Incorporation

Business tax

Factsheet

rouse
Chartered Accountants

Incorporation

The issue of whether to run your business as a company or a sole trade or partnership is an important decision. In this factsheet, we summarise the relevant tax changes which apply and show the potential tax savings currently available from operating as a company.

If you would like to discuss how we can assist you, please contact us on 01494 675321 or by email at info@rousepartners.co.uk

Changes to the taxation of dividends

Significant changes to the taxation of dividends took place for dividends received from April 2016. Our calculations show that incorporation may still result in lower tax bills than remaining unincorporated but the tax savings are significantly reduced from prior years.

The rules for the taxation of dividends

From 6 April 2016:

- The 10% dividend tax credit was abolished with the result that the cash dividend received is the gross amount potentially subject to tax.
- The rates of tax on dividend income are 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.
- A new Dividend Tax Allowance removes the first £5,000 of dividends received in a tax year from taxation. The Dividend Tax Allowance is to be reduced to £2,000 from 6 April 2018.

Is trading as a limited company still be the best option?

If you trade as a limited company you may think that to trade as a sole trader or as a partnership may now be a better option. In our view there is still a benefit in tax terms for most individuals to continue to trade as a limited company as there is still an annual tax saving.

Will it be better to take a dividend rather than an increase in salary?

In our view there is still a benefit for a director -shareholder to take a dividend rather than a salary. The amount of the tax saved will be less than under the previous rules but is still beneficial.

Tax savings

The examples below give an indication of the 2017/18 tax savings that may be achievable for husband and wife who are currently in partnership.

Example

Profits	£30,000	£50,000	£100,000
Tax and NI payable:	£	£	£
As partners	2,750	8,550	23,998
As company	2,499	7,499	20,037
Potential savings	251	1,051	3,961

The extent of the savings is dependent on the precise circumstances of the couple's tax position and may be more or less than the above figures. The examples are computed on the basis that the couple:

- share profits equally
- have no other sources of income
- both partners take a salary of £8,164 from the company with the balance (after corporation tax) paid out as a dividend.

When might a company be considered?

A company can be used as a vehicle for:

- a profitable trade
- buy-to-let properties.

Summary of relevant tax and national insurance rates 2018/19

Rate of corporation tax

Profits are taxed at 19%.

Taxation of dividends

The cash dividend received is the gross amount potentially subject to tax.

The rates of tax on dividend income are 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

A Dividend Tax Allowance taxes the first £2,000 of dividends received in a tax year at 0%.

National Insurance

The rate of employees' NIC is 12%. In addition, a 2% charge applies to all earnings over the NIC upper earnings limit (£46,350 for 2018/19). The rate of NIC for the self-employed is 9%, and 2% on profits above £46,350 for 2018/19.

All NI contributions can be avoided by incorporating, taking a small salary up to the threshold at which NI is payable and then taking the balance of post-tax profits as dividends.

Pension provision

As an employee/ director of the company, it should be possible for the company to make pension contributions (subject to limits) to a registered fund irrespective of the salary level, provided it is justifiable under the wholly and exclusively rule.

For further details of the tax position of pension provision for individuals see the factsheet on Pensions - Tax Reliefs. Such contributions are deemed to be a private expense for sole traders or partners.

Other tax issues

In addition we consider other relevant factors including potential disadvantages. It is all too easy to focus exclusively on the potential annual tax savings available by operating as a company. However, other tax issues can be equally, and in some cases more significant and should not be underestimated.

Capital gains

Incorporating your existing business will involve transferring at least some of your assets (most significantly goodwill) from your sole trade or partnership into your new company. The transfer of goodwill may create a significant capital gain although there is a mechanism for deferring the gain until any later sale of the company if the business is transferred in exchange for shares in the company.

