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## Keeping it Simple

*Small Business Bookkeeping,  
Cash Flow, Tax & VAT*

By James Smith BSc FCA

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TAX GUIDE – ‘Keeping it Simple - Small Business Bookkeeping, Cash Flow, Tax & VAT’

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## About the Author

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I am a chartered accountant and have been working in general practice for over ten years. Based in Oxfordshire but with clients located across the country, I deal predominantly with small businesses and individuals. I originally trained with KPMG, one of the largest accounting firms in the country, before moving into the 'real world' of industry, taking on a number of roles in both a large manufacturing company and smaller scale service businesses until setting up my own practice in 2002.

If you have any suggestions to make things easier for readers of future editions of this book, I would be very pleased to hear from you.

For more details about my practice, please see my website. Unlike traditional High Street accountants, I can usually deal with most UK tax and business issues wherever you are located.

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## Dedication

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To my grandparents, for your guidance and encouragement.

## Contents

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<b>Introduction</b>		<b>1</b>
<b>SECTION 1 Basic Bookkeeping</b>		<b>3</b>
<b>Chapter 1</b>	How to Keep Basic Records	<b>5</b>
<b>Chapter 2</b>	Basic Accounting Controls	<b>9</b>
<b>Chapter 3</b>	How to Send Out Invoices That Get Paid!	<b>16</b>
<b>Chapter 4</b>	What Records the Taxman Expects You to Keep	<b>21</b>
<b>SECTION 2 Introducing VAT</b>		<b>29</b>
<b>Chapter 5</b>	How VAT Works in Plain English	<b>31</b>
<b>Chapter 6</b>	VAT Jargon Demystified	<b>35</b>
<b>SECTION 3 How Good Accounts Help a Business Grow</b>		<b>43</b>
<b>Chapter 7</b>	Introduction	<b>45</b>
<b>Chapter 8</b>	Case Study 1: James's Bookshop	<b>46</b>
<b>Chapter 9</b>	Case Study 2: Emily's Art	<b>50</b>
<b>SECTION 4 How to Complete Your Tax Return Without Fuss</b>		<b>55</b>
<b>Chapter 10</b>	Business Tax Return Basics	<b>57</b>
<b>Chapter 11</b>	Case Study 1: Simple Service Business	<b>65</b>
<b>Chapter 12</b>	Case Study 2: Simple Stock Business	<b>73</b>
<b>Chapter 13</b>	Case Study 3: Simple Stock Business – Cash Basis	<b>86</b>
<b>Chapter 14</b>	Further Self-Assessment Issues	<b>94</b>
<b>Chapter 15</b>	General Self-Assessment Tips	<b>100</b>
<b>SECTION 5 Accounting for Limited Companies</b>		<b>103</b>
<b>Chapter 16</b>	The Basics	<b>105</b>
<b>Chapter 17</b>	How to Benefit from a Director's Loan Account	<b>106</b>
<b>Chapter 18</b>	How to Claim Back Money from Your Company	<b>109</b>
<b>Chapter 19</b>	Limited Company Summary	<b>113</b>

## Contents (cont...)

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<b>SECTION 6</b>	<b>Everything You Need to Know About VAT</b>	<b>115</b>
<b>Chapter 20</b>	Basic Bookkeeping with VAT	<b>117</b>
<b>Chapter 21</b>	How to Complete Your VAT Return	<b>123</b>
<b>Chapter 22</b>	Overseas Purchases & Sales	<b>132</b>
<b>Chapter 23</b>	Pros & Cons of the Cash Basis	<b>136</b>
<b>Chapter 24</b>	How to Benefit from the Flat Rate Scheme	<b>138</b>
<b>SECTION 7</b>	<b>How to Pay Less VAT</b>	<b>141</b>
<b>Chapter 25</b>	Who Should Register for VAT Early?	<b>143</b>
<b>Chapter 26</b>	How to Register for VAT	<b>152</b>
<b>Chapter 27</b>	VAT Schemes – Saving You Time & Money	<b>154</b>
<b>Chapter 28</b>	Clever VAT Registration Strategies	<b>161</b>
<b>SECTION 8</b>	<b>How to Increase Cashflow &amp; Boost Profits</b>	<b>165</b>
<b>Chapter 29</b>	Why Is My Cash Flow Poor?	<b>167</b>
<b>Chapter 30</b>	Smart Business Strategies for Strong Cash Flow	<b>171</b>
<b>Chapter 31</b>	Great Billing Tactics to Get the Cash Rolling In	<b>174</b>
<b>Chapter 32</b>	Effective Credit Control	<b>187</b>
<b>SECTION 9</b>	<b>Other Issues for the Small Business</b>	<b>197</b>
<b>Chapter 33</b>	The Best Accounting Software	<b>199</b>
<b>Chapter 34</b>	Your First Employee	<b>203</b>
<b>Chapter 35</b>	How to Choose an Accountant or Bookkeeper	<b>211</b>
<b>Appendix 1</b>	<b>Headed Paper</b>	<b>221</b>
<b>Appendix 2</b>	<b>HMRC Categories for Self-Assessment</b>	<b>223</b>
<b>Appendix 3</b>	<b>Flat Rate VAT Scheme Rates</b>	<b>225</b>

## Introduction

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The purpose of this guide is to help owners of small businesses keep basic accounting records, improve their cash flow, complete a self-assessment tax return and understand VAT.

