

HOW TO START A BUSINESS IN THE UK

THE STARTUP GUIDE FOR FOUNDERS & SIDE HUSTLES

# SET UP FOR SUCCESS

AVOID COSTLY MISTAKES - KEEP MORE - BUILD IT RIGHT

- Sole Trader vs Limited Company
- Self Assessment & Tax Returns
- Making Tax Digital (MTD)
- Director Pay, Salary & Dividends
- Allowable & Non Deductible Expenses
- Companies House Guide
- Xero & Bookkeeping Setup
- Corporation Tax Explained
- Registering with HMRC
- Payroll, PAYE & NIC

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WRITTEN BY

**START SHARP**

UK CHARTERED CERTIFIED ACCOUNTANTS

ESSENTIAL  
GUIDE FOR  
NEW BUSINESS  
OWNERS

# SET UP FOR SUCCESS

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*The UK Startup Guide for Side Hustles & Founders*

**By Start Sharp**

UK Chartered Certified Accountants

# Set Up for Success

Published by Start Sharp · UK Chartered Certified Accountants

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## About This Guide

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Welcome to Set Up for Success — the no-nonsense guide to starting and running a business in the UK, written by UK Chartered Certified Accountants at Start Sharp.

Whether you are thinking about turning a side hustle into something more serious, leaving employment to work for yourself, or setting up a limited company for the first time, this guide is designed to give you practical, real-world knowledge — not complicated theory.

Most people starting a business in the UK learn the hard way. They choose the wrong structure, miss important tax deadlines, overclaim expenses, underpay themselves, or simply do not know what they do not know. At Start Sharp we see the same mistakes made every day — and this book is our answer to that.

The book is split into two parts. Part One covers everything you need as a sole trader — registering with HMRC, tax, expenses, bookkeeping and Making Tax Digital. Part Two covers limited companies — incorporation, directors' responsibilities, payroll, Companies House and how to read a set of accounts.

No accounting knowledge is needed. Every concept is explained in plain English with worked examples throughout.

This guide is for general informational purposes only and does not constitute professional legal, tax or financial advice. For advice specific to your circumstances, please speak to a qualified accountant. Start Sharp would be delighted to help — [support@startsharp.co.uk](mailto:support@startsharp.co.uk).

Now, let us get started.

### **The Start Sharp Team**

*UK Chartered Certified Accountants*

**PART ONE**

# **Sole Traders**

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*Understanding self-employment, registration & finances*

## Introduction: Sole Trader vs. Limited Company

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When it comes to starting your own business, the first decision you face isn't about what to name it or what colour the logo should be — it's about choosing your battlefield: Sole Trader or Limited Company. Think of it as the ultimate “choose your fighter” moment. On one side, you have the simpler, no-fuss Sole Trader, ready to take on the world with simplicity and a “do-it-yourself” charm. On the other side, there's the polished and professional Limited Company, suited up for credibility and armed with the power of limited liability.

But the question is: are you a lone wolf who thrives on independence and light admin work, or do you aspire to the prestige of a corporate alter ego? Choosing between these two isn't just about taxes and liability (although those are pretty important); it's about understanding your business's DNA and setting yourself up for success as an entrepreneur.

In this guide, we're pulling back the curtain on these two business structures, stripping away the jargon, and giving you the inside scoop — minus the boring textbook fluff. Whether you're launching a side hustle or dreaming of empire-level domination, this is where your entrepreneurial journey gets its official title. So, are you ready to pick your side? Let's dive in and get you set up for success.

## Sole Traders and the Self-Employed — Spot the Difference

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So, you've decided to step off the beaten path and start working for yourself. Congratulations! But before you start scribbling your genius ideas on napkins or printing those shiny business cards, there's a question lurking in the background: Are you a sole trader or just self-employed? Or... both?

It's like trying to solve a riddle: all sole traders are self-employed, but not all self-employed people are sole traders. Confused? Don't worry, you're not alone. Think of it this way: if being self-employed is like saying, “I work for myself,” being a sole trader is like declaring, “I'm running my own business — and I'm the boss, the employee, and the HR department all rolled into one.”

Sole traders are the ultimate one-person show: no shareholders, no directors' meetings, just you, your business, and your ambitions. It's simple, flexible, and perfect for those who like the freedom to call the shots. But don't let the simplicity fool you — there's still a difference between being “self-employed” as a freelancer, contractor, or partner in a business, and going the full-on sole trader route.

In this section, we're breaking down what it means to be a sole trader, how it fits into the self-employed universe, and what makes this business structure both uniquely appealing and sometimes a little tricky. Ready to discover what being a sole trader is all about? Let's get started — because running your own show means you need to know the script!

### Distinction Between Sole Trader and Self-Employed

#### What Does It Mean to Be Self-Employed?

Being self-employed means that you work for yourself rather than being employed by someone else. It's an umbrella term that covers a wide range of work styles and business structures, including:

- Sole traders.
- Partners in a business partnership.
- Freelancers or contractors.
- Directors of a limited company (even though legally, a director is employed by the company in a traditional sense).

When you're self-employed:

- You're responsible for finding clients, managing your income, and paying your taxes.
- You don't get employee benefits like sick pay or holiday leave.
- You have to register with HMRC as self-employed and file a Self Assessment tax return each year.

### **Example of Being Self-Employed:**

Sarah is a graphic designer who works on projects for multiple clients. She invoices them for her work, sets her own rates, and pays her taxes directly to HMRC. Sarah might choose to be a sole trader or form a limited company, but either way, she is self-employed.

### **What Does It Mean to Be a Sole Trader?**

A sole trader is a specific type of self-employment where you run a business as an individual. As a sole trader:

- You and your business are legally the same entity.
- You're personally responsible for all debts and obligations of the business (unlimited liability).
- You keep all the profits after paying tax but also bear all the risks.

Being a sole trader is one of the simplest ways to start a business. It's popular among freelancers, tradespeople, and small-scale entrepreneurs because of its straightforward setup and minimal paperwork.

### **Example of Being a Sole Trader:**

John is a plumber who runs his own business. He owns his tools, advertises his services, and manages his schedule. John invoices his clients directly and keeps his profits after paying tax. He is a sole trader and therefore self-employed.

## **Key Differences Between Sole Trader and Self-Employed**

### **Taxes and Record-Keeping:**

- **Self-Employed:** All self-employed individuals must register with HMRC and submit a Self Assessment tax return if they earn income over a £1,000 threshold. They pay Income Tax and National Insurance Contributions (NICs).
- **Sole Trader:** Sole traders follow the same tax process but operate under a specific business structure with fewer statutory requirements.

### **Liability:**

- **Self-Employed & Sole Trader:** Unlimited liability — business debts are personal debts.

### **Flexibility and Control:**

- **Self-Employed:** Varies depending on work style; often flexible but inconsistent work.
- **Sole Trader:** Full control over all decisions and operations, with full responsibility.

### **Key Takeaways**

- Self-employment is the umbrella term for anyone working for themselves.
- Sole trader is a specific legal structure for running a business as an individual.

- Both involve managing your own taxes and responsibilities, with both having no legal separation from their business depending on the specific set-up.

## Trading as a Sole Trader

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So, you've made the leap! After navigating the maze of self-employment options, you've chosen to stand tall as a sole trader — the DIY dynamo of the business world. Whether it's the simplicity, the flexibility, or just the joy of being able to say, "I'm the boss," you're officially in charge of your own destiny. But now comes the next big step: getting your business set up the right way.

Choosing to trade as a sole trader means taking on all the responsibility of your business. The good news? You get to keep all the profits (after tax, of course). The other news? You've got a few admin boxes to tick before you can officially start raking in those earnings.

Now that you've decided to trade as a sole trader, here's everything you need to know to register your business with HMRC. Think of this as your one-stop guide to turning your dream into an official reality — without drowning in paperwork. Let's get started and make it official!

# Comprehensive Guide: Registering as a Sole Trader with HMRC

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## Step-by-Step Guide to Registering as a Sole Trader

### Step 1: Check If You Need to Register

As a sole trader, you need to register with HMRC if:

1. You've earned more than £1,000 from self-employment in the tax year (6 April to 5 April).
2. You're running your own business and are not employed by someone else.
3. You're responsible for managing your income and paying your taxes directly.

### Step 2: Gather All Required Information

Before registering, ensure you have the following details ready:

- Your full legal name.
- Your residential address.
- National Insurance Number (NI): found on payslips, HMRC letters, or your personal tax account.
- Business Name (optional): you can trade under your name (e.g. John Smith) or a chosen business name (e.g. "Smith Carpentry").
- Business Start Date: the day you began trading, such as issuing your first invoice. Your year-end date will follow the tax year for which you begin trading (e.g. if you started trading in September 2025 your first reporting period will be from September 2025 to 5 April 2026).
- Contact Details: include your email and phone number for HMRC updates.

### Step 3: Create a Government Gateway Account

4. Visit the Government Gateway registration page at [gov.uk/log-in-register-hmrc-online-services](https://www.gov.uk/log-in-register-hmrc-online-services).
5. Select "Create Sign-In Details" and enter your email.
6. Create a strong password for your account.
7. Verify your email using the code sent by HMRC.
8. Keep your login credentials safe — this account will manage your tax affairs.

### Step 4: Register as a Sole Trader

9. Log into your Government Gateway account using the credentials you just created.
10. Navigate to the Self Assessment registration page at [gov.uk/register-for-self-assessment/self-employed](https://www.gov.uk/register-for-self-assessment/self-employed).
11. Complete the online form, providing your personal information (name, address, NI number) and business details (type of work, start date of trading).
12. Review carefully to avoid errors, then submit the form and wait for confirmation.

### Step 5: Receive Your UTR (Unique Taxpayer Reference) Number

HMRC will process your registration and send you a letter with your UTR within 10 working days (or 21 days if abroad). Keep it safe — this 10-digit number is essential for your tax returns and correspondence with HMRC.

## Step 6: Understand National Insurance Contributions (NICs)

As a sole trader, you'll typically pay:

- Class 2 NICs: mandatory Class 2 NICs were abolished from April 2024. You may still pay them voluntarily (£3.65/week for 2026/27) to protect your State Pension entitlement if your profits are below £6,845. If your profits are above £6,845, your contributions are treated as paid automatically.
- Class 4 NICs (for 2025/26): 6% on profits between £12,570 and £50,270, and 2% on profits above £50,270.

These payments are calculated automatically through your Self Assessment tax return.

