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Special Report …

"How To Pay Less TAX – A Mini Guide For One Man Sole Traders Only"

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Contents

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Section 1

How To Pay Less Tax And Using Tax Planning For A One Man Sole Trader

Attitude towards tax planning is what matters – read this even if you read nothing else

Hello

And welcome to **Tax Planning For A One Man Sole Trader.** This Special Report is more than just an introduction to tax planning. It gives you lots of ideas you can start **implementing almost immediately** after speaking to your accountant.

Apologies for the use of the word "Man". The report is equally applicable to One Woman Sole Traders.

This report is specifically tailored to **small sole traders who work by themselves, have no employees and are not VAT registered**. Unless mentioned otherwise, every strategy suggested has been used successfully in practice by many sole traders time and time again. Some ideas have to be updated or even removed as legislation changes but at the time of writing, they are 100% **proven** methods that work today.

Why This Report Has Been Created For You

- ☐This report **focuses on one man sole traders**, identifies the key tax saving areas for them and uses jargon free language to explain them.
- ☐By reading the report, it will help you **get inside the head of your accountant** to put you in a position to know if your accountant is doing everything possible for you. You won't become a tax expert but it will enable you to have a sensible conversation with your accountant regarding what he or she should be looking at in your own situation.

- The ideas in this report don't go into every last detail of each idea. What it's trying to do is **help you to see** to a lot of what you could be doing. The further detail may mean they are not applicable to you after checking them out with your accountant in your situation, but they will work in the majority of cases. Sometimes matters are simplified to help you understand the point. It's a report for clients, not accountants.

- This isn't a report about what forms you have to fill in, what the deadlines are, etc. That's all the **boring compliance stuff that accountants look after.** This is the **proactive** stuff that makes a real difference that you also want your accountant to be doing for you. This is the stuff that will pay for their fees many times over.

If You Can't Be Bothered To Read This Report

It's recommended that you do. However, if you just want someone to do it all for you, you need to choose the right accountant. If you want the type of advice contained in this please call us.

The Ideas That Are Best For Sole Traders

The type of tax planning ideas ideal for sole traders are:

1. **LOW COST** in relation to the tax savings obtained. Small businesses don't have never ending budgets for accountancy fees and all solutions have to be cost effective for you**.**

2. **QUICK & EASY**– you're busy with your business and don't have ages to spend on implementing tax ideas. So they must allow you to do them relatively quickly. Having the right accountant who is experienced and who can show you exactly what to do and provide you with any standard documentation makes this a lot easier.

3. **LEGAL** – you don't want to get into trouble with the Taxman as this could lead to an **investigation** that can cost you thousands in accountants fees, as well as a lot of time and stress.

All the ideas in this report are legal and apart from one or two that were just too good to leave out, they all follow the above principles. They are the key areas faced by many sole traders although in your own particular circumstances it is likely other tax planning ideas may also be suitable. Tax planning is unlimited if you put your mind to it.

This Report assumes your tax knowledge is either non-existent or limited.

But My Existing Accountant Looks After All That Tax Stuff For Me

They may do, but consider the following…

- ☐ **How do you know** they are doing everything possible for you to reduce your tax bills and avoid the chance of having a tax investigation? This report will help you find out.

- ☐ Not **all accountants are the same**. Of course, partly thanks to Monty Python there is the stereotype of the accountant being that "appallingly dull fellow, unimaginative, timid, spineless, easily dominated, no sense of humour, tedious company and irrepressibly drab and awful". But not all accountants are like this!

- ☐ **Have you asked** your accountant to save you tax? May be they just prepare your accounts and tax return, a tax compliance job rather than tax planning.

- ☐ Because your accountant is qualified, doesn't mean he or she automatically has a high level of tax planning skills. **Every accountant has skills in different areas** and you need to find one suitable to you.

- ☐ Different accountants have different attitudes to tax planning and it's **attitude** that counts for so much.

- ☐ **Are you sure** if your accountant is doing a good job for you or not with saving tax. This report will help you to decide and then you can make an informed decision to do something about it. This report will allow you to have a more informed discussion with them. If you don't know what to discuss in the first place, you can't do anything about it. **Knowledge is everything.**

"My Mate Down The Pub" Syndrome

Do you have a mate down the pub that makes about the same amount as you do but his accountant sorts it out for him not to have to pay any tax, and wonder **why your tax bills so high**?

Many accountants are familiar with this type of story, told by their clients.

Lets take a look at the reality of this….

Does your mate declare all his earnings to his accountant, (and hence to the Taxman)? Perhaps there is a large amount of **cash takings** that don't go through his books. The accountant may say " your any cash takings must go into your accounts", so your mate doesn't let on about cash-in-hand jobs. Either way, the figure of earnings the accountant is working with is very different to yours, so your tax position will be very different as well.

This has nothing to do with the skill of the accountant. Your mate is simply exposing himself to the risk of a tax investigation, a process known to have triggered **heart attacks**, depression and nervous breakdowns. You don't want this.

Also, many people like to brag about their accountant. After all, it's a reflection of the good choice they made. After **a few pints**, don't believe everything you're told.

There is so much you can do legally, so please do it and you'll have less need to act illegally.

Tax Evasion v Tax Avoidance
& Why The Taxman Isn't Always Right

In very simple terms, **tax avoidance is legal, but tax evasion is illegal** and you risk prosecution for breaking the law. However, in some sophisticated cases the Taxman has been trying to blur the boundaries and claim some forms of tax avoidance are illegal.

