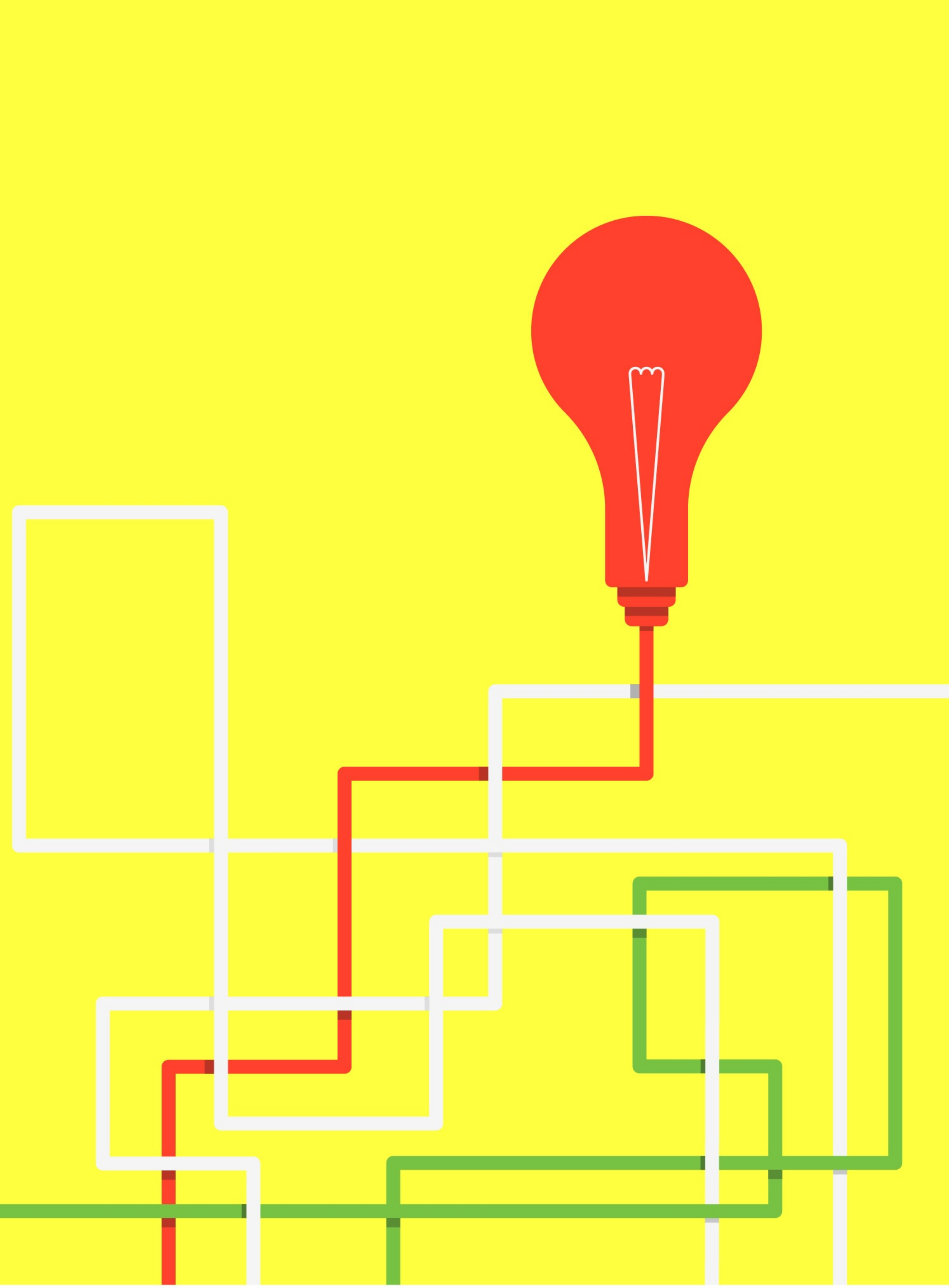

inniAccounts

Tax Optimisation Strategies for your Limited Company

Tax optimisation strategies for your Limited Company

inniAccounts Ltd

Tax optimisation strategies for your Limited Company

Preface

Welcome to your guide to reducing your corporate and personal tax bill from inniAccounts. We'll share our top hints and tips from basic strategies through to more advanced measures to optimise your tax exposure and keep more of your hard-earned income in your pocket.

As an experienced consultant and contractor, I was pretty efficient at running my own business but it took me a while to get to grips with maximising my tax efficiencies when I first started out. This was a common theme among the team before we set up inniAccounts and it's something we're asked about a lot by our customers.

As a contractor, consultant or small business owner you'll be looking for ways to improve your bottom line; how to ensure more of the money you earn stays in your business and ultimately your pocket. Reducing your tax bill through effective expense management and optimising your tax exposure can reap substantial financial benefits in the long term.

This ebook is the followup in our "Starting and running a successful limited company" series and it's designed to give you hints and ideas to apply to your business; to reduce both your corporate tax exposure as well as reducing your personal tax bill. It's aimed at existing contractors, consultants and small business owners but it is informative for newly formed limited company owners too.

It's by no means an instructional manual, but we share the most common strategies as well as some advanced tax optimisation tips to help you find ways to minimise your tax bill. We'll run through everything from good expense management techniques through to the more unusual ways you can ensure your tax liabilities are cut down to size.

This guide doesn't constitute tax advice; we strongly advise that for complex tax planning you speak to a qualified tax adviser. That said, there are some common sense ideas that you can apply straight away such as ensuring that you are claiming for all your business expenses and that you are maximising the opportunities regarding pension and childcare entitlements – so you can start saving on your tax bill from today.

James Poyser

Co-founder, inniAccounts

Section 1: Maximising business expenses to reduce your tax bill

An introduction to business expenses

Managing expenses is an important part of running a limited company. Ensuring that you claim for all your business expenses will increase your tax efficiency and is the first place to start when looking at reducing your corporate and personal tax bill.

Many freelancers, contractors and small businesses see claiming business expenses as an onerous task, but it doesn't need to be. By understanding the HMRC rules and following some simple guidelines, you can ensure that you maximise the tax benefits and improve your balance sheet, quickly and efficiently.

Why good expense management is important to your limited company

The majority of expenses incurred by your company will be tax deductible. This means that they are deducted from your profits and therefore reduce your tax bill. A lower tax bill means more working capital and you have more cash available, increasing the value of your company and maximising profits available for investment or drawing as dividends.

Good expense management gives you a clear view of how your company is performing and ensures that you have a true view of your financial position throughout the year. So many people fall into the trap of storing up receipts and invoices to deal with later. This makes claiming expenses an onerous task and means that the end of year accounts and tax bill can come as a shock.

What is a business expense?

In its simplest terms you should be looking to record any expense, paid by the business, by you, or by your employees that is for physical items or services needed to run the business. The HMRC rule is clear on this; a business expense must be necessary and wholly and exclusively incurred as part of the day-to-day running of your business. On the face of it, this definition appears simple, but what does it mean for you?

There are two main categories of expenses, and they are treated and recorded differently in your year-end accounts and tax returns:

- Tax deductible – the most common type of expense. Tax-deductible expenses are taken from company profits so your tax bill is reduced. These include business travel, IT equipment and services like web hosting. For a full list click here.
- Non-tax deductible – this type of expense is not deducted from year-end profits and therefore does not impact on the company tax bill. The most common example of this expense is client entertaining where you can still record them but it won't reduce your tax bill and VAT isn't recouped.

So, if the expense is necessary and wholly incurred as part of the running of your business, it is a business expense. Personal items and expenses must not form part of your expense recording; examples include clothes (non-uniform), dry cleaning and supermarket shopping. Many businesses have exposed themselves to scrutiny by HMRC by including personal expenses; they incurred penalties and additional administrative burdens. If you are in any doubt, check the HMRC website for guidance. Two questions you need to ask are:

- *"Did I purchase this item or service because I need it for my business?"* If the answer is yes, then it is a business expense.
- *"Is the item or service used purely for business?"* This helps you ascertain whether a proportion of the cost needs to be deducted for personal use. Examples of this are: mobile

phones in your own name but used for business calls too, home-office space running costs, personal vehicles used for business.

Personal expenses – the detail

There is some confusion around personal expenses, and whilst some items appear obvious such as your weekly shop and clothes, others can appear to be in the grey area. Common queries are around company cars, gym membership and private healthcare, for example.
This sort of personal expense is seen as a benefit in kind, which means that there is no reduction in Corporation Tax, you can't claim the VAT and you'll need to pay Income Tax and National Insurance too: it just adds to your paperwork for no financial gain. We advise that you should not put personal expenses of any kind through your company.

Classes of business expense

The best way to identify your business expenses is to think about what your business uses:

- Products: physical items like stationery, work wear, furniture, IT equipment, printer supplies, tools.
- Services: IT support, web hosting, accountant and legal fees, outsourced office functions, insurance.
- Utilities: power, water, rates, rent, telephony.
- Professional subscriptions: membership and subscription to HMRC-approved bodies.
- Client entertaining: whilst you can't reduce your tax bill or claim the VAT back, it is a valid business expense for many companies.

Some expenses are simple to process as they are wholly used by the business. Others will require careful calculation because they constitute a benefit in kind (e.g. where a company vehicle is also used as a personal vehicle) or the service/utility is used by the wider household (e.g. your office is a space in your home). In these cases you should refer to the HMRC guidelines on how to calculate what proportion constitutes the business expense.

Claim for business start-up costs incurred before you formed your Limited Company

Yes, business set up costs can be claimed as business expenses. Any expenses that are paid for using personal funds should be documented and claimed for when the company starts trading. You do need to remember a few rules when claiming this type of expense:

- Does it meet the business expense criteria above?
- For Corporation Tax purposes the expense must be no more than 7 years and for VAT purposes no more than 6 months before you started trading. In reality, it would be best to concentrate on the expenses incurred 6 months or less prior to the start of trading.

