How business owners can be tax-efficient – and why it matters

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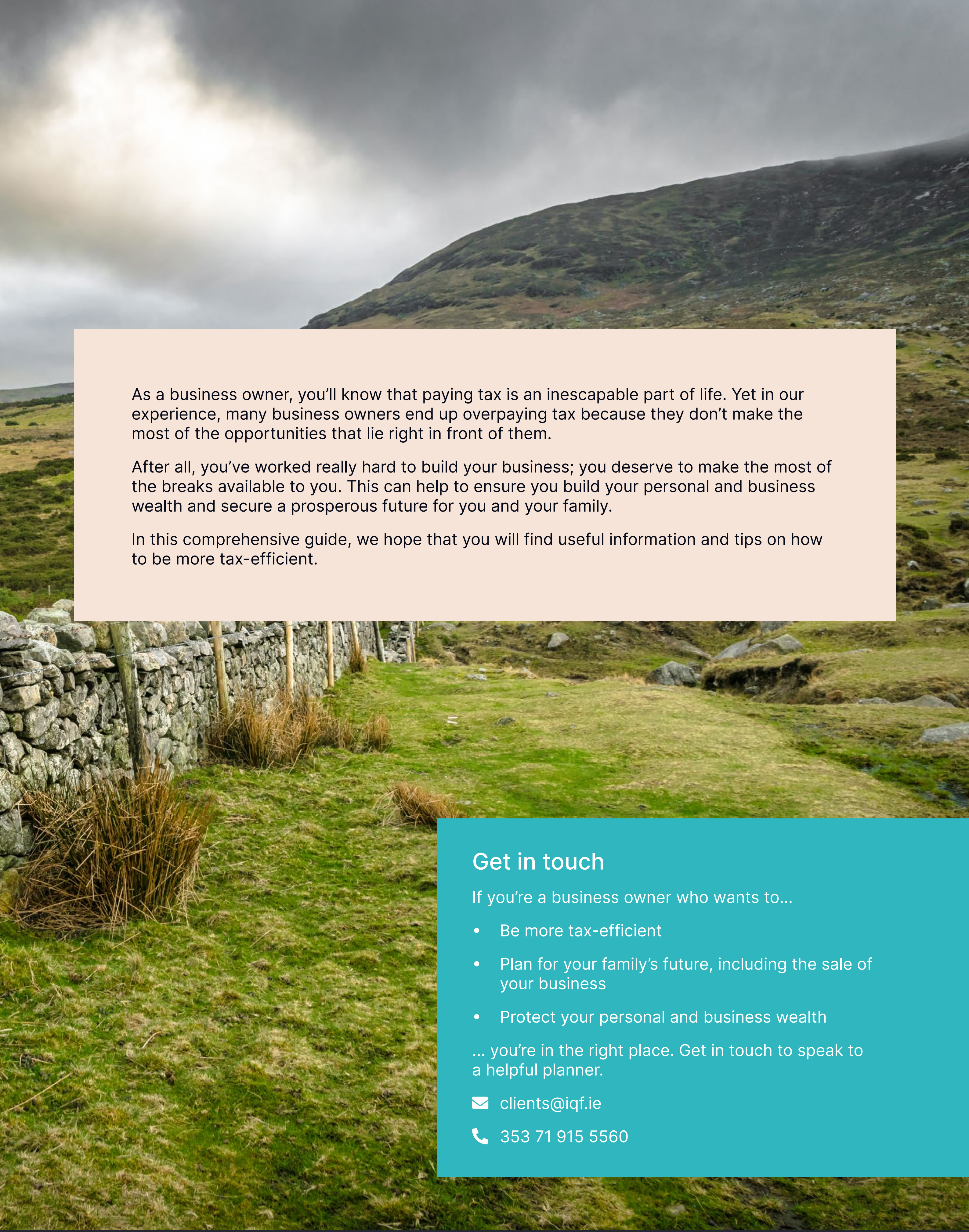

As a business owner, you'll know that paying tax is an inescapable part of life. Yet in our experience, many business owners end up overpaying tax because they don't make the most of the opportunities that lie right in front of them.