A few examples will show the difference…

- The most common example of Tax Evasion amongst small businesses is making **cash sales** and not putting this money into your bank account or recording it in your accounting records, so the tax man will never know about it, or so you think!

- A slightly more thought out example, may be making up some **forged purchase invoices**. You write out the cheques to pay them with the name of the fictitious supplier on the cheque stub but it's actually made payable to you and goes into a secret offshore account. Again, this is tax evasion and is illegal.

- Paying wages to your spouse for work they actually do in the business to reduce your taxable profit and use up their personal allowance is an example of Tax Avoidance and is **legal**.

But it's not always black and white, there are grey areas…

- This may be because the **law itself is in question** or the facts of your particular case are in question. It often arises that HMRC may interpret something in one way, surprisingly to their advantage, but the accountant and the taxpayer may interpret it differently.

- Please remember that HMRC **do not make the law of the land** and they often get it wrong. Be prepared to stand up for your rights if necessary and don't be bullied by them.

- You should fight HMRC on technical grounds, but you need to be very sure of your facts and the law. If you can't come to an agreement with HMRC, the matter normally ends up before the first tier Tax Tribunals who are an informal independent Tax Court to decide the matter. **Many accountants don't like going to the tribunal** but they shouldn't be afraid to go if they have a reasonable argument.

- HMRC know it costs you money in accountants fees to argue with them and you may back down as the tax saved is not worth it after paying your accountant. In these situations look at getting your accountant to work on a **no win, no fee basis** for you.

- This report will point out any grey areas and the risks, so that you are fully informed. **Taking a small, calculated risk can be a legitimate business decision.**

Do Your Tax Planning In Advance

Tax planning needs to be in advance, not after the year-end. Many small businesses will meet their <u>accountant after the year-end</u> to go through their accounts – **that's no good at all.**

Perhaps after the year-end your accountant suggests putting some wife's wages through the accounts to keep the tax bill down - **<u>this can really harm your financial health</u>** and you'll find out why in this report. Get it right at the beginning and you can do it. If not…face the consequences.

Pre year-end tax planning can be useful but you can't beat doing most of the planning before the year even starts. The sooner you act, the sooner you'll save the tax.

TAX WARNING AGAIN

Do not attempt to implement any tax idea in this report without talking to an accountant who specialises in tax planning first to get full information on the idea in your own personal circumstances, as not all ideas may be suitable for **<u>you</u>**.

OK, so that's the background. Let's get on with saving tax…

Section 2

Understand The Taxes That Are Out To Bite You

"The Income Tax People Are Very Nice. They're letting me keep my own mother"
Henny Youngman

You probably want to go straight into the more interesting tax planning stuff, but it helps to make sure you have a basic knowledge of the main taxes and terminology you'll encounter as a sole trader.

This is a summary of the most important aspects.

The tax year runs from 6th April to the following 5th April. It's an historical thing dating back to 1752 when England changed from the Julian calendar to the Gregorian calendar, and lost 11 days. The end of the financial year was always 25 March, so when 11 days were lost 25 March became 5 April. The rates and allowances in this report are for the 2019/2020 tax year.

Income Tax (IT UK Taxpayer)
Every individual person, including children pay tax at the following rates…

The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.

The next £37,700 is taxed at 20%

From £50,270 to £150,000 – taxed at 40% (higher rate)

Everything above that (meaning over £150,000) - taxed at 45% (additional rate).

The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is payed on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

Income Tax (IT Scottish Taxpayer)
Every individual person, including children pay tax at the following rates…

The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.

The next £2,096 is taxed at 19% known as the Starter rate

From £14,668 to £25,296 is taxed at 20% known as Basic rate

From £25,297 to £43,662 is taxed at 21% known as Intermediate rate

From £43,663 to £150,000 is taxed at 41% known as Higher rate

Everything above £150,000 is taxed at 46% known as Top rate

The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is payed on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

Income Tax (IT Welsh Taxpayer)
Every individual person, including children pay tax at the following rates…

The first £12,570 – this is tax free and is known as your personal allowance. It is reduced for those earning over £100,000 by £1 for every £2 of gross income above this limit.

The next £37,700 is taxed at 20%

From £50,270 to £150,000 – taxed at 4% (higher rate)

Everything above that (meaning over £150,000) - taxed at 45% (additional rate).

The first £2,000 of dividends you receive will be tax free.

A personal savings allowance is available, this means no tax is payed on £1,000 of savings income for basic rate taxpayers and £500 for higher rate taxpayers.

The main types of income most relevant to small business owners are:

The profit you make as a sole trader, or your share of the profits you make as a partner in the business.

It helps to explain what this is…

Your profit and loss account is simply all your business income for the whole year less all your business expenses for the year. It is normally prepared on an accruals basis, which means sales count as income whether you've been paid for them yet or not, and the same applies for expenses.

The Balance Sheet is optional for small businesses as it is less relevant for tax purposes. It shows the assets and liabilities of your business on the last day of your financial year. The Taxman may want to see the balance sheet to understand how much money you have personally invested in the business.

The profit shown on your accounts isn't necessarily the profit you are taxed on. Your accountant will often produce a tax computation, changing your accounts profit to a taxable profit. This normally covers items in your accounts that are not allowed as deductions for tax purposes. Examples are a proportion of your motor expenses which represent the private use of your car and claims for capital allowances on equipment you have purchased. .

Make sure your accountant explains these adjustments to you so that you can agree with them.

If you operate through a Limited Company, it's important to understand that the Company is a legal person in its own right that pays corporation tax, not income tax. However, you are normally the Director who runs the company and may earn a salary liable to income tax as well as a shareholder who receives dividends liable to income tax.

