2022/23

TAX TIPS FOR COMPANY DIRECTORS

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Contents

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About Jennifer Adams

Jennifer Adams FCG 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*, is the author of the book titled '101 Property Tax Secrets' and 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 various CGT reliefs are 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.

'Optimal' salary amount

The calculation of the 'optimal' salary amount to ensure the most tax-efficient amount of salary to withdraw for directors depends on whether the employment allowance (EA) is available.

In the Spring Statement presented on 23 March 2022, the employee NIC primary threshold (PT) was increased to match the personal allowance amount of £12,570. However, this was only to commence from 6 July 2022, such that a threshold of £9,880 per annum applied for the earlier months of the tax year. As a result, the employee NI PT is £11,908 for the tax year 2022/23. If the EA is not available, the optimum salary amount for 2022/23 is £11,908; if the EA is available, the optimum salary amount is £12,570.

Calculations

Assuming the EA is not available, then although NIC is not payable by the employee on the PT amount of £11,908, the employer is liable for NIC of an amount in excess of £9,100 (i.e. (£11,908 – £9,100) x 15.05% = £422.60). However, corporation tax relief is available on the whole amount such that by paying an optimal salary amount of £11,908 to the director, the corporation tax deduction outweighs the amount of NIC due by £191.

Additional corporation tax relief on additional salary:

(£11,908 – £9,100 + £422) x 19% = £613.70

Employer's NIC payment = £422

Balance of additional tax relief over NIC payable £613.70 – £422 = £191

Practical tip

Assuming this extra saving is to be paid out as a dividend, this reduces the tax saving to £175 for a basic rate taxpayer. Also, whereas the NIC payments totalling £422 are payable during the tax year, the corporation tax saving is not obtained until nine months and one day after the year end; this effectively reduces the benefit of the £175 saving even further.

Despite the overall tax saving, many companies find that the practicalities and administration required in setting up a payroll scheme, making monthly or quarterly employer's NIC payments and then having to wait to claim the corporation tax relief is not worth the small tax relief obtained. Instead, a salary of the NIC Secondary Threshold amount of £9,100 is taken so that no employee or employer's NIC is payable but with the year still counting towards state benefits.

To incorporate or not to incorporate 2022/23?

The table below shows the comparison in take-home pay between continuing as a sole trader and incorporation for the tax year 2022/23.

The table assumes that:

- in the case of a company owner, all profits are extracted via salary at the NIC PT optimal amount of £11,908, the remaining profit being taken as dividends;
- 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;
- no EA is available, as is usually the case with a sole director-employee;
- in the Spring Budget, the Class 4 NIC lower profits limit threshold was aligned with the personal allowance and the rate increased to 10.25%; *and*
- Class 2 NIC is charged at a rate of £3.15 a week (£163.80 a year) above the lower profits limit of £11,908.

Example 1 – Income gains on incorporation

	2022/23		
Profit	Sole trader net after tax and NIC	Company owner net after tax and NIC	Extra received
	£	£	£
£20,000	17,520	17,810	290
£30,000	24,495	25,201	706
£40,000	31,470	32,592	1,122
£50,000	38,445	39,983	1,538
£60,000	44,156	47,312	3,156
£70,000	49,830	52,678	2,848
£80,000	55,505	58,045	2,540
£90,000	61,180	63,411	2,231
£100,000	66,856	68,777	1,921
£125,000	76,043	81,554	5,511
£150,000	90,203	90,413	210
£200,000	116,078	116,078	nil

Example 1 calculation

Sole trader	Company
Profits £60,000	Profits £60,000
Income tax £11,432 £60,000 – £12,570 = £47,430 £37,700 x 20% + £9,730 x 40%	Corporation tax £60,000 – £11,908 – £422.60 (employer's NIC) x 19% = £9,057
Class 2 NIC £163.80 (£3.15 x 52 weeks)	Dividend available £60,000 – £11,908 – £422.60 – £9,057 = £38,612
Class 4 NIC £4,248 (£50,270 – £11,908) x 10.25%= £3,932 £60,000 – £50,270 = £9,730 £9,730 x 3.25% = £316.23	Income tax on salary and dividend after personal allowance and £2,000 dividend allowance: £11,908 + £38,612 – £12,570 = £37,950 £2,000 x 0% £35,700 x 8.75% = £3,123.75 Balance of dividend £250 x 33.75% = £84 Total tax £3,208

Sole trader	**Company**
Total deductions £15,844	Total deductions CT £9,057 IT on dividend £3,208
Employers Class 1A NIC £422.60 Total £12,688	
Net income £44,156	Net income £47,312

Conclusions

The table shows 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 exactly level at £200,000; this is due to the extra tax that is payable on company dividends at the higher rates and, importantly, reflects the abatement of the personal allowance on 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 a self-employed individual, all of the personal allowance of £12,950 is cancelled, whereas a company profit of £125,000 would mean a dividend and salary available of £103,170 – allowing £10,985 personal allowances to be deducted.

To incorporate or not to incorporate 2023/24?

The Chancellor has already announced the rates of corporation tax for the year 2023/24 as follows:

- Profits over £250,000 – the main rate of 25% applies.
- Profit of £50,000 or less – the small company rate of 19% applies.
- Profits between these thresholds are taxed at the main rate of 25%, subject to the marginal small companies relief (MSCR).

MSCR tapers the effect of the increased rate using the calculation:

(Upper limit – profits) x basic profits/profits x MSCR fraction

where:

- Upper limit is £250,000.
- Basic profits are the company's trading profits/gains.
- Profits are basic profits plus dividends from other companies.
- MSCR fraction is 3/200ths.