

BE YOUR OWN BOSS

Accounting 101

CHAPTER	TAKE CONTROL OF YOUR FUTURE	
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What every freelancer needs to know about accounting and bookkeeping

As a freelancer, understanding the basics of accounting and bookkeeping is vital to the health of your business. And there are a few key things you need to understand and take care of to keep on top of your finances and run a successful business.

Choosing your business structure

‘Going freelance’ essentially means that you are setting yourself up as a business. To do this, you must formally set up a legal business structure and let the tax authorities know how you are operating. This is the first and most important step to determine how you manage the accounts of your freelance business. The main business structures for freelancers are Sole trader and Limited Company. Each has its own tax and legal implications. Whichever way you choose, however, it’s essential to start thinking in terms of the business, not you as an individual.



1. Sole Trader

A sole trader is a type of business that is owned and controlled by one person, who takes all the decisions, responsibility and profits.

You pay tax and National Insurance Contributions (NICs) on the profit from the business, regardless of how much you draw, so the accounting is very straightforward.

Sole traders pay tax twice a year under the self-assessment system known as ‘payment on account’.

Setting up as a sole trader:

If you do decide that this is the way to go then you need to register as self-employed. This can be done online at the government website: gov.uk/set-up-sole-trader/register.

And don’t forget: you have to register within three months of starting your business or you’ll be fined!

Some people choose the sole trader route because it’s easy to set up, but there are good reasons to explore the limited company route too.



2. The Limited Company

A common reason independent professionals set up limited companies is that some clients are wary of working with sole traders because it puts them at risk if the tax authorities challenge their employment status. Having a limited company also lends a certain credibility.

A limited company is a distinct legal entity. It has rights and responsibilities and can own property or equipment. This means that there are more rules and regulations – as well as costs – involved in running a limited company than setting up as a sole trader. There is also a high level of paperwork and the tax requirements are more complicated. However, a limited company gives you a certain amount of control over when and how you pay tax, which can lead to significant savings.

Setting up as a Limited company:

The easiest way to set up a limited company is to ask an accountant to set one up for you, although it would be a bit cheaper to do it yourself. You can find out more about this in the guide books available on the Companies House website companieshouse.gov.uk.

Getting a business account



It's very important to keep your business and personal affairs separate. Mixing the two is a really bad idea as it can lead to confusion and complications with tax. To help you keep them separate, set up a dedicated business bank account. Many freelancers choose to run two accounts – a business current account for

everyday transactions and a business deposit account to set aside money for tax and VAT.

Look for accounts that offer free banking and a good rate of interest on cash savings. Rates vary but should be within a couple of percentage points of the current Bank of England rate.

Registering for VAT

You don't have to register for VAT until your billings (also known as turnover) hit the VAT threshold amount. As of 1 April 2017, this amount is £85,000.

If your billings are less than this, you can still register voluntarily. This may be an especially good idea because the VAT Flat Rate Scheme can result in significant savings.

Keep track of the latest VAT threshold at gov.uk/vat-registration-thresholds.

Bookkeeping

Bookkeeping should be an everyday part of your business because it makes doing your tax return at the end of the year much easier. Keep records of all incomings and outgoings as you go along – including income generated through invoices, expenses and bank transactions.

There are many useful bookkeeping systems on the market to help you keep your paperwork in order. Alternatively, your accountant may be able to provide you with a system.

What records do I need to keep?

- A list of all sales or fee income and other business receipts as they come in, plus supporting records such as invoices, bank statements and paying-in slips to show where the income came from
- A list of all purchases and other expenses, with supporting receipts or invoices for large amounts
- All purchases and sales of assets used in your business
- All amounts taken out of the business bank account, or in cash, for personal use
- Business diaries, mileage logs, minutes of board meetings



Invoicing

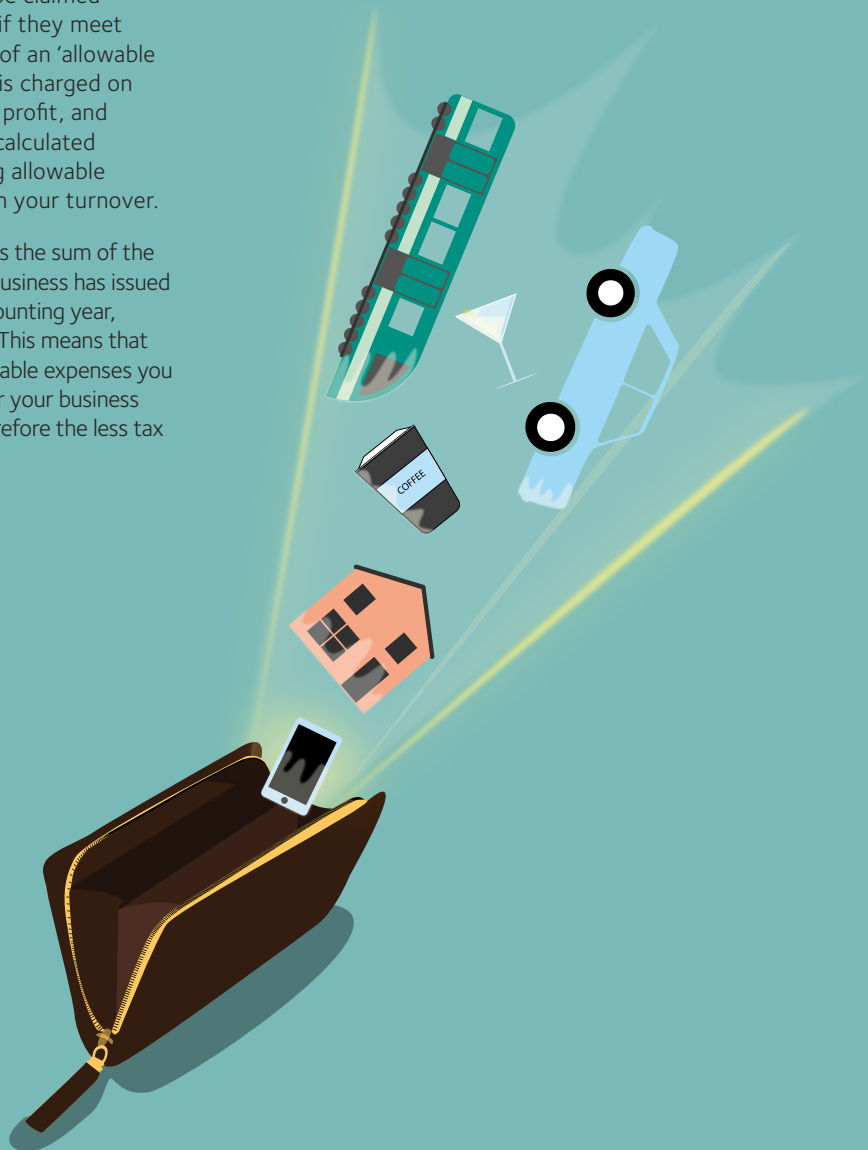
Invoices are very important to a freelance business because you are unlikely to get paid until you produce an invoice. It is professional, helps you get paid on time and avoids you having to chase for late payments. It is also helpful for record-keeping.

