

# **The Musician's Guide to Tax**

## **Introduction**

The UK tax system can be complicated. Sometimes a taxpayer completing their own Tax Return may unwittingly declare the wrong income or might claim relief for an item which does not qualify for a tax deduction. The Tax Return is nonetheless submitted to HM Revenue & Customs in good faith.

As HMRC only checks a fraction of the Tax Returns it receives, the assumption will be, when the Return is accepted without challenge, that all is in order. Months or even years after the event, however, a letter might arrive querying the figures and asking to see the records and bank statements. It is only then 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 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 provide a set of self-employed accounts for you, summarising the taxable income and tax-deductible expenses using the relevant figures provided. 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:

By phone: **01929 423229**

By E-Mail **seaforthtaxation@btinternet.com**

## **Contents**

### **1) The Self-Employed Business**

### **2) Self-Employed Income**

### **3) Expenses in Self-Employment**

### **4) Capital Items**

### **5) The Income Tax Computation and the Self Assessment System**

### **6) Value Added Tax (VAT)**

### **7) The Future – "Making Tax Digital"**

## **1) The Self-Employed Business**

When you are self-employed you are your own business in the eyes of HMRC, and they expect that you will keep records to a reasonable standard, as any business should, so that you can pay the correct Income Tax (and National Insurance Contributions) on your business profit.

Your business profit is, put simply, your self-employed income minus 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 a salary from an employed position (where tax and NIC are deductible at source), 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 would claim for travel costs that you had to pay to fulfil a self-employed engagement but you would not claim the cost of travelling to a restaurant for a night out.

HMRC requires 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” for the good reason that HMRC does not work out your profit or the tax bill for you: you must do the calculations yourself, either alone or with the help of a tax adviser.

The Tax Return contains various sections to declare the 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 online. Initially, HMRC accepts 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 deliberately incorrect, they can investigate without a time limit.

When HMRC establishes that a Return is inaccurate, they can look back over previous years and demand additional tax and NIC for the earlier years as well as the year under investigation.

The Return could be wrong simply because you have misunderstood the rules. Nonetheless, you could face having to pay extra tax, plus interest and a penalty. The penalty in the most serious cases, where deliberate fraud is involved, can double the amount payable.

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.

## **2) Self-Employed Income**

Getting your 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. From April 2026 those earning over £50,000 from self-employment will need to keep their records digitally. This is part of the “Making Tax Digital” project (see section 8 below).

From April 2024, HMRC is moving to the “cash basis” as the default method of recording income. This means that you only need to declare a fee once you have received payment. Historically, HMRC had expected that all self-employed fees should be recorded as and when they are earned and this is still good practice to make sure that nothing is omitted in compiling the record of income.

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.**

### **FAQs**

#### ***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?***

From April 2024, all business profits must be reported to HMRC on the basis of the tax year so an accounting date other than 5 April will be actively discouraged. When you start self-employment, it is normal to prepare a part-year statement of income and expenses up to 5 April 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?***

At present, the strict basis for declaring a fee is by reference to when it was earned. Under the “earnings basis” your Tax Return for 2023/24 will include all fees earned from 6 April 2023 up to 5 April 2024, including any fee earned in that year but paid after 5 April 2024. From April 2024 the default basis of assessment is changing and all businesses can declare their income from 2024/25 onwards on the basis of when fees are received, on the “cash basis”.

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

In most cases, no: the deduction of NIC at source would indicate that this is employment income which must be declared separately on the Tax Return. If, however, it was only National Insurance that was deducted and a “No Tax” or “NT” PAYE code was in operation, then the fees can be classed as self-employed income and included in the accounts. The rules that govern Income Tax and National Insurance are different and it is sometimes possible for a self-employed fee to be free of tax but subject to the deduction of NIC, especially in the case of work in schools, colleges and theatres.

***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 level 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: 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.

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

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.

### **3) Expenses in Self-Employment**

Tax law recognises that, in order to earn money, the self-employed person will have to spend 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 instruments) 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 the 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.

If your self-employed expenses are minimal, or you simply do not want to keep a record of them, you can instead reduce your profit by the £1,000 “Trading Allowance”.

#### **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 floorspace or 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 practice and perhaps research. If you teach private pupils at home this will increase the amount that you can claim.

***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 on a mortgage 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 for use as a practice 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 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 number of 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 studios, rehearsal rooms or venues should all be allowable. If you teach in a school on a freelance basis and pay a facilities fee or room rent this can also be deducted.

