General taxation

1. Different taxes

1.1 A self-employed person, or any employee of a business, pays income tax (see 3 and 4).

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

1.3 National Insurance is a form of taxation paid by both employers and individuals (see 13).

1.4 Value added tax (VAT) is a tax on 'supplies' (usually sales) of goods and services.

1.5 Capital gains tax may be payable when you sell certain assets for more than you paid for them (see 14).

1.6 Inheritance tax may be payable if you die leaving assets worth over £325,000. This personal tax is not covered in this briefing.

1.7 Stamp duty land tax (SDLT) is charged on transfers of land and property. The rates are based on the value of the property being transferred and differ for residential and commercial properties.

1.8 Stamp duty at 0.5% is charged on share transfers above £1,000.

2. Are you self-employed?

A self-employed person can enjoy significant tax and National Insurance advantages over a company employee (see 4 and 13).

2.1 You are self-employed if you are your own boss and trade as a sole trader or as a partnership.

- If you trade as a limited company, you, as a shareholding director, are an employee of the company. You are not classed as self-employed.

2.2 Some people who work full-time for a single company call themselves consultants, or contractors, and claim to be self-employed. A tax inspector is unlikely to treat you as self-employed unless you can show features such as you:

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

3. Income tax

3.1 There are currently three income tax bands (for the income tax year starting 6 April 2017):

taxable income (£)	tax rate
1–33,500	20%
33,501–150,000	40%
Over 150,000	45%

Your taxable income is reduced by allowances (see 11).

There are complex new rules for tax payable on dividend income and savings income. Please contact us if you require further information.

3.2 If you are a company employee, you pay income tax every time you are paid. This is called PAYE — Pay As You Earn.

- The tax year runs from 6 April to 5 April.

Any overpayment or underpayment of tax is corrected after you complete your tax return at the end of the tax year.

4. Tax for the self-employed

4.1 The self-employed pay tax on the profits they make — not on their drawings. For example, if you make £30,000 profit, you pay income tax on the full £30,000 — even if you have drawn only £10,000 as salary and have retained the other £20,000 in the business.

- Profit is revenue less allowable expenses, excluding your salary. The expenses which are allowable are covered in 6 to 10.
- The same tax bands apply as for employees.

4.2 You usually pay tax on the profit of a 12-month accounting period. You pay tax on the profit for the accounting period which ends in that tax year.

- Tax is due in two equal instalments, on 31 January (during the tax year) and on 31 July after the end of that tax year.
- The interim amounts payable are based on the previous year's tax liability. If profits are falling, it is possible to reduce the payments.
- A balancing payment is then due on the following 31 January to adjust for the difference between the amounts paid and the tax due as a result of the actual profits.

4.3 A new business can initially be taxed twice on some of the first year's profits, depending on its choice of accounting period.

- 'Overlap relief' may be available to correct the position, but the calculations are complex and there will always be a cashflow cost to the business.

4.4 Skilful tax planning can ensure that the self-employed pay their income tax much later than company employees.

- Take the example of a self-employed person with an accounting period which ends on 30 June 2017. This person will pay tax on those profits in part on 31 January 2018 and 31 July 2018 (based on prior year tax liability), and then make a final payment on 31 January 2019, based on actual profits.

5. Corporation tax

Corporation tax is payable on the profit — sales less allowable expenses, plus investment income and chargeable gains (see 14) — of a limited company. Expenses are covered in 6 to 8.

5.1 The corporation tax rate for 2017/18 is 19% of the company's taxable profits.

5.2 Companies have to calculate their own corporation tax liability. Set out the payment structure.

- Companies with profits over £1.5 million pay corporation tax by quarterly instalments.
- Interest is charged on underpayments.
- The tax return can be filed later – normally up to 12 months after the accounting year end. It must be accompanied by accounts. Late returns incur automatic penalties.

5.3 Small to medium-sized companies (with profits up to £1.5 million) continue to pay corporation tax nine months after the company's accounting year end.

6. Expenses

You need to be clear about what expenses are allowable when working out your profit figure. Business costs are allowable, personal ones are not. Allowable expenses include:

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

- The allowable expense will be affected by the value you place on stocks at the year end. A common mistake is to value stock at its selling price, rather than cost. This inflates your profit figure and increases your tax bill.

