# Essential Tax Guide for Limited Company Freelancers & Contractors

## 2016-17 Edition

An eBook by The Friendly Accountants


Chartered Accountants | Chartered Tax Advisers

Directors: Lesley Ward BSc FCA | Richard Baldwyn ATT CTA

The Friendly Accountants is a trading name of TFA Accountants Limited

Registered in England Number: 10396833 |Registered Office: Arena Business Centre, Holyrood Close, Poole, Dorset, BH17 7FJ

t: 01202 048696 | e: richard@thefriendlyaccountants.co.uk | www.thefriendlyaccountants.co.uk

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This guide is designed to alert you to some of the major issues you should be considering. It is not a replacement for professional advice tailored to your precise needs and circumstances.

You should always seek the advice of a suitably qualified professional before acting on any of the advice.

And if you would like to speak to us about any of the issues covered in this guide, please feel free to give us a call or drop us an email.

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This e-book is intended as a general tax planning guide for UK based limited company freelancers and contractors, in relation to the 2016/17 tax year.

It assumes the directors and shareholders are UK residents living in the UK full time, running their business from the UK.

The book has been written by The Friendly Accountants, a small accounting practice that specialises in working with freelancers, contractors and small businesses. For more information please visit: www.thefriendlyaccountants.co.uk.

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# 1 Introduction

There really is no correct answer to the question, “Should I trade as a limited company?”

The primary reason most small businesses choose to go limited is because it can have significant financial benefits due to the fact that the tax treatment is much more efficient.

However, because of ever frequent tax changes it makes it even more important to give careful consideration to whether this is the right business vehicle for you.

It can also give a business an enhanced appearance in certain market places – customers may think a limited company has more gravitas and is more likely to be a ‘serious’ supplier than a sole trader or partnership.

Apart from the tax implications of becoming a limited company, there are certain other issues which you need to consider.

For example, you need to think about how quickly you expect to grow your business. The more profits you make, the more beneficial it will be for you to trade as a limited company.

You also need to take into account your personal preferences. Just because everyone else is doing it doesn’t mean it’s right for you!

A couple of myths:

> Contrary to popular opinion, there is no limit to the turnover you can make and still remain a sole trader or partnership!
>
> Just because you’re a limited company doesn’t mean you have to have an ‘audit’ – you won’t need an audit until you meet certain criteria – in practice this means you’re not likely to need an audit until your sales are at least £10.2m (as at 2016).


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# 1.1 Advantages of trading as a limited company

## 1.1.1 Tax savings

A common reason for becoming a limited company is the tax benefits. How much these tax benefits amount to depend on your profits, but let's take the following example (based on 2016/17 tax rates):

| Annual Profits | £45,000 |
|---|---|
| **Self Employed** | |
| Tax Payable | £7,200 |
| National Insurance | £3,330 |
| Total Payable | £10,530 |
| Net Spendable Personal Income | £34,470 |
| **Limited Company** | |
| Company Tax Payable | £7,388 |
| Dividend Tax Payable | £1,621 |
| Total Payable | £9,009 |
| Net Spendable Personal Income | £35,991 |
| **Saving** | |
| **Saved By Registering As A Limited Company** | **£1,521** |

Whilst there are still tax savings to be made if you trade as a limited company these are less attractive due to the introduction of the new dividend tax. However from a tax perspective, trading as a limited company does provide you with the ability to manage your tax liabilities more effectively.

If you'd like to know exactly how much you could save by going limited, just get in touch and we'll run the numbers for you.

However before you decide whether or not this is the option to take, make sure you take a look at section 1.2 - Disadvantages of trading as a limited company.


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### 1.1.2 Separate legal entity

Because the company is a separate legal entity it can sue and be sued in its own right.

Therefore, if you believe there is a reasonable chance of being sued then it may make sense to trade as a limited company.

For example, many magazines will trade as a limited company because they may be at risk of being sued over inflammatory or derogatory remarks – this is why 'Private Eye' magazine is published by a limited company!!

### 1.1.3 Shareholders

Most limited companies are limited by shares and the shareholders own the company.

Shareholders usually have a right to a dividend (a distribution of a company's post-tax earnings), can vote on key issues (depending on the class of share capital they own – see section 6) and will share in the distribution of any cash left in the company if it's wound up (closed down) or made insolvent (after all creditors have been paid).

Shareholders rights will be listed in the articles of association. All companies are required to have articles of association which set out how the company is run, governed and owned. In practice, most small companies adopt the standard default articles from Companies House.

Shareholders then appoint directors to run the company. For most small businesses, the shareholders and directors are the same people. However shareholders and directors have very different roles – you can see more about what these are in section 2.

### 1.1.4 Limited liability

Most limited companies are limited by shares. The shareholders' liability is limited to the amount of issued share capital they hold.

If the company was to become insolvent whilst owing significant amounts of money, the creditors could not require the shareholders to provide any further funds towards paying off those debts.

However, beware. As noted in section 1.1.5, a lot of lenders (banks for example) will require the directors or shareholders to give a personal guarantee when obtaining finance. This means that the lender can still go after the directors and shareholders personally should the company go bankrupt.


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### 1.1.5 Bank loans and overdraft

In some instances, it can be easier to obtain finance as a limited company because the bank can obtain what is known as a "floating charge" over the assets owned by the company. This gives the bank extra security and gives the company greater borrowing power.

### 1.1.6 Transfer of ownership

Effective ownership of a company can be readily transferred (subject to the articles of association) by selling the shares in the company. However do give due consideration to the capital gains tax and inheritance tax implications before undertaking such a transaction.

### 1.1.7 Planning for retirement

Trading through a limited company offers a greater degree of flexibility when it comes to your pension provision.

Where the company has set up a scheme registered with HMRC some of the advantages are as follows:-

1) Any pension contribution paid by your company reduces its taxable business profits providing they are made wholly and exclusively for the purposes of the company's business – for example part of a company director's specified remuneration package.

2) The pension contributions paid by your company are not treated as a taxable benefit nor do they count as your earnings for NIC purposes.

3) The investment income and capital gains of the company pension scheme are not taxed.

4) A tax-free lump can be paid to you on retirement.

Further detailed advice on company pension schemes is outside the scope of this guide however, we would strongly recommend you seek the advice of a suitably qualified professional when setting up a pension scheme.

### 1.1.8 Perception

Rightly or wrongly, a limited company can often be perceived as a more 'established' or 'bona fide' business.


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## 1.2 Disadvantages of trading as a limited company

Whilst a lot of time is spent talking about the benefits of trading as a limited company, it's important to remember that there are some significant downsides as well.

### 1.2.1 Losses

Because the company is considered to be a separate legal entity, any losses made by the company can only be set off against any profits made by the company in prior years or any profits which the company may make in future years.

This may be a great disadvantage - especially in the early years of the business when the likelihood of losses is high.

In direct contrast the losses made by a partnership or sole trader in opening years may be offset against other income in prior years (subject to certain rules).

Let's take an example:

> You've been in a job for the past few years where you've been paying tax at 40%.
>
> You decide to leave and set up your own business. In your first year of trading you make losses of £20k.
>
> If you were trading as a sole trader, you could take those losses and set them off against your income in the prior year – entitling you to a tax refund of up to £8k (40%).
>
> However, if you were trading as a limited company, you'd only be able to carry those losses forward to set off against future company profits.

Think this sounds far-fetched? Well, we've seen many clients over the years in just that position – and all because 'their friend' told them they should trade as a limited company!

So if you're just starting out in business, make sure you get the right advice for which trading vehicle is best for you – otherwise it could literally cost you thousands of pounds.


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### 1.2.2 Personal guarantees

Whilst finance may be easier to obtain as a limited company, banks may (and quite frequently do) require directors to give personal guarantees that they will repay any borrowings should the company become insolvent.

Some suppliers may also require personal guarantees and so this may reduce directors' limited liability significantly.

### 1.2.3 Visibility of results

Because a company's Statutory Accounts are required by law to be filed at Companies House, then the company's results are freely available to the public (and your competitors).

Companies who are defined as small (broadly those with a turnover less than £10.2m as at 2016) can file abbreviated annual accounts. These accounts do not include any profit and loss information but will still have the balance sheet included.

You may also find that you need to pay your accountant an additional fee to produce abbreviated accounts for you.

### 1.2.4 Withdrawing funds

It's important to remember that the company's money and your money are completely separate – something which a lot of limited company owners forget!

And there's a nasty tax charge lurking if you don't make sure that you do things correctly.

However if you're a sole trader or partnership, you can generally introduce or withdraw cash from the business without any tax implications.

### 1.2.5 Expenses

When you are director of a company you can only claim tax relief on expenses which are incurred wholly, exclusively and necessarily in the performance of your duties as a director.

However, if you're a sole trader or partner the expenditure only has to be incurred wholly and exclusively in your role as sole trader or partner. This is a difference which can sometimes catch business owners out.


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## 1.2.6 Administration

Running a company involves a lot more administration then being a sole trader or running a partnership

For example, a limited company is required to file annual returns with Companies House and must produce dividend tax vouchers and minutes for any dividends paid.

A company's accounts must also be in a format which is prescribed by the Companies Act 2006 (unlike sole trader accounts which can be set out in any format). These accounts are then known as 'Statutory Accounts'.

Many of these requirements will incur penalties if they are not dealt with on time - and the directors are at risk of prosecution if they don't fulfil their statutory obligations correctly.

However a suitably qualified accountant can help you with all of your statutory obligations making sure you don't incur any penalties.

And whilst the additional administration required means additional costs, these can often be more than offset by the tax savings gained by trading as a limited company – but make sure you get advice as to what these might be!


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# 2 Running a limited company

Whilst a company is owned by its shareholders, the job of running it rests with the directors.

The details below give an overview as to the issues involved in running a limited company.

## 2.1 Directors' responsibilities

As a director of a limited company, the law says you must:

- try to make the company a success, using your skills, experience and judgment
- follow the company's rules, shown in its articles of association
- make decisions for the benefit of the company, not yourself
- tell other shareholders if you might personally benefit from a transaction the company makes
- keep company records and report changes to Companies House and HM Revenue and Customs (HMRC)
- make sure the company's accounts are a 'true and fair view' of the business finances
- register for Self-Assessment and send a personal Self-Assessment tax return every year

You can hire other people to manage some of these things day-to-day (eg an accountant) but you're still legally responsible for your company's records, accounts and performance.

You may be personally liable for your company's business liabilities and be fined, prosecuted or disqualified as a company director if you don't follow the rules.


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# 2.2 Shareholders agreement

Whilst it's not a legal requirement, it's a very good idea to have a shareholders agreement in place. This covers a number of 'what if' scenarios eg what if a shareholder wants to sell their shares and what if there's a dispute between shareholders.

You may not believe this is necessary due to the close relationship you have with other shareholders – but you'd be amazed how many difficult situations we've come across which could have been avoided with a simple agreement in place. And the effect on the company's performance can be catastrophic.

As a minimum we'd suggest your shareholders agreement should cover the following:

- Rights to appoint and remove directors.
- Terms to protect minority shareholders so that, for example, unanimous shareholder approval is required for certain company decisions.
- Restrictions on freedom to dispose of shares and, if other shareholders have pre-emption rights, at what valuation such transactions should take place. A minority stake in a company is usually powerless, so the value of the minority shares is correspondingly reduced. This can be over-ridden in favour of treating all shares as being of equal value, rather as if the company was publicly quoted.
- Restrictions on changing the nature of the business.
- Terms regulating the raising of capital to avoid diluting existing shareholdings.
- Dividend policy and entitlement. Note that a stated dividend policy may affect the value of the company's shares for tax purposes.
- Waiver of dividends. Certain shareholders may agree to waive dividends for an agreed period or permanently. Again this may have tax implications because it may entail a value shift from one shareholder to another.
- Limitations on directors' freedom of action, for example to invest in a new capital project or charge the company's assets.
- Business plan. Setting out the business plan in a shareholders' agreement may help to ensure that all shareholders have the same vision.
- How shareholder disputes should be resolved.

It's always best to get this sorted out **before** the problem arises!


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# 2.3 Records

Records must normally be kept in support of the return for 6 years from the end of the accounting period. The penalty for non-compliance can be as much as £3,000 for each accounting period.

# 2.4 Signs, stationery and promotional material

## 2.4.1 Signs

You must display a sign showing your company name at your registered company address and wherever your business operates. If you're running your business from home, you don't need to display a sign there.

**Example**

If you're running 3 shops and an office that's not at your home, you must display a sign at each of them. The sign must be easy to read and to see at any time, not just when you're open.

## 2.4.2 Stationery and promotional material

You must include your company's name on all company documents, publicity and letters.

On business letters, order forms, invoices and websites, you must show:

- the company's registered number
- its registered office address
- where the company is registered (England and Wales, Scotland or Northern Ireland)
- the fact that it's a limited company (usually by spelling out the company's full name including 'Limited' or 'Ltd')

If you want to include directors' names, you must list all of them.

If you want to show your company's share capital (how much the shares were worth when you issued them), you must say how much is 'paid up' (owned by shareholders).


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# 3 IR35 issues for contractors & freelancers

## 3.1 An overview

IR35 came into effect in April 2000 and was introduced to tackle those individuals who were providing their services via a limited company (known as a ‘personal service company’) in circumstances where had the company not existed they would have been taxed as employees.

IR35 is also known as the ‘intermediaries legislation’.

For the purposes of this guide we are assuming you are not caught by IR35. If you are caught by IR35 most of the information in this guide will be irrelevant. If you are concerned as to whether you might be caught by IR35 feel free to give us a call.

Trading through a limited company has significant tax advantages – for example, dividends are not liable to national insurance whereas salary is. So if you are trading through a limited company and are caught by IR35 all payments to you will be reclassified as salary by HMRC and taxed accordingly.

If you are subject to an HMRC enquiry and are deemed to have been caught by IR35 then the tax enquiry may go back several years and the costs could mount up.

IR35 is a complex area and if you think you are caught by this legislation then we would recommend you talk to your accountant or obtain specialist advice if you don’t have an accountant. Alternatively, feel free to give us a call.

However it’s important to say at this point that HMRC have not been very successful when trying to prove an individual is caught by IR35 and the tax revenue raised by such enquiries has been relatively modest compared to other areas, for example tax avoidance schemes involving contractor loans.

So what do you need to be aware of? Well, if HMRC do decide to investigate your employment status, they will speak both with the contractor (you) and the engager (your client). They will also examine the contract as well as ensuring working practices mirror the contract.

So having both a robust contract and making sure that your actual working arrangements match the contract are equally important.


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So what will they look at in particular?

Well, there are a number of key areas that HMRC will review in order to determine whether IR35 applies, but the three main areas are as follows:

### 3.1.1 Substitution

This is one of the main areas looked at when determining the true relationship between a contractor and engager (for 'engager' read your client).

A contractor should provide a service rather than their own personal skills and expertise.

This is often defined as an employee relationship which involves a contract *of* service whilst a contractor (or self-employed) relationship involves a contract *for* services.

This means that the contract should allow the contractor/freelancer to provide someone else to do the work ie they should be allowed to substitute their services with the services of a suitable replacement.

This is fundamentally different from the relationship between an employer and employee where the employee is expected to provide their services and would not be allowed to send someone else to do their job!

So if the contract allows for substitution and you are able to substitute your services occasionally with another contractor, then this will be very strong evidence of a contractor/client arrangement, rather than an employee/employer relationship.

In reality, this can often be difficult for freelancers and contractors to demonstrate in practice as they will rarely, if ever, bring anyone else in to do their work. However, even if you are not able to appoint a substitute, if you have a genuine right to provide the client with a substitute to undertake the work, then this is very strong prima facie evidence that the contract is not caught by IR35.

If the engager retains a right to say no to a substitution, this should only be on the basis that any substitute lacks the necessary skills and experience or other reasonable grounds.


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### 3.1.2 Mutuality of obligation

Mutuality of obligation is a legal term which looks at whether the engager has an obligation to provide the contractor with work and whether the contractor has an obligation to accept any work offered by the engager.

Where this is the case, the relationship will be held to be one of employer and employee.

In terms of the contractor/engager relationship, it's important that the contract relates to a specific project and that there is no obligation placed on the engager to provide further work once the contract has finished and there is no obligation on the contractor to accept any further work.

It is also good practice for the contract to have a notice period of one month or less as well as the contractor and engager both having the ability to terminate the contract early.

Where a contract is a 'rolling' contract or is performed over a longer period of time, HMRC could try to argue that the contractor is actually an employee.

### 3.1.3 Control

This is another key area which is reviewed when determining the nature of a relationship between engager and contractor.

The less control the engager has over the working arrangements of the contractor or freelancer, the better – they are more likely to be viewed as a contractor rather than employee.

The contractor is being engaged on the basis of their knowledge and expertise – not because they will turn up every day at set hours.

### 3.1.4 Other areas

Some of the other areas HMRC will look at when determining the true nature of the relationship are as follows:

- **Financial risk**
  If a contractor makes a mistake, he or she should have to correct this mistake at their own expense. Also, if a fixed price is given for a job then it is more likely to be perceived that there is financial risk if the job takes longer than anticipated.


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- **Provision of equipment**
  Do you have to buy your own equipment eg laptops etc? In reality this can be difficult for example where security measures prohibit the use of say using your own laptop. If this is the case, then this could be evidence that the relationship is not a contract for services.

- **Freedom to offer services**
  The contract should allow you to undertake work and exploit your skills in the marketplace as you see fit. One aspect of this means you have the freedom to take on another contract provided this does not compromise your primary contract.

- **Employee style benefits**
  If you are a contractor your contract should not allow for any holiday pay, sick pay, pension contributions, training courses, Christmas dinners or the annual staff summer outing.

## 3.2 Summary

As mentioned above, the area of IR35 is complex and there is a great wealth of case law which has examined the contractor/engager relationship.

So it's very important to ensure that your contract addresses the main areas above and that the reality of your working practices reflects the conditions detailed in your contract.

Given its lack of success in the courts, HMRC are currently reviewing IR35 and this may result in a change to their approach or new legislation being introduced in the next few years. However their recent success in the courts with regard to Uber drivers being classified as employees may open the gates for more status challenges by HMRC.

Again, just to re-iterate, in writing this guide we have assumed that you are not caught by IR35.


