

Investment by way of Directors loans

As more and more owner managed businesses are struggling to obtain funding from lending institutions they are looking for alternative ways to inject cash in to their businesses. This is often achieved by way of a director's loan however, it is important to ensure that the correct security is in place to protect the investment. This article explores this popular method of investment and considers the best means of protecting the director.

It is usually envisaged that money invested into a business by way of director's loan will be paid back to the director when the company is in a position to do so. Whilst this is a method regularly used few directors consider it necessary to put paperwork in place to regulate the investment. However, ensuring that formal documentation is drawn up to secure the repayment of the loan is imperative to protect the director in the event the business hits "rocky times".

A simple Loan Agreement can be drawn up to regulate how the loan is repaid and the amount of interest which is chargeable. Interest should always be charged as this represents an income for a director which does not attract National Insurance and more over it is a tax deductible expense. The Loan Agreement will not guarantee repayment of the loan therefore it should be secured by way of a debenture over the company encompassing a fixed and floating charge. A legal charge over the freehold property of the company should also be considered where applicable. By putting in place such security a director would become a secured creditor of the company and upon liquidation the debt would take priority albeit the director may rank behind existing security such as the bank. However even as a first fixed or floating charge holder, repayment of the loan would depend upon the availability of liquidated funds within the company and there is no certainty the director will receive full repayment.

Where more than one director provides a loan and requests security, a Deed of Priority should be put in place which will provide for the proportions in which the directors will receive any available funds for repayment of the loan. For example, if three directors put £50,000 in each and on a return of assets there is only £75,000 available, where the Deed of Priority sets out that they receive payment in equal proportions then they will receive £25,000 each. A Deed of Priority can also be put in place with a bank so that a director can achieve a certain percentage of the loan back if the bank calls in their prior security.

The above method of investment can be used by all companies and if you would like to discuss the pro's and con's of the above and/or would like assistance in drawing up the relevant paperwork please contact Ruth Coleridge of Hawkins Hatton LLP, rcoleridge@hawkinshatton.co.uk or 01384 216840.