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TAX-EFFICIENT WAYS TO EXTRACT CASH FROM YOUR COMPANY

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Contents

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About Sarah Bradford

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- Tax-Efficient Business Exit Strategies;
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- Cash Basis for Landlords;
- Directors' Loan Accounts Explained;
- 101 Business Tax Tips; *and*
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All these guides are available for purchase from TaxInsider.co.uk.

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 2023/24 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 2023/24, 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 2023/24, the personal allowance is set at £12,570. It is due to remain at that level until 5 April 2028. 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 2023/24, 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 2023/24 on taxable income falling within the basic-rate band. For 2023/24, 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 £125,140 and at the additional rate of 45% on taxable income in excess of £125,140. The additional rate now applies once the personal allowance has been fully abated.

As far as NICs are concerned, if you are self-employed, you will pay Class 2 NICs of £3.45 per week for 2023/24 if your profits exceed the lower profits threshold of £12,570. However, if your profits are between £6,725 (the small profits threshold) and £12,570 (the lower profits threshold), you will be treated as having paid Class 2 contributions at a zero rate giving you a qualifying year for state pension purposes for zero contribution cost. You will also pay Class 4 NICs on your profits if they exceed the lower profits limit, set at £12,570 for 2023/24. Once this limit is reached, Class 4 NICs are payable at the main rate of 9% on profits between £12,570 and £50,270 and at 2% on any profits above that level.

Having paid your tax and NICs, 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 2023 (running from 1 April 2023 to 31 March 2024, the rate at which you will pay corporation tax will depend on the level of your profits. If you have no associated companies, you will pay corporation tax at the small profits rate of 19% if your taxable profits are £50,000 or less. If your profits are between £50,000 and £250,000, you will pay corporation tax at the main rate of 25% but this will be reduced by marginal relief. As a result, the effective rate within this band gradually increases from 19% to 25%. If your profits are more than £250,000, you will pay corporation tax at the main rate of 25%. If you have one or more associated companies, the limits of £50,000 and £250,000 are divided by the number of associated companies plus one. The limits are also proportionately reduced where the accounting period is less than 12 months. When deciding on a business structure, the level of your likely profits and the rate at which you will pay corporation tax should be factored in.

If your accounting period spans 1 April 2023, you will need to apportion your profits to the period prior to 1 April 2023 and the period on or after this date. Profits arising in the period prior to 1 April 2023 are taxed at 19% – the rate of corporation tax for the financial year 2022.

For the financial year 2023, depending on the level of your profits, the rate of corporation tax may be higher or lower than the basic rate of income tax. However, regardless of your profits, it will be lower than the higher and additional rates of income tax.

This is not the end of the story. A 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 employer NICs 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 and, like secondary Class 1 contributions, are deductible in calculating the company's profits. 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 implications 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.