Dividend Payments

In many small companies, the owners are also the directors, and this gives considerable scope for deciding how profits should be taken out of the company.

The declaration of a dividend has for many years been a strategy adopted by many small businesses. Traditionally, small companies pay salaries to the directors and tend to ignore their second role as shareholders, which entitles them to receive dividends.

This help sheet outlines the main considerations for declaring dividends.

Tax Implications

Corporation tax is charged on the profits of the business after taking into accounts all salaries, whilst Income tax is chargeable on all profits withdrawn from a company.

Paying a salary reduces profits and hence reduces the corporation tax bill. Income tax is then collected through the PAYE system, and National Insurance contributions are payable.

Currently, dividends carry a 10% income tax notional credit resulting in a basic rate tax payer having no further tax to pay. A higher rate tax payer has further income tax to pay equal to 25% of the gross dividend, while an additional rate taxpayer liable to the 45% rate of tax will pay additional income tax equal to 30.6% of the gross dividend.

From 6 April 2016, the 10% notional dividend tax credit is to be abolished and individuals will instead have a £5,000 tax free dividend allowance each year. Dividend income in excess of the annual allowance will be taxed according to the taxpayers' income tax band; basic rate tax payers will be liable to pay income tax at 7.5%, higher rate taxpayers at 32.5% while additional rate taxpayers will pay income tax at 38.1%.

Assuming an individual receives a salary of £8,000 and receives a dividend, a summary of the position is as follows:

Dividend	**2015/16** After tax income	**2016/17** After tax income	**Decrease**
£9,000	£17,000	£16,925	£75
£13,500	£21,500	£21,088	£412
£18,000	£26,000	£25,250	£750
£40,000	£45,997	£44,350	£1,647
£50,000	£53,497	£51,100	£2,397
£60,000	£60,997	£57,850	£3,147

Whilst the tax savings will decrease from April 2016, dividends will still be more tax efficient than a bonus.

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When can dividends be paid?

Dividends may be paid only out of profits for the year, or any undistributed profits from previous years.

Additionally, all shareholders are entitled to dividends in proportion to the number of shares held. This means that non-working shareholders are entitled to any dividend declared.

This can be countered by creating different classes of share with different dividend entitlements.

Cashflow

PAYE and national insurance on salaries are payable monthly, whereas corporation tax is payable nine months and one day after the company's yearend. Additional income tax on dividends is payable on 31 January after the end of the tax year in which the dividend is paid (payments on account may be required).

Other considerations

To ensure tax compliance, we would urge you to consider the following points and act on them accordingly:

- Vote dividends on a per share basis rather than trying to use a total figure
- In order to avoid attack from HM Revenue & Customs under the settlements legislation be careful about issuing shares to family members especially minor children. If you have any doubts on this matter, please contact us.
- Do not give effect to a dividend waiver unless the waiver is signed and delivered before the dividend is due. Avoid waivers by higher rate taxpayers in favour of those paying basic rate – they are also open to attack under the settlements legislation.
- Ensure contemporaneous evidence of payment is available, i.e. cashbook entries, minutes of board meetings, dividend resolution and divided vouchers – we can help you with proforma documents if necessary.
- It may be prudent to obtain board meeting minutes the signature of all directors and the company secretary as this will strengthen the validity of the document and ensure all company officials indeed support the resolutions involved.
- Do not, under any circumstances, 'backdate' documents.
- Dividends can be paid by cheque or transfer to a loan account. Avoid transferring dividends to joint loan accounts between husband and wife whenever possible.
- Do not pay dividends where there are insufficient reserves – the dividend will in whole or in part be unlawful and therefore legally void. Also, dividends should not be paid if it would be generally imprudent to do so, specifically if as a result the company were unable to pay its debts as they fall due. It is imperative therefore that you have reliable financial information to hand when dividends are declared.
- Be aware that until the first annual accounts are produced, any dividend will be automatically unlawful unless the initial/management accounts have been produced to evidence sufficient distributable profits.

If you would like further information or advice please contact one of our team

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