After all, you've worked really hard to build your business; you deserve to make the most of the breaks available to you. This can help to ensure you build your personal and business wealth and secure a prosperous future for you and your family.

In this comprehensive guide, we hope that you will find useful information and tips on how to be more tax-efficient.

Get in touch

If you're a business owner who wants to...

- Be more tax-efficient
- Plan for your family's future, including the sale of your business
- Protect your personal and business wealth

... you're in the right place. Get in touch to speak to a helpful planner.

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Section 1: How to use your business profits to boost your personal wealth

The first section of this guide will focus on extracting wealth from your business to serve your personal circumstances, including information on:

- The importance of extracting capital from your company to manage risk down the line
- 5 key options for taking wealth from your business
- How to pay yourself, and the advantages of doing so
- An overview of the two trading structures you could consider
- The pension benefits of providing yourself with a salary.

Section 2: Understanding some of the reliefs that may be available to you

This section outlines some of the reliefs available to business owners, covering the following subjects:

- 2 key reliefs available when you sell or pass on your business
- Tax-efficient asset transfers
- The importance of Pay-Related Social Insurance (PRSI) contributions.

Section 3: How to effectively plan for your family's future

Finally, we discuss the benefits of working with experts, including:

- The importance of having a long-term plan
- How to figure out your “number”, and why it matters as a business owner
- The benefits of choosing iQ Financial as your financial planners.

Section 1: How to use your business profits to boost your personal wealth

Extracting wealth from your business over the years can shield you from unnecessary risks down the line

If your focus is on ensuring that your business is performing well and generating a decent profit, it's natural that you may be less concerned about extracting wealth from it, in order to build and increase your personal balance sheet.

Many business owners don't see a difference between their business assets and their personal assets. Yet there is a difference – a big one.

Relying on a business sale to fund your retirement can incur unnecessary risks

Eventually, every business will either be sold to a third party, sold or passed on to a family member, transferred to your estate on death, or liquidated.

Securing enough profit from the sale of your business, and/or taking enough out of your business for yourself year after year, will be the determining factors in deciding if:

- You have the money to live the life you want
- You can provide for your family
- You could potentially explore new business opportunities that interest you.

However, relying solely on the sale, transfer, or liquidation of your business to deliver all your personal financial targets can often be a risk that you don't need to take. In this scenario, you are relying on a number of things to go in your favour, all at the same time. You'll be hoping that:

- There are purchasers interested in your business
- Decent valuations are available
- Prevailing tax rules are accommodating.

Using business profits to boost your personal wealth year after year could take the pressure off a future sale

On the other hand, if you plan correctly and use your business profits on an ongoing basis to increase your personal wealth, you could maximise your chances of maintaining the lifestyle that you and your family enjoy for the rest of your days.

In doing so, you are also addressing the significant risk that you won't get enough money from a sale, transfer, or liquidation of your business.

5 ways to extract wealth from your business

Option	
Sell your business	This option is usually a one-off transaction that could be a significant boost to your personal wealth. Remember, this gain is subject to Capital Gains Tax (CGT). It is important to review the following three reliefs before you sell. We explore these in more detail in Section 2. **1. Retirement Relief** This is a relief on CGT when disposing of any part of your business or farming assets. **2. Entrepreneurial Relief** This reduces CGT on part of the gain from the sale. **3. Termination payments** You can potentially receive a tax-efficient termination payment.
Pay yourself a salary	Paying yourself a salary from your business can help extract wealth slowly over the course of many years. Of course, this option is subject to tax through Pay As You Earn (PAYE), Pay-Related Social Insurance (PRSI), and Universal Social Charge (USC).
Take dividends	Similar to a salary, dividends can extract value from your business over the long term. This form of remuneration is subject to Dividend Withholding Tax, and cannot be offset against Corporation Tax.
Buy a car or other assets for personal use.	Taking this option can help utilise business profits for personal matters. It is subject to Benefit in Kind (BIK) tax.
Set up a personal pension account	In a pension account, you can contribute up to €2 million for each business owner. This route is often tax-efficient, and can provide both tax-free and tax-reduced lump sums on retirement.

Remember: here at iQ Financial, we are not tax advisers. As financial planners, we can work with your professional tax advisers to help find the most efficient solution to extracting wealth from your business.

