Tax and NI

This briefing provides an introduction to the taxes most likely to affect your business. The sooner you set up systems for maintaining your records, and the better you keep them, the less money you will need to spend on professional help in dealing with the tax authorities. It will also be easier to plan for your liabilities.

Nevertheless, it is well worth consulting a tax expert — a qualified accountant, solicitor or tax adviser — for advice. An expert may be able to save you much more in tax than you spend on fees. But as well as sparing you time and effort, it should also help you avoid running into problems.

This briefing covers:

- Which taxes will affect your business.
- What can be classed as business expenses.
- Your responsibility for calculating and paying tax and National Insurance for your employees.
- Tax breaks for investors in small and medium-sized companies.

1 Different taxes

1.1 Both the self-employed and employees pay **income tax** (see **2**, **3** and **4**).

1.2 A limited liability company pays **corporation tax** (see **5**).

1.3 Employers are responsible for collecting and paying the tax on **employee pay** and **benefits** (see **9**).

1.4 Employers are also responsible for paying **National Insurance** (NI) contributions for, and on behalf of, employees (see **10**).

1.5 **Value added tax** (VAT) is payable on VATable 'supplies' (usually sales) of goods and services (see **11**).

1.6 **Capital gains tax** (CGT) may be payable when certain assets are sold for more than they cost (see **12**).

1.7 **Stamp duty land tax** (SDLT) is charged on transfers of land and property.

- For commercial property transactions, SDLT rates on commercial property transactions are 1 per cent on transfers in excess of £150,000, 3 per cent in excess of £250,000 and 4 per cent in excess of

£500,000. Stamp duty at 0.5 per cent is charged on share transfers.

1.8 Substantial **tax breaks** are available to investors in small or medium-sized companies (see **13**).

2 Are you self-employed?

People who are self-employed can benefit from significant short-term tax and NI advantages compared with company employees (see **3** and **10**).

2.1 You are **self-employed** if you are your own boss and trade as a sole trader or member of a partnership. To convince HM Revenue & Customs (HMRC), you must at least show you:

- Control what you do, and how and when you do it.
- Have more than one customer.
- Bear an element of business risk.
- Have a right of substitution.

2.2 If you trade as a limited company, you will be an **employee** of the company.

- This also applies to shareholding directors.

2.3 If the company contracts your services to a single client, who would otherwise employ you, it will probably be classed as a **personal service company**.

3 Tax for the self-employed

3.1 The self-employed pay income tax on their **profits** — not on their drawings. For example, if you make £30,000 profit, you pay income tax on the full £30,000 — even if you draw only £10,000 as salary.

- Profit is business turnover less allowable expenses, excluding your salary (see **6** and **7**).

3.2 You pay tax on the profits made over the **accounting period** (usually 12 months) which ends in that tax year.

- Tax is due in two equal instalments, on 31 January (during the tax year), and on 31 July (after the end of the tax year).
- The interim amounts payable are based on the previous year's tax liability. Arrangements can be made to cut payments, if profits are falling.
- If the profits made are higher than those for the previous year, a balancing payment is due on the following 31 January.

3.3 **New businesses** may be taxed twice on their first year profits, depending on the accounting period you choose.

- 'Overlap relief' will be available to compensate you for this, but the calculations are complex and there will always be a cashflow cost to the business. Consult your accountant or tax adviser.

3.4 Tax planning can ensure the self-employed pay tax due **later** than employees.

- For example, if your accounting period ends on 30 June 2009, you pay tax on the profits for the period on 31 January 2010 and 31 July 2010 (both payments being based on the previous year's tax liability). The final payment (based on actual profits) will not be made until 31 January 2011.

4 Income tax

4.1 There are currently **two income tax bands** (for the tax year 2009/10):

Taxable income (£)	Tax rate
1–37,400	20%
over 37,400	40%

These tax bands apply to both employees and the self-employed.

For the tax year 2010/11 there will be an additional higher rate of 50 per cent for taxable income above £150,000.

4.2 Taxable income is reduced by a **personal allowance**.

- For the tax year 2009/10, the basic personal allowance is £6,475 (more for those over retirement age).
- If you run your own business, and your spouse has no other income, it makes sense for tax purposes to employ him or her on a salary of at least £6,475. The job must be genuine, you must pay the going rate and make actual payment.
- From 2010/11, the basic personal allowance will only be avilable to people earning less than £100,000. Where income is more than £100,000, the amount of the allowance will be reduced by £1 for every £2 above the limit.

5 Corporation tax

Corporation tax is payable on the profits — business turnover less allowable expenses, plus investment income and chargeable gains — of limited companies.

