

Institution **CIOT - ATT-CTA**

Course **CTA APS VAT and Other Indirect Tax**

Answer-to-Question-\_1\_

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Dear Debbie

The Wychwood proposal

Further to your letter dated 3 May 2022, I have addressed the queries identified by you below.

1. Scope of the advice

In accordance with our engagement letter, this letter will over:

- The tax and VAT treatment on the Wychwood proposal for you.
- The two options of work arrangement with Merle with tax consequence and our recommendation.

- The different options with working with Joanne going forward and the legal set up.

This advice has been prepared according to the information that provided by you dated on 3rd May 2022 and the letter from David Blacklock dated on 25 April 2022. If any informationn has been misunderstood, please do let us know as it may affect the advice. We have prepared our advice soley for the benefit for you, as such, its contents may not be disclosed to a third party without our prior written consent.

## 2. Executive Summary

The business proposal is a 15 year commerical lease with 2 year rent free, as there is no premium on the lease. You will not need to pay Stamp Duty land Tax.

It is important to set up the legal contract with Curabimus to avoid the agent argument.

The contribution made by Curabimus is outside the scope as there is nothing in return. You will be able to deduct the fitting cost by using capital allowance subject capital cost only.

We would recommend to have a contract with Merle to confirm that she will be come a self employed stylist. The salon will offer a

chair subject to chair rent. As such, this will reduce the salon income that it will slow down the income build up to the VAT registration threshold.

Merle will be an self employed person, there are also less administration work for you such as set up a PAYE scheme etc.

You will be charging Merle a chair rent, which is subject to VAT at 20% when you are VAT registered.

To above business disaggregation by HMRC, we suggest to set up a business with Joanne from the begin.

There are two options for getting Joanne involved into the business, partnership and company. However, partnership is still taxed similar to sole trader. Sole trader will have to pay for class 2 and 4 NIC, as such we would suggest to set up the company on a low salary and high dividen income structure. As listed in Appendix B, this would save £4179 cash left for a company compare to sole trader.

However, we have listed both legal requirement for partnership and company for you in the below advice.

Since both you and Joanne estimate the sales to increase by 50% in the new salon. Bsed on this projection, the profit will go over 85,000 soon in 2023, you should consider the VAT

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registration. There are two VAT registration test, one is the historical test and one the future test.

We will not suggest to register VAT voluntarily now, because you are dealing with public and including 20% on the price will reduce your competitiveness.

Once you are VAT registered, you will need to be Making Tax Digital required, however this can be achieved by using softwares such as Xero or SAGE.

You can also choose to use flat rate scheme that hairdressing and beauty related work is taxed at 13%, and you will be have 1% deduction for the first year i.e. 12%. This may be a advantage. However, you will not be able to deduct any input tax except capital spendings over £2000.

Once you are VAT registered, any goods sold by the salon should also include VAT as each rate.

### 3. Business proposal for Wychwood:

#### 3.1 The lease on the property:

The business proposal is for you to take a 15 years lease of the personal care suite. Since there is no premium on the lease agreement, there will be no Stamp Duty Land tax (SDLT) payable.

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Although David confirmed that the development company will contribute £15,000 towards the fit-out cost, as there is nothing in return, we would not consider that this is a barter transaction. As such, this contribution is outside the scope of VAT.

### 3.2 The Cost of using the personal care suite:

For the fit-out cost in the personal care suite, you should consider whether the fit out is related to the revenue element or the capital element, for example, if it is to buy and install a new sink for the hair salon. Then this is capital cost as a sink is capital item and you will be able to reclaim capital allowance on such cost. However, if it is for decoration, then it will not be classified as capital allowance.

This capital allowance will be deductible from your profit in order to reduce the tax charge. We will discuss this further in the below sections.

As David has confirmed in his letter that they have exercised the option to tax on Wychwood, which means you will have to pay VAT on the rent and the service charge. Normally, the rent is exempt from VAT, however, if the landlord opted to tax the property, it will change the property from exempt to taxable (20%). As such you will effectively be paying £7200 (VAT inclusive) annually on the rent and the service charge. The VAT element is  $20\% * (£5500 +$

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£500)=£1,200. You will not be able to deduct this unless you become VAT registered, which we will also cover in the below section.

### 3.3 Legal arrangement:

We understand that you will not be working in the hari saloon full time once you take the lease. You and Curabimus plc will also not be in any kind of agent agreement. However, as Curabinmus plc want you to giving booking priority to their residents in the care home, we would recommend you to confirm this clause is written in the contract as this is a common issue for indenpent hairdresser. HMRC would check on the employment status to confirm that whether they are acting for a firm or themselves as a sole trader.

