Lambert Chapman
Chartered Accountants

Tax planning for businesses

Getting started

If you are thinking of starting a business, you should consider, among other factors: the nature of the business, the demand for the service or product, the state of the economy, the availability of suitable funding, your break-even, the profit potential, the rate at which you expect the business to grow, the impact of being the business owner on all areas of your life and the degree of risk involved.

Business plan

You should prepare a business plan that will address such planning matters as: the source of your business capital, including your start-up requirements as well as your working capital funding (tax - efficiency is an important factor here), whether the business needs a PAYE scheme, whether it should be VAT registered and, not least, the business structure that will best meet your needs - sole trader/sole practitioner, partnership, limited liability partnership or limited company.

Most people use SatNav to aid navigation - in fact many would suggest that this is the most important car accessory. Likewise, a business plan is an aid to help you navigate the direction of the business. We can help you through the planning and decision making process - and with the appropriate registrations.

Business structure

There are both advantages and disadvantages for each trading structure with respect to control, perception, support, and costs. There are also some things to avoid. For example, if you decide that incorporating your business is the preferred solution there may be important issues to consider before you proceed. Also, you may wish to discuss with us where the ownership of any freehold property should be vested - should property be owned by a company or personally by the owners?

The choice of business structure can also be relevant in how you extract the money from the company. A limited company is a useful tax shelter, but only until you take the money out for personal use. There are different ways of doing this - salaries, dividends, loans, rent, for example. We can discuss your options and implications of each of these with you and help you determine which is most suitable.

The importance of the accounting date for your business

It is also important to choose the right accounting date for your business. Is there a time of year when it is more convenient to close off your accounting records, ready for the preparation of your financial statement? What would be the best time of year for stocktaking? To what extent is your business seasonal? From a tax viewpoint, the choice of a year-end early in the tax year for an unincorporated business usually means that an increase in profits is more slowly reflected in an increased tax bill. This can, however, backfire when profits reduce, as the reduction in tax is similarly delayed, and can leave you with a large tax liability when you retire or scale down your business.

Because of the rules about how profits are taxed in the early years of a business, some profits may be taxed twice at start up. A record of this is kept (called overlap profits), and the amount is deducted when the business ceases or changes accounting date, although if profits have fallen sharply, the benefit of this may be limited. In cases where businesses see a significant permanent fall in profitability, it is often wise to change accounting date to 5 April to benefit from the overlap profits sooner.

HMRC registration

Advising HMRC when you become self-employed, and probably liable to Class 2 national insurance contributions (or alternatively you will need to establish if you qualify for exception), may not be very high on your list of priorities in the first weeks and months of a new business - but failure to notify that you are in business can attract a penalty. You may not even be sure about the date that your business started! If you have any doubts, we can advise you. Most tax registrations and returns are now required to be done online.

Make the most of your expenses

Our role as accountants and business advisers is to work with you to help you maximise your profitability and look at the various available options to help you minimise your taxes - we know that you do not want to pay a penny more than is absolutely required.

You will pay tax on your taxable profits (which will differ from the profit shown in your accounts), so it is essential to claim all business related expenses. You can claim a proportion of your household running costs and a proportion of your home telephone bills if you maintain an office at home. You can also claim for the cost of travel and accommodation when you are working away from your main place of business.

You must keep adequate business records - including a log of business journeys - because in addition to ensuring your accounts are accurate, these records may be requested by HMRC. There are a number of easy to use apps which you can install on your smart phone to enable you to record business journeys. Have you considered using a good computer package for record keeping? Cloud accounting is becoming increasingly popular while Sage, QuickBooks, Xero provide good solutions for some companies. If you are considering a computerised solution, please ask for our advice. You must keep your business records for six years. Make sure that they are kept safely and not exposed to damp. It is important to ensure that computer records are properly backed up.

Capital allowances

'Capital allowances' is the term used to describe the deduction we are able to claim on your behalf for expenditure on business equipment, in lieu of depreciation.

For expenditure on business equipment, including vans and fixtures in buildings, but not cars, you may claim a full 100% deduction of up to £200,000.

If your business is in a new economic activity located in an Enterprise Zone your business is entitled to a 100% deduction on all expenditure (until 31 March 2020) qualifying as referred to above but with further conditions.

The allowance is available for each enterprise if you run more than one, provided these businesses are not controlled by the same person and either occupy the same premises or carry on the same business activities.

A 100% first year allowance is available for investment in designated energy saving plant and machinery, plant and machinery to reduce water use and improve water quality, and for new unused cars with official emissions of up to 50g/km.

Most plant and machinery qualifies for an allowance of 18% on a reducing balance basis. There is a lower rate of 8% for long-life assets, fixtures integral to buildings, high emission cars and thermal insulation.

