THE PLAYBOOK · 2026/27 EDITION

The UK Sole Trader & Micro Business

Tax Playbook

Everything a self-employed person, freelancer or micro business owner needs to navigate UK tax in 2026/27 — income tax, National Insurance, VAT, expenses, MTD ITSA, and when (or whether) to become a limited company.

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About this playbook

This is a practical, plain-English guide to UK tax for people running themselves as a business — sole traders, freelancers, side hustlers and micro business owners with turnover up to around £100,000.

It uses the rates and rules in force for the 2026/27 tax year (which started 6 April 2026), including the new dividend tax rates of 10.75%, 35.75% and 39.35% for limited companies, the MTD ITSA rollout starting April 2026, and the abolition of the Furnished Holiday Letting regime from April 2025.

We've tried to be specific about numbers rather than vague. Every worked example uses real figures. Every threshold is the one that actually applies. Every common mistake is one we've genuinely seen.

A QUICK NOTE

Who this isn't for

If you're running a limited company with turnover over £500k, have international operations, are planning a sale or exit, or are dealing with HMRC investigations or disputes, this playbook will be too general. Talk to a chartered tax adviser or call our sister firm The Tax Lead (thetaxlead.co.uk).

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SECTION 01

Income tax for the self-employed

When you're self-employed in the UK, your **profit** — not your turnover — is what gets taxed. Profit is everything you've invoiced or received as a business, minus everything you've spent that's a legitimate business expense.

That profit gets added to any other taxable income you have (employment, dividends, rental income, etc.), and the total is taxed at the current Income Tax bands.

The 2026/27 Income Tax bands (England, Wales, NI)

Band	Taxable income	Rate
Personal Allowance	Up to £12,570	0%
Basic rate	£12,571 to £50,270	20%
Higher rate	£50,271 to £125,140	40%
Additional rate	Over £125,140	45%

The Personal Allowance reduces by £1 for every £2 of income above £100,000 — so by £125,140 it's fully tapered away. This creates an effective marginal rate of 60% between £100k and £125,140.

Scottish rates are different

If you're tax-resident in Scotland, you pay Scottish income tax bands which run at 19% (starter), 20% (basic), 21% (intermediate), 42% (higher) and 47% (top). Scotland keeps its own thresholds and rates. This playbook uses the rates that apply to England, Wales and Northern Ireland throughout.

Worked example: A freelance designer with £45,000 profit

Annual profit (after expenses): **£45,000**

Personal Allowance: £12,570 (tax-free)

Basic-rate band: £45,000 – £12,570 = £32,430 × 20% = **£6,486**

Total Income Tax: **£6,486**

Effective rate: 14.4% of profit (the "average tax rate").

Note: there's also National Insurance on top — see Section 2.

Payments on account: how you actually pay

If your Self Assessment tax bill is over £1,000, HMRC asks you to make **payments on account** — advance payments towards the next year's bill. Each one is half of last year's total liability.

You'll pay these on 31 January and 31 July each year, alongside the balancing payment for the year just ended. This catches a lot of new sole traders out: your first January bill might be 1.5× the tax you actually owe for that year, because you're paying the year just gone plus half of the year ahead.

WATCH OUT

The hidden January surprise

If your first Self Assessment bill is £4,000, you'll actually owe £6,000 on 31 January — the £4,000 for the year just ended plus £2,000 as the first payment on account towards the next year. Then another £2,000 on 31 July. Budget for it.

Deadlines you genuinely need to know

Date	What's due
5 October	Register for Self Assessment if first year self-employed
31 October	Paper return deadline (rare these days)
31 January	Online return deadline + balancing payment + 1st payment on account
31 July	2nd payment on account
5 April	Tax year ends (the new year starts 6 April)

Missing the 31 January deadline triggers an **automatic £100 penalty** — even if you owe no tax. Further penalties kick in at 3, 6 and 12 months. Interest also accrues on unpaid tax from 1 February.

