The UK SME
Tax & Business Guide

A Beginner's Guide to UK Taxation for Small and Medium Enterprises

Covering the 2025/26 and 2026/27 Tax Years

Including all changes effective from April 2026

Published by

REINZA LIMITED

www.reinza.com | contact@reinza.com

First Edition – February 2026

This guide is for general information and training purposes only. It does not constitute professional tax advice. Always consult a qualified accountant or tax adviser for your specific circumstances.

About This Guide

This guide is written for anyone starting or running a small or medium-sized enterprise (SME) in the United Kingdom. Whether you are launching your first business, considering going self-employed, or already operating a limited company but unsure about the tax system, this guide will provide you with a solid foundation.

The UK tax system can seem complex, but the core principles are straightforward once you understand the basic structure. This guide takes you through that structure step by step, starting with fundamental concepts before moving on to specific taxes, rates, and rules.

What This Guide Covers

- The structure of the UK tax system and its key institutions
- How to choose the right business structure for your needs
- Income Tax, National Insurance, Corporation Tax, VAT, and Capital Gains Tax
- The PAYE system and employer obligations
- Making Tax Digital (MTD) – the new digital reporting requirements
- Allowable business expenses and record-keeping best practices
- Key filing dates and deadlines
- Legitimate tax planning strategies
- A complete timeline of upcoming policy changes through to 2029

How to Use This Guide

Throughout this guide, you will find colour-coded information boxes to help you navigate the material:

KEY CONCEPT: Key Concept

Blue boxes explain essential terminology and concepts in plain language. Every technical term is explained when it first appears.

PRACTICAL TIP

Green boxes contain practical tips to help you make better decisions and save money within the rules.

IMPORTANT WARNING

Red boxes highlight important warnings and common pitfalls to avoid.

WORKED EXAMPLE: Worked Example

Yellow boxes provide concrete calculations and scenarios using real numbers to illustrate how the rules work in practice.

All figures, rates, and thresholds are current as of February 2026 and include all confirmed changes taking effect from April 2026 (the 2026/27 tax year).

Contents

About This Guide 2
Contents 4
Chapter 1: The UK Tax System – An Overview 6
- 1.1 The Two Key Government Bodies 6
- 1.2 The UK Tax Year 6
- 1.3 Taxes That Affect UK Businesses 7
- 1.4 The Basic Logic of UK Taxation 7

Chapter 2: Choosing Your Business Structure 8
- 2.1 Sole Trader – The Simplest Way to Start 8
- 2.2 Limited Company – A Separate Legal Entity 9
- 2.3 Partnerships and LLPs 10
- 2.4 Which Structure Should You Choose? 11

Chapter 3: Income Tax 12
- 3.1 The Personal Allowance 12
- 3.2 Income Tax Rates and Bands 12
- 3.3 The £100,000 Personal Allowance Trap 12
- 3.4 Dividend Tax Rates 13

Chapter 4: National Insurance Contributions 14
- 4.1 What Is National Insurance? 14
- 4.2 Types of National Insurance 14

Chapter 5: The PAYE System and Employer Obligations 16
- 5.1 What Is PAYE? 16
- 5.2 Employer Responsibilities 16
- 5.3 Employer NI – Key Rates (2025/26 onwards) 16
- 5.4 National Minimum Wage and National Living Wage 17

Chapter 6: Corporation Tax 18
- 6.1 How Corporation Tax Works 18
- 6.2 Corporation Tax Rates 18
- 6.3 Extracting Profits from Your Company 18

Chapter 7: Value Added Tax (VAT) 20
- 7.1 What Is VAT? 20
- 7.2 When Must You Register for VAT? 20
- 7.3 VAT Rates 20
- 7.4 VAT Schemes for Small Businesses 21

Chapter 8: Capital Gains Tax (CGT) 22
- 8.1 What Is Capital Gains Tax? 22
- 8.2 CGT Rates (2025/26 and 2026/27) 22
- 8.3 Business Asset Disposal Relief (BADR) 22

Chapter 9: Making Tax Digital (MTD) 24
- 9.1 What Is MTD? 24
- 9.2 Who Is Affected? 24
- 9.3 Implementation Timeline 24
- 9.4 What Changes Under MTD? 24

Chapter 10: Allowable Expenses and Record-Keeping 26
- 10.1 Allowable Business Expenses 26
- 10.2 Working from Home 26
- 10.3 Essential Record-Keeping Rules 26

Chapter 11: Key Dates and Deadlines 28
- 11.1 Self Assessment (Sole Traders and Directors) 28

11.2 Limited Company Deadlines 28
11.3 Late Filing Penalties 28
Chapter 12: Legitimate Tax Planning Strategies 30
12.1 Use All Available Allowances 30
12.2 Pensions – One of the Most Powerful Tax Tools 30
12.3 Director Remuneration Optimisation 30
12.4 Year-End Tax Checklist 31
Chapter 13: Capital Allowances 32
13.1 Types of Capital Allowances 32
Chapter 14: Timeline of Upcoming Tax Changes 33
Appendix: Frequently Asked Questions 34

Chapter 1: The UK Tax System – An Overview

Before diving into specific taxes, it is essential to understand how the UK tax system is organised. Grasping the overall framework makes everything else much easier to follow.

1.1 The Two Key Government Bodies

KEY CONCEPT: HMRC – His Majesty's Revenue and Customs

HMRC is the UK's tax authority. It is responsible for collecting all taxes, including Income Tax, Corporation Tax, VAT, and National Insurance. If you run a business in the UK, HMRC will be the government body you interact with most frequently. Website: www.gov.uk/government/organisations/hm-revenue-customs

KEY CONCEPT: Companies House

Companies House is the registrar of companies in the UK. If you operate as a limited company, you must register with Companies House and file annual returns and accounts with them. It maintains a public register of all UK companies, which anyone can search. Website: www.gov.uk/government/organisations/companies-house

PRACTICAL TIP

If you operate as a sole trader, you only need to deal with HMRC. If you run a limited company, you must deal with both HMRC and Companies House.

