Directors Warned About Taking Early Dividends

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Company directors who take a proportion of their salaries as dividends could be building up a significant liability if things do not go according to plan, warns insolvency experts Cranfield Business Recovery.

It is common practice for accountants and financial advisers to recommend to owner directors of companies that they take a minimum salary and the rest of their annual remuneration as dividends, which are posted to the directors' loan account. Dividends can only be declared out of retained profits and, while the business is doing well, it saves money on the PAYE and National Insurance bills, and is acceptable and legal practice.

However, Cranfield is warning directors that problems can arise if the business starts to struggle and the directors' loan account becomes overdrawn. This typically happens when a company enters an insolvency process, with directors being personally liable for any outstanding debts showing on directors' loan accounts.

If profitability is in question, the answer, according to Cranfield, is to incur the extra PAYE income tax and National Insurance by drawing a full salary rather than build up an overdrawn director's loan account, which may not get repaid via dividends at the end of the year.

Profitability is one of the key indicators of whether a company is about to hit troubled times. Towards the start of this year the insolvency body R3 stated that 37% of small businesses were experiencing decreased profits, and almost a quarter of small firms were regularly using their maximum overdraft. These worrying statistics suggest that many business owners could be liable to repay their overdrawn director's loan accounts when profits do not achieve expectations and dividends cannot be declared.

Tony Mitchell, managing director of Cranfield Business Recovery said: "During uncertain times, my advice to all owner directors is that if there is any doubt at all about the solvency or profitability of your company, consider very carefully whether the savings that can be made in PAYE Income Tax and National Insurance contributions are worth the risk of having to repay an overdrawn director's loan account."

Cranfield states that other factors indicating a company may be struggling include cash flow pressures and staffing pressures as a result of pay cuts and freezes or redundancies creating discontent within the workforce, which can ultimately affect the viability of a business.

Tony concludes: "Similarly, accountants and financial advisers should review all their clients' arrangements, where directors receive minimum salaries and take drawings in anticipation of future dividends. They need to evaluate the solvency of client companies and where necessary advise clients to pay additional PAYE Income Tax and National Insurance, even if this incurs more costs for the business. In the long run, this might actually work out as a better option for directors."

- Ends -

About Cranfield Business Recovery:

Cranfield Business Recovery is the number one insolvency practice in Coventry, employing a total of 15 staff. Set up in November 2001 to offer a professional service to individuals with corporate, business, and personal financial problems, they work closely with professional advisors to assist their clients. Cranfield offer a bespoke and sympathetic service in circumstances that are often difficult and stressful.

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