The benefits of paying yourself a full salary as a business owner

Many business owners, particularly when they are in the early start-up years, pay themselves a very small (or possibly no) salary.

In addition, some take funds from the business at different times depending on their personal needs and business cash flow.

Setting yourself up as an employee includes many benefits:

- A salary creates pensionable service. Even if you don't make pension lodgements, having even a small salary means that, in future years, you have more options to lodge to a pension in your own name.
- If you need to use a tax-efficient termination payment, the longer the length of time you are in salaried service, the better.
- The more employee PRSI contributions you pay, the higher your future State Pension could be.

It could also be wise to consider paying a salary to family members who work for the business. This may present opportunities for improving the family balance sheet, giving extra pension and termination payment options to your wider family.

2 important trading structure options to consider

In our experience, the vast majority of progressive businesses incorporate using a limited company structure.

A limited company will not be an option for some professions, including medical consultants, dentists, and solicitors, although these professions may be able to incorporate part of their business.

Expert advice from an experienced tax adviser is vitally important here, as some business owners have been badly advised in this area in the past.

The advantages and disadvantages of a limited company versus a sole trader structure

The advantages of operating as a sole trader

- The business is simple to set up and close.
- There is less financial reporting involved compared to a limited company.
- Your business will have more financial privacy than a limited company, as your financials are not visible to the public.

The disadvantages of operating as a sole trader

- You'll carry unlimited liability – your personal assets can be used to settle debts.
- All your earnings (after expenses) are taxed as your income at a rate of up to 52%.
- There is limited scope for tax planning.
- More restrictive pension rules may apply.

The advantages of a limited company

- At the time of writing, your profits are taxed at 12.5% Corporation Tax, rather than as Income Tax.
- Your company carries limited liability – your personal assets generally can't be used to settle company debts.
- Company directors may have more tax planning opportunities than sole traders.

The disadvantages of a limited company

- Your company is subject to more compliance and annual filing requirements than a sole trader.
- The public may have access to the company's financial statements.
- A limited company can be more time-consuming and expensive to set up than a sole trader.
- Directors have legal duties and obligations to act in the best interest of the company, which can increase costs.

2 key ways to pay yourself as the owner of a limited company

1. Pay yourself a director's salary

If you set up a limited company, directors' salaries are subject to the same rate of Income Tax as any other employee of the business.

A director's salary can be included in your company profit and loss as an expense, which can reduce company profits and the amount of Corporation Tax you pay.

2. Pay yourself dividends

Whereas directors' salaries can be paid regardless of whether the limited company is profitable or not, dividends are only paid to shareholders if the limited company has profits available to be distributed.

Salaries are often the preferred remuneration for business owners

In the vast majority of cases, company directors and shareholders of small businesses are the same people.

So, dividends are often considered less attractive, because companies cannot include dividend payments as an expense in the business's profit and loss. For this reason, dividend payments do not reduce Corporation Tax costs.

Paying yourself as a business owner can improve your pension options down the line

Ultimately, it is vital to pay yourself a liveable salary from your business. One of the main reasons, aside from those described already, is that your personal pension options will increase when you pay yourself as a business owner.

Simply put, having a consistent salary will allow the business to contribute to your pension.

Finally, receiving a salary could mean you are able to use a tax-efficient termination payment when exiting your business.

Financial planning can help you to decide what salary level is right for you.

You and your family can benefit from pension contributions when paid a salary from your business

Making pension contributions from your business to a pension account in your name is a great way for business owners to use their profits to increase their personal wealth.

What's more, ensuring family members employed in the business are also in receipt of a salary can open the door to additional pension planning for them.

Company-sponsored pensions are often overlooked, but they can be a hugely tax-efficient asset for business owners

A company-sponsored pension has significant personal benefits and tax advantages that many business owners overlook. Ignoring the benefits of these pensions could be a big mistake.

Crucially, a company-sponsored pension allows you to contribute up to €2 million to a pension in your personal name (and up to €4 million for a couple working in the business). Once you draw a salary from your business, you can transfer money from the company into a separate long-term pension account in your own name.

