orangegenie

Deciding on How much Salary and Dividends to Pay

Legal Status

- It is important to realise from the start that the Limited Company is a separate legal entity to the directors who form it
- The monies within the company bank account do not belong to the directors and can only be withdrawn as salary, dividends, expenses or a loan

IR35 Status

- If you are deemed to be outside of IR35 then generally the most tax efficient method of withdrawing funds is via a combination of salary and dividends

Deciding how much Salary to pay

- As the owner of the company the level of salary you choose to pay is your decision
- Since salary is subject to Tax and NI and dividends are not subject to NI, it makes sense to consider a lower salary and a higher dividend as this will be more tax efficient
- Your choice of salary will depend on your attitude towards risk.
- We would recommend that you do not set your salary at less than £7,488, which is the lowest level you can pay and still get credit for NI purposes which is important for certain state benefits
- A very low salary may increase the chances of triggering an investigation from HMRC and if you are risk adverse you may prefer to consider paying a salary equal to the National Minimum Wage , which would be around

  £12,000 gross per annum or any other amount you require
- This higher level of salary may be seen by HMRC to be more commercially realistic and therefore likely to be less contentious if your IR35 status was reviewed

Rates of Tax on Salaries

- Companies are legally obliged to operate PAYE on wages paid to employees. These consist of:
- Employers National Insurance is charged to the employer (the company) at a rate of 13.8%
- Employees National Insurance is deducted from the employees' gross salary at a rate between 12% and 14% depending on the level of wages
- Income Tax is deducted as follows for income exceeding the tax allowance of £8,105 (2012/13):

Earnings	% Tax
£0 - £34,370	20%
£34,371 - £150,000	40%
Above £150,001	50%

When can a Dividend be paid?

- Dividends can only be paid from available net profits once Corporation Tax has been paid
- Dividends do not reduce Corporation tax whereas salary and pension contributions do
- Dividends have to be paid by reference to the company's latest accounts and the director has to have best regard for the future cash requirements of the company
- A dividend is simply a transfer from the company bank account

The payment should be accompanied by a dividend voucher which the system will produce

All dividend transfer payments should be kept separate from payments made for wages or expenses so that they are clearly and separately identifiable to HMRC

How is a Dividend Taxed?

- Since Dividends are distributed out of taxed company profits they are deemed to be paid to an individual with the basic rate income tax having been suffered
- In effect in your hands they are effectively tax free up to the higher rate income tax limit and are taxed at 25% of what you take above that amount
- The tax rate increases to 36% of the amount you take at the additional rate limit, but only if your overall income exceeds £150,000 for the tax year
- No NI is payable on dividends

How much Dividend should I pay?

- You have complete control over your tax planning since you can choose to pay yourself a dividend at any time – subject to available profits
- If you pay yourself a dividend that along with any salary taken keeps you below the higher rate tax bracket you will in effect have no further tax to pay during that tax year
- Any undistributed profits that remain in the company can then be drawn in the following tax year if you wish or during times when earnings are lower e.g. maternity leave, unemployment, holidays etc.
- Funds left in the company long term can extracted on cessation using a route taxed under Capital Gains Tax rules and currently have the potential to be withdrawn at an effective rate of 10% subject to certain conditions being met
- Example – assume you are risk adverse and have opted for a salary of £12,000 per annum, have no other income and a standard tax code, you could therefore extract £27,000 in dividends with no additional personal tax bill for 2012/13.
- If you were to draw additional dividends you can expect to pay

25% on the amount you take – so if you take £35,000 in total dividends, the tax will be 25% of the extra above £27,000 i.e. £2,000

- It is not normally recommended that you pay out the maximum amount of dividend available since it leaves little scope for contingencies within the company and your circumstances

IR35 Contingency

- If you are concerned about your IR35 status or are particularly risk adverse you may decide to retain a contingency within the company to cover any potential IR35 liability should your status be reviewed