Seaforth Taxation
Specialist Accounts & Tax Advice For Musicians

THE MUSICIAN'S GUIDE TO TAX

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Introduction

When you are self-employed, HM Revenue and Customs (HMRC) require you to report your income to them on a Tax Return each year. The system is called "Self Assessment": you must report your taxable income; deduct the allowable expenses; and calculate the tax and NI Contributions that you must pay on the net profit (taxable income minus tax-deductible expenses).

The Tax Return also contains various sections to declare the different types of income you might have: self-employed income and expenses; employment income (taxed at source under the Pay As You Earn system); investment income; rental income, etc.

The Return is usually submitted on-line. HMRC will initially accept the figures but they can query and correct figures included on the Tax Return for up to a year after it is filed. Indeed, if information comes into their possession that indicates that the Return is incomplete they can raise queries at any time.

If HMRC decides an error has been made (income has been omitted or expenses have been over-claimed) they can increase the tax and NIC payable. Adjustments can be made for up to six years.

The "error" in the Return could be a simple mistake or you may have misunderstood the rules. The Inspector could look to rectify matters by demanding payment of seven years' extra tax and NIC; plus interest on the unpaid amounts from up to seven years ago; plus a penalty, which in cases where deliberate fraud is suspected 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 booklet aims to provide some guidelines to assist you and answer some common questions.

Tax is complicated and this guide is intended to be simple. If you have any doubts about the advice contained here, please do call to discuss the right way to proceed.

1) Self-Employed Income

Getting the income right is the most important part of preparing accounts. The amount of expenses that you can claim might sometimes be open to interpretation but there is only one correct figure for income each year.

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.

HM Revenue and Customs expects that all fees should be recorded as and when 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 earnings 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.

The Inspector, if he or she chooses your case for in-depth enquiry, 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. Where a credit to a bank account cannot be accounted for, the Inspector 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 subsistence – is it the fee only that is taxable?

No, the full amount must be declared. You can claim a deduction for any sums actually spent on travel and subsistence.

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

No, your accounts can cover any year of your choosing but it is 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 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 fee is by reference to when it was earned. If you work for someone in March 2018 and they don't pay you until June 2018 you would include the fee in the accounts for the year to 5 April 2018. You can choose instead to declare income on the basis of when it is received but in the long run the same income will be declared. When you work for an organisation such as an orchestra or school that 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 quite possible for a fee to be free of tax but subject to the deduction of NIC, especially in the case of work in schools, colleges and theatres. NI Contributions deducted at source can be taken into account when calculating the self-employed NI Contributions due.

Should I include in my accounts fees where PAYE tax has been deducted?

Generally speaking, no. Employment income taxed under PAYE is taxed under separate rules and is declared on a different section of the Tax Return. But if the amounts involved are small and the engagement forms a natural part of your self-employed activities, we can apply for a "No Tax" PAYE code so that the income can be paid tax-free and be included in future self-employed accounts.

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 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 for Income Tax. Students have the same tax-free Personal Allowance as anyone else and if you start to earn freelance fees while still at college you may need to register your self-employment with HMRC. If income exceeds the Personal Allowance (£11,500 for 2017/18) you may need to pay tax.

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.

I have won a prize in a music competition. Is this tax exempt?

No, such awards are generally regarded as being earned in the course of your self-employment and will be taxable. Only if you win a prize before self-employment has started would it not be part of taxable income. Prizes awarded as a mark of public esteem rather than won in competition are tax-exempt.

2) Expenses in Self-Employment

HMRC recognises that to earn money the self-employed person will incur expenses. 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 freelance work will be allowable as a deduction from profit.

The law says that a deduction from business profits may be claimed only for expenses incurred "wholly and exclusively" for business purposes. Some expenses are specifically disallowed by law; some expenses are "capital" in nature (large sum expenses on business assets like cars or instruments) for which there are special rules; some expenses can be deemed to be for personal rather than business purposes; and some expenses will need to be apportioned where there is a mixture of business and personal usage.

Whether an expense is tax-deductible can only be determined by reference to statute law, 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 or cashbook. 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 computer spreadsheet or in a written record such as our own record-keeping booklet.

a. Use of Home

For most musicians 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 house: heating and lighting bills; insurance; Council Tax; and rent or mortgage interest. "Business purposes" will include office administration time as well as practice and perhaps research. The time taken in teaching private pupils at home will also be counted.

It is important to note that where the home is being purchased it is only the interest on any mortgage that will be eligible for relief. You cannot claim on the whole monthly mortgage payment for a repayment mortgage. The interest only is to 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 converting my loft into a music room. 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 as such cannot be claimed against income.

In that case can I claim a capital allowance for a loft conversion?

Capital allowances cannot be claimed on private dwellings 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 the cost against tax?