Claim VAT back on expenses

You can claim VAT back on certain types of expenses. You'll need to enter the VAT rate charged when entering the business expense. This is usually noted on the receipt, but if not, the main rates are below:

- Standard (20%): the VAT rate charged on most expenses.
- Exempt: bank charges, postage, insurance and interest.
- Zero: train tickets, flights, books, newspapers, food (except hot prepared food to eat in or takeaway which is standard

rated).

Remember: VAT can't be claimed back on business entertaining expenses.

If you use the VAT Flat Rate Scheme, VAT is not reclaimed on individual expenses; it's calculated using the flat rate percentage for your business type and recording individual expenses won't influence your VAT calculations and return directly. If you use the Flat Rate Scheme, only VAT on purchases in excess of £2,000 can be claimed.

Next steps

Effective expense management is a powerful tool in reducing your tax liabilities; the following chapter highlights the most common expense types and how to record them to reduce your tax bill.

Quick links

- HMRC expenses guidance: a guide to your business expenses
- HMRC list of recognised professional bodies

Maximising your business expenses

Effective expense management enables you to maximise your tax efficiencies and it needn't be complicated or time consuming.

This chapter will arm you with all the information you need to identify all the business expenses you should be claiming for and how to keep the relevant records.

Why you should claim for all allowable business expenses

It can seem counterintuitive that claiming your business expenses will improve the financial health of your company as they eat into your company profits; but business expenses are deducted pre-tax and VAT, so in real terms you'll have more cash in your business and your pocket. It's not just your financial health you are improving; business expenses form part of your evidence supporting your IR35 exemption status. Independent businesses by their very nature incur expenses and running costs. Marketing costs, professional fees and asset accumulation are all strong indicators that you are operating as a separate entity from your clients. For more information visit our guide to IR35.

Claiming expenses

It is important that you maintain auditable proof of your business expenses. That means that you need to ensure:

- You log all the information about the expense including date of the expense, total cost, VAT paid, type of expense, narrative where appropriate.

- How the expense was paid for – if the expense was paid for directly by the company this is the most efficient way of dealing with expenses. If the expense was paid for personally, this needs to be tracked to enable you to reimburse yourself either through your payslip or directly.
- Categorising the expense is important as this drives the amount of tax and VAT that is deductible as well as ensuring you apply the correct amount of VAT to the expense should you go on to charge it to the client.
- Receipts and other items of proof need to be retained for at least 6 years. This is how long HMRC asks for records to be kept. It is wise to keep both hard copies and electronic copies for ease of retrieval.

Good expense management

Don’t let receipts and notes on expenses pile up. Deal with them daily or at least weekly. That way the information is fresh and you are less likely to lose the receipt. By tracking your expenses as they are incurred it will take you less time to reconcile your outgoings against your bank statements each month and you’ll have a true picture of how much available cash you have in your business.

Business expenses – the specifics

Equipment

Any equipment you purchase for the sole use of the business is fully tax deductible. It is worth noting that shared use of the equipment, e.g. using your laptop as the family computer at weekends, means it is not a deductible expense. Business equipment should be reserved for the sole use of the business. The majority of the equipment you purchase will be classed as an asset and needs to be entered onto your asset register as well as tracking the expense incurred.

Examples

- Laptop
- Phone
- Office furniture
- Storage devices
- Trademarks and patents
- Property (premises)

When to record equipment as an asset

In general terms, an asset is an item purchased for prolonged used by the company – for example a new laptop, printer or office chair would typically be classed as an asset. It’s important that you classify your expenses and assets correctly – there are two simple questions to ask yourself when making a purchase:

- Will the item have a useful life of more than one year?
- And, does the item cost more than £200?

If so it’s likely that the purchase is an asset, not an expense. Conversely, if not, it is likely the purchase is an expense.

By entering your purchase on the company asset register you effectively retain the real-time value of the asset within your business so it improves the value of your business. The value of your asset should be reduced (depreciated) over time – for example, by 25% each year, so after four years the value of the asset in the accounts will be zero.

Consumables

Consumables differ from equipment as they are not durable items. They are by their definition consumed by the company. They are typically purchased by the company for sole business use.

Examples

- Printing supplies – paper, ink/toner
- Small office items under £200

- Stationery – letterheads, business cards
- Pens and other desktop equipment
- Postage – stamps, envelopes, packaging

These expenses are relatively simple to record as they are a basic expense of the business. The cost is allocated to the business at the point of purchase and there is no long-term benefit to the business.

Professional Fees

Your business needs support from other professionals such as accountants, solicitors and tax consultants.

Marketing expenses

Marketing your business is important and marketing expenses are one of the core expense areas that HMRC looks at in ascertaining whether you are working outside IR35. Ongoing marketing costs show you are actively investing in and promoting your business.

Examples

- Website build and development
- Website hosting fees
- Advertising fees – adverts, directory submissions
- Promotional material – brochures, branded items and flyers

Utilities

While certain utilities will be solely business use (e.g. mobile phone contracts) others may have shared use if you work at home. It is important to only claim for the proportion used by the business. We'll cover how to claim for home office expenses in the following chapters. You need to be able to show evidence to support your calculations should HMRC question the amount you are claiming.

Examples

- Landline telephone cost

- Mobile phone package
- Broadband fees
- Heating and lighting
- Cleaning

Personal development, subscriptions and memberships to professional bodies

As a part of your continued professional competence, HMRC recognises certain professional bodies and personal development tools such as business publications as a necessary business expense. It is important to ensure that the professional body subscription/membership fee is allowable by HMRC; check that the professional body is recognised by visiting HMRC's recognised bodies list.

It is important to note that lifetime membership fees are not an allowable expense.

Examples

- Membership fees to recognised bodies
- Subscriptions to business publications and websites
- Training courses essential to your business
- Business textbooks

Business insurance

All insurance policies designed to protect your business interests are classed as a business expense. We've listed the most common business insurance categories below, but you'll find more complete list of insurances in the chapter "Considering a relevant life policy":

Examples

- Professional Indemnity
- Business Contents
- Directors and Officers Liability

Travel expenses

Travel expenses fall into two categories. The more straightforward is public transport – you simply claim for your fare and retain the receipt. Mileage involves a little more information gathering as your claim is based on the number of miles you travel rather than a flat cost.

For any travel expense you need to be aware of the 2 year or 24 month rule regarding travel expenses.

2 year rule

The 24 month or 2 year rule is set by HMRC. Travel and subsistence expenses can be claimed whilst working at a 'temporary' workplace such as a client's site. After this the workplace is classed as permanent and travel expenses can no longer be claimed.

Note: The rule also states that as soon as you are aware that for a temporary contract you will be at a workplace for more than 2 years you must stop claiming travel-related expenses straight away. For example, if you start with a 12 month contract and you secure another 12 month contract with that client, you must stop claiming expenses at 12 months.

Mileage

If you're travelling to and from a temporary place of work (for example, to a client's office) using your personal vehicle you can claim for the mileage. HMRC publish a fixed rate for mileage which you can claim without having to pay tax – for a car this is 45p per mile for the first 10,000 miles per year, and 25p per mile after this. The mileage allowance is designed to cover the car's running costs and the fuel costs: you cannot claim for the fuel, road tax or other motor expenses as well as mileage.

Mileage claims soon add up so claiming for all work-related journeys can make a real difference to your tax liabilities.

Example

If you make a 20-mile round trip to a client's site 3 times per week you'd clock up 2,880 miles per year – that's £1,296 towards the running costs of your car, tax free.

What's more, you can claim mileage for using your bike. Cycling to and from a client's premises can soon add up too.

The HMRC Mileage Approved Payments (MAPS) are:

Vehicle	First 10,000 miles/yr	Additional miles
Cars and vans	45p	25p
Motorcycles	24p	24p
Bicycles	20p	20p

When using these rates there will be no additional tax to pay – in the example above an extra £108.00 per month (£1,296/12) would be on the payslip with no extra tax or National Insurance deductions.

Entertainment

Business entertainment is a necessary expense for many businesses, but it is important to understand the different types of entertainment and how it impacts on your tax bill.

Client entertainment

As mentioned earlier, client entertaining is a valid business expense. It is important to note that entertainment expenses do not reduce your Corporation Tax bill and you can't reclaim the VAT back either.

Annual reward events

HMRC allows you to reward your employees and their partners with annual events, such as Christmas parties or summer barbecues. You're allowed to claim up to £150 per person (including VAT), which can include food and drink; and even transport and hotel stays. What you need to know:

- The event must be an annual event and open to all employees.
- The £150 applies per person, and you can even claim for partners who don't work for your company – so that's £300 per couple.
- You can only claim for a maximum of £150 per person, if you claim just 1p over this the whole amount becomes taxable.
- It's not an allowance – you cannot just claim the amount as-is, you must claim for an actual meal or event and provide receipts.
- It's not just for Christmas parties – the allowance applies to any annual event. You could even have a Christmas party and a summer event too – as long as the combined total is £150 per head, or less.
- Even if you're a one-person limited company you can still claim back the cost of annual company events – so why not treat you and your partner to a festive soiree or a summer getaway?

Full details about annual parties can be found in the HMRC Employment Manual EIM21690.

Next steps

Think of your business expense receipts as cash as well as a voucher to reduce your tax bill – they need to be held securely and recorded appropriately. By taking a few minutes each day to record your expenses accurately you are enhancing your business finances. You'll know exactly how much cash is available in your business and minimise your tax liabilities all in one go.

- Audit all your outgoing expenses and ensure you are recording all of the allowable business expenses against your business.
- Ensure that the business expenses are wholly attributable to the business where possible and that any proportional expenses are realistic – err on the side of caution.

- Keep your records up to date and your auditable proof safe – track your expenses as you go and store the receipts in at least two places.

There is a complete list of business expenses in the chapter “Allowable business expenses”. The following chapter covers how to claim back the VAT on capital assets over £2,000.

