BWM
CHARTERED ACCOUNTANTS

Accounting and tax for start-up and small businesses

A guide for clients

BWM, Castle Chambers, 43 Castle Street, Liverpool, L2 9SH
www.bwm.co.uk 0151 236 1494

Contents

Page

Introduction

There are many responsibilities that small businesses need to ensure that they fulfil. Legally, all businesses in the UK need to have accurate financial records and this can be a daunting task to those developing a business for the first time. This session will help you to understand what is required and offer some top tips for bookkeeping.

Additionally the tax rules for the self-employed are much more complex than for ordinary employees. We will provide an overview of the main UK business taxes you will encounter as a business owner.

This guide will also outline some of the key payroll considerations for any employees you may take on and the related auto-enrolment pension requirements. We will also cover the pros and cons of which type of entity to use for a new business venture and the reporting requirements of these entities to Companies House and HMRC.

Small business and start-ups services

We are approved members of the ICAEW Business Advice Service scheme, offering all start-up and small businesses a free initial consultation and a tailored package of support to suit their needs. We welcome the opportunity to discuss your individual needs and agree the right support package for you.

By outsourcing the necessary finance and accounting tasks to us, you will be able to increase your own efficiency and performance. Our aim is to be always alongside you, helping you plan successful growth.

How we can help

We have helped businesses from start-up, through growth and onto ultimate sale. We can advise you on all the matters mentioned in this document and many other issues that you might encounter at any stage in the life of your business.

We will keep you aware of changes in regulations affecting businesses and smooth your dealings with HMRC.

Services we can offer include:

- Developing your business plan
- Helping you identify sources of start-up funding
- Preparing budgets and making projections
- Acting as a referral source to help you find a solicitor, banker or insurance agent
- Devising the best structure for your business and advising you on when to incorporate
- Advising you on the acquisition and implementation of a computer system and software.

Limited company or sole trader – which is right for your business?

You will have to decide whether to set up your business as a sole trader, partnership or limited company. Many start-ups are as a sole trader, because this is the simplest, most flexible, business structure. But it can result in you paying more tax. Where two or more people are in business together, a partnership may be preferable; although partners need to be sure they can work happily together.

Becoming a sole trader

Working as a sole trader represents the most rudimentary form of doing business. There is a minimal paperwork involved, organising tax affairs is simple (at least compared to limited companies) and there are a few statutory obligations to meet.

Things get slightly more complicated if you earn more than £83,000 a year, at which point you'll need to register for, collect and pay VAT.

Employing other people will also mean that you'll need to set-up suitable payroll infrastructure and submit separate returns.

The degree of freedom attracts many to the idea of being a sole trader. You are your own boss, and you alone control the direction of the business. The downside is that you are solely responsible for your business's liabilities; if debts remain unpaid or if you make significant losses your personal assets will be at risk.

Sometimes it is best to start off as a sole trader or partnership, and to then incorporate later. This can be beneficial if you expect your business to take a while to become profitable, as losses from a sole trader business or partnership can be offset against your other income for the previous three years. It is much more difficult to change business structures in the opposite direction.

Forming a limited company

Incorporating your business is an entirely different process to setting up as a sole trader. The opportunities for tax planning are more comprehensive but administration can be complex and there are additional regulations to comply with.

A limited company is owned by its shareholders and run by its directors. Unlike sole traders, a limited company is legally separate from its owners. Directors therefore only take on limited liability, meaning that they are only liable for what they have invested in the business.

Compliance with the Companies Act can seem intimidating for those thinking about incorporating their business. After registering the Companies House your business will need to:

- File and maintain statutory accounts
- Pay corporation tax, PAYE and national insurance (NI) bills
- File VAT returns if applicable
- Comply with auditing requirements (if your business is above the small business auditing threshold).

While limited companies face the additional burden of corporation tax, various tax reliefs are able to mitigate this and extracting profits via dividends and salaries can lower exposure to income tax and NI for directors and shareholders.

A limited company structure has several benefits but also some disadvantages. You may pay less tax and find it easier to raise finance, but there is more administration involved and your financial statements are available for anyone to look at - at least in an abbreviated form. In theory, a company offers personal protection from your business debts. However, this protection is reduced if you have to give personal guarantees. It is much easier for your family, relatives and others to become involved in the running of the business given a company structure (they can be made directors without you losing any control), and some suppliers and lenders prefer to deal with a company.

Entering a partnership

Partnerships offer an alternative for those who want to go into business with other people, but don't want to set up a limited company.

