Backdating dividend payments to a previous tax year is asking for trouble

Limited company contractors who have adopted a strategy of declaring dividends prior to April 2016 but who have not yet paid them out can still attract the dividend tax rates for tax year 2015/16, providing they can provide sufficient evidence to prove it was declared and payable before 6 April 2016.

This is according to Duncan Strike of specialist contractor accountancy firm **Intouch**, who warns contractors against backdating dividends that can easily be proven wrong.

“Misleading HMRC in any way, shape or form is wholly wrong, and can lead to unintended consequences for the contractor,” he explains. “The right thing is to consider your financial needs and create an income plan early in the tax year, and then to reassess that prior to 6 April, making any changes in a timely way. This would negate even the consideration to backdate dividends as you would have made any necessary transactions in time.”

Few benefits to holding back dividend payments

Whilst it is quite commonplace for directors of contracting companies to declare a dividend and leave the money within the company, Strike points out that there are no benefits to doing so unless you intend to allow the company to invest those funds.

"It's more of a disadvantage because you're leaving your personal money in the hands of the company," Strike adds. "Therefore it is as at risk to commercial issues as any other company money would be."

Legitimately declared dividends can still attract less tax

“When a company declares a dividend, the director makes a resolution which determines that a sum of money will be paid on a particular date,” Strike explains. “If no date is given, the date that the dividend is deemed to be taxable is the date that the resolution was made.”

As such, contractors who have unpaid dividends that were declared prior to the turn of the tax year can legitimately claim them without incurring the **higher dividend tax rates** that came into effect on 6 April 2016. However, Strike adds that, unless the contractor has all of their paperwork in order, there is always the risk that the taxman will take an alternate view.

“If you declare a dividend but forget to prepare a resolution, there’s absolutely nothing wrong with preparing a resolution at a later date. However, the practical problem for HMRC is determining whether the contractor has genuinely declared the dividend when they claim to have. In which instance you may require more substantial evidence.”

Backdating dividends is a major red flag

Some contractors might be tempted to backdate dividend paperwork in order to avoid the recently implemented dividend tax hikes. However, Strike strongly advises against this as it is wrong and would result in fines and additional attention from HMRC if it were discovered.

“You should never backdate anything that suggests something happened that did not, and could be considered tax evasion. Contractors can’t just make a decision in September to prepare a resolution that says a dividend was declared in March when it actually wasn’t. If discovered, HMRC would find it very easy to overturn it and the contractor would be left in serious trouble.”

Strike explains that HMRC will view the date upon which the transaction is entered into the company records as evidence to support the date that the dividend is declared. For contractors using an online accounting system which logs the dates that transactions are entered, a quick skim of the company transactions will provide HMRC with sufficient evidence to determine that the dividend is backdated.

What are the repercussions of backdating a dividend?

“In practical terms, HMRC would treat the dividend as being paid in a later tax year,” comments Strike. “That would mean your tax returns for both the previous year and the current year are wrong.”

As a result, contractors could face penalties and interest for the late payment of any taxes that have arisen. Whilst contractors are very unlikely to face prosecution, Strike warns that they will lose a lot of credibility in the eyes of HMRC.

“What the contractor does by backdating dividends is they leave themselves open to further investigation from the taxman, who will examine for further discrepancies. HMRC will begin to question: “If they’ve backdated dividends, what else have they done?” So, on top of potential fines, contractors could be earmarked for unwanted HMRC attention.”

Proper tax planning is essential for effective withdrawal of dividends

Instead, contractors shouldn't even encounter the need to attempt to backdate dividends. Strike encourages contractors to plan their financial affairs at the beginning of each tax year to allow them to consider the level of dividends required and the tax liabilities that will arise.

This should include consideration of what they are going to need to take from the company, whether they will be within IR35 and what the salary/dividend split will be if they are outside IR35. Towards the end of the tax year, the contractor should reassess their tax position and decide whether or not to draw any further dividends.

Contractors should consult with their accountants who should be alert to any additional sums within the contractor company, and possible savings their clients can make by timing their dividends. If they failed to do this prior to 6 April, they may have cost themselves a few thousand pounds in extra tax.

"A little bit of discipline goes a long way. It means that contractors know what their higher rate tax liability is going to be in advance. Knowing this, they would be able to set the correct amount aside so it's available when required."

Duncan Strike

Director

Intouch Accounting

Duncan has successfully developed accountancy businesses for many years. He is an expert in tax law and is passionate about client service and excellence.

Intouch have been championing the cause of Limited Company contractors and freelancers since they were established in 2010. **Read Full Profile...**

View all our experts

Strike concludes: "At the end of the day, having to consider backdating dividends is a key indicator that you're not planning your affairs properly; you're not taking your contracting business seriously; and you're digging a hole for yourself by running into potential problems with the taxman."

Published: Thursday, June 2, 2016