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The Solicitors Qualifying Examination - SQE

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Chapter 2

INCOME TAX

2.1 THE UK TAX SYSTEM

Tax is a means of raising finance by the Government (as well as local government) for various purposes. Her Majesty's Revenue and Customs (HMRC) is responsible for administration and collection of taxation in the UK. HMRC is a non-ministerial department of the British Government.

Taxation may involve payments to both central and local government. Tax payable to central government includes Income Tax, National Insurance contributions, Value Added Tax, Corporation Tax, Capital Gains Tax, Inheritance Tax, fuel duty, stamp and customs duties. Whilst central government grants funding, local government can also generate revenue from business rates in England and Wales, Council Tax and from fees and charges such as those from on-street parking.

Income tax yields the highest source of revenue collected by the Government and is, therefore, a vital source of revenue from which public resources, such as health, education, welfare, transport and defence can be funded. Income Tax is followed by National Insurance contributions, then Value Added Tax (VAT) and Corporation Tax.

2.2 DIRECT AND INDIRECT TAXES

Direct tax is tax which is suffered directly by the taxpayer, e.g. Income Tax, Capital Gains Tax and Corporation Tax. Indirect tax is tax which is passed on to the final consumer, e.g. Value Added Tax and customs duties. It follows that direct tax is a tax on income and cash received, while an indirect tax is a tax on expenditure.

2.3 INCOME TAX

The charging statute governing Income Tax is the Income Tax Act 2007, as amended by later Finance Acts. Other statutes are also relevant. These include the Income Tax (Earnings and Pensions) Act 2003 and the Income Tax (Trading and Other Income) Act 2005 (respectively referred to, in this chapter, as ITA 2003 and ITA 2005).

2.3.1 DEFINITION

As its name suggests, Income Tax is a tax on ***income***. By contrast, capital profits are subject to Capital Gains Tax. Generally, money received will be income if there is an element of recurrence (e.g. a salary or partnership profit share received each month, or interest paid on a bank or building society account every quarter). Capital gains tax, on the other hand, essentially taxes the profit made from disposing of an ***asset***.

Income tax is paid by individuals, e.g. employees pay Income Tax on their salaries or wages (Part 3 ITA 2003). Income tax is also paid by various businesses on their profits, e.g. sole traders and partnerships (Part 2 ITA 2005).

Income tax must also be paid on other types of income, such as income from property or from investments (Parts 3 and 4 ITA 2005).

Income that is derived from one of these sources will be chargeable for Income Tax purposes. Each part of the ITA has its own rules for calculating the amount of income. Thus, while under Part 3 ITA 2005 Income Tax will be payable on rents/receipts that a landlord obtains from land, expenses will not be chargeable, e.g. repairs made to the property. Income Tax is chargeable on trading or property income irrespective of whether it is received in monetary or non-monetary form.

2.3.2 WHO PAYS INCOME TAX?

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Aside from **individuals**, Income Tax must be paid by **partnerships** (partners are individually responsible for the tax due on their share of partnership profits); **personal representatives** (who pay the deceased's outstanding Income Tax and Income Tax chargeable during the administration of an estate); and **trustees** (who pay Income Tax on the income produced by a trust fund).

Companies pay Corporation Tax, as will be explained in the next chapter.

2.3.3 TAX YEARS AND ACCOUNTING PERIODS

The tax year in the UK, which applies to Income Tax and other personal taxes, runs from the 6th of April in one year to the 5th of April in the subsequent year. Hence, the 2019-20 tax year runs from the 6th of April 2019 to the 5th of April 2020.

Self-employed sole traders and business partnerships are normally taxed on the profits for the 12-month accounting period ending during the tax year. For example, if a sole trader made its annual accounts up to the 31st of December each year, their profits to the 31st of December 2018 are used in their 2018-19 tax return (for the year to the 5th of April 2019).

The simplest approach is to make the annual accounts up to the 5th of April, so that they match the tax year.

2.3.4 COLLECTION OF INCOME TAX PAYABLE

Income Tax is collected in different ways, depending on the type of income and whether someone is employed, self-employed or not working. The different ways Income Tax is collected include:

- PAYE. Payment of Income Tax by employees and those receiving company pensions is made through the Pay As You Earn (PAYE) system. This means that Income Tax (including on any private or company pension) and also National Insurance contributions is deducted by the employer, before the employee receives his salary, i.e., deduction of tax at source, on a weekly or monthly basis. In the UK, different types of income used to be taxed under so-called "Schedules", but which today simply means "types" of taxes. Employees are thus paid Income Tax under the IPA 2003 ("Schedule E"). The Income Tax Act 2007 is currently the primary legislation concerning Income Tax paid by individual earners. The Income Tax (Earnings and Pensions) Act 2003 and the Income Tax (Trading and Other Income) Act 2005 abolished the schedular system of Income Tax for individuals under the Income and Corporation Taxes Act 1988.
- Self-Assessment. The self-employed (who previously paid Income Tax under "Schedule D") are responsible for making the relevant payment to HMRC. A Self-Assessment return is used to report income and calculate liability. For this reason, there is a statutory requirement, backed up by penalties for default, for self-employed persons to keep full and accurate records of all transactions of their business. Self-employed taxpayers must inform HMRC – within six months of the end of the relevant tax year – that they have income which is liable to Income Tax via Form SA1.
- Businesses including sole traders and partnerships, but not companies, are also required to register for Self-Assessment. Income tax is generally payable to HMRC in two equal instalments, on account: the first payment is due on the 31st of January in the tax year in question while the second payment is due on the 31st of July after the end of the tax year.

The deadline for making Self-Assessment tax payments depends on how and when the taxpayers receive their Self-Assessment tax return:

- If they were sent a tax return (or a letter telling them to send in a tax return if they filed online) by the previous 31st of October, then they must pay HMRC any balance of any tax they owe by the 31st of January. This payment deadline is the same whether a taxpayer files on paper or online. This is also the date by which they may be asked to make any first 'payment on account' for the current tax year.

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- If a taxpayer is due to make payments on account, the deadline for making a second payment on account is the 31st of July for tax owing for the preceding tax year.
- If a taxpayer received their tax return (or a letter telling them to send in a tax return if they filed online) after the 31st of October, they must complete and return it to HMRC within three months of the date of the receipt. As a rule they then have 30 days from the date of the request for payment. If they don't pay the tax they owe for the previous tax year by the following 31st of January, they may have to pay a penalty based on the amount of tax due as well as interest on the late payment and on any penalties.

Some taxpayers can choose to pay by Budget Payment Plans. These plans are only available to Self-Assessment taxpayers who are up to date with their payments and who pay by Direct Debit.

A major advantage of Self-Assessment, as opposed to PAYE, is that self-employed traders can deduct expenses which would not be allowable to employed workers, e.g. the trader may use a room in his house from which to work and a partner may use another room as an office from which to help with the work. A proportion of the utility costs of the home would thus be allowable against tax in the case of a self-employed person, whereas an employee who brought work home with him to complete in his study would not be entitled to a similar deduction. Capital allowances may also be available to the trader, e.g. any plant or machinery, such as a new computer, which has been purchased during the year.

Taxpayers may be able to choose how they pay tax on any extra income received – either through PAYE throughout the following tax year or through Self-Assessment by way of an additional payment. Employees or pensioners who want to pay tax on non-employment income – like investment and rental income – through PAYE rather than by Self-Assessment can ask HMRC to collect it in this way under certain conditions. If taxpayers earn more than £2,500 from untaxed savings, £10,000 or more from investments or £10,000 or more from property before allowable expenses, or £2,500 or more after allowable expenses – they must fill in a Self-Assessment tax return. Taxpayers with income of more than £100,000 a year, or those who made profits from selling assets (e.g., shares, funds or a second home) in excess of the annual capital gains exemption for individuals, or those with annual income of over £50,000 and they or their partner keep getting Child Benefit from the 7th of January 2013, must also send a tax return. If they don't want to pay tax on non-employment income through PAYE, they can ask HMRC to stop collecting it in this way. They then have to pay through Self-Assessment instead.

The Finance Act 2016 provides HMRC with the power to administer Simple Assessment of a taxpayer's income tax or capital gains liability, without the taxpayer having to complete a Self-Assessment return, where it has sufficient information about the taxpayer to do so. Taxpayers who wish to dispute the amount due under HMRC's Simple Assessment have 60 days to submit their dispute.

2.3.5 PERSONAL ALLOWANCE AND ADJUSTED NET INCOME

The "Personal Allowance" is the annual income a person can earn before they start paying Income Tax. A person who receives less than their Personal Allowance in taxable income in a given tax year does not pay Income Tax; otherwise, tax is levied according to the income earned above this level.

Below are the Personal Allowance rates for the 2018-19 and 2019-20 tax years:

Personal Allowance	**2018-19 Tax Year**	**2019-20 Tax Year**	**Income Limit**
Applies to all taxpayers regardless of their date of birth	**£11,850**	**£12,500**	**£100,000**

The amount of an individual's Personal Allowance depends on their adjusted net income in the tax year, which is total annual income adjusted to take account of certain deductible allowances and reliefs such as trading losses, donations made to charities through Gift Aid (which will be discussed later on) and some pension contributions.

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If the taxpayer's adjusted net income is over £100,000, the Personal Allowance is reduced by half of the amount – £1 for every £2 – over that limit. If the taxpayer's income is large enough (£123,700 or more in the 2018-19 tax year, and £125,000 or more in 2019-20), the Personal Allowance will be reduced to nil. This £100,000 limit applies irrespective of age.

There are a number of tax bands, as we shall see below – each taxed at a different rate (e.g. a basic Income Tax rate of 20% is charged on *up to* £37,500 of taxable income, with a higher rate of 40% charged on income in excess of this amount up to a threshold of £150,000, in excess of which 45% Income Tax will be payable).

