

A GUIDE TO LIMITED COMPANY FORMATION



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What is a Limited Company?

Once registered, a company becomes its own entity, separate from the person(s) who run the business. The company has its own legal rights and obligations, aside and distinct from those of its shareholders and directors. This means any property or assets are owned by the company and it is the company who takes out finance, employs staff etc not the individuals who own the business.

If you run a limited company, you are protected in case things go wrong. Assuming no fraud has taken place, you will not be personally liable financially for any losses made by your limited company. The liability of the owner(s) is limited to the amount that they invested in the company.

Types of Limited Company

Limited Company with Shares

A company limited with shares has share capital which people may purchase, becoming shareholders in the company. Such a company may have different classes of shares and these shares can be bought and sold or transferred to other people.

A limited company with shares must have at least one shareholder and one director. The director or board of directors are responsible for the day to day running of the company and usually receive 'director's remuneration' for this work. The shareholder(s) own the business and receive dividends based on the profitability of the business.

Company Limited by Guarantee

Companies limited by guarantee are widely used for not-for-profit organisations. A company limited by guarantee has no share capital and has members rather than shareholders. Once again the liability to the members is limited to the amount invested in the company. Such companies do not distribute profits to their members but retain profits within the company to use for reinvestment.

The Company Formation Process

Companies House is the regulatory body for the registration of all limited companies, and maintains the registry of companies.

Before you can start a business as a limited company, the company itself has to be registered with Companies House.

There are three typical ways of registering a company:

1. Use an Accountant
2. Register online with Companies House
3. Register online using a Company Formation Agent

Registration is a fairly simple process. The name that you have chosen must be checked to see if it is available. With online registration this can now be done very quickly. If the name you have chosen is not available you will be asked to select another. Once you register your company with Companies House your company name is protected by law. No-one else can use the same name as you, or anything deemed to be too similar.

On incorporation of the company, the following documents have to be completed and returned to Companies House:

1. Memorandum of Association. The Memorandum of Association is a statement made by each subscriber confirming their intention to form a company and become a member/shareholder of that company. If the company is to have share capital on formation, each shareholder also agrees to take at least one share.
2. Articles of Association. The Articles of Association outline the directors' powers, and any shareholders' rights.
3. Detailed Company Information. Such information will include details of the director(s), details of the company secretary (if required), details of any shareholders, and details of the share capital. It will also give details of the company's registered office.

What are my Duties as a Director?

The Companies Act 2006 codifies the duties of company directors into a statutory statement of seven general duties. As a company director you have a:

1. Duty to act within your powers as a company director
2. Duty to promote the success of your company
3. Duty to exercise independent judgment
4. Duty to exercise reasonable care, skill and diligence
5. Duty to avoid conflicts of interest
6. Duty not to accept benefits from third parties
7. Duty to declare interest in proposed transaction or arrangement with the company

Are there Regular Documents which I must Submit to Companies House?

1. You are responsible for completing and submitting annual accounts. These must be filed within 9 months of the company's financial year end. Typically a small limited company will only file abbreviated accounts so that limited information is displayed on public record.
2. You are responsible for completing and returning a Confirmation Statement (known as Form CS01). A confirmation statement is a snapshot of general information about the company's directors, secretary (where one has been appointed), registered office address, shareholders, share capital and persons of significant control (PSCs).
3. You should submit forms to Companies House to notify them of any changes in the particulars of company director(s) or secretary.
4. You should notify Companies House if you change your registered company address.

Are there any Penalties for Late Submission of Documents?

If you do not submit the annual accounts of the company within 9 months of the company's financial year end, late filing penalties will begin to accrue. The penalties are, as follows:

How late are the accounts delivered	Penalty
Not more than one month	£150
More than one month but not more than three months	£375
More than three months but not more than six months	£750
More than six months	£1,500

If you submit the accounts late for two consecutive years, the filing penalty that is due, depending on the date of delivery will be doubled.

There are currently no penalties in force for the late submission of a Confirmation Statement, although reminder letters are sent by Companies House to the registered office to notify the director(s) that this Form needs to be submitted. These letters do carry the following warning: 'Failure to meet the above deadline will result in the Registrar starting the process to strike your company off the register. Please note that it is also a criminal offense not to file an annual return on time. If prosecuted, directors can be fined £5,000'.

How do I notify HM Revenue & Customs that I have Formed a Company?

When your limited company is formed and registered at Companies House they tell HM Revenue & Customs that this has happened. This applies whether you start your business as a limited company or change from a sole trader or partnership to a limited company. It also applies whether or not your company is 'active' or has started trading.

HM Revenue & Customs use the information they receive from Companies House to set up a computer record for your company and allocate it a reference number known as a Unique Taxpayer Reference (UTR). They then send form CT41G (Corporation Tax - Information for New Companies) to your company's registered office which may or may not be its principle place of business.

