POINT ACCOUNTING

GUIDE 2

Paying Yourself

Salary, dividends, expenses and director’s loans

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When you operate through a limited company, taking money for yourself is not simply described as a “drawing”.

The company is legally separate from you, so every payment made to you must have a proper explanation. In most owner-managed companies, money is extracted through some combination of salary, dividends, repayment of expenses, repayment of money previously introduced and, occasionally, a director’s loan.

Each route has different tax, National Insurance, accounting and company-law consequences.

Start with the separation

The company’s bank balance is not the same as your personal disposable income.

Before taking money out, the company must retain enough cash to meet its obligations, including:

- Corporation Tax
- VAT
- PAYE and National Insurance
- Payroll and supplier costs
- Loan repayments
- Professional fees
- Upcoming business expenditure
- Any personal tax that you will need to pay on dividends or other income

A profitable company can still run short of cash. Equally, a company may have cash in the bank without having sufficient accumulated profit to support a dividend.

This distinction is fundamental.

Salary

A director can receive a salary through the company payroll.

Salary is normally:

- Deductible when calculating the company’s taxable profit
- Subject to PAYE Income Tax where applicable
- Subject to employee National Insurance where applicable
- Potentially subject to employer National Insurance
- Reported to HMRC through payroll submissions

Where the company pays salary, benefits or reimbursed expenses that require reporting, it may need to register as an employer. HMRC states that salary payments must be dealt with through PAYE, with the appropriate Income Tax and National Insurance deducted and paid over.

The most tax-efficient salary level is not identical for every director. It can depend on:

- Other income
- The number of employees
- Eligibility for Employment Allowance
- Whether the director has another employment
- State Pension and National Insurance considerations
- The company’s profitability
- Whether there is more than one director
- The director’s personal circumstances

For that reason, salary should be agreed as part of a deliberate remuneration plan rather than copied from another business owner.

Dividends

Dividends are payments made to shareholders from profits available for distribution.

They are not a business expense and do not reduce the company’s Corporation Tax bill. They are paid from profit remaining after Corporation Tax and may then be taxable on the shareholder personally.

Before declaring a dividend, the directors must be satisfied that sufficient distributable reserves exist. A healthy bank balance alone is not enough.

The company should also complete the appropriate dividend documentation, normally including:

- A board minute or written decision
- A dividend voucher
- The date of the dividend
- The amount paid
- The shareholder receiving it
- The relevant shareholding

Dividends must normally be paid in accordance with the rights attached to the company’s shares. Where shareholders hold the same class of shares, paying different amounts without the correct legal structure can cause difficulties.

Salary and dividends are not interchangeable

Salary rewards work carried out for the company. Dividends represent a return to shareholders on their investment and ownership.

Calling a payment a dividend does not make it one.

Where the company has insufficient reserves, the paperwork has not been completed or the payment does not follow the share rights, the amount may need to be reclassified. This can create additional tax, payroll or director’s-loan consequences.

We therefore recommend that dividends are reviewed and documented during the year rather than reconstructed after the year end.

Personal tax on dividends

Dividend income is considered alongside your other personal income.

The rate of tax depends on the tax year, your total income and the tax band into which the dividend falls. The dividend allowance does not mean that the income disappears: dividends within the allowance may be taxed at 0%, but they still form part of total income when determining the applicable tax band.

HMRC publishes the current dividend rules and examples through its dividend-tax guidance.

Dividend tax is generally a personal liability. The company does not usually deduct it before paying the dividend, so you may need to retain money separately for your Self Assessment bill.

Expenses paid personally

Where you personally pay a genuine company expense, the company can normally reimburse you without treating the repayment as salary or a dividend, provided the expense is properly allowable and supported by evidence.

Examples might include:

- Business mileage
- Travel costs
- Software
- Postage

- Small equipment
- Professional subscriptions
- Other company costs initially paid on a personal card

These amounts should be recorded separately from salary and dividends. Reimbursement is simply the company repaying a cost that was incurred on its behalf.

Keep the original receipt and explain the business purpose.

Money introduced into the company

When you pay money into the company, this may create a credit on your director's loan account.

The company can normally repay that amount to you without the repayment itself being treated as salary or a dividend, because it is returning money that you previously lent to the business.

This can include:

- Start-up capital introduced as a loan
- Company expenses paid personally
- Cash transferred to support working capital
- Amounts left undrawn from previous transactions, depending on their treatment

Your accounting records should distinguish between money subscribed for shares and money lent to the company. They are not the same.

Borrowing from the company

Where you take more money from the company than it owes you, an overdrawn director's loan account can arise.

This is not automatically prohibited, but it can create several consequences:

- The loan may need to be disclosed in the accounts
- The company may face an additional Corporation Tax charge if the loan remains outstanding after the relevant deadline
- Interest or benefit-in-kind rules may apply
- The amount may need formal approval
- Repayment or write-off can create further tax consequences

Using the company bank account as an informal personal overdraft is therefore risky. The problem often develops gradually through personal card payments, ad hoc transfers and expenses that have not been analysed.

The safest approach is to agree a regular remuneration plan and review the director's loan balance throughout the year.

Pension contributions

The company may be able to make employer pension contributions for a director.

Properly structured employer contributions can be commercially valuable because they may receive Corporation Tax relief and do not normally operate in the same way as salary or dividends. However, pension annual allowances, carry-forward rules, the director's overall remuneration and the "wholly and exclusively" test may need to be considered.

Large or unusual contributions should be planned before payment rather than corrected afterwards.

Benefits provided by the company

A company may provide benefits such as:

- A company car
- Private medical insurance
- Assets available for personal use

- Certain loans
- Accommodation
- Other non-cash benefits

Some benefits are tax-free where specific exemptions apply. Others must be reported and may create personal Income Tax and employer National Insurance liabilities.

The fact that the company receives Corporation Tax relief does not necessarily mean that the director receives the item tax-free.

A sensible payment routine

For many new companies, the best starting point is:

1. Agree a properly considered salary.
2. Process that salary through payroll.
3. Reimburse genuine business expenses separately.
4. Review available profits before declaring dividends.
5. Produce dividend paperwork when dividends are declared.
6. Retain money for company and personal taxes.
7. Monitor the director’s loan account.
8. Review the overall strategy when profits or personal circumstances change.

The practical rule

Do not simply transfer money whenever the company bank balance looks healthy and decide what it was later.

A clear payment strategy gives you a more reliable view of what you are earning, what the company can afford and what tax liabilities are being created. It also allows us to plan in advance, rather than using the year-end accounts to repair decisions that have already been made.

This guide provides general information only. Salary and dividend planning must be based on the company’s current profit, distributable reserves, cash position and the director’s wider personal tax circumstances.

Need advice tailored to your company?
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