5.1 There are **three corporation tax bands** for the tax year 2009/10:

profit (£)	tax rate
1–300,000	21%
300,000-1,500,000	29.75%
Over 1,500,000	28%

If your profits fall between £300,000 and £1.5 million, you are eligible for marginal relief. This is designed to ease the transition from one rate to the next. The limits are reduced for companies belonging to groups.

The small companies' rate will increase from 21 per cent to 22 per cent from 1 April 2010.

5.2 Companies have to **calculate** their own corporation tax liability.

- If profits are likely to be in excess of £1.5 million, companies pay corporation tax by quarterly instalments. All other companies continue to pay corporation tax nine months after the end of the company's accounting period.
- Interest is charged on underpayments (and paid on overpayments).
- The tax return has to be filed within 12 months after the end of the accounting period and must be accompanied by accounts. Late returns incur automatic penalties.

Handle with care

Some expenses do not count and cannot be deducted when calculating your profit figure, even though they may seem necessary costs. They include:

- Personal expenses, including living expenses, ordinary clothes, and travel to and from your regular place of work.
- Entertaining, including any food or drink bought for clients.
- Certain professional fees, such as the costs associated with forming a company and obtaining a lease.
- Depreciation. Instead of deducting an element for depreciation, you claim capital allowances (see **7**).
- Fines, including parking tickets.

6 Expenses

You need to be clear about what expenses are allowable when working out your profit figure.

Business costs are allowable, but personal ones are not. Allowable expenses include:

6.1 Goods and materials, including anything your business buys in and then resells.

- Be careful about the value you put on your stock at the year end. A common mistake is to value it at selling price, rather than cost. This inflates your profit figure and increases your tax bill.

6.2 Spending on **research** and **development** (R&D) by small and medium-sized limited companies.

- You can claim R&D tax credits on qualifying spending at 175 per cent. This means you can set £175 off against your profits, for every £100 you spend.
- R&D tax credits apply to the costs of staff and consumable stores used in your R&D efforts, including expenditure on software, power, fuel and water.
- Companies not yet in profit (or not yet trading) can claim cash payments instead.
- You must spend £10,000 or more on R&D a year to claim these credits.

6.3 Costs associated with your **premises**, such as rent, rates and heating.

- If you work from home, you can usually count a fair proportion of your domestic bills such as electricity and telephone bills and fixed costs such as mortgage repayments as business expenses.

6.4 Selling costs, including marketing and advertising expenses.

6.5 Finance costs, such as bank charges and interest (including leasing and hire purchase interest charges).

6.6 General **running expenses**, including telephone, travel and subsistence (eg hotel costs on a business trip), insurance postage, accounting and other services.

6.7 Directors' and employees' **wages** and **benefits** (see **9**), and employer's NI contributions (see **10**).

6.8 Bad debts, where specific invoices are unlikely to be paid.

6.9 If you are not registered for **VAT**, you treat the VAT element as part of your expenses.

- If you are registered, VAT is reclaimed separately (see **11**).

  In addition to allowable expenses, you can claim allowances to reflect investments you have made in plant and machinery (see **7**).

7 Capital allowances

Whether you are self-employed or trading as a limited company, you cannot count the full cost of purchasing or improving premises and equipment as an expense. Instead you have to claim a 'capital allowance', which is then set off against your profits like an allowable expense.

7.1 In most cases, capital allowances allow you to write off a **percentage** of the value of the asset against profits, over several years.

- You apply the percentage to the original cost in year one, and write the value of the asset down by that amount.

  In subsequent years, you apply the percentage to the written-down value, so that the allowance gradually declines.

7.2 Capital allowances **range** from 0 per cent to 100 per cent, depending on who you are and what you are purchasing.

- There are 100 per cent allowances for energy saving and environmentally beneficial equipment. Loss making businesses can surrender losses attributable to expenditure on such equipment in exchange for tax credit.
- There are also 100 per cent capital allowances for businesses purchasing low-emission cars (emitting up to 110g/km of carbon dioxide).
- There is a new Annual Investment Allowance that allows businesses to claim 100 per cent capital allowances on the first £50,000 of investment on plant and machinery (excluding cars). Expenditure over £50,000 will be dealt with under the main or new special rate pools (see below). The Annual Investment Allowance is open to all businesses, not just small and medium-sized businesses.
- The new 'special rate' pool gives 10 per cent capital allowances on integral features of buildings, thermal insulation and long-life assets.
- The allowance for qualifying industrial buildings and large hotels is 3 per cent a year, based on cost.
- Since 11 April 2007, businesses have been able to claim the Business Premises Renovation Allowance. It gives businesses in designated disadvantaged areas 100 per cent capital allowances for the costs of renovating or converting business premises that have been vacant for more than one year.

