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1 Introduction

If you are self-employed then this means you work for yourself and not for an employer. A sole-trader is a self-employed person, meaning they are the sole owner of their business.

Being a sole trader is the simplest way to run a business and does not involve paying any registration fees (which happens when you form a limited company), but you must register with HMRC as self-employed.

When you are a self-employed sole trader you and the business are the same legal entity.

Contrary to popular opinion, there is no limit to the turnover you can make and still remain a sole trader or partnership!

1.1 Registering with HMRC

Once you've started working for yourself one of the first things you need to do is register with HM Revenue & Customs as self-employed. You need to do this within three months of the date you commenced trading - otherwise you could be liable to a penalty of £100.

You can notify the Revenue by the following methods:

- By post using the form CWF1 – (go **here**). Complete then print off and post the form.
- telephone HMRC on 0300 200 3300
- register online at **https://www.gov.uk/register-for-self-assessment**

The tax rules for you once you start self-employment are different from when you were an employee. For starters you are responsible for your own tax and national insurance, rather than having it deducted from your monthly salary or weekly wage packet.

1.2 Choosing an accounting date

You can choose any accounting date for your business although it's usually easiest to prepare accounts either up to 31st March or up to 5th April.

Normally you are taxed on whatever accounting date ends in the relevant tax year e.g. the year end 30th June 2022 ends in the 2022/23 tax year and the year end 31st March 2022 ends in the 2021/22 tax year.

However, there are a number of considerations you need to think about when deciding which accounting date to use and we've highlighted these below:

1.2.1 Overlap profits

The taxman aims to tax your profits in full once and once only over the lifetime of your business.

However unless your accounting date falls between 31 March and 5 April (inclusive) there will always be some element of double counting or 'overlap profits' (see below), in the first full tax year your profits are taxed on the current year basis.

This is because a business is taxed slightly differently in the first year of its trade than it normally is in subsequent years.

The easiest way to demonstrate this is to show you an example:

> Let's assume your first business accounts were drawn up for the year ended 30 April 2022 and the profits were £30,000. You would be taxed as follows:
>
> **2021/22 ('Actual' profits in the tax year)**
>
> Profits for the period 1 May 2021 to 5 April 2022 fall within the 2021/22 tax year.
> Therefore 309/365 x £30,000 = £25,397 taxable profits.
>
> **2022/23 (Profits for the twelve month period ending in the 2022/23 tax year)**
>
> Profits for the period 1 May 2021 to 30 April 2022
> Therefore £30,000

As you can see the profits of £25,397 for the period 1 May 2021 to 5 April 2022 are actually taxed twice in the 2021/22 and 2022/23 tax years - hence the reason why they are known as ‘overlap profits’.

These ‘overlap profits’ can be deducted from your profits either when you cease your business (see below) or when you change your accounting date at a later stage.

However, because of inflation, overlap relief is likely to be worth less to you when you finally ‘cash it in’ at a later stage.

1.2.2 Higher profits in your final year of trade

Depending on your accounting year end date you could end up paying tax on more than 12 months' worth of profits when you cease the business.

This is because you are taxed in your final year on the profits right back to the start of your final accounting date – this could be in a previous tax year.

For example the accounting year ended 30 April 2022 straddles two tax years – the year ended 5 April 2022 and 5 April 2023.

Let's see how this works in practice.

> You have been trading for many years and your accounting year end date is 30 April.
>
> You then decide to cease trading on 31 January 2023.
>
> For the tax year 2021/22 you would therefore have been taxed on the profits for the year ended 30 April 2021.
>
> For the 2022/23 tax year you would have been taxed on the profits for the year ended 30 April 2022, but your business has ceased trading (see below).
>
> Because your business ceased trading before the end of the 2022/23 tax year (remember it ceased on 31 January 2023), you are taxed on the profits for the period 1 May 2021 to 31 January 2023 (ie from the start of your last full year). In other words, you are taxed on 21 months instead of 12 months!
>
> Although 'overlap profits' can be deducted from these profits, due to inflation etc, the benefit of this deduction could have been eroded over time.

So it's important, where possible, to think carefully about the accounting date you choose when your start in business and ultimately when you think about ceasing to trade.

1.2.3 Change of accounting date

Once you've been trading for at least three years, you can then change your accounting date in the fourth year or later.

In order for HMRC to approve the change to your year end you need to meet three conditions:

1) The first accounts prepared to the new date must not be in excess of 18 months.

2) The notice of the change must actually be given to HMRC by 31 January following the tax year of change. So for example a change of accounting date in the 2022/23 tax year would need to be notified to HMRC by 31 January 2024.

   The notification can be included either in the Self-Assessment tax return or separately in writing - although it must be made within the relevant time limit (see above).

3) There has been no earlier change of accounting date in the previous five years, unless the latest change has been made for a commercial reason – obtaining a tax advantage is not one of them!

1.2.4 Allocating taxable business profit to tax years

As a rule of thumb, the tax for a tax year is based on the profits of a twelve month accounting period ending in a tax year.

For example the tax liability for the year ended 5 April 2023 (2022/23) could be based on accounts for a year ended 30 April 2022, 30 September 2022 or even 5 April 2023.

