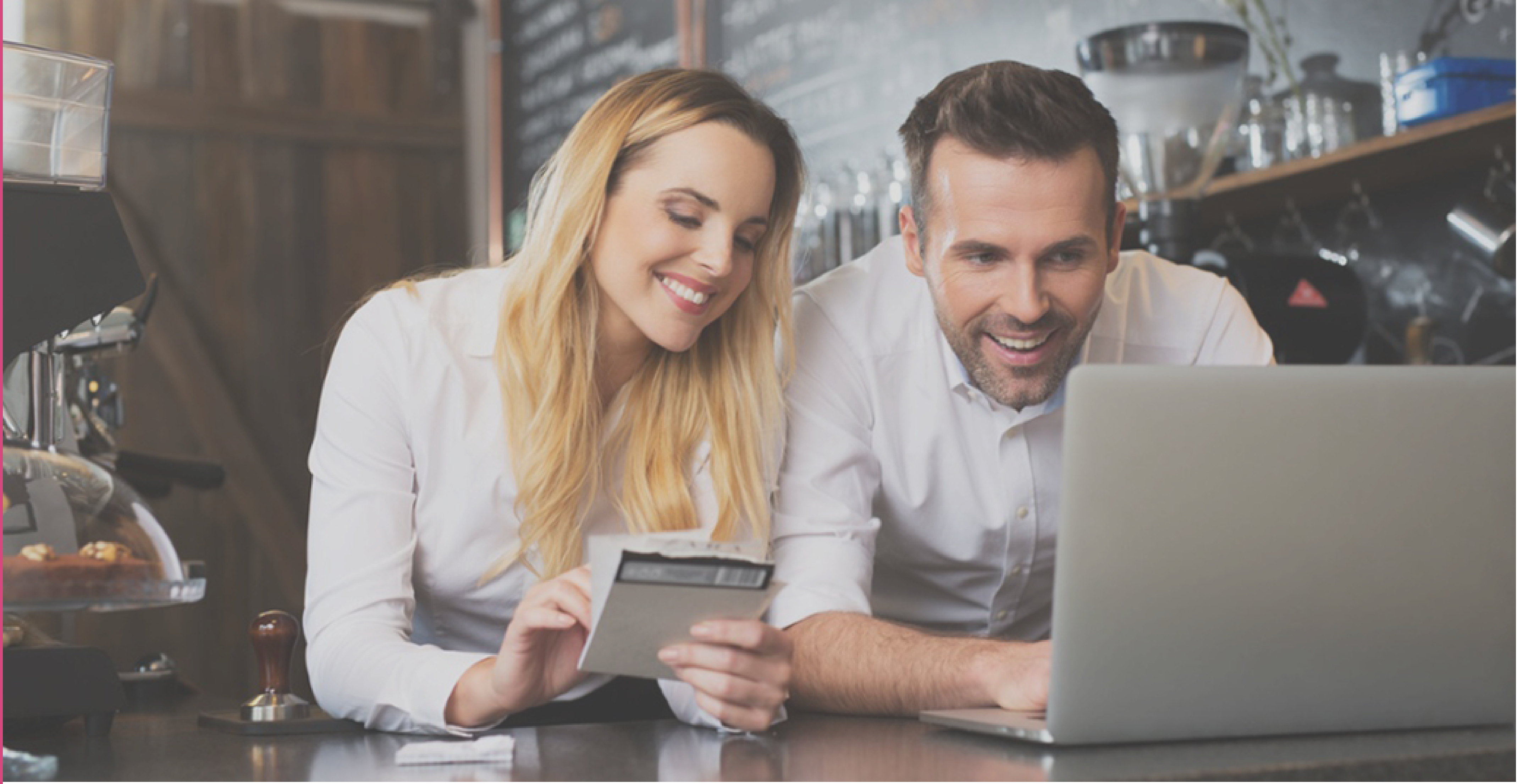

A Guide to **Salary & Dividends**

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Salary and Dividends Explained

Taking money from your own company can be confusing, especially if you've not done it before.

That's why we've crafted this handy guide to help you decide on the most tax efficient method for you.

