

MAY 2020

Smooth Sole Trader/Partnership Accounts Guide

HELP FOR BUSINESSES
AND THEIR OWNERS

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Introduction

Rules

There are various rules that a self-employed person (sometimes called a sole trader) has to abide by as follows:

- 1 You must keep an up to date record of income
- 2 You must be able to provide a receipt for income received
- 3 Records must be kept for at least 5 years after the 31 January submission deadline of the relevant tax year. For example, your 2018-19 return is due online by 31 January 2020, you must keep your records until at least the end of January 2025.
- 4 You must advise HMRC that you have a new source of income and hence need to complete a tax return by 5th October in your business' second tax year.
- 5 You must complete tax returns annually
- 6 Expenses claimed must be reasonable and for business purposes, and an up to date record should be kept

Guidelines

The above rules are all in law. However, there is a lot of other legislation that applies. Principally official guidelines, or advice given to the tax Inspector on what he should challenge and allow. Individual cases are taken to court and form the frame work for these guidelines. The following general guidance is based on these guidelines along with experience over many years.

Tax Returns

A tax return reports all your personal income, from all sources, for a full tax year 6th April to 5th April, in order to assess your tax bill. Sole trader income requires extra pages on your tax return. The tax inspector will compare results with others in the same trade to pick out those who look different, for investigation. He has seen it all before.

The profit of the business is subject to tax. That is income less legitimate allowable expenditure.

It is now compulsory to keep such records of income and expenditure as you go along, as the tax inspector now has a right to inspect them and they must be correct and up to date. Hence it is a good idea to get it right and log it down from the start.

Income

A record of income is compulsory, but how you keep it is up to you e.g. invoice book, list of monies received etc.

The tax inspector will expect all income to be included as gross before deductions. And income rules mean income can be included as earned, whether or not invoiced or received or on a cash basis.

On investigation the tax inspector is allowed to look at ALL your bank statements so do mark/note non-business income, or he may think it needs taxing e.g. gifts, winnings, cloud software (Xero) etc.

Bank Account

A separate bank account for business income is a very good idea, although not compulsory.

Cash

Cash is a dirty word with HMRC especially as regards VAT so the less cash income the better. It is also best (but not compulsory) to bank all income intact i.e. before deduction of any expenses. If you need cash then draw it separately.

Income

Income to be included in the accounts is usually all income earned, regardless of whether it has yet been collected.

Invoices

Consecutive invoice numbering and recording of credits, bad debts and spoiled numbers is also recommended and compulsory if VAT registered.

Also, as you are preparing a tax return, all your income will need to be noted (not just business income). So, you need to keep interest certificates etc too.

What Expenses Can I Claim?

The main rule on expenses is that they must be for your business and 'reasonable'. That is, would a reasonable person, in your position, with your expertise, incur such an expense.

However, the more evidence the better (i.e. receipts) and you must now keep an ongoing record of what you are going to claim.

There is no comprehensive list of expenses but please see on the next few pages a brief summary of allowable expenditure under headings used by the tax inspector.

Accountancy, legal & other professional fees

Costs of getting professional help in the running and maintaining of your business.

- e.g.
- Accountants
 - Solicitors fees for business work
 - Professional Subscriptions
 - Financial Advisors fees (if it includes business advice given)
 - Licence/registration fees

Advertising, and business entertaining

Any costs incurring in promoting your business, directly or indirectly.

- e.g.
- Social media/Google ads
 - Promotional products/gifts with your name on (max value £50 each)
 - Website costs
 - Leaflets/flyers/Posters
 - Mailshot costs
 - Networking events/clubs
 - Sponsorship – race night, news-sheets etc
 - Donations – raffle prizes (should be local or small)

Bank, credit card & other financial charges

Costs of getting loans, running bank accounts, being paid etc.

- e.g.
- Bank charges
 - Overdraft arrangement fee
 - Credit card membership fees
 - Paypal fees
 - Fees charged for collection of income via credit/debit card
 - Ebay charges

Broadband

If you have a separate broadband contract for your business then the whole cost will be an allowable expense. However, if you use your home broadband for both business and personal then you can only claim for the business use percentage. An estimate of business and personal use has to be taken and can be included.