Running the business ad paying tax are responsibilities shared by partners, as are the profits. Partners pay income tax and NI on their individual shares of the profits, and each partner must send separate self-assessment tax returns.

There are 3 main types of partnership:

Business partnership

Business partnerships (also called 'ordinary' partnerships) are the simplest way for 2 or more people to go into business together. All partners in a business partnership are personally liable for losses incurred by the business.

Limited partnership

In a limited partnership (LP), debt liability is unequally shared among partners who fall into 1 of 2 categories: general partners and limited partners.

General partners are those with primary responsibility for managing the business and take on personal liability for all of the business's debts.

Limited partners are only liable for their initial investment in the business.

Limited liability partnership

Limited liability partnerships (LLP) function also allows partners to assume limited liability on unpaid debts; they will not be held personally liable for the business's debts, only for the money they have put into the business.

LLPs are more complex and cost more to set up than other types of partnership; limited liability means that you will need to maintain accounts and submit them to Companies House and a legally-binding LLP agreement will need to be drawn up by a solicitor.

Which structure is best for you?

In summary, the limited company route affords limited liability for its members, it is the more tax efficient route to take, but involves more administration than the self-employed route.

Becoming self-employed is an easier process, and aside from keeping your tax records in order, this is a more flexible route to take for many.

It is important that you take some time before deciding which route is best for you, and we would advise you discuss your options with us.

If you decide on the limited company route we can set the company up for you, and if you are going to use our services on an ongoing basis, we can also set you up for a number of other things, such as VAT and Corporation Tax at the same time.

Comparing business structures and implications

	Sole Trader	Partnership	Limited company
Tax	Tax planning opportunities for sole traders are minimal. As a result, they often face proportionally higher personal tax bills.	Partners pay tax in the same way as sole traders and face similar tax planning limitations.	Opportunities to reduce income tax and NI liabilities mean that company directors often pay less personal tax.
Liability	Sole traders bear unlimited liability for their business. There is no legal separation between you and your business.	This depends on what kind of partnership you have set up and, if you are part of an LP, whether you're a general or limited partner.	Limited company directors have limited liability. Business assets are seen as separate from those of the directors, reducing the personal risk.
Administration	Administration for many sole traders is limited to submitting an annual self-assessment tax return. However, if you are VAT-registered and employ other people, you will also need to file VAT and payroll returns.	Each partner must submit a self-assessment return, and pay their NI and income tax bills. Like limited companies, LLPs must submit audited annual accounts, maintain statutory records and submit an annual return.	Meeting the requirements of the Companies Act, complying with statutory audits and submitting multiple tax returns makes administration far more complex for limited companies.

	Sole Trader	Partnership	Limited company
Extracting profits	As there is no personal-business separation, sole traders do not need to extract profits. Money is paid directly to you and your profit is everything that remains after you've paid tax.	For the same reasons as sole traders, partners do not need to extract profits.	Company directors and shareholders must extract profits from the business. The 2 most common ways of doing this are with salaries and dividends which are then taxed and/or have NI deducted.
Privacy	Sole traders are not obliged to publish their business's financial and accounting details, allowing you a greater degree of privacy.	Business and LPs are not obliged to make public their accounts and financial information. However, LLPs must submit accounts to Companies House for public record.	In order to comply with the Companies Act limited companies must release financial and accounting information to the public, reducing your privacy.

How to register as self-employed

If you are in business as a sole trader or partnership, you will need to register with HM Revenue & Customs (HMRC) as soon as you start working for yourself. You do this by registering for self-assessment. Again your accountant can help you with this if you wish. Even if you have already completed an annual self-assessment form, you will need to complete the registration process to let HMRC that you have become self-employed.

The payment of national insurance contributions (NICs) will entitle you to the state pension and some other benefits. HMRC is normally aware of new limited companies and should contact you. As a director, both you and your company will pay NICs on your remuneration from the company. Your contributions will entitle you to the state pension and contribution-based benefits such as jobseeker's allowance.

Your company's contributions will be reduced, maybe to nil, by the annual £2,000 employment allowance.

Registering for VAT

You must normally register for VAT if your sales exceed the registration threshold, which since 1 April 2016 has been £83,000. Sometimes it is a good idea to register for VAT even if your turnover is below the threshold, so that you can recover the VAT that you are charged on your purchases. There are some special schemes for small businesses, such as cash accounting and the flat rate scheme, as well as schemes for retailers and some other types of business. Choosing the right scheme can simplify your VAT administration and may produce VAT savings.

