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2011smallbusinessspecial

As a small business owner you have to keep your eye on the ball in order to ensure everything you are entitled to claim against your tax bill, is claimed. Fortunately we take care of this for you but you may want to know some of the rules we work to when calculating just what you can claim against tax.

You also need to make certain you are not paying too much in National Insurance and our article on class 2 NIC will interest those with lower profits. National Insurance is a minefield to negotiate your way through and again we take care of this calculation and any claim for the small earning exemption.

The correct structure for your business is something we talk to you about at our accounts meeting but perhaps you would like to know more about what is entailed in being a Ltd company or if you already operate via a Ltd company perhaps you would like to discuss the possibility of running a new venture through an LLP (Limited Liability Partnership).

Using Your Home as an Office – Just What Can you Claim and What is at Risk?

The home has a dual role for many self employed individuals. It is where they live and also where they carry on some or all of their business. Even if you carry on most of your business elsewhere you are still entitled to a deduction for a part of the household expenses provided that there are times when a part of your home is used solely for business purposes.

Many of the bills for household expenses cover both private and business use. For example a self- employed person who uses electricity both privately and for business will normally get one electricity bill. A single bill does not mean that the whole of the expenditure is disallowable. The part of the cost attributable to business use is allowable.

What is allowable depends on the particular facts, including the extent and the nature of the business activities undertaken in the home.

If there is only minor use, for example writing up the business records at home, you may accept a reasonable estimate without detailed enquiry. Therefore amounts up to £3 per week will not be questioned by HM Revenue and Customs (HMRC).

Wholly and Exclusively – Tax Law says that an expense is only allowable as a deduction if it is incurred 'wholly and exclusively for the purpose of the trade'

Wholly and exclusively **does not mean** that:

• Business expenditure must be separately billed, or

• Part of the home must be permanently used for business purposes and not used for any other purposes at any other time.

Wholly and exclusively **does mean** that when part of the home is being used for the business then that is the sole use for that part of the home at that time. So if the part of the home used for business purposes is also, at the same time, used for some other non-business purpose, no deduction is due.

The question is whether there are periods when part of the home is being used solely for business purposes. If part of the self–employed person's home is set aside solely for business use for a period, they can claim as a deduction the costs they incurred on that part during the period. It is most unlikely that they will have separate bills and usually this exercise will involve apportioning the total relevant bill between the period of solely business use and the remainder of the time covered by the expenses.

In many cases there may be more than one method of arriving at a reasonable apportionment. The results may differ in detail but would be equally acceptable. But this does not apply in all cases – some methods may be more appropriate than others for a particular type of expense.

Different traders organise their affairs differently and there is no fixed proportion of costs allowable in a particular type of business although it is reasonable to assume that business conducted in the same way may be expected to result in similar deductable amounts.

The standard way to calculate this depends on these factors;-

• Area; Apportioning the area may be on the basis of number of rooms in relation to the whole or an alternative would be the area of floor space used to establish n identifiable area occupied for the business purpose.

• Usage; how much is consumed? This is appropriate where the supply is metered such as water, gas or electricity.

• Time; how long is the business use as compared with other periods of use?

If two different methods produce substantially different figures then that is likely to signify that one method more accurately reflects the underlying facts and the other method is flawed.

Expenses fall broadly into two categories, fixed costs and running costs.

Fixed Costs

These costs relate to the whole house for example Mortgage interest, Council Tax, Insurance, Water Rates, and General Repairs.

It is normal to apportion these by the Area or Time method however it should be remembered that only the interest on a mortgage can be included – repayments of capital are not allowed.

If the general repairs undertaken are solely for an area used solely for the business then these costs would be wholly allowable in other circumstances and apportionment by area would be appropriate.

Running Costs

There are some costs which may vary depending on the amount and nature of the work undertaken in the home. They would include cleaning, heat, light and metered water. Where there is significant business use it is appropriate to apportion such expenses by reference to the facts of the usage.

