



# FINANCIAL ADMINISTRATION

A GUIDE FOR UK BASED SMALL BUSINESSES

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# ABOUT THE AUTHOR

My name is Thomas McQuade. I run a Finance and Accountancy consultancy that focuses on small businesses which are planning on or experiencing significant growth.

I have 10 years of Finance experience working across listed and privately owned companies. Check out my LinkedIn page (at the end of this book) and please feel free to drop me a message.

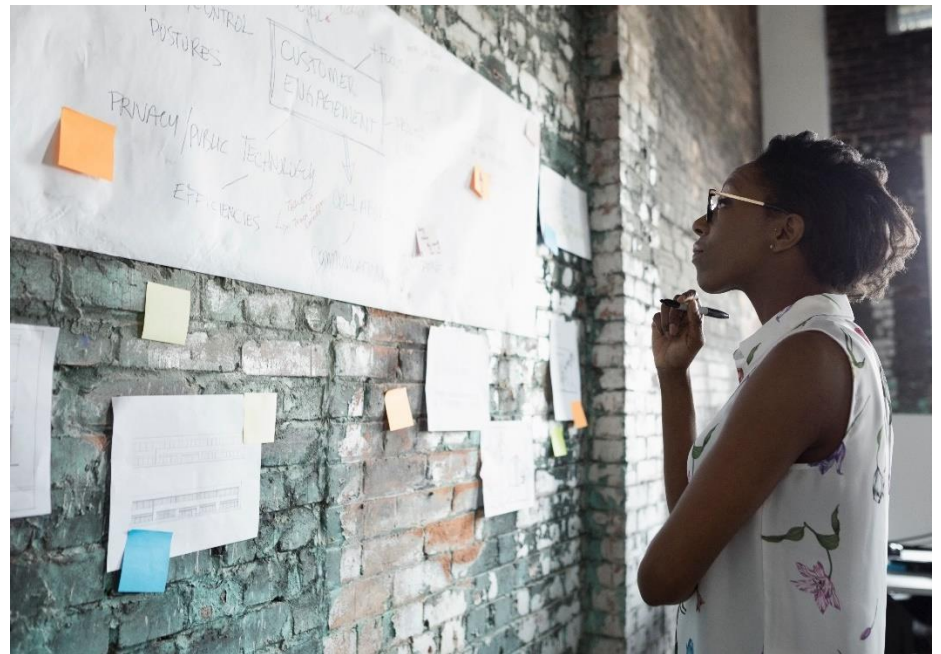
# INTRODUCTION

## WHO IS THIS BOOK FOR?

Entrepreneurs who have tested their business idea, completed their market research and are ready to formally run their business. This book gives you everything that you need to know about the financial administration required for your business, and will address the following topics:

- How do I structure my business?
- Where do I need to register my business?
- Which taxes will I be liable for?
- How do I pay myself?
- How should I record my financial transactions?
- Should I set up a business bank account?

Please note that this is a general guide. The business world is incredibly complex and there may be exceptions to the rule, however this book will cover the vast majority of small businesses.



# BUSINESS STRUCTURE

The two most common business structures are:

- 1) Sole Traders
- 2) Limited Companies

There are numerous other structures out there such as Partnerships, Public Limited Companies, Charities etc. however these are not covered in this book.



## SOLE TRADER

In the eyes of the government there is no legal distinction between a sole trader and their business. Any business earnings are classed as personal income.

Being a sole trader involves shouldering the responsibility for any business losses, all bills and business accounts (meaning that accurate records of sales and spending must be kept diligently).

As a sole trader (aka being self-employed), the business owner must submit their income and expenditure to HMRC via an annual self-assessment to calculate any income taxes due in the year.

### ADVANTAGES OF BEING A SOLE TRADER:

- 1) Autonomy – as a sole trader you are your own boss.
- 2) It is easy to set up. After you have registered for self-assessment, you are ready to go.
- 3) Tax efficiency – versus being employed, there are certain expenses that are considered a business expense which will reduce your tax liability. For example, if you travel to meet a client you can claim travel expenses.

