New Business Kit 2018/19

The Financial, Tax and Accounting Considerations of Starting a New Business

With this handy reference guide to starting a business, you should be able to successfully handle many of the problems encountered in starting and running a business. Always remember to seek professional advice in areas that you are not sure about. The benefits will far outweigh the cost. Good luck!

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Chapter 1 - Selecting a Legal Entity for Your Business

One of the first major decisions you will have to make as you start your new business is the form of legal entity it will take. To a large degree, this decision may be dictated by the way you have organised your operations and whether you intend to work on your own or in conjunction with others.

The form of entity you choose can have a significant impact on the way you are protected under the law and the way you are affected by taxation rules and regulations. There are four basic forms of business organisation. Each has its own benefits and drawbacks and is treated differently for legal and tax purposes.

Sole Proprietorship

A sole proprietorship is typically a business owned and operated by one individual. A sole proprietorship is not considered to be a separate legal entity under the law, but rather is an extension of the individual who owns it. The owner has possession of the business assets and is directly responsible for the debts and other liabilities incurred by the business. The profit or loss of a sole proprietorship is combined with the other income of an individual for income tax purposes.

A sole proprietorship is perhaps the easiest form of business to own and operate because it does not require any specific legal organisation, except, of course, the normal requirements such as licenses or permits. A sole proprietorship typically does not have any rules or operating regulations under which it must function. The business decisions are solely the result of the owner's abilities.

Partnership

In a partnership, two or more individuals join together to run the business enterprise. Each of the individual partners has ownership of partnership assets and responsibility for liabilities, as well as authority in running the business. The authority of the partners, and the way in which profits or losses are to be shared, can be modified by the partnership agreement. The responsibility for liabilities can also be modified by agreement among the partners, but partnership creditors typically have recourse to the personal assets of all of the partners for settlement of partnership debts.

The rights, responsibilities and obligations of partners are typically detailed in a partnership agreement. It is a good idea to have such an agreement for any partnership.

A partnership is a legal entity recognised under the law and, as such, it has rights and responsibilities in and of itself. A partnership can sign contracts, obtain trade credit and borrow money. When a partnership is small, most creditors require a personal guarantee of the general partners for credit.

A partnership is also required to file an income tax return. A partnership typically does not pay income tax; the information from the partnership tax return is combined with the personal income of the partners to determine their overall tax liability.

Limited Liability Partnership

The Limited Liability Partnership ("LLP") offers limited liability to its members but, like a traditional partnership, is tax transparent and offers flexibility in terms of its internal organisation.

An LLP is a separate legal entity from its members. Therefore, it may enter into contracts and deeds, sue and be sued and grant floating charges over its assets in its own name. This avoids the problems that exist in relation to partnerships, where technically it is often necessary for every partner to be party to certain documents or litigation, and the creation of floating charges is not possible.

The members of the LLP are those persons registered at Companies House as members. These members can be individuals, limited companies or even another LLP.

The main "price" paid in return for limited liability is public availability of financial statements. An LLP must file accounts (prepared on a "true and fair view" basis) annually at Companies House, the same as a limited company.

In addition the LLP must also file details of the name and address of every member at Companies House. At least two members must be "designated members" responsible for making proper filings at Companies House (and subject to penalties in the event of default).

Provided an LLP carries on a trade or a profession and is not simply an investment vehicle, it is tax transparent - that is, the LLP itself is not taxed on its income or capital gains. Instead the members are taxed on their shares of the LLPs' profits and gains, just as partners in a partnership are currently taxed.

Up until 6 April 2014, all members of an LLP were taxed as self employed individuals. However, from 6 April 2014, certain members (mainly those receiving a fixed profit share) are now required to be taxed as employees with PAYE and Class 1 National Insurance Contributions ('EEs and 'ERs) being payable on their remuneration from the LLP.

LLPs were primarily intended for use by the professions. However, any type of business operating for profit may use LLPs. An LLP may be suitable for use as a joint venture vehicle or as an alternative to a limited company, particularly for small businesses.

Limited Company
A limited company is a separate legal entity that exists under the authority granted by statute. A limited company has substantially all of the legal rights of an individual and is responsible for its own debts. It must also file tax returns and pay taxes on income it derives from its operations. Typically, the owners or shareholders of a limited company are protected from the liabilities of the business. However, when a limited company is small, creditors often require personal guarantees of the principal owners before extending credit. The legal protection afforded to the owners of a limited company can be useful.

A limited company must obtain approval from Companies House to use its proposed name. A limited company must also adopt and file a Memorandum and Articles of Association, which govern its rights and obligations to its shareholders, directors and officers.

A limited company must file annual tax returns (CT600 corporation tax returns) with HM Revenue & Customs.

Incorporating a business allows a number of other advantages such as the ease of bringing in additional capital through the issue of share capital, or allowing an individual to sell or transfer their interest in the business. It also provides for business continuity when the original owners choose to retire or sell their shares. From a tax perspective, the act of incorporation can create advantages via:

- Selling the business to the company at market value and paying Capital Gains Tax (CGT) on the gain at 10%, with the benefit of entrepreneurs' relief, instead of the normal rate of tax when funds are withdrawn from a limited company.

- Saving National Insurance contributions (NICs) by drawing profits as dividends rather than as salary. Note however that after 6 April 2016 there were significant increases in the rates of tax on such dividends to discourage this tax planning strategy (see later) although it remains valid.

- Involving family members in the business with potential tax benefits

Should you decide to incorporate your business venture, you should seek advice from OCL Accountancy. We can also incorporate the company for you and register it (as appropriate) for PAYE and VAT.