The bookkeeping and accounting chapters start by going over the basics of record keeping for sole traders and gradually build to take account of your legal responsibilities and information needs.

The self-assessment section takes a guinea pig taxpayer and shows how the 'self-employment' tax return pages can be completed with minimum fuss.

The cash flow section contains numerous tips I have picked up over the years and will help your business get paid on time and make sure the money keeps rolling in.

The VAT section starts at ground level, showing you how VAT operates and helping you decide whether to register voluntarily or wait until you are forced to do so. The book gives practical pointers on how to register for VAT and what VAT scheme options exist to help you. The book ends with some suggested strategies you can use to get the most out of the VAT system.

The earlier sections of the book are useful when you are just starting up. Some of the themes covered later on will probably only become relevant after your first year or two of trading so you should find this book a useful resource for several years to come.

# **Section 1**

## **Basic Bookkeeping**

## Chapter 1

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# How to Keep Basic Records

Although each business must assess its own record needs, there are certain things that apply to all businesses and the following section sets out the fundamentals.

### **Separation of Business & Personal Accounts**

If you have recently started a business the first thing you should do is open a business bank account. This may sound obvious if you have already done so but many people start off using their personal bank accounts. This makes your record keeping that much harder as you will later have to determine whether each transaction was for personal or business reasons and you are unable to control your accounts with good bank reconciliation.

Most banks offer free banking for start-ups (typically for 18 months) and many throw in free advice and other perks. Do pay close attention to the fees once the free period ends, which may either be per transaction or a fixed monthly amount. At the time of writing the only major bank offering longer term free banking was the Co-operative Bank, but this is for Federation of Small Business members only. Generally speaking, 'direct banking' accounts which are run via the internet/post/phone are available at a lower cost than traditional branch-based accounts. If however you like or need to bank over the counter due to handling cash, these accounts will not generally be suitable.

### **Records of Your Income**

Different businesses receive income from different sources. However, the basic principle does not change: you should keep good records that summarise your sources of income.

For a service company that sends out invoices, this record would simply be a list of invoices issued, as depicted in Figure 1.1.

Figure 1.1 Income Spreadsheet

Ref	Description	Date	Amount
INV001	Mr A	05/01/2018	1,000.00
INV002	Mr C	06/01/2018	250.00
<b>Total</b>			<b>1,250.00</b>

- 'Ref' is the sequential and unique invoice number.
- 'Description' gives the client name and possibly the work completed.
- 'Date' is the invoice date.
- 'Amount' is the total invoice value.

A good idea is to keep a copy of all the invoices in a ring binder, in sequential order, detailing the work completed. The above spreadsheet would be your summary accounting record.

For a retail business, totals of the daily or weekly till receipts may be appropriate. The following sections discuss in more detail how to amend the basic record above for your own specific business needs, so don't worry too much if the above layout is inappropriate.

## **Retaining Your Receipts**

A receipt is proof that you bought something. HM Revenue & Customs may require this proof to be produced if you are ever investigated. You can submit secondary evidence, such as proof the payment went through your bank account or credit card statement, but you should not rely too heavily on this method of record keeping.

## **Keeping Your Receipts in Order**

If you just throw your receipts in a carrier bag and hope for the best you will always struggle to keep good accounting records. The first step towards improving your records is to convert your carrier bag into some sense of order.

For example:

- Sort out your receipts into rough date order or by month.
- Number them with a thick marker pen starting with '1' for your earliest receipt. Keep this numbering system running forward so every receipt has a unique number on (say) the top right corner.
- Clip together a bundle of receipts (in numerical order) for every week or month.
- Put each bundle in a separate clear plastic wallet to stop them getting lost. It is helpful to indicate on the outside of the wallet the range of receipt numbers.
- Place in a box file or binder.

## Processing Your Receipts

Now that you've got your receipts in order it's time to process them using a basic computer spreadsheet or manual accounts book. You may choose to use some accounting software but this will probably be overdoing it if you are just starting out. Figure 1.2 shows the layout for two example purchases: stationery for keeping your records and this book.

