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Using a Company to Save Tax

By Nick Braun PhD

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TAX GUIDE - 'Using a Company to Save Tax'

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

17th Edition, August 2017

ISBN: 978-1-911020-20-2

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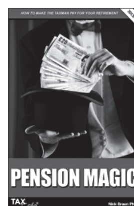

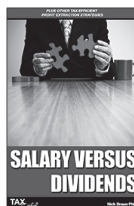

About the Author & Taxcafe

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 17 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

Introduction 1

Using This Guide & Limitations 4

Part 1 Non-Tax Benefits & Drawbacks 5

Chapter 1 Company Benefits 6

Chapter 2 Company Drawbacks 11

Part 2 Why Companies Are Excellent Tax Shelters 17

Chapter 3 Why You and the Company Aren't Really Separate 18

Chapter 4 Company Tax Basics 20

Chapter 5 Owning More than One Company: Benefits & Drawbacks 24

Chapter 6 Trading Companies versus Investment Companies 28

Chapter 7 How the Self-Employed Are Taxed 31

Chapter 8 Companies as Tax Shelters 35

Part 3 How Company Owners Can Pay Less Tax 40

Chapter 9 Employment Income 41

Chapter 10 How Dividends are Taxed 47

Chapter 11 Company Owners: Tax-free Salaries 53

Chapter 12 Salaries: Pension Benefits 57

Contents (cont...)

Chapter 13 Company vs Sole Trader: Tax-Free Salary & Dividends 59

Chapter 14 Reinvesting Profits to Make Bigger Tax Savings 68

Part 4 **Salaries & Dividends: Practical Issues & Dangers** **75**

Chapter 15 How to Avoid the Minimum Wage Rules 76

Chapter 16 Is My Salary Tax Deductible? 78

Chapter 17 Paying Salaries & Dividends: Profits & Paperwork 80

Chapter 18 Dividends Taxed as Earnings 83

Chapter 19 Small Salary, Big Dividends: Potential Dangers 86

Chapter 20 Personal Service Companies 88

Chapter 21 Future Tax Changes 91

Part 5 **How Couples Can Save Tax** **95**

Chapter 22 Companies Owned by Couples 96

Chapter 23 Splitting Income: Practical Issues 107

Part 6 **Controlling Your Tax Bill** **117**

Chapter 24 Company Owners Can Control Their Income Tax Bills 118

Chapter 25 Using a Company to Protect Your Child Benefit 121

Contents (cont...)

Chapter 26 Business Owners with Income From Other Sources 127

Chapter 27 How to Pay Less CGT by Postponing Dividends 133

Part 7 **Using a Company: More Tax Benefits & Drawbacks** **135**

Chapter 28 Pension Contributions 136

Chapter 29 Tax-Free Interest 139

Chapter 30 Losses 142

Chapter 31 Cash Accounting 145

Chapter 32 Motoring Costs 147

Chapter 33 Selling Your Business 151

Chapter 34 Business Property 158

Chapter 35 Borrowing Money 162

Part 8 **Incorporating & Disincorporating an Existing Business** **165**

Chapter 36 Incorporating an Existing Business 166

Chapter 37 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 £45,000 pay 42% income tax and national insurance. Those with income over £150,000 pay 47% tax.

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 6th 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 £45,000, £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 March 2017 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.

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.

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