

Remuneration planning strategy (Lecture B1352 – 13.54 minutes)

When considering how to extract money from the company in a tax-efficient way, we are normally thinking about the difference between salary and dividends. There is a subsidiary issue involving loan interest (where money has been lent to the company by the individual) and rental income (where it is possible to purchase business premises outside the main company) but these are not really going to generate the main income for a household other than in a few cases.

Looking at the two options is superficially straightforward. Salary payments will be tax deductible in the company but attract tax and NICs for both the payer and the payee. Dividend payments are not tax deductible for the company but will only attract tax and not NICs. Given the changes in corporation tax rates and the various changes to the rates of tax and NICs this year, it is useful to revisit this situation.

The following calculations are very simplified, but are really to make a general comparison between the different options. We are assuming that the personal allowance has already been used as well as the dividend allowance. We are also ignoring any employment allowance that might be available at this stage.

In reality, most director/shareholders will already be paying up to the lower earnings limit for NI purposes in order to guarantee the year qualifies for state pension purposes so we are really looking at how we top-up the main income.

Calculations – basic rate taxpayer

Bonus

Gross	100.00
Secondary class 1 NIC (13.8/113.8)	(12.12)
Gross salary	87.88
Income tax and NIC at 32%	(28.13)
Retained	<u>59.75</u>
Total tax and NI cost	40.25%

Dividends

For dividends, it is assumed that the dividend tax allowance has already been utilised.

Gross	100.00
Less corporation tax (19%)	(19.00)
Gross dividend	81.00
Income tax 8.75%	(7.09)
Retained	<u>73.91</u>
Total tax and NI cost	26.09%

Making this comparison for higher rate and additional rate taxpayer we can see the following figures:

	Basic rate taxpayer	Higher rate taxpayer	Additional rate taxpayer
Salary	41.98%	49.03%	53.42%
Dividends	26.09%	46.34%	50.87%

What about the changes in April 2023?

The figures then change again when the rate of corporation tax goes up in 2023 since the tax rate for dividends depends on the marginal rate of tax of the company as dividends are not tax deductible.

This change will not affect the marginal rate of tax for salaries as these are deductible for corporation tax purposes and so there is no impact if the corporate tax rate increases.

	Basic rate taxpayer	Higher rate taxpayer	Additional rate taxpayer
Salary	40.25%	49.03%	53.42%
Dividends			
19% CT	26.09%	46.34%	50.87%
26.5% CT	32.93%	51.31%	55.42%
25% CT	31.56%	50.31%	54.51%

This shows that once we have a company paying either marginal or main rates of corporation tax the salary route is actually more tax effective due to the increased benefit of the corporation tax deduction, other than for a basic rate taxpayer. This was seen before when the marginal rates of tax were higher – when we had a tiered corporation tax system. In that situation you might think it would be better to take salary to bring profits down to the small profits rate and then take dividends if you wanted to take more income.

However, when the calculations are done, it is an interesting situation. You have to do the calculations as it is not easy to predict the outcome. There may not be an overall tax saving or the overall tax may be reduced by this strategy but the amount of money extracted by the individual could be less, because you are reducing the corporation tax payable, not the individual tax.

For example, if you had a standalone company with profits of £75,000 after deduction of a salary at the level of the personal allowance (set at this level to make the calculation easier!). They want to pay £50,000 gross to the individual as either dividends or salary.

Option 1: pay salary of £50,000

Employers NICs = $£50,000 \times 13.8\% = £6,900$

Corporation tax = $(75,000 - £50,000 - £6,900) \times 19\% = £3,439$

NIC on director: salary of £12,570 already paid, so £37,700 @ 12.8% plus £12,300 @ 2% = £5,071.60

Tax on director: £37,700 @ 20% plus £12,300 @ 40% = £12,460

Total tax payable = £27,870.60

Net take home for director = £32,468.40 (out of £50,000)

Option 2: pay dividends of £50,000

No NICs due

Corporation tax = $(£50,000 \times 19\%) + (£25,000 \times 26.5\%) = £16,125$

Tax on director = $(£1,000 @ \text{nil}) + (£36,700 @ 8.75\%) + (£12,300 @ 33.75\%) = £7,362.50$

Total tax payable = £23,487.50

Net take home for director = £42,637.50

Option 3: pay salary to bring profits down to £50,000 and then balance as dividends

Want net deduction of £25,000 so $13.8/113.8 = £3,031.63$ giving salary of £21,968

Balance as dividend = $£50,000 - £21,968 = £28,032$

Corporation tax = $£50,000 \times 19\% = £9,500$

NIC on director: £21,968 @ 12% = £2,636

Tax on director: $(£21,968 @ 20\%) + (£1,000 @ \text{nil}) + (£14,971 @ 8.75\%) + (£12,300 @ 33.75\%) = £9,848.81$

Total tax payable = £25,022.44

Net take home for director = £37,515.19

Best outcome

In this situation, you can see that it still makes sense to pay dividends because so much of the income is being taxed at basic rate, where the difference between salary and dividends is so great. If you had the same individual who had other income so that they were being taxed at higher rates, the figures might be different. You just have to do the calculations.

Capital gains tax rates

Interesting, if no money was extracted on an annual basis but the funds were retained in the company and then extracted subsequently as a capital distribution, the following marginal rates of tax would apply:

	BADR	No BADR Basic rate	No BADR hHgher rate
19% CT	27.1%	27.1%	35.2%
26.5% CT	33.85%	33.85%	41.2%
25% CT	32.5%	32.5%	40%

Of course, this leads to many questions about the availability of capital treatment in various circumstances – for example, will retaining cash in the company lead to a situation where the BADR is prejudiced?

Contributed by Ros Martin