*Figure 1.2 Expenses Spreadsheet*

No.	Date	Payee	Description	Amount	Stationery	Books	Other
1	05/01/2018	Staples	Office Supplies	59.50	59.50		
2	06/01/2018	Taxcafe	Books	24.95		24.95	
				-			
				-			
				-			
				84.45	59.50	24.95	-

- In the first column 'No.' is the receipt number you have written in the top right corner when putting your receipts in order.
- 'Date' is the date of the invoice.
- 'Payee' is the person you bought the item from.
- 'Description' is the type of item you purchased.
- 'Amount' is the amount of the invoice you paid out (VAT is covered in later sections).
- There are now three further columns 'Stationery', 'Books' and 'Other'. These columns are there to describe the *type* of expenditure you incur and are very powerful and one of the keys to keeping good records.

Over time you will end up with a long list of expenses. Using this spreadsheet you will be able to:

- Easily see your total expenditure.
- See the total spend in a period for any type of item, such as stationery, by looking at the total at the bottom of the relevant column. You can insert subtotals to monitor the weekly or monthly performance.
- Find information. If you know you spent money on stationery, for example, but can't recall who the supplier was, you can quickly review the relevant analysis column and find the supplier and price.
- Find a given invoice. All you need do is find the relevant invoice number in the first column. Assuming you have marked up your invoices in numerical sequence and placed them in a box file they should be easy to retrieve without hours of searching.
- Save money. If instead of typing up your expenses yourself you give them to an accountant, they will charge you for this service. Rates vary widely depending on what firm you use and where you live. However, it is not unusual to pay between £15 and £30 an hour to have an accountancy firm type up your expenses.

**Important:** This section is fundamental to keeping good records. If you aren't happy with the basic principles listed above I strongly recommend you stop and go back over this section again, perhaps completing some worked examples using your own records. The following sections build on a basic working understanding of the above.

## Chapter 2

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# Basic Accounting Controls

This chapter outlines the basic controls or 'checks and balances' that you can use to make sure your accounts are accurate.

Without controls it is very easy for your accounts to become inaccurate and unreliable. Good controls provide 'control loops' that ensure all entries are complete and accurate.

This might sound complex but it is actually straightforward if you take time and are patient about entering your data.

The only real difference between good and bad bookkeeping is the check procedures to ensure mistakes in data entry are quickly spotted and resolved.

### **Batch Totals**

A batch total can be used to check that a group of figures (for example, your monthly expenses) is entered correctly into your accounting records.

In Chapter 1 I outlined a way to keep your receipts bundled – one bundle for every month. By adding up all the invoices in any particular month with a calculator, you can check if this figure matches the total amount appearing in your spreadsheet.

This is your batch total.

I always keep a printed copy of the spreadsheet, listing all the expenses, on the front of my invoice batches. This serves as a useful quick reference.

The more invoices you have the more important this type of procedure is to ensure you don't miss something or make a typing error.

A batch procedure may go something like this:

- Gather up the purchase invoices for the month as described in Chapter 1.
- Enter the invoices into your accounting records, for example using a spreadsheet.
- Add up all the invoices you've typed up (programs like Microsoft Excel let you do this automatically).
- Using a calculator add up all the paper invoices manually to check if the totals are the same.
- If there are any differences between the spreadsheet and the calculator:
  - Print out your spreadsheet for the period showing all the expenses.
  - Tick off line by line the invoices appearing in the spreadsheet against the paper invoices in your batch. As they are (hopefully!) in the same order this should be pretty painless and you will quickly see where the errors are.

## **Bank Reconciliations**

Bank reconciliations are the fundamental control within any accounts system. They ensure that everything that has gone through the bank account is reflected somewhere in the accounts, even if it is in the wrong place. It is, therefore, helpful to get into the habit of doing regular bank reconciliations.

To complete accurate bank reconciliations you need two basic things:

- A separate business bank account so that only business transactions go through the account.
- Good accounting records showing the income and expenditure in the period.

The best time to complete a bank reconciliation is once a month when your bank statement arrives in the post. The worst time to do one is at the end of the financial year, having not completed one all year.

'Little and often' is the golden rule of good business bookkeeping.

Figure 2.1 shows how a simple bank reconciliation would look.

*Figure 2.1 Bank Reconciliation*

Opening bank balance as at 1st January 2018		500.00
Less purchases in the period		(84.45)
Add sales Income in the period		1,250.00
Closing balance expected 31st January 2018		1,665.55
Actual balance on the bank statement		1,660.55
Difference		(5.00)

We take the opening balance from the last time a reconciliation was completed (in this case the 1<sup>st</sup> of January), deduct the known purchases listed in the expenses spreadsheet, add the sales income from the sales spreadsheet and calculate an expected closing balance.

Looking at the actual balance on the bank statement you can see that the totals don't quite match up. Now £5 might not sound like much but there could be several things going wrong both ways – in other words, missed income AND missed expenditure.

