Your Essential Guide

to Business Tax

2022/23

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BUSINESS TAX

Starting a business

Starting a business is an exciting and challenging experience and one which also carries a fair degree of risk. You will need to make decisions that could be critical to the long-term success of the enterprise, such things as the type of business and its attributes; your target market and competition; profit potential and how you will extract those profits; the rate of business growth; and the impact of running the business on your personal life. At some point, you'll also need to consider how you will exit the business when the time comes.

Writing a business plan – One of the first things you need to consider is your business plan. This is not only for the benefit of potential investors but to help you stay on the right course in the short, medium and long-term. It should include: the business structure that best meets your needs; your intended funding sources; tax-efficient borrowings; whether a PAYE scheme is necessary; and whether the business should be VAT registered.

Choosing your business structure – Deciding on the most appropriate structure for your business isn't necessarily straightforward. Sole traders, partnerships, limited companies and limited liability partnerships all have their own pros and cons, with different implications for control, perception, support and costs. For example, careful consideration is needed regarding

personal ownership of any freehold property on incorporation.

Deciding on a year end – It's also important to choose a year end that suits your business. Is there a time of year when it will be more convenient to close off your accounting records, ready for us? What time of year would be best for stock-taking? Is your trading seasonal? Speak to us for advice about choosing your year end, especially with the forthcoming changes in connection with basis period reform.

Registering with HMRC – When you start a business, it is important to inform HMRC of your new self-employed status as soon as possible. If and when you take on employees you need to register for and set up a PAYE scheme and accept all the responsibilities and obligations that go with it, including compliance with Real Time Information reporting (and remember for this purpose you will most likely be an employee of your limited company, if you incorporate). You will also have to comply with the pensions auto-enrolment obligations, although exemptions apply to director-only companies, so do get in touch for advice in this area.

Claiming expenses

You will pay tax on your taxable profits, so a crucial element of tax planning is to claim all deductible expenses, many of which will be included in your accounting records.

If you are self-employed and carry on your business from home, you can claim tax relief on part of your household expenses, including insurance, repairs and utilities. You may also be able to claim for the cost of travel and accommodation when you are working away from your main place of business, so you should keep adequate business records, such as a log of business journeys. In addition to ensuring that your accounts are accurate, these records may also be requested by HMRC.

As part of Making Tax Digital for VAT, most taxpayers are required to use an appropriate computer package to aid concise and effective record-keeping and to enable them to meet their Making Tax Digital and VAT obligations. We can advise you on suitable software to meet your business needs.

You may also wish to consider the optional cash basis for calculating taxable income for small businesses, which allows eligible self-employed individuals and partnerships to calculate their profits on the basis of the cash that passes through their business. Businesses are eligible if they have annual receipts of up to £150,000 and they will be able to continue to use the cash basis until receipts reach £300,000. Allowable payments include most purchases of plant and machinery, when paid, rather than claiming capital allowances.

Unincorporated businesses are able to choose to deduct certain expenses on a flat rate basis. However, this is worth discussing before opting for it, as the flat rates are not generous.

Capital allowances

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

Annual Investment Allowance (AIA)

The majority of businesses are able to claim a 100% Annual Investment Allowance (AIA) on a portion of expenditure on most types of plant and machinery (except cars). The AIA applies to businesses of any size and most business structures, but there are provisions to prevent multiple claims.

The AIA temporarily is currently £1 million but will reduce to £200,000 from 1 April 2023. Businesses with accounting periods which straddle 1 April 2023 will need to calculate a hybrid allowance using the two rates. It is therefore important to time the purchase of plant and machinery carefully, in order to make the most of the increase.

Businesses are able to allocate their AIA in any way they wish, so it is quite acceptable for them to set their allowance against expenditure qualifying for a lower rate of allowances (such as integral features).

Plant and machinery – super-deduction

Between 1 April 2021 and 31 March 2023, companies investing in qualifying new plant and machinery benefit from first year capital allowances.

Under this measure a company is allowed to claim:

- a super-deduction providing allowances of 130% on most new plant and machinery investments that ordinarily qualify for 18% main rate writing down allowances
- a first year allowance of 50% on most new plant and machinery investments that ordinarily qualify for 6% special rate writing down allowances.

This relief is not available for unincorporated businesses.

Writing Down Allowance (WDA)

Any expenditure not covered by the AIA or super-deduction generally enters either the main rate pool or the special rate pool, attracting WDA at 18% and 6% respectively for 2022/23.

The special rate pool applies to higher emission cars, long-life assets and integral features of buildings, specifically:

- electrical systems (including lighting systems)
- hot and cold water systems
- space or water heating systems, powered systems of ventilation, air cooling or purification and any floor or ceiling comprised in such systems
- lifts, escalators and moving walkways
- external solar shading.

For most other plant and equipment, including some cars, the main rate applies.

A WDA of up to £1,000 may be claimed by businesses where the unrelieved expenditure in the main pool or the special rate pool is £1,000 or less.