Both the salary and the dividend form part of your taxable income, although the Dividends are taxed a bit differently, which will be covered when we get to tax planning with dividends.

You may have other sources of income that count towards your own individual taxable income such as rental income from a property you rent out, interest on bank and building society accounts (taxed at slightly different rates), etc but we're going to be mainly interested in this report on your business situation as this is where the main tax savings will come from.

National Insurance (NI)

If you are self-employed as a sole trader or a partner you pay two types of National Insurance:
Class 2 National Insurance that is fixed at £3.05 per week
Class 4 National Insurance on your taxable profits at:
9% on the profits between £9,568 and £50,270
Plus
2% on any profits over £50,270.

If you are an employee, and that's you if you're a Director of your own Limited Company, there are three types of National Insurance to worry you. The most common rates, unless you are contracted out of the state pension scheme are:

Employees class 1 National Insurance (paid by you)–
First £9,568 per year – nothing
Earnings between £9,568 and £50,270 – 12%
Everything above £50,270 – 2%

Employers class 1 National Insurance (paid by your company)–
First £9,568 per year – nothing
Everything above that – 13.8%
There are exemptions for startup businesses in some parts of the country for 12 months for up to 10 employees, capped at £5,000 per employee (for earnings paid up to 5 September 2013).

Class 1A National Insurance (paid by your company)–
Paid on the value of benefits provided by your company – 13.8%

Corporation Tax (CT)

It's paid by Limited Companies on their taxable profits.

The rate of tax on all profits is 19%.

Salaries paid to directors are deducted in arriving at the taxable profits, but dividends are not.

The first £2,000 of dividends received is covered by your dividend allowance and no tax is due, the basic rate of tax above the dividend allowance is 7.5%, the upper rate for dividends is 32.5% and the additional rate of tax is currently set at 38.1%

Capital Gains Tax (CGT)

It's a tax on gains made on disposing of capital assets, such as shares, selling your business and property, although your main home is not normally subject to CGT.

The first £12,300 of gains you make in a year are exempt from tax. This is known as your annual exemption.

Capital gains are taxed at a higher rate of 20% for gains (28% for residential property gains) where total taxable gains and income are above the income tax basic rate band of £50,270.
Below that an 10% rate (18% for residential property) is applied. There are various reliefs available that can reduce this.

Most of the legislation regarding capital gains tax is all about the exemptions and how to avoid it, so you often find there are ways around it or ways to lessen its impact.

Inheritance Tax (IHT)

If you're worth more than **£325,000** dead, there's 40% tax to be paid on the excess. You are also entitled to any unused allowance of former deceased spouses or civil partners up to a maximum of another £325,000.

With the rise in **house prices**, more and more people are being caught and it's often one tax that gets forgotten about. There's not that much you can do when you're dead, but there is something, which this report will explain.

The injustice of the tax is that it's a tax on wealth you have accumulated and already paid tax on whilst accumulating. **Who said taxes were fair?**

Stamp Duty Land Tax

From 4th December 2014, Stamp Duty Land Tax (SDLT) will be charged at each rate on the portion of the purchase price which falls within each rate band.£0 to £125,000 - 0%
£125,001 to £250,000 - 2%
£250,000 to £925,000 - 5%
£925,000 to £1.5million - 10%
Over £1.5million - 12%

The SDLT on **commercial property** starts at £150,000 and it also applies to leases as well as to freehold sales. However, there are a number of exemptions from this tax.

Business Rates

Another form of tax in disguise for small businesses is business rates, also known as unified Business rates (UBR). We will take a quick look at how it might affect small businesses **working from home** so you can make sure you avoid it. There are also special discount schemes for small businesses.

Penalties, Surcharges & Interest

Every tax seems to also have provision for these if you don't do things on time or act illegally.

Let's move on to the more interesting stuff…

Section 3

How To Minimise Your Business Profits For Tax Purposes

"Income tax returns are the most imaginative fiction being written today"
Herman Wouk

Claim Every Cost You Incur In Running Your Business

If you pay for something connected to running your business make sure you keep a record of it.

Normally, you'll get a **receipt** but many people think that if they haven't got a receipt they can't claim for it – **not true**. It's often the little items of expenditure that are not claimed, but over a year they can add up to a few thousand pounds, just as smoking a pack of cigarettes every day does.

As an aside, with over 80% of the price of cigarettes just tax, another tax saving device is to **stop smoking.**

The test is whether you can **satisfy** HMRC that you incurred the expense. So, if you pay for something in **cash** but don't have a receipt, still record it and anything that would help satisfy HMRC you incurred the expense.

For example…

> You buy a piece of equipment in cash from a nomadic traveller for £300 who won't give you a receipt. Still record what you bought, when, from whom and how much you paid. You have this item of equipment that you can prove if necessary because it physically exists. You must reasonably have purchased it and so by noting a few details down, it will help to satisfy HMRC.

The same is true for anyone who wants paying in cash and didn't give you a receipt. If it's a business expense, you're entitled to claim it so long as you can satisfy a **reasonable tax inspector**. The more information you have, the better.

Small items you might not have receipts for, such as car parking. If you haven't kept a record there's no reason why you can't **estimate** on a sensible basis, how much you've spent over the year. If you calculate it sensibly, you can satisfy HMRC. It would of course be better to record them as you go to avoid any debate over it.

You Work From Home So Claim The Cost of Running Your Home

- ☐ You can claim any additional expenses that are incurred through working from home.

