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The Companies Act 2014

Directors' loans and advances

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In this update on the Companies Act 2014 (the "Act") we discuss the topical issue of loans/advances between a company and its directors.

Loans to directors

The general rule of the Act as laid out in Section 239 of Part 5, is that loans, quasi-loans* or other arrangements, such as entering into a transaction as a creditor on behalf of the director of the company or of its holding company, or providing guarantees or any other security in connection with a loan, quasi-loan or credit transaction, are prohibited to directors or parties connected to directors except under the following five circumstances:

- the value of the arrangement is less than 10% of the company's relevant assets;
- the arrangement is with a group company (i.e. holding company, subsidiary or sister company);
- the arrangement is a reimbursement of the director's expenses (i.e. expenses properly incurred in the discharge of their duties as officers of the company);
- the arrangement is where the company enters into the transaction in the ordinary course of business and the value of the transaction is not greater than that which the company would offer to an ordinary person, taking out the same loan; or
- the relevant Summary Approval Procedure ("SAP") is followed with regard to permitting a company to enter into a loan or quasi-loan, or a credit transaction or to enter into a guarantee or provide security in connection with a loan, quasi-loan or credit transaction to a director or persons connected to the director.

10% exemption considered in more detail

Relevant assets in the context of the 10% exception where a company makes a loan to a director or party connected to a director refer to the company's net assets as determined by its latest statutory financial statements as laid before its AGM.

In circumstances where the company's net assets fall, and by virtue of this the arrangement with the director, the loan came to represent more than 10% of the company's net assets, then the company and the director, or other parties involved, must take reasonable steps to reduce the balances outstanding such that they are less than 10% once more and they must do so within two months after the date of becoming aware or ought reasonably to have become aware of the situation.

The open question in this instance is therefore, at what point should the director or the company be reasonably aware of such a situation? The Act provides no guidance as to what is reasonable in these circumstances.

Where directors fail to take reasonable steps to rectify this situation within the prescribed time-frame, the Act provides the arrangements shall be voidable at the instance of the company.

Summary Approval Procedure (SAP)

An innovation of the Act is the introduction of the SAP. The SAP permits companies, in a cost effective and efficient way, subject to certain procedures being executed, to perform transactions or enter into arrangements that may previously have been deemed prejudicial to the interests of the owners or creditors of a company - in this case permitting a company to make a loan or quasi-loan, enter into a credit transaction, or enter into a guarantee or provide any security to directors or persons connected to directors as prohibited under Section 239 of the Act.

*A quasi-loan is where one party settles a liability for another party

The SAP procedure is as follows for this type of transaction:

1. a declaration containing the information prescribed for each restricted activity as detailed below is made by the directors (the "Declaration") and delivered to the Companies Registration Office (CRO) within 21 days of the loan being made. Where the prescribed time-frame is not adhered to the loan will be in breach of the Act. An application to court for an order validating the activity may be sought. The court may grant such an order provided the court believes it to be just and equitable to validate the activity.
2. the members must pass a special resolution not more than 12 months prior to the loan being made giving the directors authority to make the loan (the "Resolution").
3. the Declaration must be made by at least a majority of the board of directors. It must contain specific information relating to the proposed transaction. The Declaration can, in practice, be made on the same day as the Resolution is passed and, in any event, the Declaration must be made at a meeting of the directors held not more than 30 days before the meeting of the members at which the Resolution is passed.

The directors' declaration must set out the:

- circumstances in which the arrangement is to be entered into;
- nature of the arrangement;
- name of the person to or for whom the arrangement is to be made;
- purpose for entering into the arrangement;
- nature of the benefit which will accrue to the company from entering into the arrangement; and
- declarants have made full inquiry into the affairs of the company and that, having done so, they have formed the opinion that the company will be able to pay or discharge its debts and other liabilities in full as they fall due during the period of 12 months after the date of the relevant act.

Section 210 of the Act provides that where the directors make a Declaration under the SAP without having reasonable grounds to believe that the company will be able to pay or discharge its debts and other liabilities in full as they fall due during the period of 12 months after the date of the relevant act, the court may, on the application of the Director of Corporate Enforcement, a liquidator, creditor, member, or contributory of the company, declare that the **directors shall be personally responsible, without any limitation of liability for all the debts of the company**. Where a company is wound up within 12 months of the Declaration, there is a rebuttable presumption that the directors did not have such reasonable grounds.

Previously, personal liability for all or some of the company's debts only applied to an individual who benefits from an arrangement (i.e. a loan, quasi-loan or credit transaction) in circumstances where:

1. the company is being wound up and is unable to pay its debts; and
2. the court considers that the arrangement has contributed materially to the company's inability to pay its debts or has substantially impeded the orderly winding up of the company.

The use of the SAP to legalise a director's loan arrangement will expose all directors to unlimited personal liability for the debts of the company. Prior to utilising the SAP to legalise an activity, the directors should carefully consider the fact that they could be exposing themselves to unlimited liability. We would recommend that independent professional advice be obtained before undertaking any action.

Evidential requirements on loans by a company to its directors

Part 5 of the Act sets out the various rules regarding evidencing loans made to directors. Section 236 specifically lists the rules regarding any loan or quasi-loan made by a company to a director (or any connected person of a director) of the company or its holding company. The basic principle is that if the terms of the loan are not set out clearly in writing (or are set out in writing but are not sufficiently clear), then it shall be presumed, until the contrary is proven, that:

- the loan is repayable on demand; and
- until such time as the loan is repaid, it has borne interest at the appropriate rate. The appropriate rate as currently defined by the Act being 5% or as may be specified by Ministerial Order.

It is worth noting that the usual tax provisions apply to loans to directors. BIK and income tax will still have to be paid on these loans in the normal course.

Careful consideration is needed and consultation with the appropriate professional advisors should also be obtained (tax, accounting or your legal advisors etc.) prior to formalising a loan to a director or person connected to a director.

Advances by a director to the company

Section 237 of Part 5 of the Act sets out the various rules regarding loans by directors (or connected persons) to the company or its holding company. Where the terms of any transaction or arrangement by a director to the company or the holding company are not set out clearly in writing or are ambiguous as to whether the arrangement constitutes a loan or quasi-loan, then it is presumed that:

- the transaction constitutes neither a loan or a quasi-loan and instead constitutes a gift or capital contribution.

Where it is proved that the transaction does in fact constitute a loan but where the exact terms are ambiguous then under the provisions of the Act the actual nature or substance of the transaction or arrangement is presumed rather than being adequately formalised in writing. Therefore, depending on which terms are ambiguous the loan:

- may be deemed to bear no interest;
- may be presumed not to be secured; or
- is proved to be secured but the terms are ambiguous with regards to its priority, then it may be deemed to be subordinate to all other debts of the company.

Conclusion

The Companies Act 2014 sets out very specific rules regarding loans and advances to and from directors and the importance of documenting such transactions. Transactions with directors of a company must be given due consideration prior to entering the transaction to ensure that the requirements of the Act are met. Inadvertent breaches are commonplace and, under the new Act, may have greater implications for directors including unlimited liability for the company's debts and liabilities.

The introduction of unlimited liability for directors in certain circumstances greatly increases directors' accountability and directors should be made aware of the implications of this change prior to using the SAP to validate a prohibited activity.

Contact

If you require assistance or want to learn more about the Companies Act 2014, please refer to our other publications at www.grantthornton.ie or contact our Companies Act 2014 team at companiesact2014@ie.gt.com.

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