How to work out the adjusted net income

Adjusted net income is calculated in a series of steps.

Step One – work out the "net income"

A person's net income is the total of their income subject to Income Tax – including income from employment, profits from self-employment, pensions and income from property, savings and dividends – less specified deductions.

The most important of the specified deductions are trading losses and payments a person may have made gross to pension schemes.

Step Two – deduct Gift Aid and pension contributions

A person's net income is then reduced by the "grossed up" amount – the amount they contribute plus the basic rate tax – of any:

- Gift Aid contributions;
- pension contributions where their pension provider has already given them basic rate tax relief.

Step Three – add back any tax relief received for certain payments

Add back any relief for payments the taxpayer has made to trade unions or police organisations which were deducted in arriving at their net income in Step One.

The result is the person's adjusted net income.

Sample Calculation 1 – Personal Allowance partially reduced

Mark's income for 2018-19 is made up of:

Income from self-employment – £85,000
Income from property – £20,000
Bank interest – £10,000
Total income – £115,000

Mark makes pension contributions without tax relief of £10,000.

Total income – £115,000
Less pension contributions – £10,000
Mark's net income – £105,000

There are no further adjustments to Mark's net income, so this is his adjusted net income. The income limit for the Personal Allowance is £100,000.

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Mark's adjusted net income exceeds the income limit by £5,000 (£105,000 – £100,000). This is divided by 2 to give a reduction to his Personal Allowance of £2,500.

Personal Allowance – £11,850
Less income-based reduction – £2,500
Mark's Personal Allowance for the year – £9,350

The solution will be similar for the 2019-20 tax year as well, with the exception that the basic Personal Allowance is £12,500, and is therefore reduced to £10,000 (£12,500 – £2,500).

Sample Calculation 2 – the taxpayer Personal Allowance reduced to nil

Margaret's income for 2018-19 is made up of:

Income from employment – £150,000
Company benefits (car and medical insurance) – £20,000
Total income – £170,000

There are no further adjustments to Margaret's total income, so this is her net income. Margaret makes net Gift Aid donations of £5,000 (£6,250 gross £5,000 plus £1,250, the value of the basic rate tax – see explanation under 'Gift Aid' below).

Net income – £170,000
Less gross Gift Aid donations – £6,250
Margaret's adjusted net income – £163,750

The income limit for the Personal Allowance is £100,000. Margaret's adjusted net income exceeds the income limit by £63,750 (£163,750 – £100,000). This is divided by 2 to give a reduction to her Personal Allowance of £31,875. Margaret's Personal Allowance cannot be reduced below zero, so she has no Personal Allowance for the year.

The solution is identical for the 2019-20 tax year.

Sample Calculation 3 – Personal Allowance reduced the taxable income to nil

Stacey has a taxable income of £4,500 in 2018-19. Subtracting Stacey's Personal Allowance (£11,850) from her taxable income (£4,500) reveals that Stacey does not need to pay any tax on her income, and if she has been paying tax, she should be due a refund.

2.3.6 ASSESSMENT AND COMPUTATION OF LIABILITY TO INCOME TAX

The amount of a person's income to which the Income Tax rates are to be applied is generally known as "taxable income". Not all income is taxable and a person is only taxed on "taxable income" above a certain level. Even then, there are other reliefs and allowances that can reduce a person's Income Tax bill – and in some cases, this means that there is no tax to pay.

2.3.6.1 Taxable and Non-Taxable Income

Taxable income includes: earnings from self-employment or from partnerships (perks or benefits from one's employer may also be included, such as a company car, medical insurance or low-interest loans); most pensions income (State, company and personal pensions); interest on most savings, bank and building society interest (not including Individual Savings Accounts); investment income, income from shares (dividends); rental income, income from a lodger over a certain amount, income from a second property; income paid from a trust; State benefits (e.g. job seeker's allowance, incapacity benefit from week 29).

Non-taxable income includes: certain State benefits (including disability living allowance, lump sum bereavement payments, winter fuel payments, housing benefit); income from tax exempt accounts; Working Tax Credit (WTC); and premium bond

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wins; the first 28 weeks of incapacity benefit; maternity allowance; war widow's pension, etc. These income sources are ignored altogether when working out how much Income Tax one may need to pay.

2.3.6.2 Deductible Allowances and Reliefs that can Reduce One's Income Tax Bill

Almost everyone is entitled to receive a certain amount of taxable income tax-free during the tax year. This is called the **Personal Allowance**, which is currently **£12,500** (2019-20 tax year), regardless of age (this factor was abolished in the 2016-17 tax year). Income tax is only due on taxable income which is above a person's tax-free allowances. The amount of someone's Personal Allowance depends on the person's total income in the tax year and on their marital status, and any disability they may have (e.g. blindness). The taxpayer must claim their allowances each year in their tax return. Any unused surplus cannot be carried over for use in future years (e.g. if someone's Personal Allowance exceeds their net income).

Total income means everything a person receives from all taxable sources. That means they need to include things like pensions and interest on savings in a building society.

Other allowances and reliefs may also be available to *reduce* someone's Income Tax bill (in contrast to a tax-free allowance which a person is entitled to receive *tax free*). The major ones are discussed below.

2.3.6.3 Married Couple's Allowance (including civil partnership)

Married Couple's Allowance (including civil partnership) is an amount that is taken off someone's tax bill – so it only applies if they pay tax. If they don't pay tax, or if their tax bill isn't high enough to use up all of their Married Couple's Allowance, they can transfer any unused allowance to their spouse or civil partner if they pay tax, who can then claim any unused allowance at the end of the tax year.

It is possible to claim Married Couple's Allowance in one of the following ways:

- Taxpayer was married before the 5th of December 2005 – if someone is married and living together and at least one spouse was born before the 6th of April 1935, either partner can claim Married Couple's Allowance, but the actual amount of relief given depends on the husband's income. HMRC reduce their tax bill by 10% of the Married Couple's Allowance to which they're entitled.

- Taxpayer was married on or after the 5th of December 2005 or is in a civil partnership – if someone is married or in a civil partnership and living together and at least one spouse or partner was born before the 6th of April 1935, the person with the higher income can claim Married Couple's Allowance. HMRC reduce the claimant's tax bill by 10% of the Married Couple's Allowance to which he or she is entitled. The actual amount depends on the income of the spouse or civil partner with the higher income.

If a taxpayer's income is over £28,900 (before any allowances) in the 2018-19 tax year or over £29,600 (before any allowances) in the 2019-20 tax year, HMRC will reduce the Married Couple's Allowance, as described below.

The maximum amount of Married Couple's Allowance is £8,695 and the minimum amount is £3,360 for the 2018-19 tax year. For the 2019-20 tax year, the maximum amount is £8,915 and the minimum amount is £3,450. The Married Couple's Allowance is decreased from £8,695 by £1 for every £2 earned above £29,600 (until reaching £3,450). A taxpayer receives 10% of the allowance amount – which means their tax saving (based on a full year's eligibility) is at least £336 and up to £869.50 in 2018-19, and at least £345 and up to £891.50 in 2019-20.

Sample Calculation 1

In the 2018-2019 tax year, a taxpayer who is entitled to Married Couple's Allowance has income before allowances of £31,500.

The calculation will be worked out as follows:

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- HMRC calculate how much the person's income before allowance ((£31,500) exceeds the income limit (£28,900), which is £2,600 over the limit) – and then take half of this amount, which is £1,300 in total.
- HMRC will subtract £1,300 from the Married Couple's Allowance entitlement of £8,695, bringing the amount down to £7,395.
- The person's Married Couple's Allowance is £739.50 (10% of £7,395).

Sample Calculation 2

In the 2019-2020 tax year, a taxpayer who is entitled to Married Couple's Allowance has income before allowances of £31,500.

The calculation will be worked out as follows:

- HMRC calculate how much the person's income before allowance ((£31,500) exceeds the income limit (£29,600), which is £1,900 over the limit) – and then take half of this amount, which is £950 in total.
- HMRC will subtract £950 from the Married Couple's Allowance entitlement of £8,915, bringing the amount down to £7,965.
- The person's Married Couple's Allowance is £796.50 (10% of 7,965).

2.3.6.4 Marriage Allowance

Marriage Allowance, introduced from the 6th of April 2015, allows a person whose income is lower than the Personal Allowance, and whose spouse or civil partner pays income tax at the basic rate, to transfer up to £1,190 of their remaining Personal Allowance in the 2018-19 tax year, and up to £1,250 in the 2019-20 tax year, to their spouse or civil partner. Hence, couples where neither partner is a higher or additional rate tax payer will be eligible to transfer. The allowance is only available to couples who were both born on or after the 6th of April 1935.

Sample Calculation

Timothy was born in 1972, and in 2019-20 had a total income of £9,100. His civil partner, born in 1969, had an income of £29,400 in 2019-20, taxed at the basic rate. Timothy has £3,400 of unused Personal Allowance (£12,500 minus £9,100). Under the Marriage Allowance, Timothy can transfer the maximum of £1,250 of his unused Personal Allowance to his civil partner.

2.3.6.5 Maintenance Payment Relief

Maintenance Payment Relief can reduce a person's tax if they make maintenance payments to their ex-spouse or former civil partner. It is an amount that is taken off their tax bill (so someone can only claim it if they pay tax). Three conditions must be met in order to get the relief:

- the taxpayer or their ex-spouse or former civil partner was born before the 6th of April 1935;
- they are separated or divorced or the civil partnership has dissolved and they're making the payments under a court order;
- the payments are for the maintenance of an ex-spouse or former civil partner (provided they aren't now remarried or in a new civil partnership) or for the taxpayer's children who are under 21.

