ACCOUNTANTS FOR TRADERS LTD

Your Future and Your Options

A Trader's Guide to Tax Efficient Trading

➤ Tax Planning ➤ Accountancy Services ➤ Wealth Planning and Advice

ACCOUNTANTS
FOR TRADERS LTD

2nd Floor, 73 Farringdon Road, London EC1M 3JQ

Kings Lodge, London Road, West Kingsdown,
Nr Brands Hatch, Kent TN15 6AR
Phone: 01474 853 856 **Fax:** 01474 852 456

E-mail: enquiries@accountantsfortraders.co.uk
Website: www.accountantsfortraders.co.uk
Find us on Linkedin under 'A4G Accountants for Traders'

Contents

Introduction

One of the most important things that you need to consider when starting out in business is which corporate structure is most appropriate to your circumstances.

Or, if you have already set up your own business, are you confident that your current structure is the most beneficial one available to you?

There are many conflicting factors involved in such a decision including tax issues, administrative costs and whether you want limited liability if anything goes wrong. In this booklet we have given a brief overview of the relative advantages and disadvantages of each structure.

This booklet is intended to help you make the right decision for your circumstances, and points out a few of the most common issues that we have come across in our work with other traders and brokers just like you.

This guide is no substitute for detailed bespoke advice and should be used for initial guidance purposes only.

If you would like to discuss your options in greater detail, please contact us on 01474 853 856 and arrange for a FREE initial consultation.

It is always recommended that you take appropriate professional advice before making any decisions on the finances of your business. Accountants for Traders Ltd. will not accept any liability on any actions taken or not taken purely on the issues raised in this guide.

Common Issues and Mistakes

Through our work with traders and brokers over the years, we have identified several issues that regularly raise their head.

Am I taxed on all profits or just drawings?

A common misconception we have found with many traders is the belief that you should only be taxed on money that has been drawn out of any of the trading accounts in the year.

Whilst this seems logical, you are actually taxable on all of your profits made during the year whether you have drawn them or left them in your trading account. This is because any monies left in the trading accounts could have been drawn down if you had wanted to and as they would have been available to you, they remain taxable.

HM Revenue and Customs have enquired into tax return where income has been incorrectly declared and high financial penalties have been imposed where tax has been underpaid.

Backed and self-funded traders

As we deal with many traders based at different trading houses and using a variety of trading platforms, we are experienced in understanding your trading statements.

- **'Backed' Traders**
  Many backed traders tend to find themselves paid on a monthly basis as a draw against their share of any trading profits made, with the remainder paid out as a lump sum less regularly.

  At some arcades, a proportion of the profits are held back as a trading reserve that is used to offset any potential future trading losses that could be incurred. Whilst this trading reserve is not accessible by the trader, it does form part of their taxable profits, so is still subject to tax, and can have a dramatic affect on your cashflow.

  By arranging your trading activities in an efficient business structure, you can both improve your cash flow and save tax.

- **Self-Funded Traders**

  Self-financed traders often have more financial risk through using their own capital, but they may also have more flexibility in how they operate.

  Trades under this option are financed from profits made on past trades and any capital introduced.

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Open Trades

In either case, if you should have any open trades at the end of your accounting period, these should be treated as effectively part of your trading account balance with any profits or losses on the open trades being realised (and taxed) in the following period.

Claimable expenses

As with any other industry, you are able to deduct expenses from taxable profits which are incurred "wholly, exclusively and necessarily" for the purposes of your business.

For traders, these expenses can include travel expenses, accommodation on trips away from home, motor expenses, accountancy/legal fees and telephone calls as well as an annual proportion of any assets used for business purposes such as computers. If there is a personal element to the expenses, relief will be generally restricted to the business proportion.

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How should I structure my affairs?

Whilst the calculation of your taxable profits is broadly the same whichever business structure you use for your trading activities, the tax rate can be dramatically different.

As you will be able to see from the case study later on in this booklet the effect of choosing an inefficient business structure can be very costly.

Some business structures (i.e. Limited Companies, Limited Liability Partnerships) also offer limited liability in the event of the business failing (subject to any personal guarantees), so you can protect personal wealth that would otherwise be at risk from any losses incurred from trading.

At Accountants for Traders Ltd., we specialise in providing you with the options available to you. Call us on 01474 853 856 to discuss the options available to you.

