A Guide to Tax for the Self-Employed

Introduction

The tax system can be complicated and taxpayers completing their own Tax Returns may unwittingly be declaring the wrong income and claiming relief for items which do not qualify for tax deduction.

As HM Revenue & Customs (HMRC) checks only a small number of the Tax Returns it receives, you could be forgiven for thinking - having heard nothing from them and having paid the tax that you calculated was due - that all was in order. Then a letter arrives querying the figures and asking to see your records and bank statements and it is only then that problems going back many years are uncovered.

This is why a tax advisor can provide a level of certainty for you: that the figures submitted will stand up to challenge from HMRC and that you are paying the right amount of tax.

When we prepare the Tax Return for you each year, we will also prepare a set of self-employed accounts for you which will give you a concise record of the taxable income and the tax-deductible expenses. We are always available to give advice to clients on tax matters by phone and email. As we do not charge by the hour there are no extra fees to pay for our advice.

We hope this guide is helpful. If you are in any doubt about the advice given please do get in touch:

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The Self-Employed Business

When you are self-employed, you are “in business” and must pay tax to HMRC on the profit that your business makes each year.

Your business profit is, put simply, the excess of your self-employed income over the total expenses that you had to spend to earn that income.

Your business income is only what you have earned from your self-employment and will not include such things as state benefits, family gifts or loans from friends.

Your business expenses will be only those amounts that you have paid out “wholly and exclusively” for business purposes. So you will claim for travel costs that you had to pay to fulfil a self-employed engagement but you do not claim the cost of travelling to a restaurant for a night out.

HMRC require you to report your business income and expenses on a Tax Return each year. The “tax year” is not the calendar year but instead runs from 6 April in one year to 5 April in the next.

The current tax system is called “Self Assessment”: you must report your business profit and calculate the tax and National Insurance Contributions (NIC) that you must pay.

The Tax Return also contains various other sections to declare different types of income that you might have. These include not only your self-employed income and expenses but employment income (taxed at source under the Pay As You Earn system), rental income and various types of investment income.

Almost all Tax Returns are now submitted to HMRC on-line. HMRC will initially accept a Return without question unless it contradicts information that they already hold from another source (perhaps an employer or a bank).

HMRC can, however, query and correct figures included on the Tax Return for up to a year after it is submitted to them. Indeed, if information comes into their possession that indicates that the Return is incomplete or deliberately incorrect, they can raise queries at any time.

If HMRC decides an error has been made they can increase the tax and NIC payable going back for up to six years.

The Return could be wrong simply because you have misunderstood the rules. Nonetheless, you could face having to pay extra tax, plus interest on the unpaid amounts from up to seven years ago, plus a penalty, which in the most serious cases can double the amount due.

Good record-keeping is essential to avoid painful and often protracted difficulties with HMRC. It is important to have at least a basic understanding of the main principles of business taxation. This Guide aims to provide some advice to assist you and answer some common questions.

1) Self-Employed Income

Getting the income right is the first task in preparing your Tax Return.

A good bookkeeping routine is vital for ensuring that all your income is declared. You should keep all the payslips you receive and all invoices that you raise and you should keep a formal record of your income in a written form such as our booklet, or as a spreadsheet, or by using one of the many software packages now available.

HMRC expects that all self-employed fees should be recorded as and when they are earned. You can declare income on the "cash basis" (that is, on the basis of when you receive payment) but it is good practice to make a record of fees as they are earned so that nothing is omitted in compiling the Tax Return. Recording income on anything less regular than a monthly basis would be unacceptable to HMRC.

If HMRC chooses your case for in-depth enquiry, they will not only want to see the records of income and expenses and the supporting paperwork, but will also analyse your bank statements. You should be prepared to account for all money paid into your bank and building society accounts, whether business income or not.

If you cannot provide an explanation for a credit to a bank or building society account HMRC can treat it as income received from self-employment. The onus of proof rests with the individual, not HMRC.