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# 4 Taking money out of a limited company

There are various ways for director/shareholders to get money out of their company – and some of these are more tax efficient than others.

## 4.1 Director's salaries

If you want the company to pay you a salary, you must register the company as an employer with HMRC. The company must take Income Tax and National Insurance contributions from your salary payments and pay these to HMRC, along with employers' National Insurance contributions.

If you are director you are classed as an officer of the company and therefore the minimum wage regulations should not apply. Make sure that salary is paid to you as an office holder (director) and not as an employee in any company minutes drawn up.

Any director's salary paid to you is an allowable deduction in the company's accounts for Corporation Tax purposes.

Depending on the salary level and the director's annual personal allowance, there may be PAYE and EEs National Insurance Contributions to be deducted from any salary paid. The company will also be liable to National Insurance Contributions at the rate of 13.8% (for 2016/17) of any gross salary paid to you above the NIC threshold.

### 4.1.1 Optimum salary

Most owner-managed businesses prefer to draw a low salary from their business and we would normally recommend a minimum amount which is equivalent to the primary NI threshold so as to obtain a National Insurance contribution record - £8,060 as of 2016/17.

You can see more about the salary strategies we recommend in sections 4.3.1 and 4.3.2.


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### 4.1.2 Administration

If you decide to take a salary from your company you will need to set up a PAYE (Pay As You Earn) scheme with HMRC. You will also be required to file an 'RTI' (Real Time Information) which is an electronic submission to HMRC. If you pay your salary monthly you will need to do this every month and if you pay your salary annually you will need to do this once a year.

BE AWARE, there are some very nasty financial penalties for late filing of RTIs.

## 4.2 Dividends

A dividend is a payment a company can make to shareholders if it has made enough profit – and these profits must be **after corporation tax** (something which a lot of small businesses forget). If there aren't adequate profits then the company is in danger of declaring an illegal dividend.

Let's look at an example:

XYZ Limited has profits before corporation tax of £25,000 for the year ended 31 March 2017 and undistributed reserves brought forward of £14,000 (that's the profits after tax which they haven't paid out as dividends in previous years).

So what profits are available for distribution for the year ended 31 March 2017?

| | |
|---|---|
| Profits | £25,000 |
| Less corporation tax due at 20% | £( 5,000) |
| Current year profit after tax | £20,000 |
| Add: Retained profit brought-forward | £14,000 |
| **Total profits available for distribution** | **£34,000** |

The company can therefore pay a dividend of up to £34,000 - anything more than this is an illegal dividend.

You also can't deduct dividends as a business cost when you work out your Corporation Tax.

Dividends can be paid during the company's accounting period (interim dividend) or after the company's year-end (final dividend).


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If a dividend is declared during the company's accounting period then the company must be very sure that they will make a profit in the months between the interim dividend and the year end – otherwise they will be at risk of turning a legal dividend into an illegal one!

If this happens, there's a real danger the taxman will seek to re-classify this as a salary you have drawn from the company and hit you with a tax and national insurance bill.

### 4.2.1 Overview

One of the main reasons for trading as a limited company is the ability to pay yourself dividends. Although the changes to the way dividends are taxed in 2016-17 has made the tax savings less attractive (see section 4.2.3), it's still an attractive option in many circumstances.

However one of the pitfalls of running a limited company is making sure you treat the company's money and your own money separately, and that you have enough profit to cover any dividends you declare.

In 'finance' talk, this means making sure you have enough distributable reserves to cover the dividends. Distributable reserves are basically the post-tax profits the company has made to date less any previous dividends taken.

If you want to see how much your distributable reserves are at the start of the year, you can look at the 'Profit and loss account' figure under 'Capital and Reserves' on the balance sheet page of your accounts. Add to this your after tax profit in the current year, less any dividends you've paid out, and that's pretty much how much you've got left to declare.

Let's look at an example. If you had a profit and loss after tax brought forward of £10,000 (be careful if the figure on your balance sheet page of the accounts is negative - that means you've made a loss!), and your after tax profits for the current year are £5,000, then you can pay out dividends up to £15,000. If you've already paid out £10,000 of dividends, you've got another £5,000 that you can pay out.

But beware - if the profit and loss brought forward is minus £10,000 that means you've made a loss to date. Until your after tax profits for the current year are greater than £10,000, then you can't pay out any dividends. This is an area which we have seen create a lot of problems for owner managed companies!

You also need to be aware of what is meant by your 'after tax profit'. Not only do you need to take into account the corporation tax you'll need to pay on your profit to date (see section 5), you'll also need to make sure you adjust for any significant accounting adjustments eg stock, bad debts, depreciation and accruals and prepayments (see section9).


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For most owner managed limited companies the checks you need to make won't be too onerous. The problem comes when no checks are made, or you misjudge how much dividend you can pay, which can lead you into a nasty tax trap!

### 4.2.2 The old rules for dividend taxation pre 2016/17

Prior to the 2016/17 tax year, dividends had an associated 'tax credit'. This meant that a dividend was posted through a company's accounts as 'net' but shown in a personal tax return as 'gross' with an associated tax credit of 10%.

So let's look at how that worked in practice:

> Company declared a dividend of £9,000 - this is what was shown in the company's accounts
>
> This was grossed up by 10% ie £9,000/0.9 = £1,000 - giving a gross dividend for personal tax purposes of £10,000
>
> You were taxed on dividend income of £10,000 with a 'tax credit' allowed against any tax due of £1,000
>
> So if your total taxable income (including the gross dividend income) was below the higher rate threshold (£42,385 for 2015/16) you had no additional tax to pay
>
> If your total taxable income was above the higher rate band, then any dividend which fell into that higher rate band was taxed at an effective rate of 22.5% of the gross dividend (or 25% of the net dividend) - remembering that the higher rate of tax on dividends was 32.5% (not 40% as for other income).

### 4.2.3 The new rules for dividend taxation post 2016/17

The dividend tax credit has now been replaced by an annual tax free dividend allowance of £5,000 - this means that the first £5,000 of any dividend income is tax free.

Any dividend income above £5,000 will be taxed as follows:

> If you have any un-used personal allowance (£11,000 for 16-17) then that element is tax free


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Any dividends in the basic tax band (up to £43,000 for 16-17) attract a tax charge of 7.5%
Dividends above the basic tax band are charged at 32.5%
Additional rates of tax will apply at the upper tax band (£150,000 for 16-17)

If you are basic rate taxpayer, and you receive all your income in dividends you will be up to £2,025 worse off with the new dividend tax!

The basic rate tax threshold for 2016/17 is £43,000 (personal allowance of £11,000, plus basic rate tax band of £32,000)

If a dividend of £43,000 is received we assume (at this stage) that it is taxable as follows, breaking it down into the different "slices":

The first £11,000 - covered by your personal allowance
The next £5,000 - covered by your dividend allowance
The next £27,000 - taxed at the new 7.5% = £2,025 tax due.

### 4.2.4 Dividend paperwork

If you have multiple shareholders with the same class of share, then you should pay the dividend in proportion to the shareholding. So for example if you have two shareholders with 80% and 20% respectively, and you pay a £10,000 dividend, you should make two payments – one for £8,000 and one for £2,000.

If you have different classes of share then the entitlement to dividends may be different – we discuss alphabet shares in section 6.

Generally it is good practice not to extract all of the available profits when you pay a dividend. This is to keep a buffer in case future months are not as profitable as you are expecting.

For contractors and freelancers, building up a buffer can be useful to help smooth any gaps between contracts/freelance work, as you can still keep drawing dividends as long as there are sufficient profits.

If you take a dividend, you will need to complete a board minute confirming the details of the meeting at which the dividend was voted. It should confirm the total dividend payable and how much is paid to each shareholder. Ideally you should draw up this paperwork at the time of the meeting, print it off, sign it and file away. An example board minute is shown below:


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**Dividend Declaration for Boggle IT**

**Directors Meeting Held On:**

**Directors Present:**

**Held At:**

At a meeting of the Directors of the Company held on the above date, it was proposed and resolved to confirm the payments to the shareholders of the Company Dividends in the proportion of their respective shareholdings in the amounts shown below.

**The total distribution details are:**

| Dividend: | £2,500.00 |
|---|---|

The shareholders were advised of these amounts and cheques paid/drawn accordingly.

There being no further business, the meeting was adjourned.

__________________

Director

__________________

Date

**Payment Details**

| Payee | Value | Date |
|---|---|---|
| Lesley Ward | £2,500.00 | 04 May 16 |

**Total: £2,500.00**

Please be aware that if you pay dividends out of losses these are illegal per company law and can cause serious tax issues with HMRC.

# 4.3 Optimum salary vs dividends

Optimum levels of salary and dividends for 2016/17

So now that the way dividends are taxed has changed, what does that mean to the most tax efficient levels of salary and dividends?

A low salary combined with dividends has long been the most tax efficient form of profit extraction for limited company contractors, freelancers and owner managed businesses. The rationale is as follows:

> Take a salary at a level which is below the personal allowance (so there is no PAYE payable) and high enough to trigger a national insurance record (usually at the lowest level so that there is no national insurance payable).
>
> The company gets a deduction for the salary in the accounts - so corporation tax is saved at 20% of the gross salary


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Dividends are then declared up to the amount of post-tax profit available in the company - remember, dividends are declared after tax and so there is no corporation tax saving on dividends

Dividends do not attract National Insurance charges

As not all profit after tax has to be paid out as a dividend in any one year, dividend payments can be managed to help keep any personal tax liability to a minimum

The introduction of the Employment Allowance in April 2014 meant it was slightly more tax efficient to take a salary up to the personal allowance - although this was offset by the administrative problem of paying any employee's National Insurance due.

From 2016-17 HMRC have announced that the Employment Allowance will no longer be available for single director companies. This is to ensure that the Employment Allowance is used for its original purpose ie to encourage employment.

Whether the Employment Allowance can be claimed where there are two directors who are husband and wife is still under debate. However, the new rules are designed to block the allowance being claimed by businesses with no 'real' employees and so, unless both husband and wife have an active role in the business, any claims made by such businesses may be challenged.

You'll find below two dividend and salary combination options which aim to keep any income below the higher rate threshold (£43,000 for 2016-17).

Please note that in both examples it’s important you have sufficient post-tax profits in the company to declare the dividends mentioned. **It is illegal to declare a dividend where there isn’t sufficient profit.** (**Because it’s so important you keep on top of your finances in order to ensure you have adequate profits – we recommend using either Xero or FreeAgent for your bookkeeping depending on your business model.)**

In general, we think it's simplest and safest to keep the salary level for husband and wife businesses below the NI threshold (2016-17 £8,060) - and for a single director business this is also generally the simplest route.


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### 4.3.1 Strategy 1: Take a salary below the NI Primary Threshold

If you want to keep things simple, or are worried about claiming the Employment Allowance, then we think this is the best strategy - and it's the one we recommend to most of our clients.

There are two main National Insurance thresholds you should be aware of:

> Lower Earnings Limit – as long as you earn above this you are protecting your entitlement to future state pension and benefits, without necessarily paying any National Insurance
>
> Primary Threshold – if you earn above this you have to start paying National Insurance (£8,060 for 2016-17)

So we recommend paying a salary up to the Primary Threshold.

You can then take dividends up to £34,940 without having to pay any higher rate tax (basic rate band of £43,000 less salary of £8,060).

However there will be basic rate tax of £2,025 to pay - calculated as follows:

- Personal allowance - £11,000 (£8,060 for salary and £2,940 against dividends)
- £5,000 tax free allowance for dividends - meaning £27,000 dividend income is taxable (£43,000 total dividends less £2,940 from personal allowance less £5,000 tax free allowance)
- Tax to pay of £2,025 (£27,000 at 7.5% tax rate)

This means you will have a 'take home' amount of £40,975 (£8,060 salary + £34,940 dividends less £2,025 tax payable).

In addition you will save corporation tax of £1,612 (£8,060 * 20%).


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### 4.3.2 Strategy 2: Claim the Employment Allowance

This option isn't available to you if the only person on the payroll is a single director - and this strategy is also quite risky if you are a husband/wife business as mentioned above.

This option is also not effective if the employment allowance will be used against the employer's NI on other employees in the business.

So for the purposes of this example we will assume that this is a sole director with other employees and there will be excess employment allowance to use against the director's income.

The recommended salary would be up to your personal allowance (£11,000 for 2016-17 - although your own personal code may be different).

Assuming you have a full personal allowance then you could take a £11,000 salary and a dividend of £32,000 without paying any higher rate tax - as this salary/dividend combination would take you up to the higher rate threshold.

However there will be basic rate tax and employee's national insurance of £2,377.80 to pay - calculated as follows:

- Employer's National Insurance - £405.72 (being £11,000 less Primary Threshold (£8,060) = £2940 *13.8%) - assume all covered by employment allowance therefore nothing to pay
- Personal allowance - £11,000 (all used against salary)
- £5,000 tax free allowance for dividends - meaning £27,000 dividend income is taxable (£32,000 total dividends less £5,000 tax free allowance)
- Tax to pay of £2,025 (£27,000 at 7.5% tax rate)
- Employee's national insurance payable on salary - £352.80 (£11,000 less £8,060 = £2,940 * 12% (assuming NI letter = A))

This means you will have a 'take home' amount of £40,622.20 (£11,000 salary + £32,000 dividends less £2,377.80 tax payable).

In addition you will save corporation tax of £2,200 (£11,000 * 20%).

So overall, strategy 2 will save you £235.20 - however you would need to remember to pay the employee's national insurance to HMRC. This can be a bit of a headache if you don't have any other payroll payments to make to HMRC. The cashflow benefit is also realised more quickly with the first strategy and this is the only strategy available to single director companies.


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### 4.3.3 Other dividend levels

What if you decide to take a salary at £8,060 but take a different dividend level? Well, assuming you have a personal allowance of £11,000 and no other income, the personal tax you'll have to pay is shown in the following table:

| Dividend | Personal Tax |
|---|---|
| £5,000 | £0 |
| £10,000 | £155 |
| £15,000 | £530 |
| £20,000 | £905 |
| £25,000 | £1,280 |
| £30,000 | £1,655 |
| £35,000 | £2,045 |
| £40,000 | £3,670 |
| £45,000 | £5,295 |
| £50,000 | £6,920 |
| £55,000 | £8,545 |
| £60,000 | £10,170 |
| £65,000 | £11,795 |
| £70,000 | £13,420 |
| £75,000 | £15,045 |
| £80,000 | £16,670 |
| £85,000 | £18,295 |
| £90,000 | £19,920 |
| £95,000 | £21,545 |
| £100,000 | £23,170 |

The tax you have to pay above £40,000 increases quite dramatically. This is because where your dividends go above £43,000 (the higher rate band) you start paying 32.5% tax on your dividends in the higher rate band.

### 4.3.4 Leaving money in your business

Whilst the company has to pay corporation tax on all of its income, one of the great benefits of trading as a limited company is that you have more flexibility in terms of when you take income from the company and so when you pay personal tax. You can choose to take lower dividends (usually at the £43k level) to minimise your personal tax and leave the remaining post-tax profit in the company.

You can then decide in a future year to pay yourself more dividends or you may decide to use the excess profits to pay yourself other benefits eg pension or childcare, or you may decide to invest in some equipment for the business.


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## 4.3.5 Other considerations

The examples above assume the only issues to consider are salary and dividends from your company. However there are also a few common areas which you may need to take into account when deciding what salary/dividend combination to take.

### *Student loan repayments*

If you have a student loan balance, then you may have some repayments to make through your personal tax return (self-assessment).

There are now two different types of student loans: Plan 1 and Plan 2

If you lived in Scotland or Northern Ireland when you started your course, or you lived in England or Wales and started your course before 1 September 2012 then you have Plan 1.

If you lived in England and Wales and started your course on or after 1 September 2012 then you have Plan 2.

You pay back 9% of your income over the thresholds of:

£17,495 for Plan 1
£21,000 for Plan 2

Your salary and dividends will count as earnings for student loan repayments. So for example if you are on Plan 1 and you have salary and dividends totalling £43,000, this will mean £2,295 of repayments for 16/17 (£43,000 less £17,495 = £25,505 * 9%).

### *Child benefit*

If you or your partner have individual income of £50,000 or more and you are receiving child benefit then you'll start losing this benefit. Also, if you your partner have individual income of £50,000 or more income then the benefit will be completely removed.

If your income is between £50,000 and £60,000 you will face a claw back of 1% of benefit for every £100 of income over £50,000. It is the partner with the highest income who will need to declare the receipt of child benefit on their tax return.

So if you are receiving child benefit you may want to consider staying below the £50k threshold so you don't have this additional 'tax' to pay.


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### *Earnings above £100,000*

Be aware, your tax free allowance is withdrawn by 50p for every £1 your earnings go over £100,000 until it is completely removed by £122,000 of earnings. This makes the effective rate of tax 60% if your earnings are between £100,000 and £122,000!

### *Multiple shareholders*

Up to now our advice has been on the basis of a single shareholder and director (we discuss income splitting with your spouse in section 5).

If you have more than one shareholder and you have the same class of shares (usually 'A' ordinary shares) it's important to understand that dividends have to be paid pro-rata to the shareholding – so if there are two shareholders each with 50% of the ordinary shares, they have to receive equal dividends when a dividend is paid out.

## 4.4 Directors' loans

If you take more money out of a company than you've put in - and it isn't salary or dividend - it's called a 'directors' loan.'

If your company makes directors' loans, you must keep records of them.

Unfortunately one of the key things people forget is that each time you take money out of the company to pay for a personal bill or to put into your own bank account this may result in an overdrawn director's loan account.

The taxman doesn't like you having the benefit of an interest free loan from your company and unless you do something to put it back into the black (see below) he will penalise you and the company in two ways.


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**Firstly** the taxman will charge you tax on the benefit of having an interest free loan during the tax year if this loan is greater than £10,000 at any time (this benefit will need to declared on a P11d). The figure was £5,000 for 2013/14 and earlier tax years.

He does this by calculating the interest you would have paid (using his rates of course) on an equivalent loan from a third party.

**Example**

Your loan account was overdrawn by £10,000 during the tax year ended 5 April 2016 and the taxman's "official rate" of interest is 3%

You will be taxed on £10,000 at 3% = £300

The simplest way for you to avoid this charge is not to go overdrawn by more than £10,000 at any time during the tax year.

