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**Orange Genie**  
Accountancy

Contractor and Small Business Specialists

**Guide to Setting a  
Tax Efficient Salary**

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HMRC has published its changes in the tax rates and thresholds for the tax year 2024/25, these thresholds will apply from the 6th April 2024 to the 5th of April 2025.

As a director of your own limited company you may want to review your salary for 2024/25. Tax efficiency is an important part of this decision, but there are other factors that you will want to consider as well.

As your accountant we cannot tell you what to pay yourself but we can make sure you have all the information you need to hand. The salary you set will affect your Income Tax and National Insurance payments so it's important you understand all the implications.

Before we get into detail it is worth remembering that if your contract is caught by IR35 legislation all your earnings will be classed as salary, and dividends cannot be paid. The rest of this guide will then be less relevant.

So assuming you are outside IR35, as a director, you don't have a contract of employment with your Limited company and so there is no minimum wage requirement. This means you can choose to pay yourself any level of salary you see fit.



Contractors typically decide on their salary based on one of three approaches:

- Maximising tax and National Insurance Contributions (NICs) efficiencies; or
- Meeting the Income Tax Threshold; or
- Paying themselves a living wage based on their specific needs or a salary to support VISA or lending requirements

## How to decide what is right for you

There are a number of considerations when deciding on your salary, including:

- What Income Tax and NICs efficiencies do you want to achieve?
- Do you want to ensure that you retain your right to a state earned pension and other benefit entitlements?
- What level of contribution do you want to set for your pension this year?
- Do you need to demonstrate a certain salary level for any reason e.g. income for borrowing purposes?
- Any additional sources of income, eg. rental income.

### Example:

The Directors of ABC Ltd would be better off in theory with a low salary and high dividends, as they have no other income and this would minimise their tax liability.

However, they both decide to take £50,000 salaries, as they prefer to pay more tax but know it was deducted at source rather than saving separately for any additional tax liabilities.



## Income Tax and NIC Efficiencies

Salaries paid are subject to Pay As You Earn (PAYE) Income Tax and National Insurance deductions at the

following rates for 2024/25:-

### Income Tax rates

The rates and bands below for Income Tax are for an individual with a personal allowance of £12,570:

	Annual income	Rate (salaries)
Tax free	£0-£12,570	0%
Basic Rate	£12,571 - £50,270	20%
Higher Rate	£50,271 - £125,140	40%
Additional Rate	Over £125,141	45%

The tax-free personal allowance for 2024/25 is £12,570, therefore, a salary up to this threshold will be free of Income Tax (but employers NIC will be payable at this level).

### National Insurance thresholds

When an individual is paid a salary more than these thresholds, employers and employees NICs are payable.

	For employees	For employers
Weekly pay	£242	£175
Annual pay	£12,570	£9,100

To continue to qualify for the state pension and to retain entitlement to benefits, a salary of at least £6,396 must be earned. Once a salary exceeds £9,100, National Insurance is payable by the employer.

If you employ staff other than yourself, you may benefit from the Employment Allowance, which can save you the first £5,000 of Employers National Insurance contributions.

## Dividend tax rates

If you're outside IR35 and able to take dividends as well as salary, it's important to understand the dividend tax rules as you will be planning for your overall tax liabilities.

From April 2023 the Government has reducing the tax free dividend allowance from £1,000 to £500.

	Rate (dividends)
Dividend allowance (£500)	0%
Basic rate band	8.75%
Higher rate band	33.75%
Additional rate band	39.35%

The first £500 of dividends will be free of Income Tax but the tax rates on dividends above £500 will depend on your overall income and the bands they fall into. Any tax that becomes due on dividends will be calculated and paid through Self-Assessment.





## Pension contribution considerations

Retirement planning is important for a lot of contractors. The salary you set will also set the maximum contribution you can make into a personal pension. If you want to supplement these payments, you may be able to make employer contributions from your Limited company but we advise that you check first with your pension provider.

There is an annual maximum of £60,000 for tax-free pension contributions as long as you were in a registered pension scheme during the tax year. You may also be able to top up your pension for the current tax year with any allowance you didn't use from the previous 3 years. This would, however, be limited to your Net Relevant Earnings (NRE) which excludes dividend income.

As accountants, we are not authorised to advise on pensions, therefore, we recommend seeking advice from an Independent Financial Advisor. We partner with pensions advisors who can provide all the pensions advice you need – just ask us to refer you!

## Demonstrating Income Levels

You may need to take a higher salary in order to satisfy visa or lending requirements where a minimum salary level is required although more lenders are becoming more flexible in terms of how you demonstrate your income. Many will now consider dividend income in addition to traditional salary income when calculating total income for borrowing. Our partners Contractor Mortgages Made Easy (CMME) can advise on obtaining mortgages and loans based on non-traditional salary evidence. You need to be sure that when determining salary you balance tax efficiencies with the ability to obtain funding if needed.

## So to summarise ...

We have said a lot about what you should consider when choosing your salary, so to summarise here are the tax and NIC implications of the most common options taken by contractors.



## COMMON CONTRACTOR SALARY OPTIONS FOR 2024/2025 TAX YEAR



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