

TAX GUIDE

Accessing your company profits

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Introduction

When business owner-managers take profits from their companies, it isn't surprising that they want to do so in the most efficient manner. There are various ways to do this that can minimise both tax and national insurance contributions (NICs).

Of course, tax is not the only issue. You will almost certainly need to draw a basic level of income to cover your personal requirements, regardless of the tax cost, and to ensure sufficient profits are retained in the company to cover its future needs.

THE CHALLENGES

For most companies, the tax rules are in a state of flux; just because you have drawn profits in one way in the past does not mean that this is now the best approach. From 1 April 2023, the rate of corporation tax for companies with profits in excess of £250,000 increased to 25%. The taxation of dividends has become even more punitive following a reduction to the dividend allowance. From 6 April 2025, taking a salary has become more expensive because the rate of employer NICs has increased from 13.8% to 15%. Additional employer NICs will also be payable because the starting point has dropped from £9,100 to £5,000. From 6 April 2026, drawing dividends will become more expensive because the basic- and higher-tax rates on dividend income will both increase by two percentage points to 10.75% and 35.75% respectively (the additional tax rate on dividend income will not change).

Owner-managers with profits between £50,000 and £250,000 now face a 26.5% marginal corporation tax charge, and they may therefore decide to take more drastic tax saving measures – such as making a substantial company pension contribution – than would have previously been considered.

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You can draw profits as dividends, which are taxed in a different way to salaries



THE FUTURE OF YOUR COMPANY

How retained profits are taxed, and how they affect later withdrawals from the company



Salary and bonuses

Directors of owner-managed or family companies often draw a low level of salary, typically between £6,500 and £12,570 a year. The lower limit in this range is the minimum level of earnings needed to be entitled to contributory social security benefits, and the upper limit is when employee NICs start to be charged.

Employer NICs, at the rate of 15%, apply once annual remuneration exceeds £5,000 (for 2025/26) and there is no upper earnings limit. Employee NICs are 8% on earnings between £12,570 and £50,270, and 2% thereafter. So, the combined NIC cost is up to 23%, although the employer portion can be deducted in calculating your company's taxable profits.

Planning point

It is normally advisable to draw a minimum salary of at least £6,500 so that you do not lose any entitlement to social security benefits. You need 35 years of contribution to qualify for the maximum state pension under the single-tier state scheme.

In a tax year where your earnings are at least £6,500 (the 2025/26 level) you will be treated as having paid NICs in your contribution records, thus preserving benefit rights, even though no contributions are actually paid.

However, you might decide to draw a higher level of salary than this bare minimum as the following example demonstrates using rates for 2025/26.

EXAMPLE Drawing salary

Mick runs a successful consultancy firm in England. The business is a limited company and he is the sole owner.

National living wage

The national living wage is just over £22,200 a year for over 21s, based on a 35-hour week, and Mick's remuneration should not be less than this if he has an employment contract with his company. Mick could avoid this requirement by not having an employment contract with his company.

Pension contributions

A low level of remuneration might limit the amount of tax relief that Mick could receive on his personal pension contributions. However, this would not be a problem if the company makes the pension contributions on his behalf.

Mortgages

A low level of remuneration could lead to difficulties if Mick needs a mortgage to purchase a property. However, specialist lenders will be aware of how owner/managers extract profits from their companies, so this should not be an insurmountable problem.

Off-payroll working (IR35) rules

If there is a chance that Mick's company could be classified as a personal service company (PSC) under the off-payroll working (IR35) rules, he might decide to take a high level of salary to forestall HMRC taking an interest in the company. The NICs cost is likely to be high, but it could be worthwhile to avoid the full force of the off-payroll working rules being applied. Note that it will normally be the client who is responsible for deciding whether the off-payroll rules apply to a particular contract.

Tax efficiency

If Mick does need a higher level of remuneration, he could take £50,270 before the higher income tax rate of 40% bites. The first £12,570 will be tax-free because of his personal allowance and the next £37,700 will be subject to the basic rate of 20%. Salaries and bonuses are taxed under PAYE, so tax and NICs will be payable on a monthly basis.