For the 2018-2019 tax year, Maintenance Payment Relief can reduce a person's tax bill by the lower of the following two amounts:

- 10% of £3,360 (£336) – this will apply where the taxpayer makes maintenance payments of £3,260 or more a year;

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- 10% of the amount the taxpayer has actually paid during the tax year – this will apply where they make maintenance payments of less than £3,360.

The Maintenance Payment Relief amount in 2019-20 is £3,450.

A taxpayer cannot claim a tax reduction for any **voluntary payments** that they make for a child, ex-spouse or former civil partner.

Sample Calculation

In the 2019-20 tax year, a person who is divorced has total income of £22,000. By court order, the person pays their ex-spouse £1,200 maintenance a year (£100 per month):

- the person's total income is £22,000;
- their personal allowance is £12,500;
- subtract the personal allowance (£12,500) from the total income (£22,000) – that leaves the person with taxable income of £9,500 and a tax bill of £1,900 (20% of £9,500);
- the person makes maintenance payments of £1,200 and is therefore entitled to tax relief of £120 (10% of £1,200), as the amount of maintenance payments is lower than £3,450;
- this amount is deducted from the person's tax bill, so the final tax bill for the tax year is £1,780 (£1,900 – £120).

2.3.6.6 Blind Person's Allowance

If a person is certified blind and is on a local authority register of blind persons, or if they live in Scotland or Northern Ireland and are unable to perform any work for which eyesight is essential, they can claim Blind Person's Allowance. Blind Person's Allowance is added to their tax-free Personal Allowance – so it is an extra amount of income they can get each year without paying tax. If they are on a low income or even if they don't pay any tax, they may be able to transfer their Blind Person's Allowance to their spouse or civil partner.

Blind Person's Allowance for the 2018-19 tax year is £2,390, and £2,450 in 2019-20. So if, for example, a taxpayer is registered blind with their local authority and has in the 2019-20 tax year:

- an annual salary of £16,000;
- a Personal Allowance of £12,500;
- Blind Person's Allowance of £2,450,

the person only needs to pay tax on £1,050 (£16,000 less the sum of £12,500 and £2,450).

Another example: in 2019-20, a taxpayer who is registered blind has a taxable income of £19,000. His tax-free allowances add up to £14,950 (Personal Allowance (£12,500) plus Blind Person's Allowance (£2,450)). Deducting the person's tax-free allowance from his taxable income leaves him with taxable income of £4,050.

If both the person and their spouse or civil partner qualify for Blind Person's Allowance, they can each get an allowance.

2.3.6.7 Personal Savings Allowance

The Personal Savings Allowance was introduced as of April 2016, and means that basic and higher rates taxpayers do not have to pay tax on certain amounts of their savings income they receive from banks and building societies[1]. As a result of the

[1] Savings income also includes sums received from interest distributions (but not dividends) from authorised unit trusts, open-ended investment companies, income from government or company bonds, and most type of purchased life annuity payments.

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new allowance, most people no longer pay tax on savings interest and banks and building societies stopped deducting tax at source from interest accumulated in their customers' accounts[2].

Interest from Individual Savings Accounts (ISAs) do not count towards the Personal Savings Allowance since it is already a tax-free savings vehicle.

The amount of the Personal Savings Allowance depends on the taxpayer's taxable income, which is the total non-savings income (e.g., employment, dividends, pension, social security benefits), and savings income, after deducting the Personal Allowance[3].

The table below shows the taxpayer's allowance, depending on whether they're a basic, higher or additional rate taxpayer.

PERSONAL SAVINGS ALLOWANCE RATES 2018-19 BY TAX BAND		
Tax Rate	**Income band (taxable income)**	**Personal Savings Allowance**
Basic 20%	Up to £34,500	Up to £1,000 in savings Income is tax-free
Higher 40%	£34,501 – £150,000	Up to £500 in savings income is tax-free
Additional 45%	Over £150,000	No Personal Savings Allowance

The examples below show how the Personal Savings Allowance works in different situations. Where appropriate, the examples use the tax rates and limits for the 2019-20 tax year. Also assume all interest received is outside of an ISA.

Sample Calculation 1

A taxpayer earns £25,000 a year from employment and gets £250 in account interest.

The person will not pay any tax on their interest, because it is less than their £1,000 Personal Savings Allowance.

If the person receives £1,500 in account interest, they will not pay tax on the first £1,000 of interest, but will need to pay basic rate tax (20%) on the £500 interest over their Personal Savings Allowance.

Sample Calculation 2

A taxpayer earns £51,000 a year from employment and gets £250 in account interest.

The person will not pay any tax on their interest, because it is less than their £500 Personal Savings Allowance.

If the person receives £1,200 in account interest, they will not pay tax on the first £500 of interest only, as they are a higher rate taxpayer, and will need to pay higher rate tax (40%) on the £700 of interest which exceeds their Personal Savings Allowance.

Sample Calculation 3

[2] Taxpayers will not need to do anything to claim their Personal Savings Allowance, as HMRC will normally collect the tax by changing the taxpayer's tax code. Banks and building societies will give HMRC the information they need to do this.
[3] Alternatively, it could be said that the amount of the Personal Savings Allowance depends on the taxpayer's adjusted net income (which is the taxable income plus any deductions made for the Personal Allowance). In which case, £11,850 would be added to the basic rate tax band limit presented in the table (i.e. up to £46,350, instead of £34,500, for the Personal Savings Allowance of £1,000, and a Personal Savings Allowance of £500 for a taxpayer with adjusted net income of £46,351 – £150,000).

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In some cases, the savings income within the personal savings allowance can put the taxpayer into the band of the higher income tax rate. To work this out, the taxpayer first must add up their non-savings income (e.g., employment, dividend, pension and other sources) and savings income interest to get their total adjusted net income. If the total income puts the taxpayer in the higher-rate band (which starts at £50,001 in the 2019-20 tax year), then the taxpayer will be deemed as a higher rate taxpayer and will only get the £500 of Personal Savings Allowance. If the taxpayer income will cross the additional rate threshold, they would not get the Personal Savings Allowance at all.

Let's see the following example, where an individual earns £49,800 from employment plus £1,000 in savings interest. In the 2019-20 tax year, the higher tax rate band starts on income above £50,001. As the person's total income including interest (£50,800) is above the higher-rate threshold, the person is only entitled to a Personal Savings Allowance of £500. So, £500 of the taxpayer's savings interest would be tax-free, while the remaining £500 would be taxed at the higher rate of 40%.

2.3.6.8 Dividend Allowance

The Dividend Allowance was introduced as of April 2016, and meant originally that individuals would not have to pay tax on the first £5,000 of dividend income they receive, no matter what non-dividend income they have. The tax-free dividend allowance was subsequently reduced from £5,000 to £2,000 in the 2018-19 tax year, and remains at that level in 2019-20. The Dividend Allowance is available to anyone who has dividend income. Individuals therefore pay tax, in the 2018-19 tax year, on any dividends they receive over £2,000 at the following rates:

DIVIDEND ALLOWANCE RATES 2018-19 BY TAX BAND		
Tax Rate	**Income band (taxable income)**	**Dividend Allowance**
Basic 7.5%	Up to £34,500	Up to £2,000
Higher 32.5%	£34,501 – £150,000	
Additional 38.1%	Over £150,000	

DIVIDEND ALLOWANCE RATES 2019-20 BY TAX BAND		
Tax Rate	**Income band (taxable income)**	**Dividend Allowance**
Basic 7.5%	Up to £37,500	Up to £2,000
Higher 32.5%	£37,501 – £150,000	
Additional 38.1%	Over £150,000	

The Dividend Allowance does not reduce the taxpayer's total income for tax purposes. However, it does mean that they do not have any tax to pay on the first £2,000 of dividend income they receive.

Dividends within the taxpayer's allowance still counts towards their basic or higher rate bands, and may therefore affect the rate of tax they pay on dividends received in excess of the £2,000 allowance. As a result of the Dividend Allowance, companies distributing dividends no longer deduct tax from source before making distributions, and dividend income is received by taxpayers in full.

Dividends received by pension funds that are currently exempt from tax, and dividends received on shares held in an Individual Savings Account (ISA), continue to be tax free.

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The way the Dividend Allowance works in different situations is demonstrated in the examples below.

Sample Calculation 1

A taxpayer receives £2,000 per year in dividends.

The person will not have to pay tax on their dividend income as it is within their £2,000 Dividend Allowance.

Sample Calculation 2

A taxpayer has an income from employment of £6,500 and a dividend income of £9,000 in the 2019-20 tax year.

The person will not have to pay tax on the first £2,000 of dividends due to the Dividend Allowance. With a Personal Allowance of £12,500, a sum of £6,000 (£12,500 – £6,500) of the dividends are under the threshold for tax, while a further £2,000 fall within the Dividend Allowance, leaving tax to pay at the basic rate (7.5%) on £1,000 (£9,000 – £6,000 – £2,000).

Sample Calculation 3

A taxpayer has an income from employment of £17,000, and dividend income of £21,000 in the 2019-20 tax year. Of the £17,000 employment income, £12,500 is covered by the Personal Allowance and the remaining £4,500 is taxed at the basic rate. Of the £21,000 dividend income, the Dividend Allowance covers the first £2,000, while the remaining £19,000 of dividends are taxed at the basic rate (7.5%).

Sample Calculation 4

A person has an income from employment of £42,000, and dividends of £12,000 in the 2018-19 tax year.

Of the £42,000 employment income, £11,850 is covered by the Personal Allowance, leaving £30,150 to be taxed at the basic rate.