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SECTION 02

National Insurance: what you pay and when

National Insurance Contributions (NIC) are a separate tax that funds state benefits including the state pension. For self-employed people, NIC works differently from employees.

Class 4 NIC — the main one

Class 4 NIC is calculated on your trading profits at:

- **0%** on profits up to £12,570 (the same threshold as the Personal Allowance)
- **6%** on profits between £12,570 and £50,270
- **2%** on profits above £50,270

The reduction from 9% to 6% (effective from April 2024) was one of the more significant tax changes of recent years — saving self-employed workers £3 per £100 of profit between the two thresholds.

Class 2 NIC — mostly abolished, but check

Class 2 NIC at £3.45/week was abolished as a mandatory charge from 6 April 2024. You no longer pay it automatically. However, you can still **voluntarily** pay Class 2 NIC if your profits are below the Small Profits Threshold (£6,725) — this preserves your qualifying year for state pension purposes.

> WORTH KNOWING
>
> **Should I voluntarily pay Class 2 NIC?**
>
> If your profits are between £6,725 and £12,570, you get a qualifying year automatically — no need to pay anything. If profits are below £6,725 and you have no other qualifying employment, paying £179.40 (one year of Class 2) buys you one qualifying year, which can add roughly £6.50/week to your state pension at retirement. That's typically a 30× return over a 20-year retirement.

Worked NIC calculations

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Worked example: Sole trader with £35,000 profit

Profit: £35,000

Class 4 NIC at 6% on (£35,000 – £12,570) = £22,430 × 6% = **£1,346**

Class 4 NIC at 2% (none — profit is below £50,270)

Total Class 4 NIC: £1,346

Income Tax (separately): £4,486

Combined tax bill: £5,832 (effective rate 16.7%)

Worked example: Sole trader with £75,000 profit

Profit: £75,000

Class 4 NIC at 6% on £37,700 (band) = **£2,262**

Class 4 NIC at 2% on (£75,000 – £50,270) = £24,730 × 2% = **£495**

Total Class 4 NIC: £2,757

Income Tax: £17,432 (basic + higher rate)

Combined tax bill: £20,189 (effective rate 26.9%)

Class 4 NIC is paid through Self Assessment, alongside Income Tax, on the same 31 January and 31 July deadlines. You don't pay it separately — HMRC calculates it from your return.

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SECTION 03

Allowable expenses — what you can claim

The HMRC test for expenses is "wholly and exclusively for the purposes of the trade." In plain English: if you spent it because of the business, and the business is the only reason you spent it, it's allowable.

Most new sole traders **under-claim** by 15–30%. This isn't aggressive tax planning — it's just claiming what you're entitled to.

The big categories

Office costs

- Stationery, printing, postage
- Phone, internet (proportion used for business)
- Software subscriptions — accounting, design, productivity tools
- Cloud storage, web hosting, domain names
- Office rent (if you rent business premises)

Working from home

Two methods to choose from:

1. **Simplified flat rate:** £10/month (25-50 hrs), £18/month (51-100 hrs), £26/month (101+ hrs) — based on hours per month working from home. No paperwork required.
2. **Actual costs:** proportion of mortgage interest, rent, utilities, council tax, insurance — usually calculated as (rooms used for business ÷ total rooms) × (hours used ÷ 24). Better claim for people who genuinely work from home most days but more paperwork.

Travel and motoring

- Business mileage at HMRC's AMAP rates: 45p/mile for the first 10,000 miles, 25p above
- Train fares, parking, congestion charges, tolls for business journeys
- Hotels and reasonable subsistence when away from home overnight on business
- **Not** commuting from home to your regular workplace — that's never allowable

Professional fees

- Accountant fees (yes, paying us is deductible)
- Legal fees for business contracts and disputes (not personal)
- Professional body subscriptions on HMRC's approved list
- Insurance — PI, public liability, employer's liability (if you employ anyone)
- Training that maintains or updates your existing skills (not learning a new trade)