Directors vs shareholders

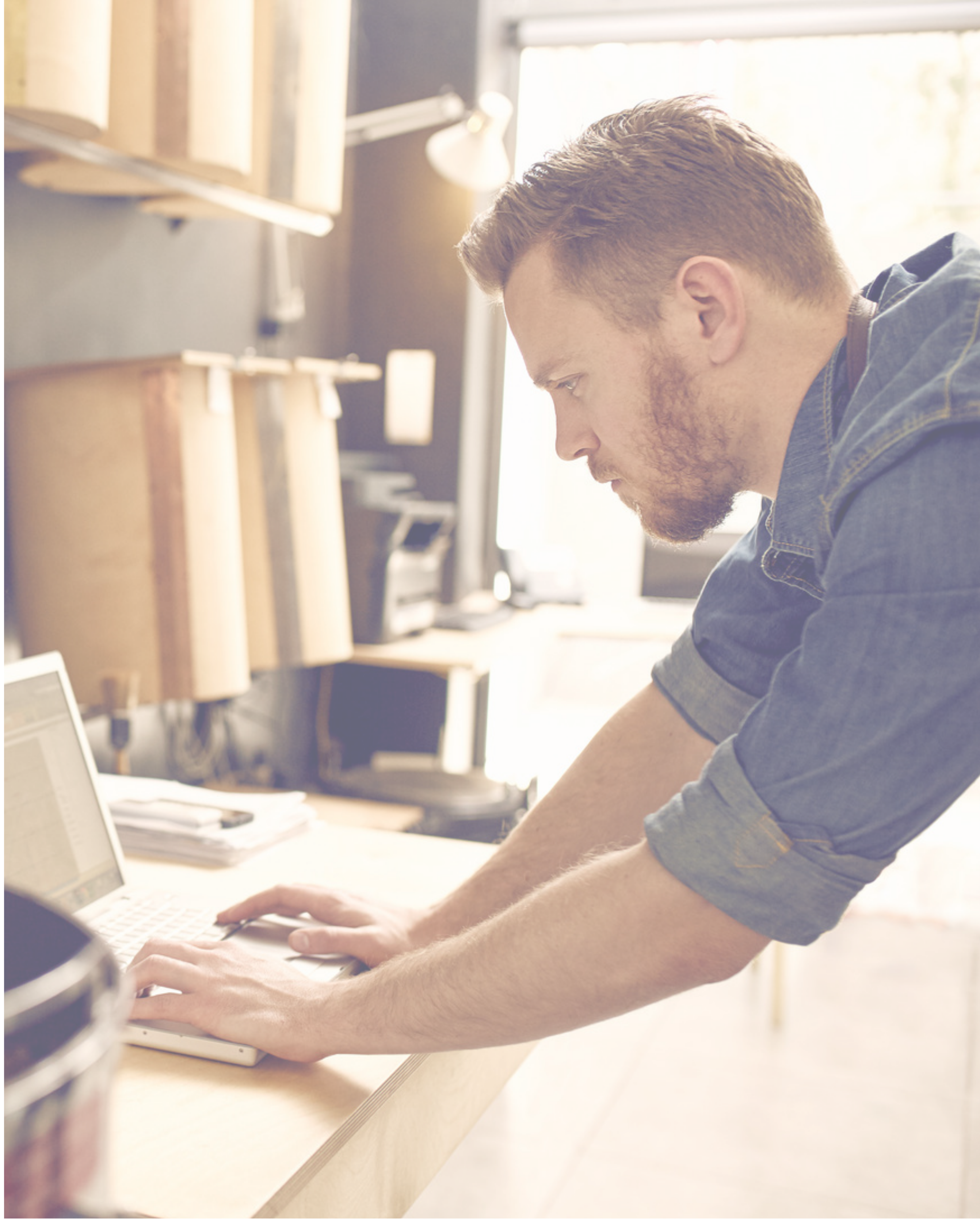
A director of a limited company is the person(s) that run the company. A shareholder of a limited company is the person(s) that owns the company. This can often be the same person(s).

A director can be paid a salary from the company through PAYE, while shareholders are paid with dividends. Dividends are profits (after corporation tax) which are distributed to the shareholders according to the percentage they own in the company.

Sole director or shareholder

If you are the only director and shareholder of a limited company, then a small salary up to the National Insurance (NI) threshold with the remainder of your income as a dividend is recommended.

The salary that you process will be an expense to the limited company (and therefore reduce corporation tax) but it will be tax and NI free to you personally. If this is your sole source of income, this is a great way to utilise your allowances.



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Dividends are tax free up to the first £5,000 then 7.5% up to the higher rate threshold. Anything above the higher rate threshold is taxed at 32.5%, so it's best to avoid this if possible!

