

## Dividends - calculation, payment and taxation

Editors note: Our content about dividends has been updated. Please see [Dividends and contracting: calculation, payment and taxation](#).

### Introduction

Many contractors choose to operate using a limited company structure for the advantageous tax advantages which can be gained by taking a small salary and dividends.

This article explains what dividends are, and how they can be calculated.

### What is a dividend?

A dividend is the distribution of 'after tax profits' to the shareholders of a limited company.

After tax profits = Total Revenue – Expenses – Company Taxes.

Any [limited company](#) which has generated profits can pay out a dividend to the shareholders.

### Dividends and IR35

Most contractors using a limited company operate a "service" business. It is essential that the income is outside the scope of [IR35](#) for dividends to be paid.

Any income caught by IR35 must be paid out as a salary and does not result in company profits after corporation tax. Therefore dividends cannot be paid.

In some instances part of the income could be outside IR35 with the rest inside IR35. Company profits would then arise only for the income outside of IR35.

### Tax advantages of dividends

For contractors outside IR35 dividends provide a tax efficient way of earning income. A [small salary](#) combined with dividend payments avoids large National Insurance (NI) payments.

Also, for higher rate tax payers, dividends are taxed less than the higher rate tax of PAYE tax.

### Avoiding illegal dividends

Dividends are only considered to be "legal" if they are correctly made out of company profits after corporation tax. It is important to avoid [illegal dividend distributions](#) and thus avoid issues with company law and corporation tax.

### Documents required

Every time a dividend is paid, [dividend documentation](#) must be prepared:

#### Company Board Minute:

This should state the date of the meeting, which is usually the date the dividend is actually paid and that "It was resolved that an interim dividend of £[X] be paid to the shareholders on [Date]".

Each board minute should be signed by the company director and filed in the company's statutory records.

For contractor service companies the accountant would normally prepare these. However, they must be informed when payments are made, so the documents can be prepared at the time the payments are made.

A common error is to forget to prepare the documents or simply believe a dividend can be voted when the accountant prepares the accounts following the year end.

Such behaviour can cause profound problems in the event of a tax inspection, with inspectors of taxes arguing that the payments were not approved and as such, were not in fact dividend payments at all but net salary for grossing up with income tax and employers/employees national insurance contributions!

#### Dividend Counterfoils:

A [dividend counterfoil](#)/voucher must be prepared for each shareholder to whom a dividend is paid.

This document shows the amount of the net dividend and the tax credit at the rate of 10% (equivalent to one ninth of the net

dividend).

### How often can dividends be paid?

Dividends can be [paid at any time and frequency](#) as long as they are "legal", meaning paid from company profits after corporation tax together with the correct preparation of documents.

Large companies tend to pay dividends once every quarter, but there is nothing in statute or tax law preventing a company from paying monthly dividends.

### Calculation of dividends during the year

To ensure dividend payments are not made in excess of company's profits after corporation tax, you should keep a monthly running total of the approximate profits generated and restrict any dividend payments accordingly.

In general terms, the approximate amount of available dividend can be calculated as follows:

	£
Income received from your agent (excluding VAT)	XXXX
Less: Expenses (including salary, employers NIC and all other costs incurred)	XXXX
Taxable profit	XXXX
Less: Corporation Tax @19%	XXXX
Maximum dividend available for distribution to the shareholders during the month	XXXX
Dividend paid	XXXX
Distributable profits carried forward	XXXX

You do not need to take out the maximum available dividend in every month. It is often better to take out what you need to live on and leave a balance in the company for future dividend distribution.

Also, any accumulated after tax profits in the company can be paid as a capital distribution when the company is finally dissolved. Such a distribution may qualify for capital gains tax exemptions and reliefs.

### Tax Issues

Basic rate tax payers have no further tax liability on net dividends received. The 10% tax credit effectively "franks" the dividend payment for the basic rate of income tax. This is the case regardless of the company's actual payments of corporation tax.

For higher rate tax payers 25% of the net dividends received from the company need to be put aside for further tax. This is payable when personal tax returns are completed.

### Dividend splits and shareholdings

Contractors often [split their dividend](#) with their partner/spouse to reduce the amount of extra dividend tax payable due to higher rate tax.

Dividends must be paid in equal proportion to each shareholder's holding. Separate cheques should be issued, so that in the event of an enquiry it can be clearly seen that each shareholder received the correct amount.

### Dividend waivers



A shareholder is entitled to waive their dividends. Any such [dividend waiver](#) should be evidenced in writing by the shareholder in a letter addressed to the company secretary or director, clearly stating the shareholder's authority for the waiver.

### Dividends and Section 660

Where dividends are paid to spouses/partners, a [section 660](#) problem may arise and professional advice should be taken in this connection where a non working spouse/partner is in receipt of substantial dividend payments from the company.

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David Colom qualified as a Chartered Accountant in the City of London in 1981 and is the founder and principal of D J Colom & Co Chartered Accountants established in 1989.

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- Section 660 Calculator

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