sakura

Nurturing Successful Businesses

# Frequently Asked Accounting Questions

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# What business expenses are allowed against income

Business expenses are the costs of running a business.

For a business expense to be allowable, it must have been incurred 'wholly and exclusively' through the process of either running the business or trying to attract additional business e.g. if your income was £30,000 last year, and you spent £5,000 on allowable expenses, then your business will only be taxed on profits of £25,000.

Expenses are either allowable (tax deductible) or non-allowable (non-tax deductible) business expenses e.g. a business may incur valid business-related expenses as part of running the business, but which are specifically not allowable, such as business entertainment etc.

To claim an expense as a business expense, then are a number of criteria that need to be met as follows:

> Only costs that are incurred 'wholly and exclusively' during the everyday running of your business are allowable.

> Expenses that have a dual purpose for business and personal use will not be deductible.

> Expenses must typically be paid through the business' bank account, with any business expenses paid personally, being deductible once the costs are reclaimed and later reimbursed.

> A record should be maintained as much as possible in respect of all business expenses, including VAT receipts, so that you can justify your actions if you're queried in the future.

# What business expenses are allowed against income

Examples of both allowable and non-allowable business expenses are as follows

## Allowable expenses

- Purchase costs of goods and/or services (for resale)
- Clothing expenses (for certain types of business)
- Staff wages and salaries (incl. temporary staff costs)
- Staff recruitment or other related costs
- Freelance staff costs
- Office rent and rates
- Light and heat costs
- Insurance costs
- Postage, stationery and printing costs
- Motor, van and travel expenses (including mileage)
- Staff entertainment costs
- Repairs and renewals
- IT and software costs
- Telephone and mobile phone costs
- Marketing and advertising costs
- Professional subscriptions
- Accountancy fees
- Legal fees
- Professional or consultancy fees
- Bank, credit card and other processing charges
- Interest on bank and other business loans, lease interest

The list of allowable expenses is very detailed, so you can see HMRC's on 'A to Z guide of allowable expenses' here: https://www.gov.uk/expenses-and-benefits-a-to-z

## Non-allowable expenses

- Client entertainment costs
- Legal fees (related to purchase of property or assets)
- Loan or lease repayments
- Penalties or fines
- Non-business expenses (personal business use of cars, office, or personal expenses).

# Sole trader / self employment vs limited company

When starting out in business, there are typically two routes taken by budding entrepreneurs e.g. via a Self employment or Sole trader status or using a limited company structure.

Being self employed or operating as a sole trader offers a great deal of freedom, as you can avoid the extra administrative burden and costs of setting up a limited company, but on the other hand there are no legal protections if something goes wrong, i.e. it is all on your own shoulders.

Where the business remains a relatively small undertaking with no need to take on staff and with a limited income, operating as a sole trader is usually preferable to a limited company.

Ultimately deciding on the right structure doesn't only depend on the size of your current business activities, but also on any longer term plans you may have for the development of the business including:

- Potential for new business partners.
- The type of clients or sector that you are operating in.
- Any exit (or retirement) plans your may have for the business.

# Self employment unlimited freedom + unlimited responsibility

Generally where the business remains a relatively small undertaking with no need to take on staff and with a limited income, operating as a sole trader is usually preferable to a limited company.

## Advantages

**More freedom, less admin:** It's simpler in terms of paperwork as there are less regulations and admin requirements in comparison with operating via a limited company.

**Saves money:** It is a less expensive option for a startup in terms of professional fees.

**Less deadlines:** There are less deadlines, legal and record keeping responsibilities to worry about.

**More Flexibility:** Being self employed can be a great way to "test" a business idea and prove that the business model involved works!

**Better Cashflow:** Income tax is paid to HMRC in tranches after the end of the tax year.

## Disadvantages

**Clients:** There may be a limit to how big a client you can attract as self employed.

**Income Tax:** You have less flexibility on managing your total tax liability in years of good trading.

# Limited company unlimited opportunity + limited responsibility

## Advantages

**Unlimited opportunities:** Many larger businesses prefer to work with limited companies compared to self employed businesses.

**Limited Liability:** If things don't go quite according to plan and your business fails, your financial liability is usually limited to your investment in the company itself.

**More pay:** Another key advantage is the opportunity to take home more earnings through the use of salary and dividends, which is not possible otherwise.

