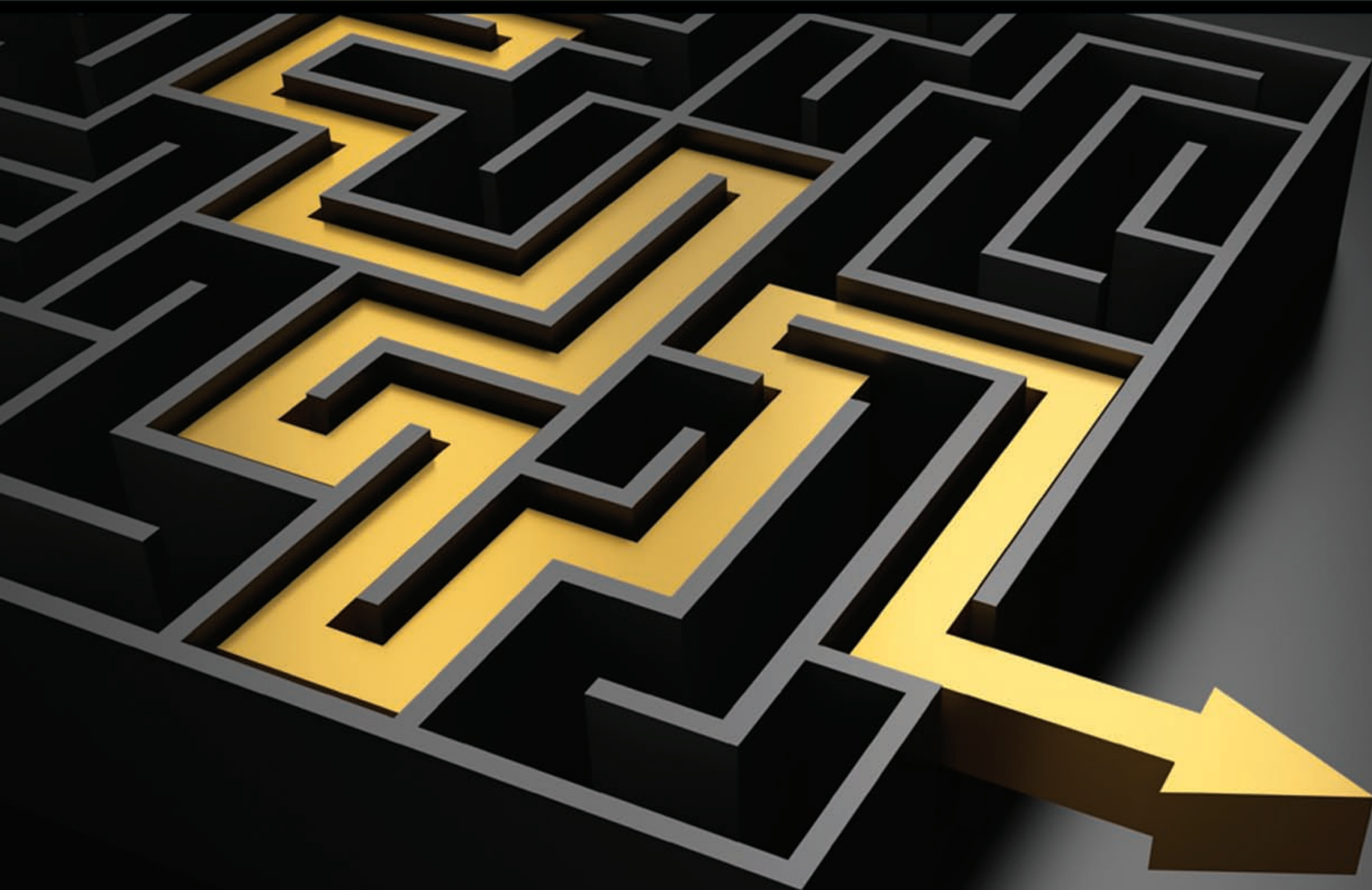
PLUS OTHER TAX EFFICIENT
PROFIT EXTRACTION STRATEGIES



SALARY VERSUS DIVIDENDS

TAX Cafe®

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Taxcafe.co.uk Tax Guides

Salary versus Dividends

& Other Tax Efficient Profit Extraction Strategies

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and

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Introduction

This guide answers one of the most common question asked by company owners: "What's the best way to take money out of my company if I want to pay less tax?"

In Part 1 we kick off with a plain English guide to how *companies* are taxed.

Corporation Tax rates increased on 1st April 2023. Calculating your company's tax bill also became more complicated. As a result, new tax planning opportunities have arisen.

The Corporation Tax changes are covered in detail in this part of the guide and, throughout the guide, we explain how the changes affect your profit extraction decisions this year, and in the years ahead.

In Part 1 we also explain how *company owners* are taxed. As a director/shareholder you can choose the best mix of salary and dividends. We examine the pros and cons of each type of income.

Company owners can also choose the most tax efficient level of income. We will see how, by smoothing your income or varying it significantly from year to year, you may be able to cut your tax bill considerably.

Tax-Free Salaries & Dividends

In Part 2 we reveal how much tax-free salary and dividend income you can withdraw from your company this year. You'll discover how to calculate the 'optimal' tax-efficient salary and how couples in business together can receive £27,140 this year without paying any Income Tax.

In Part 3 we explain how much dividend income you can take taxed at just 8.75% and how to avoid paying tax at 33.75%.

This part of the guide also contains important tax saving strategies for parents who want to avoid the Child Benefit Charge. This kicks in when your income exceeds £50,000, but many company owners will be able to avoid it completely or in part.

