Sole Traders Tax Planning & Other Issues

2023/24 Edition

An eBook by The Friendly Accountants

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Disclaimer

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

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

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

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The information can only provide an overview of the regulations in force at the date of publication and no action should be taken without consulting the detailed legislation or seeking professional advice.

This e-book is intended as a general tax planning guide for UK based sole traders in relation to the 2023/24 tax year.

It assumes the sole trader is UK resident living in the UK full time and running their business from the UK. The personal tax rates and allowances are those for the UK excluding Scotland – if you are a Scotttish taxpayer you will have different tax rates and allowances than those in this book.

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

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1 Introduction

If you are self-employed then this means you work for yourself and not for an employer. A sole-trader is a self-employed person, meaning they are the sole owner of their business.

Being a sole trader is the simplest way to run a business and does not involve paying any registration fees (which happens when you form a limited company), but you must register with HMRC as self-employed.

When you are a self-employed sole trader you and the business are the same legal entity.

Contrary to popular opinion, there is no limit to the turnover you can make and still remain a sole trader or partnership!

1.1 Registering with HMRC

Once you've started working for yourself one of the first things you need to do is register with HM Revenue & Customs as self-employed. You need to do this within three months of the date you commenced trading - otherwise you could be liable to a penalty of £100.

You can notify the Revenue by the following methods:

- By post using the form CWF1 – (go **here**). Complete then print off and post the form.
- telephone HMRC on 0300 200 3300
- register online at **https://www.gov.uk/register-for-self-assessment**

The tax rules for you once you start self-employment are different from when you were an employee. For starters you are responsible for your own tax and national insurance, rather than having it deducted from your monthly salary or weekly wage packet.

1.2 Choosing an accounting date

You can choose any accounting date for your business although it's usually easiest to prepare accounts either up to 31st March or up to 5th April.

Normally you are taxed on whatever accounting date ends in the relevant tax year e.g. the year end 30th June 2023 ends in the 2023/24 tax year and the year end 31st March 2023 ends in the 2022/23 tax year.

However, there are a number of considerations you need to think about when deciding which accounting date to use and we've highlighted these below:

1.2.1 Overlap profits

The taxman aims to tax your profits in full once and once only over the lifetime of your business.

However unless your accounting date falls between 31 March and 5 April (inclusive) there will always be some element of double counting or 'overlap profits' (see below), in the first full tax year your profits are taxed on the current year basis.

This is because a business is taxed slightly differently in the first year of its trade than it normally is in subsequent years.

The easiest way to demonstrate this is to show you an example:

> Let's assume your first business accounts were drawn up for the year ended 30 April 2023 and the profits were £30,000. You would be taxed as follows:
>
> **2022/23 ('Actual' profits in the tax year)**
>
> Profits for the period 1 May 2022 to 5 April 2023 fall within the 2022/23 tax year. Therefore 309/365 x £30,000 = £25,397 taxable profits.
>
> **2023/24 (Profits for the twelve month period ending in the 2023/24 tax year)**
>
> Profits for the period 1 May 2022 to 30 April 2023
> Therefore £30,000

As you can see the profits of £25,397 for the period 1 May 2022 to 5 April 2023 are actually taxed twice in the 2022/23 and 2023/24 tax years - hence the reason why they are known as ‘overlap profits’.

These ‘overlap profits’ can be deducted from your profits either when you cease your business (see below) or when you change your accounting date at a later stage.

However, because of inflation, overlap relief is likely to be worth less to you when you finally ‘cash it in’ at a later stage.

1.2.2 Higher profits in your final year of trade

Depending on your accounting year end date you could end up paying tax on more than 12 months' worth of profits when you cease the business.

This is because you are taxed in your final year on the profits right back to the start of your final accounting date – this could be in a previous tax year.

For example the accounting year ended 30 April 2023 straddles two tax years – the year ended 5 April 2023 and 5 April 2024.

Let's see how this works in practice.

> You have been trading for many years and your accounting year end date is 30 April.
>
> You then decide to cease trading on 31 January 2024.
>
> For the tax year 2022/23 you would therefore have been taxed on the profits for the year ended 30 April 2022.
>
> For the 2023/24 tax year you would have been taxed on the profits for the year ended 30 April 2023, but your business has ceased trading (see below).
>
> Because your business ceased trading before the end of the 2023/24 tax year (remember it ceased on 31 January 2024), you are taxed on the profits for the period 1 May 2022 to 31 January 2024 (ie from the start of your last full year). In other words, you are taxed on 21 months instead of 12 months!
>
> Although 'overlap profits' can be deducted from these profits, due to inflation etc, the benefit of this deduction could have been eroded over time.

So it's important, where possible, to think carefully about the accounting date you choose when your start in business and ultimately when you think about ceasing to trade.

1.2.3 Change of accounting date

Once you've been trading for at least three years, you can then change your accounting date in the fourth year or later.

In order for HMRC to approve the change to your year end you need to meet three conditions:

1) The first accounts prepared to the new date must not be in excess of 18 months.

2) The notice of the change must actually be given to HMRC by 31 January following the tax year of change. So for example a change of accounting date in the 2023/24 tax year would need to be notified to HMRC by 31 January 2025.

   The notification can be included either in the Self-Assessment tax return or separately in writing - although it must be made within the relevant time limit (see above).

3) There has been no earlier change of accounting date in the previous five years, unless the latest change has been made for a commercial reason – obtaining a tax advantage is not one of them!

1.2.4 Allocating taxable business profit to tax years

As a rule of thumb, the tax for a tax year is based on the profits of a twelve month accounting period ending in a tax year.

For example the tax liability for the year ended 5 April 2024 (2023/24) could be based on accounts for a year ended 30 April 2023, 30 September 2023 or even 5 April 2024.

As you will see in section 1.9 you would get more time for your 2023/24 tax bill to be calculated if your accounts ended on 30 April 2023. This is why 30 April can be a popular accounting year end for some self-employed people, because of the potential cash-flow benefit.

However for simplicity we tend to advise clients to choose either 31st March or 5th April.

1.3 Taxable trading profits

1.3.1 Taxable trading profit

The starting point for your taxable profit is your profit and loss account.

In calculating your taxable profits you are entitled to claim deductions for business expenses from your business income in your profit and loss account. However, in order to be allowable, these business expenses must be wholly and exclusively for the purposes of your business.

It's not always straight-forward and noted below are a couple of areas where the rules are slightly different:

- When you buy equipment for your business, such as a new computer, desk or car, you are entitled to deduct a proportion of the cost each year that you own and use them in your business - these expenses are known as capital allowances.

- When you take business stock for your own use, this is treated as a sale at retail value not the wholesale cost to you.

  An example would be a newsagent who took a copy of the daily newspaper and a bar of chocolate home with him each night.

Any drawings from your business bank account are not tax deductible, though if your spouse works for you in the business then any drawings to pay her salary are allowable provided they are actually paid to her and represent the market rate for her duties.

See Section 4 for more examples as to what adjustments will be made in calculating your taxable profits.

And be careful - because if the taxman does not consider the expenses qualify they will be added back to your business profit.

If you are in any doubt as to what you can and can't claim, feel free to contact us at any time.

1.4 Class 4 National Insurance

Class 4 National Insurance is bit of a misnomer as it's really a form of tax levied on your business profits and doesn't count towards your retirement pension or any other state benefits you might be entitled to claim (e.g. maternity allowance).

Class 4 NI is payable at 9% on any profits between a lower and higher threshold and 2% for any profits above the higher threshold.

To find the latest rates go to **https://www.gov.uk/self-employed-national-insurance-rates**.

For the 2023/24 tax year Class 4 NI is 9% of profits between £12,570 and £50,270 and 2% over that amount.

So, if your profits are £35,000 then you will pay Class 4 NI of £2,019 (being 9% of £35,000 less £12,570) and if your profits are £51,000 then you will pay Class 4 NI of £3,408 (being 9% of £50,270 less £12,570 and 2% of £51,000 less £50,270).

1.5 Class 2 National Insurance

As well as Class 4 NI you also have to pay Class 2 National Insurance.

To find the latest rates go to **https://www.gov.uk/self-employed-national-insurance-rates**.

For the 2023/24 tax year Class 2 NI are £3.15 per week if your profits are over £6,725.

If your business profits are below £6,725 per annum, you may wish to pay Class 2 NI voluntarily in order to maintain entitlement to any state benefits – unlike Class 4 NI, Class 2 National Insurance contributions count towards your contribution record.

Class 2 National Insurance used to be paid weekly, monthly or quarterly but can now be paid via your self-assessment tax return.

There has been speculation that payment of Class 2 NI contributions would be abolished by the government. However, these plans have been put on hold and there is no specific timetable for these to be scrapped by the government at the moment.

1.6 Trading losses

These are difficult times at the moment for established businesses as well as for those just starting up, so what if the worst happens and you make a loss?

Well if you're a sole trader or partnership, there are several options which aren't available to you if you trade through a limited company.

Generally speaking, the principle reliefs that are available to you are as follows:

1) Trading losses arising in the first four years of your business can be carried back and set against any income of the previous three tax years - earliest years first.

   For example a 2023/24 loss can be carried back and relieved against any income for the tax years 2020/21, 2021/22 and then 2022/23.

2) If you're an established business that's been trading for a number of years, you can make a claim to set off your trading loss against any income for the tax year in which the loss arises and/or any income for the previous year (if the loss is large enough).

   For example a 2023/24 loss can be relieved against any income for the tax years 2023/24 and 2022/23.

3) You can carry-forward the loss to reduce any profits for later tax years from the same trade.

   This is the most straightforward way of obtaining relief, though not necessarily the most tax beneficial.

   For example a loss for the year 2023/24 can be relieved against your profits from the same trade for the tax years 2024/25 onwards.

4) If a loss arises when you cease to trade you can claim relief against your trade profits for the final tax year (things can get complicated where the loss straddles a tax year), then carried back against your trading profits of the previous three tax years, latest first.

   For example a 2023/24 trading loss arising on the cessation of your business can be offset against your trading profits for the tax years 2022/23, 2021/22 and then 2020/21.

5) A trading loss can be offset against capital gains in **either or both** the tax year of loss or previous tax year, but only if there is any excess loss available after a claim in point 2 has been made.

   For example any excess 2023/24 trading losses can be relieved against 2022/23 and/or 2023/24 capital gains.

6) If you decide to incorporate and you have unused trading losses arising from your business, these cannot be carried forward and relieved against the company's profits.

   However you may be able to relieve them against any future income you might draw from the company e.g. salary/dividends etc.

From a tax perspective the principle objectives are to obtain the maximum tax relief at the earliest opportunity. You should also be aware that HM Revenue impose strict time limits on the above loss claims and are highly unlikely to agree a claim submitted outside the time limit.

1.7 Budget 2021 trading losses – further relief

In Budget 2021 the Chancellor announced additional initiatives to relieve trading losses for sole traders and partnerships.

Under these new proposals, the following will apply:

- Trading losses arising in the tax years to 5 April 2021 and 2022 can be carried back three years against profits of the same trade. This applies to all businesses not just start-ups
- Losses are offset against trading profits of most recent years first.
- The limit on losses carried back in this way is £2m for 2020/21, the same limit applies for 2021/22.
- This new relief will also apply to Class 4 National Insurance Contributions.
- The relief will also apply to those trading losses from a Furnished Holiday Letting business.
- Relief is not available for uncommercial trades. However, this has always been the case
- Claims can be made in a Self-Assessment tax return.
- It's possible to make a stand alone claim where a loss relief claim affects more than one tax year.
- The time limit for making a claim in respect of the 2020/21 tax year is 31 January 2023, and 31 January 2024 for a claim in the 2021/22 tax year.

You can see some example of how the relief will work in practice from HMRC's guidance here.

1.8 Submitting your tax return

Once you are self-employed you have to file a tax return covering your income for the tax year ended 5 April.

This tax return will include your taxable business profits (see below).

Each year's tax return needs to be submitted by the following 31 October if you are submitting it by paper copy or by the following 31 January if you are filing on-line.

So for example your 2024 Tax Return will cover your income from 6 April 2023 to 5 April 2024. This needs to be submitted by 31 October 2024 if it is a paper return or 31 January 2025 if you are filing online.

And if you want the Revenue to work out your tax for you, you must send the tax return back by 30 September following the tax year concerned. So your 2024 tax return needs to be with the Revenue by 30 September 2024 if you want them to calculate your tax.

If we are completing your tax returns for you, we will make sure that these are completed to meet all relevant deadlines.

1.9 Paying your tax

Payments on account of income tax and Class 4 National Insurance are normally due on 31 January and 31 July each year.

Each payment is one-half of your total estimated tax liability for the current tax year (less any tax paid at source eg on bank interest).

So, let's assume that you have been trading a number of years. The payments you make on account on 31 January 2024 and 31 July 2024 (for your 2023/24 tax liability) will be based on your tax liability for the year to 5 April 2023 (2022/23).

If you have either under-paid or over-paid your 2023/24 tax and Class 4 NI, then this will be adjusted for in your 31 January 2025 tax payment.

Let’s look at an example:

> Let’s assume you had made payments on account of your 2023/24 tax bill of £4,000 but your actual tax bill turns out to be £4,500.
>
> On 31 January 2024 you will make a payment of £2,750:
>
> > This is £500 additional tax for 2023/24 (you paid £4,000 but your actual bill is £4,500)
> >
> > plus
> >
> > £2,250 payment on account for tax year 2024/25 (half of your actual 2023/24 tax liability of £4,500 which forms the basis of your initial 2024/25 tax payments on account).
>
> On 31 July 2025 you will make a second payment on account of £2,250 (half of your actual 2023/24 tax bill).
>
> When your final 2024/25 tax bill is calculated, you may have an under/over payment which will be adjusted in the payment collected on 31 January 2026.

