Incorporation Factsheet

Incorporating your business can offer significant benefits, including tax savings and limited liability protection. However, it’s important to weigh the pros and cons to determine if it’s the right move for you. This factsheet provides a summary of incorporation and highlights potential tax savings. The figures in this factsheet are based on 2024/25 data.

What Is Incorporation?

Incorporation involves registering your business as a limited company with Companies House. This makes your business a separate legal entity, offering protection for your personal assets.

Is Trading As A Limited Company The Best Option?

In our view and experience (being a limited company ourselves) it is generally more beneficial, in tax terms, to trade as a limited company as there are annual tax savings.

Key Benefits Of Incorporation

In our view, there is generally a benefit for a director- shareholder to take a dividend rather than further salary.

Tax savings

As a sole trader, profits are subject to Income Tax and National Insurance (NI) at rates as high as 47% (including NI).

As a limited company, profits are taxed at the Corporation Tax rate (currently 19%), which is significantly lower.

Potential Tax Savings Example (2024/25 figures)

Sole Trader	Limited Company
Profit: £50,000	**Profit: £50,000**
Tax & NI £9,200+	Corporation Tax: £9,500
Take-Home Income: £40,800	Salary & Dividends after tax: £43,300

In this example, incorporating saves over **£2,500 annually** in taxes, with further savings possible depending on circumstances.

Pension Provision

As an employee/director of the company, it should be possible for the company to make pension contributions (subject to limits) to a registered fund irrespective of the salary level, provided it is justifiable under the 'wholly and exclusively' rule. Pension contributions are deemed to be a private expense for sole traders or partners.

Other Tax Issues

In addition, we consider other relevant factors including potential disadvantages. It is all too easy to focus exclusively on the potential annual tax savings available by operating as a company. However, other tax issues may be significant and should not be underestimated.

Capital Gains

Incorporating your existing business will involve transferring at least some of your assets from your sole trade or partnership into your new company. The transfer of goodwill may create a significant capital gain although there is a mechanism for deferring the gain until any later sale of the company if the business is transferred in exchange for shares in the company.

Relief for goodwill

Generally, where goodwill is sold to the company, a company may be able to deduct the cost of goodwill in the year it is acquired. This is typically allowed when the goodwill is associated with the purchase of a trade or business.

The deduction reduces the company's taxable income in the year of acquisition, leading to immediate tax savings.

Important Considerations: The specific rules and regulations regarding goodwill impairment, and deduction can vary depending on the circumstances.

Property Taxes

Depending on where the property is situated there will be Stamp Duty Land Tax (SDLT), Land and Buildings Transaction Tax (LBTT) (the Scottish SDLT) or Land Transaction Tax (LTT) (depending on where you are in the UK) charges to consider.

Limited companies currently pay a surcharge on top of the standard SDLT rates when purchasing residential properties. This means they effectively pay higher rates than individuals buying their first home, and the First-Time Buyer Relief is not available for a limited company.

Income Tax

The precise effects of ceasing business in an unincorporated form, including 'overlap relief', which is a measure designed to prevent self-employed individuals and partnerships from being taxed twice on the same profits when their accounting year doesn't align with the tax year, need to be considered.

Other Advantages

There may be other non-tax advantages of incorporation, and these are summarised below.

Limited Liability

A company normally provides limited liability. If a shareholder's shares are fully paid, they cannot normally be required to invest any more in the company. However, banks often require personal guarantees from the directors for borrowings. The advantage of limited liability will generally apply in respect of liabilities to other creditors.

Legal Continuity

A company will enjoy legal continuity as it is a legal entity in its own right, that is separate from its owners (the shareholders). It can own property, sue, and be sued.

Transfer Of Ownership

Effective ownership of the business may be more readily transferred, in comparison to a business which is not trading as a limited company.

Borrowing
Normally a bank is able to take extra security by means of a "floating charge" over the assets of the company and this will increase the extent to which monies may be borrowed against the assets of the business.

Credibility
The existence of corporate status is sometimes deemed to add to the credibility or commercial respectability of the business.

Pension Schemes
The company could establish an approved pension scheme which may provide greater benefits than self-employed schemes.

Staff Incentives
Employees may, with adequate safeguards, be offered an opportunity to acquire an interest in the business, reflecting their position in the company.

Disadvantages
No analysis of the position would be complete without highlighting potential disadvantages.

Administration
The annual compliance requirements for a company in terms of administration and accounting tend to result in costs being higher for a company than for a sole trader or partnership. Annual accounts need to be prepared in a format dictated by the Companies Act and, in certain circumstances, the accounts need to be audited by a registered auditor. Details of the directors and shareholders are filed on the public register held by the Registrar of Companies.

Privacy
The annual accounts must be made available on public record – although these can be modified to minimise the information disclosed.

PAYE/Benefits
If you do not have any employees at present, you do not have to be concerned with Pay As You Earn (PAYE) and returns of benefits forms (P11Ds). As a company, you will need to complete PAYE records for salary payments and submit details of salary payments on a

timely basis under PAYE Real Time Information (RTI). You will also need to keep records of expenses reimbursed to you by the company. Forms P11D may have to be completed.

Dividends

If you require regular payments from your company, it is important that the correct system is set up and adhered to for correctly pay dividends.

Transactions With The Business Owner

A business owner may introduce funds to and withdraw funds from an unincorporated business without tax implications. When a company is involved, there may be tax implications on these transactions.

Director's Responsibilities

A company director may be at risk of criminal or civil penalty proceedings e.g. for the late filing of accounts or for breaking the insolvency rules.

Need help? Contact us today:

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