Claim back VAT on capital assets over £2,000

The majority of contractors, consultants and service-based small businesses use the flat rate VAT scheme as it is the simplest and most efficient way of accounting for VAT. If you use the Flat Rate Scheme, you can’t normally claim back the VAT you spend on capital assets you buy for your business, this is already taken into account in the flat rate percentage for your type of business. However, you may be able to claim back the VAT on certain asset purchases with a VAT-inclusive price of £2,000 or more.

HMRC rules for claiming back VAT

HMRC has clear rules governing reclaiming VAT for large asset purchases.

- It must be a single purchase of capital goods with a VAT-inclusive price of £2,000 or more. That doesn’t mean you are restricted to claiming back the VAT on a single item – for example, you could buy a pizza oven, fridge and dishwasher, as long as you buy them at the same time from the same supplier and the price is more than £2,000 including VAT.
- It must be a purchase of capital goods, not services. Capital goods are goods you can use in the business but are not used up by it – for example, a van, computer or bottling machine are capital goods, but not the fuel, printer ink or bottles that go in them. A van leased or hired to you is a continuous supply of services, but one bought on hire purchase is considered a supply of capital goods.
- Software is not classed as an asset for VAT purposes as it is considered a service, not a good. Software cannot therefore

be included within the VAT inclusive price of £2,000 for capital assets.

- You can't claim back VAT on goods that you intend to either resell, or incorporate into other goods to supply on to someone else.
- You can't claim back VAT on goods that you will let, lease or hire out – for example, a bouncy castle.
- You can't claim back VAT on goods that you intend to use up (consume) within a year.
- Building materials and work are not capital goods. You can't claim back the VAT if you have building work done (even if it includes expenditure on materials), and you can't claim back the VAT if you buy building materials yourself for someone else to build with.
- As long as all the other conditions are met, you can claim back all the VAT even if the goods will have some private use. For example, if you buy a van but employees are allowed free use at weekends to move private belongings, you can still claim back all the VAT.
- There is an upper limit on claims for certain items. If you buy something that falls within the Capital Goods Scheme you must write and tell HMRC and leave the Flat Rate Scheme immediately. Goods that fall within the Capital Goods Scheme are computers or items of computer equipment with a VAT-exclusive price of £50,000 or more, or land and buildings, civil engineering works and refurbishments with a VAT-exclusive value of £250,000 or more.

Next steps

Ensure that the capital assets you want to reclaim the VAT on fit the criteria above. It is important to ensure that the VAT reclaimed on your asset purchase is reflected in your VAT return for that period. This covers the majority of large purchases you'll make as a part of increasing the assets of your company. The next chapter covers the transfer of personal assets to your company.

Transfer personal assets into your company

When you start your business you may have some existing personal assets that you'd like to transfer into your company. This is a great way of keeping the start-up costs low as you aren't buying brand new equipment. The main benefit is that the cost of the transfer (what your company pays you for the equipment) is a business expense and therefore has a positive impact on your tax liabilities.

Transferring personal assets to your company is straightforward, as long as you take a pragmatic view of the value of the assets.

If you have an asset that was originally purchased for personal use you'll need to establish the current market value of the asset. You cannot claim the full cost of the asset, unless it was purchased solely for use by your new business. A straightforward method to establish the value of a used asset is to research the second hand market – eBay is a simple way to do this.

Once you have determined the value of the asset, you need to prepare an invoice from yourself to your company listing the items and cost of each separately. A simple invoice created using a word processor or spreadsheet will suffice; you just need to show on the invoice your name, address, invoice to (your company), invoice date, the items and their costs. If you have the original purchase receipts for the item, it is useful to attach them for your company records.

Next steps

As the cost of personal assets transferred is a business expense, it impacts positively on your tax liabilities. Transferring personal assets not only reduces the cost of starting your business, it enables you to reduce your tax bill.

In order to comply with HMRC guidance, you need to ensure that the value is reasonable and that you record the transaction adequately. The next chapter delves further into using personal assets for business use; namely how to claim home office expenses.

Claim for home office expenses using the proportionate method

Claiming home working expenses is a bit of a grey area and one that fewer business owners choose to take advantage of, perhaps because HMRC allow a flat rate claim of only £4 per week for incidental home expenses.

But if you spend even a moderate proportion of your time working at home it is possible to claim more for home expenses – and you don’t need to operate a full-blown home office to do so. In this chapter we cover how to generate the maximum tax saving from your home working and, more importantly, how you can apportion the correct level of expenses to your business.

Defining ‘working from home’

It doesn’t matter how little or how much you work from home; you can still claim home expenses providing that they are proportionate to the business usage of the space.

Whether you:

- Use the home PC to tidy up a few loose ends or organise your expense claims for the week;
- Work from home on a regular basis and you clear some dedicated space in one room to use as a work space when you need it e.g. the space doubles up as a functional personal space in the house; or
- Regularly (or always) work from home in a more clearly defined ‘office’. Whether this is a converted garage, a free standing garden studio or a spare bedroom doesn’t matter;

the important definition is that the room is primarily used as a work space;

it is possible to save money by claiming for home working expenses, as long as you follow the rules. In order to do this you need to figure out exactly what you can claim, and how you measure it.

Understand what you can claim

If you use part of your home for business, you can deduct expenses such as mortgage interest, insurance and utilities. However, you can only deduct a figure that relates to business usage, which must be clearly separated from private usage. Home expenses broadly fall into two categories: fixed costs and running costs.

- **Fixed costs** relate to the whole house and have to be paid even if there is no business use. These include costs such as Council Tax, mortgage interest or rent and insurance. If part of the home is set aside solely for business use for a specific period then a part of these costs is allowable; these will need to be apportioned by area and time (see the following section for details).
- **Running costs** relate to expenses where the bill may vary with the amount of business use. They include telephone line rental, broadband, cleaning, heat and light. HMRC officers are now instructed to “accept a claim based on any reasonable basis” provided that apportionment is based on usage.

Measure your usage

When allocating a proportion of fixed and running costs to your business there are three variables that need to be accounted for.

- Area: what proportion in terms of area of the home is used for business purposes?

- Expense: how much is consumed? This is appropriate where there is a metered or measurable supply such as electricity, gas or water.
- Time: how long is it used for business purposes, as compared to any other use?

Calculating area

There are two ways to calculate this element – the easiest one is when the rooms in your house are all a similar size. If there are 5 rooms, one of which you use for business, then one fifth of the area is used for business. When calculating the total number of rooms in your house you should exclude bathrooms.

For a more accurate calculation, you can use the total floor area of your house and calculate the proportion utilised by the room you use for work. This is a fairly easy task if you have the house particulars from when you purchased the property, but more time consuming if you need to measure each room. Nonetheless, it is the most accurate and therefore the best method to adopt if the space you use to work in is larger than other rooms in your house.

Defining total usage

The total cost for the utilities/services and fixed costs are required to enable you to apportion business usage from the total expense.

Time

You don’t work 24/7 and it is important to ensure that you calculate the time you spend working within the defined home-working space. Note the hours you spend working at home to feed into the overall usage calculation. HMRC says “… it is possible to apportion the use and cost of a room on a time basis, and to allow the expense of the room during the hours in which it is used exclusively for business purposes, in the same way as it is possible to calculate the business expenses of a car which is sometimes used for business purposes exclusively and sometimes used for pleasure.”

The proportionate expense calculation

This calculation can be utilised for every expense related to working from home. This will enable you to work out how much to claim in business expenses.

Total usage (the total expense) x area% x time% = Proportionate Business Expense

Example

Jane works from home 3 days a week for 10 hours each day in her study which has an area equivalent to 15% of his house area. Her mortgage interest is £1,000 per month.

- Time: (10 x 3)/(7 x 24) = 30/168 = 18%
- Area: 15%
- So she uses 15% of her house for 18% of the time
- Total usage: £1,000

Proportionate Business Expense = 1,000 x 18% x 15% = £27 per month.

This may not seem a lot, but when you combine all the relevant fixed and running costs together, it can amount to a substantial sum.

Here are some typical expenses to consider:

Expense	Measurement	Notes
Electricity & Gas	By room, square metre, or on the metre	For example, if your house has five rooms of approximately equal size and one of them is used as a home office, then 20% (one fifth) of the electricity bill can be claimed for business usage for the days/hours worked.

Telephone	By percentage	The claim for line rental should be based on the ratio of business use to total use and the overall claim should reflect all aspects of use, including incoming calls.
Rent	By room or square metre	Rent can include council tax, insurance, mortgage interest and even cleaning bills, and should be claimed according to the amount of space you use solely for business (as with electricity and gas).
Repairs and Renovations	By 'purpose'	If you have business equipment you keep at home, for instance a PC, you can claim for repairs. You can also claim for renovations ONLY on rooms that are used for business purposes. For example, if you have the dining room and the study/office redecorated but you do not use the dining room for business you cannot claim the full redecorating costs.
Fixtures and Fittings	By 'purpose'	Any claims in this category must be restricted solely to business items: for instance, if you need some shelving for business publications, the cost can be claimed.
Broadband	By percentage	As with the phone line, the claim should be based on the ratio of business use versus personal use, but relating specifically to broadband time.

Next steps

1. Identify any expenses that relate to working from home.
2. Calculate the proportion using the formula above.
3. Claim for the expenses from your company as you would any other business expense.
4. Ensure that you retain both the bills PLUS the calculations you use to allocate the proportion to your company – this is important should HMRC require to see your calculations.
5. Review the business usage regularly to ensure your calculations are accurate – date the relevant calculations each period.

Home usage forms part of legitimate business expenses and the final chapter in this section of our tax optimisation ebook is a complete list of business expenses. In the second section we'll look at more complex tax optimisation techniques.

Allowable business expenses

As a wrap up to the first section of our tax optimisation guide, we've compiled a complete list of the most common business expenses.

Accountant fees

Accommodation

Assuming that you are not caught by the 24 month rule, you can claim for the cost of hotels and B&Bs near to the place of work provided you have another principal residence.

