



FACT SHEET NO. 8

SOLE TRADERSHIPS

INFORMATION

Anyone who is self-employed and owns a business on his/her own is classed as a sole trader. Typical examples of a sole trader are taxi drivers, window cleaners, hairdressers, newsagents, sales persons, painters and decorators and so on.

WARNING

All sole traders are liable for the debts of their business and in effect have to pay for these debts out of their own personal income and assets if they have any.

REGISTERING AS SELF-EMPLOYED

You must notify Her Majesty's Revenue and Customs (HMRC) within three months of becoming self-employed using form CWFI available from the website www.hmrc.gov.uk or by calling the registration helpline on 08459 154 515.

As a self-employed sole trader you are also required to complete annual tax returns and keep adequate trading records, such as receipts and invoices. Detailed accounts do not have to be submitted to HMRC but they will be needed to complete your tax return.

Once you have notified HMRC of your self-employed/sole trader status you will be issued with a tax return which must be completed and sent back to HMRC by the following dates:

- 30 September following the tax year end if you wish HMRC to calculate your tax liability, if any; or
- 31 January following the tax year end if you wish to calculate your own tax liability.

You can also fill in and submit your return on line at www.hmrc.gov.uk up until 31 January following the tax year end. If you do this your tax liability will still be calculated for you.

Payment of any tax owed to HMRC will also have to be paid by 31 January following the tax year end at the very latest and penalties, interest and surcharges will start to accrue if you fail to do so.

FACT SHEET

For more information on tax debt, see our fact sheet, 'Dealing with tax debts'.

Furthermore, payments on accounts (POA) are required in advance by HMRC where the income tax liability exceeds £500. These payments are required by 31 January and 31 July following the tax year end and are based on what you will be due to pay for the following year, on the assumption that your profits will be the same as this year.

For example, in 2004/05 the income tax liability for a sole trader was £5,000; the POA will be as follows:

Income tax for the year ending Apr 05, £5,000
payable by 31 Jan 06.

POA due by 31 Jan 06 £2,500

POA due by 31 Jul 06 £2,500

ADVICE

As payments on account are paid in advance this will mean that you will have to pay in excess of your normal tax payable after submitting your first return. This will however be balanced out in later years as the business fluctuates.

If you believe that either:

- you expect the amount you will have to pay in tax under self-assessment is going to be less than the POA calculated; or
- there will be no amount due under self-assessment or such liability will be covered at source.

You can ask HMRC for a reduction of the amount you have to pay for POA.

DOCUMENTATION

There is no requirement to submit any documents apart from the tax return but it is advisable that all evidence supporting the figures should be kept in case HMRC starts an enquiry. In the case of the financial year 2005/06 this will be until 31 January 2008. However the normal enquiry window can be extended if HMRC make a discovery about your tax affairs that affects your tax liability.

In addition, the normal enquiry window does not apply if there has been negligence or fraud, in which case HMRC can investigate your tax affairs as far back as twenty years.

ADVICE

A self-employed sole trader must keep records for six years. So for the year 2005/06 this will be until 31 January 2012.

Under self assessment the tax return must include information about the business on the self employed supplement pages.

There is no requirement to submit separate accounts though this would help HMRC to get the full picture of the business. Use the additional space should you wish to do so.

Small businesses with an annual turnover of less than £15,000 need only enter three figures on the tax return:

- sales;
- allowable expenses total; and
- net profit (loss).

If the annual turnover exceeds £15,000 a more detailed breakdown of income and expenditure is required. There is no need to supply a balance sheet though you may wish to do so.

For more information on tax returns and self-assessment go to the HMRC website at www.hmrc.gov.uk or alternatively, there is an independent organisation called Taxaid who have a website at www.taxaid.org.uk.

NATIONAL INSURANCE CONTRIBUTIONS (NICs)

Self-employed sole traders will be liable to pay two classes of NICs.

Class 2 NICs are compulsory and currently payable at the rate of £2.10 per week. This can be set up as a direct debit. You can claim exemption from paying these if you earn less than the small earnings exemption limit of £4,465 per year. Be aware that doing this may mean that you will not be entitled to certain contributions based benefits or that your state pension may be reduced.

Class 4 NICs are payable in addition to Class 2 if you earn above £5,035 per year. They are payable as a percentage of your earnings along with your income tax. See our tax sheet for further information.

