2024/25

TAX-EFFICIENT PROFIT EXTRACTION FOR COMPANIES

Sarah Bradford

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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 2024/25 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 2024/25, the income tax rates and limits applying to Welsh taxpayers are aligned with the rest of the UK, excluding Scotland. The Scottish rates of income tax apply to the non-dividend non-savings income of Scottish taxpayers.

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 2024/25, the personal allowance is set at £12,570. It is due to remain at that level until 5 April 2028. The personal allowance is gradually reduced once the taxpayer's adjusted net income reaches £100,000. The allowance is reduced by £1 for every £2 by which your income exceeds £100,000. This means that if you have adjusted net income of £125,140 or above for 2024/25, you will not receive a personal allowance.

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 2024/25 on taxable income falling within the basic-rate band. For 2024/25, this is set at £37,700 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 £125,140 and at the additional rate of 45% on taxable income in excess of £125,140. The additional rate now applies once the personal allowance has been fully abated.

As far as NICs are concerned, if you are self-employed, you will pay Class 4 NICs on your profits if they exceed the lower profits limit, set at £12,570 for 2024/25. Once this limit is reached, Class 4 NICs are payable at the main rate of 6% on profits between £12,570 and £50,270 and at 2% on any profits above that level. Class 2 NICs, previously payable by the self-employed, are abolished from 6 April 2024. However, self-employed earners with profits between the small profits threshold (set at £6,725 for 2024/25) and the lower profits limit for Class 4 purposes (set at £12,570) will be awarded a National Insurance credit to provide them with a qualifying year for state pension purposes. Self-employed earners with profits below the small profits threshold will be able to pay voluntary contributions at the 2023/24 Class 2 rate of £3.45 per week.

Having paid your tax and NICs, 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 2024 (running from 1 April 2024 to 31 March 2025), the rate at which you will pay corporation tax will depend on the level

of your profits. If you have no associated companies, you will pay corporation tax at the small profits rate of 19% if your taxable profits are £50,000 or less. If your profits are between £50,000 and £250,000, you will pay corporation tax at the main rate of 25% but this will be reduced by marginal relief. As a result, the effective rate within this band gradually increases from 19% to 25%. If your profits are more than £250,000, you will pay corporation tax at the main rate of 25%. If you have one or more associated companies, the limits of £50,000 and £250,000 are divided by the number of associated companies plus one. The limits are also proportionately reduced where the accounting period is less than 12 months. The same rates apply for the financial year 2023 (running from 1 April 2023 to 31 March 2024). When deciding on a business structure, the level of your likely profits and the rate at which you will pay corporation tax should be factored in.

Depending on the level of your profits, the rate of corporation tax may be higher or lower than the basic rate of income tax. However, regardless of your profits, the rate of corporation tax payable on your company's profits will be lower than the higher and additional rates of income tax.

However, this is not the end of the story. A company is entirely separate from 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; however, employer NICs 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 and, like secondary Class 1 contributions, are deductible in calculating the company's profits. Where the director has a student loan, student loan repayments will be deducted where income exceeds the relevant loan threshold.

Consequently, when looking at the overall tax position, it is necessary to consider the tax payable by the company on its profits and any tax and NICs on money taken out of the company. The tax and NIC consequences on money taken out of the company will vary depending on the way in which this is done – not all extraction methods are equal. Therefore, it is not only necessary to decide how much to take out but also how to extract the profits. Adopting a tax and NIC-efficient strategy can save significant sums of money, so it pays to plan ahead.

This report will explore the ways in which cash can be extracted from a company and look at the tax and NIC implications of each method. The report starts by looking at some of the basic and most straightforward methods and progresses through more sophisticated ideas. By the end of the report, you should have a comprehensive view of the ways to extract profits from your company in a tax-efficient manner.

The report covers:

- Salaries – as a director of the company, you are entitled to be paid a

salary for your work – and so are any members of your family who work for the company. At first glance, salaries (which attract income tax and employee's NIC via the Pay As You Earn (PAYE) system, together with employer's NIC at 13.8% for 2024/25) are an expensive way to take money out, but as we shall see, they definitely have their place and there is a lot to be said for taking a small salary at least equal to the lower earnings limit for Class 1 NIC purposes.
- Benefits in kind – profits do not need to be taken out in cash form and can be extracted in kind instead. Some benefits in kind, such as mobile phones and even parties, can be provided tax-free. Although withdrawing profits in this way is unlikely to save you a fortune, taken together, a package of tax-efficient benefits adds up to a useful and often neglected escape route for some of the company's cash.
- Dividends – these are paid to shareholders in a company and are one of the main routes for extracting company profits in a tax-efficient manner as dividend tax rates are lower than the income tax rates and individuals benefit from a separate dividend allowance (set at £500 for 2024/25). However, they have their own problems, too, and a falling dividend allowance and recent increases in the dividend tax rates have eroded some of the benefits. Dividends are paid out of the company's post-tax profits, and any money extracted as dividends has already suffered a corporation tax hit. Further, a company can only pay dividends if it has sufficient retained profits from which to pay them. Dividends must be paid in proportion to shareholdings, so it is valuable to consider the share structure up front and the advantages of using an 'alphabet' share structure to provide flexibility.
- Pension provision – paying money into a pension can be tax-effective due to the tax reliefs that are available. Making employer contributions to a pension scheme can be a useful way to take money out of a company, and the company can deduct these in computing its taxable profits. The lifting of the lifetime allowance increases the attractiveness of making pension contributions.
- Loans – although tax liabilities generally arise where a company lends money to shareholders, employees or directors, there are some useful exceptions to this rule. Techniques using loans to provide access to company profits vary from very basic planning ideas to complex arrangements. It should, however, be noted that HMRC targets what it regards as abusive arrangements and tax avoidance schemes, and continues to be alert to schemes that seek to use loans to avoid tax and NICs that would otherwise be payable. Directors and shareholders may make loans to the company. Interest can be paid on loans to the company, representing another avenue for extracting profits.
- Capital taxation – this may come into play when looking at ways of building up a 'tax-free' nest egg in the company at the start of its life, and also when looking to extract the cash from a company at the end of its existence at a rate of 10% tax or less.
- Spouses and civil partners have additional tax planning opportunities denied to single taxpayers.
- Rent and sales of assets to the company – these provide further ways of getting money out of the company.
- Other ideas – the final section will look at some of the more complex structures that can be used to maximise the tax-efficiency of a business involving a limited company.