In summary, if you were filing a 2024 Tax Return you would pay the balance of any 2023/24 tax and Class 4 National Insurance due on 31 January 2025 and your first 2024/25 payment on account (based on one half of your 2023/24 tax liability) at the same time.

Your second 2024/25 payment on account would be payable on the 31 July 2025 and the balance of any 2024/25 tax would be payable on 31 January 2026 and so on.

Because this estimate is based on your previous year’s taxable income, it is important to understand whether your current year’s taxable profits are increasing or decreasing. If they are decreasing, it may be worth reducing your payments on account as you may end up paying too much tax unnecessarily.

However, beware – if you reduce your payments on account and the final tax liability turns out to be higher than previously thought, HMRC will charge you interest on the additional tax which should have been paid on time. HMRC’s interest rates are quite high and this could cost you a pretty penny!

The balance of any tax due for the current year must also be paid by 3 March following the tax year concerned otherwise you will incur a 5% penalty on any tax for this year which is still outstanding.

For example if your 2023/24 tax bill is £5,000 and £2,000 is still outstanding on 3 March 2025 you will incur a penalty of £2,000 x 5% = £100 – this is on top of any interest you will also owe to the taxman for paying the tax late!

2 Housekeeping issues

2.1 Bank account

As a sole trader you do not need to have a separate business bank account – as long as your bank is happy for you to use your personal account for business.

However it can help to have a separate bank account for your business transactions as this will make record keeping easier.

2.2 Record keeping

You need to ensure you have sufficient back up evidence for any items of income and expenditure included in your sole trader accounts.

There is no strict definition of 'sufficient'- so if you lose the odd receipt for small amounts of expenditure this is probably not a problem. However, you should ensure you have receipts and invoices for all larger expenditure.

You should make sure that you can identify the receipts and invoices included in your accounts and can find the relevant paper invoice if needed.

If you prefer (and we recommend this) you can keep digital or electronic copies of your receipts and invoices. So if you receive a pdf invoice from a supplier there is no need to print this for your records. However you must make sure you have adequate back-ups available so that you can still access these invoices if your PC crashes!

You also need to keep receipts for a minimum of 6 years.

2.3 Bookkeeping systems

You don't have to use a bookkeeping system but this will make life easier for you. It can be as simple as an excel spreadsheet which you use to record all your income and expenditure.

If you run a larger or more complicated business you may want to consider using a proper bookkeeping package – we recommend FreeAgent or Xero depending on your business model.

2.4 Profit and loss

The profit and loss (p&l) account summarises the sales and costs of a business.

The profit and loss account will generally be split down as follows:

	£	
Sales	100	Also known as revenue, turnover, income
Less: Cost of Sales	(80)	Also known as direct costs
Gross Margin	20	Also known as gross profit
Less: Overheads		Also known as indirect costs
Telephone	2	
Advertising	1	
Insurance etc	2	
Net profit	15	If this figure is a negative it means you have made a loss

It's important to note that if you are VAT registered all the figures in the profit and loss account exclude VAT.

2.5 Balance Sheet

Whilst the profit and loss account summarises the sales and costs of your business, the balance sheet tells you where you are at a certain point in time.

The balance sheet will generally be split down as follows:

	£	£	
Fixed Assets		100	Such as office equipment & PCs
Current Assets:			
Trade debtors	80		Customers who owe you money
Stock	115		
Prepayments & accrued income	5		See section 3.1.1
Cash at bank and in hand	30		
		230	
Current Liabilities:			
Trade creditors	70		Suppliers you owe money to
Accruals & deferred income	20		See section 3.1.2
Other creditors	10		
Bank loans and overdrafts	20		
		(120)	
Total assets less current liabilities		210	
Capital and reserves			
Proprietor’s account		100	
Profit and loss account		110	
Shareholders’ (proprietor/partners’ funds)		210	

As a sole trader you don’t need to prepare a balance sheet and most small sole traders won’t find this necessary.

However, if you are a larger sole trader you may find this useful.

3 Methods of accounting

3.1 Accrual based accounting

Accrual based accounting means that your income and costs are included in the year they relate to. This isn't always the same as the year in which they are paid or received.

So for example, if you have a 31st March 2024 year end and you raise an invoice to a customer in March 2024 which isn't paid until April 2024, then this invoice is included in your income for the year ended 31st March 2024 and will also form part of your 'trade debtors' in your balance sheet at that date.

And, using the same year end, if you receive an invoice from a supplier for goods you received before 31st March 2024 but you don't pay this until April 2024, then this will form part of your expenses for the year ended 31st March 2024 and will also form part of your 'trade creditors' in your balance sheet at that date.

We list out below the other main adjustments you may need to make if you are accrual accounting.

3.1.1 Prepayments

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

You should put an adjustment through to take these costs out of your overheads and post them to the balance sheet.

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

3.1.2 Accruals

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

You should put an adjustment through to add these costs to your overheads and post them to the balance sheet.

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

3.1.3 Fixed Assets & Depreciation

Capital vs revenue

In accounting terms, there is a difference between expenses which are considered to be 'capital' in nature and those which are 'revenue'. Revenue items are those items which are intended to be used in the year they are purchased. So printer ink would be a revenue item whilst the printer itself would be considered to be a capital item.

You may wonder why ink isn't a capital item as there may be ink left at the year end and so the cost straddles two years. Well you can take a 'common sense' approach to determine what is a revenue expense vs a capital asset – if the amount is small you can usually treat it as a revenue item even if it lasts longer than a year. We generally recommend a sensible cut off point is somewhere between £150 and £500.

You should then charge a percentage of the asset cost to your profit and loss account each year (and also posted against your asset account in the balance sheet effectively reducing the asset value) depending on how long you believe the asset will last – this charge is called 'depreciation'. Generally a capital asset would be expected to last more than 3 years although occasionally an asset will last only 2 years.

Capital assets such as computers, printers, furniture etc are also referred to as 'Fixed Assets'.

An example:

> You buy a computer for £900 and expect it to last 3 years – you would charge £300 each year to your profit and loss account and you would reduce the value of that asset in your balance sheet by £300. The accounting entries would look as follows:

	Year 1 Purchase	Year 1 Depreciation	Year 2 Depreciation	Year 3 Depreciation
Bank account	£(900)			
Fixed Asset (Balance Sheet)	£900	£(300)	£(300)	£(300)
Depreciation (Profit & Loss)		£300	£300	£300

> So at the end of year 3, the asset on the balance sheet has a nil value.

If you haven't included the depreciation charge in your bookkeeping, this adjustment will make your accounting profit less than your bookkeeping profit.

3.1.4 Bad debts

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

You can put an adjustment through to ‘write off’ these debtors so they no longer show on your debtors report.

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

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

3.2 Cash based accounting

Under cash accounting, a business declares its profits based on its sales receipts less business expenses – there is therefore no need to adjust for prepayments or accruals. There is also no need to account for stock, WIP or bad debts.

For 2023/24, you can't start using cash accounting if your business receipts are higher than £150k. Your business receipts are combined if you run more than one business.

There is also an exit threshold of £300k for 2023/24 – so if you are currently using cash based accounting you will need to exit the scheme if your business receipts are higher than £300k.

(The limits have increased significantly in the 2020/21 tax year as HMRC believe this will make it easier for sole traders and partnerships to meet the new Making Tax Digital requirements – see section 4.)

There are also certain businesses which are not allowed to use cash based accounting as follows:

- Lloyd's underwriters
- farming businesses with a current herd basis election
- farming and creative businesses with a section 221 ITTOIA profit averaging election
- businesses that have claimed business premises renovation allowance
- businesses that carry on a mineral extraction trade
- businesses that have claimed research and development allowance
- dealers in securities
- relief for mineral royalties
- lease premiums
- ministers of religion
- pool betting duty
- intermediaries treated as making employment payments
- managed service companies
- waste disposal
- cemeteries and crematoria

To use cash based accounting, you simply tick the relevant box on your tax return.

Under cash based accounting, you don't ordinarily claim capital allowances for any plant or equipment purchased – you simply include this in your profit and loss account as a deduction (other than cars and vans which are subject to the normal capital allowances regime).

However whilst the limits for using the cash based scheme have increased significantly in 2020/21, there are more restrictions on what can, and can't, be claimed for capital expenditure.

From 6th April 2021 no deduction will be available for capital expenditure on:

- A business or part of a business
- Any asset that is not a 'depreciating asset' (see below)
- Any asset not acquired or created for use on a continuing basis in the trade
- Cars
- Land (except for the provision or installation of a depreciating fixture)
- Non-qualifying intangible assets (see below)
- Education or training
- Financial assets

An asset is a 'depreciating asset' if it is reasonable to expect that within 20 years:

- It will be at the end of its useful life, or
- Its value will have declined by at least 90%

An intangible asset is as defined under UK GAAP, and in particular includes:

- Internally generated intangibles, and
- Intellectual property

An intangible asset will be 'non-qualifying' unless it is expected to cease to exist within 20 years.

Transitional rules are proposed for the first year the new rules apply. You can still claim a deduction in 2022/23 if:

- You would not be allowed a deduction under the new rules,
- But would have been allowed a deduction under the old rules

Whilst cash based accounting may be simpler than invoice based accounting, bear in mind the following (which are still in place at the time of writing this guide):

- If your business makes a loss you will not be able to offset these losses either against other income in the same tax year or against profits from a previous year (see section 1.6). You will only be eligible to carry these losses forward.
- Under cash based accounting you can only claim up to £500 in interest and bank charges.
- Accounts drawn up under the cash basis may not be accepted by banks or other lenders if you are trying to get finance for your business. You may therefore still need to prepare accounts using the accrual basis.
- If your business is more complex (eg high levels of stock) then cash based accounting may not suit you.

3.3 Simplified business expenses

Simplified expenses are a way of calculating some of your business expenses using flat rates instead of working out your actual business costs.

You don't have to use simplified expenses. You can decide if it suits your business.

You can use flat rates for:

- business costs for vehicles – see section 5.16.1
- working from home – see section 5.28.1
- living in your business premises – see section 5.13

4 Making Tax Digital (MTD)

4.1 An Overview

Making Tax Digital (MTD) is a government initiative to ‘transform the tax system and see the end of the tax return by 2025’.

The changes were first proposed in the **Making Tax Digital roadmap** published in December 2020 based on what HMRC call the ‘**Four Foundations of Making Tax Digital**’.

One of the main aims of MTD is to give every taxpayer better access to the information HMRC hold about their business in order to encourage better tax compliance.

Whilst it’s recognised that the majority of taxpayers want to pay the right tax, HMRC estimate that the amount of tax not collected due to avoidable taxpayer errors and carelessness has risen to over £8bn a year. In addition, because of the penalties imposed, taxpayers can often feel punished unfairly for lack of compliance.

The roll out of MTD has already started with taxpayers (both businesses and individuals) having access to a digital tax account to check their records and manage their details (see more about this **here**).

4.2 Major changes

The MTD initiative involves both businesses and landlords and the major changes for those businesses are:

- Businesses will need to report their information quarterly to HMRC using software or apps
- HMRC will improve its business tax portal so that business have better visibility of their tax affairs

In order to simplify the requirements for a lot of small businesses, HMRC have drastically increased the number of businesses who can use cash reporting – see section 3.2.

4.2.1 Quarterly Reporting

The requirement for businesses and landlords to report their figures quarterly is one of the most radical changes to tax in a generation.

Going forward any business reporting under MTD will need to use digital tools (eg software or apps) to record their income and expenditure.

If you currently use spreadsheets to record your income and expenditure, you can continue to do so as long as these meet HMRC's requirements.

HMRC have said they won't provide their own software but will make sure that basic apps and software are available for the most straight-forward businesses.

How this will work in practice is still under review - you can read more about this **here**.

Many businesses will probably look to use commercial software such as **FreeAgent** or **Xero** (the two software packages we recommend for our clients) in the same way as a lot of businesses currently use software for quarterly VAT reporting.

HMRC are aware that a small minority of taxpayers will not be able to use digital tools and exemptions to this requirement will be allowed based on age, religion, disability or remoteness of location. HMRC have stated they will consider exemptions on a case by case basis.

4.2.2 Improved taxpayer portal

Along with quarterly reporting, HMRC recognise the need for taxpayers to have better visibility of their tax affairs and the information which HMRC hold.

So by 2025 taxpayers will have a single digital account where they can see all their liabilities in one place.

They will also be able to offset overpayments in one tax with underpayments in another.

4.3 Benefits of MTD

Whilst there are concerns from the wider community regarding MTD (HMRC aren't known for their successful and stream-lined IT implementations), if MTD is implemented correctly then there could be many benefits such as:

- Being able to plan more effectively as your tax will be calculated in real-time
- Having a full picture of your tax affairs in one account
- Less hassle as you can interact with HMRC digitally (HMRC already have Webchat available for most taxes)

For those who are more cynical about the reasons for the implementation of MTD, HMRC have produced a '**Making Tax Digital: Myth-Buster**'.