Changes to relief for goodwill

Generally where goodwill was sold to the company for cash or debt on or after 3 December 2014, individuals are prevented from claiming Entrepreneurs' Relief (ER) and capital gains tax arises on the gain. The exceptions to this rule are that a claim to ER is allowed:

- for partners in a firm who do not hold or acquire any stake in the successor company
- where the individual claiming relief holds less than 5% of the shares and the voting power of the acquiring company
- where an individual holds 5% or more of the shares or voting power if the transfer of the business to the company is part of arrangements for the company to be sold to a new, independent owner.

Stamp Duty Land Tax (SDLT)

There may be SDLT charges to consider when assets are transferred to a company. Goodwill and debtors do not give rise to a charge, but land and buildings may do so.

Income tax

The precise effects of ceasing business in an unincorporated form, including 'overlap relief' need to be considered.

Capital allowances

Once again the position needs to be carefully considered.

Other advantages

There may be other non-tax advantages of incorporation and these are summarised below.

Limited liability

A company normally provides limited liability. If a shareholder's shares are fully paid he cannot normally be required to invest any more in the company. However, banks often require personal guarantees from the directors for borrowings. The advantage of limited liability will generally apply in respect of liabilities to other creditors.

Legal continuity

A company will enjoy legal continuity as it is a legal entity in its own right, separate from its owners (the shareholders). It can own property, sue and be sued.

Transfer of ownership

Effective ownership of the business may be more readily transferred, in comparison to a business which is not trading as a limited company.

Borrowing

Normally a bank is able to take extra security by means of a 'floating charge' over the assets of the company and this will increase the extent to which monies may be borrowed against the assets of the business.

Credibility

The existence of corporate status is sometimes deemed to add to the credibility or commercial respectability of the business.
Pension schemes

The company could establish an approved pension scheme which may provide greater benefits than self-employed schemes.

Staff incentives

Employees may, with adequate safeguards, be offered an opportunity to acquire an interest in the business, reflecting their position in the company.

Disadvantages

No analysis of the position would be complete without highlighting potential disadvantages.

Administration

The annual compliance requirements for a company in terms of administration and accounting tend to result in costs being higher for a company than for a sole trader or partnership. Annual accounts need to be prepared in a format dictated by the Companies Act and, in certain circumstances, the accounts need to be audited by a registered auditor.

Details of the directors and shareholders are filed on the public register held by the Registrar of Companies.

Privacy

The annual accounts have to be made available on public record - although these can be modified to minimise the information disclosed.

PAYE/Benefits

If you do not have any employees at present, you do not have to be concerned with PAYE and returns of benefits forms (P11Ds). As a company, you will need to complete PAYE records for salary payments and submit details of salary payments on a timely basis under PAYE Real Time Information. You will also need to keep records of expenses reimbursed to you by the company. Forms P11D may have to be completed.

Dividends

If you will require regular payments from your company, we will need to set up a system for you to correctly pay dividends.

Transactions with the business owner

A business owner may introduce funds to and withdraw funds from an unincorporated business without tax implications. When a company is involved there may be tax implications on these transactions.

Director's responsibilities

A company director may be at risk of criminal or civil penalty proceedings eg for late filing of accounts or for breaking the insolvency rules.

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It's the old adage that all accountants are the same, but ask yourself this; what kind of service would most add value to your personal or business position? In our opinion, the quality of advice and service is what separates a good accountant from a great one. This is where Rouse Partners can make a difference for you.

Our award-winning team make it their business to get to know you and your specific needs. Whether your goal is to grow your business, increase your personal wealth or improve your work-life balance, by understanding your challenges, we will address them together.

We also know how important it is for you to have a team that you can rely on for timely advice and reassurance. At Rouse, our people are our most important asset and we will select team members who offer an optimum mix of experience, specialism and knowhow. From your Partner, to your Tax Advisor, each team member will be accessible to you or your team and be proactive in seeking solutions.

At the heart of our way of working is a determination to think differently, to challenge the 'status quo' and to ask 'what if?'. Whether you are facing a complex tax, accounting or management situation, we are ready to find a solution.

Contact us today to discuss how we can support your personal or business tax needs:

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