

NOTES AND GUIDANCE

TRADING IN BUSINESS

Before you make a business plan or look for finance for your business, you should decide how you're going to operate. The options are:

SOLE TRADER (also referred to as the **PROPRIETOR**)
PARTNERSHIPS
LIMITED COMPANIES

Let's look at what each of these options offers.

SOLE TRADER (SELF EMPLOYED)

This just means being your own boss, and making your own decisions about how you organise your business. You will have to keep accounts and pay your own tax and national insurance (NI) contributions; this is different from the PAYE system which applies if you work for someone else, where tax and NI are taken out of your wages before you get them. You should notify your local tax office as soon as you start trading, or, if you have an accountant, get them to do it for you.

You might indicate on business stationery that you are the proprietor or sole trader, and you should always check the legal requirements if you are trading from home or rented accommodation. (See Premises)

Things to consider about sole trading

As a sole trader you will be personally responsible for any business debts you run up, and if you are unable to pay your debts, creditors might be entitled to seize and sell your personal possessions - such as your car, house, furniture and musical equipment - to meet outstanding debts.

Remember that even as a sole trader, if you earn money by working with other people you could be considered a partnership in legal terms.

Working freelance

Freelance means working for yourself – in other words, being a sole trader.

However, many musicians and DJ's have another normal job as well as their music job, so they are a combination of things!

For their freelance work, they will have to prepare an annual tax return which declares their earnings. But if they have a normal daytime job working for someone else, the chances are that the tax relating to their work will be paid directly by the employer.

PARTNERSHIPS

Partnerships are set up every day in the music business. Musicians, DJs, producers, managers and many others perform together, record together and earn income together without any real thought that they are business partners. Many never understand the liabilities they may be held to. An example might be a group of musicians who work together on an amateur, semi-pro or professional basis. Any money they earn would be accountable for tax purposes and each member would be 'jointly and severally liable' for any debts.

A partnership has similarities to sole trading (in terms of the personal liability) and you should give think very carefully before trading in partnership with a person you do not know well.

➤ WORKBOOK 7 – COPYRIGHT, LEGAL AND MANAGEMENT – CHAPTER 4

LIMITED COMPANIES

The decision to form a limited company will depend on what business you have in mind and how you want to run it. Trading as a private limited company is totally different to trading as a partnership or on your own.

In a limited company, you become an employee of your own company. The company structure may include a Company Secretary, Directors and Shareholders, but it is only necessary to have either two directors or one director and one company secretary to set up a company.

The main legal benefit of a limited company is limited liability. For example, should a company fall into difficulties, creditors can only claim against that the company owns. The personal assets of its employees will be unaffected, unless a personal guarantee has been given by them.

For example, some lenders insist on 'personal guarantees' when financing a limited company with little or no trading history..

Limited companies can be formed with the help of an accountant, and a cost effective way is to buy a ready made company 'off the shelf'. This involves paying an agency a fee for the necessary documentation and proper registration of a business that has not yet traded, but is already formed.

Things to consider about limited companies:

The business will have to be registered with Companies House as a legal requirement
Annual returns will have to be made (updating information on the business itself)
Audited annual accounts will have to be made (only if the company is above a certain size)
A different method of calculating tax will apply (this will not have the same benefits as partnerships or sole-traders)
As an employee, you would pay tax as you earn (PAYE)
Shareholders and company directors will make most decisions about business matters.

If you form a limited company, the directors are employees and are taxed on a PAYE basis on any salaries or bonus paid to them. The company will pay corporation tax on its annual profits retained in the business after deducting capital allowances.

Take expert advice when considering the formation of a limited company. You can get plenty of information on this matter from local business links and books listed in the reading list.



Finding a company name
If you want to see if another limited company exists with the same name, search for it on www.companieshouse.gov.uk

You can also buy information about that company, such as details of their accounts and directors.

Liabilities

If you are running a business, you may be potentially liable for all sorts of things that you haven't even considered. For example :

You own a recording studio and a customer falls over a piece of equipment and breaks their leg – you could be threatened with legal action.

You've borrowed some equipment from a friend and it gets stolen – and you have no insurance.

You share your PA system with other bands at a gig and someone gets an electric shock due to a fault.

Even when you don't think you are acting formally, you can still be liable – you need to consider this.

NATIONAL INSURANCE, INCOME TAX AND VAT

NATIONAL INSURANCE

Self employed people pay two separate forms of National Insurance Contributions (NIC)

Class 2

Can be paid monthly by Direct Debit, or quarterly at a rate of £2.10 per week (2003-04) This covers basic state pension and other benefits, but not unemployment benefit. You can apply for exemption if your net earnings in a tax year are not expected to exceed £4095.

Class 4

contributions are calculated as a percentage of annual profits and are payable with income tax following the end of your financial year at the rate of 8% on business profits above £4615 up to £30940 (tax year 2003-04).

If you employ people you may need to deduct NIC and income tax from their gross wages under the PAYE scheme. You will also have to pay additional employers contributions. Contact your local Contributions Agency Office for further details.

