Freelancing: the financial issues

A freelance musician is a professional musician who is self-employed. This might be as a musician, singer/songwriter, session engineer, producer, artist manager, music publisher, music promoter, event manager, or more than one of these. A study in the USA by the National Endowment for the Arts, found that nearly 45% of professional musicians are self-employed.[1]

I intend to set myself up as a freelance music producer as I believe that working on a freelance basis will provide autonomy and flexibility over my working life and the freedom to explore and develop different aspects of work that interest me. I hope to work on a wide range of projects with companies across the industry, and make new contacts on each new project that will help to further my career. This paper reviews some of the financial issues that any self-employed person must deal with in the music industry.

Freelancing allows you more control of your financial future. For instance, you will not have to hope for the infrequent pay rises that come as an employee. However, on the downside, freelancing also means that you are directly responsible for your income. If you do not work you do not earn any money and your income can be uncertain and unpredictable and may vary considerably from month to month. Freelancers have no set salary, no paid holiday or sick leave, no paid training, and no automatic enrolment in pension or health insurance schemes. Being self-employed also affects your eligibility for unemployment benefits.[2]Freelancers may have less social interaction with workplace colleagues and can risk becoming isolated. They also need to manage the financial issues that would normally be taken care of by an employer. These issues are not difficult to deal with, but they require time and effort, and meticulous record keeping.

Budgeting

For many musicians, the line between profit and debt is very fine. You need to prepare a budget to ensure that you spend less than you earn.[3]

The first step in budgeting is to calculate the costs of meeting your basic needs, that is items such as rent, food, mobile phone, internet and professional expenses. The website of the " Savvy musician" provides a useful template for monthly budgeting.[4]It is the optional expenses like eating out, buying new clothes and consumer goods that often cause problems unless they are managed carefully. Credit card expenditure needs to be managed particularly carefully, otherwise the monthly bill can come as a shock. Ideally you should pay off the credit card expenses immediately to avoid late payment fees and interest. If you are thinking of making a major purchase, it is wise to ask yourself how long it will take you to earn that money.[5]

Ideally, to cope with the risks and uncertainties of freelancing, you should have savings that will cover at least six months of basic expenses. Freelancers also need to consider their retirement. This might seem like an irrelevant distant eventuality, but the sooner you set up a retirement fund, the better. It is essential to take professional advice on your pension options.

Income

Income from self-employment is known as ' trading income'.[6]Many freelancers are over-optimistic about their likely income, especially when starting out; it is better to err on the side of caution.

There are many ways to earn money as a musician.[7]Few musicians rely on one source of employment; the majority juggle numerous different roles. A survey in 2012, by the Future of Music Coalition (which aims to ensure that artists are paid fairly for their work), found that more than half of the professional musicians surveyed earned their money from three or more roles. Only 18% of respondents made their income from a single role.[8]It is sensible to have a range of income sources to draw upon in case circumstances change in one area of your work. So, when planning your business, think creatively about *all* the ways you might earn money. Brainstorming the options, can lead to some surprising avenues such as teaching, tutoring, selling jingles and ringtones, or playing non-traditional instruments. The Future of Music Coalition has published a list of over 40 possible sources of revenue for musicians.[9]It is also important to remember that, despite recent funding cuts, some organisations do still provide grants for musicians for specific projects. Some of the sources recommended by the Musicians Union are listed in Appendix 1.

You can of course, work both on a freelance basis and as an employee, and many freelancers start in this way, perhaps employed by an orchestra, or a music studio, and gradually building up the freelance side of their work. However, this can involve a fine balancing act, since it is important that you are available for freelance commissions. If you are approached but are not available, then that contact may not ask for your help again.

Obviously a key issue is to decide what hourly rate to charge for your services. When you are starting out as a freelancer, this can be hard to gauge. It is advisable to try to get a sense of what the going market rate is in the field in which you intend to work. You may have a rough idea of your worth, but do ask around to check that you are not under or over estimating what you can charge. You may also need to be flexible with your rates. When you are just starting out you may find that you need to take whatever work comes your way, even if this means that you do not always get to use the full range of your professional skills. You may need to accept more menial roles. For example, as a freelance producer, I accept that I may need to carry out some of the tasks that I might expect a session engineer to perform such as setting up the recording studio – microphones, consoles, booths, amps, stands, or sound checking for live events. Or I may do the work usually undertaken by a session engineer such as recording, editing and mixing audio. Many freelancers undersell their skills simply to get work and it can be a fine balancing act to get work at a rate that reflects your skills. This does take both experience and confidence and it is something that you will learn after some time in the industry.

