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DIVIDENDS TO SHAREHOLDERS HOW TO DO IT RIGHT

Many owner managed Limited Companies opt to pay dividends to the shareholders. Doing so can often offer tax savings and it is essential that the correct documentation is put in place at the correct time otherwise their legality or timing can be challenged by HM Revenue & Customs and others.

Dividends can only be declared out of the retained profits of the company. This is a combination of the balance brought forward on the profit and loss account and any further profits achieved in the current year, less a provision for corporation tax due thereon. A dividend is illegal if such reserves do not exist. Up to date management accounts need to be prepared whenever a dividend is to be declared to demonstrate that at that point in time sufficient reserves existed to do so.

The Directors of the company propose the payment of a dividend and a formal resolution should be documented at that time they do so to which the management accounts should be attached.

If the dividend is physically paid to the shareholders the date of payment is its effective date for accounting and taxation purposes and dividend vouchers should be prepared and issued to the recipients.

If however the shareholders wish to leave the money in the business for cash flow or other reasons then the sums due can be credited to their loan account with the business. This decision is a shareholder one and needs to be evidenced by a letter from them to the company instructing it accordingly and this determines the date the dividend is treated as being declared. It is illegal to back date such a resolution and the associated accounting entries. Again dividend vouchers should be prepared and issued to the recipients.

If a shareholder wishes to waive their entitlement to receive their share of the dividend they should write to the company informing them of their decision after the dividend has been declared but before it is paid or credited. There must have been sufficient distributable reserves to have paid them had they not waived their entitlement. Please note that dividend waivers can constitute a settlement for tax purposes and should only be exercised after taking further professional advice.

Adherence to these procedures is especially important if the company has only modest retained profits and tends to distribute profits by way of dividends as soon as they are earned as these are the circumstances when the legality of the transactions are most likely to be challenged.