

# A Beginners Guide to Tax and Business Accounts for eBay Traders

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## Introduction

eBay has been referred to as part of the ‘black economy.’ But ... the taxman’s been looking closely at the popularity of the site and the growing number of UK internet users who are earning some or all of their income by trading as ‘untaxed’ entrepreneurs. According to industry sources, the Inland Revenue have obtained records and contact details of eBay traders -particularly power sellers- which the auction house was forced to hand over. So there is a good chance that those who use the site will be picked up if they neglect their tax responsibilities!

But what should you be thinking about in terms of accounting and the legal side of issues when starting up a business through eBay? Many people who start eBay businesses begin in a small way - more as a way to get rid of stuff or hobby. Not being experienced business people, they don’t consider all of the basic steps in setting up in business. On the other hand, businesses using the site need to think carefully about making sure that they keep records and account for everything. And where does this leave moonlighters ... well there are so many people using eBay that the Revenue will probably only target those who have a significant sales history – but **if you are a power seller consider this as bad news for you!** What you are going to do? And do you need to hurry up and register with the taxman before a nasty letter arrives on your doormat!

### Do you have an eBay business?

Simply selling off stuff that you have accumulated over the years, or inherited, does not mean that you have a business. Being “in business” implies a lot more than that. But lets face it, if you just sell off a few pictures or a used push-bike then you are having the electronic equivalent of a car boot sale and the taxman isn’t going to be interested in you.

The taxman has a number of tests that it uses to work out if you are in business, but in most circumstances the answer is pretty straightforward. The taxman starts to be interested when you are carrying out an economic activity, when you are “in business”. Or to phrase it another way, if you buy or make something with the aim of selling it for a profit. So, you should be able to arrive at a common sense answer for yourself of this question!

## **What should you do when starting an eBay business?**

There are a number of things that you should do, some general business tips and some more specific to eBay.

- 1 Get the best cash flow management by setting up accounts with your suppliers, preferably a credit account. This way you buy from the supplier, sell it on eBay, get paid and then pay the supplier later (in theory anyway).
- 2 Keep your startup costs down by opening an account with eBay and get their free listing tool for your adverts.
- 3 Minimise your bad debts and maximise your sales potential by taking credit cards - open a Paypal or World pay account so you can take payment via credit card. Check out [www.paypal.com](http://www.paypal.com), [www.nocheck.com](http://www.nocheck.com), [www.worldpay.co.uk](http://www.worldpay.co.uk) for information. You can also set up a merchant account with most of the high street banks, but probably not until you have established your business.
- 4 Using Paypal or Worldpay is easy – but expensive! So organise your auctions so that you take cheques as well. Cashing foreign cheques can also be expensive, so you might want to encourage your UK buyers to pay by cheque to keep your costs down.
- 5 Taking credit cards will open you up to worldwide sales – and worldwide fraudsters! Be careful when dealing with other countries, as card fraud is rampant in some of them (for example Malaysia is allegedly a source of card fraud). But also prepare yourself with delivery information and costs to non-UK destinations!

- 6 Get all the necessary booklets on postal charges from your local post office, then buy a cheap set of kitchen scales – and weigh your goods with packaging to work out the postal charges. Get this wrong and you will eat into any profit you make.
- 7 Within three months of starting you must let the Inland Revenue know you are starting a business – or face a potential £100 fine.
- 8 If your sales exceed £60,000 in a 12 month period then you need to register for and charge VAT on your sales. So, when your sales reach, or average, £5,000 per month or more get the forms, take advice and get it sorted out.
- 9 You have a couple of options of business entity - Either as a limited company or as a self employed individual. Either choice will have implications for income tax or corporation tax and national insurance, but they make no difference to VAT. If you trade as a limited company then there are also employment issues to be considered – so take professional advice!
- 10 Keep good records and receipts of **everything** that is bought and sold - record everything and let your accountant decide if it qualifies for tax relief!
- 11 Lots of expenditure qualifies to be offset against your income, for example: Equipment, computers, office and stationery costs, vehicle running costs, some meal or subsistence expenses, most travel expenses, advertising costs – and obviously internet and web expenses.
- 12 It is worthwhile investing £100 or so in accounting software package such as QuickBooks. Your records can be kept manually or on a spreadsheet, but an accounting software package should help with tax, payroll and other business accounting requirements.