Contacts and Networking

While you may be working for yourself, your work prospects are highly dependent on your network of contacts and on developing good relationships with others in your field. The better your contacts are, the more likely it is that some will be able to push work in your direction. So, keeping your contacts list up to date, and actively seeking new contacts in the fields that you want to work in, is essential. This may involve attending record launches, socialising where those in your field hang out, even helping for free in studios in the hope that you will make useful contacts. Those who succeed independently are often ruthless in their pursuit of good contacts.

You need to plant as many seeds as possible in the widest possible range of fields, with the aim of diversifying your sources of work and revenues so that, if for some reason you fail in one field there are other options to pursue in other fields.[10]

Be organised

Whether you use an accountant, or look after your own books, you must be organised, particularly regarding expenses claims, and must set aside time every week to ensure your books are up to date. You must keep copies of all your receipts, contracts, invoices and correspondence in case the Tax Office (HMRC) require evidence for your accounts. You are also obliged to retain this information for up to 6 years after submission.[11]Ideally your documents should be filed in chronological order, and separated into different types of document.

Receipts

It is advisable to pay for as many things as possible by cheque or credit card as this gives you a useful double-check on expenses, and provides a receipt in case you lose the original. It is also recommended to have separate bank accounts for your business and personal affairs. If possible, you should also have a different credit card for work-related expenses, so that these are clearly separate from any personal expenditure. It is a good idea to staple any receipts for items paid by credit card onto your credit card statement.

Spreadsheets

The easiest way to keep track of your expenditure in a way that will help you or your accountant to submit the annual tax return, is to set up a simple Excel spreadsheet (although dedicated financial management programmes are also available). The columns in the spreadsheet might for example, be labelled as follows:

- Date (expenditure incurred)
- Item (description of expenditure)
- Cash}
- Cheque} How you paid
- Direct Spending}
- Debit card}
- Credit Card}
- Phone}
- Internet}
- Print/post}
- Subscriptions}
- Books/Music} Type of Expenditure
- Computer}
- Equipment}
- Wages}
- Consultancy}
- Entertaining}
- Travel/Subsistence}
- VAT}
- Accountants}

- Tax}

You then organise your receipts in chronological order and enter the details into the spreadsheet.

Invoices should be numbered sequentially and paper copies filed as they are submitted. A similar Excel spreadsheet can help you keep track of when invoices were sent, the amount of VAT and expenses they include and when they were paid. The columns might for example be labelled:

- Invoice No
- Date sent
- Date received
- Total amount
- Expenses
- VAT
- Total Net
- Running Annual Total

Accountant

As your business grows, you may decide to hire an accountant. If you are earning around £20, 000 a year, with £2, 000 annual expenses, you may find your own accountant pays for itself.[12]People who do their own taxes are often unaware of all the deductions that are legitimate, so the money spent on hiring an accountant can pay off.[13]Either way, do seek advice on what expenses are deductible.

Contracts

It is obviously essential to ensure that you are paid for your work, and are paid fairly. Rather than leaving this to chance, or trusting to the goodwill of your employer, you must have a robust contract for all the work that you undertake.

There are many unscrupulous agents and managers in the industry who will exploit those who fail to handle this appropriately. Always get professional advice before signing contracts, as these can contain complex clauses which could reduce your income substantially.

Invoicing

You should submit your invoices promptly and professionally; otherwise your income could be delayed by your own inefficiency. If your contractor has cash flow problems, then that is their problem. You must not allow your generosity or inexperience to leave you out of pocket.

The Musicians' Union lists a number of elements that all invoices should include:[14]

- Business name, logo, (if you have one), address, phone number, email address;
- Contact name for queries;
- VAT number (if you are VAT registered);
- Company Number (if you are trading as a Limited Company);
- Date of invoice and invoice number (generally sequential by date issued);
- Engager's name and address;

- Description of the services – date, times and venue etc.;
- VAT payable;
- Expenses;
- Total due;
- Payment information – bank name and address, account name, account number and sort code, plus IAN number and Swift Code (for international payments);
- Terms – For example: “ Strictly 30 days’ net”.

