2021/22

TAX TIPS FOR COMPANY DIRECTORS

Jennifer Adams

tax insider
BUSINESS

Contents

About Jennifer Adams **5**

About this guide **5**

1. The beginning – Incorporation **6**

1.1 Income tax savings 6
1.2 Becoming a limited company 10
1.3 Incorporation relief 10
1.4 Business asset disposal relief (BADR) and transfer of goodwill 11
1.5 'Hold-over' relief 11

2. Running a company **12**

2.1 Withdrawing payments 12
2.2 Salary 12
2.3 National insurance contributions 12
2.4 The employment allowance 13
2.5 'Optimal' salary amount 13
2.6 Bonus 14
2.7 Timing of a bonus payment 14
2.8 Dividends - General 16
2.9 Dividends - Assets 18
2.10 The 'dividend allowance' 19
2.11 Which is best for 2021/22? Salary, bonus, dividend or combination? 21

3. Other methods of withdrawing monies **22**

3.1 Paying a salary to a family member 22
3.2 Tax trap - 'Settlements legislation' 22
3.3 How much to pay 23
3.4 Use of home as office 23
3.5 Rent paid by company for use of business premises 25
3.6 Benefits in kind and expenses 27
3.7 'Salary sacrifice' 30
3.8 Other miscellaneous benefits 31

4. Director's loan account **36**

4.1 Overdrawn DLA 36
4.2 Charge to tax 37
4.3 Charge to NIC 38
4.4 'Matching' rules 39

4.5 Settling the loan ... 40
4.6 Practical checklist – Directors loans: ... 42

5. Director's pensions ... 43
5.1 General rules ... 43
5.2 'Directors' pension ... 45
5.3 Directors and 'automatic enrolment' ... 46

6. Alphabet shares and dividend waivers ... 46
6.1 Alphabet shares ... 46
6.2 HMRC's view of alphabet shares ... 47
6.3 Dividend waivers ... 48
6.4 HMRC's view of dividend waivers ... 48

7 Extracting cash from the company on cessation ... 49
7.1 'Strike off' ... 50
7.2 Members' voluntary liquidations (MVL) ... 51
7.3 'Phoenix' companies ... 51
7.4 Business asset disposal relief (BADR) ... 51
7.5 Associated disposals – Assets ... 55

8. Succession planning ... 56
8.1 Purchase of own shares by company ... 56
8.2 Gifting shares ... 56
8.3 Use of a family trust ... 58
8.4 Family investment companies ... 58

‘Tax tips For Company Directors’ – First published June 2016; second edition August 2017; third edition June 2018; fourth edition July 2019; fifth edition July 2020, sixth edition July 2021.

About Jennifer Adams

Jennifer Adams FCIS TEP ATT (Fellow) has been a professional business author for over 15 years, specialising in corporate governance and taxation. She is also the proprietor of her own accountancy firm and, as such, is well placed to advise on tax problems that companies and their directors may face.

Jennifer has been a regular contributor to *Tax Insider*, *Business Tax Insider* and *Property Tax Insider* and is the author of the following Tax Insider guides:

- Dividend Tax Saving Strategies Explained
- Directors Loan Accounts Explained
- How To Use Trusts to Reduce Property Taxes
- How to Maximise Landlord Expenses
- Investing in Property – Personal or Company Ownership

About this guide

This special guide has been written with the director of the small or medium sized company in mind.

It looks at possible tax planning strategies for such directors at each stage of a company's life from incorporation through to cessation when either the director leaves or the company closes.

Note that this guide is aimed at tax planning for private limited company directors only.

1 The beginning – Incorporation

When a limited company is formed a new entity is created. Legally, this entity is separate from all other individuals, including the owners (shareholders) who may or may not be the same people as those who manage the company (directors).

It is invariably the case that a sole trader or partnership commences in business and the business grows such that the matter of incorporation needs to be considered. Although the decision to incorporate should be for commercial reasons rather than tax savings, any tax savings that may result need to be factored into the decision.

There are tax costs relevant to incorporation that need to be taken into account when making the decision, not least capital gains tax (CGT) and possibly stamp duty land tax (SDLT) (land and buildings transaction tax in Scotland; land transaction tax in Wales) should property be transferred to the company. Although there are various CGT reliefs available to reduce or defer chargeable gains made on incorporation (see sections 1.2 to 1.5), there are no such reliefs available for the SDLT charge.