Planning point

If your husband/wife, civil partner or a family member have little or no income, it can be beneficial for your company to employ them as a way of extracting profits. If corporation tax is payable at 25% or 26.5%, it can even be worthwhile employing them when they are subject to 20% basic rate tax.

Employing family members

If your spouse, civil partner or another family member has little or no income, it can be beneficial for your company to employ them as a way of extracting profits. They could receive a salary of between £6,500 and £12,570 a year at little or no tax cost, with your company benefiting from tax relief at up to 26.5% on the amounts paid. Although employer NICs will be due (for example, employer NICs will be £1,050 on a salary of £12,000), they might be covered by the employment allowance.

The £10,500 NICs employment allowance cannot be claimed where a director is the sole employee of a company. Employing a spouse, civil partner or another family member on a salary of at least £5,000 will mean the employment allowance becomes available, and this will then reduce the employer NICs payable; for both the employee and the director.

With many companies now facing a marginal corporation tax rate of 25% or 26.5%, it might be worthwhile employing a spouse, civil partner or another family member even if they are a basic rate taxpayer, especially if it means the £10,500 employment allowance will reduce the employer NICs otherwise payable on the director's remuneration. If the employment allowance is available, you will be able to take a fairly substantial amount of director's remuneration before employer NICs becomes an issue.

However, you must be able to justify the cost of the salary on commercial grounds by the work that your husband/wife, civil partner or family member carries out; otherwise, it will not be deductible in calculating your company's taxable profits.

DRAWING DIVIDENDS

The main advantage of drawing profits as dividends is that no NICs are payable. Taking a dividend has traditionally been more attractive than a salary or a bonus, but this may now not



always be the case given the increased rates of corporation tax that came in from 1 April 2023.

The situation has become even more complex since 6 April 2025. The increased rate of employer NICs has (in theory) improved the attractiveness of a dividend compared to salary or a bonus, but the opposite might be the case if the – now much higher – employment allowance of £10,500 is available. Each owner-manager's tax situation therefore has to be considered on a case-by-case basis. The increased tax rates on dividend income coming in from 6 April 2026 will move the dial back towards taking a salary or bonus.

Considering just the 2025/26 tax year, it will still be beneficial for many owner-managers to take a small salary to use up their personal allowance and then withdraw the remainder of their income as dividends. However, the tax advantage of taking dividends is less than it used to be, and full workings are now necessary taking into account both the director's and the company's tax situation. Given the constant changes, workings need to be redone each tax year.

Dividends have no effect on your company's tax position, but the recipient pays tax where dividends exceed the £500 tax-free allowance. Any dividend over the allowance, but within the basic rate band for income tax, will be taxed at 8.75%. Dividends falling into the higher rate bracket will be taxed at 33.75%, and at 39.35% where they fall into the additional rate tax bracket. (these rates will be 10.75%, 35.75% and 39.35% from 6 April 2026).

The reduced dividend allowance from the previous level of £2,000 means an increase in taxation for most business owners extracting profits by way of dividends. There are some drawbacks to taking a dividend, in addition to those mentioned above in regard to drawing a low level of salary:

- Your company can only pay a dividend if it has sufficient profits or qualifying reserves from which to pay it, even if there is ample cash in the company bank account. A salary or bonus can be paid even if the payment results in your company making a loss for the year.

- Dividends are payable in proportion to shareholdings. This does not represent a problem if you are the only shareholder, but deciding on the level of dividend payment can be more complicated where there are several shareholders. It could mean having to pay dividends to an outside investor, which you might prefer to avoid. One way to circumvent this problem would be to have more than one class of shares.
- Paying regular dividends could increase the value of any minority shareholdings in your company for capital gains tax and inheritance tax purposes. However, this might not be too important given the potential reliefs that are available for both taxes. Having different classes of shares would also solve this problem since dividends would not then be payable.

One advantage of taking dividends, however, is if you have to pay higher or additional rate tax on the dividend income. This will not be due until 31 January following the end of the tax year, meaning a considerable delay if you take dividends early in the tax year. There is less advantage if you continue to take dividends on a regular basis because the payment on account rules will accelerate your tax payments in future years.

Planning point

If the £10,500 NICs employment allowance is available and corporation tax is payable at the rate of 25% or 26.5%, it might now be beneficial for a director to take a higher level of salary or bonus compared to previous tax years.

