# EXPLAINING HOW INCOME TAX PAYMENTS ON ACCOUNT WORK FOR INDIVIDUAL LANDLORDS

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**Individual landlords and property investors generally pay income tax on their profits, and may also need to make Payments on Account towards the following tax year. This article looks at how the Payments on Account system works, and how these can be changed if required.**

## WHAT ARE PAYMENTS ON ACCOUNT, EXACTLY?

Individuals pay income tax on their personal incomes, including those who own rental property personally, and those who receive salary and dividends from their company. The tax year ends on 5 April each year, and the tax due on that year's income is due for payment by the following 31 January.

However, as well as that year's tax bill, there is also a requirement to make a 'Payment on Account' (POA) – effectively an advance payment – for the following year's tax bill, if the current year's tax bill is >£1,000. This is payable in two instalments – the first due on 31 Janaury along with the current year's tax due, and the second due the following 31 July. These POAs are then credited against the following year's tax bill.

**Eg, Boris is a landlord, and owns 20 rental properties in his personal name. For the 2021 tax year (ending 5 April 2021), he earns a rental profit (ie income after all expenses) of £30,000. The income tax due is therefore 20% of £17,500 taxable profit (income after the Personal Allowance), so £3,500.**

**The 2021 tax of £3,500 is due by 31 January 2022. And, as the 2021 tax due is more than £1,000, there is also a need to pay POAs towards the 2022 tax bill, of 50% of the 2021 tax due (so, £1,750 each).**

**So, the total amount due on 31 January 2021 is £5,250, and a second POA or £1,750 is due on 31 July 2022.**

## WHAT IS THE POA BASED ON?

POAs are based on the income tax figure only, and any Class 4 National Insurance (which only applies to self-employed people, not to landlords). POAs are not payable on:

- **Capital gains tax**
- **Student Loan contributions**
- **Class 2 National Insurance**

## CAN I REDUCE OR AVOID MAKING PAYMENTS ON ACCOUNT?

It is possible to avoid making POAs, or to reduce the amount payable, by filing the annual tax return to exclude/reduce the POAs, or by applying to HMRC before 31 January to do so (remember, the UK tax system is a 'self-assessment' system).

It's important to understand that POAs should only be reduced or excluded on the basis that you expect next year's income (and so tax bill) to be substantially lower (ie not just lower by a trivial amount).

For property investors, there are two reasons NOT to change the POAs from the standard amount of 50% of the previous tax year:

