

## The Business Column - Starting a new business

Everyone's got to start somewhere, and if it wasn't for those intrepid entrepreneurs who are willing to face the many hurdles and barriers that life and government throw at new businesses, our economy would soon take a nose dive.

Fortunately, there doesn't seem to be any shortage of new start ups, at least to judge from the number of company incorporations registered at Companies House, but this is not to take anything away from the fact that those setting up new businesses need every encouragement they can get.

Unfortunately there is usually a sort of "Catch 22". As this article will, I trust, demonstrate quite clearly, there are few stages of a business' evolution when there is a greater need for professional advice than at the outset. The problem is, except in those rare instances where there is plenty of cash around to provide capital for the new business, the beginning is precisely the time where there are no resources around to meet professional fees for this very much needed advice. So in practice most people muddle through somehow.

Hopefully this piece might help those starting new businesses to make it less of a muddle.

### **The Red Tape**

Although the current government have increased the burdens on brand new businesses with a certain amount of red tape, there is still comparatively little: compared, that is, with many other countries.

In some countries, it is a condition of carrying on a business that it be registered with some form of trade body. It is actually illegal to carry on any trade until you have done so. This is not the case in the UK, except in certain specialist areas, for example the provision of finance on a commercial basis is illegal unless you have a consumer credit licence. But for the generality of businesses the requirement to register is principally related to direct tax and VAT.

First of all, if your business is being carried on as a sole trader, partnership, or LLP, the individuals who have become newly self-employed are required to fill in form CWF1, available from tax offices, which, although it appears to be mainly about registering for payment of the weekly national insurance stamp, actually also forms the basis for the taxman's new file. There is a penalty of £100 for failing to send this form in within three months of beginning business. (This can raise some interesting questions as to when a business actually commences, and we suspect that many who have missed the three month deadline on one interpretation are quite willing to adopt a different interpretation?)

If the business is being set up in limited company form and there are no self-employed individuals, there is a form which the Revenue issue requiring various details about the company's directors etc, but this is somewhat more a relaxed affair. If the business is

going to employ anyone, it is quite important to get your application for a Pay As You Earn Scheme in as soon as possible, because these can often take an age to come through, and in the meantime your employees need paying. When you have done so, though, you may well regret it, because of the sheer bulk of the information that will be sent to you in the post in response. Most sensible businesses make use of the services of a payroll bureau who take all the red tape off your hands for what is usually a fairly economic monthly fee.

Don't forget that if you are running your business through a company and taking a regular salary yourself, the PAYE rules apply just as much as to the employment of third parties.

## **VAT**

Do you have to register your new business for VAT?

Well, the first question to ask is whether your business turnover is going to be vatatable in any event. If the turnover of the business is going to be VAT exempt, there is no question of VAT registration, even if you wanted to. Examples of exempt businesses are: letting residential property (other than holiday lets), insurance and insurance broking, bookmakers, mortgage brokers and other financial services, doctors and dentists, nursing homes and undertakers.

Generally speaking, anyone else in business is going to be within the scope of VAT, and these people, if they are setting up a business from zero, have a choice to make.

The VAT registration threshold is currently £67,000 per annum, and the way this works is that if, in the last twelve months, your business has not exceeded this amount of turnover, you are not obliged to register. The only exception to this is if you anticipate going over £67,000 turnover in the following 30 days. (Bear in mind that if you take over a business as a going concern you have to add in your predecessor's turnover to see whether the threshold has been breached in the last twelve months.)

Even though you don't have to register, though, you might choose to voluntarily. This decision sometimes depends on who your customers are: if they are VAT registered businesses themselves, that can therefore reclaim any VAT you charge them on your goods or services, there is no disadvantage beyond the (not negligible) inconvenience of keeping VAT records and having these liable to inspection at any time by the VAT man. The significant advantage of registration is that you can reclaim VAT on your purchases and overheads. You can also reclaim the VAT on capital assets you have acquired including assets you have acquired prior to beginning the business, providing you have a valid VAT invoice.

A lot of people simply register for VAT at the outset on a voluntary basis to avoid the hassle of having to change from VAT free to VATable trading later.

So at one extreme you have the business whose turnover is going to be substantial and whose customers are going to be other VAT registered businesses. This type of business will almost always

choose to register from the outset. At the other extreme, you have the very small business which is going to be supplying only non VAT registered persons. A good example of this is the plumber, carpenter, or gardener who works for various private individuals. At this extreme, they are likely to resist VAT registration until it becomes compulsory (if it ever does).

## **The Business Structure**

This is a classic example of where professional advice is most needed and can very often not be afforded. Once again, the problem arises because the new business owner has a choice. The business vehicles most often used in this country are the following:-

- Sole Traderships
- Limited Companies
- Partnerships
- Limited Liability Partnerships

This is a subject which I have said an awful lot about in business columns over the past two or three years, and the reason for this is because it is such a crucial decision. I could fill the whole of this edition of the Schmidt Report with a further consideration of it now, however there obviously isn't space to do the subject full justice.

So if you possibly can afford it, take properly qualified professional advice. If you can't, at the risk of telling only some of the story, here are a few rules of thumb:-

If limited liability is important, choose a limited company or a limited liability partnership (LLP).