There are no capital allowances available on the purchase or construction of buildings. However many items that may seem to be part of a building may actually be regarded as plant or as features integral to a building, and may therefore qualify for a capital allowance deduction of 8% or 18%.

As capital allowances are based on qualifying expenditure in the accounting year, you might consider buying plant and machinery before the end of the year, rather than just after, in order to obtain an earlier deduction.

Research and development

R&D claims are rising year on year by 19%. To date, over 25,000 companies have made a claim but that is far less than 1% of all companies.

Tax relief is available on qualifying research and development (R&D) expenditure at varying rates. These reliefs are for more than the amount spent and so represent a form of government grant. The relief is particularly generous for smaller businesses.

However, the relief is only available to businesses which operate as limited companies. This may be a critical issue to consider at the commencement of your business. Maximum rates of relief for this tax year:

- For small and medium-sized companies paying tax at 19%, the maximum rate of tax relief is 43.7% (that is a tax credit of 230% of the expenditure)
- For small to medium-sized companies not yet in profit, the maximum rate of relief is 14.5% as a payable tax credit, applied to the 230% scaled up expenditure, which provides a net cash payment of 32.6% of the amount spent
- Relief is available for larger companies and SMEs that have received grant funding towards their R&D. This provides a 12% (11% for expenditure before 1 January 2018) taxable addition to profit (known as 'above the line relief') in respect of qualifying R&D costs. The tax credit is payable in full to companies which have losses, and is set against the corporation tax payable otherwise.
- There is also a limit of around £5.5 million on the amount of additional tax relief a company can claim under this SME scheme, as a result of EU state aid rules.

SMEs barred from claiming SME R&D tax credit by virtue of receiving some other form of state aid (usually a grant) for the same project may claim the large company R&D tax credit. This means they will qualify for an above the line credit of 12% - see above.

If your company exploits a patent, you may be able to benefit from the ‘patent box'. This is an arrangement that reduces the effective rate of corporation tax to 10% of the income from exploiting the patent.

However, new claimants from 1 April 2017 are subject to stricter qualifying conditions and may gain less relief than those claiming before that date, as a result of the UK agreeing to abide by the (base erosion and profit shifting) BEPS rules put forward by the OECD.

Involving the family

You can employ family members in your business, provided the salary and other benefits you pay them is commercially justifiable. You can remunerate family members with a salary, and perhaps also with benefits - such as a company car or van. However, before buying a vehicle through the business you should discuss this with us as it is possible to incur a personal tax charge on a van of £1,792 (that is at the additional rate tax of 45% - at 20% the maximum personal charge is £797) including the use of fuel for private purposes - the tax cost of cars can be even greater. Other options include medical insurance or making payments into a registered pension scheme.

You can also take family members into partnership, thereby gaining more flexibility in profit allocation. In fact, taking your children into partnership and gradually reducing your own involvement can be a very tax efficient way of passing on the family business. Be aware, though, that taking family members into your business may put the family wealth at risk if, for example, the business were to fail. HMRC may challenge excessive remuneration packages or profit shares for family members, so seek our advice before you make any decisions.

If you operate your business through a limited company, under current tax law you can pass shares onto other family members and thus gradually transfer the business with no immediate tax liability in most cases. However, a tax saving for the donor usually impacts on the recipient and you also need to steer clear of the anti-avoidance rules known as the settlements legislation, so again, seek our advice first.

Bringing in people from outside your company

Employees

Under the Enterprise Management Incentive scheme (EMI) employees can be granted options of up to £250,000 for shares in your company. Employee commitment can be rewarded through the growth in value of the shares for which options are held, with the resulting capital gain, potentially, taxable at 10%. The company, and the shares issued will need to meet strict qualification criteria for the scheme to apply.

EMI and the Share Incentive Plan (SIP) are tax efficient incentives that can be packaged to attract and retain the right people for the future of your company, at a cost the company can afford. Even the potential national insurance contributions liability on the growth in value of SIP shares during the option period can be attached, by consent, to the employee.

We welcome the opportunity to discuss an employee share ownership strategy, whether for individual employees or for the entire workforce.

Investors

There are several schemes under which tax reliefs or tax deferrals are available for investment in new and growing businesses, which tend to increase the availability of venture capital for qualifying companies.

- The Enterprise Investment Scheme allows income tax relief (30%) and CGT deferral, plus a tax exemption for any increase in the value of the investment after an initial three-year retention period
- The seed enterprise investment scheme (SEIS) offers income tax reliefs of 50% provided the investment is in a qualifying company and the shares are held for three years from the date of issue. Venture capital trusts offer income tax reliefs (30%) and the opportunity to pool investment with others looking to invest in qualifying companies
- Social Investment tax relief (SITR) offers income tax relief of 30% to investors in qualifying social enterprises, plus a CGT deferral and tax exemption on the investment provided held for at least 3 years. SITR is also available to those providing loan capital to qualifying enterprises.