If you stay as a sole trader, then the main legal issue is that are you a employees of Curabinmus and providing services to their resident or you are providing the service directly.

As such, the legal agreement is important to include this point that they are not a agent and you have control over the salon.

This may not be an issue if you form a partnership or company with Joanne later.

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#### 4. Arrangement for Merle as self-employed or employee:

We understand that there are two hairdressing chairs in the salon and you wish to let Merle to use the second chair. There are two options for you to provide this chair to Merle that you could hire her as an employee of your salon, or you can rent the chair to you on the basis that she is acting as a sole trader.

##### 4.1 Hire Merle as an employee and the tax treatment:

You can hire Merle as an employee in the hair salon, that means Merle is providing hairdressing service to you, and the service is provided from the salon to the customers. Therefore, the salon will need to declare the output tax on the gross value. The salary you paid to Merle is outside the scope. Before you get VAT registration done, this total amount paid by the customer will count towards your VAT registration threshold £85,000p.a currently.

##### 4.2 Self- employed and tax treatment:

If you rent the chair to Merle, the chair rent is subject to VAT at 20% once you become VAT registered. Merle will be a self employed contractor that supply her services to the salon, the salon then need to account for the output tax on gross takings. However, only the money paid by the salon to Merle is the consideration for a supply of service.



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If Merle is providing the service directly to the customer i.e. only rent the chair in the salon. Then Merle will have to account for the supply to the customer herself and if it is exceeding £85,000, then she will need to be VAT registered. If she sells products in the salon, the money will be passed back to the salon, than it is consideration for products by the salon. However, this should detailed in contract.

#### 4.3 The tax and VAT treatment difference:

From VAT and Tax prespective, we would recommende to set up an contract with Merle and let she become an self employed stylists in the salon. This will have signifigent VAT advantages if Merle contract with the customer directly. As such the hairdressing service income will then belong to Merle instead of going towards your business income (which will count toward VAT registration threshold).

As it is unlikely for Merle to have annual income over £85,000, she will be unregistered and have no VAT on her cutting.

In this arrangement, Merle should only pay for her chair rent to you.

This will also have a great VAT and Tax saving advantage as you also do not need to pay national insurance for Merle. This

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include employer NIC and auto pension. We have included a project calculation in Appendix A to show that how much cash will left if you hire her as an employee. Based on the assumption of her annual salary is £20,000, higher than her current wage. So you will have to pay auto pension at £4128 and employer NIC £988.

#### 4.4 The Chair rent and HMRC

The chair rent is a special defination in salon that when salon offers a space to self employed stylists. This supply will be taxable subject to the VAT regisration status.

But this does not include the provision of utilities such as water, gas, and electricity or cleaning charge etc.

#### 4.5 The legal contract with Merle:

It is important to set up the legal contract right with Merle to avoid disput with HMRC as employment status is a common issue.

You should include the below consideration in the contract to evidence that Merle is an self-employed stylist:

-She is only earning when working and she is in control of her own hours

-When customers are booking an appointment, they should be aware that they are booking with Merle in the future rather than with

the salon

-The customers are aware of Merle is self employed by communication

-Merle should provide her own tools such as scissors, clippers etc.

-The written contract include the terms of Merle being self employed.

-It also include the term that Merle is providing service directly to the customer rather than to the salon.

-The price for the chair rent

#### 4.6 Recommendation:

Based on above, we would recommend to have a contract with Merle to confirm that she will be come a self employed stylist. The salon will offer a chair subject to chair rent.

As such, this will reduce the salon income that it will slow down the income build up to the VAT registration threshold. You will also take more money back home. She Merle will an self employed person, there are also less administration work for you such as set up a PAYE (pay as you earn) scheme etc.

#### 5. Arrangement with Joanne:

##### 5.1 Business disaggregation

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We understand that Joanne is also a sole trader at the moment and wish to run the business with you and take the beauty place. However, there is an anti avoidance measure there to prevent from a business split into two artificially in order to avoid VAT registration. This is called business disaggregation and HMRC challenge often on small and connected businesses.

There are some key elements to consider this including financial links: financially support each other. Common financial interest in the proceeds of the business.

economic links: Seeking to realise the same economic objectives. Supplying to the same circle of customers.

organization links: using the same employee, same equipment and common management.

Considering that the salon and the beauty shop is connected in the suite and you and Joanne both had interest in working together. It will also be providing service to the residents and there are common objectives for the business to grow. As such, It is likely that HMRC would consider these two businesses are one.