Employees

You might start off doing everything yourself, but when your business grows you will probably need to employ staff.

Employers must deduct tax and NICs from employees' pay under the PAYE system.

Employers are now required to provide real time information (RTI). This generally requires payroll information to be provided to HMRC 'on or before' payment to the employee. You will have to register with HMRC as an employer and run payroll software that reports real time PAYE information online to HMRC whenever you pay your employees. The reporting requirements can make running payroll quite difficult, you might therefore decide to simply outsource your payroll function to your accountant or other payroll provider.

Other important staffing issues include training and improving staff performance, the national minimum wage and employee rights, health and safety and pension arrangements (including automatic enrolment).

Responsibilities of limited company directors

As a limited company director, you will be tasked with a number of responsibilities, which sole traders do not have to concern themselves with.

You must produce annual company accounts, submit an Annual Return (AR01) each year, and keep Companies House informed of any changes to the company (such as director, or address changes).

You will need to appoint an accountant to deal with your tax affairs, although it is ultimately your responsibility to ensure that any legally required documentation is submitted on time, and all tax liabilities are paid to HMRC on time.

How are limited companies taxed?

All limited companies must pay Corporation Tax on their annual profits.
If your company turnover is expected to exceed the current threshold (£82,000), you must register for Value Added Tax (VAT).

Limited company directors typically receive a small salary, and shareholders draw down company profits in the form of dividends.

Income Tax and National Insurance Contributions (NICs) will be deducted from directors' salaries via your own payroll system at source (assuming any liabilities are owing), and your will pay tax on the remainder of your earnings via the annual self-assessment process.

Avoiding Corporation Tax penalties

HMRC expects you to take reasonable care over your company's tax affairs. If you took reasonable care but still made a mistake, HMRC may not charge a penalty or the amount of the penalty may be reduced.

How the penalty is calculated

The amount of the penalty is calculated by applying a percentage to the amount of tax that you owe. The percentage applied depends on whether your error (of failure) was:

- Careless – a lack of reasonable care
- Deliberate – such as intentionally sending incorrect information
- Deliberate and concealed – such as intentionally sending incorrect information and taking steps to hide the error

The maximum penalty for each type of failure

Type of failure	Maximum penalty payable
Non-deliberate	30% of the potential lost revenue
Deliberate but not concealed	70% of the potential lost revenue
Deliberate and concealed	100% of the potential lost revenue

Penalties for not filing your Company Tax Return on time

If HMRC has sent you a 'Notice to deliver a Company Tax Return' and you don't file your return on time, your company or organisation will be charged a penalty.

The penalty is a percentage of the extra tax due when HMRC corrects your mistake (PLR). The amount of penalty you'll face will depend on the type of error and when you told HMRC about it.

The penalty will be less if you tell HMRC about your error before they find out about it – this is known as 'unprompted disclosure'. If you told HMRC after they found out about the error, or if you told them because you thought they were about to find out, this is called 'prompted disclosure'.

Penalty ranges for unprompted and prompted disclosure

Type of error	Penalty range for unprompted disclosure	Penalty range for prompted disclosure
Careless	0% to 30%	15% to 30%
Deliberate but not concealed	20% to 70%	35% to 70%
Deliberate and concealed	30% to 100%	50% to 100%

Record keeping tips and guidance and accounts preparation

Once you have started in business you will need to decide on your **accounting date** that is the date to which your annual accounts will be prepared. You can choose any convenient date. This can be the anniversary of the date on which you started in business or a period when you tend to be less busy so that you have more time to deal with your accounts.

- Important to keep an accurate record of all income (receipts) and purchases/expenses paid as these figures are used in preparation of your annual Accounts and Tax Return
- If HMRC choose your case for review must be able to back up figures
- Records must be kept generally for another 5 years after the 31 January submission date for the Return of the year concerned
- Penalties for inadequate records or if you don't retain them for long enough.
- Records to maintain may include the following:

  Cashbook

  Bank statements (better to have a separate business account)

  Invoices/receipts

  Mileage records

  P60 (if you are also employed)

  Hire purchase records

  Record of money taken out for personal use

Record keeping and accounts preparation (cont'd)

At the start if your affairs are quite simple you might only need to prepare an Income and Expenditure Account (one page summary) of your income and expenses in order to be able to complete your Self Assessment Tax Return.

