

Contractor dividend timing and dividend waivers

Contractors who use their own [contractor limited company](#) can maximise their tax efficiency by [paying themselves a low salary](#) and taking additional remuneration from their business in the form of [dividends](#).

However, Phil Richards of specialist contractor accountant [Blevins Franks](#), urges contractors to consider seriously exactly how much dividend they should pay themselves, when to raise the dividend and when to pay it. The reason is that each of these factors can contribute to increased tax efficiency and reduced risk of attracting unwelcome attention from [HMRC](#).

"Dividend payments are not a salary and the company is not a personal piggy bank for the contractor to draw on at a whim," explains Richards. "A well-informed contractor can maximise their tax efficiency and minimise their compliance risks by careful treatment of company dividends."

Calculating dividends

The first step in dividend management is to calculate how much of a dividend can be paid. Dividends can only be paid out of the profits of a limited company, and if the company is not making a profit then it should not be paying a dividend.

"Good management accounts will tell the contractor at any particular time how much profit there is in the business," continues Richards. "Our recommendation to stay below HMRC's radar is for the contractor to calculate the minimum cash they need to live on, the maximum amount of dividend the profits in the company will allow, and pay themselves something in between."

And they should also take into consideration their [dividend tax planning](#), particularly with regard to the 40% tax bracket, when considering the amount of dividend to pay. In other words, they should either have a management system that tells them how much they have earned in the fiscal year or have regular conversations with their accountant.

Contractors should avoid what are known as '[ultra vires](#)' dividends, warns Richards, who explains: "This is when a dividend has been paid when it should not have been, typically when there is not enough profit in the company to do so."

It's all about timing

"There is a difference between 'raising' a dividend and 'paying' a dividend," says Richards. "To raise a dividend is an accounting exercise and goes straight into the profit and loss account of the business, whereas dividend payment is a cash flow issue."

That means a contractor can raise a dividend, which is an exercise in [dividend paperwork](#), but does not have to actually pay the dividend, which means moving cash about. Or they may not be able to pay the dividend because there is not at that time enough cash in the company.

But how would raising and not paying a dividend be useful? Richards explains: "It's quite common for a contractor to raise a dividend and not pay themselves because the company might still be owed fees from the client. Therefore, the company cannot pay, and the contractor is a creditor. When the company gets the money from the client, the company is free to pay it."

Tax allowances

According to Richards, another example of when a contractor may wish to raise a dividend, but not pay themselves immediately, is on 31st March at the tax year end: "If a contractor has not used their full lower rate tax allowance, they may wish to declare a dividend before the end of the tax year."

Assuming the company was profitable enough to do this, the contractor would be able to use the full extent of their lower rate tax band and pay themselves when the company had the cash.

"Contractors can also choose to defer payment of the dividend until it is more tax efficient for them to do so," says Richards.

Dividend frequency

"If contractors are generating profits on a regular basis, then it is perfectly reasonable for them to raise and pay a dividend on a periodic basis," continues Richards. "However, a contractor making a regular monthly dividend of the same amount from irregular income and profits could be challenged by HMRC to be paying themselves a salary."

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And the converse is true – if the contractor limited company had a regular stable income, with regular profits, and the contractor paid themselves a regular dividend (but as before between the minimum cash the contractor needs and the maximum dividend that could be paid), HMRC would have difficulty challenging this on any reasonable grounds.

Absolute don'ts, warns Richards, are: "Standing orders or direct debits. Ideally, contractors should make three separate payments to themselves each time they do make a payment: [expenses](#), [salary](#) and [dividend](#), with each accounted for separately. That way, HMRC has no grounds to take the contractor to task."

Dividend waivers

Some contractors may have heard on the grapevine that dividend waivers are a good wheeze, allowing contractors to shift their dividend payments onto their spouse to save tax.

Not so, insists Richards, especially since a recent ruling, [Buck v Revenue & Customs](#), which is explained in Richards' [blog](#) on the case. "HMRC has [clearly demonstrated](#) that it considers dividend waivers in limited companies as potentially a settlement, and therefore solely as a means to avoid tax."

Contractors trying this one on will find themselves given short shrift by HMRC, and are likely to gain little sympathy from their professional advisers when a large tax bill arrives on their mat.

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