



*A Guide To:*

# **ACCOUNTING & TAXATION FOR SMALL BUSINESSES**

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## **INTRODUCTION**

Someone starting up a new business has the choice to structure it in several ways, the most common being as a sole trader; as a partnership; or as a limited company. Our guide [Why Trade as a Limited Company](#) sets out the legal and practical advantages of each of these and touches on the accounting and taxation differences.

This guide has been produced for two main reasons:

1. to give more detailed advice on the accounting records that each of these structures will need to keep and why it is important that they are kept up to date; and
2. to highlight the differences in tax treatment of each of these structures and the potential advantages for business owners to legally reduce their tax bills.

In doing so we will look at the following matters:

- Why you have to keep accounts
- Do you need an accountant
- Bookkeeping: what records you have to keep and how to keep them
- Preparing the accounts
- Calculating your taxable profit
- Personal taxation of a sole trader
- Personal taxation of a partner
- Personal taxation of owners of limited companies
- The accounts and returns you have to file

## **WHAT IS THE POINT OF KEEPING ACCOUNTS?**

If you ask that question to most of the people who are considering starting a business they will probably say “to work out my tax bill”. Perhaps a few might say “so I know who owes me money”. In fact, if we are honest most people view accounts (and accountants) as a necessary evil. Something they have to have but which gets in the way of their main concern, which is getting out and doing the work they get paid for. This is a pity as although annual accounts are necessary, the fact is that unless you have a very simple business, annual accounts are not so important as what are termed “management accounts”.

No matter how large or small your business you need to keep track of the money coming in to your business and the money going out. This is termed “cash flow” and it is of vital importance. You can only monitor cash flow and prepare management (and annual) accounts if you keep proper accounting records.

Cash is the lifeblood of business. If you loose control of your cash then you probably loose control of your business. There is a saying in accountancy – “cash is king”. It doesn’t matter if you are owed

thousands more than you owe – if you don't get the cash in on time and cannot pay your own bills your business will go under and you could be left bankrupt, possibly even if you are trading as a limited company. This is because if your company has been “trading whilst insolvent” you, as a director, could be liable for the debts of the company. If you don't keep proper accounting records you will not know when you are in danger of trading whilst insolvent.

Although monitoring cash flow is very important to the day-to-day control of your business it won't of itself reveal any profits or losses that the business is making. The fact that you have thousands of pounds sitting in the bank doesn't mean it is all profit.

Unless you prepare management accounts you will only know the true state of your business when the annual accounts have been prepared. But by the time these are completed if they show that your business isn't doing as well as you thought it will be too late to take remedial action.

Depending on the size of your business you should be preparing management accounts at least quarterly and you may or may not need the assistance of an accountant to do so. However do remember that if you do use an accountant then the work they do on preparing the management accounts will in effect be work they would have to do in order to prepare annual accounts and so the net cost to your business is likely to be only a little more than just having annual accounts prepared but with the advantage of having up to date information on the financial health of your business.

## **DO YOU NEED AN ACCOUNTANT?**

There is nothing in law that states that a business must utilise the services of an accountant. Even if you are trading as a limited company you can prepare and file your accounts and tax returns yourself. Whether you can or should do so is another matter.

The terms “accountant” and “accountancy” cover a whole range of activities – a “multitude of sins” if you prefer. At the basic level we have “bookkeeping”. Historically businesses employed bookkeepers who wrote all the transactions: sales, purchases, bank records etc, into separate account books – real bound books, which were known as “the books of prime entry”. From these books an accountant would extract all the information needed to draw up the actual trading accounts – the profit and loss account and the balance sheet. Next a tax accountant would take these trading accounts and prepare a computation of what is known as the “taxable profit”. This could be substantially different from the profit shown in the trading accounts as some things are fully tax deductible and others are not. For example if the company spent £10,000 on a machine it may not get tax relief on the whole amount in the year it bought the machine, but would spread the tax relief over a number of years.

At the basic bookkeeping level it probably isn't beyond the ability of most people to do the record keeping, particularly if they use a computer program or an online package. Whether you want to do it or not is another matter. It takes time, so either you do the work outside normal business hours or you take time out of the working day – time that might be better spent earning a better hourly rate than you might have to pay a bookkeeper. Some people pay their wife or husband to do the bookkeeping and that's fine. Whatever works for you.

