TAKING MONEY OUT OF YOUR COMPANY *TAX-EFFICIENTLY*

Many property investors operate a property company, which of course means that company profits need to be taken out of the company to provide an income for the investor – but what is the best way to do this, and why does it matter? **Specialist property accountant Stephen Fay ACA looks at how profits can be taken from a company tax-efficiently, and the benefits of using a property company generally.**

WHY DO INVESTORS USE A PROPERTY COMPANY IN THE FIRST PLACE?

Property investors use a company for two main tax reasons:

1 To save Higher Rate (40%) income tax

For those investors with property profits – or income from other another source – that is taxed at 40% (for tax year 2013, this means more than £42,475), using a property company will halve the tax rate paid to 20%. The 20% tax rate applies to company profits up to £300k per annum – hence there is an obvious advantage in using a company – this is the primary reason to use a company.

2 To save National Insurance (around 10%)

Not all property people are landlords – there are developers, traders, sourcing and lettings agents, educators – the list of ways to make money in property other than being a landlord is endless! A major tax difference between all these activities and being a landlord is that non-rental income is subject to National Insurance (Class 2 and Class 4) at a rate of 10%. This is a tax that landlords don't pay and so investors who branch out into non-rental activities tend to use a company.

WHY DO I NEED TO TAKE MONEY OUT OF THE COMPANY – ISN'T IT MY COMPANY AND SO MY MONEY?

For legal and tax purposes, a company is a separate 'legal person' from its owners, and so the company's money is the company's money – not the investors'! So, this means that the investor has to 'extract' funds from the company – tax-efficiently, naturally.

THERE ARE THREE WAYS TO TAKE MONEY OUT OF YOUR PROPERTY COMPANY

1 Salary

A salary is taken by each director / shareholder, usually at or around the Personal Allowance level (typically £7,500 pa). This is a tax deductible cost to the company, whereas it is not taxable on the investor, as this is covered by the Personal Allowance (if unused elsewhere).

And, other family members can be paid a salary if beneficial and some work is done to earn the salary – this means that any family members that are not using their Personal Allowance can receive a salary – which would save the company 20% of the salary paid since the salary is tax deductible for the company (e.g. 20% of £8,105 = £1,621 tax saved). Salary payments can also contribute to earning the State Pension in later life.

2. Dividends

A salary above the Personal Allowance is usually not advised, because National Insurance is payable by ***BOTH*** the company ***AND*** the individual (@25% in total).

Instead, the company pays out a 'dividend' to the shareholder(s) (literally 'a share of the profits'), which is not taxable on the shareholder(s) up to the Higher Rate income tax threshold.

For a typical two-shareholder company (often spouses), a total of ***£42,475 PER PERSON*** would be received from the company, and there would be no personal tax or National Insurance to pay at all. This is because the dividend payment is deemed to include a tax credit which settles the tax due on the dividend.

Therefore, a total of around £85,000 can be taken tax-free from a company, for a typical two-shareholder company set-up.

Any dividends paid out above this level would be subject to income tax on the shareholder @ 25% – hence, most investors prefer not to take beyond the above figures amount per year.

3 Expenses

Of course, general business expenses are paid by the company – this is not income, and so is not taxable. Typical expenses include computers and office equipment, travel and training costs, marketing and professional fees, in fact anything that is business-related can be paid directly by the company. Business mileage and other non-direct expenses such as a home-office allowance can also be paid by the company to its owner(s). The company can also pay a director's pension contribution – again, fully tax deductible.

There are also 'discretionary' tax-efficient benefits that a company can pay its directors and employees: such as a mobile phone, laptop or iPad, company car (if CO2-efficient!), medical insurance, professional subscriptions – the list is substantial.

Investors therefore need to get into the mindset of ensuring that business expenses are paid directly by the company, or at least reclaimed, to ensure that a tax deduction is obtained. A key benefit that employees do not have is the ability to pay for expenses out of pre-tax income – this is a major benefit that only business owners can take advantage of.

WHAT ABOUT VERY PROFITABLE COMPANIES WHICH HAVE VERY SIGNIFICANT PROFITS?

For those investors lucky enough to have company profits in excess of around £105,000 per year, taking the small salary / larger dividend and having expenses paid by the company may still leave substantial profits within the company. In these circumstances, many investors would use those 'excess' funds to buy property ***WITHIN*** the company, or invest in non-property assets – a company can itself invest in pretty much anything that an individual can.

Using a company to shield business profits from Higher Rate income tax and National Insurance has a huge impact on wealth accumulation over the years – and a valuable company can of course by passed on tax-efficiently to heirs in later life in a piecemeal way.

OVERVIEW

Many investors are surprised at how beneficial using a company can be – the powerful combination of a tax-free income of £85,000 per year, plus expenses paid by the company, and remaining profits only taxed at 20%, means that the default business structure for many, many businesses is to use a company. This enables business profits to be shielded from excessive taxation, and so used productively to generate further wealth for the owners and their families.