



## Client Bulletin

February 2024

### **EXTRACTING PROFITS FROM A PERSONAL OR FAMILY COMPANY**

As the 2023/24 tax year draws to a close, directors of personal and family companies are advised to review their profits extraction strategy and to consider whether it would be worthwhile to withdraw further profits from the company before the current tax year comes to an end on 5 April 2024.

A typical profit extraction strategy involves taking a small salary and withdrawing further profit as dividends. It may also be tax efficient to extract profits in the form of benefits in kind or for the company to make pension contributions on the director's behalf.

For 2023/24, where the director has the standard personal allowance and that has not been utilised elsewhere, the optimal salary is one that is equal to the personal allowance of £12,570. As this is also the primary threshold for Class 1 National Insurance contributions, there will be no employee's National Insurance to pay on the salary.

If the company is eligible for the National Insurance employment allowance and this remain available, there will be no employer's National Insurance to pay on a salary of £12,570. However, if the allowance is not available or has been used elsewhere, employer Class 1 National Insurance contributions will be payable to the extent that the salary exceeds the secondary threshold of £9,100 at the rate of 13.8%. On a salary of £12,570 this equates to £478.86. However, this is a cost worth paying as both salary payments and employer's National Insurance are deductible in computing the company's taxable profits, and the rate of secondary Class 1 National Insurance is less than the rate at which corporation tax would otherwise be payable on those profits.

Once a salary at the optimal level has been paid, it is more efficient to switch to dividends if you wish to extract further profits for use outside your company. This is only an option if you have sufficient retained profits from which to pay the dividends. These are profits on which corporation tax has already been paid.

All taxpayers have a dividend allowance of £1,000 for 2023/24 and dividends covered by the allowance are taxed at a zero rate. If profits permit, it is advisable to pay dividends to make use of this allowance, as if it is not used in the tax year it is lost. The dividend allowance falls

to £500 from 6 April 2024; consequently, it may be preferable to take dividends before this date rather than delay the payment if the 2023/24 dividend allowance remains available.

Once the dividend allowance has been used up, dividends are taxed at 8.75% where they fall in the basic rate band, at 33.75% where they fall in the higher rate band and at 39.35% where they fall in the additional rate band.

If your corporation tax rate has increased as a result of new rules applying from 1 April 2023 but your profits are unchanged, the higher tax rate may mean that you do not have the retained profits available to maintain dividends at the level paid in previous years.

It can also be very tax efficient for your company to make pension contributions to your personal pension if you have not used your available annual allowances in full. There is no tax for you to pay, and the company can deduct the contributions in working out its taxable profits.

You could also consider making use of tax exemptions for benefits in kind, such as those for mobile phones and trivial benefits, to extract further profits in a tax-free fashion.

We can help you formulate a tax-efficient profit extraction strategy tailored to your personal circumstances.

## NATIONAL INSURANCE

### ***National Insurance contributions for employees and directors***

Employees benefitted from a cut in the main primary rate of Class 1 National Insurance contributions with effect from 6 January 2024. From that date, the main primary rate, which is payable on earnings between the primary threshold of £242 per week and the upper earnings limit of £967 per week fell from 12% to 10%. There was no change to the additional rate payable on earnings in excess of the upper earnings limit, which remains at 2%. The cut will save employees up to £62.82 per month.

Directors have an annual earnings period regardless of their actual pay interval. This means that their National Insurance liability (and the corresponding employer liability) is calculated on their earnings for the year as a whole by reference to the annual rates and thresholds. The in-year change to the main rate complicates the calculation.

Where the liability is calculated on a cumulative basis, the prevailing rate of 12% is used for payments made prior to 6 January. After that date, the annual composite rate of 11.5% should be used.

If the alternative arrangements are used, the contributions are calculated as for other employees with the exception of those due on the final payment of the year, using the prevailing main rate at the time that the payment is made (12% prior to 6 January 2024 and 10% on or after that date). An annual recalculation must be performed when the director is paid for the final time in the 2023/24 tax year, and this is done using the annual rate for the year of 11.5%. Any balance owing for the year is deducted from the final payment.

We can help with the annual recalculation and advise you what you need to do to ensure that your employees and directors pay the right National Insurance for 2023/24.

### ***National Insurance contributions and the self-employed***

If you are self-employed, there will be changes to the National Insurance that you pay from 6 April 2024 onwards.