If the income from the business is not likely to be taxable on you at more than the basic rate (i.e. if your total income is not likely to be more than £40,000 or so) you probably don't need a limited company.

If the business' income is likely to take you into higher rate tax if it were taxed on you directly, but you are likely to be drawing all of the profits out to live on, then again a limited company is not likely to be of any great tax advantage.

Sole traderships and partnerships (not LLP's) are cheaper to run because they are not bound up in red tape as to accounting and company secretarial requirements imposed by law.

If your plan is to build up the business over a set time scale and sell it for a substantial gain in the future, there is a significant inherent disadvantage in limited companies.

At the risk of over complicating the structure, it is sometimes possible and appropriate to have the "best of both worlds", which is a limited company in partnership with an individual. This can open up the benefits of the lower corporation tax rates on profits, (sometimes approximately half those applying to individuals) without the potential disadvantage on sale

(and other disadvantages which I have not mentioned) which apply to a business carried on through a limited company structure.

## **Records**

Having skated delicately over that huge subject, back to practicalities. What are the record keeping requirements?

No matter what some VAT men and tax men might say, there is no set format for records which you are legally required to keep. As far as the direct tax rules are concerned, these prescribe the results rather than the means. The records must be such as to enable you to provide a profit and loss account which correctly states your taxable profits or losses, and accompanying vouchers etc must be retained. The VAT rules are a little more prescriptive, providing that you must keep a "VAT account" which summarises all the VAT you are due to pay and all the VAT you are claiming back.

Don't underestimate the value of good record keeping. If you can't provide the back up for expenses, for example, both the VAT man and taxman are going to want to disallow the expense. In the case of the VAT man, he has an absolute right to do so, and the taxman usually acts as if he has as well, even though this is more arguable. One particularly acute problem with record keeping for a new business relates to expenses incurred, and assets acquired, before the business has fully been set up. These expenses and assets, providing they are related to the business, are just as eligible for a tax deduction as

expenses incurred after commencement: it's just that the records for these expenses tend to be more sporadic and scattered around different places (if, for example, an individual has incurred the expenditure personally because there isn't a business bank account yet). The solution to this problem is to keep a file of pre-commencement expenses, indicating clearly for accounting purposes how these have been financed.

Good record keeping can also pay dividends in relation to business mileage in cars. For non company businesses, the rule is that the expense of keeping a car (including depreciation and financing) is claimable against tax to the extent that the car is used on business. So if the car is used 80% on business, say, 80% of all the running costs etc can be reclaimed. This, as you can imagine, is one of those areas that the taxman looks most closely at if he decides to investigate the business accounts. Frankly, the most frequent result of such an enquiry is that the business owner doesn't have a leg to stand on. He has no records of business versus private mileage, and the percentage he has used to form the basis for his tax claim is no more than a "guesstimate".

You can set yourself apart from the common herd then, by keeping a mileage log. This may seem a formidable requirement, noting down every journey as you make it, and indeed for most people it is an impossible burden. So as a compromise, you may decide to take a typical period of say three months where you log every journey, and, in the absence of significant changes in the business circumstances, continue to use the same percentage thereafter. You

will still be doing a lot better than most people if you do this!

## **Tax Tips for New Businesses**

If you are likely to incur “start up losses”, don’t set up your business as a limited company. Instead, set it up as a sole tradership, partnership, or LLP. To the extent that you have financed the start up losses yourself, they are available for offset against your other income, not just in the year of loss, but going back three years. If you were a higher rate taxpayer in those years, you can therefore find the government subsidising your start up expenses to the extent of 40%!

Assets that you owned prior to the commencement of the business, like vehicles, computers etc can be brought into the business at the outset and, even though you haven’t paid out money as such for those assets from the business, allowances can be claimed based on the market value of those assets at introduction.

The choice of accounting year end for the business can be very important, particularly in terms of the timing of tax payments. If, say, you begin a new business on 1 August 2008, and it doesn’t become profitable overall until say November 2009, a choice of 31 October 2009 as your first accounting year end will ensure that no tax is payable until the year ended 31 October 2010. Alternatively, you may wish to choose a year end which maximises the start up losses by drawing the line immediately after those losses have stopped being incurred.

If you are securing bank or other finance for the new business, maximise the extent to which the bank is providing this. In other words, rather than putting your own cash in to start the business, use this cash, to the extent possible, to repay any borrowing you may have personally which is not securing tax relief, for example home mortgages or personal loans. By correspondingly increasing the bank finance raised for the purposes of the business, you are maximising the allowability of interest you are paying.

## **To Sum Up**

Hopefully the above contains some useful direction pointers. Those who can afford to take full professional advice at the outset of the business, of course, will do so, and hopefully what I have said above indicates quite what a difference intelligent structuring, record keeping etc can make to the tax wellbeing of a new business.

Alan Pink FCA ATII is a specialist tax consultant for APT. Based at their Tunbridge Wells office, Alan advises on a wide range of tax issues and regularly writes for the professional press. Alan has experience in both major international plcs and small local businesses and is recognised for his proactive approach to taxation and solving tax problems. Please send an email to [info@aptpartner.com](mailto:info@aptpartner.com) if you would like to contact Alan.

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