Business use of home

If you work from home you can claim a proportion of your electric, gas, water, council tax, insurance and mortgage interest or rent. If you are lucky enough to have a cleaner you can also claim the business proportion of their costs. The amount to claim is based on the amount of rooms in your house used for business purposes and the amount of time working from home. We have a separate spreadsheet that can calculate this for you, please ask. See Rent, Rates, Power and insurance costs.

A proportion of your own home costs is allowed – both fixed costs (mortgage interest, rent, council tax, insurance, broadband) and variable costs (gas, electric, cleaning). Up to £6 per week needs no backup; but over this, and you should have detailed calculations for apportionment, as well as copies of bills to substantiate costs. We have a spreadsheet that helps you work this out and links to HMRC detailed rules. Let us know if you need it.

Car, van expenses

Cost of running business vehicles – bought for the purposes of the business.

- Costs for vehicles used both for the business and personally, will need apportioning
- If you have access to a second vehicle (i.e. car) for personal use, then you may be able to have all your business vehicle costs. However, it is usual to apportion costs between business and personal use. (If you have any personal use then 100% is wrong)
- The official method of such apportionment is mileage but it is rare for someone to keep all mileage records both business and personal use. A reasonable estimate is therefore usually acceptable

Costs are usually:

- Road Fund Licence
- Insurance
- Repairs and servicing
- Vehicle leasing payments (but not HP payments)
- MOT
- Fuel
- Cleaning and accessories
- Speeding and parking fines are not allowed!

You do not have to put any vehicle costs though, you could choose the mileage alternative instead – see travel costs.

Charitable donations

You can get tax relief on some charitable donations. However, these are not to be included as a business expense, they are taken into account separately in your tax return.

Clothing

Generally clothing is not an allowable expense. However, there are a few exceptions. If you have to wear a uniform or costume as part of your business then these can be claimed. Clothing which has a logo is also an allowable expense. Protective clothing (such as safety helmet, high vis jacket, steel toe cap boots, aprons, etc) can also be claimed as an expense.

Computer equipment, consumables & software

Computer Equipment will not be classed as an expense, but will be classed as an asset and you can claim capital allowances for the costs. You can also claim capital allowances for second hand equipment and equipment you owned personally then brought into the business. If you use the equipment for personal purposes as well, then only the business percentage can be claimed. Software and consumables are classed as an expense, and only the business percentage of these can be claimed if there is any personal use.

Costs of goods bought for resale

These are any cost recharged on to the client either directly or indirectly.

- e.g.
- The product itself
 - Parts that make it up
 - Packaging
 - Work subcontracted to others who may have done the job in your stead

or goods used – any costs incurred because you did work for the client but which are not recharged.

e.g. • Commission

- Purchase of samples or brochures
- Consumables, for tools etc
- Tendering costs
- Franchise fees

Depreciation

There is an economic apportionment to each year of the value of equipment held and used in the business. The tax inspector has his own rules, which replaces this for the purposes of calculating taxable income, called capital allowances.

Entertaining

Entertaining clients - unfortunately you can't claim any expense for entertaining clients.

Entertaining employees - this is allowable for tax relief, but only in certain circumstances. To ensure it is a qualifying event and not a taxable benefit for your staff it must be an annual event (i.e. Christmas party), open to all staff, and cost less than £150 per guest present.

Food & drink

Food and drink have always been a tricky one, as HMRC argue you need food and drink to live, and, therefore, it is not an allowable expense. However, there are a few occasions when you can claim the costs as an expense.

At your home or office - if you don't have any staff then you can't claim the cost of food and drink you buy for when you are working at home or in your usual office. If you do have employees, you can claim the cost of basic food and drink for them (and free meals at a canteen) - as long as they are available to all staff.

While travelling - you are only able to claim for food and drink when making a journey outside of your normal working pattern, or for when you are staying away from home overnight for business purposes.