What income do I need to include in my self-employed accounts?

You must record and account for all income received as a result of your self-employment. If you are paid a fee plus expenses you must declare the full amount, including the expenses. Fees or per diems paid in cash must be declared. Always declare the full gross amount of payments.

I have received a one-off fee in cash. Do I need to declare it?

Yes, all fees, no matter in what form payment is made, should be declared. HMRC has years of experience to draw upon: they know the types of businesses where cash payment is prevalent.

I have been paid a fee plus an amount to cover travel and food and drink costs – is it the fee only that is taxable?

No, the full amount must be declared. You can claim a deduction for the sums actually spent on travel and associated costs as part of your business expenses.

Do I have to declare my self-employed income on the basis of the tax year?

No, your business accounts can cover any year of your choosing. It is, however, usually most convenient to have self-employed accounts that cover the tax year – and there is no real benefit to choosing any other period. When you start self-employment, it is normal to prepare a part-year statement of income and expenses for the first tax year and prepare annual accounts to 5 April thereafter. You can if you prefer choose a year-end of 31 March as this is treated for tax purposes as if it were 5 April.

Can I declare my income on the basis of when it goes into my bank account?

The strict basis for declaring a fee is by reference to when it was earned. So, if you work for someone in March 2022 and they don't pay you until June 2022, you would include the fee in the accounts for the year to 5 April 2022 (tax year 2021/22). You can choose instead to declare income on the basis of when it is received (the "cash basis") but in the long run the same income will be declared. When you work for an organisation operates a payroll, the date on the payslip will usually be sufficient to determine the date of the earnings.

Should I include in my accounts fees where National Insurance has been deducted at source?

Yes, so long as it was only National Insurance that has been deducted and a "No Tax" or "NT" PAYE code is in operation. The rules that govern Income Tax and National Insurance are different and it is possible, although not common, for a fee to be free of tax but subject to the deduction of NIC.

Are self-employed fees earned abroad subject to UK tax?

Yes. If you are resident in the UK you are liable to UK tax on your worldwide income. In most cases tax deducted from an overseas fee can be claimed as a tax credit, deductible from the UK tax due on that fee. You should ensure that if you work overseas you always get a tax certificate so that your UK liability on the overseas fee can be reduced as much as possible.

I earn only a few hundred pounds a year as a self-employed musician – do I have to tell HMRC?

No, there is now a "Trading Allowance" of £1,000 per tax year and if your earnings are below that amount you do not need to advise HMRC that you are self-employed.

I am a still at University. Is it right that students don't pay tax?

No. One of the commonest misconceptions regarding Income Tax is that you do not need to register to pay tax until you leave higher education. This is not the case as there are no age limits or educational exemptions for Income Tax. Students have the same tax-free Personal Allowance as anyone else and if you start to earn freelance fees exceeding £1,000 per tax year while still at University you should register your self-employment with HMRC.

I have a student bursary in addition to self-employed income – is this taxable?

No: bursaries and scholarships are tax-exempt so long as you are in full-time education at a college or similar institution.

2) Expenses in Self-Employment

HMRC recognises that the self-employed person will have to spend money to earn money. It is accepted that Income Tax will be levied only on the net profit of a business, but this does not mean that every expense incurred in the course of your work will be allowable as a deduction from profit.

The Income Tax Act says that a deduction from business profits may be claimed only for expenses that you pay out "wholly and exclusively" for business purposes. Expenses that are for personal rather than business purposes or perhaps have a dual business/personal purpose are therefore not allowed as a deduction from business profit.

Similarly, some expenses are "capital" in nature (these are large sum expenses on business assets like cars or equipment) and these are not deductible except under special rules. Some expenses, like business entertaining are specifically disallowed by law and some expenses will need to be apportioned where there is a mix of business and personal use and there is a reasonable method of apportioning between the two (such as car expenses which can be apportioned according to mileage).

