Personal Taxation

Learning Outcome 1.1

By the end of this learning outcome you will be able to demonstrate an understanding of the UK tax system as relevant to the needs and circumstances of individuals and trusts including sources of income, liability, allowances and reliefs, priorities for taxing income, and income of trusts and beneficiaries.

1.1.1 Introduction

Income tax is payable by all UK residents, including children, based on any income in the UK and abroad, and by non UK residents on income in the UK.

There are four main types of income as detailed in the table below:

Earned Income	Unearned Income
Trading income: including the earnings of the self employed is taxed at rates of 20%, 40% and 45% depending on the amount of income earned. Allowable deductions for trading income are expenses that are wholly and exclusively for business purposes. Employment income: taxed at rates of 20%, 40% and 45% depending on the amount earned. Includes salary, bonus, benefits in kind, pensions and other taxable benefits assessed in the year earned.	Income from property is classed as investment income and is taxed at income tax rates of 20% 40% and 45%. Allowable deductions for income tax purposes include expenses for repairs and maintenance which can be offset, legal fees, professional charges, insurance premiums, costs wholly and exclusively incurred in the course of lettings and interest on loans for purchase. However, from April 2017, the relief for finance costs (mortgage interest and interest on loans to buy furnishing) will be restricted to basic rate, with the restriction being gradually introduced over the follow 4 years. Improvement costs or costs for additions to property are not allowed.
Savings and Investments Income	**Other Income**
Products that produce savings interest, where taxable, are taxed at 0%, 20%, 40% and 45% depending on the rate of tax applicable to the individual. Products that produce a dividend income are taxed at 7.5%, 32.5% and 38.1%, where they exceed the dividend allowance.	A cover all – to cater for tax on income such as receipts from intellectual property, beneficiary income from estates in administration, all other income not otherwise charged.

1.1.2 Total Income

To calculate the total tax payable you need to take the gross income and deduct any amounts for which tax relief is given such as:

- Qualifying interest payments
- Allowable business losses

- Capital allowances
- Qualifying Occupational Pension contributions and Retirement Annuity Contracts, where tax relief not be given at source

Additionally, you need to consider:

- Income where some tax has been deducted at source, e.g. interest paid on collective investments
- Tax reducers deducted from the final figure, e.g. married couples allowance
- Payments made that increase the basic rate tax band, e.g. some charity and pension contributions

1.1.2.1 Qualifying loans

Qualifying loans include loans used for the purchase of shares in the borrower's company or to finance loans. The interest is tax deductible.

Also deductions are allowable on interest for loans taken out to fund the following:

- Purchase of shares in the borrower's company or to finance loans
- Investment in a partnership
- Purchase of plant and machinery for use in a partnership
- Payment of inheritance tax

1.1.2.2 Grossing Up Savings Income

Interest paid by banks and building societies will, from April 2016, be paid without deduction of income tax (gross). Interest paid from a collective investment will be paid gross from April 2017.

Where interest income is paid net you will need to gross it up to work out the total tax payable. You take the net interest and divide it by 0.8

Brian has received interest from his collective investments totalling £750.

What is the gross interest?

As this interest is paid with 20% tax deducted at source the gross interest is:

£750 divided by 0.8 = £937.50

£187.50 has therefore been taken at source:

£937.50 - £750 = £187.50

1.1.2.3 Tax relief available through Charitable Giving

There are two main tax efficient ways of giving to charities:

Gift Aid	Payroll Giving
Introduced to encourage charitable donations by rewarding donors with an additional payment to the charities representing basic rate tax relief on any donation made in this way.	Employees encouraged to make regular gifts to charity through their employer's payroll system for ease and to enable tax relief to be added to any donations through this method.