This leaves £4,350 of income that can be earned within the basic rate limit of £34,500 before the higher rate threshold is crossed (£34,500 – £30,150). The Dividend Allowance of £2,000 is tax free, leaving £2,350 to be taxed as the basic rate. The remaining £7,650 (£12,000 (total dividend income) – £2,000 (allowance) – £2,350 (dividend taxed at the basic rate)) of dividends are all taxed at the dividend higher rate (32.5%). This example demonstrates how the Dividend Allowance interacts with the basic rate band and how to determine the tax rate individuals pay on dividends received in excess of the £2,000 allowance.

2.3.6.9 Pension Contributions

The Government encourages people to save for their retirement by giving them tax relief on pension contributions.

2.3.6.10 Various Business Expenses

An *employee* or a *director* can obtain tax relief for business expenses paid, for example, the cost of: travel and subsistence required in the course of one's job, work tools or special clothing, fees and subscriptions to professional bodies, expenses of home working, capital expenditure (e.g. plant or a new computer which one has purchased during the year). *Self-employed* persons can obtain tax relief for all of the business expenses paid by them that are solely for the purpose of the business. A self-employed person's business expenses might include: buying stock or materials and paying sub-contractors, business premises costs, repairs and renewals, motor and travelling, advertising, legal and professional fees, general office costs, etc.

2.3.6.11 Interest Payments on Qualifying Loans

Tax relief is available for interest on loans where the borrowed money is used for certain specific purposes. A qualifying loan may have its interest payments deducted.

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Such purposes include:

- purchasing shares, or financing loans to, a close company in which the taxpayer owns more than 5% of the ordinary share capital and the taxpayer works for a greater part of their time in the management and conduct of the company's business, or that of an associated company;
- acquiring share capital in an employee-controlled company in which the taxpayer is a full-time employee;
- acquiring a share, or financing loans to, a co-operative which is used wholly and exclusively for the purposes of its business;
- buying a share in a partnership or making an investment into certain types of partnerships and co-operatives (e.g. if a loan is taken out by a partner for use wholly and exclusively for partnership business, the interest on the loan will be an allowable tax relief); or
- buying plant and machinery for use in a trading, professional or property partnership's business.

If the conditions are met, the gross amount of interest paid on the loan during the tax year can be deducted from the taxpayer's pre-tax income. This has the effect of reducing the amount of income he will need to pay tax on.

A taxpayer can also claim relief for alternative finance payments paid on a qualifying alternative finance arrangement on the same basis as someone claiming relief for interest paid on a loan.

A limit to **all uncapped Income Tax reliefs** was introduced in April 2013, whereby those seeking to claim reliefs of more than £50,000 are restricted to 25% of their income for the year in question (or £50,000, whichever is the greater). Reliefs which are already capped (such as the relief for pension contributions) are not affected.

For example, Ben's total income in 2019-20 is £500,000. He claims relief for qualifying loan interest arising in 2019-20 of £150,000. Ben's relief limit is £125,000 as 25% of his income is greater than £50,000.

Another example: Simon, who is as yet unmarried, earns a £50,000 salary as a translator and £10,000 from selling health products in the 2019-20 tax year. Simon makes interest payments of £5,000 per annum on a qualifying loan. Simon's total income is £60,000, of which he will be entitled to an allowable relief in respect of the interest on the qualifying loan, thus reducing his total income to £55,000. From this, his Personal Allowance will be deducted, and the tax payable calculated at the applicable rates.

2.3.6.12 Tax Allowance for Property and Trading Income

The trading income allowance provides a £1,000 tax-free allowance for individuals earning trading income from selling goods or providing services. If the taxpayer's trading income is up to £1,000, they are not required to report the income at all. If the trading income is more than £1,000, the taxpayer has the choice of (i) calculating trading profits in the usual way, by deducting expenses from income, or (ii) deducting the allowance from gross income, without reference to actual expenses.

The property allowance provides a £1,000 tax-free allowance for individuals earning income from property. If the taxpayer's property income is up to £1,000, they are not required to report the income at all. If the property income is more than £1,000, the taxpayer has the choice of (i) calculating profits in the usual way, by deducting the expenses from the property income, or (ii) deducting the allowance from gross income, without reference to actual expenses.

The allowances do not apply to partnership income from carrying on a trade, profession or property business in partnership.

The two allowances are independent of each other so taxpayer can claim them both.

Sample calculation 1

Geoff earns £23,000 per year from his job as a telesales executive, and earns annual trading income of £930 from selling model aeroplanes on an online auction site. Geoff does not have to report his trading income, as it falls within the annual £1,000 trading income allowance.

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Sample calculation 2

Luciana earns £4,000 per year in trading income from her small business selling cupcakes. Her annual expenses are £2,200. Luciana can choose between paying tax on her trading profit of £1,800 (£4,000 – £2,200), or deducing the annual trading income allowance of £1,000, leaving her with taxable trading income of £3,000 (£4,000 – £1,000).

Sample calculation 3

Floyd earns £29,000 from his job as a financial analyst, and earns annual property income of £780 from providing storage services in his loft. Floyd does not have to report or pay any tax on his property income, as it falls within the annual £1,000 property allowance.

Sample calculation 4

Nigella earns £84,000 per year from her job as a television presenter, and earns annual property income of £4,800 from renting out her driveway. Her annual property expenses are £375. Nigella can either pay tax on her property profit, which is £4,425 (£4,800 – £375), or she can deduct the annual property allowance of £1,000, and pay tax on £3,800 (£4,800 – £1,000).

2.3.6.13 Social Investment Tax Relief (SITR)

The SITR is a tax relief that was introduced on the 6th of April, 2014. The relief offers an income tax rebate at 30% to individuals making unsecured investments in charities, community interest companies and community benefit societies, as well as in social impact bonds. SITR is available for organisations with a maximum number of 500 staff. Under EU rules governing the initial introduction of SITR, eligible organisations can receive up to €344,827 (about £300,000) over three years. The exact sterling equivalent is the spot exchange rate on the date of investment. From April 2017, the maximum qualifying investment increases to £1.5 million over the lifetime of an organisation, but the maximum number of staff for eligible organisations is reduced to 250 (not including volunteers).

2.3.6.14 TAX RELIEF FOR RESIDENTIAL LANDLORDS

Since April 2017, landlords are no longer able to deduct *all* mortgage interest from their taxable income. Previously, 100% of mortgage interest was considered an allowable cost meaning that someone who earned £5,000 per year in rent and paid interest on their mortgage of £1,000 per year, would have taxable rent of £4,000.

From April 2020, landlords will no longer be able to deduct *any* of their mortgage interest as an allowance cost. Instead, tax relief on mortgage interest will be given at the basic rate only. The new provision is being phased in as per the following table:

Mortgage Interest	2016-17 Tax Year	2017-18 Tax Year	2018-19 Tax Year	2019-20 Tax Year	2020-21 Tax Year
Previous provision – deduction from rental income as an allowable cost	**100%**	**75%**	**50%**	**25%**	**0%**
New provision – tax relief on mortgage interest at basic rate	**0%**	**25%**	**50%**	**75%**	**100%**

Sample Calculation 1

Sarah's income is made up of:

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Income from employment (after deduction of Personal Allowance) – £10,000
Income from property – £5,000

Mortgage interest – £1,000

Sarah's income is well within the basic rate tax band for each year from 2016-17 until 2020-21.

In 2016-17: 100% of the mortgage (£1,000) would have been deducted from the property income, giving Sarah a total taxable income of £14,000. Taxed at 20%, this would mean total tax payable of £2,800.

In 2020-21: 0% of the mortgage (£0) would be deducted from the property income, giving Sarah a total taxable income of £15,000. Taxed at 20%, this would total tax payable of £3,000. However, mortgage interest relief of 20% would be available 100% of the mortgage interest, therefore reducing Sarah's tax bill by £200 (£1,000 x 20%). This would, therefore, mean that again the total tax payable is £2,800.

For all the years in between, the calculation in Sarah's case remains £2,800. Therefore, those who are will within the basic rate will not be adversely affected.

Sample Calculation 2

Mario's income is made up of:

Income from self-employment (after deduction of Personal Allowance) – £70,000
Income from property – £5,000

Mortgage interest – £1,000

Mario is, therefore, a higher rate tax payer. Presuming a static basic rate threshold of £37,500 for all years (note that this is just for the purpose of the calculation, the basic rate threshold changes each year), the following calculations would apply.

In 2016-17: 100% of the mortgage (£1,000) would have been deducted from the property income, giving Mario a total taxable income of £74,000. With the first £37,500 taxed at 20% (£7,500) and the remaining £36,500 at 40% (£14,600), this would mean total tax payable of £22,100.

In 2017-18: 75% of the mortgage (£750) would have been deducted from the property income, giving Mario a total taxable income of £74,250. With the first £37,500 taxed at 20% (£7,500) and the remaining £36,750 at 40% (£14,700), this would mean tax payable of £22,200. Mortgage interest relief of 20% would be available on the remaining 25% of the mortgage interest, therefore reducing Mario's tax bill by £50 (£250 x 20%). This would, therefore, mean that the total tax payable is £22,150 (£50 more than in the previous year).

Mario's tax liability would grow increasingly greater as the new provision is phased in, until 2020-21.

In 2020-21: 0% of the mortgage (£0) would be deducted from the property income, giving Mario a total taxable income of £75,000. With the first £37,500 taxed at 20% (£7,500) and the remaining £37,500 at 40% (£15,000), this would mean tax payable of £22,500. However, mortgage interest relief of 20% would be available 100% of the mortgage interest, therefore reducing Mario's tax bill by £200 (£1,000 x 20%). This would, therefore, mean that the total tax payable is £22,300 (£200 more than under the previous provision).

