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Using a Company to Save Tax

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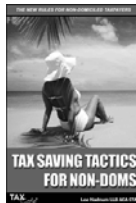
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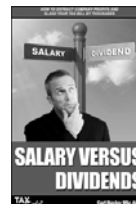
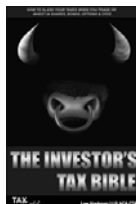
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Chapter 1

Introduction

Using a company could easily save you over £10,000 in tax *every year*...possibly as much as £50,000.

There are several reasons why companies are such powerful tax shelters.

First of all, while sole traders and partnerships pay income tax and national insurance on their profits, companies pay corporation tax – and corporation tax rates are much lower than personal tax rates.

For example, small companies with profits under £300,000 currently pay corporation tax at just 20%. By contrast, sole traders and partners who earn over £42,475 pay 42% income tax and national insurance. Those with income over £150,000 pay 52%.

A company paying tax at just 20% will therefore have a lot more money left over to reinvest and grow than a sole trader or partnership paying tax at 42% or 52%.

Another reason why using a company is so attractive is because, unlike other self-employed people, company owners are in the fortunate position of wearing two caps.

On the one hand, you can reward your hard work as an *employee*; on the other, you can reward your entrepreneurship as a *shareholder*.

As a company employee and shareholder you can split your income into salary and dividends and this could generate large income tax and national insurance savings.

For example, while national insurance is payable on salaries, it is not payable on shareholder dividends.

There are lots of other important tax issues that you have to be aware of when using a company and these are discussed in detail in this guide.

Some of the subjects covered include:

- All tax changes made in the June 2010 emergency Budget and the March 2011 Budget.
- A plain-English guide to how companies are taxed.
- Detailed examples showing the exact amount of tax **you** could save by using a company.
- How to avoid paying any national insurance as a company owner.
- The tax benefits of dividends, plus info on how to pay them correctly and avoid trouble from the taxman.
- How to save thousands more in tax by bringing your spouse or partner into the company.
- The benefits and dangers of owning multiple companies.
- How to incorporate an existing business, including how to make sure you pay zero capital gains tax, VAT, and stamp duty.
- The benefits and drawbacks of using an offshore company.
- A guide to future tax changes.

The guide also contains many useful tables which show the exact tax savings enjoyed by company owners at every profit level. These tables take account of all taxes: income tax, corporation tax, national insurance etc.

There has been much speculation in recent years that the Government would end the significant benefits of incorporation. However, Budgets have come and gone and, while there have been changes, by and large the opportunities to slash your tax bill are still there.

There are also many non-tax reasons why using a company might be a good or even a bad idea. Many of these are listed in the next chapter but they're not the focus of this guide. No other publication focuses on the all-important tax benefits of incorporation, but there are plenty that focus on all the other issues.

It's not always the case that using a company will result in a lower tax bill. There are many occasions when you will be better off owning a business personally. We've therefore included a chapter looking at when running your business as a sole trader or partnership may actually decrease your tax bill.

Chapter 2

Non-Tax Reasons for Using a Company

The most important reason for setting up a company is to save tax. However, there are many other benefits which have nothing to do with cutting your tax bill. Although these are not the focus of this guide, they are worth mentioning in brief:

Limited Liability Protection

In layman's language this means that a company's shareholders are not responsible for the company's debts and cannot be sued by outsiders.

This legal protection comes about because the company and its owners are separate legal entities in the eyes of the law. In legal terms this is often known as the 'veil of incorporation', with the company providing a barrier separating its assets from the shareholder's personal assets.

In practice, much of the limited liability benefit will be taken away by cautious lenders and suppliers. For example, banks will usually not lend your company any money without the directors or shareholders first providing personal guarantees. In fact, many banks make it compulsory to have the personal guarantee concept explained to you by a solicitor... which could cost you hundreds in legal fees.

There are also a number of laws that limit the usefulness of limited liability protection. For example, the wrongful trading legislation effectively states that a director is liable for the debts of a company, where he knows that the company is in a poor financial state yet continues to trade.

Having said this, limited liability protection could prove invaluable, especially if you receive a lawsuit out of the blue or the

company goes bankrupt and creditors who did not ask for guarantees are beating at your door. In these circumstances you will owe nothing, except any remaining share capital unpaid.

Given the increasingly litigious climate in the UK, the benefit of limited liability is becoming increasingly important. If this is one of your main reasons for using a company it's important to understand exactly when the courts will ignore the company's separate status and look at your own personal assets to satisfy any company claims.

When Do Courts Pierce the Corporate Veil?

You'll be pleased to know that the general rule is that the separate legal personality of the company should not be broken. There are, however, a number of exceptions to this rule.

The courts can pierce the corporate veil if the company is used:

- For fraud, or
- As a sham to evade contractual or other legal obligations, or
- As a façade to conceal the true facts

However, these 'exceptions' are interpreted pretty narrowly and the courts are keen to preserve company independence.

Where the courts do look through the company to the assets of the shareholders, it will be because the circumstances fall into one of the above categories. They tend to resist any extension of these principles. This was reaffirmed in a case (known as the 'trustor' case) in which the courts needed to determine whether a shareholder, who was the owner and controller of an offshore company, could be held personally liable for the company's debts.

In this case the court said that the shareholder could be held liable because the company had been used as a façade to conceal the true facts. However, the court upheld the strict approach and refused to acknowledge any further exceptions to the basic principles.

