TAX TIPS FOR COMPANY DIRECTORS 2020/21

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Contents

‘**Tax Tips For Company Directors’**
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About Jennifer Adams

Jennifer Adams FCIS TEP ATT (Fellow) has been a professional business author for over 15 years, specialising in corporate governance and taxation. She is also the proprietor of her own accountancy firm and, as such, is well placed to advise on tax problems that companies and their directors may face.

Jennifer has been a regular contributor to *Business Tax Insider and Property Tax Insider* and is the author of the following Tax Insider guides:

- Dividend Tax Saving Strategies Explained
- Directors Loan Accounts Explained
- How To Use Trusts to Reduce Property Taxes
- How to Maximise Landlord Expenses

About This Guide

This special guide has been written with the director of the small or medium sized company in mind.

It looks at possible tax planning strategies for such directors at each stage of a company’s life from incorporation through to cessation when either the director leaves or the company closes.

Note that this guide is aimed at tax planning for private limited company directors only.

1 The Beginning – Incorporation

When a limited company is formed a new entity is created. Legally, this entity is separate from all other individuals, including the owners (shareholders) who may or may not be the same people as those who manage the company (directors).

It is invariably the case that a sole trader or partnership commences in business and the business grows such that the matter of incorporation needs to be considered. Although the decision to incorporate should be for commercial reasons rather than tax savings, any tax savings that may result need to be factored into the decision.

There are tax costs relevant to incorporation that need to be taken into account when making the decision, not least Capital Gains Tax (CGT) and possibly Stamp Duty Land Tax (SDLT) (or Land and Buildings Transaction Tax in Scotland or Land Transaction Tax in Wales) should property be transferred to the company. Although there are various CGT reliefs available to reduce or defer chargeable gains made on incorporation (see sections 1.2 to 1.5), there are no such reliefs available for the SDLT, etc. charge.

1.1 Income Tax Savings

NOTE: this section refers to the tax rates in England which differ from the Scottish and Welsh tax rates.

The table below shows the comparison in take home pay between continuing as a sole trader and incorporation for the tax year 2020/21. The table assumes that all profits are extracted via salary at the NIC Primary Threshold (PT) limit 'optimal' amount of £9,500, the remaining profit being taken as dividends, that the director is over 21 years of age, has no other income and as such is entitled to the full personal allowance of £12,500. The calculations also assume that no Employment Allowance (see section 2.4 'Employment Allowance') is available as is usually the case with a sole director employee.

'Optimal' salary amount

The NIC Secondary threshold £8,788 is the amount below which no NIC payments are made by either the employer or employee. In years previous to 2020/21 the PT and ST thresholds were aligned such that this amount was the 'optimal salary' for company director's. However, for the year 2020/21 this alignment was broken such that the 'optimal' amount is now the higher amount of £9,500 producing a tax saving of £37.03 as calculated below.

Although NIC is not payable by the employee on PT amount of £9,500, the employer is liable for NIC of an amount in excess of £8,788 (i.e. £9,500 - £8,788 x 13.8% = £98.25). However, corporation tax relief is available on the whole amount such that by allocating an 'optimal' salary amount of £9,500 to the director, the corporation tax deduction outweighs the amount of NIC due such that for 2020/21 the 'optimal' director's salary is £9,500.

Additional corporation tax relief:

£9,500 - £8,788 x 19% = £135.28

Employers' NIC payment = £98.25

Balance of additional tax relief over NIC payable £135.28 - £98.25 = £37.03

Despite the tax saving overall, nevertheless many companies find that the practicalities and administration required of paying employer's NIC of £98.25 and then having to wait to claim the corporation tax relief at a later date is not worth the small tax relief obtained. Instead a salary of the Primary NIC threshold amount of £8,788 is claimed meaning that no employee or employer's NIC is payable.

The table below shows that the additional amount of income gained on incorporation of a business at the lower levels of profit is eroded; the difference being the charge of Class 4 NIC for the sole trader which results in a net reduction in liability for those with low profits.

Practical Tip

For further detail on 'Optimal Salary' see section 2.5 'Optimal Salary Amount'.