4.4 Timescale

The original timescale was as follows:

- April 2019 – HMRC have been trialling the new Making Tax Digital requirements with a very small number of businesses
- April 2020 – Self-employed and landlords turning over more than the VAT threshold will begin reporting quarterly
- April 2021 – Most other self-employed and landlords will begin reporting quarterly and VAT will get combined with quarterly reporting into a single reporting requirement. Capital gains tax on the sale of residential properties will be payable within a 30 day time frame. This reporting requirement has been brought forward – see here
- April 2022 – Limited companies start quarterly reporting

In order to make MTD easier for small businesses, the limits for cash accounting for sole traders and partnerships have increased significantly as you can see in section 3.2.

No further announcements were made in Budget 2022 as the UK is currently on high alert in dealing with the Covid-19 virus.

- It is anticipated that Making Tax Digital will apply for Income Tax for return periods commencing after 6 April 2023 or later.
- This will apply to self-employed taxpayers and landlords.
- Employees and pensioners will be under a different system.
- This will mean that it will be compulsory to use software to prepare your accounts and for submitting five tax returns per year.

Further announcements are expected once HMRC has determined the results of Making Tax Digital for VAT which commenced on 1 April 2019.

4.5 Exemption threshold

HMRC have confirmed that landlords and unincorporated businesses with a gross income of less than £10k will be exempt from the quarterly reporting requirements.

4.6 Penalty Regime for MTD

HMRC are proposing to introduce a new penalty regime for Making Tax Digital. This will be far more onerous than the existing penalty system that HMRC currently have in place.

The new penalty regime for Making Tax Digital works on a points based system. However, in this case, points will be imposed for non-compliance and deducted for good behaviour. The new late submission penalty rules will be used for VAT and Income Tax Self-Assessment. It will also replace the one used for Income and Capital Gains Taxes, currently used by HMRC.

4.6.1 When do the new penalties apply?

HMRC introduced legislation in **Finance Act 2021** to implement the new late submission penalty rules in conjunction with Making Tax Digital.
The new late submission penalty rules will be introduced as follows:

- For VAT registered businesses they will apply to all accounting periods beginning on or after 1 January 2023. The original date was 1 April 2022, so this something of a welcome reprieve.
- If you have business and or property income exceeding £10,000 and are required to submit quarterly returns (see here) these penalties apply from the beginning of the 2024/25 tax year (6 April 2024).
- For everyone else required to submit a Self-Assessment Tax Return, they will apply from the beginning of the 2025/26 tax year (6 April 2025)

4.6.2 How will the new penalty regime for Making Tax Digital work?

The new system is points based. Essentially the more points that are imposed by HMRC the greater the potential risk of penalties. However these will be deducted for timely and consistent filing by the deadlines.

A point will be received every time a return is submitted late and once a specific threshold is reached (see below) a penalty is charged. Every subsequent late return submission will also incur a penalty. However the points can be reset to zero after a period of good behaviour (filing on time).

You will have a points total for each obligation to submit a return to HMRC under Making Tax Digital. So for example, there may be one total for your VAT and one for your personal Self Assessment submissions. Additionally, there will also be a points total for each business you have. Therefore, your penalty points total could soon start to add up if you are not consistent with your filings.

If you make two or more failures relating to the same submission obligation, you will only incur a single point for that month. However this maximum of one point per month will not apply across different Making Tax Digital Self Assessment filing obligations.

You may recall that we covered the concept of tax returns 5 times a year (see here). So for example, if you missed your quarterly update, end of period statement and final declaration deadline you could be 'awarded' as much as 3 points if you miss all three deadlines

4.6.3 How many points before a penalty is imposed?

The points thresholds (before penalties potentially apply) are as follows:

- The threshold for annual returns will be 2 points
- For quarterly returns it will 4 points
- Those returns which are monthly will have a threshold of 5 points

If you're compliant and file on time, HMRC will 'reward' you by resetting your points. For annual returns this will be 2 timely submissions, for quarterly returns 4 timely submissions and finally monthly returns will require 6 timely submissions.

Points can only be reset if all submissions due in the previous 24 months have been made. Additionally, these points have a finite lifespan of 24 months, except when the threshold has already been reached.

4.6.4 Time limits for imposing penalties

HMRC must apply points within specified time limits. Although this will be contingent on the frequency of your submissions (monthly etc) and commence on the date the failure occurred. The time limits are as follows:

- For annual returns it will be 48 weeks.
- The time limit for quarterly returns will be 11 weeks.
- Those returns that are monthly will have a 2-week time limit.

Additionally, HMRC will be able to impose a penalty up to 2 years after the failure which gave rise to the penalty in the first place.

The above time limits will allow HMRC plenty of time to spot a default and apply points (and penalties), assuming their IT systems are working effectively(!).

4.6.5 Appealing against penalties

It will be possible to appeal against a penalty on the grounds of reasonable excuse. For example one of these is where HMRC's own systems prevent you making a submission. This doesn't bode well for Making Tax Digital when this fully goes live(!).

Further details of what is considered reasonable excuse can be found here (part 3 of the legislation). However because each penalty point is subject to a separate appeal this could result in an administrative nightmare for HMRC.

Fortunately HMRC have discretionary powers not to 'award' a penalty or charge a point. Although how freely these powers will be exercised in practice is unclear.

5 Allowable business expenses

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

The general rule is that any expenditure put through the business accounts should be wholly and exclusively incurred for the purpose of the business in order to be able to claim a deduction against your tax bill.

Where there is a dual element of any expenditure you should be able to clearly identify the business-related element in order to claim a deduction. So for example, if you use your personal phone for business use you should only claim the cost of calls you made relating to the business.

In this section we discuss the main expenses which are allowable for sole traders.

5.1 Advertising and marketing

5.1.1 Advertising & PR

Money spent on advertising will be allowable. Examples include direct mail, newspaper adverts and Pay per Click (PPC) advertising.

You can also claim any costs incurred in either setting up or running a website. However, depending on how much you spend, it may be necessary to include any costs designing and building your website as a capital cost and depreciate this over time. For more information about capital assets and depreciation, please review sections 3.1.3 and 6.2.

5.1.2 Hospitality

For more information on what can and can't be claimed for hospitality, please review sections 5.7.1 and section 5.7.5.

5.1.3 Networking

Costs of attending networking events are an allowable business deduction (even where they include a breakfast or lunch) as are any costs related to getting to the networking event eg mileage or parking.

5.1.4 Sponsorship

Sponsorship will be an allowable expense as long it is 'wholly and exclusively' for the business, however there are some exceptions where it is not allowed:

- It must not be for the benefit of a relative
- There should not be any other non-business involvement between the two parties
- The sponsorship spend should not be wildly out of line with the potential benefits being received by the sole trader business

5.2 Bad and doubtful debts

If you are using the accrual method of accounting (see section 3.1) then you will be recording your sales based on either when you raise your invoice or when you carry out any work. This means that the situation may arise where you have an outstanding invoice which may not be paid. In this case you would need to either provide for the bad debt or write the bad debt off.

This will be an allowable deduction for tax purposes if it meets the following criteria:

- The invoice has been included as a sale either this period or preceding periods
- The invoice has not been paid
- You are sure the invoice will not be paid going forward

You should make sure you have adequate evidence that you have rigorously chased the debt. HMRC will expect to see evidence of this if you have an enquiry.

You cannot claim bad debt relief for invoices which are not in the normal course of trade – so for example you would not be able to claim bad debt relief if you sell an asset and the purchaser does not pay.

You can also only claim bad debt relief against specific invoices. Some businesses estimate that a percentage of the money owed by customers each year will not be paid and they create a bad debt expense for this amount. This is considered to be a 'general' provision and will not be an allowable tax deduction.

5.3 Broadband/internet

If this is entirely for your business it's an allowable expense.

If there is a mix of business and personal you will need to take a similar approach as with your mobile phone costs (see section 0).

5.4 Charitable donations

Donations to charity are not normally an allowable deduction for tax purposes.

If you wish to make donations to your favourite charity, and you are near to the higher rate tax bands, you might want to consider doing this under Gift Aid - both you and the charity will then benefit.

5.4.1 Gift Aid

Gift Aid is an Income Tax Relief for charities and Community Amateur Sports Clubs (CASC).

Under Gift Aid, donations received by the charity are treated as if they have been received net of tax. The charity is then able to claim back the basic rate tax credit:

Example: A taxpayer makes a donation of £80. The charity can claim back an additional £20 (£80 * 20/80).

If the taxpayer is a higher and/or additional rate taxpayer, then they can also claim tax relief on the difference between the higher/additional rate tax and basic rate on the grossed up donation.

Example: A taxpayer makes a donation of £80. The charity can claim back an additional £20 (£80 * 20/80) giving a grossed-up donation of £100. Where the taxpayer is a 40% taxpayer, £20 (40%-20% x £10) can be reclaimed, giving a net donation cost of £60.

Where the taxpayer is a 45% taxpayer, £25 (45%-20% x £100) can be reclaimed.

Gift Aid applies to money donation payments, made by individuals who have made a Gift Aid declaration. Payments for subscriptions, memberships & sponsorship may also be Gift Aided providing certain qualifying conditions are met. Gift Aid is restricted where the donor receives a valuable benefit as a consequence of making a donation.

5.5 Clothing and uniform

You are allowed to claim uniform costs (and might be able to claim for clothing if it has your business logo on it) as well as any protective clothing required for your business.

Protective clothing includes:

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

Because they are in the public eye, actors and entertainers may be allowed deductions for items purchased for specific roles or attending a promotional event. For example an actor appearing in a period drama set in the 1800's would be allowed a deduction for items of clothing purchased specifically for this role or it they had purchased an outfit for attendance at a film premiere.

However you can't claim for everyday clothing - even if you only buy a suit to wear to business meetings!

5.6 Computer and office equipment

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

If there is significant personal use it can still be put through as a business expense but the personal element of the usage will need to be disallowed.

If you are using accruals accounting (see section 3.1) the cost of any such equipment will be written off in the accounts over a number of years by means of a depreciation charge (see section 3.1.3 for more details as to how depreciation works).

What you will claim for tax purposes are capital allowances – you can see more about this in section 6.2.

5.7 Entertaining customers/suppliers

5.7.1 An overview

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

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

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

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

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

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

And remember that supplier also includes any subcontractors or freelancers you may engage.

5.7.2 Should I bother recording client entertaining in my accounts

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

Well, our answer is always yes.

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

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

5.7.3 VAT

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

5.7.4 Gifts

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

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

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

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

5.7.5 Room Hire

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

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

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

5.8 Entertaining employees

5.8.1 An overview

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

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

5.8.2 Who counts as an employee

So who’s an employee?

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

HMRC defines staff as to include retired members of staff and the partners of existing and past employees.

As a sole trader, neither you nor your family count as employees – unless members of your family are also your employees.

5.8.3 Mixed events – employees and others

If you do decide to hold an event for your employees, if other individuals who aren’t employees are invited to the event then the expenditure and VAT related to the non-employees is not allowable. If any expenditure can’t be reasonably apportioned then you may find that the whole expenditure won’t be deductible for either tax or VAT.

5.8.4 Christmas party

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

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

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

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

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

5.8.5 Gifts

Whilst gifts to employees are allowable as a tax deductible expense for your business, they are normally regarded as a taxable benefit in kind and will have to be declared on an annual P11d – your employees may not thank you for this!

However the good news is that there is in practice an exemption relating to small gifts given at Christmas, such as a turkey or bottle of wine.

5.8.6 Trivial Benefits

New rules were introduced for the 2018/19 tax year which allow up to £300 of 'trivial' benefits per employee tax free. The rules for these benefits are as follows:

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

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

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

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

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

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

5.9 Office Equipment and Plant & Machinery

The cost of any equipment bought for use in your business is an allowable tax expense. Such items could include:

- Computers
- Printers
- Office furniture
- Mobile phone handsets
- Tablets
- Plant & Machinery

However be aware that as most of the items would have a use in the business which is more than one year, they would be classed as a 'fixed asset' rather than a revenue expense and so you would claim the cost of these via 'Capital allowances' rather than directly through your profit and loss account. You can read more about 'capital assets' in section 3.1.3 and 'capital allowances' in section 6.2.

5.10 Goods purchased for resale/stock

If your business involves selling goods, rather than services, you can include the cost of any goods purchased as an allowable tax deduction.

However if you are accrual accounting you will need to make sure you match the cost of the stock purchased to the sale of that stock. This means you will need to put an entry at the year end to account for any stock which hasn't been sold.

As an example, consider a furniture store which buys ten chairs to sell for £100 each. At the end of the year they have only sold 8 chairs – so they have 2 left in stock. Those two chairs cost £200 to buy so this is how much should be posted as a stock adjustment – and only £800 will be allowed as a tax deductible expense in the year.

And if one of the two remaining chairs was damaged (and so couldn't be sold), then they would also be allowed to write the cost of that chair off.

5.11 Hotel and subsistence

As a general rule the cost of your food and drink incurred away from your place of business during the day time (and where an overnight stay is not involved) cannot be claimed as a tax deductible expense. This is on the basis that everyone must eat to live and so food and drink isn't incurred wholly and exclusively for your business (this precedent was established many years ago by the Caillebotte v Quinn tax case).

HMRC do accept that extra allowable costs for food and drink may be incurred where either the nature of your business is itinerant (for example a construction worker who works in a different location every week) or where you make an occasional business journey outside of your normal pattern (for example your business is based in Poole and you pay for breakfast on the way to attending a business conference in London).