Therefore provided you do not use your company for one of the above 'underhand' reasons, the separate legal personality principle will usually be observed.

A common question is whether a company can be used to protect personal assets against a negligence claim. This is important for many professionals, such as lawyers, dentists, IT professionals, and engineers.

To successfully claim negligence a duty of care should exist between the provider of the service and the person suffering the loss.

In order to show that this duty of care was in place, a claimant must usually establish that there was a direct relationship between the claimant and the person providing the service. The claimant must also have relied on the statements made.

This reliance must have been seen to create a 'special relationship' between the director and the claimant (in other words, the director must have taken personal responsibility for the matter and must not merely be acting in the capacity of a manager of the company).

These circumstances where the courts will 'look through' the corporate veil are therefore limited to the established exceptions identified above, and the company can still provide valuable asset protection advantages against creditors generally (provided no personal guarantees have been given).

For detailed advice on the asset protection advantages of a UK limited liability company ensure that you consult a solicitor specializing in this area.

Borrowing Money

It is potentially easier for a company to raise additional finance.

For example, an unincorporated business cannot raise a 'floating charge' over its assets, a company can. (With a floating charge the lender's claim is lodged over a group of assets rather than one specific asset. This leaves the borrower free to sell, buy and vary the assets within the group.)

Equity finance is also available to companies and there are schemes such as the Enterprise Investment Scheme (EIS) that can provide tax relief to the providers of the finance.

Enhanced Status

Trading as a company is often seen as more prestigious than trading in your own name. Many people will have more faith in a business called Joe Bloggs Limited than just plain Joe Bloggs. Of course, it makes virtually no difference in practice whether a business is incorporated or not.

Flexibility of Ownership

Using a company makes it easy to involve new people in the ownership of the business and to separate ownership and management.

For example, if you want to involve your adult children or key employees, all you have to do is issue them some shares.

If you want to keep your stake in the business but do not want to be involved in its day to day management, you can hold on to your shares but resign as an employee.

Similarly, passing the business on to family members can be easier if you use a company as you can leave shares to a number of different beneficiaries.

There are specific tax reliefs available for transferring shares in trading companies (but not investment companies). Therefore if you want to involve younger family members in the business you can frequently transfer shares to them free of UK tax by taking advantage of the various tax reliefs.

Continuity

It's something almost nobody setting up a business thinks about but it's probably the most important decision facing business owners close to retirement: succession.

A company structure allows for a smooth exit from the company.

The death of a company member does not affect the existence of the company. If a partner dies the partnership ceases to exist.

Chapter 3

Company Drawbacks

Using a company is not always in your best interests and it's worth pointing out some of the negative factors:

Costs

It costs virtually nothing to set up a company. All you have to do is go to one of the many company formation experts and they'll do most of the work for not more than £150.

Where you will incur higher costs is in ongoing accountancy fees. Most accountants charge companies more than sole traders and partnerships because of the extra requirement to prepare and file accounts with Companies House. Company accounts need to be filed in a prescribed format and often need to be prepared in accordance with various financial reporting standards. In most cases though, the tax savings should easily cover these extra fees.

Company Law

As a company director you will be subject to UK company law.

Loans to directors are no longer prohibited in the new Companies Act, however there are approval and disclosure requirements unless the loan is less than £10,000.

There are also separate taxation rules that apply an additional tax charge of 25% of the amount of the loan. If the loan is repaid the tax charge is effectively repaid. This is discussed in more detail later in the guide.

Having to undergo annual audits can be an extremely time-consuming and expensive process. However, most small companies no longer have to worry about them.

Generally, a company's accounts will only need to be audited if the company meets one of the following criteria:

- Turnover exceeds £6,5 million per year, or
- Balance sheet value exceeds £3.26 million.

Reporting Requirements

When you operate as a company your annual accounts have to be filed with Companies House. These will reveal financial information about your company. However, small companies only need to file an abbreviated balance sheet. These documents will tell the outside world very little about your dealings.

Accounts must be filed within 9 months of the end of the financial year and there are penalties for late filing.

Company directors are also obliged to keep minutes of directors' meetings, and to comply with statutory filing obligations. Every year an annual return has to be filed with Companies House but, unless there have been significant changes to the company's ownership or structure, this is essentially a 10-minute exercise. There is a small annual filing fee (currently £30, unless you file online in which case it is £15).

PAYE

PAYE applies to any business that has employees and can therefore apply to not just limited companies but also unincorporated businesses. The difference with a company is that, for a sole trader business, the proprietor will not be an employee and therefore not subject to PAYE – rather he or she will be taxed on the profits of the business.

In a limited company setting, the chances are that the directors (previously the sole trader and often a spouse) will also be employees and therefore PAYE would be deducted from any salaries paid to them.

PAYE is essentially a method of paying income tax throughout the year, and the employer company will therefore need to calculate

the appropriate income tax and national insurance to deduct from any salary payments and pay this over to Revenue and Customs.

PAYE is usually paid over on a monthly basis: every month you pay the income tax and national insurance for the previous month. However where the monthly income tax and national insurance is less than £1,500, quarterly payments are permitted.

In order to start paying PAYE, the first thing to do is phone Revenue and Customs' new employer helpline: 0845 6 070 143. They will send you a 'starter pack' that explains how PAYE is deducted, along with a variety of forms for you to use.

However, an even better idea is to get a bean-counter to do it for you! There are lots of accountants and payroll firms that will run your payroll for as little as a few pounds per person, per month.

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