ZAZEN TAX

# The Freelancer's UK Tax Handbook

For sole traders and one-person companies. Everything the tax system does to a freelance business, on 2026/27 rates.

Ten chapters. Written to be read once and kept.

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# Contents

Read it in order the first time. After that, chapters six and seven are the ones people come back to.

# 1. Employed, self-employed, or somewhere in between

Nobody chooses their employment status. It is decided by what the working relationship actually is, and it can be different for tax than it is for employment law.

Three things carry most of the weight. Control: who decides what is done, how, when and where. Substitution: whether you could genuinely send someone competent in your place. Mutuality of obligation: whether the client has to offer work and you have to take it.

If you have several clients, provide your own equipment, take the risk of putting mistakes right at your own cost and can turn work down, you are almost certainly self employed. If you sit in one client's team, take their direction and could not send anyone else, the answer is less comfortable, and if you work through your own company that is where IR35 arrives.

> **WORKING THROUGH A COMPANY DOES NOT SETTLE IT**
>
> Incorporating changes who is liable and which rules apply. It does not change what the working relationship is. A contract that would be employment if you were a sole trader is an inside IR35 engagement if you work through a company, and the tax lands in much the same place.

# 2. Sole trader or limited company

This is the decision people ask about first and the one where the received wisdom is most out of date.

A sole trader pays income tax and Class 4 National Insurance on the profit, whether or not they take it out. A company pays corporation tax on its profit, and then the director pays dividend tax on whatever they take out on top of a small salary. Two layers instead of one.

For years the second layer was cheap enough that the company won anyway. Dividend rates have risen since, and for 2026/27 they are 10.75 per cent, 35.75 per cent and 39.35 per cent, with a £500 allowance. Any comparison you read that uses 8.75 and 33.75 is describing a tax system that no longer exists, and it will tell you to incorporate.

### The arithmetic, drawing everything out

Take profit before tax, run it both ways, and assume you need all of it to live on. The company takes a small salary to the personal allowance and pays the rest as dividends.

| Profit | Sole trader keeps | Company keeps |
|---|---:|---:|
| £30,000 | £25,468 | £24,403 |
| £50,000 | £40,268 | £38,862 |
| £60,300 | £46,285 | £46,298 |
| £100,000 | £69,311 | £65,210 |
| £200,000 | £117,912 | £107,827 |

THE WINDOW IS REAL, AND IT IS TINY

Between about £60,150 and £60,500 of profit the company does come out ahead, by about £15 a year. That is the whole of the tax advantage, and it is smaller than the cost of one extra filing. Below it and above it the sole trader keeps more, by about £4,100 at £100,000 and about £10,100 at £200,000.

### So why does anyone incorporate

Because the comparison above assumes you draw everything. If you can leave profit in the company, the second layer of tax is deferred and the picture changes. And because tax is not the only reason:

- Limited liability, which for some kinds of work is the whole point.
- Clients and agencies that will not engage a sole trader at all.
- Bringing in a co-owner, which a sole trade cannot do.
- Retaining profit for a large purchase or a lean year.

Those are good reasons. Saving tax on money you are going to spend is not one of them.

# 3. What you can actually deduct

The test is that the cost is wholly and exclusively for the business. Where something has a private side, you claim the business proportion.

| Usually allowable | The catch |
|---|---|
| Software and subscriptions | Business use only |
| Professional indemnity insurance | None |
| Accountancy and bookkeeping | None |
| Training that maintains existing skills | New skills for a new trade are not allowable |
| Travel to a temporary workplace | Not to a place you attend regularly |
| Phone and broadband | Business proportion only |
| Bank charges on a business account | None |
| Marketing and a website | None |

The two that catch people are training and travel. Training that keeps your existing skills current is allowable. Training that equips you to do something new is treated as capital in nature and is not. Travel is allowable to a temporary workplace, not to somewhere you go so regularly that it has become your base.

> **ENTERTAINING CLIENTS IS NEVER ALLOWABLE**
>
> However business the lunch was. It comes out of taxed profit, and there is no version of the rules where it does not.

# 4. Working from home

Two methods. Pick the one that gives the bigger number and keep the evidence for it.

### The flat rate

Simplified expenses, by hours worked at home each month. No records of actual costs needed at all.

| Hours a month | Claim a month |
|---|---|
| 25 to 50 | £10 |
| 51 to 100 | £18 |
| 101 or more | £26 |

At the top rate that is £312 a year. It is easy, and for most people working full time from home it is low.

### The actual cost method

Add up rent or mortgage interest, council tax, insurance, heat, light and metered water, then claim the business proportion. Usually by rooms and by time: one room out of six, used for business four days out of seven.

> KEEP SOME PRIVATE USE OF THE ROOM
>
> A room used exclusively for business can bring part of your home into capital gains tax when you sell. Some genuine private use of the space avoids that, and it costs you very little in the claim.

# 5. Equipment, and what a capital allowance is

A laptop is not an expense in the ordinary sense. It is a capital purchase, and it gets its relief through capital allowances instead.

In practice this matters less than it sounds, because the Annual Investment Allowance lets you claim the whole cost in the year of purchase, up to £1,000,000 a year. For a freelancer that is effectively everything.

## What changes when you sell it

Sell something you claimed for and the proceeds come back into the profit as a balancing charge. It is capped at what you claimed, so you can never be charged on more than you had. Subscriptions and other revenue costs never create one, because there was no capital claim to unwind.