	2020/21		
Profit	**Sole trader net after tax and NIC**	**Company owner net after tax and NIC**	**Savings**
£20,000	17,396	17,669	273
£30,000	24,496	25,161	665
£40,000	31,596	32,654	1,058
£50,000	38,696	40,146	1,450
£60,000	44,496	47,557	3,061
£70,000	50,296	53,025	2,729
£80,000	56,096	58,492	2,896
£90,000	61,896	63,960	2,064
£100,000	67,696	69,427	1,731
£125,000	77,196	82,613	5,417
£150,000	91,696	91,915	219
£200,000	118,196	118,084	-112

Example 1:

Sole trader:	Company
Profits £20,000	Profits £20,000
Income tax £1,500 (£20,000 - £12,500 x 20%)	Corporation tax: £20,000 - £9,500 - £98.26 (employer's NIC) x 19% = £1,976.33
Class 2 NIC £158.60 (£3.05 x 52 weeks)	Dividend available: £20,000 - £1,976.33 - £9,500 - £98.26 = £8,425
Class 4 NIC £945 (£20,000 - £9,500 x 9%)	Income tax on salary and dividend after personal allowance and £2,000 dividend allowance: £9,500 + £8,425- £12,500 - £2,000 x 7.5% = £257
Total deductions £2,603	Total deductions £2,331
Net income £17,396	Net income £17,669

Practical Tip

Considering whether to incorporate or not from purely a tax savings point of view for profits under, say £40,000, incorporation is not worthwhile bearing in mind the additional work and cost involved in preparing more detailed accounts, running a payroll and submitting additional returns to both Companies House and HMRC.

However, reach a profit of £60,000 and the situation changes dramatically for incorporation. Greater than £60,000 and the saving/amount of additional income starts to be less inviting becoming nearly level at £150,000; this is due to the extra tax that is payable on company dividends in the higher rates and reflects the abatement of the personal allowance at income of £100,000.

Personal Service Companies ('PSC')

The decision as to whether to incorporate a company that supplies services to the End client needs to be aware of the IR35 and 'off-payroll' working rules.

Companies that supply services to End clients are termed 'Personal Service Companies' ('PSC')). Legislation for PSC companies working as an intermediary (termed 'IR35') requires the individuals to pay broadly the same tax and NIC as if they were working for the client as an employee, making a 'deemed payment' at the end of the tax year. The 'deemed payment' is calculated on the turnover received during the period, minus a fixed 5% allowance, certain other allowable expenses and any salary and employers' NICs already paid during the tax year. If the 'deemed payment' is greater than zero, then further tax on this amount is payable.

The 'IR35' rules apply if the worker would be classed as an employee if they were contracted directly and the onus is on the PSC to make the decision. However, HMRC is of the opinion that too many companies are not applying the rules correctly, working outside of IR35 and therefore, in April 2017, the 'IR35 off-payroll' rules were introduced.

HMRC Guidance 'Off-payroll working for an intermediary' states that *'A worker is involved in 'off-payroll' working when they work for a client through their own intermediary, often a personal service company (PSC), but would be an employee if they were providing their services directly'.*

Such rules currently apply to workers within the public sector and will apply to medium and large private sector companies as from April 2021. From that date, the responsibility for determining the status of workers will fall on the large or medium private sector companies that engage them. 'Small' companies having less than 50 employees, turnover of less than £10.2 million and a balance sheet total of £5.1 million or less will not fall within the new 'off-payroll' rules.

Under these rules, the End Client must inform the PSC of its size and if that End Client is a large or medium-sized entity, then the fee payer is required to deduct PAYE and NIC from the fee paid to the worker's PSC. The fee payer may also be the End Client but need not necessarily be so, as the payment may be made via an agency or an umbrella company. If the End client is a small entity, then the 'IR35' rules apply.

HMRC has produced a basic online tool intended to simplify the decision-making process (the Check Employment Status for Tax (CEST) tool). If the End client fails to make a determination or apply the rules, HMRC will hold them liable for the PAYE and NICs on payments made to the worker's intermediary.

A PSC has the right to appeal to a tax tribunal should they believe that their status has been decided incorrectly.

Further information on 'IR35' can be found at:
https://www.gov.uk/guidance/ir35-find-out-if-it-applies

Information on 'Off payroll' can be found at:
https://www.gov.uk/government/publications/rules-for-off-payroll-working-from-april-2020/rules-for-off-payroll-working-from-april-2020

Tax Trap - Construction Industry Scheme

Both the 'off-payroll' working rules and the Construction Industry Scheme could apply if the worker is a subcontractor working in the construction industry through a limited company. Special rules are in place to stop Income Tax and NIC being paid twice on the same earnings.

1.2 Becoming A Limited Company

Incorporation involves the disposal of the existing self-employed or partnership business to a new entity ('person') in exchange for shares in the company. Transfer of assets into the company (e.g. the business's premises) will automatically trigger a Capital Gains Tax (CGT) charge if a gain is made on the transfer at market value because the purchaser and disposer of the assets are connected persons.

However, there are reliefs which, if possible to claim, can reduce or at least defer the CGT chargeable.