However, if you do go overdrawn by more than £10,000 and you don't want to have the headache of preparing a P11d, then the company can charge you interest on your overdrawn loan account. This interest is added to your loan and you will need to pay this back to the company at a future date. Also the company will be liable to corporation tax on the interest it charges.

**Secondly** the taxman will charge the company corporation tax at 32.5% on the balance of any loan made to you which is still outstanding 9 months and one day after the end of the company's accounting period – this applies even if the loan is less than £10,000.

**Example**

Your company's accounting year end is 31 March 2017 and on 1 January 2018 you owed the company £10,000.

The company will be taxed on £10,000 at 32.5% = £3,250.

This tax will be repayable when you repay the loan – but be aware there can be a significant time lag before the taxman pays you back!

You can read more about directors loans in section 0.


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# 4.5 Other ways to get money out of your company

We've talked about the advantages of paying dividends to yourself, but what about the company's tax position?

The major downside of paying dividends is that the company doesn't get a tax deduction, so are there any alternatives?

Well, as owner/manager of the business it should be possible to structure a benefits package which is not only tax free in your hands, but one for which the company can deduct the cost from its profits charged to corporation tax.

Some examples of the more popular tax free benefits are as follows:

- A company contribution to a registered pension scheme
- Car, motor cycle or bicycle parking facilities at or near the workplace
- Child care vouchers
- Staff canteen and dining facilities (provided they are available to all directors and employees)
- Sports facilities (provided they are available to all directors and employees)
- Use of a pool car
- Staff entertaining costs (this could be your wife or any other family members that work for your company)
- Long-service awards (provided they are an established practice within the business or are in the employee's contract) up to specified limits.
- Approved share incentive plans
- Use of a mobile phone (only one per employee where provided)
- Use of computer equipment (if available to all directors and employees) up to specified limits - yes this does include blackberries (though does anyone use these anymore?).
- Mileage allowances paid to a director/employee for use of their privately owned car when used for business travel.

The above list is by no means exhaustive and you accountant can sit down with you to discuss the options available and come up with the best solution for your circumstances.


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# 5 Income Splitting

If you are married or in a civil partnership, it may be beneficial for you to have your spouse (or civil partner), as either a shareholder or officer (director/secretary) of your company, or both.

We discuss the issues to be aware of below.

## 5.1 The strategy

If you're married and your spouse doesn't have a paying job, then you can make use of a useful tax-saving strategy known as income splitting.

You can do this by structuring your income so that both you and your spouse can use your tax free allowance and basic rate of tax – a big saving compared to paying higher rate tax on the same amount of income.

By setting up a company, making both you and your spouse directors and giving out equal shares of the company, you can both take dividends and pay less tax.

You can also potentially make your spouse an officer of the company (director or company secretary) and pay them a low salary of £8,060 (as per section 4.1).

## 5.2 Making your spouse a shareholder

Please note the advice below applies equally to civil partnerships as well as marriages.

### 5.2.1 The Risk

Historically HMRC have tried to attack the strategy of having a spouse as a shareholder of a company where, in reality, there is only one main worker – as is often the case with contractor/freelancer companies.

HMRC's anti-income splitting stance was tested to its limits in 2007. The tax authorities fought a lengthy court battle with IT contractor Geoff Jones and his wife Diana in 2007. Mr Jones had given his wife shares in Arctic Systems Ltd. Mr Jones in fact carried out the majority of work for the company and his wife performed some administration work for the company.


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HMRC attempted to invoke tax rules known as the 'settlements legislation' in order to argue that the dividends from Mrs Jones shareholding should be attributed to Mr Jones in their entirety and taxed on him at the higher rate.

The case went all the way to the House of Lords. However whilst The House of Lords agreed with HMRC that a 'settlement' had been established this was rendered null and void by the fact that the married couple's exemption applied in this set of circumstances. Ultimately, their key findings in this case were:

- there was a gift from the husband to the wife
  and (more importantly)
- the gift was not wholly or mainly a right to income

The second point was confirmed because Mrs Jones shares had full rights – including rights to vote and rights to the company's assets on winding up - and not just a right to a fixed dividend.

It is now accepted opinion that as long as the following conditions are met, a gift of shares from one spouse (or civil partner) to another is free of capital gains tax provided:

- the asset gifted carries a right to the whole of the income produced by that asset;
- it is not wholly or substantially a right to income;
- the gift is outright and no conditions applied to it – in other words no strings attached.

So to take advantage of this tax planning strategy you'll need to make sure that any shares issued to your spouse should have full voting rights and not just a right to a dividend. This means that your spouse has some ownership of your company which may have future implications – make sure that you seek legal advice if this is of particular concern to you.

However whilst income splitting has been put on the back burner for now, don't be surprised if this isn't reviewed again in the future. The current view of most tax advisers is:

- Having your spouse as a shareholder is a low risk (but not zero risk) strategy
- Ensure any shares issued to your spouse have full voting rights
- Don't be surprised if this strategy is challenged again by HMRC at some time in the future


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### 5.2.2 How many shares

How many shares to issue your spouse will depend on the personal tax situation for you and your spouse.

If your spouse doesn't have any other income, then from a tax efficiency perspective it may make sense for them to be a 50% shareholder in the company. However be aware of the legal implications as mentioned above.

If your spouse has other earnings, then you'll need to take account of these in deciding what is the optimum level of shares to issue for the greatest tax efficiency overall.

If your spouse has other earnings but doesn't have any other dividend income, it may still be worth issuing some shares to them to take advantage of the £5,000 dividend tax free allowance in 2016/17.

### 5.2.3 How to issue shares to your spouse

#### *On incorporation*

When you incorporate your company you can make your spouse a shareholder with a shareholding equivalent to up to 50% of the shares – so if you issue 100 shares, up to 50 can be issued to your spouse.

#### *After incorporation*

There is a tax exemption for married couples , which allows spouses (and civil partners) to gift shares to each other with no capital gains tax issues.

In order to transfer shares to a civil partner you will need to complete a 'Stock Transfer Form' and a set of board minutes.

If there is only one share in issue then before you can transfer any shares to your spouse, you will first need to issue (allot) additional shares to yourself. Once you have been allotted additional shares you can then transfer some to your civil partner/spouse. This requires some additional paperwork which needs filing with Companies House. You are best to engage a professional advisor to deal with this for you to ensure it is done correctly.


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### 5.2.4 Paying a dividend

Dividends will then be paid pro-rata to the overall shareholding – so, for example, if there are 100 shares and you each own 50 shares, if you declare a £10,000 dividend then each of you should receive £5,000. You should also pay your civil partner's/spouse's dividend to their personal bank account for them to do with as they please.

### 5.2.5 Making your partner a shareholder

If you are not married, then the risk of this strategy being challenged successfully by HMRC is much higher as any income splitting would not be covered by the spousal exemption.

If both partners are very involved in the business then the risk is less – but this must be a genuine involvement and reflected in the roles each partner takes in the business.

## 5.3 Paying your spouse a salary

If you appoint your spouse as an officer of the company (either director or company secretary) then you could pay them a salary. This salary would then be justified as being payment for their duties as an officer of the company. However you should ensure that they are responsible for some of the administrative or other tasks relating to the company.

The salary you pay should also be commensurate with the duties undertaken. Unless they are involved in the day to day running of the business, we would normally recommend a salary taken at the optimum salary level as mentioned in section 4.1.1.

If they are heavily involved in the business, then you will need to decide on the optimum salary/dividends/benefits (including pension) levels.

If your partner has a salary from elsewhere there is normally little benefit to paying them a salary through the business. This is because whilst the company will save corporation tax on the salary, the partner will probably have to pay income tax on the salary.


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# 6 Alphabet shares

Ordinarily a small company will have one type of ordinary share. All the shareholders will have equal rights in respect of voting and dividends. So any dividend will be paid according to the share capital held. So if there are 100 shares issued, with Mr X owning 80 shares and Mrs X owning 20 shares, then if a dividend of £10,000 is paid, Mr X will get £8,000 and Mrs X will get £2,000.

However, a company can also have different types of ordinary shares – called A, B, C etc. That's why they are known as alphabet shares!

Unless you issue alphabet shares on incorporation, you will need to ensure you comply with all the legal requirements. You may need to amend the company's articles of association, pass a board resolution and submit the relevant documentation to Companies House. We recommend you use a professional advisor to do this.

Each share type can have different rights – both voting and dividends. So in the example above, Mr X could have 80 'A' shares and Mrs X could have 20 'B' shares which have very different dividend rights attached. This can be beneficial if a company wants more flexibility in the dividends it pays out – with alphabet shares you don't have to pay the dividend pro-rata to the number of shares as dividends can be voted on separately for each class of share. However, when considering how to structure alphabet shares, you may fall foul of the taxman if you try to use this to artificially adjust the income each shareholder receives.

Where alphabet shares are issued on incorporation to non-related parties, there is little HMRC can do to attack any structure put in place. However, as mentioned above in section 5.2.1, there are special rules relating to gifting shares between spouses and civil partners exempting these transactions from capital gains tax and in particular any such transfer must meet the following conditions:

- the asset gifted carries a right to the whole of the income produced by that asset;
- it is not wholly or substantially a right to income;
- the gift is outright and no conditions attach to it.

HMRC are likely to challenge any structure where dividends are paid vastly out of proportion to who is doing the work as this deprives the main worker of their fair share of the profits. So in the example above, if Mr X does most of the work in the company and Mrs X does some administration, voting a dividend of £10 per share to Mr X (thus giving him a dividend of £8,000), and £1,000 per share to Mrs X (thus giving her a dividend of £20,000), will not be viewed favourably by HMRC.


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# 7 Dividend waivers

A dividend waiver is a document signed by a shareholder waiving rights to any dividends from the company.

In order for a dividend waiver to be valid, the following must be adhered to:

1. The waiver must be made at the start of the financial year, before there is any indication of future profits. It is a deed and should be properly witnessed (by a lawyer).
2. The actual dividends paid out must not totally deplete all available profits for distribution. Such profits should remain that mean that if that shareholder had not waived his entitlement, all shareholders could have been paid out in full. It is then possible to argue that there is no settlement, as the waiving party's share of the profits are still within the company and have not benefited any one or more person.

Dividend waivers can be useful when there is a requirement for one shareholder to forfeit their right to a dividend one year – for example, if cashflow does not allow all shareholders to be paid a dividend.


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# 8 Corporation Tax

## 8.1 How corporation tax is calculated

A company pays corporation tax on its taxable profits. Taxable profits are the company's turnover (sales excluding VAT) less any allowable business expenditure.

Your accountant will normally take your bookkeeping profit and make some adjustments to calculate your accounting profit – you can see the main adjustment made and the effect on your profit in section 9.

There will then be an adjustment made to your accounting profit to calculate your taxable profit. Again the main adjustments are shown in section 11.

## 8.2 Corporation tax rates

The corporation tax rate for 2016/17 is 20%.

## 8.3 Registration

To ensure avoidance of penalties, companies should notify HM Revenue & Customs within 3 months of commencing trading. This is normally done by means of completing form CT41G.

## 8.4 Filing Dates of Returns

The corporation tax self-assessment return (CTSA) must be submitted to HMRC along with the accounts and tax computations.

HMRC require the accounts to be submitted in a format known as iXBRL – your accountant will be able to prepare these accounts for you.

The filing deadline for the CTSA return (plus accounts and tax computations) is normally 12 months from the end of the accounting period.


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## 8.5 Penalties for late filing

If the return is late there are penalties as follows:

| | |
|---|---|
| Up to 3 months late | £100 (increasing to £500 for a third consecutive late return) |
| Over 3 months late | £200 (increased to £1,000 for a third consecutive late return) |
| 18 to 24 months late | Extra tax geared penalty of 10% of the unpaid tax |
| More than 24 months late | 20% of the unpaid tax |

Be aware that HMRC are proposing to introduce a unified penalty regime which will result in higher penalties for non-compliance.

## 8.6 Payment Dates for Corporation Tax

This is usually 9 months and 1 day after the end of the accounting period for small companies.

Large companies (£1.5 million of profits) pay under 4 quarterly instalments that commence 6 months into the accounting period, so they must use an estimate of their eventual tax liability for the year. Companies that form a group may fall into the definition of 'large' and be required to pay corporation tax by instalments.

Interest is charged on Corporation Tax paid late (you can find up to date rates here).

## 8.7 CT61 Returns

Companies must also deduct income tax from some payments (such as some interest payments) and pay this over to HMRC within 14 days of a quarter end. Quarters end on 31 March, 30 June, 30 September and 31 December, with an extra return in the period up to the accounting period end if it does not coincide with these dates.


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## 8.8 Time limits for correcting and enquiring into tax returns

HMRC have 9 months after a return is filed (or an amendment filed) to correct obvious errors such as arithmetic mistakes. The company can amend the return with 12 months of the filing date.

With regards to enquires, returns can be selected at random or for a reason (but HMRC don't have to say which) at any time within 12 months from the day on which the return is delivered or, if the return is filed late, it is 12 months from the date it is filed plus the period to the next quarter day (31 Jan, 30 April, 31 July, 31 October).

Where there is an amendment, the time limit changes to 12 months from the date of the amendment plus the period to the next quarter day.

However, HMRC can make a discovery assessment if there is a loss of tax due to fraud or negligence, or if the facts giving rise to the loss of tax only became known to HMRC after the time limit for opening an enquiry had expired and they could not reasonably have been expected to be aware of the facts from the information made available to them at the time.

The normal time limit for discovery assessments is 6 years after the end of the accounting period but is increased to 20 years in cases of fraud or neglect.


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# 9 Accounting profit

Depending on how good your books and records are, there may be only a few adjustments to be made to your bookkeeping to prepare your accounts.

However, unless you're audit registered (with a turnover of more than £10m as at 2016) then your accountant won't be 'auditing' your books.

We've noted down the main adjustments your accountants will make below.

## 9.1 Prepayments

When you post invoices from your suppliers into your bookkeeping package you will post it all in one month. But some of these expenses may relate to after your year end.

Your accountant will put an adjustment through to take these costs out of your overheads and post them to the balance sheet.

So this will make your accounting profit greater than your bookkeeping profit.

## 9.2 Accruals

There may be costs which you have incurred but for which you haven't received an invoice or which were invoiced after your year end.

Your accountant will put an adjustment through to add these costs to your overheads and post them to the balance sheet.

So this will make your accounting profit less than your bookkeeping profit.


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# 9.3 Depreciation

When you buy an asset, you will post it in your bookkeeping software to an asset account.

But what you probably won't do is make any allowance for depreciation.

So your accountant will put an adjustment through to reduce the cost of the asset and this charge will be added to your overheads (and also posted against your asset account in the balance sheet effectively reducing the asset value).

So this will make your accounting profit less than your bookkeeping profit.

# 9.4 Deferred tax

When calculating the corporation tax charge for a limited company a number of adjustments are made. The most significant of these is that any depreciation charge on fixed assets (assets which will last more than one year eg computers, plant & machinery etc) will be disallowed and instead the company will be allowed to claim capital allowances.

The capital allowances which a company can claim as a deduction are often far more generous (because of the Annual Investment Allowance – see section 11.7) than the depreciation charge. This means that if we calculated corporation tax on the accounting profit it would be higher than the corporation tax charge on the taxable profit in the first year but vice versa in the following years.

Putting through a deferred tax charge is a way of 'ironing' out these differences, so that the company doesn't overestimate its profit and thus over-declare any dividends. A provision is created when deferred tax is charged to the profit and loss account and this provision is reduced as the timing difference reduces.

Let's look at an example.

A business has profits each year of £5,000 before any depreciation charge. In year 1 they buy a computer for £1,800 and this is written off in the accounts by way of a depreciation charge over 3 years. So each year there's a depreciation charge of £600 - meaning their accounting profit after depreciation is £4,400. If corporation tax was charged on accounting profit then they would have tax charge of £880 (£4,400 * 20% as at June 2016). Assuming the company's profits stayed consistent for the next two years, year 2 and year 3 would have the same accounting profit after depreciation and the same taxation charge.


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However the tax computation is different. Rather than a £600 charge for depreciation each year, 100% of the cost of the computer is allowed in year 1 and then there is no allowance in years 2 and 3. So the tax payable is higher in years 2 and 3 than in year 1.

Let's see how this looks in a table:

| | Year 1 | Year 2 | Year 3 | Total |
|---|---|---|---|---|
| Accounting profit before tax | £4,400 | £4,400 | £4,400 | £13,200 |
| Add: Depreciation | £600 | £600 | £600 | £1,800 |
| Less: Capital allowances (currently 100% first year) | £(1,800) | £0 | £0 | £(1,800) |
| Taxable profit | £3,200 | £5,000 | £5,000 | £13,200 |
| Corporation tax on taxable profit at 20% | £640 | £1,000 | £1,000 | £2,640 |
| Corporation tax on accounting profit at 20% | £880 | £880 | £880 | £2,640 |
| Difference - put through the accounts as a deferred tax charge/(release) | £240 | £(120) | £(120) | £0 |
| Deferred tax provision on balance sheet | £240 | £120 | £0 | |
| Total tax charge per accounts - corporation tax and deferred tax | £880 | £880 | £880 | £2,640 |

So the deferred tax charge is just a way of accounting for the timing differences due to the different corporation tax rules. Over time the corporation tax charged will be the same whether it's calculated on the accounting profit (£4,400 per year) or on the taxable profit (£3,200 in year 1 and £5,000 in years 2 and 3).

Also the deferred tax provision on the balance sheet is £240 in year 1 but reduces by £120 in year 2 and £120 in year 3 - so at the end of the 3 years there is no provision left.

Remember, this adjustment ensures that the company doesn't over-estimate its post-tax profits and over declare dividends to shareholders.


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## 9.5 Bad debts

You might have debtors showing on your balance sheet who are never going to pay – for example, they may have gone bankrupt.

Your accountant will put an adjustment through to 'write off' these debtors so they no longer show on your balance sheet.

This adjustment will be posted to a bad debt expense account in your overheads.

So this will make your accounting profit less than your bookkeeping profit.