1.2 The UK Tax Year

KEY CONCEPT: Tax Year (for individuals)

The UK personal tax year runs from 6 April to 5 April the following year. For example, the '2025/26 tax year' runs from 6 April 2025 to 5 April 2026. All personal tax allowances, thresholds, and rates are set on a tax year basis. This applies to Income Tax, National Insurance, and Capital Gains Tax for individuals.

KEY CONCEPT: Financial Year (for companies)

Corporation Tax uses a slightly different cycle: the financial year runs from 1 April to 31 March. So the '2026 Financial Year' is 1 April 2026 to 31 March 2027. However, a limited company can choose any accounting year-end date it wishes – it does not have to match either the tax year or the financial year.

Understanding these dates is important because all tax rate changes and new rules take effect at the start of a tax year or financial year. When this guide refers to 'April 2026 changes', it means changes taking effect from the start of the 2026/27 tax year (6 April 2026) or the 2026 financial year (1 April 2026).

1.3 Taxes That Affect UK Businesses

Depending on your business structure and size, you may encounter some or all of the following taxes:

Tax	Applies To	Brief Description
Income Tax	Individuals	Tax on personal income: salary, self-employment profits, rental income, savings, dividends
National Insurance (NI)	Individuals & employers	Contributions funding the State Pension and certain benefits; paid by employees, employers, and the self-employed
Corporation Tax	Limited companies	Tax on company profits (separate from the director's personal tax)
Value Added Tax (VAT)	VAT-registered businesses	A consumption tax charged on most goods and services; businesses collect it and remit it to HMRC
Dividend Tax	Shareholders	Income Tax charged on dividends received from a company, at special dividend rates
Capital Gains Tax (CGT)	Individuals	Tax on the profit when you sell or dispose of an asset that has increased in value

Not every tax will apply to you. The chapters that follow explain each one in detail and tell you when it becomes relevant.

1.4 The Basic Logic of UK Taxation

The fundamental calculation behind UK taxation follows this formula:

Income – Allowable Deductions = Taxable Income × Tax Rate = Tax Due

The UK operates a self-assessment system. This means HMRC does not calculate your tax for you. You (or your accountant) must work out how much tax you owe, file a tax return, and pay the correct amount by the deadline. If you get it wrong or file late, HMRC can charge penalties and interest.

> **KEY CONCEPT: Self Assessment**
> Self Assessment is the system through which individuals report their income and calculate their tax liability. It applies to the self-employed, company directors, landlords, and anyone with complex tax affairs. You must register for Self Assessment, file an annual tax return, and pay any tax owed by the statutory deadlines.

> **IMPORTANT WARNING**
> Self Assessment is not optional. If you are self-employed or a company director, you are legally required to register and file. Failure to do so can result in penalties, even if no tax is actually owed.

Chapter 2: Choosing Your Business Structure

This is one of the first and most important decisions you will make. Your business structure determines what taxes you pay, how much administration is required, and what legal protections you have.

2.1 Sole Trader – The Simplest Way to Start

KEY CONCEPT: Sole Trader (Self-Employed)

A sole trader is an individual running a business in their own name. There is no legal distinction between you and your business. Your business profits are your personal income, and your business debts are your personal debts. This is known as 'unlimited liability'.

How to Register

Registration is free and straightforward. You register with HMRC for Self Assessment online at www.gov.uk/register-for-self-assessment. You will receive a Unique Taxpayer Reference (UTR) number, which is your tax identification number. Total cost: £0.

IMPORTANT WARNING

You must register by 5 October following the tax year in which you started trading. For example, if you start trading in June 2026, you must register by 5 October 2026. Late registration may result in a penalty.

Taxes You Will Pay

- **Income Tax** – on your business profits (revenue minus allowable expenses)
- **Class 2 National Insurance** – a small weekly flat-rate contribution (£3.50/week in 2025/26)
- **Class 4 National Insurance** – a percentage of your profits
- **VAT** – only if your taxable turnover exceeds £90,000 (or if you register voluntarily)

Advantages

- Free and simple to set up
- Minimal administrative burden – no requirement to file formal company accounts
- You keep all profits and have full control
- Financial information remains private (not published publicly)

Disadvantages

- Unlimited liability – creditors can pursue your personal assets (home, savings) if the business fails
- At higher profits (above approximately £50,000), the overall tax burden may be higher than with a limited company
- More difficult to sell or transfer the business

- May be perceived as less credible by some clients or lenders

WORKED EXAMPLE: Sole Trader Tax Calculation

Sarah runs a freelance graphic design business. Her revenue for 2025/26 is £45,000. After deducting £10,000 in allowable business expenses, her taxable profit is £35,000.

Income Tax: First £12,570 is tax-free (Personal Allowance). Remaining £22,430 is taxed at 20% = £4,486.

Class 4 NI: 6% on profits between £12,570 and £35,000 = £1,345.80 (plus 2% on anything above £50,270).

Class 2 NI: £3.50 × 52 weeks = £182.

Total tax and NI: approximately £6,014. Effective rate: about 17.2%.

2.2 Limited Company – A Separate Legal Entity

KEY CONCEPT: Limited Company

A limited company is a separate legal entity from its owner(s). The company owns its own assets, earns its own profits, and is responsible for its own debts. As a shareholder, your liability is normally limited to the amount you invested in the company. This is known as 'limited liability'.

KEY CONCEPT: Director and Shareholder

A director manages the company's day-to-day affairs and has legal duties under the Companies Act 2006. A shareholder is an owner of the company who is entitled to a share of profits (dividends). In most SMEs, the founder is both the sole director and sole shareholder.

How to Register

You register a limited company with Companies House. You will need a company name, a registered office address, at least one director, at least one shareholder, a memorandum and articles of association, and a Standard Industrial Classification (SIC) code for your business activity.