Cars

The tax allowance on a car purchase depends on CO_2 emissions. Under current rules, purchases of new unused cars with zero emissions attract a 100% first year allowance. For cars purchased with CO_2 emissions up to 50g/km, the main rate of 18% applies. Cars with CO_2 emissions above 50g/km will be restricted to the special rate WDA of 6%.

For non-corporates, cars with a non-business use element are dealt with in single asset pools, so the correct private use adjustments can be made but the rate of WDA will be determined by the car's CO_2 emissions. Remember, cars do not qualify for the AIA or FYA.

Buildings

When a building is purchased for business use, it may be possible to claim capital allowances on plant elements contained therein, e.g. air conditioning, subject to certain conditions. A joint election may need to be made with the vendor. Please contact us for further details and advice prior to any purchase.

The Structures and Buildings Allowance is available on new, or the renovation of old, non-residential structures and buildings. Relief is available on eligible construction costs incurred on or after 29 October 2018, at an annual rate of 3% on a straight-line basis.

Research and Development (R&D) investment

Tax relief is available on R&D revenue expenditure incurred by companies at varying rates. The current rates of relief are as follows:

- for small and medium-sized (SME) companies paying corporation tax at 19%, the effective rate of tax relief is 43.7% (that is a tax deduction of 230% on the expenditure). For SMEs not in profit, the relief can be converted into a tax credit payment, effectively worth 33.35% of the expenditure although the payment is restricted to £20,000 plus three times the company's relevant expenditure on workers
- an 'above the line' credit exists for companies which do not qualify for the SME scheme. This is known as the R&D Expenditure Credit (RDEC) scheme and allows companies to claim a taxable credit of 13% for qualifying expenditure incurred on or after 1 April 2020. Generally, the credit is fully payable, net of tax, to companies with no corporation tax liability

Involving your family

You can employ family members in your business as long as it can be justified commercially. Family members can be remunerated with a salary and possibly with benefits such as a company car or medical insurance. You can also make payments into a registered pension scheme.

It is worth noting that HMRC may challenge excessive remuneration packages or profit shares for family members, so seek our advice first.

Unincorporated businesses

Business profits are charged to income tax and Class 2 and Class 4 national insurance contributions (NICs) on the current year basis. This means that the profits 'taxed' for each tax year (ending 5 April) are those earned in the accounting period ending in the tax year.

For example, in the case of a trader who draws up his accounts to 31 July each year, his profits for the year ended 31 July 2022 will normally be taxed in 2022/23 however the forthcoming basis period reform will see a change to a 'tax year basis' so that a business's profit or loss for a tax year is the profit or loss arising in the tax year itself, regardless of its accounting date.

Numerous 'fines' are administered for those who fail to comply with the rules and regulations set by government departments. We have already mentioned income tax but other possible 'traps' to avoid are:

- late VAT registration and late filing penalties
- late payment penalties and interest
- penalties for errors in returns
- penalties for late PAYE returns
- penalties for failing to operate a PAYE or sub-contractors scheme
- penalties for failing to comply with pensions auto-enrolment regulations.

In order to help you to steer clear of these pitfalls, we must receive all of the details for your accounts and Tax Returns in good time and be kept informed of any changes in your business, financial and personal circumstances.

Employment or self-employment?

There is no statutory definition of 'employment' or 'self-employment', so determining whether someone is employed or self-employed is not straightforward.

Instead, HMRC applies a series of 'tests' in order to ascertain whether someone is classified correctly. As large amounts of both tax and NICs can be at stake, HMRC often takes quite an aggressive line with regard to this issue and errors can be costly, so seeking advice that is tailored to your situation is essential. Please contact us for assistance in this matter.

Unpaid bills and unbilled work

Small businesses may opt into the cash basis and calculate their profits on the basis of the cash passing through the business. However, it is a feature of the tax system that other businesses (including all corporates) must include in their turnover for the year the value of incomplete work, of unpaid bills (debtors) and of work completed but not yet billed, all as at the end of the year.

We will need to discuss with you exactly what needs to be identified and the basis of valuation. Keeping an eye on debtors and unbilled work is very important to your cash flow.

Forming a limited company

Forming a limited company may be a consideration if the limitation of liability is important, but it should be noted that banks and other creditors often require personal guarantees from directors for company borrowings.

Profits in the company will be taxed at 19% but when paid out in the form of salaries, bonuses or dividends may be liable to top tax rates on the individual,

Funds retained by the company can be used to buy equipment or to provide for pensions – both of which can be eligible for tax relief. They could be used to fund dividends or capitalised and potentially taxed at 10% and/or 20% on a liquidation or sale.

Increasing your net income as an owner-director

As an example, consider how much you might pay if, as an owner-director, you wanted to extract £10,000 profit (pre-tax) from your company in 2022/23 by way of a dividend rather than a bonus. We have assumed in this scenario that the director has already taken salary in excess of the upper earnings limit for NICs, is a 40% taxpayer, and the £2,000 dividend tax allowance has already been utilised.