Where you undertake a business trip which requires you to stay away from home, the hotel accommodation and reasonable overnight subsistence costs will be tax deductible.

However, where your business base is away from home and you pay for overnight accommodation and subsistence simply to allow you to be at or near where your business is situated, this expenditure will **not** be tax deductible.

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

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

If it is necessary for you to take a business trip and stay in a hotel overnight, be sensible as HMRC might consider receipts for champagne paid for at The Ritz Hotel excessive!

In addition, as with other travel, the cost of overseas trips is allowable if there is a clear business purpose for the trip.

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

5.12 Insurance

If an insurance policy is taken out which is wholly and exclusively for the business, then this will be allowable as a tax deductible expense. An example would be public liability or professional indemnity insurance.

However if the insurance includes a personal element (for example, loss of profits or keyman insurance) this will not usually be allowable.

Where there is a dual benefit (eg motor insurance where you are not using the simplified method to claim car costs as described in section 5.16.2) then the insurance cost should be split appropriately with only the business element being allowable.

5.13 Living at your business premises

If you live at your business premises (eg a bed & breakfast) you can claim a flat rate per month based on the number of people living at the premises as follows:

Number of people	Flat rate per month
1	£350
2	£500
3 or more	£650

To find out whether you'd be better off using the simplified expenses method, you can use HMRC's handy calculator **here**.

If you choose not to use the flat rate then you will need to work out the split between what you spend for your private and business use of the premises.

5.14 Loan interest

Interest on loans which relate totally to the business are allowable as a tax deduction. However, be aware that you would need to demonstrate that the loan was taken out purely for the purpose of the trade – eg to buy stock or assets.

If there is a dual purpose of the loan then you will need to apportion the interest appropriately – so, for example, if you take out a £10k loan to buy £8k stock and use the remainder for personal expenditure, then only 80% of any interest will be allowable.

Also if the loan is used to buy an asset which has a personal use, then the interest allowed should be reduced by the personal usage element.

And remember that it is only the interest that's allowable – the loan itself is not a deductible expense.

5.14.1 Bank interest & charges

If you have a totally separate bank account for your business and any interest and charges are due to the business use then these can be claimed as a tax deduction. However be aware that should the charges or interest be due to any personal use (eg large amounts of drawings) then the interest and charges claimed will need to be restricted.

If you do not have a separate business bank account and you incur interest and charges due to your sole trader activities then you will need to use a reasonable basis to calculate the charges and interest which can be claimed as a tax deduction.

5.15 Mobile phone

If you're trading as a sole trader, you basically have two choices:

- Have two phones with one exclusively for work. You can then claim all the costs relating to the work phone through your business (including claiming the VAT element against your VAT bill if you're VAT registered and not on the VAT flat rate scheme).

  Whilst it might be the simplest method, we've rarely seen a business owner do this in practice - the main reason being that this doubles the cost of having a mobile phone!

- Have one phone and work out a reasonable split of your bills (and VAT if you're VAT registered and not on the flat rate scheme) between business and personal. You can do this whether you pay for individual calls or have an all-inclusive contract.

  If your call usage is fairly regular then you can work out this split over a period of, say, 3 months. Go through your calls line by line and highlight your business calls (or personal calls if you've got less of these!). Then calculate the business calls vs the total calls.

  Apply this percentage to your total mobile phone costs - including line rental and VAT.

  This won't be 100% accurate each month but as long as your calculations are reasonable (and you can show these to the taxman should the need arise), you shouldn't have any problems.

  If your call usage fluctuates massively each month then you may need to do this on a monthly basis. Again, you don't need to be 100% accurate but your calculations should be reasonable and you should be able to show these to the taxman if he asks.

You can also apply a reasonable split if you have a monthly contract which includes all your phone calls.

5.16 Motor expenses

5.16.1 Mileage allowance

Rather than calculating the actual costs of running your car each year and then claiming the business proportion (as shown here), under the simplified expenses rules for self-employed business owners (NOT limited companies) you can simply claim a flat rate per business mile if you use your own car, van or motorbike for work.

The rates for 2023/24 as follows:

Annual Mileage	Rate per mile
Cars & vans - up to 10,000 miles	45p
Cars & vans - over 10,000 miles	25p
Motorbikes	24p

So if you've driven 11,000 business miles in a year you can claim £4,750 (10,000*45p + 1,000*25p).

5.16.2 Actual cost

Rather than charging the simplified motor expense as shown above, you could charge the business a proportion of your actual running costs (fuel, maintenance, servicing, repairs etc) based on the amount of business mileage you do each year.

So let's look at an example:

> You have total running costs of £5,000, total mileage of 10,000 miles and 5,000 business miles. You can charge your business £2,500 (£5,000 * 50%).

You can claim the following as your running costs:

- Fuel
- Insurance
- Repairs
- Maintenance
- Servicing
- Tax

You can also claim a proportion of the purchase price of the car via capital allowances (see section 6.2.2 - but, again, you would need to reduce this claim by the private element of your car usage.

You can also claim tax relief for interest on any loan specifically used to purchase your car or van, though this will need to be restricted to reflect private use.

For most self-employed business owners, using the flat rate method is going to be far easier but it's worth doing the calculations when you first buy your car to make sure you're not losing out.

But be aware, once you've chosen a method you will have to continue with that method until you change your car.

5.17 Motorbikes & bicycles

The same options apply as with cars and vans but if you choose the mileage rate option the rates to claim are:

- Motorbikes: 24 pence per mile for all business mileage
- Bicycles: 20 pence per mile for all business mileage

If you choose the actual cost option then the purchase of the motorbike is likely to be dealt with through 'Capital Allowances' which is covered in section 6.2.

5.18 Printing, postage and stationery

As long as these costs are incurred purely for business then they will be allowable.

This might include:

- Paper
- Envelopes
- Toner cartridges
- Stamps
- Courier costs
- Business cards

5.19 Professional fees

5.19.1 Accountancy fees

Any accountancy fees you incur for preparing your sole trader accounts are an allowable business expense.

However any fees incurred in preparing your personal tax return in general are not allowable.

In practice this generally means that your total accountancy fees will be allowable as an expense as the argument would be that the incidental cost of preparing your personal tax return would be minimal.

5.19.2 Legal fees

Any legal costs which relate to the sole trader business, and not you personally, will usually be allowable. Examples of this include paying a solicitor to:

- draw up a commercial services agreement for you to use in your business when you get new customers.
- send a warning letter to a client who is not paying an outstanding bill

5.20 Rent – office, shop, desk space

Any rent paid and associated costs for offices or shop will be a tax deductible expense for your business as will any costs incurred to rent desk space – as long as this is used solely for business. If you also use any space rented for both business and personal then you will need to disallow the personal element.

The types of costs you can claim are as follows:

Rent or desk hire

- Business rates
- Internet
- Phone charges
- Electricity, gas and water
- Insurances
- Office and computer equipment (although you may need to claim this via capital allowances – see section 6.2)

5.21 Sales commissions

Where you are required to pay commissions to a salesperson or third party in exchange for their services in facilitating, supervising, or completing a sale then these costs that are wholly and exclusively for the purposes of the trade are normally allowable expenses for tax purposes.

5.22 Software

Software is allowable as long as the primary use is for business.

Where there is a dual element (eg Dropbox costs) then you will need to disallow the personal element.

5.23 Subcontractors

If you hire people to do work on your behalf then these will be allowable for tax.

However you must make sure the relationship between you and them is a contractor/subcontractor relationship and not one of employer/employee.

As a minimum you must make sure you get an invoice from them – this will be prima facie evidence that they are self-employed and not employees.

However you also need to be careful when it comes to employment status – for example it is unlikely you can have someone working with you full time yet treat them as a subcontractor just because they issue an invoice. You need to make sure they are genuinely self-employed otherwise you could get yourself into trouble with HMRC.

Some key indicators of self employment are:

- The subcontractor provides their own equipment such as computers and phones
- They are free to turn down work if they wish and there is no obligation to provide work to them
- If they have to correct any of their work they do so at their own cost i.e. they are not paid additionally for this
- The subcontractor can choose to subcontract their work or part of their work to someone else
- Typically a subcontractor will be on a short term contract and not engaged long term
- The subcontractor will usually have a large degree of control over their work – in other words how, when and where it is performed

It is advisable to have a contract in place making clear that the relationship is that of a subcontractor not an employee.

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

5.24 Subscriptions and publications

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

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

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

5.25 Tools

If you buy tools for use in your business then this is an allowable expense.

However if the tools will last more than one year then they should probably be classed as a 'fixed asset' rather than a revenue expense and so you would claim the cost of these via 'Capital Allowances' rather than directly through your profit and loss account. You can read more about 'fixed assets' in section 3.1.3 and 'capital allowances' in section 6.2.

5.26 Training and development

Where you undertake training to keep your current skills updated, or because it is required to maintain membership of a professional body, then any such training will be allowable.

However if you undertake training to acquire a new skill then this will not be allowable. HMRC's view (supported by case law) is that acquiring a new skill enables you to carry out your trade, for example a doctor can't claim the cost of a degree course required to become a doctor although they can claim for 'continuing professional development'. Any costs associated with any disallowed training would also be disallowed (eg travel, books etc).

5.27 Travel

What is and isn't allowable for travel and subsistence is a surprisingly complex area.

5.27.1 What is business travel?

If you have a permanent base (for example an office) that is separate to where you live, then any travel between home and that base is regarded as ordinary commuting and will **not** be tax deductible.

If you carry out your business from home then you should be able to claim the cost of travelling between your home and where your work is carried out.

However, be aware! HMRC are most likely to challenge the position where they suspect you 'artificially' claim to operate a business from home by setting up an office there, though in reality you carry out the vast majority of your work at a different location regularly.

Given their success at tribunal, HMRC are paying particularly close attention to the matter of travel expenses and taking a more bullish attitude.

So think very carefully about any 'home to office' claims you are currently making in your business accounts. Obviously no two cases are alike, however make sure you have sufficient evidence to support the fact that your business operates from home. For example are your business records kept and written up at home? Do you keep you tools and equipment there?

5.27.2 Motor expenses

We have covered the methods of claiming for car and van expenses related to business travel in sections 5.16.

5.27.3 Other Travel Costs

In addition to expenses relating to your car running costs, you can also claim any parking fees, motorway tolls and congestion charges if these relate to business trips. You can also claim VAT on these expenses as long as they are business related.

You can also claim the cost of any trains, taxis etc where these relate to business trips.

5.28 Working from home

5.28.1 Simplified method

Rather than working out a proportion of your actual home costs (you can see how to do this in section 5.28.2), you can claim a flat rate based if you work more than 25 hours a month from home.

Hours of business use each month	Flat rate per month
25 to 50	£10
51 to 100	£18
101 or more	£26

Let's assume you worked 40 hours a month for 10 months and then 60 hours a month for 2 months, you could claim £10*10 + £18*2 = £136.

5.28.2 Home running costs apportionment

Rather than claiming the flat rate for working from home mentioned above, you can calculate the costs associated with working from home and charge your business that amount instead.

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

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

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

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

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

A couple of things to be aware of:

- Don't use any room in your house 100% of the time for business as this could lead to capital gains tax problems!
- Double check the amount you are charging with local market rents for similar office space and usage - this will ensure you are not significantly overcharging your business

And what's the benefit of doing this?

Well, you'll save tax on the rental charge equal to your marginal rate of tax.

5.28.3 Mortgage interest relief restriction

From April 2018 new rules were introduced restricting the amount of tax relief available to landlords for the finance costs (ie mortgage interest) they claim against any rent they receive for their properties.

HMRC have suggested that these rules will also apply to anyone who charge their own business rent for use of their home as an office.

Prior to this change, you would simply include the whole of the loan interest as an expense in any calculations above.

The new rules no longer allow you to claim the loan interest as an expense. Instead, you get a basic rate deduction for any loan interest on your tax return.

The new rules have been phased in over the tax years 2017/18 to 2020/21. For 2023/24 you will be able to claim 0% of your mortgage interest as an expense (25% is the case prior to 2022/23) and you will claim tax relief at the basic rate on the remaining 100% on your tax return.

How will this work in practice?

Let's look at an example (this is for 2023/24 only).

Claire is an IT contractor working mainly from home. She has a mortgage on her home which has 4 rooms (excluding bathrooms and kitchen). She uses one room for business 80% of the time – so will apply 20% to any costs (25% * 80%).

Her old and new calculations are as follows:

Expense type	Total cost	Included in 2022/23 calculation	Included in 2023/24 calculation
Mortgage interest	£5,000	£0 (0% of cost)	£0 (0% of cost)
Council tax	£2,000	£2,000	£2,000
Electric & gas	£1,500	£1,500	£1,500
Total cost to include in 'use of home' calculation		£3,500	£3,500
Amount to charge business (20% of costs)		£700	£700

HMRC have some further worked examples **here**.

6 Non-allowable business expenses

There are certain expenses which are not allowable for tax purposes. This is because there is considered to be a ‘duality of purpose’ ie they benefit the individual as well as the business. They therefore fail the ‘wholly and exclusively’ costs.

Expenditure which has a duality of purpose and where the business element cannot be easily identified will also not be allowable for tax.

Where there is mixed personal and business usage, (eg mobile phone – see section 0) then the expenditure should be split with an appropriate personal usage deduction.

6.1 Childcare costs

Unlike limited companies, sole traders cannot get a deduction for childcare costs.