You may be wondering why it's best to take up to the NI threshold (£8,060 in 2016-17) rather than the Personal Allowance threshold (£11,000 in 2016-17).

The reason is that as a sole director you are not entitled to the employer's NI allowance, meaning that you would pay 12% employee's NI and 13.8% employer's NI on your income above the NI threshold, which is more than you save in corporation tax.

More than one director or shareholder

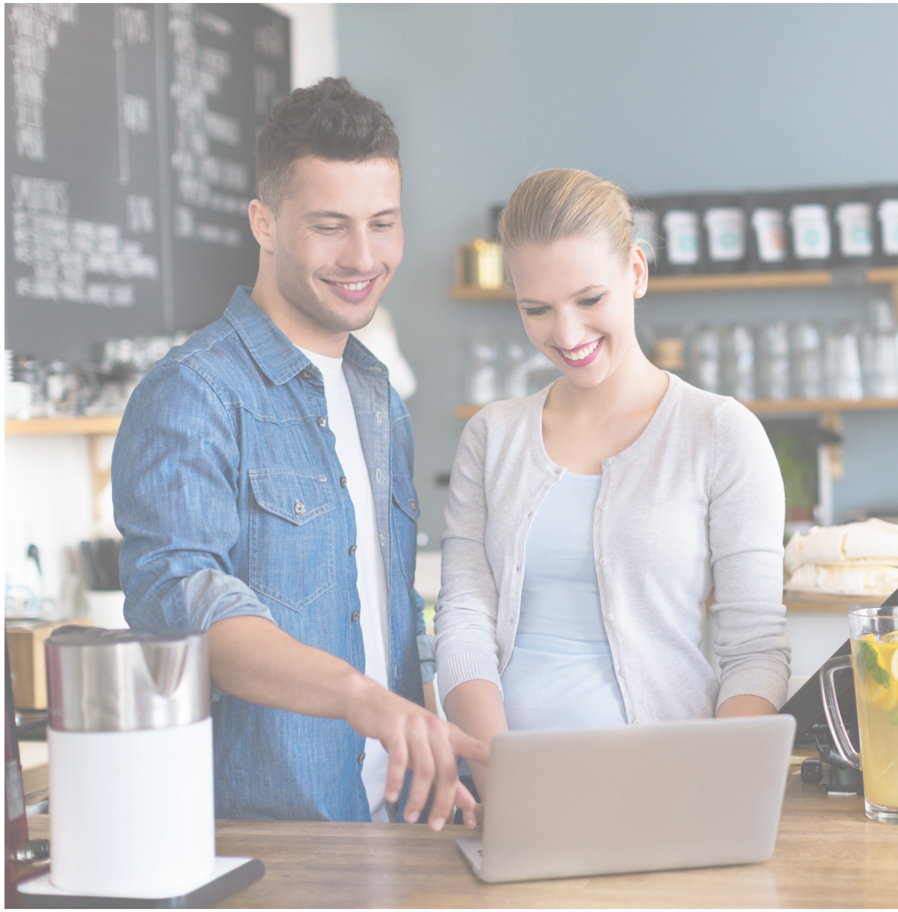
A director of a limited company is the person(s) that run the company. A shareholder of a limited company is the person(s) that owns the company. This can often be the same person(s).

A director can be paid a salary from the company through PAYE, while shareholders are paid with dividends. Dividends are profits (after corporation tax) which are distributed to the shareholders according to the percentage they own in the company.

This means the directors can run a salary up to the Personal Allowance threshold rather than the NI threshold, therefore saving more tax. There will be some employee's NI to pay but this is just 12% with the additional salary being offset against 20% corporation tax.

If you have multiple directors and shareholders with different ownership percentages, then the above arrangements will likely not be feasible.

In this instance it's usually better to pay the directors a full salary in relation to the work they carry out and for the shareholders to receive dividends at agreed intervals in time. Although not as tax efficient, everyone is then paid fairly.



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What if I have other income?

If you have other income during a tax year then running a director's salary may not be tax efficient for you. If the other income has breached the thresholds, it may be better to just take dividends from your company to avoid the NI.

If the other income is below the thresholds, then the difference can be calculated and put through as salary to fully utilise your allowances.

I don't pay any NI, what about my pension contributions?

As long as payroll is being run for you and it's over the lower threshold, then deemed NI contributions are made on your behalf which count towards your state pension and other benefits.

What if my salary is less than minimum wage?

The minimum wage only applies to employees and does not affect directors. As a director of a company you can pay yourself as little or as much as you like without having to worry about these restrictions.