Marketing and promotion

- Website costs, design, hosting, domain
- Advertising — Google Ads, social media ads, print advertising
- Networking event fees (the event itself, not extravagant entertainment)
- Business cards, branded clothing with logo
- Free samples or gifts to customers (up to £50/person/year, with branding visible)

Things you cannot claim

- Client entertainment (taking a client to lunch is not allowable, even with a contract on the table)
- Personal clothing, even if you only wear it for work (unless it's specialist PPE or branded uniform)
- Fines and penalties (parking, speeding, late tax, HMRC penalties)
- Personal pension contributions (these are claimed differently — via your tax return, not as expenses)
- Childcare costs (claimable via the separate Tax-Free Childcare scheme instead)
- The cost of your own time — you can't "pay yourself" as an expense

JUDGMENT CALL

The grey area: mixed-use expenses

Phone bills, broadband, vehicles — most have both business and personal use. You're expected to apportion fairly. A reasonable apportionment (e.g. "70% business use of my mobile") is fine; HMRC challenges obvious overclaims, not honest estimates.

Capital purchases vs revenue expenses

Routine running costs (rent, phone, fuel) go straight into your expenses for the year — these are **revenue** expenses.

Buying equipment that lasts more than a year (laptop, camera, van, machinery) is treated as **capital expenditure**. You claim it via **capital allowances** — usually the Annual Investment Allowance, which lets you deduct the full cost in the year of purchase (up to a £1 million annual cap, far more than any micro business spends).

The practical effect: most micro business owners can deduct the full cost of a new laptop, camera, etc. against their profit in the year they bought it.

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SECTION 04

VAT: when you must register and which scheme to choose

The registration threshold

You must register for VAT when your **VAT-taxable turnover** exceeds **£90,000** in any rolling 12-month period (this threshold was raised from £85,000 in April 2024). You can also register voluntarily before reaching the threshold.

"Rolling 12 months" matters: it's not your accounting year — it's any 12 months. So if your turnover is £85k for the year to 31 March but you have a strong April taking you over £90k for the year to 30 April, you need to register.

> WATCH OUT
>
> **Register late and you'll regret it**
>
> If you exceed the threshold and don't register within 30 days, HMRC treats you as registered from the date you should have registered — meaning you owe VAT on all sales since then, even though you didn't charge it. You then have to either swallow that as a cost or chase old customers for the VAT they never knew they owed.

Should you register voluntarily?

Voluntary registration makes sense when:

- Most of your customers are VAT-registered businesses (they reclaim the VAT, so it costs them nothing)
- You buy a lot of VAT-able inputs and could reclaim significant input VAT
- You want to project credibility — some larger customers expect VAT registration

It's a bad idea when:

- Most of your customers are individuals or non-VAT-registered (you become 20% more expensive overnight)
- Your input VAT is minimal (you're paying HMRC without much offset)
- Your turnover is well below threshold and unlikely to scale soon

Which scheme should I use?

Scheme	How it works	Best for
Standard VAT	Charge 20% on sales, reclaim 20% on purchases, pay difference quarterly	Most businesses, especially with significant input VA
Flat Rate Scheme	Charge 20% normally, pay HMRC a flat % of gross turnover (sector-specific)	Service businesses with low input VAT — che
Cash Accounting	Account for VAT on receipt/payment, not invoice date	Businesses with slow-paying customers and quick-pa
Annual Accounting	Pay 9 instalments + 1 balancing payment, file annually instead of quarterly	Stable businesses wanting predictable cashflow

The **Flat Rate Scheme is the most-misunderstood**. Since April 2017, service businesses with low VAT-able goods spend (under £1,000/year or under 2% of turnover) are classified as "limited cost traders" and pay a punishing 16.5% — usually more than they'd pay on the Standard scheme. For most consultants, IT contractors and marketers, the FRS no longer saves money. Run the numbers before joining.

Making Tax Digital for VAT (MTD)

Since April 2022, all VAT-registered businesses must use MTD-compliant software to keep digital records and submit returns. The main MTD providers: Xero, FreeAgent, QuickBooks, Sage, FreshBooks. Spreadsheets are technically allowed if you use a "bridging" tool, but in practice everyone moves to proper accounting software.

