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TAX EFFICIENT WAYS TO EXTRACT CASH FROM YOUR COMPANY

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Contents

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- Tax Efficient Way to Extract Cash from Your Company.
- IR35 – Tax Tips for Contractors.
- Tax-efficient Business Exit Strategies.
- Cash basis for landlords.
- Director's Loan Accounts Explained.
- 101 Business Tax Tips.
- 101 Practical Tax Tips.

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About this guide

This special report reveals a number of strategies to help extract profits from a company in a tax-efficient manner.

The rates and limits quoted throughout are those applying for 2021/22 unless otherwise stated. The income tax rates and limits used are those applying to UK taxpayers, excluding Scottish taxpayers. Dividend tax rates apply equally to Scottish taxpayers, as do capital gains tax rates. For 2021/22, the income tax rates and limits applying to Welsh taxpayers are aligned with the rest of the UK, excluding Scotland. The Scottish rates of income tax apply to the non-dividend non-savings income of Scottish taxpayers.

1

At a glance

The way in which you run your business will affect the amount and type of tax and National Insurance that you pay. When deciding on an appropriate structure for a business, the tax and National Insurance regime under which the business operates is one of the factors that should be taken into consideration.

If you run your business as a sole trader, or as a member of a partnership, depending on the level of your profits, you will pay income tax and National Insurance contributions (NIC) on your profits. Your income tax liability is computed by reference to your total taxable income and if you have other sources of income, this will impact on your marginal rate of tax. For 2021/22, the personal allowance is set at £12,570. It is due to remain at that level for the following four years, up to and including 2025/26. The personal allowance is gradually reduced once the taxpayer's adjusted net income reaches £100,000. The allowance is reduced by £1 for every £2 by which your income exceeds £100,000. This means that if you have adjusted net income of £125,140 or above for 2021/22, you will not receive a personal allowance.

After you have used up your personal allowance, (for UK taxpayers excluding Scottish taxpayers), income tax is payable at the basic rate, set at 20% for 2021/22 on taxable income falling within the basic rate band. For 2021/22, this is set at £37,700 for the UK, excluding Scotland (although it applies to Scottish taxpayers for the purposes of savings and dividend income). Income tax is payable at the higher rate of 40% on taxable income in excess of the basic rate band up to £150,000 and at the additional rate of 45% on taxable income in excess of £150,000.

As far as NICs are concerned, if you are self-employed, you will pay Class 2 NICs of £3.05 per week for 2021/22 if your profits exceed the small profits threshold of £6,515. You will also pay Class 4 NICs on your profits if they exceed the small profits limit, set at £9,568 for 2021/22. Once this limit is reached, Class 4 NICs are payable at the main rate of 9% on profits between £9,568 and £50,270, and 2% on any profits above that level.

Having paid your tax and NIC, it is up to you how you spend the remaining profits. The business profits are taxed on you personally and once the tax and NICs have been paid, there is no further tax to pay if you transfer money from your business account to your personal account.

If you run your business through a limited company, the situation is very different. For the financial year 2021 (running from 1 April 2021 to 31 March 2022), you will pay corporation tax at 19% on your profits, regardless of the level of those profits. The rate is also 19% for the financial year 2020 (running from 1 April 2020 to 31 March 2021). The government has announced that the corporation tax rate will remain at 19% for the financial year 2022. However, corporation tax rates will rise from 1 April 2023 where profits are more than £50,000. From that date, the small profits rate of 19% will apply to companies with taxable profits of £50,000 or less. The main rate will be 25%. This will apply where profits are more than £50,000. However, marginal relief will reduce the effective rate where profits are between £50,000 and £250,000, such that the rate within this band gradually increases from 19% to 25%. The limits of £50,000 and £250,000 are reduced where the company has associated companies. When deciding on a business structure, the future increases in the corporation tax rate should be factored in.

For the financial year 2021, the rate of corporation tax (at 19%) is lower than the basic rate of income tax (at 20%). However, this is not the end of the story. The company is entirely separate from the shareholders, directors, and employees and if they wish to take cash out of the company to use personally, additional (personal) tax liabilities may arise. Depending on the way in which cash is extracted, NICs may also be payable. This will be the case on any salary or bonuses paid to you by the company, although these payments are deducted in calculating the company's corporation tax bill. If you take benefits in kind from the company, these too may be taxable and the company may have to pay Class 1A NICs on any taxable benefits provided. These are employer-only contributions. Where the director has a student loan, student loan repayments will be deducted where income exceeds the relevant loan threshold. Consequently, when looking at the overall tax position, it is necessary to consider the tax payable by the company on its profits and any tax and NICs on money taken out of the company.

The tax and NIC consequences of money taken out of the company will vary depending on the way in which this is done – not all extraction methods are equal. Therefore, it is not only necessary to decide how much to take out, but also how to extract the profits. Adopting a tax and NIC-efficient strategy can save significant sums of money, so it pays to plan ahead. This report will explore the ways in which cash can be extracted from a company, and look at the tax and NIC implication of each method. The Report starts by looking at some of the basic and most straightforward methods and progresses through more sophisticated ideas. By the end of the report, you should have a comprehensive view of the ways to extract profits from your company in a tax-efficient manner.

The sections will cover:

- Salaries – as a director of the company, you are entitled to be paid a salary for your work – and so are any members of your family who work for the company. At first glance, salaries (which attract income tax and employee's NIC via the PAYE system, together with employer's NIC at 13.8%) are an expensive way to take money out, but as we shall see, they definitely have their place and there is a lot to be said for taking a small salary at least equal to the lower earnings limit for Class 1 NIC purposes.
- Benefits in kind – profits do not need to be taken out in cash form and can be extracted in kind instead. Some benefits in kind, such as mobile phones and even parties, can be provided tax-free! Although withdrawing profits in this way is unlikely to save you a fortune, taken together, a package of tax-efficient benefits add up to a useful and often neglected escape route for some of the company's cash.
- Dividends – these are paid to shareholders in a company and are one of the main tools of tax planning for companies, but they have their own problems, too. The availability of the dividend allowance, set at £2,000 for 2021/22, the lower tax rates that apply to dividends and the lack of National Insurance mean they are still a tax-efficient exit route. But as dividends are paid out of the company's post-tax profits, any money extracted as dividends has already suffered a