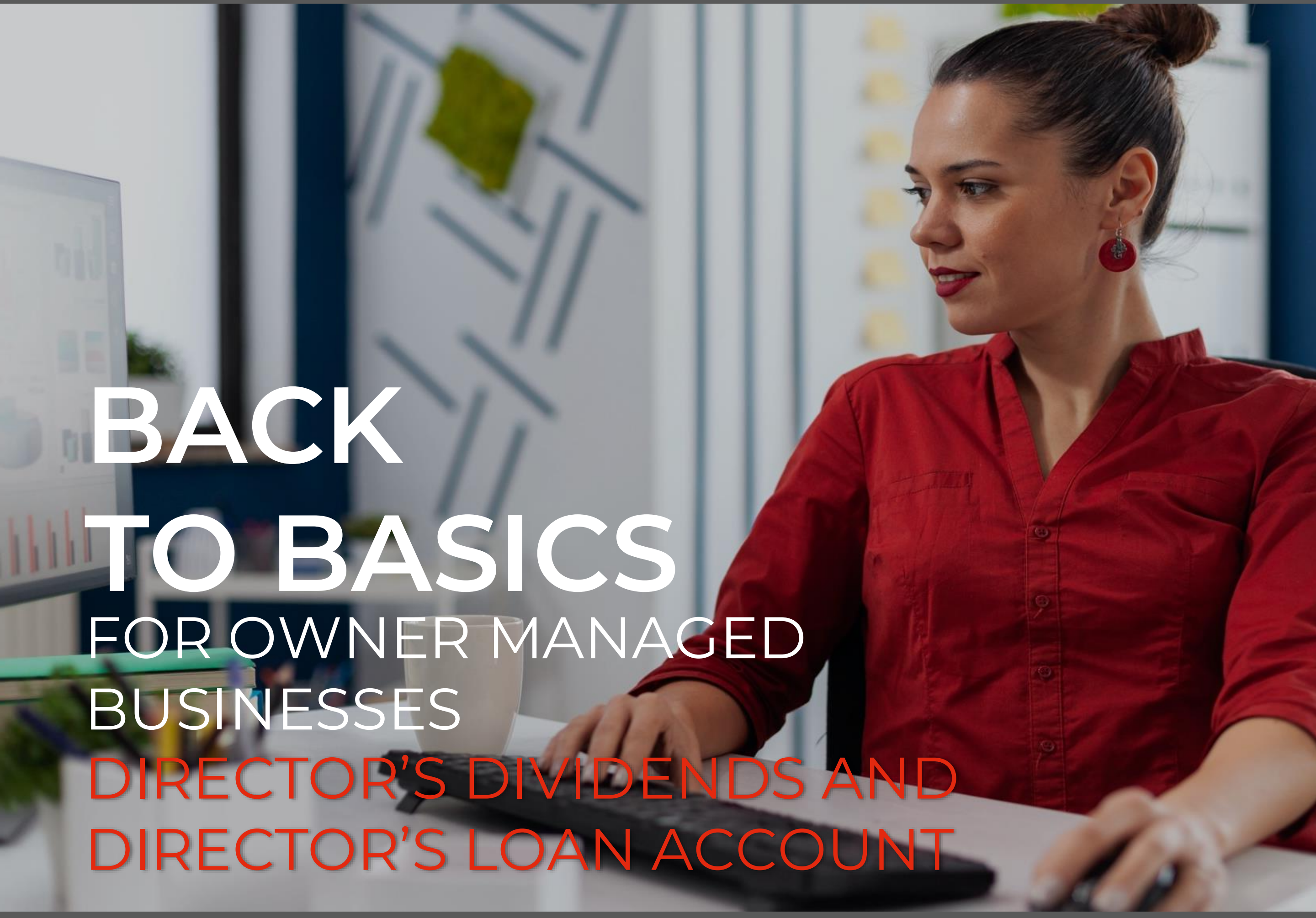
MD ACCOUNTANCY

TEAM LIMITED



BACK TO BASICS

FOR OWNER MANAGED BUSINESSES

DIRECTOR'S DIVIDENDS AND DIRECTOR'S LOAN ACCOUNT

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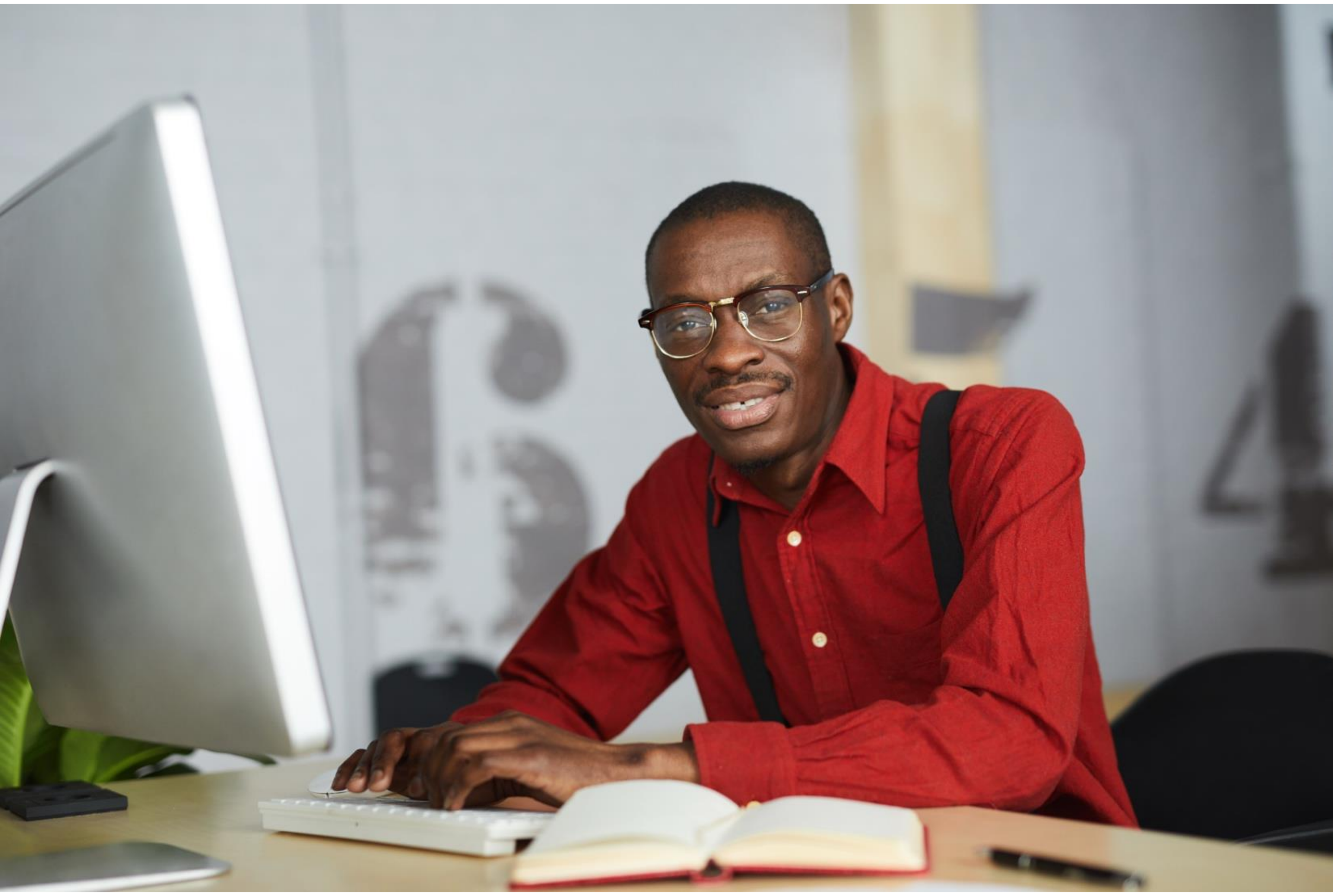
Director’s drawings from a company

When a director draws money out from a company in which they are also a shareholder, there is only 3 possible classifications for that money:

- Salary
- Dividend
- Loan

Director’s Salary

Unless the director’s salary is less than the Lower Earnings Limit for National Insurance AND there are no other employee earning more than that amount AND neither the other employees nor the directors are employed elsewhere, for a payment to a director to be a salary, the company must be registered as a payroll and the salary must be declared to HMRC under Real Time Information.



