

Start-up Legal and Tax Issues

The basics of setting up a business in the UK

A checklist of things to do when starting a business can run to many pages. There are many practical issues to address in terms of setting up the administration of the business, obtaining the resources to trade and then, even harder, finding and keeping the first customers! Here is a summary of the main actions that a start-up needs to address:

Register the business:

A sole trader needs to let the Inland Revenue know that a new business has been started so that appropriate income tax and national insurance records can be maintained. A private limited company needs to be registered with Companies House, including the various incorporation documents (formal legal records) which describe how the business will operate and who the shareholders and company officers are. Depending on sales turnover, the business may also need to register to account for value added tax (VAT) on its transactions.

Choose an appropriate business name:

This might sound easy, but it is easy to get a business name wrong! Customers deduce a lot about what a business does and what it can deliver from the name. There are also strict rules about what a private limited company can call itself (e.g. the name cannot include offensive words, suggest the business is of national importance or connected with royalty!) It is also important that the business name does not breach any existing trademarks (most brands are protected by these).

Choose a business location:

Many (in fact most) start-ups begin life at home, operating from the back bedroom, loft conversion or garage. Alternatively, the business may need to rent office or warehouse space, or lease an appropriate retail outlet in order to begin trading. Choosing the right premises is a key business decision. The start-up wants premises that help it operate effectively without excessive costs. At the same time, it is important to avoid being tied to premises that might not suit the business in the future. Different options suit different businesses. Working from home is a good option if all the business needs is a small office space. You can also rent premises or buy a property outright - depending on what start-up finance is available.

Start to keep proper business records immediately:

The importance of this cannot be overstated. It is easy for the start-up entrepreneur to ignore or postpone record-keeping, but this can come back to haunt the business if the tax authorities decide to investigate the business. It is also vital that a start-up has a detailed understanding of the revenues, costs and cash flows of the business. A good solution is for the start-up to set up and use a dedicated business credit or debit card, so that all business

expenses are controlled and recorded separately. A simple Excel spreadsheet can be used to maintain monthly summaries of income and expenses, comparing with the start-up financial budget. Hiring a book-keeper for a day or two each month is also money well-spent.

Main legal areas a start-up should address

A start-up soon finds that it needs to consider a variety of legal issues, both before and after it has started to trade. The key legal areas it must cover include:

Legal structure

The main choice is between forming a private limited company and operating as a sole trader with unlimited liability. Some businesses are formed as partnerships – where the partners also have unlimited liability. Generally it is best for a start-up to set-up a limited company, given the important protection provided to shareholders.

Employment

Many start-ups don't employ people at first. However, once someone is employed, even on a part-time or temporary basis, then there are significant legal responsibilities to be complied with. For example:

- An employee has to be provided with a legally-binding employment contract
- Recruitment and selection procedures must comply with laws aimed at preventing discrimination
- Business must maintain proper staff records (vital for tax purposes)
- Working conditions must comply with health & safety requirements
- Employer must check that employees are eligible to work in the UK

Consumer protection

Almost every business that sells goods and services to someone gets customers who are unhappy with some aspect of the transaction. Consumers are well protected by a variety of laws, including the Sale of Goods Act, the Trade Descriptions Act and laws that protect customers who buy online or via distance-selling.

Environmental protection: A business needs to ensure that it complies with:

- Waste disposal regulations (e.g. landfill, packaging, waste water)
- Legislation on carbon emissions

For many smaller businesses these legal issues don't turn out to be too significant.

Taxes

The main taxes that a start-up needs to consider are summarised below:

Value Added Tax (VAT)

VAT is a tax that is charged on most goods and services that VAT-registered businesses provide in the UK. VAT is charged when a VAT-registered business sells to either another business or to a non-business customer such as a customer in a shop. When a VAT-registered business buys goods or services they can generally reclaim the VAT they have paid. Not all businesses charge VAT. However, once annual turnover exceeds a threshold (in 2010 it is £68,000) then VAT needs to be charged. The current rate of VAT in the UK is 15% (due to rise to 17.5% in 2010).

Income tax and National Insurance

Most people who work have to pay income tax (a deduction from gross pay) and national insurance contributions (also based on weekly pay). A business needs to account for these taxes, ensuring that it calculates the correct amount of tax due (from employees) and also making sure that it pays the taxes collected to the Inland Revenue by the due date. A business effectively acts as a tax collector for the government for income-based taxes!

Corporation tax

Corporation tax is a tax based on the profits earned by a company. A sole trader will pay **income tax** on the profits earned by the business, whereas a company's profits are taxed using **corporation tax**.

Companies benefit from a range of "tax reliefs" which reduce the profits on which tax is charged. For example, a company is allowed to offset money spent on capital items like computer systems, plant and machinery. **Small companies also pay a lower rate of corporation tax**, at around 19-20% compared with the normal rate of 30%. Corporation tax is paid around 7 months after a financial year has been completed, so there is plenty of time for a business to calculate what the tax is going to be and ensure that it has enough cash to settle the bill!

Business rates

Rates are another form of business taxation. The difference is that rates are paid to local authorities rather than central government, since they are meant to contribute towards the cost of local services. The amount of business rates payable depends on the kind of business location occupied by the business and also the rates charged by different local authorities.