101 Business Tax Tips

By

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TAX INSIDER

How to beat the taxman and boost your income

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About This Guide

All businesses, large or small, like to save tax and there are many simple steps that a business can take to achieve this aim.

This guide contains 101 tax savings tips. The tips follow the lifecycle of a business meaning that there is something for everyone, regardless of whether you are thinking of starting a business, a new start-up or an established business. Many of the tips apply equally to sole traders, partnerships and companies, whereas some are specific to a particular type of business.

However, it should be noted that tips in this guide are for illustration purposes only and are intended to demonstrate where tax savings can be made. The savings that can be made will depend on the precise circumstances and the examples are a guide only. Professional advice should always be sought.

Chapter 1.
Business Structure

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1. Choose The Right Structure For Your Business

There are various ways in which businesses can be structured, and it is important that the structure that is chosen is the right one for the business.

There are four main options:

- Sole trader;
- Partnership;
- Limited liability partnership; and
- Limited company.

The choice of business vehicle affects the type of taxes you pay, your liability for business debts and the legal and administrative requirements imposed on the business. It will also affect the way in which business decisions are made and the sources of finance available to the business.

In deciding on the right structure for the business, it is necessary to take account of all relevant factors and also your attitude to risk.

For example, a sole trader is the simplest set-up and the proprietor gets to keep all the profits. However, he is also liable for all business debts.

A limited company is more complicated to set up and administer, but the shareholders' liability is limited to the amount of capital that they own – a major plus.

Choosing the Right Structure for Your Business

Bill wants to set up his own business. He has some money to invest but does not want to risk losing his family home if the business fails.

He is also keen to present a professional image to potential customers to help him win new business.

Having considered all the factors Bill decides that a limited company is the right vehicle for his business. Limited liability is very important to him and he is prepared to undertake the additional administrative burden associated with a limited company in return for this.

2. Choose Which Taxes You Pay

The choice of business vehicle will also determine which taxes are paid by your business. Sole traders and partnerships pay income tax on their profits, whereas a limited company pays corporation tax.

Gains realised by individuals are liable to capital gains tax, whereas a company pays corporation tax on chargeable gains.

All businesses with turnover of VAT taxable goods and services above the VAT registration threshold (£77,000 from 1 April 2012) must register for VAT. All businesses with turnover below this level can choose to register if they wish, but this is not compulsory.

A sole trader and an individual partner in a partnership are self-employed and pay both Class 2 flat rate National Insurance contributions and Class 4 contributions on their profits.

Companies do not pay National Insurance on their profits but must pay employer contributions on payments of earnings made to employees.

By choosing the structure for your business, it is also possible to choose which taxes you pay.

Choosing Which Taxes You Pay

Richard wants to set up a business. Having considered the options, he decides that being a sole trader is the right decision for him.

Richard will pay income tax on any profits from his business. His income tax liability will depend on his total income from all sources.

He will pay capital gains tax on any capital gains made from the sale of business assets, etc.

He will also need to register for Class 2 National Insurance contributions and will also pay Class 4 contributions on his profits.

If his turnover exceeds the VAT registration threshold he must also register for VAT.

3. Take Advantage Of The Veil Of Incorporation

Sole traders have unlimited liability for any debts that their business incurs. By contrast, a shareholder is only liable for company debts up to the amount of any share capital that they own. Limited liability is the main advantage of choosing to run your business as a limited company rather than as a sole trader or partnership.

A limited company is a separate legal entity from its shareholders and directors. This is known as the veil of incorporation. The shareholders' and directors' personal assets are not available to meet the debts of the company. However, the money and assets of the company belong to the company rather than to the shareholders personally.

By contrast, where an individual operates a business as a sole trader, there is no legal distinction between his business and private affairs. This means that the individual is personally liable for any business debts.

Benefit From the Veil of Incorporation

Jack has set up in business as a limited company. He has 100 £1 shares that are fully paid up. He is the sole shareholder.

The business collapses with debts of £10,000. Jack is not personally liable for those debts. His liability is limited to his shareholding of £100.

4. Save Incorporation Costs

A limited company must be properly created in accordance with company law requirements and registered with Companies House. This process is known as incorporation.

Although a company formation agent, accountant, solicitor or chartered secretary can be used to incorporate the company in return for a fee, it is possible and relatively straightforward to set up the business yourself using the web incorporation service offered by Companies House. The fee for this service is only £18 (see www.companieshouse.gov.uk).

However, you may wish to seek professional advice prior to setting up a business.

Save Incorporation Costs
Bill investigates the process of setting up a company for his new business. He wants to keep costs to a minimum and uses the web incorporation service offered by Companies House. This is straightforward to use and costs him only £18.

5. Create Different Categories Of Shares In A Limited Company

When setting up a limited company consider creating different classes of shares to allow the flexibility for different rights to be attributed to different shareholders. For example, dividends must be paid out in accordance with shareholdings. By creating different classes of shares it is possible to declare a dividend for one class and not for another, or to declare different dividends for different classes of shares. This allows the flexibility to extract profits in a tax-efficient manner.

