

Contractor Doctor: How can I account for overpaying my dividend?

Dear Contractor Doctor,

On reconciling my net profit I have calculated that I paid myself a dividend that is in excess of the net profit made by my limited company.

How should I account for the overpayment of dividends?

Thanks

Ian

Contractor Doctor says:

According to Phil Richards of accountant [Blevins Franks](#), the most effective way to deal with an overpayment of this type is to treat it as a loan to the director: "If a contractor has paid themselves, for example, a [dividend](#) of £10,000 and the profit in the period was only £9,000, the contractor should treat the remaining £1,000 as a loan from the company."

"As long as the loan amount is less than £5,000 and the loan is repaid within nine months of the end of the tax year in question," continues Richards, "the contractor will have no problems with their P11D and no corporation tax liability on the loan."

No profit - no dividend

Technically, unless there is a declared profit contractors cannot pay dividends to themselves even if there is cash in the company to afford a payment. So how can contractors overpay their dividends?

"In this particular case, it appears that the contractor has been taking too much cash out of the business," explains Richards. "To avoid this scenario, I would recommend that contractors run monthly management accounts that can give them a regular, up-to-date snapshot of the company's cash and profit position."

Contractors can ask their accountant to prepare monthly management accounts, or they can create their own system. It is well worth the effort if there is the possibility that a contractor's monthly cash requirement is likely to exceed profits.

Reversing dividend decisions

Contractors who are adhering to the rules should have held a meeting and formally [declared a dividend](#) and issued a [dividend voucher](#) to themselves, and other shareholders.

But even if this has been done, it is still not a problem, as Richards explains: "Just because a contractor has held a formal meeting to declare a dividend does not mean that the contractor can't hold another meeting to reverse the dividend decision and to turn the overpayment into a loan."

As long as the meeting minutes and records clearly state what has been decided then the contractor is clear to repay the loan as soon as they have cash available to do so.

Avoid the notice of HMRC

However it is corrected, Richards says that it is important to take action before another financial year passes: "Contractors should have ample time to correct a dividend overpayment once they have discovered the oversight by creating the paperwork for a loan."

But, warns Richards, don't let the overpayment remain through another financial year: "If HMRC spots the dividend overpayment in a contractor's accounts and there has been no correction in the following financial year, they will take a very dim view of the contractors accounting."

Contractors should avoid the attention of HMRC whenever possible as it could spark an [investigation](#) and a challenge over [IR35](#) status. And because the solution is potentially so simple, contractors would be unwise to risk their IR35 status over an overpayment issue.

"Ideally contractors should avoid the issue entirely," concludes Richards, "by keeping a close eye on their finances during the year using regular management accounts."

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Phil Richards, Blevins Franks

Good luck with your contracting!

Contractor Doctor

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