7.3 To make life simple, all equipment subject to the main rate (except cars costing more than £12,000) is generally put into a '**pool**', and capital allowances are calculated at 20 per cent of the total value.

- Each time you buy something, the cost is added to the value of the pool.

7.4 Where assets have an expected life in the business of four years or less, you can elect for them to be treated separately as **short-life assets**. This can accelerate tax relief.

7.5 You can choose to **defer** claiming capital allowances.

- The whole process of writing down the assets is simply delayed by a year, leaving their value unchanged.

7.6 If you are not registered for **VAT**, you can also claim capital allowances on the VAT charged on the equipment you buy.

8 Offsetting losses

8.1 If you are **self-employed**, you can offset trading losses against other income received in that tax year or the preceding year, such as earnings from a job or income from investments, plus any capital gains arising in that year.

- Alternatively, losses can be carried forward to offset against future profits from the same trade.
  Losses in the first four years, or in the last year, may also be carried back up to three years.

8.2 Limited companies can also offset their trading losses against other income in the accounting period.

- Losses incurred in the initial accounting period of a new company can be carried forward to reduce future tax bills, or carried back for one year to reclaim tax

already paid.
A temporary measure was brought in as part of the 2008 Pre-Budget Report allowing companies to carry losses back for three years when making returns for an accounting period ending in the period 24 November 2008 to 23 November 2009.
After carry back to the preceding year, a maximum of £50,000 of the balance of unused losses is then available for carry back to the earlier two years.
There is a similar loss relief when a business is closed down. Losses can be carried for three years in this situation.

Cars and tax

A If you are **self-employed**, and use your own car for work, you must keep a record of business miles travelled.

- Whenever your car is serviced, make sure the mileage reading is noted. This allows you to work out the car's total mileage for the year — and provides evidence to satisfy the tax inspector.
- You must estimate what percentage of the mileage was for business purposes. For example, if the business mileage was 75 per cent of the total, you can claim 75 per cent of your car costs (petrol, insurance, repairs) as business expenses.
  You can also claim 75 per cent of the capital allowance you would have had if the car had only been used for business (see **7.2**).
- Alternatively, you may be able to claim an allowance in line with HMRC Approved Mileage Allowance Payments (AMAP) (see **B**).

B Employees who use their own cars usually receive a **mileage allowance**.

- If mileage allowances are paid in line with HMRC's AMAP, there is no extra liability.
  If they are greater than AMAP, the difference is taxable.
- AMAP for all cars (and vans) are 40p a mile for the first 10,000 miles, and 25p a mile thereafter.

C An employee using a **company car** for private use pays income tax on the benefit, based on a percentage of the list price determined by the car's carbon dioxide emissions. The employer must also pay NI on the benefit, as if it were part of the employee's salary.

- If fuel is provided for the employee's private use, the taxable benefit is based on the car's carbon dioxide emissions.

9 Tax and employees

9.1 The employer must deduct employees' **income tax** from each wage payment.
The tax must then be sent to HMRC on a monthly or quarterly basis.

- Employers can make quarterly payments of PAYE and NI if their average net monthly payments fall below £1,500.
- Most redundancy payments under £30,000 are tax free.
  Any overpayment or underpayment of tax will be corrected once employees have sent their tax returns in.

9.2 Employee benefits are generally taxable. There are some exceptions:

- Payments into HMRC-approved pension schemes.
- Approved schemes to encourage employees to take up shareholdings.
- Low-interest loans of up to £5,000 from the employer.
- Workplace childcare and up to £55 per week of childcare vouchers for approved childcare and welfare counselling provided by employers.
- Provision of some office services, equipment and consumables. For example, provision of a mobile phone or the loan of a computer.
- Some less commonly-used benefits.

9.3 If you trade as a limited company, you could cut the tax bill for your employees by introducing tax-favoured **share schemes**.
Such schemes can provide employees with incentives for staying with the company and promoting its success.

- Enterprise Management Incentive schemes allow small firms to give key employees tax-favoured share options.
  To qualify, companies must be independent with gross assets of less than £30 million and fewer than 250 employees. The total value of shares under option is limited to £3 million.
- Share Incentive Plans (SIPs) allow companies to give their employees up to £3,000-worth of shares each year, free of tax and NI.
  Some or all of this can be awarded in respect of performance targets.
  Employees can buy shares, free of tax and

NI, out of their pre-tax salaries, up to a maximum of £1,500 a year.
Employers can give their employees up to two free shares for each share purchased. Provided the shares are held for at least five years, no tax or NI will be payable.