Registration Method	Fee (from 1 February 2026)
Online (digital filing)	£100
Same-day online incorporation	£156
Paper filing	£124

Annual Confirmation Statement: £50/year (digital) from 1 February 2026. This is a mandatory annual filing to confirm or update the company's details held at Companies House.

After incorporation, you must also register with HMRC for Corporation Tax (within 3 months of starting to trade). If you will pay yourself a salary, you must register for PAYE as well.

Taxes Involved

Company level: The company pays Corporation Tax on its profits (19%–25%).

Personal level: You pay personal Income Tax and potentially NI on any salary or dividends you take from the company.

PRACTICAL TIP

This two-tier structure is where tax planning opportunities arise. By choosing the right mix of salary and dividends, you can often reduce your overall tax burden compared to being a sole trader. More on this in Chapter 12.

Advantages

- Limited liability – your personal assets are normally protected
- Often more tax-efficient at higher profit levels
- Flexibility to structure remuneration (salary + dividends + pension)
- More professional image; easier to raise finance or sell the business

Disadvantages

- Higher setup and ongoing costs
- Significantly more administration – annual accounts, Corporation Tax return, Confirmation Statement, PAYE
- Usually requires an accountant (£800–£2,500/year for a small company)
- Profits cannot be freely withdrawn – must be taken as salary, dividends, or pension contributions
- Financial information is publicly available on the Companies House register

2.3 Partnerships and LLPs

KEY CONCEPT: Partnership

A partnership is a business owned and run by two or more people. Each partner shares the profits (and losses) according to their partnership agreement. Each partner pays tax individually on their share of the profits. In an ordinary partnership, all partners have unlimited liability.

KEY CONCEPT: LLP – Limited Liability Partnership

An LLP combines the flexibility of a partnership with the liability protection of a limited company. Partners enjoy limited liability, but are each taxed individually on their share of profits (like a standard partnership). LLPs must register with Companies House.

IMPORTANT WARNING

If you go into business with one or more partners, always have a written partnership agreement. This should cover profit-sharing arrangements, decision-making authority, responsibilities, what happens if a partner wants to leave, and how disputes are resolved. Many partnership disputes arise from the lack of a clear written agreement.

2.4 Which Structure Should You Choose?

Your Situation	Recommended Structure	Main Reason
Just starting out, income uncertain	Sole Trader	Zero cost, simple administration
Annual profits below £30,000	Sole Trader	Tax difference is minimal; save on admin costs
Annual profits consistently above £50,000	Limited Company	Significant tax savings become available
Business carries meaningful legal risk	Limited Company	Limited liability protects personal assets
Planning to grow, seek investment, or sell	Limited Company	Better suited for external investment and sale
Going into business with others	Partnership or LLP	Depends on whether limited liability is needed

PRACTICAL TIP

Review your business structure annually. It is very common to start as a sole trader and later incorporate as a limited company once profits grow. Your accountant can advise on the best timing.

Chapter 3: Income Tax

Income Tax is the most fundamental tax in the UK. It applies to almost all forms of personal income, including employment salary, self-employment profits, rental income, savings interest, and dividends.

3.1 The Personal Allowance

> **KEY CONCEPT: Personal Allowance**
> Every UK resident individual is entitled to a Personal Allowance – an amount of income they can earn each year without paying any Income Tax. For the 2025/26 and 2026/27 tax years, the Personal Allowance is £12,570. This allowance has been frozen since 2021/22 and will remain frozen until at least 2030/31.

Only income above the Personal Allowance is subject to Income Tax. The frozen allowance means that, as wages rise over time, more of your income falls into taxable brackets. This effect is known as 'fiscal drag'.

3.2 Income Tax Rates and Bands

For 2025/26 and 2026/27, the Income Tax rates for England, Wales, and Northern Ireland are:

Tax Band	Annual Income Range	Tax Rate
Personal Allowance	£0 – £12,570	0% (tax-free)
Basic Rate	£12,571 – £50,270	20%
Higher Rate	£50,271 – £125,140	40%
Additional Rate	Over £125,140	45%

These rates and thresholds have been frozen since 2021/22 and will remain frozen until 2030/31. Scotland has its own income tax bands and rates, which are set by the Scottish Parliament.

3.3 The £100,000 Personal Allowance Trap

One of the most important traps in the UK tax system occurs when your income exceeds £100,000. For every £2 of income above £100,000, your Personal Allowance is reduced by £1. By the time your income reaches £125,140, your Personal Allowance has been completely eliminated.

This means that income between £100,000 and £125,140 is effectively taxed at a marginal rate of 60% (the 40% higher rate plus the loss of the tax-free allowance). This is higher than even the 45% Additional Rate.

> **PRACTICAL TIP**
> If your income is close to or above £100,000, making pension contributions is one of the most effective ways to bring your 'adjusted net income' back below £100,000 and preserve your full Personal Allowance. This can produce substantial tax savings.

3.4 Dividend Tax Rates

Dividends received from a company are subject to special, lower tax rates (because the company has already paid Corporation Tax on the underlying profits). Every individual has a £500 tax-free Dividend Allowance.

From April 2026, the basic and higher rate dividend tax rates increase by 2 percentage points:

Tax Band	2025/26 Rate	2026/27 Rate (from April 2026)	Change
Dividend Allowance	£500 tax-free	£500 tax-free	No change
Basic Rate	8.75%	10.75%	+2%
Higher Rate	33.75%	35.75%	+2%
Additional Rate	39.35%	39.35%	No change

IMPORTANT WARNING

The April 2026 dividend tax increase has a significant impact on limited company directors who use a low-salary-plus-dividends strategy. If this applies to you, discuss your remuneration plan with your accountant before the new tax year begins.

Chapter 4: National Insurance Contributions

National Insurance Contributions (NICs) are a separate charge from Income Tax, although they are often collected alongside it. NICs fund the State Pension, Statutory Sick Pay, Maternity Allowance, and certain other welfare benefits.

