Jelf A Simple Tax Guide for Small Businesses

Jelf SMALL BUSINESS

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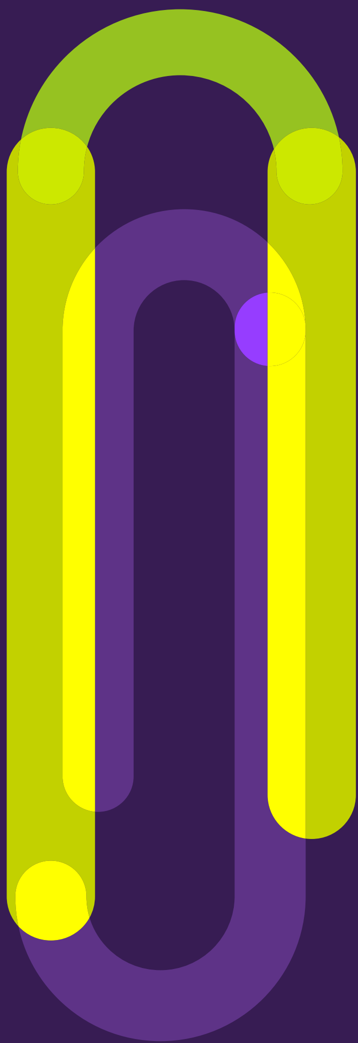
One of the first things to get in order when you're starting a new business is how to pay tax: leave it too late and you could find yourself paying the wrong amount, which could cause significant problems down the line.

There are different tax requirements for different types of business, which can be confusing. Here, we bring you a straightforward guide to ensure you know what you need to do, tax-wise, as a small business - whether you are a self-employed sole trader, in a partnership, or have set up a limited company.



1

Tax and National Insurance for small businesses: Getting started

Types of tax for small businesses

The tax you are liable for as a small business owner depends on your trading status. (More information about trading statuses can be found in this guide http://www.jelfsmallbusiness.co.uk/business-network/guides/2014/10/beginners-guide-to-trading-status)

- If you are a **sole trader** or a member of a partnership then you pay your **Income Tax** and **National Insurance Contributions** using a **Self Assessment** tax return, which you need to complete online by January 31st each year.
- If you have a **limited company**, you will need to pay **Corporation Tax** on your company profits. How you take money out of the business is also important: if you are taking a salary, your company will need to deduct Income Tax and National Insurance from it, as well as pay **Employers' National Insurance** contributions.
- Whatever your trading status, you must register your business for **VAT** if your company takings for the previous 12 months have exceeded £81,000, or if you expect them to exceed this figure in the coming 12 months. Once registered, you must complete a quarterly VAT return.

If you are working as an independent consultant being paid through an intermediary, you will have to look into **IR35** tax legislation. This covers workers who, in the taxman's eyes, are 'disguised workers'; if the intermediary wasn't there and the company was paying the consultant directly, they would be an 'employee'. If you're a consultant and think this may affect you, you can find out more about IR35 here: http://www.hmrc.gov.uk/ir35

Registering for business taxes

You can register for Self Assessment and Corporation Tax at: https://online.hmrc.gov.uk/registration/options.

If you are taking on staff, you can register for **Pay As You Earn (PAYE)** there too, and it is also the place to go to register for VAT.

After registering and providing HMRC with information about yourself and your business, they will automatically enrol you for the appropriate online service and set up tax records for you to keep track of things like Self Assessment, National Insurance, and - if you have people working for you – PAYE.

They will also send you a Unique Taxpayer Reference.

When you register online for business taxes, you'll also automatically be sent a Self Assessment tax return that you need to complete each year.

Ultimately, the message here is understand what you're getting into with VAT and National Insurance and when you need to do it - don't overcomplicate things unless you need to.

What is Self Assessment?

If you are a sole trader or a partner in a business partnership, you will need to complete a **Self Assessment tax return** each year to show your income and capital gains (profits you make from the sale of certain assets), and to claim any tax allowance or reliefs owed to you.

