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HOW SHOULD I EXTRACT THE PROFITS FROM MY LIMITED COMPANY?

There are various profit extraction strategies for owner managed companies and it is important that these are reviewed on a regular basis to take in to account changes in circumstances of directors/shareholders and in tax rates and rules. So which are the best options for you and your limited company? I set out below some of the options available:

Salary

It is relatively common practice for director/shareholders of 'owner-managed companies' (e.g. companies that are owned and managed by a single person or more than one individual such as husband and wife etc.) to pay themselves a salary sufficient to gain a 'credit' for their National Insurance (NI) contribution record and 'top-up' their income with dividends from the company.

To maintain one's NI contribution record for 2019/20, a salary of at least £512 per month should be paid (that being the 'Lower Earnings Limit' for NI purposes) but it is usually better to pay more than that, up to approximately £719 per month, since any salary up to that level does not incur any NI costs but still contributes to your NI record for state pension and other benefits purposes.

Any salary paid above this level will attract NI contributions that will be payable to HM Revenue & Customs. Employee's NI is payable at 12% on earnings above £719 per month (with a further 2% payable for higher-earners) and Employer's NI is payable at 13.8% on earnings above the same threshold (but see below regarding the NI Employment Allowance).

Company directors can therefore pay themselves a salary of £8,628 for 2019/20 without incurring any Income Tax or NI liabilities and the salary is usually an allowable expense for Corporation Tax purposes

Dividends

The introduction of the annual dividend allowance back in April 2016 was a welcome measure but having initially been introduced at £5,000, it was soon cut to £2,000 so that the first £2,000 of dividend income, per individual per tax year, is tax-free. However, dividends received above this level are taxed at the following rates:

- 7.5% for basic rate taxpayers
- 32.5% for higher rate taxpayers
- 38.1% for additional rate taxpayers

As mentioned above, it is fairly common tax planning for director/shareholders to receive relatively small salaries and 'top-up' their income with dividends. This is still suitable in many situations, but each individual's circumstances will vary and certain director/shareholders may want to consider increasing their salaries slightly and reducing dividends. This is particularly the case where the NI Employment Allowance is available to the company, whereby the first £3,000 of any Employer's NI in the tax year is waived. However, Employee's NI is still payable above the relevant threshold (see above) so this needs to be considered carefully when deciding upon the level of salary and dividends to be paid. Those over state pension age are not liable to Employee's NI so they may want to consider increasing their salaries further.

It should also be noted that the criteria to be met in order to claim the NI Employment Allowance are not straightforward in some cases. It cannot be claimed by companies where there is only one director and no other employees. There are added complications where there is more than one director (or a director and other employees) as it may then be available but will depend on the level of salaries paid to the directors and employees. Restrictions may also apply where two or more companies are deemed to be connected. Please contact us if you would like specific advice regarding this.

What other options are there?

Consideration could be given to the company making employer pension contributions in to a pension scheme for directors. Although this will usually mean the individuals cannot access the funds straightaway, it is a tax efficient means by which to extract profits from companies (since such contributions will usually qualify for Corporation Tax relief). In most cases, the Annual Allowance for pension contributions is currently capped at £40,000 per individual. However, if you have been an active member of a pension scheme in previous years and have not made full use of the allowance in more recent years, you may be able to utilise those unused allowances now. Advice should be obtained from your pension adviser or an independent financial adviser in this respect, as the rules are not straightforward.

Where a director/shareholder has a credit balance on his or her loan account with the company, opportunities can arise for the payment of interest by the company to the director, which should qualify for Corporation Tax relief in the company. The first £1,000 of interest received by individuals per tax year is free of tax for a basic rate taxpayer (£500 is free of tax for higher rate taxpayers), with the excess being taxed at the individual's marginal rate of tax. Depending what rate that is and the size of the loan account, this could be a tax efficient method by which to extract profits from the company.

It is worth bearing in mind when considering all of the options above that with the Corporation Tax rate due to reduce to 17% in April next year (it is currently 19%), the overall tax benefits of retaining profits in companies (if practicable and desirable) rather than extracting all of the profits by one of the methods mentioned above will become increasingly attractive.

As mentioned above, each individual's circumstances will be different and specific advice is therefore essential. If you wish to discuss your tax affairs and those of your company we would be pleased to hear from you. The above is for general guidance only and no action should be taken without obtaining specific advice.

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