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

b. Other Premises Costs

The rental of studios, rehearsal rooms or venues should all be allowable. If you teach in a school on a freelance basis and pay a "facilitation" fee or room rent this can also be deducted.

c. Instrument Maintenance

The costs of hiring, repairing, maintaining and insuring instruments will be allowable.

You should, however bear in mind that some restriction to the claim for expenses may be due where the instruments are also used in PAYE employment. For instance, if you work in an orchestra and receive your salary after deduction of tax, your PAYE code may include a fixed rate allowance for expenses. This will often include a sum for instrument maintenance and a further claim for expenses against freelance income may therefore be inappropriate.

d. Fees, Commissions and Wages Paid

Commission paid to an agent for obtaining work can be allowed, as can fees paid to other musicians where you have, for example, arranged for a string quartet to play at a wedding or fixed a band to play at the reception. You declare the full fee as part of your income and claim the musicians' fees as an expense.

Wages paid to a bookkeeper or secretary 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 carefully a number of factors:

a. If they have other income will the wages you pay mean they have to make a Tax Return?

b. If you are paying them a wage should you be operating PAYE as an employer?

c. Are you paying them a commercial wage considering the amount of work involved?

Can I pay my non-earning partner/spouse a nominal amount for their help?

No, an actual transfer of funds must take place if tax-relief is to be obtained. A monthly standing order to an account in their name only would satisfy most Inspectors, so long as the amount paid is not excessive bearing in mind the work undertaken.

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

Because these costs are not incurred in the work itself but instead put you in a position to do the work they are disallowed for tax purposes so cannot be included as an expense deducted from self-employed income.

Under the "Tax-Free Childcare" scheme introduced in 2017 you can register and open an online account at gov.uk (the Government website). You will then receive 'top up' payments into this account at a rate of 20p for every 80p that you pay in, subject to a limit of £2,000 Government support per child per year. Full details of the scheme are online and not everyone will qualify for this.

e. Administrative Costs

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

In this connection it is worth emphasising that "business usage" 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 for business (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 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.

The authorised mileage rate method may only be used if turnover is less than the annual VAT registration limit (2017/18 £85,000). 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.

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 unlawful behaviour.

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 with a restriction 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.

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.

Can I swap between the two methods?

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

What journeys can I include in the business mileage calculation?

There is no tax relief for "ordinary commuting" to and from an employment where you pay PAYE tax at source. So, for example, travel to and from a school where you are taxed at source must not be included as business mileage. If you rent business premises separate from your home, such as a teaching room, this is also not business travel.

Where your home is the only base for self-employed work you may claim business travel to and from the places you attend for self-employed purposes. If, however you attend an additional "place of business" on a regular and predictable basis, HMRC could argue that no relief for travel costs would be due. This would only apply if the number of places travelled to was very limited.

g. Other Travel Costs

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 you can claim expenses based on authorised mileage rates: 24p per mile for motorbikes and 20p per mile for bicycles.

Where a hotel or other accommodation is booked for an overnight stay before or after a performance or while on tour 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" if the business trip is outside the "normal pattern of travel". So expenses incurred on a one-off engagement will be allowed but expenses on trips to a usual base (for example, an orchestra's normal concert venue, a school where you teach regularly, or a theatre where you work for a number of weeks) would be disallowed.

Can I claim for the cost of buying a meal for an agent?

No, the cost of "entertaining" business contacts or prospective clients, agents etc. is specifically disallowed by law.

Can I claim meal costs at a school where I teach every week?

No, there must be an element of exceptional travel for any claim to be allowed.

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.

h. Loan Interest and Bank Charges

Where you purchase a vehicle or equipment/instruments 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 any charges will not be deductible from the business profit.

i. Professional Clothing

For the cost of an item of clothing to be claimed as a deduction from profit 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.

Items which will be allowable will include: dress suits and tail coats for male classical musicians; concert dresses and evening wear for female classical musicians; stage wear in the nature of a costume and unsuited to normal wear for other musicians.

The cost of laundry and dry cleaning for professional clothing is also allowable.

I work in a pit orchestra – can I claim for the cost of the black clothing that I must wear?

If we apply the letter of the law, probably not. But in practice a moderate claim in this respect might be accepted.

I wear a dress suit for concerts and need to buy expensive shoes to go with it. Can I claim for these?

In strictness an Inspector would probably disallow such a cost. But if the shoes were really kept only for use on the concert platform the cost could be passed.

j. Make Up and Hairdressing

HM Revenue 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. If, however, costs are incurred for stage make-up an allowance will be due.

k. Tuition Fees

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

Costs of courses 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 musical career. The tuition fees you pay as a student in higher education are not tax-deductible.

l. Music, CDs, Downloads and Magazines

Expenses in purchasing music for performance or study and for recordings purchased to help in learning repertoire will be allowable in full.