Have a go at the example below to see how Gift Aid can benefit both donors and charities:

David, a higher rate taxpayer, makes a donation of £500 to his preferred charity using gift aid.

a) How much does the charity receive once they have reclaimed any tax due in respect of the donation?

b) How does the gift affect David's tax position?

a) The charity receives an additional payment representing basic tax relief (20%) To find out how much this is we gross up the £500 donation, dividing it by 0.8:

£500 divided by 0.8 = £625

The charity therefore actually receives a £625 total donation from David.

b) David is therefore deemed to have donated £625. The way he benefits from this is that £625 is added to his basic rate tax band. Normally the basic rate tax band is up to £33,500. But David will have a basic rate tax band (2017-18) of:

£33,500 + £625 = £34,125

He therefore benefits from paying tax at 20% on an additional £625 of his income rather than 40%.

1.1.2.4 Tax relief available through Pension Payments

There are a number of tax efficient ways of making payments into pension plans and the main ways of making such contributions are:

Relief at source

- All individual pension and some occupational pension payments are made using this method
- Payments are made into the pension scheme net of basic rate tax
- The pension scheme administrator then claims from HMRC the tax relief element, which is then paid into the pension scheme
- If investor is a higher rate taxpayer the additional 20% tax relief can be reclaimed through their self assessment and, like gift aid, extends their basic rate tax band by the amount of the gross contribution

Elaine, a higher rate taxpayer, has made a payment of £2,000 into her Stakeholder Pension Scheme.

How does this affect her tax position?

This payment is net of basic rate tax, so the grossed up payment is:

£2,000 divided by 0.8 = £2,500

The scheme pension administrator claims this additional £500 tax relief from HMRC.

The total payment into Elaine's pension is therefore £2,500

As a higher rate taxpayer Elaine can claim a further 20% tax relief through her self assessment.

The way she benefits from this works in the same way as gift aid.

Her basic rate tax band is extended by the amount of the gross pension contribution.

£33,500 + £2,500 = £36,000

She therefore benefits from paying tax at 20% on an additional £2,500 of her income rather than 40%.

This represents a further saving of:

(£2,500 x 40%) less (£2,500 x 20%) = £500

Net Pay method

- Contributions are taken from the employee's gross income before income tax is deducted and shown on their payslip
- Tax relief is therefore achieved at their highest marginal rate immediately
- Employees payments to an occupational scheme are normally paid in this way, although it is possible to use 'Relief at source' as an alternative
- No further need to reclaim from HMRC

Relief by making a claim

- Some older schemes, such as Retirement Annuity Contracts, do not offer 'Relief at source' as a payment method and therefore the investor has to make a claim via self assessment

1.1.3 Pension contributions

An individual up to the age of 75 can make contributions to a personal pension with, or without, UK relevant earnings.

- Relevant UK earnings are those that are subject to income tax
- Individuals without UK relevant earnings can contribute up to £3,600 gross
- An individual is a relevant UK individual if they have UK relevant earnings for the year or are resident in the UK at some point during the year or the previous five years and were UK resident when they joined the pension scheme

1.1.4 Employee benefits

Many employees receive an element of non cash benefits. Prior to 6 April 2016, the taxation of these additional benefits varied. The general rule for deciding on whether to tax these benefits was determined by classifying employees as 'P11D employees' or 'lower paid employees'. Now, however, all employes (other than "lower-paid" ministers of religion) are taxed in the same way.

Form P11D has to be completed by the employer for these individuals. Both the individual and HMRC must receive it by 6 July following the end of the tax year.

The term 'Benefits in Kind' refers to the amount of taxable benefit declared on form P11D and the amount is then effectively added to an individual's income for income tax purposes and taxed at their relevant rate of income tax.

They are taxed by way of a deduction from the allowances available and the amount is then collected through a reduction in their tax code.

1.1.4.1 Benefits that are taxable

Where an employee is given an asset they are taxed on the cash equivalent based on the market value of the asset. If the employee only has use of the asset then the cash equivalent is the annual value of the asset plus any costs incurred by the employer in maintaining the asset. The annual value is taken as 20% of the market value when it was provided to the employee.