Whether an expense is tax-deductible can only be determined by reference to relevant laws, the decisions of the courts over the years and HMRC's own guidance. Without going into detail on any of this, I will list the most common types of expenses, with my experience of what will be allowed and what will be excluded.

All expenses that are to be claimed against profit must be properly recorded. For each expense for which you wish to claim a tax-deduction you should retain evidence of purchase, such as a receipt. For small sum expenses where there is no receipt, HMRC will accept a "contemporary record" as evidence. This might be an entry in a diary, cashbook or a phone app. You should not rely on entries on a bank statement or credit card statement as these can be ambiguous.

A record of all expenses should be kept either on a spreadsheet, software package or in a written record such as our own record-keeping booklet.

a. Use of Home

For most self-employed people the base of their business is the home. An allowance can be claimed for the costs of the home insofar as they relate to business use. The amount claimable will depend upon the number of rooms out of the total used for business and the amount of time they are used exclusively for business.

The amount to be claimed is based on the running costs of the property including rent or mortgage interest. "Business purposes" will include office administration time as well as perhaps research.

What bills can I take into account for the business use of home?

You should consider heating and lighting bills; buildings and contents insurance; Council Tax; and rent or mortgage interest. You cannot claim on the whole monthly mortgage payment if you have a repayment mortgage. It is only the interest that can be taken into consideration. Where your home is shared with a spouse or partner it is only your share of the costs that should be the basis for the calculation.

I am building a garden office purely for business use. How much of the cost will be claimable against my self-employed income?

None of the cost is allowable against Income Tax. Such costs are regarded as "capital" expenditure and no deduction is due as an expense against business income.

Can I claim a capital allowance for the garden office?

Capital allowances can only be claimed for "plant and machinery" so the cost of loft conversions, extensions or garden offices is not tax-deductible. You may be able to claim for separately invoiced fittings such as sound-proofing.

I have redecorated the outside of my house: can I claim any of the cost against tax?

If a room or rooms is used exclusively for business a proportion of the cost could be claimed.

Is there a simpler way of claiming household costs?

Yes, you may calculate your allowable expenses using an HMRC-approved flat rate based on the hours you work from home each month. The top rate for more than 100 hours of business use per month is £312 per year so the rates are not particularly generous.

b. Other Premises Costs

The rental of a studio, office or other workspace should all be allowable.

c. Equipment Maintenance and Insurance

The costs of hiring, repairing, maintaining and buying accessories for any equipment used in your business will be allowable. The cost of insuring such equipment is also tax-deductible.

d. Fees, Commissions and Wages Paid

Commission paid to an agent for obtaining work for you will be allowed. So will any fees that you pay to others who are subcontracting for you.

Wages paid to a secretary or assistant are also allowable. If you want to pay a low-earning partner, spouse or other family member for secretarial services you will need to consider whether you should be operating PAYE and paying tax and NIC as their employer. You may also have an obligation to open a pension scheme for your employee.

Can I include as an expense a nominal amount to my husband, wife or partner for secretarial help?

No, an actual payment must take place if tax-relief is to be obtained. So long as you are paying them no more than a commercial wage considering the amount of work that they undertake, a monthly standing order to an account in their name only would satisfy HMRC.

Can I claim for child care costs while I am working?

As childcare costs are not incurred in the course of your self-employed work itself but instead put you in a position to do the work, they are disallowed for tax purposes. The purpose of the cost is to look after children and as such this cannot be "wholly and exclusively" a business expense.

There are, however, various government schemes open to the self-employed to provide subsidised child care. Details of these can be found online here:

https://www.gov.uk/tax-free-childcare

e. Administrative Costs

Stationery, postage and printing costs of your business can be claimed under this heading, as can a proportion of home telephone/Internet and mobile phone costs. The costs should be apportioned according to the business/private use. Usually a broad estimate of business use will be sufficient but you should be aware that HMRC may request a full breakdown of calls if there is a perception that the amount claimed is excessive.

