CHARTERED ACCOUNTANTS

KEY GUIDE

Setting up a business in the UK

INTRODUCTION

Anyone contemplating starting a new business, especially a bricks and mortar one, needs to be wary of current economic conditions. Company insolvencies in England and Wales have recently hit a 13-year high. Many small firms are struggling, with restaurants particularly hard pressed.

The government's emergency package of support towards the cost of electricity and gas introduced from 1 October 2022 will protect businesses from soaring bills over the winter months, but the support is only set to last for six months – far from ideal for a new business which will want to plan at least two or three years ahead.

Your plans will also need to factor in the current high rate of inflation, increased borrowing costs following six Bank of England base rate increases during 2022 and higher salary expectations along with staffing shortages.

This brief guide sets out some of the key issues you should think about when setting up a business in the UK.

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YOUR BUSINESS PLAN

Some of the decisions and actions that you take when starting a business can have significant effects for some time. But with careful planning and good advice, starting your own business may prove to be one of the best steps you ever take. First you need to research and develop your business idea and review the market for it. Market research can be as basic as asking your friends and colleagues what they think, or as sophisticated as employing a market research agency.

The next stage is to prepare a business plan. This should describe the business, its objectives, its strategies and its financial forecasts. Every business should have a business plan, but it is especially important at the beginning. A good plan is essential if your business needs external funding such as bank finance but, critically, it will also allow you to measure how well your business is doing once you start trading.

The financial projection is particularly important, because this will cover pricing and costs, sales and profit forecasts, how much capital you will need and projected cashflow statements for the first three to five years. If you start with insufficient capital, your business may be dead in the water before it even begins.

Planning point

The current economic situation has increased the level of risk and volatility faced by businesses, meaning financial projections are unlikely to be anywhere near 100% accurate. Adopting a "what if" approach can help. Scenarios such as "*what if my raw material cost rises 10% more than expected?*", or "*what if I cannot attract enough staff and instead have to pay for high levels of overtime?*" can be built in to your risk management planning.

The initial financial projection will essentially be an educated guess without any track record to base it on, and its accuracy will depend on your research. One way to deal with the likely inaccuracy of the initial projection is to prepare best- and worst-case outcomes. Once you start your business, you should keep updating your financial projection and, because it will then be based on actual figures, it should become increasingly accurate.

Leaving the EU

Your business plan will have to take account of the impact of the UK having left the EU, not just for your own business, but also how potential suppliers and customers will be affected.

Imports and exports from/to the EU are now subject to more stringent conditions, with possible delays at the border. A just-in-time supply chain model may therefore no longer be feasible. Exporters of food and drink have been hit particularly hard, seeing a sharp decline in sales since the UK left the EU.

Finance and grants

Despite its limitations, your financial projection should give you an idea about how much finance you will need. Having adequate finance is probably the biggest hurdle for many new businesses. The obvious starting point is your own savings (but be careful of the capital gains consequences, if cashing in investments) and loans from family and friends.

In some cases, a bank overdraft or business loan may be available, although remortgaging your home might be the only option (be warned that the cost of remortgaging has increased significantly). Other possibilities include commercial mortgages (useful if you are buying business premises) and grants (available from various sources).

Planning point

Rather than running the business alone, consider the benefits of having a partner or bringing in a co-shareholder. It's a good way of obtaining complimentary skills – for example, you may be good at developing the business but lack sales, marketing or financial skills.


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WHICH BUSINESS ENTITY?

Many start-ups are as a sole trader because this is the simplest, most flexible, business structure. Running your business as a sole trader can result in paying more tax compared to trading as a limited company, but the position is not as straightforward as it was a few years ago. This is because the basis of taxing company dividends has changed, making the withdrawal of profits from a company by way of dividends a much less attractive proposition.

Example – Tax cost of different business structures

Samantha is currently self-employed, with annual profits of £80,000. For 2022/23, her total tax and national insurance contributions (NICs) will be £24,076. If she had instead run the business as a limited company – withdrawing £8,000 as director's remuneration, with the remaining profits taken as dividends – the tax cost could have been reduced to £22,221. The tax saving may not be considered sufficient compensation for losing the simplicity and cost savings of operating as a sole trader.

