Dartnell Lynn Ltd
straight talking self assessment and small company tax

Limited Company or Sole Trader?

Sole Trader

As a sole trader you are the business. So it is just a case of what income you generate and how much it costs to secure that income. You take off one against the other and what's left you pay Tax and National Insurance Contributions on. Well nearly – You may need assets that you need to run the business with such as computers or a car or tools. The value of these assets can be written off against tax and there are some special rules for these. You can withdraw money for personal use whenever you want there is no separation of you and the business, you are the business.

You are the business. So you are responsible for everything. If you owe money you will have to pay it, even if that means selling your house. You are legally responsible personally for all debt and it is you where legal responsibility lies.

You are self-employed; you cannot be your own employee. You can however employee other people as a sole trader but you will have to operate a PAYE system. If you intend to employ people then the limited liability status of a limited company may become important.

You pay Class 2 & 4 National Insurance and Income Tax on the taxable profits of your business. Class 2 is paid monthly and Class 4 is based on your profits. Class 4 rates are set by the budget and the government sets a threshold of profits at which you pay Class 4 NI. Personal allowance and taxes apply to your taxable profit.

You can offset your trading losses against your other income. From 2013/14 there is a cap on the amount of relief that you may claim for losses and interest payments.

Your profit is held in your own personal bank account so you can take it out and spend it as you wish. You don't employee yourself so you don't run a wages cycle. You just have to pay the Inland Revenue the Tax and NI due on the profit you make.

Limited Company

The business is a separate legal entity. You are a Director of the company. So you will be become an employee. The company will sell it goods or services, purchase goods and have a set of expenses to secure those sales. You as an employee will be an expense to that company, a cost of the sale. The company will make a profit (hopefully) and the company will pay tax on the profit it makes (Corporation Tax). You as an employee will take home a salary.

You have invested in the company and so you are a shareholder; you hold all or a proportion of the company's share capital. If the company makes a profit you will be able to take that profit as personal income through a dividend payment. You will pay personal taxation on dividend payments as an individual tax payer. A Director is an office holder and therefore not automatically an employee. Directors do not necessarily have contracts of employment that bind you to employment law. So you don't necessary have to pay a Director a wage or if you do if can be less than the minimum wage. A Director might only take a dividend from the company based on the profits it makes.

The company pays corporation tax on its taxable profits. Company tax rates are lower than higher rates of Income Tax.

Employees and office holders are subject to PAYE and NICS on their earnings from employment and many benefits attract income tax too. If you pay yourself a salary you will need to submit RTI data monthly. Shareholders who are higher rate taxpayers will pay additional tax on dividend income.

The company can offset its trading losses against its other income, but not against your income as an individual.

You are taxed on any income withdrawn from the company. If it is a distribution it is taxed as a dividend. If it is earnings it is under PAYE and subject to NICs. Most employment benefits received by you or your family and household are taxable (subject to tax-free exceptions).

Limited Company or Sole Trader?

You are free to borrow from the business bank account; it is your bank account. If your business bank runs at an overdraft due to the amount of funds that you have withdrawn personally, tax relief on bank charges and interest will be proportionately restricted.

If the business fails you will be personally (or jointly with your partners) liable for its debts. You may go bankrupt.

There is no requirement that you prepare accounts for tax purposes. However you may find that it is difficult to keep on top of your business, collect debts and work out profits without keeping accounts. From 2013/14 you have the option of cash accounting or conventional accounting. There is no requirement for Sole Traders to file their accounts. You may need annual accounts to complete your personal tax return which includes a balance sheet section. Small businesses may use a very basic (three line) format for a business which trades below the VAT threshold. Your accounts are not submitted to HMRC unless you are subject to an investigation.

Your taxable profit under Self Assessment must be prepared in accordance with Generally Accepted Accounting Practices (GAAP) for tax purposes When the business or assets used in it are sold, you are personally taxed on any gain under the Capital Gains Tax (CGT) rules.

You can withdraw any amount of profits, but it is not classed as remuneration as you are not an employee. Paying a salary to a spouse or family members must be commercially justified to be allowable for tax purposes.

You can only have a Personal Pension.

