



Taxcafe.co.uk Tax Guides

# Using a Company to Save Tax

By Nick Braun PhD

## **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

19<sup>th</sup> Edition, November 2018

ISBN: 978-1-911020-35-6

### **Copyright**

Copyright © Taxcafe UK Ltd. 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 publisher 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, Saffron House, 6-10 Kirby Street, London EC1N 8TS.

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

### **Trademarks**

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

### **Disclaimer**

Before reading or relying on the content of this tax guide please read the disclaimer.

# TAXCafe®

Pay Less Tax!

with help from Taxcafe's unique tax guides

All products available online at

**[www.taxcafe.co.uk](http://www.taxcafe.co.uk)**

Popular Taxcafe titles include:

*How to Save Property Tax*

*Using a Property Company to Save Tax*

*How to Save Inheritance Tax*

*The Big Landlord Tax Increase*

*Salary versus Dividends*

*Using a Company to Save Tax*

*Small Business Tax Saving Tactics*

*Keeping it Simple:  
Small Business Bookkeeping, Tax & VAT*

*Tax Planning for Non-Residents & Non Doms*

*Pension Magic*

*Isle of Man Tax Saving Guide*

*How to Save Tax*



## About the Author & Taxcafe

---

Dr Nick Braun founded Taxcafe in 1999, along with his partner Aileen Smith. As the driving force behind the company, they aim to provide affordable plain-English tax information for private individuals, business owners and professional advisors.

Over the past 18 years Taxcafe has become one of the best-known tax publishers in the UK and has won several prestigious business awards.

Nick has been a specialist tax writer since 1989, first in South Africa, where he edited the monthly *Tax Breaks* publication, and since 1999 in the UK, where he has authored several tax books including *Small Business Tax Saving Tactics* and *Pension Magic*.

Nick also has a PhD in economics from the University of Glasgow, where he was awarded the prestigious William Glen scholarship and later became a Research Fellow.

## Contents

---

<b>Introduction</b>	<b>1</b>
<b>Using This Guide &amp; Limitations</b>	<b>4</b>
<b>Part 1      Non-Tax Benefits &amp; Drawbacks</b>	<b>5</b>
<b>Chapter 1</b> Company Benefits	6
<b>Chapter 2</b> Company Drawbacks	11
<b>Part 2      Why Companies Are Excellent              Tax Shelters</b>	<b>17</b>
<b>Chapter 3</b> Why You and the Company Aren't Really Separate	18
<b>Chapter 4</b> Company Tax Basics	20
<b>Chapter 5</b> Owning More than One Company: Benefits & Drawbacks	24
<b>Chapter 6</b> Trading Companies versus Investment Companies	28
<b>Chapter 7</b> How the Self-Employed Are Taxed	31
<b>Chapter 8</b> Companies as Tax Shelters	36
<b>Part 3      How Company Owners Can Pay Less Tax</b>	<b>41</b>
<b>Chapter 9</b> Employment Income	42
<b>Chapter 10</b> How Dividends are Taxed	48
<b>Chapter 11</b> Company Owners: Tax-free Salaries	54
<b>Chapter 12</b> Salaries: Pension Benefits	58

## Contents (cont...)

---

<b>Chapter 13</b>	Company vs Sole Trader: Tax-Free Salary & Dividends	60
<b>Chapter 14</b>	Reinvesting Profits to Make Bigger Tax Savings	69
<b>Part 4</b>	<b>Salaries &amp; Dividends: Practical Issues &amp; Dangers</b>	<b>75</b>
<b>Chapter 15</b>	How to Avoid the Minimum Wage Rules	76
<b>Chapter 16</b>	Is My Salary Tax Deductible?	78
<b>Chapter 17</b>	Paying Salaries & Dividends: Profits & Paperwork	80
<b>Chapter 18</b>	Dividends Taxed as Earnings	83
<b>Chapter 19</b>	Small Salary, Big Dividends: Potential Dangers	86
<b>Chapter 20</b>	Personal Service Companies	88
<b>Chapter 21</b>	Future Tax Changes	91
<b>Part 5</b>	<b>How Couples Can Save Tax</b>	<b>95</b>
<b>Chapter 22</b>	Companies Owned by Couples	96
<b>Chapter 23</b>	Splitting Income: Practical Issues	107
<b>Part 6</b>	<b>Controlling Your Tax Bill</b>	<b>116</b>
<b>Chapter 24</b>	Company Owners Can Control Their Income Tax Bills	117
<b>Chapter 25</b>	Using a Company to Protect Your Child Benefit	120

