Blackman Terry Accountants have recently teamed up with **Servo Private Wealth** to discuss the benefit of an integrated approach to tax planning. In the first of our educational editions, we look at the options available when you withdraw money from a limited company.

Thank you to James Mallinson for the following article:

What options are available when I withdraw money from my limited company?

There are only four ways which you can withdraw money from your company's account into your own:

1. **Salary**
2. **Dividend payments**
3. **Director's loan**
4. **Reimbursement/payment of legitimate expenses (including pension contributions & insurances)**

It's wise to review how you're currently withdrawing money from the business to ensure you're maximising all available allowances and aren't missing out on anything.

But what if you have spare leftover money sitting in your business account? Would you like to put your company's leftover cash to work? We have helped many Limited Companies and Directors do exactly this.

We have seen many businesses in this situation, and the pattern usually goes something like this: The business is making a profit and starts generating some cash. The business owner/directors take income plus dividends up to a point that is tax-efficient, usually around £40,000.

People cannot extract the business cash remains without paying a huge tax bill and cannot expense it either because business expenses is a sensitive area only used for business purposes. As a result, the company profits stack up and a large amount of cash is sitting "locked in" in the business account, or at best in business savings accounts paying around 1-1.5% AER (at the time of writing).

If you have a look at the UK inflation data (1.9% at the point of writing), cash is losing their purchasing power. In plain English, your cash can buy less stuff than today in a few years' time.

£10,000 will be worth £8284 in 10 years' time. So, doing nothing is really not an option! Similarly, £100,000 will be worth £82,843. A £17,157 loss!

What are the options?

It looks like there could be a better way. In other words**, investing through a limited company** and not taking the money out until really needed. But, what's better? Take the money out and then invest, or invest through a limited company?

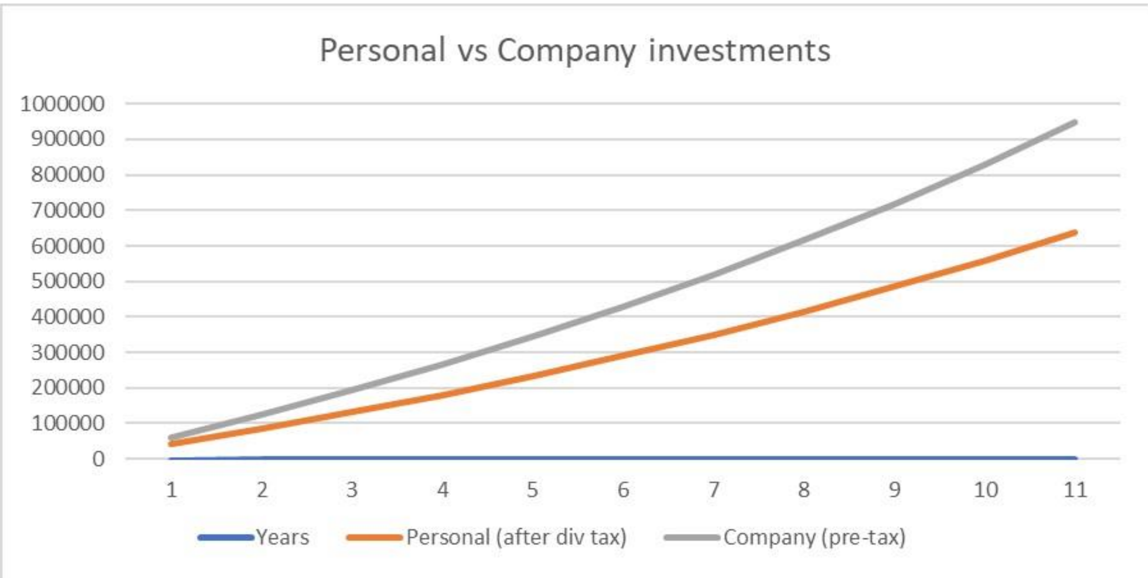
In both cases, taking the first £40k or so almost tax-free makes sense. But what about the cash surplus?

Obviously, if you need the money for personal reasons (e.g. to buy a house or to pay bills) there is no question. You just need to take everything out and take the tax hit upfront.

But for those who want to put the money to work for them let's dive into the numbers and decide.

To take the money out you would have to pay a 32.5% dividend tax upfront. That's a lot, but your money could then potentially grow tax-free thanks to ISAs and other allowances. This is not always the case but let's assume you and your partner have a £40k tax-free allowance.