We would recommend to set up a partnership or a company from the beginning to avoid this dispute with HMRC.

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## 5.2 Set up a partnership

To set up a partnership between you and Joanne could make this arrangement work. Partnership is a relationship between two or more person that carring the business together with a view to make profit. However, this is similar to sole trader that all partner will be joint and severally liable for any VAT due and potential liabilities.

The tax calculation is also similar to sole trader, that just to work out the total profit and then allocate profits between partners. Then each partner will be taxed as they were individual traders. I trust that both you and Joanna will be familiar with this.

Therefore, It is important to have a partnership agreement that including the profit shares for you and Joanne. It should include the respective rights and obligations. Also should open a new bank account for the partnership.

As I mentioned above that partnership also has personal liabilities unless you regiter as a limited liability partnership (LLP). That means the liability to the partnership is limited, and you will not need to use personal assets or money to for debt created by the partnership

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You must register your partnership for self assessment with HMRC if you are the 'nominated partnership'. That means you are responsible for sending the partnership tax return. Joanne will need to register separately and both you and Joanne need to send your own tax returns. You will have to register by 5 October in your businesses second tax year otherwise you will be charged a penalty.

You can also register the partnership by using form SA400 or SA401.

However, based on the figure and the estimation by you that your turnover increase by 50% i.e. in 2023 you will be making £79,176 (£52784\*1.5). Under this figure, even including the consideration of reducing expenses, you still will be paying for individual tax at 20% and 40%. Therefore, we would recommend to set up a company.

### 5.3 Form a company:

It would be recommended to set up a company instead of a partnership as the corporation tax is 19% which is lower than the personal tax and you will be able to use more capital allowance to deduct the trading profit (subject to super deduction).

To set up a company, you will need to notify HMRC (Company house) of the chargeability to tax within 3 months from the start of the

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year. Corporation tax will be payable at 19% by the company on trading profits. You can do this process by yourself and it is less than £50.

You will need to complete company accounts and comply with the companies act, however the benefits of having a company is significantly outweigh continuing trading as a sole trader.

The corporation tax need to be paid on 9 months and 1 day after the end of your accounting period. The accounting period is usually your financial year by using CT600 form.

#### 5.4 legal issues

There are more legal issues than a partnership, as the company will need to file a confirmation statement each year, which is also call as annual return. As you and Joanne will be director of the company, so the obligations will be your and her. As a small company, there will be no audit requirement to do. As it is a limited company, only the company is liable for any debets of the business, therefore, you and Joanne's personal assets will not be affected.

#### 5.5. Capital allowance advantages

As we mentioned in the first section of this advice, certain part of the fitting cost will be the capital to the business. As such it will be deducible as capital allowance.

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Company has super deduction and first year allowance for new plant and machinery that is purchased between 1.4.21-31.3.23. This is 130% of the amount spent for asset that sit in the general pool.

For certain fittings such as a fire door, it will be classified as integral features, and it will be in the special rate pool for 6% deduction. The super deduction for this is 50%.

However, you will have 100% annual investment allowance subject to 1 million available to your. Therefore, we would the total £20,000 will be fully deductible (subject to the details of the fitting cost as there will be labor and other service cost which will not be included).

#### 5.6 The tax advantage of form a company:

Sole trader will have to pay for class 2 and 4 national insurance contribution (NIC) , however, we would suggest to set up the company and you and Joanne will only have low salary at £8840 to avoid the employer NIC. This is often call a low salary and high dividen income structure. Based on the project that Joanne will be making 50% extra as well. Therefore, we have set up a table in Appendix B to compare the cash difference for a sole trader or a company. Which showed that there is There are £4179 cash left for a company compare to sole trader.



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There is no PAYE or NIC payable on dividend income. The first £2000 dividend income is free not taxable, and then you will pay 7.5% on dividend in the basic rate band, and then 32.5% on the high rate bank and 38.1% on the additional rate band (you can see this in Appendix B).

Extracting funds by this method is much cheaper for the director (you and Joanne) than drawing fund by a salary.

In addition, as a director you will be payable on NIC on the salary and bonus under Class 1 primary at 12% between £9568 and £50270 pa, and 2% thereafter. However, employers secondary class 1 nic at 13.8% must also be paid to HMRC whenever a salary is above £8840. Because of this, we would suggest to set up the salary at the level of £8840 and this is also cheaper compare to sole trader from NIC perspective.

## 6. VAT registration requirements

As the projection of profit will go over 85,000, you should consider the VAT registration. There are two VAT registration test, one is the historial test and one the future test.