Business Structure – The Pros and Cons

Company	Sole Trader/Partnership
A company must be formally incorporated with a written constitution in the form of a Memorandum and Articles of Incorporation. There is, therefore, an initial setup cost	There are no formation costs, but a written partnership agreement is advised. There is a need to register with HMRC and that involves some cost.
Companies are governed by the Companies Acts. A company must:- - Keep accounting records - File accounts and an annual Confirmation Statement with the Registrar of Companies. This information is available to the public. - Keep Statutory Books showing details of shareholders and directors	Sole traders and partnerships are not required by law to have annual accounts nor to file accounts for inspection. However, annual accounts are necessary for the HM Revenue and Customs tax returns.
Companies may have greater borrowing potential. They can use current assets as security by creating a floating charge.	Sole traders and partners are unrestricted in the amount and purpose of borrowings but cannot create floating charges.
Shares in a company are generally transferable – ownership may change but the business continues.	
Incorporation does not guarantee reliability or respectability but gives the impression of a soundly based organisation. Personally, there may be prestige attached to directorship.	The unincorporated business does not carry the same prestige.
Tax is payable on directors' remuneration paid via PAYE on the 19th of the following month (as for any employee). If applicable, higher rate tax is paid by shareholders on dividends under the self-assessment rules. Corporation tax is generally payable 9 months after the year-end.	For a sole trader or partnership, tax is generally paid by instalments on the 31 January in the tax year and the 31 July following the tax year. For an ongoing business the tax for (e.g.) 2018/19 is payable as: first payment on account on 31 January 2019, second payment on account on 31 July 2019, with any final balance due on 31 January 2020. For a start-up business, this is slightly different and covered later.
First year losses in a company can only be carried forward to set against future profits.	Start up losses generated by a sole trader or a partner in the first years may be set against other income of the year or carried back to previous years.
The corporation tax rate is now 19% irrespective of the level of profits, and this will reduce to 17% from 2020.	Profits are taxed at 20% on taxable income up to £34,500 for 2018/19 and 40% thereafter with a 45% rate on income over £150,000
There is both employers' and employees' national insurance payable on directors salaries and bonuses. The NI charge is greater than that paid by a sole trader/partner, but there is no NI charge on dividends.	A partner/sole trader will pay Class 2 NI of £2.95 p.w. (2018/19) and Class 4 NI dependent on the level of profits, 9% up to £46,350 and 2% thereafter.

Chapter 2 - Registering with the Tax Authorities

A significant task for the new business owner is ensuring that the business is properly complying with the extensive tax and information filing requirements imposed by the various authorities. Problems and penalties could arise if the new business is not registered with the appropriate tax authorities in a timely fashion. HMRC is moving towards electronic forms and notifications via the internet. Paper forms are still required in some instances. To ensure compliance, we ensure that clients (and their companies where applicable) are registered as necessary.

There are many ways we can help you:

- We can assist you in registering for VAT online
- We can act as your agent and file VAT returns online with you providing us with the figures to be entered
- We can help you implement online filing through software
- We can provide you with accounting software with integrated online filing so you can easily calculate and file the figures

When do I need to submit digital accounts information to HMRC for my business?

The Government proposes to require businesses to submit accounts information to HMRC quarterly as part of the “Making Tax Digital” project. This was originally scheduled to start for some businesses in 2018. However, on 13 July 2017 it was announced that Making Tax Digital for Business would be delayed to 2020 at the earliest but would be introduced for VAT quarterly reporting from April 2019. This means that all VAT registered business above the VAT registration threshold will need to keep their accounting records in a digital format that links to the HMRC computer system. The legislation to introduce Making Tax Digital (MTD) was included in the second 2017 Finance Act. Many of the detailed rules are now set out in regulations in secondary legislation. We can help you choose a suitable computerised accounting system for your business that satisfies the new digital accounting rules.

It has now been confirmed that quarterly updating would not be mandatory for those businesses below the VAT registration threshold (currently £85,000)

Tax Calendar

The following summarises some of the more significant filing dates for a corporation using a calendar year end. Many of these requirements also apply to partnerships and sole traders. Naturally, if a year-end other than 31 December is used, some of these dates will vary.

Chapter 3 - Accounting & Bookkeeping

As an owner of a business, you must remember that your company's books and financial statements represent a score sheet which tells how you are progressing, as well as an early warning system which lets you know when and why the business may be going amiss. Financial statements and the underlying records will provide the basis for many decisions made by outsiders such as banks, landlords, potential investors and trade creditors, as well as taxing authorities and other governing bodies. The necessity for good, well-organised financial records cannot be over-emphasised. One of the greatest mistakes made by owners of small businesses is not keeping good financial records and making improper or poor business decisions based on inadequate information.

Quality financial information does not necessarily translate into complicated bookkeeping or accounting systems. Far too often owners of businesses become overwhelmed by their accounting system to the point where it is of no use to them. An accounting or book-keeping system is like any tool used in your business; it needs to be sophisticated enough to provide the information you need to run your business and simple enough for you to run it (or supervise the book-keeper). Questions you should ask in developing an accounting and financial reporting system are:

1. Who will be the users of the financial information?
2. What questions do I need answered to manage the business?
3. What questions should be answered for HMRC authorities? It should be noted that HMRC are increasingly making Business Records Checks of those businesses they reckon could have poor records

As your business grows, you should work closely with your accountant to ensure that your accounting system is providing you with appropriate information.

The Government proposes to require businesses to submit accounts information to HMRC quarterly as part of the "Making Tax Digital" project. This was planned to start in 2018 but has now been deferred apart from VAT reporting. You should therefore consider a computerised accounting package from the outset that enables you to comply with this new obligations. We can advise on the most suitable accounting software for your business.

Cash or Accrual Accounting

One of the decisions to be made as you start a business is whether to keep your records on a cash or accrual basis of accounting. The cash basis of accounting has the advantage of simplicity and almost everyone understands it. Under the cash basis of accounting, you record sales when you receive the money and account for expenses when you pay the bills. Unfortunately, the business world is not always so easy. Sales are made to customers and you sometimes must extend credit. Your business will incur liabilities which are due even though you may not have received the invoice or have the cash available to pay them.

