WHAT IS A 'DIRECTORS LOAN ACCOUNT' – AND WHY IS IT USEFUL?

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WHAT IS A DIRECTORS LOAN ACCOUNT (DLA), EXACTLY?

Simply, a Directors Loan Account (DLA) is a running balance between the director of a company, and the company itself. In the early stages of a company's life, the company itself won't normally have any funds of its own, and so the director will normally fund the company initially. This creates a DLA, ie the cumulative total of all the funds the company receives from the director to get started.

Crucially, it is important to keep a good record of the total of the DLA because, once the company has funds of its own, the DLA can be repaid to the director tax-free. Given that dividends above £5,000 are now taxable for everyone, it's now more important than ever that the DLA is maximised and preserved for as long as possible – as tax-free extraction of company profits can't be beaten!

This is where a DLA becomes useful – money can be taken out of the company and NOT treated as income to you as the director.

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WHAT GOES INTO A DLA?

Typically, a DLA will initially be made up of:

- **Cash transferred to the company bank account**, eg director transfers £50,000 cash into the company bank account – therefore the company has a debt (DLA) back to the director for £50,000
- **Properties transferred to the company**, eg director transfers legal title of an unencumbered personally-owned property to the company valued at £100,000 – therefore the company has a debt (DLA) back to the director for £100,000
- **Equity transferred to the company**, eg a personally-owned £100,000 property with a £70,000 mortgage is transferred to a company, and the company takes a £70,000 mortgage (ie simply replacing the personal mortgage £ for £) – therefore the company has a debt (DLA) back to the director for £30,000

When a DLA is in credit (meaning, the company owes the director back for all funds and property transferred to the company), the director can extract those funds from the company tax-free by having the DLA repaid, rather than take a salary or dividend, which would be taxable.

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 easily and tax-free from a company.

PRACTICALITIES

Ideally, once a property investment company has been formed, the director would then promptly set up a company bank account (directors: prepare yourself for some admin hassle when doing this!).

The director would then 'seed' the company with funds for general expenses, and label such transfers as 'DLA', or 'Loan', or similar, so that it's obvious what the receipt into the company bank account is, when the company's accounts are being prepared at year-end. Obviously, it wouldn't be ideal for receipts into the company bank account to be treated as rental income, and therefore taxed!

PRESERVING THE DLA ...

During the accounts year-end process, the DLA will typically be increased by the value of:

- **Any dividends declared – eg, currently there is a £5,000 per shareholder tax-free dividend allowance (typically a director would also be a shareholder)**
- **Any interest charged by the director on the DLA – Basic Rate taxpayers can receive £1,000 per annum of tax-free interest (Higher Rate taxpayers: £500 per annum), though there is no requirement to charge interest on an in-credit DLA**
- **Any expenses that the director has incurred on the company's behalf, ie costs incurred that did not get paid through the company bank account (travel, computers, professional fees etc)**
- **'Allowances' to be claimed – home office allowance, vehicle expenses via a business mileage claim**
- **Any additional cash funds that the director wants to store in the company bank account – this can be beneficial as it means the director can charge the company interest on the increased DLA**

And, the DLA will typically be reduced by the value of:

- **Any funds taken from the company during the year – for whatever reason**
- **Any company assets taken from the company by the director, eg the transfer out of the company to the director of a property**
- **Any expenses paid through the company bank account that are not the company's expense, eg if the company bank account (or debit card) is used to pay for the director's personal expenses**

A NOTE ON TRANSFERRING A DLA TO ANOTHER COMPANY

A fairly common scenario is for a director to have a non-property company (eg, a contracting company), which is used to fund day-to-day expenses, and also a property investment company. There may then be an undesirable scenario whereby the director has an overdrawn DLA in one company and an in-credit DLA in another company.

The solution to this problem in many cases is to simply transfer enough of the in-credit DLA to the other company, in order to eliminate the overdrawn DLA, via an 'intercompany loan' (which isn't a taxable transfer).

> ***"Using a company to invest in property makes tax sense for many property investors who would otherwise suffer an excessive tax charge"***

WATCH OUT FOR ... A LENDER'S 'DEED OF POSTPONEMENT'

Lenders usually prefer a scenario where the director has loaned a company the deposit funds to purchase a new company property – quite rightly, lenders see this as a sign of the director's commitment to the company. However, as with any investment, there is risk involved even in property investing, and many investors subsequently prefer to re-finance their company in order to repay their own DLA, effectively leaving the lender as the company's sole lender.

However, since the new Section 24 mortgage interest relief restrictions have made corporate property investment more popular, lenders are keen to avoid this potentially risky scenario, and so will often put a 'deed of postponement' in place, as a condition of any finance.

This deed restricts what the director can take from the company as a repayment of the DLA – it will normally be set at a particular £ value, and be assessable at each year-end. Most lenders word a deed prohibitively, so that the financed property can be repossessed if the director takes more funds from the company than is specified in the deed – this is serious stuff!

IN SUMMARY ...

Using a company to invest in property makes tax sense for many property investors who would otherwise suffer an excessive tax charge because of mortgage interest relief restrictions, if investing personally.

Having a company repay a Directors Loan Account enables company profits to be accessed without having to extract the funds as taxable income (salary or dividends). This avoids dividend tax (for dividends above £5,000, currently) of 7.5% (for Basic Rate taxpayers) or 32.5% (for Higher Rate taxpayers).

For many property investors, drawing a small salary dividend with the remainder of any funds taken as a director's loan repayment, can mean that profits are earned in the lower-tax (19%, currently) company, and a full tax deduction for mortgage interest paid is available. Of course, all good things come to an end however, and once the Directors Loan Account has been fully-repaid, company profits then need to be extracted as salary / dividend – but often that point can be many years after the company was formed.

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