Forming a Limited Company and becoming a Director

Forming a Limited Company

Regardless of whether this is your first business or you've been doing it for years, one of the choices you are likely to face is whether to become or stay as a sole trader or Partnership, or perhaps instead become or convert to a Limited Company, especially if that choice is brought about by getting larger orders, becoming bigger or taking on staff or contractors.

So when is the right time to be a limited company? The short answer is that the right time will be different for each business; it might be the right thing to trade through a limited company from day one, you may never need to trade through a limited company at all or, you might need a combination. One of the key decision triggers will be about how much and what type of risk the business faces both today and into the foreseeable future.

That said, the two main reasons for forming a limited company are tax efficiency and shareholders' (the investors) limited liability. It's worth pointing out that even though you may be both a shareholder and director of the same business, you as a director have, in some circumstances, an unlimited personal liability.

The degree of tax efficiency is always relative but, as a general rule, limited companies themselves and their owners (the shareholders) pay less tax than if they had traded as a partnership or sole trader. In addition, it can help to visibly 'legitimise' the business, make it more robust, easier to lend to or invest in, exit from and / or exist in perpetuity if your heirs want it to.

Meanwhile, limited liability is a huge benefit. If you are a sole trader and rightly or wrongly someone brings a claim against you (being a sole trader means that you are your business), then unless you have the necessary liquidity or insurance to satisfy any judgment or award, you risk losing your personal assets which includes your home, car and, in some cases, your pension.

As a limited company though, then unless you have given personal guarantees or, as a director, been found guilty of wrongful trading, a Health & Safety breach or employment law issues etc., and the company has insufficient assets to meet that cost, assuming that it is its Articles of Association say that it can and the shareholders are happy for company funds to be used in that way, then your ultimate protection is to wind the company up and your creditors will have no rights against you personally.

If however, you have been found personally responsible for certain matters, then you will have no protection whatsoever even if you are also a shareholder. A word or warning here, you are judged to be director by that which you do and not that by what you are called, hence the term 'shadow director'.

Being a limited company generally offers more tax planning opportunities; meaning that you get to keep more of what you earn and it's easier to pass on your wealth to the next generation and beyond. Another major advantage is that with your accounts being in the public domain, the credit analysts find it easier to give your business a better credit score, which in turn tends to result in larger orders and better trade terms.

Being a company director is not always a bed of roses; you'll still have a business to run, orders to get, paperwork to do and nobody but you will change a light build or replace the loo roll! If your business is a limited one, then in addition to you as a director now being an employee, you'll also have certain legal obligations that if not complied with could result in a hefty fine or, in the worst cases, a prison sentence.

Being a Company Director

Directors' responsibilities

It's very easy to both set up a limited company and instantaneously become a Company Director, but what does being one actually mean and, did you know then even if you own shares in the same business at which you a director, that you may be personally liable for your company's business liabilities and be fined, prosecuted or disqualified as a company director if you don't follow the rules.

As a director of a limited company, the law says you must: -

- try to make the company a success by using your skills, experience and judgment
- follow the company's rules as shown in its Articles of Association
- make decisions for the benefit of the company and not yourself
- tell other shareholders if you might personally benefit from a transaction the company makes
- keep company records and report changes to Companies House and HM Revenue & Customs
- make sure the company's accounts are a 'true and fair view' of the business' finances
- register for Self Assessment and send a personal Self Assessment tax return every year

You can ask other people to manage some of these things for you on a day-to-day basis, such as engaging an accountant to manage your accounts - but you're still legally responsible for those accounts and in making sure that the accountant you chose was suitably qualified and experienced.

Taking money out of a limited company

As a director of a limited company, you can take money from the company in three ways, namely: Salary, expenses and benefits, Dividends and Directors' loans.

Salary

If you want the company to pay you a salary, expenses or benefits, you must register the company as an employer with HM Revenue & Customs (HMRC). The company must deduct Income Tax and National Insurance contributions from your salary payments and pay those to HMRC, along with employers' National Insurance contributions.

Dividends

A dividend is a payment a company can make to its shareholders if it has made enough profit, but it mustn't pay out more in dividends than its available profits from either the current or previous financial years. In addition, dividends cannot be accounted for as business costs when working out your Corporation Tax. Dividends are usually paid to all shareholders, but to do so you must first: -

- hold a directors' meeting to 'declare' the dividend
- keep minutes of the meeting, even if you're the only director

For each dividend payment the company makes, you must write up a dividend voucher showing the: -

- date
- company name
- names of the shareholders being paid a dividend
- amount of the dividend
- the amount of the 'dividend tax credit' (the tax credit means your company and shareholders don't need to pay tax when the dividend is paid, but shareholders may personally have to pay tax on it.

Directors' loans

If you take more money out of a company than you've put in - and it isn't salary or dividend - it's called a 'directors' loan', for which you must keep records. You should be aware that as well as being detailed tax rules about how directors' loans are handled, the company's credit rating may be adversely affected.

Company changes you must report

You must tell Companies House if you want to change your company's registered office address and, if the change is approved, they will tell HM Revenue & Customs (HMRC). However, your company's new registered office address must be in the same part of the UK that the company was registered (incorporated), e.g. if your company was registered in England and Wales, the new registered office address must be in England or Wales. You should note that your registered office address won't officially change until Companies House has confirmed it with you.

