

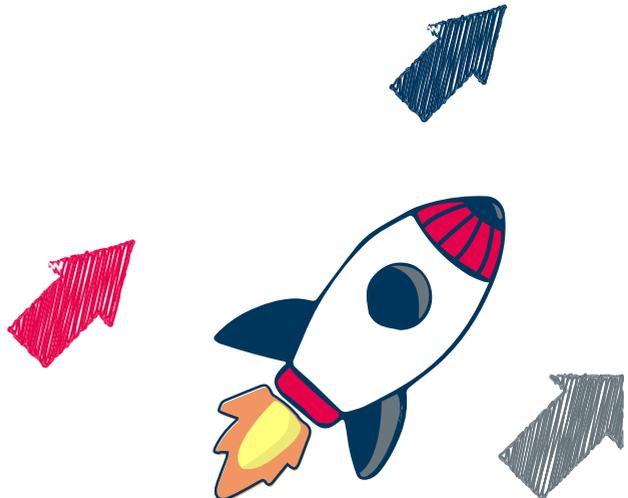


Helping Businesses Grow Since 1997

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## Beyond dividends

**5 WAYS** you can make the most out of  
setting up a Limited Company



## A Limited Company offers more than just dividend payments

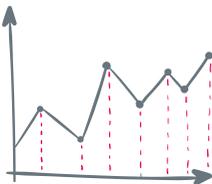
Last year there were 1.9 million Limited Companies in the UK – of which the vast majority were one-person outfits, start-ups and small businesses. This is compared to the 3.8 million or so sole traders and partnerships\*.

There are numerous reasons you might want to run your enterprise as a Limited Company – from protecting your business's name, to reducing personal liability if things go wrong, or to show that your firm is more than just a temporary thing. But, surely the main reason most people set up as a Limited Company is for the financial advantages it offers over other business structures.

By becoming a Limited Company, you can pay yourself a lower salary and therefore avoid paying so much income tax or National Insurance Contributions (NICs). Instead, you mainly pay yourself in dividends, which are taxed lower than income tax. Ultimately, setting up a Limited Company means you can take thousands of pounds more home every year.

Many founders of Limited Companies stop there. The 'take-home' pay is already an obvious boost to your bank balance. But, what if you could make more of the benefits of setting up a Limited Company?

***In this eBook we will cover five ways you can get more out of your business's Limited Company status.***



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\* FSB. 2017. UK Small Business statistics. Available online: <https://www.fsb.org.uk/media-centre/small-business-statistics>

## Paying yourself dividends? Here's how it works

Paying yourself in dividends means you ultimately have a lower tax liability. Here's the most common way that Limited Company owners do it:

- *Most Limited Company owners pay themselves a low salary, then the rest of their remuneration through dividends from the company profits*
- *Pay yourself an annual salary lower than the 2020/2021 tax-free allowance of £12,500 and also avoid National Insurance Contributions*
- *Next, pay your company's corporation tax on your profits (19% in 2020/2021)*
- *Pay yourself the remaining money in dividends – you must declare this in a formal meeting and keep minutes*



# Why launch a Limited Company?

Setting up a Limited Company offers you a range of benefits – not least the tax advantages. Key reasons to set up a Limited Company include:

- **'Serious' reputation**

*Running a Limited Company tells people you're a serious business – not just an individual doing a bit of work on the side*

- **Some companies don't work with Sole Traders**

*Certain clients or agencies will not work with a Sole Trader and expect their suppliers to be Limited Companies*

- **Register your business name**

*To set up a Limited Company, you need to register your name with Companies House, and can therefore trademark your name and logo*

- **Tax advantages**

*As already mentioned, Limited Company owners can take more money out of the business than the owners of Sole Traders or Partnerships*

## The process for setting up a Limited Company

1. **Register with Companies House**

*Provide a unique business name and business address and decide who the shareholders are. Ask your accountant for help with this step*

2. **Inform HMRC**

*Get in touch with HMRC (you can do this via the self-service portal) and tell them you plan to incorporate your business, and give them a date for when the business will start trading*

3. **Set up a business bank account**

*The Limited Company is a separate legal entity to you, so it needs its own separate bank account too*

Once you have registered your Limited Company, the next step is to make the most of what the business structure has to offer. In the rest of this booklet, we'll show you how to do just that.

# 5 WAYS You can maximise the benefits of setting up a Limited Company

Once your small company or consulting business starts generating more profit than the 2020/2021 annual tax-free allowance of £12,500, it immediately becomes more tax efficient to set up as a Limited Company than as a Sole Trader or a Partnership. However, starting a Limited Company also introduces some additional responsibilities and a more complex way of running your finances. You therefore should aim to make the most of the benefits of starting a Limited Company to make it worth your while.