There are advantages and disadvantages to a limited company structure:

Advantages	Disadvantages
It may be easier to raise finance.	More administration.
In theory, a company offers personal protection from your business debts (this protection is reduced if you have to give personal guarantees).	Your financial statements are publicly available in an abbreviated form (less information is reported if your company qualifies as a micro-entity, although this is set to change).
It is much easier for your family, relatives and others to become involved in the running of the business as they can be made directors without you losing any control.	
Some suppliers and lenders prefer to deal with a company.	

It can be better to start off as a sole trader or partnership and incorporate later if you expect your business to take a while to become profitable.

This is because losses from a sole trader business or partnership can be offset against your other income for the previous three years. It is more difficult to change business structures in the opposite direction.

While unincorporated businesses are currently able to structure their tax payments on a tax year or a current year basis, from 2024/25 these businesses will only be able to use the tax year basis. If you are setting up a business now, it therefore makes sense to begin under the tax year reporting basis with a 31 March or 5 April year end.

Off-payroll working

If you are a contractor and working for clients using a limited company structure, then you need to be aware of the tax implications if you fall foul of the off-payroll working (IR35) rules.

The rules apply if you would be classed as an employee were you to be working directly for the client without the intervening company structure.

The responsibility for deciding whether the off-payroll working rules apply currently falls on the client. They effectively treat you as an employee for tax purposes if the rules apply – but with no entitlement to the rights and benefits that go with employment, such as holiday pay.

PREMISES AND EQUIPMENT

You want premises that enable you to operate effectively but without any unnecessary costs. You also need to consider the future – you don't want to be tied to premises that might be unsuitable when your business grows. The main choices are:

- working from home – maybe a spare room or a cabin in the garden;
- renting – this usually has minimum upfront costs but rent is a tax-deductible expense;
- buying outright or taking a long lease.

Whether you are renting, buying or leasing business premises, make sure you budget for all the related costs. Business rates can be a substantial cost, so make sure you apply for small business rate relief (in Scotland, the small business bonus scheme) if you qualify. For premises in England, 100% relief applies where the rateable value is less than £12,000.

Additionally, there is a 50% discount on business rates for retail, hospitality and leisure businesses in England and Wales for 2022/23, subject to a cash cap of £110,000 per business. Similar relief is no longer available for businesses situated in Scotland or Northern Ireland.

High overheads have resulted in many business failures and you must be careful if your business is seasonal – the costs will continue despite a reduced off-season


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income. The Covid-19 crisis has starkly illustrated this problem. Trading or working online (see below) should remove much of your overhead.

Capital allowances

Tax relief for buying equipment is provided through the system of capital allowances. These give tax relief in the year of purchase or spread it over several years. There is an annual 3% write-off if you buy business premises where the construction contract was signed on or after 29 October 2018. For a temporary period until 31 March 2023, companies investing in qualifying new plant and machinery benefit from a 130% super-deduction. This means that for every £100 of expenditure, an allowance of £130 is available.

> **Planning point**
> Consider leasing the equipment you need rather than buying it outright. Leasing can be more tax-efficient and leasing high-value items, such as cars, will be much healthier for your cash flow during the first few years of trading.

REGISTERING FOR TAXES

If you are in business as a sole trader or partnership, you will need to register with HM Revenue & Customs (HMRC) as soon as you start working for yourself. Paying NICs will entitle you to the state pension and some other benefits. HMRC is usually aware of new limited companies and should contact you.

As a director, both you and your company will pay NICs on your remuneration from the company. Your contributions will entitle you to the state pension and contribution-based benefits, such as jobseeker's allowance. Your company's contributions will be reduced, maybe to nil, by the annual £5,000 employment allowance (although this is not available if you are the company's sole employee).

You must register for VAT if your sales exceed the registration threshold (£85,000 until 31 March 2024). Even if your turnover is below the threshold, if you register for VAT you can recover the VAT that you are charged on your purchases. There are

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special schemes for small businesses, such as cash accounting and the flat rate scheme, as well as schemes for retailers and some other types of business.

