TAX EFFICIENT WAYS TO EXTRACT CASH FROM YOUR COMPANY

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Contents

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About Sarah Bradford

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Sarah writes widely on tax and National Insurance. She contributes regularly to:

- Business Tax Insider;
- Property Tax Insider; and
- Tax Inside Professional

And is the author of:

- Tax Efficient Way to Extract Cash from Your Company;
- IR35 – Tax Tips for Contractors;
- Tax-efficient Business Exit Strategies;
- Cash basis for landlords; and
- Director's Loan Accounts Explained.

All these guides are available for purchase from TaxInsider.co.uk.

About This Guide

This special report reveals a number of strategies to help extract profits from a company in a tax-efficient manner.
The rates and limits quoted throughout are those applying for 2019/20 unless otherwise stated. The income tax rates and limits used are those applying to UK taxpayers, excluding Scottish taxpayers. Dividend tax rates apply equally to Scottish taxpayers, as do Capital Gains Tax rates. For 2019/20, the income tax rates and limits applying to Welsh taxpayers are aligned with the rest of the UK, excluding Scotland.

1 At A Glance

The way in which you run your business will affect the amount and type of tax and National Insurance that you pay. When deciding on an appropriate structure for a business, the tax and National Insurance regime under which the business operates is one of the factors that should be taken into consideration.

If you run your business as a sole trader, or as a member of a partnership, depending on the level of your profits, you will pay income tax and National Insurance contributions (NIC) on your profits. Your income tax liability is computed by reference to your total taxable income and if you have other sources of income, this will impact on your marginal rate of tax. For 2019/20, the personal allowance is set at £12,500. After you have used up your personal allowance, for UK taxpayers excluding Scottish taxpayers, income tax is payable at the basic rate, set at 20% for 2019/20 on taxable income falling within the basic rate band. For 2019/20, this is set at £37,500 for the UK excluding Scotland (although it applies to Scottish taxpayers for the purposes of savings and dividend income). Income tax is payable at the higher rate of 40% on taxable income in excess of the basic rate band up to £150,000 and at the additional rate of 45% on taxable income in excess of £150,000. As far as NICs are concerned, if you are self-employed, you will pay Class NICs of £3.00 per week for 2019/20 if your profits exceed the small profits threshold of £6,365. You will also pay Class 4 NICs on your profits if they exceed the small profits limit, set at £8,632 for 2019/20. Once this limit is reached, Class 4 NICs are payable at the main rate of 9% on profits between £8,632 and £50,000, and 2% on any profits above that level.

Having paid your tax and NIC, it is up to you how you spend the remaining profits. The business profits are taxed on you personally and once the tax and NICs have been paid, there is no further tax to pay if you transfer money from your business account to your personal account.

If you run your business through a limited company, the situation is very different. For the financial year 2019 (running from 1 April 2019 to 31 March 2020), you will pay Corporation Tax at 19% on your profits, regardless of the level of those profits. The rate is also 19% for the financial year 2018 (running from 1 April 2018 to 31 March 2019).

For the financial year 2019, the rate of Corporation Tax (at 19%) is lower than the basic rate of income tax (at 20%). However, this is not the end of the story. The company is entirely separate to the shareholders, directors, and employees and if they wish to take cash out of the company to use personally, additional (personal) tax liabilities may arise. Depending on the way in which cash is extracted, NICs may also be payable. This will be the case on any salary or bonuses paid to you by the company, although these payments are deducted in calculating the company's Corporation Tax bill. If you take benefits in kind from the company, these too may be taxable and the company may have to pay Class 1A NICs on any taxable benefits provided. These are employer-only contributions. Where the director has a student loan, student loan repayments will be deducted where income exceeds the relevant loan threshold.