Salary and dividends guide

the accountancy partnership

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What are dividends?

Dividends are payments made from the company's profits (after Corporation Tax) to its shareholder(s).

The amount of dividends paid out is usually dependent on the percentage each shareholder has in the company.

Taking salary and dividends

As a director and/or shareholder of a limited company, it can often be more tax efficient to take your income as a mixture of salary and dividends.

However, if you haven't done this before, or if you are struggling to get your head around the idea, the process can quickly become confusing.

Directors vs shareholders

Director

A director of a limited company is the person(s) that runs the company.

Shareholder

A shareholder of a limited company is the person(s) that owns the company.

This can often be the same person(s).

A director can be paid a salary from the company through PAYE. However, shareholders (who are not directors) can only be paid with dividends.

If the director is also a shareholder they can be paid a salary through PAYE and also take dividends from the company.

What are the dividend tax rates for 2020-21?

Dividends are tax free up to £2,000.

Over £2,000, dividends are taxed at the basic rate of 7.5% up to £37,500.

The higher rate of 32.5% is then applied to dividends taken between £37,501 to £150,000.

Sole director and shareholder

If you are the sole director and shareholder of a limited company, often the most tax efficient way for you to receive income is to take a small salary up to the National Insurance (NI) threshold, then take the remainder as a dividend.

The salary you process will be an expense to the limited company (and therefore reduce your corporation tax), but it will be tax and NI free to you personally.

If this is your sole source of income, this is a great way to utilise your allowances.

Why only take salary up to NI threshold?

You may be wondering why it's best to take salary up to the NI threshold (£9,500 in 2020-21) rather than the Personal Allowance threshold (£12,500 in 2020-21).

The reason for this is that as a sole director, you are not entitled to the employer's NI allowance.

This means that you would pay 12% employee's NI and 13.8% employer's NI on your income above the NI threshold, which is more than you would save in corporation tax.

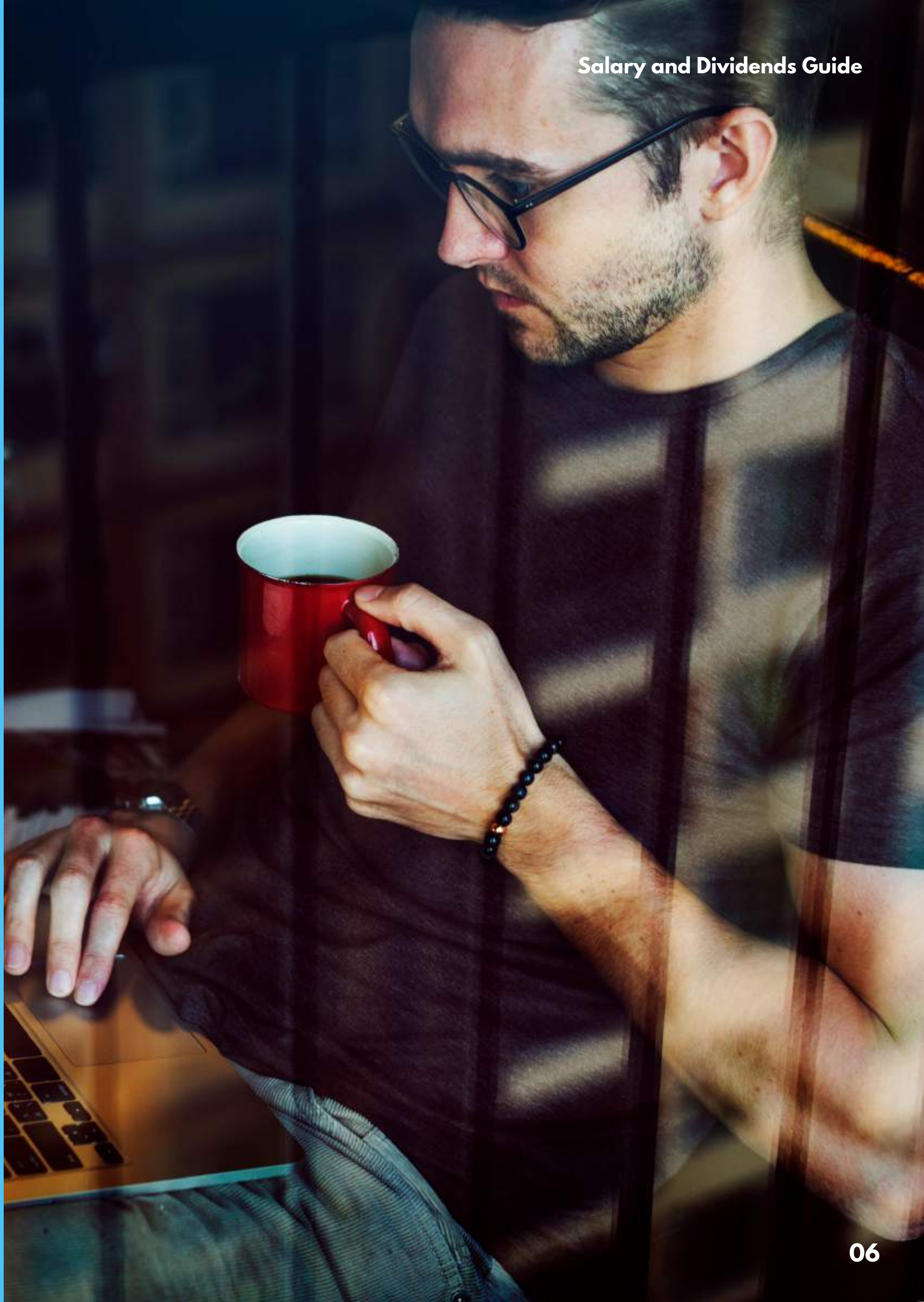
As a director you can pay yourself as little or as much as you like without worrying about the minimum wage, as this only applies to employees.

What happens if I have other income?

If you have other income then taking a director's salary may not be the most tax efficient option.

If your other income breaches the thresholds, it may be better to only take dividends from your company, to avoid the NI.

If your other income is below the thresholds, the difference can be calculated and put through as salary so all your allowances are used.



What about my pension contributions?

As long as a director's payroll is being run for you and it's over the lower threshold, then deemed NI contributions are made on your behalf - which count towards your state pension.

More than one director or shareholder

If you're running a company with an equal business partner or spouse then the same arrangement can be applied to them so that each of you receives a tax efficient sum.

An additional director means your company (as long as it's not a connected company) is eligible for the employer's NI allowance.

Therefore, the directors can run a salary up to the Personal Allowance threshold, rather than the NI threshold and save more tax as a result. There will be some employee's NI to pay but this is just 12%, with the additional salary being offset against 19% corporation tax.

However, it's important to note that if your company has multiple directors and shareholders, with different ownership percentages, then the above arrangements will probably not be feasible.

In this instance it's usually better to pay the directors a full salary in relation to the work they carry out and for the shareholders to receive dividends at agreed intervals.

Although not as tax efficient, everyone is then paid fairly.

Looking for more help with salary and dividends?

If you have any further questions simply call us on 020 3355 4047 and one of our friendly accountancy advisors will be happy to help.

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