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What Should I Do With Extra Business Cash?

Having worked hard to build your business, seeing the profits accumulate is extremely satisfying. But if your turnover grows quickly, or you have an especially profitable year, it's a good idea to have a plan for the extra cash. This can help to make the most of the money while avoiding excessive tax.

In this guide, you will find multiple options for extra cash in your business.

Grow Your Business

If you are looking to expand, investing in the growth of your business could be a good use of the money. You could use the cash to upgrade your equipment, take on more staff or move to bigger premises.

It could also be a good time to invest in your website. Many companies do not review their websites regularly, but technology is evolving all the time, and you could be missing out on opportunities for organic lead generation.

Perhaps you could invest in an impressive new design or even add new functions, such as online orders, appointment booking or a customer portal.

Another option is to invest in marketing. If your business has already grown through word of mouth and social media, imagine the level you could reach with a proper PR campaign.

Many of these costs may be allowable as deductible expenses for Corporation Tax purposes, subject to conditions.

It's a good idea to seek advice from your accountant on any capital expenditure, as it may be treated differently from regular expenses. Additional relief could be available if your company undertakes research and development.

Declare A Dividend

In many cases, a dividend may be a tax-efficient method of extracting profits, but the optimum depends on individual circumstances and should be discussed with your accountant or tax adviser.

Dividends are paid after deduction of Corporation Tax. The dividend is added to your taxable income after accounting for any salary, pensions, or property rental.

Dividends of up to £500 are free of tax each financial year. If your spouse also works in the business, paying them a dividend can make efficient use of this allowance.

Above this level, dividends are taxed at the following rates:

- 8.75% for a basic rate taxpayer
- 33.75% for a higher rate taxpayer
- 39.35% for an additional rate taxpayer

Dividends have an advantage over a salary in that they are not subject to National Insurance Contributions. However, they don't contribute to your State Pension record, nor do they count towards 'relevant earnings' for the purposes of personal pension contributions.

You may have flexibility over the timing of dividend payments (subject to available profits and company articles), which can support tax planning, but you must ensure the company has sufficient distributable profits when the dividend is declared.

Withdraw a Bonus

In some cases, it might be more appropriate to withdraw the extra cash as a bonus.

This is taxed in the same way as salary, i.e. it normally qualifies for Corporation Tax relief, but you will pay your full marginal rate of income tax. Bonuses are also subject to National Insurance Contributions.

Dividends are usually more tax-efficient, but there are situations when a bonus is more appropriate. Unlike dividends, bonuses do not have to be split proportionately between shareholders. This can be useful if there are multiple shareholders but one key director.

Take a Director's Loan

If you need some temporary cash, the company can loan it to you.

This is a complex area, and it's worth seeking advice. You will normally need to pay interest on the loan, and there may be implications for Corporation Tax and Benefits in Kind depending on how it is structured.

However, if you have previously invested your own money in the company, your director's loan account will be in credit.

This means that you can withdraw your money without paying tax.

Make a Pension Contribution

If you don't need cash for the business or your own immediate use, a pension contribution could be an efficient way of extracting the money.

You can contribute up to a maximum of £60,000 per tax year to a pension. You can also carry forward any unused allowances by up to three tax years, providing you have been a member of a pension scheme throughout.

Pensions are normally an allowable expense for Corporation Tax purposes, although excessive contributions may not receive full relief.

No personal tax is due on the contribution unless you exceed the annual allowance.

Your pension fund grows free of tax and is usually outside your estate for Inheritance Tax purposes. When you retire, you can take 25% of the fund as a tax-free lump sum. The remainder is taxed at your marginal rate, but only when you withdraw it.

Invest the Money

Your company can invest the money for long-term growth.

Any dividends generated by the investment are not subject to Corporation Tax in the hands of the company. Interest and capital gains are taxable. Unlike an individual investor, the company does not have an annual exemption to set against gains.

Investments held within the company generally do not qualify for business relief and will be fully within your estate for Inheritance Tax purposes.

Keep it in Reserve

Remember, you do not need to make a decision right away. If the company has made a profit, it will be subject to Corporation Tax, but beyond that, the company can hold onto the money indefinitely.

All companies should have an adequate cash reserve as this can ensure the business is kept afloat if there are unexpected bills or quiet trading periods.

Boosting this reserve can mean that the business is even more resilient, particularly during economic downturns. It also means that you can take advantage of opportunities to grow and advance your business as they arise.

Please don’t hesitate to contact a member of the team to find out more about business and tax planning.

Please note:

This article is for general information only and does not constitute tax, legal or financial advice. You should seek independent advice tailored to your circumstances before taking any action. Tax treatment depends on individual circumstances and current legislation, which may change. Pension and investment values can go down as well as up, and you may not get back the amount invested. Past performance is not a reliable indicator of future results. Pension benefits, including tax-free cash, are subject to HMRC rules and may change in future. Director’s loans, bonuses, dividends and other profit extraction methods can carry tax implications and may not be appropriate in all situations. Professional advice should be obtained before implementing any financial or tax planning strategies.

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