## Contents (cont...)

---

<b>Chapter 26</b>	Business Owners with Income From Other Sources	127
<b>Chapter 27</b>	How to Pay Less CGT by Postponing Dividends	133
<b>Part 7</b>	<b>Using a Company: More Tax Benefits &amp; Drawbacks</b>	<b>135</b>
<b>Chapter 28</b>	Pension Contributions	136
<b>Chapter 29</b>	Tax-Free Interest	139
<b>Chapter 30</b>	Losses	142
<b>Chapter 31</b>	Cash Accounting	145
<b>Chapter 32</b>	Motoring Costs	147
<b>Chapter 33</b>	Selling Your Business	151
<b>Chapter 34</b>	Business Property	158
<b>Chapter 35</b>	Borrowing Money	162
<b>Part 8</b>	<b>Incorporating &amp; Disincorporating an Existing Business</b>	<b>165</b>
<b>Chapter 36</b>	Incorporating an Existing Business	166
<b>Chapter 37</b>	Disincorporation Relief	173

## Introduction

---

Using a company could save you over £10,000 in tax *every year*...possibly over £40,000.

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

While sole traders and partnerships pay income tax and national insurance on their profits, companies only pay corporation tax – and corporation tax rates are much lower than personal tax rates.

Companies currently pay corporation tax at just 19%, whereas most sole traders and partners who earn over £46,350 pay 42% income tax and national insurance. Those with income over £150,000 pay 47% tax. (Different income tax rates apply in Scotland, which we will examine later.)

A company paying tax at just 19% will therefore have a lot more money left over to reinvest and grow than a sole trader or partnership paying tax at 42% or 47%.

Companies will enjoy even bigger tax savings when the corporation tax rate is reduced to 17% in April 2020.

Company owners also have to pay income tax on most of the money they extract from their companies (typically as dividends) and the bad news here is that dividend tax rates were increased significantly on 6<sup>th</sup> April 2016.

However, as a company owner you have complete control over *how much* income you withdraw from your company. This gives you complete control over your personal tax bill, allowing you to avoid the higher tax rates that kick in when your income exceeds £46,350, £50,000, £100,000 or £150,000. Sole traders and partnerships cannot control their income tax bills in this way.

Nevertheless, the increase in dividend tax means that companies no longer deliver guaranteed tax savings in all circumstances. What matters is how much profit your company makes and what you do with those profits.

Some of the subjects covered in this guide include:

- All relevant tax changes made in the November 2018 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.
- A plain English guide to how dividends are now taxed with lots of examples.
- How company owners can increase their tax savings by tens of thousands of pounds by keeping money inside their companies.
- How to save thousands more in tax by bringing your spouse or partner into the company.
- How to protect your child benefit payments.
- How to pay just 10% capital gains tax when you wind up your company and extract profits, plus details of new anti-avoidance rules.
- The *non-tax* benefits and drawbacks of using a company.
- The benefits and drawbacks of owning multiple companies.
- How to incorporate an existing business, including how to avoid capital gains tax and stamp duty land tax.
- Future tax changes and proposals.

The guide also contains many useful tables that show the exact tax savings (and losses) that can be enjoyed by using a company at every profit level. These tables take account of all taxes: income tax, corporation tax, national insurance etc.

The guide also examines a variety of other important tax issues facing company owners, including:

- Pension contributions
- Motoring expenses
- Tax treatment of losses
- Selling or winding up the business
- Business property
- Borrowing money

There has been much speculation in recent years that the Government will end the significant benefits of using a company.

The increase in dividend tax rates went some way towards achieving this but forthcoming cuts to corporation tax have also increased the attractiveness of using a company.

Politicians and governments have come and gone and, while there have been numerous changes, using a company will still produce handsome tax savings in many situations.

## **Using This Guide & Limitations**

---

This tax guide deals primarily with the 2018/19 tax year, which started on 6 April 2018 and finishes on 5 April 2019. There are references to other tax years, however it is important to emphasise that the tax rates and tax laws that will apply in future tax years are not known with certainty.

Tax rates and tax laws (including HMRC's interpretation of those laws) are continually changing. The reader must bear this in mind when reading this guide.

The aim of this guide is to explain in plain English the tax benefits and drawbacks of using a company. Please note that this is NOT supposed to be a do-it-yourself (DIY) tax planning guide. If you are thinking of setting up a company I strongly recommend that you obtain professional advice after reading this guide.

Furthermore, although the guide covers a fair amount of ground, it does not cover every possible scenario and angle. Businesses and their owners come in many different shapes and sizes, so it is possible that the information contained in this guide will not be relevant to your circumstances.

There are also non-tax factors that have to be considered when deciding whether or not to use a company and these may be as important or more important than the tax issues.

For all of these reasons it is vital that you obtain professional advice before taking any action based on information contained in this guide. The author and Taxcafe UK Ltd cannot accept any responsibility for any loss which may arise as a consequence of any action taken, or any decision to refrain from taking action, as a result of reading this guide.