## Step 7: Maintain Accurate Records

Good record-keeping is essential for a sole trader. Ensure you:

- Record all income (e.g. invoices, receipts).
- Track expenses — for example: office supplies, travel costs, advertising, and professional subscriptions.
- Keep these records for at least 5 years from 31 January following the tax year for which the tax return is made (this is equivalent to roughly 6 years in practice).

## Step 8: File Your Self Assessment Tax Return

Every year, you'll file your tax return via HMRC. Deadlines are:

- 31 October: for paper returns.
- 31 January: for online returns (also the deadline for paying tax owed).

## Worked Example: Registering as a Sole Trader

### Scenario: Jake's Plumbing Business

Jake started his plumbing business, "Jake's Plumbing Services", on 1 July 2025. By October, he earned £5,000 from clients. Here's how Jake registered as a sole trader:

### Checking Eligibility:

Jake confirms he needs to register because his self-employment earnings exceed £1,000.

### Gathering Information:

- Full Name: Jake Green.
- Address: 14 Fictitious Lane, Newtown, NT1 2XX.
- NI Number: ZZ999999Z.
- Business Name: Jake's Plumbing Services.
- Start Date: 1 July.
- Contact: jake.green@email.com, 07700 900123.

### Creating a Government Gateway Account:

Jake creates his account and receives verification.

### Registering as a Sole Trader:

Jake logs in, completes the Self Assessment form with his details, and submits the application on 15 October 2025.

### Receiving His UTR:

By 25 October 2025, Jake receives a letter from HMRC with his UTR: 9876543210. He stores it securely.

## Understanding National Insurance:

Jake anticipates paying Class 4 NICs at 6% on profits above £12,570.

## Tracking Income and Expenses:

Jake records £25,000 in earnings and £5,000 in expenses for tools and travel.

## Example Summary

- Earnings: £25,000 for the year.
- Expenses: £5,000 for tools, subscriptions, and travel.
- Taxable Profit: £20,000 (£25,000 income – £5,000 expenses).
- Income Tax: £1,486 (20% on income above £12,570).
- Class 4 NICs: £445.80 (6% on £7,430 of profits).
- Total Tax and NICs: £1,931.80.

Jake keeps the remaining £18,068.20 as his net income.

## Frequently Asked Questions

### Can I start trading before registering?

Yes, but you must register within 3 months of starting your business.

### Do I need to register if I work part-time?

Yes, if your self-employment earnings exceed £1,000.

### Is registration free?

Yes, registering as self-employed is free.

## More on the Government Gateway

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Now, let's look at the Government Gateway in more detail. Picture this: you've stepped into the world of self-employment, and now you're facing a digital maze. The Government Gateway is like your map — it's the key that unlocks a treasure trove of tax services, allowing you to navigate the bureaucratic jungle with ease. Think of it as your personal passport to the land of HMRC, where you can file your taxes, track your payments, and manage your business's tax affairs all from the comfort of your laptop (or even your phone!).

## What Is the Government Gateway and Why Is It Important?

The Government Gateway is a secure online system used by HMRC and other government departments in the UK to manage your tax-related services. It allows you to access and interact with various HMRC functions, including Self Assessment, VAT registration, National Insurance contributions, and more.

When you register as a sole trader, you'll need a Government Gateway account to complete the registration process. It's also used to file your Self Assessment tax return, check your tax status, and pay any taxes you owe — basically, it's your one-stop shop for all things tax-related.

### Why Is It Important?

- **Centralised Access:** the Government Gateway is a single entry point for multiple government services, saving you time and effort. No more hunting down different sites or having to remember multiple login details.

- **Secure and Official:** it's the official channel to handle your tax matters with HMRC. You'll know you're communicating securely and directly with the government, avoiding any potential scams or third-party confusion.
- **Convenience:** forget about standing in long lines or waiting for paper forms. The Gateway allows you to manage everything online, at your own pace.
- **Tax Tracking and Transparency:** by using the Gateway, you can stay on top of your tax obligations, view payments, and track due dates. It provides real-time information, so you're never left guessing about what's owed or when.

### How Does It Work?

Once you've created your account, you can access a variety of HMRC services based on your personal tax situation. Whether you're a sole trader, a freelancer, or even someone who needs to track their VAT, everything is handled through this system.

Your account is linked to your Unique Taxpayer Reference (UTR) number, which helps HMRC identify you in the system, ensuring everything from your tax return to your payments is processed smoothly.

### Key Takeaway

The Government Gateway is not just a fancy login portal — it's your trusted companion in managing your self-employment and tax responsibilities. It's the official digital space where you and HMRC can meet, exchange all the essential paperwork (digitally, of course), and ensure you're on the right side of the tax system. So, log in, keep track, and stay in control!

## Now You're Registered with HMRC — What's Next?

Congratulations! You've completed the not-so-terrifying paperwork, braved the digital maze of the Government Gateway, and officially registered as self-employed with HMRC. You're now on the path to becoming your own boss, so what comes next? Well, now the fun begins — because running your own business isn't just about setting up and forgetting. It's about staying on top of your responsibilities, keeping track of your finances, and making sure the taxman is always in the loop.

So, now that you've ticked the all-important "register with HMRC" box, let's look at the next steps to keep your business running smoothly and your finances in check. Spoiler alert: it's not as scary as it sounds!

### Next Steps for a Newly Registered Sole Trader

#### 1. Set Up a Business Bank Account

Although there is no HMRC requirement for sole traders to have a separate business bank account, it is highly recommended. Here's why:

- **Organisation:** keeping your business finances separate from your personal ones makes it much easier to track your income and expenses.
- **Professionalism:** having a dedicated business bank account makes you look more professional to clients and suppliers.
- **Easier Tax Filing:** having all your business transactions in one place makes it much easier to calculate your profit and loss for the year.
- **Cash Flow Management:** it helps you manage your cash flow by tracking business inflows and outflows, and reduces the likelihood of accidentally spending business funds on personal use.

How to set it up: most banks offer business accounts with various features such as bookkeeping tools, online banking, and invoicing. Some popular banks for sole traders include Barclays, HSBC, and Lloyds, as well as online-only options like Monzo Business or Starling Bank.

## 2. Keep Detailed Financial Records

Accurate record-keeping is critical for both running your business smoothly and complying with HMRC requirements. As a sole trader, you need to track every penny that comes in and out of your business.

### What to track:

- **Income:** every payment you receive from clients or customers (invoices, receipts, or any form of payment — cash, bank transfer, credit card).
- **Expenses:** all business-related expenses, including office supplies, materials, tools and equipment, marketing costs, travel and transport costs, and utility bills or a proportion of home office costs.
- **Receipts and Invoices:** always keep receipts for purchases, and store digital or physical copies of invoices you issue.

Tools to help: use accounting software like QuickBooks, Xero, or FreeAgent for automated tracking. Alternatively, use a simple spreadsheet if you're comfortable doing it manually — but be aware that changes are coming for Making Tax Digital (MTD) for some sole trader businesses from April 2026. More on this in later chapters.

## 3. Understand Your Tax Obligations

As a sole trader, you're responsible for reporting your income and paying your taxes. You pay Income Tax on your profits (your income minus any allowable expenses). The tax-free Personal Allowance is £12,570 for the 2026/27 tax year. If you earn more than this, you will be taxed as follows:

- 20% on earnings between £12,571 and £50,270.
- 40% on earnings between £50,271 and £125,140.
- 45% on earnings above £125,140.

**National Insurance Contributions (NICs):** if your profits are above £12,570, you'll also pay Class 4 NICs — 6% on profits between £12,570 and £50,270, and 2% on profits above £50,270.

As a sole trader, you'll file a Self Assessment tax return every year, which is due on 31 January for online submissions.

## 4. Set Aside Money for Tax Payments

When you're self-employed, you're responsible for making sure you have enough money set aside to pay your taxes and NICs. A common rule of thumb is to save 20–30% of your earnings for tax purposes, but this percentage will depend on your actual tax bracket and allowable expenses.

Consider setting up a separate savings account just for your taxes, and automate monthly transfers into that account to make it a habit.

## 5. Consider Insurance for Your Business

While not a legal requirement for some sole traders, business insurance is a wise investment to protect yourself, your business, and your customers. Types you may need:

- **Public Liability Insurance:** protects you if a customer or member of the public is injured or their property is damaged because of your business.
- **Professional Indemnity Insurance:** if you provide advice or services, this protects you against claims of negligence or mistakes that affect your clients.

- **Employers' Liability Insurance:** if you hire any employees (even just one), this insurance is legally required to cover their work-related injuries or illness.
- **Tools and Equipment Insurance:** covers loss or damage to your business equipment.

## 6. Keep Track of Deadlines

Once you're a sole trader, it's essential to stay organised and meet all your important deadlines:

- **Self Assessment Deadline:** for online submissions, the deadline is 31 January. For paper returns, it's 31 October.
- **Payment Deadlines:** you must pay any tax owed by 31 January. If you make payments on account, the next payment will be due on 31 July.

Use a digital calendar or reminder app, or accounting software that tracks deadlines and sends reminders.

## 7. Pay Your National Insurance Contributions (NICs)

As a sole trader, you are responsible for paying National Insurance Contributions, which fund state benefits like pensions. Paying NICs ensures you're eligible for things like the State Pension, and is part of your tax obligations, so paying them on time is essential for avoiding fines and maintaining your tax record.

## 8. Start Building Your Brand

Now that your business is set up legally, it's time to grow it! A strong brand sets you apart from competitors and helps you attract and retain customers, while a solid online presence gives your business credibility.

- **Design a logo:** a logo helps establish your brand identity. Consider using tools like Canva or hiring a professional designer.
- **Create an online presence:** set up a website or at least a business profile on social media platforms like LinkedIn, Facebook, Instagram and/or TikTok.
- **Marketing:** develop a marketing strategy that includes both online and offline tactics, such as social media marketing, SEO, and email marketing.

## 9. Review Your Business and Personal Goals

As your business grows, you'll want to set new goals and adjust existing ones. Setting goals ensures you're moving in the right direction, and keeps you motivated and focused, especially when challenges arise. Set annual or quarterly business goals, and periodically assess whether your business is on track to meet your financial goals.

## 10. Stay Organised

Finally, organisation is key to being a successful sole trader. Keep everything in order, from finances to scheduling to client communications.

- **Accounting Software:** use tools like QuickBooks or Xero for keeping track of finances and filing taxes.
- **Project Management Tools:** tools like Trello or Asana can help you stay on top of client projects and deadlines.
- **Filing System:** create a paper or digital system for organising contracts, receipts, and invoices.

# Making Tax Digital (MTD) — What Every Sole Trader Needs to Know

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Making Tax Digital (MTD) is one of the biggest changes to the UK tax system in a generation. If you are a sole trader, this affects you — so read this section carefully.

