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SPOTLIGHT ON:

Director's loans: How to stay clear of unwanted tax charges

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WHAT BUSINESS OWNERS NEED TO KNOW BEFORE BORROWING FROM THEIR COMPANY

Many business owners withdraw funds from their companies beyond salary and dividends at some point. It could cover a short-term personal cost, help with a property deposit, or bridge the gap between dividend declarations.

That flexibility can be useful, but director's loan accounts come with tax rules that are easy to underestimate. If the balance is not managed properly, the company may face a section 455 tax charge, the director may have a taxable benefit, and HMRC may challenge repayments that appear to be short-term fixes.

The rules matter even more in 2026/27 because the section 455 rate has increased for new loans made from 6 April 2026.

This guide explains how director's loan accounts work, when tax charges arise, and what practical steps can help keep the position under control.

WHAT A DIRECTOR'S LOAN ACCOUNT RECORDS

A director's loan account, often called a DLA, records money owed between you and your company outside normal salary, dividends, reimbursed expenses or genuine business costs paid personally or by the company.

If you put personal money into the company, for example, to cover early trading costs, the company owes you. The DLA shows a credit balance.

If you take money out of the company for personal use and it is not salary, a dividend, an expense repayment or another business payment, you owe the company. The DLA shows a debit balance.

This distinction matters because most owner-managed limited companies are "close companies" for tax purposes. Broadly, a close company is one controlled by five or fewer participators, or by participators who are also directors. A participator is usually someone with a share or interest in the company, such as a shareholder.

The UK had around 2.1 million actively trading companies at the start of 2025, according to government business population estimates, so these rules affect a large number of small and owner-managed companies.

Section 455 of the Corporation Tax Act 2010 is designed to stop owners extracting company profits as informal loans instead of taking a salary or dividends, which would normally carry income tax and, in some cases, National Insurance.

WHEN SECTION 455 TAX APPLIES

If your DLA is overdrawn at the end of the company's accounting period, and the balance is not repaid within nine months and one day of the year-end, the company must pay a section 455 tax charge.

For loans made on or after 6 April 2026, the rate is 35.75%. This follows the increase in the higher dividend tax rate for 2026/27. Loans made before 6 April 2026 are not automatically brought into the new rate. In many cases, loans made from 6 April 2022 to 5 April 2026 remain within the 33.75% section 455 rate.

For example, say your company has a 31 March 2027 year-end, and you take a £40,000 director's loan in May 2026. If the loan is still outstanding on 1 January 2028, the company will owe section 455 tax of £14,300.

That charge is paid by the company, not by the director personally. It is reported through the company's Corporation Tax return, using the CT600A supplementary pages.

Section 455 is not a permanent tax. Once the loan is repaid, released or written off, the company can claim relief. But the timing can still create a real cashflow problem, because the money may sit with HMRC for some time before it can be recovered.

A few points are worth noting:

- The rules apply to loans made to participators, which usually means shareholders, and can also catch loans to people connected with them.
- Several small withdrawals can still create an overdrawn loan account. Taking £2,000 a month for personal spending can lead to the same problem as taking a £24,000 loan.
- The charge applies to the company, but the director can also face separate personal tax consequences if the loan is interest-free or written off.

EXEMPTIONS WORTH KNOWING

Not every company loan gives rise to a section 455 charge.
The main exemptions include:

- Loans of no more than £15,000 to a full-time employee or director who does not have a material interest in the company. Broadly, this means they do not hold more than 5% of the ordinary share capital.
- Normal trade credit on business transactions, provided it is settled within the required time limits.
- Loans made by a company whose ordinary business includes money lending.

These exemptions are useful, but they are narrow. For most owner-managed companies, the safer working assumption is that an overdrawn director's loan account can trigger section 455 unless it is cleared properly and on time.

THE BENEFICIAL LOAN RULES AND THE £10,000 THRESHOLD

Section 455 is not the only issue. If a director owes the company more than £10,000 at any point in the tax year, and pays no interest or pays interest below HMRC's official rate, the director may have a taxable benefit-in-kind.

HMRC's official rate of interest is 3.75% from 6 April 2025 (reviewed quarterly).

Where a taxable beneficial loan exists:

- The director pays income tax on the interest they avoided paying, not on the full value of the loan. HMRC calculates this using its official rate, currently 3.75%.
- The company reports the benefit on Form P11D.
- The company pays Class 1A National Insurance on the benefit, at 15% for 2026/27.

This can catch people out because the beneficial loan rules work separately from section 455. A loan might be repaid within nine months of the company's year-end, avoiding a section 455 charge, but still create a P11D benefit if it exceeded £10,000 during the tax year and was interest-free or low-interest.

