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TAX-EFFICIENT WAYS TO WITHDRAW VALUE FROM YOUR COMPANY

Private Client Tax

A major change to the taxation of dividend income was announced in the 2015 summer Budget – it is time to review how and when you withdraw value from your company.

Budget updates

Corporation tax rates have fallen considerably over recent years and this is set to continue:

- The large company rate of corporation tax fell to 20% on 1 April 2015, aligning it with the small company rate (so the marginal rate no longer exists).
- Corporation tax rates are due to fall to 19% from 1 April 2017 and to 18% from 1 April 2020.

Although income tax rates have remained static and are 'locked' until 2020, the taxation of dividend income is changing significantly from 5 April 2016:

- The notional 10% dividend tax credit is to be abolished.
- A new £5,000 dividend allowance will be introduced (regardless of income levels). The personal allowance can also be used against dividend income although this will continue to be tapered for income (including dividends) over £100,000.
- The dividend rates from 2016/17 will be as follows:
  - Basic rate – 7.5%
  - Higher rate – 32.5%
  - Additional rate – 38.1%.

Leaving aside the dividend allowance and the personal allowance, these new rates would increase the effective rate of tax on dividend income by at least 6% for all company owners. In practice, the effective rate of tax that company owners pay on dividends will depend on many factors, including the level of their other income and how much is withdrawn from the business each year. For example, higher and additional rate taxpayers taking low levels of dividends may actually be better off.

For most taxpayers below state retirement age, withdrawing value from your company by way of dividends will remain more tax-efficient than taking a salary or bonus in 2016/17. For those above state retirement age, the savings from taking dividends will be lower as no employee's NIC is payable on their employment income in any case. Owners who can withdraw funds through pension contributions, interest or rental payments from their company will find these more tax-efficient (if less flexible) than taking dividends.

Other considerations

The company's current share ownership structure may mean it is not as straightforward to withdraw value as the owners might wish, but expert advice should be taken before any restructuring or other withdrawal arrangements are put in place.

Individuals facing the high income child benefit charge or the personal allowance clawback suffer very high marginal rates of tax. As these clawbacks ratchet up the effective rate, withdrawing income taxed at a low rate is particularly important.

Dividends have the cash flow advantage that they can be received gross, whereas PAYE and NIC must be deducted in real time at source from salary and bonus payments.

Where companies undertake qualifying R&D activity or have qualifying patent box profits, the corporation tax relief available may reduce (or reverse) the tax advantage of taking dividends rather than salary.

The table overleaf provides illustrative effective tax rates for different methods of withdrawing value from your company.

Company owners should seek expert help to review how they withdraw value and whether payments should be brought forward so that they remain tax-efficient.

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July 2015 Budget

Comparison of effective tax rates - for salary, dividends, rent, interest and pension contributions

Year	2015/16	2016/17	2017/18
	%	%	%
Basic rate taxpayer			
Dividends	20.00	26.00	25.08
Salary/bonus	40.25	40.25	40.25
Rent	20.00	20.00	20.00
Interest	20.00	20.00	20.00
Higher rate taxpayer			
Dividends	40.00	46.00	45.33
Salary/bonus	49.03	49.03	49.03
Rent	40.00	40.00	40.00
Interest	40.00	40.00	40.00
Additional rate taxpayer			
Dividends	44.44	50.48	49.86
Salary/bonus	53.43	53.43	53.43
Rent	45.00	45.00	45.00
Interest	45.00	45.00	45.00
All taxpayers			
Pension contributions	0.00	0.00	0.00

Explanation of effective tax rates

The table above can only show illustrative effective tax rates (including corporation tax on profits) for owners withdrawing funds from their companies. In all cases, the actual effective rate that an individuals pays will depend on many factors including the individual's age, the level of their other income in the tax year and how much is withdrawn from the business.

Assumptions

Please note the following assumptions were made when creating this table:

1. The effective tax rates are based on an individual who has not reached retirement age and has fully utilised their income allowances (both the existing personal allowance and new £5,000 dividend allowance) against other income (ie the rate is based on a marginal increase in income).
2. Rental - the company operates from a premises owned by the shareholder and pays rent which qualifies for a corporation tax deduction.
3. Interest - the shareholder has loaned funds to the company and the interest is deductible for corporation tax purposes.
4. No account has been taken of the following in arriving at the above tax rates, all of which can have an impact:
   - The effect of the high income child benefit tax charge on income between £50,000 and £60,000
   - The loss of the personal allowance where income exceeds £100,000
   - Qualifying R&D expenditure or profits qualifying for the patent box regime.
5. The pension contributions made on the employees' behalf do not exceed their available annual allowance and qualify for immediate corporation tax relief. Any income tax arising on subsequently drawing pension benefits has not been taken into account.