If a business is generating a £60k cash surplus every year (over and above what is already being taken out), assuming 7% annual return and 19% corporation tax when investing via the company. 10 years later, you'd have £937,000 in company assets vs £640,000 in personal investments. The company investments end up £297,000 higher!



As you can see, not paying the tax upfront gives a nice £297,000 advantage compared to tax-free personal investments, even after paying the corporation tax on the profits.

At the end of the 10-year period, you can either take everything out of the company or we can simply withdraw as much as we need and pay much lower taxes.

You wouldn't want to pay £304,000 (32.5%) dividend tax to take £940,000 out, so why do it incrementally over 10 years? The numbers stack up.

It looks like keeping the money in the company and accessing it only when needed could be a much more profitable strategy. Even more importantly if you want to stop working at some point and achieve financial independence.

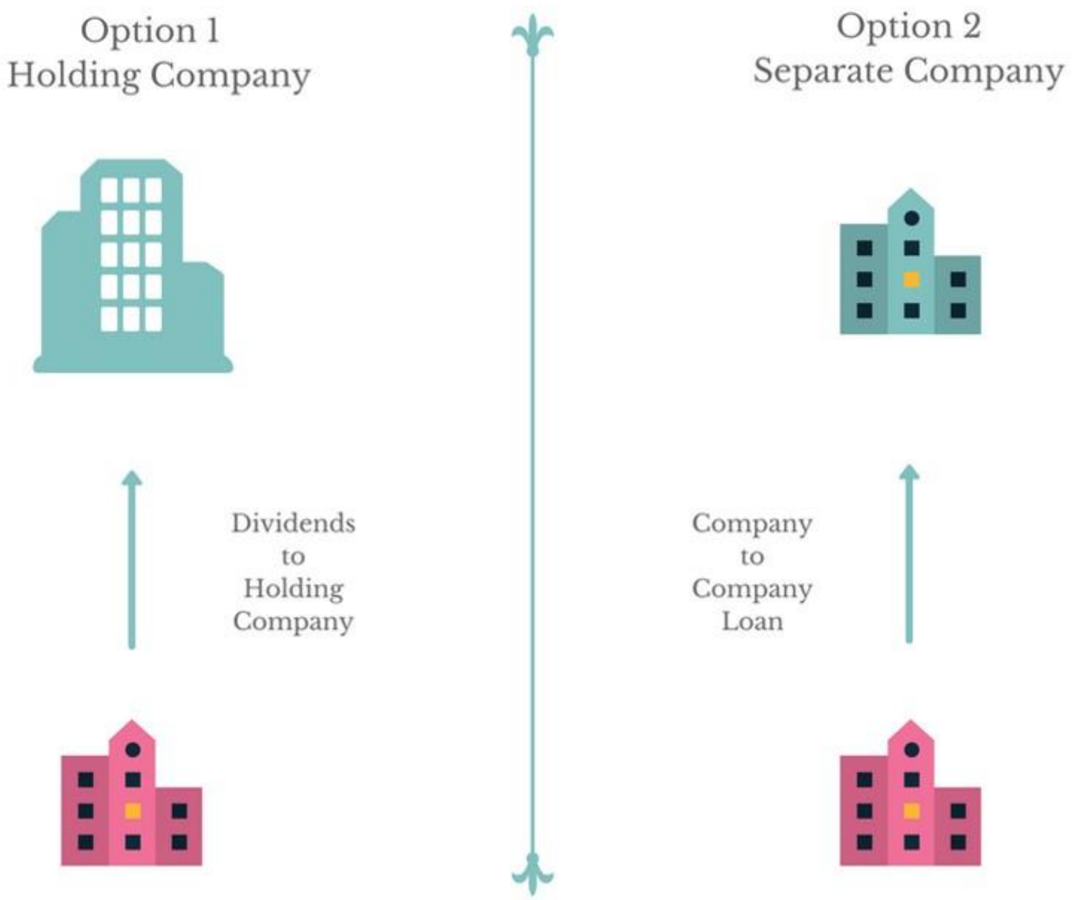
Crucially if the money is needed back in the company, and subject to the money being in realisable liquid assets, transferring the funds back over shouldn't take much time at all.

So how would a Company invest its profits?

There are two ways that you can invest via a limited company. Let's say you are a manufacturing business operating via a limited company: "Nuts & Bolts Ltd".