Cash Vouchers, Non Cash Vouchers and Credit Tokens are all valued as cash equivalent.

Benefits paid by an employer on behalf of employees – e.g. Professional fees, School fees, club subscriptions – are generally taxable on the cost of the benefit provided.

For "lower-paid" employees receiving benefits (other than those above) these are only taxable if they can be converted into a monetary value, i.e. as if they were sold on the open market.

If a "lower- paid" employee only has use of an asset, such as a company car, then no taxable benefit is derived unless they have sacrificed salary in return for use of the vehicle.

Beneficial loans by virtue of employment are based on the difference between the rate you pay and the official rate (2.5% in 2017/18) and the amount borrowed. Interest free loans of less than £10,000 are excluded. Where more than one loan is held they are added together to calculate any taxable benefit due. Where a loan is cleared or written off by the company the taxable benefit is the value of the amount cleared or written off.

Fred has a loan from his employer of £20,000 and pays interest at 2.0%. The official rate of interest set for the 2017/18 tax year is 2.5%.

How much is the taxable benefit?

£20,000 x (2.5% – 2.0%) 0.5% = £100

£100 is therefore the taxable benefit added to tax calculation via P11D

Where an employee enjoys rent free or pays a very small rent for living accommodation there is generally a tax charge on the benefit, unless deemed necessary in performance of job e.g. caretaker, is customary, such as a publican, or if there is a threat to security of an employee.

Medical insurance, where the employer pays for cover is taxed as a benefit in kind. If the employer has negotiated a cheaper deal but the employee pays for cover then it is not classed as a benefit in kind.

Company cars and fuel provided for business use and available for personal use are treated as taxable benefits in kind. The annual benefit is a percentage of the list price, with the percentage dependent on the level of CO_2 emissions.

The minimum benefit is 9% for emissions of zero to 50g/km, 13% for emissions between 51- 75g/km, 17% of emissions of 76g/km to 94g/km and for emissions of 95g/km it is 18%. From 95g/km the rate is 18% increasing by 1% for each additional full 5g/km up to a maximum charge of 37% for emissions of 190g/km and above. Emission levels are rounded down to the nearest multiples of 5.

Diesel cars are subject to an additional 3% charge (subject to an overall maximum of 37%.

If fuel is provided for private use, the car benefit percentage is applied to £22,600.

Georgina has a company car with a list price of £25,000 and a current value of £20,000. It is a Ford Galaxy, diesel model and has CO_2 omissions of 208g and also has her private fuel paid for by her employer.

How much tax will she have to pay on her company car and private fuel?

Round down the emission level to the nearest multiple of 5:

208g rounded down = 205g

As the car is over 100g, the 1% rate will apply, with an additional 1% being added for every full 5g above 95g.

205g less 95g = 110g

110g divided by 5 = 22

Basic rate of 18% + additional 22% = 40%. Add 3% extra for diesel = 43%, but as the overall maximum is 37%, 37% would apply. So;

£25,000 x 37% = £9,250 benefit in kind via P11D

Private Fuel:

£22,600 x 37% = £8,362 benefit in kind via P11D

1.1.4.2 Benefits that are not taxable

- Expenses received that are wholly and exclusively incurred in the performance of business duties
- Goods sold at a discount to an employee where they pay at least the wholesale price
- Professional services that do need additional staffing, e.g. financial services
- Public transport costs that do not displace fare paying passengers.