10 National Insurance

10.1 The **self-employed** pay much less NI than company employees. But they get substantially fewer benefits.

10.2 Employees pay Class 1 contributions. This is deducted from pay at source, along with the employee's income tax.

- Employees earning less than £110 a week are exempt.
- Contracted-in employees pay 11 per cent on weekly earnings of between £110 and £844 plus an additional one per cent on weekly earnings over £844. From 2011/12 this will rise by 0.5 per cent to 11.5 per cent. Contracted-out employees pay 9.4 per cent.

10.3 Employers pay the 'employer's contribution' on pay and benefits.

This is charged at 12.8 per cent for contracted-in employees on earnings over £110 a week. From 2011/2012 this will rise by 0.5 per cent to 13.3 per cent. There are lower rates for contracted-out employees.

- Employers pay nothing for employees earning less than £110 a week.

10.4 The **self-employed** currently pay:

- Class 2 contributions of £2.40 a week (£124.80 a year). The National Insurance Contributions Office collects this. Someone earning less than £5,075 a year can apply to be exempted from Class 2 contributions. Ask for Form CF10.
- Class 4 contributions of eight per cent on profits of between £5,715 and £43,875 plus an additional one per cent on annual profits over £43,875.
  HMRC collects this at the same time as income tax.

If you have a job as well as working on a self-employed basis, you pay Class 1 contributions. In this situation, you can apply to defer payment of Class 2 and Class 4 contributions.

11 VAT

Unless a specific relief applies, VAT is payable on all sales (of goods and services) at 15 per cent, and is recoverable on most purchases.

The reliefs are laid down in legislation. They are 'exempt supplies' which include health, finance, insurance, education and many property transactions; 'zero-rated' (VATable at 0 per cent) on food, children's clothes, new houses and printed matter; 'reduced rate' payable at 5 per cent on items including domestic fuel, insulating products, safety seats and certain conversions/refurbishments.

11.1 All businesses must pay VAT, but only those that are **VAT-registered** can reclaim it.

- Businesses – whether companies, sole proprietors or partnerships – must register once their annual turnover exceeds the VAT-registration threshold (currently £68,000).
- VAT-registered businesses must charge VAT on their sales of VATable goods and services, and account for the tax to HMRC.
- They may deregister if their annual turnover falls below a certain limit (currently £66,000).
- Businesses with turnover below the VAT-registration threshold may choose whether to register. They have to weigh the advantages (the ability to recover VAT) against the disadvantages (having to charge VAT, and the costs of administration).

11.2 Certain small and medium-sized businesses have the option of using the **cash accounting** system.

- The amount paid in VAT is based on sales revenue actually received, while the amount recovered is calculated according to the invoices that have been paid. This avoids the problems that can otherwise arise with late payment or bad debts.
- The scheme is open to businesses with a turnover of up to £1.35 million that meet the conditions in HMRC's Notice 731. The leaving threshold is £1.6 million.
- Eligible businesses do not need to apply to use this scheme but must start from the beginning of a VAT period.

11.3 Small to medium-sized businesses can choose **annual accounting**, rather than submitting quarterly returns.

- The same threshold limits apply as for the cash accounting scheme.
- Any business under the threshold can use the scheme from the date of VAT registration.

11.4 A **flat-rate scheme** is available for small businesses.

- It is available to any VAT registered entity with an annual VATable turnover of up to £150,000.
- The net VAT payable to HMRC is calculated as a percentage of turnover (which is specified by HMRC) rather than being the net difference between the VAT charged and incurred on individual transactions.

This reduces the costs of compliance considerably, but is not primarily designed to reduce the amount of VAT paid.

12 Capital gains tax

Capital gains tax (CGT) is a tax on successful investments, such as those in property or shares. If you sell something for more than you paid for it, you may have to pay CGT.

12.1 From 6 April 2008, capital gains tax is paid at a flat **rate** of 18 per cent on all gains of an individual.

- Capital gains are added to any other income.
- The first £10,100 of capital gain each year is tax free. A husband and wife or people in a civil partnership can each claim this allowance.
- CGT is payable on 31 January following the end of the tax year in which the gain is made.

12.2 Limited companies pay corporation tax on any capital gain.

- Capital gains are treated as part of the company's taxable profit.

12.3 The **self-employed**, like other individuals, pay CGT at a flat rate of 18 per cent.

12.4 CGT **exemptions** include increases in the value of your car and your principal private residence.

- If you work from home and have not claimed any part of your mortgage payments as a business expense, there is usually no CGT on the profits made from the sale of your house.
- Under certain conditions, some investment vehicles, life assurance policies and charitable gifts may also be exempt.

