

## Optimum limited company director salary and dividends 2017/18

If you operate through your own UK limited company you'll often want to use the optimum tax planning strategy of extracting money from your company through a combination of dividends and a low salary.

### How are salary and dividends taxed?

For the 2017/18 tax year the personal allowance is £11,500 – this means your first £11,500 of income is tax free. If your only income was your company director salary then any additional salary above £11,500 would be taxed at 20%, and then once you hit the higher tax band of £45,000 any additional salary would be taxed at 40% up to £150,000 and above that 45%.

With regards to dividend income, for the 2017/18 tax year dividends are taxed as follows:

The dividend allowance means that an individual's first £5,000 of dividends are tax free. Over and above this £5,000 the dividend income is taxed as follows:

- If you have any un-used personal allowance (£11,500 for 17-18) then that element is tax free
- Any dividends in the basic tax band (up to £45,000 for 17-18) attract a tax charge of 7.5%
- Dividends above the basic tax band (£45,000 for 17-18) are charged at 32.5% and at 38.1% above £150,000.

So if for example imagine your only income was dividend income, you could receive £16,500 of tax free dividend income in 17-18 from both your £11,500 personal allowance and the £5,000 dividend allowance.

### Tax efficient dividend and salary structure

For limited company contractors, freelancers and small business owners, taking a low basic salary with the balance of income being extracted as dividends is a common tax planning strategy. The theory is as follows:

- You take a low tax efficient salary no higher than the personal allowance so that it does not attract personal tax
- You should make sure the salary is high enough for national insurance purposes i.e. that it counts as a year's 'stamp' for your national insurance history to help protect your future entitlement to state pension and other benefits
- The salary is a tax allowable cost for your business so corporation tax is saved at 19% (corporation tax rate for 2017/18) on the gross (pre-tax) salary
- Any additional amounts you extract from your company are treated as dividends which do not attract national insurance, therefore you are not paying any more national insurance than you need to be

### What are the best levels of salary and dividends for 17-18?

The NI Employment Allowance enables employers to not pay the first £3,000 of employer's national insurance. Typically, the employment allowance means that it is slightly more tax efficient to take a gross salary all the way to the tax free allowance level (£11,500 for 17-18), however HMRC announced that from 16/17 the Employment Allowance will not be available to companies where the only person on the payroll is a director, i.e. 'single director employee' limited companies.

With this in mind, we have outlined two different salary and dividend options which are put together on the basis that you wish to stay below the higher tax band (£45k). We have made a few key assumptions e.g. you are not caught IR35 and you have a standard personal allowance.

### Option 1: Salary of £11,500 claiming the NI employment allowance

Take an annual gross salary of £11,500 which will not attract any personal income tax, but it will attract some Employees National Insurance which will total around £400 however no Employers National Insurance will need to be paid as it will be covered by the Employment Allowance, assuming you can claim it.

With regards to dividends, the higher tax band is £45,000 so assuming you want to stay in the basic tax band this leaves you £33,500 of dividends to take with the first £5k tax free and after that they are charged at 7.5% tax.

Any dividends taken above the higher tax band will be taxed at 32.5% and even higher if you trigger other tax tipping points such as the child benefit charge at £50k, £100k tax free allowance withdrawal and the upper tax band at £150k.

### Option 2: Salary of £8,164 and bigger Dividend

There are two National Insurance thresholds you need to be aware of:

- Lower Earnings Limit – as long as you earn above this you are protecting your entitlement to future state pension and benefits, without necessarily paying any National Insurance, leading us on to....
- Primary Threshold – if you earn above this you must start paying National Insurance

So the sweet-spot is to go up to the Primary Threshold but no higher. The National Insurance Primary Threshold for 17/18 is £157 per week or £8,164 for the year. Therefore, we would suggest a monthly Gross Salary of £680 which stays just below this threshold and you pay zero NI.

With regards to dividends, assuming as with Option 1 you wish to take dividends up to the higher tax band but no further, then you can take slightly more dividends with Option 2 than with Option 1. This is because you are only taking just over £8k of salary which leaves approximately £3.3k of dividends that are in the tax free allowance, as well as the £5k tax free for the dividend allowance. This in effect means you take more dividends than option 1 but pay the same dividend tax.

### Which Option is best for you

You will note that the net cash in pocket after income tax and employees NI is slightly higher in Option 2 than Option 1, by £400, however this doesn't factor in the additional corporation tax you save on the higher Gross Salary in Option 1.

For limited company contractors and freelancers, Option 2 is the recommended

route (due to single Director rule for NI Employers allowance) and has the added benefit of being able to get a bit more take home pay despite costing a little more corporation tax.

Option 2 also has the added benefit of being less admin intensive as no national insurance needs paying over to HMRC.

	Option 1	Option 2	1 v 2
Salary	11,500	8,164	3,336
Dividend	33,500	36,836	(3,336)
<b>Total Income (Gross)</b>	<b>45,000</b>	<b>45,000</b>	<b>-</b>
Less Income Tax	-	-	-
Less Dividend Tax	(2,138)	(2,138)	-
Less Employee NI	(400)	-	(400)
<b>Take Home Pay</b>	<b>42,462</b>	<b>42,862</b>	<b>(400)</b>
Corporation Tax saved on Salary	2,185	1,551	634
<b>Total "Saving" of Option 1 v Option 2</b>			<b>234</b>



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