1.1.4.3 Benefits generally exempt from tax

- Christmas party, or similar event, provided the cost is no more than £150 per head
- Employer provided liability / indemnity insurance
- Employer provided Permanent Health Insurance / Income Protection Insurance
- Home-working costs covered up to £4 per week without evidence and larger amounts remain tax free with suitable evidence
- Long Service Awards, 20 years and over, no more than £50 per year of service
- Mobile Phone – one only and does not include cost of personal calls
- Provision of in-house sports, recreational facilities, meals either free or subsidised
- Relocation and removal expenses up to £8,000 – any excess is taxable
- Suggestion Scheme awards of £25 or less for ideas or up to £5,000 if implemented and award represents no more than 50% of any saving to employer
- Work related training plus health and safety and first aid training
- Childcare vouchers up to £55 per week tax free, £28 if higher rate taxpayer, £22 if additional rate taxpayer

1.1.5 Personal Allowances

Every UK resident receives a personal allowance which means the first part of their income will not be liable to income tax. Many individuals and most investors will have enough income to use up their personal allowance and will therefore pay income tax.

The personal allowance (2017/18) is granted in two bands:

- Personal allowance of £11,500
- Once income hits £100,000, the personal allowance reduces by £1 for every £2 over £100,000 until eventually it is no longer available
- Additionally for married couples where one of them was born before 6 April 1935 there is an allowance of £8,445, which is reduced by £1 for every £2 of income over £28,000,
    - Subject to a minimum allowance of £3,260
    - Allocated to husband, or eldest unless elected differently by couple or to highest earner for marriages after 5 December 2005
    - Applied at the rate of 10% as a tax reducer

James is 45 and has total income of £115,000. How is his entitlement to a personal allowance calculated?

£115,000 - £100,000 (the income limit) = £15,000.

£15,000 reduced by £1 for every £2 = £7,500.

Deduct this from the normal personal allowance of £11,500

£11,500 - £7,500 = £4,000.

So his personal allowance will be £4,000.

Harry is aged 85, married and receives £29,030 p.a. from pension income.

He is eligible for a personal allowance of £11,500 as well as married couple's allowance of £8,445 at 10%.

How does his income affect his entitlement to these allowances?

Personal Allowance calculation:

As his income is less than £100,000, his personal allowance is not reduced.

Married couples allowance:

- £29,030 income less £28,000 (income limit for married couples) = £1030
- £1030 is reduced by £1 for every £2 = £515
- £8,445 – £515 = £7930 (Above minimum figure of £3,260)
- Applied as tax reducer at the rate of 10%
- Income tax bill reduced by £793 (£7930 x 10%)

1.1.5.1 Transferable tax allowances for married couples and civil partners (Marriage Allowance.

A spouse or civil partner who is not liable to income tax (i.e. they have an annual income of less than £11,500) will be able to transfer up to £1,150 of their personal allowance to their spouse/civil partner, provided that the recipient of the transfer is not liable to income tax above the basic rate. There will of course be a corresponding reduction to the transferring civil Partner or spouse's personal allowance. Married couples or Civil partnerships entitled to claim the married couple's allowance (i.e.

where at least one of them was born before 6 April 1935) will not be entitled to make a transfer.

This will enable a spouse or civil partner who is not using all of his/her allowance to transfer part of it to a spouse or civil partner who can make use of it, with a potential tax saving of up to £.

Online registration can be made at 'www.gov.uk/marriage-allowance'.

1.1.5.2 Personal Savings Allowance

This is an additional allowance that applies to savings income paid from 6th April 2016.

Savings income includes interest on deposit accounts, on collective investments (open-ended investment companies, unit trust and investment trusts) as well as interest from government or company bonds and most purchase life annuities. It does not include interest from an ISA as this is already tax free.

The allowance depends on the tax payer's income, i.e. on what rate of income tax they pay. However, in determining that, any savings income that isn't actually taxed, i.e.as it falls within the personal savings allowance, is still taken into account.

Type of tax payer	Allowance
For basic rate taxpayers	£1,000
For higher rate taxpayers	£500
For additional rate taxpayers	£0

All saving income, including that which falls into the allowance, is part of an individuals 'total income' for the purpose of their tax thresholds and allowances.

David receives a salary of £35,000 and savings income of £1,200. What income tax is payable on his savings income?