There is also important tax planning information for high income earners (those with income over £100,000) and for *really big* earners, who may actually benefit from reversing the strategy that usually benefits everyone else.

Income from Other Sources

In Part 4 we turn to company owners who have income from other sources (e.g. pensions, rental income, interest income, income from another business and stock market dividends).

We explain why you may need to adjust your company salary or dividends to avoid the higher tax rates that kick in when your income reaches certain key thresholds (£50,000, £50,270, and £100,000).

We also examine some tax planning techniques that can be used to reduce or eliminate the tax payable on your income from other sources.

Company owners who are also landlords need to be aware of the restriction to tax relief on mortgage interest. Fortunately, company owners have more flexibility than other landlords when it comes to avoiding some of the worst effects of this tax change.

Company owners can also enjoy much more tax-free interest than other taxpayers (up to £6,000 per year).

Splitting Income with Family Members

Part 5 explains how company owners can gift shares in the business to their spouses, partners or children and save over £10,000 in tax this year, with similar savings every year.

We also show how additional savings can be achieved by paying tax-free salaries to family members, including your minor children.

There are, however, many traps to avoid when it comes to splitting income with family members and these are fully covered in this part of the guide. For example, we examine the danger of gifting shares that have fewer rights than ordinary shares and the danger of using dividend waivers to divert income to your spouse/partner.

Alternative Profit Extraction Strategies

Part 6 looks at alternative profit extraction strategies:

- **Directors' loans:** How they can be used to reduce or postpone tax.

- **Rent:** Why getting your company to pay you rent is more tax efficient than a dividend in many circumstances.

- **Interest:** How to receive up to £6,000 of tax-free interest from your company.

- **Charity:** Who should donate: you or the company?

- **Pension contributions:** Why they're better than dividends, who should make them (you or the company), plus a chapter on putting property into a pension.

- **Capital gains:** How to pay 10% tax when you sell or wind up your company; How to pay 0% tax when you sell your company to an employee ownership trust.

In Part 7 we turn to some of the practical issues and dangers that may be experienced when extracting money from your company:

- How to avoid the minimum wage regulations
- How to make sure your salary is a tax-deductible expense
- Making sure your company has sufficient distributable profits to declare dividends
- How to declare dividends properly and avoid an HMRC challenge
- When HMRC might try to tax your dividends as earnings

Finally, in Part 8, we look at some other tax saving strategies for company owners, including how they may be able to reduce the amount of Capital Gains Tax payable when assets like rental properties are sold.

In this part we also explain how you may be able to completely avoid tax by emigrating. There is also a chapter explaining how you can reduce your Income Tax bill by investing in venture capital trusts.

Using This Guide & Limitations

This tax guide deals primarily with the 2023/24 tax year, starting on 6th April 2023 and finishing on 5th April 2024. Unless expressly stated to the contrary, all references, examples, illustrations, etc, are based on the tax rates, thresholds, and allowances applying for 2023/24.

Nonetheless, there are some references to other tax years, for example when discussing the advantages and disadvantages of postponing income to a future tax year.

Following the Chancellor's various Budgets and Statements over the last year or so (including the Autumn Statement on 22nd November 2023), we now know the expected tax rates and thresholds for each tax year until 2027/28. However, it is important to emphasise this could all be changed in a later statement, especially if there is a change of Government, so we cannot truly say the tax rates that will apply in future years are known with absolute certainty: and the further one strays into the future, the more uncertain the position becomes!

As well as rates and thresholds, tax laws (and HMRC's interpretation of those laws) are also continually changing. The reader must bear all this in mind when reading this guide.

Please note that, although small company owners are this book's main target audience, this is NOT supposed to be a do-it-yourself (DIY) tax planning guide.

Our purpose in writing this guide is to explain in plain English how companies and company owners are taxed and provide some tax planning ideas that can be taken to an accountant or other professional adviser for further discussion.

We do not recommend 'going it alone' when it comes to this type of tax planning and there are several reasons for our cautious approach.

Firstly, although the guide covers a fair amount of ground, it does not cover every possible scenario: that would be impossible without making the guide much longer and possibly much more difficult to digest.

In other words, in places we have had to sacrifice definitiveness in favour of making the guide a manageable and hopefully enjoyable read for the average small company owner.

Companies come in many different shapes and sizes, as do their owners, so it is possible the information contained in this guide will not be relevant to your circumstances.

In particular, please note this guide is aimed mainly at UK resident director/shareholders who own and work for UK resident companies.

Secondly, the main focus of this tax guide is *Income Tax* planning: helping company owners pay less tax on their salaries, dividends and other income. There are, however, other taxes that often have to be considered, including Capital Gains Tax and Inheritance Tax.

Steps that you take to reduce one type of tax can have an adverse impact on your liability to pay other taxes. While some mention is made of other taxes in this guide, we cannot guarantee that all interactions are covered.

Thirdly, there are potential risks involved when it comes to structuring your affairs to reduce the tax payable on salaries, dividends and other payments made by your company.

While most of the tax planning ideas contained in this book are widely used by many accountants and other professional advisers, and have been for many years, this does not mean they have the blessing of HM Revenue & Customs!

There are some grey areas when it comes to this area of tax planning and some tax savings may not always be guaranteed. In other words, we cannot be certain that some of the tax planning ideas contained in this book will not be subject to some sort of attack from HMRC, even if only at some point in the future.

For example, in the chapters that follow, we will show that the most tax-efficient mix of income for most company owners is a small salary coupled with a larger dividend. While this is a well-established, reasonable form of tax planning which, if carried out correctly, is generally accepted, even if grudgingly, by HMRC, there are circumstances under which they might seek to tax dividends as earnings.

