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Small Business Tax Saving Tactics

**Tax Planning for
Sole Traders & Partnerships**

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and
Nick Braun PhD**

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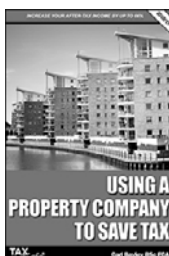
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About the Authors & Taxcafe

Carl Bayley is the author of a series of Taxcafe guides designed specifically for the layman. Carl's particular speciality is his ability to take the weird, complex and inexplicable world of taxation and set it out in the kind of clear, straightforward language that taxpayers themselves can understand. As he often says himself, "my job is to translate 'tax' into English".

In addition to being a recognised author, Carl has often spoken on taxation on radio and television, including the BBC's *It's Your Money* programme and the *Jeremy Vine Show* on Radio 2.

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Nick Braun founded Taxcafe.co.uk in 1999, along with his partner, Aileen Smith. As the driving force behind the company, their aim is to provide affordable plain-English tax information for private individuals and investors, business owners, IFAs and accountants.

Since then Taxcafe has become one of the best-known tax publishers in the UK and has won several business awards.

Nick has been involved in the tax publishing world since 1989 as a writer, editor and publisher. He holds a doctorate in economics from the University of Glasgow, where he was awarded the prestigious William Glen Scholarship and later became a Research Fellow. Prior to that, he graduated with distinction from the University of South Africa, the country's oldest university, earning the highest results in economics in the university's history.

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Chapter 1

Introduction

The main purpose of this guide is to help self-employed business owners (sole traders and partnerships) pay less Income Tax and National Insurance on their profits.

Most of the chapters will show you how to claim more tax deductible expenses or bigger tax deductible expenses.

Expenses are vital in business tax planning because, in simple terms, taxable profit is calculated as follows:

$$\text{Taxable Profit} = \text{Income} \textit{ less} \textit{ Tax-Deductible Expenses}$$

So the bigger your tax deductible expenses, the lower your taxable profit and the smaller your tax bill.

Lesser-known and Big Tax Deductions

Most business expenses are tax deductible, providing they are incurred 'wholly and exclusively' for business purposes.

You probably don't need us to tell you that stationery purchased for a business is a tax deductible expense, as is a salary paid to an employee.

The focus of this guide is not the obvious expenses. Our aim is to help you:

Claim tax deductions you didn't know about

and

Maximise big, important tax deductions

Lesser-known tax deductions may include the cost of travelling abroad on business or entertaining staff. They may also include

paying wages to your minor children or claiming tax relief on your *home's* mortgage interest.

Maximising big important tax deductions may include paying your employees in more tax-efficient ways, increasing the tax relief on your motoring expenses, and maximising your property tax deductions.

Many of the tax planning ideas contained in this guide are not widely known or covered in other tax publications.

We are quite confident that even those with fairly substantial tax knowledge will uncover many useful nuggets that will help them save tax.

Capital Gains Tax & Inheritance Tax

The main focus of the guide is helping business owners pay less Income Tax and National Insurance. These are the taxes that have to be paid year in, year out and are levied at potentially extortionate rates.

Some of the later chapters of the guide also contain important information on reducing other taxes, including VAT, Capital Gains Tax and Inheritance Tax.

Tax Red Tape

The focus of this guide is tax planning, i.e. helping you pay less tax.

We do not spend any time explaining how to complete a tax return, compile accounts or do basic bookkeeping.

Whilst this is important, there are plenty of accountants out there who will help you with your tax compliance.

We feel business owners are far better served by a guide that focuses solely on helping them pay less tax.

Companies

This tax planning guide is aimed at self-employed business owners, namely:

- Sole traders, and
- Partnerships

It is not for company owners. Many of the tax rules that apply to sole traders and partnerships apply differently to company owners.

When putting this guide together we decided that it would make for easier reading if the target market was focused. Having lots of qualifiers and special rules for company owners would muddy the waters.

Taxcafe has a range of other guides aimed at company owners (go to www.taxcafe.co.uk for details).

