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Using Director's Loans as Your Private Bridging Facility

By specialist property accountant **Stephen Fay** ACA

In last month's article, we covered how operating a company and having that company manage or lease your personally-held properties, can enable rental profits to be legitimately diverted to the company. This can halve the rate of tax paid on rental profits.

The next question is - how can a Higher Rate taxpayer use the company's funds without incurring significant additional tax charges?

Why can't I just take the company's money out and use it - after all, it's my money really, as I own the company?

If you're self-employed, or a landlord, you can take money out of your business bank account at any time and use it as your own - the money is yours.

However, if you're a Higher Rate taxpayer company director and take money out of the business over and above any money you've put in, that money is not yours - it belongs to the company. So you must pay tax on that extra income.

This extra tax when taking money out of the company defeats the purpose of using a company - in fact, the overall tax burden would increase!

This is where a 'director's loan account' becomes useful - money can be taken out of the company and NOT treated as income to you as the director (with some strings attached!).

Introducing ... the 'Director's Loan Account' (DLA)

Director's may have a 'loan account' with their company - which may at any point in time be in credit (the company owes you money), or overdrawn (you owe the company).

When an account is in credit the director can extract monies from the company tax-free by having his loan repaid, rather than take a salary or dividend.

This means that when introducing money into a new company, it is almost always better to 'loan' the company money rather than pay any more than (say) £100 in share capital - since share capital cannot be extracted. These funds can be repaid to the director tax-free.

> **"This is where a 'director's loan account' becomes useful - money can be taken out of the company and NOT treated as income to you as the director"**

For example, a director may introduce a property to his company and therefore create a large credit loan account balance - which can be repaid tax-free from profits allowing the director to effectively swap a property for the company's cash.

Tapping your own bridge finance - the company can lend you its money

The key benefit of using a DLA is that the company can loan you its cash, rather than you having to extract the profits and pay more tax.

This enables you to use up to 100% of funds within the company as third-party finance to fund further property investing in your personal name, (which is generally preferable as financing is much easier and cheaper than using a company).

'The rules'...

As you would expect, there are some rules to stick to in order to keep on the right side of HM Revenue & Customs: ▶

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1. Paying interest to the company

To avoid you having to pay tax on the 'benefit' you receive by taking money from the company (i.e. an interest-free loan), we recommend that director's pay interest to the company at the HMRC-approved rate (currently 4.0% per annum).

Compare the cost of external bridging finance - often 1.5-2% per month (APR over 20%) - to borrowing from your own company at a very reasonable 4% per annum.

And, don't forget, you are effectively paying this money…back to yourself!

However, the interest element will be subject to 20% tax on the company, but most investors agree this is a small price to pay to access cheap, flexible finance…with guaranteed loan approval of course! To put this in context, £50k borrowed for 9 months would cost just £33 per month in tax.

2. Pay the loan back to the company within 9 months + 1 day of year-end

This is the key to ensuring the arrangement makes financial sense - funds must be repaid to these timescales every year, or a 25% tax charge is incurred. However, this tax is repaid when the director eventually does repay the loan - even so, it's a significant cashflow issue, usually.

Take care - the accounting for director's loan accounts must be done carefully - it's common for directors to take a slap-dash approach to this and then find themselves, incurring tax charges as a result - and ensure that your accountant checks your amounts/dates/repayments.

Monies can then be re-drawn after the year-end to fund the next project…

In summary: Using a company is a great way of transferring profits out of a personally-held portfolio into a company, and so having those profits taxed at 20% rather than 40% or more.

Using a director's loan account enables those company profits to be accessed without having to extract the funds as income. This ability to control the income taken, while still accessing the company's cash, enables investors to buy property and re-finance or sell before the funds become due for repayment back to the company.

This allows profits to be rolled up in the lower-tax company environment, but put to good use before eventually being extracted - probably when interest rates rise and personal profits subside down to normal levels and the investor reverts to becoming a Basic Rate taxpayer - when company profits can be taken out tax-free. PIN

Visit Stephen's website (www.fyldetaxaccountants.co.uk) for useful tools, tax tips and free reports.