First year of self-assessment?

Don't get caught out by payments on account!

Low Incomes Tax Reform Group
A voice for the unrepresented

If you have to complete a self-assessment tax return, you usually have to send it in and pay any taxes that you owe to HM Revenue & Customs (HMRC) by 31st January following the end of the tax year in question.
On this date, as well as paying your tax bill for the previous year, you may have to pay some tax in advance for the current tax year.
Many newcomers to self-assessment fail to factor in these 'payments on account' when budgeting for their first tax bill and are shocked when they owe more money than expected.
Make sure you are not one of them!

Payments on account (POAs)

What are they? These are amounts you may have to pay towards your next tax bill, based on the amount you owe for the previous year. Please note that if you are self-employed your tax bill includes income tax (payable once your earnings exceed the tax free personal allowance) *and also* Class 2 and Class 4 National Insurance contributions (NIC) – for 2018/19, Class 2 NIC is payable once your earnings are above £6,025 and Class 4 when your earnings exceed £8,424. However, you can chose to pay voluntary Class 2 contributions.

Why do they exist? They are intended to help you spread out your tax bill.

Who has to pay them? If your tax bill for the year that you are completing the self assessment for is more than £1,000, you will have to make POAs for the following year. However if more than 80% of your income is taxed at source, e.g. under Pay As You Earn (PAYE) or the Construction Industry Scheme (CIS), then you will not have to make such payments.

How are they calculated? When calculating the payments for say, 2018/19, you have to look back to 2017/18 to work out the tax due for that year – tax due being tax liability less tax deducted at source – and then deduct any Class 2 NIC, capital gains tax liabilities and also student loan repayments from the tax due. If you divide this figure by two, the resulting number is each POA for 2018/19.

When are they due? Payments are due on 31 January and 31 July. If you still have tax to pay after you've made your POAs, you must make a 'balancing payment' by 31 January in the next year.
So consider the 2018/19 tax year:

31 January 2019	1st POA for 2018/19
31 July 2019	2nd POA for 2018/19
31 January 2020	Balancing payment for 2018/19 and 1st POA for 2019/20 and so on...

This is all best explained by looking at an example…

Paul began trading in 2018/19 and has a tax bill of £1,553.40 for that year. The tax bill is due for payment on 31st January 2020. However, because his tax bill is over £1,000, he also has to make his first POA for the 2019/20 tax year. This is half of £1,553.40 **after** deducting Class 2 NIC of £153.40 (£1,400) so £700 by 31st January 2020 – in addition to his tax bill. This means that he owes £2,253.40 to HMRC on 31st January 2020 – ouch! His second POA of £700 will be due on the 31st July 2020.

Example, continued…

The theory behind asking for these POAs is that by the time Paul has completed his 2019/20 tax return, he should already have paid a good portion of his tax in respect of that tax year, and should only then have a balancing payment to make – plus his POAs for the next tax year 2020/21 of course.

How can I best prepare for my first tax bill?

For most people, setting aside a rough percentage (%) of their 'net' income (i.e. after any expenses) in their first year, will help make sure that the initial tax bill, along with the POAs, can be met. Our table may help you work out your rough % using 2018/19 rates*:

Net income	Total first year's tax and Class 4 NIC	First year's payment PLUS next year's POAs	Rough % of net income to save
£15,000	£1,221.80	£1,832.76	12%
£17,500	£1,946.84	£2,920.26	17%
£20,000	£2,671.84	£4,007.76	20%
£22,500	£3,396.84	£5,095.26	23%
£25,000	£4,121.84	£6182.76	25%
£27,500	£4,846.84	£7,270.26	26%
£30,000	£5,571.84	£8,357.76	28%

(* Please note this is based on non-Scottish income tax rates and bands – see our website for more information on Scottish income tax)

It is also a good idea to then do your tax return as early as possible so you know well in advance how much tax will be due by 31st January and how much your POAs are.

Example, Hugh

Hugh began trading as an electrician in April 2018. In the tax year 2018/19, he worked on a number of home renovations and issued invoices as follows:

Job 1: Labour £3,500, Materials £750, Total: £4,250
Job 2: Labour £5,250, Materials £930, Total: £6,180
Job 3: Labour £3,900, Materials £450, Total: £4,350
Job 4: Labour £1,305, Materials £80, Total: £1,385
Job 5: Labour £4,870, Materials £310, Total: £5,180

His total income in 2018/19 was £21,345 but his expenses totaled £2,520, so his 'net' (i.e. taxable) income was £18,825. Hugh looks at the table above and decides to put aside 20% of his 'net' income each time his invoices were paid, meaning at the end of the tax year, he had saved £3,765 towards his tax bill. His 2018/19 tax bill looks like this:

Net income	£18,825
Less personal allowance:	(£11,850)
Taxable income	£6,975
Tax due on £6,975 @ 20%	£1,395
Class 4 National Insurance due @ 9%	£936.09
(on £10,401, i.e. amount of earnings over £8,424)	
Total tax bill for 2018/19	£2,331.09
1st POA for 2019/20	£1,165.54
Total due by 31st January 2020	£3,496.63

We can see that Hugh has saved enough to pay what he needs to on 31st January 2020. He has some left over to go towards his 2nd POA of £1,165.54 due on 31st July 2020.

TOP TIP!

You do not have to calculate POAs yourself – HMRC will do it if you send them a paper tax return by 31st October. They are also calculated automatically as part of filing online.

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Do I *have* to pay my payments on account?

Income can change from year to year, or even stop altogether. It is therefore possible to reduce your POAs if you think that your taxable earnings will be lower in the following tax year. This can be done by filling in a SA303 form (https://www.gov.uk/government/publications/self-assessment-claim-to-reduce-payments-on-account-sa303) or, if you file your tax return online, by logging into your HMRC online services account and clicking 'Reduce my payments on account' or via your personal tax account. You should, however, base it on a reasonable estimate of your income.

If you reduce your POAs and it then turns out that you have underpaid, you will have to pay interest on the outstanding amount. HMRC may also charge you a penalty if a claim to reduce POAs was made fraudulently or negligently. This can significantly increase your tax bill in the long term.

See 'What if I *can't* pay' below if you don't think you can claim to reduce your POAs but may struggle to pay them on time, as you may be able to ask HMRC for extra time to pay.

Important note on HMRC's software calculation and POAs

POAs will be taken off the liability arising on the next tax return. If the POAs are less than the eventual tax bill, you will have a balancing payment to pay, however if they are more than the eventual tax bill HMRC will refund the difference to you.

Confusingly if you file your tax return online using HMRC's system, it will not take POAs that you've already made into consideration when calculating your final tax bill, so you will have to do this bit of maths yourself. So let's say you paid £1,250 on account for 2018/19. When you come to do your tax return for 2018/19 the calculation tells you that you have £1,900 to pay, plus POAs of £950 each for 2019/20.

How much do you really need to pay on 31st January 2020? £1,600 (£650 (£1,900 less £1,250 POAs) plus £950 (first POA)).

What if I *can't* pay?

It is important that you contact HMRC immediately if you can't pay all your tax on time, as you may be able to get more time to pay.

Please don't ignore the matter – things might not be as bad as you think, particularly if you speak to them *before* a tax bill becomes overdue and can arrange to pay in instalments for example. For more information go to: http://www.litrg.org.uk/tax-guides/tax-basics/when-things-go-wrong/what-if-i-cannot-pay-my-tax-bill

This factsheet was written by the Low Incomes Tax Reform Group. Everything we do is aimed at improving the tax experience of low income workers. We do not offer an advice service, but our website is full of general helpful tax information, including more on POAs: www.litrg.org.uk