The simplest way to avoid this is to keep the balance below £10,000 throughout the tax year. If that is not possible, the company can charge interest at or above HMRC's official rate and make sure the interest is actually paid.

A written loan agreement is also sensible. It should set out the amount borrowed, the interest rate, repayment terms and what happens if the balance is not cleared.

BED AND BREAKFASTING: WHY QUICK REPAYMENTS MAY NOT WORK

HMRC is alert to directors repaying loans just before the deadline, then borrowing the money again shortly afterwards. Two anti-avoidance rules are designed to stop this.

The first is the 30-day rule. This can apply where repayments of £5,000 or more are made, and new loans of £5,000 or more are taken within a 30-day period. In broad terms, the repayment can be matched against the new borrowing, leaving the original loan outstanding for section 455 purposes.

The second is the arrangements rule. This can apply where at least £15,000 is outstanding before repayment and, at the time of repayment, arrangements exist for at least £5,000 of new loans to be made. There is no simple 30-day escape from this rule.

These rules look at the substance of what happened, not just the dates on the bank statement. Repaying a loan with the intention of withdrawing the funds later can fail, even when the timing appears carefully planned.

WHAT HAPPENS IF A LOAN IS WRITTEN OFF

Sometimes, a director cannot repay an overdrawn DLA, and the company considers writing it off. This is possible, but it should not be treated as an easy fix.

For a director who is also a shareholder, the written-off amount is usually treated as a distribution for income tax purposes. In 2026/27, dividend tax rates are 10.75% for basic rate taxpayers, 35.75% for higher rate taxpayers and 39.35% for additional rate taxpayers, after the dividend allowance.

The dividend allowance remains small (£500), so most of a written-off balance may be taxable.

There may also be National Insurance and employment tax points to review, especially where the director is an employee of the company. HMRC's guidance says written-off employee loans must be reported, with Class 1 National Insurance due on the value of the benefit, though the precise treatment depends on the facts.

The company can usually claim relief for section 455 tax once the loan has been repaid, released or written off. But the personal tax cost often makes a write-off an expensive way to clear the position.

RECLAIMING SECTION 455 TAX

Section 455 is a temporary charge, but the reclaim process is not immediate.

A close company can claim relief where the loan has been repaid, released or written off. HMRC confirms that relief cannot be claimed until 9 months and 1 day after the end of the Corporation Tax accounting period in which the loan was repaid, released, or written off.

For example, if a company with a 31 March 2027 year-end repays a loan during that accounting period, the earliest repayment date for section 455 relief would normally be 1 January 2028.

The company will need details, including:

- The accounting period in which the loan was made.
- The date and amount of the original loan.
- The accounting period in which the loan, or part of the loan, was repaid, released or written off.
- The date and value of the repayment, release or write-off.

Partial repayments can lead to partial relief, so the company does not always need to clear the full loan before claiming some tax back.

REPAYMENT ALLOCATION: WHY RECORDS NOW MATTER MORE

The move to a 35.75% section 455 rate creates a practical planning point. Some companies may now have director's loans made before 6 April 2026 at the 33.75% rate, as well as newer loans made on or after 6 April 2026 at the 35.75% rate.

Where repayments are made, it is important to record which loan the repayment clears. This can affect how much Section 455 tax can be relieved, and when.

If no allocation is made, HMRC may apply default principles that do not yield the most helpful result for the company. In practice, older borrowings may be treated as repaid first, leaving newer, higher-rate loans outstanding.

The point does not need to be overcomplicated. A simple written record at the time of repayment can help. For example, the director could email the company confirming that a specific payment is intended to repay the loan advanced on a particular date.

The key is to make the allocation clear before any dispute arises.

PRACTICAL STEPS TO STAY CLEAR OF CHARGES

The rules are technical, but good habits make a big difference.

KEEP THE DLA UP TO DATE

Do not leave the director's loan account until the year-end accounts are prepared. Review it monthly, especially where the director regularly pays personal costs through the company or draws funds outside payroll.

A current DLA balance makes it easier to decide whether to vote a dividend, repay funds, charge interest or adjust drawings before the position becomes costly.

PLAN DIVIDENDS PROPERLY

If the company has sufficient distributable profits, a dividend can be used to clear an overdrawn DLA.

This must be done properly. The company should have board minutes, dividend vouchers and evidence that profits were available at the time. HMRC can challenge dividends that were not validly declared.

A dividend cannot be paid if the company does not have sufficient retained earnings. In that case, the payment may simply worsen the director's loan position.