### DISADVANTAGES OF BEING A SOLE TRADER:

- 1) A sole trader accepts unlimited liability for their business finances. If the business fails and files for bankruptcy, then the owner is also considered bankrupt. Personal assets can therefore be at risk, such as property or cars if the business gets into trouble.
- 2) Stress! Sole traders run an entire organization on their own. It is possible to employ people as a sole trader, however this is uncommon. Nonetheless, sole traders generally master all aspects of the business therefore may experience heavy workloads.

### SUMMARY:

If your business is likely to remain small in nature, then being a sole trader is probably right for you. Also consider whether your business requires borrowing to establish itself before it becomes profitable. If it does, then setting up a Limited Company may be more suitable for you (this can always be done after a period of operating as a sole trader) as it separates the financial risk from you as an individual.

## LIMITED COMPANY

Imagine a Limited Company as a person. It is a separate legal entity from those that own the business.

'Limited' means that the liabilities undertaken by the shareholders of the business are limited to what has been invested. For example, if a Limited company ran into £1000 of debt and its creditors wished the company to be liquidated, (assuming that the debt was legitimate and not fraudulent), and the shareholders had started the business with £500 of equity, then the shareholders would not be personally liable for the remaining £500. The business would be liquidated, and any assets of the business (in this case £500) would be paid back to the creditors without any further repercussions on the shareholders.

## ADVANTAGES OF TRADING AS A LIMITED COMPANY:

- 1) Minimising personal liability – your personal assets are legally separate from the business
- 2) It looks good! Limited companies are more rigorously monitored in terms of reporting and accounting requirements so it shows more dedication
- 3) Tax Efficiency – by using the correct tax planning techniques you should pay less tax
- 4) Investment opportunities – if you were to ask for investment from a venture capital company for example, they need to have a legal entity to invest in. A limited company provides that structure. Similarly, if you were to sell the business, then it is packaged up into sellable structure, compared to if you were a sole trader where there isn't a distinction between the business and the individual

## DISADVANTAGES OF TRADING AS A LIMITED COMPANY:

- 1) Greater administration – more reporting requirements results in more time spent on submitting companies house submissions and corporation tax returns
- 2) Greater costs – for example, accountancy fees for a limited company will be greater than those for a sole trader

## SUMMARY:

If you expect or are planning to grow your business to a significant level of income, then a Limited Company is right for you. Just be aware that as a Director of a company there are a lot of requirements, such as keeping accurate accounting records, submitting returns on time etc. You should ideally employ an expert in this field to manage this for you, however be aware that this will incur a cost.



# WHERE SHOULD I REGISTER MY BUSINESS?

## SOLE TRADER

Very simply, all you need to do is to register as Self Employed on the HMRC website:

[Register for Self Assessment: Register if you're self-employed - GOV.UK \(www.gov.uk\)](https://www.gov.uk/register-for-self-assessment)

1. Register online using the above link. Once you have completed the questions, HMRC will create your account.
2. You will receive a letter with your Unique Taxpayer Reference (UTR) number within 10 days (21 if you are abroad). You will need your UTR to file a return.
3. You will then receive another letter with an activation code for your account. You can get a new activation code if you do not receive it or you misplace it.

Once you have activated your account, you can file your tax return any time before the deadline.

## LIMITED COMPANY

### REGISTER AT COMPANIES HOUSE:

Companies House is a registrar of all Limited Companies within the UK who:

- Incorporate and dissolve limited companies.
- Examine and store company information.
- Make information available to the public.

[Set up a private limited company: Register your company - GOV.UK \(www.gov.uk\)](https://www.gov.uk/register-your-company)

The set up process is relatively simple. You will complete sections on:

1. The type of business you are setting up (defined by a SIC code)
2. The Directors of the business (the people who run the business)
3. The Shareholders of the business (the people that own the business)
4. The share volumes and values

Once all is complete, pay the £12 fee and you will receive a Certificate of Incorporation.

### REGISTER CORPORATION TAX:

First of all you will need to create a Government Gateway ID – link below:

[HMRC services: sign in or register: Register for HMRC online services - GOV.UK \(www.gov.uk\)](https://www.gov.uk/register-for-hmrc-online-services)

Now you can register the business for Corporation Tax:

[Set up a private limited company: Register for Corporation Tax - GOV.UK \(www.gov.uk\)](https://www.gov.uk/register-for-corporation-tax)

You will need the Government Gateway ID and password from the previous step, as well as your company registration number (issued by Companies House).

