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Pay yourself by dividends and reduce your tax bill!

One of the main tax advantages of running your own company is an ability to decide how you draw money from the business. We are looking at situations where the directors and shareholders are the same – or family members – and where a pooling of interests (and therefore income) is possible.

This flexibility is important because at different times, the different methods of drawing funds offer tax advantages and disadvantages.

For some time there has been an advantage in structuring director / shareholder benefits to pay a lower salary and take a bigger proportion of income as dividend.

Dividends are the sharing out of taxed profits to shareholders and are normally voted once or twice a year; the same concept applies to dividends from shares held in a FTSE company and may be familiar.

The difference is that **you** can decide the timing and amount of the dividends, subject to there being available profits. This can have advantages when your company's financial year bridges two income tax years, allowing you to decide into which income tax year the dividends fall.

Dividends can be paid from the accumulated post-tax profits of the company i.e. not just the current year but any accumulated profits from previous years. The company pays corporation tax on its profits in any one year and the "after tax profits" is added to a pot which can be used for dividends.

A "Director's salary" is still paid, this being a tax efficient amount geared to use up your personal allowance and to ensure that you record a National Insurance contribution in order to secure state pension rights.

The dividends which are paid don't suffer NI contributions in any form – employer or employee – and savings can be made compared to paying a higher salary or if you were self employed (one reason to consider incorporating your business).

Currently the first £2,000 of dividend income is tax free; you also have the ability to give shares to a partner / spouse and so divide the dividend income and get £4,000 tax free combined.

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In terms of timing, you don't have to take ALL of the profits in any year as dividend – so if you don't need the funds they can stay in the company, where they've suffered corporation tax - but no more. The profits are therefore ring fenced and available for you to take in the future.

Although the dividends might only be voted once or twice a year, it doesn't mean that you can't take funds on a monthly basis from the company; you can run a "tab" with the company, drawing what you need when you want.

The dividends are "credited" to the tab account, clearing any negative balance or providing you with a balance to draw upon.

The "tab" is called a Director's Loan Account and provided any overdrawn balance is less than £10,000 at the end of the company's financial year, there is no reporting requirement to HMRC (although there are certain actions to carry out).

This is a simple guide to an approach widely adopted and providing benefits to director/shareholders everywhere.

Please call or email to make an appointment – NO OBLIGATION OR CHARGE – to discuss your personal situation and to see how we might help.