Case Study

As you can see in this case study, the net income is increased by 8% by opting to declare a dividend. Be sure to discuss this with us, as this is a complex area of tax law.

	Bonus £	**Dividend £**
Profit to extract	10,000	10,000
Employers' NICs (15.05% on gross bonus)	-1,308	
Gross bonus	8,692	
Corporation tax (19% - dividend is not deductible for corporation tax)		-1,900
Dividend		8,100
Employees' NICs (3.25% on gross bonus)	-282	
Income tax (40% on gross bonus)	-3,477	
Income tax on dividend (33.75%)		-2,734
Net amount extracted	4,933	5,366

For Scottish taxpayers paying the Scottish Higher Rate of 41%, the net amount extracted on the bonus would be reduced to £4,846 (£8,692 less tax @ 41%

and NICs of £282). The tax payable on dividends is the same wherever you are in the UK so the net income would be increased by 10%.

Remember that dividends are usually payable to all shareholders and are not earnings for pension contributions and certain other purposes. Finally, you need to consider with us the effect of regular dividend payments on the valuation of shares in your company.

National insurance contributions (NICs)

Leaving profits in the company may be tax-efficient, but you will of course need money to live on, so you should consider the best ways to extract profits from your business.

A salary will meet most of your needs, but you should not overlook the use of benefits, which could save income tax and could also result in a lower NIC liability.

Four key NIC points to consider:

1. Increasing the amount the employer contributes to company pension schemes. Care should be taken however as there are limits on the amount of pension contributions an individual can make both annually and over their lifetime.
2. Share incentive plans (shares bought out of pre-tax and pre-NIC income).
3. For some companies, disincorporation and instead operating as a sole trader or partnership may be beneficial.
4. Paying dividends instead of bonuses to owner-directors.

Planning for the year end

Tax and financial planning should be undertaken before the end of your business year, rather than left until the end of the tax or financial year. Some of the issues to consider include:

- the impact that accelerating expenditure into the current financial year, or deferring it into the next, might have on your tax position and financial results
- making additional pension contributions or reviewing your pension arrangements
- how you might take profits from your business at the smallest tax cost, and how the timing of payment of dividends and bonuses can reduce or defer tax.

Minimising the risk of late filing penalties

It is important to keep your personal tax affairs in order so that you avoid incurring any Tax Return late filing penalties.

The timetable for making tax payments is relatively straightforward for the self-employed:

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

A system of interest and penalties applies. For example, if any balance of tax or NICs due for 2021/22 is not paid within 30 days after 31 January 2023, further penalties may apply as HMRC will seek to charge a 5% late payment penalty as well as the interest that will be charged from 1 February 2023, with further 5% penalties chargeable on 31 July 2023 and 31 January 2024, plus interest on any outstanding liabilities.

If your business is incorporated, it will be liable to corporation tax. Corporation tax is usually payable nine months and one day after the end of the company's accounting period.

If there are cash flow issues, HMRC might be persuaded to accept a spreading of your next business tax payment – you will have to pay interest at the HMRC rate, but keep to the agreed schedule and late payment penalties will be waived. Arrangements need to be put in place before the due date for paying the tax, so talk to us in good time if you wish to apply.

Payments on account

Payments on account are normally equal to 50% of the previous year's net liability and are due on 31 January in the tax year and 31 July following the tax year.

A claim can be made to reduce your payments on account, if appropriate, although interest will be charged if your actual liability is more than the reduced amount paid on account. There is no equivalent mechanism to make increased payments on account when the year's tax will be higher, so you should ensure that you build a reserve of money to pay the balance of tax due.

Don't wait until it's too late if you have difficulties! Please tell us in good time about any issues facing your business, as we may be able to offer solutions.

Payments on account are not due where the relevant amount is less than £1,000 or if more than 80% of the total tax liability is met by income tax deducted at source. In these cases, the balance of tax due for the year, including capital gains tax, is payable on the 31 January following the end of the tax year.

Case Study

Peter is self-employed. His accounts are made up to 31 August each year. When we prepare the 2022 Return we will be including his profit for the year ended 31 August 2021, and that is the profit which will be taxed for 2021/22.

Peter's payments on account for 2022/23 will automatically be based on the 2021/22 liability.

Your next steps: contact us to discuss...

- **Starting up a new business**
- **The impact of the forthcoming change to the "tax year"basis**
- **Raising finance for your venture**
- **Timing capital and revenue expenditure**
- **Minimising employer and employee NIC costs**
- **Improving profitability and developing a plan for tax-efficient profit extraction**

We are here to help...

So please make good use of us! This guide is designed to help you identify some of the areas that could have a significant impact on your tax planning. Please consult us early for help in taking advantage of tax-saving opportunities. We will be delighted to assist you.

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