An Introduction to the Tax System for the Self Employed

Registering with HM Revenue & Customs (HMRC)

If you start working for yourself, you must register with HMRC by 5 October following the end of the tax year in which your self employment starts. Otherwise you may be liable to a penalty based on the tax due to HMRC.

There are three ways that you can register:

- Online – visit https://www.gov.uk/register-for-self-assessment
- Phone – call the Newly Self-Employed Helpline on 0300 200 3500
- Post – download and complete form CWF1

Once you become self-employed, the tax rules are quite different from those that may have applied when you were an employee. Instead of tax (and national insurance) being deducted from your earnings at source, you must be prepared to receive a bill at some time in the future. This can be a nasty shock if you haven't put enough money aside.

We aim to give you as much warning as possible of the likely timing and amount of tax payments, but it is not easy to do this during the first year of your new business, or if you do not keep your records up to date.

What profits do HMRC tax?

The starting point for the calculation of taxable profits is your profit and loss account. In calculating taxable profits you are entitled to claim deductions from your business income in respect of any expenses incurred for the purposes of trade (with a few minor exceptions).

For most of the equipment you buy for your business, you will be entitled to deduct the full cost (up to £1 million). For most cars, you can deduct only a proportion of the cost for each year you own them and use them in the business.

If you take stock out of the business for your own use, this should be shown as a sale at market value in the accounts, and not at original cost. It may be better to show the original purchase as private expenditure (drawings).

Tax is payable on the whole of the profits of a trade, and so payments for your own ‘wages’ (drawings) are not deductible. However, if your spouse works in the business, their wages are an allowable deduction, provided they are actually paid and represent a reasonable reward for what is done.

There are other adjustments to profit for tax purposes which we can discuss with you in more detail. There is also the opportunity to claim certain flat rate deductions; for example, if you operate your business out of your home.

How does HMRC allocate profit to tax years?

From 2024/25, tax will be charged on the profits actually arising in the tax year so from 6 April 2024 to 5 April 2025. This will mean that if your business has an accounting date other than a date falling between 31 March and 5 April, the profits from two sets of accounts will need to be apportioned to calculate the profits relating to the tax year. If the accounts have not been finalised provisional figures may be used.

Historically, tax for an ongoing business would have been calculated based on the profits of the twelve months to the accounting date in the year. As the basis of taxation is changing there will be a transition period in 2023/24 where adjustments will be made. For a business starting to trade in 2023/24, the profits taxed in 2023/24 will be those from the date of starting to trade to 5 April 2024.

How is the tax collected?

Tax returns

Assuming the business starts to trade in 2023/24, tax returns covering income for the year ending 5 April 2024 will have to be submitted to HMRC by the ‘filing date’ which is 31 October 2024 for paper returns and 31 January 2025 for online returns. The return will include a self assessment of your liability to income tax and capital gains tax.

There are automatic penalties for late filing of tax returns.

Payment of tax

Payments on account of income tax and Class 4 national insurance contributions (NICs) for 2023/24 will be due on 31 January 2024 and 31 July 2024. These interim payments will be based on one half of the total liability (less any tax deducted at source) for 2022/23. You will have the right to reduce payments on account if you believe the income tax for 2023/24 will be lower.

The balance of income tax for 2023/24 is due on 31 January 2025 (along with the first payment on account for 2024/25 and any capital gains tax for 2023/24).

If the business only started to trade in 2023/24 and amounts payable for 2022/23 under Self Assessment were either less than £1,000 or you paid more than 80% of your liability via deduction at source (eg through PAYE on your salary) then you should not have to make payment on account. In this case the due date for payment for 2023/24 will be 31 January 2025.

Interest and penalties will be levied for late payment.

What about national insurance?

The self-employed are subject to a two-tier system of national insurance contributions (NICs). Class 2 NICs are at a flat rate of £3.45 per week, if earnings exceed £12,570 per annum.

Payments for self-employed Class 2 NICs are due on 31 January following the end of the tax year.

Profits between £12,570 and £50,270 are subject to Class 4 NICs at a rate of 9%. Any excess of profit above £50,270 is subject to Class 4 NICs at the rate of 2%, without any upper limit. Class 4 NICs are collected by HMRC and are payable at the same time as the instalments of income tax.

Save for your tax

It is essential that you make proper provision to ensure the availability of funds to pay income tax and Class 4 national insurance. Interest on unpaid tax is chargeable by HMRC, and is not deductible from business profits.

Cash basis for small businesses

In order to try to simplify the calculation of taxable income for small businesses, HMRC introduced an optional alternative system for eligible unincorporated businesses. Such businesses may calculate taxable income figures on a simpler cash basis if this suits the business. They will not have to compile figures of debtors, creditors and stock, or distinguish between ‘capital’ and ‘revenue’ expenditure and will not have to compute capital allowances to arrive at taxable income.

Please call us if you would like further help or advice on any of the above issues.