The historial test is based on the past 12 rolling months, and if the income has gone over £85,000. The future test is that whether you will be over £85,000 in the next 30 days.

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As there will not be any big income, we would recommend you to use the historic test and if at any calendar month your turnover for the past 12 months has exceeded £85,000 then you will be to register for VAT.

When you are registered, you will need to include a 20% VAT on the price to your customers. Otherwise, this will be a cost to you if you remain the price. This may become any adverse effect to your business.

You will be charging Merle a chair rent as mentioned in the above, which is subject to VAT at 20% when you are VAT registered.

However, when you are become register you will be able to recover any input VAT incur on the cost, such as the VAT on the rent, equipment, clothing and laundry. Or any goods. As long as you register within for years of the trade and you still have the goods on hand which is used for the trade.

You will also be able to recover VAT on the ongoing cost such as advertings, telephone and accountancy fees.

You will also be able to recover service related to the ongoing busines within 6 month before VAT registrtaion. However, you have need to obtain the invoice.

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In the meantime, you can register for VAT voluntarily, however, as you are providing service to public and there is a 2 year rent free period that there will not be VAT incurred on rent for 2 years. We would recommend you not to register VAT unless you have exceeded the threshold.

#### 6.1. Making Tax Digital (MTD)

Once you are VAT registered, it is mandatory to use MTD now by HMRC. This will involve keeping your accounting records on functional compatible software. The software must be application program interface enabled therefore you can submit return online directly to HMRC.

VAT return will be submitted quarterly. The software must be used to record each sales and purchase invoice, that you can set up the till system linked to this software. There are many softwares to choose on the market and they are not expensive to use, such as Xero, or SAGE.

MTD is also good for management accounting and you can keep track of profit and loss account.

For the sales or purchase invoice, you will have to include the time of the supply, the value of the supply, the VAT rate or the input VAT.

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HMRC also offers relaxations on employee expenses and petty cash for MTD that it can effectively treat the summary of the statement as one invoice.

Please notice that if you fail to register on time, there will be a penalty. If it is deliberate and concerted failure, the penalty will be 100%.

## 6.2 Flat rate scheme

In the meantime, you can use Flat rate scheme (FRS), it is 13% for hairdressing or other beauty treatment services, in the first year, there is 1% deduction. So you will be paying 12% VAT in the first year and 13% onwards.

You can register for FRS as if you do not expect to have sales exceed £150,000

FRS is calculated including all her taxable supplies excluding non-business income.

However, you will not be able to claim input tax such as the VAT on the rent. Although a single purchase of capital goods with a total VAT inclusive value of £2000 or more is entitled to full recovery.

For both FRS or normal VAT, you will have to keep the accounting

and VAT records for 6 years.

#### 7. Selling hair products.

We understand that you also sell goods in the salon, as those are also sales. Those income will also be included. However, if you start importing goods from overseas, then the VAT treatment will be different, for example, you will have to pay for the import VAT and import duty on the goods. As you will be VAT registered, the import VAT can be deferred by using postponed VAT accounting defer to the next VAT return (but you can deduct in full as input VAT as it will be related to the taxable sales), so it will not be a cost to you.

Once you are VAT registered, you will also need to include VAT i.e. 20% on those goods.

We trust that the advice provided within this letter is clear, however, if you do have any more issues, please feel free to contact us.

Your Sincerely

Derya Tarhan

Appendix A: Projection of total turnover assume it is VAT registered

	Employee		
Turnover	100,000		
VAT	16667		
total	83,333		
Fixed cost	30,000		
Merle salary	20,000		
Employer NIC: (20,000-4000-8840)*13.8%	988		
Auto pension: (20,000-7240)*3%	4128		
Cash left	28217		

Appendix B  
 Debbie 2023 profit:  $38379 \times 1.5 = 57,568$   
 Joanne 2022 profit:  $22050 \times 1.5 = 33075$   
 Total: 90643

	Sole trader				
profit	90643				
Income tax					
Personal allowance	-12570				
Left	78073				
0-37700 @20%	8074				
37701-15,000 @40%	16149				
Total	24223.8				

Class 2 nic					
3.05pw	159				
Class 4 NIC					
9569-50270 @9%	3663				
50270 @2%	807				
Total	4471				
Cash left	61790				

Company:

Total trading profit	90643		
Salary	-8840		
Left	81803		
CT @19%	15543		
Dividen	66260		
Personal allowance	3730		
Dividen allowance	-2000		
Sub total	60630		
0-37,000 @7.5%	1712		
37701-150,000 @32.5%	7420		
Subtotal	9132		
Cash left	65968		

There are £4179 cash left for a company compare to sole trader.