On your Self Assessment tax return you will declare your earnings and any other income you get during that tax year - which runs from April 6th to April 5th. Providing details of this income will let HMRC work out how much Income Tax you need to pay, as income is only taxable above a certain level.

Sources: GOV.uk, HMRC, Taxdonut, Which, Smarta, Smallbusiness.co.uk,

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What is Taxable

When your business generates revenue, there are certain things that can be deducted from this amount **before** you need to pay tax:

- Business expenses: This covers most things that you need to buy to run your business, such as materials for making your goods, advertising, insurance, and so on. The list is extensive and obviously will vary from business to business, so if you want to know more check out HMRC guidance here: **http://www.hmrc.gov.uk/factsheets/expenses-allowances.pdf**
- Capital allowances: This covers the purchase of assets used in your business, such as machinery or computers. Again, the long list of what may count as capital allowances is available at HMRC: **http://www.hmrc.gov.uk/capital-allowances/basics.htm#1**
- **Annual Investment Allowance:** This typically covers the expenditure related to already-purchased assets.
- **Business losses**

What is left over after you have made these deductions are the taxable profits.

2

Typical Scenarios

To help you understand what tax liabilities you may have, we'll outline some practical examples for different small business owners.

Side-Business Startups

Many small companies begin as side-businesses, where someone who is working full-time for an employer decides to use their hobby or skills to start up a part-time business of their own.

In these cases, the business owner must follow the tax registration set out above for their chosen trading status, but there is no need to be concerned about tax from your full-time employed role being affected. Starting your own business allows you to keep your existing tax code with your employer, although your income from that job will be taken into account when HMRC is reviewing your Self Assessment, so **having two jobs may impact the amount of tax you pay**.

Sole Traders

Tradespeople are a typical example of a sole-trader, such electricians, plumbers and plasterers. They are set up under a business name, but the individual effectively is the business in the eyes of the law.

This means that you are **personally responsible** for the business, and you must register with HMRC to pay your own Income Tax and National Insurance contributions as soon as business activities begin. As well as registering as a sole trader, you will need to keep business records - essentially things like invoices, receipts and bank records, though we'll explain these records in detail towards the end of this guide. These will advise HMRC of your taxable profits throughout the tax year (April 6th to April 5th).

At the end of each year you are self-employed, you will use your business records to fill in a **Self Assessment tax return**. You need to fill this in even if your business makes a loss, and it must be done by January 31st.

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Partnership

Partnerships often come about from two friends having distinct areas of expertise that they feel would be complimentary: for example, one is an experienced builder and the other has a history working in real estate and lettings; the result may be a business partnership purchasing, renovating and renting homes.

There may be more than two partners, but however many are involved, one individual will need to be the **nominated partner**. This person is responsible for registering the partnership for business taxes online, and a Self Assessment online account will automatically be set up for the partnership. HMRC will send out a **Partnership Tax Return** to in April or May for the nominated partner to complete. The nominated partner will need to provide details of the partnership's profit and loss, any interest received after tax has been deducted, and other types of income and gains. You'll also need to provide details of each partner's share of the profits and losses.

Other partners will have to complete their own Self Assessments each year, in order to pay Income Tax and National Insurance contributions on their shares of the company profits.

National Insurance for startups, sole traders and partnerships

You will normally need to pay Class 2 National Insurance contributions, which are currently at a flat rate of £2.75 a week (correct as of May 2014).

You may not need to pay if your earnings are below £5,885 per year (2014 to 2015).

You may have to pay Class 4 contributions as well as Class 2 contributions if your annual profits go over a certain amount – currently £7,956.

HMRC provides more information on Class 2 and Class 4 National Insurance contributions here: http://www.hmrc.gov.uk/working/intro/class2.htm
and here http://www.hmrc.gov.uk/working/intro/class4.htm,
while a handy table is also available: https://www.gov.uk/self-employed-national-insurance-rates

Sources: GOV.uk, HMRC, Taxdonut, Which, Smarta, Smallbusiness.co.uk,

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A limited company

The reason for starting a limited company as opposed to one of the other trading status options is usually less about what you are doing, and more about separating your business from your personal liabilities. Businesses dealing with higher-risk profit and loss are suitable to set up as a limited company, as they are not putting their personal assets on the line.