In this connection it is worth emphasising that "business use" in this context means use for a business purpose and not simply use while at work. If you are away from home on a business trip and use a mobile phone to call home, this is not classed as a business call unless the purpose of the call was business-related (e.g. to check your diary or make arrangements for transportation, etc.).

f. Motor Car Costs

If you own a car or van and use it in your business, you can claim part of the running costs as an expense against your self-employed income.

There are only two officially recognised methods of calculating the car expenses that can be claimed: either you can keep a log of business mileage and claim a set amount (the authorised mileage rate) per mile; or you can record all the costs associated with the car and claim a business use percentage of the total.

You do not have to be the owner of the car to use the mileage rate method but you must be responsible for paying for its maintenance, etc.

Whichever method is chosen, a mileage record is required. You will need to note the overall mileage at the beginning and end of each tax year and on any change in vehicle. You must also be able to distinguish between business and non-business mileage. Non-business mileage will include not only private or personal journeys but also commuting to and from a place of business that is separate from your home or travel to and from work that is taxed under PAYE as an employment.

Congestion charges, motorway tolls, parking fees and meter charges incurred on business journeys can be claimed. Parking fines and other road traffic penalties, however, are not tax-deductible as allowing tax relief could be seen as encouraging people to break the law.

Can I claim for a car that I lease rather than purchase?

The running costs of a leased car can be claimed with a restriction for non-business use. The mileage rate method cannot be used for a leased car. The monthly rental payments can be claimed, although there are restrictions for non-business use and if the car has a high CO_2 emissions rating.

Is there a limit on the number of cars I can claim in the accounts?

Any number of cars can be claimed so long as there is genuine business usage of each one of them.

What if my partner and I have two cars both used for business and personal purposes?

This does complicate matters but you could: claim one car each and ignore any occasional business mileage of your partner; or you could both claim for the two cars but apply an overall business use percentage to the claim.

Is there any reason not to adopt the "authorised mileage rates" method?

The current rates are 45p for the first 10,000 business miles and 25p thereafter. Clients with larger or older cars may find these rates do not reflect the real cost of running their car. In addition, these rates are inclusive so if your insurance or maintenance bills are higher than the average, you will lose out. Finally, the rates are intended to reflect the depreciation of the vehicle as well as the running costs, so no capital allowance on the purchase cost can be claimed. Unfortunately, there is no way of knowing for sure in advance which of the two methods will be beneficial over the period of ownership of the car.

Can I swap between the two methods?

Once either method has been adopted for a vehicle it must be applied until that vehicle is sold or otherwise no longer in business use.

<u>g. Other Travel Costs</u>

Subject to the normal rules of recording expenses and retaining evidence, there is normally no problem in claiming the costs of public transport and taxis for business journeys. If you make periodical payments for Oyster Card travel, for example, it will be necessary to consider a disallowance of part of the cost to account for non-business journeys.

You may claim a business proportion of expenses for a bicycle or motorbike in the same way as motor car costs are claimed. Alternatively, for a motorbike you can claim expenses based on an authorised mileage rate of 24p per mile.

<u>h. Hotel/Accommodation and Subsistence</u>

Where a hotel or other accommodation is booked for an overnight stay due to business travel the whole cost will be allowable, including, if applicable, the cost of an evening meal and breakfast. The cost of sundries like bar bills and newspapers should not be claimed.

The cost of meals is not normally an allowable business expense. The reason for this is that the statute law governing expenses states that a deduction can be made only for expenses wholly and exclusively incurred for business purposes. As we must all eat to live the expense can never be said to be "wholly" for business.

Where you have incurred travel costs however, you are allowed to claim reasonable expenses incurred on food and drink ("subsistence") if the business trip is outside your normal pattern of travel or your business is itinerant in nature.

If I am away from home for a long period and renting a room, can I claim for my grocery shopping?