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SECTION 05

Making Tax Digital for Income Tax (MTD ITSA)

This is the biggest change to UK personal tax in a generation. Instead of one annual Self Assessment return, MTD ITSA requires **quarterly digital submissions** plus a final declaration. The transition starts for the highest earners first.

When does it apply to me?

From	Threshold (combined SE + rental income)
6 April 2026	£50,000+
6 April 2027	£30,000+
6 April 2028	£20,000+

"Combined" means your **gross** self-employment turnover plus your **gross** rental income, before expenses. Two part-time activities each below threshold can together push you into MTD ITSA scope.

What you'll need to do differently

1. **Keep digital records** — spreadsheets or software, not paper or shoebox.
2. **Submit quarterly updates** to HMRC — summary of income and expenses, within one month of each quarter end (5 July, 5 October, 5 January, 5 April).
3. **File a final declaration** by 31 January — confirming the annual figures and making any adjustments (capital allowances, jointly-owned property splits, etc.).

REALITY CHECK

Software is now non-optional

If you've been keeping records in spreadsheets, you'll likely move to FreeAgent (free if you bank with NatWest/RBS/Ulster Bank/Mettle), Xero (from £16/month), or QuickBooks (from £12/month). Spreadsheets with bridging software technically work but few sole traders bother with the extra complexity.

Who's exempt?

- Anyone whose gross income from self-employment + property is below the threshold for their year
- Pensioners with no self-employment or rental income
- Foster carers receiving qualifying care relief
- Anyone HMRC accepts is digitally excluded (limited grounds — age, disability, religion, location)

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What stays the same

- Tax rates and rules — same as before
- What's allowable as an expense — same as before
- When tax is due (31 January / 31 July) — same as before
- Class 2 and Class 4 NIC — same calculation
- The final declaration deadline (31 January) — same as the old Self Assessment deadline

MTD ITSA is fundamentally a **process change**, not a tax change. Your tax bill won't go up because of MTD — only your reporting frequency.

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SECTION 06

Sole trader vs limited company: when to switch

This is the most-asked question we get. The honest answer is that for **2026/27, the tax benefit of being a limited company has narrowed substantially**. Below around £30,000 of profit, sole trader is now almost always cheaper. Between £30k and £60k, the gap is small. Above £60k it depends on what you do with the profit.

Why the maths changed in April 2026

Dividend tax rates rose by 2.75 percentage points across all bands:

Band	2025/26 dividend rate	2026/27 dividend rate
Basic	8.75%	10.75%
Higher	33.75%	35.75%
Additional	39.35%	39.35%

Combined with Corporation Tax at 19% (small profits rate) on the way in to the company, the effective combined tax on profits taken as dividends has risen materially. For typical owner-managers, the "tax efficiency" case for going limited is now much weaker than in years past.

Sole trader: still good reasons to stay

- Simpler — one Self Assessment, no Companies House, no separate accounts
- Lower cost — no incorporation fee, fewer accountant hours, no confirmation statement
- More privacy — your figures aren't on a public register
- Loss-relief flexibility — you can offset trading losses against other income
- Below ~£30k profit, you'll pay less total tax than you would as a limited company

Limited company: still has its uses

- **Limited liability** — personal assets protected if the business fails or faces a lawsuit
- Credibility with larger customers — many require limited company status in contracts
- Ability to retain profits in the company — useful if you don't need all the income personally
- Easier to bring in investors, partners, or sell the business later
- Pension contributions are corporation-tax deductible at company level
- Multiple shareholders — split ownership with family for tax planning

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Worked example: Profit £40,000 — sole trader vs limited company

As a sole trader:

Income Tax: £5,486 + Class 4 NIC: £1,646 = **Total: £7,132** (17.8% effective)

As a limited company (taking small salary + rest as dividends):

Salary £12,570 + dividends £27,430. CT on £27,430 = £5,212. Dividend tax on £25,930 = £2,838.