Sole Trade/Partnership

Registration as a self-employed person at HM Revenue & Customs (whether a sole trader or a member of a partnership) is the most straight forward approach.

As a self-employed trader/partner all profits are subject to Income Tax and National Insurance (Class 4) through your self-assessment tax return (less any allowable expenses) whether these are drawn from the business or not. Class 2 National Insurance will also be payable, usually by Direct Debit.

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Tax is payable on the 31st January following the end of the tax year (e.g. tax relating to the tax year ending 5th April 2013 will be payable on 31st January 2014) with payments on account towards the liability for the following tax year payable on 31st January 2014 and 31st July 2014. (For your first year of trading, it can appear that you are paying up to 150% of your tax bill on 31st January!)

If your spouse or partner is involved to some extent in the business or has some degree of financial risk, then it may be possible to involve them as a partner which could allow the use of their personal allowance and basic rate tax band.

Whilst this is the easiest and least expensive way to trade (from an administrative point of view), self-employment can result in the highest tax liabilities and also means that you have unlimited liability on you personally in the event of losses outstripping accumulated reserves.

Therefore, unless you are prepared to take significant personal financial risk and pay the highest rates of tax, it is likely that other business structures would be more appropriate to you.

Limited Company

A limited company is a separate legal entity to the owners (shareholders) of the company with the owners enjoying limited liability in the event of business failure. Therefore, the owners would only stand to lose the money and assets invested if the business was to fail.

Unlike self-employment options, Limited Companies must be incorporated at Companies House and abbreviated accounts and a return of statutory information must be filed and published annually.

Like a sole trade, a limited company can be run by just one individual who will be both the director and shareholder.

The limited company is assessed on its taxable profits under the Corporation Tax regime. Salaries paid to directors and other employees are deductible expenses for the purposes of calculating the taxable profits.

Directors and employees are subject to Income Tax and National Insurance on any salaries drawn from the limited company. The limited company is also required to pay Employer’s National Insurance above a certain threshold.

Dividends may then be paid to the shareholders who will be subject to Income Tax on any dividends received, but if the shareholders remain basic rate taxpayers, then their liability is covered by a notional tax credit and there is no further personal tax to pay.

If your spouse or partner is involved to some extent in the business or has some degree of financial risk, then it may be possible to introduce them as either a director or shareholder, potentially increasing the amount of money available to draw before any higher rate tax is payable.

As a general rule of thumb it is generally more beneficial to use a limited company if taxable profits per individual are likely to exceed c£20,000 per annum.

Hybrid Partnerships

A Hybrid Partnership is effectively a combination of the self-employment and limited company options. If the Hybrid Partnership takes the form of an LLP (a Limited Liability Partnership), this ensures that the partners also have limited liability in the event of business failure (subject to personal guarantees).

A Hybrid Partnership can have as partners a mixture of individuals, Limited companies or other partnerships/LLP's which means it is a very flexible structure for both joint ventures and individual proprietary traders alike.

From a tax point of view, the Hybrid Partnership does not face a bill on its profits but the partners are taxed on their own share of the profits.

If the members are individuals, they are assessed as self-employed under the Income Tax/National Insurance (Class 2 & 4) regime. If the members are limited companies, they are assessed under Corporation Tax rules.

The combination of self-employment and limited company rules can provide an extremely tax-efficient method of drawing money.

Varied tax planning options such as a **tax-efficient way of running motor vehicles** and the ability to **legitimately pass profits to the partner facing the lowest rate of tax** are available.

Optional structures such as **Investment Partnerships** can be bolted on for traders who:

- Hold significant assets outside of the business, or
- Wish to build a tax efficient investment portfolio.

As this structure is entirely bespoke for each trader's circumstances, the setup is often more complex with increased annual administrative costs than a more traditional structure.

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Case Study
- based upon a current client's own circumstances

A trader using a Hybrid LLP alongside an Investment LLP made taxable profits of £170,000 in the year ended 31st March 2012. This was his first year of trading having been previously employed.

He drew £70,000 for the purposes of living expenses, investing a further £30,000, and left the remainder in his trading account for future trading.

If **self-employed, he would have suffered a total liability of £68,853** leaving just £1,147 for future trading activities.

All of this liability, plus his first payment on account towards the 2012/13 tax liability of £34,426, a total of £103,279, would be payable by 31st January 2013. A further £34,426 would be payable in July 2013 towards to the 2012/13 tax liability.

