RPGCC

Business & Personal Tax
Extracting Company Profits

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Extracting company profits - 2024/2025

If you run a family or personal company, you will need to consider how best to extract profits from your company. There are various ways in which you can do this. A traditional tax-efficient approach is to take a small salary and to extract any further profits as dividends. However, you can also extract profits in other ways.

Salary

If you pay a salary that is at least equal to the lower earnings limit for National Insurance purposes (set at £6,396 for 2024/25), the year will count as a qualifying year for state pension and contributory benefit purposes. To be eligible for the full single tier state pension when you reach state pension age, you will need 35 qualifying years. If you do not have 35 qualifying years when you reach state pension age, but you have at least 10 qualifying years, you will receive a reduced state pension.

For 2024/25 the primary threshold (the point at which employee National Insurance contributions become payable) is fully aligned with the personal allowance at £12,570. Both are to remain at this level until at least 6 April 2028.

The optimal salary level where the recipient is in receipt of the standard personal allowance with no deductions and the allowance has not been used elsewhere is equal to £12,570. At this level, the employee will not pay any tax or any National Insurance, but the year will count as a qualifying year for state pension and contributory benefit purposes.

If the employee's personal allowance is not £12,570 or has been fully or partially used elsewhere, the optimal salary will depend on the employee's circumstances. There is no substitute for doing the sums.

The extent to which employer National Insurance contributions are payable on an optimal salary of £12,570 will depend on whether the employment allowance is available and also whether one of the upper secondary thresholds (applying where the employee is under 21, an apprentice under the age of 25, an armed forces veteran in the first year of their first civilian employment since leaving the armed forces or a new Freeport employee) is available.

If the employment allowance is not available (as is the case for a personal company where the sole employee is a director) and none of the upper secondary thresholds applies, a small amount of employer's National Insurance will be payable on earnings between the secondary threshold of £9,100 and the annual primary threshold of £12,570 at the rate of 13.8%.

However, as this is deductible for corporation tax purposes, paying a salary equal to the higher primary threshold rather than one equal to the secondary threshold (so no National Insurance liability arises) is worthwhile. The rate of relief will depend on the rate at which the company pays corporation tax which from 1 April 2023 onwards will be at marginal rates of between 19% and 26.5% depending on the level of the company's profits.

Where the employment allowance is available, for example, if your company is a family company with more than one employee, no employer contributions will be payable on the optimal salary of £12,570. This will also be the case if one of the upper secondary thresholds applies.

With falling employee National Insurance rates (they have fallen 4% in this year – 2% now and a further 2% after 6 April 2024), a bonus will often be more tax efficient than a dividend.

In addition, where director/shareholders spend significant time on qualifying R&D projects, it is more beneficial for their remuneration to be via salary than dividends as salary attracts R&D relief.

Dividends

Once you have paid yourself the optimal salary, it may be tax-efficient to extract further profits in the form of dividends rather than paying yourself a higher salary. However, you can only pay dividends out of retained profits and, therefore, you must have sufficient retained profits to cover the dividends that you wish to pay.

Dividends are paid out of post-tax profits and the profits from which they are paid will have already suffered corporation tax. From 1 April 2023, the rate of corporation tax depends on the level of the company's profits, marginal rates ranging from 19% to 26.5%. Where profits exceed the lower profits limit (set at £50,000 for a standalone company), the company will pay corporation tax at a higher rate from 1 April 2023, reducing the profits available for distribution.

Dividends must be paid in proportion to shareholdings. However, if you use an alphabet share structure whereby each shareholder has their own class of share (e.g., A ordinary shares, B ordinary shares, etc.) you can tailor dividend payments by declaring different dividends for different classes of shares.

All taxpayers, regardless of the rate at which they pay tax, have a dividend allowance. Dividends covered by the allowance are tax-free. This provides the opportunity to extract profits tax free by paying dividends to family shareholders to utilise their available dividend allowance.

The dividend allowance has been reduced to £500 for 2024/25, down from £1,000 for 2023/24. The reduction in the dividend allowance reduces the profits that can be extracted tax-free by paying dividends to family members to mop up their dividend allowances.

Once the dividend allowance has been used up, dividends (which are taxed as the top slice of income) are taxed at 8.75% where they fall within the basic rate band, at 33.75% where they fall within the higher rate band and at 39.35% where they fall within the additional rate band. As dividends are paid out of retained profits, they have already suffered corporation tax.

Rent

If you run your company from home, you can consider renting your home office to the company. The rent, which should be at a commercial rate, is deductible in computing the company's taxable profits. However, you must pay income tax on it and declare it on your self-assessment tax return. On the plus side, there is no National Insurance to pay.

Benefits in kind

There are a number of tax exemptions for benefits in kind, such as those for mobile phones and trivial benefits, which enable you to extract profits as a benefit in kind without an associated tax or National Insurance liability.

Electric company cars can also be provided at very low tax cost. The benefit amount (on which tax is due) is currently 2% of the list price and is scheduled to rise to 5% by 2027/28. Employer National Insurance Contributions also need to be paid at 13.8% on the benefit amount.

Pension contributions

You can also extract profits in the form of pension contributions as your company can pay contributions into a pension plan for you (if your available annual allowance has not been used up).

A catch-up for the last three years' of allowances can also be made if there are unused allowances from those years.

Directors' loans

If your need money for a short time, taking a director's loan can be tax efficient. You can borrow up to £10,000 for up to 21 months tax-free. However, there are tax consequences if the balance exceeds £10,000 at any point in the tax year, or if you do not repay the loan within nine months and one day of the end of your accounting period.

Leave profits in your company

Extracting profits from your company may trigger tax and National Insurance charges. If you do not need the profits for personal use, consider leaving them in the company to extract later when this can be done more tax efficiently.

RPGCC can help

RPGCC have been helping both family companies and private clients plan their tax affairs for many years. The RPGCC team can help you formulate a tax-efficient strategy for extracting profits from your personal or family company. If you would like to speak to a member of our team you can contact us on 020 7870 9050.

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