Personal Taxation

Learning Outcome 2.1

By the end of this learning outcome you will be able to demonstrate an ability to analyse the taxation of **direct investments** as relevant to the needs and circumstances of individuals and trusts including cash and cash equivalents, fixed interest securities, equities, and property.

2.1 Introduction

This section provides a brief description of the taxation of the four main asset classes: cash, fixed interest investments, equities and property.

It is important for an adviser to be aware of the tax implications of any solutions he recommends to a customer as well as the potential tax planning opportunities that may be present.

2.1.1 Cash Deposits

Cash deposits pay an interest distribution to the investor which is taxable, if it exceeds their personal allowance or Personal Savings Allowance (PSA) (see Personal taxation – Learning outcome 1.1), at the starting, basic rate, higher rate or additional rate of tax relevant to the recipient's circumstances in the tax year they receive the interest.

Taxation of Cash	
Bank and Building Society Accounts	Paid gross, taxable
National Savings and Investments	Savings Certificates, Children's Bonus Bonds, and ISA's – tax free Direct Saver, Guaranteed Growth and Income Bonds and Investment Account – paid gross, taxable
Offshore Accounts	UK tax is not deducted from interest on accounts held offshore Interest is paid gross but taxable as it arises by self assessment No tax is taken if details of accounts held are disclosed to HMRC, but if no permission is given then interest from accounts in the Channel Islands, Isle of Man, Switzerland and a number of other countries is paid out less a withholding tax of 35% This can be offset against UK tax payable

Individuals who receive interest payments must disclose the details of these on their self assessment forms in order to pay the correct tax.

Cash Summary	Income Tax	CGT
- pays interest gross	Within PSA 0% NTP 0% STP 0% BRT 20% HRT 40% ART 45%	None

2.1.2 Building Society Demutualisation

When moving from being a mutual organisation (a Building Society) to a company owned by its shareholders (a Bank), members may benefit from the receipt of either a cash bonus or some free shares.

Taxation on Demutualisation	
Cash Bonus	A cash payment made for giving up membership rights. The payment is a disposal for CGT purposes, but in most cases will be below an individual's annual exemption. If no membership rights were held, then no asset is being given up and the cash amount received is not subject to income tax or CGT.
Free Shares	The issue of shares on demutualisation are free from CGT and income tax. Acquisition costs are nil and therefore on disposal this is the cost that will be used.

2.1.3 Fixed Interest Securities

Income from fixed interest securities falls in the category of interest distribution and therefore taxable as savings tax.

Individuals generally are not subject to Capital Gains tax on holding Fixed Interest Securities with the exception of convertible corporate bonds.

Taxation of Fixed Interest Investments	
Gilts	• Interest paid twice per year, gross and taxed as savings income through self assessment • Basic rate taxpayers have to pay 20% tax • Higher rate taxpayers have a 40% liability • Additional rate taxpayers have a 45% liability • Accrued interest received in the sale proceeds of gilts is taxable if gilt holding exceeds £5,000 • Individuals do not pay CGT on disposals & losses are not allowable (unless held within a Collective Investment i.e. an OEIC / Unit Trust)
Local Authority Bonds	• Interest paid twice per year, paid gross, and taxed as savings income through self assessment • Individuals do not pay CGT on disposals. Losses are not allowable
Corporate Bonds	• Interest paid twice per year, paid gross, and taxed as savings income through self assessment • Individuals do not pay CGT on disposals. Losses are not allowable
Deep Discounted or Zero Coupon bonds	• Either pay very little or, as the name suggests, no interest at all • Both bonds are offered for sale at a large discount and investors make their money on sale of the bond • These bonds are exempt from CGT but any profit on sale is taxed as additional income tax in the year of disposal. • Acquisition and sale costs are allowed as expenses and losses can be offset against income tax in the year of encashment
Permanent Interest Bearing Shares (PIBs)	• Interest paid twice per year gross but is taxable by self assessment at the usual rates • No CGT payable on any profit • When a Building Society demutualises, any PIBs will become Perpetual Subordinated Bonds (PSBs) with the tax treatment remaining the same

Fixed Interest Summary	Income Tax	CGT
- Most pay interest gross -	Within PSA 0% NTP 0% STP 0% BRT 20% HRT 40% ART 45%	None unless wrapped in an OEIC or Unit Trusts