Total: £8,050 (20.1% effective)

Sole trader saves ~£918/year at this profit level.

Worked example: Profit £80,000 — the structures compared

As a sole trader:

Income Tax: £19,432 + Class 4 NIC: £2,857 = **Total: £22,289** (27.9% effective)

As a limited company (salary + dividends, all profit extracted):

Salary £12,570 + dividends £61,012. CT on £67,430 = £14,012. Dividend tax = £6,839.

Total: £20,851 (26.1% effective)

Limited company saves ~£1,438/year at this profit level.

But if you can leave £20k in the company, savings increase further.

When to actually make the switch

We typically suggest considering incorporation when:

- Your sustainable profit is consistently above £50,000 (where tax savings start outweighing extra costs)
- You're working with customers who require limited company status
- You face genuine liability exposure that personal cover doesn't address
- You want to bring in family members as shareholders for income-splitting
- You're planning to scale, take on employees, or attract investment

FROM OUR EXPERIENCE

Don't incorporate to save tax alone — do it for structural reasons

Tax savings of £1,000–£2,000/year often get eaten by the extra accountancy fees and your time on company admin. Incorporate when you have a non-tax reason — liability, customer requirements, growth plans — and let the tax efficiency be a bonus rather than the driver.

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SECTION 07

Record-keeping and your year-end checklist

HMRC requires you to keep records for **at least 5 years after the 31 January submission deadline** of the relevant tax year. So records for the 2026/27 year (filed by 31 Jan 2028) must be kept until 31 Jan 2033.

What you must keep

- All sales invoices and receipts you've issued
- All purchase invoices and receipts for things you've claimed as expenses
- Bank statements (business and personal account if you use it for business)
- Mileage log — date, journey, purpose, distance
- Records of any cash transactions (yes, even small ones)
- Capital purchases — equipment, vehicles, anything claimed via capital allowances
- VAT records (if registered) — usually 6 years
- Employee records (if you employ anyone) — 3 years after tax year end

Year-end checklist for a self-employed person

3 months before 5 April

1. Review your year-to-date profit estimate
2. Check whether you're approaching the £90k VAT threshold
3. Consider whether to bring forward planned capital purchases (laptop, equipment) for AIA
4. Top up your pension if you have capacity in the £60k annual allowance
5. Review your business mileage log — reconstruct missing journeys while you still remember

1 month before 5 April

1. Make any planned charitable donations (must be paid by 5 April for Gift Aid relief)
2. Crystallise any planned capital purchases
3. Pay any outstanding business invoices to bring expenses into this year
4. Decide whether to invoice work in March or early April (affects which year the income falls in)

First week of April

1. Tally your year's invoices and receipts
2. Reconcile your bank statements
3. Identify any expenses you've forgotten (annual subscriptions, professional bodies, training)
4. Note your closing position on capital allowance pools
5. Save digital copies of receipts that have started to fade (especially thermal-printed ones)

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Over April-July (before 31 July payment on account)

1. Prepare and file your Self Assessment online (you have until 31 January but earlier is better)
2. Check what tax you owe and plan how to pay
3. If using MTD ITSA, file your first quarterly update by 5 August
4. Review your accountant's fee for the year against the savings/peace of mind delivered

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SECTION 08

The 10 most common (and expensive) mistakes

From years of taking on new sole trader clients, these are the recurring mistakes we see — ranging from costly to dangerous.

01. Mixing personal and business banking

Using one bank account for both makes year-end reconciliation a nightmare, increases the risk of missing expenses, and looks suspect to HMRC if they ever look. Open a separate business account on day one — many are free.

02. Not claiming home-office costs

If you genuinely work from home, you're entitled to the simplified flat rate of £10–£26/month with no paperwork. Most people forget. Over a year that's £120–£312 in deductible costs.