4.1 What Is National Insurance?

KEY CONCEPT: National Insurance Contributions (NICs)
NICs are payments made by employees, employers, and self-employed individuals to qualify for certain state benefits, most importantly the State Pension. Your NI record determines your entitlement to these benefits. NICs are separate from Income Tax – even if your income is below the Income Tax threshold, you may still need to pay NICs.

KEY CONCEPT: National Insurance Number
Every person who works or claims benefits in the UK has a unique National Insurance number (format: AB 12 34 56 C). This is your lifetime identifier within the NI system. You need it when starting employment, registering as self-employed, or claiming benefits.

4.2 Types of National Insurance

Class	Who Pays?	Rate / Amount (2025/26)	Purpose
Class 1 (Employee)	Employees	8% (£12,570–£50,270); 2% above £50,270	Deducted from wages automatically via PAYE
Class 1 (Employer)	Employers	15% on earnings above £5,000	Paid by employer on top of wages; not deducted from employee pay
Class 2	Self-employed	£3.50 per week (approx. £182/year)	Builds entitlement to State Pension
Class 4	Self-employed	6% (£12,570–£50,270); 2% above £50,270	Calculated on profits; paid via Self Assessment
Class 3	Voluntary	£17.75 per week	Voluntary contributions to fill gaps in your NI record

Class 2 NI – Important Notes for the Self-Employed

Since April 2024, if your self-employment profits are between £6,845 and £12,570, you are automatically treated as having paid Class 2 NI (at no cost to you). This means you still build up State Pension entitlement even though you are not actually paying anything. If your profits are below £6,845, you can choose to pay Class 2 voluntarily – at just £3.50 per week, this is an extremely cost-effective way to maintain your pension record.

PRACTICAL TIP

To receive the full new State Pension, you need 35 qualifying years of National Insurance contributions. Even small voluntary Class 2 or Class 3 payments can be worthwhile if you have gaps in your record. You can check your NI record online at www.gov.uk/check-national-insurance-record.

Chapter 5: The PAYE System and Employer Obligations

If you employ anyone – including paying yourself a salary as a company director – you must understand the PAYE system. It is the mechanism through which the UK collects Income Tax and NI from employment income.

5.1 What Is PAYE?

> **KEY CONCEPT: PAYE – Pay As You Earn**
> PAYE is the system by which employers deduct Income Tax and employee NI from wages before paying the employee. The employer then sends these deductions to HMRC. From the employee's perspective, the salary they receive is already net of tax. PAYE ensures that tax is collected in real time, rather than in a single annual payment.

> **KEY CONCEPT: Tax Code**
> HMRC assigns a tax code to every employee. This code tells the employer how much tax-free income the employee is entitled to. The most common tax code is 1257L, which corresponds to the standard Personal Allowance of £12,570. Other codes may reflect additional allowances, underpaid tax from previous years, or benefits in kind.

> **KEY CONCEPT: RTI – Real Time Information**
> Employers must report every payment to employees electronically to HMRC on or before each pay date, using RTI-compatible payroll software. The main submission is called a Full Payment Submission (FPS). This allows HMRC to maintain up-to-date records of everyone's earnings.

5.2 Employer Responsibilities

As an employer, you must:

1. **Register for PAYE** with HMRC before your first employee's payday (this includes company directors paying themselves a salary)
2. **Calculate and deduct** the correct amount of Income Tax and employee NI from each payment
3. **Calculate employer NI** – this is an additional cost on top of the employee's gross salary
4. **Report via RTI** – submit an FPS to HMRC each time you run payroll
5. **Pay HMRC** the total deductions (employee tax + employee NI + employer NI) monthly or quarterly
6. **Issue a P60** to each employee at the end of the tax year, summarising their total pay and deductions

5.3 Employer NI – Key Rates (2025/26 onwards)

The employer NI changes introduced in April 2025 represented one of the most significant recent increases in employment costs:

Item	2024/25 (Old)	2025/26 Onwards (New)
Employer NI rate	13.8%	**15%**
Secondary Threshold (per employee)	£9,100/year	**£5,000/year**
Employment Allowance	£5,000/year (employers with NI bill < £100k)	**£10,500/year (no upper limit)**

KEY CONCEPT: Employment Allowance (EA)

The Employment Allowance is a relief that allows eligible employers to reduce their employer NI bill by up to £10,500 per year. This can completely eliminate the employer NI liability for small businesses. However, there is an important restriction: if the company's only employee is the director (i.e., no other staff), the company cannot claim the Employment Allowance.

WORKED EXAMPLE: Employment Allowance in Action

A small company has two employees (in addition to the director), each earning £28,000 per year.

Employer NI per employee: 15% × (£28,000 – £5,000) = £3,450. Total for two employees: £6,900.

Because the total (£6,900) is less than the £10,500 Employment Allowance, the company pays zero employer NI.

5.4 National Minimum Wage and National Living Wage

All employers must pay at least the statutory minimum. From 1 April 2026, the rates are:

Age Group	2025/26 Rate	2026/27 Rate (from April 2026)
21 and over (National Living Wage)	£12.21/hour	£12.71/hour
18–20	£10.00/hour	£10.85/hour
16–17 / Apprentices	£7.55/hour	£8.00/hour

IMPORTANT WARNING

HMRC actively enforces minimum wage compliance. Underpayments can result in penalties of up to 200% of the arrears owed, and employers may be publicly named. Even small errors (such as a few pence per hour due to rounding or deductions) can be treated as a breach.

Chapter 6: Corporation Tax

Corporation Tax is the tax that limited companies pay on their profits. It is entirely separate from the personal taxes that the company's directors or shareholders pay on income they draw from the company.

6.1 How Corporation Tax Works

KEY CONCEPT: Corporation Tax

Corporation Tax is charged on a limited company's taxable profits – that is, revenue minus allowable business expenses. The current rates are among the lowest in the G7, with the government committing to cap the main rate at 25% for the duration of this Parliament.

