

How To Avoid Illegal Dividends

It is vital for contractors to get their dividend payments right in order to preserve the tax status of the transaction. If the dividend is deemed to be not “legal” then what was the payment for? HMRC would probably try to argue that it is a payment of salary and should therefore have PAYE deducted accordingly. Or perhaps it’s a loan from the company until the dividends have been declared some time after the end of the accounting period. In either case you could end up paying more tax than you originally intended.

Follow the steps below to ensure your dividends are legal dividends. Don’t risk having to pay more tax than you have to.

Step 1: Prior to declaring a dividend you need to work out whether the company has sufficient reserves. This does not mean that if the money is in the bank account then its ok! What it does mean is a profitability review using Generally Accepted Accounting Principles (GAAP) to establish the *realised profits* of the company. This review will also take into account any corporation tax which may due on these profits.

Step 2: It must be demonstrated that this review has taken place. The actual review may not be a long process but there must be evidence to show that a consideration of the company’s profits has taken place.

Step 3: Once the above has been established then the correct paperwork must be issued. This involves producing the minutes of the meeting in which the dividend was declared and also the issuing of the dividend vouchers to all the shareholders.

Contractors who leave this process until the end of the year, but still make in year payments to themselves from their limited company, are putting themselves at risk of having to pay more tax than was originally intended. By signing up to the monthly contractor service with ABM, this process is completed for you every month. If you would like to find out more information regarding the issuing of interim and final dividends or clarification on your own position, then please contact Loraine Sullivan.



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