First, take a good look at your bank statement. Figure 2.2 is a sample bank statement which contains the following transactions:

*Figure 2.2 Bank Statement*

Any Bank Account		Payments	Receipts	Balance
1 Jan 2018	Brought Forward			500.00
7 Jan 2018	Switch	59.50		440.50
9 Jan 2018	Switch	24.95		415.55
15 Jan 2018	Cheque		1,000.00	1,415.55
17 Jan 2018	Cheque		250.00	1,665.55
19 Jan 2018	Cheque		100.00	1,765.55
22 Jan 2018	Transfer	105.00		1,660.55
	Closing Balance			1,660.55

At this point a lot of people give up, especially in a real-life scenario where the bank statement contains dozens of items and the apparent difference is very small. However, if your records have been prepared as described above, you should be able to quickly find the problem.

First, compare the payments in your bank statement with the list of expenses on your spreadsheet.

You can quickly tick off the £59.50 and the £24.95 but there is also a mystery payment of £105 on 22 January. You quickly realise that this amount was money taken out as a 'drawing'.

Drawings are amounts taken personally by the owner of a sole trader business. Strictly speaking they are not a business expense, but recording them on your expenses sheet makes sense for bookkeeping purposes.

You therefore go back and amend the 'expenses' spreadsheet adding a descriptive column for 'drawings' (Figure 2.3)

*Figure 2.3 Expenses Spreadsheet*

No.	Date	Payee	Description	Amount	Stationery	Books	Drawings
1	05/01/2018	Staples	Office Supplies	59.50	59.50		
2	06/01/2018	Taxcafe	Books	24.95		24.95	
3	22/01/2018	Self	Drawings	105.00			105.00
				-			
				-			
				<b>189.45</b>	<b>59.50</b>	<b>24.95</b>	<b>105.00</b>

A similar review of the sales income shows a mystery cheque for £100 deposited in the bank. Then you recall that you had completed three items of work in January and had forgotten to list the third invoice and update the sales list accordingly.

The revised reconciliation is as follows (Figure 2.4):

*Figure 2.4 Bank Reconciliation*

Opening bank balance as at 1st January 2018		500.00
Less purchases in the period		(189.45)
Add sales income in the period		1,350.00
Closing balance expected 31st January 2018		1,660.55
Actual balance on the bank statement		1,660.55
Difference		0.00

There is now no difference showing between the bank statement and the spreadsheet and the accounts are therefore fully reconciled.

Sometimes there are genuine differences between your cash position and what is shown in your accounts.

Typical reasons for this would be:

- Sales invoices that haven't been paid yet.
- Things you have bought but not paid for yet.
- Cheques you have paid into the bank account but haven't cleared.
- Personal items purchased from the business account.
- Business items purchased from private funds.

In these circumstances you may have some 'reconciling items'.

Some of these, such as invoices not yet paid and uncleared cheques, will be 'reversing' items. In other words, what is a reconciling item one month will be cleared the next.

Other items, such as mixing private and business money, will be permanent and you should record these as you go along.

Most reconciliation problems can be dealt with by applying a little logic and if you get into the routine of reconciling your bank account

every month you will learn how to deal with the occasional oddity or missed transaction.

If you struggle to complete your bank reconciliation don't be afraid to get some help. Bank reconciliations are probably the most troublesome problem people face with basic bookkeeping, but are certainly worth doing as they help ensure your records are accurate.

### Check Totals

Check totals can be used to make sure all the individual expense columns add up correctly.

In the example expenses layout in Figure 2.3, the total of the 'Amount' column should be the same as the total of all the individual analysis columns. In other words, the total of the 'Stationery' column (£59.50) plus 'Books' (£24.95) plus Drawings (£105) equals the total of the 'Amount' column £189.45.

#### Spreadsheet Tip

You can use a check formula to add up the sum of all the analysis columns and check this is the same as the total of the 'Amount' column. If you put this formula just under the total of the Amount column (see Figure 2.5) it will alert you where there is a difference.

Figure 2.5 Looking for Counting Errors

	A	B	C	D	E	F	G	H
1								
2	<b>No.</b>	<b>Date</b>	<b>Payee</b>	<b>Description</b>	<b>Amount</b>	<b>Stationery</b>	<b>Books</b>	<b>Drawings</b>
3								
4	1	05/01/2018	Staples	Office Supplies	59.50	59.50		
5	2	06/01/2018	Taxcafe	Books	24.95		24.95	
6	3	22/01/2018	Self	Drawings	105.00			105.00
7								
8					189.45	59.50	24.95	105.00
9								
10					0			
11								

In this example the spreadsheet formula would be:

**=sum(E4:E6) – sum(F8:H8)**

If the number in the box is not zero you can immediately see something is wrong with your analysis.

If you're using manual books you will have to manually add up the column totals and check this comes back to the total of the 'Amount'. Typically you would do that at the bottom of each page as you go on through your accounts book.

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