**c. Instrument Maintenance and Insurance**

The costs of hiring, repairing, maintaining and buying accessories for instruments will be allowable. The cost of insurance is also tax-deductible.

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 example, 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 for you will be allowed. You can also claim the deputy fee where you cannot fulfil an engagement.

Fees paid by you to other musicians will be deductible 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 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.

Any salary paid will need to be commensurate with the hours and duties undertaken, otherwise HMRC could challenge the cost as not being wholly and exclusively for business.

#### ***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 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.

Commuting to work (if you have only one place or very few places at which you work) is not classed as business mileage but as part of your personal use of the car, even if you are travelling, for example, to a school where you are engaged on a freelance basis. HMRC may disallow costs of travel to places of business that are attended on a “regular and predictable basis”.

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 CO2 emissions rating.

#### ***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.



### **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, for a motorbike you can claim expenses based on an authorised mileage rate of 24p per mile.

### **h. Hotel/Accommodation and Subsistence**

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 or your business is itinerant in nature. These “subsistence” costs can be claimed where you are touring or visiting a town for a one-off engagement. 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 or months) would be disallowed.

#### ***If I am touring and renting a room in digs, 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/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, 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. No deduction is available for the costs of clothing which forms part of an 'everyday' wardrobe. Even if you wear the clothing in question only on business occasions, it will still be disallowed if the clothing might suitably be worn as part of a hypothetical person's "everyday" wardrobe.

Items which will be allowable will include: dress suits, tail coats, concert dresses, evening wear and stage wear in the nature of a costume.

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

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

A black shirt or blouse, it could be argued, is not an everyday item of clothing, so an allowance for the cost of purchase could be claimed. Black trousers, however, are to be found in most people's wardrobe so, if we apply the letter of the law, we should probably not claim for those. 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, HMRC 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.

### **k. Make Up and Hairdressing**

HMRC will refuse to allow these costs on the grounds that they are a normal periodical cost incurred by most people in their day-to-day lives. Hairdressing, etc. costs for a specific occasion like a photo-shoot or stage appearance, can be claimed.

### **I. Tuition and Training Costs**

If you undertake a course of training, attend a masterclass or have private coaching to improve or update your musical skills, 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, even if the course is directly related to your musical career, as such costs are regarded as “capital” in nature i.e. the fees paid bring into being an asset (the qualification) which is of enduring benefit. For this reason the tuition fees you pay as a student in higher education are not tax-deductible.

Where a training course is intended to have a broad impact across a person’s personal as well as their professional life, this will not be attended solely for a business purpose and the costs are therefore disallowed, even if you believe that the course will make you a better professional.

### **m. 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. Monthly subscriptions for music-streaming services can be claimed where the predominant purpose is for research. Generalised subscriptions to services such as Netflix or Amazon Prime are not tax-deductible.

Reference books and magazines purchased for research, etc. can also be claimed.

### **n. Private Medical and Other Health-Related Expenses**

Normally such expenses are disallowed as having by their very nature a personal element, since we will all want to enjoy better health in our daily lives. The costs of maintaining or improving health are not tax-deductible but some allowance may be given if it can be shown that, for example, a delay in NHS treatment would adversely affect your business. If the treatment or procedure is only available privately (for example, specialist dental treatment for wind players) 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.

#### ***Can I claim for the cost of visiting an osteopath?***

The cost of osteopathy or physiotherapy would strictly fail the test of being “wholly and exclusively” business in nature. As, however, it is clear that musicians suffer disproportionately with these issues - and the impact on their professional lives can be more acute than would be the case for, say, an office worker – we do typically stretch a point and include part of the costs as a tax-deductible expense.

#### ***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 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.

***As a woodwind player can I claim for the cost of dentistry?***

The cost of normal check-ups or treatments will not qualify for deduction. If, however, you have treatment made more expensive by considerations around the embouchure and your dentist can confirm that in writing, a tax deduction will be available.

***o. 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.

***p. Entertaining***

There are not many items that are specifically disallowed from tax relief by law but the Income Tax Act forbids relief for 'any expenses incurred in providing business entertainment'. Such costs will include buying a meal or a concert or theatre ticket.

The purpose of the entertainment is irrelevant when considering whether to disallow the cost. 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 or the cost of your own meal.

#### **4) Capital Items**

Income Tax, as its name suggests, is not a tax on capital or wealth, and for this reason expenditure on capital items (that is: higher value items that are used in business for a prolonged period) has not in the past been deducted from business profit.