- ☐ In practice HMRC also allow you to claim a **proportion** of costs that are part private and part business.

- ☐ At one extreme, you may have a dedicated office at home just used for the purposes of the business. You can therefore claim on a sensible pro rata basis a proportion of the running costs of the home, including rent, insurance, heat & light, repairs, council tax, mortgage interest, etc.

- ☐ You can calculate the proportion of expenses to claim on a square footage basis (office compared to total area of the home) or as a ratio of the office to the total number of rooms in the home (excluding hallways & bathrooms)

- ☐ If you can sensibly argue that the cost of **heat and light** used for the business is actually higher than worked out with this formula, because you're at home all day working, then claim whatever is sensible. Just keep a record of the calculation.

- ☐ If an office has been built specifically for the business and you financed it with a loan, claim all of the **interest on the loan**.

- ☐ The other possibility is where perhaps a spare bedroom <u>doubles</u> as an office and a spare bedroom for guests. You can calculate the expenses to claim, by first apportioning on a pro rata basis as above and then by the proportion of time it is used for business purposes. Where a room is used for two things at the same time, you should not claim for the business use.

- ☐ Your accountant should do the calculation for you but check to see if you think it's high enough. They may have just claimed **£5 per week** without giving any more thought as to whether this is really enough.

But won't I have to pay CGT when I then sell my house for a profit?
The fly in the ointment that is often trotted out by the **ever cautious accountant** is that there will be Capital Gains Tax to pay should the house be sold, and you have claimed for part of it to be used for the business. Well, lets look at the reality of this.

Capital Gains Tax only applies to a part of the home used **exclusively** for business purposes. If the room doubles as a private room as well, there's no CGT to worry about. Even if it is used exclusively, there will in practice probably be no CGT to worry about. Let's explain this…

- Property prices can go down as well as up– so you could claim a capital loss for tax purposes.

- The amount of the gain relates only to the **proportion** of the house you have claimed as business use. If it's owned jointly by husband and wife/civil partners, you are both entitled to an annual CGT exemption of £11,000 each, so unless that gain on that bit is more than £22,000 and you have no other capital gains in the year, there'll be no tax to pay.

- Are you still worried? Well even then, if you move to another house with business use, you are allowed to avoid paying the CGT by what is called **rolling over** the gain into the new house. If not, there are still other assets you could invest in to avoid the CGT. It's probably time to <u>stop worrying and claim for use of home.</u>

Aren't Business Rates payable when I work from home?
Business rates may be due in respect of any part of your home if there is an **exclusive** business use of part of the property. Business rates will be due on that part and Council Tax on the remainder.

However, if there is only part business use of a room, the property will remain banded as wholly domestic unless the business use predominates or structural alterations have been carried out to facilitate business use.

There is also a case which indicates that Business Rates wouldn't be due even if part of the property is used predominantly for business use if no customers or clients visit the home in connection with business.

In summary, business rates are unlikely unless the premises are **advertised** or **planning permission** is sought for business use.

So, to be safe, if you use a room partly for business purposes and partly for private, you'll be OK.

How To Maximise Claims For Expenses With Mixed Business & Private Use.

You may put all your motor expenses through your books. However, when your accountant completes the tax computation he is likely to enter a **proportion,** lets say 25%, of these as relating to private expenditure and they are not allowed as a deductible tax expense**.** Accountants refer to these as **add backs.** This proportion may be based on a discussion you had years ago and its no longer up to date.

Many clients don't even know what proportion their accountant is adding back for them, so how do you know if it's right?

Perhaps, it should be far less than what your accountant is doing. Therefore, make sure you **find out** what is being added back.

You should be able to satisfy the Tax Inspector that this is reasonable. You should for example, **keep a log** of all your business mileage and make a note of the total mileage for the car over a year, - this can be taken from the MOT certificates. Comparing the business miles to total mileage will give you the right proportion of motoring costs to claim.

The same is true of other mixed expenses such as **use of the home phone** that is also used for **business purposes**.

How To Get Tax Relief For Loan Interest

Ensure any loan you take out is classified as **business loan**, not a **personal loan** to get tax relief on the interest. If you need to borrow some money, try to make sure that the funds from the loan go directly into the business so that you can claim relief on the loan interest. Get the loan agreement to state the **purpose** as being for a business use if at all possible.

How To Claim For Motor Expenses From Home To Your Place Of Work

The normal rule is that you **can't** claim for travel from your home to place of work.

The obvious way around this is to **make your home your main place of work**. This means whenever you step outside your door, you're on business travel and it's tax deductible.

By claiming in your accounts for use of home, it's going to make it easier to substantiate you do work from home. Whether you work from home or not is judged on the **facts** of your case, not where you say your work base is.

If you start work at home each day, go into an office for a meeting and then finish working at home each day, this is clear evidence your base is at home, even though you may also attend an office elsewhere.

Doing the books at home, keeping stock at home, keeping the daily takings at home, etc can all help to substantiate this. It can be one of those grey areas and you should speak to your accountant about what you need to do in your own situation to be able to claim for travel from your home.

When you travel to a place **other than a regular workplace**, this would always be tax deductible.

How To Maximize Your Capital Allowances Claim

When you purchase a capital asset such as a car or an item of equipment, you don't get tax relief for this expenditure all at once.

Often your accountant will calculate some depreciation on the asset and write the cost off over the useful life of the asset in your accounts. However, whatever the accountant calculates as the **depreciation**, it's not allowed as a deduction for tax purposes.