The claim is allowable for contractors and freelancers that, say, live in one city and need to be in another to work. If you have come to the UK from overseas to work then claiming such expenses are unlikely to be allowable as that residence is likely to be classed as your normal residence.

Should rented accommodation be more economic and practical, it can be treated as an allowable expense provided the costs are reasonable. Should HMRC view the costs as excessive then they are likely to take the view that the accommodation is of personal benefit and are likely to challenge the claim. When signing up for a rental agreement or lease, it should be in the company name and paid for directly by your company.

It is important to remember that there must be no personal benefit to any claim such as providing residence for family members, i.e. it must be necessary, wholly and exclusively for the purpose of the business.

Advertising & marketing

Annual health check e.g. BUPA

Annual return fee (Companies House)

Assets

An asset is something of value that is owned by your business such as computer equipment or machinery. An asset is often described as something that has value and that is able to add value to your business, for example a video camera owned by a media company. The camera in its own right is owned by the business and has value, plus it is used in the day-to-day activities of the business to add value.

Bank charges

Bicycles

The way expenses are claimed is dependent on who owns the bike. If the bike is owned privately, 20p per mile can be claimed for business mileage.

Alternatively the Cycle to Work Scheme allows employers to purchase bikes and safety equipment and provide them to employees. The scheme must be open to all employees and the bicycle must be used for business purposes more than 50% of the time. The equipment is tax deductible for the business and is loaned to the employee with no benefits in kind (P11D) liability for the employee.

Note that the 20p per mile tax free mileage allowance for business travel cannot be claimed if the bicycle is owned and loaned to an employee by your company. There is no limit on the cost of the equipment including the bicycle; however, if the value of the equipment exceeds £1,000 a consumer credit license is required from the Office of Fair Trading.

Full details of the scheme can be found here.

Bicycles – mileage payments (own bike)

If a privately owned bicycle is used for business-related travel, the employee may claim 20p per mile under the HMRC approved mileage scheme. Keep a record of your bike journeys in your mileage log. Note that the 20p per mile tax free mileage allowance for business travel cannot be claimed if the bicycle is owned and loaned to an employee by your company (Cycle to Work Scheme).

Bicycles – protective equipment

If you use the Cycle to Work scheme, protective equipment can be claimed and items include: helmets, reflective clothing, reflectors, lights, mirrors, bells/horns, mudguards (to ensure visibility is not impaired), cycle clips, panniers/luggage carriers to allow luggage to be transported safely, locks and chains to ensure security, pumps, puncture repair kits, cycle tool kits and tyre sealant to allow for minor repairs.

Books & magazines

Provided the purchase is necessary to conduct the activities of the business, the item can be claimed. To give an example, if a technical manual is purchased specifically related to work being conducted, it can be claimed.

If, however, a book or magazine is of benefit personally or is to aid in the development of a new skill, the item will not be tax deductible. In such cases if it is paid for by your company and enjoyed by you personally it will need to be captured on a P11D for the benefit in kind and result in additional tax and NI liabilities. In these circumstances it is probably best to pay for the item personally.

Broadband

If the broadband contract is in the company name and therefore invoiced to and paid for by your company, then the full cost can be claimed even if there is a small amount of personal use. If the broadband is billed personally and the contract is not in your company name, then only the portion of business use can be claimed. This must be worked out and evidence provided if requested by HMRC.

Car hire

Car parking

Car parking can be claimed for qualifying business journeys that form part of business activities, i.e. site or client visits, and journeys related to attendance at a temporary workplace. Generally if the receipt has a VAT number then VAT at the standard rate is included, or if the parking is on-street then normally it is VAT exempt.

Christmas / annual events

See the chapter “Maximising your business expenses”.

Client entertainment

Typically entertainment of a prospective or existing client is not a tax deductible expense and although it can be paid for by your company, no Corporation Tax relief will be given. In reality the true benefit of client entertainment isn’t from the tax deductions but from the gesture and what it can do for your business in the future.

Clothing

Uniform and protective - You can claim the cost of either of the following: necessary protective clothing to conduct duties such as safety footwear or glasses and/or work uniform worn whilst carrying out your duties, for example, a coat that carries a distinctive permanent logo of your company.

Company start-up fees

Computer hardware and software

Congestion charge

Course fees

Provided the training is work-related to upgrade a current skill, and not to develop a new one, the cost of the training can be claimed along with the associated costs, such as books or additional travel costs incurred. Should the training be overseas then details may be scrutinised in more detail by HMRC.

It is recommended that full details of the training be retained including receipts for the course, the course itinerary, evidence of attendance, accommodation expenses that cover the period of the training etc. – essentially everything needed to demonstrate that there was no personal benefit.

Credit and debit card charges

Director’s loan account

See the chapter “Director’s loan account - borrowing money”.

Donations to charity

Equipment repairs

Extended working hours

If you work extended hours e.g. you are contracted for 8 hours per day and you work for 12 hours, it would not be unreasonable to claim the cost of an evening meal. However, if you are contracted to work 12 hours per day the cost of meals would not be allowable.

Eye tests

Flights (except first class)

Fuel

Gifts

Gifts to customers are not a tax deductible expense unless they are promotional gifts worth less than £50 and carrying a conspicuous advertisement for your business. This could include a bottle of wine that carries your logo and an advert on it.

Glasses

In most instances glasses and contact lenses cannot be claimed as a business expense. Even if you require glasses to use a computer to fulfil your company activities, chances are that you probably use them outside of the work environment too, e.g. for reading, therefore they cannot be claimed for.

If, however, a prescription is required for glasses that are solely to use a computer for business purposes and they are not used elsewhere, then this is allowable provided you have evidence to support it. Other examples would be welding or safety glasses.

Hire purchase (in company name)

Home office

See chapter “Claim for home office expenses using the proportionate method”.

Incidental overnight expenses

Assuming you are not caught by the 24-month rule and you stay away from your main residence for the purpose of business, you can claim up to £5 per night when staying in the UK or £10 per night if overseas to cover incidental expenses such as newspapers, laundry, phone calls etc.

These claims do not need to be receipted, however it is not an allowance; therefore you cannot just claim £5/£10 in full and you must only claim the actual amount of the incidentals incurred. The claim for incidentals is over and above the costs of subsistence such as evening meals.

Insurances

Insurances required by your company to conduct its duties such as Professional Indemnity, Employers’ Liability and Public Liability can be claimed for. Health insurance policies are not a business expenses and are therefore not tax deductible.

Interest on business loans

Key person life insurance

Late night transport home (after 9pm)

Lodging

Medical expenses (overseas only)

Mileage expenses when using personal vehicle

Mileage claims can be made for business-related travel only. Often the easiest way to claim for travel costs is to use a personal vehicle and claim for the mileage at the HMRC approved rates.

The advantage of using mileage rates is that they are based not just on the cost of fuel, but also costs such as insurance, road tax and maintenance, therefore it saves you having to keep details of your actual motoring expenses.

Mileage rates are used to work out the amount that can be paid free of tax under the AMAPs legislation.

The current rates for use of a personal vehicle are:

Vehicle	First 10,000 miles	10,000+ miles
Car	45p	25p
Motorbike	24p	
Bicycle	20p	

As with all expenses, HMRC expects you to be able to provide evidence to support mileage claims, e.g. a mileage log. If you do not maintain a log and cannot provide it to HMRC if requested, then Income Tax and National Insurance will be due on the mileage payments.

Mobile and smart phones

The simplest way to claim for a mobile or smart phone is to purchase it through your company and have the contract in your company's name. This way, even if there is a small amount of personal use, the purchase and contract costs can be claimed. If the contract is in an individual's name and not the company's, then only the calls made related to the business may be claimed.

If this is the case then an itemised bill will allow such calls to be identified. If the contract has inclusive minutes and only the inclusive minutes are used in a billing period including business calls, then no claim can be made. HMRC are likely to take the view that no additional expenses in making business calls have been incurred and therefore a claim is not allowable.

Moving house

The HMRC criteria that should be used to determine if relocation costs are allowable are:

Firstly the reason for relocation must be one of the following: you or an employee started a new job; a change in employment duties; or a change in the place where employment duties are normally carried out.

Secondly the expenses and benefits must fall into one of the six categories: the employee's sale of their old residence; their purchase of a new residence; transporting the employee's belongings to the new residence; associated travel and subsistence costs; domestic goods for the new premises; bridging loans.

Thirdly, there is a time limit: To qualify, the expenses must be incurred or the benefits must be provided before the end of the tax year after the one in which your circumstances changed (as outlined in the first step of this list).

Fourthly, the distance: the new residence must be within reasonable daily travelling distance of your new normal place of work, and your old residence must not be within reasonable daily travelling distance of the new normal place of work. Costs up to £8,000 are not taxable; any payments made in excess of this must be reported on a form P11D as a benefit in kind.

Office rental

Parking

Pension payments

See the chapter “Tax-efficient pension contributions”.

Postage

Professional fees & subscriptions

If you are a member of an HMRC-approved professional organisation related to your business activities, then the fees can be claimed. You may get tax relief on professional fees and subscriptions if you are registered as a member of the organisation because it’s necessary to your work and, HMRC has approved the organisation. HMRC approved organisations can be found here.

You cannot claim fees and subscriptions paid to an organisation that HMRC hasn’t approved or if the subscription is a life membership.

Software (installed and online / subscription)

Sponsorship

Stationery

Subsistence

Provided the requirements of the 24 month rule are met, you can claim for travel and the related costs i.e. accommodation and subsistence. Whilst working at a temporary workplace you can claim for lunch but always ensure that the cost is reasonable and receipts are retained.

If you are staying away from home then the cost of accommodation, breakfast, lunch and evening meals can be claimed provided the costs are not excessive. If you do stay away from your main residence, then you can also claim for incidental overnight expenses.

Meals do not have to be purchased from a restaurant therefore a pre-packed sandwich from a supermarket would be an acceptable alternative. You cannot claim for ingredients to make a meal yourself.

