

Limited Companies Dividend and Salary Policy

After the Artic Systems case was concluded, there were a number of articles published discussing the implications for small owner operated Limited Companies.

The following is a summary of the views and discussions that have been voiced.

The court case was the Inland Revenue versus a small owner operated IT Company, where there were two shareholders, a husband and wife. The husband was paid a low salary of £7000, and the wife £4000. The dividends were considerably higher, and were paid equally. In the case, the judge found that the husband was the main earner, with the wife working 4-5 hours per week.

The judge was unhappy that the husband was taking a small salary as the main earner, and agreed with the Inland Revenue that the couple were reducing the overall tax bill by paying the wife the same dividends as the husband.

The ruling has resulted in advice that dividend policies should be "commercially viable".

The Inland Revenue will probably see the following as evidence of income diversion or abuse.

- The main earner takes a lower salary resulting in higher dividends being paid to other low tax rate shareholders.
- The allocation/purchase of shares by a spouse or partner at a nominal value (£1) giving access to high values of dividend.
- Waivers on dividends to one shareholder where others are paying a lower tax rate.
- Certain classes of shares giving dividends that benefit the same low tax rate shareholders.
- Dividends paid to children.
- Other shares issued to lower tax rate relatives/friends with income rights only. (No voting or capital rights to the company)

In the light of the ruling small businesses, whether limited or a partnerships, should review their policy on how profits are allocated.

The following could be considered

- Where salaries are small, there must be tax and National Insurance paid otherwise the employee may lose rights to sick pay and other such benefits longer term.
- Share holdings should reflect the balance of work done, with the main earner holding a larger share holding.
- Where there is a husband and wife team, both should be directors.

New Income Shifting Legislation that was proposed to be put into place in April 2008 has been delayed due to pressure from commerce and the accountancy profession until further notice. With the current government reviewing all areas of tax there maybe a change of focus again.