**Easier to borrow money or obtain funding:** Banks, investors and other funders are unlikely to provide funding to a business that is not operating as a limited company.

## Disadvantages

**Fees:** With the additional legal and tax compliance associated with a limited company, your accountancy fees will be higher.

**Admin:** You need to ensure that your personal and business transactions are kept entirely separate from each other to avoid confusion.

# When does a business need to register for VAT?

Value added tax (VAT) is a tax charged on most services and products which are provided by VAT- registered businesses in the UK.

All limited companies or sole trader businesses will generally find themselves incurring VAT from their first day of trading, where invoices and other costs are received from any VAT registered suppliers, even where the business itself is not registered for VAT. On this basis the VAT incurred on such invoices from its suppliers will just be additional cost to the business.

## Voluntary VAT registration

Outside of a business exceeding the VAT threshold and being required to register with HMRC for VAT purposes, there is an opportunity to register ‘voluntarily’.

## Compulsory VAT registration

A business will only be required to register for VAT purposes with HMRC where it’s sales activity (or turnover) exceeds (or is about to exceed within the next 30 days) a minimum threshold (£85,000 for 2019/20).

# What information is required on a VAT invoice?

Once a business has become registered for VAT, whether voluntarily or because activities have increased beyond the registration threshold, it is important that invoices provided to customers or clients contain the correct details.

Failure to do this may result in issues for your customers with HMRC in respect of reclaiming the VAT charged to them on your invoices, whether now or at some point in the future!

## What details or information MUST be included on a VAT invoice?

- A unique reference (or invoice) number
- Your name, address and contact information
- The Company name, address of your customer
- A clear description of the services or products that have been purchased
- The date that the services or products were provided (supply date)
- The date of the invoice (if different) and the amount(s) being charged
- The VAT amount
- The total amount to be paid

## Are there any specific details applicable to sole trader invoices?

- Your name and any business (or trading) name being used
- A specific business address where any legal/formal documents can be received

## Are there any specific details applicable limited company invoices?

- Your full company name as it appears on the Certificate of Incorporation
- Your company registered office should also be included, if it is different to the business address used
- The names of all the directors on the limited company are not required (but generally included on the bottom of the invoice)

Although most online accountancy software (Xero or QuickBooks) will provide most of the above information as standard on their invoice templates, there is certain information that will need to be proactively included from the settings options to ensure all information is included accurately.

# Once registered for VAT, what are my responsibilities?

Once registered for VAT, there will be a number of additional responsibilities that the business needs to be compliant with, including the following:

You must charge VAT on all invoices from the date of registration to your customers (ignoring non-UK and other specific issues).

You must always reflect your VAT registration number on all invoices (in order to be able to include VAT on that invoice).

You have the responsibility for ensuring that you are charging the right amount of VAT on each sales invoice.

You must prepare and submit VAT returns to HMRC on a quarterly basis.

You must pay any VAT due to HMRC within the required payment deadlines.

You are required to keep adequate VAT records and a VAT account e.g. copies of sales invoice, supplier invoices, receipts and bank statements.

## Key reasons why a business might register for VAT before they are required to register:

**If the amounts of VAT being incurred on business costs are high** anyway, then it may be financially beneficial to register and be able to reclaim this VAT e.g. investment in a website or online platform, significant amount(s) of marketing spend in the early stages of business etc.

From a marketing perspective, **being VAT-registered may be an important consideration to customers** and potential business partners e.g. it makes you look larger (non-VAT registered businesses are below turnover of £85,000).

**Where the majority of your customers are already VAT registered** then whether you charge VAT or not on your goods or services to them may not be a concern (and you can reclaim input VAT from Day 1).

# Can I claim motor expenses as a tax deductible business expense (mileage claims)?

## What are mileage expenses?

Mileage expenses are expenses that a business may pay an employee (or director) for using their own vehicle for business purposes, **and which are fully tax deductible for the business itself.**

HMRC allow businesses to pay employees up to an amount (the ‘approved amount or rate’) per mile where there is use of their own motor vehicle, van, motor cycles and even bicycle.

**However the key issue is that these approved rates apply to business related journeys only!**

## What costs do mileage expenses cover?

The mileage expense rates have been calculated by HMRC to ensure that they cover an appropriate element of the various motoring costs that are being incurred personally by the employee (or director) (for their motor vehicle, van, motor cycle etc.) e.g.

