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1 Introduction

There really is no correct answer to the question, “Should I trade as a limited company?”

The primary reason most small businesses choose to go limited is because it can have significant financial benefits due to the fact that the tax treatment is much more efficient.

However, because of ever frequent tax changes it makes it even more important to give careful consideration to whether this is the right business vehicle for you.

It can also give a business an enhanced appearance in certain market places – customers may think a limited company has more gravitas and is more likely to be a ‘serious’ supplier than a sole trader or partnership.

Apart from the tax implications of becoming a limited company, there are certain other issues which you need to consider.

For example, you need to think about how quickly you expect to grow your business. The more profits you make, the more beneficial it will be for you to trade as a limited company.

You also need to take into account your personal preferences. Just because everyone else is doing it doesn’t mean it’s right for you!

A couple of myths:

> Contrary to popular opinion, there is no limit to the turnover you can make and still remain a sole trader or partnership!
>
> Just because you’re a limited company doesn’t mean you have to have an ‘audit’ – you won’t need an audit until you meet certain criteria – in practice this means you’re not likely to need an audit until your sales are at least £10.2m (as at 2021).

1.1 Advantages of trading as a limited company

1.1.1 Tax savings

A common reason for becoming a limited company is the tax benefits. How much these tax benefits amount to depend on your profits, but let's take the following example (based on 2022/23 tax rates):

Annual Profits	£50,270
Self Employed	
Tax Payable	£7,540
National Insurance	£4,304
Total Payable	£11,844
Net Spendable Personal Income	£38,426
Limited Company	
Company Tax Payable	£7,674
Dividend Tax Payable	£2,452
Total Payable	£10,126
Net Spendable Personal Income	£40,144
Saving	
Saved By Registering As A Limited Company	**£1,717**

Whilst there are still tax savings to be made if you trade as a limited company these are less attractive due to the introduction of the new dividend tax. However, from a tax perspective, trading as a limited company does provide you with the ability to manage your tax liabilities more effectively.

If you'd like to know exactly how much you could save by going limited, just get in touch and we'll run the numbers for you.

However before you decide whether or not this is the option to take, make sure you take a look at section 1.2 - Disadvantages of trading as a limited company.

1.1.2 Separate legal entity

Because the company is a separate legal entity it can sue and be sued in its own right.

Therefore, if you believe there is a reasonable chance of being sued then it may make sense to trade as a limited company.

For example, many magazines will trade as a limited company because they may be at risk of being sued over inflammatory or derogatory remarks – this is why 'Private Eye' magazine is published by a limited company!!

1.1.3 Shareholders

Most limited companies are limited by shares and the shareholders own the company.

Shareholders usually have a right to a dividend (a distribution of a company's post-tax earnings), can vote on key issues (depending on the class of share capital they own – see section 5) and will share in the distribution of any cash left in the company if it's wound up (closed down) or made insolvent (after all creditors have been paid).

Shareholders rights will be listed in the articles of association. All companies are required to have articles of association which set out how the company is run, governed and owned. In practice, most small companies adopt the standard default articles from Companies House.

Shareholders then appoint directors to run the company. For most small businesses, the shareholders and directors are the same people. However shareholders and directors have very different roles – you can see more about what these are in section 2.

1.1.4 Limited liability

Most limited companies are limited by shares. The shareholders' liability is limited to the amount of issued share capital they hold.

If the company was to become insolvent whilst owing significant amounts of money, the creditors could not require the shareholders to provide any further funds towards paying off those debts.

However, beware. As noted in section 1.1.5, a lot of lenders (banks for example) will require the directors or shareholders to give a personal guarantee when obtaining finance. This means that the lender can still go after the directors and shareholders personally should the company go bankrupt.

1.1.5 Bank loans and overdraft

In some instances, it can be easier to obtain finance as a limited company because the bank can obtain what is known as a "floating charge" over the assets owned by the company. This gives the bank extra security and gives the company greater borrowing power.