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# 10 Allowable business expenses

It's important to make sure you claim as many allowable expenses as possible from your company as this will decrease your corporation tax payable.

The general rule is that any expenditure put through the company's accounts directly (rather than an expense incurred by a director or employee personally) should be wholly and exclusively incurred for the purpose of the business in order to be able to claim a deduction against the company's corporation tax liability.

If the expense is incurred by the director or employee, and the company reimburses this expense, then in order for the director or employee to avoid a personal tax charge, the expense must be incurred wholly, exclusively **and necessarily** in the performance of their duties as a director or employee.

This is an important distinction that sometimes gets overlooked where an individual is a director of their own company.

Where there is a dual element of any expenditure you must be able to clearly identify the business-related element in order to claim a deduction. So for example, if you use your personal phone for business use you should only claim the cost of calls you made relating to the business. If you have an all in one contract then you won't be able to claim anything through the company as there is no additional cost to you of making a business call.

## 10.1 'Out of pocket' expenses

If you use your own money to pay for business expenses, these are still allowable and should be recharged to the company.

You should make sure you keep good evidence of any expenditure you incur and recharge the company for this expenditure. Using an expense claim system is a good way of doing this.

As a general rule, you should try to pay nearly all your company expenses through the company current account or credit card as this will keep your administration of expenses to a minimum.


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## 10.2 Benefits in kind

### 10.2.1 What are they?

Some costs are allowable for corporation tax but may be considered a benefit in kind for you personally. Benefits in kind include things like company cars (see section 12 enter section), private medical insurance (see section 0), subsidised loans (see section 0) and allowances paid in excess of the HMRC agreed rates (eg fuel allowance – see section 10.5.2).

Any benefits in kind are reported at the end of a tax year on a P11d. These must be filed with HMRC by 6th July following the tax year in question. So any P11ds relating to the 2016/17 tax year must be with HMRC by 6th July 2017. If you don't file these by 19th July 2017 then the company will incur a penalty of £100 per month for each 50 employees.

The impact on the individual is that the cash value of the benefit in kind is taxed on them personally as if it was salary. It is taxed either through a self-assessment tax return or via the individual's next year's coding notice.

The employer also has to pay Class 1A national insurance on the benefit (13.8% for the 2016-17 tax year).

Because of the changes to the dividend tax in the 2016-17 tax year, there can be some small tax savings to be made by paying for a 'perk' out of the limited company rather than paying for it personally. However you would need to be sure there was a tax saving and that this saving outweighed the administrative hassle of completing and filing the P11d.

### 10.2.2 An example

A company pays £1,000 for private medical insurance on behalf of its director and the director does not contribute anything towards the cost.

Assuming the director is on an annual salary of £8,060 and has already used all their basic rate of tax (i.e. their salary and dividends have hit £43k) the director will be taxed personally by way of £1,000 of the dividends that would otherwise be taxed at 0% being moved into the higher rate of 32.5% – the extra tax charge being £325.

This is because benefits in kind are taxed before dividends in the order of taxation. In this example the director's salary of £8,060 still leaves £2,940 of the personal allowance which is currently being used by some of the dividends. So although there is no tax charge on the benefit itself, £1,000 of dividends are effectively pushed into the higher tax rate from the 0% personal allowance rate and charged at 32.5%.


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The company will also pay the Class 1A National Insurance at 13.8% on the benefit being £138.

However, the company will receive corporation tax relief on the total cost of the benefit and the national insurance paid which would be: £1,000 + £138 = £1,138 x 20% = £227.60.

This makes the overall cost to director and company £235.40 calculated as follows:

> £325 personal tax plus £138 Employer's Class 1A National Insurance less £227.60 Corporation Tax savings

So what if the director was to pay for the benefit personally?

Well, let's assume the director takes an additional £1,000 dividend to pay for the medical insurance. This additional dividend will create an additional personal tax liability for the director of £325 (as we've assumed his salary and existing dividends have already taken him to the £43k tax band) – being 1000 at 32.5%.

So the cost of paying for the medical insurance personally is £325 while the cost of paying for this through the company is £235.40 – a saving of £89.60 if the company pays for the insurance.

The director will need to decide whether a tax saving of £89.60 is worth the administration of preparing and filing the P11d.

You will need to look at the numbers for your specific circumstances before deciding whether to put a benefit through your company or not. However you should remember to take into account the following:

- Your personal tax charge on the benefit (and effect on dividend tax)
- The company's national insurance cost
- The company's corporation tax saving on the cost of the benefit + national insurance


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### 10.2.3 Tax free benefits

There are a number of tax free benefits which an employer can provide eg childcare (section 10.17), mobile phone (section 10.3) and pension (section 10.18).

### 10.2.4 'Trivial' benefit allowance

New rules have been introduced for the 2016/17 tax year which allow up to £300 of 'trivial' benefits per employee/director tax free. The rules for these benefits are as follows:

- the cost of providing the benefit does not exceed £50
- the benefit is not cash or a cash voucher
- the employee is not entitled to the benefit as part of any contractual obligation (including under salary sacrifice arrangements)
- the benefit is not provided in recognition of particular services performed by the employee as part of their employment duties (or in anticipation of such services)

If any benefit provided goes over £50 then it must be reported on a P11d.

The limit is per employee/director (or officer) so both husband and wife can receive up to £300 of 'trivial' benefits.

There is no definition of what is a 'trivial' benefit but would include the following:

- a meal out to celebrate a birthday
- a turkey at Christmas
- a bottle or two of wine
- coffee and tea provided at work

The benefit can be applied to the director or a member of their household. The definition of a member of their household is as follows:

- spouse (or civil partner)
- children and their spouses (or civil partner)
- parents
- domestic staff, dependants and guests

So if you and your spouse are directors of the company, you and your two children could go out for a meal costing up to £50 per head and £100 would be applied to you and £100 to your spouse – this would leave another £200 allowance each.


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## 10.3 Mobile phone

Since 2012 your company has been able to provide staff and directors with one smartphone each without this being considered to be a taxable benefit in kind. As long as the contract is in the company's name, then the phone can be used for both business and personal calls. The company can also claim back the VAT if it is VAT registered (unless it is using the flat rate VAT scheme).

If your phone is in your personal name then you will only be able to charge the company for the cost of business calls – and, as mentioned above, this can be problematic if you have a call inclusive contract. However, if you pay for your calls separately then you can charge the company for any of these calls which were business related - including charging the VAT element.

So what should you do if your mobile phone is in your personal name?

Well, you can ask your phone provider to transfer the contract into your company's name (get permission to do this if you're just an employee!) or take out a new contract in the company's name. The downside of this is that the phone providers often charge more for contracts with businesses than they do for contracts with individuals. However the tax savings may more than justify the increased costs.

## 10.4 Broadband/internet

As long as the broadband contract is in the company's name then this will be an allowable expense for corporation tax and, as long as any personal use is insignificant, then there will be no personal benefit in kind.


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# 10.5 Travel costs

HMRC brought in new rules for 2016/17 which state that if you are under the 'supervision, direction or control' (SDC) of a client then you cannot claim mileage or subsistence. In reality this should only apply if you are caught by IR35 – see section 3 for more details about IR35.

## 10.5.1 What is business travel?

### *HMRC's definition of a 'business journey' is one which either involves travel:*

**From one place of work to another**

> For example, if you're like a lot of company directors who run their own business you probably have an office or premises which you attend regularly. Occasionally you might make trips from your company premises to another 'workplace' - for example you travel directly from the office to visit a customer or supplier.

**Or**

**From home to a temporary workplace or vice versa**

> Remember trips from your home to the office are business journeys. These journeys are regarded as 'ordinary commuting' (see above) and this means that you (or the company) will have to bear the cost of these journeys – even if you're forced to go in and work at the weekend!

### *Temporary workplace*

A 'temporary workplace' means that you attend the workplace for a limited duration or temporary purpose.

However, even then some of the travel between a temporary workplace and home may not qualify as a tax deduction if the trip made is substantially similar (i.e. using the same roads, train or bus for most of the journey) to your usual trip to the office.

You therefore cannot set up a temporary base within a similar geographical location to your company's existing premises (say 10 miles away) and not expect a challenge from HMRC if you claim tax relief on any travel costs to and from your home to this temporary base.


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Likewise, if you are contracting through your limited company and carry out a series of engagements with clients for example in Central London. Even though the contracts may be of less than 24 months duration, HMRC may seek to disallow travel expenses on the grounds that this geographical area has become your permanent workplace and should be treated as 'ordinary commuting' see above.

Hopefully we haven't lost you at this point, so let's give you some examples so you can see how this works in the real world.

**Example 1**

John is an IT manager and usually commutes by car between his home in Preston to his normal place of work in Blackburn. This is a daily round trip of 20 miles. On a particular day he drives from home to his firm's other offices in Newcastle. This is a total round trip of 274 miles.

John can claim a tax deduction for any costs incurred on this journey which are not reimbursed to him by his employer.

**Example 2**

It is of course possible to have more than one permanent workplace which you attend regularly and so are not able to claim travel expenses between them as HMRC will deem this 'ordinary commuting'.

For example, Alan lives in Taunton and is the area manager for a chain of electrical retail stores and spends 2 days a week at their store in Bristol and 3 days a week at their head office in Bath.

Whilst travel between Bristol and Bath will be an allowable expense, Alan cannot claim tax relief for his journey from home to Bristol or home to Bath and vice versa because HMRC regard this as 'ordinary commuting'.

## *Temporary workplace – further rules*

Attendance at a workplace is not treated as 'temporary' or of 'limited duration' if it represents the whole (or virtually the whole) of the period of employment. So for example if you have a 6 month temporary contract you will not be able to claim tax relief for travel expenses incurred travelling to your business premises.


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Where you as a director (or employee) are sent to a temporary workplace from your usual base of operations for many months, this new workplace may still be treated as a temporary workplace if either:-

a) It is expected to last for less than 2 years

b) If it is a temporary workplace expected to last for more than 2 years and you will be spending less than 40% of your working time at this temporary workplace.

**Example 3**

Susie works in Poole. Her employer sends her to Bristol for 1 day a week for 26 months. Even though this is for more than 2 years, Susie should still be able to claim for her travel expenses to Bristol as less than 40% of her time is spent there.

## *What happens if there is no permanent workplace?*

You may not have a permanent or normal place of work and actually work at a number of different places for several days, weeks or even months. The taxman refers to an employee in this situation as a 'site based employee' - common examples of these are IT consultants, safety inspectors and relief workers.

If you fall into this category your travel and subsistence can be reimbursed to you by your company tax free (and it obtains a tax deduction for this cost) if the period spent at each site is expected to be, and actually is, less than 2 years.

But be careful, the taxman has rules to prevent you abusing this tax break - you cannot simply take a series of recurring temporary appointments in order to claim the relief.

## *Travelling appointments*

It may be that travelling is an integral part of your job, a typical example is where you are a travelling salesman and you don't have an office where you work or are required to report to regularly.

The taxman refers to this as a 'travelling appointment' and if you fall into this category you should be able to claim a tax deduction for all of your business travelling expenses even where the journey starts from home.

This is because the taxman regards you as travelling on your work (instead of travelling to it), from the moment you leave your home.


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### *Home based employees*

If you work at home occasionally, or even regularly, this doesn't always mean that your home can be treated as your place of work - much as you might like to think so!

You must be able to demonstrate that there is an actual requirement for your work to be performed at home rather than elsewhere. If you can show that this is the case, then the cost of any trips between your home and any other workplace for the same employment will be tax deductible.

If you can't prove this, it might mean that somewhere else (other than home) is your permanent workplace - for example, the office you regularly report to. So any cost of travel between your home and the office would not be tax deductible because it's treated as 'ordinary commuting'.

However trips between your home and a temporary workplace (see above) will be allowable.

## 10.5.2 Business mileage

If you use your personal car for business mileage, you can charge your company for the business mileage you do. Make sure you keep good records of any mileage claimed including date, start and end point, business mileage and reason for travel.

As at 1st April 2016 the fixed mileage rate is 45p per business mile for cars and vans for the first 10,000 business miles and 25p per mile thereafter.

You can see the up to date rates **here**.

The rates are to cover your fixed and variable running costs, for example petrol, maintenance, road tax, MOTs, insurance and depreciation on the cost of your vehicle. No other charges can be made to the business for any other costs related to your car – so an expensive repair must be paid personally!

If the mileage allowance paid is above the approved rates there will be taxable benefit in kind on the excess.


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**Example**

During the 2016/17 tax year you travel 8,000 business miles and your employer pays you a mileage allowance of 50p per mile.

The position is as follows:-

| | |
|---|---|
| Mileage allowance payments received | £ 4,000 * |
| Mileage allowance approved amount | £(3,600) ** |
| Surplus | £ 400 |

You will be taxed on the excess of £400.

* 8,000 x 50p per mile
** 8,000 x 45p per mile

If the mileage allowance paid to you by your employer is less than the approved rates, you are entitled to claim a deduction for the difference.

**Example 2**

During the 2016/17 tax year you travel 5,000 business miles and your employer pays you a mileage allowance of 30p per mile.

The position is as follows:-

| | |
|---|---|
| Mileage allowance payments received | £ 1,500 * |
| Mileage allowance approved amount | £(2,250) ** |
| Deficit | £ 750 |

* 5,000 x 30p per mile
**5,000 x 45p per mile

You will be able to claim a tax deduction for £750.


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### 10.5.3 VAT on fuel element of AMAP

If your company is VAT registered and does not use flat rate VAT accounting, it can also claim VAT back on the fuel element of the mileage allowance (AMAP).

So how does it calculate the fuel element?

Well, your company can use HMRC's advisory fuel rates which are published **here**.

**Example**

If you have a car with a 1500cc petrol engine, the fuel portion of the mileage rate is 13p per mile (as at June 2016).

13p per mile represents the VAT inclusive amount ie 120% (100% plus 20% VAT).

So to work out the VAT included, you need to do the following:

13p ÷ 120 * 20 = 2.2p

So you can claim 2.2p in VAT.

But beware, your company will need to show HMRC on request that it has enough VAT receipts to cover the claim.

So for example, if 1,000 miles is claimed in the VAT period, then you will have claimed £22 in VAT (2.2p x 1,000). The fuel receipts will therefore need to total £130 (the VAT inclusive amount - £22 ÷ 20 *120).


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## 10.5.4 Bicycles

### *Claiming mileage*

If you use your bike mainly for personal use with a bit of business travel, you can claim a per mile rate back from the company just as with a car. The agreed rate is currently 20p per mile. As with your business mileage make sure you keep good records of any mileage claimed including date, start and end point, business mileage and reason for travel.

### *Company bicycle*

If you use your bike predominantly for allowable business you may find it tax efficient for the company to buy the bike for you. There will be no taxable benefit in kind as long as the bike is used mainly for business.
However you'll need to remember that the bike belongs to the company and any proceeds from its sale will need to be paid back to the company.

If the company has other employees then all employees must be able to take advantage of the same offer.

The cost of safety equipment and maintenance can also be claimed.

## 10.5.5 Other Travel Costs

In addition to mileage, you can also claim any parking fees, motorway tolls and congestion charges if these relate to business trips. Your company can also claim VAT on these expenses as long as they are business related.

You can also claim train, flight and underground costs if these relate to business trips.


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## 10.6 Hotel and subsistence

Any accommodation, food and drink costs you incur whilst you are away from your permanent workplace are tax deductible (though the local takeaway across the road from your company's premises does not count!).

Make sure your subsistence expenditure is reasonable though, as HMRC may question bills for dinner at The Ivy restaurant washed down with Cristal Champagne!

### 10.6.1 Hotels & Other Accommodation

Accommodation is allowable if it relates to a qualifying business trip.

So if you are working away from home at a temporary workplace, reasonable hotel bills will be allowable.

Sometimes you may find it cheaper to get alternative accommodation eg a short or long term let or a Bed and Breakfast. This is fine as long as the cost of the accommodation is at an appropriate level for the needs of the business. It must not be excessive and should represent better value to the company than hotel accommodation. However you should make sure the agreement is made out in the company's name.

You may even decide you would prefer to stay with relatives. This is fine as long as you get a receipt for any rent you pay them and the rent is at market rates. Again, it should represent better value to the company than staying at a hotel and any invoice or receipt should be made out in the company's name.

In order to claim accommodation costs through the company you must have a permanent residence elsewhere – the accommodation costs must not represent your main place of living.


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### 10.6.2 Subsistence

HMRC have published a list of advisory scale rates which your company can use to make day subsistence payments to you (as their employee). These payments can be made free of tax and national insurance contributions ('NIC') when you incur allowable business subsistence expenses. Again your company can claim a tax deduction for this expense.

The rates are as follows:-

#### Breakfast rate

Up to £5
Before you get too excited, this only applies to irregular early starters - where an employee leaves home earlier than usual and before 6am. You should ask yourself the question - **i**s breakfast really worth getting up early for?

#### One meal rate

Up to £5 can be paid where you are away from your home/normal place of work for a period of at least 5 hours**.** An additional £10 may be claimed if the journey lasts beyond 8pm.

#### Two meal rate

Up to £10 can be paid where you are away from your home/normal place of work for a period of 10 hours. An additional £10 may be claimed if the journey lasts beyond 8pm.

#### Late evening meal rate (irregular late finishers only)

A rate of up to £15 can be paid where you have to work later than usual and finish work after 8pm having worked your normal working day and it is necessary to buy a meal which you would usually have at home.

In all of the above cases, you must actually incur a cost on subsistence in order to qualify for these tax breaks.

Your company will need to ensure that it has sufficient records in place to support this expenditure.


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Once this agreement is reached with HMRC it shouldn’t be necessary to produce receipted evidence of costs incurred. It might be possible to agree payments in excess of these benchmark rates but you would need to agree a tailored scale with the taxman.

Additionally your company can pay you incidental overnight expenses (e.g. the cost of telephone calls) tax free:

Up to £5 per night for overnight stays in the UK
Up to £10 per night for overnight stays outside the UK.