A sole trader can claim capital allowances on a car, disallowing a proportion for private use. Low-emission cars can be tax efficient for family members on the payroll. There is no adjustment for fuel benefit for you as a sole trader; you merely disallow a proportion of your fuel costs in relation to private use.

A director may borrow from his own company. Limits are set by Companies Act 2006, but there are tax costs: The company will pay a tax charge of 25% if you borrow from the company and do not repay the loan within nine months of the year end. If the loan is interest-free there will be a tax charge for the director based on beneficial loan interest.

If the company fails, your liability is limited to the amount unpaid on your shares (if any) unless you have made a personal guarantee (which is often required by banks). As a director you can be held personally accountable if you continue trading when your company is insolvent and this causes financial loss to creditors. This could result in your personal bankruptcy.

You must prepare annual accounts under the provisions of the Companies Act; these can be abbreviated for filing with Companies House. HMRC require full accounts for Corporation Tax which must be submitted using its own or specialist software. Accounts must be prepared in accordance with accounting standards. From 1 April 2011 most companies must submit their accounts online in iXBRL.

Accountings events include 1) Companies House Annual Return 2) Companies House Annual Accounts 3) HMRC Corp Tax 4) HMRC Company Accounts 5) HMRC RTI and PAYE 6) HMRC VAT

When the business or the assets used in it are sold, there is a double tax charge on shareholders. The company pays corporation tax on any profit that it makes on disposal. The shareholders are taxed on the distribution of the proceeds. It may often be more efficient to sell the shares in a company, rather than its trade or business, or individual assets.

Company shares can be gifted. Providing you own more than 5% of a trading company, a disposal with gains of up to £10 million may qualify for CGT Entrepreneurs' Relief

There is no restriction on the size of your salary, but it is subject to PAYE and NICs. Paying a salary to a spouse or family members must be commercially justified to be allowable for tax purposes.

Limited Company or Sole Trader?

Alternatively a sole trade can apply AMAP (Authorised Mileage Approved Payments) as a cost against the business and charge for business use of their private car for each business journey made.

Mobile phones will be subject to private use so a tax add-back is expected on your tax return.

You can obtain capital allowances on a computer. An add back of allowances will apply if there is substantial private use.

You can only have a Personal Pension.

Tax-free benefits and incentives. These do not apply to the self-employed

You will be able to claim a deduction for mortgage interest, rates and light and heat, if you have an office at home.

A sole trader cannot charge himself rent.

If your contracts fall within the IR35 regime or the company is a managed service company PAYE and NICs will apply to income.

Company schemes may be far more generous in terms of benefits and limits than Personal Pension. A SIP or SAS, or an unapproved scheme may be used to hold assets used in the company and may have flexibility on borrowing multiples.

There are stakeholder pension arrangements for employees as a legal minimum.

The company obtains full capital allowances on cars, irrespective of any private use by employees. The car will have to be declared as a benefit in kind and this may be expensive to the Director or employee but this depends on list price and the CO2 emissions of the vehicle. Low-emission cars can be a tax break for family members on the payroll. It is not tax efficient to provide company car drivers with fuel for private use, Employers are permitted to reimburse company car drivers for business mileage but they must use special employer's advisory rates. The Director or employee can run their own car and the company can reimburse using HMRC's Authorised Mileage rates (AMAP). AMAP payments do not need to be declared less than 12,000 miles and are non-taxable. Mobile phones can be provided if the contract is in the company's name, tax free. Only one per household.

Providing you need to use one to perform your role your company can provide a computer without any tax consequences.

Tax-free benefits and incentives. Many different benefits and employment incentives can be provided free of tax (the company will obtain tax relief on the cost of providing these too) i.e. Subscriptions, working at home, tools and a few more.

ou can claim £4 per week without receipts for home expenses. Alternatively, the company can reimburse you for light and heat, but not mortgage interest or council tax.

Limited Company or Sole Trader?

A director you may set up a licence between you and your company to rent an office (or other space) in your home or outbuildings. This will enable you to recharge a proportion of mortgage interest and council tax. You will need to declare this as income and prepare rental accounts as for Self Assessment tax purposes.