Sunflower Accounts

Helping your business grow to new heights

ACCA

Dividend vs Salary 2017/18

Stephanie Rickaby explores whether it is better to extract profits from a personal or family company as salary, dividends or both.

Before we decide on the most tax efficient strategy, I would recommend asking the question,

“what level of profits need to be extracted from the company?” Have you prepared a personal budget? If the profits are not needed outside the company, often it is more tax efficient to leave the profits in the company beyond a certain level.

What level of salary should be paid?

For state pension purposes, a person reaching state pension age on or after 6 April 2016 needs 35 qualifying years to gain full pension. Therefore where a director or family member does not have the full 35 years, then paying a small salary can be beneficial. To make a qualifying year, a salary must be set at £5,876 (2017-18). Up to a salary of £8,164, no national insurance is actually paid either employees or employers but you receive a notional zero rate contribution and receive a qualifying year towards your state pension.

Could we pay a higher salary?

Your personal allowance is set at £11,500, assuming no other income i.e. pensions, you could pay a salary equivalent to your personal allowance.

However you will pay employee national insurance at 12% and employers will pay NI at 13.8%.

Currently there is an employer’s allowance of up to £3,000 to help reduce an employers NIC bill. Therefore if you have not fully utilised this allowance you could pay a salary equivalent of your personal allowance as you will not be subject to paying employers national insurance on this salary level.

The company therefore receives corporation tax relief on the higher salary of £633.84 (£11,500 - £8,164 * 19%) But the director does have to pay employees NI of £400.32. This gives you a tax saving overall of £233.52

Therefore:

- **If you have other income but you are short on your qualifying years then pay yourself the minimum – pay £5,876**
- **If you are a sole director/ shareholder on the payroll or as a firm your employers allowance of £3,000 is fully utilised – pay £8,164**
- **If employers allowance is not fully utilised within the company – pay £11,500**

Dividends

Dividends are paid out of post tax profits therefore already suffered corporation tax (2017 – 19%) You can only vote dividends if the company has sufficient profits and usually in proportion to the shareholding.

The first £5,000 is taxed at zero % and is tax free. However if you have not fully utilised your personal allowance i.e. being paid a salary of £8,164, then you could top up your personal allowance with dividends and also receive your £5,000 NIL rate dividends. Once the dividends and personal allowance are used up, then dividends are taxed at 7.5% if falls within basic rate band, 32.5% when income reaches higher rate and 38.1% when income reaches the additional rate.

£16,500 tax free (assuming no other income)

	£	£
Salary	8,164	11,500
Dividends	7,836	5000
	16,000	16,500

If you require further information please contact Stephanie Rickaby – steph@sunfloweraccounts.co.uk