

# Incorporating a Company

what you need to know

# About this Guide

This guide has been produced by Sean Toomer, Founder of Diverso, a firm of accountants, taxation advisors and business consultants based in Hampshire, for their clients, associates and business contacts. It should be used as a guide to learn more about the advantages, disadvantages and other information about incorporating a Limited Company. Diverso, its employees or Sean Toomer is not liable for any adverse effects caused by action taken from any of the advice, strategies, systems or processes recommended within this guide. We recommend you seek the guidance of a professional.

## First things first.....

You've downloaded this guide for one of the following reasons:

- ▶ You've been trading in business as a Sole Trader or Partnership for some time and are considering trading as a Limited Company
- ▶ You're just plain curious
- ▶ You're just starting in business and are deciding which business structure to choose

If the last reason is you, we recommend you check out our guide: Starting a business, which you can download for free from our website. We say this as there may be some things, important things, which you have not thought about before starting your business. This guide will help you make sure you know everything you need to know about starting a business, from choosing the right business structure for you, to how much you should pay yourself.

# Let's begin.....

## What is a Limited Company?

A Limited Company is simply a type of business entity. There are two types. The first (which we will be talking about) is a Private Limited Company (Ltd). The second is a Public Limited Company (Plc). The main difference being that a Plc can trade it's shares on the stock market.

In this guide, we will be focusing on the most popular, Private Limited Company (Ltd).

There are around 1.15 million limited companies operating in the UK, compared to around 2.8 million sole traders and 500,000 partnerships.

As a brief introduction to a Limited Company, here are some points to better explain what a limited company is and we will talk about them in more detail later:

- ▶ Under a limited company structure, your company and personal finances are kept separate
- ▶ A limited company is a completely separate legal entity to its owners
- ▶ A limited company is owned by its shareholders
- ▶ Limited companies are subject to corporation tax on their profits
- ▶ Limited companies have directors, who are responsible for the day to day running of the company
- ▶ A director can also be a shareholder
- ▶ Limited company directors and shareholders have more legal, financial and administrative responsibility than sole traders and partnerships
- ▶ If things go wrong and a limited company fails, it's owners and directors liability is limited only to the amount of shares invested; they have limited liability
- ▶ A private limited company cannot offer its shares on the stock market
- ▶ Limited companies are registered with Companies House
- ▶ Limited companies are required to produce two sets of statutory accounts; Full Accounts and Abbreviated Accounts, as well as submitting an Annual Return
- ▶ As the owner of a limited company, you are still required to submit a personal tax return each year

## Positions

Let's start looking at the positions involved in a limited company, who is best to fill them and what their responsibilities are.

### Shareholder

The share holders of a limited company are simply the owners of the business. This could be one person owning a single £1 share, it could be a husband and wife owning one £1 share each or it could be 50 different individual entities (including other limited companies) owning differing amounts each. The shareholders collectively own the company and are also known as the 'members'.

The shareholders have a number of rights within the limited company:

- ▶ The right to vote
- ▶ The right to propose resolutions
- ▶ The right to share in a distribution of the company's income (dividend)

- ▶ The right to purchase new shares in the company
- ▶ The right to the company's assets during liquidation

However, shareholders rights to the company's assets are subordinate to the rights of the company's creditors. This means that if the company goes bust, everything that the company owes will be paid first, leaving the shareholders with whatever is left (if anything).

## Director

A director's job is to oversee the company's day to day activities. The directors are chosen by the shareholders and are bound by a set of bylaws which states that the directors should act in the best interests of the shareholders.

In most small limited companies, the director(s) and shareholder(s) are the same person.

It is the responsibility of the director(s) to ensure the company keeps up to date and proper accounting records and ensures that the company delivers annual accounts to Companies House and HM Revenue & Customs.

A limited company can have any number of directors from a minimum of 1.

## Company Secretary

The company secretary is responsible for the efficient administration of a company, particularly with regard to ensuring compliance with statutory and regulatory requirements is met.

As from September 2009, it is no longer a legal requirement for a limited company to have a company secretary.

## Day to day stuff

Generally speaking, a limited company has more legislation and regulations to stick to. This can change the way some businesses operate, on a daily basis. In reality, not a lot changes, but here's what is legally required of a limited company:

- ▶ The Registered number and registered office must be shown on the company's headed paper (Just like a VAT number)
- ▶ The registered number & address must be shown on all electronic communication (including e-mail & website)
- ▶ If you are a sole director, the way you take money out of the company may change slightly (see 'How to pay yourself')

## The legal bits

This is where the more admin bit comes in. As a limited company, there is more you need to do annually, compared to a sole trader.

## Annual Accounts

Limited companies need to produce a set of annual accounts. Sole traders & partnerships need to do this too, I know, but they are not under any legislation obliged to submit those accounts to anyone (they are solely for tax calculation purposes). A limited company is required to submit its full annual accounts to HM Revenue & Customs at the end of each financial year. What's more, those accounts are now governed by a completely different set of rules and regulations which means the accounts, as a document, more than doubles in size. In reality, this means more work for your accountant!

