Dividends/Director Loan Account/ Personal Tax Interaction

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1 Overview

One of the most complex areas to consider when running a limited company is the interaction between the following:

- Dividends
  - How much profit does the company have
  - Are the company's profits increasing or decreasing

- Personal tax
  - Are you happy paying higher rate tax or would you like to remain in the basic rate band?

- Director's loan account
  - Do you owe the company money or does the company owe you money?

When we prepare the accounts we will consider all of the above and we explore each of these in more detail below.

2 Dividends

2.1 Have you taken dividends which will take you into the higher rate band or over £100k?

If you have, can some be deferred until the next tax year - what would the implications be if we did that?

On the director's loan
Would it make it overdrawn?
Would interest need to be charged?

On the following year's dividends
If you are going to continue taking dividends at such a high level, is there a chance your income could go above £100k and you would start losing your personal allowance?

2.2 Does the company have more profit to enable you to take more dividends and still be within the basic rate band?

This might be useful if the company's profits are increasing and they might 'tip over' into the higher rate band the next year if you don't take maximum dividends.

The potential upside of this strategy is that we may be able to save you tax at 32.5% (33.75% from 6th April 2022) if we can prevent your dividends going into the higher rate.

The potential downside of this strategy is that we may crystallise a tax liability a year earlier than otherwise if your dividends don't tip over into the higher rate band.

3 Overdrawn director's loan account

This means that you have taken too much money out of the company. If this ‘overdrawn director’s loan accounts’ isn’t cleared by the director within 9 months of the year end, then the company will have to pay S455 tax on the remaining balance – this is 32.5% (33.75% from 6th April 2022) of the balance and will be repayable once the loan is cleared by the director.

As part of preparing the accounts, we will consider the following:

3.1 Can it be cleared by a dividend within the current financial year?

3.1.1 Yes

3.1.1.1 Which tax year should this fall in?

As per section 2.2, the only downside of having the dividends in an earlier tax year (assuming higher rate and £100k isn't an issue), is that this will crystallise the tax liability sooner.

However unless you are happy paying higher rate tax and having income > £100k, we will still want to try ensure your dividends mean your total income remains within the basic rate band.

3.1.2 No

3.1.2.1 Profit & Loss forecast

We may prepare a profit and loss forecast to see if there are adequate profits to clear this with a dividend declared in the next financial year.

If we do, then we will ask you to confirm that you are happy the dividends we suggest can be covered by the draft profits in the next financial year. This is because unfortunately if we later find the company does not have enough post tax profits to cover the dividend, it may be necessary to prepare amended accounts. Whilst this is unlikely, if we do have to prepare amended accounts (and/or re-submit your personal tax return), this will be subject to an additional charge.

3.1.2.2 Can you pay back the money?

If there aren't adequate future profits, we need to ascertain if you can pay back the funds within 9 months - however we need to see this repaid before finalising the accounts.

If you want us to finalise based on confirming that you will repay the loan, and you subsequently don't repay it, then there will unfortunately be additional fees if we have to re-do the accounts.

3.1.2.3 Should you take a bonus

It's possible to include a salary bonus in the accounts – as long as this is paid within 9 months of the company's year end.

We would rarely suggest this course of action however, as any PAYE or NI on the bonus payment is not repayable – unlike the S455 charge mentioned below. And it is likely that any PAYE/NI payable will be similar to the S455 tax payable – so there is no cashflow advantage to this strategy.

The instances when we might suggest it are if it is likely that your overdrawn loan account will simply keep increasing – and it doesn't appear that there will ever be enough future profits to clear the loan via a dividend.

3.1.2.4 If we can't do any of the above, then S455 will be charged

This is charged at 32.5% (33.75% from 6th April 2022) of the amount remaining 9 months after the company's year end and is repayable once the loan is cleared.

4 Personal tax

When considering all the above, we will also be mindful of your personal tax situation.

There is a workbook to help you estimate your personal tax here.

4.1 Basic rate band

We will always do our best to declare the maximum dividend to make the best use of your basic rate band.

As mentioned in section 2.2 the only downside to this is that you might pay tax slightly earlier – however not ensuring you make the best use of your basic rate band may result in your paying more tax!

4.2 Higher rate band

Whilst we usually recommend clients to avoid taking income from their company which will put them in the higher rate band, it may be that this is unavoidable if you need to take more income from your company.

This isn't an issue however you do need to be aware that you will be paying personal tax of 32.5% (33.75% from 6th April 2022) on income above £50k and you need to budget for these payments.

4.3 Income above £100k

Once your personal income goes above £100k you will start to lose your personal allowance. This means your marginal rate of tax will be higher than 32.5% (33.75% from 6th April 2022).

Again, this is not an issue but you will need to budget for these payments.