Taxi fares

Travel

Travel cards

If you purchase travel cards through your company instead of individual tickets; if you also use the card for personal travel then the personal benefit from your company may result in additional tax / National Insurance being due. If, however, the cost of the business travel had it been paid for by purchasing individual tickets, exceeds the value of the travel card purchase, then the travel card can be used for personal travel and no additional tax / National Insurance will be due.

Disclaimer

The guidance on what are allowable expenses is complex and needs to be considered based on individual circumstances. No responsibility can be accepted for the tax status of any expense claims made. The information provided in this chapter is for general information only and specialist advice should be sought prior to submitting business expenses for tax relief.

Next steps

More information can be found in the guidance on the HMRC website. This chapter concludes the section on business expenses. The second section of this ebook looks at further tax optimisation strategies and techniques.

Section 2: Tax optimisation

Introduction to tax optimisation

A small caution

Tax is a complicated subject. Always seek professional advice before embarking on any tax planning strategy.

Tax overview

All businesses are subject to a number of taxes, and a better understanding of these taxes will lead to a better ability to plan for them. Here's an overview of the main areas:

Income Tax

The salaried income you and your employees receive is subject to Income Tax, which is deducted from you gross salary payment during payroll. Currently (for the 2015/16 tax year) most individuals can earn £10,600 per year free of Income Tax; after this, Income Tax is deducted at a rate of 20%, 40% or 45%, depending on your earnings.

National Insurance

Salaried income is also subject to National Insurance payments, which are paid by both the employee (deducted from their gross salary) and the employer (an additional expense on top of the salary). National Insurance is a little more complicated to calculate than Income Tax, however in most cases the employee must pay 12% and the employer must pay 13.8% of the employee's annual earnings above £8,060.

Qualifying for National Insurance benefits

Aside from partly funding the NHS, National Insurance is used to pay for a number of benefits, including: jobseeker's allowance; incapacity benefit; bereavement benefits; maternity payments and State Pensions. If your earnings are below £5,824 per year you may not qualify for all of these benefits.

VAT (value added tax)

If your company turns over £81,000 or more per year you must register for VAT and make the appropriate charges to your clients. VAT is charged on top of your net invoice amount – for example if you charge a client for 10 days' work at £200 per day your invoice will total £2,400 including VAT (at 20%).

As well as charging VAT to your clients, you can also claim back the VAT from purchases your company makes – you only pay the difference between the VAT you charge to your clients and the VAT you pay on purchases. Many contractors, freelancers and small service-based businesses will choose to adopt HMRC's flat rate VAT scheme. In this instance you again charge VAT on your net invoice amount at the normal VAT rate but just pay a fixed percentage of your gross income as VAT over to HMRC, depending on the flat rate percentage relevant to your business.

Corporation Tax

Corporation Tax is payable annually and based on the profit that your company makes during your financial year. Your profit is your company's income minus its expenditure (including salaries paid to employees but excluding dividends paid).

The current Corporation Tax rate for small companies is 20%. The Corporation Tax needs to be taken into account to determine what profits remain available to pay to the shareholders; this remaining amount can be issued to the shareholders as dividends. If your company has made £20,000 profit, up to £16,000 can be withdrawn as dividend payments.

Tax-efficient withdrawals

During the day-to-day running of your business, you'll need to decide how best to manage your money in order to reduce your tax burden. The following list details how money can be withdrawn from your business, listing the methods from the most tax-efficient to the least:

- **Legitimate business expenses** – expenses that are incurred during the running of your business with no personal element can be repaid without being subject to tax. Common expenses include mileage to and from a client's office, sustenance whilst working away from home, hotel stays and office consumables.
- **Payroll up to your personal allowance** (commonly £10,600) – by making use of your personal allowance your income will not be subject to Income Tax. You will, however, pay National Insurance on income above £8,060.
- **Dividend payments** – you can withdraw profit from your company in the form of dividends. These payments can be made after deducting Corporation Tax from your company's profit. Corporation Tax is currently 20%. You will, however need to personally pay higher rate tax on any dividends over the higher rate tax threshold.
- **Payroll above your personal allowance** – once you earn an annual salary above your personal allowance figure, you will be subject to Income Tax at a rate that falls between 20% to 45%, plus employees' and employers' National Insurance.

Personal expenses / benefits in kind

It's also possible to pay personal benefits to employees – such as providing assets for personal use, for example health insurance or gym memberships. However, the taxation rules around these benefits can be quite complicated and we strongly suggest you have an in-depth discussion with your accountant before considering them.

Tax saving tips

Maximise legitimate expenses

As we've already discussed, expenses can be offset against company profits, thus reducing Corporation Tax. Therefore you should ensure you're recording and claiming all legitimate business expenses. In particular, don't forget the following:

- **Mileage** – you can claim for the mileage incurred when travelling to and from a client's office, and with tax-free rates up to 45p per mile this soon adds up. Remember to include your car parking and congestion charges.
- **Carry passengers** – you can claim 5p per passenger per business mile for carrying fellow employees in a car or van on journeys that are also work journeys for them. Note that the payment can only be made if the journey is specifically for carrying passengers.
- **Sustenance** – you can claim for meals and refreshments purchased whilst working with a client.
- **Accommodation** – if you're working away from home you can claim for accommodation costs, such as hotels or B&Bs.
- **Computer hardware and software** – you can claim for IT equipment so long as it is purchased solely for business use.
- **Business phones / broadband** – you can claim for mobile phone and broadband costs when they are used for business purposes.
- **Eye tests** – if you are required to use a computer for work you may be able to claim back the costs of an eye test.

- **Professional memberships and subscriptions** – HMRC publishes a list of recognised professional bodies for which you can claim back the membership fee

Pay yourself a small salary and take profits as dividends

By maintaining a small salary you can reduce your Income Tax and National Insurance bill by using your tax-free personal allowance. By paying more out as dividends you will be paying Corporation Tax (around 20%) which ultimately is lower than the Income Tax and National Insurance rate you would pay if you had a larger salary.

It is not uncommon for a spouse to have shares and hence receive dividends when they are paid. The advantage of this approach is it may allow use of any unused personal tax allowances. This is covered in more detail in chapter 13.

Maximise company pension contributions

One of the easiest methods to save tax is to put money into a pension scheme. This will either reduce the Corporation Tax paid on the company profits by making employer contributions or you'll receive tax relief on your personal contributions, depending on the selected pension scheme.

Should you need to set up a pension or review your current arrangements, we recommend you discuss this with an independent financial adviser.

More information on pensions can be found in our guide to savings and pensions.

Opt for contracts where you can operate outside of IR35 legislation.

Understanding and working outside IR35 is a powerful way of keeping your tax bill to a minimum. By understanding IR35 and seeking contracts that comply you will inevitably reduce your tax burden.

Structure your remuneration tax efficiently

It’s a sensible idea to put money aside within your business for a period when you may decide to have a break or are waiting for your next contract.

If you were to withdraw all your earnings it could force you into a higher rate tax bracket, so why not reduce your earnings and ensure greater peace of mind by keeping as much profit as possible within your business?

Review your VAT method

It’s important to occasionally review the VAT method used by your company; this will both help you to stay on top of VAT rate changes and keep your tax bill as low as possible. For example, consider if you would be better moving away from flat rate VAT to the standard scheme or vice versa.

Next steps

Review each of the points in this chapter and consider if you are doing enough to minimise your tax bill. In the next chapter we provide five advanced tax-saving tips before we look at more in-depth tax optimisation strategies in this section.

Five advanced tax-saving tips

If you are a seasoned contractor, consultant or small business owner you're probably well-practised in the usual tax efficiencies around salary and dividend splits and company expenses, but here's a quick round up of the top 5 more unusual tips for saving tax that you may not have considered.

1. Tax breaks for green cars

If you have a company car, the tax and National Insurance contributions are based on the CO_2 emissions and the list price of the car plus accessories. Owning a green company vehicle for company use only can save you hundreds of pounds a year on vehicle excise duty and benefit in kind deductions. Standard company car benefit in kind deductions start at 11% for conventional petrol and 14% for diesel vehicles. The maximum level is 37% for the biggest CO_2 emitters.

The greener the car in terms of emissions, the more you can save. Owning a hybrid can decrease your benefit in kind rate by at least 5%. Low and ultra-low carbon emissions vehicles (such as plug-in hybrids and all electric vehicles) attract the lowest benefit in kind rates at just 5% as of April 2015.

Benefits in kind are any personal benefits received from your company that are taxable such as a company car, loan, gym membership etc. They must be declared to HMRC using a form known as a P11D and as a result additional Income Tax will be due plus your company will have to pay Class 1A National Insurance on the value of the benefits.

2. Tax-efficient entertaining

Business entertainment isn't tax deductible, but there are ways to claim VAT back on certain expenses that would otherwise be seen as entertainment.

Quid pro quo – put simply you can provide proper and sufficient quid pro quo (something of equivalent value given in return for cash/goods or services) to suppliers, customers or potential customers. The key to ensuring you comply with this interpretation is that it is equivalent value.

An example of this would be refreshments and nibbles on a trade stand for feedback questionnaires. A full lunch and travel expenses would be considered for more input – say, a full day of product testing or a workshop. If it is part of a contractual agreement then the hospitality provided needs to be an explicit part of a contractual agreement. In this case it is not classed as business entertainment as there is a compulsion to provide a service or reciprocate.

An example of this is if you have a co-supplier and you agree to provide the accommodation and subsistence for their workers whilst they work onsite with you with the contractual understanding that they provide the same (the equivalent value) for you. For HMRC guidance click here.

3. Director's tax-free loans

The ability for directors to take out tax-free loans from their company for a specified period of time has been in place for some time. There are some important rules to consider; one is the amount you can borrow as a director without attracting benefit in kind deductions, the other is the length of time you can borrow the money without your company being taxed on the amount borrowed.