Many electronic bookkeeping systems include an invoicing function that lets you customise a template, generate invoice numbers, issue invoices and track payments.

Claiming expenses

Many of the expenses you incur while running your business can be claimed against tax – if they meet the definition of an ‘allowable expense’. Tax is charged on your business profit, and your profit is calculated by subtracting allowable expenses from your turnover.

Your turnover is the sum of the invoices your business has issued during the accounting year, excluding VAT. This means that the more allowable expenses you have, the lower your business profit, and therefore the less tax there is to pay.



Some claimable expenses:

Capital items: computers, cars, furniture, equipment, property	Legal and professional fees	Subscriptions to professional and trade associations on HMRC's approved list	Trade magazine subscriptions or purchases	Bad debts (as long as they've been individually identified, formally written-off and you're not waiting to be paid)
Interest on debts incurred to finance the business (as long as it isn't used to pay the directors)	Entertaining employees and/or directors of your own limited company (but not clients or anyone outside the company)	Travel (but not to a client site where you have been for more than 24 months – and this ceases to be allowable from the moment that you know you will be there for more than 24 months, nor to your regular office/workplace if you have one, as that is seen as normal commuting, nor if you are 'deemed employed' under IR35)		
Mileage for your own car at 45p per mile for the first 10,000 miles and 25p per mile thereafter	Up to £150 per person per year (unfortunately this isn't claimable by sole traders)	Use of home for work (HMRC automatically accepts £4 per week for employees, sole traders and partnerships, but if you have a limited company it becomes more complicated and you should discuss the best approach with your accountant)		
Accommodation and subsistence	Mobile phone bill (as long as the contract is in your limited company's name – if it isn't, or if you're a sole trader, you can only claim for itemised calls made for business, not the whole bill)		Training (but only if used to update existing skills or in connection with new services you are genuinely seeking to launch)	Salaries (for limited companies)
Phone and Internet (put the contracts in your business name)	Rental of office premises	Insurance (but only business ones such as Professional Indemnity, and not personal ones such as life insurance)		

Paying yourself

If you're a sole trader you don't have the option to 'pay yourself', because any money you receive from your business activities is yours already. You are taxed on your profit, which is the difference between the amount you invoiced and the expenses you claimed.

Limited company directors, on the other hand, have more options – and some are more tax efficient than others. Unlike with sole traders or partners, money received by your company isn't

yours. It belongs to your company. To make it yours you can take money out of the business as salary or dividends (which are payments made by a company to its shareholders) or both.

If you are a UK taxpayer, generally speaking it's more tax efficient to pay yourself a mix of salary and dividends from your limited company. A popular route is to pay no more than £11,000 in salary, and the rest in dividends.



Hiring an accountant

Running your own accounts alone can be time-consuming and complicated, so in many cases it is a good idea to hire an accountant. Using a qualified professional also helps show the tax authorities that you're taking extra steps to comply with the rules.

However, it is important to shop around to find an accountant who is right for you.

You can browse the list of IPSE Accredited Accountants on ipse.co.uk/ipse-resources/supplier-directory.html.



To make sure they give you a good service, check for the following:

- Do they understand freelancing and all the rules that apply to independent professionals?
- Will you have a central point of contact to manage your account or will you be bounced from person to person?
- Do they belong to one of the Chartered Institutes? This will give you more protection against malpractice.
- Are they cost effective? Expect to pay between £60 and £120 plus VAT per month to draw up the end of year accounts and tax returns for a limited company.
- Do they offer additional services, such as bookkeeping, including recording and processing of receipts and expenses and invoicing?
- Do they come well recommended?

Don't forget we're here when you need us

IPSE, the Association of Independent Professionals and the Self-Employed, is the UK's only not-for-profit association dedicated to supporting, representing and protecting the freelance community.

So far 67,000 UK freelancers, contractors and consultants have joined IPSE because it helps them get ahead in business. To find out more visit ipse.co.uk.

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