6.2 Depreciation/Capital allowances

6.2.1 Capital allowances on equipment

Unless you’re cash accounting in your business (see section 3.2), if you buy a fixed asset (one which will last in the business for more than one year eg computers – see more about this in section 3.1.3) then you won’t be allowed to write the cost off to your profit and loss account – even if you depreciate this over a number of years you will have to disallow the depreciation when calculating your taxable profit.

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

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

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

From 1 April 2008 businesses have been able to claim what is known as the 'Annual Investment Allowance' (AIA) for expenditure on most plant and machinery. The limit for AIA from 1st January 2023 is £1,000,000, from 1st January 2020 it was £200,000 and from 1st April 2019 to 31st December 2019 it was £500,000.

This means the business can effectively claim 100% of the cost of any new equipment up to the value of £1,000,000 bought since 1st January 2023.

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

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

The types of assets where you can claim AIAs are as follows:

- Computers
- Printers
- Office furniture
- Mobile phone handsets
- Tablets
- Plant & Machinery
- Vans
- Motorbikes

AIAs are not allowable on cars (see section 6.2.2), items you owned for another reason before you started using them in your business or items given to you or your business. These will be claimed under WDAs.

You may also prefer to claim for the cost of vans and motorbikes using the simplified method as referred to in section 5.16.

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

6.2.2 Capital allowances on cars

Vans and motorbikes can claim AIAs. However, cars cannot claim AIAs and have to claim a reduced level of Capital Allowances, although low emission cars potentially qualify for enhanced capital allowances (see below).

As mentioned in section 5.16 you have a choice when claiming motor costs – either claiming a mileage allowance per business mile or claiming a proportion of the actual costs of using the car – including any capital allowances.

If you choose to claim the mileage allowance then this section is not relevant for you.

For the 2023/24 tax year there are three different capital allowance percentages as follows:

- CO_2 emissions greater than 50g/km - 6%
- CO_2 emissions greater than 1g/km and less than or equal to 50g/km - 18%
- CO_2 emissions less than 50g/km (second hand vehicles) – 18%
- Electric cars or cars with CO_2 emissions of 0g/km or lower - 100%

The capital allowance percentage is applied to the written down value (WDV) of the car ie the car after any capital allowances previously claimed (before any private use restriction).

Example:

You buy a car costing £20,000 with emissions of 40g/kg (ie within the 18% band) and you use the car equally for personal and business use.

Year 1 - 2023/24: The capital allowances you can claim are as follows:

£20,000 * 18% (the relevant capital allowance rate for the emission level) = £3,600
£3,600 * 50% (the business usage of the car) = £1,800

So you would claim £1,800 capital allowances on your tax return

The written down value (WDV) of the car is now £16,400 (£20,000 less £3600)

Year 2 - 2024/25: The capital allowances you can claim are as follows:

£16,400 * 18% (the relevant capital allowance rate for the emission level) = £2,952
£2,952 * 50% (the business usage of the car) = £1,476

So you would claim £1,476 capital allowances on your tax return

The written down value (WDV) of the car is now £13,448 (£16,400 less £2,952)

If you sell your car, you will have an adjustment to make based on the difference between the written down value and the sales proceeds. If you sell your car for more than the WDV you will have to declare a Balancing Charge, if you sell it for less you will have a Balancing Allowance.

6.2.3 Cash accounting and capital allowances

As mentioned in section 3 you can choose to use the cash based accounting method. If you choose to use this method you need to be aware that from 6th April 2022 no deduction will be available for capital expenditure on:

- A business or part of a business
- Any asset that is not a ‘depreciating asset’ (see below)
- Any asset not acquired or created for use on a continuing basis in the trade
- Cars
- Land (except for the provision or installation of a depreciating fixture)
- Non-qualifying intangible assets (see below)
- Education or training
- Financial assets

An asset is a ‘depreciating asset’ if it is reasonable to expect that within 20 years:

- It will be at the end of its useful life, or
- Its value will have declined by at least 90%

An intangible asset is as defined under UK GAAP, and in particular includes:

- Internally generated intangibles, and
- Intellectual property

An intangible asset will be ‘non-qualifying’ unless it is expected to cease to exist within 20 years.

6.3 Gifts to customers

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

However, the following conditions must be met:

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

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

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

6.4 Gym costs

As with medical expenses, gym costs are usually not allowable as there is a duality of purpose though there are some exceptions – for example if you're a personal trainer then your gym costs will usually be allowable as a cost of your trade.

6.5 HMRC fines and penalties

Fines and penalties for late filing of HMRC documents (eg personal tax return or VAT return) are not an allowable tax deduction.

HMRC have long held that as a fine or penalty is imposed as a punishment for contravening a law then this charge should not be 'diluted by tax relief'.

6.6 Medical expenses

Medical expenses (including eye tests) are not allowable for tax as it's perceived there is a personal benefit derived from the treatment as well as business benefit – this is known as duality of purpose (this is illustrated in the tax case Prince vs Mapp).

6.7 Non-staff entertaining

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

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

You can read more about this in section 5.7.

6.8 Parking fines

A recent tribunal case involving G4S saw a ruling that parking fines incurred where there was a breach of the law – so most fines issued by local councils will not be allowable. However that still raises the question as to whether a fine issued by a private parking company is a breach of the law and so might be allowable for tax.

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

6.9 Pension contributions

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

However please note we are not financial or pension advisers and we strongly recommend you speak to a financial adviser qualified to provide investment advice for your own personal requirements.

Pension contributions are paid into a pension scheme by you personally and are not allowable as a tax deduction against your sole trader profit.

Any such payments are usually 'grossed up' by the basic rate of tax. This means if you pay £80 into the pension fund it is treated as though you had paid £100 – the £20 is added to your pension fund by the government.

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

6.9.1 Pension contribution limits

In any given tax year an individual cannot claim tax relief for amounts that are over the greater of their relevant earnings or £3,600. Relevant earnings for pension purposes are most forms of income, but do not include dividends.

The total maximum gross pension contribution per person is £60,000 per year for the 2023/24 tax year. You might also have un-used allowances from previous years that you can bring forward to increase this limit (check with your pension advisor).

The lifetime limit of £1,073,100 has been removed as part of the Spring 2023 budget for the 2023/24 tax year and there will be no tax implications if this is breached.

The following also applies:

- The higher rate for taper allowance remains at £200,000
- The threshold income continues to be from £110,000 to £200,000
- The adjusted income is now between £150,000 to £260,000
- The minimum tapered annual allowance (for high earners) is still £4,000

6.10 Personal clothing

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

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

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

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

6.11 Student Loans

Any student loans you pay are not tax deductible as these are always paid out of post-tax income as they are considered to be a reduction of a personal loan.

6.12 Tax/National Insurance

Any income tax or National Insurance which you pay personally will not be deductible from the business profits.

Any employer's National Insurance which you pay on behalf of your employees will be allowable – see section 6.14 for more information about taking on employees.

6.13 Working lunches

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

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

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

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

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

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

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

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

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

6.14 Your own time

The time you spend on your own business is not a tax deductible expense for tax purposes – so you can't charge your hours at an hourly rate as you might do for an employee!

7 Becoming an Employer

Taking on your first employee is a big step and so this section covers what you need to do and the issues you may come across.

7.1 Registering as an employer

The first thing you will need to do if you want to employ someone is consider whether you need to register as an employer.

You don't necessarily need to register as an employer once you take someone on. Check first that at least one of the following conditions applies to you. If any apply, then you need to register:

- the employee already has another job
- they are receiving a state or occupational pension
- you're paying them at or above the National Insurance lower earnings level (check at **https://www.gov.uk/government/publications/rates-and-allowances-national-insurance-contributions/rates-and-allowances-national-insurance-contributions** for the latest limits)
- you're providing them with employee benefits

If you need to register you can do so up to four weeks in advance of your first pay day.

You can register as an employer by going on line at **https://www.gov.uk/register-employer**

7.2 Taking on a new employee

7.2.1 Should they be paid through PAYE?

You don't need to operate PAYE for an employee if you are paying them below the National Insurance lower earnings level (check at https://www.gov.uk/government/publications/rates-and-allowances-national-insurance-contributions/rates-and-allowances-national-insurance-contributions for the latest limits)

You also don't need to operate PAYE for self-employed workers.

As a general rule (although in certain circumstances this may not be clear cut), someone is:

- employed if they work for you and don't have any of the risks associated with running a business
- self-employed if they run their own business and are responsible for its success or failure

Someone is probably self-employed and doesn't have the rights of an employee if they're exempt from PAYE and most of the following are also true:

- they put in bids or give quotes to get work
- they're not under direct supervision when working
- they submit invoices for the work they've done
- they're responsible for paying their own National Insurance and tax
- they don't get holiday or sick pay when they're not working
- they operate under a contract (sometimes known as a 'contract for services' or 'consultancy agreement') that uses terms like 'self-employed', 'consultant' or an 'independent contractor'

If you're not sure whether someone is employed or self-employed you can use HMRC's Employment Status Indicator (ESI) tool. However, the end result may be weighted in favour of employment as this is more advantageous for HMRC.

From our experience, the situation isn't always clear cut even though the taxman may disagree.

7.2.2 Information you need

You need to get certain information from your employee so you can set them up with the correct tax code and starter declaration on your payroll software.

You'll need your employee's:

- date of birth
- gender
- full address
- start date

From your employee's P45, you'll need their:

- full name
- leaving date from their last job
- total pay and tax paid to date for the current tax year
- student loan deduction status
- National Insurance number
- existing tax code

You must keep this information in your payroll records for the current year and the 3 following tax years.

You'll need to ask your employee for this information if you don't have their P45, or if they left their last job before the end of the last tax year.

7.2.3 Using the right tax code

It's very important to make sure you set your employee up with the right tax code.

If you don't have a tax code for them for the current tax year you can use HMRC's online service to work this out **https://www.gov.uk/new-employee-tax-code**

Going forward, HMRC will send you notification if your employee's tax code changes – it's extremely important that you update this in your payroll software immediately. If you use the wrong tax code and end up over-paying your employee, HMRC will ask you to repay the tax. You will then need to try to get this tax back from your employee.

Numbers in a tax code

The numbers in a tax code tells the employer or pension provider how much tax-free income the employee gets in that tax year.

- HM Revenue and Customs works out the tax-free Personal Allowance.
- Income that the employee hasn't paid tax on (eg untaxed interest or part-time earnings) and the value of any benefits from their job (eg a company car) are added up.
- The income that they haven't paid tax on is taken away from their allowances. What's left is the tax-free income they're allowed in a tax year.
- This amount is divided by 10 and added to the letter for their circumstances.

The process is different if they have the letter 'K' in their tax code.

Letters in a tax code

Letter	What it means
L	You're entitled to the basic tax-free Personal Allowance
P	You were born between 6 April 1938 and 5 April 1948 and entitled to your full tax-free Personal Allowance
Y	You were born before 6 April 1938 or over and entitled to your full tax-free Personal Allowance
T	Your tax code includes other calculations to work out your Personal Allowance (eg it's been reduced because your income is over specific limits)
0T	Your Personal Allowance has been used up, or you've started a new job and don't have a form P45, or you didn't give your new employer the details they need to give you a tax code
BR	All your income from this job or pension is taxed at the 20% basic rate (usually used if you've got more than one job or pension or when you start your first job and your employer is waiting for a tax code)
D0	All your income from this job or pension is taxed at the 40% higher rate (usually used if you've got more than one job or pension)
D1	All your income from this job or pension is taxed at the 45% additional rate (usually used if you've got more than one job or pension)
NT	You're not paying any tax on this income

L, P, T V or Y usually appear at the end of a tax code whilst D codes appear at the beginning of a tax code.

K tax codes

Tax codes with 'K' at the beginning means that your employee has income that isn't being taxed another way and it's worth more than their tax-free allowance. For most people, this happens when they're:

- paying tax they owe from a previous year through their wages or pension
- getting State benefits that they need to pay tax on (like the State Pension)
- getting benefits from work that they must pay tax on (like a company car or health insurance)

The employer or pension provider takes the tax due on the income that hasn't been taxed from the employee's wages or pension - even if another organisation is paying the untaxed income to the employee.

Employers and pension providers can't take more than half an employee's pre-tax wages or pension when using a K tax code.

BR and NT

BR and NT are letter only tax codes.

BR means you must deduct tax at the basic rate from all the employee's pay.

NT means you mustn't deduct any tax from their pay.

(Note: Do not refund any tax deducted from an employee before the issue of an NT code, unless your HM Revenue & Customs office tells you to.)

Week 1/Month 1 tax codes

Most tax codes have the effect of deducting tax evenly over the full tax year – that way your employee’s take-home pay doesn’t change much from week to week or month to month.

However sometimes you'll have to use a special method of working out their tax deductions - called a 'Week 1' or 'Month 1' basis depending on how often you pay them. With this method, you ignore all previous pay and tax in the year. HMRC will sort out the final position with your employee at the end of the tax year.

You must use the Week 1 or Month 1 basis if:

- HMRC tell you to
- HMRC issue a code starting with D
- HMRC issue a code that says Week 1 or Month 1 - for example 522L M1 or 522L W1
- your new employee gives you a P45 with a Week 1 or Month 1 code on it
- it's the 53rd pay week in a tax year

You may also have to use the Week 1 or Month 1 basis when your new employee gives you a P45 for an earlier year.