This form tells you what you need to do if your company has become 'active' - for example started any business activity such as trading or receiving income - and suggests other tax implications your company may need to consider.

It's important that you read form CT41G carefully and take any action that's needed promptly. You must advise HM Revenue & Customs that your limited company is active and has started its first accounting period within 3 months of starting business activity. You can advise them by letter or by using HM Revenue & Customs online registration service.

What Happens Next?

HM Revenue & Customs will update their computer records to reflect the additional information you have provided. They will then send you form CT610 to confirm your company's deadline dates for paying Corporation Tax electronically and submitting Company Tax Returns online.

Are there Regular Documents which I must Submit to HM Revenue & Customs?

If your company is liable to pay corporation tax on its profits you must:

1. File a self-assessment Company Tax Return (CT600). This form tells HM Revenue & Customs how much tax you believe is due. This must be submitted within one year of your financial year end.
2. Submit detailed computations to show how you have arrived at the figures on the CT600.

The Company Tax Return (CT600) and the supporting computations must be submitted to HM Revenue & Customs electronically. They will be submitted in Inline eXtensible Business Reporting Language (iXBRL) format.

What Records Do I Need to Keep?

If your company is registered at Companies House, you must keep and retain certain accounting records showing your company's transactions and its financial position. Accounting records are records which are sufficient to show and explain a company's

transactions and to disclose (with reasonable accuracy) its financial position at any time. The accounting records must enable the directors to prepare accounts that comply with the Companies Act.

Typically such records will include:

- bank statements (a bank account should be opened on incorporation)
- cheque book stubs (giving full details of the payment made)
- bank paying-in books (giving full details of the monies banked)
- copies of your sales invoices generated
- original purchase invoices
- receipts for all cash purchases
- remittance advice slips from customers
- credit card statements
- loan statements
- finance agreements for items purchased on lease or hire purchase
- copies of VAT returns submitted with supporting documentation
- a record of your company's assets, for example, a record of 'capital expenditure' such as the purchase and sale or disposal of company assets, equipment, office furniture and vehicles
- details of any stock on hand at or work in progress at the end of your financial year

It is also important to keep all receipts in respect of expenses claimed by directors and reimbursed to the directors by the company.

In keeping such records detailed above, the company will also have sufficient records to complete the company tax return.

How Long do I Need to Keep the Records?

HM Revenue & Customs requires any company to keep its records for at least six years from the end of the accounting period. In certain circumstances, such as a late tax return or an HM Revenue & Customs enquiry, your company may need to keep records longer than the six-year period. If your company does not keep sufficient records, HM Revenue & Customs can charge a penalty of up to £3,000 and there will inevitably be disallowance of expenses that cannot be supported by written evidence.

Preparation of Accounts

A company must prepare accounts on an annual basis. The accounting records will be used to prepare these accounts. The net profit for each year will be calculated after all of the relevant expenditure has been deducted from the income generated by the company.

How do I Calculate the Corporation Tax Liability?

In order to calculate the corporation tax liability you need to know how much taxable profit the company made in the accounting period covered by your tax return. The tax year for corporation tax runs from 1 April to the following 31 March. An accounting period which straddles 31 March would require two computations.

The taxable profit is not necessarily the same as the company net profit shown in the accounts. The reason for the difference is that the accounting treatment and the taxation treatment of expenses can differ.

For example:

Depreciation is charged on fixed assets to allocate the cost of using the asset over its useful life. The directors decide on an appropriate rate to write off each year which can vary between companies from 0% to 100%. However, in order to ensure that all companies are treated equally HM Revenue & Customs stipulate how much of an asset can be written off each year – the capital allowance. To calculate **taxable** profit, depreciation charges are added back and capital allowances (standard HM Revenue & Customs depreciation) are deducted.

Certain expenses such as ‘entertainment’ are not allowed as expenses for the purpose of calculating corporation tax.

What Rate of Corporation Tax will the Company have to Pay?

From 1 April 2015 the corporation tax rate for company profits is 20%.

From 1 April 2015 there is a single Corporation Tax rate of 20%.

At Summer Budget 2015, the government announced legislation setting the Corporation Tax main rate at 19% for the years starting 1 April 2017, 2018 and 2019 and at 18% for the year starting 1 April 2020. At Budget 2016, the government announced a further reduction to the Corporation Tax main rate for the year starting 1 April 2020, setting the rate at 17%.

When does the Corporation Tax have to be Paid?

If your company has taxable profits of up to £1.5 million, you must pay your Corporation Tax by the normal due date, which is nine months and one day after the end of your Corporation Tax accounting period. For example, if your company's accounting period ends on 31 May, your Corporation Tax payment is due on or before 1 March the following year.

If your company's profits for an accounting period are at an annual rate of more than £1.5 million, you must normally pay your Corporation Tax for that period in installments.