As his total income is below the threshold for higher rate tax, he will receive a personal savings allowance of £1,000. So the income tax payable on his savings income is;

£1,200 less £1,000 x 20% = £40.

Sarah receives a salary of £48,300 and savings income of £1,200. What income tax is payable on her savings income?

Her total income is £49,500 and the threshold for higher rate tax is £45,000 (a personal allowance of £11,500 plus the standard rate band of £33,500). This means that her personal savings allowance is £500.

As the remaining basic rate band is covered by the personal savings allowance, the balance of £700 which is taxable is all taxed at the higher rate of 40%, giving tax payable of £280.

Interest paid from banks and building societies is paid without deduction of tax. Interest paid from collective investments will be paid gross from April 2017 Tax at 20% continues to be deducted from the interest content of a purchase life annuity.

1.1.5.3 Dividend Allowance

From 6 April 2016 dividends will no longer be paid with a 10% tax credit, but that will be replaced by a tax-free Dividend Allowance of £5,000. The allowance will apply to all individuals regardless of what other income they have.

Above this allowance, dividends will be taxed as follows:

- 7.5% on dividend income within the basic rate band
- 32.5% on dividend income within the higher rate band
- 38.1% on dividend income within the additional rate band

Dividend income received within an ISA will continue to be tax free.

All dividend income, including that which falls into the allowance, is part of an individuals 'total income' for the purpose of their tax thresholds and allowances.

David receives a salary of £35,000 and dividend income of £6,000. What income tax is payable on his dividend income?

The first £5,000 is covered by the dividend allowance. As all of the dividend income falls within David's basic rate band, the excess of £1,000 is taxed at 7.5%, so the tax payable is £75.

Sarah receives a salary of £44,500 and dividend income of £6,000. What income tax is payable on her dividend income?

The first £5,000 is covered by the dividend allowance, leaving £1,000 to be taxed. However, the basic rate band is used by her other income meaning that the £1,000 excess of dividends is all taxed at 32.5%, so the tax payable is £325.

1.1.5.4 Other allowances

Blind person's allowance, additional allowance of £2,320 if registered blind.

Rent a room relief, £7,500 per year can be claimed.

In most cases, the payer of maintenance does not receive tax relief and the recipient receives the payment tax free. Formerly tax relief was available and remains available now only if one party to the marriage was born before 6 April 1935.

1.1.5.5 Ownership of assets

HMRC will assume 50/50 ownership of assets and charge tax accordingly.

Couples can elect a different rate of ownership by declaration to HMRC.

An asset can be held in different proportion to income, e.g. If 60/40 ownership split they could elect for 60/40 or 50/50 income split.

Once a declaration has been made it can be changed, but in the absence of any further declaration will continue until death, separation or divorce.

1.1.5.6 Children's income

Most children have little or no income but they are liable to income tax from birth and have the standard personal allowance available to them.

- A child is classed as anyone under the age of 18
- Anyone under this age in receipt of income will be taxed in the normal way after allowing for the standard personal allowance, e.g. 17 year old in part or full time work

  However, if assets are gifted by a parent to their child, the 'parental settlement' rules apply;

- Any income earned on these gifted assets up to £100 is considered the child's income and taxed accordingly
- Any income earned over £100 is considered the parents income and the whole amount of income is treated as that of the parent and taxed as their income

1.1.5.7 Scottish income tax

Although the examination is based on tax rates in England, Wales and N.Ireland, it will be useful to understand the income tax position for clients in Scotland.

Although the tax rates and personal allowances are the same as for the rest of the UK, different tax bands will apply to non-savings and non-dividend income. The basic rate band for other income is from £0 - £31,500, with the higher rate band from £31,501 - £150,000. As a result , the higher rate threshold above which Scottish taxpayers pay income tax will be £43,000 for 2017/18.