1.1.6 Transfer of ownership

Effective ownership of a company can be readily transferred (subject to the articles of association) by selling the shares in the company. However do give due consideration to the capital gains tax and inheritance tax implications before undertaking such a transaction.

1.1.7 Planning for retirement

Trading through a limited company offers a greater degree of flexibility when it comes to your pension provision.

Where the company has set up a scheme registered with HMRC some of the advantages are as follows:-

1) Any pension contribution paid by your company reduces its taxable business profits providing they are made wholly and exclusively for the purposes of the company's business – for example part of a company director's specified remuneration package.

2) The pension contributions paid by your company are not treated as a taxable benefit nor do they count as your earnings for NIC purposes.

3) The investment income and capital gains of the company pension scheme are not taxed.

4) A tax-free lump can be paid to you on retirement.

Further detailed advice on company pension schemes is outside the scope of this guide however, we would strongly recommend you seek the advice of a suitably qualified professional when setting up a pension scheme.

1.1.8 Perception

Rightly or wrongly, a limited company can often be perceived as a more 'established' or 'bona fide' business.

1.2 Disadvantages of trading as a limited company

Whilst a lot of time is spent talking about the benefits of trading as a limited company, it's important to remember that there are some significant downsides as well.

1.2.1 Losses

Because the company is considered to be a separate legal entity, any losses made by the company can only be set off against any profits made by the company in prior years or any profits which the company may make in future years.

This may be a great disadvantage - especially in the early years of the business when the likelihood of losses is high.

In direct contrast the losses made by a partnership or sole trader in opening years may be offset against other income in prior years (subject to certain rules).

Let's take an example:

> You've been in a job for the past few years where you've been paying tax at 40%.
>
> You decide to leave and set up your own business. In your first year of trading you make losses of £20k.
>
> If you were trading as a sole trader, you could take those losses and set them off against your income in the prior year – entitling you to a tax refund of up to £8k (40%).
>
> However, if you were trading as a limited company, you'd only be able to carry those losses forward to set off against future company profits.

Think this sounds far-fetched? Well, we've seen many clients over the years in just that position – and all because 'their friend' told them they should trade as a limited company!

So if you're just starting out in business, make sure you get the right advice for which trading vehicle is best for you – otherwise it could literally cost you thousands of pounds.

1.2.2 Personal guarantees

Whilst finance may be easier to obtain as a limited company, banks may (and quite frequently do) require directors to give personal guarantees that they will repay any borrowings should the company become insolvent.

Some suppliers may also require personal guarantees and so this may reduce directors' limited liability significantly.

1.2.3 Visibility of results

Because a company's Statutory Accounts are required by law to be filed at Companies House, then the company's results are freely available to the public (and your competitors).

Companies who are defined as small (broadly those with a turnover less than £10.2m as at 2022) can file abbreviated annual accounts. These accounts do not include any profit and loss information but will still have the balance sheet included.

You may also find that you need to pay your accountant an additional fee to produce abbreviated accounts for you.

1.2.4 Withdrawing funds

It's important to remember that the company's money and your money are completely separate – something which a lot of limited company owners forget!

And there's a nasty tax charge lurking if you don't make sure that you do things correctly.

However if you're a sole trader or partnership, you can generally introduce or withdraw cash from the business without any tax implications.

1.2.5 Expenses

When you are director of a company you can only claim tax relief on expenses which are incurred wholly, exclusively and necessarily in the performance of your duties as a director.

However, if you're a sole trader or partner the expenditure only has to be incurred wholly and exclusively in your role as sole trader or partner. This is a difference which can sometimes catch business owners out.

1.2.6 Administration

Running a company involves a lot more administration then being a sole trader or running a partnership

For example, a limited company is required to file annual returns with Companies House and must produce dividend tax vouchers and minutes for any dividends paid.

A company's accounts must also be in a format which is prescribed by the Companies Act 2006 (unlike sole trader accounts which can be set out in any format). These accounts are then known as 'Statutory Accounts'.