Sample Calculation 3

Jenny's income is made up of:

Income from self-employment – £160,000 (no Personal Allowance available due to level of income)
Income from property – £5,000

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Mortgage interest - £1,000

Jenny is, therefore, an additional rate tax payer. Presuming a static basic rate threshold of £37,500 and a static higher rate threshold of £150,000 for all years (note that this is just for the purpose of the calculation, the basic rate threshold changes each year), the following calculations would apply.

In 2016-17: 100% of the mortgage (£1,000) would have been deducted from the property income, giving Jenny a total taxable income of £164,000. With the first £50,000 taxed at 20% (£10,000), the next £100,000 at 40% (£40,000) and the remaining £14,000 at 45% (£6,300), this would mean total tax payable of £56,300.

In 2020-21: 0% of the mortgage (£0) would be deducted from the property income, giving Jenny a total taxable income of £165,000. With the first £50,000 taxed at 20% (£10,000), the next £100,000 at 40% (£40,000) and the remaining £15,000 at 45% (£6,750), this would mean tax payable of £56,750. However, mortgage interest relief of 20% would be available 100% of the mortgage interest, therefore reducing Jenny's tax bill by £200 (£1,000 x 20%). This would, therefore, mean that the total tax payable is £56,550 (£250 more than under the previous provision).

Sample Calculation 4

Paul's income is made up of:

Income from employment (after deduction of Personal Allowance) – £33,500
Income from property – £5,000
Mortgage interest – £1,000

Paul is, therefore, a basic rate tax payer. Presuming a static basic rate threshold of £37,500 for all years (note that this is just for the purpose of the calculation, the basic rate threshold changes each year), the following calculations would apply.

In 2016-17: 100% of the mortgage (£1,000) would have been deducted from the property income, giving Paul a total taxable income of £37,500. Taxed at 20%, this would mean total tax payable of £7,500.

In 2020-21: 0% of the mortgage (£0) would be deducted from the property income, giving Paul a total taxable income of £38,500. With the first £37,500 taxed at 20% (£7,500) and the remaining £1,000 at 40% (£400), this would mean tax payable of £7,900. However, mortgage interest relief of 20% would be available 100% of the mortgage interest, therefore reducing Paul's tax bill by £200 (£1,000 x 20%). Therefore, the total tax payable is £7,700.(£200 more than under the previous provision, as Paul's income has been pushed into the higher rate bracket).

2.3.7 GIFT AID

The Gift Aid scheme is for gifts of money given by taxpayers to charities or to Community Amateur Sports Clubs (CASCs). Donating through Gift Aid means charities and CASCs can claim an extra 25p for every £1 the taxpayer gives.

Gift Aid donations are regarded as having basic rate tax deducted by the donor. Charities or CASCs take your donation – which is money you've already paid tax on – and reclaim the basic rate tax from HMRC on its 'gross' equivalent – the amount before basic rate tax was deducted.

The current basic rate tax is 20%, which means that if a taxpayer gives £10 using Gift Aid, it's worth £12.50 to the charity (in other words, £12.50 is treated as the gross amount of the donation, and deducting 20% gives the actual donation amount of £10).

If a donor is a higher rate taxpayer, they too can benefit from the tax relief as they can claim back the difference between the higher rates of tax at 40% or 45% and the basic rate of tax at 20% on the total value of their gross donation. For a basic rate taxpayer, this adds approximately 25% to the value of any gift made under Gift Aid. Higher rate taxpayers can claim Income Tax relief, above and beyond the amount claimed directly by the charities.

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In order to make a Gift Aid reclaim, a taxpayer will need to make a Gift Aid declaration to HMRC to each charity they want to donate. All donations from the last four years can be included in the declaration.

For example, if a person donates £100 to a charity, the total value of the donation is considered to be £125 – so the person can claim back:

£25 – if he pays tax at 40% (£125 × 20%)

£31.25 – if he pays tax at 45% (£125 × 20%) plus (£125 × 5%)

2.3.8 CALCULATING THE INCOME TAX RATE

After a taxpayer's allowable expenses and any tax-free allowances have been taken into account, the amount of tax they are required to pay is calculated using the different tax rates and series of tax bands. Tax is paid on the amount of taxable income remaining after allowances have been deducted, as reflected in the table below:

INCOME TAX RATES 2018-19 BY TAX BAND AND TYPE OF INCOME			
Income Tax band	**Income Tax rate on non- savings, non-dividend income (self-employment, pension income, rental income)**	**Income Tax rate on savings (interest)**	**Income Tax rate on dividends (income from shares in UK companies)**
£0 to £5,000 Starting rate for savings*	Not available	0%	Not applicable – see basic rate band and Dividend Allowance
£0 to £34,500 Basic rate	20%	20%	7.5%
£34,501 to £150,000 Higher rate	40%	40%	32.50%
Over £150,000 Additional rate**	45%	45%	38.1%

In the 2018-19 tax year, the overall threshold for paying the 40% higher tax rate (the combined effect of the Personal Allowance and the basic rate), is therefore £46,350 (£11,850 plus £34,500). The following table shows the rates and bands with personal allowance:

Band	**Taxable income**	**Tax rate**
Personal Allowance	Up to £11,850	0%
Basic rate	£11,851 to £46,350	20%
Higher rate	£46,351 to £150,000	40%
Additional rate	over £150,000	45%

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*From 2015-16 and beyond there is a zero-rate band for savings income of up to £5,000. For example, a taxpayer who in the 2018-19 tax year has non-savings income of £11,850 and receives a total of £5,000 in savings interest, will pay no income tax. The £11,850 will be tax-free because that falls within the Personal Allowance, while up to £5,000 of savings interest qualifies for the zero-rate band. Any savings interest above £5,000 would be taxed at 20%, while any other income above £11,850 would reduce the zero-rate band by the same amount.

So someone with £17,850 (or more) in non-savings income would not qualify for the zero-rate band at all (this figure comprises: (i) Personal Allowance of £11,850; (ii) £5,000 of savings interest which qualifies for the zero-rate band; and (iii) £1,000 Personal Savings Allowance which applies to basic rate taxpayer).

To assess a person's taxable income, it is first necessary to separate the different types of income from one another into the categories of: non-savings income (all sources of income except for savings income) and savings income (interest).

Because the rate of Income Tax a taxpayer pays on savings and dividend income is worked out *after* any non-savings income has been taken into account, if a person's non-savings income is within their Personal Allowance – or if savings and investments are his only source of income – his savings income will not be taxed at all up to the £5,000 limit. However, if he already has non-savings income which takes him *above* the zero-rate band, all of his savings will be taxed at the 20% basic rate.

Until April 2016, tax at the rate of 20% was deducted from bank/building society interest "at source" by the bank or building society, before the interest was paid to individuals or personal representatives, while companies were required to deduct tax at the rate of 10% before distributing dividends. If a person's taxable income was less than their tax allowances, they could register to have their interest paid 'gross', without tax taken off. To register to get interest on savings tax-free, the taxpayer had to fill in form R85 (Getting your interest without tax taken off) and send it to the bank or building society where the account is maintained. If a person was under 16, his parent or guardian could register for him.

A taxpayer could have also claimed back tax he has paid on his savings when he didn't need to. The claim had to be done for each year the taxpayer thinks he overpaid tax. There is a time limit of four years to claim a refund.

From April 2016, however, banks and building societies no longer deduct tax from payments of interest to their depositors. Similarly, companies no longer deduct tax from payments of dividends to their investors.

Tax rates for 2019-20 (figures represent the taxable income remaining *after* allowances have been deducted):

INCOME TAX RATES 2019-20 BY TAX BAND AND TYPE OF INCOME			
Income Tax band	**Income Tax rate on non- savings, non-dividend income (self-employment, pension income, rental income)**	**Income Tax rate on savings (interest)**	**Income Tax rate on dividends (income from shares in UK companies)**
£0 to £5,000 Starting rate for savings*	Not available	0%	Not applicable – see basic rate band and Dividend Allowance
£0 to £37,500 Basic rate	20%	20%	7.5%
£37,501 to £150,000 Higher rate	40%	40%	32.50%
Over £150,000 Additional rate**	45%	45%	38.1%

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*In the 2019-20 tax year, with the Personal Allowance of £12,500, £5,000 of savings interest which qualifies for the zero-rate band, and £1,000 Personal Savings Allowance which applies to basic rate taxpayers, individuals whose total income is less than £17,85018,500 will not pay tax on any savings income.

**The tax rate bands table could also be presented by showing the adjusted net income *before* deducting the Personal Allowance.

Band	**Taxable income**	**Tax rate**
Personal Allowance	Up to £12,500	0%
Basic rate	£12,501 to £50,000	20%
Higher rate	£50,001 to £150,000	40%
Additional rate	over £150,000	45%

Sample calculations for tax-free savings (for the 2019-20 tax year)

Warren earns £12,000 a year in his part-time job as a gardener. His tax-free personal allowance is £12,500, so he does not pay any income tax on his wages. He then earns £400 a year in savings income (interest earned on his savings). When you add up Warren's earnings and his savings income it equals less than £18,500, so Warren will not pay tax on his savings income.

Cynthia earns £27,000 in her job as a chef. Her tax-free personal allowance is £12,500, so she is taxed at 20% on £14,500 of her wages. Cynthia also earns £1,300 a year in savings income. However as Cynthia earns over £18,500, some of her savings income is also subject to tax. The first £1,000 is tax free due to the Personal Savings Allowance and the remaining £300 will be taxed at 20%.