6.2 Corporation Tax Rates

Rate Category	Annual Profit Range	Effective Rate
Small Profits Rate	Up to £50,000	19%
Marginal Rate	£50,001 – £250,000	19%–25% (tapered)
Main Rate	Over £250,000	25%

KEY CONCEPT: Marginal Relief

If your company's profits fall between £50,000 and £250,000, the tax rate is not a flat 25%. Instead, Marginal Relief applies, gradually increasing the effective rate from 19% to 25%. The effective marginal rate in this band is approximately 26.5%, meaning that each additional pound of profit in this range is taxed at a higher rate than 25% to smooth the transition.

WORKED EXAMPLE: Corporation Tax Calculation

ABC Ltd has annual profits of £80,000. Because profits exceed £50,000 but are below £250,000, Marginal Relief applies.

The effective tax rate is approximately 21.2%, resulting in a Corporation Tax bill of around £17,000.

If the same £80,000 profit were earned by a sole trader, the combined Income Tax and NI bill would be approximately £21,500. The limited company structure saves around £4,500 at company level (though personal tax on extracting the profits must also be considered).

6.3 Extracting Profits from Your Company

A limited company's money belongs to the company, not to you personally. You cannot simply transfer money from the company bank account to your personal account. There are four main legitimate ways to extract profits:

Option 1: Salary

- Paid through PAYE; subject to Income Tax and employee NI
- The company must also pay employer NI (15%)
- **Benefit:** Salary is a deductible expense for Corporation Tax purposes

Option 2: Dividends

- Paid from after-tax profits to shareholders
- Not subject to National Insurance (a major advantage)
- Taxed at the dividend tax rates (lower than employment income rates)
- **Limitation:** Not deductible against Corporation Tax (because they come from post-tax profits)

Option 3: Pension Contributions

- Company contributes directly to the director's pension scheme
- Fully deductible against Corporation Tax
- No NI is payable by either the company or the director
- **Limitation:** Funds are locked away until you reach your pension age (currently 55, rising to 57 from 2028)

Option 4: Expense Reimbursement

- The company reimburses you for legitimate business expenses
- Not treated as personal income; no tax or NI payable
- **Requirement:** Must be genuine business expenses with supporting receipts

PRACTICAL TIP

The most common strategy for SME directors is to take a salary around the Personal Allowance level (£12,570) to avoid Income Tax and employee NI, and then draw additional profits as dividends. Company pension contributions add a further layer of tax efficiency. See Chapter 12 for more detail.

Chapter 7: Value Added Tax (VAT)

7.1 What Is VAT?

KEY CONCEPT: VAT – Value Added Tax

VAT is a consumption tax charged on most goods and services sold in the UK. Businesses registered for VAT charge it to their customers and then pay the collected VAT to HMRC, after deducting any VAT they have paid on their own business purchases. The end consumer ultimately bears the cost of VAT.

VAT is not a tax on profits. It is a tax on the value added at each stage of the supply chain. The amount you owe HMRC is the VAT you charge your customers (output VAT) minus the VAT you pay on your business purchases (input VAT).

WORKED EXAMPLE: How VAT Works

You sell a product for £120 (including 20% VAT of £20). You purchased the raw materials for £60 (including VAT of £10).

VAT you collected (output): £20. VAT you paid (input): £10. Amount you owe HMRC: £20 – £10 = £10.

7.2 When Must You Register for VAT?

- **Compulsory registration:** If your taxable turnover (not profit) exceeds £90,000 in any rolling 12-month period, you must register within 30 days.
- **Voluntary registration:** You can register at any turnover level. This may be beneficial if your customers are VAT-registered businesses (they can reclaim the VAT you charge) or if you have significant VAT-reclaimable business purchases.
- **Deregistration:** If your turnover drops below £88,000, you can apply to deregister.

7.3 VAT Rates

Rate Type	Rate	Examples
Standard Rate	20%	Most goods and services: electronics, professional services, restaurant meals, clothing (adult)
Reduced Rate	5%	Domestic energy (gas and electricity), children's car seats, some energy-saving installations
Zero Rate	0%	Most food and drink, children's clothing, books, newspapers, public transport
Exempt	N/A	Financial services, insurance, education, healthcare, sale/lease of residential property

KEY CONCEPT: Zero-Rated vs. Exempt – An Important Distinction

Both result in no VAT being charged to the customer, but they are fundamentally different. Zero-rated supplies are within the VAT system – the business can reclaim input VAT on related purchases. Exempt supplies are outside the VAT system – the business cannot reclaim input VAT on related costs. This

> distinction matters significantly for businesses that make exempt supplies, as they may be unable to recover VAT on their expenses.

7.4 VAT Schemes for Small Businesses

HMRC offers several simplified VAT schemes designed to reduce the administrative burden for smaller businesses:

- **Flat Rate Scheme:** Rather than tracking input and output VAT on every transaction, you pay a fixed percentage of your gross turnover (the percentage varies by industry). Available to businesses with taxable turnover up to £150,000.
- **Cash Accounting Scheme:** You account for VAT based on when you actually receive or make payments, rather than when you issue or receive invoices. This helps cash flow. Available to businesses with taxable turnover up to £1.35 million.
- **Annual Accounting Scheme:** You submit one VAT return per year instead of four, making advance payments throughout the year. Available to businesses with taxable turnover up to £1.35 million.

Chapter 8: Capital Gains Tax (CGT)

8.1 What Is Capital Gains Tax?

KEY CONCEPT: Capital Gains Tax (CGT)

CGT is a tax on the profit (gain) you make when you sell or dispose of an asset that has increased in value. It applies to assets such as investment properties, shares, business assets, and valuable personal possessions worth over £6,000. It does not apply to your main home (see Private Residence Relief below) or to assets held within an ISA.

KEY CONCEPT: Annual Exempt Amount

Each individual has a tax-free CGT allowance. For 2025/26 and 2026/27, this is £3,000 per year. Only gains above this amount are taxed. This allowance has been significantly reduced in recent years (it was £12,300 as recently as 2022/23).