**Note: If a payment to a director or employee exceeds these limits, the whole of the payment becomes taxable as a benefit in kind and not just the excess. For example, a payment of £7 per night for incidental overnight expenses in the UK would be fully taxable.**

**The limit is also applied to the whole of the period that the employee spends away from home and not to each night separately. For example, if you spent 5 nights away on business in the UK and your company paid you £30 the whole amount would be taxable.**

**The fact that expenses on specific nights may have been less than £5 is irrelevant and does not exempt the whole payment from tax.**

## Tip

Be careful if you don’t come to an agreement with HMRC over payment of these expenses (and don’t have evidence to support it) - you could end up in hot water with a nasty tax and NIC liability.


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### 10.6.3 Overseas trips

As with other travel, the cost of overseas trips is allowable if there is a clear business purpose.

If you combine a business trip with a holiday then this will be treated as a benefit in kind. If the primary motive for the trip was business, and the holiday element is incidental, then you can normally claim the business element. However be aware that this is an area which HMRC look at carefully and if you take a family member with you on a business trip, unless there is clear evidence that this was necessary for the business, HMRC are likely to consider that the expenditure was personal.


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## 10.7 Accounting fees

Fees for preparing the company's accounts and tax return are allowable.

However the fee for preparing a director's or shareholder's tax return is not allowable. If you pay an all-in-one fee which includes preparation of personal tax returns this should be charged back to the individual rather than claimed through the company – otherwise there will be a benefit in kind charge on the individual for the perceived benefit of the tax return charge.

## 10.8 Software

Software is allowable as long as the primary use is for business. Where there is a dual element (eg Dropbox costs) then the personal use should be minimal in order for the software costs to be claimed.

## 10.9 Computer and office equipment

As long as computer and office equipment is used primarily for the business with minimal personal use then it can be claimed.

If there is significant personal use it can still be put through as a business expense but it will have personal benefit in kind tax consequences (see later section about benefits in kind).

The cost of any such equipment will be written off in the accounts over a number of years by means of a depreciation charge (see section 9.3 for more details as to how depreciation works).

What you will claim for tax purposes are capital allowances – you can see more about this in section 11.7.


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# 10.10 Working from home

When you run your own business, a very tax efficient strategy is to charge your business for the costs of you working from home.

Whilst the documentation required is slightly different if you're trading as a sole trader or partnership rather than a limited company, the calculations involved are broadly the same.

So what do you need to be aware of? Well, we recommend you take the following steps:

1. Work out what the actual annual running costs of your home are - you can include mortgage interest (or rent), maintenance, gas, electricity, council tax, service charges, cleaning and insurance.

2. Identify what proportion of these costs relate to the area of your home you use for business - a simple way to do this is to count the number of rooms in your home (excluding kitchen and bathroom) and then identify how many rooms you use for business and what proportion of the time you use them for business.

   Let's take an example - assume you have 5 rooms in your home (excluding bathrooms and kitchen) and you use 1 of them 50% of the time for business - so the calculation is 1/5*50% = 10%.

3. Apply the percentage you calculated in step 2 to the costs you calculated in step 1. So if your total costs a year are £20,000 then you can claim up to 10% of these costs ie £2,000.


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And just a few additional points to note:

- If you work from home and you don't want to go through the steps above, you can just charge your business £4 a week (as at May 2016) or £208 (or you can use the simplified expenses rate if you're self-employed - see more about this here)
- From a personal tax perspective you will be receiving rental income - but as long as the costs of this are equal to the income there will be no taxable profit and so no tax to pay
- Don't use any room in your house 100% of the time for business as this could lead to capital gains tax problems!
- Double check the amount you are charging with local market rents for similar office space and usage - this will ensure you are not significantly overcharging your business
- Draw up a licence agreement between you and the company (and also a dividend minute and resolution agreeing the licence)

And what's the benefit of doing this?

Well, you'll save corporation tax at 20% as well as being able to withdraw this money tax free from the company.

**If you are claiming a proportion of mortgage interest as a deduction against the rental income you receive, you need to take into account the fact that relief from 6 April 2017 will be restricted if you are a higher rate taxpayer.**


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# 10.11 Subscriptions and publications

**Professional subscriptions** - subscription fees paid to professional bodies where membership of the organisation is of relevance to the company are tax allowable expenses with no benefit in kind as long as they appear on HMRC's approved list which you can find **here**.

**Newspapers and magazines** – if the primary purpose and benefit is for your business, then you can claim these costs. However if the main benefit and purpose is personal then you cannot claim it. Specialist magazines relevant to the business would normally be allowable.

**Books** – as long as they are purchased for the benefit of the business (rather than for personal benefit) and in line with the business activities, these can usually be claimed.

# 10.12 Subcontractors

If you hire people to do work on your behalf then these will be allowable for tax. However you must make sure you get an invoice from them – this will be prima facie evidence that they are self-employed and not employees.

You also need to have in mind the employment indicators mentioned in section 3 (relating to IR35) to ensure that HMRC would not consider any such subcontractors to be employees.

If you work in the construction industry you may also have to deduct CIS from any such payments and pay this over to HMRC. CIS is quite an in-depth topic and you can read more about this here.

If you need any specific help with CIS feel free to give us a call.


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# 10.13 Training costs

Training costs can be provided to an employee or director of a limited company and will be an allowable expense for corporation tax purposes, with no benefit in kind impact on the employee, provided that the training concerned is a course or other activity designed to impart, instil, improve or reinforce any knowledge, skills or personal qualities which:

- are likely to prove useful to the employee when performing the duties of the employment; or
- will better qualify the employee to perform those duties.

If you're intending to spend a large amount on training, make sure you are able to demonstrate the value to the business of this training.

# 10.14 Clothing and uniform

The company can claim uniform costs (and might be able to claim for clothing if it has the business logo on it) as well as any protective clothing required for your business.

Protective clothing includes:

- Helmets
- Steel toe cap boots
- Body armour
- Protective suits
- High visual wear
- Overalls

You cannot claim for expenditure on normal business wear (suits, ties, shoes etc) even if you only use this clothing when on company business.


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## 10.15 Medical expenses

Some medical expenses can be paid by your company and there is no taxable benefit in kind on you personally. These include:

- Annual health check or health screening – this must only be once a year and must be offered to all employees
- Computer screen users - if an employee or director is required to use a computer screen then the employer can claim the cost of any eye tests. It may also be possible to claim the cost of any special corrective glasses if these are required as a result of computer screen use - however this can be more difficult to prove.

Medical expenses which will give rise to a taxable benefit in kind include:

- Private medical insurance
- Gym membership

## 10.16 Charitable donations

Donations to national charities are an allowable deduction for corporation tax, so your company will automatically receive 20% tax relief on any donations made.

However, deducting charitable donations from taxable profit are not allowed to create or increase a taxable loss, so there would be no corporation tax saving under these circumstances.


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# 10.17 Childcare vouchers

There are two ways your company can do this, either through a voucher scheme or through a direct agreement with the provider. If it's just you (and your spouse) running your own company, then a more practical alternative is that your company pays a registered childcare provider directly for childcare.

This can be done through a relatively simple process of having an agreement between you and your company setting out the amount that your company is willing to spend on childcare on your behalf.

Whichever option you decide to pick, the childcare fees must be paid directly from company's business bank account.

The following childcare costs will not qualify for the tax and National Insurance Contribution exemptions:

- Any cash payments made to you for your childcare costs
- Paying your childcare bills when invoices are issued in your name rather than that of your company
- Payments made for your children's school fees
- Payments made under the childcare scheme which do not meet the qualifying criteria (see above)

Some examples of childcare costs which do qualify for tax relief are as follows:

- Payments for registered childminders, play schemes and nurseries
- Out-of-hours clubs which are run on school premises by a school or local authority
- Childcare schemes run by approved providers

Your company can pay for as much childcare as you choose, however you will be liable to tax and National Insurance if you exceed the limits below:

| Rate of income tax | Weekly exempt limit | Monthly exempt limit | Annual exempt limit |
|---|---|---|---|
| Basic (20%) | £55 | £243 | £2,915 |
| Higher (40%) | £28 | £124 | £1,484 |
| Additional (45%) | £25 | £110 | £1,325 |


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# 10.18 Pension costs

As with CIS, pensions are a huge topic that we can only cover as an overview. In this book we will discuss how pensions work and why they can be such a good tax saving device for limited companies.

However please note we are not financial or pension advisers and we strongly recommend you speak to a pension adviser to discuss your own personal requirements.

## 10.18.1 Personal contributions

Personal pension contributions are paid into a pension scheme by you personally. Any such payments are usually 'grossed up' by 20%. This means if you pay £80 into the pension fund it is treated as though you had paid £100 – the £20 is added to your pension fund by the government.

If you are a higher rate tax payer you will also save an additional 20% tax through your personal tax return.

With a personal pension fund you are not able to pay in any more than your earnings for the year. Earnings include your salary but not any dividends. So for most freelancer/contractor company directors this will be limited to the low rate of salary taken from the company (see section 4.1 for more details).

## 10.18.2 Employer contributions

Employer pension contributions are paid directly to the pension provider from the company's bank account and the pension scheme must be set up as a company scheme. This means that the amount paid in by the company is the amount which goes in to your pension – there is no 'grossing up' as with a personal pension.

Any pension contributions paid by the company will be allowable for a corporation tax saving of 20% (2016/17).

HMRC will also review any pension contributions made on behalf of employees and directors to ensure these are not excessive in terms of the role being performed. So for example, if a director has a salary of £8,040 and pension contributions of £30,000, then HMRC will consider the total remuneration to be £38,040 and will decide whether this is excessive.


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This may become a contentious issue if pension contributions are made for directors who are paid a salary but don't work full-time in the business – for example a spouse. It is best to keep these contributions at a lower level to avoid an HMRC challenge.

Issues to consider when deciding if contributions are excessive are as follows:

- How much would you have to pay someone to do your role
- What is your level of experience and how senior is your role
- How many hours do you work i.e. how full time is your role
- Is the company making sufficient profits to support the level of contributions

**Limits:**

The total maximum gross pension contribution (company and personal) per person is £40,000 per year for the 2016/17 tax year. However, tax relief on pension contributions will be restricted if your earnings are in excess of £150,000.

You might also have un-used allowances from previous years that you can bring forward to increase this limit (check with your pension advisor).

There is also a lifetime limit which is set at £1,000,000 for the 2016/17 tax year and there will be tax implications if this is breached.


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# 10.19 Entertaining customers/suppliers

## 10.19.1 An overview

Possibly the most annoying rule regarding entertainment is that entertaining customers, prospective customers or suppliers is NEVER allowable for tax purposes.

HMRC's definition of entertainment expenses are those expenses you incur when providing either subsidised or free hospitality to clients or staff. So these expenses could include food and drink, theatre or concert tickets, sporting event tickets and use of company assets such as executive suites.

This rule may seem harsh and unfair (the argument being that you wouldn't be able to attract or keep customers unless there was some form of entertainment), however HMRC's view is that the purpose of this expenditure is not directly to earn profit for your business and so this is not allowable. And it doesn't matter whether you take your client out for coffee or for a slap up meal at the Ivy restaurant – all client/customer entertaining is disallowable.

However, if the entertainment provided is part of a contractual obligation (for example, a training company who include lunch as part of their all day course and include this in their terms and conditions) then this will be allowable.

So basically any entertaining for anyone other than employees is disallowed – and by association, the expenses of any employees at the same event or meeting would also be disallowed.

However, just to confuse the issue, normally the cost of travel and accommodation for the business owner/employee to attend the event or meeting would be allowable – although, beware, don't offer your customer or supplier a lift as then the whole cost of travel will be disallowed!


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## 10.19.2 Should I bother recording client entertaining in my accounts

As client entertaining is disallowable, we often get asked whether it's even worth recording this expenditure in their accounts.

Well, our answer is always yes.

In the real world, client/supplier entertaining is a valid business expense (even though HMRC don't allow it for tax purposes!). Therefore when assessing the profitability of your business, you'll need to take into account how much you've had to spend to generate that business.

Also, if you're a limited company and spend your own money to entertain clients or suppliers, you need to make sure you record that in the company as an expense in order for the company to reimburse you.

Just make sure that you annotate your client entertaining expenditure clearly so it can easily be disallowed in your tax computation.

## 10.19.3 VAT

The VAT treatment of any non-employee entertainment expenditure is simple – it isn't allowed for all attendees whether customers, suppliers or employees.

## 10.19.4 Gifts

The cost of gifts for customers or suppliers is also not allowable unless certain circumstances apply – the gift must meet the following criteria:

1. it must carry a conspicuous advertisement for the donor
2. it must not be food, drink, tobacco or a token exchangeable for goods
3. it must cost less than £50 in total in an accounting period (per recipient)

As long as the gift meets all three of these criteria it will be a tax deductible expense against business profits.

If the gift meets criteria 1 (it doesn't need to meet criteria 2 or 3) then your business can reclaim the VAT on the gift.


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## 10.19.5 Room Hire

So what if you decide to run an event at which you'll be presenting information about your latest product?

Well, if the primary purpose of the event is selling or marketing (rather than giving all your clients a lovely day out!) then the room hire element should be allowable for both business tax and VAT. Just remember to keep evidence proving that the event was for marketing purposes – such as invitation emails, literature given to customers at the event etc.

Unfortunately though, it's highly unlikely you'll be able to claim any expense on entertaining (ie food or drink) in either your tax computation or for VAT. So remember to analyse any costs of entertaining separately from the cost of room hire.


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## 10.20 Entertaining employees

### 10.20.1 An overview

Generally, entertaining employees is allowable as a business expense and the business can reclaim VAT. This is because any such entertaining is considered to be staff welfare rather than entertaining.

But beware, other than Christmas parties (see below) you may find that your employees will incur a benefit in kind charge related to any entertainment and they may have to pay tax on that benefit.

### 10.20.2 Who counts as an employee

So who's an employee?

Generally HMRC will consider an employee to be someone who is on the payroll and who is paid a salary.

If you are a director of a limited company where there are only directors on the payroll with no other employees, then HMRC's view is that the cost of any entertaining doesn't qualify for tax relief or a VAT deduction.

### 10.20.3 Christmas party

There is an exemption to the normal tax rules for a 'Christmas' (or annual) party.

There is no benefit in kind on employees who attend an annual event/party provided it meets three criteria:

- the average cost per head of the event (or events if you hold more than one a year) must be less than £150 per guest present
- the event must be an annual event – and not a one-off event such as an event to celebrate winning a new contract
- all staff must be invited

If there are two or more annual parties then the £150 limit will be applied across all events – although the employer can decide which events to apply the limit to.


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Employees can bring along guests to the event and the total cost will still be both tax and VAT deductible. But beware, don't try to circumnavigate the rules by inviting lots of clients or suppliers – you're likely to fall foul of the taxman! The primary purpose of the event HAS to be to entertain staff!

So if you're a director of your own limited company, you can treat your wife to slap up meal and claim a tax deduction at the taxman's expense!

# 11 Non-allowable business expenses

There are certain expenses which are not allowable for corporation tax. It is therefore important that you identify these separately so that your accountant can adjust your business tax accordingly.

## 11.1 Non-staff entertaining

You may feel that entertaining your customers and suppliers is a legitimate part of your business – unless you play the game, you won't get their custom.

Unfortunately the taxman doesn't feel the same way and any expenditure on entertaining your customers will not be allowable.

## 11.2 Working lunches

If HMRC undertakes a PAYE compliance visit you can be sure that they will scrutinise your staff costs.

One matter in particular is the cost of providing staff lunches. Unless they're provided to all the staff (though not necessarily taken up by them) this produces a tax bill for those enjoying the lunch.

HMRC's starting point is that any meal taken with a work colleague is likely to have personal ramifications, so any expenditure on meals has not been incurred 'wholly, exclusively and necessarily in the performance of the employees duties' and is therefore taxable on the employee.


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There are a few examples where the taxman considers that no tax liability arises on a free meal. For instance, if a meal is provided in the course of discussing the employee's contract, then HMRC are unlikely to view this as taxable.

You therefore need to demonstrate that social and personal considerations play no part in coming together for a meal. If your spouse works in your business and you take them to lunch you will need a cast-iron excuse for arguing it's for a business purpose (!).

Or if a meal is provided as a reward to just a few staff who have worked hard on a particular project, it still may still be potentially taxable.

There seems every reason to try and claim a deduction for lunches where the business element clearly outweighs the social side. In-house staff training during a lunch time would be allowed as if staff are expected to attend the meeting and there is some genuine technical or business related session in progress it will be difficult for HMRC to argue there is any social aspect.

Furthermore, you don't have to provide all employees with the same meal to qualify for the exemption (so vegans can be catered for).

If you provide free or subsidised coffee and biscuits for all staff, this will be covered by the exemption in the taxes legislation.

## 11.3 Personal clothing

There is a lot of case law around clothing. You may feel that any expenditure on a business suit should be allowable because you wouldn't be seen dead in one if it wasn't for running your business.

But unless the expenditure relates to a uniform which would make you or your staff recognisable outside of the workplace, then it isn't allowable. Having a distinctive business logo or business colours may be enough to claim that it's a uniform.

If you decide to provide your staff with clothes which aren't regarded as a uniform, then they will be taxed on the cost of the clothing personally, as a benefit in kind, and your business will have to pay employer's NI on the cost. However the business can claim a deduction against its taxable profit for both the cost of the clothing and the NI contributions.

However, if you are a sole trader and buy non-uniform clothing for yourself, then generally speaking this will definitely be disallowed. Unless of course you're an entertainer or in the public spotlight!


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## 11.4 Parking fines

If the company pay its employees' parking fines, then the employees will be taxed on the cost of the fines as a benefit in kind and your business will have to pay employer's NI on the cost. However the business will be able to claim a deduction in its taxable profit for both the cost of the fines and the NI.

## 11.5 HMRC fines and penalties

If the company is late paying your corporation tax or filing its tax return and receives a fine or penalty, then it will not be allowed to claim a deduction for this in your tax computation.

If the company incurs interest charges on late payment of tax, then this will be allowable.

## 11.6 Gifts to customers

Gifts which contain a conspicuous advertisement for your business are, under certain conditions, allowable for corporation tax purposes.

However, the following conditions must be met:

- The gift must not be food, drink or tobacco, nor should it be a token or voucher exchangeable for goods.
- The cost of the gift (together with the cost of any other such gifts to the same recipient in the relevant tax period) must not exceed £50.

Common examples of allowable gifts are diaries, pens and mouse mats.