Using a company-sponsored pension as part of your financial plan should be a priority for all business owners looking to build long-term personal wealth. This option can be a really smart, reliable way to use your business profits tax-efficiently.

The tax advantages of a company-funded pension are extremely attractive:

1. Lodgements to your pension can be included as an expense in your business's profit and loss, which may reduce your Corporation Tax bill.
2. Lodgements are not usually subject to any Benefit in Kind (BIK) tax charge.
3. Gains can generally grow tax-free in your pension account. Plus, you could potentially benefit from decades of tax-free compound growth once your pension funds are prudently invested.
4. Tax-efficient lump sums are usually available when you are ready to start taking money out of your pension.

Remember: seeking the advice of an experienced tax adviser is a vital part of your financial planning work – and is also a helpful when it comes to considering how you will sell or pass on your business.

Section 2: Understand some of the reliefs that may be available to you

2 key reliefs that may benefit business owners when selling your business

Understanding the opportunities available to you could reduce your tax bill while you're trading, and when you come to sell or pass on your business.

There are two important reliefs you could benefit from when planning the sale of your business.

These reliefs can, if available, help ensure that you maximise the value you receive after tax. They can make a huge difference to your personal finances, and allow you to do the things you really want to do when your business has been sold.

1. Entrepreneur Relief

This relief reduces the rate of CGT on a portion of the gains made when you sell your business.

Before you can qualify for Entrepreneur Relief, there are a number of anti-avoidance tests and conditions you must pass. These may be investigated in detail with your tax adviser, and we suggest that you begin planning in this area at least three years in advance of any sale.

2. Retirement Relief

Although this is referred to as "Retirement Relief", you do not need to retire from your business or from farming. There are two types of Retirement Relief, depending on whether you dispose of your business or farm to your child, or someone outside your family.

The two types of Retirement Relief available are:

The passing of a business or farm to your child

The amount of relief you can claim depends on your age at the time of disposal. For disposals made from 1 January 2014, the rules are as follows:

- If you're between 55 and 65, you can claim full Retirement Relief.
- If you're 66 or older, the relief is restricted to €3 million.

The disposal of a business or farm to someone outside of family

You can claim full relief when the market value at the time of disposal does not exceed the threshold of:

- €750,000 for disposals on or after 1 January 2014, if you are under 66
- €500,000 for disposals on or after 1 January 2014, if you are 66 or older.

If the market value is more than the threshold, marginal relief may apply. This limits the CGT to half the difference between the market value and the threshold.

Making tax-efficient asset transfers could mean you benefit in the years to come

In addition to understanding Entrepreneur Relief and Retirement Relief, making the most of tax-efficient asset transfers can be a great choice for business owners.

Transferring assets to those you love, whether it's property, cash or investments, will incur tax in the form of Capital Acquisitions Tax (CAT). As of 2023, CAT stands at 33% on all amounts that exceed the thresholds that apply to the person receiving the asset.

At the time of writing, here the CAT thresholds:

- Transfers to a Spouse or Civil Partner are exempt from CAT.
- Parents can gift or leave up to €335,000 to a child.
- You can transfer €32,500 to a grandchild or other close relation.
- You can transfer €16,250 to anyone not covered above.

So, taking the time to plan how you will pass wealth onto the next generation can help minimise the tax payable by your beneficiaries.

Current tax legislation provides various reliefs and exemptions, so it is important that these are used, where possible, to ensure your loved ones receive the inheritance they deserve.

Getting advice from experienced tax, legal, and financial experts can help ensure that you plan effectively, so that you can maximise the value you pass on.

Four key options for tax-efficient planning all business owners should know about

Use the annual Small Gift Exemption

The Small Gift Exemption, which allows you to gift up to €3,000 a year to anyone before CAT is payable, is likely to form part of your plan.

While this may seem a relatively small amount, used early and as one part of an overall plan, this can help you to greatly reduce the tax your loved ones will eventually pay over time.

Use a Section 72 policy

Providing funds to pay CAT can be done by way of a life insurance policy known as a "Section 72 policy".

The proceeds from the policy do not usually form part of your estate, as long as they are used to pay CAT.

In return for paying a set premium for the rest of your life, you get certainty around a payout amount that could cover the CAT arising on your estate.