If using a **limited company**, corporation tax of £32,586 would fall due on 1st January 2013.
Alongside this, his personal income tax liability would have been £25,702.
All of this liability, plus his first payment on account towards the 2012/13 tax liability of £12,851, a total of £38,553, would be payable by 31st January 2013. A further £12,851 would be payable in July 2013 towards to the 2012/13 tax liability.
Therefore, **the total tax liability using a limited company would amount to £58,288**.

As our client has been trading through a **Hybrid LLP with an Investment LLP,** the limited company partner has incurred £31,526 of corporation tax payable on 1st January 2013, whilst he will personally suffer income tax of £979 due on 31st January 2013.

Therefore, the **total tax liability payable using a Hybrid structure is just £32,505 (saving £36,348 over self-employment or £25,783 over a limited company).**

If you are not currently using a Hybrid structure and would like us to review your affairs, call us on 01474 853 856

NB. Please note that this case study presumes that the trader did not receive any further taxable income from other sources.

Other considerations

Spread-betting

One question often raised is whether profits would be assessable to tax at all by using a spread-betting platform, although tax should not be the only consideration of using such a platform.

HM Revenue and Customs' viewpoint (taken from their Business Income Manual) is that:

"To be taxable, the spread betting wins must come not merely from an opportunity to trade, they must come from the carrying on of that trade. Whether or not a particular spread bet is taxable will depend on the terms of the contract and the economic substance of what is done."

In other words, if a person seeks to maximise their profits (or minimise losses) rather than simply gambling on a specific outcome, the person may be seen to be carrying out a trade and thus should be taxable on this income. Prior experience in trading activities may further indicate the taxable nature of any 'winnings'.

In practice, the argument of spread-betting vs. trading is a very grey area of legislation and it would be especially important to obtain professional advice in this area based on your own personal circumstances.

VAT

Unless you are providing advisory or fund management services, it is highly likely that your business (in whichever structure) will be wholly exempt from VAT.

This means that your business will be unable to register for VAT and it will not charge VAT nor reclaim any VAT on expenses.

If your business provides advisory or fund management services, it may need to register for VAT if income from these sources exceeds the VAT registration threshold. This may result in 'partial exemption' allowing only partial reclaim of any VAT on expenses but it will have to charge VAT on any advisory/fund management services supplied.

IR35/Intermediaries Legislation

If you supply services to a third party through an 'intermediary' (e.g. a partnership, LLP or limited company) it is possible that HM Revenue and Customs could assess you for tax purposes as being effectively an employee of the third party.

In most cases, it is highly unlikely that a trader would be attacked under this legislation particularly where they trade largely independently and face significant financial risk.

However, each case is invariably slightly different to the next and it would be important to consider this as part of the overall assessment of your options.

Who are Accountants for Traders Ltd.?

We are a specialist accountancy practice set up by A4G LLP to deal solely with the accountancy and tax affairs of proprietary traders and brokers.

If you have any questions which you would like to discuss, then please contact our experienced team on 01474 853 856 who will be happy to help.

Wes Mason FCA (Tax Partner)

wes@accountantsfortraders.co.uk

Having joined A4G in 1998, Wes became a partner in 2006, and has since become one of the key advisers to a wide range of clients. Wes has frequently re-iterated his desire to continue to work with proprietary traders and brokers given his family background in investment banking.

You can find out more about Wes by visiting his LinkedIn profile
www.linkedin.com/in/wesmasona4g

Mark Goodfellow ACA (Partner)

mark@accountantsfortraders.co.uk

As well as being the A4G's sporting influence (Mark previously played semi-professional football), Mark has developed a great understanding of the financial sector as a whole with clients ranging from insurance brokers to financial traders since qualification in 2007.

You can find out more about Mark by visiting his LinkedIn profile
www.linkedin.com/in/markgoodfellowa4g

Emma White ACA (Partner)

emma@accountantsfortraders.co.uk

Emma brings her experience in dealing with a wide-ranging client base to our traders. This experience allows Emma to guide her clients very effectively through the potential pitfalls associated with corporate structures, particularly those that look very complex at first sight, whilst also helping her clients reduce their tax bills to the absolute legal minimum.

You can find out more about Emma by visiting her LinkedIn profile
www.linkedin.com/in/emmawhitea4g

Caroline Coleman FCCA (Partner)

caroline@accountantsfortraders.co.uk

Since qualification in 2003, Caroline has acted for a varied client base including numerous traders. Given this wealth of experience that Caroline has gained, she is extremely well placed to advise traders on methods to reduce their tax bills whilst reducing the nuisance factor of the statutory requirements associated with the trading structures utilised.