Changes to tax codes

The most common reasons for a tax code change are if your employee starts or stops getting:

- benefits from their job that you need to pay tax on
- expenses from work that they can reclaim tax for
- income that isn't being taxed (like rental income)
- State benefits (including the State Pension) that they need to pay tax on

Their tax code will also change if they need to pay tax due from previous years through their wages or pension.

An employee may be temporarily put on an emergency tax code if you change jobs.

What happens when your tax code changes

The employee, the employer or the pension provider tells HM Revenue and Customs (HMRC) about the change.

HMRC works out what to do with the employee's tax code (or tax codes if they've got more than one).

HMRC sends a new tax code to the employer or pension provider. Once they've got it, they'll use it to work out how much tax to take from the employee's payments from the next time they pay the employee.

HMRC sends the employee a 'PAYE Coding Notice' which explains the changes.

7.3 Real Time Information

RTI (Real Time Information) is a new payroll reporting system which was introduced by HMRC in April 2015 and involves the submission of employee pay related information at the time of payment rather than at year end.

It replaces both submitting P45/P46 details for new employees and the P35 end of year submission.

7.3.1 Reporting

There are two main reporting requirements:

> The Full Payment Submission (known as FPS) - each time a payroll is run (usually weekly or monthly) a payroll submission has to be sent to HMRC, showing that periods pay and deduction details for each employee. This should be submitted either before or on the date payment is made.
>
> The Employer Payment Summary (known as an EPS) – this is used to recover statutory payments (Sick/Maternity/Paternity/Adoption pay) and to report a NICs holiday (eg the £2k holiday given in 2018-15). The EPS must also be used to report if a nil payment to HMRC is due for the month (in which case no FPS will be required).

If you send an FPS after you have paid your employee, you must let HMRC know why in the ‘Late Reporting Reason’ field.

Part of the information that is submitted is the employee’s average expected working hours, this information will then be used when qualifying individuals are in receipt of Universal Credits (Universal Credit will eventually replace most existing benefits and tax credits).
The way you do this will depend on whether your employee gives you a P45 from a previous job or not.

7.3.2 Penalties for late submission

HM Revenue and Customs (HMRC) has introduced penalties for employers who report their payroll information late.

You can get a penalty if:

- your Full Payment Submission (FPS) was late
- you didn't send the expected number of FPSs
- you didn't send an Employer Payment Summary (EPS) when you didn't pay any employees in a tax month

HMRC won't charge a penalty if:

- you're a new employer and you sent your first FPS within 30 days of paying an employee
- it's your first failure in the tax year to send a report on time

Existing employers with fewer than 10 employees, who take advantage of the temporary reporting relaxation, must remember to use late reporting code 'E'.

How much you're charged depends on how many employees you have.

Number of employees	Monthly penalty
1 to 9	£100
10 to 49	£200
50 to 249	£300
250 or more	£400

If you're over 3 months late you can be charged an additional penalty of 5% of the tax and National Insurance that you should have reported.

HMRC sends penalty notices in July, October, January and April. A notice will include what you owe, how to pay and what to do if you don't agree with HMRC's decision to charge you.

Pay the penalty within 30 days of getting the notice - you'll be charged interest if you don't.

You can appeal online against a filing penalty, using HMRC's Online Service. In some cases, HMRC will accept and settle the appeal automatically.

You can appeal if you think:

- the penalty is not due
- the amount of the penalty is wrong
- you had a reasonable excuse for sending your reports late

These are some of the reasons you can give as grounds for appeal:

- data on the returns was incorrect
- death/bereavement
- filing expectation incorrect
- filed on time
- fire/flood/natural disaster
- ill health
- IT difficulty
- missed correction/easement
- no longer have any employees
- no payments to employees
- theft/crime
- other

You can also send your appeal in writing to:

Customer Operations Employer Office
BP4102
Chillingham House
Benton Park View
Newcastle Upon Tyne
NE98 1ZZ

The Notice of Penalty Assessment will contain a 'Unique ID' for each penalty shown on the notice. You must include the Unique ID to identify which penalty you wish to appeal against.

Where HMRC discovers careless or deliberate errors, the penalties that could apply will be based on the behaviour that led to the error and the amount of potential lost revenue for that return.

7.4 Paying any NIC/PAYE due

You must pay your PAYE bill to HM Revenue and Customs (HMRC) by the 22nd of the month (or the 19th if paying by post) when you're running payroll.

Make sure you pay HMRC by the deadline. You may have to pay interest and penalties if your payment is late.

The time you need to allow depends on how you pay.

Same or next day

- online or telephone banking (Faster Payments)
- CHAPS

3 working days

- by debit or credit card online (Bill Pay)
- Bacs
- at your bank or building society
- at the Post Office
- Direct Debit (if you've already set one up)
- by post

5 working days

- Direct Debit (if you haven't set up one before)

If the deadline falls on a weekend or bank holiday, make sure your payment reaches HMRC on the last working day before it (unless you're paying by Faster Payments).

You need your HMRC payment booklet, if you pay at a bank or building society, at the Post Office or by cheque in the post. You can ask HMRC to stop sending you payment booklets if you pay by online or telephone banking, Direct Debit, or by debit or credit card online.

If your monthly PAYE/NIC due is less than £1,500 per month, you can pay quarterly instead of monthly.

You will need to pay your quarterly bills by 19th (if paying by post) or 22nd, of July, October, January and April.

7.4.1 Paying online

You can pay by Faster Payments, CHAPS or Bacs to HM Revenue and Customs' (HMRC) account.

Sort code	Account number	Account name
08 32 10	12001039	HMRC Cumbernauld

You'll need to use your 13-character Accounts Office reference number as the payment reference. You can find this on:

- the letter HMRC sent you when you first registered as an employer
- the front of your payment booklet or the letter from HMRC that replaced it

Your payment may be delayed if you use the wrong reference number.

Payments made by Faster Payments (online or telephone banking) will usually reach HMRC on the same or next day. CHAPS payments usually reach HMRC the same working day if you pay within your bank's processing times.

Bacs payments and payments using 'Bill Pay' with a debit or credit card usually take 3 working days.

Check your bank's transaction limits and processing times before making a payment.

If you're making a payment for a period other than the current tax period, add 4 numbers to the end of your 13-character Accounts Office reference to tell HMRC which tax month and year you're paying for.

These extra numbers are made up of:

- 2 digits for the tax month, eg '01' for month 1 (6 April to 5 May)
- 2 digits for the year, eg '22' for 2023/24

Example:
To submit a late payment for month 2 (6 May to 5 June) in the tax year 2023/24, add the digits '2202' to the end of your reference number.

HMRC will assign it to the wrong tax month if the reference is incorrect.

7.5 End of year requirements

At the end of the year you will need to complete certain requirements as follows:

P60 The P60 is given to the employee at the end of the year as a record of his pay and deductions. The P60 must be given to the employee by 31st May each year.

P11D This form details certain expenses and benefits (eg company cars, telephones, medical insurance etc) given to employees earning over £8,500 or directors even if they earn less than £8,500.

P9D This form details certain expenses and benefits (eg company cars, telephones, medical insurance etc) given to employees earning less than £8,500.

P11D (b) This form summarises the Class 1A NIC liability due on the expenses and benefits reported on the P11D and P9D. If HMRC send you a P11D (b), you must complete it and return it even if there are no NICs due.

The P11D, P9d and P11d(b) must be filed with HMRC by 6th July following the end of the tax year and any class 1A NIC due on these benefits must be paid by 19th July or 22nd July following the end of the tax year depending on your method of payment.

7.6 Company cars

You need to tell HMRC if you provide company cars to your employees by filling in form P46 (Car). You will normally be able to do this via your payroll software.

You need to tell HMRC if you provide any cars for private use by employees earning at a rate of £8,500 or more including expenses and benefits. ‘Private use’ includes employees’ journeys between home and work, unless they’re travelling to a temporary place of work.

If you replace a company car, you can tell HMRC straight away by submitting the new details online. Otherwise, you’ll have to report the change on your end-of-year forms.

You also need to tell HMRC if:

- you stop providing a company car
- you provide someone with an additional car, available for private use
- someone you provide with a car starts earning at a rate of £8,500 or more

You don’t need to tell HMRC if you provide:

- ‘pool’ cars, which are used by more than one employee for business purposes, and normally kept on your premises
- cars adapted for use by employees with a disability, if the only private use is for journeys between home and work
- emergency vehicles used only by on-call employees of the police, fire and rescue, ambulance or paramedic services

There are different deadlines for sending in form P46 (Car), depending on when the change to company cars you provide happens.

When the change takes place	When you need to tell HMRC by
6 January to 5 April	5 April (electronic form)
6 January to 5 April	3 May (paper form)
6 April to 5 July	2 August
6 July to 5 October	2 November
6 October to 5 January	2 February

7.7 Auto-enrolment

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

Please be aware that the information below is just a guide. TPR have published over 50 documents and guides to help with implementation.

7.7.1 What is automatic enrolment?

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

7.7.2 Will it affect me?

Auto-enrolment affects anyone with an employee. If you're self-employed it won't affect you.

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

7.7.3 When will it affect me?

Every employer will be given a staging date.

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

If you can't find your staging date using this tool (usually if you've become an employer after 1 April 2015), then you may find your staging date **here**.

7.7.4 What do I need to do?

The first step is to determine whether you believe AE affects you. Unless you have two or more workers (anyone earning over £10,000 per year) then AE won't affect you. If you do believe AE affects you then we recommend you get professional guidance as soon as possible.

7.8 Payroll software

Many small employers use the HMRC Basic PAYE Tools to run their payroll. This is suitable if you have up to 9 employees although this doesn't produce payslips.

There are also other payroll providers – some of whom have free versions of their software.

Our personal paid for favourite is called Moneysoft Payroll – it costs about £60+VAT a year but does everything you need it to do.

8 VAT

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

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

As at April 2023 there are three rates of VAT:

- A standard rate of 20%
- A reduced rate of 5% - e.g. gas and electricity, children's seating. A temporary reduced rate of 5% also applies to goods and services supplied by the tourism and hospitality sector until September 2023
- A zero rate – applied to goods which are socially or economically important eg most food, books, newspapers, public transport, children's clothing

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

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

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

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

For a list of the major categories see below.

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

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

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

8.1 When to register for VAT

A business must register for VAT when cumulative turnover for the previous twelve months exceeds the VAT threshold (as at 2023/24 this is £85,000). This is known as the 'twelve month' test. Budget 2021 has confirmed that the VAT registration threshold and Deregistration threshold (£83,000) will be frozen until 31 March 2025.

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

You must also register for VAT if you believe your turnover may exceed the VAT threshold (£85,000) within the next 30 days. This is known as the '30 day test'.

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

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

8.2 Reclaiming VAT on expenses incurred before registration

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

8.2.1 Pre-registration VAT on goods:

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

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

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

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

8.2.2 Pre-registration VAT on services:

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

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

8.3 VAT administration

8.3.1 How to register for VAT

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

By post

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

On-line

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

8.3.2 Who should you issue a VAT invoice to

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

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

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

8.3.3 What to include on a VAT invoice

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

- a modified invoice for retail supplies over £250
- a simplified invoice for retail supplies under £250 - and for other supplies under £250 from 1 January 2018

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

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

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

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

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

To convert to sterling you can:

- use the market selling rate at the time of supply
- use the European Central Bank's rate - from 1 January 2018
- use HMRC's period rates of exchange - the rates usually stay the same for each calendar month
- apply to HMRC to use a different method to account for the VAT

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

- your invoice is only for exempt or zero-rated sales within the UK
- you're giving goods as a gift
- you sell goods under a VAT second-hand margin scheme
- your customer operates a self-billing arrangement
- you are a retailer selling to unregistered businesses (as a retailer you may assume that no VAT invoice is required unless your customer asks for one)

8.3.4 Time of supply

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

You need to know this because for example:

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

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

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

The date of supply is:

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

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

There are different tax point rules for:

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

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

8.3.5 Records to keep for VAT

Records you must keep include:

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

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

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

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

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

8.3.6 Filing your VAT return online

Since 1st April 2015 it has been a requirement to file your VAT returns online.

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

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

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

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

8.3.7 Filing deadlines

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

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

8.3.8 Payment deadlines

All VAT payments must now be made electronically.

Direct debit

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

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

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

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

Other payment methods

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

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

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

8.4 VAT Penalty System

8.4.1 Penalties for Late Submission

Put simply, when you miss a VAT return submission deadline you will incur a point.

Once you reach a points threshold (which is based on frequency of submissions) you will be subject to a £200 penalty. The relevant thresholds are set out below:

- For annual returns it is 2 points.
- Returns submitted on a quarterly basis will have a threshold of 4 points.
- Those returns which are submitted monthly have a threshold of 5 points.

Any points that have accrued, expire after 2 years when you remain below the points threshold. Once you have reached the threshold, any points tally will be reset to zero provided two conditions are met.

The first is that you have met your return obligations for a set period based on their submission frequency (monthly, quarterly etc). This is known as the period of compliance - see below.

The period of compliance is based on frequency of returns. For annual returns it is 2 years, for quarterly returns it is 1 year and for monthly returns it is 6 months.

The period of compliance starts on the first day of the month, following the date falling one day after the missed deadline.

So for example Phil has a missed submission deadline of 7th July so his period of compliance starts on 1st August.

Luke on the other hand has a missed submission deadline of 31st March so his period of compliance starts on 1st May (1 day after the submission deadline is 1st April).

The other condition you'll need to fulfil so as to reset your points tally to zero, is to ensure you have submitted all outstanding tax returns for the last 2 years.