Late Payment of Debts

The Musicians Union also provides guidance on the Late Payment of Commercial Debts (Interest) Act 1998. Under this Act, you may be able to claim statutory interest at 8%, and may also be eligible for compensation for late payment. The Union’s legal services can help their members to pursue debts.[15]

Expenses

Keeping track of all your business-related expenses is absolutely crucial; many of these will be either tax-deductible or will need to be claimed back from your engager. This can be laborious, but is well-worth doing accurately as it can save a lot in unnecessary costs. HMRC has many detailed rules regarding items that can be claimed as legitimate business expenses, but essentially anything claimed must be used solely for your business.

Legitimate expenses can include computers, data storage, music software, instruments, instrument cases, strings, drumsticks, resin, instrument insurance, repairs and spare parts, manuscripts and sheet music, publicity costs (flyers, badges, T-shirts, posters and photos), hire costs for rehearsal rooms, studios and instruments, audio equipment (such as CD or MP3 players), memberships, coaching, commission paid to agents and managers, solicitors' fees, theatrical clothing, stationary, printing and photocopying, postage, business-related phone calls, internet costs, travel and expenses, entertainment and any other related expenses.

If you use a distinct area of your home as an office, and use it *just* for business purposes, you can also claim for a proportion of the total running costs of your home – the interest on your mortgage, or your rent, property and contents insurance, and utilities.[16]However, if you also use your home office for another purpose such as a guest room, then the amount that you can claim may be restricted. Some bills, such as phone use, must be apportioned into personal and business use before making a claim. You can also claim for any wages that you pay (e. g. for secretarial help or roadies). However, if you regularly use assistants you may need to sign up to a PAYE scheme which will involve deducting tax and National Insurance Contributions.[17]

Many musicians travel extensively and all travel costs can be claimed. If your car is used for both business and pleasure, it is essential to use a mileage logbook to record details of the mileage. If you want to claim part of your car expenses against your tax, it will then be relatively straightforward to work out the proportion of business to private mileage.[18]Motoring expenses cover road tax, insurance, petrol, servicing, maintenance, spare parts, subscriptions to motoring organisations, interest on loans for buying a vehicle, vehicle rental, and garage leasing.

Instead of recording all your motoring expenses separately, it can be simpler just to claim Authorised Mileage Rates (AMRs). Currently the HMRC allowance for use of your own car or van, is 45p per mile for the first 10, 000 miles. Any mileage over this in one year can only be claimed at 25p a mile. Motorbike rates are 24p per mile, and the rate for travel by bicycle is 20p a mile. To use this scheme, business mileage must be logged separately, but you cannot claim any other motoring expenses apart from parking fees, road tolls and the congestion charge.[19]The AMRs scheme is only applicable if your turnover is below the VAT registration threshold[20], £83, 000 a year (from 1 April 2016).[21]You must stick with one or the other scheme.

Airfares and taxi, bus and train fares are all claimable, as are accommodation and subsistence costs (food and drinks). However, it is advisable to be modest in what you claim as any expenses can be scrutinised by HMRC.

Collecting Royalties

The world of music licensing and royalties is highly complicated, and the literature is full of stories about expensive legal disputes between artists, writers, recording companies, publishers, and internet companies. So, you may need to take legal advice if your income is dependent on collecting royalties. The system is also changing in response to demands from the industry, so you need to keep a careful watch on new legislation, particularly in the digital field. There are several types of royalties:

Public Performance royalties– are paid to songwriters and publishers by anyone who publicly performs their music on radio and television, live performances, retail outlets or over a service like Spotify or Pandora.

Mechanical royalties– are paid to songwriters and artists for CD or DVD sales, and when music is streamed " on-demand" (e. g. Spotify). [22]

Print royalties– are generated from sheet music for writers or publishers only. These royalties are typically bundled with performance rights royalties.

Songwriters and recording artists usually assign their rights to a third party to manage, instead of trying to track a song's use and seeking payment independently. Song copyrights are often assigned to a music publisher, while master recording copyrights are assigned to a record label.

Musicians and artists receive royalties in various ways according to their field. Many royalties are paid through membership of a ' collection society'. In the UK, these are:

- PRS for Music, represents songwriters, composers and music publishers. It licenses the use of members' compositions and lyrics and if a member's music has been performed or broadcast, it collects and pays out the licence fees. In 2012 it collected music royalties of £641. 8m. [23]
- MCPS (Mechanical Copyright Protection Society), collects licence fees on behalf of writers and publishers when their music is sold.

- PPLcover royalties from recorded music when it is broadcast or played in public.