We'll look at this potential threat further in Chapter 36, but it's also worth pointing out that, *at present*, such attacks are rare and generally only occur where aggressive tax avoidance schemes are involved. For the vast majority of small company owners, the danger is remote and lies firmly in the future.

Fourthly, there are also *non-tax* factors that have to be considered when deciding how much money you withdraw from your company and in what form. In some instances, other considerations will outweigh any potential tax savings.

For all of these reasons it is vital that you obtain professional advice before taking any action based on information contained in this guide. The authors and Taxcafe UK Ltd cannot accept any responsibility for any loss that may arise as a consequence of any action taken, or any decision to refrain from taking action, as a result of reading this guide

Corporation Tax Rates

Much of the planning and analysis in this guide is dependent on the company's Corporation Tax rate. As we will see in Chapter 1, many companies' Corporation Tax rates have been increased and others are currently in the process of increasing. Once the changes are fully in force, a company's overall Corporation Tax rate could be anything between 19% and 25%. In Chapter 1, we explain this new Corporation Tax regime in detail.

What we will also see in Chapter 1, however, is that it is generally a company's *marginal* Corporation Tax rate that matters for the purposes of this guide, rather than its *overall* tax rate.

From this point of view, 2023/24 is a transitional year and a company's *marginal* Corporation Tax rate could be anything between 19% and 26.5%. (Chapter 1 also includes details of how these rates are calculated and when they apply.)

However, once the Corporation Tax changes are fully in force (company accounting periods commencing after 31st March 2023), a company's marginal Corporation Tax rate can only be one of three rates: 19%, 26.5%, or 25%. Hence, it is these three rates we will use in our illustrations, examples, etc, throughout most of this guide.

We will only refer to other possible marginal Corporation Tax rates when necessary, either to illustrate a particular point, or when a certain marginal Corporation Tax rate is needed before a strategy becomes beneficial. For example, we might say something like, 'In this scenario, it is better to pay salary where the company's marginal Corporation Tax rate is at least 23.5%.'

If we simply say, 'In this scenario, it is better to pay salary,' then this applies at any Corporation Tax rate.

To check what your company's marginal Corporation Tax rate is this year, see Appendices A and B. The application of these appendices is explained in Chapter 1.

Matching Up Company and Personal Tax Rates

Under the new Corporation Tax regime, it is *most likely* that a company owner who is a basic rate taxpayer will have a company paying Corporation Tax at 19%, while higher or additional rate taxpayers will have companies paying Corporation Tax at higher rates. We will generally follow these principles for our main examples throughout this guide.

However, we will also cater for the possibility that higher or additional rate taxpayers may have companies paying Corporation Tax at only 19%, while basic rate taxpayers may have a company paying Corporation Tax at a higher rate as, for various reasons, all these combinations are possible.

Scottish Taxpayers

The Scottish Parliament can set the Income Tax rates applying to most types of income received by Scottish taxpayers, but not interest or dividends. The vast majority of the information contained in this guide is relevant to Scottish taxpayers. However, unless stated to the contrary, all examples, tables and calculations assume the taxpayer concerned is not a Scottish taxpayer.

Spouses and Civil Partners

Under UK tax law, all legally married spouses and registered civil partners are treated the same. Hence, when we refer to a 'spouse' in this guide, it includes a civil partner. For tax purposes, a spouse does not include a common-law partner or co-habitee. Where we are discussing a partner who may either be a legally married spouse or a common-law partner, we will use the term 'spouse/partner'.

Part 1

How Companies & Company Owners Are Taxed

Chapter 1

How Companies Are Taxed

Companies pay Corporation Tax on both their income and capital gains. In the last financial year, ended on 31st March 2023, all companies (except some in the oil and gas or banking sectors) paid Corporation Tax at the same flat rate of 19%. As we shall soon see, this still remains relevant when looking at payments of salary to many directors in 2023/24.

From 1st April 2023, the main rate of Corporation Tax increased to 25%. But not all companies will be paying Corporation Tax at the new rate. In fact, most of the small companies this guide is aimed at will be paying tax at a different rate.

Calculating the Company's Effective Tax Rate

Not only has Corporation Tax increased, it has also become more complicated, just like it was a few years ago. From 1st April 2023, there are two official Corporation Tax rates:

- Small profits rate 19%
- Main rate 25%

The practical effect is that companies will pay tax as follows:

- **Profits £50,000 or less** – Company will continue to pay 19% tax on all its profits

- **Profits between £50,000 and £250,000** – Company will pay 19% tax on the first £50,000 and 26.5% on the remainder

- **Profits greater than £250,000** – Company will pay 25% tax on all its profits

Some sample Corporation Tax bills and overall Corporation Tax rates are shown in Table 1.

TABLE 1
Overall Corporation Tax Rates
After the Increase

Profits	Corporation Tax	Corporation Tax Rate
£50,000	£9,500	19.00%
£60,000	£12,150	20.25%
£70,000	£14,800	21.14%
£80,000	£17,450	21.81%
£90,000	£20,100	22.33%
£100,000	£22,750	22.75%
£110,000	£25,400	23.09%
£120,000	£28,050	23.38%
£130,000	£30,700	23.62%
£140,000	£33,350	23.82%
£150,000	£36,000	24.00%
£160,000	£38,650	24.16%
£170,000	£41,300	24.29%
£180,000	£43,950	24.42%
£190,000	£46,600	24.53%
£200,000	£49,250	24.63%
£210,000	£51,900	24.71%
£220,000	£54,550	24.80%
£230,000	£57,200	24.87%
£240,000	£59,850	24.94%
£250,000	£62,500	25.00%

A company with profits of £100,000 will pay 19% on the first £50,000 and 26.5% on the final £50,000. The total tax bill will be £22,750 which means the company will have an overall tax rate of 22.75% (£22,750/£100,000).