INCOME TAX

Income Tax is payable on business profits before your drawings (wages) are taken out. You are allowed to deduct allowable business expenses, the current personal allowances and capital allowances set by the Inland Revenue.

Car expenses, telephone bills and other items that are partly used for business, and for private use, have to be apportioned (in other words, the costs need to be split between private and business use). The ratio can be agreed with your tax office. For details about current personal and capital allowances, contact your local tax office.

You will also need a copy of booklet CWL1 to let the Inland Revenue know you are starting your business.

VAT (Value Added Tax)

VAT registration is compulsory if your 'taxable supplies' exceed a certain figure (around £58,000 per annum) The rate at which you pay and charge VAT is currently set at 17.5% in the UK, although some supplies are zero rated.

You cannot reclaim any VAT you have paid on purchases or expenses unless you register for VAT.

Once you have registered, VAT must be charged (except on goods and services not subject to VAT) and paid quarterly to Customs and Excise less any VAT you have paid on business purchases and expenses in the same period.

Customs and Excise operate a couple of current schemes such as the flat fee scheme which offers a reduced VAT rate you would pay to them if your supplies are generally charged to others and your purchases are low.

For further information, contact your local Customs & Excise office.

Business Premises

Many businesses are actually run from home. The benefits include convenience and a saving on the cost of renting other premises. The down-side includes distractions in the home, the difficulty of switching off between business and your personal life, and the scope of being able to display your products.

Making a decision to move into commercial property needs thought and planning. You would have to sign a lease or rent agreement in most cases and would have to rely on enough business income to meet the payments.

Rent & Lease agreements

Commercial workspace is often let on the basis of a formal agreement. The contract will usually have a variety of conditions that range from repair clauses to annual rent increases. You should always consider the cost of good legal advice against costly disputes with a landlord!

It is worth researching and planning a budget with the help of an accountant, solicitor or professional adviser before making a commitment.

➤ For more on business premises, see
WORKBOOK 8 – BUSINESS AND MONEY
– CHAPTER 2

GENERAL TAX ISSUES

Tax laws are complicated and often the subject of review in terms of music industry income. It is advised that you employ an accountant or firm who specialise in music industry financial affairs, if you are generating revenues from music. The advice and service is vital when touring abroad or generating large sums of international income.

PAYE and SELF EMPLOYED

PAYE

This is called 'Pay as You Earn' (PAYE). Your employer deducts income tax and National Insurance at source and pays the Inland Revenue direct. You are left with the remainder. (If you formed a limited company, you would become an employee of your own company and pay yourself this way). This is called Schedule E tax code. Most people pay their tax this way.

SELF EMPLOYED

If you are registered as Self Employed, you receive the gross income and account to the Inland Revenue against profit and loss on income generated in a financial year (often running from April to April). In other words, you don't pay tax immediately on your income, you work out your profit and loss every year and pay your tax in big lumps to the Inland Revenue. This is called Schedule D tax code.

TIP

Save a reasonable reserve to pay tax bills that may arrive up to two years into your business start-point. There is a great tendency for musicians to spend income as it arrives in the belief that the next pay cheque is always around the corner. You will find many well know artists who are a testament to this very same comment, some are still working hard to pay tax debts a decade old!

FULL AND PART TIME

There is a huge difference between being an employee and being self employed. If you want to be a full time musician or DJ, then you generally have no option but to go self-employed. A lot of part time musicians, DJs and performers have regular day jobs, which they combine with music work in the evenings and weekends. In this case, they would pay tax through the PAYE system for their regular job, but they would have to declare the extra income in their tax return.

➤ See WORKBOOK 8 – BUSINESS AND MONEY – CHAPTER 2 (Preparing for Self Employment) for more information on this.

DEDUCTIONS AND ALLOWANCES

Allowances are the amounts you are allowed to earn before being taxed and are set by the government each budget. Expenses can be deducted from your overall profits before tax is calculated. These are items or services paid for (and receipts kept) without which you would not be able to carry out your work. A good accountant will advise you as to what constitutes a "deductible" expense, but the obvious include:

Travel and accommodation expenses relating to your work (hotels, trains, planes, van hires etc.)

Instrument maintenance (equipment servicing, spares, strings, and so on)

Telephone/fax/e-mail costs incurred when arranging work

Advertising and hire charges

Personnel hired for recordings and tours

Other services such as commissions, legal and accountancy charges.

Equipment purchase (including Instruments) and vehicles are classed as 'capital allowances' that can be carried over and used partially over several years if you wish.

National Insurance contributions are payable on a weekly stamp basis (see previous section on National Insurance). You are advised to pay the maximum contribution allowed as soon as possible.

KEEPING RECORDS

Keeping records of accounts can be as simple as a small book purchased in the high street with amounts received on the left hand side of a page and expenditures on the right hand side, together with an envelope or box containing payslips, bills and receipts filed by date.

You will need to keep records of all tour income and expenditure, so try to start the process as soon as possible.

➤ WORKBOOK 8 – BUSINESS AND MONEY – CHAPTER 5 for more information on book keeping and accounts.