BASIC GUIDE FOR SOLE TRADERS OR PARTNERSHIPS

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Sole Traders

A sole trader describes any business that is owned and controlled by one person. Sole traders do not have a separate legal existence from their owner and as a result, the owner is personally liable for the business costs and debts.

Partnerships

Partnerships are businesses owned by two or more people. A contract called a deed of partnership is normally drawn up. This states the type of partnership it is, how much capital each party has contributed, and how profits and losses will be shared. Partnerships can benefit from shared expertise, but like a sole trader, have unlimited liability.

Limited Liability Partnerships

A limited liability partnership is similar to the partnership structure described above. However, unlike in a standard partnership, the liability of the partners in a limited liability partnership is normally limited to the amount of their partnership commitments.

The owners or partners of sole traders, partnerships and limited liability partnerships are taxed personally on their share of profit and complete self-assessment tax returns incorporating this share

Notifying HM Revenue & Customs that you have Started to Trade

As a general rule, you must register with HM Revenue & Customs once you decide to go self-employed and start working for yourself.

There are three ways to register with HM Revenue & Customs:

1. Register online with HM Revenue & Customs using their website

2. Call the Newly Self Employed Helpline on 0300 200 3504

3. Fill in Form CWF1 (sole trader) or Forms SA400 and SA400 (partnership). This will give information on your personal and business details

You should register the moment you start out as a sole trader or partnership otherwise you could incur a financial penalty.

What Records Do I Need to Keep?

You must keep and retain certain accounting records showing your business transactions. Accounting records are records which are sufficient to show and explain a transaction and to disclose (with reasonable accuracy) the financial position of the business at any time.

Typically such records will include:

- bank statements (a separate bank account is recommended)
- cheque book stubs (giving full details of the payment made)
- bank paying-in books (giving full details of the monies banked)
- copies of your sales invoices generated
- original purchase invoices
- receipts for all cash purchases
- remittance advice slips from customers
- credit card statements
- loan statements
- finance agreements for items purchased on lease or hire purchase
- copies of VAT returns submitted with supporting documentation
- a record of your assets, for example, a record of 'capital expenditure' such as the purchase and sale or disposal assets, equipment, office furniture and vehicles
- details of any stock on hand at or work in progress at the end of your financial year

Why do I Need to Keep These Records?

These records will be used to prepare your annual accounts. Accounts are a historical record of your business' performance over a past period - usually one year. There is also a legal obligation to retain your business records for 5 years after 31 January following the end of the tax year.

Accounts typically include the following two elements:

Profit and Loss Account - This measures your business' performance over a given period of time, usually one year. It shows the income of your business and the cost of goods/services and expenses incurred in earning that income.

Balance Sheet - This is a snapshot of your business' assets (what you own or are owed) and your liabilities (what you owe) on the last day of your financial year.

Whilst these accounts do not need to be formally submitted to HM Revenue & Customs, they form the basis of the profit figure entered onto the self-assessment tax return.

Other Considerations

Once you've decided to become a sole trader, you should think about taking out the appropriate business insurance cover for your new venture. Some types of insurance are mandatory (such as if you employ people), whereas others will simply provide peace of mind that your business will be protected in case something goes wrong. Most sole traders will look at taking out public liability insurance and employers liability cover, as well as any other policies required for industry-specific reasons, or if customers or clients require it.

Accounting Periods

Accounts do not have to be prepared for the tax year itself; businesses can choose their annual accounting date. The taxable profits of a tax year are taken to be those of the accounting year ending in the tax year. For example if your accounting year end is 30 September 2017 the profits arising would be taxable in the 2017/18 tax year.

Accounting periods for new businesses which are not in-line with the tax year may give rise to 'overlap profits'. In their first tax year, new businesses are taxed on their profit from the start date to the end of the tax year. The second year's charge is normally based on the profits of accounting period which fall in the tax year. Part of that profit has usually already been taxed in the first year and this is called 'overlap profits'.

Example

A business started on 1 January 2017 and made its first accounts for 12 months to 31 December 2017, then annually to 31 December.

The taxable profits are:

2016/17	01.01.17 to 05.04.17	3/12 of 1st year's profits
2017/18	01.01.17 to 31.12.17	1st year's profits
2018/19	01.01.18 to 31.12.18	2nd year's profits
Overlap profits are:		3/12 of 1st year's profits

Overlap relief is given for the overlap profits when the business ceases.

How are Business Profits Calculated?

Whether the business is that of a sole-trader or a partnership, profits are calculated in accordance with generally accepted accounting practices. They are then subject to adjustment as required by tax legislation, such as private use restrictions and add backs for disallowable expenditure such as business entertaining.

Revenue expenditure is allowable in calculating taxable profit, but capital expenditure cannot be deducted in the same way. Capital expenditure on assets such as vehicles and equipment will however attract capital allowances.

Capital Allowances

You deduct capital allowances from your taxable income - so you pay less tax. The allowances cover items that you have to provide so that you can do your work. They are to recognise that assets or equipment lose value as a result of general wear and tear - or depreciation. Broadly speaking, anything that you have to use in your work that's likely to last for at least two years may be covered by capital allowances.

Calculating Capital Allowances

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What is a Self-Assessment Tax Return?

Your business income, expenditure and capital allowances claim are submitted to HM Revenue & Customs on a self-assessment tax return – form SA100 and self-employment pages SA103. These will be issued automatically by HM Revenue & Customs soon after the end of the tax year on 5 April. You may also need additional pages if you have other employment to declare, or specific kinds of investments or earnings.

Filing Deadline

The self-assessment Tax Return must be submitted to HM Revenue & Customs by 31 October, if you are returning it by post, or 31 January if you are filing electronically. Penalties will be incurred if your Return is filed late.

Tax/National Insurance Contributions

You will have to pay tax and Class 4 National Insurance Contributions (NICs) on your profits and HM Revenue & Customs will calculate this liability when your self-assessment return is submitted to them. This liability falls due for payment by 31 January following the tax year to which it relates.

Payments on Account

If your total liability, inclusive of Class 4 NICs, is over £1,000 and at least 20% of the total tax due (if you have additional sources of income) you will also be required to make payments on account in respect of the next year's liability. The payments on account will be two equal payments made on 31 January in the tax year and 31 July following the end of the tax year based on the prior year's liability. If the actual liability is known for the following tax year and is of a lower amount a claim can be submitted to reduce the payments on account accordingly.

Other National Insurance Considerations

Sole traders and members of a partnership also have to pay Class 2 National Insurance Contributions. These contributions are currently £2.85 per week. From 6 April 2015 payment is collected through Self Assessment together with any Class 4 National Insurance Contributions.

Late Payments of Tax/National Insurance Contributions

If you have not paid the tax you owe, you will have to pay a penalty when the payment is 30 days late. If it is six months late, you have to pay a further penalty and another final penalty if it's 12 months late. You will also be charged interest from the due dates.

Late Filing of Self Assessment Returns

HM Revenue & Customs introduced new penalties for late self assessment returns, which will affect Returns for 2010/11 and all future tax years are:

- An initial £100 fixed penalty, which will now apply even if there is no tax to pay, or if the tax due is paid on time;
- After 3 months, additional daily penalties of £10 per day, up to a maximum of £900;
- After 6 months, a further penalty of 5% of the tax due or £300, whichever is greater; and
- After 12 months, another 5% or £300 charge, whichever is greater. In serious cases, the penalty after 12 months can be up to 100% of the tax due.

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