## What Is Making Tax Digital?

MTD is a government initiative to modernise the UK tax system. Instead of filing one Self Assessment tax return each year, you will need to keep digital records and submit quarterly updates to HMRC using compatible software, followed by a final end-of-year declaration.

The aim is to reduce errors, close the tax gap, and make it easier for business owners to stay on top of their finances throughout the year — rather than scrambling every January.

## Who Does It Apply To and When?

MTD for Income Tax is being rolled out in phases based on your qualifying income (your gross income from self-employment and/or property before expenses):

- From 6 April 2026 — mandatory for sole traders and landlords with qualifying income over £50,000.
- From 6 April 2027 — mandatory for those with qualifying income over £30,000.
- From 6 April 2028 — mandatory for those with qualifying income over £20,000.

Your qualifying income is based on your most recent tax return. It does not include employment income (PAYE) or dividends — only self-employment and property income counts.

**Important: HMRC will not sign you up automatically. You must sign up yourself (or ask your accountant to do it) before your start date.**

## What Will You Need to Do?

Once MTD applies to you, your obligations each tax year are:

- Keep digital records of all your income and expenses using MTD-compatible software.
- Submit four quarterly updates to HMRC — one for each quarter of the tax year.
- Submit a Final Declaration at the end of the tax year (this replaces your Self Assessment tax return).

The quarterly updates are not extra tax returns — they are simple summaries of your income and expenses pulled directly from your software. HMRC describes them as light-touch.

## What Software Do You Need?

You must use software that is recognised by HMRC for MTD. HMRC does not provide its own free software, but there are both free and paid options available. Popular choices include:

- Xero (covered in the next chapter)
- QuickBooks
- FreeAgent
- Sage

If you prefer using spreadsheets, you can continue to do so — but you will also need bridging software to create a digital link between your spreadsheet and HMRC's systems. You can find the full list of compatible software on the HMRC website at [gov.uk](https://www.gov.uk).

## Quarterly Deadlines

Your four quarterly updates follow the tax year (6 April to 5 April). Your Final Declaration is due by 31 January following the end of the tax year — the same deadline as the current Self Assessment return.

## Penalties

A points-based penalty system applies to late submissions. Each missed deadline earns one penalty point. Once you reach the threshold (four points for quarterly filers), you will receive a £200 fine. Points reset after a period of compliance.

Good news for 2026/27: HMRC has confirmed that sole traders joining MTD in April 2026 will not receive penalty points for late quarterly updates during the first twelve months, giving you time to get used to the new system.

## What Should You Do Now?

- Check your qualifying income — use HMRC's online eligibility checker at [gov.uk](https://gov.uk) to confirm when MTD applies to you.
- Choose your software — do not leave this until the last minute; set it up and get familiar with it early.
- Sign up before your start date — HMRC will contact you, but you must sign up proactively.
- Speak to your accountant — if you use one, make sure they are aware and MTD-ready.

MTD is coming whether we like it or not — but with the right software in place, many business owners find it actually simplifies their record-keeping. The key is to prepare early.

### **Start Sharp Academy — Making Tax Digital Made Easy**

MTD is coming for every sole trader and landlord in the UK — and the rules, deadlines and software choices can feel overwhelming. That is exactly why we created the Start Sharp Academy.

As a member you will get: step-by-step MTD setup guides so you never miss a deadline; downloadable quarterly record-keeping templates built for MTD compliance; live Q&A sessions with our UK Chartered Certified Accountants where you can ask your MTD questions directly; and early access to our members-only website packed with resources, tools and worked examples.

Whether you are not yet sure which software to choose or you want a hand setting it all up, our Academy members never have to figure it out alone. Join the Start Sharp Academy today and get MTD-ready with confidence.

[support@startsharp.co.uk](mailto:support@startsharp.co.uk) · [www.startsharp.co.uk](http://www.startsharp.co.uk)

# Cash Basis vs Accruals Basis for Sole Traders

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Welcome to the ultimate accounting showdown! In one corner, we have the cash basis, the quick-and-easy favourite for small businesses and sole traders, where everything's about the actual cash flow. In the other corner, we have the more formal and structured contender, the accruals basis, where transactions are recorded when they occur, regardless of when the cash changes hands.

So, which one should you choose? How do they impact your profit and loss? And most importantly — how does this affect your taxes? Well, don't worry! We're about to break it down for you, with a touch of humour, a sprinkle of accounting wisdom, and, of course, examples to show exactly how these methods work.

## The Cash Basis: The Fast and Loose Approach

The cash basis is like a casual dinner at your favourite restaurant — easy, straightforward, and all about what happens right now. Under the cash basis, you only record income and expenses when actual payments are made. In other words, you don't count a sale until your customer pays you, and you don't count an expense until you actually pay for it.

### How profit and loss is calculated under the cash basis:

- Income is recorded when you receive payment for services or products.
- Expenses are recorded when you actually pay for goods or services.

### Example:

Let's say you sell a computer for £1,000 in December, but your customer doesn't pay you until January. Under the cash basis, you'll only record the income in January, when the cash actually hits your account. Similarly, you buy office supplies for £200 in December, but you don't pay the bill until January — again, under the cash basis, you'll record the expense in January, when the payment is made.

Tax implications: because you're only counting income and expenses when cash changes hands, you only pay tax on the income you actually receive in a given year. This method is generally easier to manage and may offer some flexibility when it comes to managing cash flow.

## The Accruals Basis: The More Formal, Structured Approach

The accruals basis is like a fine-dining experience — everything is carefully planned and recorded, and you don't care when the cash actually changes hands, just when the transaction happens. Under the accruals method, you record income and expenses when the transaction occurs, not when the money changes hands.

### How profit and loss is calculated under the accruals basis:

- Income is recorded when you make the sale, not when the payment is received.
- Expenses are recorded when you incur the cost, not when you pay for it.

### Example:

Let's say you sell a computer for £1,000 in December, but your customer doesn't pay until January. Under the accruals basis, you'll record the income in December, when the sale happens — not when you receive the payment. Likewise, if you buy office supplies for £200 in December and pay the bill in January, you'll record the expense in December, when you received the goods.

Tax implications: under the accruals basis, you pay tax based on your profits in the period when the transaction happens, regardless of whether the cash has been received or paid. This means you may end up paying tax on income you haven't received yet, but it also means you can deduct expenses you've incurred even if you haven't paid for them yet. This method is great for businesses that have more complex transactions, but it can be more time-consuming and requires more detailed record-keeping.

## Cash Basis vs Accruals Basis — Which One Wins?

In the cash basis corner, we have simplicity and speed — perfect for smaller businesses or sole traders who want to avoid the hassle of complicated bookkeeping. It's all about what's in the bank right now, which makes it easy to track and manage.

In the accruals basis corner, we have precision and structure — perfect for businesses that want to match income with the costs incurred to earn it, even if the cash hasn't changed hands yet. It gives a clearer picture of financial performance but requires more effort to keep things tidy.

Both methods are valid, and it ultimately depends on your business needs and how you manage your cash flow. Whichever method you choose, the goal is the same: to keep your finances in check and minimise that tax bill. Once you've made that decision, we can start looking at the software to support your new business!

## Xero — Your New Best Friend in Business Accounting

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Picture this: you've finally embarked on your solo journey as a sole trader, and everything is running smoothly — except for one little detail: keeping track of your business finances. Enter Xero, the sleek, cloud-based accounting tool that's about to become your new best friend. Gone are the days of scribbling down receipts in a notebook or stressing over spreadsheets. With Xero, you can manage your finances with the grace and ease of a well-oiled machine. Plus, it's user-friendly, intuitive, and surprisingly fun for something that tracks invoices and expenses!

### Why Xero Is a Great Accounting Tool for Sole Traders

#### **Easy to use:**

Xero is built with simplicity in mind. It's designed for people who may not be accounting experts but still need a reliable and efficient way to manage their finances. The interface is clean, easy to navigate, and doesn't overwhelm you with technical jargon.

#### **Cloud-based and accessible anywhere:**

Xero is entirely cloud-based, which means you can access it from anywhere with an internet connection. Whether you're on your laptop in the coffee shop or checking your accounts on your phone while commuting, your financial data is at your fingertips.

#### **Seamless bank integration:**

Xero can connect directly to your business bank account. Transactions automatically import into your Xero account, making it simple to reconcile your books — no more manual data entry or worrying about missed expenses.

#### **Tax time, made easy:**

The software automatically tracks your income and expenses, and generates the reports you need for filing your Self Assessment tax return. This makes it easier to see what you owe and helps you avoid the last-minute scramble for receipts.

**Invoicing made simple:**

You can create and send professional, customisable invoices to clients in just a few clicks. Xero also allows you to set up recurring invoices, track when payments are due, and send reminders for overdue payments.

**Financial reports at your fingertips:**

Xero generates reports like profit and loss statements, balance sheets, and cash flow forecasts, updated in real time, so you can make informed decisions about your business without any guesswork.

**Scalable as your business grows:**

As your business grows, you can easily upgrade your plan to suit your needs — whether you're adding employees, expanding your product offerings, or needing more advanced features. You can also integrate with other business tools and apps.

**Great support and resources:**

Xero provides excellent customer support, live chat, and a comprehensive help centre with tutorials, webinars, and training materials.

**Key Takeaway**

Xero is more than just accounting software; it's a business partner that helps you stay organised, efficient, and on top of your finances. With features that automate tedious tasks and generate accurate reports, Xero allows you to focus on what truly matters: growing your business.

## What Needs to Be Reported to HMRC

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Congratulations on your entrepreneurial journey so far! You've registered, set up your business bank account, and embraced the magic of accounting software like Xero. Now it's time to tackle what might seem like a daunting task: reporting to HMRC. But fear not! We're here to break it down into bite-sized chunks.

HMRC wants to know exactly how much you earned, what it cost to make those earnings, and how much of it is subject to tax. Here's what you need to report:

**Profit and Loss Statement (P&L):**

This is the financial snapshot of your business over a specific period (usually annually). It shows total income (how much you made), expenses (how much you spent), and net profit (how much is left after expenses).

**Balance Sheet (optional, depending on the information you compile):**

This tells HMRC about your business's financial health by showing your assets, liabilities, and equity. It's essentially a snapshot of your business's financial position at a specific point in time.

**Calculating profits:**

Your net profit is what HMRC is most interested in when it comes to taxes. To calculate this, you'll subtract allowable expenses from your income. The result is your taxable profit, which will be used to determine how much tax you owe.

## Worked Example: Claudia the Cakemaker

Claudia has been running a small business as a cakemaker for the past year. She's made some money, and now she needs to calculate her profits and report everything to HMRC. Here's how she does it.