When it comes to management accounts or even annual accounts and tax returns there are computer and online systems that can do most of the work for you. Again it is up to you, but no matter how confident you feel it may be advisable to have an accountant guide and advise you and check your figures. Remember the accounting software can't know if the figures you type in are correct.

Whilst the basic bookkeeping isn't too difficult, when it comes to drafting full accounts and working out tax then external advice is well worth having. This is because some expenses can be claimed against tax and others cannot and sometimes knowing how to treat a particular invoice can make a difference. Also, it's a bit like proofreading a letter or a guide such as this one. A new pair of eyes can spot errors that the writer has missed.

## WHAT RECORDS DO YOU NEED TO KEEP & HOW DO YOU KEEP THEM?

No matter whether you are operating as a sole trader, partnership or limited company there are a number of basic records that should be kept in order to enable you to monitor your cash flow and prepare management accounts to help you manage your business. These are:

- A record of income and expenditure - money received and paid out (cheques, cash, cards);
- The source documents to substantiate the entries in your records; such as vouchers, cheques, bank statements, invoices, receipts and other relevant papers;
- A record of the assets and liabilities of your business, including listings of your business debtors (people who owe you money) creditors (people you owe money to) and cash/bank account balances. Note that your assets may also include office equipment, machinery, vehicles or the premises used by your business.

You can keep your accounting records manually or electronically. By that we mean that you can write up your accounts into actual books or you can use a computer and a suitable accounting program of which there are many. Some are free, some cost a few pounds, some cost hundreds or pounds, and some cost thousands of pounds. Ask your accountant or a business friend what they would recommend. Otherwise a search on Google will soon bring up a range of choices and you can then narrow these down by looking at what other people say about the ease (or otherwise) of use as most of them have an on-line forum or user group. As a good starting point I'd suggest you try [DIY Accounting](#) who have a range of products to suit most business needs at very low prices.

### Manual Record Keeping

Manual record keeping means recording all business transactions in a physical record book or books. These transactions must be supported by source documents such as receipts or purchases invoices from suppliers, copies of sales invoices or cash register rolls and copies of bank deposit slips and bank statements for bank accounts used in the business.

You can buy all-in-one accounts books from stationery shops or you can use a number of separate accounts books. For small or simple businesses manual systems are perfectly adequate and allow you to break down your purchases into different categories. For example the book would typically have a column for rent, another for telephone, one for heat & light, one for wages, and so on. This is important when it comes to preparing the management or annual accounts as not all business expenses are recorded or treated in the same way.

### Electronic Record Keeping

Instead of recording all the transactions in physical record books if you use a computer system you type all the information into the accounting program. However you will still need to keep all the source documents referred to above so as to be able to substantiate your income and expenses. Despite that it is still the case that using an electronic record keeping system will make your job easier and you will incur lower manpower costs because you do not have to manually track every business transaction. Having entered the details just once the software will be able to provide you with a great many useful reports, which will help you manage the business finances at the touch of a button.

Whether you keep your records manually or electronically you must make sure you keep all your records in a legible and well-organised manner. For example, you should file your records in chronological order and retain photocopies of receipts if they fade easily (as a lot of till receipts do). Typically you will have a ring binder with all your sales invoices or cash sales receipts in chronological order (oldest at the back) and another with all your purchase invoices and receipts also in chronological order.

## PREPARING THE ACCOUNTS

As explained above in addition to the annual accounts which you are required to prepare for tax and other official purposes, it is recommended that, in order to monitor the financial health of the business, management accounts should be prepared “drawn up” at least quarterly. This takes place only after the bookkeeping records have been completed up to date the accounts are to be drawn up to.

For limited companies their annual or management accounts will consist of two parts:

- The Profit & Loss Account (“P&L”)
- The Balance Sheet

There is no requirement for sole traders or partnerships to include a balance sheet in their accounts but many do. However, as will be seen below the information contained in a balance sheet can be obtained from the bookkeeping records in another and more useful way.