The HMRC guidance is that you may claim for "extra" costs incurred on food and drink whilst travelling for business. You should not, therefore, claim the costs of shopping but only the additional costs of eating out.

Do I have to have a receipt to claim the cost of meals?

Not always – HM Revenue will accept a "contemporary record" like a diary or cashbook entry to vouch small sum subsistence expenses. So if you are dining in a group you don't all need to ask for separate receipts.

Do I need to declare cash per diems received on tour?

Yes, all payments received in connection with your self-employment will form part of your self-employed income. Any subsistence costs that you incur on tour will of course be allowable as a tax-deductible expense in the normal way. You should not ignore the per diems even if you are sure that you have spent the whole amount on tour.

i. Loan Interest and Bank Charges

Where you purchase a vehicle or equipment for use in your business on a hire purchase agreement or with a loan of any kind, the interest paid can be claimed against profit. It is important that you retain the loan documentation and indicate if the car or equipment is used both for business and personal purposes.

Interest on overdrafts or credit cards cannot be claimed in this context, as it is impossible to distinguish between interest charged on business and personal expenditure.

Charges applied to a business bank account can be claimed as a deduction. If, however, you use an ordinary account with a mixture of business and personal transactions, the charges will not be deductible from the business profit.

j***. Professional Clothing***

For the cost of an item of clothing to be claimed as a tax deduction it must be: purchased specifically for business use; be inappropriate for everyday use; and used only in a business context.

Items that cannot be claimed will include: overcoats; underwear; hosiery; and most footwear. Indeed, any item of clothing purchased from a high street retailer that could form part of anyone's everyday wardrobe will not be tax-deductible.

Items which will be allowable are restricted to protective clothing, uniforms or costumes, unsuited to normal wear.

The cost of dry cleaning for professional clothing is allowable as a deduction.

k. Make Up and Hairdressing

HMRC will refuse to allow these costs on the grounds that they are a normal cost incurred by most people in their day-to-day lives.

l. Tuition Fees

If you undertake a course of training or have private coaching to improve or update the skills you utilise in your business, a deduction for the costs will be allowed.

The cost of courses that are unrelated to your self-employment or of training for a new trade or profession are not allowable. Similarly, the cost of a course that will lead to a new qualification will not be allowed as such costs are regarded as "capital" in nature. This is the case even if the course is directly related to your business. The tuition fees you pay as a student in higher education are not tax-deductible.

m. Books and Magazines

Expenses in purchasing reference books and magazines purchased for research, etc. can be claimed.

n. Private Medical and Other Health-Related Expenses

Normally such expenses are disallowed as having by their very nature a personal element. The costs of maintaining or improving health are not tax-deducible but some allowance may be given if it can be shown that a delay in NHS treatment would adversely affect your business. If the treatment or procedure is only available privately a deduction may be approved. Where a procedure is for cosmetic purposes it is unlikely (although not completely impossible) that it will qualify as a business expense.

Costs such as Alexander Technique or performance psychology treatments can be claimed on the basis that any personal benefit is purely incidental to the business purpose.

I have joined a gym to improve fitness as my work is physically demanding: can I claim the membership fees I pay?

This is too remote from your business to be allowed. The costs cannot be “wholly and exclusively” for business purposes.

Can I claim for contact lenses and dentistry as my appearance is very important to my work?

No allowance is due for such costs on the grounds that there is always a private purpose involved.

o. Professional Subscriptions

Annual subscriptions to the unions or another professional association can be claimed. HMRC publishes a list of approved professional bodies

p. Entertaining

Not many items are specifically disallowed by law but the Income Tax Act forbids relief for ‘any expenses incurred in providing business entertainment’.

The purpose of the entertainment is irrelevant. Entertaining expenditure may be incurred wholly and exclusively for the purposes of your business, such as when you take an agent or promoter out to lunch: it will nonetheless be disallowed. Nor may a deduction be made for any expenditure which is incidental to business entertainment, such as your own travelling costs and the cost of your own meal.