You can now borrow up to £10,000 without attracting benefit in kind deductions. You must repay the company loan within 9 months of the company financial year end to avoid the 25% company tax bill. In addition to repaying the loan you need to ensure that there is a gap of at least 30 days before you take another loan from the company, or HMRC consider the arrangement as tax avoidance.

Loans over £15,000 that are repaid and then taken out after a short-term loan facility is utilised attract the 25% charge under the avoidance rules too.

In short, you can borrow £10,000 completely tax free, providing you repay the loan to the company within 9 months of its accounting year end, and wait 30 days before re-applying for a loan from the company. Arrange a short-term overdraft or loan facility to cover the thirty days (or borrow from a relative) and you can borrow £10,000 from your company almost indefinitely.

See also the next chapter for more details.

4. Tax-free income protection insurance

For more detailed information see the chapter “Considering a relevant life policy”. Income protection insurance is valuable protection should the worst happen and you are unable to work for a while due to illness, for example. But premiums can be expensive, up to thousands of pounds in some instances.

You can set up corporate income protection for yourself or multiple employees; this means that you pay the insurance premium out of company funds (not your taxed income).

HMRC allows you as a company to choose the way in which you are taxed for the income protection cost; declare it as benefit and kind and pay tax on the premium or choose not to declare it as benefit in kind and pay tax on any associated pay-outs in the event of a claim. To make the most of tax savings:

- Opt not to declare the premium as benefits in kind for any claim-free years.
- Opt to declare the premium as benefits in kind for any claimants on the policy for the year of claim.

This way, you maximise tax efficiencies by only paying tax in the event of a claim being made, and it is only on the premium rather than the more substantial pay-out.

5. One for the future – tax-free childcare changes

HMRC has announced that a new childcare allowance scheme is due to be launched in autumn 2015. Under the new scheme parents earning between £50 per week and £150,000 per year will be eligible. It's thought that HMRC will notify eligible parents so they can sign up online.

The scheme will consist of an online account that the parent can pay into, that HMRC tops up by 20% to a maximum value of £2,000 per year, per child, for a maximum of 5 children up to the age of 11. The childcare provider is then paid via the online account for any qualifying childcare.

If you qualify for the scheme, it will mean that for every 80p you contribute, HMRC will top this up to £1. That's a saving of £400 per year, per child.

Next steps

This chapter provided a snapshot of five less well known tax optimisation tips. We'll cover the majority in more detail in this section. In the next chapter we look at how you can borrow money, tax free, using a director's loan account.

Director’s loan account – borrowing money

A small caution

Care must be taken when borrowing money from your company. Please ensure that you fully understand the tax and National Insurance implications before taking any sort of loan from your company.

A director’s loan account is an accounting record of money being borrowed from or loaned to your company. You can borrow up to £10,000 from your company tax-free by adhering to the rules governing director’s loans set out by HMRC.

Tax implications of director’s loans

For Income Tax purposes HMRC class a director’s loan as *overdrawn* if you borrow money from your company and this, at any point in time, exceeds £10,000. If your loan account does become overdrawn by £10,000 it means you will have received a benefit in kind.

An added complication with a director’s loan is if there is *any* balance outstanding on the loan when your year-end accounts and Corporation Tax return are prepared it must be shown on your Corporation Tax return. Your company must then pay 25% of the loan value in additional Corporation Tax if there is still a balance outstanding 9 months after the year end.

For example, if you have a loan of £4,000 outstanding when your Corporation Tax return is prepared you will need to pay HMRC

£1,000 in additional Corporation Tax. Once the loan is repaid the Corporation Tax on the loan amount can be reclaimed however this can't be done until nine months after the end of the accounting period in which the loan was paid off.

We recommend your accounts and Corporation Tax returns are filed as soon as possible after your company financial year end. However, as the filing deadline is 9 months after your company financial year end it is possible to delay filing your return. This would allow you additional time to repay the loan, therefore avoiding the additional Corporation Tax.

Our advice is if you need a loan try to keep it below £10,000 to avoid additional tax and National Insurance and, if possible, repay the loan in full before the end of your company financial year.

> Using a director's loan account ensures that no tax is paid on the money when it enters and leaves your company.

Points to remember

If you borrow money from your company's bank account and it is not a salary or a dividend, then it's a loan from the company to you. This is recorded on your director's loan account and it is said to be overdrawn. The loan can then be repaid by paying the money back into the company bank account or by the company crediting the loan account using a salary or dividend payment to clear the loan. When crediting the loan account a dividend or salary is recorded but not paid out – it is used to clear or reduce the balance of the loan account.

If at any point the outstanding value of the loan to the director exceeds £10,000 in the tax year, the company will need to pay Class 1A National Insurance and the director will need to pay additional tax. This is declared on a P11D.

Depending on how your loan account is managed, it will determine what you need to tell HMRC and whether you need to pay Corporation Tax on the loan amount.

If you clear the entire balance of your director’s loan by the last day of your company’s financial year:

- You do not need to pay Corporation Tax on the loan.
- You don’t need to tell HMRC about the loan on your Corporation Tax return.

If your director’s loan account is still overdrawn after the end of your financial year but it is repaid in full within nine months of it:

- Your company does not pay tax on the loan.
- Details of the loan must be included on your Corporation Tax return.

If your director’s loan account is not paid off in full within nine months after the end of your financial year end:

- You must pay Corporation Tax on the loan which currently is 25% of the loan value, e.g. if your director’s loan account is overdrawn by £10,000 you need to pay £2,500 in additional Corporation Tax.
- You must pay HMRC interest which is non-refundable.
- You must include details of the loan in your Corporation Tax return.

If you pay the additional Corporation Tax of 25% of the loan value, you can reclaim this from HMRC once the loan has been repaid to your company. However, the claim will be made nine months after the end of the financial year in which the loan was paid off therefore you may be in for a long wait!

Next steps

The next chapter provides information on how to choose a tax-efficient salary when structuring your personal income stream.

How to choose a tax-efficient salary

This chapter is aimed at giving you the facts about how different salary levels will affect your tax and National Insurance obligations. We want to give you the information so that you can decide what salary is best for your circumstances. Armed with the tax threshold figures, you can make an informed decision on the salary level that meets your needs.

Setting your salary for the current tax year can be daunting, but by exploring the options, you can make the right decision for your needs. It's worth noting that there is no minimum wage requirement if you are a director of a company (unless you have a contract of employment with the company). Typically, business owners take one of four approaches:

1. Maximising tax and NIC efficiencies; or
2. Meeting the Income Tax threshold; or
3. Paying themselves a living wage based on their specific needs; or
4. Taking a higher salary to satisfy visas or lending requirements.

It's important to take all your income streams into account when calculating your tax and NIC liabilities; this can include salary or income from other jobs, share and savings income, pension income and any other source of income. If you have multiple income streams, you should contact an IFA for advice.

Are you inside IR35?

You can only set a salary and pay dividends when you operate outside IR35; if you operate within IR35, all earnings must be taken via a salary.

Deciding what's right for you

What you need to consider:

1. What Income Tax and National Insurance contribution efficiencies do you want to achieve?
2. Do you want to ensure that you retain your right to a state-earned pension and other benefit entitlements?
3. What level of contribution do you want to set for your pension this year?
4. Do you need to demonstrate a certain salary level for any reason e.g. income for borrowing purposes?
5. Do you have other sources of income?

Income Tax and National Insurance efficiencies

The tax-free personal allowance for 2015/16 is £10,600; therefore the first £10,600 you earn will be free of Income Tax.

Income Tax rates

Based on an employee with a personal allowance of £10,600.

Tax rates	Income per year	Rate (salaries)	Rate (dividends)
Tax free	£0 – £10,600	0%	0%
Basic rate	£10,601 – £42,385	20%	10%
Higher rate	£42,386 – £150,000*	40%	32.5%

Additional rate	Over £150,000*	45%	37.5%

**Once you earn above £100,000 taxation becomes a little more complicated. Your personal tax-free allowance is gradually removed. Please use our tax calculator for an exact tax computation.*

National Insurance thresholds

If you earn above the amounts listed below, then National Insurance contributions are payable, however you may benefit from the £2,000 National Insurance Allowance.

NI payments	For employees	For employers
Weekly pay	£155	£156
Annual pay	£8,060	£8,112

The maximum salary you can take without paying Income Tax or National Insurance contributions is £8,060

State Pension and benefit entitlement retention

In order for this year to count towards your qualification for the State Pension and other benefits, you need to earn a minimum salary of £5,824. So to retain your State Pension entitlement but maximise NIC efficiency, you should ensure your total annual salary income is £5,824 - £8,060.

Pension contribution considerations

It's important to ensure that you plan for your retirement. In setting your salary level, you also set the maximum amount you can contribute to a personal pension.

From April 2015, the annual maximum of £40,000 has been set for tax-free pension contributions and (as long as you were in a registered pension scheme during the tax year) if you don't use the full allowance in the year, you can carry it forward for the next three. This is, however, limited by your Net Relevant Earnings (NRE). Dividends don't count towards the pension contribution figure; you can only contribute an amount equal to the salary you receive for the year if you earn less than £40,000. If you pay more in, it will be taxed.

If you want to supplement these payments, you may be able to make employer contributions for director-shareholders to top up your pension. You should consult an IFA to ensure your pension contributions meet your needs.

Demonstrating income levels

You may want to consider taking a higher salary in order to satisfy visa or lending requirements where a minimum salary level is required.

The majority of lenders are now more flexible in terms of how you demonstrate your income. More lenders now consider dividend income in addition to traditional salary income when calculating your total income for borrowing, so it is always worth exploring the opportunities as this may mean you can maximise tax efficiencies by reducing your salary.

Taking all income streams into account

When you are calculating your tax and National Insurance contribution liabilities, it is important to ensure that you consider all your income streams. This can include: salary or income from other jobs, share and savings income, pension income and any other source of income.

Summary – all the key figures in one place

Below you'll see a handy infographic that summarises the key points to consider when setting your salary for 2015/16:

Next steps

By using a blend of tax-optimised salary and dividends you can minimise your personal and corporate tax liabilities. The next chapter details when and how to pay yourself a dividend.