1.1.6 Savings Income Table

The table below shows how savings and investments income is taxed at source and in the hands of the investor:

	Deposit	Gilts	Corporate Bonds (as part of a collective investment)	Equities	Property

At source	Gross	Gross	Gross	Gross	Gross
Non taxpayers	No action required	No action required	No Action	No action required	No action required
Starter rate taxpayers	No action required	no reclaim or tax payable	No reclaim or tax payable	No reclaim or tax payable	Pay 20% via Self Assess
Basic rate taxpayers	Pay 20% tax (unless covered by the personal savings allowance)	Pay 20% via Self Assess (unless covered by the personal savings allowance)	Pay 20% via self assess (unless covered by the personal savings allowance)	7.5%, (unless covered by the dividend allowance)	Pay 20% via Self Assess
Higher rate taxpayers	40% via Self Assess (unless covered by the personal savings allowance)	Pay 40% via Self Assess (unless covered by the personal savings allowance)	Pay 40% gross interest via Self Assess (unless covered by the personal savings allowance	32.5% (unless covered by the dividend allowance)	Pay 40% via Self Assess
Additional rate taxpayers	45% via Self Assess	Pay 45% via Self Assess	45% gross interest via Self Assess	38.1% via Self Assess (unless covered by the dividend allowance)	Pay 45% via Self Assess

Starting rate of tax (for savings income).
The maximum amount of an eligible individual's savings income that can qualify for the starting rate of tax for savings is £5000. And this starting rate is 0%.

So, if your total income (things like wages, pension, benefits and savings income) is less than your personal allowance plus £5000, you will pay no income tax on any savings income.

1.1.7 Calculating income tax – process

Step	Process	Notes
1	Gather together all the income streams and set out in 4 columns: 1. Non Savings 2. Savings Interest 3. Dividend distributions 4. Chargeable Gains on Life Policies	• Gross up interest payments (where necessary) • Income from assets such as investments for spouses treated as owned 50/50, income split 50/50 unless declared otherwise to HMRC • Where an investment has been made by a parent for their child and the income is over £100 – the total income is treated as that of the parent and taxed accordingly
2	Add items that increase income	• Add onto income any benefits in kind
3	Deduct items that reduce income	• Payroll Giving for charity payments • Retirement Annuity Contracts • Occupational Pension contributions (where not already deducted at source, i.e. tax relief not already received) • Qualifying loan interest
4	Deduct Allowances	• Consider Married Couples Age Allowance Trap and reduction of personal allowance if income exceeds £100,000.
5	Extend basic rate tax band if required	• Stakeholder / Personal Pension and Gift Aid contributions
6	Apply tax rates	• Income taxed at 20%, 40% and 45% • Savings interest at 0%, 20%, 40% and 45% • Dividend distribution at 7.5%, 32.5% and 38.1% • Gains on onshore life policies at 20% or 25% in addition to 20% tax credit from being in life fund
7	Deduct any tax reducers to give the total tax liability.	• Married couples allowance at 10% • EIS 30% on max investment £1,000,000 • VCT 30% on max investment £200,000
8	Deduct any tax already paid leaving you with the tax due to HMRC.	Savings Interest 20% at source (where applicable)

1.1.8 Tax Bands

Income Tax bands are currently as follows

- Basic rate tax band covering the first £33,500 of income charged at 20%
- Higher rate tax band on income between £33,500 and £150,000 charged at 40%
- Additional rate tax band on income in excess of £150,000 charged at 45%
- Taxable savings income that falls within the £5,000 starting rate for savings Income Tax band is taxed at 0 per cent - but only if the rate band has not been used up by other income as savings income is taxed last

Have a go at these examples. Work them out for yourself and then compare your methods and answers with those below.

Isobel is 50 and earns £12,500p.a. from her part time job and a further £5,500 gross interest from her building society account.

How much income tax must she pay?

