



September 2023

## NEWSLETTER

### Limited Companies

**Recent** conversations have shown me that many people do not understand the true nature of a limited company and its relationship with the people who own and manage it. I hope that this brief summary will help.

The first thing to say is that a limited company is a legal person in its own right, separate from the people involved with it. A company can own assets (including bank accounts) and can take or defend legal action in its own name. It also has to submit tax returns and pay Corporation Tax on its profits.

A company is owned by its shareholders. Part of the formation process is that one person or more has to agree to buy shares, usually at the nominal price of £1 each. A company is called limited because the shareholders' liability to the company is limited to paying for their shares. Once that is done, they cannot be held liable for any of the company's debts (unless of course, they have separately given a personal guarantee to the lender). Further shares can be issued later to the same or new shareholders.

Most small companies issue only a few shares, just enough to give each shareholder the desired proportion of the total. For instance, if three people form a company and wish to have equal shareholdings, it is necessary to issue only three shares, one to each shareholder. Generally, there is only one class of shares, called ordinary shares, and all shareholders have equal rights.

The shareholders then appoint directors to manage the company's affairs. The directors have a collective responsibility to run the business in the best interests of the company, not their personal interests. Strictly, a directorship is an office, not an employment, so the National Minimum Wage does not apply unless the director also has a contract of employment with the company. Either way, any salary paid to the director is taxed as wages under the PAYE system. That is the only way for the company to remunerate a director.

Once a company has provided for its Corporation Tax, any remaining profit can be used to pay dividends, in either the same year or a later year. A dividend has to be ultimately approved by

the shareholders, but an interim dividend can be provisionally declared by the directors. A dividend is declared as an amount per share, so each shareholder receives that amount multiplied by the number of shares held. Sometimes, a company may wish to pay different rates of dividend to different shareholders. That can be achieved by creating different classes of share, such as Ordinary A, Ordinary B and so on, so that a separate rate of dividend can be declared on each class.

The dividends received by shareholders are their personal income and need to be declared on their own tax returns. Often, the shareholders and directors of a small company are the same people, so they can set their salary and dividends to pay themselves in the most tax-efficient way. Actually, the most tax-efficient way would be to pay only dividends, but there is another consideration: it is usually beneficial to take some salary in order to receive National Insurance credits, which earn benefits, including the state pension.

I often hear people saying that they have been advised (usually by a friend in the pub) to form a limited company because it gives protection against their house being seized to pay the company's debts. Although that is theoretically correct, the protection given by limited liability is largely illusory, because no bank or finance company will lend to a small company without the shareholders/directors giving their personal guarantees. Directors can also be held personally liable for debt incurred when acting beyond their authority, or for deliberately withholding payment of certain taxes.

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### A Cultural Divide

**HM** Revenue and Customs was formed in 2005 by the merger of the Inland Revenue and HM Customs and Excise, two tax collection departments whose responsibilities had little or no overlap. Those two sides seem to have continued to operate separately, largely following their traditional cultures. The old HMCE side, for instance, sometimes seems to have an attitude akin to 18<sup>th</sup> century excise officers pursuing smugglers, by assuming that any misdemeanour or default is a deliberate criminal act.

One significant difference has been the separate penalty systems, arising from VAT and Income Tax legislation. Part of the move to Making Tax Digital (MTD) is to introduce a new penalty regime from 1 January 2023. However, as MTD for Income Tax will not start before 2026, the new system currently applies to only VAT returns and payments. Under this new system, accountants acting for VAT-registered traders now have to be sent copies of VAT penalty and surcharge letters, something which the Inland Revenue had always done for Income Tax, but HMCE never did for VAT. Two recent experiences of mine have shown that the VAT office is having difficulty adapting to this change of culture.

First, I submitted an appeal on behalf of a client against a VAT decision which seemed unfair and not supported by any legislation or guidance. Unlike with Income Tax, I received neither an acknowledgement of the appeal, nor a letter giving a decision with reasons. The VAT office just sent a letter to the client reversing the original decision; the client did pass a copy of that letter to me, but he should not really have needed to.

Second, a client was late submitting a VAT return and a copy of the default letter was sent to me. I received an exact copy of the letter sent to the client, with my name and address, but no mention of the client's name. It therefore read as if I were the one in default and the only indication that it did not relate to me was the client's VAT number as reference. I have made a formal complaint about the bad design of that letter, but I doubt whether I shall receive a reply.

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## Proof of Income

I recently heard the strangest reason ever for a lender refusing to accept proof of income for a mortgage. As usual, the lender wanted confirmation of the income declared to HMRC, so the applicant provided copies of the tax return and the resulting tax calculation based on those figures. The lender, however, refused to accept that evidence because the tax return was handwritten!

That is grossly unreasonable when some people do still submit paper tax returns completed by hand. Once processed by HMRC, they are evidence just as valid as a computer-generated return and can be verified by matching the entries to the tax calculation, which is no different whether the return was filed online or on paper.

## Asda Fuel Receipts

**One** of my staff pointed out something odd about the fuel receipts issued by the Asda filling station in Newark, where the customer has asked for a VAT invoice. The receipt shows the details of the fuel purchased, with the VAT analysis, but then the card payment total at the bottom is often larger, showing that something else was purchased. Even if those items were valid business expenses, they cannot be claimed for VAT or Income Tax because there is no indication of what they were.

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## Spell Checkers

**Most** people don't seem to realise that word processing programs usually have American English as the default setting, so it needs to be changed to British English. Failure to do that will result in misspellings of words like practice/practise and licence/license, which I find annoying. I have even seen errors with those words in publications from my Institute, which should know better.

If you use a spell checker, please set it correctly for the country you live in.

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## Old Post Processing

**HMRC** recently appointed a task force to assist with processing old letters which they have not replied to. This will look at post more than 12 months old, which is a staggering admission that they actually have unanswered letters from so long ago. No organisation, especially a government department, should ever have allowed that situation to arise.

By contrast, I have always annoyed HMRC by generally answering their letters by return of post and sending monthly reminders when they have not answered mine.

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## Pass it on

**Please** feel free to copy or pass on this newsletter to friends and business acquaintances. Anyone who would like to be added to the mailing list should e-mail me at the address below.