and Customs* [2024] UKFTT 367 (TC), the taxpayer was a director and shareholder of a company ('BGH'). The taxpayer had a director's loan account with BGH. In BGH's financial statements for the year ended 31 January 2014, the sum of £783,289 showing as owing to BGH by the taxpayer was recorded as having been written-off in the tax year 2013/14. On the form to reclaim tax paid by close companies on loans to participators', BGH reclaimed from HMRC the tax previously paid on an amount recorded as having been written off by BGH on 29 January 2014 in respect of the director's loan account. However, in the taxpayer's self-assessment return for 2013/14, no mention was made of income received by way of the written-off director's loan account (NB. this was an amended tax return; the taxpayer's original return had recorded as 'other income' a written-off director's loan account sum of £783,289). Following an enquiry into the taxpayer's amended return for 2013/14, HMRC amended the return on the basis that the director's loan account had been written off, resulting in an income tax liability. The taxpayer contended that the director's loan account had not been written off in 2013/14, and so there was no income tax liability thereon.

The First-tier Tribunal concluded from the evidence that the taxpayer had shown it was more likely than not there was no writing-off of his director's loan account on 29th January 2014. Among the reasons for its decision, the tribunal noted there were no relevant documents whatsoever from that tax year showing the directors' loan account being written off.

HMRC presented evidence of what it considered to be directors' board meeting minutes (dated 29 January 2015), reflecting a writing-off of the director's loan account on 29 January 2014. However, the tribunal held the document didn't reflect a meeting of the board, and there was compelling evidence that the meeting hadn't occurred. In addition, BGH's tax repayment claim to HMRC (under CTA 2010, s 458) was dated prior to when the minutes were created. The taxpayer's appeal was allowed.

Record keeping

HMRC's Directors' Loan Account Toolkit indicates that there's a possible risk if transactions relevant to director's loan accounts haven't been posted contemporaneously. It states that where a contemporaneous record hasn't been kept, consideration should be given to whether the loan account should be rewritten to identify if it was overdrawn at any point during the year. Keeping the director's loan account up-to-date could therefore save further work in the long run.

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