Most users of financial statements such as bankers and investors are used to accrual-basis statements and expect to see them. Once you become familiar with them, they provide a much better measuring device for your business operations than cash-basis statements.

Whether you use the cash or accrual basis, it is possible to keep books for income tax purposes on a different basis than for financial statements. It may be more advantageous (less tax) for you to do so and we can advise you on the advantages and feasibility of doing this in your business.

Accounting Records and Record Keeping

Another question that the owner of a business must answer is "Who will keep the books of the business?" Will you do it yourself, will the receptionist or a secretary double as a part-time bookkeeper, will you have a bookkeeper that comes in periodically, or will the volume of activity be such that a full-time bookkeeper will be required?

A Word about Accounting Software Systems

There are a number of very good and easy to use accounting software systems which are commercially available, but none of them will solve the problems of inaccurate or poor quality financial records. All they will do is generate bad information faster. This is one of the reasons that the computer has also probably caused more headaches for the owners of modern businesses than any other single cause. If you want to use a computer-based accounting package, either in your own business, with a service bureau, or through your accountant, it is imperative that you generate accurate information to be entered into the system.

The real value of accounting software becomes apparent once it is running smoothly in your business. Your accountant can then function in the capacity for which he was trained, not as a "number cruncher", but as your business adviser, consultant and strategist. Both of you can focus not on producing reports for various regulatory agencies but on analysing your business to make it more profitable.

Chapter 4 - Value Added Tax

VAT is a tax on consumer expenditure and is ultimately paid by the final customer. Most business transactions involve the supply of goods or services and VAT is payable if they are made:

a) in the United Kingdom
b) by a taxable person
c) in the course or furtherance of business and are not specifically exempted or zero-rated

VAT is collected by HM Revenue & Customs and is normally payable quarterly.

Registration
There are two different types of registration - compulsory and voluntary:

A. **Compulsory**
A person who makes taxable supplies becomes liable to be registered if:

a) At the end of any month, the value of his taxable supplies in the period of one year then ending has exceeded the registration limit, which is £85,000 from 01 April 2017.

b) At any time, there are reasonable grounds for believing that the value of his taxable supplies in the next 30 days will exceed the £85,000 limit.

c) If, where a business carried on by a taxable person is transferred as a going concern, the taxable supplies for the twelve months prior to the transfer exceed £85,000.

Note that the VAT registration threshold is normally increased in year in line with inflation but the 2017 Autumn Budget proposes to fix the VAT threshold at £85,000 until 31 March 2020.

In the most common situation, i.e. (a) above, the person must notify HMRC of the liability within 30 days of the end of the month in which the value of the taxable supplies first exceeded £85,000. If, for example, the value of the taxable supplies first exceeded £85,000 in the twelve months to 31 March, then HMRC must be notified by 30 April and VAT registration would commence on 1 May.

B. **Voluntary**
In certain circumstances, it is possible to register on a voluntary basis for VAT even though the value of taxable supplies may never exceed £85,000. This is normally only beneficial where the majority of supplies are being made to customers who are themselves VAT registered, e.g. it would not be beneficial for a domestic painter with taxable supplies of £30,000 to be registered, whereas it may be beneficial for a commercial or industrial painter with the same level of supplies.

The other situation in which a voluntary registration might be beneficial is where the supplies are all zero-rated and no VAT is charged on the transaction. All VAT suffered by the trader on expenses can be reclaimed from HMRC.

In summary, the advantages and disadvantages of a voluntary registration are as follows:

Advantages

- enables input VAT suffered to be reclaimed;

- a VAT number can give the impression that a business is larger than it actually is which sometimes can increase the possibility of obtaining work.

Disadvantages

- the requirement to prepare VAT returns on a quarterly basis and to submit them and if applicable pay over the VAT due approx one month + 7 days after the quarter end - is the amount of work involved worth it for the amount of input VAT that can be reclaimed?

- HMRC may periodically visit the business (about every five years, but depends upon the risk of errors) to ensure that VAT is being properly accounted for. There may be penalties for incorrect returns.

- Where most of the customers cannot reclaim VAT, such as domestic consumers, your prices will be uncompetitive compared to non VAT registered suppliers.

Taxable Persons and Supplies

a) Taxable Persons

It should always be remembered that it is a person that is registered for VAT and not a business. If a person has two separate different businesses, both with taxable supplies of £50,000, then that person will be required to be registered for VAT and account for VAT at the appropriate rate on the total supplies of £100,000.

It is possible to mitigate the effect of VAT by having one of the businesses operated by a limited company or by a partnership with a relative, but professional advice needs to be taken since HMRC have the power to still treat the two businesses as one if strict criteria are not met.

b) Taxable Supplies

Taxable supplies are all supplies made by a business either to a third party or to the trader himself (goods for own use), which are not exempt supplies. Taxable supplies therefore include zero-rated supplies.

The major categories of exempt supplies are:

- Land (but not buildings)
- Insurance
- Postal services
- Betting, gaming and lotteries
- Finance
- Education
- Health and welfare

It is important that at the outset of a business, a trader establishes the VAT status of any supplies being made to avoid mistakes, e.g. the services of a physiotherapist are exempt, whilst the services of an acupuncturist are standard rated.

Tax Rates
There are three rates of VAT:

1. 20% - the standard rate of VAT, applying to any sales of standard-rated goods or services
2. 5% - for certain supplies of fuel and power and sanitary goods
3. Zero-rated - the four main areas of zero-rated goods are:

    - Food and agriculture (but excluding pet food and most catering)
    - Printed matter, including books and newspapers
    - Young children's clothing and footwear
    - Passenger transport (but excluding hire cars, taxis and parking)

Any VAT charged by the business, whether at 20% or 5% is known as output VAT and the total charged or collected in the VAT quarter is payable to H M Revenue & Customs.