If you continually miss your submission deadlines after the points threshold has been reached (plus a penalty has been charged), you'll be liable to an additional £200 fixed penalty for each missed obligation. **Under the new regime, penalties apply to late filed returns even when there is no liability, or a repayment is due.**

It may be possible to avoid penalties and points for late filing, where you have a reasonable excuse for doing so.

These penalty rules for late submission do not apply to the first VAT return of a newly registered person, or the final VAT return once a business cancels their registration.

Additionally, they do not apply to a one-off return that covers a period other than one month, one quarter or one year.

8.4.2 Penalties for Late Payment

These penalties can be charged as a result of a VAT return being submitted, an amendment or correction to a previously filed VAT return, or a VAT assessment being raised by HMRC.

However, penalties are not charged on late payments on account, or instalments for the VAT annual accounting scheme.

Essentially, the sooner a late payment is made, the lower the penalty will be. Although no penalty will be payable if the VAT liability is settled within 15 days of the due date.

Additionally, HMRC have indicated that for the first year (to 31 December 2023) of the new system being implemented, there will be no penalties raised for late payment. This is on the proviso that any VAT liability is settled within 30 days of the due date.

A first late payment penalty will be payable 30 days after the payment due date based on a percentage of the balance outstanding.

Those payments made between 16 and 30 days late attract a penalty of 2%. This is based on the amount of VAT due on day 15.

It VAT is still unpaid 30 days after the due date, an additional 2% will be charged on any VAT liability owed at day 30.

From day 31, a second late payment penalty will be charged at 4% per annum. This will accrue on a daily basis and will be based on amounts outstanding.

It may be possible to stop penalties accruing where a Time To Pay agreement has been reached with HMRC. Unfortunately, this does not prevent late payment interest being charged on any outstanding VAT liability, regardless of whether an agreement has been reached.

Once again, it may be possible to appeal against any penalties raised by HMRC on the grounds of reasonable excuse.

8.5 Charging VAT to Charities

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

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

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

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

The charity should give you either:

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

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

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

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

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

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

- medicine or ingredients for medicine
- resuscitation training models

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

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

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

The eligible items include:

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

8.6 VAT MOSS

8.6.1 Definition of VAT MOSS

VAT MOSS is short for VAT Mini One Stop Shop.

Historically, businesses charged VAT on sales of digital services to consumers at the VAT rate in the country the business was based. This enabled certain larger businesses to save money by locating themselves in countries with low rates of VAT, such as Luxembourg.

So if your business sold certain digital services to consumers in the wider EU, from 1st January 2015 you had to charge them local VAT based on where they used the service. If your business is based in the UK then it would have been necessary to register for Union VAT MOSS. For the purposes of this guide, we have assumed a business is registered for Union VAT MOSS.

In strictness a business was required to register for VAT in each and every EU country where a consumer makes a digital purchase. Obviously, this could have proved to be an administrative nightmare for a business which has multiple sales in a number of EU countries.

Therefore, instead of having to register for VAT with all the different countries in the EU where you might have a number of customers, as an alternative, you could register with HMRC in the UK to use their "Mini One Stop Shop" and report and pay the VAT you charge under these rules over to HMRC instead.

The aim of these rules was to reduce the wide-scale VAT avoidance carried out by larger businesses (see above) - but unfortunately the effects on micro-businesses were not considered in detail!

8.6.2 The UK leaving the EU

From 1 January 2021, you'll either need to register for either VAT MOSS in **any EU member state** or for VAT in **each member state** where you sell digital services to consumers.

8.6.3 Registering for VAT MOSS in an EU member state

If you wish to continue using VAT MOSS, you'll need to register for the VAT MOSS scheme in an EU member state by the **10th day of the month following your first sale to an EU customer.**

So, for example, if you make your first sale on 18 May 2021, then you must register by 10 June 2021. However, you could not register for VAT MOSS in an EU member state **before 1 January 2021.**

8.6.4 VAT registration in an EU member state

If you prefer not to use VAT MOSS from 1 January 2021, you'll need to register for VAT in each EU member state where you sell digital services to consumers. **However, it's important to mention that there is no de-minimis threshold for the sale of digital products to consumers in the EU.**

Please also be aware that VAT MOSS does not apply to all digital products sold. If in doubt, we recommend you seek professional advice.

8.7 VAT schemes

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

8.7.1 Cash accounting

Overview

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

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

Eligibility

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

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

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

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

You can't use cash accounting if:

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

How to join and leave

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

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

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

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

Return and payment deadlines

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

Your VAT online account tells you:

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

The deadline for submitting the return online and paying HMRC are usually the same - 1 calendar month and 7 days after the end of an accounting period. You need to allow time for the payment to reach HMRC's account.

VAT should be paid electronically – either direct debit or internet banking.

Advantages

Cash accounting for VAT means you don't have to pay any VAT due to HMRC until your customers have paid you – but conversely you can't claim any VAT on supplier invoices until you have paid your suppliers.

This scheme will be better for you if you extend credit to your customers and your VAT supplies exceed your VAT purchases. However if you are in a business where customers pay straight away (eg a restaurant or shop) then you will need to standard account for VAT rather than cash account.

8.7.2 Annual accounting

Overview

Usually, VAT-registered businesses submit their VAT Returns and payments to HM Revenue and Customs 4 times a year.

With the Annual Accounting Scheme you:

- make advance VAT payments towards your VAT bill - based on your last return (or estimated if you're new to VAT)
- submit 1 VAT Return a year

When you submit your VAT Return you either:

- make a final payment - the difference between your advance payments and actual VAT bill
- apply for a refund - if you've overpaid your VAT bill

The scheme wouldn't suit your business if you regularly reclaim VAT because you'll only be able to get 1 refund a year (when you submit the VAT Return).

Eligibility

You can join the Annual Accounting Scheme if:

- you're a VAT-registered business
- your estimated VAT taxable turnover is £1.35 million* or less in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- your business is part of a VAT registered division or group of companies
- you're not up to date with your VAT Returns or payments
- you're insolvent

You must leave the scheme if:

- you're no longer eligible to be in it
- your VAT taxable turnover is (or is likely to be) more than £1.6 million* at the end of the annual accounting year

You can join the scheme when you register for VAT or at a later date.

How to join and leave

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 AA and send it to the address on the form (or use VAT600 AA/FRS to apply for the Flat Rate Scheme at the same time)

Confirmation you've joined the scheme is sent to your VAT online account (or in the post if you don't apply online).

You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave. From this date, you must account for your VAT in the usual way.

HM Revenue and Customs
Annual Accounting Registration Unit
Imperial House
77 Victoria Street
Grimsby
DN31 1DB

You have to wait 12 months before you can re-join the scheme.

Return and Payment deadlines

There are 12 months in your accounting period. Your VAT return is due once a year, 2 months after the end of your accounting period.

You must make advance payments towards your VAT bill (either monthly or quarterly) during your accounting period and a final payment when you submit your VAT Return.

Payment	Deadline
Monthly	Due at the end of months 4, 5, 6, 7, 8, 9, 10, 11 and 12
Quarterly	Due at the end of months 4, 7 and 10
Final payment	Within 2 months of month 12

How much to pay

Each payment is either 10% of your estimated VAT bill (monthly payments) or 25% (quarterly payments). The amount is based on previous VAT returns (or estimated if you're new to VAT).

HMRC will write telling you when your instalments are due and how much they'll be.

The final payment (known as a 'balancing payment') is the difference between your advance payments and the actual VAT bill confirmed on your VAT Return.

You may be due a VAT refund if you've overpaid HMRC.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.

You also need to let HMRC know if your turnover is likely to be much higher or lower than the previous year or if your VAT payable is likely to increase by more than 10% since the last time your instalments were calculated.

Advantages

This scheme cuts down on the amount of paperwork to be completed and also gives you two months at the end of the year to pay any underpayments rather than just one month.

However, the amounts paid are calculated based on your previous year's turnover and so if your turnover is decreasing you may end up paying more VAT during the year than necessary.

8.7.3 Flat rate

Overview

Usually, how much VAT a business pays or claims back from HM Revenue and Customs (HMRC) is the difference between the VAT they charge customers and pay on their purchases. However under the flat rate scheme, a fixed percentage of the business VAT inclusive turnover is paid over instead.

The flat rate scheme has the advantage that you don't have to keep VAT invoices or account for any VAT on your expenses – although we would recommend keeping any receipts or invoices you are given for future reference.

The fixed percentage used to calculate the VAT payable under the flat rate scheme originally related to the industry the business was in – and could mean a significant saving between the VAT charged to customers and the VAT paid over to HMRC. So from 1st April 2021 the flat rate scheme has changed significantly.

What are the changes?

From 1 April 2020 HMRC have introduced a new category of trader - known as a 'limited cost trader' - which has a FRS percentage of 16.5%.

Who will be regarded as a limited cost trader?

A business will be treated as a limited cost trader if its VAT inclusive expenditure on goods is:

- Less than 2% of its VAT inclusive turnover; or
- More than 2% of its VAT inclusive turnover though less than £1,000 per year

What are goods as far as the new rules are concerned?

Goods are anything used exclusively for business purposes except:

- Capital expenditure. So for example you won't be able to purchase a new computer in order to circumnavigate the 2% rule detailed above.

- Food and drink for consumption by you as the business owner or your employees. This is consistent with the existing rules whereby VAT recovery is blocked on business entertaining expenditure.

- Vehicles, vehicle parts and fuel, unless your business is one which supplies transport services for example a taxi business. In any event VAT recovery on the purchase of a car, or repairs is blocked/restricted for a number of existing businesses.

- Goods for resale, leasing, letting or hiring out if your main business activity doesn't ordinarily consist of selling, leasing, letting or hiring out such goods

- Goods that you intend to re-sell or hire out, unless selling or hiring is your main business activity

- Any services

HMRC have given the below examples of relevant goods however be aware that this is not an exhaustive list:

- stationery and other office supplies to be used exclusively for the business
- gas and electricity used exclusively for your business
- fuel for a taxi owned by a taxi firm
- stock for a shop
- cleaning products to be used exclusively for the business
- hair products to use to provide hairdressing services
- standard software, provided on a disk

HMRC have also given the below examples of items that are NOT relevant goods:

- accountancy fees, these are services
- advertising costs, these are services
- an item leased/hired to your business, this counts as services, as ownership will never transfer to your business
- food and drink for you or your staff, these are excluded goods
- fuel for a car this is excluded unless operating in the transport sector using your own, or a leased vehicle
- laptop or mobile phone for use by the business, this is excluded as it is capital expenditure
- anything provided electronically, for example a downloaded magazine, these are services
- rent, this is a service
- software you download, this is a service
- software designed specifically for you (bespoke software), this is a service even if it is not supplied electronically

You can more about this **here**. The examples mentioned above are in section 4.5 and 4.6.

An example

Let's assume you're a contractor with income of £80k a year before VAT and you are now classed as a limited cost trader.

Your VAT inclusive turnover is £96k (£80k * 1.2) – and your VAT is £16,000
The VAT payable as a limited cost trader is £96k * 16.5% = £15840
So there is a saving of £160

If you have VATable expenses then you would only need to reclaim VAT on expenses of £160 to be better off using the standard VAT scheme.

Who are these measures aimed at?

The new rules are aimed at making the Flat Rate Scheme far less attractive for service-related businesses such as IT consultants or accountants(!) who incur VAT on services such as rent, software licences, telecoms etc but not on physical goods.

What action do you need to take?

If your business is registered under the flat rate scheme, then going forward for each VAT accounting period, you will need to consider whether your business is a limited cost trader. If you are a limited cost trader, then your FRS percentage will be 16.5% regardless of what business sector you operate in.

Are there any other changes you need to be aware of?

HMRC have introduced measures which take immediate effect where a business tries to reduce their post 1 April 2018 turnover by issuing invoices early.

For most businesses, the new rules will apply for any invoices raised after 1st April 2018 which relate to services supplied after 1st April 2018.

However beware if you issue an invoice or receive a payment before 1st April 2019 which relates to services supplied after 1st April 2018. If this applies to you then, for the purposes of considering whether the limited cost trader definition is met, your VATable supply will be treated as being made on 1st April 2018.

Where your services are performed during a period which spans 1st April 2018, an apportionment must be made on a fair and reasonable basis when applying the new flat rate percentage.

You will also need to make adjustments to your VAT turnover if you issue an invoice or receive payment after 23rd November 2017 (the date these measures take effect) and before 1st April 2018 which relate to services performed on or after 1st April 2018.

Eligibility

You can join the Flat Rate Scheme if:

- you're a VAT-registered business
- you expect your VAT taxable turnover to be less than £150,000* (excluding VAT) in the next 12 months

VAT taxable turnover is the total of everything sold that isn't VAT exempt.

You can't use the scheme if:

- you left the scheme in the last 12 months
- you committed a VAT offence in the last 12 months, e.g. VAT evasion
- you joined (or were eligible to join) a VAT group in the last 24 months
- you registered for VAT as a business division in the last 24 months
- your business is closely associated with another business
- you've joined a margin or capital goods VAT scheme

You can't use the scheme with the Cash Accounting Scheme. Instead, the Flat Rate Scheme has its own cash-based method for calculating the turnover.