Let’s have a look at each of these parts:

### The Profit & Loss Account

This shows the sales a business has made over a given period of time be that of goods or services. It also sets out the expenses incurred – the cost of goods sold, and the overheads (wages, admin expenses, rent etc.). The difference between sales and expenses is the net profit. If expenses are greater than sales then the business has made a loss. All the information recorded in your bookkeeping records is summarised in the P&L account.

Note that the P&L account shows the income earned during the period based on your cash sales and invoice totals – it doesn’t show whether those invoices have been paid or not. In the same way it shows expenses incurred during the period but not whether you have paid them or not. This information is however shown on the balance sheet (see below).

Also the P&L account does not show any loans made from the business or to the business. This is because loans are not concerned with actual trading and are therefore included on the balance sheet.

### The Balance Sheet

The balance sheet is rather more complicated than the P&L account, but it can give a far more illuminating picture of how well the company is doing. Whilst the P&L shows how much business the company has brought in and how much it has spent doing that, the balance sheet provides a snapshot of how much money the company has at a particular point in time. Typically it will include details of the following as appropriate:

- Fixed Assets: Plant, machinery, motor vehicles, property, stocks & shares, goodwill.
- Current Assets: Goods in stock, work in progress, debtors (people who owe the business money), pre-payments (bills paid in advance, such as rent for future months), money in the bank or building society, cash (in the till or petty cash).
- Current Liabilities: Creditors (people the business owes money to), accruals (bills due but not yet received, for example part of a quarterly bill which won’t be received until later, bank or other loans, overdrafts).

These are added and subtracted as appropriate in order to find the current value of the assets of the business, which could be negative if it owes more than it is owed.

Once that figure has been calculated it has to be balanced (hence the name balance sheet) against the capital and reserves of the business. Again depending on what is appropriate this includes the figure from the profit and loss account, capital introduced by the sole trader or partner, shares issued, reserves of profit (or loss) from previous years etc. The total of the capital has to equal the value of the assets at the same date.

The balance sheet is only a summary and is mainly intended for public consumption as all limited companies must file a balance sheet at Companies House (see below). Because it is only a summary, whilst it can tell you the total amount owing to your business at the date of the balance sheet it can't tell you who owes you the money or how long they have owed it – and this is much more important when it comes to managing your business and its cash-flow. It is however easy to obtain this information from your accounting or bookkeeping software which will print out an “aged debtors” report telling you who owes money and how long it has been owed for and an “aged creditors” report identify the people to whom the business owes money and for how long it has been owed. These reports – and many others – can be quickly obtained for all software systems and are of more importance than the balance sheet for the manager of a business be that a sole trader, partnership or limited company.

*Note that the layout of the P&L and Balance Sheet will be different for a sole trader, a partnership or a limited company but all will be based on the same bookkeeping information. The software you or your accountant use to produce the accounts – which may be the same piece of software you use for bookkeeping or a separate one – will automatically produce the correct layout and legal notes.*

## **CALCULATING TAXABLE PROFIT**

The “taxable profit” of a business is worked out by deducting *allowable business expenses* from the turnover - the total sales of goods or services that the business has made (excluding VAT if you are VAT registered).

The problem is that not all business expenses are allowable as tax deductions and there are quite a few special rules on the purchase of plant, machinery, property and motor vehicles etc. Sometimes even the wording on an invoice can make a difference in whether the expense is tax deductible or not. This is the one area where the advice of an accountant is probably vital. If you don't already have an accountant you might find this article on **finding the right accountant** to be of use.

Although working out the taxable profits of a business is pretty much the same whether you are trading as a limited company, a sole trader or a partnership there are differences in the way a business owner can extract the profits of the business depending on how it is structured.

For example, a sole trader will take “drawings” from the business account without paying tax or National Insurance Contributions (NIC) at that point (these are paid later) but a business owner using a limited company can pay him/herself partly by wages on which tax and NIC may have to be paid when it is taken, and partly by “dividend” on which no NIC payment needs to be made and which can be taxed at a lower rate of income tax than the same money drawn from the sole trader account. *The issue of taxation on business owners is dealt with later in this guide.*

## **Expenses You Can Deduct for Tax**

You can claim for any business expenses that have been incurred *wholly, exclusively and necessarily for business purposes*. This could include any of the following:

- Purchase of goods for resale;
- Wages of employees, rent, rates, repairs, lighting, heating, etc;