Although capital expenditure is disallowed as a deduction for Income Tax, "Capital Allowances" can be claimed for items which can be classified as "plant and machinery".

For musicians, the most common capital items are motor cars and musical instruments, but computers or recording equipment can also be classed as 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.

Having said that, since 2008 there has also been an "Annual Investment Allowance" (AIA) that allows 100% deduction of expenditure on "plant and machinery" capital expenses, such as instrument purchases. For example, if you buy a piano for business use, you can claim the full cost as a deduction from profit in the year of purchase. You should bear in mind that if you sell the piano at a later date the sale proceeds will be a "balancing charge" to be added to profit in the year of sale. The value of the capital items held at the cessation of self-employment will also need to be taken into account at retirement.

The Annual Investment Allowance 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 currently a 100% allowance for brand new electric cars. Cars with emissions of less than 50g/km are given an 18% allowance. Cars with CO<sup>2</sup> emissions above 50g/km are given a 6% allowance.

Any capital allowance claimed for a car will be restricted to take non-professional use into account.

#### ***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 electric 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, can 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 HMRC on the sale of the asset or the cessation of self-employment if that comes first, 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 later sold the sale proceeds (up to the original purchase price) are added to the computation and will give rise to “balancing charge” on which tax/NIC will be payable.

## **5) The Income Tax Computation and the Self Assessment System**

### **a) Income Tax Rates and Allowances**

The amount of tax/NIC that you are due to pay each year depends on a number of factors: the level of profit from self-employment; whether you have other sources of income, such as PAYE employment salary or investment income; whether your total income puts you into the higher rates of tax; and whether you have paid any tax or NIC at source.

Everyone in the UK is entitled to a tax-free Personal Allowance (although if you are lucky enough to earn more than £100,000 it will be reduced). For 2023/24, this means that you pay no tax on the first £12,570 of income. The level of Personal Allowance is set by the Budget and will usually increase each year. Since 2019/20, however, the allowance has only increased by £70.

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 2023/24 you would pay:

$$£15,000 - £12,570 = £2,430 @ 20\% = £486.$$

A higher rate of tax of 40% is currently charged where the taxable income exceeds £50,270 for 2023/24. So if taxable income for 2023/24 was £60,000 the tax bill would be:

Tax Due @ 0% on £12,570 =	£0
Tax Due @ 20% on £37,700 =	£7,540
Tax Due @ 40% on £9,730 =	<u>£3,892</u>
Total Tax =	£11,432

There is an additional higher rate of tax for 2023/24 of 45% but this is not due until taxable income is over £125,140. 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 £3,600 to the sum due. If a Student Loan Repayment was also to be included this would add a further £3,400 (approximately) to the liability.

## **b) National Insurance Contributions**

When you register with HMRC 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 (£3.45 per week for 2023/24) 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 state retirement pension. The Class 2 contributions also give entitlement to some other benefits such as Maternity Allowance.

When self-employed profits are below a lower limit (£12,570 for 2019/20) no Class 2 Contributions are payable. Where income is between the small profits threshold of £6,725 and £12,570 you will get a credit for NIC with no payment required.

If self-employed profit is less than £6,725 you may voluntarily pay the Class 2 NIC 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 main rate of Class 4 NIC is 9% and this charged on profits between £12,570 and £50,270 (2023/24 figures). Class 4 contributions are also charged at the rate of 2% on profits above £50,270 without limit.

You may find that you pay employee's NIC (Class 1 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.

## **c) Student Loan Repayment**

A liability to Student Loan Repayment (SLR) starts from the 6 April following the date you leave higher education. For example, if you graduate in summer 2023, the first tax year for which you will be liable to pay SLR is 2024/25 (6 April 2024 – 5 April 2025). 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 to repay the outstanding debt.

There are now four types of Student Loan Repayments: Plan 4 relates to Scottish loans only, whereas Plans 1 – 3 relate to the rest of the UK.

Plan 1 is for loans taken out before September 2012; Plan 2 for loans taken out after 1 September 2012; and Plan 3 for Post-Graduate Loans. Plan 4 loans are for Scottish students who started an undergraduate or postgraduate course anywhere in the UK on or after 1 September 1998.

The annual thresholds for 2020/21 are £22,015 for Plan 1 loans; £27,295 for Plan 2 loans; £21,000 for Plan 3 loans; and £27,660 for Plan 4 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.