- Fuel, servicing and/or MOT costs,
- Motor repairs
- Insurance
- Depreciation of the vehicle

## What costs do mileage expenses NOT cover?

The mileage expense rates do not cover other incidental costs associated with motor travel, which are generally reimbursed separately outside of the mileage rate (when related to the specific business journey) e.g.

- Motorway tolls
- Parking fees
- Congestion charges

## Are these payments 'tax free' to the employee or director?

Where an employee is paid at or below, the approved amount i.e. rate per mile, then these amounts can be paid out by the business without any requirement to report them to HMRC, or for the employee to pay any tax.

Generally there is no practical reason why a business should reimburse rates of mileage that are higher than HMRC's approved rates, but where a business does this then there are a number of consequences e.g. an annual P11d form will need to be prepared by the business for each employee receiving these (higher) mileage payments and the amounts (above the approved rates) will be taxable on each employee (in their Self Assessment tax return).

## What counts as a business journey?

The two tests that HMRC uses to assess this are as follows:

You are unable to carry out your job unless you make this trip, e.g. a courier.

You have to be somewhere other than your usual place of work, in order to carry out your duties, for example, you usually work in a particular office, but you need to go to another location to meet clients, staff, suppliers or to a temporary work location

Please also note that a business journey is generally NOT a journey from an employee (or director's) home location to the normal office location e.g. home to work commuting.

## HMRC approved mileage rates

An example of the approved amount(s) are set out below, and are calculated based upon specific thresholds of the number of miles/kms actually travelled on relevant business journeys annually.

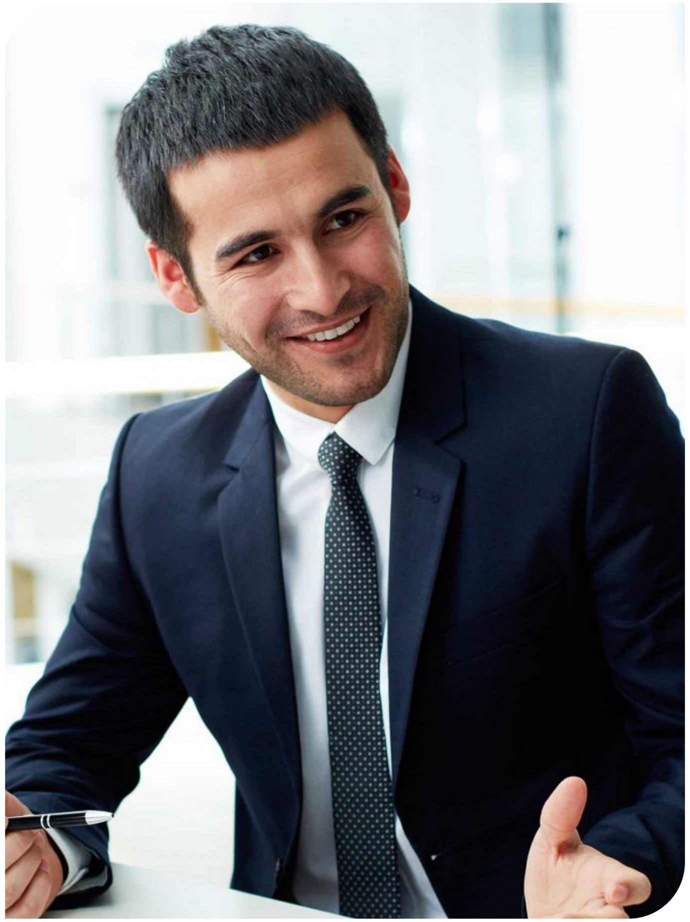
| Vehicle Type | First 10,000 miles | After 10,000 miles |
|---|---|---|
| Cars / Van | 45p | 25p |
| Motorcycles | 24p | 24p |
| Bikes | 20p | 20p |

# How do I register with HMRC when I become self employed or start as a sole trader business?

When you become self employed or start a sole trader business, you are required to officially register with HMRC.

This will ensure that you receive a Self Assessment tax return at the end of the tax year to enable you to report (and pay the appropriate taxes) on your business activities.

The registration process is fairly straightforward, and can either be done by completing the relevant form(s) and submitting them to HMRC by post, or more simply online.



## How to register with HMRC?

To register by post, then complete the form **'Register if you're a Self Employed sole trader'** (CWF1) with all of the requested information and then send it to HMRC.

