Payments on account

What they are, who pays them and when, plus the dangers of underestimating them

Anyone who receives income that hasn't been taxed before they get it has until 31 January following the end of the tax year to pay the tax due.

If you're in this category and have to fill out a tax return – for example, if you're self-employed or have large amounts of investment income – you may be asked to make some interim payments (known as payments on account) before this date. But even if you fall into this category, you may escape having to make payments on account – see 'Exemptions', below.

If you are employed and receive your other income through interest from bank or building society accounts, you probably 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 that they become applicable.

WHAT 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
- any other tax deducted at source (such as through PAYE).

But you can choose to pay less than half your previous year's tax bill if you think these payments will be too high – see 'Reducing the payments', on the next page.

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.

If the payments you are due to make are greater than your tax bill, you can claim a refund at any time – you don't have to wait until the 31 January following the end of the tax year to to get the excess back. Contact Revenue & Customs to get it back immediately.

You are responsible for making your payments on account by the deadlines of 31 January and 31 July, even if you don't receive a statement of account (a statement from Revenue & Customs showing how much tax you owe).

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 the full tax return.

If Revenue & Customs 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. Remember that your tax liability for the current tax year affects your payments on account for the following tax year, so contact Revenue & Customs straight away if you have any queries or don't understand how it arrived at its figures.

EXEMPTIONS

You may escape having to make payments on account but you won't escape having to pay any tax due

Not everyone who receives 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 of the tax due for the previous tax year was deducted at source. So if your total tax bill for 2005-2006 was, say, £5,000, but £4,500 (90 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 2007 for the 2005-2006 tax year). Alternatively, you can ask Revenue & Customs to collect the tax via your PAYE code, provided that the amount you owe is less than £2,000. But you need to bear in mind that your tax office can guarantee to do this only if you file your tax return by 30 September after the tax year (or by 30 December if you file online).

If you're eligible to have your underpaid tax deducted via PAYE, but don't want it to be collected this way, you must tick box 23.1 on the tax return.

SUPERSTOCK

! Warning

You are responsible for making payments on account by the deadlines, even if you aren't prompted to do so by Revenue & Customs.

REDUCING THE PAYMENTS

You'll have to make up the shortfall if you underestimate and you will incur interest

You can ask for your payments to be reduced if you think your tax bill for next year is going to be less than it was for this year. But you must be able to justify this. It might be because:

- you know your income will be lower. You may already know this if your accounting year has finished – see 'Working for yourself', p21
- you have more tax deducted at source
- you have more tax allowances or tax reliefs – for example, you become eligible for an age-related allowance (see p33).

HOW TO REDUCE YOUR PAYMENTS

If you calculate your own tax, you apply to reduce your payments on account by ticking box 18.6 on the main 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 2005-2006 as opposed to 2004-2005 and change each payment to half of the new 2005-2006 amount.

You need to enter the amount you believe to be correct as the first payment on account in box 18.7 and, in the 'Additional information' box 23.9 on your return, explain why you have reduced the payments.

If Revenue & Customs 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 write to your tax office advising it that you want to reduce the payments (with your reason).

People who file their tax return online can also make a claim to reduce their payments on account online.

UNDERPAYING

If you have reduced your payments on account, you will have to pay interest on the difference between the estimated amount and the actual amount. Interest will be charged from the date the payment was due – 31 January or 31 July. Revenue & Customs charges interest at a variable rate (6.5 per cent a year when we went to press).

OVERPAYING

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 Revenue & Customs (2.25 per cent a year at the time we went to press). The interest is tax-free.

HOW YOU CAN BE CAUGHT OUT

During the 2004-2005 tax year, Ann Artist made a profit of £36,000 from her freelance design business, and paid tax and Class 4 National Insurance of £8,835. Her payments on account for the 2005-2006 tax year were set at £4,417.50, due 31 January 2006, and £4,417.50, due 31 July 2006.

However, because Ann planned to cut back on the amount she worked, she estimated that her earnings would reduce to about £25,000 in 2005-2006.

This would mean a tax and National Insurance contributions bill of £5,781, so Ann reduced her payments to half the estimated tax bill – £2,890.50 each.

But by her year end, Ann had in fact made a profit of £34,000, giving her a £8,394 tax and National Insurance liability in 2005-2006.

Ann has paid £5,781 but still owes £2,613, which she has to pay by 31 January 2007.

As she underpaid each interim payment by £1,306.50, she'll also have to pay interest from the date the payment was due to the date the tax was paid.

HOW ANN LOST OUT BY UNDERESTIMATING	WHAT ANN SHOULD HAVE DONE
Ann pays the tax outstanding on 31 January 2007. She is charged interest as follows:	**If Ann made payments on account as requested, she would have received a refund of £441. She would also have received interest on her overpaid payments on account as follows:**
31 JANUARY 2006 PAYMENT 12 months' interest on £1,306.50 x 6.5% a year = £84.92	31 JANUARY 2006 PAYMENT 12 months' interest on £220.50 x 2.25% a year = £4.96
31 JULY 2006 PAYMENT 6 months' (184 days') interest on £1,306.50 x 6.5% a year = £42.81 Total interest to pay on underpaid payments on account = £127.73	31 JULY 2006 PAYMENT 6 months' (184 days') interest on £220.50 x 2.25% a year = £2.50 Total interest received on overpaid payments on account = £7.46

Warning

Revenue & Customs 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.

MORE HELP

HMRC leaflets

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