Reference books and magazines purchased for the same purposes can also be claimed.

m. Private Medical 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. Where the cost is for cosmetic purposes, a performer may claim a deduction in some circumstances and in certain other cases, such as specialist dental treatment for wind players, a deduction may be approved.

Costs such as Alexander Technique or performance psychology treatments can be claimed. The cost of osteopathy or physiotherapy can be claimed where the treatment arises specifically from the strains of playing an instrument, etc. A deduction of a percentage of the costs to reflect the personal benefit accruing to the individual will usually be appropriate in these cases.

I have joined a gym to improve fitness after an accident: can I claim the 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 glasses or contact lenses?

Generally no allowance is due but a claim can be made for music-reading glasses with a specific prescription for mid-range use in an orchestra.

n. Professional Subscriptions

Annual subscriptions to the Musicians Union, ISM or another professional body for your particular branch of music can be claimed. If you are also in PAYE employment at a school or college a teaching union subscription will often be available for tax relief through your PAYE code.

3) Capital Items

Items purchased for your business, which will benefit the business for a number of years, are called capital items. The most common are, of course, motor cars and musical instruments, but other equipment such as computers or recording equipment used in self-employment can be capital items.

Income Tax is not a tax on capital or wealth, and for this reason capital items have not in the past been deducted pound for pound from trading profit. Instead "Capital Allowances" are claimed. The allowances (currently set at 18% per year) have the effect of spreading the cost of the item over its useful life in the business.

You may, however, claim an "Annual Investment Allowance" (AIA) allowing 100% of expenditure on capital items (excluding cars) up to £200,000 per 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 75g/km. This only applies to brand new cars. Cars with emissions of more than 130g/km are given an 8% allowance only. Cars with CO^2 emissions between 75-130g/km and second-hand low emission cars are given an 18% allowance.

From April 2018 the threshold for the 100% allowance will be reduced to 50g/km of CO_2, to reflect falling vehicle emissions. Similarly the threshold at which the lower 8% allowances applies will be reduced to 110g/km

The changes to these thresholds will have effect in relation to cars purchased from 1 April 2018 to 31 March 2021, when the 100% allowance for low emission cars will be withdrawn.

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.

I have recently started self-employment and have a number of instruments gifted to me by family. Can I claim for these?

Yes, so long as ownership of the instruments has passed to you, an allowance can be claimed. It does not matter if items have been gifted to you. The allowance will be calculated according to the value of the instruments held on the first day of self-employment.

I expect my instrument to increase in value: can I claim an allowance for it?

A claim can be made for capital allowances or Annual Investment Allowance. You should, however, bear in mind that assets such as instruments, whose value may appreciate over time, may give rise to an addition to profits when sold or otherwise disposed of, or on the cessation of self-employment.

This is because the aim of the allowance is to give tax relief to a business over the length of time for which an asset is used, equal to the cost to the business of owning the asset. In most cases this is straightforward: for example when you buy a car and use it until it is scrapped, tax relief is due on the full cost of the car.

Where the value of an asset does not in fact depreciate, the cost to the business of owning the asset will be nil as the asset is sold for a value above its purchase price. Any allowances given in the intervening period are then recouped by the Revenue on the sale of the asset or cessation of self-employment, increasing substantially the tax liability for the year in which the event occurs.

Where the Annual Investment Allowance (AIA) has been claimed on the purchase of a new instrument, the value carried forward in the capital allowance computation is nil. If the instrument is sold the sale proceeds are added to the computation and will give rise to "balancing charge" on which tax/NIC will be payable.

4) The Income Tax Computation

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 £11,000 for 2016/17. 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 was £12,000 for 2016/17 you would pay:

£12,000 - £11,000 = £1,000 @ 20% = £200

A higher rate of tax of 40% is currently charged where the taxable income exceeds £43,000 for 2016/17. So if taxable income for 2016/17 was £50,000 the tax bill would be:

Tax Due @ 0% on £11,000 =	£0
Tax Due @ 20% on £32,000 =	£6,400
Tax Due @ 40% on £7,000 =	£2,800
Total Tax =	£9,200

There is an additional higher rate of tax for 2016/17 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 £50,000 taxable income would add £3,920 to the sum due. If a Student Loan Repayment was also to be included this would add a further £2,925 to the liability.

5) The Self Assessment System

To illustrate how the system works we will look at a person who leaves college in summer 2016 and starts self-employment on 1 September 2016.

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, online or by completing and submitting one form to HMRC. 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 20% of gross income this should be sufficient for most people.

As self-employment started in September 2016 the first Tax Return will be issued on 6 April 2017. On this Return income for the whole year 6 April 2016 to 5 April 2017 will be declared, including the first period of self-employment from 1 September 2016 to 5 April 2017. The self-employed income and expenses with a capital allowance computation 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. 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.