- Running costs of vehicles or machinery used in the business;
- Bank charges, accountancy and certain legal and other professional fees;
- Interest paid on money borrowed to finance business expenditure;
- Leasing charges in respect of plant, equipment or vehicles used for the business;
- Expenses incurred before the business started trading (pre trading expenses) such as legal or accountancy fees, advertising, the cost of preparing feasibility studies or business plans, rent paid for the premises from which the business now operates

### **Expenses That You Cannot Deduct for Tax**

- Any expense, not wholly and exclusively paid for the purposes of the trade or profession;
- Any private or domestic expenditure e.g. food, clothing (except protective clothing) etc.
- Business entertainment expenditure such as food and drink or other hospitality expenses; and
- Capital expenditure. (However you can claim capital allowances - see below.) Expenditure is regarded as “capital” if it has been spent on acquiring or altering assets that are of a lasting use in the business, for example, the purchase of premises, or the cost of plant, machinery or vehicles.

You can however, claim capital allowances on capital expenditure incurred on items such as office furniture & equipment, plant & machinery, vehicles and certain buildings. Capital allowances account for the wear & tear on these items and are deducted from your profit before you are taxed on it. Currently you can claim all the expenditure in the year up to a maximum of £50,000 per year and any in excess is calculated at 20% per annum on the cost of the asset on a reducing balance method. There are special rules on the amount you can claim on cars.

### **Expenses Which are Partly Business and Partly Private**

Where expenditure relates to both business and private use, only that part which relates to your business will be allowed. In such circumstances the expenses will need to be apportioned to exclude the private use. For example if you use your telephone partly for business and partly for personal use then you will need to agree a split with the tax inspector based on actual usage. This means you will have to identify business and private calls on your bills over a period of time.

### **Motor Expenses**

You can claim a deduction for the running expenses in respect of a vehicle used for business purposes. When you use a vehicle for both business and private purposes, a split of both the capital allowances (allowance for wear and tear) and running expenses has to be made. Sometimes the easiest thing to do is for you to own the car yourself and charge a mileage cost which currently is 40p per mile for the first 4,000 miles per year and 25p for each additional mile. These figures include an allowance for depreciation and wear & tear. Note that journeys between your home and regular place of work are treated as private and not business.

### **Using Your Home for Business**

You can claim, as an expense, the cost of using a part of your home for the business. Typically this could be as an office, or as consulting rooms or just for storage. To do this should work out the total cost of running your home. Take into consideration all running costs such as heat and light, Council

Tax, insurance rent or mortgage interest. After that just work out what proportion of your house you are using for the business.

For example if the house has six rooms including an office which you use for the business then it would be reasonable to say that 15% of the house was used for business, taking into account that the office would not be used all the time. So if you calculated your total annual running costs to be £5,000 then you can claim £750 a year as a business expense.

Note that it is not a good idea to use one room exclusively for your business otherwise you could end up paying Capital Gains Tax (CGT) when you sell the house. This is because although your home is exempt from CGT as your only or main residence, you could lose that exemption on part of the house if you use part of it *exclusively* for business. You could also find yourself being charged business rates as well as Council Tax.

So, make sure you use the room for non-business activities. I listen to music in my home office, which also contains books that I can read whilst relaxing to the music, though as I live in the Isle of Man where there is no CGT it isn't relevant to me. A friend has an exercise cycle in his office and when my wife used to teach music when we lived in the UK she also used the music room as a library and games room. Whatever suits your circumstances should be fine.

## **PERSONAL TAXATION OF A SOLE TRADER**

If you decide you are going to run your business as a sole trader then the first thing you need to do is inform HM Revenue & Customs (HMRC) that you are now self employed. You can [do this online](#) or by telephoning the self-employment helpline on 08495 154515. You must inform HMRC within three months of commencing business or you will incur a fine. Note that you can still be an employee elsewhere, or even run a separate business or businesses via a limited company or partnership.

Once you have informed HMRC you will become liable to pay National Insurance as a self-employed person. Whereas an employee has to pay Class 1 National Insurance Contributions (NIC) a self-employed person pays Class 2 NIC and Class 4 NIC instead.