BENEFITS IN KIND

Given the corporation tax changes which came in from 1 April 2023, it can be quite difficult working out whether having a fringe benefit from your company is worthwhile, especially as any personal tax charge from having the benefit will continue whilst the benefit is in place.





Although there are no employee NICs on fringe benefits, your company will pay NICs at the rate of 15% (2025/26 and 2026/27) if the benefit is taxable. The tax cost of having the benefit needs to be compared to the cost of taking a dividend (or even salary) and incurring the expenditure personally.

However, it will generally be worthwhile taking certain types of benefits because of their special tax rules, such as a low- or zero-emission company car (full electric and certain hybrids), a loan from your company, or even occupying accommodation provided by the company. Being provided with the benefit may be preferable where:

The benefit is exempt from tax or only results in a low tax charge

Benefits which carry no tax cost or a low tax cost are widely used in 'salary sacrifice' arrangements, where a reduction in salary is exchanged for a tax-efficient benefit. There is a tax advantage because of the NICs savings for both employee and employer. There may also be an income tax saving. Along with company pension contributions, a salary sacrifice arrangement also works well for full electric and certain hybrid cars which only attract a low benefit charge.

Be warned, however, that the tax advantages of salary sacrifice arrangements involving pension contributions are to be curtailed from April 2029. The change will remove the NIC exemption for salary sacrificed pension contributions above £2,000 per year.

Having the benefit avoids higher rates of tax

With a high value item such as a house, you would have to take out a large dividend or bonus to cover the purchase cost. This is likely to push you into the 45% additional rate of tax (48% top rate in Scotland). But if your company buys the house for your personal use, the amount of taxable benefit will be substantially lower. Although the benefit will continue to be charged each year, it may be worthwhile if this means your income remains below the additional or top rate threshold.

PENSION CONTRIBUTIONS

Company pension contributions are generally highly tax-efficient, especially if corporation tax is saved at the rate of 25% or 26.5%. Contributions can be made into a registered pension scheme and your company can then deduct the contributions when calculating its taxable profits. The pension contributions are not treated as a taxable benefit, so you will not have to pay any income tax and there are no NICs.

The funds invested in the pension scheme are free of tax on investment income and capital gains. Up to 25% of the accumulated fund is available as a tax-free lump sum and the balance, however withdrawn, will be subject to income tax but not NICs. However, there are two main catches:

- You will not have any immediate income as a result of the contributions – the funds are locked away until at least age 55 (due to increase to 57 from 6 April 2028). So for younger people, pension contributions are generally appropriate only after you have taken sufficient income as salary, bonuses and dividends to cover your immediate expenses.
- Pension contributions are effectively restricted to an annual limit. Even though this limit is now £60,000, it is reduced for high earners.

Although younger pension savers will not have access to the pension funds, it may be possible in some circumstances for the pension scheme to lend money back to your company or to purchase a property for company use.

Planning point

Pension savers aged 55 or over have immediate access to the 25% tax-free lump sum, although any further withdrawals will mean that future pension contributions are restricted.

RETAINING PROFITS

You might decide to leave surplus profits within your company over and above the capital it would need to maintain the business. This might look preferable given the tax cost of



extracting profits and the downside to pension contributions. The only immediate cost to this approach is the corporation tax payable by the company, with the rate ranging from 19% for profits up to £50,000 to 25% where profits are above £250,000. The effective rate on those profits between £50,000 and £250,000 is 26.5%.

Your company can invest the surplus funds in much the same way as you could personally, for example in shares or investment property. But, of course, at some point you will probably want to take the surplus funds out of the company.

EXAMPLE Retaining profits

Ben and Claire are shareholding directors of LifePlan Holdings Ltd. They have equal shareholdings and the business has retained profits of £100,000.

Salary and dividends

The funds could be used to pay salaries and dividends if the company were to go through a poor year or two at some point in the future. In effect Ben and Claire would be averaging out their profits, so that they do not incur higher tax rates in some years and then have little or no income in other years – something that a sole trader or partner cannot do. Another possibility is that Ben and Claire might take a long break from work to travel or spend time with their families.

