AF1 Income Tax 2023/24
Part 8: Paying Income Tax

This final part will cover how individuals pay income tax.

The milestones are:

- To understand the differences between Pay as You Earn and Self-Assessment.
- To be able to establish accurately when payments are due under self-assessment
- To have an awareness of the changes starting in 23/24
- Know the fines HMRC impose for non-filing and non-payment

HMRC have two ways of collecting income tax:

- **Pay as You Earn (PAYE)**. Used to collect tax from employees and pensioners.
- **Self-assessment**. Used to collect tax from the self-employed.

They are not mutually exclusive and a salaried employee who also runs a consultancy on a self- employed basis will pay tax under both PAYE and Self-Assessment.

Pay As You Earn

Employers and pension providers operate the PAYE system and are legally obliged deduct tax from gross pay or pension sending this directly to HMRC.

PAYE aims to collect the right amount of tax and does this by giving each employee a tax code which consists of a letter and a number. The most common one is 1257L. This is used when the employee has no other taxable income or Benefits in Kind. It is derived by taking the last digit off the PA. Therefore £12,570 becomes 1257L

The suffix letter gives information about the individual's personal allowance. L is used when the full PA is available, N when 10% of the PA has been transferred.

Apart from individuals whose ANI is above £100,000 everyone can use the full PA of £12,570 in calculating their income tax liability. Some income, such as the State Pension will be paid gross and to avoid individuals having a tax liability at the end of the year, HMRC will adjust their tax code.

Jack has retired and gets a company pension of £20,000 and a State Pension of £9,000. Whilst he is entitled to the full PA HMRC give him a code of 357L (£12,570 - £9,000/10) His company pension scheme will use this code to calculate his tax and at the end of the year Jack should have paid the right amount of tax

This approach is also used when an employee gets taxable Benefits in Kind.

Kate gets a company car with a P11D value of £5,000. Her tax code will be reduced by £5,000 so instead of being 1257L it is 757L.

If Kate's BIK were £13,570 her code would be K100. This is because the BIK are more than the standard PA. Assuming her total income is less than £100,000 she still has the standard PA of £12,570. The code ensures that the employer deducts the correct amount of tax and Kate isn't faced with a large tax bill at the end of the year.

If the PA has been lost because ANI is more than £125,140 an OT code is used so tax is payable on all income.

Retired individuals may have more than one pension and normally the scheme with the highest pension will hold the pensioner's main code including their personal allowance. Any other pensions will usually have a code that will instruct them to deduct 20% (BR) or 40% (DR) from the gross payment. A similar situation will arise if someone has more than two jobs.

PAYE works extremely well for anyone who receives a regular income. The tax code will deduct the correct amount of tax. They don't need to have any further dealings with HMRC nor complete a tax return. However, the code may be incorrect or there may be other sources of untaxed income so too much or too little tax may have been deducted which will have to be adjusted. If the amount owing is less than £3,000 this can be repaid over the next tax year by an amendment to their tax code. It is unusual for anyone with a regular salary and no other income to have to make a lump sum payment for any underpayment.

Do you need to complete a tax return?

Most individuals do not have to complete a tax return although there is a legal obligation to declare any untaxed income to HMRC.

HMRC require a form to be completed by the following:

- The self-employed.
- Company directors
- Individuals who have a gross savings or investment income is more than £10,000 gross
- You have a CGT liability.
- You or your partner's income was over £50,000 and are claiming child benefit
- Individuals who have taxable income from abroad.
- Individuals with gross income over £100,000

They can ask anyone outside these categories to submit a return. The return can be made on paper but HMRC encourage people to complete it on line. Confusingly HMRC refer to this as a **self-assessment form** even if the individual is an employee and pays tax under PAYE.

If an employed person has to complete at tax return this must be done by October 31 if they want HMRC to calculate the tax or January 31 if they file on line.
If they want any unpaid tax to be collected through PAYE, they must file by December 30.

Self Employed and Self-Assessment

The self-employed pay income tax on their profits. PAYE would not work because profits will not be known until the end of the trading period.

HMRC could wait until the end of the tax year and demand a single payment but self-assessment requires the self-employed to make three payments. These are known as **Payments on Account**.

The payments on account process

The tax year runs from April 6 to April 5 and all tax for any one tax year must be finalised and paid by the following January 31. Therefore:

April 6 2020 to April 5 2021	All tax paid by January 31 2022
April 6 2021 to April 5 2022	All tax paid by January 31 2023
April 5 2022 to April 5 2023	All tax paid by January 31 2024

The easiest way to understand the process is to give an example.

Tom has been self-employed for a number of years and his trading year is the same as the tax year.

On **January 31 2023** he finalised his tax for 2021/22 and his liability was £20,000.

