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YEAR-END TAX PLANNING FOR BUSINESSES

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BUSINESS

Contents

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About Sarah Bradford

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Sarah writes widely on tax and National Insurance. She contributes regularly to:

- Business Tax Insider;
- Property Tax Insider;
- Tax Insider Professional;
- Tax-Efficient Ways To Extract Cash From Your Company;
- IR35 – Tax Tips For Contractors;
- How To Maximise Deductions For Business Expenses;
- Tax-Efficient Business Exit Strategies;
- Cash Basis For Landlords; *and*
- Directors' Loan Accounts Explained.

1 About this guide

As the end of the tax year or the accounting period approaches, it is a good time for businesses to take stock and review their affairs. No one likes to pay tax unnecessarily, and a little time spent considering the tax position ahead of the year end can realise considerable tax savings. Now is the time to ask questions such as:

- Have we claimed a deduction for all available expenses?
- Have we claimed all the tax reliefs to which we are entitled?
- Have we made best use of all the available tax allowances?
- Do we have losses, and how best should we utilise them?
- Should we consider changing our accounting date?
- Should we bring family members into the business?
- Have we made sufficient pension contributions?
- Have we claimed capital allowances?
- When is the best time to realise gains?
- Should we pay a dividend?
- Should we pay a salary?

While some of these questions are relevant regardless of whether the business operates as a sole trader or other unincorporated business, as a partnership, or as a company, other questions (such as the issue of whether to pay a dividend) are only relevant to a particular business structure (in this instance, a company).

This guide considers the answers to these and other questions in the context of year-end tax planning for businesses. For ease of use, there are tips of relevance to sole traders and unincorporated businesses (see section 2), partnerships (see section 3), and family and personal companies (see section 4).

2 Sole traders and unincorporated business

2.1 Overview

A sole trader is the simplest type of business set-up. The proprietor gets to keep all of the profits; however, they are also liable for all of the business debts.

From a tax perspective, a sole trader is taxed on their total income after their personal allowances – the profits of the business are not taxed separately but form part of the sole trader's taxable income, together with income from other sources, such as any employment or investment income.

Consequently, when looking to minimise their overall tax liability, a sole trader cannot consider the business in isolation – it is also necessary to consider what other income and gains are received in the year, as this will impact on the individual's tax position and, therefore, on any tax planning that is undertaken. For example, if the sole trader has already used their capital gains annual exempt amount realising personal gains in the tax year, it may be advisable to delay realising a business gain until the start of the following tax year.

The following tips, therefore, cover not only the business's but also the individual's overall tax position as for effective year-end tax planning, the two cannot be considered in isolation.

2.2 Basis of accounts preparation – Cash basis vs accruals basis

One of the decisions that needs to be made is the basis on which the accounts are to be prepared. Sole traders and unincorporated businesses can choose whether to prepare accounts using the cash basis or whether to use traditional accounting and prepare accounts using the accruals basis.

The cash basis is to be extended from 6 April 2024 and is to become the default basis for unincorporated businesses. Prior to that date, it is only available to unincorporated businesses with a turnover (computed using the cash basis) of £150,000 or less.

Practical tip

Decide which basis of accounts preparation best suits your business.

2.2.1 The cash basis

The cash basis is the simpler option. Under the cash basis, the trader need only take account of money in and money out. Income is only recognised when the cash is received. An advantage of this is that it provides automatic relief for bad debts. On the flip side, relief for expenses is only given when the bill is paid.

For 2023/24 and previous tax years, the cash basis is only available where turnover (computed on a cash basis) is £150,000 or less. However, from 6 April 2024, the turnover threshold is to be removed, allowing unincorporated businesses to use the cash basis regardless of their size.

Prior to 6 April 2024, businesses that wished to use the cash basis needed to elect to do so. However, from 6 April 2024, the cash basis will become the default basis for unincorporated businesses, and unincorporated businesses wishing to use the accruals basis must elect to do so.

Simplified rules also apply in relation to capital expenditure where the cash basis is used. Unless the expenditure is of a type (such as cars and land) for which a deduction is expressly disallowed, capital expenditure is simply deducted in working out the profits of the business; there is no need to worry about capital allowances (except in relation to cars).

Under the cash basis, relief for interest or bank charges is capped at £500 for 2023/24 and earlier tax years. However, this restriction is lifted from 6 April

2024, allowing interest costs to be deducted in full in computing taxable profit under the cash basis for 2024/25 and later tax years.

For 2023/24 and earlier tax years, there are restrictions on the way in which losses arising under the cash basis can be used. For example, claims for sideways loss relief are not permitted. However, the restrictions on the use of losses under the cash basis are lifted for 2024/25 and subsequent tax years.

The cash basis will not suit every business. For example, you may prefer to stick with traditional accruals accounting if your business is more complex, for example, if you have high and varying levels of stock.

If you decide that the cash basis is for you, for 2023/24 and earlier tax years, you need to elect for it to apply (by checking the requisite box on your tax return). If you are entering the cash basis for the first time, transitional rules apply to ensure that income is neither double counted nor slips through the net as you move from the accruals basis to the cash basis and, similarly, that relief for expenses is not given twice or not at all. Under the rules as they apply for 2023/24 and earlier tax years, once a trader was within the cash basis, they could remain in it as long as their turnover did not exceed £300,000 per year. For universal credit claimants, the cash basis entry ceiling was doubled. If the exit limit is reached, the sole trader had to move back to traditional accounting. However, with the removal of the turnover limits from 2024/25, the exit provisions cease to apply from that date.

From 2024/25 the cash basis is the default basis of accounts preparation for unincorporated businesses. Businesses that wish to prepare their accounts using the accruals basis will need to elect for the cash basis not to apply.

2.2.2 Traditional accounting: The accruals basis

For 2023/24 and earlier tax years, sole traders and unincorporated businesses that are not eligible, or do not elect to use the cash basis, must prepare their accounts instead using the traditional accruals basis. Under the accruals basis, income and expenditure are matched to the period in which they were earned or incurred rather than being taken into account when the income is received or the expenditure paid. This means that it is necessary to take account of debtors and creditors and work out prepayments and accruals. A deduction for capital expenditure is not permitted under the accruals basis; instead, relief for qualifying capital expenditure is given in the form of a capital allowance.

The accruals basis is the default basis for traders in the absence of a cash basis election for 2023/24 and earlier tax years.

From 2024/25 onwards, the cash basis becomes the default basis for unincorporated businesses, and businesses that do not wish to prepare their accounts using the cash basis will need to elect for it not to apply. Traders who wish to use the accruals basis from 2024/25 must therefore opt out of the cash basis.