Likewise, attaching different voting rights to different shares allows the decision making to be vested in one person but for another person to receive a greater share of profits.

Create Different Categories of Shares in a Limited Company

The Smith family are shareholders in their family company Smith Ltd.

Mr Smith holds 100 A class shares. These have full voting rights but no right to assets on a winding up.

Mrs Smith has 100 B class shares. They have no voting rights and no right to assets on a winding up.

Mr and Mrs Smith's sons, James and John, hold 50 C class shares each. They have no voting rights but have a right to a share of the assets on winding up.

Having different classes of shares allows Mr Smith to retain full control over the decision making and provides the flexibility to declare dividends for each class of share. On a winding up, the assets would be shared equally between the children.

6. Keep Administration Costs Low

A sole trader is the simplest business structure to set up and run. It does not have the legal requirements associated with a limited company, nor is it necessary to agree the division of profits or losses as in a partnership or to negotiate a partnership agreement. There is no incorporation process, as for a company, and no need to file an annual return and accounts with Companies House. Consequently the administrative burden associated with being in business as a sole trader is considerably less than for a company.

However, a person operating as sole trader must notify HMRC of their self-employment and register for National Insurance. As with all businesses, records must be kept and tax returns filed.

7. Keep All Business Profits For Yourself

An individual who is in business as a sole trader gets to keep all the profits made by his business. By contrast, profits made by a partnership are shared between the partners in accordance with the profit sharing ratio. Any profits made by a limited company belong to the company and must be paid out to the directors/shareholders in the forms of a salary, bonus or dividend (as appropriate).

A sole trader is uniquely placed to enjoy all the benefits of his business success.

Keep All Business Profits

Lucy is in business as a sole trader. She has a successful year and makes a profit of £100,000, which is treated as her income.

Her sisters, Katie and Emily, are in partnership, sharing profits equally. The partnership also makes a profit of £100,000. This is due mainly to a contract negotiated by Emily. However, the profits must be shared in accordance with the profit sharing ratio and Katie and Emily each have profits of £50,000.

In each case the profits are taxed as income of the individual concerned.

8. Maximise The Skill Base

For a business to be successful, a range of skills are needed. Where a person operates as a sole trader, they either need to possess the necessary skills or pay an expert, such as an accountant, to provide the skills that they lack.

A partnership offers the opportunity to bring together people with different skills in a business scenario. This can strengthen the business and increase the likelihood of success.

9. Agree The Split Of Partnership Profits And Losses

The legal definition of a partnership is the relationship that subsists between persons carrying on a business in common with a view to profit.

In a simple partnership the partners share profits and losses in accordance with a pre-agreed profit sharing ratio. A partnership is not a separate legal entity and partners are jointly and severally liable for the debts and losses of the partnership.

Normally one would want the partnership agreement to be crystal clear on the split of profits. However, where the partnership comprises a husband and wife or civil partners it may be advantageous to have a more loosely worded agreement to provide some flexibility in profit allocation to allow profits to be split in a way that minimises their combined tax liability. This could be achieved by a clause in the agreement which provides for profits to be determined in such a ratio as is agreed by the partners.

Agree Split of Partnership Profits and Losses

William and Ann are husband and wife who are in partnership together. As their other income fluctuates they decide to keep the partnership agreement loose as to the share of profits and agree the split each year depending on their other income.

In year 1 William has other income of £20,000 and Helen has no other income. The profits of the partnership are £50,000 and are allocated £35,000 (70%) to Helen and £15,000 (30%) to William to equalise income and minimise tax liabilities.

In year 2, neither has any other income and profits from the partnership are £70,000. They agree to split the profits equally.

The absence of a set profit sharing ratio in the agreement provides the flexibility to allocate profits in a tax-efficient manner.

10. Consider Purchasing An Existing Business

The rate of failure among start-up businesses is very high. Another option is to purchase an existing business. Although this may be more expensive initially, the success of the business is already proven and the investment may be less risky in the long term. The aim of any business is to succeed commercially. It is also easier to attract finance for an established business than for a new start-up.

When buying an existing business, the purchaser can either buy the shares in the business (if the business is a limited company) or the assets in the business. Where the business is an unincorporated business it will be the assets that are bought.

Professional advice should be sought prior to the acquisition of an existing business to ensure that the sale is structured in a tax-efficient manner and all legal requirements are met.

11. Run A Franchise

If you fancy being your own boss but have not had much previous business experience or are unsure whether your business idea will be successful, one option worth considering is running a franchise. Under a franchise arrangement the owner of a business (the franchisor) grants a licence to another person allowing them to use the business idea in a specific geographical location. The franchisee sells the franchisor's business or products under the franchisor's established brand name and receives help and business support. The franchisee pays an initial fee to the franchisor and also a percentage of profits.

Although it can be quite expensive to buy a franchise, the business is run on a proven model with an established name and identity, and support is available from the franchisor. Banks may also be more willing to lend to a franchise than to a new start-up.

Well-known franchises include Costa Coffee, MacDonald's, Carphone Warehouse and Subway.