While PRS for Music charge a £50 joining fee, there is no charge for PPL at present. Royalties from PRS are paid quarterly while those from PPL are paid on an annual basis. In relation to radio and TV broadcasts and live performances, the royalties are calculated exactly. However, for background music (as in say, shopping precincts), payments are based on survey data. It is advisable to join a collecting society if your music has been recorded, broadcast, performed live or played in public. [24]

The licensing and royalties' system is highly complicated and contains many ' middle-men' all of whom take their share of the profits from music. It also has several specific problems that artists should be aware of. These include ' bad' contracts for example those that contain clauses that reduce royalties due to ' breakage fees', which may have been reasonable when most music was distributed on vinyl, but are still included in contracts in the age of CDs. ' Grant of rights clauses' mean that a contract can affect your revenue even beyond the end of a contract period. Similarly, a ' Controlled Composition' Clause limits the amount of mechanical royalties the company is required to pay for records it releases, and holds the artist responsible for the excess. Its main purpose of is to NOT pay artists the statutory rate and to NOT increase royalties as costs of living increases; basically, to thwart copyright law. [25] This shows the importance of taking good legal advice on contracts.

Sole Trader or Limited Company

Working as a sole trader is the more straighforward way to commence your business, and allows you to focus on getting the business going without having to worry about the extra administration that comes with operating as a limited company. The process of setting up a limited company is more complex, and brings additional financial and administrative responsibilities such as appointing directors, registering with Companies House, completing company accounts and an annual return, and dealing with Corporation Tax. However, a limited company brings several benefits over sole trading. This is the main reason why after trading for a couple of years, and perhaps earning at least £30, 000 per year, many freelancers set up as a limited company. [26]

The cost of setting up a company is minimal, and it is possible to handle much of the paperwork yourself to minimise accountant's fees. You may not bother with an accountant if you are a sole trader with a small turnover, but most limited companies use accountants. Their charges for preparing the annual accounts for a company are normally a little higher than for sole traders.[27]

Tax and National Insurance Contributions (NICs)

Most freelancers set up a limited company to reduce the amount of tax that they pay. The profits of a limited company are subject to Small Profits' Corporation Tax rate, which is currently 20%, on a turnover of £300, 000 or less per year. Income tax rates are currently: 0% on earnings up to £11, 000, 20% between £11, 001 and £43, 000, 40% between £43, 001 and £150, 000 and 45% over £150, 000.[28]Therefore the *direct* tax advantages of trading as a limited company only come into play when your earnings are over £43, 000.

However, since salaries and not dividends are subject to NICs, many company directors opt to draw a small salary and to take most their income as a dividend. In this way NI contributions are minimised, which is the main reason why the limited company is more tax efficient than the sole trader route.

Company directors must complete an annual self-assessment tax return, just like freelancers. The company also pays tax, but separately from its directors. This tax must be paid before any profits are allocated to shareholders, and within 9 months after the end of the period for which the corporation tax returns have been produced.[29]

National Insurance (NI)

Self-employed individuals pay Class 2 and Class 4 NICs. Class 2 NICs are £2. 80 per week, (except for those with low earnings). Class 4 NICs apply to annual profits, and are payable at 9% on profits between £8, 060 and £43, 000 per year, and 2% on any profits above this threshold.[30]Limited companies and their employees pay Class 1 NICs on salaries above £155 per week. Thereafter, the company pays NICs at 13. 8% of salaries, and employees pay NICs at 12% on salaries up to £827 per week (2% above this threshold).[31]

Limited Liability

Under law, limited companies are deemed to be separate entities from their owners. This means that the company bank account, any assets and any tenders or contracts are just the business of the company and are totally separate from the interests of the company's shareholders. If you run a limited company therefore, your personal assets, such as your house, are protected against company debts. Sole traders do not have this protection from financial claims, and may therefore decide to take out professional liability insurance (if appropriate to the risks they face).

Funding

As a limited company is a distinct entity from its owner, banks can look more favourably on applications for loans than they would for sole traders.[32]

Professional

Many larger firms, prefer to deal with limited companies rather than sole traders. So, trading as a company can open access to a range of clients that might be reluctant to engage sole traders. Having a limited company can also bestow a more professional image; being able to introduce yourself as a " Director", can mean that your clients accord you more respect.[33]

Company Name

When your company is registered with Companies House, its name is legally protected, and cannot be used by anyone else. Sole traders have no such protection.