Input VAT
Input VAT is the VAT that you are charged on your business purchases and expenses (the other persons output VAT) and is normally recoverable in full by a trader who only makes standard rated or zero-rated supplies. Businesses that make some exempt supplies (known as partially exempt businesses) have different recovery rules. The total input VAT suffered in the quarter is deducted from the output VAT charged or collected and the difference is either the amount of VAT due to HMRC or the amount repayable by HMRC. The majority of input VAT is recoverable but there are special rules for:

- cars
- petrol supplied for private usage;
- business entertaining;
- goods sold under a VAT second-hand scheme.

To reclaim VAT you have been charged as input VAT, you must hold valid evidence that you have received a taxable supply, which normally means a valid VAT invoice from a registered trader showing his VAT number and the amount of VAT charged.

Quarterly returns
As mentioned earlier, as part of the Making Tax Digital project, all VAT registered businesses above the registration threshold will need to keep their accounting records in a digital format and update HMRC quarterly from April 2019. Currently most businesses manually input their VAT details and are not required to maintain computerised accounting records.

Penalties
There are penalties for errors in VAT returns. More details can be found at the HMRC website:
https://www.gov.uk/vat-returns/surcharges-and-penalties

Money Laundering Regulations
HM Revenue & Customs have responsibility for administering certain aspects of The Money Laundering Regulations 2007, particularly relating to High Value Dealers (HVDs).

HVDs are those traders who may receive 15,000 Euros (approximately £12,000) in a single transaction or a series of linked transactions. The Regulations principally apply if cash or cash equivalent are offered in settlement.

If you believe you may be a HVD you should discuss this with your advisors or visit HMRC's website at www.hmrc.gov.uk

Further, if you believe you may be affected by the Regulations as they related to regulated businesses, you should discuss this with your advisors as the penalties for not complying are serious.

Chapter 5 - Payroll Taxes and Pensions

Irrespective of the form of business in which you operate, if you are going to have employees, then you will have to contend with payroll taxes. If you are trading as a limited company then remember that the directors are also employees. The brief summary that follows will give you some guidance in the rules and regulations of HMRC.

Helpful Publications

HMRC publish guidance on their website relating to how PAYE is operated and the legislation that you have to comply with. Not only do you collect and remit PAYE to the Collector of Taxes on behalf of HMRC, you also operate the sick pay scheme and maternity pay scheme. You should run the PAYE scheme in accordance with the legislation and should you fail to comply then HMRC will look to the employer for the tax or NIC you failed to deduct. This can be costly if you are unable to recover the tax and NIC from the employee.

Do You Have Employees?

Whether an individual is an employee or not in a particular situation is a question of fact depending on the terms on which he works. The question of whether an individual is employed or self-employed is very important for the business "employing" him or her, as that business has to comply with the reporting requirements. The "employer" should not just accept that the worker says he is "self employed".

In certain areas HMRC has placed emphasis on reclassifying individuals claiming to be self-employed and has issued leaflet IR56 entitled "Tax: employed or self-employed". The booklet sets out the questions that should be answered to determine the problem. If you have treated someone as self-employed and subsequently after a routine visit from HMRC it is clear that they were employees, then the tax and NIC which should have been paid will be assessed on the employer. Therefore it is important to ensure when using the services of self-employed people that they are in fact self-employed. If doubt exists as to the status of an individual, the situation can be clarified with HMRC. HMRC provide an interactive software tool to help employers and workers at:
https://www.gov.uk/employment-status-indicator

The Operation of PAYE and Real Time Information

Most businesses operate a computerised payroll system these days and we can advise on the software to use if you wish to run the payroll yourself. Alternatively we can prepare the payroll on your behalf if you provide us with employees' hours, rates of pay and overtime on a timely basis each week or month.

A system of Real Time Information (RTI) has been introduced which will allow businesses to submit information electronically to HMRC every pay period. This will in due course eliminate the need for annual end of year returns of wages and salaries. You will need RTI-enabled software provided by several software companies. Alternatively where there are 9 or fewer employees you can use HMRC's Basic PAYE Tools which can be downloaded from the HMRC website.

The tax and national insurance should be paid to HMRC by the 19th of the month following that in which the salaries were paid (22nd of the month if paying electronically).

Under RTI, the employer tells HMRC about tax, NICs and other deductions when or before the wages and salary payments are made, instead of waiting until the end of the tax year. It is hoped that this system will make the PAYE process simpler and less burdensome for employers and HMRC. It removes the need for the end of year return on P35 and P14, although the end of year form P60 still has to be prepared and given to employees. RTI will also simplify the employee starting or leaving processes.

Pensions Auto Enrolment

Recent changes to Pensions legislation require all employers, , to provide a pension scheme for their employees. This “Auto Enrolment” is now an obligation for all businesses with exception of one man band companies.

New Businesses will be required to auto enrol relevant employees as at the date that the business makes its first payment to the employees. There are exceptions and additional procedures for businesses to follow so please contact us for further information.

For automatic enrolment there are minimum contributions you must pay in order to comply with your duties. These are a percentage of earnings and are shown in the table below.

Date	Employer minimum Contribution	Total minimum contribution
06/04/18 – 05/04/19	2%	5%
06/04/19 onwards	3%	8%

Your worker may also wish to pay additional pension contributions, which you will need to make sure you deduct and pay to the scheme on time. Ongoing automatic enrolment responsibilities: www.tpr.gov.uk/ongoing

After you have automatically enrolled your staff members, they may ask to ‘opt out’ of the pension scheme. You must then stop deductions of contributions and arrange a refund of any contributions they have paid to date.

