REMUNERATION STRATEGIES IN A RECESSION

2020/21

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BUSINESS

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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 or funds from a company in a tax-efficient manner during a recession.

The rates and limits quoted throughout are those applying for 2020/21 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 2020/21, 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

During a recession, a business may make reduced profits or may instead make a loss. This will impact on the ability to take funds from a business, which may be needed outside the business to meet living costs. As a result, some of the standard profit extraction strategies may not be available or may need to be tweaked. For example, dividends can only be paid from retained profits and where the company has no retained profits, a dividend cannot be paid.

Where a business is operated through a company, the company is a separate legal entity distinct from the shareholders who own it. The company must pay tax on any profits that it makes. However, if the profits are required by the shareholders or directors outside the company, these must be extracted. The extracted funds are income in the hands of the recipient and are liable to personal taxes and, depending on the nature of the payments, possibly National Insurance also. Thus, any extraction strategy needs to consider the company position and the individual position and the overall tax and, where relevant, National Insurance that is payable.

For the financial year 2020 (running from 1 April 2020 to 31 March 2021), Corporation Tax is at 19% on any profits of your company, regardless of the level of those profits. The rate is also 19% for the financial year 2019 (running from 1 April 2019 to 31 March 2020), and will remain at 19% for the financial year 2021.

Having paid corporation tax on the profits made by the company, additional (personal) tax liabilities may arise depending on the way in which cash is extracted. NICs may also be payable.

Any salary or bonuses paid to you by the company, will be liable to income tax (once the personal allowance has been used up) and also, where the relevant thresholds are exceeded, to employee's and employer's Class 1 NICs. However, the salary and bonus payments, together with any associated employer's NICs, are deducted in calculating the company's profits liable to corporation tax..

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. Again, the cost of providing these and the associated Class 1A NICs are deductible in calculating the profits liable to corporation tax. There are no employee NICs to pay on most benefits in kind.

Where the director has a student loan or a post-graduate loan, loan repayments will be deducted where income exceeds the relevant loan threshold.

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 the options that are available for extracting funds (which may vary depending on the profitability or otherwise of the company), but also the associated tax and National Insurance implications. 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 during a recession, 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 funds from your company in a tax-efficient manner.

While the treatment of losses is outside the scope of this Report, it should be borne in mind, that if the company has sustained a loss, claiming tax relief may generate a repayment of corporation tax which may provide much-needed funds in financially challenging times.

The different sections of the report 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. Salaries may be beneficial where funds are needed in a recession and the company lacks the retained profits to pay dividends.

- 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. Dividends are paid out of the company's post-tax profits; consequently any money extracted as dividends has already suffered a Corporation Tax hit. Further, a company can only pay dividends if it has sufficient retained profits from which to pay them. In a recession, this may not be the case. Dividends must also be paid in proportion to shareholdings, so it is valuable to consider the share structure up front and the advantages of using an 'alphabet' share structure to provide flexibility. However, where sufficient profits are available to enable dividends to be paid, dividends can be tax-efficient. All taxpayers are entitled to a dividend allowance of £2,000 for 2020/21. Once that (and the personal allowance) have been used up, dividends are taxed at the dividend tax rates, which are lower than the income tax rates. A further benefit is that there are no NICs to pay on dividends.

- Pension provision – paying money into a pension can be tax-effective due to the tax reliefs that are available. Taking advantage of employer contributions to a pension scheme can be a useful way to take money out of a company.

- Loans – although tax liabilities generally arise where a company lends money to shareholders, employees, or directors, there are some useful exceptions to this rule. In particular, it can be tax efficient to take loans of up to £10,000 from the company for a limited period, and this facility can be very useful to tide the director over during a recession. The techniques for using loans to provide access to company funds vary from very basic planning ideas to complex arrangements. It should, however, be noted that

HMRC have targeted what they regard as abusive arrangements and tax avoidance schemes, and they continue to be alert to schemes that seek to use loans to avoid tax and NICs that would otherwise be payable. Directors and shareholders may make loans to the company. Interest can be paid on loans to the company, representing another avenue for extracting profits.

- Capital taxation – this may come into play when looking at ways of building up a 'tax-free' nest egg in the company at the start of its life, and also when looking to extract the cash from a company at the end of its existence at a rate of 10% tax or less.

- Spouses and civil partners have additional tax planning opportunities denied to single taxpayers.

- Rent and sales of assets to the company – these provide further ways of getting money out of the company.

- Other ideas – the final section will look at some of the more complex structures that can be used to maximise the tax efficiency of a business involving a limited company.

Practical Tip

During a recession, it may be necessary to rethink long-standing profit extraction strategies to and amend them to take account of changing circumstances. Consideration should be given as to what options are available and how funds can be extracted to meet day-to-day living costs in a way that is tax and NIC-efficient.

2 Covid-19 Pandemic

For 2020/21 the impact of the Covid-19(coronavirus) pandemic and its impact on businesses and individuals should not be overlooked and this may affect the profit extraction strategy. A number of measures were put in place during the pandemic to help businesses and individuals weather the financial implications of the pandemic.

2.1 Coronavirus Job Retention Scheme

The Coronavirus Job Retention Scheme (CJRS) enabled employers to place staff on furlough and to claim a grant from the Government to provide furloughed employees with a minimum level of pay (set at 80% of the employee's wages to a maximum of £2,500 per month (proportionately reduced for furlough periods of less than one month). Directors can be furloughed but while furloughed can do no work for the company other than compliance with statutory duties. From 1 July, directors furloughed prior to that date for at least 3 continuous weeks could be flexibly furloughed as for other employees, receiving their usual pay for hours worked and a furlough grant for the remainder of their usual hours.

The scheme runs from 1 March 2020 to 31 October 2020.

For periods prior to 1 August 2020, employers could claim furlough pay up to the cap plus associated employer NICs and the minimum level of employer pension