Broadcast

FACTSHEET: SETTING THE 2025/26 SALARY

SPECIAL ISSUE

01753 888211
www.nhllp.com

Directors of personal and family companies need to extract profits from the company to have them available for personal use. A tax-efficient strategy is to pay a small salary and to extract further profits as dividends. This may also provide the director with a qualifying year for state pension purposes.

Key dates

This note applies for the 2025/26 tax year and explains what level the salary needs to be set at to secure a qualifying year for state pension purposes, and also the optimal salary level.

Salary needed for year to be a qualifying year

A person needs 35 qualifying years to receive a full state pension. If they have less than 35 qualifying years, but at least 10 qualifying years, they will receive a reduced state pension.

If a person does not already have the requisite 35 qualifying years and is unlikely to do so by other means by the time they reach state pension age, it is worth setting the salary at a level sufficient to ensure that the year is a qualifying year, To do this, the earnings must be at least equal to 52 times the weekly lower earnings limit for Class 1 National Insurance purposes. For 2025/26, the lower earnings limit is £125 per week, meaning that the director needs a salary of at least £6,500 for 2025/26 to be a qualifying year.

Where the salary is between the lower earnings limit and the primary threshold (which remains at £12,570 for 2025/26), the earner is treated as having paid Class 1 contributions at a notional zero rate. This means that they benefit from the qualifying year without having to pay any Class 1 National Insurance contributions.

Impact of the Employment Allowance

The Employment Allowance is an allowance which can be claimed by eligible employers and set against the secondary (employer's) contributions that they pay over to HMRC. The Employment Allowance is set at £10,500 for 2025/26, capped at the employer's secondary liability for the year. Unfortunately, companies with a single employee who is also a director are not eligible to claim the allowance. This means most personal companies do not qualify. However, family companies with more than one employee, paid at least £96 per week, are able to claim the allowance.

For 2025/26, the secondary Class 1 threshold is reduced to £5,000 and the secondary Class 1 rate is increased to 15%. This means that where the Employment Allowance is not available, unless one of the upper secondary thresholds applies, it is not possible to pay a salary which is sufficient for the year to be a qualifying year free of employer's National Insurance. Paying a director of a personal company a salary of £6,500 will come with an employer's National Insurance bill of £225 (15% (£6,500 - £5,000).

If the Employment Allowance is available, as should be the case for a family company with at least two employees, a salary of £6,500 can be paid free of employer's National Insurance; the Employment Allowance will shelter the employer contributions that would otherwise be due.

Optimal salary

As both salary payments and any associated employer's National Insurance are deductible in calculating the company's profits for corporation tax purposes, it can be tax-efficient to pay a salary higher than that needed to secure a qualifying year for state pension purposes. Where the Employment Allowance is available, a salary equal to the personal allowance of £12,570 can be paid free of tax and National Insurance. However, it not worth paying a salary of more than this unless the director has a higher personal allowance (for example, because they receive the marriage allowance) as the tax and primary Class 1 hit (at, respectively, 20% and 8%) will outweigh the corporation tax relief (at between 19% and 25%).

Where the Employment Allowance is not available, it is still worthwhile paying a salary of £12,570 as the corporation tax relief (at between 19% and 25%) will outweigh the secondary Class 1 National Insurance payable at 15% on earnings over £5,000.

We can help

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