

## **SETTING UP BUSINESS – DON'T PANIC**

There are 4 business types you could use in operating your own business:-

- 1) Sole trader
- 2) Limited company
- 3) Partnership
- 4) Limited liability partnership

The tax authorities are generally very helpful to people establishing a new business. So there is no need to be concerned about contacting them and discussing your problems.

### **Sole trader**

- This is the simplest form of organisation and the easiest to establish.
- Simply ring the HM Revenue and Customs (HMRC) helpline, they will guide you through it <http://www.hmrc.gov.uk/selfemployed/>
- Failure to register as self employed within 3 months of starting will result in a £100 fine.
- You can have any accounting year end you wish but 31 March is often the most convenient.
- As a sole trader you and the business are the same, so if anything goes wrong and you are sued for example, your personal assets are at risk.
- You will need to fill in Tax Return every year. The profits of the business are taxed as an individual using the same rates (i.e. 20% to £36000 and 40% above £36000). Income tax is payable in two slices, 31<sup>st</sup> January and 31<sup>st</sup> July
- You will need to pay part of your National Insurance monthly. There is Class 2 NIC at £2.30 per week and Class 4 NIC at 8% on taxable profits between £5435 and £40,040. Profits above £40,040 attract an additional 1%. <http://www.hmrc.gov.uk/nic/background-nic.htm>

Note that money withdrawn from the business for personal use (drawings) is not a wage and is not a cost to the business. Taxation is based on the taxable profits of the business not drawings. This also applies to partnerships.

### **Limited company**

- This is more complicated to form.
- You can contact Companies House and they will guide you through the procedures. <http://www.companieshouse.gov.uk/infoAndGuide/companyRegistration.shtml>
- There are companies that will set up a company for you, so look on the internet. Prices seem to start from about £45 upwards.
- A limited company is a separate legal entity to the individual controlling it (i.e. the shareholders). Provided the company is not trading illegally or fraudulently the shareholders personal assets are not at risk if the company is liquidated (this is the limited liability).
- The accounting is more complicated than for a sole trader in that accounts have to be produced in a certain format.
- Accounts have to be sent to Companies House 9 months after the year end.
- For most small companies all that need be sent to Companies House is abbreviated accounts which only show a balance sheet and a few notes. You can choose any year end you wish.

- For most small companies the shareholder is also a director.

There are only 4 ways to take money out of a limited company:-

- Taking money out of money or assets (such as computers) previously introduced into the company by a director. This is just returning a loan and therefore attracts no tax.
- Salary- this operates just as for any normal employee, tax and NIC will be deducted at source. Many companies only pay the shareholder/director £5435 per year. The shareholder/director won't pay any tax or NIC on the salary but will still get credit towards state benefits such as pensions.
- Dividends-these can be taken only from retained earnings i.e. profits after corporation tax is paid. A company making losses cannot pay dividends. Dividends are taxable in the hands of the shareholder receiving them. However, provided the shareholder is not a higher rate tax payer (over £36,000) there is no extra tax to pay. So if you pay your self £5435 and this is your only other income you can take dividends of c£31,000 without attracting additional income tax, assuming there is no other income. Dividends are not a cost to the company.
- Mileage-if you use a car for business you can charge the company 40p for the first 10000 miles in a tax year and 25p for all subsequent miles. Mileage is not taxable in the hands of the shareholder/director, but is an allowable expense in the company. You will need to keep proper mileage records.

You could have your car as a company car, in that the company will purchase and run the car. However this will be taxed as a benefit in kind and taxed accordingly.

This is why many people do not transfer their personal car to the company.

As a director will have to fill in an annual Tax Return

There is still an advantage in tax terms in being limited and taking dividends in that company national insurance is avoided. However this advantage is less than it was and future tax changes may eliminate it completely.

The Company will pay Corporation tax of 21% on profits up to £300000. This is payable 9 months after the year end.

### **Partnerships**

- This operates just like the sole trader except that 2 or more individuals are involved. Please see Sole Traders.
- The profit or loss of the partnership is calculated as for a sole trader and then split between the partners on an agreed %.
- This profit or loss then forms part of the individual partners Tax Return and is taxed as a sole trader's tax.

### **Limited Liability Partnership (LLP)**

This has some of the characteristics of a partnership and a limited company. It provides the advantage of limited company in providing limited liability. However like a company, accounts in a certain format have to be sent to Companies House. It is taxed like any other partnership. LLP accounts have to be submitted to Companies House.

## **Value Added Tax**

- You have to be registered for VAT if your sales in the previous 12 months exceed £67000. You have 30 days from the end of the month in which sales were exceeded to register.
- The same rules apply to all forms of business noted above
- You can however volunteer to be VAT registered right from the start
- There are various different VAT schemes for small business, such as payment on the Cash Basis and the Flat Rate Scheme.
- You can do your own VAT return if you feel confident in this matter.
- Note you cannot claim VAT on a car, a van yes. You can also claim VAT on stock and equipment you have in the business at the date of registration.

## **Accounting Records**

- You don't have to an accountant but you must keep business records, especially on income (sales). At the very least you must keep copy sales invoices or a list of sales if you don't supply invoices.
- You should keep all invoices/receipts for business expenses, all bank statements, credit card statements, cheque book stubs and paying in books.
- Some businesses use Excel spreadsheets, some accounting computer packages such as Quick Books.
- If in doubt keep everything and your accountant can sort it out at the year end.

## **Allowable expenses**

- Allowable expenses for all types of business are the expenses of the business, not a very helpful comment I know.
- As a sole trader/partnership/LLP you can either put all the car expenses through the business and make a deduction for private use or keep business mileage records and charge the business 40p per mile for the first 10000 miles and 25p per mile for subsequent miles.
- If you work from home you can claim part of your home expenses as a business.
- You cannot claim clothing unless they are obvious work ware or clothing with the name of the business on it (e.g. on a tee-shirt).
- You can claim professional subscriptions, training courses, publications, insurances etc.
- Sole Traders and partnerships can employ people in the normal way, including spouses/partners, which is a means of using spouse/partners allowance of £6035, if they do not already have an income.

## **STARTING A BUSINESS CHECK LIST-THE ORDER IN WHICH TO DO:-**

### **Sole Trader/Partnership**

- 1) Inform HMRC that you are starting a business, with a start date. You will need names, addresses and NI number for the sole trader or partners
- 2) Establish business bank account
- 3) Register for VAT if you wish too. The VAT requires details of the bank account

### **Limited Company**

- 1) Establish limited company – either through one of the many agencies that do this (e.g. on internet) or via Companies House
- 2) You will receive a Form 41g from HMRC asking for details of directors, start of business date and nature of business.
- 3) Establish a business bank account. The bank will want full details of the company.
- 4) Register for VAT if you wish too. The VAT requires details of the bank account.

### **Limited Liability Partnership (LLP)**

- 1) Complete form LLP2-send to Companies House. Form can be got from the Companies House website.
- 2) Inform HMRC of the establishing of LLP-give details of partners including NIC number.
- 3) Establish a business bank account. The bank will want full details of the LLP
- 4) Register for VAT if you wish too. The VAT requires details of the bank account.

Remember there is a bureaucratic element in starting and running a business and it cannot be avoided, so grit your teeth, get it done and then concentrate on the important matter of finding clients and making a living.

You can only make a living if you make profits, and profits involve paying tax.

To avoid paying tax, make losses. In that case you have a hobby not a business.

[Tony Mindham of AJ Mindham & Co](#)