Follow the instructions and provide information of the date that you started trading, the date that the business accounts will be made up to. HMRC will then issue you with a Unique Tax Reference number (UTR).

As a Director of a company you will be taxed as an individual for any profits taken from the business. Each Director will therefore need to register as self employed (see the Sole Trader section).

There may be other taxes such as payroll taxes (if you employ staff) or VAT, which will be covered in the next section, however this section covers off the bare essentials.

# WHICH TAXES WILL I BE LIABLE FOR?

## CORPORATION TAX (LIMITED COMPANIES)

Corporation tax is the tax that limited companies pay on their profits. Corporation tax is calculated over the financial year of the company (as defined when registering the company at Companies House and for Corporation tax)

Revenue – tax deductible expenses = taxable profit  
Taxable profit x Corporation tax rate = Corporation tax due

At the point of writing this E-book, the Corporation Tax rate in the UK is 19%.

To demonstrate this example, let's imagine we have a company called ABC Limited that sells Trainers on Amazon. Their Corporation Tax would be calculated as follows:

Income	£10,000
Cost of Goods	-£5,000
Selling fees (Amazon fees)	-£600
Payment fees (e.g. Paypal)	-£450
Postage fees	-£1000
Marketing costs	-£750
Overheads	-£250
<b>Profit</b>	<b>1,950</b>

In this example, the company has made £1,950 of profit throughout their financial year. 19% of this is £370.50 which will need to be paid to the HMRC. £1,950 - £370.50 = £1579.50 is therefore the post-tax profit which can be paid to the shareholders as dividends or reinvested into the company.

Your accountant will calculate the corporation tax due and should be able to advise as to which expenses are tax deductible, so that you can operate your business in the most tax efficient way. It is imperative that you as a Director keep accurate accounting records, which enables the above calculations to be made – how to do this is covered off in the next chapter.

## VALUE ADDED TAX (LIMITED COMPANIES AND SOLE TRADERS)

Value added tax, or VAT, is the tax you have to pay when you buy (or sell in our case) goods or services.

The standard rate of VAT in the UK is 20%, with about half the items households spend money on subject to this rate.

There is a reduced rate of 5% which applies to some things like children's car seats and home energy.

If your business has an income of £85k per annum or more then it needs to be VAT registered. This means that for any products or services that you sell you will need to charge 20% (in most cases) to the customer. The VAT collected therefore needs to be paid to the HMRC via a quarterly VAT return.

As well as collecting the VAT from the sales that your business makes, you can reduce the VAT payment to the HMRC by claiming back any VAT on any expenses that your business has incurred.

Let's go back to ABC Limited. Let's imagine that throughout January-March they sold £2000 worth of goods (including VAT). This means that £333.33 of VAT has been collected. Let's also say that they paid £500 on a marketing consultant who is also VAT registered. The VAT charged on the invoice would be £83.33. Therefore, ABC Limited would state on their quarterly return that they charged £333.33 of VAT, however paid £83.33 of VAT. Therefore, the VAT payable to HMRC is £250.

To register your business for VAT, you will need to again go back onto the HMRC website and register the business for VAT. Once registered, the company will be provided with a VAT reference number which should be displayed on your invoices. Once registered, you will be required to submit a quarterly VAT return.

[Register for VAT - GOV.UK \(www.gov.uk\)](http://www.gov.uk)

## PAYROLL TAXES (LIMITED COMPANIES AND SOLE TRADERS)

If your business employs staff then you will need to register your business as an employer, using the below link:

[Register as an employer - GOV.UK \(www.gov.uk\)](http://www.gov.uk)

Once registered your business will be provided with an employers PAYE reference number. When you pay your employees you will have to collect Employers and Employees National Insurance contributions as well as any payroll taxes that the employees are liable for. These will then need to be paid to HMRC. Payroll is usually ran on a monthly basis.

Payroll submissions are very complex – your accountant will be able to manage this for you. It is also advisable to choose accounting software that has integrated payroll capability (most do nowadays). The software will link directly with HMRC, so that each time the payroll is ran it automatically notifies HMRC of the amounts due.

