

This factsheet is designed to give a brief explanation of dividends.

What is a dividend?

Dividends are a portion of post tax profits paid to the shareholders, the owners of a Limited Company.

Declaring a dividend

When the directors of a company decide a dividend should be paid they hold a board meeting where they discuss, amongst other things, the company's profitability, the levels of funds needed to be retained within the business to enable day to day activities to continue and the funds to be reinvested within the business.

Before declaring a dividend the directors must ensure that the company has sufficient distributable reserves from which to pay the dividend, if there are not sufficient reserves available the dividend would be seen as illegal. Nixon Williams will calculate the profit available on a monthly basis upon submission of the client's records.

Upon consideration of these factors the directors can decide on the level of dividends to be declared. When a dividend is declared it is done based on a 'rate per share' i.e. £10 per share. This is multiplied by the total of issued shares to give the total dividend payable by the company.

This dividend will be distributed to the company's shareholders in proportion to their shareholding i.e. someone holding 50 shares will receive £500 in dividends based on £10 per share.

Dividends are always declared and paid net of a 10% notional tax credit. This 10% tax credit is not actually paid to anyone by the company it is simply treated as a deemed payment of tax by HMRC and is only used when calculating the individuals personal tax liability.

Dividend paperwork

For a dividend to be legal there must be profits to cover the dividend payment and it must be correctly documented (in addition to the points made above). This means that board minutes should be prepared to show the meeting of the directors to consider the dividend and dividend certificates prepared and given to all shareholders receiving the dividends.

Nixon Williams will prepare the necessary documentation upon a client's request.

Dividend taxation

From the company's position, dividends are paid out of taxed profits i.e. after corporation tax has been paid and as such there are no further taxation issues on the company when paying a dividend.

From the individuals position the gross dividend needs to be considered when reviewing their tax position. The gross dividend is calculated by adding the net dividend and the tax credit together or alternatively, dividing the net dividend by 0.9.

If the individuals total gross income for the year (including gross dividends) is below the high rate threshold (£42,475 for 2012/13) then no further tax will be payable on the dividend. If the individual is a high rate tax payer then the tax will be 25%, calculated on the net dividend (22.5% of the gross dividend). If the individual is an additional rate tax payer the tax will be 36.1%, calculated on the net dividend (32.5% of the gross dividend) with the potential of additional tax due to the reduction in the personal allowance.



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