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# INSOLVENCY BULLETIN

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## A DIRECTOR'S LOAN ACCOUNT...IS A DIRECTOR'S LOAN ACCOUNT

A director can lawfully receive monies from a limited company as a salary, as dividends or as a loan. A director's loan account ("DLA") is created when a director borrows money from (or lends money to) a limited company.

Director's borrowings are usually characterised by unexplained cash withdrawals or payments to third parties made for non-business purposes. Often those payments reflect lifestyle choices.

When a company enters into formal insolvency the day of reckoning arrives. If money is owed by a director to an insolvent company such monies must be repaid. Many of our readers will be very familiar with the explanation that an overdrawn DLA is "all a bit of a misunderstanding" and that some form of credit or set off should be given in lieu of a paltry salary.

A credit may be given in lieu of "final" dividends declared previously out of distributable profits at a time when the company was solvent. However, there must still have been proper compliance with company law and accounting procedures.

By comparison, the *Sky Wheels* case in 2020 confirmed that salary could not be taken into account. That makes perfect sense, as otherwise it would give carte blanche to a director not to pay PAYE and NI.

Last month judgment was given in *Bass and Ors v Buchanan [2021] EWHC 2740 (Ch)* where the following declarations were sought:

that the director was a debtor of the Company for £286,421;

that a reclassification of sums owed on the DLA in 2014 as drawings was ineffective; and

alternatively, if the reclassification was effective, that was then a transaction at undervalue and/or a breach of director's duties.

The following excerpt from the Bass judgment epitomises, in a nutshell, the classic attempt at a defence to a claim for overdrawn DLA monies to be returned:

*"The crux of Ms Buchanan's defence is that the amounts that she received from the Company should have at all times been recorded as salary. She was officially paid a salary of (£) 6,000 but that was not commensurate with a director who often worked 15 hours a day for a business with an approximate annual turnover of (£)500,000."*

The Court was unconvinced:

*"In my judgment, it is simply not open to a director to recreate history and the basis on which they have historically received money from a company...As reflected by Ms Buchanan's failure to declare them as such, the payments she received or took from the Company's account were not, nor were they ever intended to be, salary for which she would be liable to pay income tax and national insurance"*.

Any claim that a reclassification of the loan as salary therefore fell away as it constituted a TUV and/or a breach of duty.

### Editor's Note

In the majority of situations, a salary for a director for running a company need not be criticised. Directors are entitled to make a living - but not to loan themselves monies from a company without paying those monies back to that company.



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