



Taxcafe.co.uk Tax Guides

Using a Company to Save Tax

By Lee Hadnum LLB ACA CTA

Important Legal Notices:

Taxcafe®
TAX GUIDE - 'Using a Company to Save Tax'

Published by:

Taxcafe UK Limited
67 Milton Road
Kirkcaldy
KY1 1TL
Tel: (0044) 01592 560081

Ninth Edition, January 2010

ISBN: 978-1-907302-04-6

Copyright

Copyright © Lee Hadnum. All rights reserved.

No part of this publication may be reproduced or transmitted in any form or by any means (electronically or mechanically, including photocopying, recording or storing it in any medium by electronic means) without the prior permission in writing of the copyright owner except in accordance with the provisions of the Copyright, Designs and Patents Act 1988 or under the terms of a licence issued by the Copyright Licensing Agency Ltd, 90 Tottenham Court Road, London, W1P 0LP. All applications for the written permission of the copyright owner to reproduce or transmit any part of this Tax Guide should be sent to the publisher.

Warning: Any unauthorised reproduction or transmission of any part of this Tax Guide may result in criminal prosecution and a civil claim for damages.

Trademarks

Taxcafe® is a registered trademark of Taxcafe UK Limited. All other logos, trademarks, names and logos in this Tax Guide may be trademarks of their respective owners.

Disclaimer

1. Please note that this tax guide is intended as general guidance only for individual readers and does NOT constitute accountancy, tax, investment or other professional advice. Taxcafe UK Limited and the author accept no responsibility or liability for loss which may arise from reliance on information contained in this tax guide.

2. Please note that tax legislation, the law and practices by government and regulatory authorities (for example, Revenue and Customs) are constantly changing. We therefore recommend that for accountancy, tax, investment or other professional advice, you consult a suitably qualified accountant, tax specialist, independent financial adviser, or other professional adviser. Please also note that your personal circumstances may vary from the general examples given in this tax guide and your professional adviser will be able to give specific advice based on your personal circumstances.

3. This tax guide covers UK taxation mainly and any references to 'tax' or 'taxation' in this tax guide, unless the contrary is expressly stated, are to UK taxation only. Please note that references to the 'UK' do not include the Channel Islands or the Isle of Man. Addressing all foreign tax implications is beyond the scope of this tax guide.

4. Whilst in an effort to be helpful, this tax guide may refer to general guidance on matters other than UK taxation, Taxcafe UK Limited and the author are not experts in these matters and do not accept any responsibility or liability for loss which may arise from reliance on such information contained in this tax guide.

5. Please note that Taxcafe UK Limited has relied wholly upon the expertise of the author in the preparation of the content of this tax guide. The author is not an employee of Taxcafe UK Limited but has been selected by Taxcafe UK Limited using reasonable care and skill to write the content of this tax guide.

About the Author

Lee Hadnum is a key member of the Taxcafe team. Apart from authoring a number of our tax guides, he also provides personalised tax advice through our popular Question & Answer Service, a role he carries out with a great deal of enthusiasm and professionalism.

Lee is a rarity among tax advisers having both legal AND chartered accountancy qualifications. After qualifying as a prize winner in the Institute of Chartered Accountants entrance exams, he went on to become a Chartered Tax Adviser (CTA).

Having worked in Ernst & Young's tax department for a number of years, Lee decided to start his own tax consulting firm, specialising in capital gains tax, inheritance tax and business tax planning. He now provides online guidance and unique tax planning reports at www.wealthprotectionreport.co.uk and www.traderstaxclub.co.uk

Lee has taken his own advice and now lives overseas himself. Whenever he has spare time Lee enjoys DIY, walking and travelling.

Contents

Chapter 1	Introduction	1
Chapter 2	Non-Tax Reasons for Using a Company	3
Chapter 3	Company Drawbacks	7
Chapter 4	Why You & the Company Aren't Separate	10
Chapter 5	Company Tax: Pros & Cons	12
Chapter 6	Corporation Tax in Plain English	14
Chapter 7	Corporation Tax versus Income Tax	20
Chapter 8	National Insurance Savings	27
Chapter 9	Using Dividends to Escape Tax	31
Chapter 10	Detailed Examples of Tax Savings	39
Chapter 11	Reinvesting Profits to Make Big Tax Savings	51
Chapter 12	Recent Tax Changes	56
Chapter 13	When Using a Company Increases Your Tax	67
Chapter 14	How to Pay Dividends	74
Chapter 15	Using Your Spouse for Further Tax Savings	79
Chapter 16	Incorporating an Existing Business	88
Chapter 17	Incorporation Checklist	106
Chapter 18	Transferring a Business Out of a Company	108
Chapter 19	Offshore Tax Planning	115
Chapter 20	Conclusion	125
	Other Taxcafe Products & Services	126

Chapter 1

Introduction

It's a decision that could save you thousands of pounds in tax each year, maybe tens of thousands.

You'll probably have guessed that I'm referring to the tax benefits of 'incorporation' – the horrible word accountants use to describe starting a company.

So what's it all about? Well, UK businesses are made up of sole traders, partnerships and companies. You also get limited liability partnerships, companies limited by guarantee and other weird and wonderful business structures but they are simply not that important from a tax angle.

Sole traders and partnerships have one key thing in common: they are unincorporated businesses. This means all the profits are added to the owner's or partners' other income and subject to income tax. A company, by contrast, is separate from its owners (the shareholders) and is subject to its very own tax regime: Corporation tax.

So why incorporate?

Unlike other self-employed people, owners of small companies are in the fortunate position of wearing two caps. On the one hand, they can reward their hard work as an employee. On the other, they can reward their 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.

National insurance rates were increased significantly in the 2002 Budget and several increases have been announced since then. The most recent was the 0.5% increase announced in the December 2009 Pre-Budget Report (on top of the 0.5% increase announced in 2008). Fortunately, company owners have more scope than anyone else to carry out effective national insurance planning.

Another reason for trading through a company is to make the most of the comparatively low corporation tax rates.

Corporation tax rates have been changed many times in recent years. The most recent announcement was in the December 2009 Pre-Budget Report. The Chancellor, Alistair Darling, had originally planned to raise the small companies rate from 21% to 22% in April 2010. However, in his Pre-Budget speech he announced that the rate would be kept at 21% for another year.

Small owner managed companies will now pay corporation tax at 21% for the 2009 *and* 2010 financial years (1st April 2009 to 31st March 2011).

Although the basic rate of income tax has been decreased from 22% to 20%, many sole traders and partners are higher-rate taxpayers and subject to 40% tax. Using a company can therefore still save you a lot of tax, in particular if you reinvest profits to help your business grow.

Using a company may become even more appealing from 6th April 2010 when a new 50% income tax rate is introduced for those earning more than £150,000. We examine the impact of this increase later in the guide.

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.

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.

If you have enjoyed reading the first few pages of this publication, please

[CLICK HERE](#)

to add it to your shopping cart at

£24.95
(+ £1.95 P&P)

You will also receive a FREE PDF copy so you can read the entire book just seconds after placing your order!