Pay yourself dividends

As an owner of a limited company, often the most tax-efficient way of paying yourself is through a mix of a small salary and dividends. The small salary is usually set to minimise Income Tax and National Insurance as discussed in the previous chapter. This chapter provides information on how to utilise dividends within your personal income stream.

Dividend – is a distribution of profits by a company to its shareholders. Dividend payments must be taken after Corporation Tax on the company profits is accounted for.

By taking a small salary, you ensure that your National Insurance contributions are up to date and you are tax efficient by taking the rest of the profits you make as dividends.

Why dividends are tax efficient

Dividends attract 20% Corporation Tax (tax paid by the company), but no National Insurance and less Income Tax (tax paid personally) than a standard salary. So after the company pays 20% Corporation Tax, typically in the 2015/16, a basic rate tax payer (with a personal taxable income* of £31,785 or less) won't pay Income Tax on dividends; a higher rate tax payer (with a personal income* of more than £31,785) will pay around 25% Income Tax on the dividends received.

* **Income = Salary + Gross dividends + Any other income – Personal allowance**

The tax band applies to your income after your tax allowances and any reliefs are taken into account, so you need to allow for your personal allowance as in the equation above.

As gross dividend income is added to your other taxable income and taxed last, you pay tax on dividend income based on your highest Income Tax band.

The tax to pay on income (including the dividends you pay yourself) is calculated at the end of the tax year via the self-assessment tax return and paid by the individual personally. If you are a higher rate tax payer, that means you will need to make provision for the Income Tax on the dividends at the end of the year calculated through self-assessment. You can keep track of this throughout the year using our Tax calculator.

The benefits of paying yourself through a mixture of salary and dividends

When you can pay dividends

You can distribute dividends any time and at any frequency throughout the year, providing there is enough profit in your company (and available cash) to do so. From an HMRC perspective, you need to ensure that all the dividend payments are covered by the company profits net of Corporation Tax. This means that you can withdraw dividends at any time as long as there's enough profit available in your company. So what does this look like from a business owner's point of view?

Income (minus the VAT if you are VAT registered) from contracts outside of IR35**
Less Expenditure (salary, NIC, all business expenses)
= *Taxable profit*
Less Corporation Tax @20%
= **Maximum dividend available for distribution to shareholders.**

** **A note on IR35** - Dividends cannot be taken on contracts falling within IR35. You must take all the income earned from these as salary. For more information on IR35, look at our IR35 guide. Any income from contracts falling inside IR35 must be treated separately.

Most contractors and small business owners pay dividends frequently throughout the year. All you need to do is ensure that the dividends you distribute are covered by the profits net of expected Corporation Tax and that you leave enough cash within the business as operating capital to meet your future outgoings.

How you pay dividends

Every limited company has to ensure that they document and pay dividends appropriately. Here are the typical steps that are required before a dividend can be paid.

1. Calculate the company profit available.
2. Calculate the cash available and any requirements for operating capital.
3. Hold a directors' meeting and produce minutes documenting the dividend payment decision.
4. Print and retain the minutes.
5. Produce a dividend voucher detailing the dividend payment.
6. Pay the dividend.

Next steps

By structuring your personal income using a blend of salary and dividends, you can look to optimise your household income through appointing shareholders and employing family members. We explain this in the following chapters.

Appointing shareholders to maximise tax efficiencies

As a part of the company formation process, you need to decide who will be a shareholder in your limited company. If you choose to appoint family members as shareholders, it enables you to distribute company profits to them.

What are shares?

Shares are used to apportion ownership of the company. Ownership of shares in a company usually affords the shareholder voting rights and therefore influence over the running of the company. Shares are also used in the distribution of profit from the company; shareholders are paid dividends based on the number of shares they hold. It is a key part of ensuring your business is as tax-efficient as possible so it is important to make sure that the distribution of company shares works for you.

What is a shareholder?

Simply put, a shareholder is someone who owns shares in a company. The majority of contractors and freelancers are the sole shareholders within the business, but there is a fair proportion that utilise shares to ‘pay’ other individuals linked with the company in a tax-efficient way. This is a technique used to share dividend income with a spouse, for example, and can maximise unused personal tax allowances.

Who can be a shareholder?

Shareholders should be a spouse, a civil partner, or anyone who actively works in the business. Shareholders usually have voting rights and therefore some control over how the business is run, as well as having rights to a share of the profits (distributed as dividends). The proportion of shares an individual owns determines their proportion of the profits.

Distributing shares

You can hold the majority of the shares and then distribute shares to other individuals; this then enables you to distribute dividends to all shareholders in accordance with their share allocation.

Things to note when allocating shares:

1. Ordinary shares can be allocated to spouses - they qualify for the spouse's exemption under Section 624.
2. Dividends paid to the spouse must be income for them to spend as they wish – you can't 'reroute' the payment back to yourself as the main shareholder.
3. Keep a solid audit trail: document all share transfers and dividend payments through transfer forms and the required board minutes and vouchers when dividends are paid. This is crucial to ensure that, should HMRC ask, a full record can be provided.
4. We would not recommend the use of dividend waivers, therefore you should approach these with extreme caution. Waivers allow a shareholder to waive their right to a dividend payment. Some shareholders use this to enable the dividend amount to remain in the business (investment), but waivers can also be seen as tax avoidance when the waiver allows profits to be diverted to lower-tax attracting shareholders.

Next steps

Tax efficiencies are only applicable for additional shareholders if their personal income is under the lower tax threshold. You can also consider employing family members to maximise household tax efficiencies. This is covered in the next chapter.

Employing your partner or family members in your company

It is common for contractors and consultants to employ their spouse or other family members in their business. It not only provides the opportunity to maximise tax efficiencies within the household but their role is often pivotal in the smooth running of the business. Employing a family member to ensure the admin or core business services are taken care of frees you up to maximise the company income.

Benefits of employing a spouse

Paying a salary can maximise household tax efficiencies by utilising their income thresholds for tax liabilities.

Things to consider

Paying a family member is like any other employee and needs to be treated as such.

- The salary must be commensurate with their hours and the role they occupy within the company.
- Your IR35 status affects how much you can pay them. If the contract is within IR35 their salary is not allowable as a deduction and therefore you would be taxed again on their salary. If you operate outside IR35 their entire salary is a tax-deductible expense, meaning it reduces your Corporation Tax bill.

Next steps

Before employing a family member, do your research to ensure you are paying them the going rate for the role.

Keep records of all salary payments and the role descriptions for at least six years, as this is how far back HMRC can investigate.

This chapter covered looking after your family income. In the next chapter we look at looking after your family in a tax-efficient way.

Tax-efficient childcare

For the majority of contractors and consultants, running a small limited company means that it is often not cost effective to set up a childcare voucher scheme; however you can pay for childcare through the company by contractual agreement with a commercial nursery or childminder. This way you can increase your personal tax efficiencies.

Requirements

The company must be invoiced directly by a nursery or childminder and the payment will be free of tax and NICs for you as an employee as long as the following criteria are met. The exemption does not apply if the company reimburses the cost or settles the bill on your behalf.

- The payment is up to the relevant exempt amount per employee (see below);
- The scheme is available to all employees;
- The child lives with the employee and the employee has parental responsibility for the child;
- The childcare provider is registered or approved; and
- An estimate of the employee’s relevant earnings has been made by carrying out a basic earnings assessment and kept in case it is required by HMRC. You must do this annually.

Relevant earnings are calculated by taking your salary plus benefits less your personal allowance.

For the 2015/16 tax year, as long as this does not exceed £31,785, tax relief is available on £55 per week (£243 per month). For relevant earnings between £31,3786 and £150,000 this is reduced to £28 per week (£124 per month). Any amounts paid above these are a benefit in kind and need to be reported on a P11D form.

Next steps

Obtain and file a copy of your childcare provider's registration details i.e. their professional body and registration number.

Ensure they provide you with correct invoices containing the following:

- Their name and address
- Registered childcare provider number or equivalent
- Date of invoice
- Invoiced to your company (not you personally)
- Service description and amount.

You need to ensure that your company pays them directly from your business account and record the cost of childcare as a business expense.

This chapter has outlined looking after your family in a tax-efficient way; the following chapter details how to plan for your retirement.

Tax-efficient pension contributions

Paying into a pension fund not only supports your income requirements for retirement, but it is also an effective way of minimising both your corporate and personal tax liabilities.

Company contributions

The payment of employer pension contributions can be paid directly from the company bank account into an appropriate pension fund (providing your pension fund accepts company contributions).

There isn’t a limit on company contributions but they must be reasonable as part of your remuneration package as a whole. Company contributions reduce your Corporation Tax liabilities.

Personal contributions

You can pay personal contributions from your post-tax income, up to 100% of your earnings in a year. There is an overall limit of £40,000 and you can carry forward three years’ worth of entitlement limit.

Paying personal contributions is an effective way of reducing your income and preserving your personal allowance.

Dividends do not count towards earnings, so the maximum contribution is based on your salary only.

Personal contributions reduce your personal tax liabilities.

Next steps

Pension advice is regulated and you should seek advice from a regulated independent financial adviser before entering into a pension scheme. This will ensure that you select the right pension scheme for you and that the money invested is at the correct level to meet the regulatory requirements and your retirement fund target.

In the next chapter we look at protecting your lifestyle and future income through insurance.

Considering a relevant life policy

A few years ago, it was impossible to find levels of cover to rival 'death in service' life insurance cover if you were a small limited company. Now, a Relevant Life Policy (RLP) can provide the level of cover for directors and shareholders of small limited companies with the tax benefits that 'death in service' cover attracts.

A 'Relevant Life Policy' is a tax-efficient life policy designed for small businesses. Standard life insurance policies are paid for by you as an individual, after tax. The beauty of an RLP is that it is paid for through your limited company, offsetting Corporation Tax and it doesn't attract personal tax either.