A company with profits of £150,000 will pay 19% on the first £50,000 and 26.5% on the remaining £100,000. The total tax bill will be £36,000 which means the company will have an overall tax rate of 24% (£36,000/£150,000).

A company with profits of £20,000 (i.e. less than £50,000) will simply pay £3,800 (19%). A company will profits of £300,000 (i.e. more than £250,000) will simply pay £75,000 (25%).

Non-Resident Companies

Only companies that are UK resident will be able to benefit from the 19% small profits rate. A non-resident company that earns rental income from UK properties, for example, will therefore have to pay 25% Corporation Tax on all its UK rental profits.

Accounting Periods vs Financial Years

Because of the way Corporation Tax is calculated, the Corporation Tax increase is not yet fully in effect for some companies.

A company's own tax year (also known as its accounting period) can end on any date, for example 31st December, 31st March, etc.

Corporation Tax, on the other hand, is calculated according to financial years. Financial years run from 1st April to 31st March. The 2023 financial year is the year starting on 1st April 2023 and ending on 31st March 2024.

This matters when it comes to calculating how much tax your company will pay as a result of the changes to the Corporation Tax rate.

For example, on 1st April 2023, the main rate of Corporation Tax increased from 19% to 25%. A company with profits of more than £250,000 whose accounting period runs from 1st January 2023 to 31st December 2023 will therefore pay Corporation Tax as follows:

- 3 months to 31st March 2023 19%
- 9 months to 31st December 2023 25%

The company will therefore pay 19% Corporation Tax on roughly one quarter of its profits (3/12) and 25% tax on roughly three quarters of its profits (9/12). (It doesn't matter at what point during the year the profits are actually made.)

This means the company's overall Corporation Tax rate for this year will be 23.5%. (Note, in practice, Corporation Tax is calculated using days not months and this will result in a tiny difference in the overall tax rate which largely disappears in the rounding. For example, the above rate correctly calculated using days not months would be 23.52%.)

If the company has profits of less than £250,000, the calculation is a bit more complicated. For example, a company with profits of

£150,000 whose accounting period runs from 1st January 2023 to 31st December 2023 will pay Corporation Tax as follows:

- 3 months to 31st March 2023 19%
- 9 months to 31st December 2023 24%

24% is taken from Table 1 and is simply the new overall tax rate payable by a company with profits of £150,000.

The practical effect is that the company will pay 19% Corporation Tax on approximately one quarter of its profits and 24% tax on approximately three quarters of its profits.

This means the company's overall Corporation Tax rate for this year will be 22.75%.

(In practice, the actual calculation must be performed in days rather than months. Also, 2024 is a leap year, which has a further small effect on the calculation for companies with profits under £250,000, which we have ignored for simplicity.)

Another Example

Let's say the company has profits of £100,000 and an accounting period that runs from 1st March 2023 to 29th February 2024. It will pay Corporation Tax as follows:

- 1 month to 31st March 2023 19%
- 11 months to 29th February 2024 22.75%

22.75% is taken from Table 1 and is simply the new overall tax rate payable by a company with profits of £100,000.

The practical effect is the company will pay 19% Corporation Tax on approximately 1/12th of its profits and 22.75% tax on the remaining 11/12ths. This means the company's overall Corporation Tax rate for this year will be 22.44%.

This example shows how the Corporation Tax increase will still not yet have fully affected some companies as late as February 2024.

Marginal Tax Rate Planning

The Corporation Tax increase means many companies will pay more tax on their profits. The good news is companies will also enjoy more Corporation Tax relief on their spending.

In recent years companies have enjoyed 19% Corporation Tax relief no matter how much profit they have made or when they have spent their money. A company incurring an additional £1,000 of tax-deductible spending would reduce its taxable profits by £1,000, saving it £190 in Corporation Tax.

The Corporation Tax increase means the amount of tax relief a company enjoys now depends on its profits. For those companies where the increase is already in full force (those with an accounting period commencing after 31st March 2023), the position is as follows:

- A company with profits of £50,000 or less has a marginal tax rate of 19% and continues to enjoy 19% tax relief on its spending.

- A company with profits of between £50,000 and £250,000 has a marginal tax rate of 26.5% and enjoys 26.5% tax relief on its spending. (However, if the company's spending pushes its profits below £50,000 it will start to receive just 19% tax relief on any additional spending.)

- A company with profits of more than £250,000 has a marginal tax rate of 25% and enjoys 25% tax relief on its spending. (However, if the company's spending pushes its profits below £250,000 it will start to receive 26.5% tax relief on any additional spending.)

In Table 1 we listed the new overall tax rates companies face. For example, a company that makes a profit of £100,000 has an overall tax rate of 22.75%. However, this overall rate is NOT used for most tax planning purposes, for example calculating the amount of tax a company will save if it spends some more money. Instead it is the company's marginal tax rate.

This makes sense when you consider a simple example. A company that anticipates making a profit of £100,000 and incurs an additional £10,000 of tax-deductible expenditure will reduce its

taxable profits by £10,000. This will reduce its tax bill by £2,650 (26.5%). The company's overall tax rate of 22.75% does not tell us how much tax the company will save.

The Marginal Tax Rate Bands

To summarise, for twelve month accounting periods commencing after 31st March 2023, companies effectively have three marginal tax rate bands, as follows:

Profits up to £50,000	19%
Profits between £50,000 and £250,000	26.5%
Profits over £250,000	25%

These bands will apply in the majority of cases, but can be affected by factors such as whether the company has any associated companies, which we will examine later. They are an important concept in tax planning for companies, so watch out for references to the company's 'marginal tax rate band' later in this guide: it is these bands we are referring to.

