Bean Counters
Accounting for your Success

Directors Optimum Salary for 2020/21

Owner managed businesses can typically decide how to pay themselves. This can be either a salary, dividends, or a mixture of both. Directors, with no other income should look to pay themselves the optimum director's salary with additional income paid as dividends.

So, how does this work? In simple terms the optimum Directors salary is the most tax efficient amount for, the majority, of directors to pay themselves. This will change from year to year as it is dependent on the National Insurance threshold set by the Government in any given year. For 2020/21 tax year this optimum is £8,788 per annum, which equates to £732 per month.

How this works in principle

The lower earnings limit for NI in 2020/21 is £6,240 per annum. If you earn over this amount it will count as a qualifying year for your future state pension.

The secondary earnings limit for NI in 2020/21 is £8,788 per annum. If your annual salary exceeds this amount the employer (your business) will need to pay NI contributions.

Therefore paying up to the secondary threshold of £8,788 but not a penny more, means the Director qualifies for the state pension but does not need to pay any contributions. Yes, you have read this correctly! You can qualify for a state pension without making any NI contributions.

How has the optimum Directors Salary Changed?

Every year the income tax and NI rates change. Consequently, the optimum director's salary changes every tax year, as you will see from the table below

Tax Year	Annual Salary	Monthly Salary
2020-21	£8,788	£732
2019-20	£8,632	£719
2018-19	£8,424	£702
2017-18	£8,164	£680

Why not pay £nil salary?

A salary paid is a tax deductible whereas a dividend paid is not a tax-deductible expense for the company. Therefore, paying a salary of £8,788 to the director saves corporation tax of £1,670. There is no such saving on dividend payments.

Also, by paying a salary of £8,788 you are ensuring another qualifying year for the state pension is added.

Caveats

Under certain circumstances a Nil salary is advisable, where the director has other income for example a pension income, another salary or rental income. Also, if the individual is already at pension age and it is no longer important to have another qualifying year.

Under these circumstances, it is imperative that you seek specialist tax advice as getting this wrong may cost you thousands in extra taxes. Conversely, in certain circumstances it may be advisable to pay in excess of the optimum director's salary. Should the director have a contract of service they must legally be paid the national living wage, details available on our website.

Dividends can only be paid out if the company has profit and loss reserves. If the company has made losses in the past it may not be possible to pay dividends. Higher salaries may be the only option.

How to optimise salary and dividends for directors in 2020/21?

When income exceeds £8,788, dividends are more tax efficient than additional salaries. This is because the dividend tax rates are lower than PAYE & NI tax rates.

Clearly an annual salary of £8,788 is not high enough for most individuals to live off. The additional income is then paid to the director as dividends. We are assuming the director is also a shareholder.

After paying a salary of £8,788, the first £5,712 worth of dividends are tax free. (Calculation: Personal allowance of £12,500 less salary of £8,788 plus the dividend allowance of £2,000).

The director has therefore now earned £14,500 all of which is completely tax free.

The next £35,500 of dividends are taxed at 7.5%. This takes us up to the top level of basic rate, which is £50,000 for 2020/21.

Dividend tax rates for higher rate taxpayers are taxed at 32.5% and for additional rate taxpayers it is 38.1%.