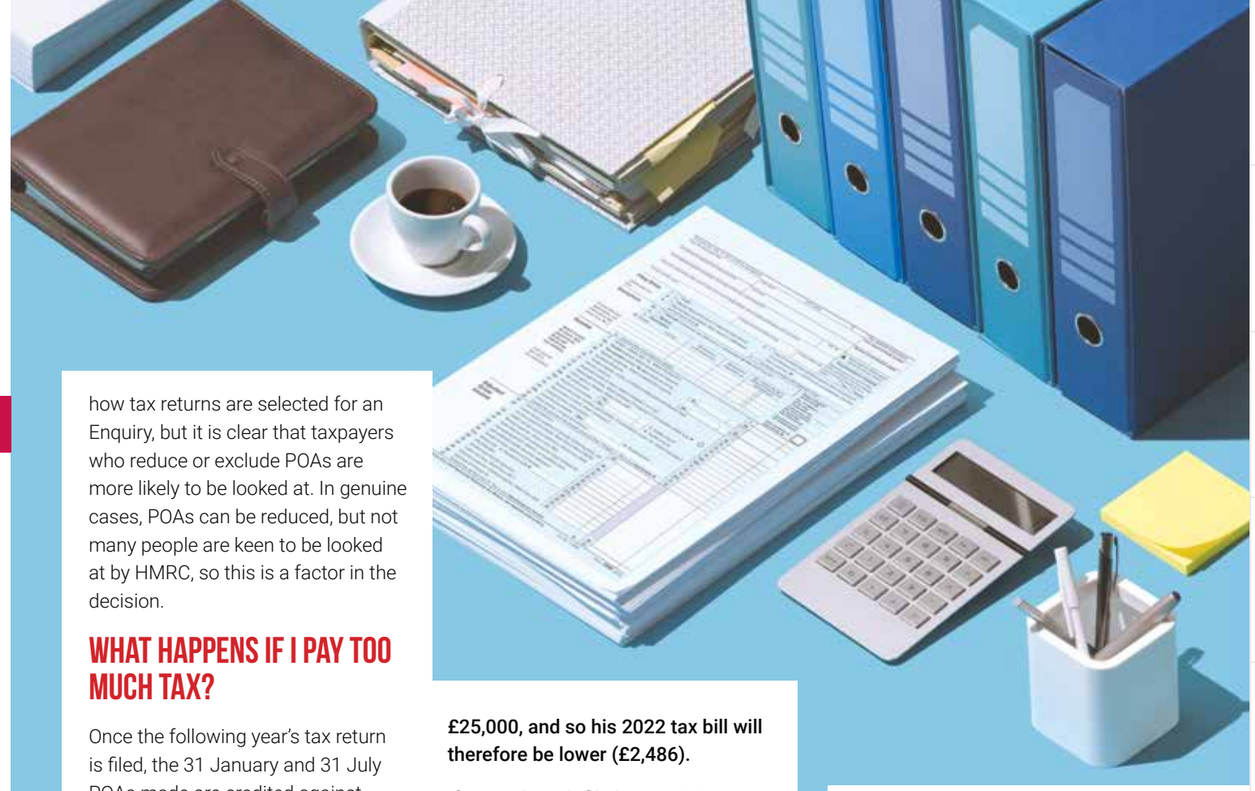
### Lenders

As most investors know, mortgage lenders routinely ask for a copy of the SA302 Tax Calculation and the accompanying Tax Year Overview. If a lender sees on the SA302 that the POA has been reduced or excluded, this communicates to the lender one thing … that you expect next year's income to be lower, which of course is not really something that a lender wants to hear!

And, the Tax Year Overview will show up interest charged by HMRC on underpaid POAs, so this is another giveaway sign to the lender that tax payments aren't being made in the standard way.

### HMRC Investigations

Not making the standard POAs likely puts an individual at an increased risk of a HMRC 'Enquiry' (the modern HMRC term for an investigation). HMRC don't generally publish the specifics of how tax returns are selected for an Enquiry, but it is clear that taxpayers who reduce or exclude POAs are more likely to be looked at. In genuine cases, POAs can be reduced, but not many people are keen to be looked at by HMRC, so this is a factor in the decision.



## WHAT HAPPENS IF I PAY TOO MUCH TAX?

Once the following year's tax return is filed, the 31 January and 31 July POAs made are credited against the latest tax bill. If this results in an overpayment of tax, the overpaid amount will be refunded by HMRC.

Usually, there will be a top-up payment to be made each 31 January, after crediting the POAs made. The 31 January tax due therefore usually consists of the top-up payment for the latest year, plus the payment on account for the following year.

## BENEFITS OF FILING YOUR TAX RETURN BEFORE 31 JULY

POAs are essentially an estimate of next year's tax bill, and are based on 50% of the previous year's tax bill. The second payment on account is due by 31 July, but is based on the previous year's tax bill.

A benefit of filing the latest tax return before 31 July is that the latest year's tax bill will then be known, and the 31 July POA can be reduced legitimately, to avoid an overpayment scenario.

**Eg, Boris has a 2021 tax year bill of £3,500, and so is due to make POAs of £1,750 by 31 January 2022 and 31 July 2022. However, Boris has a reduced 2022 income, of £25,000, and so his 2022 tax bill will therefore be lower (£2,486).**

**If Boris doesn't file his 2022 tax return by 31 July (not that he needs to, of course), he would be due to make his second POA of £1,750 by 31 July 2022. However, he does file his 2022 tax return before 31 July 2022, and is able to pay a reduced second POA. Boris owes £2,486, but has already paid £1,750, and therefore pays just £736 as his second POA (£1,750 + £736 = £2,486).**

## UNDERPAYMENT OF POAS …

Obviously, nobody wants to have to pay tax in advance, and as the tax system is a self-assessment system, a tax return can be filed with no (or reduced) POAs included.

However, once the following tax return is filed, and this shows that the POAs should have been made, interest will become payable on the underpaid amounts, calculated at 2.6% per annum, based on the number of days late that the tax is paid. This interest would show up on the Tax Year Overview and as mentioned can lead to lender issues, as it is an indicator that tax payments are not being made as they should be.

## THE FUTURE OF POAS … AND 'MAKING TAX DIGITAL' ('MTD')

The current date for the introduction of the new 'Making Tax Digital' regime for income tax is April 2023. For most landlords, this won't actually change their financial admin, as most will already be maintaining 'digital' financial records (ie via software or Excel), and file their tax returns online.

The news on the tax grapevine is that the introduction of MTD could lead to the frequency of making POAs increasing from six-monthly to quarterly … ie four POAs per year, with the fourth payment being the top-up to the calculated final tax bill for each year. You heard it here first!

## SUMMARY …

**Payments on Account are a fact of life for most landlords, and require that tax payments are made by 31 January and 31 July each year. Most landlords will make the default 50% POAs as it allows for the annual tax bill to be paid in two halves, and lenders generally like to see POAs being made in the standard way … as well as HMRC being less likely to investigate taxpayers who pay what is owed on time.**

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