BUSINESS & PERSONAL TAX SUPPORT

Extracting Company Profits

Options for 2022-23

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If you run a family or personal company, you will need to consider how best to extract profits from your company. There are various ways in which you can do this. A traditional tax-efficient approach is to take a small salary and to extract any further profits as dividends. However, you can also extract profits in other ways.

Salary

If you pay a salary that is at least equal to the lower earnings limit for National Insurance purposes (set at £6,396 for 2022/23), the year will count as a qualifying year for state pension and contributory benefit purposes. To be eligible for the full single tier state pension when you reach state pension age, you will need 35 qualifying years. If you do not have 35 qualifying years when you reach state pension age, but you have at least 10 qualifying years, you will receive a reduced state pension.

The optimal salary for 2022/23 will depend on whether your company is entitled to the National Insurance employment allowance. If you run a personal company and are the only employee and director, you will not qualify for the employment allowance as it is not available where the sole employee is also a director.

If the employment allowance is not available, and assuming you are a director, your optimal salary is equal to the annual primary threshold of £11,908, if sufficient of your personal allowance remains available to shelter the salary. At this level, no tax or employee's National Insurance will be payable. However, a small amount of employer's National Insurance will be payable on earnings between the secondary threshold of £9,100 and the annual primary threshold of £11,908 at the rate of 15.05%. However, as this is deductible for corporation tax purposes, paying a salary equal to the higher primary threshold rather than one equal to the secondary threshold (so no National Insurance liability arises) is worthwhile. Once the salary level reaches the primary threshold, employee contributions (at 13.25% for 2022/23) are also payable. At this level, it is preferable to switch to dividends.

Where the employment allowance is available, for example, if your company is a family company with more than one employee, your optimal salary level is one equal to the personal allowance, set at £12,570 for 2022/23. You can pay a salary to other family members who work for the company too. A salary paid at this level will be free of employer's National Insurance. However, a director will pay employee's National Insurance at 13.25% to the extent that the salary exceeds the primary threshold of £11,908.

Dividends

Once you have paid yourself the optimal salary, it is tax-efficient to extract further profits in the form of dividends rather than paying yourself a higher salary. However, you can only pay dividends out of retained profits and, therefore, you must have sufficient retained profits to cover the dividends that you wish to pay.

Dividends must be paid in proportion to shareholdings. However, if you use an alphabet share structure whereby each shareholder has their own class of share (e.g., A ordinary shares, B ordinary shares, etc.) you can tailor dividend payments by declaring different dividends for different classes of shares.

All taxpayers, regardless of the rate at which they pay tax, have a dividend allowance. This is set at £2,000 for 2022/23. Dividends covered by the allowance are tax-free. If shareholders have their dividend allowance available, paying a dividend to use up the allowance enables profits to be extracted from the company without paying further tax.

The dividend tax rates have been increased by 1.25% for 2022/23. Once the dividend allowance has been used up, dividends (which are taxed as the top slice of income) are taxed at 8.75% where they fall within the basic rate band, at 33.75% where they fall within the higher rate band and at 39.35% where they fall within the additional rate band. As dividends are paid out of retained profits, they have already suffered corporation tax at 19%.

Rent

If you run your company from home, you can consider renting your home office to the company. The rent, which should be at a commercial rate, is deductible in computing the company's taxable profits. However, you must pay income tax on it and declare it on your self-assessment tax return. On the plus side, there is no National Insurance to pay.

Benefits in kind

There are a selection of tax exemptions for benefits in kind, such as those for mobile phones and trivial benefits, which enable you to extract profits as a benefit in kind without an associated tax or National Insurance liability,

Pension contributions

You can also extract profits in the form of pension contributions as your company can pay contributions into a pension plan for you (if your available annual allowance has not been used up).

Directors' loans

If your need money for a short time, taking a director's loan can be tax efficient. You can borrow up to £10,000 for up to 21 months tax-free. However, there are tax consequences if the balance exceeds £10,000 at any point in the tax year, or if you do not repay the loan within nine months and one day of the end of your accounting period.

Leave profits in your company

Extracting profits from your company may trigger tax and National Insurance charges. If you do not need the profits for personal use, consider leaving them in the company to extract later when this can be done more tax efficiently.

We can help

We can help you formulate a tax-efficient strategy for extracting profits from your personal or family company.