The long run

If you reinvest the profit in growing the company's business, you won't pay any income tax on that money for the time being – it won't be paid out in salary or dividend. In the long term, you might realise that money by selling the company – or possibly winding it up with surplus cash – and making a capital gain.

Entrepreneurs' Relief means that CGT on gains of up to £10m on owner-managed businesses is charged at only 10%, which is a substantial saving against income tax. However, HMRC have some rules to stop people disguising dividends as capital gains – for example by winding up a company, paying out its reserves, and immediately starting up another one. They'll argue that dividend rates should apply. A concession which allowed a simple winding up may soon be restricted to companies with only £4,000 of assets, so it could be harder to pay the lower CGT rates on large retained profits.

His and hers

Because husband and wife or registered civil partners have separate tax allowances and lower rate bands, there are significant savings if the income of a business can be split between them rather than all being earned by one. This can be done by employing a spouse in a business, or by sharing ownership. HMRC have lost an important case in which they tried to restrict the effectiveness of this plan, but there are limits on what can be done, so it's worth discussing the latest position with your advisers.

How we can help

The rules on taking money out of your company are a maze. We can steer you past the obstacles and help you to find the exit still holding as much of your cash as possible!

ABOUT US

OUR SERVICES

Essex Abel are here to help guide you through the issues detailed in this guide or any other business or taxation issue you may have.

We offer a FREE initial consultation to discuss your individual requirements, from which we will be able to provide a clear and concise plan of action to address the issues discussed.

All our clients (whatever their size or needs) all have something in common – they receive the same professional, reliable, friendly, quality service that forms the basis of our core business values.

We offer an extensive range of services, including the following:

- Tax Planning Advice
- Tax Returns
- Business Start-up Support
- Business Plans & Forecasts
- Year End & Management Accounts
- VAT Returns & Bookkeeping
- Payroll & CIS Bureau
- Statutory Audits
- Company Secretarial Services

For further information on our services, please see our website www.essexabel.co.uk or contact us directly on 01509 267827

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2011–2012 GUIDE TO

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Extracting Profit

You don't go into business so your company can have the money – you want to spend it yourself.

Whose money?

If you run a business, you work hard and you expect to enjoy the results. Unfortunately, the taxman wants his slice first – but the rest is yours, surely? As so often with tax, it's not that simple.

If you run an unincorporated business, the money is yours. You have to pay tax and NIC on the profits, but what's left in the bank account belongs to you. If you run your business through a company, though, it's the company that pays tax on the profits – there may be more to pay when you draw the remainder out.

Tax rates

There are many reasons for setting up a company rather than staying unincorporated, but the difference in tax rates is one of them. At the lowest levels a company pays 20% on profits, the same as an individual - but the individual will also pay NIC at 9%. When the higher rate threshold is reached – £42,475, ignoring other income – the personal tax and NIC go up to 42%. At £150,000, it's 52%. A stand-alone company continues to pay 20% on profits up to £300,000, and the main rate of corporation tax is 26% for profits over £1.5m.

That makes the decision look like a no-brainer – a business pays less tax if it's a company. But you don't go into business so the company can have the money – you need to take it out so you can spend it yourself. There's the catch: when the company pays you, there will be more tax.

Salary

The simplest thing is to pay yourself a salary. It also carries the highest tax liability. Salary will be an expense for the company – reducing the corporation tax charge at 20% on profits up to £300,000 or higher rates above that – and it will be taxable income for the recipient, bearing income tax at 20%, 40% or 50%, as well as NIC.

A self-employed person pays Class 4 NIC on profits with a highest rate of 9%. An employee – which is what you are if you run your own company – suffers Class 1 NIC at 12%, and the employer pays contributions at 13.8% as well.

Tax on salary is also paid quicker than anything else – PAYE will be payable the month after you get the money.

Benefits

"Perks" are covered by a multitude of tax rules, some of them generally harsh – like the taxation of larger company cars and fuel – and some of them generous. For example, if your company provides you with a mobile phone, it will be an expense for the company and you pay no tax on the benefit. The rules are varied and complex, and the benefits that can practically be provided depend on the circumstances of the company – but this is an area where savings can be made.

Dividends

If a company makes a profit after tax, it can pay a dividend to the shareholders. If the shareholders are the same people as the directors, they have a choice between paying a salary or paying a dividend. Salary is an expense for the company, but a dividend is not, which makes the numbers complicated.

Example

A company makes a profit of £200,000 before paying its two director-shareholders. If it pays the maximum salary, they can have £88,731 each – the rest is employers' NIC. They will pay income tax and Class 1 NIC on that.

If the company pays the maximum dividend, it will pay £40,000 in corporation tax and distribute £80,000 to each shareholder – but the tax on that will be much lower than on a salary of £88,731, because a dividend is treated as coming with 10% tax already paid and there is no NIC. The difference could be as much as £27,000 on £200,000.

As a general rule, paying dividends rather than salary means lower tax charges. However, it is necessary for the company to have legally distributable profits under Companies Act rules, and proper procedures must be followed for a distribution to be lawful. You can't simply pay out the money that happens to be in the company's bank account.

Anything else?

There are other ways to take money out of a company. For example, if you have a dedicated office in your home, you might consider paying rent for the use of the room – but this has several different tax consequences and must be considered carefully.