Instead, your tax computation that accompanies your accounts includes **capital allowances** that are calculated at specific rates as determined by the tax legislation. For example, on plant and machinery, small businesses are entitled to claim 100% of the cost in the year you purchase up to £1,000,000 per annum. Over £ 1,000,000, 18% can be claimed and the remaining balance is then written down by 18% each year.

You get the full 100% tax relief in the accounting year in which you purchase the item, even if that's on the last day of your accounting period. . However the new asset must also be brought into use in the business. So if you are approaching your year end, by buying just **one day earlier,** you get the full 100% relief **one year earlier**, giving a great help to your cash flow.

Beware of falling into the trap of spending money just to save tax. It's hard to understand those people who say, you should buy it because it's tax deductible. Why spend £100 to save £40? But if you're going to spend it anyway, consider when is the best time to make the purchase.

Short Life Asset Elections

For items of plant and equipment that are likely to last less than 8 years, you can also elect to treat them as short life assets. This means that rather than being mixed in with all your other items of plant in a general pool, they are separated out so the tax written down value can be monitored separately.
If you sell the short-life asset within 8 years, you can claim the balancing allowance as soon as you sell it.

This is ideal for assets such as **computers** that tend to have a short shelf life and helps to increase the rate at which you receive capital allowances. Cars don't count as short life assets.

Why It Pays To Not Always Claim Your Capital Allowances

If by claiming your capital allowances, it brought the level of your taxable income below that of where no tax or national insurance is payable £9,568), then you are **wasting** your personal allowances as any not used can't be carried forward to another year.

Therefore, it can sometimes pay in years when you have a low level of income, **not** to claim or only **partly** claim your capital allowances. This leaves more allowances to be claimed in future years, when you need them.

Is it Advertising Or Entertainment?

Advertising is an allowable business expense and entertainment isn't.

If promoting your business through having a **box at a football club, sponsoring a horse,** etc you need to show a true attempt to benefit the business for it to be allowable. For example have the name of the horse named after your business, enter horse races in your geographic catchment area where business is likely to come from and keep your personal hobbies out of it. You get the idea.

Using Your Own Goods For Personal Use

If you use some of the goods you sell for your own personal use, then by law you are taxed on these at their **selling price**.

So the goods cost you £100, you normally sell for £300 and if you take some for personal use, you have to pay tax on £200. This seems **grossly unfair**, but it's the law.

One way around it is to use your personal relationships with your suppliers to get them to sell directly to you personally at your cost prices and you pay for them personally. This then avoids the problem.

Valuing Stock To Save Tax.

Take a fresh look at your stock valuation at the end of the year that goes in your accounts if you buy and sell goods.

Stock should be valued at cost, but can be valued at **net realisable value** if this is a lower figure. In simple language this means valued at what you could get for it. This is often the case with stock that is obsolete or perishable.

Every pound by which you reduce the stock value will reduce your taxable profits for that year. It **shifts** the profit into the next year, so delaying payment of tax. It is especially important if you want to shift profit form a year in which you are paying higher rate tax to one when you are likely to pay basic rate tax. Then you **save** tax as well as delaying payment by a year.

Note if you subsequently sell the stock you have written down for a significantly higher value, the Taxman may well insist on adjusting your accounts for the earlier year and charge you additional tax and interest.

Get The Best Year End For Your Business

You don't have to make up accounts that follow the tax year; it's **up to you** what your year-end is.

If you are a sole trader or partner, your tax bill for a tax year is worked out by reference to the profits of the accounting year ending in that tax year.

For example, if your accounts run to 30th June 2021, these accounts will form the basis of your tax bill for the tax year 2021/22 (6/4/21 to 5/4/22).

However when a business **starts** and **finishes** or changes its year-end, there are slightly more complicated rules. Without going into all the details of these as it may well confuse or bore you, you're going to have to accept what follows on trust for the time being.

If you have a new business starting that you expect to have lower profits in its first year than subsequent years, a year end **early** in the tax year such as 30th April will help keep your tax bills down in the early years.

In addition, having a year-end early in the tax year, helps give you more time to plan for your tax bills.

You should also consider if your business is **seasonal.** For example**,** if you sell lots around Christmas time, you don't want all those profits you make in December falling into your accounts by having a December year-end. If you had a November year-end, you could **delay** paying the tax for another year by just shifting your year-end by one month. It's also easier to do a stock take at a time when you're not busy.

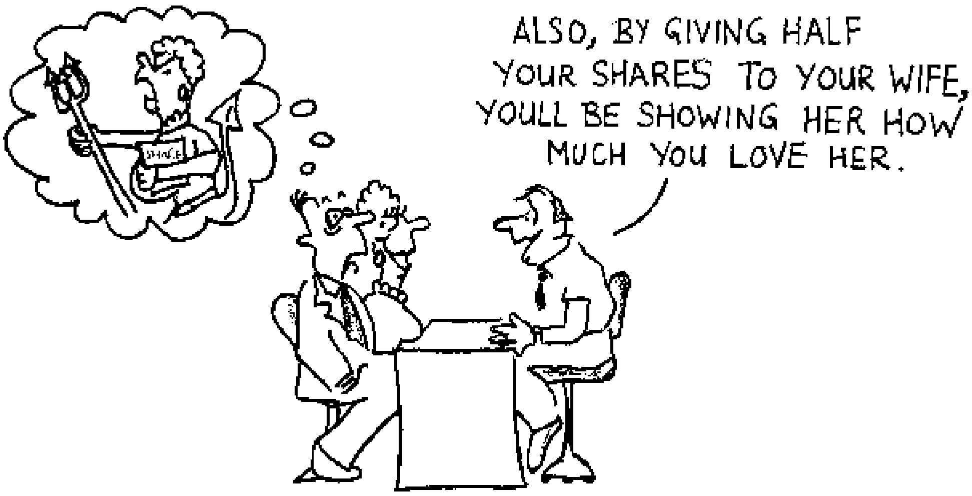
Changing Your Accounting Date Can Also Help

If you are an existing unincorporated business that has **rising profits**, a change to an accounts year-end falling **earlier** in the tax year will lower your tax bills and if **falling** profits, a **later** year end will help. The calculations get a bit more complex, so just take it on trust again.

