



Hornbeam Highlights 48

February 2012

Could we save you £8,000 a year?

George has a little metal working business in Norwich. Until a couple of years ago he had chosen to stay under the VAT threshold, and let his business tick along. The birth of his first child and the loss of his wife Jo's income changed all that, and he decided to go all out for profit.

I recently prepared his sole trader account with profit having jumped from £25,000 to £60,000 his tax has increased from £5,234.75 to £17,807.50. So of course this January he has £21,476.50 tax to pay. Ouch.

So we set about looking at how we can reduce the tax burden for George.

I ran a quick calculation. Incorporating the business, paying George a salary of £7,800, paying corporation tax and taking out all of the remaining profit as dividends would save George a staggering £4,535.86 of taxation.

The reason for this is quite simple and quite interesting. There is no National Insurance on dividends so for profits between £7,225 and £42,475 it is possible to save a maximum of £3,172.50 of National Insurance. That is the simple bit.

The interesting bit is that because dividends are grossed up at 10% but tax rates are at 20%, the point at which higher rate taxes commence is higher for the incorporated client.

Let me explain. The self-employed client starts paying higher rate tax at £42,476 profit. However at this point; if a company has paid 20% tax and distributed the balance as dividend, the grossed up dividends only amount to £37,756 and the owner can receive a further £4,720 of gross dividends (equivalent to £5,310 profit) before triggering higher rate tax. So there is a further one off saving of £1,062 by deferring higher rate tax.

But this isn't the end of the possible saving, by bringing in Jo as a minority shareholder and director, the savings can be increased further.

First; because Jo has unused personal allowances she can earn up to £7,228 without paying NI and £7,475 without paying tax. We organised a salary of £7,800 for George to buy him into the State social security system (National Insurance). This costs £234.10 Tax and NI, which in our view represents a good investment. Because Jo works considerably less hours we settle on a salary of £5,000 for her. This however saves a further £2,000, pushing the tax saving up to £6,535.85.

By persuading Jo to put up £10,000 of her own savings to buy 20% of the shareholding when the company is set up we are able to raise the point at which higher rate taxes start for this family from £51,910 to £61,660.

So for this family now, the tax at £60,000 profit is £9,654.01, a saving of £8,153.49 per year.

CGT and SEIS

We have mentioned this new tax-based scheme before, and more details are now emerging before the scheme starts on 6 April 2012.

One novel feature is that the capital gains tax (CGT) payable on the disposal of ANY chargeable asset in the tax year 2012/13 is exempt if you buy shares under SEIS. How that works has now been announced, and to get full CGT exemption you only need to invest the amount of the gain – not the whole proceeds of sale. If, for example, you make a gain of £50,000 in 2012/13 on a sale for £80,000, full CGT exemption is available if you invest at least £50,000. If you reinvested £30,000, the gain left to tax is £20,000.

Please talk to us for more details.

Written by Phil Needham

Closing your Company

When the time is right to get rid of your limited company, whatever the reason may be, the most cost-effective way is to distribute the reserves to the shareholders and apply for the company to be struck-off. The costly alternative is to have a formal liquidation which can easily cost somewhere in the region of £7,500.

The problem with the cheaper route is that capital gains tax treatment, in the hands of the shareholders receiving something from the company, is not automatic (as would be the case under a liquidation). Instead certain conditions have to be met; if they are not, the receipts from the company are taxed as income instead.

Under proposals applying from 1 March 2012, the cheaper route will only be available on distributions from the company of a maximum of £25,000. This unwelcome move needs to be fully considered, so if and when your plan is to close the business down please talk to us to maximise the tax attractions. With care the rate of CGT will only be 10% which will usually be a good deal less than being charged to income tax.

2012/13 PAYE Tax Codes

These are now being issued, something that will continue throughout February and March. Previously, we received a copy automatically, but as a cost-cutting exercise this is no longer the case.

Regrettably, therefore, you can no longer assume that we know about your 2012/13 Code Number unless you send us a copy of the Coding Notice. Please send it to us as soon as you receive it for our immediate attention – past experience shows that code numbers are often wrong.

DISCLAIMER

Most of the information contained in this Hornbeam Highlights is of necessity greatly oversimplified. We are trying to bring to your attention tax planning and business management opportunities. However, you should not take action based upon this leaflet without obtaining specific professional advice.

Whether you are a client or not, if we can provide further help or advice concerning any of the matters covered here, please do not hesitate to telephone us on (01603) 720424.