Future business exit funds

Ben and Claire could leave the funds in the company until they retire, or at least wind down a bit, and then keep withdrawing the same level of income as when they were working full-time. This would also be averaging the taxable profits, but it would operate over a longer timescale. Such an approach would almost certainly be significantly less tax efficient than pension contributions, but it would probably be more flexible.

Company wind-up

Ben and Claire could wind up the company and extract the funds as a capital gain. The advantage to this approach is, if the disposal qualifies for business asset disposal relief, they will only pay capital gains tax (CGT) at a rate of 14% (this rate will increase to 18% on disposals from 6 April 2026). For disposals of qualifying assets, the 14% rate applies to a lifetime maximum of £1 million of gains. If business asset disposal relief applies, their overall tax rate would normally be in the region of 35.5% (25% corporation tax and 14% CGT on the remaining 75% of the profit). However, retaining a large amount of surplus funds in their company could mean that business asset disposal relief is not available. Ben and Claire must therefore be careful with this approach. If their shares in the company do not qualify for relief, the tax rate will be 24% to the extent that the gain exceeds their basic rate income tax band. The combined overall rate would then become less attractive, being in the region of 43% (although the overall business asset disposal relief route rate will be in the region of 38.5% once the 18% rate comes in from 6 April 2026).

Retiring abroad

Ben and Claire could retire abroad with the possibility of taking their accumulated funds tax free whilst non-UK resident, although the company would still be subject to corporation tax. It would be necessary to stay away for more than five years, which should not be a problem if both Ben and Claire are retiring. Provided their plans are definite, there is no reason why the funds should not be withdrawn soon after leaving the UK so that they can be used to fund their retirement plans. The couple would also need to consider their tax position in the country where they intend to settle.

SELLING YOUR COMPANY

In the longer term you may be in the position to sell your company, especially if it has grown beyond being an owner-manager operation.

Planning point

The problem with long-term planning for retained profits is that tax rates and reliefs might change. The rates of CGT have recently increase from 10% and 20%, to 18% and 24%, and from 6 April 2026 the rate of CGT where business asset disposal relief is available will increase from 14% to 18%. Further increases cannot be ruled out.

It will normally be beneficial for you to sell your company shares rather than for the company to sell its business and assets. If the company sells its business and assets, you will then face the problem of extracting the sale proceeds from the company; this could mean a double tax charge.

The most important tax consideration will normally be whether you will qualify for business asset disposal relief, with its lifetime limit of £1 million. The company must be carrying on a qualifying trade and this may not be the case if more than 20% of income or assets are non-trading.

Any gain could be exempt if you dispose of your shareholding during a period of non-UK residence, although this might not seem so attractive if you are just cashing in your business at a young age when you have a family, rather than when you are retiring.

Planning point

If business asset disposal relief is currently not available, it may be possible to rectify this situation provided action is taken well in advance of a sale. However, with a higher rate of CGT of 24%, the cost of not qualifying for business asset disposal relief is not as onerous as it once was (especially as the rate of CGT where business asset disposal relief is available is set to increase to 18%).

OTHER CONSIDERATIONS

It is important to bear in mind your overall tax and long-term financial position when considering the various options for extracting profits. For example, you do not want to end up unnecessarily losing universal credit or tax credits, losing some or all of your personal allowance, or incurring a child benefit tax charge because you have taken a little too much income.

As an owner-manager of your own company, you are invariably in a better tax position than employees or the self-employed because you have much more flexibility about when you receive your income and the form it takes.

Planning point

Be warned that HMRC is increasingly clamping down on anything it considers to be tax avoidance. Therefore, be wary of any clever schemes you come across which, in theory, allow you to withdraw profits from your company at minimal tax cost.



HOW WE CAN HELP

We can help you decide how best to extract profits from your company, and can make sure that all the relevant legal requirements are complied with.

We can help with your company's payroll, or can manage this on your behalf. We can complete all the necessary tax returns both for you and for your company.

We can advise you on longer-term strategies for retirement planning or the possible future sale of your company. We can make you aware of changes in regulations so that you can take appropriate action. In addition, we can offer advice on any tax, financial or business planning arrangements which you wish to consider. Our aim is to relieve you of tax worries so that you can concentrate on doing your job.

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