Use a Section 73 savings policy

A Section 73 policy is a savings policy that provides for a similar exemption to Section 72.

If the proceeds are used specifically to pay CAT on gifts or inheritances arising from future gifts made by the insured person during their lifetime, they may be exempt from tax.

Funds can be used, for example, if you want to help your child with a deposit for a house.

Make the most of the reliefs granted to business owners and farmers

Passing a business or farm can attract the following reliefs. Guidance from an experienced tax adviser may be taken to ensure you maximise these reliefs:

- Business assets relief
- Agricultural relief
- Retirement relief
- Entrepreneur Relief.

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Putting a will in place can underpin and protect your tax-efficient wealth transfer plans

Underpinning all of the above, it is important to have a will in place that accurately sets out your plans for transferring wealth.

Making a will and reviewing it regularly are important elements of planning for the efficient transfer of assets to the next generation. Without one, your plans could be fruitless.

Want to create a will and prepare for an efficient transfer of your wealth? Here's where you could start.

List all your assets

When reviewing your assets, think about how your asset profile will develop over time, and the consequences this will have for you and your family when transferring wealth.

For example, with the help of your financial planner, you can ensure you have the right type of pension account for your circumstances, in order to pass these funds to your estate in a tax-efficient manner. Not all pension accounts are the same in this regard, so working with a professional could be beneficial.

Take time to establish your priorities when it comes to wealth transfer

If you have young children, objectives such as education fees will be shorter term in nature. Other objectives, like retirement planning, may be longer-term issues you need to consider.

Obtain expert advice

Working with experienced tax, legal, and financial professionals may be the key to ensuring that your plans are effective.

Leaving this to chance could result in your loved ones receiving less than they could have if proper planning had been done – a situation you might wish to avoid at all costs.

PRSI contributions can entitle business owners to the State Pension later in life

Although it may not seem like much, paying yourself tax-efficiently as a business owner can improve your entitlement to the Contributory State Pension.

At the time of writing, the maximum state contributory pension in Ireland is €13,795 a year from age 66.

No matter your wealth status, paying yourself as a business owner could entitle you to the Contributory State Pension

The Contributory State Pension in Ireland is available to business owners. This is an important benefit to maintain as it could form a part of your long-term retirement plans. The State Pension is not means-tested. It is currently available from age 66.

Over the years, successive governments have increased the payment to keep up with the effects of inflation. In 1993, the maximum Contributory State Pension was 68 punts and 90 pence, or €87.50. The amount has increased substantially over this 30-year period.

In addition to the State Pension payment, business owners who pay Pay-Related Social Insurance (PRSI) are entitled to payments towards dental, optical, and aural health services. You pay PRSI at a rate of 4% of your income, and it is paid directly to the Revenue Commissioners.

The State Pension rules are subject to change – but we still encourage business owners to make as many PRSI contributions as possible.

Like all government schemes, the rules regarding the State Pension are subject to change. In the future it could be means-tested, not available until an older age, or curtailed in any other number of ways.

Notwithstanding this, it could be wise for all business owners to make the maximum number of contributions and to ensure your spouse does too (if you are married). You may be able to make voluntary contributions for a spouse who is not in receipt of a salary from your business.

Remember, the number of PRSI contributions you make dictates how much you receive. So, it is important to aim for full credits to your PRSI record every year.

If you're unsure where you stand with your PRSI, check with your accountant, and make sure you maximise your contributions to get the highest possible benefit at retirement.

This is yet another way business owners can make the most of tax efficiencies by paying themselves a salary.

Section 3: How to effectively plan for your family's future

Creating a financial plan is an essential step towards providing for your family

Benjamin Franklin once said: "By failing to plan, you are preparing to fail".

As a business owner, you know that this is true of so many things in life – certainly when planning for your family's financial security. Financial planning is an ongoing process that can help you take control of your finances, plan your future financial life, and ensure you align the use of your money to what's really important to you.

Like all good plans, you should start by looking at where you are today, take time to figure out what you want to achieve, then develop a plan to help ensure you get there.