There are restrictions on how often you can change your year-end but it can be worth crunching the numbers where you have rising or falling profits.

Section 4

Spouses/Civil Partners, Children & Other Family Members



How To Pay Your Spouse/Civil Partner Or Children Wages To Reduce The Tax You Pay

Your spouse/civil partner may not have any income at all, and almost certainly your children don't. This means their personal allowance is being wasted every year. Even children are entitled to a personal allowance.

If the amount up the level at which national insurance becomes payable of £9,568 in 2021/22 was paid to them as wage, they would pay no tax on it and your business profits could be reduced.

Please note that children under the minimum school leaving age can only work a **limited number of hours** per week and local by-laws may restrict their working hours further

If you pay just 20% income tax and 9% Class 4 National Insurance this would save you **£** 2,685 **every year** on each salary. And how many children do you have?

STOP! It's not quite that simple. To pay wages like this you need to follow the following rules:

- ☐It must be for **work actually done**. Now it's going to be tough to argue your 2-year-old son is working for you but many wives/husbands do work and mature children may also help out.

  May be they do the books, answer the phone, stuff envelopes, etc. Keeping out of your way so you can get on doesn't count, as valuable as it may be.

  At present they do it for free because it's a family business but they should and can be paid for it.

- ☐If this is the case, it's reasonable to pay them a salary commensurate with what they actually do. How much would it cost to get someone in to do that job? The **minimum wage** level is at least a good place to start but more if you can justify it.

- ☐The amount must actually be **paid**. It's no good the accountant just putting it through the accounts at the end of the year.

  Pay it, ideally through the **bank** from an account in your name to the spouses own bank account rather than cash or into a joint account so that it's easy to prove it's been paid and is for the spouse. Also record it in your accounting records.

- ☐Comply with any **PAYE procedures** such as getting a P46 signed, completing an end of year P60 as you would do for normal staff. Remember, it may also help keep up their National Insurance contribution record even if they don't pay any National Insurance on the salary.

Giving Investments To Your Spouse/Civil Partner & Children

You should also look at your investments held by you and your spouse/civil partner to see if the total tax you pay on the income can be minimised. If you pay a lower rate of tax than your spouse/partner pays, you should consider transferring some income producing investments to your spouse/ partner to reduce higher rate tax you pay.

For any **jointly held** investments with your spouse (other than shares in the family company) they are treated as being owned 50/50 for tax purposes, however actually owned, unless you make an election to the contrary.

Any gifts to your **children** who are under the age of 18, which result in them receiving an income, will still be classified as your income for tax purposes apart from the **first £100** of income each year.

Section 5

Pension Matters

"I have always paid income tax. I object only when it reaches a stage when I am threatened with having nothing left for my old age – which is due to start next Tuesday or Wednesday"
Noel Coward (Attrib.)

How To Invest £1260 In A Stakeholder Pension And Get A Pension Fund Of £2700.

- If you invest £2880 into a registered pension scheme, the government makes a **tax contribution** of £720 for a basic rate taxpayer making your gross contribution £3600. A **higher rate** taxpayer can claim additional tax relief of £720 through their tax return.

- If you are over 55 and under 75, you could take a **tax free lump sum** from the pension fund of 25% x £3600 = £900.

- So as a higher rate taxpayer you invest £2880 less £720 less £900, a total of £1260 and now have a pension fund left of £3600 - £900 = £2700. Worth looking into a bit more!

Set Up A Pension For The Kids

You may feel it is a little early to set up a pension for the kids but the new style stakeholder pension does throw up a tax opportunity in this respect.

If you invest up to £2,880 net (£3,600 gross) per year there is no need to provide any proof of earnings. Any UK resident can pay into a pension whether or not they have a job.

It is quite possible for a parent or other relative to start making pension contributions from the day the child is born. The fund then grows **tax-free,** but cannot be accessed until the child is aged 55**.** There are also certain inheritance tax advantages for grandparents.

A fund with contributions made up until the child is just 18 would grow substantially at even modest interest rates even if no more contributions were made after the age of 18. Perhaps using this method and relying on growth between 18 and 55 is the way to fund pensions.

Section 6

Capital Gains Tax

The legislation is all about how not to pay it

Own Assets Jointly

If you make a £22,000 capital gain in this tax year (net of taper relief), you will pay tax on £9,700 (£22,000 less the £12,300 annual exemption). If you had owned those same assets jointly, say with your spouse or partner, and they had no other capital gains this year, then you would pay no CGT.

Bed And Spousing

Bed And Spousing is used to avoid wasting your **CGT annual exemption.** With shares you could sell just enough to use up the annual exemption and you sell part of your shareholding to make a gain covered by your annual exemption. You don't want to lose the shares, so your spouse/civil partner and rather than you buy them back immediately. This raises their base cost to decrease any future taxable gains on the shares.

Alternatives to Bed & Spousing are:

- Bed & Trust
- Bed & Company
- Bed & ISA

All these do pretty much what they say, with the Trust, Company or ISA (all controlled by you) buying the shares back on the open market.

