

# Driving down tax



In a former life Ray Cadman was a Tax Inspector, specialising in serious tax investigations. He saw the light in the late Eighties and, after spending 5 years with Coopers & Lybrand, joined Garbutt & Elliott, as a senior tax consultant. Here he guides us through the tax-efficient forms of remuneration for directors and senior executives.\*

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Although I still do investigation work, much of my time these days is spent in advising clients on remuneration planning, in the widest sense of the phrase. Not that it is easy money! There are just three main areas for tax planners to get involved with these days. The first of these, share schemes, is outside the scope of this article, in which I focus on that old favourite, car vs cash, and also look in detail at salary vs dividends.

## Are company cars dead?

The short answer is absolutely not! However, it is vital to consider the sums carefully. Company cars are taxed by reference to their CO<sub>2</sub> emissions and so is the fuel scale charge. As each car will have its own CO<sub>2</sub> rating, and the list price varies by reference to model and specification, it follows that the taxable benefit is different in just about every case. This makes the calculation of an accurate cash alternative a finely-tuned “bespoke” operation. Clearly, an employer does not want to be paying much, if anything, more than the company car currently costs. On the other hand an employee will not be interested in taking a cash alternative which leaves him out of pocket.

Lots of things enter the financial equation. How far does the driver live from his place of work? (Home to work mileage is treated as private.) What is his marginal tax rate and is he under or over the National Insurance “ceiling” (currently £40,040)? What is the residual value of the vehicle in question? What is the company policy on reimbursing business mileage? (Using the maximum Revenue & Customs rate is most tax-efficient).

Then there are the non-financial or emotional factors. Some people hate keeping mileage records, but this goes hand-in-glove with running your own car. Some like the “no-hassle” comfort of driving a company car, knowing that it is not their own no-claims discount at risk if they have a prang. For the company there may be issues of corporate image to consider – is it really okay for the sales manager to roll up to a customer’s premises in a well-used, under-serviced, Fiat Panda? All one can say for sure is that, until you do the sums, it is impossible to even try to weigh these non-financial factors.

## “Free fuel”

The old saying that there is no such thing as a free lunch was never truer than when applied in the case of company-provided fuel. Firstly, let’s get one thing clear - the fuel scale charge only applies in the case of *company* cars. If fuel is provided for a privately-run car the benefit is simply the cost of the fuel, not a scale rate.

Company-provided fuel is taxed by taking a figure of £16,900 and multiplying that by the CO<sub>2</sub> tariff figure. If you are unfortunate enough to fall into the 35% category you will currently be paying tax on a figure of £5,915. If you are a 40% taxpayer that means that the tax cost to you alone is over £2,300. At 30 miles to the gallon and a pump price of around £5, you would have to do 15,000 *private* miles to get your money’s- worth out of that!

On top of all that, the company will pay Class 1A NICs of 12.8% - another £757 landing up in Alistair’s coffers.

In the vast majority of cases it is much better to pay a cash alternative of something similar to the cost of the private fuel already being borne by the employer. This will leave the employee with a higher take-home pay, which is then boosted by having the fuel benefit taken out of his coding, leaving more than enough to fund the private fuel purchases. The employer saves all or most of the Class 1A – et voila! – the proverbial win-win situation!

## Salary vs dividends

This subject is particularly relevant for owner-managers, who are in a position to determine how they take their company profits. The way I explain this to my clients is to ask them to imagine that the company and themselves are two hemispheres in a circle – a bit like a single cell which has just divided into two. Assuming they own all the shares, all that really matters is how much tax etc leaves the circle and goes to Gordon. It really doesn’t matter too much how that is comprised as between corporation tax, National Insurance, income tax or VAT. If the corporate left-hand pocket pays more but this is more than compensated by the extra money in the personal right-hand pocket then that is good!

Dividends up to the basic rate ceiling (roughly £41,400) attracts no tax liability whatsoever! Even if you use up all your basic rate band you will only pay tax on the “excess” dividends at a net rate of 25%.

It is however important to understand that there is a trade-off when considering dividends. A dividend is just a distribution of profit, therefore (unlike remuneration, which is a charge against profits) it does not reduce the corporation tax payable. On the other hand, the payment of remuneration generates a 12.8% NI cost to the company, plus an 11% NI cost to the director, up to the upper earnings limit and 1% above that figure. For an owner-managed business this is effectively a double whammy of up to 23.8%.

Companies get a corporation tax deduction for both the remuneration costs *and* the associated Employer’s NICs. For example, a single company with taxable profits of up to £300,000 will pay the standard small companies rate of corporation tax, currently 21%. The real cost of paying, say, a £10,000 bonus is £8,911, i.e £10,000 plus NICs of £1,280 less 21% tax relief on £11,280.

The key thing is to ensure that there is a salary, or benefits in kind, (or a combination) which at least use up the personal tax allowance of £5,435, otherwise this gets wasted. If the remuneration is restricted to this level there is no National Insurance to pay by either the company or the director. For cash remuneration, even a yearly payment of £4,700 will ensure that the director receives full National Insurance credits for State pension purposes, even though nothing is actually paid. Strange but true!