You must set up a workplace pension scheme before your staging date, if you don’t already offer one. If you already have a pension scheme, you may be able to use that scheme. We can advise you on your obligations and assist you in complying with the new rules.

Benefits in Kind

In most businesses, the directors, and often the employees, have benefits that are not immediately taxed through the PAYE system, the most usual being the provision of a car and possibly fuel. Class 1A national insurance contributions (currently 13.8%) are due on the taxable value of these benefits in kind and are due on the 19 July following the fiscal year in which the benefits are made available. In addition, HMRC requires on an annual basis a form P11D (Return of expenses payments and benefits). The form is also used to report reimbursed expenses, such as employee travel and subsistence, however where these are incurred by employees wholly, exclusively and necessarily in the performance of their duties they do not need to be reported. Tne form P11D(b) is required to declare the overall amount of Class 1A National Insurance contributions due on all the expenses and benefits you have provided.

Payroll Software

If you plan to operate and process your own employee payroll there are various software packages available including the free software from HMRC "Basic PAYE Tools" referred to above.

However, operating a payroll system can be complex and time consuming. OCL Accountancy offer a bureau facility for processing your payroll and supplying you with reports, payslips etc. Contact us if you would like further details.

HMRC make available a checklist to help ensure compliance with expenses and benefits:

https://www.gov.uk/government/publications/hmrc-expenses-and-benefits-from-employment-toolkit

Information about completing forms P11D and P11D(b) can be found at:
https://www.gov.uk/employer-reporting-expenses-benefits/overview

You can register online and obtain more details at the HMRC website:
https://www.gov.uk/topic/business-tax/paye

Chapter 6 – Income Tax and Corporation Tax

Eventually, you will have to deal with income or corporate taxes. The taxation legislation is extensive and can be confusing for an individual starting a business. This chapter does not cover all the tax ramifications of a new business, nor does it detail all the expenses you can claim for, nor does it give details of allowances available on the purchase of some capital items. We should be consulted when you are dealing with the taxation affairs of the business. The payment of taxation has a direct impact on your cash flow.

Tax Rates

Companies
Companies are charged corporation tax at the rate applicable during the financial year (1 April - 31 March). Where a company's accounts period spans two financial years the profits for the period are apportioned between the years.

The corporation tax rate used to change most financial years, but from 1 April 2017 the rate for almost all companies will be 19%, irrespective of their level of profits. This rate will reduce to 17% from 1 April 2020.

A company is required to make an estimate of its own liability to corporation tax and pay that liability by the normal due date, **nine months after the end of the accounting period**, without an assessment being raised.

The company is required to send its completed self-assessment tax return (form CT600), accounts and tax computation to HMRC by the filing date, which is 12 months after the end of its accounting period. Penalties will be charged if it is late. These accounts and returns need to be submitted online to HMRC in iXBRL format. We can deal with this on your company's behalf.

HMRC may generally have 12 months from the filing deadline (24 months after the accounting period) to open an enquiry into the company's corporation tax return, otherwise the self-assessed figures are considered final. If additional tax is determined to be payable, interest (and possibly penalties) will be charged on the additional tax due.

Sole Traders / Partnerships
Sole traders and partnerships are charged income tax at the rate applicable during the fiscal years (6 April - 5 April). The rates are as follows:

	2018/19	Rate	2017/18	Rate
Lower	*see below	0%	*see below	0%
Basic- next	£34,500	20%	£33,500	20%
Higher-over	£34,500	40%	£33,500	40%
Additional - over	£150,000	45%	£150,000	45%

*A zero starting rate for savings income up to £5,000 was introduced from 6 April 2015. This rate does not apply if taxable non-savings income exceeds that amount. From 2018/19 the first £2,000 of dividend income is tax free (was £5,000). In addition, the following amounts of interest income will be tax free:

- £1,000 a year interest tax free for basic rate taxpayers
- £500 a year interest tax free for higher rate taxpayers

Tax free interest will not be available to those with income in excess of £150,000 a year.

There may also be a liability to Class 2 and Class 4 National Insurance Contributions, depending on the level of profit in each fiscal year. Class 2 contributions are at a weekly rate of £2.95 (2018/19). Class 4 NI is payable by the self-employed on profits.

Class 4 contributions are levied at 9% on profits between £8,424 and £46,350 for 2018/19. There is a further 2% charge for 2018/19 on profits in excess of the upper limit.

For the self employed and those that pay tax on other income such as rents, tax is normally payable in three instalments - the first two instalments are based on the tax paid on the previous year's business tax liability. Therefore half is paid by the 31 January in the year of assessment, the other half by the 31 July in the year following the year of assessment. The third instalment will be any balance due (payable the following 31 January) or any amount repayable by the Inland Revenue if your final liability is lower than the amounts paid on account.

However – a word of warning when you start up an un-incorporated business.....depending on accounting dates chosen and when you start to trade, you may not pay any tax on profits for some considerable time (for example if you start to trade on 1 May 2018 and first accounts run to 31 March 2019). You will not pay any tax in July 2018 or January 2019, nor will you pay any tax in July 2019. So the first tax liability won't arise until January 2020. This will be 100% of the tax liability for the period to 31 March 2019. In addition, you will also have to pay 50% of that sum "on account" for the following tax year, with a further 50% in July 2020. You are then in the six monthly "cycle" and we can work with you to estimate the tax payments so that you can budget and set the money aside.

A lesson to take on board is to ensure that your accounts are prepared as soon as possible after the end of the accounting period. In our example of 5 April year end, if accounts can be prepared before 31 July it will be possible to calculate the tax for the year to 5 April and the July 31 instalment can be adjusted accordingly – downwards if tax due is found to be less. If tax due is actually more for the year, there is at least early knowledge of the tax bill due in the following January. Under self-assessment your income tax return, which encompasses your trading results, needs to be filed by 31 January following the tax assessment year. This date is moved forward to the end of September if you wish the Inland Revenue to calculate your tax liability. We will however file the returns electronically and perform the tax calculations on your behalf.