8.2 CGT Rates (2025/26 and 2026/27)

Taxpayer Status	CGT Rate (all assets)	Annual Exempt Amount
Basic rate taxpayer	18%	£3,000
Higher / Additional rate taxpayer	24%	£3,000

Since October 2024, the CGT rates for all assets (including residential property) have been unified at 18% and 24%.

8.3 Business Asset Disposal Relief (BADR)

KEY CONCEPT: BADR – Business Asset Disposal Relief

Formerly known as Entrepreneurs' Relief, BADR provides a reduced CGT rate when you sell all or part of your business, or shares in a qualifying trading company. The lifetime limit is £1,000,000 of qualifying gains.

The BADR rate has been increasing:

- 2024/25 and earlier: 10%
- 2025/26 (current): 14%
- **2026/27 onwards (from 6 April 2026): 18%**

IMPORTANT WARNING

If you are considering selling your business, the timing matters significantly. On £1,000,000 of qualifying gains, the difference between 14% (before April 2026) and 18% (from April 2026) is £40,000 in additional tax. Seek professional advice well in advance.

PRACTICAL TIP

Your main home (principal private residence) is normally exempt from CGT under Private Residence Relief (PRR). However, partial charges may apply if the property was used for business, let to tenants, or if you have more than one property.

Chapter 9: Making Tax Digital (MTD)

9.1 What Is MTD?

> **KEY CONCEPT: Making Tax Digital (MTD)**
> MTD is HMRC's programme to modernise the tax system. It requires businesses and individuals to keep digital records using compatible software and submit tax information to HMRC electronically. The aim is to reduce errors, increase efficiency, and move towards a more real-time tax reporting system.

MTD has already been implemented for VAT (since April 2019). The next major phase – MTD for Income Tax Self Assessment (MTD for ITSA) – begins in April 2026.

9.2 Who Is Affected?

- **VAT-registered businesses:** Already using MTD since 2019. No further change.
- **Self-employed individuals and landlords:** Phased rollout based on gross income thresholds (see below).
- **Partnerships:** No confirmed date yet.
- **Limited companies:** No MTD for Corporation Tax has been announced.

9.3 Implementation Timeline

Start Date	Who Must Comply?	Qualifying Income Threshold	Status
April 2019	VAT-registered businesses	—	Already in effect
April 2026	Self-employed / Landlords	**Over £50,000**	Imminent
April 2027	Self-employed / Landlords	Over £30,000	Planned
April 2028	Self-employed / Landlords	Over £20,000	Planned

> **KEY CONCEPT: Qualifying Income**
> The income threshold for MTD is based on gross business income (turnover), not profit. It includes combined self-employment income and rental income. For example, if your self-employment turnover is £40,000 and your rental income is £15,000, your qualifying income is £55,000 – above the £50,000 threshold.

9.4 What Changes Under MTD?

The biggest change is the frequency of reporting. Instead of a single annual Self Assessment return, you will need to submit:

- **Four quarterly updates** to HMRC summarising your income and expenses for each quarter
- **One end-of-period statement (EOPS)** – finalising the position for the tax year

The quarterly deadlines are:

Quarter	Period	Submission Deadline
Q1	6 April – 5 July	7 August
Q2	6 July – 5 October	7 November
Q3	6 October – 5 January	7 February
Q4	6 January – 5 April	7 May
Final declaration	Full tax year	31 January (following year)

IMPORTANT WARNING

Quarterly updates are information submissions only – they do not change your tax payment dates. The tax payment deadline remains 31 January following the end of the tax year (with a second payment on account due 31 July).

PRACTICAL TIP

Good news for the first year: HMRC has confirmed that late filing penalties will not be imposed for quarterly updates during the 2026/27 tax year (the first year of MTD for ITSA). The new penalty regime takes full effect from April 2027. This gives you a year to adapt to the new system.

Chapter 10: Allowable Expenses and Record-Keeping

10.1 Allowable Business Expenses

KEY CONCEPT: Allowable Expenses

Expenses that are incurred 'wholly and exclusively' for business purposes can be deducted from your income, reducing your taxable profit. This is one of the most important concepts for any business owner – legitimate expenses directly reduce the amount of tax you pay.

Expense Type	Sole Trader	Limited Company	Notes
Premises rent	Yes (Full)	Yes (Full)	Home office – proportional only
Utilities (electricity, gas, internet)	Yes (Proportional)	Yes (Proportional)	Business use portion only if working from home
Stock / raw materials	Yes (Full)	Yes (Full)	Stock must be valued at year-end
Business insurance	Yes (Full)	Yes (Full)	Employer's liability, professional indemnity, etc.
Mobile phone	Proportional	Proportional	Business calls/data only (or company contract for Ltd)
Vehicle costs	Mileage only	Mileage only	£0.45/mile (first 10,000); £0.25/mile thereafter
Accountancy fees	Yes (Full)	Yes (Full)	
Employee wages	Yes (Full)	Yes (Full)	Including employer NI
Director's own salary	No	Yes	Sole trader profit = personal income
Professional training (CPD)	Yes (Existing skills)	Yes (Full)	Training for an entirely new trade is not deductible
Fines and penalties	No	No	No fine or penalty is deductible, regardless of the reason
Client entertainment	No	No	Not deductible for Income Tax or Corporation Tax

10.2 Working from Home

If you work from home, you can claim for the business use of your home. There are two methods:

- **Simplified method:** Claim a flat rate of £6 per week (£312 per year) with no receipts needed. This is the easiest approach.
- **Actual cost method:** Calculate the business proportion of your household costs (rent or mortgage interest, utilities, council tax, broadband) based on the area used and time spent. This usually produces a higher figure but requires detailed records.

10.3 Essential Record-Keeping Rules

1. **Separate business and personal finances:** Open a dedicated business bank account. Many digital banks (Starling, Tide, Monzo Business, Revolut Business) offer free or low-cost business accounts.

