

## **Beware overdrawn Director's Loan Accounts**

We have seen a number of cases recently where there have been overdrawn director's loan accounts.

In the main, these have arisen because directors have taken drawings which historically they would have rectified by way of a dividend. This is fine whilst the company is making profits, has distributable reserves and is clearly tax efficient.

However, when a company has hit troubled times, the directors may have continued to withdraw monies. If there are no profits or distributable reserves then it is not possible for a dividend to be voted and the only choice is to put any drawings to the loan accounts thus making them overdrawn.

In a number of cases the director's loan account has been reduced by voting a bonus or been written off against the profit and loss account. This can be very dangerous, particularly if a company then goes into liquidation shortly thereafter. Following the introduction of RTI, HM Revenue and Customs (HMRC) are now more up to date with payments made.

All Insolvency Practitioners are required to undertake certain investigations into a company's affairs and this includes a review of the director's loan account since the last audited accounts.

This could lead to a number of claims against the director, including preference, transaction at undervalue, or simply misfeasance. As in a number of these actions, it is up to the director to prove that the transaction was in the best interests of the company and the creditors, which, given the insolvency, will be very difficult to prove.

The director may be asked to repay the overdrawn loan account and this could then lead to financial difficulties for the director including possible bankruptcy.

The story does not necessarily end there. HMRC is actively looking into insolvency cases to identify overdrawn director's loans to ensure these sums have been repaid. Remember, in a number of cases this information will have already been reported to HMRC via previous accounts or tax returns.

If a liquidator does not have the funds to pursue the director for repayment of the loan account it is possible that HMRC may pursue the director personally for either untaxed earnings in the case of an outstanding loan account or failure to pay over PAYE/NIC if a bonus has been voted but the tax has not paid.

It is therefore important that companies and their advisors understand the issue with overdrawn loan accounts and ensure all parties concerned are fully aware of the consequences should a company hit troubled times.

Please note that should your clients require any confidential advice regarding this or any other insolvency matter they are welcome to contact one of our Partners. An initial consultation is provided free of charge and without obligation. Also, if you or any of your colleagues require any clarification regarding insolvency law or procedure, please do not hesitate to contact us.