2.1.4 Shares

Taxation of Shares	
Income Tax	Dividends paid gross No tax to pay within the Dividend Allowance (DA) of £5,000. Above the DA; - BRT – 7.5% - HRT – 32.5% - ART – 38.1%
Capital Gains Tax	Gains made on disposals of individual shares are subject to CGT. Losses can be claimed and offset against other gains The annual exempt amount of £11,300 can be used Gains which fall in the basic rate band or below are charged at 10% Gains which fall within the higher rate bands are charged at 20%

2.1.5 Property

Property as an investment has become more popular with investors and therefore it is essential to have an understanding of the different methods of investing in property and the taxation implications of each.

2.1.5.1 Let Property

Profits made from letting property are taxed in a similar way to a business.

Profits are taxable in the year they arise and accounts must be drawn up.

Tax is payable under self assessment and any property losses can be carried forward against future property gains.

Income from all UK let properties is pooled together. Any expenses incurred in earning rental income from UK properties can then be deducted. The remainder is taxed as investment income.

Income received by a UK resident from letting properties overseas is chargeable to income tax in the UK and is calculated in the same way but will be detailed on the overseas section of the self assessment form completed.

There are several legitimate deductible expenses and capital allowed for let property:

Expenses, Allowances and Reliefs	
Deductible Expenses	Repairs and maintenance – the cost of repairs can be deducted but not the cost of alterations or improvements. Interest payable on borrowing for the purpose of the property letting business. From April 2017 restrictions on income tax relief on finance for dwelling-related loans are being phased in so that after 4 more years relief will be available only at the basic rate. . Legal fees, professional charges, insurance premiums, utility bills if paid by the landlord etc.
Capital Allowances	Capital allowances are deducted as an expense in arriving at the taxable profit. Plant & machinery allowance is available for capital expenditure on equipment installed in let property or used in maintaining it Capital allowances are not available for furniture used in residential property.

Additionally, where the landlord provides substantial services in connection with the lettings (laundry, cleaning, meals etc.), the income can be taxed as a trading income.

Trading income counts as net relevant earnings and means the taxpayer can receive tax relief at their highest rate on any pension contributions made from this income.

On the sale of a buy to let property CGT will be due – rollover relief, holdover relief and entrepreneurs' relief will only be available where the property involved is treated as a business.

2.1.5.2 Residential Property

Capital allowances are not allowed for residential property. Instead they can use the Wear and Tear allowance. Up to 6 April 2016, this enabled 10% of the annual rent to be offset against profits. From that date, the 'automatic', deduction will cease to apply and the allowance will only apply to costs actually incurred.

2.1.5.3 Letting Rooms – Rent a Room Relief

If the property is owner occupied and used as a main residence, it is possible to obtain 'rent-a-room' relief of up to £7,500 per annum per property by letting out a room to a lodger.

There are a number of smaller points here to note as well:

- If the tenant sublets the room then both the owner and the tenant can obtain a maximum of £3,750 rent-a-room relief each
- If the rental income exceeds £7,500 then the owner has the choice of paying tax on the excess income above this figure or being taxed on gross income less expenses with no rent-a-room relief in the same way as Buy to Let properties

- The property must be in the UK and the room let, which must be furnished, must be part of the main residence, i.e. not a self contained unit

2.1.5.4 Furnished Holiday Lettings

Furnished holiday lettings are taxed like other lettings but qualify for certain advantages.

To qualify, they must be situated in UK or elsewhere in EEA, they must be furnished and they must be let on a commercial basis.

In addition, they must be available for at least 210 days per year and must be actually let for at least 105 days per year.

Lettings of more than 31 days cannot be counted, unless this period is exceeded due to unforeseen circumstances, e.g. the holidaymaker is required to extend their stay due to illness or a delayed flight.

Tax advantages of furnished holiday lettings…

- Treated as a trade for loss relief
- Only be offset against income from the same furnished holiday lettings business
- Income counts as net relevant earnings and is therefore pensionable
- Attracts CGT rollover relief, holdover relief and Entrepreneurs' relief on disposals

Personal Taxation Learning Outcome 2.1 (TAX2.1) – End of Module Test

Multiple Choice Questions

Question	Answer	
2.1.1 - Which of the following statements about gilts is INCORRECT?	A.	Gilts normally pay a fixed rate of interest.
	B.	Interest is normally paid gross and is taxable as savings income.
	C.	Interest is normally paid twice yearly.
	D.	Gilts held by individuals in a collectives wrapper are completely exempt from CGT.