2. **Keep evidence for every transaction:** Retain invoices, receipts, and bank statements for all income and expenditure.
3. **Retain records for six years:** HMRC can investigate your tax affairs going back up to six years (longer if fraud is suspected). Company constitutional documents should be kept permanently.
4. **Record transactions promptly:** Do not leave everything to the year-end. Under MTD, quarterly reporting makes real-time bookkeeping essential.
5. **Account for all cash receipts:** Every cash payment received must be banked and recorded.

IMPORTANT WARNING

The three issues HMRC most commonly investigates are: mixing personal and business expenses, missing invoices or receipts, and unreported cash income. Avoiding these three problems will significantly reduce your risk of an HMRC enquiry.

Chapter 11: Key Dates and Deadlines

11.1 Self Assessment (Sole Traders and Directors)

Date	What You Must Do
6 April	New tax year begins
5 October	Deadline to register for Self Assessment if newly self-employed
31 October	Paper Self Assessment return deadline (for the previous tax year)
31 January (following year)	Online Self Assessment return deadline + tax payment due + first payment on account due
31 July (following year)	Second payment on account due

KEY CONCEPT: Payments on Account

If your Self Assessment tax bill exceeds £1,000 (and less than 80% of your tax was collected at source via PAYE), HMRC requires you to make advance payments towards next year's tax bill. These are called 'payments on account' and are set at 50% of the previous year's bill each. The first is due on 31 January; the second on 31 July. This means that in your first year of Self Assessment, you may need to pay significantly more than expected: the full previous year's tax plus 50% of the estimated current year's tax.

11.2 Limited Company Deadlines

- **9 months and 1 day** after accounting year-end: Corporation Tax payment due
- **9 months** after accounting year-end: Annual accounts must be filed with Companies House
- **12 months** after accounting year-end: Corporation Tax return (CT600) must be filed with HMRC
- **14 days** after anniversary of incorporation: Confirmation Statement due to Companies House (£50 fee)

PRACTICAL TIP

You can choose any date as your company's accounting year-end. Common choices include 31 March (aligning with the Corporation Tax financial year), 31 December (calendar year), or 5 April (aligning with the personal tax year).

11.3 Late Filing Penalties

UK tax penalties can be substantial:

Self Assessment Late Filing

- Immediate £100 penalty on the day after the deadline
- After 3 months: additional £10 per day (up to 90 days = £900)
- After 6 months: further 5% of tax due (minimum £300)

- After 12 months: additional 5% of tax due (minimum £300)

Late Tax Payment

- Interest accrues from the due date
- After 30 days: 5% surcharge on unpaid tax
- After 6 months: further 5% surcharge
- After 12 months: further 5% surcharge

Corporation Tax Late Filing

- £100 if up to 3 months late; a further £100 after 3 months
- After 6 months: 10% of the unpaid tax
- After 12 months: further 10% of the unpaid tax

PRACTICAL TIP

If you cannot pay your tax on time, contact HMRC proactively to arrange a 'Time to Pay' arrangement. This allows you to pay in instalments and is far better than simply missing the deadline and incurring penalties.

Chapter 12: Legitimate Tax Planning Strategies

Tax planning (sometimes called tax avoidance) is the legal practice of arranging your financial affairs to minimise your tax liability within the rules. It is entirely different from tax evasion, which involves deliberately concealing income or providing false information to HMRC and is a criminal offence.

12.1 Use All Available Allowances

- **Personal Allowance (£12,570):** Ensure every eligible family member (e.g. a spouse) makes use of their Personal Allowance if they have income.
- **Dividend Allowance (£500):** Even small dividend amounts should utilise this.
- **Trading Allowance (£1,000):** Side income below £1,000 need not be declared.
- **CGT Annual Exempt Amount (£3,000):** Consider spreading asset disposals across tax years to use the annual exemption each year.
- **ISA Allowance (£20,000):** All income and gains within an ISA are completely tax-free.

12.2 Pensions – One of the Most Powerful Tax Tools

- Personal contributions receive tax relief: a basic-rate taxpayer contributing £80 sees the government add £20 (effectively 25% free money)
- Employer pension contributions by a company are fully deductible against Corporation Tax and exempt from NI – a double benefit
- Annual allowance: £60,000 (or 100% of earnings, whichever is lower), with the ability to carry forward unused allowance from the previous three years

IMPORTANT WARNING

Important pension changes ahead:

• From April 2027, unused pension savings will be included in your estate for Inheritance Tax purposes

• From April 2029, salary sacrifice pension contributions above £2,000 per year will be subject to NI

• Pension funds are typically inaccessible before age 55 (rising to 57 from 2028)

12.3 Director Remuneration Optimisation

For limited company directors, the mix of salary and dividends can make a significant difference to your overall tax bill. The general principles are:

- **Set your salary at or near the Personal Allowance (£12,570):** This avoids Income Tax and employee NI, while the salary is a deductible company expense.
- Take additional profits as dividends – the dividend tax rates are lower than employment income rates, and no NI is payable on dividends.
- Top up with employer pension contributions for maximum tax efficiency.

PRACTICAL TIP

The optimal salary and dividend strategy varies depending on your company's profit level, whether you have other income, whether the company has other employees (affecting Employment Allowance eligibility), and the upcoming dividend tax increase in April 2026. Review your strategy with your accountant at the start of each tax year.

12.4 Year-End Tax Checklist

1. Confirm all available allowances and reliefs have been fully utilised
2. Review pension contributions and consider additional top-ups before 5 April
3. Maximise your ISA contributions for the year
4. Consider whether any CGT disposals should be made before or after the year-end
5. Ensure all allowable business expenses have been recorded
6. Discuss next year’s salary and dividend strategy with your accountant
7. Assess whether your current business structure remains the most tax-efficient

Chapter 13: Capital Allowances

When your business purchases equipment, machinery, vehicles, or other capital assets, you generally cannot deduct the full cost in the year of purchase as you would with everyday expenses. Instead, the cost is spread over time through the capital allowances system.