Telephone and Broadband – the total cost of the business calls is allowable and also a proportion of the line rental (based on the ratio of business use to total use). In most cases reference to an itemised bill will provide a reasonable and acceptable measure. Expenditure on internet connection is allowable to the extent that it is for business purposes. Where there is 'mixed' (business and none business) use then the treatment is as for telephones.

Capital Expenditure

An example of Capital Expenditure would be home improvements to the property and these are not allowable. Although expenditure on some items of Plant and Machinery may be appropriate for certain expenditure.

Capital Gains Tax Implications

A gain made on your main residence is generally free from Capital Gains Tax (CGT) but the exemption is restricted if and to what extent that part of the home is used 'exclusively' for the purpose of a trade or business. The important word here is 'exclusively' Use of a part of a home for the business will not compromise the CGT relief if that part is also used for domestic purposes.

If part of the home is used exclusively for the business there may in the event of a sale be little or no CGT to pay if the gain is within the annual exemption (currently £10,600). However it must be considered on an individual basis and will depend on other Capital Gains made in the year of sale, increases in domestic property prices and the rate of tax you pay.

Tip

The team review premises expenditure as a key part of the accounts production process. We will be pleased to discuss with you the amounts which will be acceptable and the records you need to retain.

Class 2 National Insurance – just how much do you pay and when?

In Budget 2011 the Government announced its wishes to integrate the operation of income tax and National Insurance Contributions (NICs). From April 2011 your Class 2 National Insurance contributions payments will become due on the 31 January and 31 July, the same dates as Self Assessment tax bill and your Class 4 National Insurance bill.

You will receive your final quarterly bill in April 2011 which will cover the period 9 January 2011 to 9 April 2011. After this HMRC will issue two payment requests (instead of four quarterly bills) in October and April, showing payments due by 31 January and 31 July respectively.

There will also be changes if you pay by Direct Debit. To meet the new due dates, collection of Class 2 National Insurance contributions by monthly Direct Debit will be delayed by HMRC to bring the payment dates into line with the dates income tax is payable under Self Assessment. This means that:

• For the first year only, monthly Direct Debits will stop for a short period and then start again.

• Class 2 contributions due for April 2011 will be requested from your bank in August 2011.

• Payments thereafter will be monthly unless you choose to pay six monthly from April 2011.

You pay Class 2 National Insurance contributions at a flat rate of £2.50 a week. However, if your earnings are below £5,315 per year (2011-12) **you might not need to pay!**

If you earn less than £5,315 per year we will apply for a Certificate of Small Earnings Exception and not pay Class 2 National Insurance contributions. However, you might decide to carry on paying them voluntarily to keep your entitlement to the State Pension and other benefits.

Tip

If you believe your income may fall to below the Small Earnings Exception level – then please advise a member of the team who can obtain the exemption certificate on your behalf and prevent the liability arising! Talk to a member of the team if you have any questions arising from the change in the collection method of class 2 NIC.

Incorporation and Beyond!

A sole trader or partnership may exist for many years without ever considering incorporation – often clients think they are too small to benefit or that the process will be too long and drawn out or that the paperwork will simply be too daunting for it to be worthwhile. Up until recently the financial benefit of incorporation would only really be noticeable when annual profits exceeded £50,000 however with Corporation Tax rates reduced to 20% companies with profits up to £300,000 whilst Income Tax rates have soared to 40% for higher rate tax payers and 50% for additional rate taxpayer you may want to think again!

On incorporation there may be an amount of Goodwill generated and this holds a **substantial tax benefit** – 10% tax in many circumstances. The valuation of goodwill is a highly specialised task and often needs to be referred to a valuation specialist however in view of the considerable tax savings this may be an area for discussion.

With considerable tax savings to be had by taking on the mantle of being limited we can provide a full review to assess if this is the way forward for you – especially if you have an accounting year end other than 5 April – you may be sitting on 'overlap' profits which could considerably reduce your liability or even reduce your liability to tax and also generate a tax credits award for you and your family!