WATCH THE £10,000 THRESHOLD

The beneficial loan threshold applies if the total loan balance exceeds £10,000 at any point in the tax year.

This means a short spike over £10,000 can still create a reporting point. If the balance is likely to exceed the threshold, decide early whether to charge interest and how it will be paid.

AVOID CIRCULAR REPAYMENTS

Repaying a loan just before the deadline and then withdrawing the same funds can trigger the anti-avoidance rules.

If the company needs to clear a loan, use a real repayment, a properly declared dividend, a salary or bonus processed through payroll, or another commercial method that reflects the facts.

PUT LOAN TERMS IN WRITING

A written loan agreement helps show that the company and director intended to create a genuine loan with clear repayment terms.

This is especially important for larger balances, repeated withdrawals, interest-bearing loans or situations where the company has more than one shareholder.

RECORD REPAYMENT ALLOCATIONS

When both old and new loans are in play, state which loan each repayment clears. This is now more important because different loans can carry different Section 455 rates.

Keep the record with the company's tax files and board papers.

ACT BEFORE THE YEAR-END

Once the accounting year has ended, the nine-month repayment clock starts. The earlier the DLA is reviewed, the more options are usually available.

A year-end review should consider the current DLA balance, likely future drawings, retained profits, dividend planning, payroll options, available cash, and the director's personal tax position.

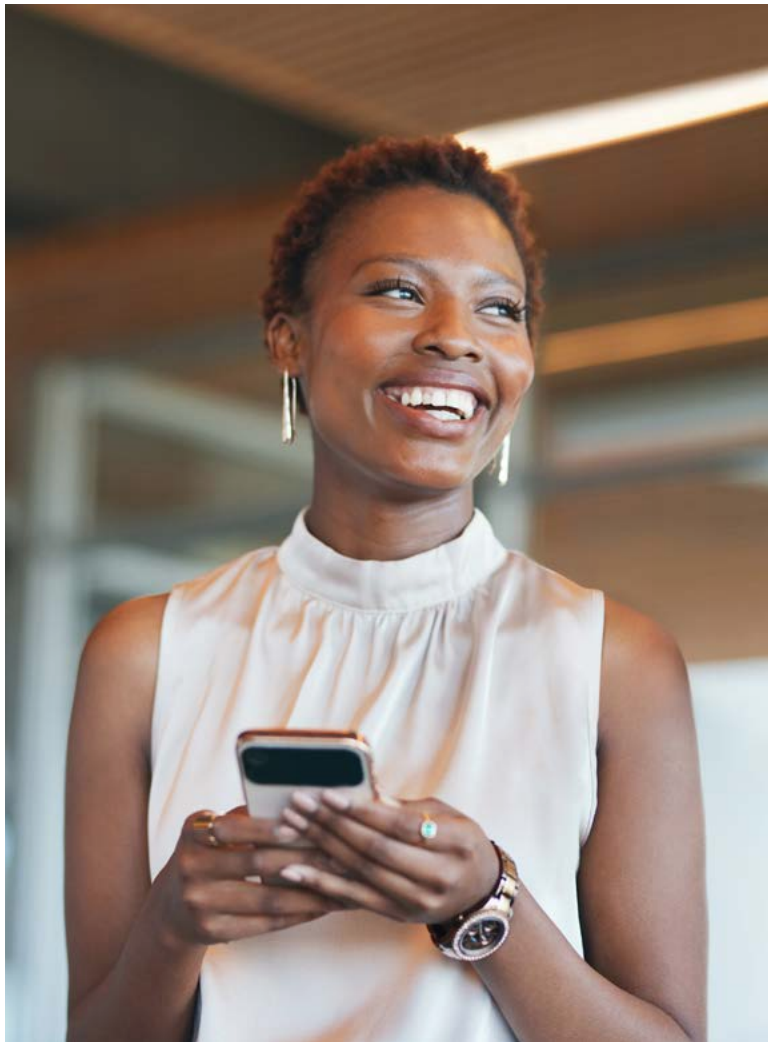
SUMMING UP

A director's loan account is a normal part of many owner-managed companies. Used carefully, it can offer flexibility. Left unchecked, it can create an expensive mix of section 455 tax, benefit-in-kind charges, National Insurance and admin.

The increase in the section 455 rate to 35.75% for new loans made from 6 April 2026 makes regular monitoring even more important.

If your DLA is overdrawn, you are thinking about taking money from the company, or you want to review the position before the year-end, please get in touch. A short review now can help avoid a much larger tax problem later.

We are here to help you.
Reach out today if you have any questions.



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