Broadcast

FACTSHEET: PAYING DIVIDENDS TO MINORS

SPECIAL ISSUE

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Children have their own personal allowance and dividend allowance. Consequently, at first sight, it may seem attractive to pay them dividends to extract profits from a family company in a tax-free fashion. However, there are tax traps that may catch the unwary and HMRC have recently drawn attention to a dividend diversion scheme which should be avoided.

Key dates

Dividend income must be declared on the recipient's Self-Assessment tax return, which must be filed online by midnight on 31 January following the end of the tax year (so by midnight on 31 January 2024 for the 2023/24 tax return).

This note explains the impact of the settlement rules when giving shares to minor children (under 18s). It also draws attention to a scheme which promotes diverting dividends to minor children to fund education and which should be avoided.

Tax efficient profit extraction

Where a business is operated through a family or personal company, the profits will need to be extracted if they are to be used personally outside the company. Extracting profits may trigger tax and/or National Insurance liabilities.

A popular tax efficient strategy is to take a small salary equal to the personal allowance of £12,570 and to extract further profits as dividends.

All individuals have a dividend allowance, set at £1,000 for 2023/24. To make use of the dividend allowances of family members, a common approach is to make family members shareholders. Using an alphabet share structure where each family member has their own class of share (e.g. A ordinary shares, B ordinary shares, etc.) provides flexibility to tailor dividends to the circumstances of the recipient.

Minor children have their own personal allowance and dividend allowance.

Dividends are tax-free to the extent that they are sheltered by the dividend allowance and any unused personal allowance. Consequently, it may seem attractive to make minor children shareholders and to pay them dividends to utilise their personal and dividend allowances to extract profits tax-free.

The impact of the settlement rules

The settlement rules are anti-avoidance rules, one of the effects of which is to treat income from a settlement as that of the parent rather than the child where a parent makes a settlement in favour of the minor child, unless the income is not more than £100 in the tax year. This means that if a director/shareholder in a family company transfers shares to a minor child of theirs, any dividends paid on those shares would be treated as dividend income of the parent rather than of the child. Consequently, the dividends would be taxed at the parent’s marginal rate of tax, rather than benefitting from the minor child’s personal and dividend allowances.

Dividend diversion scheme

HMRC have recently published details of a dividend scheme which purports to allow a director/shareholder of a family company to avoid tax by diverting dividend income to his/her minor children to fund their education. In a bid to avoid being caught by the settlement legislation, the scheme works as follows.

1. A company issues a new class of share which usually entitles the owner of the shares to certain dividend and voting rights.
2. A person other than the company owner, such as grandparent of the minor child or a sibling of the company owner, purchases the new shares for an amount significantly below their market value.
3. That person gifts the share to a trust or declares a trust over the shares for the benefit of the company owner’s children.
4. The purchaser of the new shares or the company owner votes for a substantial dividend payment in respect of the new class of share.
5. The dividend is paid to the trustees of the trust.
6. As beneficiaries of the trust, the company owner’s children are entitled to the dividend.

HMRC are of the view that the arrangements are caught by the settlements legislation and do not work. The overall effect of the arrangements is to divert dividend income from the company owner to his/her minor children and, as such, the income will be taxed as that of the company owner rather than as that of the minor child. HMRC also warn that similar schemes will fall foul of the settlement legislation.

Details of the scheme (published as Spotlight 62) can be found on the Gov.uk website HERE

We can help
Please call us on **01753 888211** or email **info@nhllp.com** if you need guidance with any of the issues raised in this Broadcast. We would be happy to help.