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Considerations for setting director's remuneration

It is not uncommon for directors in owner managed companies to be remunerated by way of a basic salary with the balance of their remuneration being drawn as dividends. Where a company has sufficient reserves to cover the dividend payments there is little risk in adopting such an approach. However, a more prudent approach to director's remuneration may be required where reserves are low.

In the case of Global Corporate v Hale, the Court of Appeal has set a **new precedent** in the treatment of director salaries and what constitutes an **illegal dividend**. Hale was the director of a limited company who, alongside a basic salary, had been drawing a regular monthly dividend. This was done for many years and at the end of the financial year the company accountant would prepare the financial statements, reclassifying the additional payments as PAYE where reserves were insufficient to support the dividend payments. The Company subsequently entered liquidation and the reclassified PAYE payments made to Hale were challenged on the basis that they were in fact dividends.

The Court of Appeal held that these payments could only be classified as dividends since that is what the company had treated them as. The Judgement specifically highlighting the fact that where directors take funds on one basis for a particular reason that benefitted them at the time, it is not open to them to seek to subsequently reclassify the payment in a more favourable way.

Once reclassified as dividends, the payments became illegal as there were insufficient reserves within the Company at the time that the payments were made. As such, all illegal payments made to Hale were repayable to the Company. Hale attempted to run a quantum meriut defence (an argument for payment of the reasonable value of services performed) to mitigate the award against him, but the appeal judges rejected the claim. The judgement emphasised the fact that even if a valid quantum meriut claim exists, it cannot be made against illegal dividends on the basis that those distributions were not lawful.

It is at no point disputed that a director is entitled to be remunerated for the work they are carrying out for the company, but as a director they must receive proper authorisation for this.

If the company does not have reserves to allow for dividends, then it may be sensible to put all payments through the PAYE system until the company has sufficient reserves. Whilst this approach may be less tax efficient for the director, it will ensure they are not liable to repay an overdrawn directors loan account or illegal dividends if the company becomes insolvent.

Please note that should your clients require any confidential advice regarding insolvency matters they are welcome to contact one of our partners. Initial advice is provided free of charge and without obligation. Also, if you or any of your colleagues require any clarification regarding insolvency law or procedures please do not hesitate to contact us.