You must also tell Companies House within fourteen days if you make changes to, amongst other things: -

- where company records are kept
- directors or their personal details, like their address
- company secretaries (appointing a new one or ending an existing one's appointment)

If you issue more shares in your company, then you must tell Companies House within a month, but before you can make changes to the shareholding, you may need to get the shareholders to vote on the decision if you want to: -

- change the company name
- remove a director
- change the company's articles of association

This is called 'passing a resolution', of which most will need a simple majority to agree (called an 'ordinary resolution'), but some (called a 'special resolutions'), generally require a 75% or more majority. In which regard, when working out whether you have a majority, count the number of shares that give the owner the right to vote, rather than the number of shareholders. This is what is known as *pare passu*. Remember, that at a board meeting it's one vote per director, but at a shareholders' meeting then each share is equivalent to one vote.

You don't necessarily need to have a shareholders' meeting to pass a resolution as long as enough of the shareholders have told you that they agree, but you must confirm the resolution in writing to all of the shareholders letting them know about the decision.

Changes you must report to HM Revenue & Customs

You must tell HMRC if your business' contact details change and / or you want to get an accountant or adviser to manage your company's Corporation Tax.

Company and accounting records

You must keep: -

- records about the company itself
- financial and accounting records
- directors, shareholders and company secretaries
- the results of any shareholder votes and resolutions
- promises for the company to repay loans at a specific date in the future ('debentures') and who they must be paid back to
- promises the company makes for payments if something goes wrong and it's the company's fault ('indemnities')
- transactions when someone buys shares in the company
- loans or mortgages secured against the company's assets
- if you keep the records somewhere other than the company's registered office address.

You must keep accounting records that include: -

- all money received and spent by the company
- details of assets owned by the company
- debts the company owes or is owed
- stock the company owns at the end of the financial year
- the stock-takings you used to work out the stock figure
- all goods bought and sold
- who you bought and sold them to and from (unless you run a retail business)
- any other financial records, information and calculations needed to complete your Company Tax Return.

You must normally keep records for at least 6 years from the end of the last company financial year they relate to, but you may need to keep them longer if: -

- they show a transaction that covers more than one of the company's accounting period
- the company has bought something that it expects to last more than six years, like equipment or machinery
- you sent your Company Tax Return late
- HMRC have started a compliance check into your Company Tax Return.

If you don't keep accounting records, you can be fined £3,000 by HM Revenue & Customs (HMRC) or disqualified as a company director.

Company annual return
You must send Companies House a company annual return every year within twenty-eight days of the anniversary of the company's incorporation and, if you miss the deadline, Companies House can close down your company, prosecute you and disqualify you as a director.

The company annual return must include details of: -

- the company's registered office address
- what type of business the company runs (e.g. retail, accountancy, catering)
- the address where the company's list of shareholders is kept
- the type of limited company (e.g. limited by shares, limited by guarantee)
- name and address of all company directors (and company secretary if you have one)
- the number and value of shares issued by the company and who owns them
- where details of 'debentures' (a type of loan the company has taken out with a promise to repay at a specific time in the future) are kept.

Signs, stationery and promotional material
You must display a sign (which is easy to read and to see at any time, not just when you're open) showing your company name at your registered company address and wherever your business operates, e.g. if you're running three shops and an office that's not at your home, you must display a sign at each of them. You don't, however, need to display a sign if you're running your business from home.

You must include your company's name on all company documents, publicity and letters and, on business letters, order forms, invoices and websites, you must show: -

- the company's registered number
- its registered office address
- where the company is registered (England and Wales, Scotland or Northern Ireland)
- the fact that it's a limited company (usually by spelling out the company's full name including 'Limited' or 'Ltd').

If you want to include directors' names, you must list all of them. If you want to show your company's share capital (how much the shares were worth when you issued them), you must say how much is 'paid up' (that is owned by shareholders).

Company director disqualification

You can be banned ('disqualified') from being a company director if you don't meet your legal responsibilities howsoever that comes to light as well as by an insolvency practitioner or a member of the public reporting your conduct as being 'unfit'.

'Unfit conduct' includes: -

- allowing a company to continue trading when it can't pay its debts
- not keeping proper company accounting records
- not sending accounts and returns to Companies House
- not paying tax owed by the company
- using company money or assets for personal benefit

How disqualification works

The Insolvency Service may investigate your company (or you personally as a director of your company) if it's involved in insolvency proceedings or if there's been a complaint. If they think that you haven't followed your legal responsibilities as a director, they'll tell you in writing: -

- what they think you have done that makes you unfit to be a director
- they intend to start the disqualification process
- how you can respond

You can either: -

- wait for the Insolvency Service to take you to court to disqualify you - you can defend the case in court if you disagree with the Insolvency Service
- give the Insolvency Service a 'disqualification undertaking' - this means you voluntarily disqualify yourself ending court action against you

Apart from the Insolvency Service, other bodies can, under certain circumstances, apply to have you disqualified, for example: -

- Companies House
- the Office of Fair Trading
- the Courts
- a company insolvency practitioner

You're automatically disqualified from being a company director if you're declared bankrupt, given a Debt Relief Order or are subject to bankruptcy restrictions.

You can be disqualified for up to 15 years during which time you cannot: -

- be a director of any company registered in the UK or an overseas company that has connections with the UK
- be involved in forming, marketing or running a company
- sit on the board of a charity, school or police authority
- be a pension trustee
- become a registered social landlord
- sit on a health board or social care body
- become a solicitor, barrister or accountant

If you break the terms of the disqualification, you could be fined or sent to prison for up to two years. In any event, your details will be kept on Companies House's database of disqualified directors, being automatically removed when your disqualification ends.