3) Capital Items

Income Tax is not a tax on capital or wealth, and for this reason expenditure on capital items has not in the past been deducted from business profit. Capital expenditure is disallowed as a deduction for Income Tax but “Capital Allowances” can be claimed for items which can be classified as “plant and machinery”.

Items of plant and machinery purchased for your business, which will benefit the business for a number of years, are regarded as capital items. The most common such items are motor cars but other equipment such as computers or office equipment used in self-employment can also be capital items.

The aim of capital allowances (currently set at 18% per year) is to spread the cost of the item over its useful life in the business.

Since 2008 an “Annual Investment Allowance” (AIA) allowing 100% of expenditure on “plant and machinery” capital expenses has been available. The amount of the allowance varies from year to year.

The AIA does not apply to motor cars but can be claimed for vans or motorbikes.

Motor cars are dealt with separately from other capital items. The rate of allowance is set according to the car’s carbon dioxide emission rating. There is a 100% allowance for the least polluting cars with emissions of less than 50g/km and electric cars. The 100% allowance only applies to brand new cars. Cars with emissions of more than 110g/km are given an 6% allowance only. Cars with CO^2 emissions between 50-110g/km and second-hand low emission cars are given an 18% allowance.

If I buy a car on a loan when can I claim the capital allowance?

The allowance can be claimed as soon as you have entered into a binding contract to purchase the car.

I am buying a second-hand car which comes into the low emission category. Can I claim the 100% allowance?

No, the 100% allowance applies to brand new cars only.

4) The Income Tax Computation and the Self Assessment System

a. Income Tax Rates and Allowances

The amount of tax/NIC you pay depends on your level of profit for self-employment; whether you have other sources of income, such as PAYE employment salary or investment income; and whether you have paid any tax or NIC at source.

Everyone in the UK is entitled to a tax-free Personal Allowance. This means you pay no tax on the first £12,500 for 2019/20. The level of Personal Allowance is set by the Budget and will usually increase each year at least in line with inflation.

The basic rate of tax is currently 20% and you will pay tax at this rate on your taxable income above the Personal Allowance.

So if taxable income is £15,000 for 2019/20 you would pay:

£15,000 - £12,500 = £2,500 @ 20% = £500

A higher rate of tax of 40% is currently charged where the taxable income exceeds £50,000 for 2019/20. So if taxable income for 2019/20 was £60,000 the tax bill would be:

Tax Due @ 0% on £12,500 =	£0
Tax Due @ 20% on £37,500 =	£7,500
Tax Due @ 40% on £10,000 =	£4,000
Total Tax =	£11,500

There is an additional higher rate of tax for 2019/20 of 45% but this is not due until taxable income is over £150,000. In addition to Income Tax you must also pay Class 2 and Class 4 NIC on business profits. There is more about this later in the guide.

HMRC is also responsible for collecting Student Loan Repayments for the self-employed (again there is more on this later). In the example above, the NIC due on £60,000 taxable income would add £3,900 to the sum due. If a Student Loan Repayment was also to be included this would add a further £3,800 to the liability.

b. Self Assessment

To illustrate how the system works we will look at a person who leaves college in summer 2019 and starts self-employment on 1 September 2019.

The first thing to do is to look out or obtain a National Insurance Number. You cannot register with HMRC without a National Insurance Number.

Self–employment must be registered with HMRC as soon as possible. There are penalties for late registration and it is recommended that registration should not be delayed for more than six months after self-employment begins.

Registration can be accomplished by phone or by completing and submitting one form to HMRC. The online registration is here:

https://www.gov.uk/log-in-file-self-assessment-tax-return/register-if-youre-self-employed

HMRC will set up a Self Assessment record so that your liability to Income Tax and Class 4 and Class 2 NI Contributions is registered and you will be advised of your "Unique Taxpayer Reference". This is a 10-digit number that will be used for paying tax, etc. in due course.