Taxation of Dividends

An important factor to consider when deciding whether to trade via a limited company or as an unincorporated business is the total amount of tax payable, not just the rate of tax on the profits. The reduction in the rate of corporation tax from 19% to 17% makes a limited company appear very attractive. However, the shareholder/director then has to pay tax personally on the profits that he extracts from the company, so there is effectively double taxation.

A big cost here is national insurance, payable by both the employer and employee on amounts extracted as a salary or bonus. Many owner-managed companies have tended to extract profits by paying themselves a low salary, with the balance being paid out as a dividend to minimise NICs.

The taxation of dividends was reformed from 6 April 2016. The old 10% dividend tax credit was abolished and in its place, individuals now have a £2,000 (was £5,000) dividend tax allowance. Individuals will pay no income tax on dividend income received up to that amount. However, dividend receipts in excess of £2,000 will be taxed at:

- 7.5% for basic rate taxpayers (previously effectively 0%)
- 32.5% for higher rate taxpayers (previously effectively 25%)
- 38.1% for additional rate taxpayers (previously 30.56%)

The new dividend rates will result in a significant tax increase for owners of small companies, who have for some years been able to extract profits from their business with a tax-efficient mixture of salary and dividends. The chancellor's justification was to make tax-motivated incorporation less attractive.

Example

In 2018/19, Alan and his wife each take a dividend from their company of £34,500 (gross, no tax credit) and a salary equal to their personal allowance of £11,850. They pay tax at 7.5% on £32,500 of that dividend, after deducting the dividend tax allowance of £2,000. In 2018/19 they will each pay income tax of £2,438 on their dividends, totalling £4,876 for the couple.

Tax Credits

Whilst not specifically related to "tax" despite the name, we will mention Tax Credits at this stage. There are two elements - Child Tax Credit and Working Tax Credit, although these are gradually being replaced by a new system of Universal Credits.

Child Tax Credit (CTC) is for families who are responsible for at least one child or qualifying young person. You should claim if you have a child or qualifying young person who usually lives with you. You do not have to be working to claim CTC.

Working Tax Credit (WTC) is for people who are employed or self-employed (either on their own or in a business partnership), who:

- get paid for their work
- expect to go on working for at least 4 weeks

and who are either

- aged 16 or over and responsible for at least one child, and usually working at least 16 hours a week, or
- aged 16 or over and disabled, and usually working at least 16 hours a week, or
- aged 25 or over and usually working at least 30 hours a week, or
- aged 50 or over and are starting work after receiving certain benefits for at least 6 months and usually working at least 16 hours a week, or
- aged 60 or over and work at least 16 hours per week

WTC is made up of several elements which we do not have space to list here.

If you are married or living with a partner you'll need to make a joint claim for tax credits. You can only make a single claim if you don't have a partner.

When starting up it may be that your income precluded you from claiming tax credits in the past. However, income may drop substantially or a “loss” for both income tax and tax credits purposes may be able to be created by claiming allowances on equipment etc. Claims can only be backdated for three months from the date of application so it is advisable to contact the Tax Credits office as soon as possible to make a claim. You may not be immediately eligible based on a provisional calculation which takes into account your income in a prior tax year, but you may become entitled to it at some stage. Telephone the Tax Credits helpline on 0845 300 3900.

Child Benefit

This basic credit is payable by reference to the number of children of the claimant. From 7 January 2013, an income tax charge has applied to this benefit where a claimant, their spouse, civil partner or person living with them earns over £50,000 per annum. The charge is 1% of the child benefit received for every £100 of the higher earner’s earnings that exceeds £50,000 in the tax year. So if either you or your partner’s income is £56,000, you will be taxed on 60% of the child benefit received. This is called the High Income Child Benefit Charge.

If your income reaches £60,000 then Child Benefit is recovered in full by the High Income Child Benefit Charge. Alternatively, the claimant can disclaim Child Benefit.

Chapter 7 - Obtaining Credit and Financing Your Business

If not independently wealthy and perhaps even if you are, eventually you will probably need to obtain some outside capital for your business. In some instances, you may need to obtain capital for the initial expenses prior to opening your business or, for instance, the funds you require may be for expansion or working capital during the off-season.

Generally, business financing can take two forms; debt or equity. Debt, of course, means borrowing money. The loans may come from family, friends, banks, other financial institutions or professional investors. Equity relates to selling an ownership interest in your business. Such a sale can take many forms such as the admitting of a partner or, if you are in a company, issuing of additional shares to investors. It is typically a prudent idea to consult with your accountant, as there are many significant legal ramifications to such a step.

How Do I Get the Money?

Irrespective of the type of financing you need and are able to obtain for your business, the process of obtaining it is somewhat similar. There are several questions that must be answered during the course of raising money for your business. The ability to answer these questions is critical to your success in obtaining financing as well as the overall success of the business. Remember, in raising capital you have to sell the ability of your business to potential investors in much the same way as you sell your product to your customers.

1. How much cash do I need?

To answer this question you will have to do some serious cash flow planning, which will require estimates of future sales, the related costs, and how quickly you must pay your suppliers. You will also have to build into your planning some assumptions about when you will generate enough cash to pay the money back. However, if you raise cash through equity you probably don't need to pay it back but your investors will want to know how the value of the business will grow and how they will benefit through dividends or selling their shares.

2. What will you do with the money?

One of the most important questions you will have to answer for a potential investor is how the money will be spent. Will you use it for equipment or to hire additional employees or perhaps for research and development for a new improved product? Again, part of the answer on how you spend the money is how it will benefit the company.