(A director also has his or her own marginal tax rate band for Income Tax purposes, we'll get onto those later but, for now, it's important to emphasise that the ***director's*** marginal rate band and the ***company's*** marginal rate band are different things: although both of them are critically important for the purposes of this guide.)

Periods Straddling the Date of Change

A company will have a slightly lower marginal tax rate for the year that straddles 1st April 2023, the date the Corporation Tax rate changed.

In other words, spending in that year attracts more than 19% tax relief but not quite as much as when the Corporation Tax increase is in full force.

Take a company whose accounting period runs from 1st January to 31st December 2023 and has profits of between £50,000 and £250,000. Its marginal tax rate for that year is calculated as follows:

1st January to 31st March	90/365 x 19%	4.685%
1st April to 31st December	275/365 x 26.5%	19.966%
Marginal rate		24.651%

Thus, if the company incurs an additional £10,000 of tax-deductible spending between 1st January 2023 and 31st December 2023 its Corporation Tax bill will be reduced by £2,465.

Note, it doesn't matter when during the year the spending takes place (it doesn't matter whether it's between January and March or between April and December).

If the company has profits of more than £250,000 its marginal tax rate will be 19% for the first three months and 25% for the final nine months. Its overall marginal tax rate for the year will therefore be 23.521%.

Appendix A contains all the marginal tax rates that apply to companies with twelve month accounting periods ending at the end of a calendar month and straddling 1st April 2023, the date the Corporation Tax increase took effect.

(As you'll have noted from the above calculations and the appendices, one of the authors of this guide is a bit pedantic and goes to the extreme of using three decimal places, but you'll be pleased to hear we will generally be keeping it down to a maximum of two for the rest of the guide.)

Companies with profits of £50,000 or less continue to have a marginal tax rate of 19% and therefore receive 19% tax relief on their spending.

The fact that many companies are now seeing their marginal rates of Corporation Tax increasing raises a number of questions for their owners:

Should My Company Postpone Spending?

At the time of writing, many companies are still in an accounting period that will at least partially be taxed at just 19%, meaning their marginal Corporation Tax rate in the current period is less than the rate they are likely to face in the next period.

For example, a company with a 31st December accounting date, which has profits between £50,000 and £250,000 each year, faces a marginal Corporation Tax rate of 24.65% for the year ending 31st December 2023, but 26.5% for the following year.

This means it will enjoy 24.65% tax relief on any additional spending this year, but 26.5% if it postpones that spending to next year. Hence it could enjoy an additional saving of 1.85% on any discretionary spending it is able to postpone. That would save just £185 for every £10,000 it postpones.

In our view, such a small saving will seldom warrant any disruption to the company's existing spending plans. It is perhaps simply a reason not to accelerate spending planned for next year.

Of course, the potential saving may be more significant where the company's profit level is changing from one year to the next. For example, a company with profits not exceeding £50,000 in the current year will be taxed at 19% on those profits but, if it expects to make profits between £50,000 and £250,000 next year, its marginal tax rate will increase to 26.5%.

A company expecting this sort of increase in its marginal tax rate would enjoy an additional 7.5 percentage points of tax relief on spending it is able to postpone, saving £750 for every £10,000 it postpones. That may sometimes be a significant enough saving to justify postponing the expenditure, although the commercial implications always need to be considered.

Investment Spending

The Government was concerned that companies would postpone some of their *investment* spending until after the increase in Corporation Tax. For this reason, the Government introduced a 'super deduction' of 130% for investment spending that took place before 1st April 2023.

Now that the Corporation Tax increase is with us, the super deduction has run its course. Hence, many companies may be able to make some savings by postponing expenditure on things like vans, computers, machinery, or equipment until their next accounting period. However, the savings available are now likely to be modest. Assuming the company's profits fall into the same marginal tax rate band next year, the maximum saving still available for accounting periods that have not yet ended at the time of writing is less than 2.5%.

Hence, like other types of spending, for the vast majority of companies, the only significant savings will come when the

company's profits are no more than £50,000 this year, but greater than £50,000 next year.

For more information about tax relief on this type of spending (known as capital allowances), see the Taxcafe guide *Putting it Through the Company*.

How Does the Tax Increase Affect Salaries, etc?

If your company pays you a salary, rental income, interest income or makes pension contributions on your behalf, these are all tax-deductible expenses for the company. Thus, the tax relief the company enjoys on these expenses increases when its Corporation Tax rate increases.

It's worth pointing out at this stage that, for the smallest companies with annual profits not exceeding £50,000 (and no associated companies: see further below), the Corporation Tax increase will generally have no effect and all tax-deductible payments will usually continue to attract relief at 19%.

Apart from these companies, however, the exact amount of tax relief the company will enjoy in respect of payments made during the 2023/24 *Income Tax* year will depend not only on the company's accounting period and profit level, but also on whether the payments are made monthly, annually, or as a 'one off', and on how the payment is recognised in the company's accounts.

Companies must operate the accruals basis of accounting, which means any periodic cost must be spread over the period to which it relates. For example, a company with a 31st December accounting date may make a single annual rental payment of £20,000 to its owner/director, who owns the company's trading premises personally. Whenever the payment is made, the director will have taxable rental income of £20,000 for 2023/24.

But the payment that suffers Income Tax in the director's hands in 2023/24 will need to be recognised on a time apportionment basis in the company's accounts. Hence £15,000 (9/12ths) of the rent will fall into the company's accounting period ending 31st December 2023 and attract Corporation Tax relief at either 19%, 24.65%, or 23.52%, depending on the company's profit level (see Appendix A); and £5,000 (3/12ths) will fall into the company's accounting period ending 31st December 2024 and attract

Corporation Tax relief at either 19%, 26.5%, or 25%, again depending on the company's profit level.