To do this online, then you will need to go to HMRC's website (see https://www.gov.uk/log-in-file-self-assessment-tax-return/register-if-youre-self-employed and ensure that you have all of the following information available:

- Name
- Address
- National insurance number
- Date of birth
- Telephone number
- Email address
- The nature of your business
- Start date of self-employment
- Business address
- Business telephone number
- Your Unique Tax Reference (UTR) (Only if you've been within self-assessment previously)
- Full name and date of birth of any business partners

## What are the key dates for my diary?

Deadline for registering for Self employment e.g. 5th October post the end of the first tax year when you started your business

End of the tax year e.g. 5th April each year (6th April to 5th April)

Income tax payments on account required to be paid to HMRC e.g. 31st July and 31st January after the end of the tax year

Deadline for Self Assessment tax return submission to HMRC e.g. by 31st January after the end of the tax year

# What is the best way to take remuneration or earnings from my limited company?

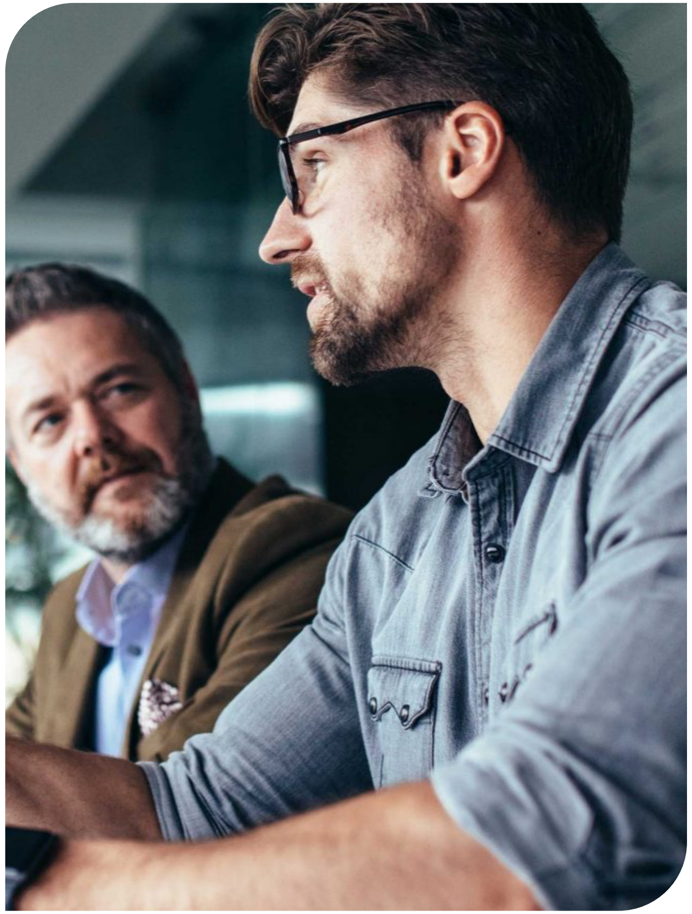
For a limited company where the owners are both the directors and shareholders, the most common way of taking remuneration (or earnings) is via a combination of both payroll and dividends.

Each director will obviously need to become an employee of the limited company to be able to follow this structure (although generally they will be able to 'opt out' of the statutory pension requirements).

Typically each individual takes remuneration as follows:

> a basic salary that uses up their annual tax-free allowance for that tax year.

> voting of dividends, which in the first instance will use up the available dividend tax free allowance, and thereafter up to an amount that enables them to maintain their lifestyle (but in many cases aim to keep the individual within the basic rate threshold, where possible).



# What is the best way to take remuneration or earnings from my limited company?

## Advantages

**A combination of both payroll and dividends** will be a more tax efficient means of taking remuneration than via payroll alone

**Dividends are specifically taxable at a lower tax rate** than other income types , the basic, higher and additional tax thresholds

**The use of dividends as income** for director/shareholders, enables funds which have been paid out as a short-term loan to be repaid.

## Disadvantages

The limited company must have an **Employer scheme registration** to have employees

The director/shareholder **must be registered as an employee** to obtain a salary

**The limited company must be profitable** in order to be able to legally issue dividends to its shareholders

Where there is more than one shareholder in the limited company, then **all shareholders must receive a dividend in proportion to their shareholding** (unless there are different classes of shares in use).