2.1.2 - Sarah is a higher rate taxpayer. She owns 12,000 shares in ABC PLC. If the company declares a gross dividend of 47p per share, how much tax will she pay?	A.	£1,410
	B.	£208
	C.	£1,833
	D.	£Nil

2.1.3 - Which of the following is not a deductible expense against income tax in relation to let property?	A.	Repairs and maintenance
	B.	Alterations and improvements
	C.	Mortgage interest on the property
	D.	Buildings insurance premiums

2.1.4 - Which of the following situations would be likely to result in the property letting being classed as a trade?	A.	More than one property being let by the same individual
	B.	Property letting losses made in previous years
	C.	The landlord providing substantial services
	D.	The property being let is overseas

2.1.5 - Jim is letting part of his main residence under the rent-a-room scheme. The gross receipts are £150 per week and Jim has chosen to be taxed on the amount by which the gross receipts exceed the limit with no deduction for expenses. He is a basic rate taxpayer. How much tax will he pay?	A.	£60
	B.	£1,560
	C.	£710
	D.	£22.50

2.1.6 - Which ONE of the following is correct in respect of the basic rate income tax treatment of interest income from Government Stocks in the hands of the investor?	A.	Interest is non-taxable
	B.	Paid gross, 20% further liability
	C.	10% paid; no further liability
	D.	20% paid, 20% further liability

2.1.7 - Terence receives total dividends of £14,500 for 2017/18. Which of the following statements is FALSE?	A.	£14,500 will be added to his income for the year and taxed at the appropriate marginal rate
	B.	£9,500 will be added to his income for the tax year and taxed at the appropriate marginal rate
	C.	He will be subject to tax on the total dividends at 7.5%, 32.5% or 38.1% depending on the total of his other income
	D.	His personal allowance may be affected

2.1.8 - Louise is an additional rate taxpayer. She receives bank deposit interest of £1,200. How much tax will she have to pay on it?	A.	£540
	B.	£457.20
	C.	£315
	D.	£90

2.1.9 - Ken is considering letting part of his main residence in order to supplement his income. He has asked his adviser about 'Rent a room' relief. Which ONE of the following statements is FALSE in relation to 'Rent a room' relief?	A.	Up to £7,500 per year of gross receipts from letting part of a home is tax free
	B.	The let accommodation must be used as a residence
	C.	The room must not be in a self-contained unit
	D.	A tenant cannot sublet their room

- **End of Questions** -

Answers

Question	Answer	
2.1.1 - Which of the following statements about gilts is INCORRECT?	D	Gilts held by individuals in a collectives wrapper are completely exempt from CGT.
2.1.2 - Sarah is a higher rate taxpayer. She owns 12,000 shares in ABC PLC. If the company declares a gross dividend of 47p per share, how much will tax will she pay?	B	£208.00
2.1.3 - Which of the following is not a deductible expense against income tax in relation to let property?	B	Alterations and improvements
2.1.4 - Which of the following situations would be likely to result in the property letting being classed as a trade?	C	The landlord providing substantial services
2.1.5 - Jim is letting part of his main residence under the rent-a-room scheme. The gross receipts are £150 per week and Jim has chosen to be taxed on the amount by which the gross receipts exceed the limit with no deduction for expenses. He is a basic rate taxpayer. How much tax will he pay?	A	£60

2.1.6 - Which ONE of the following is correct in respect of the basic rate income tax treatment of interest income from Government Stocks in the hands of the investor?	B	Paid gross, 20% further liability
2.1.7 - Terence receives total dividends of £14,500 for 2017/18. Which of the following statements is FALSE?	A	£14,500 will be added to his income for the year and taxed at the appropriate marginal rate
2.1.8 - Louise is an additional rate taxpayer. She receives bank deposit interest of £1,200. How much tax will she pay on it?	A	£540
2.1.9 - Ken is considering letting part of his main residence in order to supplement his income. He has asked his adviser about 'Rent a room' relief. Which ONE of the following statements is FALSE in relation to 'Rent a room' relief?	D	A tenant cannot sublet their room