Mathilda receives £16,000 per year from her pension. Her tax-free personal allowance is £12,500, so she is taxed at 20% on £3,500 (£16,000 – £12,500). She also earns £4,000 a year in savings income. Mathilda's total income is £20,000. Mathilda has £1,500 of savings income that falls within the 0% saving rate bracket of up to £5,000 (£17,500 – £16,000 = £1,500). The rest, £2,500 (£4,000 – £1,500), is potentially taxable at the rate of 20%. However, Mathilda is entitled to £1,000 tax free due to the Personal Savings Allowance and therefore will only pay tax on £1,500 of her savings income (£2,500 – £1,000 = £1,500) at the rate of 20%.

2.3.9 CALCULATING THE INCOME TAX DUE

Order of Taxation

In many cases a taxpayer will have income from various sources. There are different ways to calculate the tax amount due, depending on the level and sources of income of the taxpayer.

Savings and dividend income are the highest part of a person's total income.

If a person has savings income but no dividend income, the savings income is treated as the highest part of total income.

If a person has dividend income but no savings income, the dividend income is treated as the highest part of total income.

If a person has both savings and dividend income, the amounts taken together are treated as the highest part of total income, and the dividend income is taken as the higher part of the combined amount.

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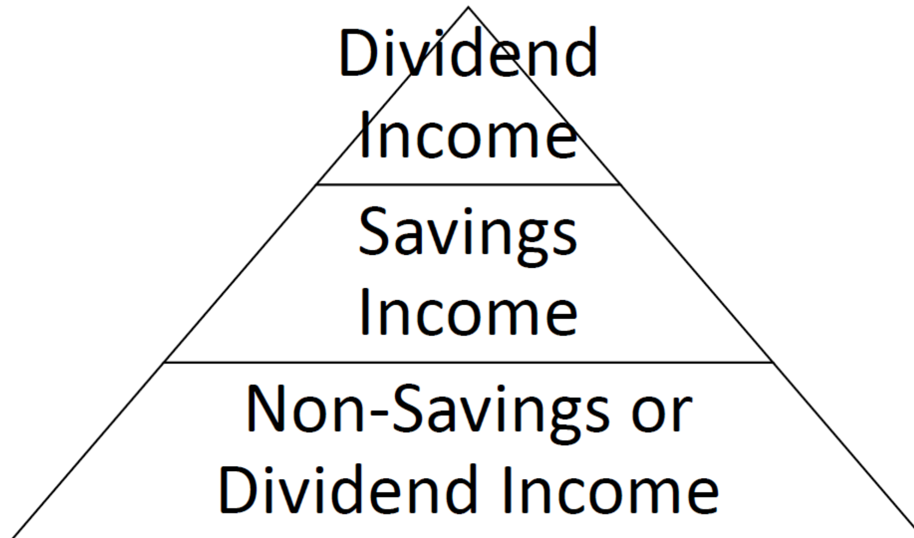
So, the first slice of a person's income comprises earnings, pensions, taxable social security payments, trading profits and income from property. The next slice is savings income, and dividend income is the top slice:



Sample Calculation

In the 2019-20 tax year Kate has income of £36,000 from employment, savings income of £1,000 and dividends of £12,000. Her Personal Allowance is £12,500 and the threshold for paying tax at the higher rate is £37,500. Kate is also entitled to the Personal Savings Allowance of £1,000 and the Dividend Allowance of £2,000.

The first slice is the income from employment. The interest on savings income is the next highest part of total income and is taxed at the savings rate of 20%. The zero-rate band for savings does not apply because non-savings income fully occupies the first £5,000 of taxable income.

Finally, the dividends are taxed at the dividend basic rate of 7.5% or higher rate of 32.5%.

Kate's tax liability in 2019-20 is as follows:

Income (£):

Employment – £36,000

Savings income – £1,000

Dividend income – £ 12,000

Less Personal Allowance (£12,500)

Taxable – £36,500 (36,000 + 1,000 + 12,000 – 12,500)

Tax (£):

Employment (at the rate of 20%): £36,000 (employment income) – £12,500 (Personal Allowance) = £23,500 @ 20% = £4,700

Interest (savings income): £1,000 @ 0% = £0 (Personal Savings Allowance)

Dividend: £12,000 – first £2,000 are tax free (covered by the Dividend Allowance)

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Of the £36,000 employment income, £12,500 is covered by the Personal Allowance, leaving income of £23,500 to be taxed at the basic rate. Then, Kate will be entitled to £1,000 of the Personal Savings Allowance as her total income from all sources is still within the basic rate of £37,500. However, the £1,000 allowance still counts towards the higher rate threshold. This leaves income of up to £13,000 (£37,500 (higher rate threshold) – £23,500 (employment income taxed at the basic rate) – £1,000 (exempt savings income)) that can be earned within the basic rate limit of £37,500 before the higher rate threshold is met. The Dividend Allowance of £2,000 is used up first, leaving £10,000 to be charged tax at the dividend basic rate band of 7.5%. So the additional tax rate threshold is not met, as only £12,000 of the available £13,000 is used. The calculation will be as follow:

Dividend: £10,000 (at the rate of 7.5%): £750

Total: £4,700 + £750 = £5,450

Kate's tax liability is, therefore, £5,450, in the 2019-20 tax year.

If Kate had £2,500 savings income (instead of £1,000), she would not be entitled to the higher Personal Savings Allowance of £1,000, as her taxable non-savings income from employment, dividends and savings income would be £38,000 (£36,000 salary + £2,500 savings + £12,000 dividends – £12,500 Personal Allowance), which is greater than the higher rate threshold of £37,500. As a result, she would only be entitled to the lower Personal Savings Allowance of £500. The remaining savings income of £2,000 would be taxed at the basic rate of 20%, as they are taxed before dividends, and therefore fall within the basic rate band. She will not be entitled to the starting rate for savings because her overall income is too high. At this stage, she will have used up £26,000 of her basic rate band (£36,000 salary – £12,500 Personal Allowance + £2,500 savings income), and still has £11,500 to be used within the starting rate (£37,500 higher threshold – £26,000 used up so far). Of the £12,000 of dividends, the first £2,000 would fall within the tax-free Dividend Allowance, but would still count towards using up her basic rate tax band. The tax rate of the remaining £12,000 of dividends would be split; the first £9,500 (£11,500 – £2,000) would be taxed at the basic rate of 7.5%, and the remaining £500 (which is above the £37,500 basic rate band) would be taxed at the higher rate of 32.5%.

Income (£):

Employment – £36,000

Savings income – £2,500

Dividend income – £12,000

Less Personal Allowance (£12,500)

Taxable – £65038,000 (36,000 + 2,500 + 12,000 – 12,500)

Tax (£):

Employment (at the rate of 20%): £36,000 (employment income) – £12,500 (Personal Allowance) = £23,500 @ 20% = £4,700

Interest (savings income): £500 @ 0% = £0 (Personal Savings Allowance)

£2,000 @ 20% = £400

Dividend: £2,000 @ 0% = £0 (Dividend Allowance)

£9,500 @ 7.5% = £712.50

£500 @ 32.5% = £162.50

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Total: £4,700 + £400 + £712.50 + £162.50 = £5,975.

2.4 NATIONAL INSURANCE

In addition to paying Income Tax on their income, taxpayers are also required to pay National Insurance contributions (until retirement age). National Insurance contributions build up a person's entitlement to certain social security benefits, including the State Pension. The amount of National Insurance someone pays depends on how much the person earns and whether he is employed or self-employed.

National Insurance is payable in addition to Income Tax and collected by HMRC, although there are some allowances and reliefs available that can lower the Income Tax bill.

The contributions are paid by employees and employers on earnings (employers also contribute amounts on certain benefits-in-kind provided to employees). Employers make the contributions from taxpayers' wages and pay it to HMRC. Taxpayers who are self-employed contribute partly by a fixed weekly or monthly payment, and partly on a percentage of net profits above a certain threshold.

2.5 INCOME TAX LIABILITY OF A PARTNERSHIP

Unlike a company, a partnership is not a separate legal person, but a group of individuals – each of whom is taxed on his own share of the partnership profits or losses, in the light of his own personal tax reliefs and other sources of income (rather than being jointly liable, as with all other partnership liabilities). Each partner is, therefore, required to include his share of partnership profits in his own tax return and is liable for the tax on his profit share (only). Yet the partnership is also required to submit a set of accounts and a tax return, in respect of total partnership profits. The final profit figure will then be apportioned among the partners, according to the profit-sharing ratio in force during the accounting period in question. Form SA 400 is used to register a partnership for Self-Assessment.

The taxable profit is calculated in the same manner as described above, i.e. taxable receipts less deductible expenses. However, in the case of a partnership, it is also necessary to examine any payment made by the business to a partner, in order to ascertain whether it constitutes a deductible expense (capable of reducing the taxable profit of the partnership), or is merely an allocation of the taxable profit *among the partners* (in which case it will not be able to reduce the taxable profit of the partnership). For example, a true "salary" payable to a "partner" will be an expense that is deductible from the firm's taxable profits (with tax being deducted at source, under the PAYE procedure), while a mere employee of the partnership who receives a "salary" will not be a legitimate deductible expense. Similarly, where a true loan is extended by a partner to the partnership, the interest payable on the loan will be a deductible expense, while interest payable to a partner will not be a deductible expense, if it is payable on a partner's contribution of capital to the firm (such payment being regarded as part of the agreed method of allocating profits among the partners).

2.6 TAX EFFICIENT SAVINGS AND INVESTMENTS

If a person saves or invests money, he will generally have to pay tax on the interest or income he gets, but there are some savings and investments that give the taxpayer a tax-free return. If a person is on a low income, he might not have to pay tax at all.

2.6.1 ISAs (INDIVIDUAL SAVINGS ACCOUNTS)

ISAs are tax-favoured savings and investment accounts. Individuals can use them to save cash, or invest in stocks and shares. The maximum a person can put into an ISA is £20,000 in the 2018-19 and 2019-20 tax years.