As soon as you start self-employment you must start to keep a record of the fees that you earn and the expenses that you can claim. You would also be well advised to start putting aside some money to cover tax bills. If you can save 10 - 20% of gross income this should be sufficient for most people.

As self-employment started in September 2019 the first Tax Return will be issued on 6 April 2020. On this Return income for the whole year 6 April 2019 to 5 April 2020 will be declared, including the first period of self-employment from 1 September 2019 to 5 April 2020.

The self-employed income and expenses (with a capital allowance computation if appropriate) will be summarised on a set of additional pages attached to the Tax Return.

The Tax Return must be submitted to HMRC on or before 31 January following its issue (in this example by 31 January 2021). If the Return is submitted late a penalty of £100 will be automatically charged. In cases of further delay HMRC may levy penalties which can exceed £1,000.

c. How and When Tax, etc is Due for Payment

Once the Return has been completed and submitted, the first tax bill will be known. The sum due will include Income Tax and the two types of National Insurance Contributions: Class 4 NIC that is profit-related and the flat rate Class 2 NIC. It may also include Student Loan Repayments, if applicable.

The first tax bill becomes due on the last filing date: for 2019/20 Tax Returns that will be 31 January 2021. It is recommended that you complete and submit the Tax Return as soon as possible so that you are aware of the size of the tax bill in advance of the sum becoming due.

If the overall tax/NIC bill payable exceeds £1,000, 50% payments on account of the next year's liability are also due. These payments on account are due on 31 January during the tax year and 31 July after the year finishes.

For example, if your liability for 2019/20 proves to be £1,200 you will be due to pay £1,800 on 31 January 2021, followed by another payment on account on 31 July 2021 of £600.

So your first tax payment if you start self-employment in September 2019 does not become due for sixteen months. But beware: if the liability exceeds £1,000 you will be paying a large lump sum.

When you have been self-employed for a further year the process begins again. If the tax bill for the next year exceeds that of the previous tax year, the extra amount above the payments on account that you may already have made is due on the following 31 January.

A typical pattern of payments in the early years of self-employment could be like this:

Tax Liabilities

2019/20 £   800

2020/21 £1,500

2021/22 £2,400

2022/23 £2,200

Dates of Payment and Amounts Due

31/01/2021 £ 800 (all tax/NIC due 2019/20)

31/07/2021 £ 0 (No payment on account required)

31/01/2022 £1,500 plus £750 = £2,250 (All tax/NIC due 2020/21 + 50% on account)

31/07/2022 £ 750 (50% payment on account)

31/01/2023 £ 900 plus £1,200 = £2,100 (Final payment 2021/22 + 50% on account)

31/07/2023 £1,200 (50% payment on account)

31/01/2024 Refund (£200) plus £1,100 = £900 (50% on account less overpaid 2021/22)

31/07/2024 £1,100 (50% on account)

It can be seen that this system means that there are often peaks and troughs in the tax payments and this can be exacerbated if a Student Loan Repayment (SLR) has to be included. The SLR is payable on the 31 of January each year and is not included when computing the 50% payments on account.

The best advice is to keep your records up to date so that the annual accounts and Tax Return can be prepared early. This will give you the most warning of impending tax payments and may also allow you to reduce payments on account or claim a refund if your profits go down.

5) National Insurance Contributions

When you register as self-employed for Income Tax you are also required to pay Class 2 & 4 NI Contributions. The Class 2 NIC is a flat rate (£3.00 per week for 2019/20) and is collected with the tax and Class 4 NIC on 31 January each year.

If you pay Class 2 NIC for a full tax year, that year will count towards the 35 years of contributions needed to qualify for the full basic state retirement pension. The Class 2 contributions also give entitlement to Maternity Allowance.

When self-employed profits are below a lower limit (£6,365 for 2019/20) no Class 2 Contributions are payable. You may voluntarily pay the Class 2 NIC in years of low profits to secure pension, etc. benefits.