How Can I Pay the Corporation Tax Due?

Companies have to pay all Corporation Tax and related payments electronically.

Related payments include interest charges on overdue Corporation Tax and penalties for not filing Company Tax Returns on time.

You should not send cheque payments for Corporation Tax to HM Revenue & Customs. If you want to use a cheque to make your payment, rather than posting your cheque to HM Revenue & Customs, you need to take your cheque and HM Revenue & Customs payslip to your own bank or building society or to a participating Post Office. HM Revenue & Customs counts these payment options as electronic. Instructions for electronic payments by BACS direct credit, internet/telephone banking or Chaps will be detailed on the reverse of the HM Revenue & Customs payslip.

Are there any Fines for Late Payment and/or Late Filing?

Yes. Corporation tax paid late will incur interest and may incur a penalty.

If your company fails to send its Company Tax Return (CT600) on time, it will be charged penalties, depending on how late it is. If the return is regularly late, the penalties increase.

HM Revenue & Customs may also charge a tax-related penalty if the tax return is incorrect or if your company fails to tell HM Revenue & Customs of its liability for corporation tax.

As a Director and/or Shareholder how may I Extract Funds from the Company?

A director may take a salary from the company known as director's remuneration. This salary is a payment made to the director by the company through a PAYE scheme. It is deducted as an expense in the accounts and therefore reduces the amount of corporation tax that the company has to pay. The salary is paid gross, usually on a monthly basis. The director pays tax and employee national insurance contributions, and the company pays employers national insurance contributions (subject to the level of salary).

The post-tax profits of a limited company can be distributed to its shareholders in the form of dividends. If you have retained profits brought forward from previous accounting periods, these can also be distributed as dividends. Dividends are a reward to the shareholder for their investment.

For each dividend declaration, each shareholder must receive a dividend voucher which states the total gross dividend paid.

Typically where a director is also a shareholder in the company, a combination of salary and dividend payments are made each year.

As a Director can I Loan Money to or Borrow Money from the Company?

Yes. These transactions are recorded in an account known as a director's loan account. If your company has multiple directors who use a directors' loan account, you must keep separate company records for each loan account your company operates.

As a director of a company, you must manage your director's loan account carefully, making sure you include all entries accurately and on time.

If you lend your company money (for example by paying money into your company's bank account as opposed to, say, buying shares) your director's loan account is in credit. You can draw some or all of this money out at any time. There are no tax implications for your Company Tax Return.

If you take money out of your company's bank account over and above money you've loaned to the company - and that money is not a salary or a dividend - then it's a loan from the company to you. Your director's loan account is overdrawn.

Are there Corporation Tax Implications of an Overdrawn Directors Loan Account?

Yes. Any loan outstanding at the year end and still outstanding at the date the corporation tax liability is due, 9 months and one day after the year end, will incur a tax liability of 32.5% of the loan outstanding (25% prior to 1 April 2016). The tax is referred to as Section 455 tax. The company:

- Must include details of the loan on the Company Tax Return.
- The company must pay the S455 Tax on the loan.
- Will incur interest on any amount of the S455 liability unpaid.

If your director's loan account is overdrawn on the last day of your financial year end but you repay it in full within nine months, the company:

- Must include details of that loan on the Company Tax Return
- Does not pay tax on the loan

For example, your accounting period runs from 1 April 2013 to 31 March 2014. You pay off your director's loan account on 30 September 2014. You need to include information about this loan on your Company Tax Return but you will not need to pay any tax on the loan.

But from 20 March 2013 the company will need to pay tax on the loan if you either:

- Take a further loan within 30 days (before or after) the repayment.
- Have arrangements in place for a further loan to be made at the time of repayment.

Are there any Personal Tax Implications of an Overdrawn Directors Loan Account?

Cumulative loans amounting to over £10,000 at any time during the tax year must be recorded as a Benefit in Kind on a P11d form submitted to HM Revenue & Customs by 6 July each year. The benefit calculated as the interest the director or employee would have incurred if the loan had been made on a commercial basis. HM Revenue & Customs dictate the interest rate to be used, currently 3%, to calculate the benefit. Any interest paid by the director or employee to the company is deducted from the interest that should have been charged. Interest is calculated on a daily basis.

For example:

Mr A borrows £12,000, on 6 April 2017, from Company B Limited of which he is a director. HM Revenue & Customs interest rate for beneficial loans is 3% for the whole tax year. Mr A pays B Limited £10 per month interest.

Beneficial Interest $£12,000 \times 3\% = £360$

Interest Paid $£10 \times 12 = £120$

Benefit in kind $£360 - £120 = £240$

Personal Tax liability:

Basic rate 20% - $£240 \times 20\% = £48$

Higher rate 40% - $£240 \times 40\% = £96$

[For details of other P11D benefits, please refer to our Taxable Benefits Advice leaflet.](#)



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