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PERSONAL COMPANIES – TIPS AND TRAPS

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- Tax-Efficient Ways to Extract Cash from Your Company;
- IR35 – Tax Tips for Contractors;
- Tax-Efficient Business Exit Strategies;
- Cash Basis for Landlords;
- Directors' Loan Accounts Explained;*
- Dividend Tax Saving Strategies Explained;
- Remuneration Strategies in a Recession;
- How to Maximise Deductions for Business Expenses;*
- Tax-Efficient Profit Extraction for Companies;*
- Tax Planning for Family Companies;*
- Property Company v Property Trust;*
- Tax-Efficient Ways to Grow a Property Portfolio;*
- Exit and Succession Tax Planning for Businesses;*
- 101 Business Tax Tips;*
- 101 Practical Tax Tips;* *and*
- 101 Employer and Employee Tax Tips.*

The guides marked with an asterisk are available for purchase from Taxinsider.co.uk.

About this guide

This guide looks at some of the tax issues of particular relevance to personal service companies, both from the perspective of the company itself and from the personal perspective of the director/shareholder. It looks at the tax position of both the company and the personal tax position of the director in respect of profits extracted from the company and highlights both tips and traps.

As far as the company's tax position is concerned, it explains the corporation tax charge on the company and outlines some tax planning strategies to minimise that charge in a legitimate fashion. It also explains how the company can obtain relief for any losses that it makes.

The guide also considers the role of the personal company as an employer and sets out the company's obligations in this role.

Where profits are made by a personal company, those profits must be extracted if they are to be used personally by the director/shareholder. The guide looks at various ways in which profits can be extracted from a personal company and the associated tax and National Insurance implications for both the company and the director. The guide suggests a strategy for the tax-efficient extraction of profits and highlights other ways in which profits can be extracted.

The director will usually have an account with the company – the director's account. The guide explains the consequences for the director and the company if the loan account is overdrawn at the end of the accounting period and beyond, and also what to consider if the account is in credit.

Where a business is operated through a personal service company, the IR35 and off-payroll working rules must be considered. The guide explains where they bite and the consequences if they do.

Finally, the guide takes a look at what happens when the owner wishes to retire, highlighting some valuable reliefs that are available if the business is passed on to the next generation, or sold.

1 Nature of a personal company

1.1 What is a personal company?

There is no single definition of a personal company, but for the purposes of this report the focus is on a company where an individual is the sole director/shareholder. The company may or may not be a personal service company, which is one where an individual provides their services to a third party through a company.

It should be noted, however, that for certain tax purposes, such as business asset disposal relief, the definition of a personal company is much wider and is met where an individual has at least 5% of both the shares and the voting rights and is entitled to either 5% of the profits available for distribution and assets on winding-up or 5% of the sale proceeds if the company is sold. A family company may be a personal company for these purposes.

A personal company may be set up from the outset, or an individual may decide to incorporate their sole trader business.

In the past, it was advantageous from a tax perspective to operate a business through a limited company. These tax advantages triggered a wave of tax-geared incorporations. However, these tax advantages have been eroded in recent years as a result of rising dividend tax rates, higher corporation tax and higher employer's National Insurance. However, there are many tax reasons why a business may prefer to operate through a limited company, including limited liability, which means that the owners are responsible for business debts only to the value of their financial investment. This can provide protection if things go wrong.

This report does not look at whether incorporation is beneficial. Rather, it considers the tips and traps of running a business as a personal company.

1.2 Succession planning

No one knows when they are going to die. It is therefore important to have a plan in place as to what will happen to the business should the business owner die. Planning ahead is also important to mitigate inheritance tax liabilities and to take advantage of available reliefs. On death, the business or business assets could be passed on to family members or sold and the sale proceeds distributed to the beneficiaries of the will.

It is important to make a will as in the absence of a will the intestacy provisions will apply and these will not necessarily provide the best result.

When putting a succession strategy in place, it is important to take professional advice.

Tip

Before setting up a company, check that this is the best structure for your business.

1.2 A separate legal entity

A company is a separate legal entity from the people who own and run it. Consequently, the company will be required to pay corporation tax on its profits and also on any capital gains that it makes. The company's corporation tax position is considered in **section 2**.

It may also need to register for VAT if its turnover exceeds the VAT registration threshold, or if it is beneficial to register voluntarily. This is considered in **section 2**.

If the directors and shareholders wish to use the profits made by the company for personal use, they will need to extract those profits. There are various ways of doing this and the tax and National Insurance implications for both the director/shareholder personally and for the company will depend on the route taken. This is explored further in **section 6**.

The company will also have legal and financial responsibilities which must be met.

1.3 Directors' responsibilities

Before setting up a limited company, it is important to understand your responsibilities as a director.

A director is responsible for keeping company and accounting records, checking the information held by Companies House is correct, filing an annual confirmation statement and filing company accounts and company tax returns.

Although a director can hire other people to fulfil these roles, such as an accountant to file the company tax returns and company accounts, the ultimate responsibility remains with the director.

Tip

Check that you understand what being a company director entails and that you are aware of your legal responsibilities.

Trap

Companies House may take action to strike off a company if company accounts and the confirmation statement are not filed. It is important to be aware of the deadlines and not to ignore letters from Companies House.

1.4 Setting up a company

In order to operate the business as a personal company, the company must first be set up.

The individual will need to decide on a name for their company and whether they are to be the only director/shareholder. They will also need to decide on what type of shares they will have and how many.

There are various routes that can be taken when setting up a company. The individual can use the services of a third party, such as a formation agent, an accountant or a lawyer, to set the company up for them. If the individual has not set up a company before and does not have experience in this area, this may be the preferred option; while this will be more expensive than setting up the company themselves, any associated advice that they receive may be invaluable.

Alternatively, the individual can set up the company themselves. This can be done on the Gov.uk website at www.gov.uk/limited-company-formation/register-your-company. A company can be registered online if it is limited by shares and it uses the standard articles of association (also known as the 'model articles'). This service costs £100 and the company is normally registered within 24 hours.

When registering a company, the director will need to verify their identity and provide the Companies House personal code. They will also need to confirm persons with significant control. These are people who hold more than 25% of the shares or voting rights.

The same service can be used to register the company for corporation tax and to register for PAYE.

Tip

Registering a company online is quick and easy and cheaper than using a third party such as an accountant or formation agent.

It is also possible to register a company by post using form IN01. The stated timescale for postal applications is eight to ten days, and the service costs £124. You must use the postal route if you do not want 'limited' in the company name.

Once a company has been registered, a certificate of incorporation will be issued. This confirms the company's legal existence and shows the company's name, company number and date of formation.

1.5 Incorporating an existing business

An individual may already be operating a business as a sole trader and decide that the time has come to incorporate that business. To do this it is necessary to set up a new company and transfer the existing business to that company.

The assets may be sold to the limited company, and this may give rise to a capital gains tax liability. Alternatively, the assets may be transferred in exchange for shares in the new company, in which case incorporation relief may be available.

Where plant and machinery are transferred to the new company, there may be capital allowances to consider.

If the sole trader is registered for VAT, there will also be VAT considerations.