Savers don't pay any tax on the interest or dividends they receive from an ISA and any profits from investments are free of Capital Gains Tax. However, on the other hand, this does mean that people cannot use losses on their ISA investments to reduce Capital Gains Tax on profits from investments outside the ISA.

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To pay into an ISA you must be a UK resident, 16 or over for a cash ISA, or 18 or over for a stocks and shares ISA. An ISA must be in your name alone; you can't have a joint ISA.

2.6.2 Lifetime ISAs

Lifetimes ISAs are a longer-term tax-free savings account, that give you a government bonus of 25% of the money invested, subject to a maximum of £1,000 per year. There is no tax on any interest, income or capital gains from cash or investments held within a Lifetime ISA. Lifetime ISAs are only available to UK residents aged 18 or over but under 40. The maximum annual investment is £4,000, but once opened, it is possible to continue to pay into it until reaching age 50. The investment made into a Lifetime ISA contributes to the overall ISA limit of £20,000 in the 2019-20 tax year.

Once invested, the money in a Lifetime ISA cannot usually be withdrawn until the investor reaches age 60. If an early withdrawal is made, there is a withdrawal charge of 25% of the amount withdrawn. A withdrawal charge does not apply if the investor is

- using it towards a first home valued at less than £450,000, with a mortgage, and the ISA has been open for at least 12 months
- aged 60
- terminally ill with less than 12 months to live or
- transferring to another Lifetime ISA provider

2.6.3 Junior ISAs

Junior ISAs are long-term tax favoured savings accounts especially for children. From the 1st of November 2011, they have been available to any child under 18 living in the UK, who does not have a Child Trust Fund (CTF) account. Like ISAs, individuals can use them to save cash or invest in stocks and shares. In the 2019-20 tax year, a person can save up to £4,368 a year in a Junior ISA and they won't pay any tax on the interest or dividends. The annual limit of Junior ISAs is adjusted in accordance with the Consumer Price Index (CPI). It is not possible to carry forward or back to other tax years any part of the limit which is not used.

The Junior ISA will be in the child's name, but the person who opens the account is responsible for managing it. They are called the 'registered contact'. When the child is 16 they can become the registered contact and manage their own account if they want to. When the child is 18 they can choose to take the money out of the Junior ISA or invest it in a different type of account. Otherwise, the Junior ISA will automatically become an adult ISA.

2.6.4 NATIONAL SAVINGS & INVESTMENTS

National Savings & Investments offer a totally safe way of saving and investing money because it's backed by the Treasury. Tax-free savings and investment products from National Savings & Investments currently include:

- Cash ISAs – for savers aged 16 or over;
- Fixed Interest and Index Linked Savings Certificates – for savers aged seven or over;
- Children's Bonus Bonds – can be invested for five years on behalf of children aged under 16.

National Savings & Investments also issue Premium Bonds. If a person buys Premium Bonds, he won't receive interest, but can win tax-free prizes.

2.6.5 CHILD TRUST FUND (CTF)

A child could be entitled to a CTF account, if they were born between the 1st of September 2002 and the 2nd of January 2011, live in the UK and are not subject to any immigration restriction (such as if they were born outside of the European Union to

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non-British parents). From the 2018-19 tax year, parents, family and friends can add up to £4,260 (£4,368 in the 2019-20 tax year) to the account each year. The money cannot be taken out of the account until the child is 18. Neither the parents nor the child will pay tax on any income or any gains in the account until then.

2.6.6 TAX RELIEF ON PENSION SAVINGS

As previously discussed, the Government encourages individuals to save for their retirement by giving them 'tax relief' on pension contributions. Tax relief reduces the individual's tax bill or increases their pension fund. When a person retires, providing their own pension scheme rules allow, they can usually take up to 25% of their pension fund as a tax-free lump sum. In April 2015, the Government introduced new rules allowing individuals aged 55 and above to access their full pension fund, subject to paying income tax at their marginal rate. For individuals who do not redeem the entire pension pot, their regular pension income is then taxed in the same way as the rest of their income.

Usually the employer takes the pension contributions from the taxpayer's pay before deducting tax (but not National Insurance contributions). The taxpayer only pays tax on what is left. So whether someone pays tax at basic, higher or additional rate, they get the full relief straightaway. However, some employers use the same method of paying pension contributions that personal pension scheme payers use – read more in the section on 'personal pensions'.

Taxpayers pay Income Tax on their earnings before any pension contribution, but the pension provider claims tax back from the Government at the basic rate of 20%. In practice, this means a pension payment of £80 results in a pension contribution of £100. If someone pays tax at the higher rate, they can claim the difference through their tax return or by telephoning or writing to HMRC. If someone is an additional rate taxpayer they can only claim the difference through their tax return.

If someone doesn't pay tax they can still pay into a personal pension scheme and benefit from basic rate tax relief (20%) on the first £2,880 a year they put in. In practice this means that if someone pays £2,880 the Government will top up their contribution to make it £3,600 (£3,600 × 20% £720 / £3,600 – £720 = £2,880). There is no tax relief for contributions above this amount.

It's possible to put money into someone else's personal pension – like a husband, wife, civil partner, child or grandchild's. They will get tax relief added to it at the basic rate, but this will not affect the individual's own tax bill. If they have no income, it's possible to pay in up to £2,880 a year – which becomes £3,600 with tax relief.

People can currently save as much as they like into any number of pensions – and get tax relief on contributions of up to 100% of their earnings (salary and other earned income) each year, subject to an upper 'Annual Allowance'. Savings above a separate Lifetime Allowance will be subject to tax charges.

The Annual Allowance amount is £40,000. The Annual Allowance amount may be increased by up to £130,000 with unused relief from the previous three years. The Annual Allowance will be reduced by £1 for every £2 of income over £150,000, including relievable contributions made by the taxpayer, down to a minimum of £10,000.

Taxpayers pay tax on any contributions they make that are above the Annual Allowance.

As mentioned above, a limit to all uncapped Income Tax reliefs was introduced in April 2013, whereby those seeking to claim reliefs of more than £50,000 is restricted to 25% of their income for the year in question (or £50,000, whichever is the greater). However, reliefs which are already capped, including relief for pension contributions, are not affected.

There is also a lifetime allowance in place which restricts the tax-advantaged pension savings that an individual can accumulate over their career. This limit is currently £1,055,000.

Chapter 2 - replace the text with the following (for your convenience the major changes are highlighted in yellow):

Chapter 3 – Corporation Tax

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Replace paragraphs 3.9 and 3.91 - with the following:

3.9 TAX RATES

Corporation Tax for the 2018-19 and 2019-20 tax years is levied at a flat rate of 19%, irrespective of the company's profit. So for example, a company with taxable profits of £1,000,000 and an accounting period from the 1st of April 2018 to the 31st of March 2019 would pay £190,000 in corporation tax.[4] From the 1st of January 2016, banks have to pay an additional 8% Corporation Tax surcharge on profits above a threshold level of £25,000,000 of group profits.

3.9.1 ACCOUNTING PERIODS THAT SPAN TWO FINANCIAL YEARS

If a company's accounting period spans two financial years and the tax rates have changed during that time, it will have to carry out two calculations, apportioning the profits according to how many days of its accounting period fall in each financial year.

Sample Calculation

Let's see how to calculate the tax due for a company with taxable profits of £1,000,000 and an accounting period from the 1st of January 2019 to the 31st of December 2019.

There are 365 days in the company's accounting period, of which 90 occur in the 2018-19 financial year, so you use the fraction 90/365 for your calculations for that year, and 275/365 for the 2019-20 financial year. You need to do two calculations; one for the financial year 2018-19 and one for the financial year 2019-20.

Obviously, this step is only necessary when the tax rates in the two consecutive years **are different** (which occasionally happens due to Budget changes), although in both 2018-19 and 2019-20 the rate is 19%. Let's assume, for the purpose of this example, that the rates are 20% in 2018-19 and 19% in 2019-20.

2018-19 calculation step	**Result**
Step 1: work out total taxable profits for financial year 2016-17	£1,000,000 × 90 ÷ 365 = £246,575
Step 2: calculate Corporation Tax due at the rate of 20%	£246,575 × 20% = £49,315
2019-20 calculation step	**Result**
Step 1: work out total taxable profits for financial year 2019-20	£1,000,000 × 275 ÷ 365 = £753, 425
Step 2: calculate Corporation Tax due at the rate of 19%	£753,425 × 19% = £143,150.75

The total Corporation Tax due for the accounting period is simply the results of your two calculations added together: £49,315 + £ 143,150.75= £192,465.75.

[4] The Chancellor of the Exchequor announced in the 2016 Summer Budget that the Corporation Tax main rate falls to 19% from the 1st of April 2017, and will remain at 19% for the next two financial years, and then will fall to 17% for the financial year beginning on the 1st of April 2020.

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Paragraph 3.11 – Partnership and Limited Company Tax – replace the text with the following:

3.11 PARTNERSHIP AND LIMITED COMPANY TAX

One major difference between a partnership and a limited company is the way in which each is taxed. A limited company pays tax on its profits, while directors are taxed on what they receive in remuneration from the company.

A partnership, on the other hand, is not taxed in its own right as a company (a partnership is not a separate legal entity). Instead, each of the partners is taxed on their share of the profit, irrespective of how much or how little they have taken out of the business.

Sample Calculation

Custom Cars Ltd is a limited company with profits of £500,000 for the accounting period. A sum of £250,000 is retained by the company and £250,000 is paid in salary to two directors. Each director earns £125,000. They do not have income from other sources.