Option 1: A holding company (i.e. "Nuts & Bolts Holdings") owns your "Nuts & Bolts Ltd" trading company and receives the cash surplus as dividends.

Option 2: You open a totally separate company and receive the money as a loan from "Nuts & Bolts Ltd".



After working with many business and accountants, having two companies as separate entities is a clearer structure and easier to set up and administer on an ongoing basis.

We have worked with many businesses who have chosen option 2 and decided to set up with an interest free loan to the separate business, with a repayment profile in a timescale to be agreed. You may want to make it more formal by having the borrower pay a small interest to the lender.

The business will need to document the loan agreement in a signed letter from the trading company to the investment company and make regular bank transfers while keeping track of the money flow. There is no obligation to pay back the loan as the Directors of Company 1 are also the sole directors of Company 2.

If you follow the company loan agreement (option 2) the trading company (Company 1) can still claim Entrepreneur's Relief as long as the loan is repaid in full. Entrepreneur's relief means that in case you want to close down or sell your business you'll only pay 10% capital gains tax on the gains.

Why not invest the money from your trading company directly?

Three reasons.

1. The trading company should not get caught up in 'non-core' activities. There is a risk of your trading company being classified as a close investment holding company which has tax implications. Your trading company should trade only in its relevant sector. In our case, "Nuts & Bolts Ltd" can make nuts & bolts etc but should not start buying stocks & shares or buy-to-let property.
2. Legal separation: If there's trouble in one company, your other company will not be affected in legal terms.
3. Easier for tax purposes: The investment company will not have any payroll, VAT obligations etc.

In both cases, you'll need to open a new company. That's actually quite easy and the Gov.uk website does a great job at explaining the process. It's also something Blackman Terry Accountants can provide advice on and do for you.

Note that you will need to provide a list of SIC codes, which technically defines the nature of your business. There are no fixed rules for what your SIC codes should be. Just focus on finding the SIC code(s) that best describes your investment activities.

Because most businesses we've helped invest in stocks, shares and bonds, and may invest in property too, they've selected the following SIC codes:

64991 – Security dealing on own account

68100 – Buying and selling of own real estate

It's better to set up a special property vehicle (SPV) if you want to invest in property. This is essentially another company that only invests in property. This way it's easier for the underwriter to give you a buy-to-let company mortgage. The downside of investing in property is that the funds are illiquid and take a lot longer to sell and may have less preferential tax treatment.

What about the Corporation Tax the investing company has to pay?

The investing company must pay corporation tax on the gains each company year. However, that's only if those gains are realised. In other words, in the stocks & shares world, if you "buy and hold" a fund but never sell, you don't have to pay anything even if the fund price keeps increasing every year. You only make a gain when you sell at a profit.

An added benefit of investing via a limited company is that the dividends received from stocks & shares are exempt from corporation tax. That's a big plus. Rent from property, however, is subject to corporation tax the year it's received.

Dividends received at the company level are exempt from corporation tax. That's as long as the location of the fund/shares is in the UK or in one of this this long country list. Because dividends have already been taxed at the company which distributes them, it therefore avoids double taxation.

On one hand, company investment gains are taxed by corporation tax, but at the same time, you invest a larger pot if you don't take dividends out.

Investing through a limited company requires a bit more upfront work to set it up. That's because you need to open a new company and a new business account, find an accountant, keep track of the loans etc. Nevertheless, this can be a much more profitable strategy to build your wealth and use it while travelling the world, raising kids, you name it!

Have you forgotten the pension?

If you don't pay yourself a pension, then it's definitely worth considering this option **first**. Your company should pay a pension into a SIPP pot which grows tax-free.

The best part is that the money going into the pension are not taxed by corporation tax. It's a win-win situation for both the company and yourself and a great way to secure your financial future and diversify a pot of wealth away from the business.

Individuals have a £40,000 allowance per year (plus up to £40,000 from the previous three years unused allowances) which they can pay into pensions, however this figure may reduce down to £10,000, or even zero in certain circumstances.

When it comes to using Pension allowances, or reviewing insurances for your business and key employees, it's worth taking specialist advice as these are both notoriously tricky areas to navigate. Even if you have arrangement in place currently, a second opinion and review costs nothing.

Summary

If you've found the contents of this article interesting and would like to know more, or would like to discuss your own circumstances, why not arrange a free no obligation discussion with **Servo Private Wealth**. This can be arranged through **Blackman Terry Accountants** or by directly contacting:

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