> **TIMING IS THE WHOLE TRICK**
>
> A laptop bought on 4 April gets its relief a full year earlier than the same laptop bought on 6 April. If you are buying anyway and the date is near, buy before the year end.

# 6. Income tax and National Insurance

Two separate charges on the same profit, with different thresholds, which is why people are surprised by the total.

| Band | Income tax | Class 4 NIC |
|---|---|---|
| To £12,570 | Nil | Nil |
| £12,570 to £50,270 | 20% | 6% |
| £50,270 to £125,140 | 40% | 2% |
| Over £125,140 | 45% | 2% |

Class 4 starts at the same £12,570 and its main rate runs out at £50,270, above which it drops to 2 per cent. The personal allowance is withdrawn by £1 for every £2 of income over £100,000, which creates an effective 60 per cent band between £100,000 and £125,140.

## A worked example

A freelancer invoices £64,000 and has £9,000 of costs, so the profit is £55,000.

| | Amount |
|---|---|
| Invoiced | £64,000 |
| Costs | £9,000 |
| Profit | £55,000 |
| Income tax | £9,432 |
| Class 4 National Insurance | £2,357 |
| **Total liability** | **£11,789** |

TWO PERCENTAGES, AND PEOPLE USE THE WRONG ONE

£11,789 is 21.4 per cent of the profit but only 18.4 per cent of what was invoiced. Reserving a percentage of invoices as they are paid is the right habit, but the percentage is not the one you see on your tax calculation.

# 7. Payments on account, and the January problem

The single most common cash flow shock in freelance life, and it is entirely predictable.

Once your liability passes £1,000 you start making payments on account: two instalments of half the previous year's liability, due 31 January and 31 July, on account of the year that has not been assessed yet.

In the first year that applies, January carries the whole of the previous year's tax plus the first instalment on account. That is 150 per cent of a year's tax in one payment.

| Date | What is due | On £11,789 |
|---|---:|---:|
| First 31 January | Last year in full, plus half on account | £17,683 |
| Following 31 July | Second payment on account | £5,894 |
| Second 31 January | Balance, plus half on account | £5,894 |
| And thereafter | Half in January, half in July | £5,894 |

> RESERVING ONE YEAR'S TAX IS NOT ENOUGH IN YEAR ONE
>
> It is exactly right from the second year onwards, when January and July are half each. In the first year it leaves you £5,894 short on this example, and the money is due whether you expected it or not.

You can apply to reduce payments on account if you know the coming year is worse. Reduce them below what turns out to be due and interest is charged on the difference, so reduce them on evidence rather than optimism.

There are no payments on account at all if the liability is under £1,000, or if at least 80 per cent of your tax was already taken at source.

# 8. VAT, and the £90,000 line

You must register once taxable turnover passes £90,000 in any rolling twelve months, not in a tax year.

That distinction matters. The test looks back over any twelve month period, so you can cross it in September on the strength of the previous autumn. Check it monthly rather than annually. You must also register if you expect to pass £90,000 in the next thirty days alone.

## The flat rate scheme

You can join with turnover under £150,000. You charge VAT normally but pay HMRC a flat percentage of gross turnover and stop reclaiming input VAT, apart from certain capital purchases.

> **MOST FREELANCERS ARE LIMITED COST TRADERS**
>
> If your spending on goods is under 2 per cent of turnover, or under £1,000 a year, the flat rate is forced to 16.5 per cent whatever your sector rate says. On a service business with almost no goods that is nearly all of the VAT you charge, and the scheme stops being worth anything.

# 9. Making Tax Digital for Income Tax

Four quarterly updates and a year-end declaration, instead of one return. It arrives in three phases.

| From | Qualifying income over | Based on |
|---|---|---|
| 6 April 2026 | £50,000 | 2024/25 |
| 6 April 2027 | £30,000 | 2025/26 |
| 6 April 2028 | £20,000 | 2026/27 |

> **QUALIFYING INCOME IS GROSS, NOT PROFIT**
>
> It is income from self employment and property before any allowances or expenses come off. The freelancer in chapter six invoices £64,000 and makes £55,000, and is in scope from April 2026. So is a freelancer invoicing £64,000 and making £12,000. The profit never enters the test.

Updates are due on 7 August, 7 November, 7 February and 7 May. Each one is a cumulative total for the year to date, not a quarter in isolation, and nothing is claimed or adjusted until the final declaration after the fourth. The payment dates do not change: 31 January and 31 July, as before.

# 10. The freelance year, in order

The whole thing on one page.

| When | What |
|---|---|
| Every invoice paid | Move the tax reserve across that day |
| Monthly | Record and categorise digitally, chase anything late |
| 7 Aug, 7 Nov, 7 Feb, 7 May | Quarterly updates, once in scope |
| Before 5 April | Equipment, pension, bad debts, while they still count |
| 31 January | Balancing payment and first payment on account |
| 31 July | Second payment on account |
| Quarterly | Utilisation, client profitability, cash flow, VAT threshold |

# Where to go next

The Day Rate Calculator turns what you need into a number you can quote. The Tax Reserve Tracker turns your invoices into the percentage you should be putting aside. The Sole Trader versus Limited comparison runs chapter two on your own figures.

Every calculator and workbook mentioned in this book is free on zazentax.com, with no email form. They use the same figures and the same rates as the chapters here.

## Zazen Tax

Accountants for people who work for themselves. If you would rather someone else did this, that is what we are for.

**zazentax.com/contact**

*General information, not advice for your circumstances. Rates are 2026/27 for the UK and change from time to time.*