The £250,000 retained by the company would be subject to a Corporation Tax at the rate of 19% (£47,500). Each director would then pay Income Tax on their salary. As each director's salary exceeds the limit for a personal allowance there is no personal allowance to deduct.

The calculation for Income Tax would then work as follows (in the 2019-20 tax year):

The first £37,500 would be taxed at the basic rate of 20% (£7,500) and the remaining £87,500 would be taxed at the higher rate of 40% (£35,000), so each director would pay £42,500 in tax. It means that £85,000 would be paid as Income Tax and £47,500 (£250,000 X 19%) as Corporation Tax. A total of £132,500 would, therefore, be paid in tax to HMRC.

However, if Custom Cars was a partnership with profits of £500,000 for the accounting period, the tax calculation would be worked out differently. Assuming there are two partners in the partnership each with an equal share, they would be taxed on £250,000 each. The £250,000 would be taxed as income and calculated as follows:

The first £37,500 would be taxed at the basic rate of 20% (£7,500). The next £112,500 would be taxed at the higher rate of 40% (£45,000) and the remaining £100,000 would be taxed at the additional rate of 45% (£45,000). Each partner would therefore pay £97,500 in tax with a total of £195,000 being payable to in tax to HMRC.

Although both types of businesses are effectively being taxed on £500,000 profits for the accounting period, the varying types of tax (corporation and income) mean that the amount of tax each business must pay differs. It should be noted, however, that in the first scenario, any dividends paid by the corporation to the directors out of the distributable profits will be subject to a dividend tax at the additional rate of 38.1%, after accounting for the Dividend Allowance.

Chapter 4 – Value Added Tax

Paragraph 4.8 – Registration for VAT (2018-2019 and 2019-2020)

- The registration threshold is £85,000
- The de-registration threshold is £83,000

Chapter 7 – Capital Gains Tax

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Paragraph 7.1 – General Principles – replace the text with the following:

Capital Gains Tax (CGT) is payable on any profit made on the disposal (including a sale or a gift) of a *chargeable asset*.

> *Jane sells her antique earrings for £15,000, which she purchased last year for £7,500. Her gain (i.e. her profit) will be £7,500 and she may have a capital gains liability on that gain.*

If a gift is made, HMRC will tax the gain that the taxpayer is deemed to have made, on the disposal, by using the market value of the asset, at the time of the gift (rather than the consideration received which would be used where there is a sale).

CGT is payable on the chargeable gains made by:

- individuals;
- partners (in accordance with each partner's share of the partnership);
- PRs (who sell chargeable assets of the deceased during the course of administration and realise a gain); and
- trustees (when there is a disposal of a chargeable asset from a trust fund).

The relevant statute is the Taxation of Chargeable Gains Act 1992.

All forms of property are chargeable, including an interest in the proceeds of sale of land held by co-owners, except for disposals of *cash* which do not attract CGT liability.

It should be noted that a disposal to a spouse or charity does not give rise to a "chargeable gain" (or "allowable loss") for CGT purposes.

As will be seen, an individual does not pay CGT on all the gains he makes. For example, there is an annual exemption for the first £12,000 of total net gains made by the individual.

There is a different tax rate on gains from residential property than on other chargeable assets.

Taxpayers who meet all the following conditions are entitled to the principal private residence relief, and will not pay CGT at all when they sell their home:

- they have lived in it as their main home for all the time they have owned it;
- they have not been absent for longer than the 'allowed period' (usually 12 months);
- they have not let part of it out (this does not include having a single lodger);
- they have not used part of it for business only;
- the grounds, including all buildings, are less than 5,000 square metres (just over an acre) in total; and
- they did not buy it just to make a gain.

Married couples and civil partners can only count one property as their main home at any one time.

However, chargeable gains made by individuals on **residential property which is not eligible for principal private residence relief**, or made on carried interest, are taxed at the rates of 18% and 28% in the 2018-19 and 2019-20 tax years, in accordance with their overall taxable income. The tax rate would be 28% for trustees or for personal representatives of a person who has died for disposals of residential property.

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The definition of residential property, for purposes of the higher rates of CGT of 18% and 28%, includes an interest in land that has at any time in the person's ownership consisted of or included a dwelling, and an interest in land subsisting under a contract for an off-plan purchase. Mixed-use properties are subject to special rules for calculating gains.

CGT is charged on the disposal of other assets which are **not-residential properties** (e.g., commercial properties), or not made on carried interest, at a rate of either 10% or 20% for individuals, 20% for trustees or for personal representatives of deceased persons, and 10% for gains qualifying for entrepreneurs' relief (see below). The rate of CGT will be held at 10% when an individual's combined taxable gains and income are up to the basic rate band of income tax (£37,500), and at 20% when the total amount of the individual's taxable income is above that threshold (over £37,500).

It should be noted that limited companies will pay corporation tax on the gains made, rather than CGT.

The tax rates applicable to non-resident investors on disposals of all types of UK real estate, whether residential or commercial, as well as indirect disposals, are at the same rate as those which currently apply to UK residents. Indirect disposals mean the disposal of interests in a "property rich" vehicle. A property rich vehicle is one that derives at least 75% of its value from UK real estate and has a substantial indirect interest in that land. However, there is an exemption from CGT on disposal for foreign investors who have a stake of less than 25% in a UK property rich company.

Paragraph 7.2.3.1 - Annual Exemption – replace the text with the following:

There is an annual exemption for the first £12,000 of total net gains made by an individual in the 2019-2020 tax year (£11,700 in 2018-2019). This includes PRs and trustees of settlements. An annual exemption of £6,000 (£5,850 in the previous tax year) is available to other trustees. However, if the individual has a net gain of less than £12,000, the unused part of the annual exemption cannot be carried forward to the next tax year.

An executor or personal representative for a deceased person's estate may get the full annual exemption during the administration period.

Paragraph 7.2.4 – Calculating the Tax Due – replace the text with the following:

As mentioned above, in the 2018-19 and 2019-20 tax years, CGT is charged at a rate of between 10% and 20% for individuals, with the exception of gains made from disposals of residential property and gains made from carried interest, taxed at 18% and 28%. The tax rate depends on the total amount of the individual's taxable income. The tax rate for trustees or for personal representatives of someone who has died is 20%.

> *The taxable income of a person is £27,000 after deducting allowances and reliefs. In the same tax year, after the deduction of his annual exemption, the person has chargeable gains of £15,000. He has no capital losses for CGT purposes.*
>
> *The income of £27,000 is used against the basic rate band (which is £37,500 in the 2019-20 tax year). This leaves £10,500 (£37,500 (basic rate band) – £27,000 (total taxable income)) to pay at the lower CGT rate of 10%, giving £10,500 X 10% = £1,050. The remaining chargeable gains of £4,500 (£15,000 – £10,500 (taxed at 10%)) are above the basic rate band of £37,500 and are taxed at the rate of 20%, giving £4,500 X 20% = £900. The person's total CGT liability is therefore £1,050 + £900 = £1,950.*
>
> *Another example: Sharon gives farmland to her brother, Edward, the market value of which is £110,000. Sharon purchased the farmland in 2011 for £50,000. She has not lived in any part of it nor has the land been used for business purposes since the purchase[5]. She makes no other disposals and has no other taxable income during this tax year, and is entitled to the annual exemption.*
>
> *The gift of the land = the disposal.*

For example, if there were a cottage on the farmland which was her main residence, principle private residence relief may apply.[5]

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Sharon's gain is the market value of the land, at the date of disposal, i.e. £110,000.

LESS the land's acquisition cost – £50,000;

LESS Sharon's annual exemption – £12,000;

Leaves total chargeable gain of £48,000;

Assuming Sharon has no other taxable income in that year, the first £37,500 is taxed at the lower CGT rate of 10%, giving £3,750, and the remaining £10,500 (£48,000 – £37,500) will be taxed at 20%, giving £2,100. The total CGT liability payable by Sharon is therefore £3,750 + £2,100 = £5,850.

Chapter 8 – Basic Tax and Estate Planning

Paragraph 8.3.4 – Main Residence Nil-Rate Band – replace the text with the following:

From April 2017, a new nil-rate band is introduced which affects individuals with direct descendants who have an estate (including a main residence) with total assets above the nil-rate band of £325,000, and personal representatives of deceased persons.

This measure introduces an additional nil-rate band when a residence is passed on death to a direct descendant. This will be based on the date when the death occurs:

- £100,000 in 2017-18
- £125,000 in 2018-19
- £150,000 in 2019-20
- £175,000 in 2020-21

The new nil-rate band effectively increases the threshold to £450,000 in 2018-2019 and to £475,000 in 2019-2020, when the conditions are met. Any unused nil-rate band can be transferred to a surviving spouse or civil partner, even where the first spouse or civil partner died before the 6th of April 2017, when the residence nil rate band was first introduced. The additional nil-rate band is also available when a person downsizes or ceases to own a home on or after the 8th of July 2015 and assets of an equivalent value, up to the value of the additional nil-rate band, are passed on death to direct descendants (as long as the person dies on or after the 6th of April 2017).

For example, a man and woman are married. On the man's death in 2000, he leaves half of his share in the matrimonial home with the remainder of his estate to his wife, who dies in May 2018. The value of the home is £500,000. The wife's remaining estate is worth £650,000. Since she has her own nil-rate band of £325,000, together with her husband's nil-rate band, the IHT on her remaining estate is zero. Additionally, £225,000 of the value of the home is covered by the main residence nil-rate band (£125,000 of the wife plus £100,000 unused, transferred from the husband's). This leaves IHT liability of £275,000 @ 40% – £110,000.

There will be a tapered withdrawal of the additional nil-rate band for estates with a net value of more than £2 million. This will be at a withdrawal rate of £1 for every £2 over this threshold.

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