The advertisement should be on the gift itself, and not just on the wrapping.


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# 11.7 Depreciation/Capital allowances

The depreciation charge put through your books when calculating your accounting profit is not allowable for tax.

Instead the taxman will allow you to deduct something called capital allowances.

Capital allowances are also an attempt to spread the cost of an asset over its expected useful life.

However, whilst a business may choose a depreciation policy which reflects how they feel the asset will wear out over the years, capital allowances are set out in the Capital Allowances Act and are subject to changing periodically.

From 1 April 2008 businesses have been able to claim what is known as the 'Annual Investment Allowance' (AIA) for expenditure on most plant and machinery. The limit for AIA from 1st January 2016 is £200,000 and from 1st April 2014 to 31st December 2015 it was £500,000.

This means the company can effectively claim 100% of the cost of any new equipment up to the value of £200,000 bought since 1st January 2016.

If any expenditure exceeds the AIA limit (or the asset is not subject AIA – see below) then it is dealt with under the normal capital allowances regime. Under the normal capital allowance regime the cost of an asset will be written off for tax purposes at a rate of either 10% or 20% per annum over the life of the equipment – this is known as a 'Writing Down Allowance' (WDA). This means the company will have to wait longer in order to get the full tax relief.

Also, you should note that for a period of account which is not 12 months, then the AIA is proportionately increased or reduced.

AIAs are not allowable on cars, items you owned for another reason before you started using them in your business or items given to you or your business. These will be claimed under WDAs.

The company is also able to claim 100% of any expenditure incurred on what is known as environmentally beneficial plant and machinery. You need to take care that the expenditure qualifies for the relief and we'd recommend you log onto **www.eca.gov.uk** for further information.


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# 12 Company Cars

If you're trading through your limited company, on the surface of it you might think it's a good idea to get your company to pay for a new car. However you'll need to weigh up all the costs involved, together with the tax implications, before you decide to go ahead with a purchase.

As a starting point the kind of questions you should be asking yourself are as follows:-

## 12.1 Private vs business use

This is vital when considering the VAT on your car - especially if you're considering an outright purchase by your company. Ordinarily you can only reclaim the VAT on a car if it is used exclusively for business and is not available for private use by yourself.

However, VAT can be reclaimed on a pool car which is kept on site overnight and used by a number of different employees throughout the working day – even if some of that use is personal.

VAT may also be reclaimed on a car when it is used primarily as a taxi, for driving instruction or self-drive hire.

And you must remember that driving to and from your regular place of work is regarded as ordinary commuting. So if you use the vehicle solely to travel to and from your workplace, you cannot reclaim the VAT.

Where your company car is leased (as opposed to purchased outright), unless there is exclusive business use (see above) then the company will only be able to recover 50% of the VAT charged on any lease payments.

You'll also need to remember that if your company car is available for private use then this will result in a taxable benefit in kind. This is what HMRC deem to be the cash equivalent of having the 'perk' of a company car which can be used privately.


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## 12.2 CO2 emissions on the car

The amount of CO2 emissions produced by the car correspond directly to the deemed cash benefit of having the 'perk' of a company car which you can use privately - and on which you will be taxed personally. So the higher the CO2 emissions, the higher the benefit in kind on which you will be taxed personally.

If the company buys the car (either outright or though some form of hire purchase) then the level of CO2 emissions will also determine the percentage rate at which the company can write-off the cost of the car for tax purposes. Again, the higher the CO2 emissions the less write-off the company will get each year.

If the company only leases the car, then the CO2 emissions will determine the proportion of rental payments that can be claimed. The higher the CO2 emissions, the lower the proportion which can be claimed.

## 12.3 How is the deemed cash benefit in kind calculated?

The deemed cash benefit of private use of your company car is calculated by multiplying the list price of the car by the CO2 emissions percentage of the car. The list price used for the calculation should include any accessories fitted before the car was first made available and also any accessories which were fitted later and which cost more than £100.

The CO2 emissions percentage can be found here.

Essentially, the higher the CO2 emissions produced by the car, the higher the percentage that is applied to the list price. Therefore a low emission car will have a low deemed cash benefit and a high emission car a high cash benefit.


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An example:

BMW 320i SE - manual

List price: £27,740

In this example the relevant $CO_2$ emissions percentage is 22%, therefore the deemed cash benefit will be:

£27,740 x 22% = £6,102.80 per annum

Depending on your marginal tax rate, your annual tax bill for having this particular company car (which is available for private use) could be anything from £1,220.56 to £2,746.26.

The company will also have to pay Class 1A National Insurance on the deemed cash benefit of the private use of the company car. Using the example above, the company would have a Class 1A tax bill of £842.19 each year.


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## 12.4 Claiming the cost of the car

Any assets bought by the company (eg motor vehicles) are treated differently for accounting and taxation purposes.

For accounting purposes the asset will be written off each year based on its estimated useful life. So if you buy an asset which will last 4 years for £20,000, then a charge of £5,000 will be made each year in the accounts.

However the tax treatment of the asset will be different and from a tax perspective there are also different rules for specific assets.

As far as cars are concerned, the greater the level of CO2 emissions the car produces, the less tax relief you can claim each year. The percentage of the car's cost which you can claim against your taxable profit each year is known as a Capital Allowances claim. Essentially there are three categories of car to consider for Capital Allowances claims.

- If the car's CO2 emissions are 75g/km or less, you can deduct 100% of the cost of the car from the company's profits in the year that you buy the car, provided that the car is purchased brand new.

- If the CO2 emissions are between 76g/km and 130g/km then 18% of the price of the car (on a reducing balance basis) can be deducted from your company's profit each year.

- For CO2 emission levels above 130g/km then 8% of the price of the car (on a reducing balance basis) can be deducted from your company's profit each year.

From the benefit in kind example, the BMW would fit into the third band, so Capital Allowances would be claimed at 8% per annum. Clearly the company would need to retain ownership of your car for a number of years in order to obtain any significant tax benefit for the original purchase price. You could also end up paying more tax than the cost of the car itself because the benefit in kind is based on your company car's price when new - not it's second hand value.

Therefore from your own and the company's perspective, in order to save the greatest amount of tax, your company would need to purchase an environmentally friendly car (either electric or low emission).


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# 12.5 Leasing a car?

The rules for you personally are exactly the same as if your company purchased the car outright. This means you will be subject to a benefit in kind which will be calculated in the same way as our BMW example in section 12.3.

However, as far as the company is concerned, the rules are much more straightforward - if the car's emissions are in excess of 130g/km then the company can only claim 85% of the total leasing costs.

# 12.6 Paying for fuel

Firstly you need to distinguish whether any fuel paid for by your company relates to business or personal journeys.

As mentioned previously, you should be aware that HMRC consider ordinary commuting from home to a fixed place of business as private mileage.

If your company does pay for any of your private fuel costs, then HMRC will consider you to have received a cash benefit based on the $CO_2$ emissions of your company car.

The benefit is calculated by multiplying the appropriate percentage (found **here**) to £22,200 (2016/17).

So if we use the BMW 320i example from section 12.3, the taxable benefit would be £4,884 (£22,200 x 22%).

The £22,200 is a fixed amount, regardless of how much fuel has actually been paid for by your company for your private mileage.

Where fuel is only paid for business use, then there is no cash benefit and so no additional tax to be paid. However, HMRC will require proof that no fuel was used for private purposes - you should therefore keep accurate mileage records to be able to demonstrate that you only had the cost of business fuel reimbursed.


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# 12.7 VAT on private fuel

Essentially the position is as follows:

a. If fuel paid relates exclusively to business use then all of the VAT on fuel can be recovered.

b. If private fuel is also paid for by your company then an adjustment to your VAT return needs to be made. The company claims for all of the VAT on fuel costs and then pays an appropriate fuel scale charge to HMRC to make up for the estimated private use element.

The fuel scale charge is based on the CO2 emissions of your car. The latest fuel scale charge can be found here.

If we use the BMW 320i in section 12.3 as an example, if your company claimed all of the VAT on your fuel costs (including private mileage), the fuel scale charge to be added to the company's total VAT liability each quarter would be £31.

# 12.8 What's the alternative to a company car?

Weighing up the pros and cons of buying a car and paying for travel through your company isn't always straight forward.

So rather than having the complications associated with having a company car, you may prefer to have the company reimburse you for business travel where you use your own car. If you use HMRC's approved mileage rates there will be no tax to pay. HMRC's rates are currently 45p per mile up to 10,000 miles and 25p per mile over 10,000 miles – these are annual allowances.

So if you travel 10,000 business miles in a year, the company can pay you £4,500 with no benefit in kind for you. The company can also deduct this payment in its accounts as an expense.

This payment is to cover both the fuel cost of any business mileage you do together with the wear and tear on your personal car. However you must keep accurate mileage records showing the business mileage which you have done during the year.


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If you have a company car and pay for all your fuel costs, it is possible for your company to reimburse you for business fuel, using the advisory fuel rates provided by HMRC **here**.

If the appropriate rate is paid, then this will not give rise to an additional tax charge.

We very seldom see a situation where a company car is tax effective. But if you do want to have a vehicle owned by the company, why not think about a van instead? Buying a van through your company can be a far more tax efficient solution.


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# 13 Company van

Unlike buying a car through your limited company, buying a van can be quite tax effective.

So what do you need to be aware of?

## 13.1 Is it a van?

Well, firstly you need to be sure that the vehicle you are buying is classed as a van for tax purposes. The dealer you buy your van from should be able to confirm this. If it isn't a van, then it's a car and, unless it's very low emissions, it won't be worthwhile buying this through your company. HMRC have quite a useful list of what they consider vans or cars **here**.

## 13.2 Administration

Whether you buy the van outright or via a hire purchase agreement, all documents must be in the company's name and all payments must go through the company's bank account.

## 13.3 VAT and corporation tax

The company can claim the full VAT on the purchase price - even if it's flat rate VAT accounting (assuming the van costs over £2k when purchased new).

The company will also be allowed to write off the full cost of the van in the year of purchase for corporation tax purposes - it will do this via its capital allowance claim (see section 11.7).

However as only a percentage of the van's cost will be allowed in the accounts as depreciation, this will invariably lead to a deferred tax charge in the company's accounts (see section 9.4).

The flip side of this tax treatment is that you will have to charge VAT when you sell the van and the sales proceeds will be liable to corporation tax.


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# 13.4 Personal tax

If you use the van for personal use, you will be liable to a benefit in kind charge on the personal usage - currently £3,170 for the 2016-17 tax year. That means if you are a higher rate taxpayer you will incur an income tax charge of £1,268 - £3,170*40%.

If the company also pays all the fuel costs then you will have a benefit in kind for the personal use of the fuel as well - currently £598 for the 2016-17 tax year. Again, if you are a higher rate taxpayer you will have income tax to pay of £239.20 - £598 * 40%.

These benefits in kind will need to be reported to HMRC each year on a P11d. And the company will also be liable to Class 1a National Insurance on the total benefit - currently 13.8% for the 2016-17 tax year. So the company will have to pay Class 1a of £520 (£3,170+£598 = £3768 * 13.8%).

If you do a lot of personal miles then you will want the company to pay all the fuel. However, if most of your mileage is business with very little personal use, you may be better off paying for all your fuel personally and recharging the company for any fuel used for business trips.


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# 14 Auto-enrolment

Auto-enrolment is the biggest change to hit employers for years. The legislation is large and complex. And if you have relevant employees, then the chances are it may already have started affecting you.

Please be aware that the information below is just a guide. TPR have published over 50 documents and guides to help with implementation. So if you are unsure about anything and want further guidance, please feel free to get in touch.

## 14.1 What is automatic enrolment?

The law on workplace pensions has changed. Auto-enrolment was introduced to ensure that employers offer all eligible employees the right to join a pension plan. It was the government's way of making sure that employers help employees plan for their retirement.

## 14.2 Will it affect me?

Auto-enrolment affects anyone with an employee. As a freelancer or contractor this won't usually affect you.

However it's important to note that even though you don't meet the criteria for having an obligation under auto-enrolment then you still need to let the Pensions Regulator know that you don't have any duties to fulfil. You can do this by completing the Duties Checker **here**.

## 14.3 When will it affect me?

Every employer will be given a staging date.

To find out your staging date, simply go **here** on The Pension Regulators (TPR) website and enter your PAYE reference number.

If you can't find your staging date using this tool (usually if you've become an employer after 1 April 2012), then you may find your staging date **here**.


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## 14.4 What do I need to do?

The first step is to determine whether you believe AE affects you. Unless you have two or more workers (anyone earning over £10,000 per year) then AE won't affect you.

Remember, directors don't count as workers unless they have an employment contract. So as a contractor or freelancer, you will probably not be affected by auto-enrolment. However it's important to complete the Duties Checker **here**.

If you do believe AE affects you then we recommend you get professional guidance as soon as possible.


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# 15 Directors Loans

## 15.1 The Rules

### Remember: You and the company are totally separate. The company's money is not your money!

Any time you use the company's bank account or credit card to pay your personal bills, you've basically borrowed from the company.

Now that's not a huge problem as long as your company isn't in financial difficulty and it's allowed to loan you money (you can check that by looking at the company's articles – but for most small companies it's not a problem).

And, except in certain circumstances*, you'll need to get the shareholders' permission to allow the company to loan you money - which isn't a major problem if you own all the shares.

* Sections 204-209 of the Companies Act 2006 cover all the exceptions, but the main one affecting small companies is that the company can loan a director up to £10,000 without needing the shareholders' permission.

If you have a current account with the company (for minor in and out transactions with the company) and also a proper, agreed loan account with your company, the two balances can be kept separate and will be treated separately.

To be on the safe side (and in the event of an HMRC enquiry) always make sure you and your company have a written loan agreement in place.


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# 15.2 Joint loan accounts

If there are two directors in your company (for example you and your wife) you may agree between yourselves to allow an offset so that you only account for the net loan (HMRC don't like this treatment because they get less tax – so make sure you document this properly!).

Make sure you have evidence to prove your intention was to create a joint loan account as otherwise HMRC will not accept this offset.

It is therefore vital that you and your company agree the treatment of aggregating or offsetting loan accounts at the time that the loans are made or when two are to be offset and record this in a board minute at the time.

You should **not** back-date any of this documentation, unless there is a genuine reason why it was not possible to record the details of a meeting at the time.

HMRC doesn't like you having the benefit of an interest free loan from your company (see above) and unless you do something to put it back into the black they will penalise you **and** your company. You can see the cost to you and your company below.


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# 15.3 The cost to you

If your borrow more than £10,000 from your company (from 5th April 2014 – before then it was £5,000) at any time during the tax year, then HMRC charges you to tax on the cash benefit of having this loan interest free.

HMRC does this by calculating the difference between the amount of interest you would have paid (using their rates of course) on an equivalent loan from a third party and the amount of interest actually charged by the company (if any has been charged).

### *An Example*

**You owe £20,000 to the company for the whole of the 2016/17 tax year. The taxman's "official rate" of interest is 3%. You paid no interest to the company on this loan.**

**The benefit in kind is calculation is as follows:**

| | |
|---|---|
| **Loan outstanding at 05th April 2017:** | **£20,000** |
| **HMRC rate of interest:** | **3%** |
| | |
| **Benefit in kind (£20,000 x 3%)** | **£600** |

If the amount you owe the company fluctuates then the tax man can choose to calculate your cash benefit by using either an averaging method or on a daily basis.


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## 15.3.1 Averaging method

The taxman looks the amount you owed the company at the beginning (6 April) and end (5 April) of the tax year and calculates the average of these two figures.

### *An Example*

**You borrow £20,000 from your company on 1 March 2016 and then a further £15,000 on 1 December 2016. At the end of the 2016/17 tax year you therefore owe the company £35,000.**

**The benefit in kind is as follows:**

| | |
|---|---|
| **Loan outstanding at 6th April 2016:** | **£20,000** |
| **Loan outstanding at 5th April 2017:** | **£35,000** |
| **Average loan outstanding:** | **£27,500** |
| **HMRC rate of interest:** | **3%** |
| | |
| **Benefit in kind** | **£825** |

The averaging method automatically applies unless you opt for the precise method or HMRC advise you that they intend to use this precise method (see below).


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## 15.3.2 Precise method

Where your borrowings fluctuate throughout the tax year the taxman might decide to calculate the cash benefit using a daily basis – especially if this leads to more tax being payable.

### *An Example*

**You borrow £15,000 from your company on 1 March 2016. You also borrow further amounts of £2,500 on 1 June 2016, £5,000 on 1 August 2016, £2,500 on 1 October 2016 and £7,500 on 1 December 2016. At the end of the 2016/17 tax year you owe the company £32,500. The cash benefit is as below:**

| | |
|---|---|
| **£15,000 x 3% x 56/365 (balance from 6 April to 31 May)** | **£69** |
| **£17,500 x 3% x 61/365 (balance from 1 June to 31 July)** | **£87** |
| **£22,500 x 3% x 61/365 (balance from 1 August to 30 September)** | **£113** |
| **£25,000 x 3% x 61/365 (balance from 1 October to 30 November)** | **£125** |
| **£32,500 x 3% x 126/365 (balance from 1 December to 5 April)** | **£337** |
| | |
| **Benefit in kind** | **£731** |

As you can see, things can get complicated when you don't keep track of your borrowings.

HMRC are most likely to apply the alternative method if:

- **your outstanding director's loan (or loans) was (or were) known to be much higher during the year than at the beginning or end of the tax year concerned or**
- **there have been large fluctuations in the amounts outstanding throughout the year (particularly where loans are aggregated, see above) in the year and the amount of tax at stake is likely to be large.**

Once the benefit has been calculated the company will need to disclose details on the form P11D and pay Class 1A National Insurance (currently 13.8%) on this figure.

You will also need to include the benefit in kind figure on your personal tax return.

You could eliminate the tax charge by simply paying interest to your company (at a commercial rate) on your loan, then you wouldn't have to complete and submit form P11D to HMRC and would avoid a Class 1a National Insurance liability.


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However, it's far easier just to keep a close eye on your company borrowings and make sure you don't go 'overdrawn' by more than £10,000 at any time during the tax year.

To do this you need to make sure your company stays up to date with its bookkeeping. If you have access to 'real time' information detailing transactions on your loan account then you are more likely to prevent this happening.