12.5 Capital **losses** can be set off against capital gains from the same year.

Any excess loss can be carried forward to be set off against future gains.

12.6 Individuals can claim **entrepreneurs' relief** on the first £1 million of gains made on the sale of a business or its assets.

- The relief gives an effective rate of 10 per cent on gains up to £1 million.
- Claims can be made on more than one occasion up to the £1 million lifetime limit.
- Gains over £1 million are charged at a flat rate of 18 per cent.

12.7 Payment of CGT can be **deferred**.

- You can get 'rollover relief' if you sell a building from which you trade (or certain other types of asset), and use the money to replace it with another.
- You can get 'reinvestment relief' if you reinvest the gain in qualifying shares in certain types of companies, under the Enterprise Investment Scheme (see **13**).
- However, capital gains tax deferral relief has been withdrawn for gains re-invested in venture capital trust shares on or after 6 April 2004.

13 Investments and tax

Various schemes exist to encourage investment in small to medium-sized companies.

13.1 The **corporate venturing** scheme is designed to encourage big companies to take stakes in smaller, unquoted ones.

- At least 20 per cent of the small company's shares must be held by individuals.
- Corporate assets must not exceed £15m before the share issue (or £16m after it).
- The small company must not obtain most of its income from royalty or licensing agreements, unless they relate to intellectual property or other intangible assets largely created by the company.
- Investors get corporation tax relief (at 20 per cent) if they hold shares for three years. They can defer tax on gains made in corporate venturing, if the proceeds are invested in another qualifying company. They must not hold stakes of more than 30 per cent.
- Capital losses can be set against income.

13.2 Both **enterprise investment** and **venture capital** schemes are aimed at boosting investment in small unquoted companies — the former by individuals previously unconnected with the company, the latter by venture capital trusts (VCTs).

- The period for which such investments must be held to qualify for income tax relief under a VCT has risen to five years.
- The definition of control has been changed to focus on who controls the company, rather than how profits are distributed.
- The annual limit on investments qualifying for tax relief under the Enterprise Investment Scheme increased to £500,000 for shares acquired from 6 April 2008.
- For investors in VCTs income tax relief on qualifying investments is 40 per cent for the tax year 2008/09.
- Other measures include protection of enterprise investment scheme status if companies go into receivership.

14 Paying less tax

There are widely-used ways of paying less tax.

14.1 New businesses expecting to make a first-year loss can delay incorporation.

- This may be advantageous because the self-employed can offset the tax loss against previous years' employment income and receive a tax rebate (see **8**). But being self-employed has other important implications, including unlimited liability.

14.2 If you are making profits and your cashflow is sound, it may be worth trying to **reduce profit** at the year end in order to cut your tax bill.

- Bring forward the purchase of assets that you will have to buy later anyway.
- Make full provision for specific bad debts.

14.3 Payments into a **pension scheme** are an efficient way of saving tax.

- But such payments will then be locked in.

  Weigh up the possibility that the cash will be needed in the business.

15 The 2008/09 tax year

The information in sections 1–14 above applies to the current tax year. The rates and thresholds for the previous year (2008/09) are outlined below.

15.1 Income tax (see **4**). The two income tax bands and rates for the tax year to 5 April 2009 were:

Taxable income (£)	Tax rate
1–34,800	20%
over 34,800	40%

15.2 Corporation tax bands (see **5**). In 2008/09 they were:

profit (£)	tax rate
0-300,000	21%
Over 1,500,000	28%

If your profits fell between £300,000 and £1.5 million, you were eligible for marginal relief. This is designed to ease the transition from one rate to the next. The limits are reduced for companies belonging to groups.

15.3 Allowances (see **4**).

- The personal allowance was £6,035.

15.4 National Insurance (see **10**).

- Employees earning less than £105 a week were exempt. Other employees paid 11 per cent (9.4 per cent if contracted-out) on any extra, up to £770 a week.
- The employer's contribution was 12.8 per cent on earnings above £105 a week (less if contracted out).
- The self-employed paid Class 2 contributions of £2.30 a week.
- Class 4 contributions were charged at eight per cent on profits between £6,035 and £40,040.
- The earnings limit for exemption from Class 2 contributions was £4,825.

15.5 Capital gains tax (see **12**).

- The annual individual exemption was £9,600.

15.6 VAT (see **11**).

- A new business had to register for VAT if it made VATable supplies of more than £67,000 in any twelve month period.

Note

On 1 December 2008 the standard rate of VAT fell from 17.5 per cent to 15 per cent. The reduced rate lasts until 31 December 2009. VAT will return to 17.5 per cent in January 2010

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