As your affairs become more complicated (or if you start as a limited company) you will need to prepare a proper set of Accounts with a detailed Profit & Loss account and a Balance Sheet.

Other issues:

- **Capital items** – You may be able to claim capital allowances for certain assets you buy in connection with your work such as computers, props etc. Keep full details and submit with your records at the end of each year. This expenditure should not be treated as a normal expense. Some items may have full tax relief at the time you acquire them for others the cost may be reclaimed over time.

- **Business and personal use adjustments –** you have to keep business and personal expenditure separate.

  You therefore have to restrict expenses where there is any element of personal use i.e. combined home phone, mobile, computer use etc.

- **Use of home as office** – the proportion of household expenses that can be claimed is based on what proportion of the area of the home is used for business purposes, how much of the household gas, electricity etc can be said to relate to the time spent working at home and how long you spend working at home when compared to any other use.

- **Lost records** – if you can't reconstruct from other details e.g. bank statements, duplicate details etc. don't delay sending in your details. You will have to calculate estimates and highlight the use of estimates on your Return. The loss or records and the use of estimates will increase the risk of being selected for a Revenue review.

Business planning, finance and grants

Your business plan should describe the business, its objectives, its strategies and its financial forecasts. Every business should have a business plan but it is especially important at the beginning. It is essential if your business will need external funding such as bank finance, but equally importantly it will allow you to measure how well your business is doing once you start trading.

Of particular importance is the financial projection as this will cover pricing and costs, sales and profit forecasts, how much capital you will need and projected cash-flow statements for the first three to five years. If you start with insufficient capital, your business may be dead in the water before it even begins.

Where do start-ups incur costs?

- Advertising, marketing and promotion
- Communications and infrastructure
- Cost of finance
- Equipment
- Insurance
- Office supplies
- Professional fees
- Product development
- Transport
- Website and technology

Of course without any track record, the initial financial projection will not be much more than an educated guess and its accuracy will depend on how much research you have done. One way to deal with the inherent inaccuracy of the initial projection is to prepare figures based on best and worst case outcomes. Once your business actually commences you should keep updating your financial projection and, because it will then be based on actual figures, it should become increasingly accurate.

Finance and grants

Despite its limitations, your financial projection should give you an idea about how much finance you will need. Having adequate finance is probably going to be the biggest hurdle for many people starting a new business. The obvious starting point is your own savings (but be careful of the capital gains consequences if cashing in investments) and loans from friends and family. If you do not have a track record in business, your only other option will probably be to re-mortgage your home. Despite the recent introduction of tighter lending requirements it’s still possible to arrange deals and, although arrangement fees can be quite high, interest rates are currently at an all-time low.

In some cases a bank overdraft or business loan may be available, and there are specialist loan providers. Other possibilities include commercial mortgages (useful if you are buying business premises) and grants (available from various sources). A fairly recent development is the availability of online financing such as peer-to-peer lending and crowdfunding.

Other routes to finance

If you intend to trade through a company, you might have the choice of raising finance either by issuing share capital (equity) or as a loan (debt).

Equity finance means that you will be bringing in outside shareholders, who may want a role in deciding how the company is run. Because shares can be sold, you could end up with a troublesome outside shareholder. There is no requirement to pay a dividend on equity, although if you pay yourself a dividend then the same rate of dividend will be payable to the outside shareholders.

Debt finance allows you to retain complete control of the business, although ultimately the debt will have to be repaid. You will also have to pay interest on the debt even if your company's business is suffering a downturn.

Of course there can be benefits to bringing in a co-shareholder, or having a partner instead of running the business alone. It's a good way of obtaining complimentary skills – for example, you may be good at developing the business but lack sales, marketing or financial skills.

Our useful guide 'Routes to Finance' provides further information on business finance.

These notes are to be seen as generic guidance. Specific advice should be sought from your accountant and no reliance should be place solely on the information above.

FOR GENERAL INFORMATION ONLY

Please note that this guide is not intended to give specific technical advice and it should not be construed as doing so. It is designed to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.

<u>About Us</u>

Professional, Personal, Affordable.

We are one of the leading, independent chartered accountancy practices in Liverpool. At BWM we provide a wide range of accountancy and business support services to organisations and individuals throughout the North of England and beyond. Our experienced and skilled partners and their teams are ready to support you with high quality, individual yet affordable services however complex your personal or business needs.

For more details of how we can help you transform your business, please visit www.bwm.co.uk or call us on 0151 236 1494.