

## Making tax work for you

### Anita Brook, director of Accounts Assist on limiting personal tax liability as a director

As a director of a limited company, there are many ways to lower your liability for personal tax, and with the cash-strapped government now looking to find extra revenue from wherever it can, it is more important than ever to have a good understanding of your options.

### Salary and dividends

Every UK worker has a personal allowance (£6,475 in 2009/10) which represents the amount they can earn before becoming liable for income tax.

There are four income tax bands, representing the tax percentage applied to income above a worker's personal allowance:

	2008-09	2009-10	2010-11
Starting rate for savings: 10%*	£0-£2,320	£0-£2,440	£0-£2,440
Basic rate: 20%	£0-£34,800	£0-£37,400	£0-£37,400
Higher rate: 40%	Over £34,800	Over £37,400	£37,401-£150,000
Additional rate: 50%	Not applicable	Not applicable	Over £150,000

Table from HMRC.gov.uk

Note: the 10% starting rate only applies to savings income only. If non-savings income is above this amount, the 10% starting rate does not apply.

In order to avoid the higher tax rates, it is sometimes possible for directors to draw a lower yearly salary and then top this up with one or more dividend payments.

Dividends are paid to directors and shareholders out of company profits, and enjoy more favourable rates of tax. In 2009/10 these are:

- 10% standard dividend tax rate if all earnings, including dividends, total below £37,400.
- A 32.5% higher dividend tax rate for any dividend earnings taking total income above £37,400.

However, because companies pay corporation tax on profits (usually at 21%) before the deduction of dividends is taken into account, HMRC allows for this by applying a tax credit.

When a dividend payment hits your bank account, it is effectively net of the 10% tax credit. This means that if you are liable for only the basic rate of tax on your dividend income, you will have no further tax to pay. The "effective" rate for dividends charged at the higher rate is 25% of the net dividend received.

Here's an illustration of the tax you would pay on a standard PAYE salary, when compared to the tax you would pay if some of your wages were taken in the form of dividends.

Both examples pay out at £60,000 gross:

<b>Salary only</b>	
Salary	£60,000.00
Personal tax allowance	£6,475.00
Taxable income	£53,525.00
Liable for 20% basic rate tax	£37,400.00
Liable for 40% higher rate tax	£16,125.00
Tax at basic rate	£7,480.00
Tax at higher rate	£6,450.00
<i>Total tax bill</i>	<i>£13,930.00</i>
<b>Salary + dividends</b>	
Salary	£6,475.00
Personal allowance	£6,475.00
Taxable income	£0.00
Liable for 20% basic rate tax	£0.00
Liable for 40% higher rate tax	£0.00
Tax bill at basic rate	£0.00
Tax bill at higher rate	£0.00
Total tax	£0.00
Cash received	£53,525.00
Total income (salary + dividends)	£60,000.00
Gross dividend up £53525 x 100/90	£59473.00
Basic rate dividend	(£37400.00)
Higher rate dividend	£22073.00
Tax at basic rate £37400 x 10%	£3740
Higher rate dividend £22073 x 32.5%	£7174
Less 10% tax credit £59473 x 10%	(£5947)
Total Tax	£4967
<b>Tax saving using dividends</b>	<b>£8963.00</b>

### Benefits and allowances

Many of your personal expenses accrued in relation to your work as a director will be subject to special tax allowances and reliefs.

For instance, it may be worth your **business** paying you less than the approved HMRC mileage rate for your business miles or fuel payments, as this could then qualify you for Mileage Allowance Relief. This is calculated based on the difference between the mileage payments received from your employer and the approved mileage payments for your **vehicle**.

You can also claim tax relief on a number of work related expenses such as the costs of subscriptions to HMRC approved member organisations, certain tools and specialist clothing, capital expenditure such as office furniture, and hotel stays.

You should also aim to take full advantage of the non-taxable benefits a company can provide to its employees. For instance, your company can pay for a **mobile phone**, parking at your workplace or a proportion of the cost of using a registered childminder without you incurring any tax liability.

In addition, if you draw a salary from the company, it is possible to pay some or all of your gross salary into a company pension scheme before income tax is calculated, which could

be used to lower your personal tax liability. This is subject to an annual cap of £245,000 in the 2009/10 tax year, with a lifetime cap of £1,750,000.

If you contribute to a personal scheme, you will pay income tax before making contributions, but your pension provider will claim a tax rebate back on your behalf at the basic rate of 20%. If you pay tax at the higher rate, you can reclaim the difference on your annual tax return.

Whilst some of these tips are quite complex, taking the time to get understand them now could save you thousands in the tax year ahead.

*Anita Brook is director of chartered certified accountancy firm [Accounts Assist](#).*