Accountants and business owners scramble to reduce tax

James Johnston from MOJO Finance explains how business owners can reduce income and corporation tax liabilities


ABOVE: James Johnston of MOJO Finance

We are fast approaching that busy and anxious time of year again with the filing of tax returns for Limited companies and sole traders, occupying the top of the agenda for accountants.

Year after year accountants bear the brunt of the familiar gripes from business owners, 'why is my tax bill so high' and 'why can't you reduce my tax bill'.

And year after year the similar response ensues from the accountant; 'did you speak with that financial advisor I put you in touch with'.

There is only so much that accountants can do for their clients when it comes to reducing income and corporation tax bills. As the old saying goes "you can lead a horse to water, but you can't make it drink".

The inertia from business owners to be proactive in this area could be for many reasons:

- They simply can't make the time to speak with a financial advisor and get the appropriate pension advice and set up.
- They believe that pensions are obscure and complicated.
- They have come across one or two negative stories and outcomes relating to pensions.

Any negative business owner pension related stories are often associated with self-administered pension schemes where the client's choice of investment is not diversified in any meaningful way. The investment adage "don't put all your eggs in one basket" exists for good reason.

There's nothing wrong with self-administered pension structures per se. The difficulty here really is that there are too many routes to high investment risk and adequate diversification can be harder to achieve.

The approach for business owners should ideally be to invest their pension contributions in a life insured policy and a well-diversified multi asset portfolio with a mixture of bonds, shares, and other asset classes to a lesser degree.

As both positive and negative market and economic news unfolds, you will experience the normal ups and downs in the value of your pension, but over the medium to long-term you can expect good growth from a diversified portfolio.

Business owners are also ideally placed when it comes to smoothing out the ups and downs of the typical pension journey.

Rather than scrambling around at year end to make a sizeable single pension contribution, the ideal approach is to make regular monthly contributions and see what's left over toward the year end. This way, if the market does dip, your next regular contribution picks up the investments at a lower market price. The other approach is to simply invest contributions in a very low risk cash or money market fund and bypass all that market volatility.

Regardless, the big win for business owners should be the tax relief associated with pensions. Compared to other methods of extracting cash from a business, there is very little that can compete with pensions as a tax efficient wealth extraction tool.

Take the following scenario and let's assume the business operates through a limited company with annual profits of €200,000 after salary and costs.

Option 1: Dividend Payment

* Before year-end the business owner pays themselves a dividend of €100,000 on which they pay €52,000 income tax, PRSI and USC.
* The company pays corporation tax of €25,000 on the €200,000 profit.
* The total cost to the business is €125,000. (Dividend + Corp. Tax)
* The total benefit to the owner is €48,000. (Dividend after tax)
* Total taxes are €77,000 which represents almost 62% of total cost.

Option 2: Company Pension Contribution

* Before year-end the business owner makes a company pension contribution of €100,000 on which they pay no tax.
* This reduces the annual profits of the business from €200,000 to €100,000 and corporation tax is now reduced to €12,500.
*The total cost to the business is €112,500. (Pension + Corp. Tax)
* The total benefit to the owner is €100,000 (not including the tax-free growth on the pension contribution).
* Total taxes are €12,500 which represents 11.1% of total cost.

TABLE

In the Table (above right) we can clearly see that the Option 2 pension contribution effectively transfers €52,000 from revenue's balance sheet to the business owners personal balance sheet and €12,500 from revenue's balance sheet to the company's balance sheet.

	€100k Dividend Payment	€100k Pension Contribution
Personal Tax	€ 52,000	0
Corporation Tax	€ 25,000	€ 12,500
Total Tax	€ 77,000	€ 12,500
Cost to Business	€ 125,000	€ 112,500
Benefit to Owner	€ 48,000	€ 100,000
Tax as % of Total Cost	62%	11.10%

For sole traders it works differently but the benefits are as equally clear.

For example, should a sole trader contribute €10,000 to their pension before Oct. 31st they will receive €4,000 back in relief from revenue and assuming they have scope within their earnings.

For limited company directors there is also a great opportunity to contemporaneously reduce a corporation tax bill whilst putting the appropriate personal and business protection in place to mitigate financial risk to their family and business caused by illness, death, or the untimely passing of a shareholder for example.

Payments of premiums on protection policies are often eligible for treatment as a tax-deductible expense.

Sole traders can avail of equally favourable reliefs when it comes to putting the right protection in place and this should be a must for sole traders who are often solely reliant on their own health and wellbeing to generate revenue.

The best course of action is to engage with a financial advisor who will cut through the industry jargon, explain things in an easily understandable way, and implement the most appropriate overall plan as efficiently as possible.

Where policies are put in place most financial advisors will not charge a fee as adequate remuneration for services will be received by a life company for example.

This typically works well for both the customer and the advisor, and your chosen advisor will clarify this with you from the start.

Either way, it shouldn't cost to engage with an advisor and have the initial conversation around what's possible.

MOJO Finance works with business owners and accountants in this way. Director of MOJO Finance, James Johnston offered that "business owners really appreciate the benefit of pension contributions when the figures are laid out in front of them.

"They also realise that they are building personal wealth which is segregated from the future success or otherwise of the business."