The funny thing about a financial plan is that, just like running a business, once you put a plan in place, life happens and your plan needs to change. The process of putting a good financial plan in place, and reviewing it regularly, can:

- Help to give you clarity about where you are financially, and how your financial future will look
- Show you your options, and the strategies you could use to help you reach your goals, which may help you to make more informed decisions
- Give you time and space to think properly about where you are today, and to figure out what is most important to you and your family
- Be flexible enough to allow for changes to be made while still allowing you to remain on track to reach your goals – you could call this your "margin of error", a key part of any plan
- Allow you to identify what needs to be done to provide for your family, should something unfortunate happen to you.

Failing to plan puts much of your future success in the hands of the gods.

If you don't take the time to figure out where you're going and to look at the different options you have to get there, ask yourself: what are my chances of success?

You would never set out on a car journey without knowing where you're going and looking at a map (or GPS) to plan how best to get there. Why leave something as important as your family's future to chance?

Finally, your spouse or significant other should, ideally, be fully involved in the planning process from the outset. They will be fundamentally affected by the plan, and should have an influence on how the plan looks initially and how it is tweaked year after year.

Knowing your “number” can help your family thrive in future

In the context of providing for your family, it is also important to know your “number”, meaning the amount of wealth they would need, should anything happen to you.

Calculating your number is easy once you have figured out the key elements that go together to form your financial plan.

These include:

1. **Working out how much you (or your family if you pass away) need to spend each year to maintain your lifestyle**

Many business owners and retirees we meet have a round number in their heads that feels like it could be enough. However, it is important to spend a little time calculating the actual number properly; rough ideas won’t suffice.

2. **Naming the milestone events that are important to you, and working out how much will they cost**

These could include a much-anticipated world trip, a home relocation, a bolthole by the sea or abroad, and helping your son or daughter pay for their wedding or house deposit – the possibilities are endless.

3. **Calculating a reasonable estimate for future inflation**

Over 10 years, based on historical rates of annual inflation, your money will lose around 30% of its real value (or purchasing power) if it is left in cash.

Choosing appropriate investments to obtain an attractive long-term return and ensuring you factor inflation into the calculation are key components of protecting your purchasing power over the years and decades ahead.

4. **Deciding where will you invest the money you have accumulated**

It is important to ascertain how much of a return it is reasonable to expect your investments to generate in the long term.

5. **Assessing how much room for error you want to build into your plan**

As the author Morgan Housel said: “The most important part of any plan is planning on your plan not going according to plan”.

Incorporating a margin of safety into your plan could be an effective way to safely navigate a world that is governed by odds rather than certainty.

What’s your “number”? We can help you find the answer

Your “number” is the amount you need to accumulate for you and your family to live comfortably once you have retired or have sold your business.

In summary, when you are putting plans in place to ensure you are as tax-efficient as possible, it may be wise to:

- Put a comprehensive financial plan in place that addresses how you are going to grow your personal wealth in the most tax-efficient manner possible
- Choose the business structure that helps meet the needs of both your business and yourself, and take time to structure your remuneration so that it meets the needs of your financial plan
- Review your assets and how their profile may change in future, then put a plan in place to ensure the assets you have worked hard to accumulate are passed onto your loved ones as tax-efficiently as possible
- Know your number – having a rough idea in your head is not enough.

5 reasons why you should choose iQ Financial

1. We deal exclusively with a small number of business owners like you, so we understand the main challenges you face when planning for your retirement.
2. We are financial planners who concentrate on you and your family. We are only interested in developing long-term, deep relationships with clients, based on a detailed understanding of all aspects of your personal finances and, critically, of your personal goals for the future.
3. We match your money with your life. Our ultimate aim is to help you lead a full and happy life, both now and in the future, with the money you have.
4. We work hard to provide a level of service to you and your family that is unmatched by other firms.
5. We will not engage a new client unless we are confident that the value you will get from dealing with us will be a multiple of the fee you pay us.

