NR BARTON

CHARTERED ACCOUNTANTS

Sole trader vs Limited company

NR Barton have been advising local businesses with accountancy services for over 70 years. We work with clients from sole practitioners to large owner managed businesses to offer a combination of commercial insight and technical wisdom to help manage the financial aspects of business. Here we consider the importance of business structure.

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Sole trader vs Limited Company

Important accounting and tax factors to consider when structuring your new business

You have decided to take the big leap of faith and start your own business, the next question is how this should be structured. Should you trade in your personal name or through a limited company?

Trading in your personal name

If you were to trade in your personal name, then you will have to register for self-assessment and complete personal tax returns. You will have to prepare accounts for your trading business with the details being shown on your personal tax return. The accounts are not published on any website and you can choose what year end you would like to have.

You will be subject to income tax and national insurance on the taxable trading profits. The maximum rate of income tax is 45%. Both Class 2 and Class 4 national insurance contributions will be due as follows:

- Trading profits more than £6,205 then Class 2 national insurance contributions of £2.95 per week.
- Trading profits between £8,424 and £46,350 then 9% class 4 national insurance contributions.
- Trading profits over £46,350 then in addition to the above 2% class 4 national insurance contributions.

The income tax and national insurance contributions liability needs to be paid to HM Revenue & Customs by the 31 January following the tax year end. For example, the income tax liability for the year ended 5 April 2019 need to be paid by 31 January 2020 otherwise interest and penalty charges may apply. It is also likely that you will have to make payments on account towards the next year's income tax liability. There are two payments on account which are due on 31 January and 31 July. The payments are based upon the earlier year's income tax liability.

If you make a trading loss, then there are several options available to you as follows:

- If the loss occurs during the first four years of trading this can be carried back to an earlier year usually resulting in a tax refund.
- If you have other income the loss can be used to reduce your taxable income in that year.
- Alternatively, the loss can be carried forward and set off against future trading profits. This will reduce the amount of tax that you pay in the future.

Trading through a limited company

The limited company is a separate legal entity to yourself. The company will need to be registered with Companies House. The company's accounts will need to be submitted and are available to the public to view. Companies pay corporation tax on the total of its profits (which includes both trading profits and any chargeable gains).

Currently the rate of corporation tax is 19% and the liability needs to be paid within nine months and a day from the year end. For example, if the company's year end is 31 March 2019, the corporation tax liability needs to be paid by 1 January 2020. From 1 April 2020 this will be reduced to 17%. If the company makes a trading loss, then as with an individuals it can either be carried back to an earlier tax year or carried forward and used to reduce future profits.

It is important to remember that when you extract the money from the company this will give rise to an income tax charge on yourself. There are three ways in which you can be paid: salary, loan or a dividend. The income will need to be detailed on your personal tax return.

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