## 15.4 The cost to the company

From 6 April 2016 HMRC will charge your company Corporation Tax at 32.5% on the money you owe your company at the end its accounting period **and** which is still outstanding 9 months and one day after that date.

Be aware that this rule applies even if you borrow less than £10,000 from your company.

### *An Example*

**You owe your company £20,000 at its accounting year end of 31 March 2017 and you haven't repaid this loan by 1 January 2018.**

(Remember, in order to avoid the 32.5% tax charge you must repay the loan 9 months and one day after the year end.)

**The company will be charged to tax on £20,000 x 32.5% = £6,500.**

So not repaying the loan in time can have a big impact on the company's cash flow.

Plus it can be a double hit because HMRC won't repay any tax previously paid on the loan until 9 months and one day **after** the end of the accounting period in which any loan repayment is made.

So in our example above, if you repay the loan on 30 April 2017, HMRC won't give you the tax back until 9 months and one day after 31 March 2018 (the accounting period when you made the repayment) – so that's 1 January 2019!


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# 15.5 Beware the 'bed and breakfast' rules

In the past it might have been possible for you to repay your loan from the company shortly before the 9 month tax payment date (see above) by using short-term borrowings from a third party (e.g. a bank).

This way your company could avoid paying the corporation tax due on the overdrawn loan and could re-lend you the money shortly after the 9 month deadline had passed.

Unfortunately, HMRC have got wise to this strategy and have now introduced measures preventing you from using this type of short-term repayment arrangement.

From now on, and as a general rule, your company can't avoid the tax on your loan where the following circumstances apply:

a) More than £5,000 of your loan repayment is reversed within 30 days (known as 'bed and breakfasting'): or

b) Your loan is greater than £15,000 and there is a clear intention by your company to lend you money shortly after you have repaid this loan. In other words this repayment was never intended to be lasting.

If this does happen, then HMRC consider there has been no actual repayment of the original loan outstanding 9 months and one day after your company's accounting period (see above) and if you're not careful the company could end up with a tax bill.

You can avoid this nasty tax trap by simply repaying your company loan in the form of a payment which is chargeable to income tax. The usual method would be to pay yourself a salary, bonus or dividend, from your company.

Make sure you think carefully about the timing of any repayment of your director's loan and ensure any dividend minutes etc. are properly documented.


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# 15.6 Writing off your loan

Repaying your loan from the company by paying yourself an interim (or final) dividend is the most common way to put your director's account back in the black and avoid a corporation tax charge (see above).

Unfortunately it may not always be possible for you to clear your loan account in this way. This is often the case if your company doesn't have the profits available to declare enough dividends to repay your borrowings.
You are therefore faced with three alternatives:

1) Don't repay your loan and let your company pay any corporation tax due.

   You'll get the tax back (eventually) but this can be a significant hit on your cashflow.

2) Clear the loan by voting yourself a bonus.

   Unfortunately, this will trigger an immediate PAYE liability and you could be charged potential penalties if you're late reporting this under RTI.

3) Get the company to write off the loan completely.

   In broad terms, the loan waived will be taxed on you as a dividend.

   This might not be a problem if you're a basic rate taxpayer although it could trigger a national insurance liability*.

   On the upside however, HMRC will at least refund your company any tax paid previously on this loan. And you won't have to wait until 9 months and one day after your year end to get the repayment!

* A recent tax case has indicated that it might be possible to avoid a national insurance liability on a loan waiver altogether. However this point is still unproven at this stage and we'd strongly recommend you discuss this with us first before you decide whether or not to pursue this strategy.


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## 15.7 Summary

Finally and most importantly, please remember the information we have given you is purely for guidance purposes and is no substitute for definitive advice.

Because the rules surrounding director's loans can be complex, we would always recommend you seek advice from a suitably qualified professional. This way you can ensure you are fully aware of any adverse tax consequences before you take action.


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# 16 VAT

Any VAT you charge on supplies you make (whether services or products) is called your **Output VAT** (but your customers will reclaim this as their Input VAT).

Similarly, any VAT you incur on business expenditure is called your **Input VAT**.

As at April 2016 there are three rates of VAT:

- A standard rate of 20%
- A reduced rate of 5% - e.g. gas and electricity, children's seating
- A zero rate – applied to goods which are socially or economically important eg most food, books, newspapers, public transport, children's clothing

Any supply which is VATable will have one of these rates applied to it.

However, some supplies are exempt from VAT which means that no VAT is payable (for example insurance, postage, finance, education and health). But if the supplies you make (your sales) are exempt then you won't be able to recover any VAT on any business expenditure which you incurred when making the supply.

Where a supply is exempt from VAT, it should still be included on your VAT return.

And there are also supplies which are 'outside the scope' of VAT – this means they're not treated as a supply of goods or services and so aren't chargeable to VAT and aren't included on your VAT return.

For a list of the major categories see below.

Please note that this list is not exhaustive. Also, seemingly similar supplies can have different categorisations – for example biscuits are standard rated but cakes are zero rated. Please don't ask us why!

And beware; VAT on non-staff entertaining is not reclaimable – even if you've been charged it.


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| Standard | Zero | Exempt | Outside of scope |
|---|---|---|---|
| Restaurant food | Public transport (buses, trains etc) | Insurance | Wages |
| Hot takeaways | Taxis | Postage and stamps | Drawings<br>Loan repayments |
| Partly+ coated biscuits and shortbread | Food* | Bank charges and interest | On-street parking |
| Decorated ginger bread men | Books | Entrance to museums and zoos | Council Tax |
| Sweetened cereal and muesli bars | Newspapers and magazines | Subscriptions to non-profit bodies | Business Rates |
| Crisps and nuts (salted) | Clothes and shoes for babies and children | Tamar Bridge toll | MOT's |
| Ice cream / frozen yogurt, arctic | Charity shop sales of donations | Art | Gratuities |
| rolls | Plain nuts and tortilla chips | Education | Charitable donations |
| Bottled water | Frozen meals | Betting, bingo, lottery | |
| Fruit juice | Water and sewerage | Medical treatment and healthcare Sports facilities | |
| Confectionery | Seeds | Postal services | |
| Alcoholic drinks | Drugs | Second sale+ houses | |
| Taxi fares | Caravans and houseboats | Second hand car sales | |
| Commercial buildings | New homes | | |
| Pet food | Protective equipment | | |
| All supplies of goods and services are assumed standard rated, unless otherwise designated. | * Bread, cakes, cream cakes, teacakes, caramel shortbread, Jaffa cakes, flapjacks, plain cereal cakes, milk and milk drinks, coffee and tea. | | |


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# 16.1 When to register for VAT

A business must register for VAT when cumulative turnover for the previous twelve months exceeds the VAT threshold (as at 2016/17 this is £83,000). This is known as the 'twelve month' test.

To check the current VAT threshold limits go to '**https://www.gov.uk/vat-registration-thresholds**'

You must also register for VAT if you believe your turnover may exceed the VAT threshold (£83,000) within the next 30 days. This is known as the '30 day test'.

If you are late in registering for VAT, you may be liable for interest and penalties in addition to the VAT which you should have paid on time. As a rule of thumb, the later the registration the greater the penalties. So it's really important to stay on top of your bookkeeping so you have access to real time information and don't miss the registration deadline.

You may also register voluntarily for VAT even if your turnover is likely to be below the VAT threshold. For example, this could be advantageous where your business has incurred significant VAT on business expenses and wishes to re-claim this in order to ease cash flow.

# 16.2 Reclaiming VAT on expenses incurred before registration

If you have already started trading and then subsequently register for VAT, you may be able to reclaim the VAT on pre-registration expenditure.

## 16.2.1 Pre-registration VAT on goods:

You can reclaim VAT on goods purchased up to four years before you were registered for VAT provided they were bought by you as the 'person' who is now registered for VAT, they are used for your VATable business purposes, are still held by you or have been used in something which you have made but continues to be used in your business.

For example, you could reclaim the VAT on any stock you purchased prior to registration and which you still hold at the date of registration.

However, you can't reclaim the VAT on any petrol which you purchased prior to registration, because this has been 'consumed' and is no longer in existence at the registration date.


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**Please note that a change of policy by HM Revenue & Customs has recently come to light. The taxman may argue for a restriction in the recovery of input tax where goods have been purchased some time prior to registration though within the four year window mentioned above. There appears to be some contention at the moment as to whether HM Revenue & Customs are correct to adopt this stance.**

### 16.2.2 Pre-registration VAT on services:

You can reclaim VAT on services purchased up to six months before you were registered for VAT provided they were bought by you as the 'person' who is now registered for VAT, they are used for your VATable business purposes and if they relate to goods which you still have in the business at the date of registration.

So for example you could claim for a service or repair on a machine only if you still had that machine at the date of registration.

## 16.3 VAT administration

### 16.3.1 To register for VAT

You can either register by downloading the relevant VAT application forms and sending them by post or you can register on line.

**By post**

If you require a copy of the form, please let us know.
Once completed, the form needs to be sent to:
National Registration Service
HM Revenue & Customs
Deansgate
62-70 Tettenhall Road
Wolverhampton
WV1 4TZ

**On-line**

To register on-line, go to '**https://online.hmrc.gov.uk/registration**' and follow the information on-screen.


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## 16.3.2 Who should you issue a VAT invoice to

If you are a seller registered for VAT you must give a buyer who is registered for VAT a VAT invoice for any standard-rated or reduced-rated items sold.

If you are a retailer, you do not need to issue a VAT invoice or receipt unless asked to do so by the buyer.

A VAT registered supplier may be fined if they do not issue a VAT invoice when asked to do so by a VAT registered buyer.


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### 16.3.3 What to include on a VAT invoice

You'll use a full VAT invoice for most transactions. You can use:

- a modified invoice for retail supplies over £250
- a simplified invoice for retail supplies under £250 - and for other supplies under £250 from 1 January 2013

Include the following on your invoice, depending on which type you use:

| Invoice information | Full invoice | Simplified invoice | Modified invoice |
|---|---|---|---|
| Unique invoice number that follows on from the last invoice | Yes | Yes | Yes |
| Your business name and address | Yes | Yes | Yes |
| Your VAT number | Yes | Yes | Yes |
| Date | Yes | No | Yes |
| The tax point (or 'time of supply') if this is different from the invoice date | Yes | Yes | Yes |
| Customer's name or trading name, and address | Yes | No | Yes |
| Description of the goods or services | Yes | Yes | Yes |
| Total amount excluding VAT | Yes | No | Yes |
| Total amount of VAT | Yes | No | Yes |
| Price per item, excluding VAT | Yes | No | Yes |
| Quantity of each type of item | Yes | No | Yes |
| Rate of any discount per item | Yes | No | Yes |
| Rate of VAT charged per item - if an item is exempt or zero-rated make clear no VAT on these items | Yes | Yes (1) | Yes |
| Total amount including VAT | No | Yes (1) | Yes |

(1) If items are charged at different VAT rates, then show this for each item.


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Usually VAT invoices must be issued within 30 days of the date of supply or the date of payment (if you're paid in advance).
You don't have to show all amounts on your invoices in sterling. If you issue VAT invoices in a foreign currency or language, you must:

- show the total VAT payable in sterling on your VAT invoice if the supply takes place in the UK
- be able to provide an English translation of any invoice within 30 days if asked to do so by a visiting VAT officer

To convert to sterling you can:

- use the market selling rate at the time of supply
- use the European Central Bank's rate - from 1 January 2013
- use HMRC's period rates of exchange - the rates usually stay the same for each calendar month
- apply to HMRC to use a different method to account for the VAT

You don't need to issue a VAT invoice if:

- your invoice is only for exempt or zero-rated sales within the UK
- you're giving goods as a gift
- you sell goods under a VAT second-hand margin scheme
- your customer operates a self-billing arrangement


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### 16.3.4 Time of supply

The tax point (or 'time of supply') for a transaction is the date the transaction takes place for VAT purposes.

You need to know this because, for example:

- it's included on VAT invoices
- it tells you which VAT period the transaction belongs to
- it tells you which VAT Return to put the transaction on

The tax point can vary, but is usually the following:

| Situation | Tax point |
|---|---|
| No invoice needed | Date of supply |
| VAT invoice issued | Date of invoice |
| VAT invoice issued 15 days or more after the date of supply | Date the supply took place |
| Payment or invoice issued in advance of supply | Date of payment or invoice (whichever is earlier) |
| Payment in advance of supply and no VAT invoice yet issued | Date payment received |

The date of supply is:

- for goods - the date they're sent, collected or made available (eg installed in the customer's house)
- for services - the date the work is finished

If you use the VAT Cash Accounting Scheme, the tax point is always the date the payment is received.

There are different tax point rules for:

- certain trades - like barristers, building and construction
- where the supply is not a 'sale' – eg business items taken for personal use

Sometimes, one sale can give rise to 2 or more tax points - eg where the customer pays a deposit in advance, and then a final payment.


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## 16.3.5 Records to keep for VAT

Records you must keep include:

- copies of all invoices you issue
- originals of all invoices you receive (pdf copies are fine)
- self-billing agreements - this is where the customer prepares the invoice
- name, address and VAT number of any self-billing suppliers
- debit or credit notes
- import and export records
- records of items you can't reclaim VAT on - eg business entertainment
- records of any goods you give away or take from stock for your private use
- records of all the zero-rated, reduced or VAT exempt items you buy or sell
- a VAT account

You must also keep general business records such as bank statements, cash books, cheque stubs, paying-in slips and till rolls.

If you use the Cash Accounting Scheme you must use these records to match them against your payment records and receipts.

If you are a retailer you don't have to issue VAT invoices unless a customer asks for one. Keep a copy if you do. Retailers can issue 'simplified invoices' for supplies under £250.

When you return goods to a supplier or a customer returns goods to you, the balance of payment can be settled with a credit or debit note.  Record these in your accounts and keep any original notes.


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### 16.3.6 Filing your VAT return online

Since 1st April 2012 it has been a requirement to file your VAT returns online.

To register to file your VAT returns on-line, go to **https://online.hmrc.gov.uk/registration** and follow the instructions on screen.

If you use an online bookkeeping package (we recommend FreeAgent and Xero) you can file your returns from within the software.

You will then need to go online each quarter to file your VAT return.

Depending on which software you are using, you may be able to file your VAT return directly from the software.

### 16.3.7 Filing deadlines

The deadline for submitting your VAT return online is usually one calendar month and 7 days after the end of a VAT accounting period.

To help you keep on top of the deadlines, you can go to your online account and tick to receive email reminders of your VAT return being due.


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## 16.3.8 Payment deadlines

All VAT payments must now be made electronically.

### *Direct debit*

Once you are registered to file your returns on-line, you can then also register to pay by direct debit. This method normally gives you an extra three days before any VAT payment due is taken from your bank account and the money will be taken from your account around the 10$^{th}$ or 12$^{th}$ of the month.

To pay by direct debit, log in on-line to your VAT account (once you have received your user ID and password) and you will see an option to set up payments by direct debit.

Please note that you need to do this well in advance of the return being due to enable HMRC to set up the direct debit in time. We would recommend doing this at least two weeks before filing your return on-line.

**Please also note that if you submit your VAT return after the due date, then HMRC will collect the direct debit payment on the third working day after the return is received, and this will give rise to a default surcharge issue.**

### *Other payment methods*

To see when you will need to make your payment using other electronic payment methods go to **https://www.gov.uk/vat-payment-deadlines**.

Electronic payments other than direct debits must be with HMRC one calendar month and 7 days after the end of a VAT accounting period.

Depending on the payment method, you will normally need to make payment by the 5$^{th}$ of the month to enable the payment to reach HMRC by 7$^{th}$ of the month.


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## 16.4 Surcharges and penalties

### 16.4.1 Surcharges

A late VAT Return or payment is known as a 'default'.

If you're turning over more than £150,000 then on the first occasion that you are late submitting a VAT return, or you pay the tax late on a return, then a default surcharge liability notice is generated. This means that VAT returns and payments need to be submitted on time for the next 12 months otherwise an escalating penalty takes effect, based on the unpaid tax liability by the due date.

If you're turning over less than £150,000 then on the first occasion you are late you'll get a polite letter reminding you that you are late. If you are late again within 12 months then you'll get a default surcharge liability notice and then the escalating penalties.

HM Revenue and Customs (HMRC) will write explaining any surcharges and what happens if you default again. Surcharges are a percentage of the tax paid late. HMRC estimate this if they don't have your return - this is known as an 'assessment'.

| Default | Surcharge if turnover is less than £150,000 | Surcharge period |
|---|---|---|
| 1st | No surcharge but if you default within 12 months you enter a surcharge period | None, but if you miss another VAT deadline within 12 months of the issue of a help letter you will formally enter the surcharge system. |
| 2nd | No surcharge but you enter a surcharge period | 12 months |
| 3rd | 2% (or no surcharge if it's less than £400) | 12 months from the date of the most recent default |
| 4th | 5% (or no surcharge if it's less than £400) | 12 months from the date of the most recent default |
| 5th | 10% or £30 (whichever is more) | 12 months from the date of the most recent default |
| 6th or more | 15% or £30 (whichever is more) | 12 months from the date of the most recent default |


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| Default | Surcharge if turnover is £150,000 or more | Surcharge period |
|---|---|---|
| 1st | No surcharge but you enter a surcharge period | 12 months |
| 2nd | 2% (or no surcharge if it's less than £400) | 12 months from the date of the most recent default |
| 3rd | 5% (or no surcharge if it's less than £400) | 12 months from the date of the most recent default |
| 4th | 10% or £30 (whichever is more) | 12 months from the date of the most recent default |
| 5th | 15% or £30 (whichever is more) | 12 months from the date of the most recent default |
| 6th or more | 15% or £30 (whichever is more) | 12 months from the date of the most recent default |

There's no surcharge if you submit a late VAT Return and you have no tax to pay or you're due a VAT repayment.

If you want to appeal a surcharge you need to write to:

Default surcharge review team
Crownhill Court
Tailyour hill
Crownhill Plymouth
PL6 5BZ

## 16.4.2 Penalties

HMRC can charge you a penalty (between 15% and 100% of the unpaid amount owed) if your VAT Return is inaccurate.