Furniture

Generally, furniture cannot be claimed as an expense, but will be classed as a capital asset and capital allowances can be claimed. Furniture includes your desk, chair, filing cabinet, etc, and must solely be used for business purposes (i.e. if you work from your dining room table you can't claim the cost of your table and chairs!).

Gifts

Gifts to employees - you can make a gift of goods and services of less than £50 to employees but it cannot be readily convertible to cash (no premium bonds!)

Gifts to anyone else - as long as the gift is prominently marked with your business' name or logo and isn't food, drink, tobacco or vouchers, and costs less than £50 per recipient then you can claim the cost as an expense.

Insurance

Policies that are solely for business purposes can be claimed. Medical Insurance is not classed as a business expense.

Interest on bank and other loans

Allowability of interest depends on purpose/use of money/loan. Security does not affect tax status. A business cannot get tax relief on loans in excess of the business capital, the money invested in the business.

Interest must also have been properly charged – you cannot include interest on money owed to yourself (you and the business are one and the same for tax purposes).

- e.g.
- Bank overdraft interest
 - Loan interest
 - HP interest
 - Interest on overdue bills
 - But not interest on credit card debt

Irrecoverable debts

If your customer will not be paying you, or they have ceased to trade you can include the amount of their invoice as an irrecoverable debt.

Laundry expense

Anyone who wears a uniform (including clothing with a logo), or protective clothing for work can claim a fixed rate laundry expense from £60 - £165 per year. This covers the cost of washing the clothing.

Mileage

If you use your own car or bicycle for business journeys then you can either claim the business proportion of the total costs or claim mileage. Mileage covers the cost of fuel, running costs, and wear and tear. Business journeys include any trips for solely business purposes - seeing a customer or supplier, deliveries, going to meetings, going to the bank etc. You must keep a mileage log, and the rates are 45p for the first 10,000 miles and 25p thereafter and 5p per passenger.

National Insurance - Class 2 & Class 4

Your national insurance payments are not included as an expense. Class 2 National Insurance is a flat weekly amount and Class 4 are paid as a % on your profits. Both are now paid as part of your tax return with effect from tax year 2015-16.

Office costs

If you work from an office you can claim all of the associated costs - electric, gas, water, rent, business rates, cleaning, etc.

Other business expenses

Any other expense you can think of that do not fall into the above categories.

- e.g.
- Training – but must be necessary, in the course of existing business
 - Trade journals

Parking fines & speeding tickets

These are not allowable expenses, even if the fines were incurred during a business journey. Fines for unpaid Dart Charges or Congestion Charges are not allowable either. Any admin fees relating to these fines are not allowable either.

Pension contributions

Any contributions to your own personal pension are not classed as an expense. However, you will gain tax relief in a separate part of your tax return. If you pay contributions into a workplace pension scheme for your employees then these are an allowable expense.

Phone, stationery and other office costs

Day to day administration costs for the business.

- e.g.
- Stationery – Paper and ink cartridges
 - Mobile phone costs - business calls in excess of monthly costs where it is a personal contract
 - Postage
 - Business line telephone costs (extra/separate line)
 - Proportion of calls on home line
 - E-mail account/charges

Postage & courier costs

You can claim any postage or courier costs as part of your business as an expense. This includes posting paperwork to customers and suppliers, delivering goods, etc.

Professional subscriptions

You can claim subscriptions to professional bodies as an expense, if membership gives you the right to use a qualification and you use the qualification in your business. For example, a nurse can claim the costs of subscriptions to the Nursing & Midwifery Council, teachers can claim their NUT costs, etc. You can also claim subscriptions to trade associations like your local Chamber of Commerce.

Reimbursement

When an expense is incurred by an individual partner then this should be reimbursed from the partnership bank account (an expense claim) and the partnership then includes this in their tax return submission. This is the simplest way to deal with the expense.

Sole traders may have a separate business account to do this or they may not, but the criteria is not as strict as for partnerships.

Rent, rates, power and insurance costs

Any costs incurred due to the business working from a particular location.

