

SAVVY WAYS TO EXTRACT CASH FROM YOUR LIMITED COMPANY

In an article aimed at director shareholders Andrew Cazalet outlines some lesser used techniques – some at rates as low as 10% (before 5 April 2008) and 18% (after 6 April 2008) - for directors/ shareholders to extract cash from owner managed Limited Companies.

Interest / Loans

Growing businesses often require the financial support of the directors in the form of loans to provide working capital. It is often overlooked but the repayment of such loans should always be the first manner in which you consider rewarding yourself. This is of course tax free as you lent the monies to the business (out of taxed funds) in the first instance. It is usually sensible for the company to pay interest on the loan whilst it remains outstanding. As this borrowing by the company is almost always unsecured it is possible to pay quite a high rate of interest – say as much as 3-4 % over base rate. The rate paid should be comparable to that payable to a third party.

If you have been required to give a personal guarantee for a *company* loan it is possible to charge the company a loan guarantee fee for the security offered. This is deductible in the company and taxable in the hands of the individual crucially however with no national insurance.

Provided it is paid within twelve months of the company year end the interest is deductible in the company as it arises. The company is required to deduct withholding tax at 20% and pay this to HM Revenue and Customs (HMRC) each quarter. The interest is taxable in the hands of the individual at his or her marginal tax rate with credit for the tax deducted at source. Even if they are very flexible the terms of the loan should be documented in writing.

Benefits in Kind

Possible efficient benefits to consider are

- Company Mobile Phones – there is no benefit in kind for private use of a *company* mobile phone bill. The bill does need to be in the name of the company otherwise there is a potential charge for private calls not included in a free minutes package.
- Fuel Efficient Cars – the benefit in kind on certain types of hybrid and pure electric car can be as low as 9% of list price per year. This is treated as deemed income and taxed at your highest rate of tax.
- Childcare Vouchers – up to £2,916 pa per working parent can be paid tax and National Insurance free to an employee in the form of vouchers exchangeable for purchased childcare.

Rent on Property – Real or Intellectual

Generally it is prudent to keep valuable assets outside a trading company for commercial reasons. This provides a lucrative manner to withdraw cash from the company in the form of rent. It also prevents a possible double tax charge on appreciating assets – once as a corporate capital gain and again on extraction from the company to the owner.

The rent should be at a market rate and documented with a rental agreement, even if this only sets out the terms in a simple letter from the company to the director. Rent is taxed at your marginal rate but crucially of course there is no national insurance.

Employees who work from home may wish to consider licensing one of their rooms to the company on a non-exclusive basis (this avoids any possible capital gains tax on the business use on the sale of the house). The rent is deductible in the company and taxable in the hands of the individual. The individual can deduct a reasonable share of the household costs against this rent eg mortgage interest/ rent/ utilities reducing the taxable income. Your employment contract should specify that you are required to work from home and use that as your office.

Most businesses especially those in the media/ technology areas develop at least some form of brand/ identity over time. You may wish to consider licensing this intellectual property say in a domain name or a brand to the company. This rent is free of National Insurance and deductible in the company. You

will need to consider and document what that intellectual property is. This can however be a highly successful method of extracting profit.

Capital Payments on Shares

It is rarer but it is occasionally possible to extract cash in the form of capital to a shareholder. This might be on liquidation (whether formally or informally by way of winding up) of a company when the remaining cash or other assets are distributed to the shareholders. It is also possible for a company to buy back in or redeem shares from a shareholder. This is often more practical for the continuing shareholder rather than purchase of the shares as the cash to fund the payment to the outgoing director is in the company.

Both strategies can mean the proceeds are treated as a capital gain deriving from a business asset – the ownership of shares in a trading company. If clearance is obtained from the specialist units of HMRC the proceeds may be taxable as a capital gain potentially at only 10% for transaction up to 5 April 2008 and 18% thereafter. Under the rules applying up to 5 April 2008 if the shares have been held for two years the “taper relief” reduces the gain by 75%.

For clearance to be granted the transaction needs to be for genuine business reasons. This might typically be at a point of change in a business eg on ceasing to trade or on departure of an existing shareholder.

Summary

This article is intended as a summary only and advice should only be implemented after consultation with your accountant or tax adviser.

In conclusion it is likely that salary and dividend will remain as the most common ways in which cash is paid to directors/ shareholders. However over the life of a business it is worth remembering other possible but less utilised strategies. At the start of a business consider interest on loans. A mature business with intellectual property should consider renting this to the company. When the business comes to an end or changes one can often obtain some form of capital return to the shareholders often at the very attractive rate of tax of 10% - 18%.

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