There are some other means of taking 'remuneration' from a limited company which are marginally advantageous, but these are not as useful as salary and dividends and/or bring additional administration or reporting to HMRC in order to utilise e.g. company paying for expenses on behalf of the directors /shareholder, mileage and use of home for business purposes etc.

# What are my key legal duties and responsibilities as a company director?

Where you take on the role as director of your limited company, it is important to remember that a company director is responsible for complying with the rules and regulations set out under the Companies Act 2006.

Most duties and responsibilities can be complied with on both occasions through a combination of acting in a professional and 'common sense' way, but it is useful to be aware of what the key issues are.

A director can also be a shareholder in a limited at the same time, however in broad terms the directors manage the day to day operations and take all necessary decisions, whereas a shareholder owns the business, but only periodically confirms confidence in the directors actions and/or confirms certain specific (key) actions of the company.

## Duties and responsibilities of a company director:

**Duty to act within powers**

A director should comply with the company's rules of behavior and activity in their decision-making and activities with shareholders. Directors are also required to exercise their powers only for the reasons for which they were given those powers.

**Duty to promote the success of the company**

All decisions made by the director, should be made with the long-term interests of the company, the shareholders, the employees, the suppliers, the general community and creditors in mind.

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**Duty to exercise reasonable skill, care and diligence**
A director must be diligent, careful and well-informed about the company's affairs in order to carry-out the functions of that office and to know / understand what is going on within the company.

**Duty to avoid conflicts of interest between the Director and the Company**
A company director must avoid a situation in which they have, or could have, an interest that conflicts, with the interests of the company.

**Duty not to accept benefits from third parties**
Directors must not accept any ‘gifts’ from third-parties, including money (bribes), corporate hospitality (tickets for trips, shows or events) or any other items of value which have been offered, because of the fact that you are a director, or in return for a business ‘favour’.

**Duty to declare interest in proposed transaction or arrangement**
A director must disclose their interest in a deal or project to the Board of Directors before the transaction has occurred, so that the deal or project in question, can be approved or not, by the other directors.

**Duty to ensure that the company’s legal responsibilities are complied with**
As a company generally acts through it’s board of directors, the directors are responsible for ensuring that the company itself complies with all other aspects of company legislation e.g. maintain full and accurate accounting records, make relevant filings at Companies House (changes in registered address, shareholders etc.).

## Breaches of directors duties

Where a director breaches any of the duties above, it is the company and shareholders that are usually the ones to take action against them. In certain circumstances, the consequences can be very serious, with the company, its creditors, or shareholders having the right to pursue them on a personal level for any loss.

If the result is a company director being pursued through the courts, this could lead to material damages or compensation for financial losses and/or criminal fines.

# Key accounting terms

## Customer
Someone to whom you have sent a (sales) invoice for your goods or services.

## Debtor
A customer to whom you have sent out a (sales) invoice and which currently remains unpaid or outstanding in Xero/QuickBooks.

## Supplier
Someone from whom you have bought goods or services and have (should have) received an invoice from.

## Creditor
Someone from whom you have (should have) received an invoice from, but which remains unpaid in Xero/QuickBooks.

## Expenses vs invoices
an expense is an ‘out of pocket’ minor cost that is paid by debit card/personally, is generally non VATable and doesn’t generate a formal invoice’. An invoice is a formal document received from a VATable supplier for a larger business cost, and generally paid within credit terms (14/30 days), or sometimes by credit card.

## Reconciliation (bank, PayPal etc.)
this is where all the transactions in a bank (or similar) account have been (accurately) input into Xero/QuickBooks and the balance on the account in Xero/QuickBooks matches that of the bank statement.

## Directors loan
this is where monies are taken from a company bank account to, or for the benefit of, that director, and these monies are not specifically for the payment of salary or dividends.

## Profit & loss
this is the key financial report that reflects all of the ‘day to day’ business income and costs that have been input into Xero/QuickBooks for the month/quarter/year to date, and indicates whether the business is making a profit or loss.

## Making tax digital
this is HMRC’s ongoing project, which will progress from VAT returns (which it covers now) through to all business and personal taxes, and which will compulsorily require all companys’ and individuals’ information to be linked with and/or submitted directly to HMRC via accountancy software (such as Xero/QuickBooks).

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