Limited Liability Partnerships

Limited Liability Partnerships (or 'LLPs') **are** covered within this guide. In most cases, the rules are the same as for any other partnership, but there are a few quirks to be aware of. Where the rules for LLPs differ, we will explain these where appropriate, but there are other legal and accounting implications of using an LLP which are not within the scope of this guide, so we would recommend taking professional advice before using this type of business structure.

Scottish and Welsh Taxpayers

The Scottish Parliament now has the power to set its own Income Tax rates and thresholds, although it cannot change the personal allowance or the tax rates on savings income or dividends.

In Chapter 2 we explain the key differences and their impact on self-employed business owners in Scotland.

Despite these differences, the vast majority of the information contained in this guide remains equally relevant to Scottish taxpayers.

However, unless stated to the contrary, all examples, tables, calculations and illustrations are based on the assumption that the taxpayer concerned is not a Scottish taxpayer.

From 2019/20 onwards, the Welsh Assembly will also have powers to vary the Income Tax rates applying to Welsh taxpayers. These powers are more limited in scope than those applying in Scotland and the vast majority of the information contained in this guide will again remain equally relevant to Welsh taxpayers. See Chapter 2 for further details.

Summary of Contents

The following is a brief chapter by chapter summary of the tax planning information contained in this guide:

Part 1 – Working from Home

Chapter 3 explains how you can maximise your tax deduction for home office expenses, including home mortgage interest, council tax, property repairs, and gas and electricity costs. This tax deduction can be claimed even if you only work from home some of the time.

Many part-time businesses are run from home and in Chapter 4 we take a look at the special tax rules that apply to this type of business, including the one that allows part-timers to offset business losses against their other taxable income, eg income from employment.

Part 2 – How Your Family Can Help You Save Tax

In Chapter 5 we look at how your spouse or partner can be employed in your business or made a partner and paid income that is either tax free or taxed less heavily than your own.

Chapter 6 explains how to save tax by employing your children (including your minor children) or making them partners in your business.

Part 3 – Employing People

When you take on employees you may have to pay employer's National Insurance. Chapter 7 explains how it's calculated and some of the reliefs.

Chapter 8 looks at some of the tax-free benefits that can be paid to employees. These are useful alternatives to cash salary when economic conditions are tough.

Entertaining is not usually a tax deductible expense but certain staff entertainment costs are fully tax deductible. Chapter 9 explains how you can maximise your claim.

In Chapter 10 we explain "auto-enrolment" – the new system of compulsory pensions.

Part 4 – Business Travel, Subsistence and Entertainment

Chapter 11 explains how you can claim a bigger tax deduction for your travel costs by making sure that more of your journeys are treated as business travel.

Chapter 12 explains how you can claim a bigger tax deduction for subsistence costs (including restaurant meals and alcohol) when you travel on business.

Entertainment costs are not tax deductible but, as we show in Chapter 13, it is possible to structure your spending so that these costs are partly tax deductible.

Chapter 14 looks at how you can claim a tax deduction for flights, hotels, meals and other costs when you travel abroad on business... even when you take some time out to relax!

Chapter 15 explains how you can claim the additional cost of travelling abroad with your spouse or partner.

Part 5 – Investing in Your Business: Capital Allowances

When you buy computers, motor vehicles and other equipment for your business you can claim capital allowances.

In Chapter 16 we explain how they are calculated and in Chapter 17 how you can claim extra tax relief by timing your capital spending carefully. You can even claim a cashback from the taxman, as we reveal in Chapter 18.

Part 6 – Leasing vs Buying Business Assets

What saves you more tax: leasing assets or buying them using HP? In Chapters 19 and 20 we explain the tax treatment of each method and provide a definitive answer to this question.

Part 7 – Motoring Expenses

This part of the guide contains invaluable information for business owners who want to maximise tax relief on their motoring costs (including reclaiming VAT).

In Chapter 21, we explain the capital allowances that can be claimed when you buy motor vehicles, including the 100% tax deduction when you buy cars with low CO₂ emissions. We also explain how self-employed business owners can claim big catch-up tax deductions when they sell their cars.

Chapter 22 looks at vehicle running costs and explains how much you can claim for fuel, insurance, maintenance etc.

Small business owners can either claim tax relief on their actual motoring costs or use HMRC's fixed mileage rates. In Chapter 23 we use some examples to show which method produces the biggest tax saving.