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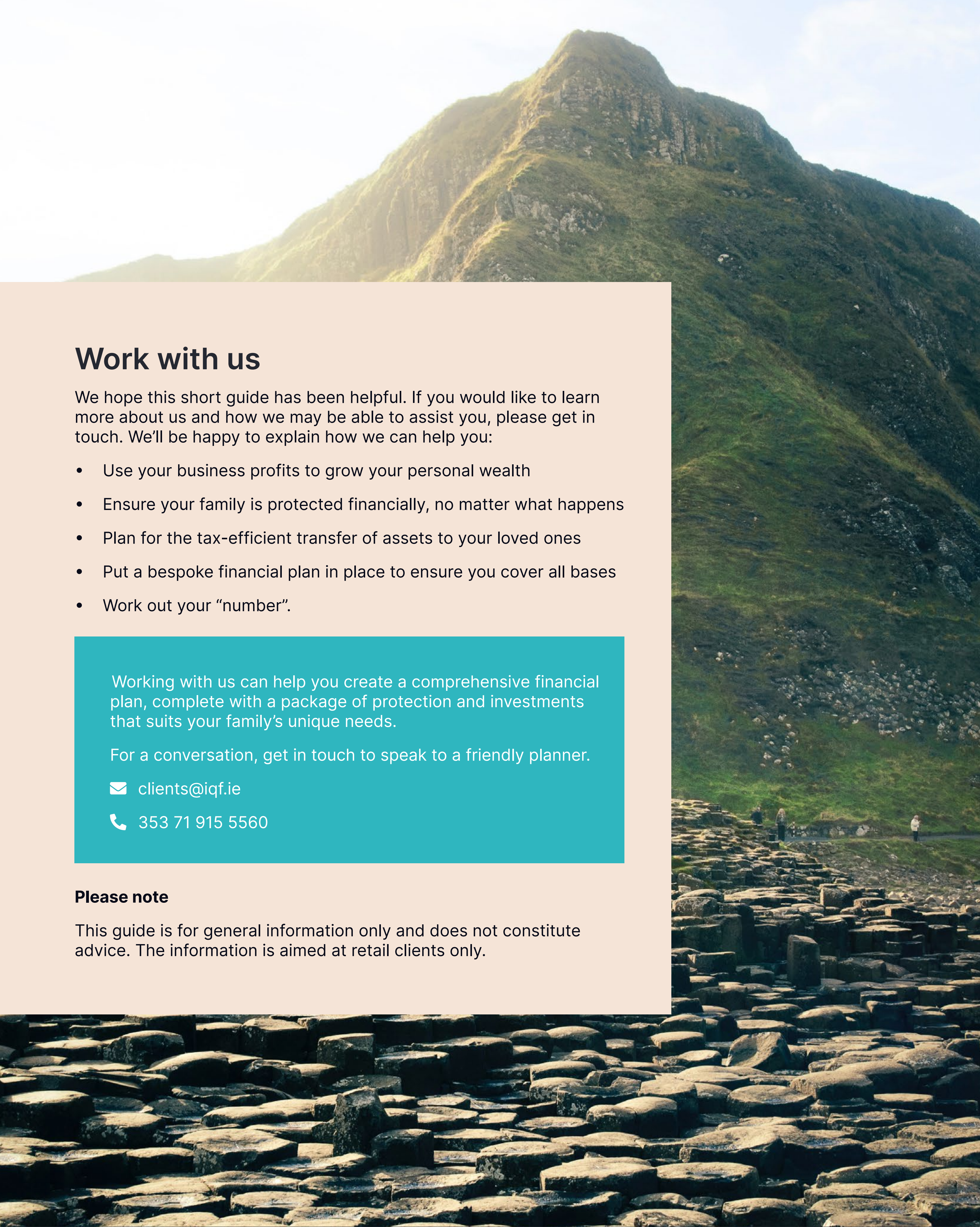

Work with us

We hope this short guide has been helpful. If you would like to learn more about us and how we may be able to assist you, please get in touch. We'll be happy to explain how we can help you:

- Use your business profits to grow your personal wealth
- Ensure your family is protected financially, no matter what happens
- Plan for the tax-efficient transfer of assets to your loved ones
- Put a bespoke financial plan in place to ensure you cover all bases
- Work out your "number".

Working with us can help you create a comprehensive financial plan, complete with a package of protection and investments that suits your family's unique needs.

For a conversation, get in touch to speak to a friendly planner.

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Please note

This guide is for general information only and does not constitute advice. The information is aimed at retail clients only.