As you will see in section 1.9 you would get more time for your 2022/23 tax bill to be calculated if your accounts ended on 30 April 2022. This is why 30 April can be a popular accounting year end for some self-employed people, because of the potential cash-flow benefit.

However for simplicity we tend to advise clients to choose either 31st March or 5th April.

1.3 Taxable trading profits

1.3.1 Taxable trading profit

The starting point for your taxable profit is your profit and loss account.

In calculating your taxable profits you are entitled to claim deductions for business expenses from your business income in your profit and loss account. However, in order to be allowable, these business expenses must be wholly and exclusively for the purposes of your business.

It's not always straight-forward and noted below are a couple of areas where the rules are slightly different:

- When you buy equipment for your business, such as a new computer, desk or car, you are entitled to deduct a proportion of the cost each year that you own and use them in your business - these expenses are known as capital allowances.

- When you take business stock for your own use, this is treated as a sale at retail value not the wholesale cost to you.

  An example would be a newsagent who took a copy of the daily newspaper and a bar of chocolate home with him each night.

Any drawings from your business bank account are not tax deductible, though if your spouse works for you in the business then any drawings to pay her salary are allowable provided they are actually paid to her and represent the market rate for her duties.

See Section 4 for more examples as to what adjustments will be made in calculating your taxable profits.

And be careful - because if the taxman does not consider the expenses qualify they will be added back to your business profit.

If you are in any doubt as to what you can and can't claim, feel free to contact us at any time.

1.4 Class 4 National Insurance

Class 4 National Insurance is bit of a misnomer as it's really a form of tax levied on your business profits and doesn't count towards your retirement pension or any other state benefits you might be entitled to claim (e.g. maternity allowance).

Class 4 NI is payable at 10.25% on any profits between a lower and higher threshold and 3.25% for any profits above the higher threshold.

To find the latest rates go to **https://www.gov.uk/self-employed-national-insurance-rates**.

For the 2022/23 tax year Class 4 NI is 10.25% of profits between £9,881 and £50,270 and 3.25% over that amount.

So, if your profits are £35,000 then you will pay Class 4 NI of £2,575 (being 10.25% of £35,000 less £9,881) and if your profits are £51,000 then you will pay Class 4 NI of £4,164 (being 10.25% of £50,270 less £9,881 and 3.25% of £51,000 less £50,270).

1.5 Class 2 National Insurance

As well as Class 4 NI you also have to pay Class 2 National Insurance.

To find the latest rates go to **https://www.gov.uk/self-employed-national-insurance-rates**.

For the 2022/23 tax year Class 2 NI are £3.15 per week if your profits are over £6,725.

If your business profits are below £6,725 per annum, you may wish to pay Class 2 NI voluntarily in order to maintain entitlement to any state benefits – unlike Class 4 NI, Class 2 National Insurance contributions count towards your contribution record.

Class 2 National Insurance used to be paid weekly, monthly or quarterly but can now be paid via your self-assessment tax return.

There has been speculation that payment of Class 2 NI contributions would be abolished by the government. However, these plans have been put on hold and there is no specific timetable for these to be scrapped by the government at the moment.

1.6 Trading losses

These are difficult times at the moment for established businesses as well as for those just starting up, so what if the worst happens and you make a loss?

Well if you're a sole trader or partnership, there are several options which aren't available to you if you trade through a limited company.

Generally speaking, the principle reliefs that are available to you are as follows:

1) Trading losses arising in the first four years of your business can be carried back and set against any income of the previous three tax years - earliest years first.

   For example a 2022/23 loss can be carried back and relieved against any income for the tax years 2019/20, 2020/21 and then 2021/22.

2) If you're an established business that's been trading for a number of years, you can make a claim to set off your trading loss against any income for the tax year in which the loss arises and/or any income for the previous year (if the loss is large enough).

   For example a 2022/23 loss can be relieved against any income for the tax years 2022/23 and 2021/22.

3) You can carry-forward the loss to reduce any profits for later tax years from the same trade.

   This is the most straightforward way of obtaining relief, though not necessarily the most tax beneficial.

   For example a loss for the year 2022/23 can be relieved against your profits from the same trade for the tax years 2023/24 onwards.

4) If a loss arises when you cease to trade you can claim relief against your trade profits for the final tax year (things can get complicated where the loss straddles a tax year), then carried back against your trading profits of the previous three tax years, latest first.

   For example a 2022/23 trading loss arising on the cessation of your business can be offset against your trading profits for the tax years 2021/22, 2020/21 and then 2019/20.

5) A trading loss can be offset against capital gains in **either or both** the tax year of loss or previous tax year, but only if there is any excess loss available after a claim in point 2 has been made.

   For example any excess 2022/23 trading losses can be relieved against 2021/22 and/or 2022/23 capital gains.

6) If you decide to incorporate and you have unused trading losses arising from your business, these cannot be carried forward and relieved against the company's profits.

   However you may be able to relieve them against any future income you might draw from the company e.g. salary/dividends etc.

From a tax perspective the principle objectives are to obtain the maximum tax relief at the earliest opportunity. You should also be aware that HM Revenue impose strict time limits on the above loss claims and are highly unlikely to agree a claim submitted outside the time limit.