## Abbreviated Accounts

These are not to be confused with annual accounts. The abbreviated accounts are really only produced to submit to Companies House which is an annual legal requirement.

Abbreviated accounts are just that, abbreviated; a smaller compact version of the full accounts, if you like, which does not show the performance of the company for the year (meaning profit & loss), only the company's balance sheet.

They are available to the public through the Companies House website.

## CT600

The CT600, in normal people language is the corporation tax return. This is produced using the full accounts and shows how much tax the limited company has to pay.

## Confirmation Statement

The confirmation statement is a report of the company's shareholders. It's required for a limited company to report any changes in its shareholding, shareholders address, company registered office etc to Companies House each year.

This is not and probably won't be all the reporting requirements for a limited company. As a limited company there are a lot more rules and regulations to stick to, which means more forms and paperwork depending on circumstances. The above four are the minimum that is required.

Please note, that on top of this, the directors are still responsible for submitting a personal tax return each year.

# Good & bad bits

If so far, reading this guide is the first time you've learnt more about a limited company, you may want to run away! See the next page for the advantages and disadvantages of trading through a limited company,

## Advantages

### Limited Liability

Should the worst happen, and the company owes money, the shareholders are only liable to pay the amount up to their shares. So, for example, if a shareholder has a £1 share, he would only have to pay £1 as his liability is limited to his investment in the company.

### Tax Savings

Depending on profit levels, it's likely that it could be much more tax efficient to trade as a limited company, in comparison to a sole trader. To show this, have a look at the table below:

| Profit<br>£ | Sole Trader net after tax<br>£ | Company Owner net after<br>tax<br>£ |
|-------------|--------------------------------|-------------------------------------|
| 20,000      | 17,087                         | 17,67                               |
| 25,000      | 20,637                         | 21,404                              |
| 30,000      | 24,187                         | 25,150                              |
| 35,000      | 27,737                         | 28,896                              |
| 40,000      | 31,287                         | 32,642                              |
| 45,000      | 34,837                         | 36,389                              |
| 50,000      | 37,737                         | 40,135                              |
| 60,000      | 43,537                         | 46,340                              |
| 70,000      | 49,337                         | 51,807                              |

It's more tax efficient because for income above £40k and above sole traders are taxed at a much higher rate of tax. Companies on the other hand are taxed at a rate of 20% (small companies rate). Where you really start to see the difference is when you start to evaluate how you are going to pay yourself as a director/shareholder (see later chapter – 'how to pay yourself').

### Credibility

With limited company status, comes added credibility. A limited company is seen as a much more stable structure than a sole trader, so you'll start to notice better relationships with suppliers, customers and other stakeholders.

## Borrowing Potential

Banks & investors see limited companies in a whole different light than sole traders. This is due to the added security of limited liability and a more stable structure, meaning it's much more likely to attain investment or raise capital.

## Protection of your business name

When you register a limited company, you also register the name. With this registration comes protection that no one else can register a business in that name, whilst you hold it.

## Business Continuity

In a sole tradership, if the owner dies (touch wood!) so does the business. However, in a limited company the business will have continuity as the business will pass on without the owner.

# Disadvantages

## Accountancy fees cost

Most accountants would charge more to look after a Limited Company – we don't.

## Complexity

As we said before, with a limited company comes more rules and regulations to stick too. But, with a great accountant who can talk normal people language – this won't be a problem for you!

## Company information available

Certain information is available to download by anyone from the Companies House registrar. This included the company address, information on when the accounts are due and the previous submitted abbreviated accounts.

# How to pay yourself

From a day to day perspective, there won't really be any change in how you pay yourself. We recommend you withdraw out of the company as and when you need to (assuming you keep strict financial controls).

Then, at the company's year end, we will decide how best to pay you by a mixture of dividends and a salary.

The reason for this is that as an individual, you have a tax free allowance of £6,475 per year, which if you don't use, you lose. A salary of this amount is a good way to use this allowance.

The rest of your income will probably be taken as dividends. This is because dividends have a lower rate of tax of just 10% (compared to 20% for a salary/sole trader income) and a higher rate of 32.5% (compared to 40% for a salary/sole trader income).

# What to do now...

The good news for you is that the incorporation process is mostly done by us. Here is what is needed, step by step:

- ▶ Register the company
- ▶ Appoint Directors/shareholders
- ▶ Fix registered office address
- ▶ Open a limited company bank account
- ▶ Notify suppliers/customers/lenders/insurers etc
- ▶ Notify any staff of any change in structure
- ▶ Register with HMRC (PAYE, Corporation tax, VAT)
- ▶ De-register with HMRC for self employment
- ▶ Fix a date to commence trade as a limited company
- ▶ Complete final set of accounts for old business