*Let's look at five ways you can do this.*



*To illustrate how a Limited Company like yours could make the most of the legal structure, we'll be using the fictional story of TrueShoe, a company that makes footwear out of organic materials, and show how DSL's accountants would help him manage his accounts to further grow the business.*

*Dan founded TrueShoe a couple of years ago as a side project from his main job at a footwear company, selling online and working as a Sole Trader. As business grew, he decided to launch the business full time, employ staff and set up a Limited Company.*

# 1 Understand expenses

As a Limited Company, you only ever pay tax on your profits after expenses. This means that if you keep a record of every product and service the business has paid for, you can tell HMRC about these expenses and it will reduce your tax bill. For instance, if your turnover was £50,000, but you claimed £10,000 in tax-deductible expenses, you would only pay tax on the remaining £40,000. So, by keeping a clear record of all your expenses over the course of a year, you reduce the amount of money you can be taxed on.

## There are three types of expenses:

- **Tax-deductible expenses**

*These include any products or services the business pays for its day to day running – this includes anything from staff salaries to stationery to services like outsourced IT. A full list of tax-deductible expenses can be found on HMRC's website\**

- **Non-tax-deductible expenses**

*Some expenses cannot be claimed – these include any client entertainment*

- **Expenses that are both personal and business related**

*Some of your expenses will cross over between work and your personal life – such as a mobile phone bill which is in your name (rather than the business's) or heating if you work from home. HMRC lets you claim a portion of that expense*

## HOW does Dan do it?

*Let's look at how DSL would help Dan, our fictional business owner, manage his expenses:*

- *We would recommend Dan use a cloud-based tool where he can upload and record all his expenses as he pays for them (including photos of paper receipts)*
- *The software logs information about cost and VAT paid on the product or service*
- *When it comes to paying his tax, DSL will add up his receipts over the year and work out exactly what tax he owes*

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\* HMRC. 2018. Expenses if you're self-employed. Available online: <https://www.gov.uk/expenses-if-youre-self-employed>

## 2 Be clever with shares

Allowing a spouse or family member to become a shareholder in your business can be a very effective way of reducing your overall tax bill. By giving someone else a share of your business, you can also pay them dividends out of the company's profits. This means you could pay yourself and your spouse a lower dividend income, and therefore both be within the lower dividend income tax bands.

This can be highly tax efficient - but you need to make sure you are following the rules and you should keep an auditable paper trail if you choose to do this, sending formal letters to the shareholder(s) about what you are doing.

In the 2020/2021 tax year, your first £2000 of dividends payments are taxed at 0% (down from the £5000 in previous years), after this you will pay tax on dividends at the rates shown in the following table.

Tax band	2020/2021 income	Dividend tax rate
Basic	£0 – £37,500	7.5%
Higher	£37,501 – £150,000	32.5%
Additional	£150,000 +	38.1%

### HOW does Dan do it?

*After getting to know him, DSL would recommend Dan asks his wife to become a shareholder in his business.*

- *This year, the company's profits after tax are £75,000 – this would mean Dan would have to pay the 32.5% tax rate on under half of his earnings if he were to pay himself all this money in dividends*
- *However, DSL would recommend his wife becomes a 49% shareholder, meaning they both receive less than £37,500 in dividends, so both only pay 7.5% dividend tax on all their take home pay*

# 3 Get to know relevant credits and tax breaks

There are multiple credits and tax breaks you can claim as director of a Limited Company – let's look at just three of the many reliefs and credits you can claim below:

- **Working tax credit**

*Especially for contractors, registering for working tax credit can help support your income if you are between contracts*

- **R&D tax relief**

*If your business invests heavily in developing new products or services, you can claim R&D relief which allows you to deduct an additional 130% of your qualifying costs from yearly profits\**

- **Tax claims for low emission vehicles**

*If you have a company car which you also drive outside of working hours, this is treated as a 'Benefit in Kind' and is subject to income tax and national insurance. However, the government is using the Benefits in Kind tax to encourage companies to choose lower emission vehicles (other factors such as car size are also included in the calculation). The least polluting cars receive a 5% BIK rate, whereas the most polluting receive a 35% BIK rate.*

You can use HMRC's online calculator\*\* to find out exactly what you can claim back on different cars and therefore reduce your tax bill.

Talk to your accountant to discuss which might be worth applying for in your circumstances.

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\* HMRC. 2018. Research and Development tax relief for small and medium-sized enterprises. Available online: <https://www.gov.uk/guidance/corporation-tax-research-and-development-tax-relief-for-small-and-medium-sized-enterprises>

\*\* HMRC. 2018. Company Car and Car Fuel Benefit Calculator. Available online: <http://cccfcalculator.hmrc.gov.uk/CCF0.aspx>

## HOW does Dan do it?

*Dan, our fictional head of a footwear company invests heavily in testing out new organic materials for the company's apparel. DSL would advise him on how to claim tax relief on the money he spends on this research:*

