DIVIDENDS GUIDE.

Starting a business should be easy. Here is Dividends explained!

Contents.

Understanding dividends.

A dividend is a payment of profit that a limited company distributes to its shareholders.

This is the money remaining after all business expenses and liabilities, as well as outstanding taxes (including VAT and Corporation Tax) have been paid off.

Dividends must be distributed according to the percentage of ownership of each shareholder. Here's an example: if you own 50% of your company's shares, you will receive dividends amounting to 50% of the retained profit.

How are dividends issued?

To make a dividend payment, you must:

- hold a directors' meeting to 'declare' the dividend
- keep minutes of the meeting, even if you're the only director

You'll need to have the correct dividend paperwork in place. For every dividend payment made, a **dividend voucher** must be issued with the following details:

- date
- company name
- names of shareholders being paid a dividend
- amount of the dividend

Each recipient must receive a copy of the voucher. A copy should also be kept for your company's records.

Types of dividends.

There are two common types of dividends you should know about:

- **Final dividends** are declared at the end of a fiscal year after all year-end financial statements have been recorded and reported during the Annual General Meeting. It is typically paid on an annual basis
- **Interim dividends** are dividend payments that are made before a business' year-end financial statements are released. As such, it is paid out from a company's retained earnings - not current earnings. Interim dividends can be paid at any time across the year, and are typically a smaller pay-out compared to final dividend.

Dividend taxes, rates and allowances.

Business owners typically pay themselves through **a blend of salary and dividends,** as this is a more tax efficient way to operate.

That's because neither the company, nor you (as an employee) are required to pay National Insurance Contributions on dividends. You are required to pay tax on dividends though - and we'll explain more about this in the following pages.

Dividend tax refers to the rates by which those dividends are taxed according to HMRC. Each year, these tax rates may differ.

Dividend tax rates and thresholds for the 2020/21 tax year:

Tax Payer Band	Dividend Rate	2020/2021 income
Basic rate	7.5%	£2,000 - £37,500
Higher rate	32.5%	£37,501 - £150,000
Additional rate	38.1%	£150,001 and above

Personal allowance: The above tax rates and thresholds apply after the personal allowance of £12,500 is used.

Dividend allowance: A dividend allowance of £2,000 is provided for the 2021/22 tax year. This means that you'll only pay tax on dividends exceeding that amount.

Example: Calculating dividend tax.

A limited company director draws a salary of £9,500 (the National Insurance primary threshold for the 2021/22 tax year) and receives dividends amounting to £55,000.

- Total income = £9,500 + £55,000 = £64,500
- First £9,500 salary = Falls under personal allowance. No tax paid
- Next £3,000 dividend = Falls under personal allowance. No tax paid
- Next £2,000 dividend = Falls under dividend allowance. No tax paid
- Next £35,500 dividend falls under the basic rate of dividend tax. £35,500 x 7.5% = £2662.50
- £55,000 - £35,500 - £2,000 - £3,000 = £14,500. This amount falls under the additional rate of dividend tax. £14,500 x 32.5% = £4,712.50
- Total dividend tax = £4,712.50 + £2662.50 = £7,375

Paying dividend taxes.

When does the dividend allowance apply?

The dividend allowance will lower your tax bill- regardless of how much you earn in dividends. Whether you receive a dividend income of £50 or £500,000, you don't need to pay taxes on the first £2,000 in dividends.

How do I pay dividend taxes?

There are two ways to pay dividend taxes. How you report and make your payment will depend on your dividend income.

1. Up to £10,000 in dividend income: If you received under £2,000 in dividends, you won't have to take any action. If you've received a dividend income between £2,001 and £10,000, you will have to do one of the following:

- Contact the HMRC helpline
- Use a Self Assessment tax return

2. Over £10,000 in dividends: You'll need to fill in a Self Assessment tax return.

Dividend FAQs.

1. How often can I pay myself dividends?

You can draw dividends from your company at any frequency across the year, as long as your company has sufficient distributable profits. Payments are typically made on a monthly or quarterly basis. While there are no hard and fast rules around this, it's something you need to consider carefully. That's because:

- **Dividends can affect how much tax you pay**: Dividends can be a way for you to balance out your profits from one year to another, so you can avoid being put into a higher tax bracket.
- **It can have an impact on your HMRC deadlines**: Income tax on dividends are due in January after the tax year in which the dividend was distributed. This means that tax on a dividend received in February 2020 will be due in January 2021. If the dividend was paid out in May 2020, the tax will be due in January 2022.

Dividend FAQs.

2. What else can I do with dividends?

You may consider paying dividends into a pension fund, ISA or to family members. You'll need to weigh out the pros and cons of each option, and consider the tax and legal implications. This can be complex, and is a decision that is best made after consulting an accountant.

3. What are important dividend date

Key dates you need to know about are:

- Dividend declaration date
- Record date
- Ex-dividend date
- Payment date

Paying dividend taxes.

4. Can dividends be paid out when a company is making a loss?

No - dividends can only be paid on profits that a company has earned during the year, or from accumulated profits from previous years. On the other hand, salaries can be paid out even when a company has made a loss.

6. How much should I draw as salary? What are considerations associated with dividend payments?

As a limited company director, you're faced with questions such as: What's the most tax efficient way to receive income from my business? What are the implications I should be aware of when I'm deciding on the amount to draw as a salary?

We briefly run through the tax implications and considerations associated with dividend payments in the next few pages.

Corporation tax deductions: Paying a dividend doesn't affect your company's corporation tax bill, as companies pay corporation tax on its profits before dividends are distributed.

On the other hand, salaries are considered as allowable business expenses. These reduce your profit, and subsequently your corporation tax.

Pension: The salary you draw will affect your pension entitlement. To maintain your State Pension contribution record, you'll need to draw a salary above the Lower Earnings Limit (set at £6,240 per annum for the 2021/22 tax year).

If you want to draw down the bulk of your earnings as dividends, you should look into setting up a company pension. Unlike personal pension contributions, employer pension contributions (contributions paid directly from a company) are classed as an allowable business expense.

Income tax: You won't pay income tax on your salary if it falls below £12,500 - the Personal Allowance for the 2020/21 tax year. Do note that income tax is calculated on a cumulative basis. For instance, if you've earned £5,000 from other forms of employment, your Personal Allowance will be = £12,500 - £5,000 = £7,500.

Employer NICs: Your company will pay 13.8% of employer's NICs on employee salaries above the secondary threshold (£169 per week for the 2021/22 tax year). This applies even if you're the sole employee and director of a limited company.

The increased salary expense will reduce your company's profits, and subsequently the amount of dividends that can be distributed.

Employee NICs: You need to pay NICs if your salary is above the Primary National Insurance threshold (£9,500 per annum for the 2020/21 tax year).

Drawing a salary up to the primary threshold can be tax-efficient - even if you do have to pay NICs -as you may save on corporation tax. This will vary depending on whether you're entitled to an employer's NI allowance or if you have additional sources of income, so it's best to consult your accountant for advice.

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