Broadcast

FACTSHEET: EXTRACTING PROFITS

SPECIAL ISSUE

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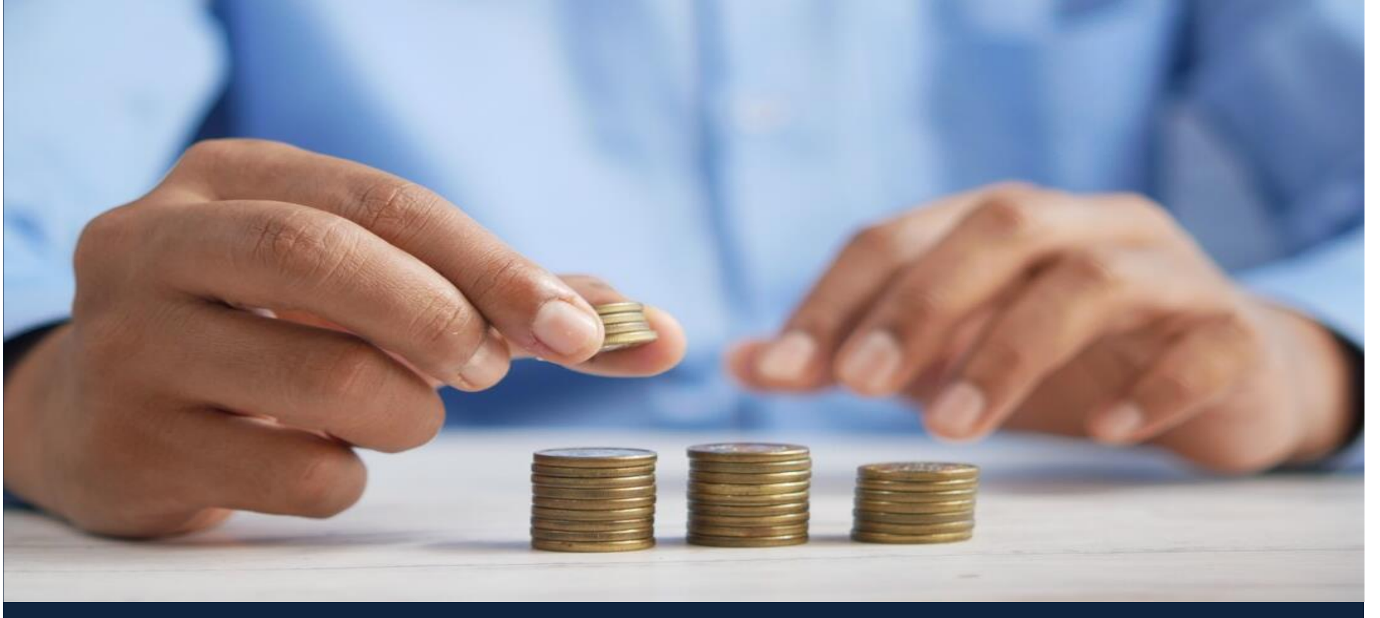

Directors of personal and family companies will need to extract profits from their company if they wish to use them for their personal use. It will generally be tax efficient to pay a small salary and to extract further profits as dividends.

Key dates

The 2023/24 tax year runs from 6 April 2023 to 5 April 2024. The optimal profit extraction policy will depend on the director's personal circumstances.

This note explains how to determine the optimal dividend/salary mix.

Preserving state pension entitlement

To qualify for a full single-tier state pension, an individual needs 35 qualifying years. A reduced state pension is paid where the individual has at least ten qualifying years.

If you do not already have 35 qualifying years, it is worthwhile paying a salary that is at least equal to the lower earnings limit, which for 2023/24 is set at £6,396. Where the salary level is between the lower earnings limit and primary threshold, set at £12,570 for 2023/24, you will be treated as if you have paid notional employee Class 1 National Insurance contributions at a zero rate.

The effect of this is that you are able to secure a qualifying year for zero contribution cost. As long as your personal allowance is available, there will be no tax to pay on a salary of this level.

However, depending on whether or not the employment allowance is available, your company may be liable for employer's Class 1 National Insurance contributions if the salary paid exceeds the secondary threshold, set at £9,100 for 2023/24.

Remember, directors have an annual earnings period for National Insurance purposes.

Employment Allowance is available
The employment allowance is an allowance which eligible employers can set against their secondary Class 1 National Insurance liability. Personal companies where the sole employee is also a director are not entitled to the allowance. However, your family company will qualify for the allowance if you have more than one employee as long as your employer's Class 1 National Insurance liability for 2022/23 was less than £100,000.

The employment allowance is set at £5,000 for 2023/24.
If the employment allowance is available, the maximum salary that can be paid free of tax and National Insurance, assuming that your personal allowance has not been used elsewhere, is £12,570.

Employment Allowance is not available
If you operate a personal company and you are the sole employee and a director, you will not qualify for the employment allowance. If the employment allowance is not available (or has been utilised elsewhere), unless one of the upper secondary thresholds applies, employer's Class 1 National Insurance will be payable to the extent that the salary paid exceeds the secondary threshold of £9,100.

While the maximum salary that can be paid free of tax and National Insurance is £9,100 where the employment allowance is not available, it is still worthwhile paying a higher salary equal to the personal allowance and primary threshold of £12,570. This is because salary payments and the associated employer's Class 1 National Insurance are deductible in calculating your company's profits for corporation tax.

For the financial year 2023 (running from 1 April 2023 to 31 March 2024), the rate at which you pay corporation tax will depend on the level of your profits, ranging from 19% if your taxable profits are £50,000 or less to 25% where your taxable profits exceed 25%. This is higher than the rate of employer's Class 1 National Insurance, set at 13.8%. Thus, the corporation tax saved by paying a salary of £12,570 rather than one of £9,100 exceeds the associated employer's National Insurance.
It should be noted that if any of the upper secondary thresholds apply, a salary of £12,570 can be paid free of tax and National Insurance even if the employment allowance is not available.

Is a higher salary worthwhile?
If the director is entitled to the standard personal allowance of £12,570, it is not worth paying a salary in excess of this, as the salary will attract tax at 20% and employee's National Insurance at 12%. If the employment allowance is not available and none of the upper secondary threshold applies, the company will also have to pay employer's National Insurance of 13.8%. The tax and National Insurance hit will outweigh any corporation tax deduction available.

However, if you have a higher personal allowance, for example, because you receive the marriage allowance or the married couple's allowance, it will be tax-efficient to pay a salary up to the level of your personal allowance if the employment allowance is available. However, in the absence of the employment allowance, unless one of the upper secondary thresholds applies, the optimal salary will remain at £12,570.

Extract further profits as dividends

Once your company has paid you a salary at the optimal level, it is more tax efficient to extract further profits as dividends. Remember, you can only pay a dividend if you have sufficient retained profits from which to pay it. Dividends must be paid in proportion to shareholdings, although having an alphabet share structure overcomes this restriction.

All taxpayers regardless of the rate at which they pay tax have a dividend allowance, which for 2023/24 is set at £1,000. Thereafter, dividends are tax at 8.75% where they fall in the basic rate band, at 33.75% where they fall in the higher rate band and at 39.35% where they fall in the additional rate band. There is no National Insurance to pay. However, corporation tax has already been paid on the profits that are available to distribute as a dividend.

If you would like help or have any questions on any of the topics discussed in this broadcast, please contact us to speak to a member of our dedicated team, call us on **01753 888211** or email **info@nhllp.com**