03. Forgetting professional subscriptions

ICAEW, RIBA, BCS, CIPD, IET — if it's on HMRC's approved list and you're a member for your work, the annual fee is fully deductible. Many people pay it personally and never claim it back through the business.

04. Missing the 5 October registration deadline

If you start trading on, say, 1 February 2026, you must register for Self Assessment by 5 October 2026 (the October after the start of the relevant tax year). Miss this and HMRC can apply a failure-to-notify penalty up to 100% of the tax owed.

05. Trying to claim entertainment of clients

Taking clients to lunch, drinks, sports events — not allowable, ever. The cost is your own after tax. The exception: staff entertainment up to £150/head/year. Get this wrong and HMRC will spot it in any enquiry.

06. Late VAT registration

Crossing £90k turnover and not registering within 30 days means HMRC backdate the registration and you owe VAT on sales you never charged. The biggest single VAT mistake we see — usually from people who don't realise they're over because they haven't done a rolling 12-month check.

07. Claiming the full cost of a personal-use phone or vehicle

If you use your mobile or car for both business and personal, you're expected to apportion. Claiming 100% when 50% of usage is personal will get challenged in any enquiry. Use a sensible percentage and document it.

08. Underestimating the January tax bill

Sole traders frequently fail to set aside cash for tax. By the time the 31 January bill lands, the money is spent. Rule of thumb: set aside 25–30% of every payment into a separate savings account from day one.

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09. Failing to report bank interest, dividends or rental income

Many sole traders forget that "Self Assessment" covers all your taxable income, not just self-employment. HMRC cross-references bank interest data, dividend payments and Land Registry data automatically — getting caught is the rule, not the exception.

10. Not getting an accountant when the situation is complex

DIY Self Assessment works fine for simple cases. But if you have multiple income streams, rental property, capital gains, foreign income, or are about to incorporate, the cost of a good accountant usually pays for itself many times over. The classic case: paying CGT at 24% when proper planning could have used Business Asset Disposal Relief at 14%.

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SECTION 09

What to do next

If you've read this far, you've already done more research than most people starting out as self-employed. The next steps depend on where you are in your journey.

If you're just starting out

1. Register for Self Assessment on gov.uk (free, takes 10 minutes)
2. Open a separate business bank account — Starling, Tide, Mettle, Wise all offer free accounts
3. Choose accounting software — FreeAgent if you bank with NatWest/RBS/Ulster Bank/Mettle (free), Xero or QuickBooks otherwise
4. Set aside 25–30% of every payment received into a separate "tax" account
5. Diarise the key deadlines (31 Jan, 31 Jul, 5 Oct, 5 Apr)

If you're already self-employed but feeling underwater

1. Get your record-keeping into software, not spreadsheets — you'll need it for MTD ITSA anyway
2. Have your last 2 years' Self Assessment returns reviewed by an accountant for missed claims
3. Check whether you're VAT-able and which scheme suits you
4. Review whether incorporation would help or hurt — we'll model the numbers for free
5. Diarise your MTD ITSA start date based on the threshold table in Section 5

If you're thinking about incorporating

1. Don't do it for tax savings alone — the gap has narrowed significantly
2. Do it for structural reasons: liability, customer requirements, growth plans
3. Model the numbers properly — we'll do this free in a 20-min call
4. Consider timing — mid-tax-year incorporation creates complexity
5. Get a clean handover from sole trader to limited company — HMRC notifications, contracts, banking, software all need updating

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Talk to Fernside Accounting

Book a free 20-minute call to discuss your specific situation. We work with sole traders, micro businesses and landlords across Redbridge, Waltham Forest and Epping — transparent monthly fees from £45/month, no surprises.

BOOK A FREE 20-MIN CALL

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Important notes

This playbook is published for general information only. It reflects UK tax law and HMRC guidance as understood in May 2026, applying to the 2026/27 tax year. Tax rules change frequently and the application to your specific situation may differ.

Nothing in this playbook constitutes personal financial, tax or legal advice. Before acting on any of the information here, you should consult a suitably qualified professional adviser who can review your full circumstances.

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