

Splitting dividends to maximise net income

Introduction

Splitting company [dividends](#) can be an effective way of maximising net income. This article explains what dividend splits are, the effects on net income, and [Section 660](#) related issues.

Who can take Dividends?

Contractors can get income via the dividend route if they are outside IR35 and are either using a Limited Company payment structure or a composite company Umbrella service.

As the "owner" or shareholder of your limited company, you are entitled to take dividends on your shares. Dividends can only be paid from the profits your company makes, after all expenses, including salary and corporation tax.

The profits must have been generated from income which falls outside the scope of IR35. IR35 income must be paid as salary, thereby reducing the company profits to a negligible amount.

What is a Dividend Split?

The shareholding of the company can be "split" between yourself and one or more people, for example, a 50:50 split between a husband and wife.

In this example, since the shareholding is split, any dividends paid out by the company would also be split on the same basis, thereby splitting the income in the same proportion as the shareholdings.

Is It Legal?

The issue of shares to other parties is quite legal, although there may be tax implications of paying dividends to substantial shareholders who have not made an investment in the company or actually work/generate income for the company.

Specifically, HMRC may refer to [Section 660](#) (of the Income Tax Act 1988) and thereby seek to tax the main income producer on the entire dividend payment made by the company, including that paid to a non working spouse.

This has only become a problem since late 2003 and prior to that time, it has been common practice for many years to split dividends on a 50:50 basis between a working and non working spouse.

Share ownership can be split, either by issuing separate shares to each shareholder or by jointly owned shares.

Following the potential problems which can arise as a result of Section 660, it is likely to prove advantageous for shareholdings to be joint rather than separate. In order to avoid a claim by HMRC that a settlement was made, it is important that the joint shareholding arose from the time that the company was incorporated.

The financial effects of being caught by Section 660 can be determined using the [Section 660 Calculator](#).

How Much Difference in Income can Splitting Dividends Make?

The difference can be illustrated by the following two typical examples:

Example 1: Main earner on £40 per hour, with a partner with no income.

Assuming a 35 hour week and 45 working weeks per year, this would generate gross income of £63k.

Joint split on a 50:50 basis between husband/wife

	Limited Company Income	Net Income
Income from contracting	£63,000	
Less: Salary paid	£4,500	£4,500
	£58,500	
Less: Corporation Tax of 19%	£11,115	
After Tax Profit distributed as dividend	£47,385	£47,385
		£51,885

If the entire dividend of £47,385 was paid to a sole shareholder, then the higher rate tax liability would arise of £4,957 and this is the saving achieved by splitting the shareholding/dividend.

This is because basic rate tax payers have no further tax liability on net dividends received. The 10% tax credit received with the

dividend effectively "franks" the dividend payment for the basic rate of income tax.

Example 2: Main earner on £40 per hour. Partner on £8k per year.

This assumes the partners income is from a separate source outside the contracting company.

With a 50:50 split the working partner will become a higher rate tax payer because of their other income and would be assessed to higher rate tax of £2,605.00.

Thus, the result of the partner having another source of income, decreases the benefit of the dividend split.

In a case where the partner is already a higher rate tax payer, there is no point/advantage in splitting dividends.

Dividends can be split in a different ratio than 50:50 to obtain maximum tax advantages by utilising the tax allowance of both partners.

Reaching the Optimum Split

The optimum dividend split would result in a situation where the partner's taxable income is exactly at the higher rate tax threshold, i.e. total income of £36,145 (taking into account personal allowances).

No further benefit can be obtained by transferring higher rate taxable income from the contracting partner to the non contracting partner.

At the time the limited company is set up, a contractor should discuss the joint income situation, in order that a calculation can be carried out to set the shareholding/entitlement to dividend payable.

You can determine the effect of splitting dividends using the [Contractor Calculator](#)

Who Can Receive a Dividend

Shareholdings can be placed in the name of any third party, including children and other family members, although it should be noted that in the case of minor children, any income arising from an investment set up by the parent, would be taxable on the parent.

Other Matters

Dividend waivers.

A technique sometimes advised by accountants is for one shareholder to take a dividend waiver from time to time. The effect of this is to temporarily cease paying dividends to that shareholder, thereby increasing the income of the other shareholder. Although this does work in theory, it is particularly provocative to Inspectors of Taxes who are prone to investigate accounts where dividend waivers are made.

Effect on pensions



Reducing salary and paying high dividends will affect the amount of pension premiums a company can make. Conversations with the company accountant and financial adviser are necessary if pension planning is an issue.

Separate classes of shares

Companies can be set up with different classes of shares, which may have similar or different rights to assets, income and voting. Such schemes may be appropriate for more complex tax planning situations and should be discussed with a qualified accountant in appropriate circumstances.

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