On that date he must pay 50% of the 21/22 bill which is £10,000. This is the **first payment on account for 22/23** Note that tax year 2022/23 hasn't ended at this point.

On **July 31 2023** he makes the **second payment on account of £10,000**. He has now paid £20,000 which is exactly the same as his 21/22 liability

Before January 31 2024 he completes his self-assessment form and his liability is £30,000. As he has already paid £20,000 he must pay a further £10,000. This is the **balancing payment** and must be paid by **31 January 2024.**

By the same date he must also make the **first payment on account for 24/25**. This is 50% of the 22/23 liability which is £15,000 so he has to pay a total of £25,000

If Tom's profits had fallen in 2021/22 and his tax liability was £15,000, he would be owed £5,000 as he had already paid £20,000. He would still have to pay £7,500 as the first payment on account but could offset the overpayment of £5,000 to make this £2,500. The second payment on account due on 31 July would still be £7,500.

Should Tom feel that his profits would be lower in the following year, perhaps because he has decided to take on less work, he could ask HMRC to accept lower payments on account.

However, if it turns out that he was too pessimistic, HMRC will charge interest on the "underpayment".

Let's summarise the process:

First payment on account	January 31 in the current tax year
Second payment on account	July 31 in the following tax year
Balancing Payment	January 31 in the following tax year

Therefore for tax year **2022/23** the payment dates are:

January 31 2023	First payment on account
July 31 2023	Second payment on account
January 31 2024	Balancing payment

In table form Tom's liability would be shown like this.

Tax payment for 22/23(£30,000 liability)

31/1/23	First payment on account	£10,000 (50% of 20/21)
31/7/23	Second payment on account	£10,000 (50% of 20/21)
31/1/24	Balancing payment	£10,000 (£30K less payments on account)

Taking this one stage further into **23/24**, if his liability was £36,000 the payments would be as follows.

31/1/24	First payment on account	£15,000 (50% of 22/23)
31/7/24	Second payment on account	£15,000 (50% of 22/23)
31/1/25	Balancing payment	£6,000

In this example Tom's trading year was the same as the tax year.

Anyone running a trading (not a property) business on a self employed basis, can elect to have a trading year that is different to the tax year, for example January 1 to December 31. Up until 2022/2023 profits for a given trading year were allocated to a single tax year using this method.

1. Look at the date of the final day of the individual's trading year
2. Identify which tax year this is in
3. That becomes the year of assessment.

- John Smith's trading year runs from January 1 to December 31
- The last day of his 2022 trading year was December 31 2022
- This is in tax year 2022/23. Profits for trading year 2022 will be assessed in tax year 22/23

BEWARE! HMRC are changing the way in profits in a trading year are allocated to a tax year and this will affect anyone whose trading year is not aligned with the tax year

From 24/25 HMRC will use a more complicated approach with profits being apportioned over the two tax years

From 24/25 John Smith's profits would be apportioned between 23/24 (January 1 to April 5) and 24/25 (April 6 to December 31). There are transitional arrangements for 23/24 and in brief Tom's profits will be what he made in the 2023 trading year plus profits made between 1/1/24 and 5/1/24.

This complication can be avoided by aligning the trading year with the tax year. HMRC will also treat the businesses' trading year as being the same as the tax year it the trading year ends between March 31 and April 5.

Because this is new (and very complicated!) it is unlikely that it will be tested but you can still expect a question where an existing business has a trading year which is the same as the tax year.

HMRC fines

HMRC have a scale of fines for both failing to file a tax return by the due date and failing to pay the amount due

Late Return

Taking the 21/22 tax year

Return outstanding	Fine
January 31 2023	£100
April 30 2023	£10 per day, maximum £900
July 31 2023	£500
January 31 2024	£500

Failure to pay on time

There is a standard penalty of **5% of the tax owing** which kicks in at 30 days, 6 months and 12 months after the tax was due. Since the deadline for paying income tax is January 31 someone who didn't pay a balancing payment of £10,000 for tax year 21/22 on January 31 2023 would be liable for the following fines

2 March 2023	£500
1 August 2023	£500
1 February 2024	£500

Interest is payable on top of this. The maximum penalty for both failure to return or to pay on time cannot be more than 100% of the tax due.

That concludes this part so you should now know:

- The differences between Pay as You Earn and Self-Assessment.
- How to establish accurately when payments are due under self-assessment
- Have an awareness of the changes starting in 23/24
- Know the fines HMRC impose for non-filing and non-payment

Sources and Further reading

https://www.gov.uk/self-assessment-tax-returns

https://www.wellersaccountants.co.uk/blog/payments-on-account

https://www.rossmartin.co.uk/penalties-a-compliance/721-tax-penalties-self-assessment-late-filing-a-payment-from-201011