### Step 1: Profit and Loss Statement (P&L)

- **Income:** Claudia's total income for the year was £40,000 (from customers for her cake-baking services).
- **Cost of Goods Sold (COGS):** the materials Claudia used (flour, decoration etc.) cost £5,000.
- **Gross Profit:** this is what's left after subtracting COGS from income — in this case, £35,000.
- **Expenses:** operating expenses like rent, utilities, and advertising. Total expenses for Claudia amount to £9,000.
- **Net Profit:** after subtracting expenses from gross profit, Claudia's net profit is £26,000.

### Step 2: Balance Sheet (optional)

A balance sheet shows the financial position of Claudia's business at the end of the year (31 March). It includes assets (what the business owns), liabilities (what it owes), and equity (the owner's share). This requires an understanding of bookkeeping and double-entry, which is not covered within this book.

### Step 3: How Profits Are Calculated and Reported

- **Net Profit:** in the P&L, Claudia calculated her net profit to be £26,000.
- **Taxable Profit:** this is the figure HMRC will use to calculate Claudia's tax. Since Claudia's business expenses are all deemed valid and wholly necessary for running her business, she can deduct them from her gross income. This may not always be the case.
- **Reporting via the Government Gateway:** Claudia will report her taxable profit of £26,000 through HMRC's Self Assessment system. This will determine how much Income Tax and National Insurance she needs to pay.
- **Using Xero:** Xero will automatically generate the reports (P&L, balance sheet, tax estimates) for Claudia, making her Self Assessment filing quick and easy.

Do be mindful with any software that the figures are only as good as the bookkeeping!

### Conclusion

Reporting your finances to HMRC doesn't have to be scary or overwhelming. With a clear understanding of how to calculate profits, create P&L statements, and generate balance sheets, you can easily stay on top of your tax obligations. Plus, tools like Xero make the entire process faster and more accurate, so you can focus on what really matters — growing your business!

## Balance Sheets for New Businesses: What You Really Need to Know

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Now, before we dive into the deep end, let's address the balance sheet. Yes, it sounds fancy, but here's the truth: you don't always need one — especially in the early stages of your business. If you're a new sole trader or freelancer, you may not need to worry too much about a full-fledged balance sheet just yet.

But here's the catch — when you start preparing full accounts later on, that's where double-entry bookkeeping comes into play. This is the method that ensures everything you do in your business (like income, expenses, and transactions) has a corresponding entry. It's like a perfectly balanced seesaw — without one side heavier than the other.

For now, as a new business owner, the balance sheet can take a back seat while you focus on simpler profit and loss reports. But when you're ready to grow your business, it's definitely worth understanding the basics of double-entry bookkeeping.

## Profit and Loss Simplified

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Alright, let's keep this simple — profit and loss. Sounds like a lot, but really, it's just about figuring out how much money you've made and how much you've spent. And that's all you need to focus on to stay on HMRC's good side (and out of their audit list!).

Now, about those disallowed expenses. In the world of tax, some things just don't make the cut. Disallowed expenses are the ones you can't claim against your taxable income — think personal meals, your streaming subscription, or any other personal expenses that aren't related to your business. So, no, you can't claim them, even if they seem like a “business expense” in your mind! More on this further on.

And here's the big question that everyone asks: what about the money I take out of my business bank account? Am I taxed on that too? The answer is — nope! As a sole trader, you're allowed to take money out of your business, but that doesn't get taxed separately. You're only taxed on the profits you make from your business, not on the drawings (the money you take out). So, take out what you need to pay yourself, but remember, it's your profits that matter when it comes to tax time, not the amount you withdraw.

In a nutshell, keep it simple: calculate your profit, subtract the disallowed expenses, and don't stress about the money you take out — it's your earnings, not your tax bill!

## Allowable vs Disallowable Expenses

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Ah, expenses — the magic word that lets you lower your taxable income and pay less tax. But here's the catch: not all expenses are created equal. Some are allowable, which means they're like the golden tickets to reducing your taxes, while others are disallowable, which means HMRC won't give you any tax breaks for those. Let's break it down.

### Allowable Expenses (The Golden Tickets)

When something is deemed allowable, it means HMRC says, “Sure, you can deduct this from your income because it's necessary for your business.” These are your business-essential expenses — things you can't run your business without. Here's a breakdown of some classic allowable expenses:

- **Office Supplies:** pens, paper, printer ink — basically, anything that helps you keep the business running smoothly.
- **Business Travel:** train tickets, taxis, and fuel for your business trips. Just don't try to deduct the cost of your trip to the beach; business trips only!
- **Marketing and Advertising:** anything from the cost of a website to your social media ads. Promoting your business is definitely allowable.
- **Insurance:** business insurance (e.g. public liability) is an allowable expense.

- **Professional Fees:** legal advice, accounting fees, or any service that helps you operate your business — tax advisor fees, for example, are allowable.

## Disallowable Expenses (The Party Crashers)

And now, for the disallowable expenses — the ones HMRC doesn't want anything to do with. Here are some examples:

- **Personal Expenses:** any expenses that are purely personal (like your gym membership, or that fancy dinner you had with friends). HMRC doesn't care if you needed that dinner to relax — they're not tax-deductible!
- **Fines:** if you get fined for anything, whether it's a parking ticket or a speeding fine, HMRC won't allow that to be deducted. It's a punishment, not a business expense!
- **Clothing (unless it's a uniform):** you can't claim the cost of a new pair of jeans or a suit unless it's branded as a work uniform that's only used for work.
- **Entertainment:** taking a client out for drinks or a random night out with friends? Personal entertainment doesn't fly.

### Key Takeaway

In the world of taxes, allowable expenses are your golden tickets to lowering your taxable income, while disallowable expenses are the ones you just can't bring to the party. Stick to the allowable ones — those are always welcomed by HMRC and will make your tax return easier and less stressful.

## Adjusting for Disallowed Expenses in Your Profit and Loss

When it's time to adjust your profit and loss for disallowed expenses, here's how the magic happens:

13. Calculate your total income — all the money that's come into the business (sales, services, or other income sources).
14. Identify your expenses — subtract your business expenses from your income. But some of those expenses might be disallowed.
15. Remove the disallowed expenses — once you've spotted them, remove them from your total expenses. This is the key adjustment: clean up your P&L by subtracting any disallowed costs.
16. Recalculate your net profit — after adjusting for disallowed expenses, your final net profit will reflect only the legitimate, HMRC-approved costs. This gives you a true picture of your taxable income.

### Example:

Let's say you had £3,000 in business expenses, but £500 of that was a personal holiday expense that can't be claimed. You'd subtract the £500 from your total expenses, leaving you with £2,500 of allowable business expenses.

### Example: Claudia's Cakemaking Business (With a Little Adjustment)

Let's revisit our friend Claudia, the cakemaker, who had a fun experience with disallowed expenses.

- **Total Income:** £40,000.
- **Total Expenses:** £9,000 (which included £1,000 for her "business trip to the Bahamas" and £500 for her personal spa day. Lovely, but disallowed.)
- **Disallowed Expenses:** £1,500 (for the holiday and spa).
- **Adjusted Total Expenses:** £9,000 – £1,500 = £7,500.

- Net Profit:  $£40,000 - £7,500 = £32,500$  (this is what HMRC is going to want to know!).

In the end, remember: the only thing you want on your plate for taxes is what's legitimately allowed. Keep your expenses clean, and your profits will stay in tip-top shape!

## Wrapping Up the Sole Trader Saga

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And there we have it — the sole trader business adventure, complete with tax tips, accounting strategies, and a touch of magic. From setting up your business and choosing your year-end date (hello, 31 March and 5 April!) to how to properly calculate your profit and loss, you've covered it all.

Running a business as a sole trader is all about flexibility, control, and getting to pocket the profit (while staying on top of those expenses, of course). You've learned to separate your income, plan your expenses, and keep your business running smoothly.

So, go ahead — keep hustling, keep growing, and don't forget: the profit is yours to claim, as long as you keep your finances in check, your records clear, and your accounting game sharp! Here's to your sole trader success — may your profits be high and your tax bills low!

**PART TWO**

# Limited Companies

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*Setting up, running & growing your limited company*

# From Sole Traders to Limited Companies — Let's Level Up!

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So, we've talked about the exciting world of sole traders — where you call the shots, manage your business finances, and enjoy the flexibility of doing it all yourself. But what if you're ready to level up? What if your business has grown, and you're looking for a bit more protection, structure, and perhaps even a sprinkle of professionalism?

Enter the limited company. It's time to move on from those solo adventures and bring in the big guns. Operating as a limited company means the business is separate from you as an individual, offering you protection from personal liability and some great opportunities for tax efficiency. You've made it past the sole trader phase, and now it's time to don the hat of a company director, where the rules change and new opportunities arise.

So, buckle up! We're about to dive into the ins and outs of setting up and running a limited company, where the stakes are higher, but so are the rewards. Let's see how this business structure can help you grow, protect, and optimise your financial future.

## Important Things to Consider When Employed and Setting Up a Limited Company

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So, you're employed, but the idea of setting up your own limited company has been lingering in the back of your mind. Maybe you've got a side hustle going, or maybe you're just dreaming of more control, more tax benefits, and the thrill of having a business empire (okay, maybe just a small one). But before you take the plunge, there are a few things to consider. Let's break it down.

### Tax Efficiency — The Power of Salary and Dividends

First things first: tax efficiency may be a reason to set up a limited company, and it was for some time; however, this is not so true anymore. It can be a way to sustain cash flow, without the monthly PAYE and National Insurance deductions, but being more tax-efficient may not be the way forward now — unless you are set up as a limited company to secure income but not yet pay yourself. As a company director, you have the option to pay yourself in two ways:

#### **Salary:**

The salary you pay yourself is generally set at the personal tax allowance (£12,570 for the 2026/27 tax year), so you won't pay income tax on it (or very little — unless this is your side hustle, in which case you will pay tax if your employment income from other sources is higher than the personal allowance). Plus, you'll still get National Insurance contributions, which count towards your state pension. So, it can be the perfect way to pay yourself without triggering a monthly tax bill via PAYE.

#### **Dividends:**

After you've paid yourself a salary, you can take the remaining profits from your company as dividends. The great news? Dividends are taxed at lower rates than salary. For example, in the 2026/27 tax year, you get £500 of dividend income tax-free, and after that, dividends are taxed at rates below those of regular income — however, the Budget has sought to level up the tax rates on dividends with an increase of 2% for each tax rate.