The Class 4 contributions are collected with the Income Tax under Self-Assessment. These contributions are profit–related and do not, at present, confer any entitlement to benefits under the state system. The rate of Class 4 NIC is 9% and this charged on profits between £8,632 and £50,000 (2019/20 figures). Class 4 contributions are also charged at the rate of 2% on profits above the NIC upper limit.

You may find that you pay employee's NIC (Class1 contributions) on some earnings included in your self-employed accounts. Where this occurs, we will adjust the profit chargeable to Class 4 NIC to take account of this and avoid a double charge. It is important that you keep the payslips/P60's to vouch any Class 1 contributions paid at source.

6) Student Loan Repayment

Student Loan Repayment (SLR) starts from the 6 April following the date you leave higher education. For example, if you leave graduate in summer 2020, the first tax year for which you will be liable to pay SLR is 2021/22 (6 April 2021 – 5 April 2022). There are exemptions from payment and those with low earnings do not have to make any repayment until their income reaches set thresholds.

For the self-employed, student loans are repaid through the Self Assessment tax system with your Tax and NIC.

The SLR can also be collected through payroll deduction if you have a PAYE employment and your earnings are higher than the set monthly threshold. If you move abroad whilst still owing a Student Loan you must make alternative arrangements.

There are now two types of Student Loan Repayments: Plan 1 for loans taken out before September 2012 and Plan 2 for loans taken out after 1 September 2012.

The annual thresholds for 2020/21 are £19,390 for Plan 1 loans and £26,575 for Plan 2 loans. The SLR is charged at 9% on income over these thresholds, so can add considerably to the payment due each January under Self Assessment.

7) Value Added Tax (VAT)

Most self-employed people are not VAT-registered and there is little benefit to registration under current rules. You only need to register for VAT if your income for any twelve-month period exceeds a turnover limit set by the budget each year. For 2019/20 the limit is £85,000.

Being registered for VAT brings its own problems and we wouldn't recommend registration unless it becomes mandatory.

If your gross income from self-employment is close to the VAT threshold you must check the level of income for the last twelve months at the end of each month. Do not wait for the end of your accounting year or the tax year if you suspect that your income is close to this threshold, as there are penalties for failing to register for VAT in good time.

From April 2019 VAT Returns are submitted in a digital format. This is part of the HMRC plan to "Make Tax Digital" ("MTD")

8) The Future – "Making Tax Digital"

At some point in the next few years HMRC plans to force all self-employed individuals and landlords to keep their business records and report their income and expenses to them digitally. Making Tax Digital (MTD) will probably apply to everyone with turnover or rents of over £10,000 per year. This will replace the current Self Assessment system.

Third party sources of income, such as employment pay and investment income, will be reported to HMRC by employers and banks, etc. so that the individual's tax record is pre-populated with this information. With the addition of four quarterly reports for self-employed and/or rental income also being logged on their system through the tax year, the need for an annual Tax Return will be eliminated.

HMRC's vision is that businesses will keep track of their tax affairs digitally using software or apps and provide summary tax data to HMRC quarterly, using these digital tools. The summary tax data will be automatically generated for the business from the electronic records. For Income Tax these updates will cumulatively build an in-year picture of the business' tax position for them.

Businesses will provide a finalised end of year position to HMRC of their tax affairs, again using digital tools. This obligation will apply ten months after the fourth quarter referred to above and will crystallise the taxable profits of that business for the previous year. For many businesses, this will simply be a matter of checking and agreeing the total for that year, based on the information which they have provided in the relevant four quarters.

It will be mandatory to keep your tax records via a mobile phone app, or on a software product on your laptop. If you prefer to keep records using an "MTD-compatible spreadsheet" this too will be permitted. It would seem that paper-based record-keeping will no longer be allowed once this system is mandated.

We hope this guide is helpful. If you are in any doubt about the advice given please do get in touch.

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