Currently, the self-employed potentially pay two Classes of National Insurance – Class 2 and Class 4. If your profits are more than £12,570 for 2023/24, you will pay Class 2 contributions of £3.45 a week and also Class 4 contributions on your profits. Class 4 contributions are payable at a rate of 9% on profits between the lower profits limit of £12,570 and the upper profits limit of £50,270 and at the rate of 2% on profits in excess of £50,270.

It is the payment of Class 2 contributions that currently provides the means to build up a qualifying year for state pension purposes. If your profits are below £12,570, you do not pay Class 2 contributions. However, if your profits are between £6,725 and £12,570 you are treated as having paid Class 2 contributions at a zero rate, giving you a qualifying year for free. If your profits are below £6,725, you can opt to pay Class 2 contributions voluntarily. This is a much cheaper option than making Class 3 contributions.

From 6 April 2024, Class 2 contributions are to be abolished and from 2024/25 you will only pay Class 4 contributions if your profits exceed £12,570. The main Class 4 rate is reduced to 8% from the same date.

However, you will benefit from a National Insurance credit if your profits are between £6,725 and £12,570, providing a qualifying year for state pension purposes. If your profits are below £6,725 for 2024/25, you will be able to make voluntary contributions at the rate of £3.45 per week.

These changes will save up to £556.40 in 2024/25.

We can explain what these changes will mean for you and help you decide whether it is worthwhile making voluntary Class 2 contributions.

### **CAPITAL GAINS TAX PLANNING**

As the tax year draws to a close, it is prudent to review your capital gains tax position and if you are likely to make any disposals, to consider the timing of those disposals.

For 2023/24, you are able to realise net gains (gains less losses in the tax year) of £6,000 before capital gains tax is payable. Spouses and civil partners have their own exempt amounts, and can also transfer assets between them prior to disposal on a no gain/no loss basis to make best use of their exempt amounts.

From 6 April 2024, the annual exempt amount reduces to £3,000.

If you are planning disposals in the near future and have yet to use your 2023/24 annual exempt amount, where possible, it may make sense to make the disposal before 6 April 2024

to take advantage of the higher annual exempt amount for this tax year, and also to leave next year's annual exempt amount available for disposals in 2024/25.

We can help you understand the tax implications of making a capital disposal and help you decide the best time to make the disposal.

## **BASIS PERIOD REFORM - NEW TAX YEAR BASIS**

If you are a sole trader, from 6 April 2024 onwards you will pay tax on your profits for the tax year regardless of the date to which you prepare your accounts. If you do not prepare your accounts to 31 March or 5 April (or a date in between) you will need to apportion the profits from two accounting periods to arrive at your profit for the tax year.

To move to the tax year basis, the 2023/24 tax year is a transitional year. If you do not have an accounting date that falls between 31 March and 5 April inclusive, you will be taxed on more than 12 months' worth of profits for that year. However, to prevent a very high tax bill in 2023/24, the profits for the period from your accounting date in the 2023/24 tax year to 5 April 2024 are taxed over five tax years unless you elect otherwise.

In the early years of your business or on a change of accounting date, you may have had profits that were taxed twice because of the way that the previous basis period rules worked. If relief has not been given for these profits, it must be claimed in 2023/24 or it will be lost.

The rules governing the move to the tax year basis and relief for overlap profits are complicated. We can help you understand what this means for your tax bill and ensure that you benefit from any overlap relief to which you are entitled.

## **MOVE TO THE CASH BASIS**

The cash basis is a simpler way of preparing accounts which takes account only of cash received and cash paid out. Unlike the traditional accruals basis, there is no need to match income and expenses to the period to which they relate, or take account of debtors and creditors.

Currently, only unincorporated businesses with turnover of £150,000 or less can use the cash basis, and must elect to do so. However, this is to change from 6 April 2024. From that date, the turnover thresholds are removed and the cash basis will become the default basis, meaning you will need to make an election to use the accruals basis. The cash basis is not available to companies.

We can explain what this change means for your business and also what adjustments are necessary when changing basis to prevent the same income from being taxed twice.

*This newsletter deals with a number of topics which, it is hoped, will be of general interest to clients. However, in the space available it is impossible to mention all the points which may be relevant in individual cases, so please contact us for personal advice on your own affairs.*

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