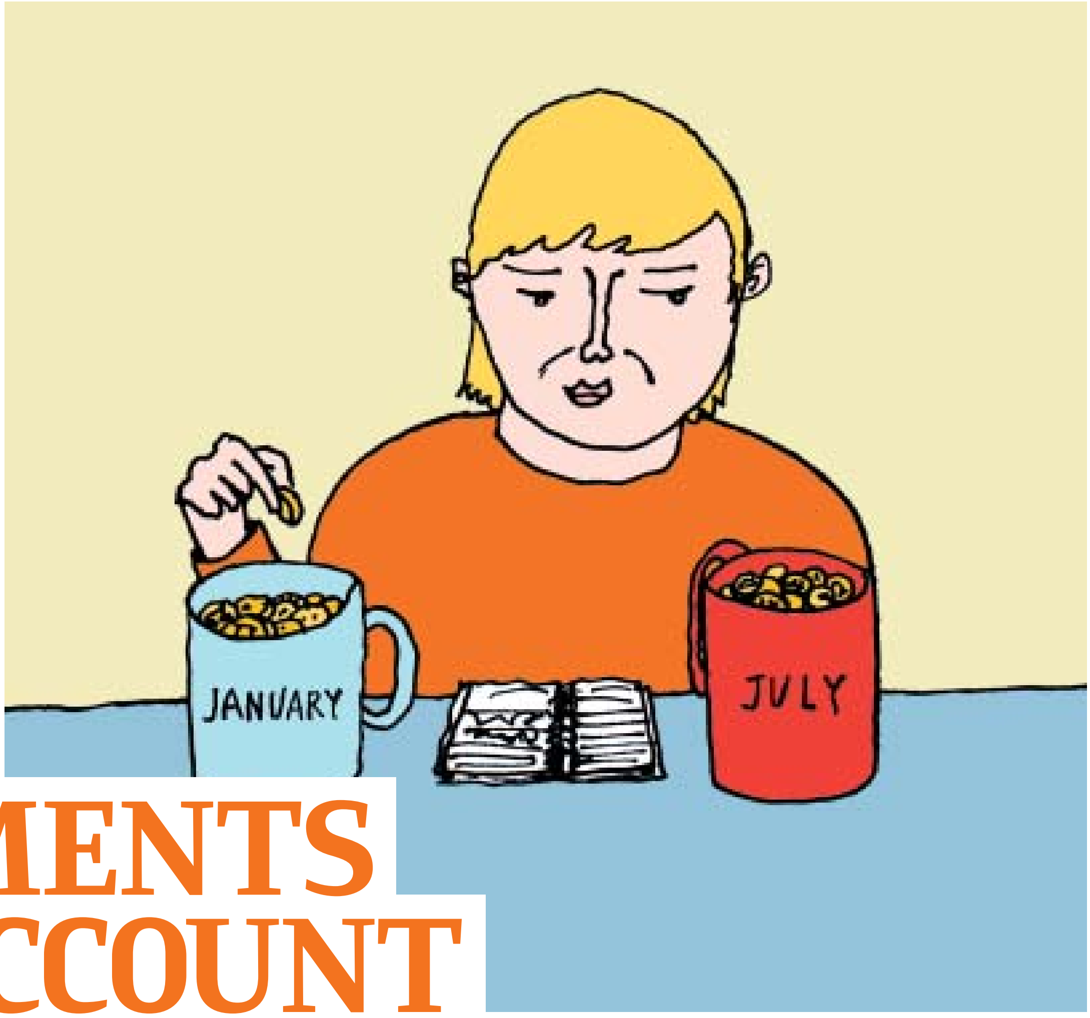

PAYMENTS ON ACCOUNT

Some people have to make advance payments towards their final tax bill. We tell you how much to pay and when, so you don't get caught out

Anyone who receives income that hasn't been taxed at source has until 31 January following the end of the tax year to pay the tax due. However, many people in this category are asked to make some interim payments (known as payments on account) before this date.

Typical examples of people who have to make payments on account are the self-employed and those with large amounts of investment income. But even if you fall into these categories, you may escape – see 'No need to pay', on the opposite page.

> **Self-employed people may have to make payments on account**

WHEN YOU PAY

You have to pay any amount due in two equal instalments – the first is due on the 31 January falling in the tax year, the second on the 31 July after it. You have to pay any balance by the following 31 January (or get a refund if you've overpaid). The tax return you receive in April 2005, which relates to the 2004-2005 tax year, is used to notify your tax office of your payments for 2005-2006.

NO UNTAXED INCOME?

If you don't receive income that hasn't been taxed at source, you won't have to worry about payments on account. But it will still benefit you to know about them, in case a change in your personal circumstances means they become applicable.

You are responsible for making the payments by the deadline, even if you don't receive a statement of account.

HOW MUCH YOU PAY

Normally, each payment will be half your previous year's tax bill, including any Class 4 National Insurance contributions, but excluding capital gains tax, student loan repayment and any other tax deducted at source (such as PAYE). But you can choose to pay less than this if you think these payments will be too high – see 'Reducing the payments', below.