- e.g.
- Rent
 - Use of home charge - see Business Use of Home
 - Storage facilities
 - Business Rates
 - Business Utility bills
 - Business insurance (contents, PI etc)

Repairs & renewals of property & equipment

Repairs and maintenance costs, including small items of equipment, not large enough to be considered assets.

- e.g.
- Protective clothing
 - Office furniture under £250 per item
 - Computer accessories – mouse, printer
 - Software updates
 - Equipment repairs
 - Ambience costs i.e. what makes the work environment
 - Fixtures and fittings – shelves
 - Maintenance contracts
 - Health and safety equipment – virus software, alarm

Stationery

Any stationery you buy for your business can be claimed as an expense. This includes business cards, letter heads, pens, paper, printer ink, notebooks, files, folders etc. You can only include items purchased solely for business purposes. So, if there is any personal use then you can't claim for the cost.

Subcontractors - construction industry

Amounts paid to subcontractors under CIS.

- e.g.
- Per their bill, labour plus materials before deduction of income tax

Telephone (landlines & mobiles)

If you have a separate contract for business only then the whole cost of the contract (line rental & calls) can be claimed as an expense. However, if you use your home phone or personal mobile for business use then only the business calls can be claimed for.

Training & personal development

You are only able to claim training costs for courses that update your existing skills or expertise. You are not able to claim costs for any new skills or knowledge.

Travel

If the main purpose of your travel is for business purposes, and you can separate any personal costs, then you can claim the cost of your travel, including flights, train tickets, tolls, parking costs and hotel/accommodation.

This is any business travel costs other than a business vehicle.

- e.g.
- Public transport
 - Mileage – 45p per mile for the first 10,000 miles and 25p thereafter
 - Parking
 - Tolls & Congestion charges
 - Hotel Bills
 - Meals whilst travelling away – see Food & Drink

Vehicles

If you purchase your car or van through your company then it will be classed as a capital asset and you can claim capital allowances, based on the CO² emissions. If the vehicle is purchased through the company then you would claim the actual running costs rather than mileage. If the vehicle is used for personal journeys too, then only the business proportion of the running costs can be claimed and the capital allowances will also reflect the business use only.

Wages, salaries, other staff costs

Amounts paid to staff. Any costs for yourself are not allowed. Work must have been done, staff must have been paid.

- e.g.
- Salaries/wages
 - Payroll taxes and National Insurance
 - Staff benefits such as childcare vouchers
 - Agency workers

Website costs

The build of your website, hosting fees, domain fees, email hosting etc are all allowable expenses.

Zebras

Likely to be tax deductible if you are a zoo! As you can see the list could become endless as different businesses have much different costs .

If you have any questions or require further clarification on any of the expenses you can or can't claim then please do not hesitate to contact us.

Assets

Any equipment used for the business is eligible for tax relief. If purchased exclusively for the business then it can be included at full cost, even if purchased before the business started. If originally purchased personally and later taken over by the business, then a second-hand value at the date it was taken over will be used.

If the equipment is dual purpose (business and personal) then the cost will need to be apportioned.

Both VAT and income tax follow this basic idea.

Assets explained

Small items are included above under repairs and maintenance e.g. replacement screwdriver in your tool box. If anything happened to an item in this category you would just buy a replacement.

Larger items are considered to be assets and separately recorded. It is expected that these items will be used/ useful over some years and if anything happened to them you would repair them, claim on the insurance or sell them second hand if not required.

A separate record of such business assets needs to be kept.

Assets have different tax treatment, depending on their categorisation. Here are the main ones.

Plant and machinery

Most equipment used in the business, including vans and commercial vehicles. The first £25,000 of such expenditure in a tax year is immediately fully tax deductible.

Any costs that fall outside this regime get an annual allowance of 18% of the residual value, annually thereafter.

Any assets with private use is separate and allowances apportioned.

Cars

Cars do not class as plant so have their own rules. As mentioned above, they would be kept separate as having part private use. The allowance available depends on CO² emissions. Below 110, above 160 or in between and the allowance varies.

If you need any help or advice, please don't hesitate to speak to us or arrange a meeting.

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