Making Tax Digital

Making Tax Digital (MTD) for VAT is now compulsory for virtually all VAT registered businesses, so they have to keep digital records and use MTD-compliant software to directly submit VAT returns to HMRC.

Businesses which become VAT registered must enter the MTD regime immediately upon registration. This obligation should be borne in mind when purchasing accounting systems for your business.

MTD for businesses and landlords is due to come into effect from 6 April 2024. Most businesses and landlords will then be required to digitally record tax-relevant data and to use MTD-compliant software to transfer the required information directly to HMRC's systems via an application programming interface (API).

Planning for tax payments

Not setting enough aside for tax payments can catch out sole traders and partners, especially early on.

A good approach is to save a regular amount to fund tax liabilities. It also helps to have your accounts prepared as soon after your year end as possible to give plenty of warning of future liabilities.


Credit: iStock/ChiccoDodiFC

Example – Tax payments

You start self-employment on 6 April 2022, preparing your first accounts to 5 April 2023. The income tax and NICs for the whole year will be due on 31 January 2024, plus possibly another 50% payment on account for the following year.

YOUR EMPLOYEES

You might start off solo, but when your business grows you may need to employ staff. Employers must deduct tax and NICs from employees' pay under the Pay As You Earn (PAYE) system. You will have to register with HMRC as an employer and run payroll software that reports real time PAYE information to HMRC every pay day.

Other important staffing issues include training and improving staff performance, the national living wage (the national minimum wage applies to employees aged under 23 and apprentices), employee rights, health and safety, and the provision of a workplace pension into which your employees must be automatically enrolled.

Workplace pensions

The cost of contributing to a workplace pension is something that is easily overlooked when budgeting the costs of running a new business, and the administrative side can be quite time consuming; especially if there is frequent staff turnover or where staff pay fluctuates from month to month. You will have pension obligations even if there are just one or two employees.

The rules are quite detailed, but in broad terms you will need to classify your employees into three categories depending on earnings and age:

- *Eligible jobholders* are those employees aged between 22 and the state pension age who earn more than £833 per month (£10,000 annually). You automatically have to enrol these employees into your workplace pension scheme.
- *Non-eligible jobholders* are those employees aged between 16 and 74 that have qualifying earnings, but who do not qualify as eligible jobholders. They are not eligible for automatic enrolment, but can choose to opt in to your workplace pension scheme.
- *Entitled workers* are those employees aged between 16 and 74 who do not have qualifying earnings. They are entitled to

join a pension scheme, but there is no requirement for you to make any contributions on their behalf.

Several pension providers offer suitable workplace pension schemes for small employers. One low-risk option is the National Employment Savings Trust (NEST). This is a low-cost scheme established by the government to ensure all employers have access to a pension provider.

The definition of earnings is based on total pay, including any commissions, bonuses, overtime, statutory sick pay or statutory maternity, paternity or adoption pay. Contributions are calculated on earnings between £520 (the lower level of qualifying earnings) and £4,189 per month (between £6,240 and £50,270 annually). The minimum contribution rate is 8%, of which you, as the employer, must contribute at least 3%.

TRADING OR WORKING ONLINE

Trading or working online should reduce (or even eliminate) overheads as it can remove the need for expensive premises. For retailers, there are other advantages:

- Online marketplaces make it easy to set up a simple online shop and sell products straight away.
- There are fewer constraints to how large your business can grow.
- Your market can be expanded beyond local customers very quickly.
- There is a wide range of online marketing tactics which can be used to target new customers.
- It should be possible to stay open regardless of any restrictions or lockdowns as long as you have the resources.

Even if not fully digital, it is important for a new business to have an online presence. At the very least, this means having a website to promote and market your business.


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HOW WE CAN HELP

We help businesses from start-up, through growth and onto ultimate sale. We can advise you on the many issues you might encounter at any stage in the life of your business.

We can also keep you aware of changes in regulations affecting businesses and smooth your dealings with HMRC.

Our aim is to help you steer clear of the hazards of business life but provide expert help if you do encounter them.

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