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 2016/17 Tax Returns that will be 31 January 2018. 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 2016/17 proves to be £1,200 you will be due to pay £1,800 on 31 January 2018, followed by another payment on account on 31 July 2018 of £600.

So your first tax payment if you start self-employment in September 2016 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

2016/17 £ 800

2017/18 £1,500

2018/19 £2,400

2019/20 £2,200

Dates of Payment and Amounts Due

31/01/2018 £ 800 (all tax/NIC due 2016/17)

31/07/2018 £ 0 (No payment on account required)

31/01/2019 £1,500 plus £750 = £2,250 (All tax/NIC due 2017/18 + 50% on account)

31/07/2019 £ 750 (50% payment on account)

31/01/2020 £ 900 plus £1,200 = £2,100 (Final payment 2018/19 + 50% on account)

31/07/2020 £1,200 (50% payment on account)

31/01/2021 Refund (£200) plus £1,100 = £900 (50% on account less overpaid 2019/20)

31/07/2021 £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 have gone down.

6) 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 (£2.80 per week for 2016/17) and is collected with the tax and Class 4 NIC for the previous year on 31 January.

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 be the exception limit (£5,965 for 2016/17) no Class 2 Contributions are payable. In some cases it may be beneficial to continue to pay the Class 2 voluntarily to secure pension, etc. benefits even though profits are low.

The last year for which Class 2 NIC will be charged is 2017/18. From April 2018 it will be abolished and the entitlement to state pension will thenceforward be based on payment of Class 4 NIC.

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 £8,060 and £43,000 (2016/17 figures). There is a 2% rate that applies to profits above the upper limit.

You may find that you pay employees 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 the Class1 contributions paid at source.

7) Student Loan Repayment

Student Loans are repaid through the tax system (unless you move abroad in which case you must make alternative arrangements). Student Loan Repayment starts from the 5 April following the date you leave higher education. It can be collected through payroll deduction if you have a PAYE employment and your earnings are higher than the set monthly threshold. Otherwise it will be collected through the Self Assessment system.

Student Loan Repayment (SLR) is calculated as 9% of income over an annual threshold (£17,495 for 2016/17) so can add considerably to the payment due each January under Self Assessment.

For example, the SLR due on taxable income of £25,000 would be £675 so this must be borne in mind when putting money aside for "tax" bills.

These figures refer to "Plan 1" loans taken out before September 2012. For "Plan 2" loans taken out after that date there is a higher threshold of £21,000 although the rate of repayment is the same at 9%. Plan 2 loans will start to be repaid from April 2017 onwards.

8) Value Added Tax

Being registered for VAT brings its own problems and we wouldn't recommend registration unless it becomes mandatory. You must register for VAT if your income for any twelve month period exceeds a turnover limit set by the budget each year. For 2016/17 the limit was £83,000.

If your gross income from self-employment is close to this 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.

9) Tax Advisors and Accountants

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 HMRC checks only 2% of the Returns it receives, you could be forgiven for thinking that all is in order and it may only be when an enquiry letter arrives that problems going back many years are uncovered.

This is why a tax advisor with experience in your professional field can provide a level of certainty that the figures submitted will stand up to challenge from HMRC and that you are paying the right amount of tax and NIC.

We are always available to give advice 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.

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 income and expenses. The figures from the accounts can be used in applying for mortgages, student grants, state benefits, etc.

To prepare the annual figures we will need to see:

1. A written record of self-employed income and expenses. This can be a computer spreadsheet or a paper record.

2. Payslips, invoices, P60s etc. to vouch the amount of income received.

3. Receipts or other evidence of the expenses to be claimed.

4. Bank statements for the main account used for business.

5. Other paperwork that may have a bearing on the tax computation such as loan agreements; foreign tax certificates; mortgage statements; agent statements, etc.

10) Making Tax Digital

HM Revenue & Customs has developed a plan 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 apply to everyone with turnover/rents of over £10,000 per year. This will replace the current Self Assessment system.

It is envisaged that 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.

- 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 VAT, these quarterly updates will effectively replace the VAT return. For Income Tax these updates will cumulatively build an in-year picture of the business' tax position for them

- 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.

Businesses, self-employed people and landlords will be required to start using the new digital service from:

- April 2018 if they have profits chargeable to Income Tax and pay Class 4 National Insurance contributions (NICs) and their turnovers are in excess of the VAT threshold (£85,000)

- April 2019 if they have profits chargeable to Income Tax and pay Class 4 NICs and their turnovers are below the VAT threshold

- April 2019 if they are registered for and pay VAT

- from April 2020 if they pay Corporation Tax (CT)

A penalty of up to £3,000 may be imposed for not keeping electronic records and preserving those electronic records for a specified period.

There will also be a voluntary system for paying tax and NIC on a quarterly basis through the year.

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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