Many of these requirements will incur penalties if they are not dealt with on time - and the directors are at risk of prosecution if they don't fulfil their statutory obligations correctly.

However, a suitably qualified accountant can help you with all of your statutory obligations making sure you don't incur any penalties.

And whilst the additional administration required means additional costs, these can often be more than offset by the tax savings gained by trading as a limited company – but make sure you get advice as to what these might be!

2 Running a limited company

Whilst a company is owned by its shareholders, the job of running it rests with the directors.

The details below give an overview as to the issues involved in running a limited company.

2.1 Directors' responsibilities

As a director of a limited company, the law says you must:

- try to make the company a success, using your skills, experience and judgment
- follow the company's rules, shown in its articles of association
- make decisions for the benefit of the company, not yourself
- tell other shareholders if you might personally benefit from a transaction the company makes
- keep company records and report changes to Companies House and HM Revenue and Customs (HMRC)
- make sure the company's accounts are a 'true and fair view' of the business finances
- register for Self-Assessment and send a personal Self-Assessment tax return every year

You can hire other people to manage some of these things day-to-day (eg an accountant) but you're still legally responsible for your company's records, accounts and performance.

You may be personally liable for your company's business liabilities and be fined, prosecuted or disqualified as a company director if you don't follow the rules.

2.2 Shareholders agreement

Whilst it's not a legal requirement, it's a very good idea to have a shareholders agreement in place. This covers a number of 'what if' scenarios eg what if a shareholder wants to sell their shares and what if there's a dispute between shareholders.

You may not believe this is necessary due to the close relationship you have with other shareholders – but you'd be amazed how many difficult situations we've come across which could have been avoided with a simple agreement in place. And the effect on the company's performance can be catastrophic.

As a minimum we'd suggest your shareholders agreement should cover the following:

- Rights to appoint and remove directors.
- Terms to protect minority shareholders so that, for example, unanimous shareholder approval is required for certain company decisions.
- Restrictions on freedom to dispose of shares and, if other shareholders have pre-emption rights, at what valuation such transactions should take place. A minority stake in a company is usually powerless, so the value of the minority shares is correspondingly reduced. This can be over-ridden in favour of treating all shares as being of equal value, rather as if the company was publicly quoted.
- Restrictions on changing the nature of the business.
- Terms regulating the raising of capital to avoid diluting existing shareholdings.
- Dividend policy and entitlement. Note that a stated dividend policy may affect the value of the company's shares for tax purposes.
- Waiver of dividends. Certain shareholders may agree to waive dividends for an agreed period or permanently. Again this may have tax implications because it may entail a value shift from one shareholder to another.
- Limitations on directors' freedom of action, for example to invest in a new capital project or charge the company's assets.
- Business plan. Setting out the business plan in a shareholders' agreement may help to ensure that all shareholders have the same vision.
- How shareholder disputes should be resolved.

It's always best to get this sorted out **before** the problem arises!

2.3 Records

Records must normally be kept in support of the return for 6 years from the end of the accounting period. The penalty for non-compliance can be as much as £3,000 for each accounting period.

2.4 Signs, stationery and promotional material

2.4.1 Signs

You must display a sign showing your company name at your registered company address and wherever your business operates. If you're running your business from home, you don't need to display a sign there.

Example

If you're running 3 shops and an office that's not at your home, you must display a sign at each of them. The sign must be easy to read and to see at any time, not just when you're open.

2.4.2 Stationery and promotional material

You must include your company's name on all company documents, publicity and letters.

On business letters, order forms, invoices and websites, you must show:

- the company's registered number
- its registered office address
- where the company is registered (England and Wales, Scotland or Northern Ireland)
- the fact that it's a limited company (usually by spelling out the company's full name including 'Limited' or 'Ltd')

If you want to include directors' names, you must list all of them.

If you want to show your company's share capital (how much the shares were worth when you issued them), you must say how much is 'paid up' (owned by shareholders).