1.1 Income tax savings

NOTE: this section refers to the tax rates in England which differ from the Scottish and Welsh tax rates.

Whether incorporation results in tax savings overall depends on a number of factors not least the amount of salary and dividends the director shareholder needs to withdraw from the company.

The table below shows the comparison in take home pay between continuing as a sole trader and incorporation for the tax year 2021/22. The table assumes that all profits are extracted via salary at the NIC Primary Threshold (PT) limit 'optimal' amount of £9,568, the remaining profit being taken as dividends, that the director is over 21 years of age, has no other income and as such is entitled to the full personal allowance of £12,570. The calculations also assume that no Employment Allowance (see section 2.4 'Employment Allowance') is available as is usually the case with a sole director employee.

The NIC Secondary threshold £8,840 is the amount below which no NIC payments are made by either the employer or employee.

'Optimal' salary amount

Although NIC is not payable by the employee on PT amount of £9,568, the employer is liable for NIC of an amount in excess of £8,840 (i.e. £9,568 – £8,840 x 13.8% = £100.46). However, corporation tax relief is available on the whole amount such that by paying an 'optimal' salary amount of £9,568 to the director, the corporation tax deduction outweighs the amount of NIC due for 2021/22.

Additional corporation tax relief on additional salary:

£9,568 – £8,840 x 19% = £138.32

Employers' NIC payment = £100.46

Balance of additional tax relief over NIC payable £138.32 – £100.46 = £37.86

Despite the tax saving overall, many companies find that the practicalities and administration required of paying employer's NIC of £100.46 and then having to wait to claim the corporation tax relief at a later date is not worth the small tax relief obtained. Instead a salary of the Primary NIC threshold amount of £8,840 is taken so that no employee or employer's NIC is payable.

The table below shows that the additional amount of income gained on incorporation of a business at the lower levels of profit is eroded; the difference being the charge of Class 4 NIC for the sole trader which results in a net reduction in liability for those with low profits.

In the table the amount of salary withdrawn is the 'Optimal Salary Amount' amount of £9,568 with dividends being used to extract the remaining profits.

Practical tip

For further detail on 'Optimal' salary see section 2.5 'Optimal' salary amount..

Example 1 – Income gains on incorporation

2021/22			
Profit	**Sole trader net after tax and NIC**	**Company owner net after tax and NIC**	**Extra received**
£20,000	17,418	17,6 84	266
£30,000	24,518	25,177	659
£40,000	31,618	32,669	1,051
£50,000	38,718	40,162	1,444
£60,000	44,551	47,587	3,036
£70,000	50,351	54,055	3,704
£80,000	56,175	58,522	2,347
£90,000	61,952	63,990	2,566
£100,000	67,751	69,457	1,706
£125,000	77,251	82,641	5,390
£150,000	91,724	91,942	(2180
£200,000	118,224	118,082	(142)

Example 1 calculation:

Sole trader:	Company
Profits £20,000	Profits £20,000
Income tax £1,486 (£20,000 – £12,570 x 20%)	Corporation tax: £20,000 – £9,568 – £100.46 (employer's NIC) x 19% = £1,963
Class 2 NIC £158.60 (£3.05 x 52 weeks)	Dividend available: £20,000 – £1,963 – £9,568 – £100.46 = £8,368.54
Class 4 NIC £937.26 (£20,000 – £9,586 x 9%)	Income tax on salary and dividend after personal allowance and £2,000 dividend allowance: £9,568 + £8,368.54 – £12,570 = £5,366 – £2,000 x 0% Balance of dividend £3,366 x 7.5% = £252
Total deductions £2,582	Total deductions CT £1,963 IT on dividend £252.50 Total £2,215.50
Net income £17,418	Net income £17,784.30

Practical points

The above figures show that from a tax savings view only incorporation is generally not worthwhile for profits under £40,000, bearing in mind the additional work and cost involved in preparing more detailed accounts, running a payroll and submitting additional returns to both Companies House and HMRC.

However, once the profit exceeds £60,000 the situation changes dramatically for incorporation but then drops becoming nearly level at £150,000; this is due to the extra tax that is payable on company dividends in the higher rates and importantly, reflects the abatement of the personal allowance at income over £100,000 for both the self employed and employed.

At £125,000 the comparison is most striking but that is because at £125,000 as self employed all the personal allowance is cancelled whereas a company profit of £125,000 would mean a dividend and salary could be available of £102,897 – allowing £11,078 allowances to be deducted.