Let's say the company's profits for each of the relevant years turns out to be £200,000, so it will have a marginal Corporation Tax rate of 24.65% for the year ending 31st December 2023 and 26.5% for the year ending 31st December 2024. The Corporation Tax relief for the rent on which the director pays Income Tax in 2023/24 will be:

£15,000 @ 24.65%	£3,697
£5,000 @ 26.5%	£1,325
Total	£5,022

The overall effective rate of relief is therefore 25.11%. You will find this rate of relief in Appendix B (it's actually 25.113% to be precise), which sets out the effective rate of Corporation Tax relief for periodic costs incurred by the company in the 2023/24 Income Tax year.

Sometimes periodic costs are apportioned on a daily, rather than monthly basis, which gives a slightly different result. Either approach is equally acceptable for both accounting and tax purposes, but we'll stick with monthly apportionment in this guide to keep life simple (or as simple as possible anyway).

The rent of £20,000 in our example might be either a single payment in respect of the twelve months to 31st March 2024 or it might be made up of the appropriate portions of annual payments made in respect of the twelve months to 31st December 2023 and twelve months to 31st December 2024. Either way, the director will pay Income Tax on £20,000 of rental income in 2023/24 and the company will enjoy Corporation Tax relief of £5,022 on that amount.

Where something is a periodic cost, it's also important to appreciate that, for Corporation Tax purposes, it is generally spread over the period to which it relates, regardless of when it is actually paid. Hence, the rent payment above would attract the same amount of Corporation Tax relief, and in the same accounting periods, even if it was not paid until after 5th April 2024.

There are some exceptions to this rule, however. Companies cannot claim Corporation Tax relief on:

- Salaries or bonuses that are still unpaid nine months after the end of the accounting period
- Interest charged by the company's owner that is still unpaid twelve months after the end of the accounting period

In these cases, relief can only be claimed when payment is actually made: credits made to the director's loan account count as payment though.

On the other side of the equation, directors are generally only taxed on payments from their company when they receive them (again, a credit to the director's loan account counts as receipt).

This applies to salary, bonuses, and interest paid to the director (as well as dividends, although these do not attract Corporation Tax relief). The only potential exception is rent, where the position depends on whether the director is taxed on their property income under the cash basis, or under traditional accruals basis accounting (see the Taxcafe guide *How to Save Property Tax* for detailed explanations of both methods and when they are available).

So, where does all this leave us with the effective rate of Corporation Tax relief for payments made to, or on behalf of, directors in 2023/24?

Generally, if something is paid monthly, it will be a periodic cost. Some things are always a periodic cost, even if paid annually.

Rent and interest are always periodic costs and thus will generally attract Corporation Tax relief at the rates given in Appendix B.

Salaries and pension contributions paid monthly will usually also be periodic costs, attracting Corporation Tax relief at the rates given in Appendix B.

Salaries or bonuses, and pension contributions, paid annually, or as a one-off, may not be periodic costs, but this depends on the circumstances. The position for salaries is discussed further below and pension contributions are discussed in Chapter 27. Where payments are not periodic costs and thus do not need to be spread over more than one accounting period, they will attract

Corporation Tax relief at the rates given in Appendix A, based on the date of payment, or the date the cost is recognised in the company's accounts.

What about Dividends?

Dividends are paid out of a company's *after-tax profits*. Thus, the total amount of tax paid on dividend income, including the Corporation Tax suffered by the company, will increase.

However, the effective rate of tax applying depends on what we are comparing the dividend with. For example, if a director takes a dividend instead of a monthly salary, the effective Corporation Tax rate applying to that dividend will be as set out in Appendix B. Alternatively, if the director takes a dividend instead of a bonus (which is not accounted for as a periodic cost) the effective Corporation Tax rate applying will be as set out in Appendix A.

Salaries in the Current 2023/24 Tax Year

The current tax year for *individuals* runs from 6th April 2023 to 5th April 2024. It's a tricky one when it comes to calculating the precise amount of Corporation Tax relief many companies will enjoy on salaries and other regular payments made to the directors.

The amount of Corporation Tax relief will vary from company to company, depending on how much profit they make, when their accounting period ends and when the payments are made.

Example: *Average Company Ltd has an accounting period that runs from January to December. It makes monthly salary payments to the directors.*

For the accounting period ending 31st December 2023, the company will enjoy 24.65% Corporation Tax relief on the salary payments it makes (assuming its profits are between £50,000 and £250,000: see Appendix A).

For the accounting period ending 31st December 2024, the company will enjoy 26.5% Corporation Tax relief on any additional salary payments, (again, assuming its profits are between £50,000 and £250,000).

The 2023/24 tax year falls into both of these years, so the company will enjoy the following tax relief on its salary payments:

April to December 2023	*9/12 x 24.65%*	*18.49%*
January to March 2024	*3/12 x 26.5%*	*6.62%*
Total Corporation Tax relief		*25.11%*

The company will enjoy a total of 25.11% Corporation Tax relief on salary payments made during the current 2023/24 tax year.

The Corporation Tax relief would be different if the company was making profits of less than £50,000 (19%) or more than £250,000 (23.89%): assuming in each case its profits fall into the same marginal tax rate band in both the year ending 31st December 2023 and the year ending 31st December 2024.

The outcome would also be different if the company's accounting period ended on a different date. For example, if the company has an accounting period that runs from August to July, it will enjoy a total of 24.84% Corporation Tax relief on salary payments made in 2023/24.