## INCOME TAX (SOLE TRADERS AND DIRECTORS OF LIMITED COMPANIES)

If you are a sole trader, your income less your taxable expenses will equal your taxable income. You will need to submit your self-assessment once a year, on or after 6<sup>th</sup> April and before the 31<sup>st</sup> January (if submitting online) or 31<sup>st</sup> October if submitting paper returns. So for the tax year 6<sup>th</sup> April 2019 to 5<sup>th</sup> April 2020 you will need to submit your online self-assessment between 6<sup>th</sup> April 2020 and 31<sup>st</sup> January 2021. If you choose to submit paper returns the deadline would be 31<sup>st</sup> October 2020. The tax due is to be paid by 31<sup>st</sup> January 2021.

If you are a Director of a company you will also need to submit your self-assessment. Rather than declaring the business income less taxable expenses (as this has already been done through the company's corporation tax submission), you will state the salary paid to you by the company and dividends that you have been paid from your limited company.





# HOW DO I PAY MYSELF?

## SOLE TRADER:

If we cast our mind back to the first page, we know that there is no distinction between a sole trader (i.e. business owner) and the business itself.

If the business generated £50,000 of revenue and incurred £10,000 of costs, there would have been a profit of £40,000. Let's say that the tax on the £40,000 was £10,000 (this is just to make this explanation simple – it wouldn't be £10,000!), then the after tax profits would be £30,000. This money is therefore the business owner's.

## LIMITED COMPANY:

Limited Companies are slightly more complex. As a Director of a Limited Company you can take payment from the business in one of two ways:

- 1) A salary paid through payroll
- 2) Dividends

Most Directors will take a mix of a salary and dividends – your accountant will advise what is the most tax

efficient method for you, however here is an explanation of what each one is:

### SALARY:

As mentioned in the first section, a Limited Company is a separate legal entity to the Shareholders and Directors of the business. A Director can then be paid as an employee of the Limited Company. A salary would be paid as any other job, with tax being collected prior to the payment being made. Any payroll processes should be managed by a professional in this field. Whilst the accounting systems mentioned in the next section will be the mechanism to manage the process, please ensure your accountant looks after this.

### DIVIDENDS:

Any profits that a Limited Company makes can be paid out to the Shareholders in the form of dividends. The dividends received need to be declared on your annual self-assessment as you are liable for a different set of taxes.



# HOW DO I RECORD THE FINANCIAL TRANSACTIONS FOR THE BUSINESS?

The answer to this is very simple – one of your first tasks needs to be to get an accounting system. There are loads of cloud accounting providers out there, all of which are relatively simple to use. Below is a link to an article that reviews each of the most well-known ones. I personally use either Quickbooks or Xero, both of which have similar functionality, however there are a number of others to choose from:

[7 Best Cloud-based Accounting Software for 2021 Accountants Should Try \(fastestgrowingsaas.com\)](https://www.fastestgrowingsaas.com/7-Best-Cloud-based-Accounting-Software-for-2021-Accountants-Should-Try/)

As a business owner, if you are managing your bookkeeping yourself you need to choose the system that saves you the most time. Most cloud accounting systems have apps that can be downloaded to your phone or tablet, which is a life saver in terms of time saved.

So, which transactions need to be recorded? The answer is everything, however they need to be recorded in the right way:

## INCOME :

Cloud accounting systems will all have invoicing functionality. This will enable you to register your customer onto the system, choose your product or service that you are charging for, and then email the invoice directly to your customer. Don't forget to record the VAT (if you are VAT registered) – this is required for your quarterly VAT returns.

For businesses which have high volumes of transactions, such as E-Commerce, your website will have the functionality to send the invoice to the customer automatically when a sale is made. For accounting purposes, it is important that a summary of the transactions can be extracted from your website/sales portal, so that the sales values can be entered into the accounting system.

## EXPENSES :

Any time your business spends some money, you need to keep the invoice or receipt for that transaction. The invoice should be uploaded to your accounting software, and the details of the expenditure entered.

Accounting systems have what is known as a Chart of Accounts. The chart of accounts is essentially a list of all 'accounts' within your accounting system. These accounts aren't where cash is held but are where the recording of transactions takes place. For example, you

would record a Go Daddy or Microsoft invoice in your 'Subscriptions' account, or hotel costs in the 'Travel Costs' account.

When recording the expenditure, it is vital that the transaction is recorded against the right account.

