

Bolt Burdon Commercial Enews – 13 October 2006

“Neither a borrower nor a lender be...”

“...for loan oft loses both itself and friend”. So said Lord Polonius in Shakespeare’s Hamlet – and how right he was. In a recent court decision, it was held that a company director who knowingly allowed the company to make regular prohibited loans to a co-director should be treated as having personally authorised the individual loans, despite the fact he did not know the details of each specific loan i.e. the amounts in question, the repayment terms etc. He was held jointly and severally liable, with his co-director, to indemnify the company for the resulting loss (when his co-director failed to repay the loans) as well as being in breach of his duty to the company.

Under the Companies Act 1985, there is a general prohibition on a company making any loan to a director, or on the company guaranteeing (or providing any security for) any loan made by a third party to any of its directors. There are some exceptions to this rule – loans of less than £5,000, or to cover expenses incurred by a director in discharging his duties to the company, are permitted. However, many small company accounts show their directors’ loan accounts as overdrawn and this is rarely as a result of loans that fall within the statutory exceptions. As such, many companies and their directors risk civil and/or criminal sanctions under the applicable legislation.

It is worth remembering that every company director is legally responsible for the accounts that the company files at Companies House, even if he or she does not ever actually approve or sign those accounts. If the accounts show unlawful transactions (such as prohibited loans to directors) or a director discovers that such transactions are taking place, he or she must take steps to remedy the situation as quickly as possible. Failure to do so could result in personal liability for the director in question.

If your company is proposing to make a loan to any of its directors, take legal advice in advance to ensure the loan is lawful. The loan will also have a number of tax consequences for the company and the director(s) in question, so get advice from the company’s accountants as well. Otherwise you are risking more than just personal liability. In the case referred to above, the directors involved were disqualified from acting as directors of any UK company for eight years. Well, Hamlet *is* a tragedy....

If you want advice on making loans to company directors, or on any other corporate law issue, please contact Matthew Miller: matthewmiller@boltburdon.co.uk or 020 7288 4739. Or, for further details of the services we provide to our range of business and private clients, please visit our website at: www.boltburdon.co.uk

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