Chapters 24 and 25 are all about maximising the amount of VAT you can recover on your motoring costs. Chapter 24 lists all the purchases that qualify: vans, motorbikes, accessories, repairs, parking costs, number plates etc.

When it comes to reclaiming VAT on fuel you have two choices: reclaim VAT on your actual business mileage only or reclaim VAT on all your fuel and pay the Fuel Scale Charge. In Chapter 25 we reveal which method produces a bigger VAT refund.

If you drive a van you can recover over half the cost in tax relief, including a VAT refund and a 100% capital allowance. In Chapter 26 we reveal which vehicles qualify for the full monty of tax reliefs (it's not just Ford Transits!)

In Chapter 27 we provide a definitive answer to a very important tax planning question: Should I lease or buy my car?

Part 8 – Maximising Tax Relief on Borrowings

Chapter 28 explains how you can claim a bigger tax deduction for interest on borrowed money and how to avoid various mistakes that will reduce your tax relief.

In Chapter 29 we reveal how business owners can even make interest on a personal loan (eg a home mortgage) tax deductible.

Part 9 – Business Property

Chapter 30 will help you decide whether it is best to rent or buy premises for your business.

In Chapter 31 we explain the difference between property repairs and improvements. Repairs will generally save you more tax. We reveal how certain spending that increases the value of your property can be treated as a repair for tax purposes.

When you buy a commercial property you can claim immediate tax relief for the value of all the central heating, wiring, lighting and other 'integral features'. Chapter 32 tells you everything you need to know about this generous tax deduction.

In Chapter 33 we explain how you can accelerate tax relief on loan arrangement fees.

Part 10 – E-Commerce

Most businesses have an internet presence these days. In Chapter 34 we explain the rules for claiming tax relief on the various costs, including website development costs and online advertising.

Dedicated internet businesses may even be able to take advantage of other tax saving opportunities, including moving to a lower tax jurisdiction. We provide a brief summary in Chapter 35.

Part 11 – Year-End Tax Planning & Pro-active Accounting

In Chapter 36 we list the things you should do before the end of the tax year to reduce your business's tax bill. Normally this involves accelerating expenses and pushing income into the next tax year; sometimes it involves the opposite approach.

Another thing you may be able to do is change your business year-end itself! In Chapter 37 we explain how doing this could save you thousands of pounds in tax.

Chapter 38 explains how businesses that sell goods can maximise their tax deduction for Cost of Sales.

Chapter 39 explains how you can claim a bigger tax deduction for bad debts.

In Chapter 40 we explain what you must do to ensure that your accountant does their job correctly.

Part 12 – VAT

Most business owners hate VAT. In Chapter 41 we explain the basics and in Chapters 42 and 43 we look at various special schemes that could save your business thousands of pounds in VAT every year.

Part 13 – Capital Gains Tax

Business owners who cash in their chips are in a privileged position when it comes to Capital Gains Tax: they can pay just 10% tax. This is thanks to Entrepreneurs' Relief and in Chapter 44 we explain the rules.

In Chapter 45 we reveal how it is possible, in certain circumstances, to pay just 10% Capital Gains Tax when you sell an investment property by running a business out of it for a short period.

Part 14 – Inheritance Tax

Business owners are also in a fortunate position when it comes to Inheritance Tax: they can completely avoid the grave robbers thanks to a special relief called business property relief. In Chapter 46 we explain how this relief works and in Chapter 47 we explain what you must do to protect it.

Part 15 – Other Important Tax Issues

In the final part of this guide we look at some other important tax issues not covered elsewhere, including the voluntary cash basis for small businesses, which is covered in Chapter 48.

It is important that readers are aware of the potential benefits and drawbacks of this accounting method and its impact on all of the other tax planning strategies contained in this guide.

Readers should note that, unless expressly stated to the contrary, it is assumed throughout the rest of the guide that the cash basis is not being used.

Chapter 49 looks at some of the most useful tax planning techniques available to avoid the High Income Child Benefit Charge on income between £50,000 and £60,000.

Finally, in Chapter 50 we take a look at the tax relief cap which places an annual limit on the total combined amount of Income Tax relief available under a number of different reliefs.

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