



FACTSHEET 20

Self Employed Profits: How Are They Taxed?

The basic starting point for the calculation of taxable profits is the Profit & Loss Account statement prepared annually by you or your accountant. Essentially this is a summary of your business takings less all valid business running costs. Adjustments to this profit figure will be made for capital allowances that can be claimed as a proportion of the cost of any items of equipment or vehicles purchased in that accounting year. Similarly adjustments to the profit will be made for any private element of expenses claimed through the business.

Always remember that your drawings or 'wages' cannot be allowed as a deduction against business profits. You should think of your drawings as extracting the profits (ie taxable) generated by the business. If your spouse works in the business then their wage would be an allowable deduction against business profits provided it reflected a reasonable rate of pay for the duties performed by them.

Tax Years

Tax liabilities are raised by the Inland Revenue for tax years. For example tax year 2006/07 covers the fiscal year from 6 April 2006 to 5 April 2007. The Inland Revenue issue tax returns for tax years. So how do they allocate your business profits to particular tax years?

The answer is that for each tax year they will take the trading profits of the twelve months to your accounting year end within that tax year. For example if your Profit & Loss Account is prepared for the year from 6 April 2006 to 5 April 2007 then these profits will form the basis of entries on your tax return for tax year 2006/07. Taking another example if your Profit & Loss Account is prepared for the year from 1 October 2005 to 30 September 2006 then the profits for that accounting year will form the basis of entries to be made on the 2006/07 tax return.

It is worth noting that special calculations have to be performed in the opening and closing years of a business and on any change of the business's normal accounting year end date.

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National Insurance

So far the above has only talked about tax but self employed people are also liable to pay national insurance in two distinct forms. Class 2 contributions of £2.10 per week are due. These can be paid by direct debit or based on a quarterly bill. Class 4 contributions are also due. For tax year 2006/07 these are calculated at 8 per cent of any profits between £5035 and £33540 plus 1 per cent of any profits over £33540. The Class 4 contributions are collected by the Inland Revenue and are payable at the same time as the instalments of income tax.

For further advice and before taking any action please give me a call.

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