### **And what not to do when starting an eBay business:**

- 1 Never mix your eBay business account with your personal spending. Mixing them makes it difficult to do your own bookkeeping and keep straight with the tax authorities.

- 2 Do not assume eBay will track or report taxes for its sellers. It's up to you to sort out the tax liabilities and reporting requirements.
- 3 Don't ignore licenses and permits. For example, if you plan to sell food over the net you WILL need to abide by health and hygiene regulations.
- 4 Don't misrepresent what you are selling. According to the Sales of Goods Act if you misrepresent goods you are liable for a whole range of penalties – but more importantly you will lose customers and end up making refunds!
- 5 Don't bury your head in the sand! The rules are there for everybody and the taxman and vatman can be very unsympathetic if you won't or don't comply with their rules. For unsympathetic think fines!
- 6 Don't think that you can avoid paying VAT if you are selling internationally. VAT applies if you are selling goods throughout the EU. It is also likely that you will have to get an export permit and register with the Customs and Excise for international trading.
- 7 Don't ignore the distance selling regulations ... read our Beginners Guide on the subject.

## **Which Taxes?**

Your tax bill will depend upon a variety of factors – but essentially it depends upon what your sales and expenses are. Tax is a general word and to be more specific we need to separate this out into VAT and income taxes.

### **VAT**

VAT is worked out at 17½ % of your sales or purchases.

So if you sell something for £10 plus VAT the sales price is £11.75 and the £1.75 extra you get belongs to the VATman. If you sell something for £10 including VAT then £8.51 is the sale amount and £1.49 is the VAT amount. For the mathematically inclined, the net amount (ie

excluding VAT) is 40/47ths of the gross amount (ie including VAT) and the VAT amount is 7/47ths of the gross amount.

And VAT on your purchases is worked out in the same way, except that not all of your purchases will have VAT on them. Postal charges for example do not have VAT, although courier charges might. You actually have to look at the receipt to see if the seller was VAT registered and if you were charged VAT.

Having listed out in your bookkeeping system or accounts package all of the sales and purchases (or expenses), you will also have worked out the total of any VAT on your sales and on your purchases. If you have more VAT on your sales than on your purchases then you need to pay the difference to the VATman, and if VAT on your purchases is more then the VATman will pay you the difference. The sting in the tail is that the formal VAT return that deals with this has to be sent in to the taxman every three months – which means staying on top of the paperwork!

## Income Taxes

If you operate a limited company then tax on income is called corporation tax. If you operate your business as a sole trader or a partnership then you will pay income tax. The means of working out the taxable profits are very similar but the tax rates are different.

The taxable profit is found by working out the difference between what you have sold and what you have purchased – which is pretty straightforward in most instances! However, there are items that do not qualify for tax relief either in full or in part. Working this out can be quite complicated and is beyond the scope of this Beginners Guide; however simply working out the difference between sales and purchases (excluding what you pay yourself) gives you a fair approximation of your taxable profit.

Just as important as working out the VAT tax return, you need to consider the impact of VAT on your prices. Charging VAT means that your profit is reduced if you cannot increase your prices!

The amount of tax depends upon your tax rates, and the small print in the tax legislation, so what are the rates? Corporation tax is charged at 19% (until your profits reach £300,000!) On average Income tax and self-employed national insurance is charged at 30%, but if your income from all sources is below the personal allowance (£4,895 for the tax year ending 5 April 2006) then you won't pay any tax at all. Conversely if your taxable income is over £37,295 then you will pay tax at 41% on the excess.

Whilst this hopefully gives you a reasonable idea of what your tax bills are going to be the rules are far too complicated for this to be more than a quick introduction.

## **Caveat**

This Beginners Guide has been prepared to give the reader general information and is no substitute for proper professional advice. No liability is accepted by Jonathan Vowles Chartered Accountants for any actions or inactions taken as a result of reading this guide.

## **Next Steps**

If you would like more information about or help with your tax or accounting responsibilities then please let us know.

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