

Tax Planning for Owner Managed Businesses

Tax changes coming into effect this April will add yet another layer of complication for tax planning for business owners. A new top rate of 50% income tax will be charged from 6 April 2010 on taxable income above £150,000. The top rate of tax on dividends will also increase from that date to 42.5%.

The prospect of losing another 10 pence in the pound to HMRC is understandably unpopular among high earners. Fortunately, business owners can use dividends to help mitigate the effects of the new 50% rate going forward and if they act now they could receive dividends subject to the current effective rate of tax of 25% for higher rate taxpayers.

For many private company owners, extracting income by dividends, rather than salary or bonus will often be more tax efficient. A company has to have sufficient distributable profits for dividends to be paid. If your company has surplus cash, it could make sense to pay an interim dividend before the new top rate of tax is introduced from 6 April 2010.

However, before dividends can be considered as a strategy for extracting profits from a trading company, the Companies Act requirements for lawful dividends must be complied with, also failure to do so could result in the dividends breaching company law and could also give rise to some unfortunate tax consequences.

In addition, the articles of association of each company limited by shares usually specify the formal procedures to be followed in respect of declaring company dividends. The decision to declare a dividend is usually recommended by the board of directors and final dividends must also be approved by shareholders, usually by ordinary resolution at a general meeting or by written resolution. In practice small limited company directors are often the shareholders so this procedural requirement is easy to achieve.

When a dividend is declared by the board meeting or a general meeting of shareholders the minutes and any required shareholder resolutions should state the amount of the dividend declared. The dividend also has to be entered into the company accounts and a dividend voucher raised for each shareholder entitled to receive the profits distributed.

Both Table A and the Model Articles allow interim dividends to be declared by a company limited by shares. This rule allows the company to distribute dividends to shareholders at any time and as frequently as one would like, subject to the company having sufficient funds to make the payment and to the procedural requirements stated in Companies Act 2006 and the Articles of Association.

Payments made without supporting documentation are unlikely to be accepted by HMRC. In addition if the correct paperwork is not generated when declaring/paying dividends, such dividends could be treated as void for tax purposes and ultra-vires and therefore recoverable for insolvency act purposes.

At Foot Anstey we have a wealth of experience in these matters and can draft all the necessary paperwork to give effect to any dividend you propose to make ahead of the change in the tax rates.

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