3. What experience do you have in running your business?

One of the primary reasons for business failure is lack of experience of management. You will need to convince your investors that you have the knowledge, experience and ability to manage your business and their money at the level at which you expect to operate.

4. What is the climate for your type of business and your geographic location?

Few investors will want to put money into your business if you haven't done sufficient "homework" to determine that you have a reasonable chance of success. If your business is based on existing economic or legal conditions that are subject to change in the near future your risk is substantially increased. Even if your business has great potential, if the local economy is sluggish to the point that it can't support your venture, you need to be aware of this before moving ahead.

Once you have developed concrete answers to these and other pertinent questions, you can begin looking for financing. One of the first steps is to determine whether to raise funds through debt or share capital. There are positive and negative aspects to each type. The cost to your company of each type of funding is different, as is the way in which they are treated for tax purposes. The interest on borrowed money is deductible by a business for tax purposes, which reduces the effective cost to your company. Dividends which you might pay on the same investment in shares would typically not be tax deductible by your company. In selling shares there usually is no firm commitment by your company to pay the money back but your shareholder will want, and generally will have, a legal right to have a voice in the management of your company. When you have made the decision as to the type of financing you think is appropriate to fit your desires and needs, it is probably a good idea to consult with your accountant as to alternative types of debt or equity financing available.

Business Plan

Typically, a potential lender will want to know all about you and your proposed venture. Many of these details will have already been provided, but are best provided in a logical consolidated format. This format, or **business plan**, is a document that enables the investor to readily obtain an understanding of your proposal. It follows that in order to successfully raise funding, the business plan should be commercial and realistic.

OCL Accountancy have experience in writing business plans and can assist you in the effective drafting of your plan.

Financing Alternatives

Whether you determine that debt or equity financing is the best choice for your company, there are a number of alternative types of financing available. Depending upon the nature of your business, the financing may be a combination of debt and equity and may be tailored to fit the specific needs of your company.

In the summary, we will only mention a few of the more conventional methods for a young company to obtain capital, though the possibilities are many. OCL Accountancy can discuss these and other alternatives in greater detail.

Debt Financing Sources

1. Banks

The first source of funds, which typically comes to mind when borrowing money, is a bank, which is why they are in business. Banks typically lend to small businesses on a secured basis preferring bricks and mortar as security in preference to equipment, stock or debtors. The more liquid and readily saleable the assets you have to offer as security, the more acceptable they are likely to be a banker. Loans from a bank may take several forms such as:

a) An overdraft limit which is reviewed annually and allows you to borrow up to a predetermined maximum as you need it and pay it back as funds from sales and receivables are collected.

b) A short-term loan that is repayable on specified dates.

c) A term loan for the purchase of a specific asset such as a computer or a machine.

As your relationship with your banker becomes better, and your business becomes established, you may consider a longer (3 to 5 years) loan which will be payable in instalments.

2. Lease Financing

In today's business environment it is quite common to acquire equipment through lease agreements. Leasing packages come in a variety of types through many sources. Leasing companies typically will accept a somewhat higher degree of credit risk because they are looking to the value of the equipment for collateral if your business cannot make the agreed upon payments. For this reason, leasing companies generally prefer to finance new equipment of a general purpose nature which can be resold if necessary. Leases often run for a period of three to five years and because of the risk that leasing companies are willing to take, they are somewhat more expensive than commercial bank loans.

3. Trade Credit

A very important source of financing for your company may be from the creditors and suppliers with whom you do business. Many suppliers will originally ask for cash on delivery or, in some instances, they want payment before starting on your order, depending on the nature of your purchase. Most suppliers will quickly establish trade credit with you once you have gained their confidence by continuing to do business with them and paying as requested.

Equity Financing Sources

Equity financing usually means selling a portion of your business. This can be accomplished in a number of ways including the sales of ordinary or preference shares. Equity sales are usually carefully tailored to meet the needs of both the company and the investor.

Venture Capital Companies

A venture capital company or fund is typically a company that is in the business of taking risks. A venture capital fund is often backed by a group of investors that may be individuals or companies. The investors are often represented by a management group that evaluates potential investments and manages the existing investment portfolio.

Private Individuals /"Business Angels"

Very often, individuals who are successful in their own right and have accumulated substantial wealth may be looked to for investment in your business venture. Such individuals may believe that the success of your business may enhance theirs as well as help increase their personal wealth. There are generous tax breaks that may be available to such investors if they subscribe for shares in a limited company that qualifies under the Enterprise Investment Scheme (EIS), or the new Seed EIS scheme for start-up companies.

Chapter 8 - Insurance

Business insurance, like many types of expenditure, is one of those items that business owners typically do not like to pay. You must remember that sufficient insurance can be as critical to the success of your business as a good product or service. Without proper insurance you could lose all the money, time and effort you put into your company. The types and amounts of coverage you purchase must be evaluated on a cost – benefit basis like any other commodity that you purchase. Your insurance broker can help you review the amount of coverage your business requires. Usually you will want to insure against risks that could have significant detrimental impact on your business. This normally would include items such as fire, storm damage, theft, employers, public liability and products liability. Depending on the nature and size of your business it is often a good idea to self-insure for all or a portion of certain losses. Often raising the deductible (excess) can have a very favourable impact on the policy premium. The administrative cost to the insurance company to process small claims is quite high; consequently, the rates typically go down substantially if they are relieved of this expense by insuring losses in excess of a sizeable deductible amount. An insurance broker can provide you with comparative costs for various types of cover and varying degrees of deductible amounts.

Required Policies

The insurance cover required by law is employers' liability and third party motor insurance. Your insurance broker can explain the required cover and help you purchase the correct policy. You must be aware that the terms of your building, office lease or mortgage may require you to carry certain kinds of insurance cover in specified minimum amounts. If you have leased equipment or have borrowed money from a bank or other lenders, there will usually be insurance requirements in the agreement relating to these transactions. There are many other types of policies that you may wish to consider. Specific cover is provided by each policy and a qualified insurance broker can explain the related costs in-depth.