The rules and tax breaks for each scheme are different, and do tend to change from time to time, but please discuss the options with us if you are thinking of attracting outside investors. SEIS is for those willing to invest in very young companies.

The tax exemption for trading companies and groups on the sale of shareholdings of 10% or more in trading companies may also encourage corporate investors. If you are aiming to bring new investment into your company, you will need to have a very clear idea of why the investors should choose your company, and what they can expect to get out of it. You will need to have a comprehensive business plan, with supporting financial forecasts to put before potential investors or lenders.

Tax and the unincorporated business

Business profits are charged to income tax and class 4 national insurance contributions on the current year basis. This means that the profits taxed for each tax year (ending 5 April) are those earned in the accounting period ending in the tax year.

There are special rules which determine the amount of profits taxed for the beginning and final years of a business, and for those joining and leaving partnerships.

There are an increased number of penalties for not complying with the rules and regulations of government departments. We have already mentioned HMRC 'late registration' penalty, covering late registration for income tax and class 2 national insurance, but other areas to avoid are:

- Late VAT registration
- Late filing penalties
- Late payment penalties and interest
- Penalties for errors in returns
- Penalties for failing to operate PAYE or subcontractors scheme in the building trade
- Penalties for breaching rules concerning workplace pension provision.

Although we will seek to help you steer clear of them, we need you to play your part by letting us have all the details for your accounts and tax returns in good time, and by telling us of all changes in your business, financial and personal circumstances.

Modernisation of the penalty rules means that many taxpayers could be liable to substantial penalties for understatements on their tax returns. Even if you make an honest mistake, HMRC may argue that you have been careless. You will need to be absolutely sure that you tell us everything that may be relevant to your tax liability for a year.

Employed or self-employed

When you take someone on in your business, you will need to determine whether they are an employee, or self employed. This is a complex area, because there is no statutory definition of employment or self-employment. The consequences of making an incorrect decision can be very serious indeed. You may be liable for not only the employer national insurance contributions (NICs), but also the amounts of tax and NICs that would normally be borne by the employee if you incorrectly treat someone as self-employed.

In particular, it is not possible for an employer and employee to agree that someone is not an employee. If the work has the nature of employment, that is how it should be taxed.

Because large amounts of tax and national insurance contributions can be at stake, HMRC can take a firm line, so obtaining advice specific to your business is essential. However, you need to seek advice before you engage workers, so that we can advise on the best strategy and engagement terms to suit your business circumstances.

You should remember that employees are entitled to receive the national minimum wage, have at least 5.6 weeks paid annual holiday (including statutory bank holidays), and have various other employment rights.

Unpaid bills and unbilled work

It is a feature of the tax system that businesses must include in their turnover for the year a value for incomplete work, work you have completed and billed, but not yet been paid for, and work completed but not yet billed, all as at the end of the year.

Service businesses are also required to have accounting records that enable them to bring into account the sales value of incomplete contracts at the end of the year. This is an aspect of your business that requires careful planning so do please discuss this with us.

For unpaid bills, you may be able to claim relief for an identified bad debt, but you cannot claim relief for a general provision based on expectations of how many customers will not pay. Claiming bad debt relief does not stop you trying to obtain payment. Smaller businesses may account for VAT on a cash balance and may soon be able to do so for income tax also. These cash accounting systems provide bad debt relief at source.

Smaller businesses (but not companies) are permitted to account for their business profits on a cash basis, which essentially means that income and expenses are accounted for only as they are paid. The business must have income of less than £150,000 and not be subject to one of the exclusions. Accounting on a cash basis can make life simpler for a new business starting out, but the profit figures produced can be more subject to significant fluctuations and therefore may prove of limited use in securing, for example, a bank loan or a mortgage.

Tax and the limited company

If the limitation of liability is an important consideration, then a limited company may be the right solution - but do bear in mind that banks and other creditors often require personal guarantees from directors for company borrowings, so the owners or directors of the business may in fact bear the liabilities of the business out of their personal assets.

Trading through a limited company can be an effective way of sheltering profits as the rates of corporation tax on profits are generally lower than those applying to unincorporated businesses which can be 47% (including 2% class 4 national insurance contributions) or more. Although profits paid out in the form of salaries, bonuses, or dividends will normally be taxable at top rates (with quite punitive amount of national insurance contributions in addition), profits retained in the company are taxed in 2018/19 at 19%.

Retained profits can be used to buy equipment or to provide for pensions - both of which should be eligible for tax relief.