Class 2 NIC is a fixed weekly amount (currently £2.40) paid by monthly direct debit or a quarterly bill and becomes payable only if your profit exceeds £5,075 per annum. If you know your profit is going to be below that figure, perhaps because your self-employment is very part-time, you can apply not to pay it. Otherwise you have to pay it but can claim it back after your accounts have been prepared.

Class 4 NIC is a percentage of your annual taxable profit from self-employment. It is payable at the same time as your income tax is due. The current rates are 8% for profits between £5,715 and £43,875 and 1% for profits above that figure.

Note that depending on your personal circumstances, particularly where you have earnings from other sources such as regular employment, you may get relief from having to pay all or some of your Class 2 or Class 4 NIC.

As a self-employed person you will be required to complete a Self Assessment tax return every year. This is used to calculate how much Income Tax and Class 4 National Insurance you need to pay and will be based on the accounting records that you have kept. The tax year runs from 6<sup>th</sup> April to the following 5<sup>th</sup> April but you don't have to prepare your accounts to 5<sup>th</sup> April. If you want you could decide on 31<sup>st</sup> December (or any other date) and if doing this part of your profit would be taxable at the rates appropriate for one tax year and the rest in the next.

Irrespective of the date that you prepared your accounts to you must still submit your tax return to a strict timetable. If you want HMRC to work out your tax and NIC bill you must submit your return by

post to arrive no later than the 31<sup>st</sup> October following the 5<sup>th</sup> April tax year end. Alternatively you can submit your return online and have the software calculate the tax for you as long as you do this no later than 31<sup>st</sup> January following the tax year-end.

When HMRC receives your return they will send you a Statement Of Account showing how much you owe, how much you may have already paid, and the balance you now owe – or may be owed to you. For the second and subsequent years that you are self employed, you may be required to make a payment of Income Tax on account. The amount due will be an estimate of what your next tax bill will be, based on your last year's profit figure.

For example if you started your business after 5<sup>th</sup> April 2008 then for the year ended 5<sup>th</sup> April 2009, you will need to pay your Income Tax and Class 4 National Insurance on 31<sup>st</sup> January 2010. In addition payments on account may be due on 31<sup>st</sup> 2010 January and 31<sup>st</sup> July 2010.

As you can see it is important that you know what your tax liability is so that you can plan your cash flow and ensure you pay on time or have to pay penalties and fines if you cannot.

A self-employed person will be taxed on the total taxable profit of the business not just on the amounts they have taken as "drawings" from the business.

## **PERSONAL TAXATION OF A PARTNER**

A partner is taxed in exactly the same way as a sole trader, which simply means that once the taxable profit of the partnership has been calculated each partner must include his or her share of the profit on their own self-assessment tax return.

## **PERSONAL TAXATION OF OWNERS OF LIMITED COMPANIES**

For many people the main advantage (and there are others) of trading as a limited company is to benefit from the tax advantages of paying themselves a mixture of salary and dividends.

Salary payments are taxed under PAYE and are subject to Class 1 National Insurance Contributions (NIC) from the employee and also from the employer. Currently an employee has to pay 11% on earnings between £95 and £844 per week and 1% on amounts above £844. The employer (the company) pays 12.8% on an employee's earnings above £110 per week.

However dividends are not subject to NIC deductions and so are seen as a tax efficient way to distribute profits from a limited company.

Company Directors are not subject to the National Minimum Wage legislation and so it is perfectly possible for a company owner who is also a director of the company to be paid purely by dividend. However unless they have income from other sources it will be advantageous for them to be paid a small salary in order to utilise their tax-free allowance and earn credit for pension, unemployment and other social benefits.

Once a limited company has been set up, either via an accountant or a reputable company formation agent, the director(s) will get an enquiry form from HMRC so that they can enter their details into their database (all directors have to fill in a Self Assessment tax return) and also so the company can register as an employer. Remember the company is a separate legal entity from its owner or owners: a legal person in fact. So, even if someone is the sole director of the company and the only shareholder, legally they do not directly own the assets of the company. They can therefore be an employee of the company – just as anyone else could be.