For a complete picture of the overall effective rate of Corporation Tax relief enjoyed by companies paying regular monthly salaries throughout 2023/24, see Appendix B.

The outcome may also be different where the director's salary is paid in a single annual lump sum, rather than monthly.

Example: *Annpay Ltd makes annual profits of £200,000 and has an accounting period that runs from January to December. Its director, Anne, takes her salary in a single lump sum in March each year. The salary she takes in March 2024 is accounted for as an expense in the company's accounts for the year ending 31st December 2024 and will thus provide Corporation Tax relief at 26.5%.*

If we compare the results in the last two examples, we can see that a single lump sum payment (as for Annpay Ltd) may produce a different overall rate of tax relief to regular monthly payments:

Average Company Ltd (monthly pay):	Relief at 25.11% on average
Annpay Ltd (lump sum):	Relief at 26.5%

In both cases, we are talking about salary falling into the same *Income Tax* year, 2023/24.

However, such single annual lump sum payments are not always accounted for as an expense of the company accounting period in which they are paid.

It would have been equally acceptable for Annpay Ltd to have accrued part of the cost of the salary paid to Anne in March 2024 as an expense of its accounting period ending 31st December 2023, with the remainder treated as an expense of the accounting period ending 31st December 2024. The split would be done on a time apportionment basis, with the end result being that the overall average rate of Corporation Tax relief for Anne's 2023/24 salary would be the same as for the monthly payments made by Average Company Ltd.

The proper accounting treatment of a lump sum payment like this is really a question of whether Anne's lump sum salary paid in March 2024 is seen as a reward for her efforts as company director over the period from April 2023 to March 2024, or as a bonus paid in recognition of her continuing service to the company.

In most cases, the decision on how to treat the director's annual lump sum salary in the company's accounts will have been made some years ago. If so, it would be very difficult to argue for a different treatment this year, just because the company's Corporation Tax rate is increasing.

So, why is all this important? As we shall see in the chapters that follow, when deciding how much salary or other income to pay yourself, the amount of Corporation Tax relief your company receives on these payments is an important factor.

In most previous editions of this guide, the Corporation Tax relief appearing in many of the examples and calculations has been 19% for all companies. In this edition (and last year's), the precise amount of tax relief in pounds and pence will vary from company to company, making it difficult to provide exact figures for every single company.

Fortunately, however, the overall conclusions will be the same in most cases.

Securing Early Relief for a Director's Salary

In general, securing early Corporation Tax relief for a director's salary would usually be a good idea, although this will not be the

case for many companies at the moment while Corporation Tax rates are still in the process of increasing (as the amount of tax saved could be less).

Nonetheless, there is a way to get Corporation Tax relief for the whole of a director's lump sum salary in an accounting period that has already ended before the director is paid (or deemed to be paid: see Chapter 2).

The first step is to hold a directors' board meeting before the end of the old accounting period and minute the fact that the directors have agreed to pay themselves a bonus in respect of their performance during that accounting period (a director's bonus is effectively the same as a lump sum salary payment). The amount of the bonus is not specified at this time (as we will see in Chapter 2, this could trigger an immediate Income Tax liability, which the company would have to put through the payroll and pay via the PAYE system).

However, while no Income Tax liability or payroll reporting obligation under PAYE has been created yet, the company now has a commitment to pay the bonus in respect of that accounting period.

As long as the director is then paid (or deemed to be paid: see Chapter 2) within nine months after the accounting date, the company can accrue the cost in its accounts and secure Corporation Tax relief in the earlier period.

Multiple Companies

Company owners often think about setting up a second company, to keep a new venture separate from an existing business. Often there are sound commercial reasons for using more than one company, including to:

- Reduce risk (limit liability)
- Involve different shareholders
- Enable a stand-alone sale of each business
- Make it easier to borrow money

Using more than one company allows you to reduce your risk: if one business goes bankrupt, the other venture housed in a separate

company should be protected because each company has limited liability status.

Using more than one company is also ideal when you want each business to have different shareholders. It's not uncommon for business owners to engage in different projects with different people.

Using separate companies may also make it easier to exit each business. For example, someone who owns an ecommerce business and a restaurant chain may wish to keep them in separate companies to make it easier to sell each business to a different buyer in the future.

When it comes to borrowing money, it's not uncommon for property investors to put their properties in a separate, stand-alone company and lenders often insist on this. Mortgage lenders tend not to like companies that have 'trading' activities, which are perceived as being more risky than property investment.

Saving Tax

Using separate companies may also be attractive when it comes to saving Capital Gains Tax and Inheritance Tax: in particular when one business is a trading business and the other is not. Companies that own too many non-trading assets, like rental property, can lose important tax reliefs, including business asset disposal relief, holdover relief, and business property relief.

For example, someone who owns a software company and a property rental business may wish to keep them in separate companies so that the trading business (the software company) is not 'contaminated' by the non-trading business (the property rental business).

Conversely, under certain circumstances, keeping all your assets in one company can actually save Inheritance Tax (see the Taxcafe guide *How to Save Inheritance Tax* for more information).

Using separate companies has drawbacks too. For example, if you initially expect losses from a new trading activity, those losses can usually be set off against the profits from an existing activity, if both businesses are in the same company. This is generally not possible if the businesses are in separate companies (unless you form a group).

With the increase in Corporation Tax, some people may also be asking whether they can benefit from more than one company each enjoying up to £50,000 of profit taxed at just 19%.

The answer is generally no if the companies are controlled by the same people.

Associated Company Rules

To prevent people artificially spreading their business activities across multiple companies, the £50,000 lower limit and £250,000 upper limit are divided up if there are any 'associated companies'.

