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Extracting Cash From Companies – Salaries And Bonuses

A company pays corporation tax on its profits, at 20% on the first £300,000, 21.25% on the next £1.2 million, and 21% on profits over £1.5 million. If the shareholders or directors want to take any cash out of the company, they will be taxed on what they take.

The simplest and most obvious way to extract cash is for the company to pay a salary to its directors, or perhaps a bonus at the end of the year, or both.

Such payments must be subjected to tax and National Insurance contributions (NIC) under the Pay As You Earn (PAYE) system, just like payments to any other employees. In addition to deducting tax and NIC, the company has to pay employer's NIC at a rate of 13.8% on payments over £7,956 per year.

This level of pay is also below the threshold at which income tax has to be deducted (assuming the individual concerned has a normal PAYE code).

In a case where the company is the sole source of income for the shareholder directors, it generally makes sense for the company to pay a salary just below this level to them. This is because salaries and bonuses paid to employees or directors of the company are normally allowed as a deduction from its profits for the purposes of corporation tax.

As far as the director is concerned, the £7,956 is taxable, but no tax will be deducted because it is below the PAYE threshold. At the end of the tax year, however, this pay will be taken into account when calculating the overall tax bill for self-assessment purposes.

Is it worth paying higher salaries to the director/shareholders? This is a very complicated question, and one where there is no substitute for doing the arithmetic in each case. However, as a very broad rule of thumb, it is likely that less tax will be paid overall (by the company and by the directors taken together) if further cash is extracted by other means. This is because the company has to pay employer's NIC at 13.8% on all such payments.

The arithmetic becomes complicated however, because the company can get a tax deduction for the payment to the director, including the employer's NIC. An example will show how this works, and that in most circumstances, dividends cost less in tax than salaries.

Example

Assume the company pays corporation tax at 20% and the director/shareholder is a 40% taxpayer.

If a company has a profit of £10,000, it can pay a total of £9,718 to the director – the other £282 is needed for the employer's NIC, but it will pay no corporation tax because it can deduct the payment and the employer's NIC from its profits. The director will pay income tax and NIC at 42%, leaving him with £5,636 in his pocket.

If the company decided to pay a dividend instead, it could only pay £8,000 because the remaining £2,000 is needed to pay corporation tax – dividends cannot be deducted for corporation tax purposes. The director will pay £2,000 income tax on the dividend, leaving £6,000 in his pocket.

Practical Tip:

In this case, paying dividends is clearly the best option (to the tune of £364), but there are so many variables that the basic proposition – salary up to the PAYE threshold, and dividends thereafter, should always be tested in the particular circumstances of the company in question.

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We are a pro-active financial and taxation consultancy delivering excellent customer service to individuals and owner-managed businesses at outstanding value. We are forward-looking in our approach, focusing on the business success of our clients rather than focusing solely on compliance.

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Personal Tax

Claim A Deduction For Mileage Payments

Under the Approved Mileage Allowance Payments (AMAP) Scheme employers can pay employees tax-free mileage rates when they use their own car for business. Provided that the amounts paid do not exceed the rates set by HMRC, no tax liability arises and there is nothing to report on the P11D.

However, many employees are unaware that if their employer pays them at a rate that is less than the approved rate they can claim a tax deduction for the shortfall. The approved rates for 2014/15 for cars and vans are 45p per mile for the first 10,000 business miles in the tax year and 25p thereafter.

Case Study:

Nigel uses his own car for work and in 2014/15 undertakes 9,000 business miles. His employer pays a mileage allowance of 30p per mile. Thus, Nigel receives mileage allowances of £2,700 during the year.

However, at the approved rate of 45p per mile for the first 10,000 business miles, John's employer could pay him a tax-free allowance of £4,050 (9,000 miles @ 45p per mile). This is known as 'the approved amount'.

Nigel can claim a tax deduction of £1,350 for the shortfall between the approved amount (£4,050) and the amount he is actually paid (£2,700). Assuming Nigel is a higher rate taxpayer paying tax at 40%, this will save him tax of £540.

Property Tax

Interest On Portfolio Mortgages

Tax relief is allowed on interest paid on mortgages/loans taken out to finance the purchase of assets held within a business. Landlords who own two or more properties are deemed to own a 'portfolio' of business assets.

Lenders have designed products that treat the 'portfolio' as one single business account regardless of the number of properties purchased or whether the full amount of capital has been utilised. The individual properties may have separate mortgages each with different interest rates charged but the 'portfolio' is treated as one single business account.

One portfolio means one agreement, one monthly payment and one mortgage statement.

Should not all of the capital be used, tax relief on interest payments made remains fully allowable because the original reason for the mortgage/loan remains – namely to finance the use of capital by a property business.

Case Study:

Avril owns six properties with a total value of £2m. With a portfolio mortgage outstanding of £1.7m there is a 'shortfall' of £300,000. This amount is not the equity found in any one property but in the portfolio spread over the six properties. This allows £300,000 for further investment; the interest will be fully tax deductible.

Business Tax

Cap On Income Tax Reliefs

From 6 April 2013 a limit is placed on the amount that an individual may deduct by way of certain specified reliefs. The limit is set at £50,000 or 25% of the individual's adjusted total income for the tax year if this is greater.

The reliefs subject to the limit include income tax loss reliefs, but not charitable donations and contributions to registered pension schemes.

Where reliefs available for the year exceed the limit, care should be taken to ensure that maximum relief is obtained subject to the cap, such as carrying back losses to the previous year or carrying trade losses forward, rather than relieving in the current year. It is advisable that professional advice is sought.

Case Study:

Geoff has income for 2014/15 of £180,000. He makes a trading loss of £60,000. He had no income in 2013/14.

Geoff wishes to set the loss against his general income of 2014/15. However, the relief available for that year is capped at £50,000 as this is greater than 25% of his income (£45,000).

He can claim loss relief of £50,000 for 2014/15. As he had no income in 2013/14, he cannot carry the remaining £10,000 of the loss back. Therefore he must carry it forward for relief against future profits.

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