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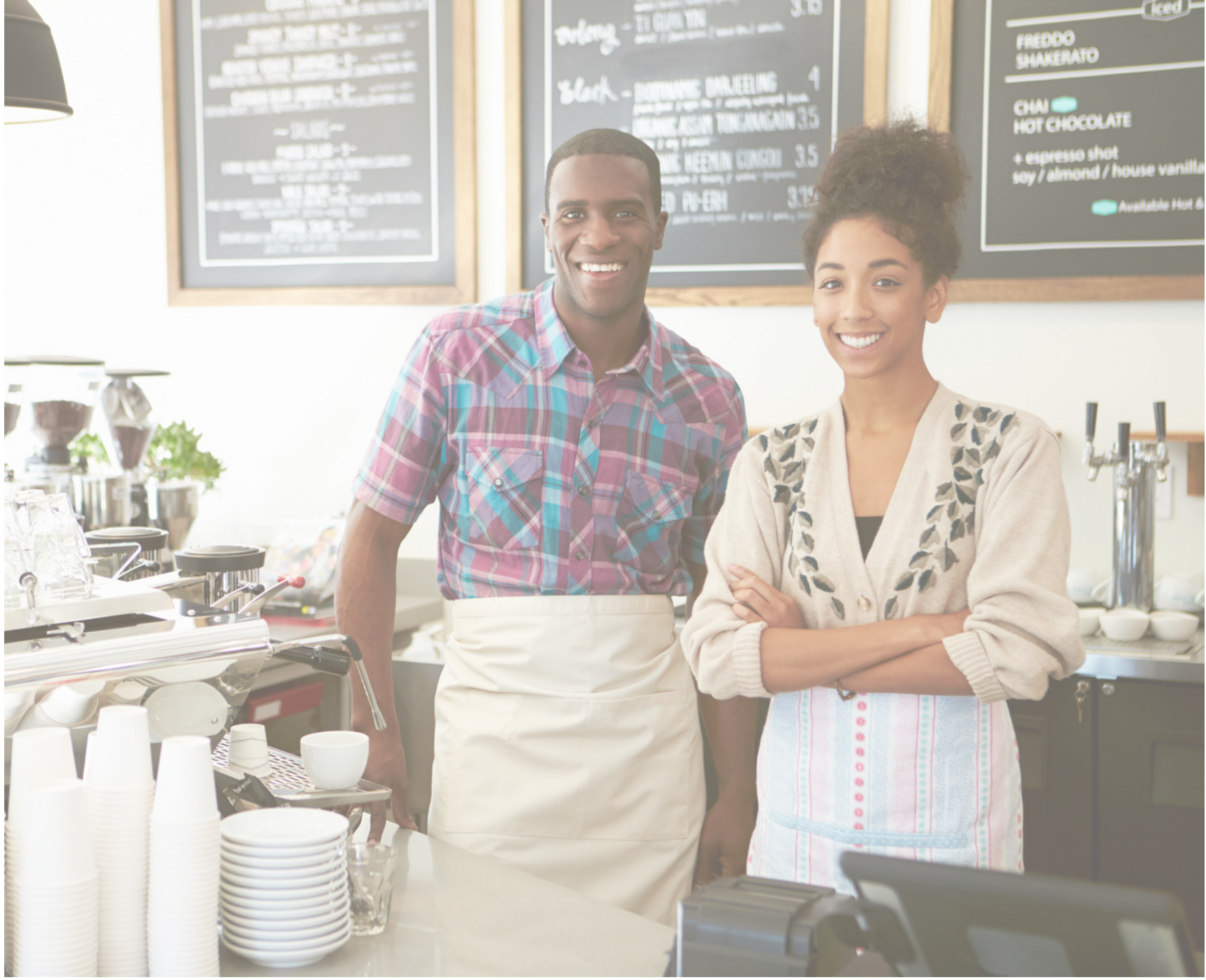
Varying levels of income for company owners



If you run a company with your spouse and he/she does not want to take the same amount of dividends as you because the higher rate threshold would be breached, then there is an alternative option.

Dividends are distributed per class of share. For example, if a dividend of £1,000 was declared for the 'A shares' then equal owners of 'A shares' would receive £500 each. An alternative option would be for your business partner/spouse to be issued a different class of shares, 'B shares'.

This would enable different amounts of dividends to be issued for the different classes of shares.

For help setting up a share structure like this please get in touch by emailing info@theaccountancy.co.uk

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