A company is associated with another company if:

- One company controls the other company
- Both are under the control of the same person or persons

For example, if you own all the shares in two companies, these companies will be associated. Each company will start paying Corporation Tax at 26.5% when its profits exceed £25,000 (i.e. £50,000/2). Each company will pay 25% tax on all its profits if its profits are greater than £125,000 (£250,000/2).

If there are three associated companies, each company will start paying Corporation Tax at 26.5% when its profits exceed £16,667 (£50,000/3)… and so on.

Example: *Let's assume the new higher rates of Corporation Tax are fully in force (i.e. we are looking at accounting periods commencing after 31st March 2023). Jamie owns Company 1, which has annual profits of £100,000. He then decides to start a second business and is trying to decide whether to house it in Company 1 or set up Company 2. Let's say the new business makes a profit of £30,000. If he keeps it in Company 1, the additional profit will be taxed at 26.5% producing a total tax bill of £30,700.*

If Jamie decides to house the new business in Company 2, the two companies will be associated (if we assume he controls them both). The companies will pay Corporation Tax as follows:

Company 1: £25,000 x 19% + £75,000 x 26.5% = £24,625
Company 2: £25,000 x 19% + £5,000 x 26.5% = £6,075
Combined tax bill: £30,700

The total Corporation Tax bill will be the same whether Jamie uses one company or two. Jamie will still benefit from having £50,000 of profits taxed at 19% (£25,000 in each company).

However, if Company 2 has profits of less than £25,000, Jamie will effectively be penalised for running two companies. For example, if Company 2 breaks even (i.e. has a profit of exactly £0) he will pay £1,875 more tax with two companies. This is because Company 1 will have just £25,000 instead of £50,000 taxed at 19%.

For further details on the associated company rules, including situations where company shareholdings owned by your spouse, another close family member, or a business partner, may have to be counted when applying these rules, see the Taxcafe guide *The Company Tax Changes*.

Corporation Tax Quarterly Instalments

The associated company rules will also be relevant in deciding whether a company has to pay Corporation Tax in quarterly instalments. Instalments are generally payable by companies whose profits exceed £1.5 million but this amount will be divided up if there are any associated companies. Whereas small companies currently only have to pay Corporation Tax nine months after the end of their accounting period, companies subject to instalments have to start paying tax half way through the year.

Trading Companies vs Investment Companies

In tax jargon, a 'trading' company is one involved in, for want of a better word, 'regular' business activities, e.g. a company that sells goods online, a catering company, or a firm of garden landscapers.

Common types of *non-trading* company include those that hold substantial investments in property or financial securities or earn substantial royalty income.

Corporation Tax

Before 1st April 2023, companies engaged mainly in non-trading activities paid Corporation Tax at the same 19% rate as most other companies.

However, the increase in Corporation Tax will see some of these companies having to pay Corporation Tax at the main rate of 25% on all their profits.

This is because a company classed as a close investment holding company (CIC) cannot benefit from the small profits rate. It will be forced to pay Corporation Tax at the main rate on all its profits.

For example, a company that is set up to hold stock market investments will pay Corporation Tax at 25% from 1st April 2023 onwards, even if it only makes a small amount of profit. (Having said that, companies do not pay Corporation Tax on dividend income: but they do on capital gains or other forms of investment income.)

For CICs with accounting periods straddling 1st April 2023, the profits are split across two financial years in the same way as other companies. The effective rate (and marginal rate) applying is as per the right-hand column in Appendix A.

Fortunately, companies that mainly derive their profits from renting property to unconnected third parties (i.e. not to family members, etc) are excluded from the CIC provisions. Hence, the vast majority of property investment companies will enjoy the small profits rate where appropriate.

Capital Gains Tax

If a company has too many non-trading activities (including most property investment and property letting) it may lose its trading status for Capital Gains Tax purposes.

This will result in the loss of two important CGT reliefs:

- Business asset disposal relief
- Holdover relief

Business asset disposal relief allows you to pay CGT at just 10% (instead of 20%) when you sell your company or wind it up.

Holdover relief allows you to give shares in the business to your children, common-law unmarried partner, or other individuals and postpone CGT. (You don't need holdover relief to transfer shares to your spouse because such transfers are always exempt.)

Clearly, if the company's only business is property investment or property letting (or any other form of investment activity) then it will not be classed as a trading company and the relevant CGT reliefs will not be available. However, it's worth noting that qualifying furnished holiday letting businesses are treated as trading for CGT purposes (see the Taxcafe guide *Using a Property Company to Save Tax* for details).

Where a company has both trading and non-trading activities, it will only lose its trading status for CGT purposes if its non-trading activities are 'substantial'. HMRC generally accepts the non-trading activities are not substantial where neither non-trading income nor non-trading assets exceed 20% of the totals for the company as a whole. However, this test is only a yardstick and is not conclusive. In a recent tax case, it was held that non-trading activities would only be regarded as substantial where they were of material or real importance in the context of the company's activities as a whole.

Nonetheless, to avoid any argument over the issue, it is wise to keep both non-trading income and non-trading assets below 20% in order to safely preserve the company's trading status wherever possible.

Inheritance Tax

Shares in trading companies generally qualify for business property relief which means they can be passed on free from Inheritance Tax. However, if the company holds investments (including rental property) this could result in the loss of business property relief.

The qualification criteria are more generous than for CGT purposes and a company generally only loses its trading status for Inheritance Tax purposes if it is 'wholly or mainly' involved in investment related activities. This time, however, furnished holiday letting is very rarely accepted as a trading activity.

For more information see the Taxcafe guide *How to Save Inheritance Tax*.

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