You must leave the scheme if:

- you're no longer eligible to be in it
- on the anniversary of joining, your turnover in the last 12 months was more than £230,000* - or you expect it to be in the next 12 months
- you expect your total income in the next 30 days alone to be more than £230,000*

How to join and leave

You can join the scheme:

- online - when you register for VAT - **https://www.gov.uk/vat-registration**
- by post - fill in VAT600 FRS and send it to the address on the form (or use VAT600 AA/FRS to apply for the Annual Accounting Scheme at the same time)
- send a pdf of the completed form to **frsapplications.vrs@hmrc.gsi.gov.uk**
- apply over the phone on 0300 200 3700

HMRC will usually notify you in writing if your application is successful.

The letter will tell you the date you can start to use the scheme. This will normally be from the start of the VAT period following receipt of your application. If you request an earlier or later start date, HMRC will consider all the facts including the timing of your application and your compliance record. HMRC will not normally allow you to go back and use the scheme for periods for which you have already calculated your VAT liability.

You can leave the scheme at any time, but you must leave if you're no longer eligible to be in it.

To leave, write to HMRC at the address below and they will confirm when you can leave.

HM Revenue and Customs
Imperial House
77 Victoria Street
Grimsby
Lincolnshire
DN31 1DB

You must wait 12 months before you can re-join the scheme.

If it's your first year of being VAT registered, you will also get an additional 1% reduction in the flat rate which is applicable until the first anniversary of your being VAT registered.

You must pay any VAT to HMRC electronically – either by direct debit or internet banking.

Advantages

You will still need to raise VAT sales invoices and you will not be able to reclaim VAT on any purchases you make. But this scheme could potentially simplify enormously your accounting for VAT.

8.8 EU Overseas VAT

8.8.1 VAT and service businesses

From 1 January 2022 the VAT rules for supplying services to the UK and EU are similar to those existing rules for **supplying services from the UK to outside the EU**. In other words, they are treated as outside the scope of UK VAT.
However, there are several notable exceptions, namely the following:

- Certain B2C services such as accountancy and consulting change from being standard rated to outside the scope of UK VAT.
- You can read about the changes to digital services **here**
- The supply of financial and insurance services changes from an exempt supply to outside the scope of VAT. This means input VAT recovery may now be possible

8.8.2 VAT and exporting goods to the EU

If you are a UK e-commerce business selling to customers in the EU the distance selling rules may have been relevant previously.

Prior to 1 January 2021 a UK VAT registered business that had relatively low sales to other EU countries could benefit from the distance selling thresholds.

Sales within the distance selling thresholds were subject to UK VAT unless the supplier decided to register for VAT in the EU country of destination.

However, from 1 January 2021 EU countries are treated the same as non-EU countries. Therefore, any goods leaving GB for the EU (though see below for Northern Ireland) will now be considered 'exports'. The government have produced a useful guide which you can see **here**.

Post Brexit, selling goods to the EU now presents the following complications.

- It will be necessary to charge VAT at the local rate applicable to the country to which the goods arrive in.
- The importer of record pays the Import VAT on arrival of the goods. This can be recovered if the customer is registered for VAT (though see below). However to become an importer of record you will need an agent in the country to which you're exporting.
- Any B2C sales in the EU will be affected as the customer will be charged duty plus VAT.
- Whilst UK VAT registered businesses no longer have to complete an EC Sales List if you are exporting zero-rated goods to the EU you'll need to retain evidence proving the goods have left the UK.

8.8.3 Zero-rating of goods

Provided certain conditions are fulfilled, the export of goods can be zero-rated for VAT purposes. However records will need to be kept to prove this.

You'll need official or commercial evidence (for example from a customs system or certificates of shipment) to prove the entitlement to zero-rating. Additionally the goods must be exported from GB (and evidence obtained) within the specified time limits. Depending on the goods exported, this is either three or six months.

If you fail to meet the conditions or retain sufficient evidence then the any sales will be treated as standard rated (if normally standard-rated when supplied in the UK). Any zero-rated supplies must still be accounted for on your VAT returns even if there is no VAT liability.

8.8.4 VAT position for Northern Ireland post Brexit

As Northern Ireland (NI) will continue to operate as part of the EU VAT area the rules on exporting to the EU will not change. However Northern Ireland is also part of the UK VAT system.

This means VAT must be applied to supplies of goods as it is in the rest of the UK. If the supply of goods is moved through NI to the EU, this will be a zero-rated supply as noted above.

8.9 Issues to be aware of

VAT is a complex subject and you need to be careful that your accounting for it correctly. The list below covers some of the common VAT pitfalls which you ought to be aware of – please note that this list is by no means exhaustive.

8.9.1 VAT on cars

As a general rule, you can’t reclaim the VAT on cars unless you buy a car purely for business use (e.g. a pool car or taxi) in which case you can reclaim the VAT in full. Similarly, you can’t reclaim the VAT on the car’s accessories unless you can show that they have a business use.

VAT on vans is recoverable – however it isn’t always easy to determine when a vehicle is a car or when it is a van!

If you lease a car for business purposes you can generally only reclaim 50% of the VAT. The only exceptions are as follows:

- There is no private usage of the vehicle in which case you can reclaim 100%.
- You are leasing a car for use in a chauffeur/tax service business, a driving school or a self-drive car hire business – then you can reclaim 100% of the VAT in full.

VAT on repairs can be reclaimed in full as long as the vehicle has some business use and the invoices are in the business name and paid by the business.

If you are a VAT registered partnership or sole trader you may be able to reclaim some of the VAT incurred on car repairs/servicing provided you can demonstrate there has been some business use of the vehicle in question.

8.9.2 VAT on fuel

You have four different options for reclaiming the VAT on fuel:

1. Reclaim 100% of the VAT – but all the fuel must have been used for business purposes.

2. Reclaim all of the VAT and pay VAT on the proportion of fuel not used for business. The fuel can be used for business and non-business purposes. The repayment is made by applying a 'fuel scale charge' to your quarterly tax return and paying this amount over to HMRC with any other VAT due.

3. Reclaim the business proportion of the VAT. You must keep detailed records of business and private mileage. You will also need to hold on to relevant petrol receipts. If you pay a mileage allowance for business miles travelled, you can reclaim the VAT on the fuel element of this allowance. The fuel only element must be similar to the HMRC guidelines for mileage payments for company cars.

4. Not reclaim any VAT. This can be useful if your mileage is low and/or you use the fuel for both business and non-business. As you are not claiming any VAT you do not need to keep detailed mileage records for VAT purposes (although you will still need these to claim business mileage in your accounts).

8.9.3 VAT on parking

Be careful with VAT for parking – multi-storey car parks include VAT at 20% but on-street parking meters and pay-and-display car parks are not subject to VAT!

8.9.4 VAT on staff business expenses

If you have to send your staff away on business, then you can claim the VAT element of any expenses they incur – but this must be on actual expenditure rather than any overnight allowance.

8.9.5 VAT on business entertaining

Generally you cannot reclaim VAT on business entertainment expenses. The person being entertained may be an existing customer, a potential customer or any other person who is not an employee. The following are not employees for VAT business entertainment purposes:

- pensioners and former employees
- job applicants and interviewees
- non-employee shareholders

Business entertainment expenses include:

- food and drink
- accommodation - eg hotels
- theatre and concert tickets
- sporting events and facilities
- entry to clubs and nightclubs
- use of capital assets such as yachts and aircraft
- payments made to third party business entertainment organisers
- free samples
- business gifts
- when you provide entertainment or hospitality only for the directors or partners of your business (but it's worth noting that if all staff are included you can reclaim the VAT)

8.9.6 VAT on staff entertaining

Whilst VAT on business entertainment is not allowable, VAT on staff entertaining is.

But be careful when it comes to the Christmas party – you can reclaim the VAT relating to the function but be careful as there may be a restriction depending on the number of guests your staff bring.

9 Trading & property allowances

From 6 April 2021, individuals now receive two new annual tax allowances of £1,000, the 'Trading and Property Allowances'.

This is designed to reduce reporting under Self Assessment where you receive small amounts of trading, miscellaneous or property income.

It covers small income from activities and could also include Airbnb income.

To simplify matters you can elect to deduct the £1,000 allowance from this income rather than claim any allowable expenses.

There is one allowance for trading or miscellaneous income and one for property income.

9.1 Key points

- The election to deduct the £1,000 allowance is made independently for the property and trading allowances and is made for a particular tax year.
- The election must be made by the first anniversary of 31 January following the end of the tax year e.g. 31 January 2026 for the 2023/24 tax year.
- The allowance is not available to partners in partnership.
- Relief is excluded if relevant income includes a payment received from the individual's employer.
- The level of other income does not affect the availability of the allowance.
- You can choose how to allocate the allowance to different sources of trading and miscellaneous income but can only claim one trading allowance and cannot use the allowance to create a loss.
- The trading allowance is not available for trading partnership income or rent a room trades or receipts
- The trading allowance is not available to someone who already has other taxable income from self-employment.
- The trading allowance is not available to someone why has received income from their employer or the employer of their spouse or civil partner. The receipt of such income prevents the allowance from being available for any trading income, even that which is not from the employer

9.2 Property allowance

- Individuals with UK and overseas property income can choose how to allocate the allowance but cannot create a loss.

- The allowance will not apply to income on which rent a room relief is given.

- The allowance will not apply to income from a property business carried on by a partnership but does apply to jointly owned property where there is not a partnership.

- The property allowance is not available if an individual receives a tax reduction for non-deductible interest

10 Tax-Free Childcare

From April 2021 a new scheme available to parents was introduced called ‘Tax Free Childcare’.

10.1 Who is eligible?

The scheme is for working parents. To be eligible:

- parents must have children under 12 (17 for disabled children)
- both parents must be in work
- both parents must earn at least £115 a week, but no more than £100,000 a year

You can contribute if you fall into one of the following categories:

- The self-employed and employees who do not have **employer-supported childcare**(for this read childcare vouchers and workplace nurseries)

- Grandparents, other family members and employers can pay into the account

- Both working parents who work the equivalent of 16 hours a week at the **National Living Wage.** This is judged 3 months from the date the claim is made, though may cause problems for a director on an annual payroll claiming

- Parents earning less than £100,000 per annum

If either parent is part of an employer's **childcare voucher scheme** they cannot contribute to a childcare account

10.2 How does it work?

Any payments into the childcare account are managed by parents via an online childcare account. The government will top up 20p for every 80p paid up to a maximum of £2,000 per child per year for an £8,000 parental contribution. The maximum government top up for disabled children is £4,000 (as opposed to £2,000 see above).

You can withdraw money from a childcare account at any time, but you will lose any contributions made by the government.

You must also re-confirm your eligibility every 3 months.

Parents can only use Tax-Free Childcare to pay for providers who sign up to the Tax-Free Childcare scheme.

10.3 The differences between tax-free childcare and childcare vouchers

If you're currently using childcare vouchers and are thinking of switching to tax free childcare, the guidance below could prove useful.

- Tax-free childcare is open to the self-employed and employed, whereas childcare vouchers are for the employed only
- Tax-free childcare is available regardless of whether your employer makes a contribution, or offers it to you
- You can only have one childcare account per child, as opposed to one voucher scheme per parent
- You cannot use tax-free childcare if you are earning in excess of £100K per annum. All employees can use childcare vouchers as long as they are paid the National Living Wage **after** salary sacrifice
- Anyone can pay into a childcare account. However, if your company contributes this is treated as net salary after tax and national insurance
- There is no requirement for both parents to work under the childcare voucher scheme

10.4 Changing from tax-free childcare to childcare vouchers

If you want to leave your employer's childcare voucher scheme you'll need to provide them with a Childcare Account Notice (or CAN for short). You can send the CAN by email, however you must notify your employer within 90 days of opening the tax-free childcare account.

10.5 Who is better off with tax-free childcare?

If you are self-employed or your employer doesn't offer childcare vouchers you are more likely to benefit under the new scheme. Additionally, if your childcare costs are high you can pay up to £10,000 per annum and the government will contribute £2,000. Whereas for childcare vouchers the maximum government 'contribution' is £933. This is the amount of tax and NIC saved when you receive £243 per month of childcare vouchers.

11 Tax Data

We set out below the main rates that apply to the current tax year - 2023/24 (please note Scottish taxpayers are subject to different rates than those below):

11.1 Personal Income Tax Rates

These figures assume a basic personal allowance of £12,570

- £0 to £12,570 — 0% Tax payable
- £12,571 to £50,270 — 20% Tax payable
- £50,271 to £125,140 — 40% Tax payable
- £125,141 + — 45% Tax payable

Dividends

- Dividend allowance — £1,000 - 0% tax payable
- Basic rate taxpayers — 8.75% - tax payable
- Higher rate taxpayers — 33.75% - tax payable
- Additional rate taxpayers — 39.35% - tax payable

11.2 National Insurance

Employer's National Insurance	13.8%
Employment allowance (if relevant)	£5,000 per employer
Class 1 Primary Earnings Threshold	£12,570
Class 2	£3.45 per week above £6,725
Class 4	Lower profits limit £12,570 per annum
	Upper profits limit £50,270 per annum
Rate between lower and upper profits	9%
Rate above upper profits	2%

11.3 Student loan deductions

Currently there are two different types of student loans: Plan 1 and Plan 2

- If you lived in Scotland or Northern Ireland when you started your course, or you lived in England or Wales and started your course before 1 September 2012, then you have Plan 1.
- If you lived in England and Wales and started your course on or after 1 September 2012, then you have Plan 2.

You pay back 9% of your income over the minimum amount of:

- £22,015 for Plan 1
- £27,295 for Plan 2