Don't Get Clobbered For CGT When You Sell Your Business

The good news here is that for most businesses, if you've owned your business for more than 1 year, the first £10million of qualifying lifetime gains since 6 April 2008 (was £5million from 23 June 2010 to 5 April 2011) are only taxed at 10%, rather than 10% or 18%. This is as a result of what is known as **entrepreneurs' relief**.

The gain is primarily the difference between what you paid for your business or shares and what you sell them for.

Even then you can avoid paying the capital gains tax by reinvesting through **The Enterprise Investment Scheme or Seed Enterprise Investment Scheme**.

One of the main conditions is that you must have owned the business for at least a year to get entrepreneurs' relief. If you have owned it for less than this it is seriously worth considering **holding on a bit longer**.

Also, you must be disposing of part or all of your business, and there are detailed rules on what part of a business' means. If you are selling a single asset, perhaps one field from your farm, entrepreneurs' relief won't apply.

The business must fall under the definition of a trading business, which means a property letting business will not qualify.

Where you are disposing of company shares you must have worked for, or have been a director or company secretary of that company, and have held at least 5% of the ordinary voting shares.

Section 7

Other Personal Issues

"I believe we should all pay our tax bill with a smile. I tried but they wanted cash"
Anon

Always Make A Provisional Claim For Child Tax Credit & The Working Tax Credit

Working Tax Credit is mainly available to employees and the self employed who either

- Do 24 hours or more paid work a week , are aged 16 or over and look after one or more children, OR

- Are 25 and over and work at least 30 hours per week.

Where relevant, the credit includes an amount for **childcare** whereby 70% of childcare costs of up to £175 per week can be claimed for one child or £300 per week for 2 or more children.

The basic credit is £2,005 per year plus a further £2,060 for a lone parent or where the claim is a joint claim.

However the WTC is reduced as the income from a single or joint claimant goes above £6,565 at the rate of 41p for every pound earned over this amount.

You qualify for **Child Tax Credit** if you are responsible for at least one child. The standard maximum amount is £545 per year, plus £2,845 per year for each child.

The important thing to note about tax credit claims is that they relate to your income of the **actual** tax year, which is **originally based** on your income of the **previous** tax year and then amended based on your actual when known.

However, claims cannot be backdated more than three months and to be entitled to your 2021/22 credit you have to claim by 5th July 2022 to get your full entitlement.

The problem is you don't actually know your income for the year at this point so it always pays to make a **provisional claim**, even if your original assessment is Nil. It will then be backdated when your actual income is known but only if you made the provisional claim.

Variations in income of up to £5,000 between tax years are disregarded to help avoid having to repay tax credits already received.

The self-employed often have very different incomes from one year to another so it is especially important for them to make a provisional claim.

Tax Credits are really a social security **benefit** that happen to be administered by HMRC, they are not connected to the tax system, apart from the name, so some accountants deal with them and others don't.

Note: Universal Credit will replace Child Tax Credits and Working Tax Credits as well as income-based Jobseekers Allowance, Income Support and Housing Benefit. It does not replace Child Benefit.

Universal Credit is starting with certain areas of North-West England in April 2013. From October 2013 there is a national launch of Universal Credits for new claimants. Existing claimants will be phased in over a period expected to be completed by the end of 2017.

Rent A Room Out In Your House Tax Free

If you let out a furnished spare room in your own home, the first **£7,500** is received tax-free. These are the basic rules…

- ☐ This applies **per property**, not per person.
- ☐ This figure is for gross rents that include rent for accommodation, meals, cleaning and utility charges.
- ☐ If you exceed this limit then just the **excess** is taxed.

Invest In Premium Bonds And Get Your Winnings Tax Free

If you invest in premium bonds all the prizes you receive are tax-free.

From 01/06/2014 there is a limit of £50,000 (previous limit was £40,000) you can invest but if you invest the full amount you are likely (but not guaranteed) to get a reasonable rate of return because of the amount of bonds you hold. Prizes are based on a rate of return of 1.0% at present.

Regular prizes should come your way and they are completely tax-free.

More importantly perhaps, there is also two opportunities of winning the **big prize** of £1 million each month.

Winnings on the **national lottery** are also tax-free but your chances of winning are far lower. If you win the lottery as part of a syndicate, make sure that you have a written agreement setting up how the group will be managed i.e. who buys the tickets and how prize winnings are to be shared out. Without such an agreement the person who collects the prize and shares it out may be considered to be making gifts for Inheritance Tax purposes.

National Savings also offer a number of tax-free investments.

Individual Savings Accounts

You can invest up to a total of £20,000 Stocks & shares and cash ISAs. The investment in all types of ISA grows tax free.

Venture Capital Trusts

Investing in **Venture Capital Trusts** (VCTs) can also be used to obtain **30%** income tax relief. VCT's are quoted companies that hold at least 70% of their investments in shares in qualifying unquoted companies. They are therefore a higher risk investment but at 30% tax relief worth thinking about.

Giving to Charity Tax Efficiently

When giving to charities through **Gift Aid**, you make your contribution net of basic rate tax, so the charity can reclaim this tax back from the Government.

If you are a **higher rate** taxpayer, you can then get relief for the higher rate tax on the donation through your tax return.

How To Minimise Stamp Duty On Purchasing A House

Beware the stamp duty land tax **thresholds** on buying a house. When you buy a house there is stamp duty land tax to pay depending on the price.

