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Directors need to be aware of the risks of taking dividends

In the last decade there has been a surge in small and medium sized businesses incorporating for tax reasons.

One of the reasons for doing so was to draw profits out and avoid National Insurance.

There is, however, a serious downside if the company gets into financial difficulties. If the company goes into liquidation it is very likely these dividends will have to be repaid. This is because dividends may only be paid out of distributable reserves (accumulated profits). The payment of a dividend not out of reserves is illegal and a breach of the Companies Act and there is no time limit on the Liquidator clawing this money back.

I have seen a number of cases recently where after going into liquidation, it becomes apparent that the directors were taking their effective salary



as dividends. One of the first acts of the Liquidator is to write to the shareholders asking for this money back which comes as a complete surprise to the directors and there is no real defence.

The directors need to be aware of the potential risks of taking dividends when their company is having financial problems. They need to keep up to date with their annual accounts and management accounts and make sure that dividends are still appropriate. In some cases they may be better off taking salary rather than dividends because of these risks.

Quick summary

- Dividends can only be paid out of profits.
- Illegal dividends can be reclaimed by a liquidator.
- Usually salary cannot be reclaimed by a liquidator.



What is a pre-pack Administration?

Pre-pack Administrations are a relatively new concept in that they have come about because of a law change in 2004. It is now a lot quicker for a company to go into Administration and can sometimes just mean faxing a form to the local court.

Administration has the effect of creating a moratorium where no creditors can take any action against the company including; banks, landlords, HMRC, suppliers, HP companies, employees etc.

A pre-pack means that as soon as the company goes into Administration it is sold immediately on to either the existing management team or a

Whittards of Chelsea went into Administration in December 2008 and was immediately re-sold

new management team. This clearly creates controversy and leaves a number of unhappy creditors.

It is perfectly legal but needs to be dealt with properly and creditors need to be kept informed as to why decisions have been made and why a sale has taken place so quickly after the Administration. We have carried out a number of these very effectively and if you wish to discuss how a pre-pack can work in detail perhaps for one of your clients please call us.

Members Voluntary Liquidations

A Members Voluntary Liquidation (“MVL”) can be a tax efficient way for the shareholders to distribute the profits of a company as capital.

Under current legislation all capital gains are taxed at 10% (for the distribution of business assets up to £1 million) and a flat 18% for thereafter.

Quite often property developers will use a new limited company for every project primarily because of the ongoing liabilities and risks if something goes wrong with the site. They have been taking advantage of the use of MVL's to wind these single purpose venture companies up to take the money out in a tax efficient way.

The alternative way of taking the money out is as dividends but this is



not very tax efficient at all and may well lead to the shareholders paying up to 40% tax.

We carry out a number of MVL's each year and are always happy to quote a fixed fee to do these.

The typical use of an MVL is as follows:-

- Tax planning - to pay a lower rate of tax on accumulated profits.
- Retirement planning - useful for shareholders considering retirement. the business can still be sold and the proceeds distributed via the MVL.
- Useful for reorganising dormant companies within a group and releasing funds to trading companies and simplifying group running costs.
- Where the company has come to the end of the project it was formed for.

What can we help with?



We deal with businesses that have financial problems.

This can range from a business that just needs some help and support to get through a current difficult period or where it has been left far too late to be saved and needs to be wound up.

We can help with:-

Administration

The directors can put a company into Administration as can the bank if they have a debenture. This protects the company for a period of time whilst a solution is worked out.

Liquidation

The directors, shareholders or a creditor can put a company into liquidation. It usually means the end of the business.

Law of Property Act Receiver

When the bank or a secured lender on a property appoint us to manage and sell a property.

Company Voluntary Arrangement

Where the directors want to save the business but cannot afford to pay all the debts due now. It usually involves a freezing of interest and part write off of the debts with an agreed payment plan over one to five years.

Individual Voluntary Arrangement

As above this usually involves a freezing of interest and part write-off of debts with an agreed payment plan over one to five years. It is used by a self employed person or a partnership.

Bankruptcy

An individual can make themselves bankrupt as can a creditor owed over £750. It is a very effective way of creating a fresh start.

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