Do be mindful that if you are employed then you will be earning a salary. Any further salary and dividends that you take from the limited company will be taxed at the rate of tax you currently pay. If you are currently paying tax at 20%, then additional salary will be taxed at 20%, perhaps even 40% depending on your income.

Not sure what this means for you? That's why we are here — and we have the community for you to ask!

## Limited Liability — Protect Your Assets Like a Business Superhero

Another huge benefit of operating as a limited company is limited liability. That means your business is a separate legal entity from you as an individual. Should your company run into any financial difficulties, you won't be personally liable for its debts (unless you're doing something seriously dodgy like committing fraud).

It's like having a business suit of armour that shields your personal assets — your home, car, or personal savings — from business risks.

## Professionalism — The Fancy Pants Effect

Let's face it: the world sees a limited company as more professional, trustworthy, and established than a sole trader. So, if you're working with clients, suppliers, or bigger companies, the limited company structure gives you an added layer of credibility. Being able to say, "I'm the director of XYZ Ltd" certainly carries some weight!

## Increased Access to Financing

Limited companies often have better access to business loans, grants, or investment, as banks and investors tend to favour companies with a formal structure. If your side business grows, you might want to take on funding or offer equity to investors.

## Separate Personal and Business Finances

With a limited company, your personal and business finances are separate, which makes accounting and bookkeeping much easier. This separation can also help protect your personal assets from being used to settle business debts. You'll also find that business expenses can be claimed more easily in a limited company, especially when it comes to things like office space, equipment, and even a portion of your home office costs.

## Pensions — Always Check with a Financial Advisor!

A limited company can make pension contributions directly from the company, which is tax-efficient. This is as far as any further comments on this can be made — it is a highly regulated area and should not be discussed with anyone outside of that regulated arena, such as a Financial Advisor.

## The Juggling Act — Managing Both Jobs

Here's the tricky bit: you can absolutely have a full-time job while running a limited company on the side. But, like any good juggler, you'll need to stay on top of things. You'll need to be organised about managing both your full-time income and business income, as they'll be taxed separately. Your company will be taxed on its profits, and you'll be taxed on the salary and dividends you take out. You'll also have to make sure you're paying your National Insurance contributions properly for both your salary (from your job) and your company.

## Paperwork — Don't Worry, You've Got This (With a Little Help)

Running a limited company requires some paperwork. You'll need to file your annual accounts and confirmation statements with Companies House, and submit a Corporation Tax return to

HMRC, along with your personal tax return. But you don't have to do it alone — you can hire an accountant to handle the nitty-gritty bits, leaving you to focus on growing your business.

There is now more to consider with a limited company, as you — as a director and/or shareholder — need to be verified with Companies House and receive a personal code. This is required to allow whomever you choose to help with your filing obligations. It is mandatory, with information provided directly to Companies House from your personal identification, such as a passport or driving licence.

## **National Insurance — Not the Most Fun, But Essential**

As a director of a limited company, you're required to pay Class 1 National Insurance contributions on your salary, depending on the level of salary you have decided upon. National Insurance isn't as glamorous as tax savings, but it helps keep everything above board and protected.

## **Checking Your Employment Contract — The Must-Do Step!**

Before you rush off and form a limited company, check your employment contract first! Many employment contracts include clauses that restrict outside work, especially if you're in a related industry. Make sure there's nothing in there — such as non-compete clauses or confidentiality agreements — that could cause problems with your new business.

## **The “Should I Do This?” Moment — The Big Question**

So, now you're probably asking, “Should I do this?” And the answer is: it depends! If you want tax advantages, asset protection, and business credibility, setting up a limited company could be a great choice. But if your side business is still very small and you're not making much profit yet, the extra paperwork and costs may not be worth it.

Operating as a limited company while employed isn't for everyone, but for those who want to grow their side business, increase tax efficiency, and enjoy limited liability protection, it can be a great move. Yes, it comes with more responsibility, but it also comes with bigger opportunities.

## **Before Deciding to Set Up a Limited Company — Let's Take a Look at What's Involved**

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So, you're thinking about taking the leap from sole trader to limited company. You want to level up, have a bit more protection, and maybe even enjoy some tax benefits. But before you start printing out business cards that say CEO, it's time to find out what running a limited company actually involves.

### **The Director's Responsibilities — The Big Cheese!**

As a director of a limited company, you hold a lot of power (and a lot of responsibility). You're the decision-maker, the one calling the shots on day-to-day operations, and the one who makes sure the company stays on the right side of the law. Your key responsibilities include:

- **Ensuring Compliance:** you have to make sure the company meets legal and financial requirements, including filing annual accounts, submitting your Corporation Tax return, and adhering to Companies House regulations.
- **Acting in the Company's Best Interest:** your duty is to act in the company's best interest, not your own personal benefit. That means no self-dealing and no conflicts of interest.

- **Financial Reporting:** you're responsible for keeping track of the company's financial health, ensuring that accurate records are kept, expenses are tracked, and all financial statements are in order.
- **Filing at Companies House:** you'll need to submit confirmation statements and annual accounts to Companies House. You can hire a qualified accountant to help you prepare and ensure the filings are correct.

## The Role of Shareholders — The Stakeholders Who Own a Piece of the Pie

Shareholders are the people (or entities) that own shares in the company, which means they have a financial stake in its success. In a private limited company, the shareholders are typically the owners and can be a mix of:

- **You (the director):** in many small businesses, the director is also the main shareholder, owning a majority of the shares.
- **Investors or Family Members:** if you have additional funding or investors, they may hold shares in exchange for capital investment or other contributions.

The more shares someone holds, the bigger their say in the company's decision-making, usually in proportion to the number of shares they own. If you're the only shareholder, then you get to call all the shots (until your business empire expands, of course).

## Assets and Liabilities — The Good, the Bad, and the Business Ugly

### Assets:

These are the valuable things the company owns. For a limited company, assets can include anything from cash in the bank, equipment, and property to intellectual property and even goodwill (the business reputation you've built).

- **Tangible Assets:** things you can touch, like property, machinery, or inventory.
- **Intangible Assets:** things like patents, trademarks, or brand reputation — valuable, but not physically measurable.

### Liabilities:

These are the debts and obligations your company owes to others, such as loans, creditor payments, and tax obligations.

- **Current Liabilities:** debts due within a year, like accounts payable (what you owe suppliers) and short-term loans.
- **Long-Term Liabilities:** debts due in more than a year, like mortgages or long-term business loans.

The most important thing to remember is that a limited company's liability is limited — which means you, as a shareholder, won't be personally responsible for the company's debts beyond the value of your shares. If your business goes bust, your personal finances should remain safe, unlike in a sole trader set-up where your personal assets can be at risk.

## The Articles of Association — The Company's Rulebook

As the director of a limited company, you need to follow the articles of association, which are like the company's rulebook. These are the internal rules and guidelines that dictate how the company operates, how decisions are made, and how shares are transferred or sold. They help define the relationship between the company, directors, and shareholders — think of them as the constitution of your company.

## The Legal Side — Keeping It All Legit

The biggest perk of a limited company is the legal protection it provides. The company is its own legal entity, distinct from its directors and shareholders. This means:

- **Personal Assets Are Protected:** as long as you don't act fraudulently or break the rules, your personal assets (house, car, etc.) won't be at risk.
- **The Company Is Responsible:** the company is responsible for its own debts and obligations, not its directors or shareholders — again, unless there's fraud or wrongdoing.

The key takeaway? A limited company isn't just about adding an extra letter to your business name. It's a whole new world of legal and financial responsibilities, but also one of growth potential and opportunity.

## Director Responsibilities, Getting It Wrong, and the Director's Loan Account

So, you're ready to set sail as a director of your limited company. You've learned the ropes of what it takes to lead the charge, from managing finances to adhering to legal duties. But before you ride off into the sunset, let's talk about what happens if you get it wrong — and the mysterious Director's Loan Account.

### What Happens if You Get It Wrong — The Director's Dark Side

Being a director isn't all about the perks and freedom of decision-making. It's also about accountability and legal responsibilities. If you don't follow the rules, the repercussions can be serious. Key repercussions:

- **Financial Penalties:** if the company doesn't follow tax rules or fails to submit reports to Companies House on time, directors can face fines or other penalties.
- **Legal Trouble:** directors who mismanage company funds or make fraudulent decisions can be held personally liable for the debts. Your limited liability only goes so far, especially when there's wrongdoing involved.
- **Director Disqualification:** if a director is found guilty of serious misconduct, such as failing to file accounts or causing the company to trade while insolvent, they can be disqualified from being a director for up to 15 years.

In short: stay legal, stay compliant, and you won't have to worry about the bad side of being a director.

### The Director's Loan Account (The Mystery Unveiled)

The Director's Loan Account records any money borrowed or loaned between you, as the director, and your limited company. In simpler terms, it's like a business IOU book. Here's how it works:

- **When you borrow from your company:** if you take money out of the company for personal reasons, this goes into the Director's Loan Account as a loan to you. You'll need to pay it back eventually.
- **When you lend to your company:** if you put your own money into the company (perhaps to cover a short-term cash flow problem), this is recorded as the company owing you money.

The catch: if you borrow too much from your company, there could be tax implications. Here are some things to watch out for:

- **Overdrawn Director's Loan Account:** if your account goes into the negative (you owe more to the company than you've repaid) and you don't repay it within 9 months of the company's year-end, the company may be hit with a 32.5% tax charge on the loan amount. This is what's called Section 455 tax. There are other things to consider, such as "bed and breakfasting" — consistently taking money, paying it back, and then borrowing again. There is anti-avoidance legislation which doesn't allow you to do this!
- **Interest on Loans:** if you borrow money from the company and don't pay it back within a certain time frame, you might also have to pay interest. HMRC expects the company to charge you interest on the loan at a reasonable rate.
- **Taxable Benefits:** if you're using the loan for personal gain, it could be considered a taxable benefit, meaning extra taxes on top of your normal bill.

### **How to avoid the Director's Loan Account pitfalls:**

- **Keep track of loans:** make sure any money borrowed from or lent to the company is properly tracked and recorded.
- **Repay on time:** always ensure that if you do borrow from your company, you pay it back to avoid that tax charge.
- **Don't overdraw:** avoid borrowing too much from your company.
- **Get advice:** the Director's Loan Account can get tricky, so it's a good idea to speak to an accountant or tax advisor if you're unsure.

## **Shareholders: Their Roles, Responsibilities, and When They're the Same as the Director**

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Shareholders are the owners of your company. They might not be managing the day-to-day, but they definitely have skin in the game. So, what exactly do they do, and when do they wear the same hat as the director? Let's break it down.