UK Companies are not liable to Income Tax and neither do they pay Capital Gains Tax. Instead a company is assessed for Corporation Tax on its taxable profit (see above) and unlike with a sole

trader or partnership where drawings taken by the owners do not reduce the taxable profit, salaries and employers NIC are taken from the taxable profit of a company.

### **Salary Payments**

So, how does this work? Generally a director/owner will be paid a salary and this will be set at a level which ensures that they don't have to pay tax and neither will they nor the employer have to make NIC payments but at a level that ensures the employee (director) qualifies for the state pension, unemployment benefit etc. For the tax year 2009-2010 the generally accepted optimum amount for a salary payment is £5,720. Take that as a monthly salary of £476.66 and you will pay no tax and although you will qualify for state benefits neither you nor the company will have to make any NIC payments. Note that whilst non-director employees have NIC calculated on a weekly or monthly basis directors NIC is worked out differently so you don't have to take your salary weekly or monthly.

The salary will be recorded as a cost and so reduce the company's profit. This in turn will decrease the corporation tax. Of course it is unlikely that this will be sufficient for you to live on which is where the payment of dividend comes in.

### **Dividend Payments**

The other way for an owner/director to get paid in a tax efficient way is for them to be paid by way of a dividend.

A dividend is not "salary" or "wages" but a payment made to shareholders out of the profits of the company and as such it is subject to tax at 10% as dividend income. This means that no NIC payments are due from the employer or from the shareholder, which means a potential saving of as much as 23.8%. And it is legal!

As dividends can only be paid out of profits or retained reserves it is normal for a company only to declare a dividend once it has worked out its annual profit and agreed how much it has in excess of its immediate cash requirements which is available to be paid to shareholders. This is technically called "the final dividend" and although proposed by the directors the shareholders must approve it. It is illegal for a company to pay out more in dividend than it has profits or retained reserves.

However the directors can declare an "interim dividend" any time they want. Unlike a final dividend, which once paid to the shareholder cannot be reclaimed by the company, an interim dividend can be reclaimed if the directors find that they have paid out more than the law allows.

However it is better not to get into the position where you have to reclaim dividends so care should be taken so as not to make the payment an "illegal distribution". Follow these rules and you should be OK:

### **Working Out the Dividend**

Firstly you need to work out how much profit there is in the company. You will need to have up to date management accounts for this. Depending on how you keep your records this may be easy or relatively difficult. However a good computerised system should quickly enable you to see what the current profit of the company is and then from this figure you need to deduct any interim dividends already paid in this financial year. Next you need to estimate how much corporation tax will be due on the profit to date. Some computer programs can do this automatically but otherwise you may need advice from an accountant or if you want to err on the cautious side allow for 21% of the profit as tax.

The amount you have left is what you have available to pay as a dividend but bear in mind that you may have clients who haven't yet paid you and unless you are 100% satisfied that they will soon do so then perhaps you should leave some money in the account in case you run into cash flow problems.

## Paying the Dividend

After you have worked out how much dividend you are going to pay there is some paperwork that needs doing. Firstly for interim dividends there needs to be a Board Minute authorising the dividend (HMRC will probably want to see evidence of this at some point) and then a Dividend Voucher needs to be completed.

After that has been done the payment can be made. If the dividend being declared is a Final Dividend then there has to be a Board Minute proposing the dividend and the members (shareholders) have to approve it. This is traditionally done at the Annual General Meeting but it can be done at any general meeting of the shareholders, which is important as many small companies no longer have to hold an Annual General Meeting. It can also be approved by a Written Resolution of the members. That used to always need 100% approval but recent changes brought in as part of the 2006 Companies Act now mean that, subject to anything to the contrary in the company's Articles of Association (so check these) a Written Resolution can be approved by a majority.

Dividends are paid out of taxed profits but when the dividend is paid to shareholders it is given an associated tax credit of 10%, which can be set against the shareholders own tax bill. This sounds confusing but in reality it is fairly simple.

Let's say that Joe Bloggs has set up a company called Bloggs Consulting Limited. It has an authorised share capital of 1,000 £1 shares ten of which have been issued to Joe who is the only shareholder.

Joe wants to be paid £10,000 from the available profit of the company so he, being the only director, declares an interim dividend of £1,000 per share. He has the only 10 shares, which have been issued so he receives a cheque for £10,000.