The cover

The RLP is designed for businesses that don't have enough employees to warrant a group life scheme; you can set up an RLP for just yourself as the director of your limited company.

You can normally insure up to 20 times your annual income: your salary, dividends and benefits in kind. Some insurance companies can cover up to as much as £10m.

The premiums and benefits don't count towards your annual or lifetime pension allowance which is important if you have a large pension fund or you want to maximise your contributions into your pension.

Restrictions to be aware of

When looking at an RLP to provide life cover, there are some restrictions to consider:

- The cover must be paid in a single lump sum before the age of 75;
- Only death benefits can be provided;
- Benefits must be paid through a discretionary trust (this keeps the policy payments in trust for the company); and
- Beneficiaries are normally restricted to family members and dependants.

Why is a discretionary trust used?

There are legislative restrictions on whom the benefits can be paid to. The use of the trust is the most practical way to ensure the requirements are met.

- Having benefits paid through the trust ensures they can't be taxed as part of the trading income, nor do they form part of the company's assets.
- The trust is discretionary, allowing trustees to be flexible in whom they pay benefits to. However the person covered can advise the trustees of their intentions by completing a nomination form. Although this is not legally binding, it helps to guide the trustees. The trustees are usually directors of the company.
- Using a trust ensures that in most circumstances the benefits paid are free of both Income Tax and Inheritance Tax.

The tax-saving benefits

RLPs are usually classed as an allowable business expense, so all premium and benefit payments qualify for Corporation Tax relief, Income Tax relief and NI relief. In real terms this means that the cost of premiums can be reduced by up to 49% for a higher rate tax payer and by 40% for a basic rate tax payer. Here's an example of the savings:

Costs	Individual	Relevant

	life policy	life policy
Premium	£100 per month	£100 per month
Employee National Insurance contribution (assuming 2%)	£3.45	None
Income Tax (assuming 40%)	£68.97	None
Gross earnings needed	**£172.42**	**£100**
Employer National Insurance contribution (assuming 13.8%)	£23.79	None
Total gross cost	**£196.21**	None
Less Corporation Tax (assuming 20%)	(£39.24)	(£20)
Tax adjusted total cost	**£156.97**	**£80**

That means you could be saving £960.00 per year through tax efficiencies with an RLP.

Next steps

Contact a qualified and regulated financial adviser or insurance broker to discuss the level of cover you need. Ensure that you purchase the policy through your company and record the transaction accordingly.

This is our final chapter in section two, and the final chapter in this book looks at actions to take at the end of the tax year to ensure you have saved all you can on your company's and your personal tax bill.

Section 3: Your company's year end checklist

Your checklist of actions to take at the end of your company's financial year

Before your company year end arrives it's important to take the opportunity to minimise your tax bill before it's too late. Taking a few minutes to read this guide could save you hundreds in tax.

If you've had a successful year and your company has made a profit, Corporation Tax will become payable. There may still, however, be opportunities before your year end arrives to reduce your Corporation Tax bill.

The aim of this checklist is to provide you with tips, advice and checks to complete in conjunction with the more detailed information in the previous chapters.

It's crucial that you take action before your year end for it to be included in your accounts and Corporation Tax calculations.

1. Review your company expenditure

The simple fact is that the higher your spending the lower your profit, and the less tax you need to pay. If you have any planned expenses or purchases then just before the end of your year is a great time to maximise your company's outgoings.

Ensuring all expenses are claimed will save at least 20% in tax relief for those that are wholly, exclusively and necessarily for the purpose of business.

If you've ensured that you are claiming for all your business expenses, as detailed in chapter 8, it's also worth thinking about ensuring you spend on, and claim for these now before the year end:

- **Double check you've accounted for all your personal expenditure** on behalf of the company – check through all those old receipts to make sure every penny is claimed back.
- **Staff events** – If you didn't get time to have a Christmas party, why not have a late celebration? Just make sure the total spend per head is under £150 including VAT for the year.
- **Stock up on office supplies** – for example printer cartridges, paper, stationery or other general office supplies.
- **Purchase assets for company use** – including IT equipment, software and office equipment.
- **Subscriptions and annual fees** – it's a great time to join an HMRC recognised professional body and make annual payments for online necessities such as domain names and hosting, file storage or project management software.
- **Mobile or smart phones** – businesses benefit from the connected world and a smart phone is the perfect tool. If you need and use a mobile phone for business and don't yet have the contract in your business' name, consider transferring it. For it to be an allowable expense the contract must be in the name of the business and paid for directly by the business. Don't worry, a small amount of personal use is allowable.
- **Other items** – it's also a good time to get any equipment repaired, updated or serviced and to ensure your insurances are up to date.

2. Repay directors' loans

If any of your directors have received a loan from your company then it's important to repay the loan back to your company as soon as you can. If loans are not repaid you may need to pay Corporation Tax of up to 25% on the balance of the loan.

3. Review salaries and bonuses

It's a good time to pay yourself or your partner for any legitimate work that's been done throughout the year. For example, if your spouse helps with company admin or project management, you may be able to pay them a salary or bonus which will reduce your Corporation Tax liability. A person needs to be on the company payroll in order to be paid a salary. If they're not already an employee you'll need to act now if you wish to pay a salary. A key tax advantage of running a business is the opportunity to keep National Insurance costs low. Typically this is achieved by ensuring the director's salary is set to an optimum level, for the 2015/16 tax year around £8,000 per year. Remember, this is only an option if your contracts are outside IR35.

4. Check your insurance cover

It's likely that you already have Professional Indemnity insurance to meet the contractual obligations but you could consider additional business cover to protect against the worst. In recent years new products have become available that are compatible with small businesses, of which some can offer tax relief.

5. Invest in or top up a company pension

The end of your company's year is a good time to take stock of your retirement planning and to top up your pension. If you plan to top up your pension, please ensure any payments are made and received by the pension company before your year end.

6. Extract profits as dividends

Once you’ve maximised your outgoings and updated your records, you can finalise your company’s dividends for the year. You may decide to pay additional dividends if you and/or your business partner(s) don’t fall into the higher rate tax bracket.

Now is the perfect time to draw dividends in order to take advantage of the tax allowances: the majority of employees can draw up to £41,865 per year via salaries and dividends before paying higher rate tax. If you want to take advantage of your allowances simply draw a dividend before 5 April.

A quick recap on the 2015/16 Income Tax and National Insurance rates

The following rates and allowances apply to the tax year starting 6th April 2015 to 5th April 2016 Income Tax personal allowance

For the majority of employees the tax-free personal allowance for 2015/16 is. £10,600. This means that the first £10,600 you earn in a year will be free of Income Tax.

This will be reflected in your tax code: if your tax code for 2015/16 is 1060L then you will be entitled to this allowance.

Income Tax rates

Income per year	Rate (salaries)	Rate (dividends)	
Basic rate	£0 – £31,785	20%	10%
Higher rate	£31,786 – £150,000	40%	32.5%
Additional rate	Above £150,000	45%	37.5%

Income Tax example

If an employee earns a salary of £56,000 they will pay tax as follows:

- Personal allowance – the first £10,600 of their salary will be free of tax
- Basic rate – they will pay 20% tax on £31,785 of their salary, which is £6,357
- Higher rate – they will pay 40% tax on the remaining £13,615 of their salary, which is £5,446
- In total this employee will pay £11,803 in Income Tax

National Insurance rates

There are two different National Insurance contributions that must be paid: one is paid by the employee and is deducted from their gross salary, in a similar way to Income Tax; the second payment is made by the employer and is an outgoing for the employer, in addition to gross salaries.

Paid by Employees		Paid by Employers	
Income per year	**Rate**	**Income per year**	**Rate**
Below £8,061	0%	Below £8,113	0%
£8,061 – £42,385	12%	Above £8,113	13.8%
Above £42,385	2%		

National Insurance and state benefits

Employees must earn over £5,824 per year in order to retain access to certain state benefits, such as State Pensions.

Next steps

It is important to review your tax liabilities regularly and perform a full review each year to ensure you take advantage of any revised thresholds and tax allowances given by HMRC.

When looking to improve your tax liabilities it is important to invest in the advice of a qualified and regulated independent financial adviser who specialises in tax affairs.

We hope you found this guide informative and that it has provided you with some ideas to discuss with your tax adviser. This guide is for information only and does not constitute or replace tax advice from a qualified professional.

Visit our comprehensive Tax Calculator and plan all your taxes and earnings tax-efficiently. Calculate your income taxes, salary and dividends, student loan and pensions contributions, and much more. Our Tax Calculator goes further than showing how much tax you can save - you can compare calculations and download your own extensive PDF tax report based on those calculations, allowing you to take in all the details in your own time, instantly, and completely free.

Welcome to the UK's Most Powerful Contractor Tax Calculator

Designed specifically for contractors, our free tax calculator offers you a uniquely comprehensive view of your tax and earnings position.

Contractor Tax Calculator goes further than showing how much tax you can save - you can compare calculations and instantly download a comprehensive PDF tax report based on those calculations, allowing you to take in all the details in your own time.

g+1 Tweet Log In

Calculate *your* tax for the year 2015/16:

Your contract rate:	25	per hour
Working week:	40	hours per week
Working year:	46	weeks per year

Start My Calculation »

Our contractor calculator takes into account:

- Corporation tax
- VAT
- Income tax and National Insurance
- Student loans
- Dividends
- Expenses, mileage and pensions

You can use contractor calculator as a:

- Wage tax calculator
- Dividend tax calculator
- Home office calculator
- Expenses calculator
- Mileage calculator

Only **Contractor Tax Calculator** offers you such a complete view of your tax position in one online tool. Once you've input your financial information and received your PDF report, you'll be in the perfect position to take control of your accounting and make big tax savings, enjoying all the advantages that contracting has to offer.

Tax Calculations Approved by Accountant

We've worked hard to ensure the accuracy of our calculations and our team of accountants here at inniAccounts have verified them. These tax calculations are intended only as a guide - please make sure you read our terms of use before you use this calculator.