### **Who Are Shareholders?**

Shareholders are the investors, the financial backers, and often the founders of your company. They hold shares (i.e. ownership stakes) in your business. The more shares they own, the more of the company they own. These shares entitle them to a claim on profits (hello, dividends) and a say in important decisions.

### **What Do Shareholders Do?**

In short, shareholders are there to protect their investment and have a say in the company's future. Their influence depends on the number of shares and voting rights they hold. Their main duties and actions include:

- **Voting on major decisions:** shareholders get to vote on big decisions, such as mergers, acquisitions, or whether to pay out dividends.
- **Receiving dividends:** when the company does well, shareholders might receive dividends — a share of the company's profits.
- **Annual General Meetings (AGMs):** shareholders attend AGMs where they're updated on the company's performance and can voice their opinions or concerns.

## Roles and Responsibilities of Shareholders

- **Duty to Act in the Company's Best Interests:** while shareholders may not be involved in day-to-day activities, they still have an ethical responsibility to act in the company's best interest.
- **Participating in Company Governance:** shareholders hold the power to approve or reject the board of directors and their decisions.
- **Liability:** the shareholders' liability is limited to the amount they've invested in the company.

## When Shareholders and Directors Are One and the Same

In the world of small businesses, the director and the shareholder can often be the same person. In fact, this is very common in many small limited companies and start-ups. In the early days, you may be the one who started the business — you own most of the shares (you're the main shareholder) and you also run the show as the director. You can make all the key decisions for the company, including declaring dividends, without needing to consult others.

## What's Available for the Public to See on Companies House

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So, you've learned the ropes and you're all set to incorporate your limited company — but before you hit that “submit” button, you might be wondering, “What's actually available for the public to see on Companies House?” While Companies House keeps a record of your business for legal purposes, it's also public — which means some information will be available for anyone to check out.

### What's Available on Companies House: The Public Register

When you register your company with Companies House, it gets added to the public register. Here's what the public will be able to see:

#### **Company Name:**

Your company name, such as “Digital Savvy Ltd”, will be visible on the public register for all to see.

#### **Company Number:**

This is the unique identifier for your company. It's assigned by Companies House when your company is incorporated, and it's used in all official filings.

#### **Registered Office Address:**

Your registered office address will appear on the register. This is the address where official documents (like notices from HMRC or Companies House) are sent. If you don't want to use your personal home address, you can use a virtual office address or an address provided by an accountant.

#### **Directors:**

Your name, address, part of your date of birth, and nationality as the director(s) will be made available to the public for transparency. You can suppress your residential address on the public record, but your name will still be available.

#### **Shareholders:**

If your company has more than one shareholder, their details, such as the number of shares they hold, will be visible. For a private limited company, the public will have access to information regarding how many shares are issued and who owns them.

**Confirmation Statement:**

This is an annual filing that updates your company's details. It includes information such as any changes to your directors, shareholders, or registered office address. From autumn 2025, all new UK incorporated businesses will require that the directors and shareholders are verified and have been provided with a personal code.

**Annual Accounts:**

Every year, your company's financial statements (i.e. profit and loss, balance sheet) will be filed with Companies House. This is, however, currently restricted to the balance sheet only, but there are talks of this including the profit and loss account in the future.

## Comprehensive Guide to Setting Up a Limited Company (with a Worked Example)

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Setting up a limited company is an exciting step in establishing a business, but it requires understanding the process and responsibilities involved. In this guide, we'll take you through each step, using a worked example to illustrate the process.

### Step 1: Choose Your Company Name

The very first step in setting up your limited company is deciding on a company name. For our example, we'll go with Digital Savvy Ltd. Guidelines:

- The name must not be identical to an existing company's name.
- Avoid using restricted words like "Royal", "National", or anything that could imply government affiliation.
- Ensure the name is professional and reflects your business values.

### Step 2: Decide on Directors and Shareholders

**Directors:**

A director is responsible for the day-to-day management of the company. A limited company must have at least one director, but you can have more. For Digital Savvy Ltd, you are the sole director. Directors are legally responsible for running the company in compliance with laws and making sure the company files accounts and returns on time.

**Shareholders:**

Shareholders are the owners of the company. They hold shares and can benefit from the company's profits. In the Digital Savvy Ltd example, you are also the sole shareholder. You can have multiple shareholders, but for simplicity, we'll assume you're the only one.

There are a number of steps to follow so that the company is officially incorporated. It would be recommended that an accountant sets this up for you, or a formation company which can provide you with all of the necessary paperwork that accompanies the set-up.

## Worked Example: Digital Savvy Ltd

- Company Name: Digital Savvy Ltd.
- Director: You (sole director).
- Shareholders: You (sole shareholder).
- Articles of Association: to be determined with your accountant.
- Registered Office: your home address or a virtual office.
- Corporation Tax Registration: complete within 3 months of starting to trade.
- Bank Account: open a business account with your chosen bank.
- Number of Shares Issued: to be determined with your accountant.
- Amount per Share: to be determined with your accountant.

I would always suggest that you speak to a qualified accountant to set up your company. Once it has been set up and is on the public record, any changes due to inaccuracies will also appear on the record.

Congratulations! You've now officially set up your limited company and are on your way to building your business empire. You've completed the legal requirements, had shares issued, and ensured your company is properly registered with Companies House and HMRC.

## Registering as Self-Employed as a Director / Shareholder

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You've taken the bold step of becoming a director and shareholder of your very own limited company. Now, you're probably wondering how to actually pay yourself. The answer? You'll need to register as self-employed! But don't worry — it's the same process we covered earlier when you registered with HMRC.

### Step 1: Why Register as Self-Employed?

As a director of your limited company, you're an employee of that company, so you'll need to pay yourself a salary. The self-employed registration allows you to:

- Pay Income Tax on the salary and dividends you take from your company.
- Make National Insurance Contributions (NICs), so you can keep your state pension and other benefits intact.

### Step 2: The Self-Employed Registration Process — Same as Before!

If you've already followed the steps in the first section (the sole trader registration guide), you'll be in familiar territory here. The key difference is that you'll be wearing your director and shareholder hats while registering.

- Go to the HMRC website to register.
- Choose "Register as self-employed".
- Fill in the basic details: name, address, date of birth, National Insurance number, and so on.
- Unique Taxpayer Reference (UTR): if you've never registered as self-employed before, HMRC will send you a UTR, which you'll use whenever you deal with tax matters in future.

### Step 3: Salary vs. Dividends — The Two Big Players

When you register as self-employed, it's important to note that you're being taxed on both your salary and dividends:

- **Salary:** as a director, you'll need to pay yourself a reasonable salary, which should be reported to HMRC through PAYE (Pay As You Earn). Salary will be taxed as income, and your National Insurance contributions will be based on your salary too.
- **Dividends:** after the company has paid Corporation Tax on its profits, the leftover money can be distributed as dividends. You'll pay a lower tax rate on dividends, and there's also a tax-free allowance on dividend income (£500 for the 2026/27 tax year). Above this, dividend tax rates are 10.75% (basic rate), 35.75% (higher rate) and 39.35% (additional rate).

### Step 4: Pay National Insurance Contributions (NICs)

Just like a regular employee, you'll pay Class 1 NIC on your salary. The NIC for directors can get a bit complex depending on how much you earn.

### Step 5: Filing Tax Returns — The Ongoing Adventure

Once you're registered, you'll need to file your annual tax return with HMRC. This return will include your salary details (reported through PAYE), your dividends (reported separately in the tax return), and any benefits from the company. Since you're a director, your company is also responsible for filing Corporation Tax returns.

## Setting Up Payroll for Your Salary — It's Essential!

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So, you've decided to pay yourself a salary from your limited company — fantastic! But before you start dreaming about your monthly pay, there's one essential step: setting up a payroll system.

### Why You Need a Payroll System

If you're drawing a salary from your company, you need to report that income and deduct taxes through the PAYE (Pay As You Earn) system. PAYE allows you to automatically deduct income tax and National Insurance Contributions from your salary before it hits your account. It ensures you remain compliant with HMRC's requirements and keeps your financial house in order.

Whether you choose a paid software provider or opt for HMRC's free RTI system, the important thing is that you're compliant and setting yourself up for success. If you need help with any of the processes, we're here to help — our community covers those details and helps guide you.

## Now You're Set Up as a Company — What's Next?

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You've got your limited company in place, registered with HMRC, and you're ready to pay yourself a salary and dividends. But the journey doesn't stop here — there are still a few more steps to get your business running like a well-oiled machine.

## Step 1: Keep Your Records in Check

Now that you're officially in business, it's time to get your bookkeeping in order. Accurate records are key to keeping your tax returns in check.

- Set up accounting software: consider tools like QuickBooks, Xero, or FreeAgent to make your life easier.
- Track every penny: record sales, expenses, loans, dividends, and salaries.
- Hire an accountant: if you're feeling overwhelmed, don't be afraid to get professional help.

## Step 2: Get Your Business Bank Account Ready

It's important to separate your business and personal finances. Open a business bank account with a bank that offers low fees and a good online platform, and link it to your accounting software to automatically track income and expenses.

## Step 3: Set Up Payroll for Yourself (and Any Future Employees)

Since you're a director of your limited company, you'll need to set up a payroll system to pay yourself a salary. This will also allow you to pay National Insurance contributions and income tax on your salary. You can set this up yourself or use a payroll provider or accountant.

## Step 4: Pay Your Taxes and Make NIC Contributions

- Corporation Tax: pay Corporation Tax on the profits your company makes after expenses. Your accounting period runs for 12 months, and you'll need to file a Corporation Tax return within 12 months of the end of your accounting period. The Corporation Tax payment will be due 9 months and 1 day after the first 12-month year-end.
- Income Tax: this will be deducted from your salary through the PAYE system.
- NICs: as an employee of your company, you'll pay Class 1 NICs on your salary. Your company will also need to pay employer's NICs.

## Step 5: Stay on Top of Legal Requirements

- File your annual accounts with Companies House.
- Submit your confirmation statement each year.
- Keep up-to-date records of your directors, shareholders, and any changes to the company.

## Step 6: Keep Your Eyes on the Prize — Grow Your Business!

The paperwork and tax set-up are all part of running a business, but the real reward is in growth. Focus on marketing — create a website, run advertisements, or network with potential clients and partners — and track your progress, keeping an eye on your financials and always looking for ways to improve.

# Managing Your Business Finances with Xero

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So, you've got your limited company all set up, your payroll in order, and your bank accounts linked. Time to manage your finances like the business mogul you are! Let's take a look at why Xero is the preferred software for many small businesses, what its pros and cons are, and how it can help you raise invoices and capture receipts.