Declaring Dividends

What is the procedure for declaring dividends?

1. The directors must review the accounts and check there is sufficient profit - making sure provisions have been made for corporation tax and any other liability
2. The directors must call a meeting and propose a dividend. Minutes of the meetings are required as evidence a dividend has been declared. They will be the company's record of the dividend.
3. Dividend Vouchers are issued to shareholders. They are the shareholder's records of the dividend for their own tax affairs
4. Payment of the dividend must be made to the shareholders (or credited to their director's loan account for future drawing)
5. Records of the dividends must be made in the company's accounts.

What's the risk if you don't do things properly?

Unlawful Dividends – If a dividend is paid when a company does not have sufficient profit, it is an unlawful distribution. The director of a close company is unlikely to be able to argue that they lacked knowledge of the state of the company's finances here. The amount paid is therefore not a dividend, and must be repaid.

If the company becomes insolvent, directors will become personally liable to repay the unlawful dividend to the company.

If the company remains solvent, the sum may still require repayment, which may leave an outstanding balance on a director's loan account triggering a tax charge for the company (See Director's loans on the next page).

Not A Dividend - If the company has sufficient reserves, but the correct procedure isn't followed, then the payment is not a dividend. It will be treated as a loan, or in the absence of any documentation, if investigated, HMRC may argue that it should have been a salary and calculate tax and national insurance due on it.

If the company becomes insolvent, directors will become personally liable to repay any loan to the company.

If the company remains solvent, a loan will still require repayment, which leaves an outstanding balance on a director's loan account triggering a tax charge for the company (See Director's loans on the next page).

Director’s Loan

A director’s loan is when the director gets money from the company that is not:

- a salary, dividend or expense repayment
- money they have previously paid into or loaned the company

It also includes any accidental personal purchases made out of the company’s bank account which aren’t repaid.

The director's loan account (DLA) is where you keep track of all the money you either borrow from your company, or lend to it.

What are the tax and other implications of loans to directors?

- Loans to directors are fully repayable to the company. If the company becomes insolvent, the director will be held personally liable for any loan, which could lead to personal bankruptcy. You could also be held responsible for the company’s financial situation if the loan is one of the reason for the company’s decline.

- If the loan is over £10,000, the company must charge interest at HMRC’s approved interest rates (2% from April 2022), or treat the interest as a benefit in kind, which must be declared to HMRC using form P11D

- Loans to Participators (shareholders with over 5% of the charges in a close company) must be disclosed to HMRC in the company’s corporation tax return

- Loans to Participators which are not repaid within 9 months of the company’s year-end trigger a temporary tax charge at 33.75%. This is refunded 9 months after the year end of repayment.

- Note that the payment of a director’s or employee’s personal bills is classed as earnings for National Insurance purposes and class 1 National Insurance should be charged through the payroll. The time and cost of compliance in this respect is high and such transactions should be avoided.

Understanding the differences

Company

Payment to Director
(or close family members)

Is it a salary?

- Declared to HMRC
- under RTI
  or
- under £120pm

NO

Is it a dividend?

- Sufficient reserves
- Board meeting held and minutes produced
- Dividend voucher produced

NO

It's a loan

!

The recipient is personally liable for the loan

YES

Salary deductible for corporation tax

Salary taxable for the recipient
(0-20%
40%
45%)

YES

Dividends paid from post-tax profits <u>not</u> deductible for corporation tax

Dividends taxable for the recipient
(0%
8.75%
33.75%
39.35%)

Payment <u>not</u> deductible for corporation tax

Additional tax at 33.75% if loan not repaid within 9 months of year end

Employer national insurance payable on cash equivalent if loan >£10,000 and no interest charged

Recipient is taxed on cash equivalent of interest if loan >£10,000 and no interest is charged

- Tax in the company
- Personal tax

Top Tips

- Make sure you run a compliant payroll if you want salaries
- Avoid paying personal transactions with company's funds
- Review your profits at least as regularly as you want to take dividends
- Understand how to document a legal dividend and don't wait till your year end to try and remember the decisions made
- Understand the legal and tax implications before taking a director's loan
- If unsure seek advice

Questions and more information

If you have any questions, or would like further information about anything contained within this Back to Basics factsheet, please speak to a member of our team who will be happy to assist you.