6.2 Directors' and employees' wages, pensions, and employers' National Insurance contributions (see 13).

6.3 Premises costs, such as rent, rates and heating.

- If you work from home, you can usually count a fair proportion of your gas, electricity, water, telephone and council tax charges to be counted as business expenses.

6.4 Selling costs, including marketing and advertising expenses.

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

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

6.7 Spending on research and development.

- You can claim R&D tax credits on qualifying spending at 230%. This means you can set £230 off against your profits, for every £100 you spend.
- Only limited companies can claim R&D tax credits.
- R&D tax credits apply to the costs of staff and consumable stores used in your R&D efforts, plus expenditure on software, power, fuel and water.
- Companies not yet in profit (or not yet trading) can claim cash payments instead.

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

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

- If you are registered, VAT is reclaimed separately.

In addition to allowable expenses, you can claim allowances to reflect the investments you have made in plant and machinery (see 8).

7. Handle with care

Some expenses just do not count. They cannot be deducted when calculating your profit figure, even though they may seem like perfectly necessary and legitimate business costs.

7.1 Personal expenses — including living expenses, ordinary clothes, and travel to and from your regular place of work.

7.2 Entertaining — including any food or drink bought for clients.

7.3 Certain professional fees — including the costs of forming a company and the costs of obtaining a lease.

7.4 Depreciation — instead, you claim capital allowances (see 8).

7.5 Fines — including parking tickets.

All of these can cause problems for start-up businesses that do not take professional advice.

8. Capital allowances

When working out your profits, you cannot count the cost of purchasing premises and equipment as an expense. This is often an important consideration for start-up businesses. Instead you claim a capital allowance, which is then deducted from your profits, like an allowable expense. This applies to both limited companies and the self-employed.

8.1 Most capital allowances are spread over a number of years, and often gradually reduce.

- Plant and machinery is the main category and the allowance is a fixed percentage of the item's value (written down for tax purposes) at the end of each year, and the value is reduced each year by the previous year's tax allowance.

Note that however many years' allowances are claimed for, you will not recover 100% of the cost of any item.

8.2 Capital allowances range from 0% to 100%, depending on who you are and what you are purchasing.

- There are 100% allowances for energy saving and environmentally beneficial equipment. Loss making businesses can surrender losses attributable to expenditure on such equipment in exchange for tax credit from the Government.
- There are also 100% capital allowances for businesses purchasing low-emission cars (emitting up to 75g/km of carbon dioxide) and electric cars.
- The Annual Investment Allowance allows businesses to claim 100% capital allowances on the first £200,000 (£500,000 up to 31 December 2015) of investment on plant and machinery (excluding cars). Expenditure over the £200,000 limit will be dealt with under the main or special rate pools (see below). The Annual Investment Allowance is open to all businesses, not just small and medium-sized businesses.
- The 'special rate' pool gives 8% capital allowances on integral features of buildings, thermal insulation and long-life assets.
- The allowance for qualifying industrial buildings and hotels is 3%.

8.3 To make life simple, all equipment subject to the main rate is generally lumped together in a 'pool', and capital allowances are calculated at 18% of the total value.

8.4 Assets which have a useful life of four years or less are called 'short life assets' and may qualify for accelerated capital allowances on disposal, depending on the circumstances.

8.5 New expenditure on company cars qualifies for capital allowances. The rate will depend on the car's CO2 emissions.

- Cars emitting more than 130g/km are allocated to the 'special rate' pool.
- Cars emitting less than 130g/km are allocated to the main rate pool.
- Low emission cars (less than 75g/km) and electric cars qualify for 100% capital allowances.

8.6 You can choose to defer capital allowances. For example, if you make a trading loss and have no tax to pay, you can defer the tax benefit you would have had until a later year.

8.7 Repairs to machinery and equipment are fully tax-deductible. Only improvements to equipment count as capital expenditure.

8.8 If you are not registered for VAT, you can also claim capital allowances on the VAT that is charged on the equipment you buy.

8.9 Time your purchases so that you buy any equipment you need before your year end.

- If you make a purchase the day before your year end, you still receive the full capital allowance for the whole of that accounting period.

9. Cars and tax

9.1 If you are a self-employed person using your own car for work, you must keep a record of business miles travelled.

- Whenever your car is serviced, make sure the mileage reading is noted on the bill. This will enable you to work out the car's total mileage for the year — and provide evidence to satisfy the tax inspector.