Reducing national insurance costs

Although leaving profits in the company can be tax-efficient, you need money to live on, so you should consider the best ways to extract profits from your company. A salary will meet most of your needs, but do not overlook the use of benefits-in-kind, which may save income tax and could also result in a lower national insurance bill. The total tax and national insurance can be as much as 70.8%.

6 strategies to save NICs

- Increasing the amount the employer contributes to company pension schemes
- Share incentive plans (shares bought out of pre-tax and pre-NIC income)
- For companies, disincorporation and instead operating as a sole trader or partnership
- Instead of more salary, paying a significant one-off bonus to reduce employee contributions (this will not work for directors)
- Paying dividends instead of bonuses to owner-directors
- New claims for childcare vouchers ended on 4 October 2018, although existing claims submitted before this date remain valid.

Owner-director - increase your net income

For the moment, consider how much you might save if, as an owner-director, you wanted to extract the £10,000 profit your company makes in 2018/19 by way of a dividend rather than a bonus. Please note that we assume that you are paying higher rate (40%) tax, so your earnings exceed the so-called 'upper limit' for NICs; this means that employee NIC is charged at 2% rather than 12%.

There are many matters to be considered when deciding whether directors should be paid by dividend or salary/bonus. In practice, a combination of each is usually an appropriate course.

Remember that dividends are usually payable to all shareholders. If you have outside shareholders who are not involved in the day to day running of the company then you will need to consider your dividend strategy carefully. Although it is possible for shareholders to waive their entitlement to dividends, this can result in tax complications, so a better option may be to have different classes of share, on which different rates of dividend can be paid. However, if this technique is used as part of a scheme to avoid tax or NICs for employees, it may not be effective and thus result in an even higher tax liability.

Finally, you may need to consider with us the effect that regular payment of dividends will have on the valuation of shares in your company.

As you can see in the following case study for a 40% tax rate payer, the net amount withdrawn is increased by more than 15% by opting to declare a dividend. But be sure to discuss this with us before you act as this is a very complex area of tax law.

Case study

Bonus or Dividend?

	Bonus £	Dividend £
Profit to extract	10,000	10,000
Employers' NIC	-1,213	

	Bonus	Dividend
Gross bonus	8,787	
Corporation tax @ 19%		1,900
Dividend		8,100
Employee's NIC (assuming a rate of 2%)	-176	
Income tax @ 40%	-3,515	
Dividend income tax upper rate @32.5%		-1,983
Net amount extracted	£5,096	£6,117

In the above example there is a gain of £1,021 as a result of opting to pay a dividend as opposed to paying a bonus.

Paying the tax

For the self-employed, the timetable of tax payments is relatively simple:

- 31 January in the tax year, first payment on account
- 31 July after the tax year, second payment on account
- 31 January after the tax year, balancing payment

The payments on account are made based on the previous year's tax liability, and are your 'down payments' towards the current year tax bill.

Reducing your payments on account

Payments on account are normally equal to 50% of the previous year's net liability. A claim can be made to reduce your payments on account, if you expect your tax liability to fall from one year to another, although interest will be charged if your actual liability is higher than you expected.

Please do not wait until it's too late - keep us informed of any factors which might change your tax liability. We can only suggest business solutions if you tell us in good time about issues facing your business.

There is also a system of interest and surcharges to encourage prompt payment.

Case study

For example, if you do not make your full 2017/18 balancing payment by 2 March 2019, HMRC will add a 5% late payment penalty in addition to interest which will be charged from 1 February 2019.

Delay until after 31 July 2019, and a further 5% penalty will be added. And interest is charged on outstanding penalties, as well as unpaid tax and NICs.

Year-round business planning

Tax and financial planning should not be left until the end of the tax or financial year, but in advance of the end of your business year, why not talk to us about:

- The impact on your tax position and financial results of accelerating revenue and capital expenditure into the current financial year, or deferring it into the next
- Reviewing your pension arrangements and maybe paying additional pension contributions
- How you might take profits from your business at the lowest tax cost, and how timing of payment of dividends (the tax-free allowance for 2018/19 is £2,000 per individual) and bonuses can reduce or defer tax
- Avoiding overvaluing stock and work in progress
- Improved cash collection strategies

- Improvements to your billing systems and record keeping, or a general systems review to improve profitability and cashflow
- Tax saving employee remuneration packages with potential cost savings for you and your employees.

© Lambert Chapman LLP 2019

Disclaimer: The views expressed in this article are the personal views of the Author and other professionals may express different views. They may not be the views of Lambert Chapman LLP. The material in the article cannot and should not be considered as exhaustive. Professional advice should be sought in connection with any of the issues contained in the article and the implementation of any actions.