If you are an active limited company (so you are carrying on business, trading or receiving an income), each year you must pay Corporation Tax electronically, complete a **Company Tax Return** and send statutory accounts to HMRC and Companies House, otherwise you may face a fine or be charged interest. Here's how you get started:

- Register your business with Companies House
- Tell HMRC that you are a limited company within three months of starting any business activity, using the registering section above and providing them with your company's name and the other details outlined in the 'Telling HMRC' section of their guide: **http://www.hmrc.gov.uk/factsheet/limited-company.pdf**.
- Also tell them that you are liable for Corporation Tax. HMRC outlines companies and organisations not liable for Corporation Tax here: **http://www.hmrc.gov.uk/ct/getting-started/new-company/who-is-liable.htm**.
- HMRC will send you a letter providing your company's Unique Taxpayer Reference and details of how to set up an online account for your company through HMRC.
- Use this account to pay Corporation Tax at the end of each year – or tell HMRC that you don't owe any – and to file your Company Tax Returns with HMRC at the end of each financial year.
- As well as paying your Corporation Tax and submitting your Company Tax Return online, you'll need to submit your tax computations and – in the vast majority of cases - the accounts that make up that Company Tax Return, in Inline Extensible Business Reporting Language (iXBRL) format. You may want to use an agent to help you file your Company Tax Return, as they can ensure it is in the correct format.

Be aware: Your Corporation Tax payment is due before your Company Tax Return.

If you are trading or receiving income (your limited company is active) you should file a Company Tax Return within 12 months of the end of your company's Corporation Tax accounting period, which is usually the end of your financial year.*

You should pay Corporation Tax on any **taxable profits** within nine months and one day of the end of this Corporation Tax accounting period (as long as your taxable profits or £1.5 million or less – if they are more you will need to find out about paying in instalments).

*Your company's Corporation Tax accounting period is usually the same as your financial year, which normally begins and ends with the dates covered by your company's annual report and financial accounts that you file to Companies House. These financial accounts are also known as statutory or audited accounts.

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3

A guide to record keeping for tax purposes

If you are self-employed as a sole trader or partner in a business partnership, you have to keep a record of your business income and outgoings in order to complete your Self Assessment return. As a limited company, you need these records to complete your Company Tax Return.

Keeping good records will not only help you run your business more smoothly, it'll make things a lot easier when it comes to filing your tax return.

You can find out which type of records you must keep at https://www.gov.uk/self-employed-records/keeping-business-records.

As a business owner, you usually have to keep a record of your business income, expenses, profit, assets and liabilities using traditional accounting methods. These traditional methods mean your tax return takes into account money you're owed but haven't received yet, as well as money you have committed to pay but haven't paid yet.

Cash basis record keeping

As a small business, you may be able to use the new cash basis, which lets you record money as it actually comes in and goes out of your business, meaning that at the end of the tax year you won't have to pay Income Tax on money you didn't receive in your accounting period.

- You can use cash basis if your total business income when you start using the scheme is £81,000 or less a year.
- You can't use cash basis if you are a limited company or a limited liability partnership.
- Cash basis probably won't suit your company if you are VAT registered.
- When using cash basis, all money counts, including cash, card payments, cheques and any other method of payment.

4

Conclusion

Many small business owners find tax to be the most worrisome aspect of starting a new venture – simply because it's something many have not had to deal with directly before.

While it can seem complicated, by being prepared and making a note of your requirements and the deadlines for meeting them, it can be a straightforward process. The key thing to remember is: if in doubt, ask. HMRC is happy to provide assistance to small business owners who are unsure of their liabilities, but it looks less kindly on those who miss tax return submission dates, which could lead to penalty fees.

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