### **Scottish Taxpayers**

The Scottish Parliament can now tax most types of income. Most of the information contained in this guide is relevant to Scottish taxpayers and there is quite a lot of information specific to them. However, unless stated to the contrary, all examples assume that the taxpayer is not a Scottish taxpayer.

# **Part 1**

## **Non-Tax Benefits & Drawbacks**

## Chapter 1

---

# Company Benefits

Although one of the most important reasons for setting up a company is to save tax, there are many other benefits which have nothing to do with cutting your tax bill. Although they are not the focus of this guide, it's worth mentioning them in brief:

### **Limited Liability Protection**

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

If your company goes bust your *personal* assets are safe. You do, however, stand to lose the money you've invested in the company and any assets you've transferred to the company.

This legal protection comes about because a 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 shareholders' 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 money to small companies unless the directors or shareholders provide personal guarantees.

Furthermore, the directors may be held personally liable for losses resulting from their own illegal acts or if they act negligently or beyond their powers.

Directors can be held personally liable for the company's debts if there has been wrongful trading, i.e. if they know or should have known that there was no reasonable prospect of the debts being repaid because the company is in financial trouble.

The courts may intervene and 'pierce the corporate veil', holding those who control the company personally responsible, if the

company is used as a device to commit fraud or to escape legal obligations.

In the case of *Gilford Motor Co Ltd v Horne*, the former employee of a car company (Mr Horne) set up a new company in his wife's name in an attempt to circumvent a non-compete clause in his previous employer's employment contract. The court granted an injunction against Mr Horne and the new company because the new company was formed merely to mask his activities.

In another case, *VTB v Nutritek*, the court confirmed that the corporate veil can only be pierced in these circumstances when there is some 'impropriety'. The company's involvement in any impropriety will not by itself justify piercing the veil – the impropriety 'must be linked to use of the company structure to avoid or conceal liability'.

In summary, limited liability protection could prove useful when the business faces unexpected losses or legal liabilities but will not protect you in all circumstances.

Finally, it should be noted that limited liability status can also be obtained by using a limited liability partnership (LLP).

### ***Sole Enterprise with Protected Assets***

In 2016 the Orwellian sounding "Office of Tax Simplification" published a discussion paper exploring the merits of introducing something called a Sole Enterprise with Protected Assets (SEPA).

The idea is to introduce a business structure that allows self-employed individuals to protect their primary residence (their home) without having to operate through a company. It would have the same tax and accounting treatment as a sole trader.

Customers seeking redress would no longer be able to place a charging order on a house under the Charging Order Act 1986, unless the sole trader was criminally negligent.

Creditors would still be able to ask for a business loan to be secured against a residence, in which case the SEPA status would

not protect the owner.

As with directors of limited companies, sole traders would still be personally liable if they were found guilty of fraud or other serious failures.

There are over three million self-employed business owners in the UK and over 700,000 non-employing limited companies, all of which represent the target market for a Sole Enterprise with Protected Assets, as well as small companies with just one or two employees.

The Office of Tax Simplification believes that a number of the simplest companies would prefer to operate as a Sole Enterprise with Protected Assets rather than as a company, providing they are given full disincorporation relief (i.e. no tax payable when assets are transferred out of the company).

A final report published in November 2016 concluded that the SEPA idea is worth pursuing, although we do not know if or when the Government will act on this proposal.

### **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 rather than just plain Joe Bloggs. Of course, it makes virtually no difference in practice whether a business is incorporated or not.

### **Borrowing Money**

Corporate status seems to be a positive factor in the eyes of some lenders and may make it easier to obtain credit from suppliers. However, in reality, a newly formed company will probably struggle to obtain credit or borrow money without personal guarantees from the directors/shareholders.

Sole traders rely on their own personal credit ratings if they wish to borrow money for the business. If the business owner's personal

credit rating deteriorates, this will affect the ability of the business to borrow.

Companies have their own credit scores, however these take time to build. For example, a lender may wish to see several years' worth of accounts before handing over any money.

Companies may, however, find it easier than sole traders and other unincorporated businesses to raise funds by issuing shares in the company to new investors.

An unincorporated business also cannot raise a 'floating charge' over its assets, whereas a company can. (With a floating charge the lender's claim is lodged over all of the assets, both present and future, 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) and Seed Enterprise Investment Scheme (SEIS) that can provide tax relief to the providers of the finance.

## **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. If you want to involve your adult children or key employees, you can issue them with shares. Using a company allows you to provide small parcels of ownership quite easily.

If you want to keep your stake in the business but do not want to be involved in its management, you can keep your shares but resign as a director.

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 is probably the most important decision facing business owners close to retirement: succession.

A company structure allows for a smooth exit from the company. Small parcels of shares can be passed on to family members over a number of years.

The death of a company member does not affect the existence of the company.

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

**[CLICK HERE](#)**

to add it to your shopping cart at

**£26.95**

+ FAST & FREE POSTAGE

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