Shareholders

Because a limited company can issue shares, you are able to sell a stake in your company, or transfer the ownership of shares. This can be an advantage if you wish to raise capital or retire.

Pension

Employees' pensions are tax-deductible in limited companies; another tax benefit that sole traders do not enjoy.[34]

Taxes

A major burden as a freelancer is being responsible for your own taxes. It is your responsibility to declare your income and pay tax on it. As a self-employed musician, instead of paying tax through a PAYE scheme (as an employee would), you must complete a Self-Assessment form every year, to inform HMRC about your income, and calculate how much tax you owe.[35]If you are newly self-employed, you will need to register using use form CWF1. Most HMRC registrations can now be done online on their website.[36]HMRC will then confirm your registration and give you a Unique Taxpayer's Reference (UTR). The UTR should be quoted on all correspondence and on all payments made. The tax return should disclose your taxable income for the relevant tax year.

Tax Returns should usually be filed with HMRC by 31 October (for returns filed by ' paper') or 31 January (for electronic submission) following the end of the year of assessment. For example, for the tax year ended 5 April

2016, a paper return must reach the HMRC by 31 October 2016, while the deadline for online filing is 31 January 2017. Fixed penalties are automatically enforced for failure to submit by these dates.[37]

A tax year starts on 6 April and ends on the following 5 April. For the first tax year of self-employment, taxes do not have to be paid until 31 January following the end of that year. Subsequent payments will normally be made in two instalments, in January and July each year. Payments can be made by Direct Debit, Bank Giro, online banking etc.[38]

You must also keep records on any other sources of income such as: bank interest, dividends, P45s/ P60s from pension providers or employers, any benefits like the State Pension or Job Seeker's Allowance, any assets you have sold, and income from any land or property in the UK or overseas.[39]

As noted above, the advantage of being self-employed is that you can deduct your business-related expenses. Be sure to keep good records on everything that you spend. Organize this into a spreadsheet and keep the back-up receipts that document your expenses.[40]

VAT

It is not compulsory to register for VAT until your turnover, exceeds £83, 000 a year (from 1 April 2016).[41]However, you can register voluntarily no matter what your turnover is, and if you do so, you can then claim back the VAT you were charged on telephones, instruments, etc. However, this does mean that you will also have to charge VAT on all your fees (every gig, music lesson, arrangement, etc.) and handle the additional paperwork. You should seek the advice of an accountant on the benefits and pitfalls of VAT registration before deciding. Failing to register for VAT at the appropriate time, can lead to a late registration fine. Although, if your income varies and only exceeds the threshold for a short time, you can notify HMRC and obtain their prior agreement not to have to register for VAT.[42]

Once you have registered for VAT, it will become chargeable at 20% on all your invoices. VAT can also be recovered on most business expenditure, subject to various rules. To recover VAT on purchases and expenses, the items must be used directly for your business and you must keep a VAT receipt as evidence, (a credit card slip is not sufficient). Items that could be used for both business and personal purposes, e. g. home telephone calls, must be apportioned and only a proportion of the VAT recovered.[43]

National Insurance Contributions(NICs)

As noted earlier, freelancers are responsible for their own Class 2 and Class 4 NICs. Even those who are employed, and paying Class 1 contributions must pay Class 2 and Class 4 contributions on their freelance earnings. The rates are dependent on profit levels. You must inform the Social Security office that you are in business by registering as self-employed. If you fail to do this within three months of becoming self-employed you will incur a penalty, the amount of which is based on the contributions missed and the reasons for registering late.

The easiest way to pay Class 2 National Insurance Contributions every month is by direct debit to the National Insurance Contributions Office. The Class 2 rate is £2. 80 per week. Self-employed people who earn less than the threshold of £5, 965 can be exempt under the Small Profits Threshold, although they may wish to preserve their state benefit entitlements by continuing to pay the contributions.[44]

The rate for Class 4 contributions is currently 9% of self-employed profits between £8, 060 and £43, 000 per annum, with a further 2% payable on all profits above this threshold.[45]

Conclusion

Most musicians, whether they are working as a singer/songwriter, session engineer, producer, artist manager, music publisher, music promoter, or event manager have little choice but to operate as freelancers today. There are simply not enough opportunities for full time salaried work in the industry to meet the potential demand. Employers have come to rely on the flexibility and low overheads that a pool of self-employed musicians can offer them. This is not necessarily a bad thing. It does mean that work is uncertain and unpredictable, but it brings musicians the freed