## Why Xero? Let's Start With the Pros

- **Cloud-based:** you can access Xero from anywhere with an internet connection.
- **Simple invoicing:** creating and sending invoices is a breeze. You can customise invoices, automatically send reminders, and even allow clients to pay directly through the invoice.
- **Real-time collaboration:** you can invite your accountant or team members to collaborate on your Xero account, with multiple users working together in real time.
- **Bank reconciliation:** Xero automatically imports transactions from your bank, allowing you to quickly reconcile your accounts.
- **Detailed financial reporting:** Xero offers a variety of reports, including profit and loss, balance sheet, and cash flow reports.
- **Add-ons and integrations:** Xero integrates with over 800 apps, whether you need payment processing, inventory management, or time tracking.

## But, What About the Cons?

- **Pricing:** Xero is subscription-based, and the price can vary depending on which plan you choose. Costs can add up over time, especially if you need to upgrade for features like multi-currency or multiple users.
- **Learning curve:** while Xero is relatively intuitive, there can still be a learning curve when you first start.
- **Limited payroll features:** Xero's payroll feature is solid but may not be as advanced as specialised payroll software like QuickBooks Payroll or Sage Payroll.
- **Lack of phone support:** while Xero offers email and chat support, there's no dedicated phone support — though the knowledge base and community forums are quite helpful.

## Raising Invoices in Xero — Get Paid Faster, Stress Less

- **Create professional invoices:** create customised invoices that reflect your brand, adding your logo or tailoring the payment terms.
- **Set up recurring invoices:** ideal for subscription-based businesses or regular clients — invoices are automatically sent on a schedule.
- **Automate payment reminders:** set up automatic reminders for overdue invoices, choosing how many to send and how often.
- **Track payments:** easily track the status of your invoices — you'll know when an invoice has been sent, viewed, and paid.

## Capturing Receipts with Hubdoc — The Secret Weapon

Hubdoc is an add-on for Xero that allows you to easily capture receipts, bills, and statements:

- **Snap a photo:** take a photo of your receipt with the Hubdoc app on your phone. The app automatically extracts the data, such as the vendor, amount, and date.

- Automatically upload to Xero: Hubdoc then uploads the receipt to Xero, attaching it to the corresponding transaction for easy record-keeping.
- Automatic document fetching: Hubdoc can even fetch bills and statements directly from suppliers like banks, utilities, and insurance companies.

## Profit & Loss, Balance Sheet and Corporation Tax

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Your company is officially up and running. Now comes the part where you get down to the nitty-gritty of accounting. Understanding your Profit & Loss (P&L), Balance Sheet, and Corporation Tax doesn't have to be complicated — let's break it all down.

### Step 1: Profit & Loss — The Story of Your Income and Expenses

The Profit & Loss (P&L) statement, also known as an Income Statement, shows the performance of your company over a specific period — usually a year. What goes into it:

- **Income:** the money you earned from selling products or services — the revenue your business generates.
- **Expenses:** the costs of running your business, including rent, employee wages, supplies, and other necessary costs.
- **Gross Profit:** calculated as  $\text{Income} - \text{Cost of Goods Sold (COGS)}$ . It shows how much money you're making from your core business activities before factoring in other expenses.
- **Net Profit:** the final number after all expenses (including operational costs and tax) have been subtracted from income ( $\text{Net Profit} = \text{Income} - \text{Total Expenses}$ ).

### Allowable vs. Disallowed Costs in a Limited Company

Some costs will reduce your taxable profits, and others won't. Allowable expenses help you grow your business and keep your tax bill down; disallowed expenses don't benefit your company directly, so you can't claim them for tax purposes.

#### Allowable Expenses — The Good Guys

- **Business Premises Costs:** rent on leased office or business space is fully deductible, as are utilities (gas, electricity, water, internet, and phone) directly related to your business.
- **Employee Costs:** salaries and wages (including your own as a director), employer National Insurance contributions, and company pension contributions are allowable.
- **Office Supplies and Equipment:** stationery is claimable; for computers, laptops, and office furniture you may be able to claim capital allowances.
- **Travel and Vehicle Expenses:** business travel (trains, flights, hotel stays, and meals on business trips) is allowable. For business vehicles, you can claim running costs such as fuel, maintenance, insurance, and road tax — apportioned for business versus personal use.
- **Marketing and Advertising:** online ads, printed brochures, and website costs are allowable.
- **Professional Fees:** accountancy and legal fees related to running your business are allowable.
- **Bad Debts:** if a customer doesn't pay, you can write off those amounts as bad debt, provided you've taken reasonable steps to collect payment.

## Disallowed Expenses — The No-Gos

- **Personal Expenses:** you can't claim expenses related to your personal lifestyle, such as clothing, groceries, or haircuts.
- **Home Office (Mixed Use):** if you work from home but use the same space for personal use, you may only claim a portion of your utility bills, rent, or mortgage. **CAUTION:** be mindful that if you claim too much you could jeopardise your private residence relief if and when you sell your personal home. You can use the HMRC £6 a week for ease.
- **Fines and Penalties:** traffic fines and late filing penalties are not deductible.
- **Entertaining Clients:** business-related meals and entertainment are generally not allowable.
- **Capital Expenditure:** the initial cost of buying property or significant long-term assets is not deductible as an expense, though it can be claimed through capital allowances over time.
- **Loan Interest (Personal Loans):** only interest on business loans is allowable, not interest on personal loans.
- **Owner's Drawings:** money you take out of the company as drawings isn't an expense — you'll be taxed on it separately through the dividend or salary route (see the Director's Loan Account).

## Step 2: The Balance Sheet — The Full Financial Picture

The Balance Sheet is a snapshot of your company's financial position at a specific moment in time. Unlike the P&L, which shows how your company performed over a period, the Balance Sheet shows what your company owns and owes at a single point in time. Key components:

- **Assets** — what your company owns. Current Assets can be converted into cash or used within 12 months (cash, accounts receivable, inventory); Non-Current Assets provide long-term value (property, machinery, equipment).
- **Liabilities** — what your company owes. Current Liabilities are due within 12 months (accounts payable, short-term loans); Non-Current Liabilities are long-term debts (long-term loans, mortgages).
- **Equity** — the residual value after subtracting liabilities from assets. It represents the owner's stake (also referred to as shareholder equity).

**Balance Sheet equation: Assets = Liabilities + Equity. This equation always needs to balance — it's a quick way to check if your company is on solid financial ground.**

## Step 3: Corporation Tax — The Business Tax You Need to Know

Corporation Tax is the tax that your company has to pay on its profits. After deducting expenses and allowable deductions, the company is taxed on the remaining profit.

### How Corporation Tax works:

- **Rate:** the UK main rate of Corporation Tax for now is 25%. However, if you are classed as a small business with profits of £50,000 or less, the rate reduces to 19%. For profits between £50,000 and £250,000, Marginal Relief applies, giving an effective rate between 19% and 25%.
- **Taxable Profits:** your taxable profits are calculated after all expenses (like wages, rent, and business costs) have been deducted from your total income.

### How to calculate Corporation Tax:

For example, if your company has £100,000 in income and £40,000 in expenses, your taxable profit is £60,000 (£100,000 – £40,000). Then, with a 25% Corporation Tax rate, your tax bill will be £15,000 (£60,000 × 25%).

**When and how to pay:**

- When to pay: Corporation Tax is due 9 months and 1 day after the end of your accounting period. So if your accounting year ends on 31 March, your tax payment is due by 1 January of the following year.
- How to pay: you can pay your tax directly through the HMRC online portal using BACS, CHAPS, or Faster Payments.
- Filing the Corporation Tax return: you'll need to file your Corporation Tax return with HMRC within 12 months of the end of your accounting period.

**Illustrative Accounts — Company XYZ Ltd**

The following section shows a simplified but realistic set of accounts prepared under FRS 102 Section 1A — the UK financial reporting standard for small companies. These are fictitious figures for illustrative purposes only.

FRS 102 1A applies to companies that qualify as small under the Companies Act 2006 (broadly: turnover below £10.2m, balance sheet below £5.1m, fewer than 50 employees). Small companies are exempt from filing a full profit and loss account at Companies House, but must prepare one internally and submit it to HMRC with their Corporation Tax return.

**A note on FRS 105:**

If your company is a micro-entity — broadly, turnover below £632,000, balance sheet below £316,000 and fewer than 10 employees — you may be eligible to prepare even simpler accounts under FRS 105. FRS 105 removes the requirement for notes to the accounts and further reduces the disclosure burden. Speak to your accountant to confirm which standard applies to your company.

**Company XYZ Ltd — Profit and Loss Account**

*For the Year Ended 31 March 2026. Prepared under FRS 102 Section 1A — Small Companies Regime.*

<b>Profit and Loss Account</b>	<b>£</b>
Turnover	285,000
Cost of Sales	(112,000)
<b>Gross Profit</b>	<b>173,000</b>
Administrative Expenses	(118,450)
<b>Operating Profit</b>	<b>54,550</b>
Interest Receivable	320
Interest Payable	(1,200)
<b>Profit Before Taxation</b>	<b>53,670</b>
Corporation Tax	(13,418)
<b>Profit for the Financial Year</b>	<b>40,252</b>

## Company XYZ Ltd — Balance Sheet

As at 31 March 2026. Registered Number: 12345678. Prepared under FRS 102 Section 1A — Small Companies Regime.

Balance Sheet	£
<b>Fixed Assets</b>	<b>48,500</b>
Stock	9,200
Debtors	34,650
Cash at Bank	18,730
Creditors: Due Within One Year	(28,910)
<b>Net Current Assets</b>	<b>33,670</b>
Creditors: Due After One Year	(15,000)
<b>Net Assets</b>	<b>67,170</b>
Share Capital	100
Profit and Loss Reserve	67,070
<b>Shareholders' Funds</b>	<b>67,170</b>

These financial statements have been prepared in accordance with the provisions applicable to companies subject to the small companies regime and in accordance with FRS 102 Section 1A.

For the year ended 31 March 2026 the company was entitled to exemption from audit under section 477 of the Companies Act 2006. The members have not required the company to obtain an audit of its accounts for the year in question in accordance with section 476 of the Companies Act 2006.

The directors acknowledge their responsibilities for complying with the requirements of the Act with respect to accounting records and the preparation of accounts. Approved by the board and signed on its behalf by: Director: J. Smith.

## What the Figures Are Made Up Of — Company XYZ Ltd

The following plain-English explanations walk through each line of the Profit and Loss Account and Balance Sheet so you can see exactly what is behind the numbers.