Some types of insurance cover that you should consider for your business are listed below.

Commercial Liability Insurance

There are many types of liability your business may need cover for. "Liability" refers to your legal obligation to pay compensation and costs awarded against you in respect of loss or damage sustained by a third party. Types of liability insurance you may want to consider are:-

- Public Liability – this will protect you from any liabilities to a third party (other than your employees) for bodily injury or loss/damage to their property that may occur during the normal operation of your business.

- Employers' Liability – if you are a limited company or employ anyone outside your immediate family, you are required by law to purchase employers' liability insurance. This insurance offers you protection for any liability arising from injury or illness sustained by employees whilst they are working for you.

- Products Liability – this will protect you from any liabilities to a third party (other than your employees) for bodily injury or damage to their property that may occur from the products you have sold or supplied.

- Professional Indemnity – this cover is usually purchased by "professionals" such as IT consultants, surveyors, accountants, solicitors etc. This cover will protect your legal liabilities to third parties arising from your or your employees' professional negligence/wrongful advice.

Property Insurance
There are many different types of property cover but generally businesses will purchase cover for buildings, machinery and stock against fire and other perils such as storm/flood etc and theft. They will also consider covering money, goods in transit and glass. For small businesses cover can be provided on a 'package' basis where certain covers such as money and goods in transit are included in the premium as standard. However, this option is only available for specific occupations/trades and you should consult with your broker for further details.

If you are working from home be aware that generally your ordinary household insurance policy will not provide cover for your business stock and liabilities. Specific policies can be purchased if you are working from home and you should contact your insurance broker for further details.

There are specific policies for property owners who rent out their premises to tenants. These policies provide cover for buildings, liability and loss of rent. Loss of rent cover is usually only provided in the event of an insured peril occurring such as a fire or flood etc.

Business Interruption
This covers loss of income/revenue or additional expenditure incurred following a disruption to the operation of your business. Business interruption usually mirrors your property policy and covers the same perils. However, it is possible to add additional perils to your business interruption cover such as food poisoning or failure of utilities.

Fidelity Guarantee
This type of insurance typically covers risk of loss from theft by employees. If your business deals in large amounts of cash, negotiable securities or similar types of assets, you may well be advised to consider this cover. Certain industries are required to carry this insurance by regulatory authorities.

Directors & Officers Liability
Directors and officers of companies in recent years have been found to be personally responsible for their negligence in the running of their company. Recent legislation has also made company directors liable for their behaviour to the company so that shareholders, creditors, customers and employees can now sue them as individuals.

Directors and officers liability cover provides indemnity to the company in respect of the costs it incurs in indemnifying a director against the successful defence of a claim or indemnifying the director where the defence has not been successful.

Key Person Protection
This provides a company with a valuable safety net should serious illness, disability or death curtail the contribution certain "key" people could make to its stability, profitability and success.

Identifying a Key Person

These are the people whose special knowledge, skills or enterprise are vital to the continuing survival of a business - people who are difficult to replace. Remember, key people come in many guises. They aren't always the Managing Director or other high profile senior managers. Consider other key functions that are necessary to the company's business when talking key person insurance with your clients.

When is Key Person Protection Needed?

There are three clearly identifiable situations when key person insurance is most needed.

- To prevent loss of profits
- To protect the repayment of loans
- To safeguard the raising of capital

Partnership Protection

The death of a partner can be extremely damaging to any business. The ability to continue trading and maintain the financial wellbeing of the firm will be vital. In addition, there are other problems which may have to be faced, in the absence of property provision in the Partnership Agreement and insurance cover:

- the partner's interest may pass to an heir who may not have the necessary skills, experience or interest to continue in the business.
- the partner's interest may need to be turned into cash to pay Inheritance Tax or provide for his or her dependants on death.

Raising the finance to buy a partner's interest may involve the sale of assets or finding someone who can afford to buy into the partnership.

Finding a suitable replacement and raising the money can be difficult and time consuming. If unsuccessful, the partnership may even have to be dissolved. It is clear that partners need to retain continuity, stability and control of the business whatever the eventuality. This can be achieved by making adequate legal and financial provision.

Shareholder Protection

Like partners, shareholder's shares may pass to an heir who does not understand the company's business or whose interests conflict with those of the other shareholders. Alternatively, the shareholder's interest may need to be converted into cash to cover Inheritance Tax liabilities or provide for dependants. Maintaining control and stability of the company during this often turbulent time is vital to its continued success. By taking the appropriate legal and financial steps shareholders can be confident that the future holds no surprises.

Fee Protection Insurance

HMRC's powers have changed and they now have wider scope than ever before to visit business premises and inspect records. The likelihood of enquiries into a taxpayer's affairs appears to be on the increase. The professional fees in dealing with such enquiries can often be costly so it is advisable to "insure" or subscribe to a tax protection service which will fund these fees in the event of an enquiry or visit. OCL Accountancy offer such a scheme and full details are available on request.

Chapter 9

Choosing an Accounting Package

It is necessary to consider your requirements and what you want to be able to do before buying a package. There are often different levels of functionality in different versions of a program. Consider both the ability to get data into the product and also the reporting requirements that you have.

Consider also online "Cloud" based accounting packages which will not incur you in any upfront costs – simply pay a monthly fee for its use. These may have integrated payroll too if you have employees in your business.

The Government proposes to require businesses to submit accounts information to HMRC quarterly as part of their "Making Tax Digital" project. This is planned to start for VAT reporting in 2019 and you should consider a computerised accounting package from the outset that enables you to comply with this new obligation. We can advise on the most suitable accounting software for your business.