As Bloggs Consulting Limited is paying the dividend out of profits on which it either has or will be paying Corporation Tax (at 21%) the payment to Joe will be subject to a tax credit of 10% (the personal rate for dividend income). Unless Joe is a higher rate taxpayer he will have no further tax to pay on the £10,000 he has received and if he is then as the higher rate for dividend income is 32.5% he will have a further 22.5% to pay. Still much less than if he has to pay PAYE at 40% as well as 23.8% employee and employer NIC.

## Example Calculation

The tax credit on Joe's £10,000 payment is calculated as follows:

- Dividend paid = £10,000
- Tax credit = £10,000 divided by 90 then multiplied by 10 = £1,111.11
- Dividend Income = £11,111.11 (This is the amount you enter onto your self assessment tax return.)

***You can pay interim dividends as often as you want. However it is probably better to declare dividends quarterly and if money is need in between time make a payment to the director's loan account, which can be cleared off when the dividend is paid.***

## Paperwork

All that is required is a minute of a meeting or a written resolution to "declare an interim dividend". Then when the payment is made it should be accompanied by a "Tax Voucher" like the following example:

## TAX VOUCHER

Bloggs Consulting Limited

Joe Bloggs  
123 High Street  
Anytown  
Someshire  
AB1 2CD

INTERIM DIVIDEND

30 April 2009

Interim Dividend of £1,000 per share for the year ended 31 March 2009 to shareholders registered on 30<sup>th</sup> April 2009

	Number of Shares	Tax Credit	Dividend Payment
Shares of £1 each	Ten	£1,111.11	£11,111.11

### KEEP IT

**Keep this for your tax records. If you have a tax advisor, give them a copy.**

This voucher should be kept. It will be accepted by the HMRC as evidence of a tax credit. You have a legal obligation to retain tax records.

## FILING REQUIREMENTS FOR LIMITED COMPANIES

Once you have registered as a sole trader all you need to provide is a set of accounts to accompany your tax return and possibly also to give to your bankers or anyone you are trying to obtain a loan from.

Although the record keeping is pretty much the same for sole traders and companies there are more complex filing requirements for a company to adhere to. These are not in fact very onerous and it is likely that you would benefit from having an accountant deal with these for you – but you don't have to.

All companies must prepare a Balance Sheet. As has been explained above the prime purpose of a Balance Sheet is to summarise the financial health of a company for filing as part of the annual accounts at Companies House where it is available online for anyone to read. (There is no requirement to file management accounts.)

The reason for this filing requirement is that although a sole trader or partner can be held personally liable for the debts of their business, the owners (shareholders) of limited companies cannot be held liable and so lenders or potential suppliers will want to have some way of forming an opinion as to the financial health of a limited company for which purpose the balance sheet is invaluable.

An indication of the importance of the balance sheet can be demonstrated by the fact that whilst only large limited companies have to file a Profit & Loss Account at Companies House, all companies – including small and medium sized companies – *must file a Balance Sheet!*

For your information the definition of a Small Company is one which has:

1. an annual turnover of £6.5 million or less ;
2. total fixed and current assets on its balance sheet of £3.26 million or less; and
3. 50 employees or less.

On the assumption that your company is a small one all you need file at Companies House is an abbreviated balance sheet which doesn't give the same detail that the full balance sheet that HM Revenue & Customs require does.

In addition small companies do not require a statutory audit of their accounts.

As director of a limited company you will need to prepare and file the following:

- Abbreviated Accounts for Companies House (a very abbreviated balance sheet);
- Annual Return for Companies House (details directors, shareholders etc);
- Corporation Tax Return;
- Full Account including Profit & Loss account for HMRC;
- PAYE - P35, P14s, P11d etc (if applicable for director and/or employees);
- Self-assessment tax return for directors.

Note that a sole trader may also have to complete the PAYE documents if there are any employees other than the owner and will also have to file a self-assessment tax return.

So there we are. This is a brief (!) explanation of why it is important for you to keep proper accounting records in order to manage your business properly and avoid getting into financial hot water as well as helping you to plan your business in such a way that you can legally pay as little tax as possible.

*Note: This guide is not designed to replace professional advice from an accountant or tax advisor who will be able to take your personal circumstances fully into account.*

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