You can download a copy of HMRC's penalty document at **https://www.gov.uk/government/publications/compliance-checks-penalties-for-inaccuracies-in-returns-or-documents-ccfs7a**

You can be charged a penalty of up to £400 if you submit a paper VAT Return, unless HMRC have told you you're exempt.


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## 16.5 Charging VAT to Charities

As a VAT-registered business, you can sell certain goods and services to charities at the zero or reduced rate of VAT. It's your responsibility to check the charity is eligible, and to apply the correct rate.

Community amateur sports clubs (CASCs) don't qualify for VAT reliefs for charities.

To make sure the charity is eligible, ask them for:

- evidence that they're a charity
- a written declaration or 'certificate' confirming they meet the conditions for the particular VAT relief

The charity should give you either:

- their Charity Commission registration number
- a letter of recognition from HM Revenue and Customs (HMRC) if they're not registered with the Charity Commission for England and Wales (eg if they're a Scottish or Northern Irish charity)

Charities are legally required to give you an eligibility certificate when you supply eligible building or construction services to them at zero VAT. The certificate must contain specific information.

A declaration is not legally required for other items you sell at the zero or reduced rate, but you should ask for one to prove the charity is eligible for the relief. You must keep the completed declarations for at least 4 years.

You may be able to apply the reduced VAT rate when you sell fuel and power in certain circumstances to an eligible charity.

You may be able to apply zero VAT when you sell the following to an eligible charity:

- advertising and items for collecting donations
- aids for disabled people
- construction services
- drugs and chemicals
- equipment for making 'talking' books and newspapers
- lifeboats and associated equipment, including fuel
- medicine or ingredients for medicine
- resuscitation training models


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You may also be able to zero-rate some other medical and veterinary equipment when you sell it to:

- certain health bodies, eg NHS Trusts
- not-for-profit research institutions
- charities that provide institutional care, or medical or surgical treatment for chronically sick or disabled people
- charities that provide transport services for disabled people
- charities that provide rescue or first aid services to humans or animals
- someone buying it specifically for donation to one of these bodies

The money used to buy the equipment must be from charitable or donated funds. This should be stated on the eligibility declaration.

The eligible items include:

- medical, veterinary and scientific equipment
- ambulances
- goods for disabled people
- motor vehicles for medical use
- rescue equipment
- resuscitation training dummies


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# 16.6 VAT schemes

There are various VAT schemes which may be advantageous for you.

## 16.6.1 Cash accounting

### *Overview*

With the cash accounting VAT scheme, you only pay over VAT on outputs when your customer pays you and conversely, you only reclaim VAT on inputs when you pay for a supply.

This can be very advantageous from a cash flow perspective, especially if your debtors take longer to pay you than you take to pay your creditors.

### *Eligibility*

You can use the cash accounting scheme if your estimated VATable turnover for the next year is below £1.35million*. Your total VATable turnover includes everything which isn't VAT exempt.

Once you start using the cash accounting scheme you can continue until your turnover reaches £1.6million* or until you are no longer eligible to be in the scheme – see below for when you can't use cash accounting.

However, you must use standard VAT accounting for the following transactions:

- where the payment terms of a VAT invoice are 6 months or more
- where a VAT invoice is raised in advance
- buying or selling goods using lease purchase, hire purchase, conditional sale or credit sale
- importing goods from within the EU
- moving goods outside a customs warehouse

You can't use cash accounting if:

- you use the VAT Flat Rate Scheme - instead, the Flat Rate Scheme has its own cash-based turnover method
- you're not up to date with your VAT Returns or payments
- you've committed a VAT offence in the last 12 months - eg VAT evasion


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## *How to join and leave*

You join the scheme at the beginning of a VAT period and can start to use this scheme as soon as you register for VAT.

You do not have to tell HMRC that you are changing from standard VAT accounting to cash VAT accounting. However you do need to be very careful to make sure that you account for all your VAT correctly on outstanding sales and purchase invoices – otherwise you could end up accounting for VAT on these invoices twice.

You can leave the scheme at any time, but you must leave if you're no longer eligible to use it. You should leave at the end of a VAT accounting period.

You don't have to tell HMRC you've stopped using it, but you must pay HMRC any outstanding VAT (whether your customers have paid you or not). You can ask for an extra 6 months to pay this.

## *Return and payment deadlines*

Check your VAT Return and payment deadlines in your VAT online account.

Your VAT online account tells you:

- when your VAT Returns are due
- when the payment must clear HM Revenue and Customs' (HMRC) account

The deadline for submitting the return online and paying HMRC are usually the same - 1 calendar month and 7 days after the end of an accounting period. You need to allow time for the payment to reach HMRC's account.

VAT should be paid electronically – either direct debit or internet banking.

## *Advantages*

Cash accounting for VAT means you don't have to pay any VAT due to HMRC until your customers have paid you – but conversely you can't claim any VAT on supplier invoices until you have paid your suppliers.

This scheme will be better for you if you extend credit to your customers and your VAT supplies exceed your VAT purchases. However if you are in a business where customers pay straight away (eg a restaurant or shop) then you will need to standard account for VAT rather than cash account.


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# 16.6.2 Annual accounting

### *Overview*

Usually, VAT-registered businesses submit their VAT Returns and payments to HM Revenue and Customs 4 times a year.

With the Annual Accounting Scheme you:

- make advance VAT payments towards your VAT bill - based on your last return (or estimated if you're new to VAT)
- submit 1 VAT Return a year

When you submit your VAT Return you either:

- make a final payment - the difference between your advance payments and actual VAT bill
- apply for a refund - if you've overpaid your VAT bill

The scheme wouldn't suit your business if you regularly reclaim VAT because you'll only be able to get 1 refund a year (when you submit the VAT Return).

### *Eligibility*

You can join the Annual Accounting Scheme if:

- you're a VAT-registered business
- your estimated VAT taxable turnover is £1.35 million* or less in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- your business is part of a VAT registered division or group of companies
- you're not up to date with your VAT Returns or payments
- you're insolvent


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You must leave the scheme if:

- you're no longer eligible to be in it
- your VAT taxable turnover is (or is likely to be) more than £1.6 million* at the end of the annual accounting year

You can join the scheme when you register for VAT or at a later date.

## *How to join and leave*

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 AA and send it to the address on the form (or use VAT600 AA/FRS to apply for the Flat Rate Scheme at the same time)

Confirmation you've joined the scheme is sent to your VAT online account (or in the post if you don't apply online).

You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave. From this date, you must account for your VAT in the usual way.

HM Revenue and Customs
Annual Accounting Registration Unit
Imperial House
77 Victoria Street
Grimsby
DN31 1DB

You have to wait 12 months before you can re-join the scheme.


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### *Return and Payment deadlines*

There are 12 months in your accounting period. Your VAT return is due once a year, 2 months after the end of your accounting period.

You must make advance payments towards your VAT bill (either monthly or quarterly) during your accounting period and a final payment when you submit your VAT Return.

| Payment | Deadline |
|---|---|
| Monthly | Due at the end of months 4, 5, 6, 7, 8, 9, 10, 11 and 12 |
| Quarterly | Due at the end of months 4, 7 and 10 |
| Final payment | Within 2 months of month 12 |

### *How much to pay*

Each payment is either 10% of your estimated VAT bill (monthly payments) or 25% (quarterly payments). The amount is based on previous VAT returns (or estimated if you're new to VAT).

HMRC will write telling you when your instalments are due and how much they'll be.

The final payment (known as a 'balancing payment') is the difference between your advance payments and the actual VAT bill confirmed on your VAT Return.

You may be due a VAT refund if you've overpaid HMRC.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.

You also need to let HMRC know if your turnover is likely to be much higher or lower than the previous year or if your VAT payable is likely to increase by more than 10% since the last time your instalments were calculated.

### *Advantages*

This scheme cuts down on the amount of paperwork to be completed and also gives you two months at the end of the year to pay any underpayments rather than just one month.

However, the amounts paid are calculated based on your previous year's turnover and so if your turnover is decreasing you may end up paying more VAT during the year than necessary.


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## 16.6.3 Flat rate

### *Overview*

Usually, how much VAT a business pays or claims back from HM Revenue and Customs (HMRC) is the difference between the VAT they charge customers and pay on their purchases.

With the Flat Rate Scheme:

- you pay a fixed rate of VAT over to HMRC
- you keep the difference between what you charge your customers and pay over to HMRC
- you can't reclaim the VAT on your purchases - except for certain capital assets over £2,000

If you're a contractor or freelancer this can be particularly attractive.

**Example**

As an example, for IT Contractors the rate in the first year is just 13.5%** of the gross amount and 14.5%** in subsequent years (you receive a 1% discount in your first year).

** Rates correct as at June 2016 – for up to date rates go here.

So assuming Jo Bloggs, an IT contractor, charges £600 per day for a five day week and works 45 weeks a year, his VATable turnover will be £135,000 and his total turnover (including VAT of £27,000) will be £162,000.

Under the FRS he will pay over £162,000 * 13.5% = £21,870 – a saving of £5,130 (£27,000 less £21,870).

However, it's important to note that this is the **maximum** saving possible. If Jo had VATable expenses that he could have offset against the £27,000 output tax bill, then the saving would have been lower.

The flat rate scheme also has the advantage that you don't have to keep VAT invoices or account for any VAT on your expenses – although we would recommend keeping any receipts or invoices you are given for future reference.


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## *Eligibility*

You can join the Flat Rate Scheme if:

- you're a VAT-registered business
- you expect your VAT taxable turnover to be less than £150,000* (excluding VAT) in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- you committed a VAT offence in the last 12 months, e.g. VAT evasion
- you joined (or were eligible to join) a VAT group in the last 24 months
- you registered for VAT as a business division in the last 24 months
- your business is closely associated with another business
- you've joined a margin or capital goods VAT scheme

You can't use the scheme with the Cash Accounting Scheme. Instead, the Flat Rate Scheme has its own cash-based method for calculating the turnover.

You must leave the scheme if:

- you're no longer eligible to be in it
- on the anniversary of joining, your turnover in the last 12 months was more than £230,000* - or you expect it to be in the next 12 months
- you expect your total income in the next 30 days alone to be more than £230,000*

## *How to join and leave*

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 FRS and send it to the address on the form (or use VAT600 AA/FRS to apply for the Annual Accounting Scheme at the same time)
- send a pdf of the completed form to **frsapplications.vrs@hmrc.gsi.gov.uk**
- apply over the phone on 0300 200 3700

Confirmation you've joined the scheme is sent to your VAT online account (or in the post if you don't apply online).


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You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave.

HM Revenue and Customs
Imperial House
77 Victoria Street
Grimsby
Lincolnshire
DN31 1DB

You must wait 12 months before you can re-join the scheme.

HMRC will notify you in writing if your application is successful.

The letter will tell you the date you can start to use the scheme. This will normally be from the start of the VAT period following receipt of your application. If you request an earlier or later start date, HMRC will consider all the facts including the timing of your application and your compliance record. HMRC will not normally allow you to go back and use the scheme for periods for which you have already calculated your VAT liability.

## How much to pay

With the flat rate scheme you calculate your VAT payable based on a flat rate percentage of your VAT inclusive turnover.

To see the flat rate percentage which applies to your industry go to **https://www.gov.uk/vat-flat-rate-scheme/vat-flat-rates**

Alternatively HMRC show more detail at
**http://www.hmrc.gov.uk/manuals/frsmanual/frs7300.htm**

You will need to choose the rate most appropriate for your industry – HMRC will not be able to give you guidance as to which is the right rate. Make sure you note down your rationale for choosing a particular industry – you may need this if HMRC challenge your choice at a later date.

If it's your first year of being VAT registered, you will also get an additional 1% reduction in the rate which is applicable until the first anniversary of your being VAT registered.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.


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## *Advantages*

You will still need to raise VAT sales invoices and you will not be able to reclaim VAT on any purchases you make.  But this scheme could potentially simplify enormously your accounting for VAT and may save you significant amounts of money if you do not have many VATable supplies.

As an example, if you invoice £100k plus VAT of £20k and have expenses of £20k excluding VAT of £4k, then under standard VAT accounting you would pay over VAT of £16k (£20k less £4k).

If you assume that the flat rate for your industry is 10%, then you would pay over VAT of £12,000 (VAT inclusive turnover of £120,000 * 10%).

As well as the financial saving, you also won't need to worry as to whether you have the correct documentation for any VAT you are reclaiming.

The scheme also allows you to reclaim all input VAT on any capital purchases which individually cost you more than £2,000 including VAT.


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# 16.7 Overseas VAT

If you sell, supply or transfer goods out of the UK to someone in another country you may need to charge VAT on them.

Generally speaking, you do not need to charge VAT on supplies exported outside the European Union (EU), or sent to someone who's registered for VAT in another EU country.

If you sell goods or services to someone in another EU country, who isn't VAT registered, you charge VAT in the normal way. Sales to another country inside the EU are called 'dispatches' or 'removals'. 'Exports' describes sales to a country outside the EU.

The rules on selling goods and services abroad are complex.

If you have a specific query related to selling goods or services either inside or outside of the EU we recommend you contact a suitably qualified professional.


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## 16.8 Issues to be aware of

VAT is a complex subject and you need to be careful that your accounting for it correctly. The list below covers some of the common VAT pitfalls which you ought to be aware of – please note that this list is by no means exhaustive.

### 16.8.1 VAT on cars

Generally you can't reclaim the VAT on cars unless you buy a car purely for business use (e.g. a pool car or taxi) in which case you can reclaim the VAT in full. Similarly you can't reclaim the VAT on the car's accessories unless you can show that they have a business use.

VAT on vans is recoverable – however it isn't always easy to determine when a vehicle is a car or when it is a van!

If you lease a car for business purposes you can generally only reclaim 50% of the VAT. The only exceptions are as follows:

- There is no private usage of the vehicle in which case you can reclaim 100%.
- You are leasing a car for use in a chauffeur/taxi service business, a driving school or a self-drive car hire business – then you can reclaim 100% of the VAT in full.

VAT on repairs can be reclaimed in full as long as the vehicle has some business use and the invoices are in the company's name and paid by the company.

If you are VAT registered partnership or sole trader you may be able to reclaim some of the VAT incurred on car repairs/servicing provided you can demonstrate there has been some business use of the vehicle in question.


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### 16.8.2 VAT on fuel

You have four different options for reclaiming the VAT on fuel:

1. Reclaim 100% of the VAT – but all the fuel must have been used for business purposes.

2. Reclaim all of the VAT and pay VAT on the proportion of fuel not used for business. The fuel can be used for business and non-business purposes. The repayment is made by applying a 'fuel scale charge' to your quarterly tax return and paying this amount over to HMRC with any other VAT due.

3. Reclaim the business proportion of the VAT. You must keep detailed records of business and private mileage. You will also need to hold on to relevant petrol receipts. If you pay a mileage allowance for business miles travelled, you can reclaim the VAT on the fuel element of this allowance. The fuel only element must be similar to the HMRC guidelines for mileage payments for company cars.

4. Not reclaim any VAT. This can be useful if your mileage is low and/or you use the fuel for both business and non-business. As you are not claiming any VAT you do not need to keep detailed mileage records for VAT purposes (although you will still need these to claim business mileage in your accounts).

### 16.8.3 VAT on parking

Be careful with VAT for parking – multi-storey car parks include VAT at 20% but on-street parking meters and pay-and-display car parks are not subject to VAT!

### 16.8.4 VAT on staff business expenses

If you have to send your staff away on business, then you can claim the VAT element of any expenses they incur – but this must be on actual expenditure rather than any overnight allowance.


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## 16.8.5 VAT on business entertaining

Generally you cannot reclaim VAT on business entertainment expenses. The person being entertained may be an existing customer, a potential customer or any other person who is not an employee. The following are not employees for VAT business entertainment purposes:

- pensioners and former employees
- job applicants and interviewees
- non-employee shareholders

Business entertainment expenses include:

- food and drink
- accommodation - eg hotels
- theatre and concert tickets
- sporting events and facilities
- entry to clubs and nightclubs
- use of capital assets such as yachts and aircraft
- payments made to third party business entertainment organisers
- free samples
- business gifts
- when you provide entertainment or hospitality only for the directors or partners of your business (but it's worth noting that if all staff are included you can reclaim the VAT)

## 16.8.6 VAT on staff entertaining

Whilst VAT on business entertainment is not allowable, VAT on staff entertaining is.

But be careful when it comes to the Christmas party – you can reclaim the VAT relating to the function but be careful as there may be a restriction depending on the number of guests your staff brings.


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# 17 Tax Data

We set out below the main rates that apply to the current tax year - 2016/17:

## 17.1 Personal Income Tax Rates

These figures assume a basic personal allowance of £11,000

- £0 to £11,000 — 0% Tax payable
- £11,001 to £43,000 — 20% Tax payable
- £43,001 to £150,000 — 40% Tax payable
- £150,001 + — 45% Tax payable

Dividends

- Dividend allowance — £5,000 - 0% tax payable
- Basic rate taxpayers — 7.5% - tax payable
- Higher rate taxpayers — 32.5% - tax payable
- Additional rate taxpayers — 38.1% - tax payable

## 17.2 Corporation tax

For the Financial year to 31 March 2017 the rate of corporation tax is 20% of the company's taxable profits.

The corporation tax liability is due to be paid to HMRC within 9 months of the end of the accounting year.

Adjusted profits are accounting profits of the company, adjusted for disallowable costs and other HMRC allowances.

## 17.3 National Insurance

| | |
|---|---|
| Employer's National Insurance | 13.8% |
| Employment allowance (if relevant) | £3,000 per employer |
| | |
| Primary Earnings Threshold | £8,060 (this is usually the optimum salary level) |


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## 17.4 Student loan deductions

Currently there are two different types of student loans: Plan 1 and Plan 2

- If you lived in Scotland or Northern Ireland when you started your course, or you lived in England or Wales and started your course before 1 September 2012 then you have Plan 1.
- If you lived in England and Wales and started your course on or after 1 September 2012 then you have Plan 2.

You pay back 9% of your income over the minimum amount of:

- £17,495 for Plan 1
- £21,000 for Plan 2

Dividends from your company will count as earnings for student loan repayments so, if you are taking salary and dividends from your company that exceed the student loan thresholds, then you will have some student loan repayment to make via your personal tax return.


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