- You must estimate what percentage of the mileage was for business purposes. For example, if the business mileage is 75% of the total, you can claim 75% of your car costs (petrol, insurance, repairs) as business expenses. You can also claim 75% of the capital allowance which you would have had if the car had only been used for business (see 8.2).
- Alternatively, you may be able to claim an allowance in line with the HM Revenue & Customs Approved Mileage Allowance Payments (see 9.2).

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

- If mileage allowances are paid in line with the HM Revenue & Customs Approved Mileage Allowance Payments (AMAP), there is no extra liability. If they are greater than AMAP, the difference is taxable.
- AMAP for all cars (and vans) are 45p a mile for the first 10,000 miles, and 25p a mile thereafter.

9.3 An employee using a company car for private use pays income tax on this 'benefit'. The employer also has to pay National Insurance on it, as if the benefit were paid out as salary.

- Calculation of the benefit is based on the list price of the car and its carbon dioxide emissions.
- The list price percentage for electric cars and vans is 0%, meaning that no income tax will need to be paid on the benefit.
- If fuel is provided for private use, this is also subject to tax and employer's National Insurance as a benefit, based on a fuel charge.

10. Pre-trading expenses

By the time you actually start trading, you may have spent thousands of pounds on research and setting up the business. Provided you have formally notified HM Revenue & Customs that you have started up a business, most of these costs are usually allowable as business expenses in the first year.

10.1 From the moment you decide to go into business, start keeping a record (with matching receipts, invoices and bank statements) of all your business expenditure.

- Set up a separate bank account to make this easier.

10.2 Some costs are not allowable.

- For example, training courses are only an allowable expense once you have officially commenced trading.

10.3 If you form a limited company, the formation costs incurred will not be allowable.

11. Non-taxable income

Below are the main types of allowances and non-taxable income.

11.1 Individuals receive a basic personal allowance of £11,500 for the tax year 2017/18.

- If your husband, wife or civil partner has no other income, it makes sense from a tax point of view to employ her or him with a salary of at least £11,500. The employment must be a genuine job and the salary must be physically paid over to the employee.
- If you are in paid work (including work as a self-employed person) you may qualify for Working Tax Credit.

- The basic personal allowance is only available to those earning less than £100,000. Where income is more than £100,000, the amount of the allowance is reduced by £1 for every £2 earned above the limit.

11.2 There is a Child Tax Credit available if you are supporting a child below the age of 16. It is paid at a higher rate for a child under the age of one, or a child with disabilities.

11.3 Redundancy payments below £30,000 may be tax free. Check your situation in advance.

11.4 Certain social security benefits may be tax free, depending on circumstances.

- These include maternity and child benefits, family credit and the mobility component of disability living allowance.

11.5 Directors and partners (but not sole traders) can claim interest relief on money which they borrow personally and then lend to the business.

12. Losses

12.1 A limited company can offset its trading losses against all other income in the accounting period.

- Alternatively, the loss can be 'carried forward' against profits from the same trade, to reduce future tax bills, or 'carried back' and offset against profits from the previous year. The company can be reimbursed for tax already paid.

12.2 A self-employed person can also offset trading losses against any other income received (earnings from a job, revenue from investments), plus any capital gains arising in that year.

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

13. National Insurance

13.1 The self-employed pay much less National Insurance than company employees, in return for substantially fewer benefits.

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

- Employees earning less than £157 a week are exempt.
- Contracted-in employees pay 12% on weekly earnings of between £157 and £866, plus an additional 2% on weekly earnings over £866.
- Contracted-out employees pay 13.8%.

13.3 Employers pay an 'employer's contribution' on pay and the taxable value of any car and fuel benefit. This is charged at 13.8% for contracted-in employees on earnings over £157 a week.

- Employers pay nothing for employees earning less than £157 a week. The employer's contribution is an allowable expense (see 6.2).

From April 2016, most employers will benefit from a £3,000 Employer Allowance which can be offset against their NIC payments.

13.4 A self-employed person currently pays:

- Class 2 contributions of £2.85 a week. The National Insurance Contributions Office collects this. Someone earning less than £6,025 a year (excluding any start-up grants) can apply to be exempted from Class 2 contributions. Ask for form CF10.
- Class 4 contributions of 9% on profits of between £8,164 and £45,000 plus an additional 2% on annual profits over £45,000.

If, as well as working as a self-employed person, you also have a job working for an employer, you will still be paying Class 1 contributions. In this situation, you can apply to defer payment of the Class 2 and Class 4 contributions.