But is the only benefit financial? Well not necessarily. The term limited liability effectively means that, should the company fail the liability for the debts of the company by the shareholder (usually the previous sloe trader or the partners in the partnership) is limited to the amount which is unpaid for the shares. This is not always the case though, as many potential lenders now ask for personal guarantees from the shareholders.

There is also a certain status attributable to the 'limited liability' status which may add to the ability to obtain opportunities where possibly a sole trader would not be invited.

It may also be a consideration that in the type of business it may be easier to sell or bequeath shares rather than the whole business or business assets – which would be necessary as a sole trader.

It is possible for a director to borrow from the company with no need to go to the bank interview or pay high credit card/loan interest. There are downsides to this – tax is charged on the shareholder and NIC on the company where no interest is paid or where interest is less than the figure prescribed by the HMRC. Tax is also payable where the loan has a balance remaining outstanding nine months after the year.

Whilst incorporation is not for everyone it is always worth considering the implications and we are specialized in providing a solution which is designed to meet your needs whilst saving potentially £0,000's in tax over the lifetime of your company!

Tip

Speak to your tax advisor regarding a review of the potential benefits of incorporation. We are more than pleased to provide an incorporation service which will take the hassle out of the process and we will manage the process from beginning to incorporation and beyond!

Company Cars – benefit or costly expense?

The company can provide employee benefits and incentives and obtain tax relief which is not possible for the self-employed employer.

It may be thought that a company car is an ideal solution for a director but this is not an option for a sole trader. Company cars with a low CO_2 emissions (no more than 120g/km) are taxed at only 10% of their list price in 2011/12 but from next year this will rise to between 15% and 35% and with the removal of the cap on the tax and NIC charged on expensive company cars this could mean a massive hike in tax payable after April 2012.

Private fuel provided for directors and employees is taxed heavily and has increase since 2010 making private fuel rarely tax efficient. The typical saving in terms of tax for a director or employee from removing the private fuel element amounts to £1,000 per car. This is not taking into the account the additional charge on the company for the National Insurance charge!

An alternative to the company car is to provide the director or employee with a car allowance. From April 2011 this amounted to 45p per mile for up to 10,000 business miles and 25p per mile for the balance and this is free of tax, any additional allowance paid by the company is subject to income tax and national insurance and if the company pays less than this amount the director or employee can claim the difference via his Tax Return.

Company Car Taxation and the Fixed Profit Car Scheme are complex areas and you will need specialist advice to assess the most tax efficient option for providing company vehicles for your self, your family members and your employees.

Tip

We offer a range of services around calculating the best possible option for providing cars for the directors, employees and family members, please ask for the most tax efficient option to be calculated prior to entering into any agreements.

Little Extra Tip

Company Cars can also be provided as part of New Venture Planning – see the following article...

A New Venture?

Whatever your business structure, Limited Company, Sole Trader or Partnership, if you are or will become a higher or additional rate tax payer then it is possible to expand your business and obtain 5 years of expansion profits 'tax free'.

The expansion needs to be a real trading business ie one you could sell and walk away from and the venture would need to be run for commercial and risk reduction reasons through a separate LLP (Limited Liability Partnership). It would need to run for a minimum of two years to establish financial soundness, but thereafter we would organise the phased buy back of the LLP generating tax free profits.

This type of planning can only be put in place prior to the establishment of the new venture and so it is essential that you speak to one of the team prior to set up.

Tip

If you are planning any kind of new venture it will greatly improve our ability to plan the tax implications and advise you of the best and most tax efficient structure if you speak to the team prior to commencement. We can help with all aspects of purchasing and setting up a company structure, registration for VAT or transferring VAT registration.

We Can Help

We can help you by ensuring that you're aware of the changes that will affect you, your family and your business. To find out more about the ways that we can help you, do not hesitate to contact us.