## BANK ACCOUNT :

Cloud accounting systems will also link directly to your business bank account. This enables the accounting system to reconcile the cash balance within your accounting system with that in your bank account. The accounting system account balances may not match the bank account, which will usually be due to timing of cash going in and out of the bank account versus the associated transaction being recorded into the accounting system.

To provide a bit of context to this, let's imagine that you have invoiced a customer on 1<sup>st</sup> March 2021, and the invoice has a due date of 14<sup>th</sup> March. The customer then pays the invoice on 14<sup>th</sup> March – the payment seen in the bank account therefore needs to be 'matched' to the outstanding invoice therefore telling the accounting system that the balance has been settled. Your accounting system has recognized the income from the sale on 1<sup>st</sup> March, however the cash for the sale isn't recognized until 14<sup>th</sup> March.

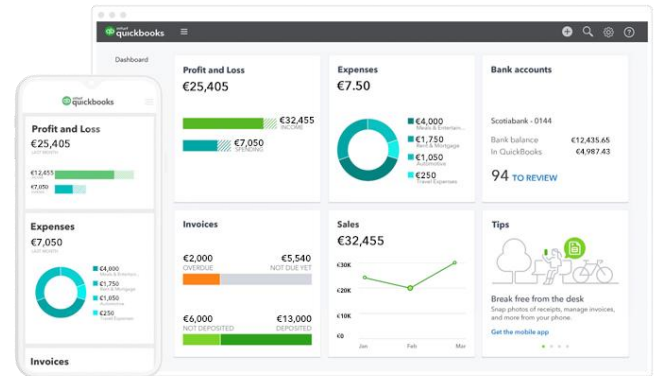
## REPORTING :

Once you have all of your transactions recorded into your accounting system, the system can produce some really insightful reports, such as:

- Profit and Loss
- Balance Sheet
- Receivables and Debtors
- Cash Flow

These reports are great tools to analyse your business performance and make decisions. Let's say that you analysed your profit and loss account over the last 3 months and noticed that your travel expenses had steadily increased month on month. This may have been because you have taken on some clients that

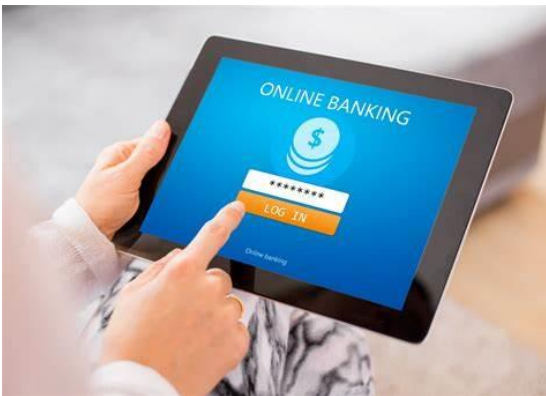
require more travel. This would be an indicator to review your pricing – you may implement a London fee and a National fee to factor in the additional costs for London travel.



## BUSINESS BANKING

Whether you are operating as a sole trader or as a Limited Company it is vital to have a separate bank account for your business income and expenditure.

The reason why this is so important is that personal banking transactions and business banking transactions should always be separate. A Limited Company is a different legal entity to the owner of the business so this is a must, however it is better practice for Sole Traders.



Business bank accounts usually incur fees (don't forget to record these in your accounting system). These fees may be a monthly fixed fee or a transactional charge. For example, some accounts charge a fee per each Direct Debit payment. Therefore, it is vital that you shop around so that you can choose the most cost effective bank account out there.

The banking world in general has really changed over the last 5-10 years with a number of smaller 'disruptor' banks such as Monzo or Starling gaining market share. I find that the newer banks often have some really interesting features that set them apart from the larger banks. For example, for one of my businesses I use Tide – I managed to set up the account within 24 hours, without having to make a phone call. This was due to their security and identification processes being automated.

The link below is a price comparison website that lists a number of business bank accounts available:

[Best business bank accounts for 2021 - Finder UK](#)

# THANK YOU FOR READING

I hope you have found this E-Book useful. This book is a guide for how to get up and running and should not be used as tax advice or accounting advice. Any specific advice should be sought from professionals in the relevant fields, however by following the above steps and registering with the right bodies your business will be well placed to operate as efficiently as possible.

If you would like to get in touch my contact details are below. I welcome any feedback so that further editions of this E-book can be published.



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