See if you can negotiate to have some of the price allocated to **fixtures and fittings** that do not count for the purposes of stamp duty.

The garden shed is also a wasting chattel and is excluded if you have some of the price allocated to it in the contract.

Section 8

Inheritance Tax Basics

"In this world nothing can be said to be certain, except death and taxes"
Benjamin Franklin,1789.

How right he was

- If your estate is worth less than **£325,000**, no IHT is ever payable.

- No inheritance tax is payable on most gifts in your lifetime so long as you live **7 years** after the gift. If a gift is made but there is some reservation on it, such as gifting your house with the understanding you can still live there until you die, this will not count and will still form part of your estate that is subject to IHT on at death. However, the gift will be effective for capital gains tax, which can create a double tax charge for the person who inherits the house.

Husband and Wife (or civil partners) - No inheritance tax is payable on gifts between spouses or civil partners as long as both parties are domiciled in the UK. This is often used as a basic method of IHT avoidance. If the gift is a transfer to a foreign domiciled spouse it is only exempt up to £55,000.

Spouses and civil partners can make full use of the nil rate band belonging to each spouse. This is retrospective and applies to anyone with a spouse or civil partner previously deceased. That gives a total inheritance tax exemption for a married couple of £650,000 (for 2021/22). The new rules allow any unused part of the nil rate band on the death of the first spouse or civil partner to be passed to the surviving spouse or civil partner for use on their death.

Say Fred dies on 1 October 2019 with an estate worth £650,000 and his wife did not use her nil rate band when she died previously, he now has the benefit of two nil rate bands totalling £650,000. Now Fred's executors will pay no IHT at all.

The amount of the nil rate band that can be transferred is the proportion of the nil rate band that was unused on the death of the first spouse or civil partner. For example if on the first death, 50% of a 325K nil rate band was unused, if on the second death the nil rate band is 350K at that time, then 50% x £350K = £175K is available for use in addition to their own nil rate band.

There is a maximum of an amount equal to the nil rate band in force at the time of the second death that can be used in addition. Therefore, it doesn't matter how many ex-spouses or civil partners there are, it is not possible to have a total nil rate band of over 650K in 2021/22.

- **Business Property Relief** is available which gives up to 100% relief from inheritance tax on death for business assets. Therefore, it can help to leave your business to someone other than your spouse/civil partner. This is because what you leave to your spouse is generally tax-free anyway. If you give them the business as well, this may increase their estate value so that when they die it is above the inheritance tax threshold of £325,000.

- By keeping hold of your business until death, it avoids any **capital gain tax** on the sale of it, as there is no capital gains tax payable on any assets at all on death.

- When you take out **life assurance**, if the policy is written **in trust** for someone else, so that the life insurance payout goes directly to them, it avoids the payout becoming part of your estate for IHT and so avoids the 40% tax charge.

- If you are transferring assets other than cash to help with inheritance tax watch out for any potential **capital gains** problems on transferring assets between connected persons. **Connected persons** cover most of your main relatives. Transfers between connected persons are valued at market value for capital gains purposes so may give rise to a capital gain on which tax is payable.

- It is possible for those entitled to your estate to vary the way in which it is distributed provided that they do so within 2 years of your death. A **deed of variation** or disclaimer is used for these purposes and can improve the inheritance tax position.

- Another point to bear in mind is that if 10% of the estate is given to charity, the IHT will be 36% instead of 40%. The 10% is a strict limit, even if the charitable donation made is 9% this will not count. The 10% limit is therefore a cliff edge so it may be beneficial to check any gifts to charities currently pledged.

Section 9

Other Considerations

"Death, Taxes & Childbirth!
There's never any convenient time
for any of them"
Margaret Mitchell in Gone With The Wind 1936.

You'll find a lot more detailed information on most of the areas in this section and a lot more in our special report aimed at small businesses generally and not just on one-man sole traders.

What About Using A Limited Company

- Having a **limited company** can change the tax rate of a 40% or 45% higher rate taxpayer from 40% or 45% to 20%. The exact tax savings do depend on how much of the profit you leave to reinvest in your business. All taxpayers can also avoid paying any national insurance at all by using dividends. For someone earning £30,000 in a year as a sole trader, the amount of Class 4 NI to be saved is around £2000.

Registering For VAT

If you supply the **general public** beware going over the VAT registration limit of £85,000 (from 1 April 2017) of taxable supplies in a year and having to register for VAT. Doing so, can cost you around £16,400. Splitting a business with say your spouse is one option to try but very good advice is needed as artificial arrangements don't work.

If you supply other businesses that are **VAT registered**, you will probably benefit from registering for VAT as you can now reclaim VAT on what you buy. You are allowed to voluntarily register before you get to the registration limit.

Making Your Spouse/Civil Partner A Partner Or Shareholder

Consider making your **spouse/civil partner a partner or shareholder** in your business to reduce your tax bill so that income that was going to be taxed on you is now shifted to your spouse/civil partner who pays lower rates of tax. To do this it has to be set up correctly and expert advice is essential to avoid HMRC attacking the arrangement, particularly if they ever get round to introduce their planned legislation on income shifting.

Are Your Workers Really Self-Employed?

The important point here is that it's <u>not up to you</u> or the worker to choose. Whether the worker is self-employed or not is judged on the facts of the case. If your workers can be considered to be self-employed there are enormous tax and other benefits to you. If you get it wrong the consequences can devastate your business. A self-employed contract will help and expert advice is essential.

Finally

The above gives you a flavour for some of what is possible with tax planning. If you would like us to help you save tax wherever you legally can, we would love to help you.