13.1 Types of Capital Allowances

KEY CONCEPT: Annual Investment Allowance (AIA)

The AIA allows businesses to deduct 100% of the cost of qualifying plant and machinery in the year of purchase, up to £1,000,000 per year. Most SMEs' capital expenditure falls well within this generous limit.

- **Full Expensing (companies only):** Since April 2023, limited companies can claim 100% first-year deduction on qualifying new plant and machinery. This is a permanent policy and does not apply to sole traders or partnerships.
- **New 40% First-Year Allowance (from January 2026):** A new allowance allowing unincorporated businesses (sole traders, partnerships) and leasing businesses to claim 40% of the cost of qualifying main-rate assets in the first year.
- **Writing Down Allowance (WDA):** For expenditure not covered by AIA or Full Expensing, a percentage is deducted each year. From April 2026, the main rate reduces from 18% to 14%. The special rate (for long-life assets, integral features) remains at 6%.
- **Zero-emission vehicles and EV charge points:** 100% first-year allowance extended until March/April 2027.

IMPORTANT WARNING

The reduction in the Writing Down Allowance main rate from 18% to 14% (effective April 2026) means that tax relief on capital expenditure not covered by AIA or Full Expensing will be spread over a longer period. Plan significant purchases accordingly.

Chapter 14: Timeline of Upcoming Tax Changes

The following is a comprehensive timeline of confirmed tax and regulatory changes that will affect UK SMEs over the coming years. Use this as a reference for forward planning.

Date	Key Changes
April 2025 [Done]	Employer NI increased to 15% (from 13.8%); Secondary Threshold reduced to £5,000; Employment Allowance raised to £10,500; CGT rates unified at 18%/24%; BADR rate increased to 14%; National Living Wage £12.21/hour
January 2026 [Done]	New 40% First-Year Allowance for plant and machinery introduced
February 2026 [Done]	Companies House fees increased: incorporation £100, Confirmation Statement £50
April 2026 [Imminent]	MTD for ITSA launches (income > £50,000); Dividend tax rates increase by 2%; BADR rate rises to 18%; WDA main rate reduced from 18% to 14%; IHT agricultural/business property relief reformed; VCT income tax relief reduced to 20%; National Living Wage rises to £12.71/hour; New VAT relief for charitable donations of goods; Corporation Tax late filing penalties double
April 2027	MTD threshold reduces to > £30,000; Property income tax rates increase by 2% (22%/42%/47%); Savings interest tax rates increase by 2% (22%/42%/47%); Cash ISA limit reduced to £12,000 (under-65s); Pensions brought into IHT scope; New MTD penalty regime fully in effect
April 2028	MTD threshold reduces to > £20,000
April 2029	Salary sacrifice pension contributions above £2,000/year subject to NI

Appendix: Frequently Asked Questions

Q1: I'm just starting a business. What should I do first?

Decide on your business structure (sole trader is usually the simplest starting point). Register with HMRC for Self Assessment (sole trader) or register your company with Companies House and then HMRC (limited company). Open a dedicated business bank account. Start keeping records of all income and expenses from day one. If you expect taxable turnover above £90,000, register for VAT.

Q2: Do I need an accountant?

For a simple sole trader business with turnover below £30,000, you may be able to manage on your own using accounting software. However, if your income exceeds £50,000, you run a limited company, you have employees, or you have multiple income sources, a qualified accountant is strongly recommended. The tax savings from professional advice typically far outweigh the fees, which range from approximately £300–£800/year for a sole trader and £800–£2,500/year for a small limited company.

Q3: Must I declare cash income?

Absolutely. All income, including cash payments, must be declared. Failure to report cash income is tax evasion, which is a criminal offence. HMRC uses bank analysis, lifestyle assessments, and industry benchmarking to detect undeclared income. Penalties range from 30% to 100% of the underpaid tax, and serious cases can lead to prosecution.

Q4: What is the difference between a UTR and a National Insurance number?

Your National Insurance (NI) number is your lifetime social security identifier (format: AB 12 34 56 C). It is linked to your NI contribution record and benefit entitlements. A UTR (Unique Taxpayer Reference) is a 10-digit number issued by HMRC specifically for Self Assessment tax purposes. They are different numbers serving different purposes.

Q5: I have income from overseas. Do I need to declare it in the UK?

If you are UK tax resident (generally determined by spending 183 or more days in the UK in a tax year), you are taxable on your worldwide income. However, the UK has double taxation agreements with many countries, which provide relief to prevent the same income being taxed twice. This is a complex area – consult an accountant with international tax experience.

Q6: Will I still be able to use the HMRC online Self Assessment system after MTD starts?

Yes, if your qualifying income is below the MTD threshold (which starts at £50,000 from April 2026). If you are below the threshold, you can continue using HMRC's existing online Self Assessment system as before.

Q7: What is an umbrella company?

An umbrella company acts as an employer for contractors and freelancers. Instead of running your own limited company or working as a sole trader, the umbrella company employs you, handles PAYE, NI, and payroll compliance, and pays you a net salary. Advantages: very simple administration. Disadvantages: management fees, and less tax planning flexibility compared to your own limited company.

Q8: What happens if I cannot pay my tax bill on time?

Contact HMRC as soon as possible to discuss a Time to Pay (TTP) arrangement. This allows you to pay in monthly instalments over a period typically ranging from 6 to 12 months. Interest will still accrue, but you are far less likely to face penalties than if you simply miss the deadline without contacting HMRC.

REINZA LIMITED

Accounting | Tax Consulting | Professional Training

www.reinza.com
contact@reinza.com

First Edition – February 2026

Disclaimer: This guide is for general information and educational purposes only. It does not constitute professional tax, legal, or financial advice. Tax laws and rates are subject to change. Always consult a qualified accountant or tax adviser regarding your specific circumstances.