### Profit and Loss — What Makes Up Each Figure

#### Turnover — £285,000

This is the total income invoiced to customers during the year before any costs are deducted. For Company XYZ Ltd this is made up of two income streams: consultancy fees billed to clients (£245,000) and software licences and ongoing support contracts (£40,000). Turnover is always shown excluding VAT. If your business is VAT registered, you collect VAT on behalf of HMRC — it is never your money and never appears in your accounts as income.

#### Cost of Sales — £112,000

These are the direct costs that relate specifically to delivering the work — the costs that go up and down directly with your income. For a consultancy this includes freelance contractors brought in to deliver client projects (£78,000), software and tools purchased specifically to fulfil contracts (£21,000), and direct travel costs incurred on client work (£13,000). If you run a product-based business, cost of sales would include raw materials, packaging and direct labour on the production line.

**Gross Profit — £173,000**

This is turnover minus cost of sales. It tells you how much money the business makes from its core activity before the running costs of the business are taken into account. The gross profit margin here is  $£173,000 \div £285,000 = 60.7\%$ .

**Administrative Expenses — £118,450**

These are the overhead costs of running the business — the costs you incur whether you win a new client or not. The main items for Company XYZ Ltd are:

- Directors' salary (J. Smith, taken through payroll): £45,000.
- Staff wages for two part-time employees: £32,500.
- Employer's National Insurance on the above: £8,750.
- Office rent and business rates: £12,000.
- Utilities — electricity, broadband, phone: £2,400.
- Business insurance (professional indemnity, public liability): £1,800.
- Motor expenses — fuel and servicing for the company vehicle: £3,200.
- Depreciation on fixed assets: £5,500.
- Accountancy and professional fees: £3,500.
- Advertising and website costs: £2,100.
- Office sundries: £700.

**Operating Profit — £54,550**

This is what the business earned from its trading activity after all costs but before interest and tax. It is the best measure of how well the business is performing day to day. The operating profit margin here is  $£54,550 \div £285,000 = 19.1\%$ .

**Interest Receivable — £320**

Interest earned on the company's business bank account during the year.

**Interest Payable — £1,200**

Interest charged by the bank on the company's loan. The loan carries an interest rate of 5.5% per annum on the outstanding balance.

**Profit Before Taxation — £53,670**

The total profit after all income and costs, but before the Corporation Tax charge is applied.

**Corporation Tax — £13,418**

Corporation Tax is charged on the taxable profit of the company at 25% for the year ended 31 March 2026. The tax is due to HMRC 9 months and 1 day after the year-end — in this case by 1 January 2027. Note that the taxable profit used for the Corporation Tax calculation may differ slightly from the accounting profit, as some costs (such as depreciation) are disallowable for tax purposes and are replaced by capital allowances.

**Note on Marginal Relief:** A note on Marginal Relief: In this illustrative example, Corporation Tax has been calculated at the flat 25% main rate for simplicity. However, if your company's taxable profits fall between £50,000 and £250,000, you may be entitled to Marginal Relief, which reduces your effective tax rate to somewhere between 19% and 25%. The further your profits are below £250,000, the closer your effective rate moves towards 19%. Marginal Relief is calculated using a specific HMRC formula and is applied automatically when you or your accountant files your Corporation Tax return. Companies with profits of £50,000 or below pay the small profits rate of 19%, and those above £250,000 pay the full 25% main rate with no relief available. Always speak to your accountant to ensure the correct rate is applied to your company's position.

**Profit for the Financial Year — £40,252**

This is the bottom line — what the company kept after paying all costs and tax. The directors can choose to pay this out as dividends to shareholders, retain it in the business to fund growth, or a combination of both.

**Balance Sheet — What Makes Up Each Figure****Fixed Assets — £48,500**

Fixed assets are things the business owns and uses over a long period rather than buying and selling in the normal course of trade. They appear at cost less accumulated depreciation. Company XYZ Ltd has two categories: office equipment (net book value £10,000 — original cost £20,000 less £10,000 accumulated depreciation, on a 25% reducing balance basis) and a motor vehicle (net book value £38,500 — original cost £32,000, less depreciation, used for client visits). Depreciation is not a cash cost — it does not leave the bank account; it is an accounting adjustment to spread the cost of the asset over its useful life.

**Stock — £9,200**

The value of goods held by the company at the year-end that have been purchased but not yet used or sold. Stock is always valued at the lower of cost and net realisable value — you cannot show stock at more than you expect to sell it for.

**Debtors — £34,650**

Money owed to the company at the year-end, broken down as: trade debtors (invoices raised but not yet paid by clients) £28,150; other debtors £2,500; and prepayments and accrued income £4,000. Keeping debtors low and collecting invoices promptly is one of the most important things you can do for your cash flow.

**Cash at Bank — £18,730**

The balance held across the company's business bank accounts at 31 March 2026. Always keep this separate from your personal accounts.

**Creditors Due Within One Year — £28,910**

Money the company owes that must be paid within the next twelve months: trade creditors (supplier invoices received but not yet paid) £8,200; Corporation Tax payable to HMRC £13,418; PAYE and National Insurance due to HMRC £3,292; and accruals (costs incurred but not yet invoiced by the supplier) £4,000.

**Net Current Assets — £33,670**

Current assets minus current liabilities. This is your working capital — the amount of liquid resource the business has available day to day. A positive figure means the business can comfortably meet its short-term obligations.

**Creditors Due After One Year — £15,000**

The remaining balance on the company's bank loan, which is not due for repayment within the next twelve months. The loan is repayable by 2028 at £5,000 per year.

**Net Assets — £67,170**

The total value of everything the company owns minus everything it owes. This is what belongs to the shareholders.

**Share Capital — £100**

The original investment made by the shareholders when the company was incorporated. Company XYZ Ltd has 100 ordinary shares of £1 each — a standard structure for a small owner-managed company.

**Profit and Loss Reserve — £67,070**

The accumulated profits retained in the business since it was incorporated, after dividends paid out to shareholders. This is not cash — it is the total of all the profits that have been left in the business over the years.

**Shareholders' Funds — £67,170**

Share capital plus retained profits. This is the book value of the owners' stake in the business. As the business grows and retains more profit, this figure increases.

**The key things to remember:**

- Your Profit and Loss Account shows how the business performed over the year — income in, costs out, and what's left.
- Your Balance Sheet shows a snapshot of what the company owns and owes on a specific date.
- The notes explain the numbers in detail and are a required part of the accounts.
- As a small company under FRS 102 1A, you can file an abridged balance sheet at Companies House — but you must always send the full accounts including the P&L to HMRC.

If any of this feels complex, that is completely normal. This is exactly the kind of work a good accountant handles for you — and exactly why Start Sharp are here to help.

## Thank You — and Welcome to the Start Sharp Academy

You have reached the end of Set Up for Success — and what a journey it has been. From understanding the difference between a sole trader and a limited company, through to Corporation Tax, FRS 102 accounts and Making Tax Digital, you now have a solid foundation to build your business the right way.

But this book is just the beginning. The UK tax system does not stand still — rates change, allowances shift, and new obligations like Making Tax Digital are being introduced every year. That is exactly why we built the Start Sharp Academy — a members-only community run by UK Chartered Certified Accountants, designed to give you everything you need to stay compliant, save tax and grow with confidence.

### What You Get as a Start Sharp Academy Member

- Templates and tools — Self Assessment checklists, expense trackers, dividend vouchers, board minutes, cash flow planners, MTD quarterly records and more — all downloadable and ready to use.
- Live Q&A sessions — monthly sessions with our qualified accountants where you bring your real questions and get straight answers, no jargon.
- Members-only website — packed with guides, calculators and worked examples updated in line with every HMRC change.
- Priority support — email us at [support@startsharp.co.uk](mailto:support@startsharp.co.uk) and Academy members go straight to the front of the queue.
- A community — connect with fellow founders, side hustlers and directors who are navigating the same journey as you.

### How to Join

The Academy is launching soon and founding member places are limited. If you have read this book, you are exactly who the Academy is built for. Register your interest right now by emailing [support@startsharp.co.uk](mailto:support@startsharp.co.uk) with the subject line ACADEMY, and we will make sure you are first through the door with founding member pricing. Find us online at [www.startsharp.co.uk](http://www.startsharp.co.uk).

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## A Final Word

Starting a business is one of the most exciting — and daunting — things you will ever do. The financial side does not have to be the part that holds you back. With the right knowledge, the right tools, and the right people in your corner, you can build something you are genuinely proud of.

We are rooting for you.

### The Start Sharp Team

*UK Chartered Certified Accountants*

[support@startsharp.co.uk](mailto:support@startsharp.co.uk) · [www.startsharp.co.uk](http://www.startsharp.co.uk)

# Sole Trader Checklist

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Use this checklist when setting up and running as a sole trader.

## Registration & Setup

- Register as self-employed with HMRC by 5 October after your first trading year
- Set up a Government Gateway account
- Note your Unique Taxpayer Reference (UTR) and store it securely
- Open a dedicated business bank account
- Register for VAT if annual turnover exceeds £90,000

## Record Keeping

- Keep records of all income and invoices
- Keep receipts for all business expenses
- Set up accounting software (e.g. Xero, QuickBooks or FreeAgent)
- Sign up for Making Tax Digital if qualifying income exceeds £50,000

## Tax & National Insurance

- File your Self Assessment tax return by 31 January each year
- Pay income tax and Class 4 NICs by 31 January
- Make payments on account if required (31 January and 31 July)
- Consider voluntary Class 2 NICs (£3.65/week) to protect your State Pension

## Ongoing

- Review allowable expenses annually
- Keep Making Tax Digital submissions up to date
- Review structure annually — should you incorporate?

# Limited Company Checklist

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Use this checklist when setting up and running your limited company.

## Incorporation & Setup

- Incorporate your company at Companies House
- Note your Company Registration Number (CRN)
- Set up a Government Gateway account for the company
- Register for Corporation Tax within 3 months of starting to trade
- Open a business bank account in the company name
- Register for VAT if annual turnover exceeds £90,000

## Directors & Shareholders

- Understand your responsibilities as a director
- Set up and maintain the Director's Loan Account
- Issue share certificates to all shareholders
- Prepare board minutes for all key decisions

## Payroll & Pay

- Set up PAYE payroll for your director's salary
- Register as an employer with HMRC
- Submit Real Time Information (RTI) to HMRC each month
- Pay dividends with dividend vouchers

## Annual Compliance

- File annual accounts with Companies House within 9 months
- File Corporation Tax return with HMRC within 12 months
- Pay Corporation Tax within 9 months and 1 day of year-end
- File Confirmation Statement with Companies House annually