VALUE ADDED TAX (VAT)

If your gross turnover for the year exceeds or you expect it to exceed £61,000 you **must** register for VAT. You may also voluntarily register for VAT if you feel you would benefit from this. You should discuss this with your accountant.

In basic terms VAT is payable on the purchases and sales made in your business. You will pay VAT on the purchases you make known as 'input tax' and you will charge VAT on the sales that you make known as 'output tax'.

You will need to submit a return to HMRC either monthly, quarterly or annually depending on what you have agreed with details of your input and output tax. There will then be either an amount for you to pay or a refund due to you. This is based on the following calculations:

- if output tax exceeds input tax the difference is payable to HMRC;
- if input tax exceeds output tax you will receive the difference from HMRC.

For more information on VAT go to HMRC's website at www.hmrc.gov.uk or visit www.taxaid.org.uk.

BUSINESS PLAN

Every business should have a realistic business plan. This should describe what you are looking to do including your product and business operations, details of your skills and the skills of any staff, what research you have done about your market and potential competitors, how you will generate business, projections and financial forecasts. The business plan will help you when applying for finance. It is a working document not just for when you are setting up but whilst you continue to trade, you should measure your position against your plan and revise as necessary.

CASHFLOW

One of the main problems you may face in running your own business is cashflow. It is very important to plan ahead by doing a cashflow forecast. This will allow you to anticipate what income and outgoings you will have over the next 12 months for example. In completing a forecast you can see ahead of time, where there will be periods of difficulty, i.e. payments at times when you do not have the income coming in. If you can recognise months where there may be shortfalls in cash, you can look at ways to compensate for this, e.g. setting up an overdraft limit. Business Debtline can send you an electronic copy of a cashflow forecasting tool. **Phone us if you would like a copy of this.**

FUNDING

Once you have done a cashflow forecast you will need to assess what funding you may need. You can try your own bank for this or alternatively shop around for the best details to finance your business. Where possible, it is a good idea to set up a business account with someone who you do not owe money to in loans or credit cards etc. This will strengthen your position if you are later in difficulties with your creditors. You will need to present a sound business plan and cashflow forecast to stand a better chance of getting an overdraft.



WARNING

Be careful if you are considering taking an overdraft on a secured basis, i.e. against your home. This would mean that if the bank calls this in and you are unable to pay, your home would be at risk.

CREDIT CONTROL

Your cashflow can be seriously affected if you do not have a good credit control system in place. Failure to seek references of customers you give

credit to or not having set procedures for collection of payment and recovery will all delay you getting paid for the work you have done.



FACT SHEET

See our fact sheet on 'Credit control' for more guidance.

STOCK CONTROL

Keep good records of your stock either manually or using IT software. Don't overstock as this will mean tying up your cash for long periods but have sufficient stock to meet the demand of your customers. Use your cashflow forecast to assist you to budget for your purchases.



REMEMBER

The more you sell the more stock you will need to buy.

LIABILITY

As a sole trader you are personally liable for your business debts in exactly the same way as your personal debts. There is no legal distinction. This means that should you encounter problems and be unable to pay your debts, your personal assets would be at risk as well as any business assets you own.

WARNING



Be careful when considering taking a business lease as you may be committing to a long-term liability. You should always seek specialist advice before taking on a lease.



HELP

For help with dealing with your business and personal debts, ring **Business Debtline on 0800 197 6026** for ask for a copy of our free self-help information pack.

USEFUL CONTACTS

There are various organisations that can help with different areas of business.

Business Debtline

You can of course contact us with any problems relating to debt:

Monday to Friday 9am till 5pm

Tel: 0800 197 6026

www.bdl.org.uk

Business Link

Your local business link can give you general advice on starting up, marketing, planning and sources of funding. They have a very useful website at: www.businesslink.gov.uk or phone them on **0845 600 9006**

Chamber of Commerce

You can join your local Chamber of Commerce which may help you to network with other businesses. They also provide seminars and useful ideas. Contact them at:

www.britishchambers.org.uk

Tel: 020 7654 5800

Federation of small businesses

You could consider becoming a member which will offer benefits such as a legal helpline for matters such as employment law. Visit the website at: www.fsb.org.uk or call **0125 333**

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Taxaid

This is a charitable organisation that offers free advice on tax issues if you are on a low income. Their website is at www.taxaid.org.uk or call **0845 120 3779** Monday to Thursday between 10am and 12pm.

Remember: You can always contact us for advice about any difficulty you have in dealing with your debts.

Freephone 0800 197 6026 Website www.bdl.org.uk

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