Heaton Lumb Lisle

FACT SHEET NO. 32 **TAX SAVINGS OF INCORPORATION** **6TH APRIL 2008**

For some years it has been beneficial for Sole Traders and Partnerships to operate their businesses through a Limited Company. Although changes announced in recent budgets, and most recently in 2007, have reduced the benefits slightly it remains the case that substantial tax savings can be made by operating a business through a Limited Company.

With profits being withdrawn from the Company partly by way of salary and partly by way of dividend the following tax and national insurance savings are possible :-

Note: These savings are based on the 2008/2009 tax rates and allowances.

	Tax & NIC Paid as Sole Trader	**Tax & NIC Paid as Limited Company**	**Annual Saving** **
Profits of £15,000	£2,678	£2,008	£670
Profits of £25,000	£5,478	£4,108	£1,370
Profits of £35,000	£8,278	£6,208	£2,070
Profits of £45,000	£11,575	£8,309	£3,266
Profits of £55,000	£15,675	£12,096	£3,579

** Whereas these are the optimum savings achievable it might be advisable to pay a small amount of National Insurance and thereby reducing these savings by approx. £100 pa.

At profits in excess of £25-£30,000 there are significant advantages of operating through a Limited Company.

In circumstances where the trader has profits in excess of £45,000 it should be possible to obtain further tax savings by allocating shares to his or her spouse and, in addition, any profits retained in the business will be sheltered to tax at 20% instead of 40%.

There are however additional costs associated with operating through a Limited Company :-

- One off cost of acquiring the Company £450 plus VAT
- One off additional cost of dealing with the transfer of the business £1,000 plus VAT
- Estimated additional annual accountancy costs £1,250 plus VAT

These figures are approximate. The actual costs will depend upon the nature and extent of the business concerned.

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In view of these costs it is not advantageous to incorporate unless profits are in excess of £25,000. Other issues that need to be considered when operating through a Limited Company:-

- A Limited Company is less flexible. Specific action needs to be taken before profits can be withdrawn whereas a Sole Trader can simply write out a cheque from the business Bank account.

- In commercial 'Partnership' arrangements it is far easier to dissolve a Partnership and for each Partner to go their own way than with a Limited Company.

- It is possible that yet further legislation will be introduced in the future that will make Limited Companies less beneficial.

- Tax changes have already been announced that will marginally reduce the tax savings in successive years from 2008.

- Some financial information will be lodged at Companies House and be on public record.

- The taxation treatment of Company cars is less beneficial within a Limited Company. In practice the individual would be responsible for paying all the running expenses and costs of the car and a claim for business journeys would then be made from the Company at the rate of 40p per mile for the first 10,000 miles per annum and thereafter at the rate of 25p per mile.

- Full Entrepreneurs Relief will not be available for 12 months from the date that the Company starts to trade and, therefore, if a sale of the business is likely within this period care needs to be taken when considering incorporation.

- It might prove more difficult to sell a Limited Company than a Sole Trader/Partnership.

- Limited Companies in the construction industry who suffer deduction of tax under the CIS system are able to recover that tax by deducting it from their own PAYE or CIS liabilities and, therefore, receive credit earlier than sole traders or partnerships.

- Any existing hire purchase or lease contracts will need to be transferred to the limited company which, on occasions, might not be possible. This also applies to Mobile Phone contracts.

- Business bank overdrafts and loan accounts will need to be re-negotiated.

- Some Building Societies do not recognise income derived from a limited company for mortgage purposes.

Further tax savings can be achieved by transferring some shares into the name of a lower rate tax paying spouse. However, the Inland Revenue have announced that from April 2009 they will seek to disallow any tax advantage gained where shares are held by a non-contributing spouse and the Company has a limited asset base. Care needs to be taken here.

IF YOU REQUIRE ANY FURTHER INFORMATION OR WOULD LIKE TO CONSIDER INCORPORATION PLEASE CONTACT US.