14. Capital gains

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

14.1 Higher-rate income tax payers are liable to pay CGT at 20% (28% for residential properties). For those paying the lower income tax rate, CGT is charged at a flat rate of 10% (18% for residential properties.

- Capital gains are added to any other income.
- The first £11,300 of capital gain each year is tax free. A husband and wife can each claim this allowance.
- CGT is payable on 31 January following the end of the tax year in which the gain is made.

14.2 Limited companies pay corporation tax on any capital gain.

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

14.3 The self-employed, like other individuals, pay CGT at a flat rate of either 10% or 20%, depending on income tax paid.

14.4 CGT exemptions include your gains in ISAs and increases in the value of your principal private residence and private cars.

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

14.5 Capital losses can be set against capital gains from the same tax year and can then be carried forward against future capital gains.

14.6 Individuals can claim entrepreneur's relief on the first £10 million of gains made on the sale of a business or its assets.

- The relief reduces the rate of CGT on gains up to £10 million.

- Claims can be made on more than one occasion up to the £10 million lifetime limit.
- Gains over £10 million are charged at the usual CGT rate.

14.7 Payment of some CGT can be deferred.

- You can get 'rollover relief' if you sell a building from which you trade (or certain other types of asset), and use the money to buy another such building (or asset).
- You can get 'reinvestment relief' if you reinvest the gain in qualifying shares in certain types of companies under the Enterprise Investment Scheme and the SEED Enterprise Investment Scheme.

15. Paying less tax

Here are some commonly-used ways of paying less tax.

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

- This may be advantageous, because a self-employed person can offset the tax loss against previous years' employment income and receive a tax rebate (see 12). The business can still be incorporated later.
- Being self-employed has other important implications, though, including unlimited liability.

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

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

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

15.3 Gains made through the disposal of an asset receive 50% income tax relief and a CGT exemption when those gains are reinvested in new, small companies under the SEED Enterprise Investment Scheme. There is an investment cap of £100,000.

Do not get carried away. Tax is just one consideration when making business decisions. For example, putting money into a pension scheme to save tax is unwise if the cash is really needed to run the business.

16. Other tax opportunities

16.1 An ordinary employee given a low interest loan by the company receives a benefit, which is normally taxable as income.

- However, for loans up to £10,000, there is no tax payable.

16.2 No tax is payable on long-service awards up to a specified value.

- The value can be up to £50 for each year of service.
- To qualify the employee must have served for 20 years.

16.3 Annual staff parties (or similar celebrations) paid for by the employer are tax free up to a specified limit.

- The cost must not be more than £150 per head a year.

16.4 Employees who receive shares under a tax-favoured share scheme are not taxed until they sell the shares.

- Where employers offer Share Incentive Plans (SIPs), employees can use up to £1,500 of salary each year, free of tax and NI, to buy shares. Employers can give up to two 'matching shares' free (also free of tax and NI) to match each share bought by the employee. After five years, the shares can be sold free of income tax and NI. They will be revalued for CGT purposes.

16.5 Employees adopting the 'employee shareholder' status who purchase company shares will be exempt from CGT on gains up to £50,000 under the Employee Shareholder scheme.

- The first £2,000 of shares will also be exempt from NICs and income tax.

This will apply to shares received through adoption of 'employee shareholder' status on or after 1 September 2013.

17. The 2016/17 tax year

The information in the earlier part of this briefing applies to the current tax year. The main changes from the previous year are highlighted below.

17.1 Income tax (see 4). The three income tax bands and rates for the tax year to 5 April 2017 were:

Taxable income (£)	Tax rate
1–32,000	20%
32,001–150,000	40%
Over 150,000	45%

17.2 The corporation tax rate was 20%.

17.3 The personal allowance (see 11) was £11,000.

17.4 National Insurance (see 13).

- Employees earning less than £155 a week were exempt. Other employees paid 12% (10.4% if contracted-out) on any extra, up to £815 a week with an additional 2% above that amount.
- The employer's contribution was 12.8% on earnings above £156 a week (less if contracted out).
- The self-employed paid £2.80 a week in Class 2 contributions.
- Class 4 contributions were charged at 9% on profits between £8,061 and £43,000 plus an additional 2% on profits over £43,000.
- The earnings limit for exemption from Class 2 contributions was £5,965.

17.5 Capital gains tax (see 14).

- The annual exemption for individuals was £11,100.