CALCULATING WHAT YOU PAY

People who work out their own tax also calculate their payments on account for the following tax year. You need to enter the amount of the first payment on account in box 18.7 of your tax return. If the Inland Revenue works out your tax bill, it will send you a notice confirming your tax liability for the tax year and, based on this calculation, what your payments on account for the next tax year will be. Contact the Revenue straight away if you have any queries.

REDUCING THE PAYMENTS

You can ask for your payments to be reduced if you think your tax bill for next year is going to be

UNDERESTIMATING PAYMENTS ON ACCOUNT

If you underestimate your payments on account you will have to pay additional interest, as our example shows. You might also have to pay a penalty.

During the 2003-2004 tax year, Ann Artist made a profit of £36,000 from her freelance design business and paid tax and National Insurance (NI) of £8,826. This meant her payments on account for the 2004-2005 tax year were set at £4,413, due 31 January 2005, and £4,413, due 31 July 2005.

However, because Ann decided to work part-time for a company as an employee and only part-time freelance, she estimated that her self-employment earnings would reduce to about £25,000 in 2004-2005. This would result in a tax and NI contributions bill of about £5,834, so Ann reduced her payments to half the estimated tax bill – £2,917 each.

Ann in fact received a lot more freelance work than she'd anticipated and, by her year end, had made a profit of £34,000, giving her a £8,375 tax and NI liability in 2004-2005.

Ann will have to pay the balance of tax due (£2,541) by 31 January 2006. As she underpaid each interim payment by £1,270.50, she'll also have to pay interest on the underpayments, charged from the date the payment was due to the date the balance of tax owed was paid.

How Ann lost out

If Ann pays the tax outstanding on 31 January 2006, she will be charged interest on the underpayment as follows:

31 January 2005 payment 12 months' interest on £1,270.50 x 7.5% a year = £95.29

31 July 2005 payment 6 months' (184 days) interest on £1,270.50 x 7.5% a year = £48.04

Total interest to pay on underpaid payments on account £143.33

What Ann should have done

On the other hand, had Ann made payments on account as requested, she would have received a refund of £451 and interest on her overpaid payments on account as follows:

31 January 2005 payment 12 months' interest on £250.50 x 3.5% = £8.77

31 July 2005 payment 6 months' (184 days) interest on £250.50 x 3.5% = £4.42

Total interest received on overpaid payments on account = £13.19

less than it was for this year. But you must be able to justify why you think this is the case. It might be because:

- you know your business profits, rent or savings and investment income will be lower. You may already know this if your accounting year has finished – see 'Self-employment', p26
- you have more tax deducted at source
- you have more tax allowances or tax reliefs – for example, you become eligible for age allowance (see p40).

If you calculate your own tax, you apply to reduce your payments on account by ticking box 18.6 on your tax return (or completing form SA303 if you've already sent in your return). Make a reasonable estimate of the tax you expect to pay for 2004-2005 as opposed to 2003-2004 and change each payment to half that of the new 2004-2005 amount.

You need to enter the amount you believe to be correct as the first payment on account in box 18.7 and, under the 'Additional information' section of your return, add an explanation of why you have reduced the payments.

If the Inland Revenue calculates your tax, you will receive a statement of account before the first payment is due, provided you have submitted your return before 30 September. The statement of account will contain an SA303 form. You can use this to reduce your payments on account, or you can simply write to your tax office advising it that you want to reduce the payments (with your reason). Online filers can make a claim to reduce their payments on account online.

IF YOU PAY TOO LITTLE

If you have reduced your payments on account and your final tax bill turns out to be more than you have estimated, you will have to pay interest on the difference. Interest will be charged from the date the payment was due – 31 January or 31 July (see 'Underestimating payments on account', left). The Revenue charges interest at a variable rate (7.5 per cent a year when we went to press).

The Revenue can charge penalties if statements to reduce payments on account are made fraudulently or negligently. The maximum penalty is 100 per cent of the difference between the payments that should have been made and those that were made, on top of the tax due.

IF YOU PAY TOO MUCH

If your payments on account turn out to be more than the tax you owe, you will receive interest on any overpaid tax. Again, interest is paid from the date of payment at a variable rate set by the Revenue (3.5 per cent a year at the time we went to press). The interest is tax-free.

NO NEED TO PAY

Not everyone who is self-employed or has untaxed income has to make payments on account. You are exempt if:

- your total income tax due from all sources of income in the previous tax year, less deductions, was £500 or less, or
- at least 80 per cent or more of the tax due for the previous tax year was deducted at source. So, if your total tax bill for 2004-2005 was, say, £6,000, but £5,100 (85 per cent) was tax you paid via PAYE, you would not have to make payments on account for the balance of tax owed.

If either of these applies, you will have to make a single tax payment on 31 January following the end of the relevant tax year (31 January 2006 for the 2004-2005 tax year). Alternatively, you can ask the Revenue to collect the tax via your PAYE code. Your tax office can guarantee to do this only if you owe less than £2,000 and you file your tax return by 30 September after the tax year (by 30 December if you file online). If you're eligible but don't want underpaid tax deducted via PAYE, you must tick box 23.1 on the tax return. ■

MORE HELP

Inland Revenue leaflets

- SA150 Tax return guide
- SA151W Inland Revenue tax calculation guide
- SA/BK8 Self assessment – your guide