- *Dan can claim a proportion of his R&D employees' salaries, wages, Class 1 NICs and pension fund contributions*
- *By working closely with him, DSL would also know he subcontracts work out to a freelance market researcher – this means he could claim back up to 65% of the cost of using them*
- *DSL would also help him work out what he can rightfully claim as R&D – HMRC only accepts certain activities as R&D, so by getting to know his business, DSL would help ensure he only claims on the legitimate expenses*

## 4 Accessing funding

As your company grows, you may well need funding – be that to tide over your cashflow when business is slow, or to invest in new equipment, premises or employees. While Sole Traders and Partnerships can access some types of loans and funding, it is significantly easier to get funding if you are a Limited Company. Many banks and lenders simply do not deal with Sole Traders - and they are rarely attractive to bigger investors either. Some of this is due to lenders' appetite for risk – a Limited Company suggests the business is stable, well run and employs people. A Sole Trader in their eyes may appear less dependable.

There are various routes for getting funding for a Limited Company, and a qualified accountant can introduce you to the most appropriate source for your business and take you through the application process. Popular sources of funding for a Limited Company include:

- **Bank Loans**

*The traditional route – you will need to provide a solid business plan, including details of your finances and business structure.*

- **P2P lending**

*Another way of accessing loans, P2P lending involves using a web platform where you can promote your business and borrow from private individuals.*

- **Equity crowdfunding**

*Crowdfunding websites allow you to sell a share of your business to online investors, in return for some of your profits if you are successful.*

- **Angel investors and Venture Capitalists**

*Angel Investors tend to be individuals who support early-stage start-ups, whereas Venture Capital firms usually work with more established businesses. They both normally request a seat on the board and shares in return for funding but can give your business a real boost.*

- **Grants**

*There are numerous government (and private sector) grants which can give your business a shot in the arm – although beware that they're very competitive.*

## HOW does Dan do it?

*As his footwear company grows, Dan needs to invest in equipment, staff and machinery fast. His first port of call was his personal bank, yet they were not ready to take a risk on his small business. DSL would be able to advise him on the best approach:*

- *As we know his business, we would be able to walk him through applications for funding, and recommend the best bank loans for his kind of business*
- *We have been working with countless start-ups and SMEs for over 20 years, so would draw on our knowledge of investors and grants to help him find sources of funding that he might otherwise never have heard of*



# 5 Director's loan

The main ways you can take money out of your business are as a salary or as dividends. However, you can also use a Director's Loan, which allows you to take out £10,000 which is not considered to be part of your income tax or dividend tax allowances.

A Director's Loan account isn't a 'real' bank account but is instead a record of all money that the business has lent you. Because a Limited Company is a separate legal entity to the business owner, it can lend you money as and when your need (as long as this is recorded).

You might use a Director's Loan for:

- *Paying for petty business expenses over the course of the year*
- *Using the company card for personal expenses*
- *Getting an interest-free loan for something else*

The benefit of using a Director's Loan is that you can access up to an additional £10,000 during a tax year, and normally not have to pay any extra tax on it. However, Director's Loans can be complicated, and if they are not paid back in full within 9 months and one day of the end of your financial year, you risk paying as much as 32.5% tax on the loan.

## HOW does Dan do it?

*Dan has chosen to pay himself quarterly dividends, but it's getting close to the end of the quarter and he's running low on personal cash. He therefore decides to take another £1,000 out of the company to tide himself over until he next pays himself. He will then have to 'pay back' the business out of his next dividend payment.*

- *Dan could talk to DSL about how to do this and how to record the lending to himself*
- *DSL would also advise Dan on how to pay back the loan to ensure that he is not breaking any rules or becomes liable for any additional tax*

## Could you make more of your Limited Company status?

Setting up a Limited Company offers you many benefits – not least that you save significant sums in Income Tax and National Insurance Contributions. However, many Limited Company directors are missing out on the additional financial benefits of this business structure. Whether it's choosing to reorganise your shares so you save on dividend tax, or investigating tax breaks that apply to you, taking advantage of these benefits requires in-depth accounting knowledge.

And this is why Limited Company owners choose to work with DSL. We work closely with our clients and are proactive in helping them get the most out of the Limited Company structure. Our focus is on partnering with your business and helping you find the best ways to manage your earnings. Ultimately, this means you have more money to spend on your business and can therefore invest it to drive growth.





We have over 20 years of experience helping start-ups, small businesses and contractors make the most of their Limited Company status. Our friendly team will get to know you and your company and provide specific advice to help you save on your tax bill, take advantage of tax relief and find other strategies for helping you grow your business faster.

**Call us for free from mobile or  
landlines on 0800 77 234 22 to  
learn more**

**The Direct, Simple and Logical  
accounting partner to help  
drive your business  
forward.**



Contact us today for Direct, Simple and  
Logical advice from our friendly team:

-  0800 77 234 22
-  [ask@dslaccounting.com](mailto:ask@dslaccounting.com)
-  [dslaccounting.com](http://dslaccounting.com)
-  Warwick House, Banbury Road, Southam, CV47 2PT