You can find out more about Caroline by visiting her LinkedIn profile
www.linkedin.com/in/carolinecolemana4g

Matthew Finch ACCA (Principal Adviser)

matthew@accountantsfortraders.co.uk

Matt was snapped up from one of our competitors in 2008 and also passed his final ACCA exams and qualified in the same year. Matt has an extensive audit background and is therefore very thorough in all that he does. Apart from audit, Matt is also our Sage specialist and has his own varied portfolio of clients as Principal Adviser and Client Manager

You can find out more about Matt by visiting his LinkedIn profile
www.linkedin.com/in/mattfincha4g

Alternatively, you can email us at enquiries@accountantsfortraders.co.uk

Appendices

Appendix 1: Advantages/Disadvantages Overview

	Sole Trader/Partnership	Limited Company	Hybrid Partnership
Advantages	• Simplest way to trade • Low start up costs • Lower annual compliance fees • Ability to run personal vehicles in business without tax charge on benefits in kind	• Limited Liability (to extent of personal guarantees and initial investment into the company) • Corporation tax suffered on profits usually less than Income Tax and National Insurance • Individual not taxed personally on undrawn profits • State pension provisions include Basic and State Second Pension (S2P)	• Limited Liability (**only if LLP** - to extent of personal guarantees and initial investment into the LLP) • Flexibility available on distribution of profits/capital between partners (and thus opportunity for lower tax liabilities on profits/incorporation of sleeping partners) • Additional tax planning opportunities including Investment Partnerships • Ability to run personal vehicles in business without tax charge on benefits in kind • Ability to build investment portfolio without initial or future tax disadvantage to holding personally • State pension provisions include Basic and State Second Pension (S2P)
Disadvantages	• Trader individually liable for any losses/liabilities • Own personal assets may be at risk • Individual taxed on profits through Income Tax and Class 2 & 4 National Insurance rates – usually higher than Corporation Tax rates • Individual personally taxed on all profits whether drawn or not • State pension provisions limited to basic state pension only • Usually only suitable if relatively low trading profits	• Rigid structure can make changes to structure difficult and expensive • Increased start-up and annual compliance costs • Running personal vehicles through company can result in additional tax charges (Benefits in Kind) • Investors as 'sleeping partners' may prove more expensive in long term if shareholders • Separate bank accounts required for limited company • Tax savings limited if all profits drawn from business • Investments held in limited company susceptible to loss in event of limited company becoming insolvent • Investments made within company will usually result in higher tax charge than if made personally	• Increased start-up and annual compliance costs • Increased administration of structure • Separate bank accounts required for each partnership/LLP and limited company • Tax savings limited if all profits drawn from structure

Appendix 2: 2012/13 Tax Rates and Thresholds

Income tax

Income tax	
Starting rate 10%	£2,710
Basic rate 20%	£34,370
Higher rate 40%	£34,371 - £150,000
Additional rate 50%	£150,000+
Savings income rate	20%

Corporation Tax

Corporation Tax	
Year commencing	**1 April 2012**
Profits	
£0 - £300,000	20%
£300,000 - £1,500,000	25%
£1,500,001+	24%

Value Added Tax

Value Added Tax	
Standard Rate	20%
Turnover registration limit	£77,000
Turnover deregistration limit	£75,000
Cash/annual accounting registration limit	£1.35m excl. VAT
Cash/annual accounting	£1.6m excl. VAT
Flat rate scheme income	£150,000 excl. VAT
Flat rate scheme income deregistration limit	£230,000 incl. VAT
VAT Scale Charge: Now based upon the CO2 Emissions of the vehicle concerned	

NI Contributions

Class 1	**Employer**	**Employee**
Weekly earnings	**% of all earnings**	
£0 - £144	NIL	NIL
£144 - £146	13.80%	NIL
£146 - £817	13.80%	12%
Over £817	13.80%	2%
The above rates apply to those not contracted out of S2P.		
Class 1A	Employer	13.80%
Class 2*	S/Employed	£2.65 pw
Class 3	Voluntary	£13.25 pw
Class 4	S/Employed	
	£0 - £7,605	0%
	£7,605 - £42,475	9%
	Over £42,475	2%

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