#### ***d) Self Assessment***

To illustrate how the system works we will look at a person who leaves college in summer 2023 and starts self-employment on 1 September 2023.

The first thing to do is to ensure you know your National Insurance Number. You cannot register with HMRC without a National Insurance Number. There is help with NI Numbers here, if needed:

[Find a lost National Insurance number - GOV.UK \(www.gov.uk\)](https://www.gov.uk)

You should tell HMRC that you are self-employed so that they know that you will be required to complete Tax Returns. There are penalties for late registration and it is recommended that registration should not be delayed beyond the next 5 April after self-employment begins.

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

[Check how to register for Self Assessment - GOV.UK \(www.gov.uk\)](https://www.gov.uk)

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.

In our example, self-employment started in September 2023 and the first Tax Return will be issued on 6 April 2024. On this Return you will declare income for the whole year 6 April 2023 to 5 April 2024, including the first period of self-employment from 1 September 2023 to 5 April 2024.

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 2025). 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.

#### ***e) 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 same day as the deadline for submission: for 2023/24 Tax Returns that will be 31 January 2025. 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, you will need to pay a further 50% of that year's tax bill to HMRC, as an advance towards the next year's bill. Six months later, on 31 July, you will be required to pay another 50% advance to HMRC.

If the tax bill for the next year exceeds that of the previous tax year, the extra amount above the advance payments that you may already have made is due on 31 January.

So your first tax payment if you start self-employment in September 2023 does not become due until January 2025. But beware: if the liability exceeds £1,000 you will be paying a large lump sum.

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

#### **Total Tax/NIC Due for Payment for Tax Year**

*2023/24* **£800**

*2024/25* **£1,500**

*2025/26* **£2,400**

*2026/27* **£2,200**

#### **Dates of Payment and Amounts Due**

*31/01/2025* **£800** (all tax/NIC due 2023/24)

*31/07/2025* **£0** (No payment on account required)

*31/01/2026* **£2,250** (All tax/NIC due 2024/25 £1,500 + 50% on account £750)

*31/07/2026* **£750** (50% payment on account)

*31/01/2027* **£2,100** (Final payment 2025/26 £900 + 50% on account £1,200)

*31/07/2027* **£1,200** (50% payment on account)

*31/01/2028* **£900** (Overpaid on account for 2026/27 - £200 + 50% on account £1,100)

*31/07/2028* **£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.

## **6) Value Added Tax (VAT)**

If you are registered for VAT you must add 20% tax to the fees that you charge and pay this over (minus the VAT you pay on business expenses) to HMRC.

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. The limit is currently £85,000. You can voluntarily register for VAT even if your income is below this limit but there is no benefit to being registered beyond the ability to recoup the VAT paid on business expenses.

If your gross income from self-employment is close to the VAT threshold, you should 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.

For example, if your turnover were to go above £85,000 in the twelve months to 30 June 2024, you would have only 30 days to register for VAT. From 1 August 2024 you must add VAT to the fees that you earn.

Since April 2019 VAT Returns have been submitted to HMRC in a digital format. This is part of the HMRC plan to “Make Tax Digital” (“MTD”) and involves the purchase of specialist software.

## **7) The Future – “Making Tax Digital”**

HMRC has announced plans to force all self-employed individuals and landlords to keep their business records and to report their income and expenses to HMRC digitally. This will replace the current Self Assessment system.

This digital project was originally announced in 2015 and has been subject to many delays and reconfigurations. Whether it will go forward as planned is open to question. The current timetable is that “Making Tax Digital” (MTD) will apply to everyone with self-employed income or rents of over £50,000 per year from April 2026. Those with an income of between £30,000 and £50,000 will be brought into the system from April 2027. Whether those with income of less than £30,000 will need to keep digital records in future has yet to be decided.

HMRC believes that businesses can and should keep track of their tax affairs digitally using software or apps and provide summary tax data to HMRC quarterly, using these digital tools. Recordkeeping by an “MTD-compatible spreadsheet” will be permitted, as long as it is coupled with bridging software to submit the details to HMRC electronically.

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 four quarterly reports for self-employed and/or rental income also being logged on the system through the tax year, the need for an annual Tax Return will, in due course, be eliminated. The taxpayer will be able to access an HMRC estimate of the ultimate tax bill for the year as the information is built up quarter by quarter.

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

**Simon Lees**

**01929 423229**

**seaforthtaxation@btinternet.com**