	Non-Savings	Savings	Tax Due
Earned income	£12,500		
Deposit (Gross) interest		£5,500	
Less Personal Allowance	£11,500		
	£1,000	£5,500	

Tax calculation:

- Earned income
  £1,000 at 20% = £200

- Savings interest

  First £1,000 covered by their personal savings allowance £0

  (£5,000 Starting Rate threshold - £1,000 non-savings income)

  (£5,000 - £1,000) = £4,000 at 0% £0
  (£4,500 - £4,000) = £500 at 20% £100

Total tax: £300

James is 32 and has a salary of £50,000; company car giving a taxable benefit in kind of £8,000; he pays interest on a qualifying loan of £2,000 and pays £5,000 into his personal pension under the relief at source method.

What is his tax liability?

Salary	£50,000	
Benefit in Kind – Company Car	£8,000	
Total earned income:		£58,000
Less deductions		
Qualifying loan interest	£2,000	
Total income for tax purposes:		£56,000
Less Personal Allowance	£11,500	
Total taxable income:		£44,500
Tax payable		
£33,500 at 20%	£6,700	
£6,250 at 20%	£1,250	

(£6,250 represents £5,000 net pension contribution grossed up by dividing by 0.8 to extend the basic rate band)

Remaining £4,750 at 40%	£1,900	
Total Tax payable:		£9,850

Karen aged 43; married and receives self-employed profit of £55,000 plus interest of £5,000 from bank deposits and £7,500 from her share income portfolio.

What is her tax liability and how much is due?

	Non Savings	Savings	Dividends
Business net profit	£55,000		
Bank deposit interest		£5,000	
Share dividend distribution			£7,500
Total income	£55,000	£5,000	£7,500
Less;			
Personal Allowance	£11,500		
Personal Savings Allowance		£500	
Dividend Allowance			£5,000
Income subject to tax	£43,500	£4,500	£2,500
Total taxable income:	£50,500		
Tax payable:			
£33,500 at 20%	£6,700		
£10,000 at 40%	£4,000		
£4,500 at 40%		£1,800	
£2,500 at 32.5%			£812.50
	£10,700	£1,800	£812.50
Total Tax:	£13,312.50		

1.1.9 Tax Credits

Child Tax Credit and Working Tax Credit are benefits payable to support people with responsibility for children and people in work. They are both awarded based on a single household claim.

Neither of these affect an individual's income tax liability, but entitlement is based upon taxable income and are means tested against household income, i.e. the more you earn the less you receive.

Claimants must advise HMRC of all changes in circumstances in connection with the following, ideally within 30 days:

Account for payment	Address
Childcare costs	Family status
Hours of work	Income
Personal status	

If any change results in an increased award it cannot be backdated more than three months.

Income changes do not have to be notified when they occur as they will be recalculated at the end of the tax year. However, any overpayment will need to be repaid.

A summary of both these credits appears on the next page.

Please be aware of the introduction of Universal Credit which is a new single monthly payment for people who are looking for work or on a low income.

Universal Credit will bring together a range of working-age benefits into a single streamlined payment and will replace:

- Income-based Jobseeker's Allowance
- Income-related Employment and Support Allowance
- Income Support
- Child Tax Credits
- Working Tax Credits
- Housing Benefit

Stating in April 2013, Universal Credit was be introduced to claimants within certain areas of the North-West of England, and will be rolled out nationally from October 2013. For details of where it can currently be claimed, see www.gov.uk/apply-universal-credit

Child Tax Credit

Two elements – Family and Child
Child for whom a claim is made must live with claimant
Child must be under 20 and in full time education
Paid to main carer, usually the mother of the child
Paid every 4 weeks
Paid in addition to Child Benefit
Not taxable
Parent does not have to be working or paying tax for it to be claimed
Payments reduced by 41p for every £1 of income in excess of £6,420
Payment reduced once income is too high (there is no set limit as it will depend on personal circumstances but, for example, this is sometimes over £26,200 for a one child family (£33,000 for families with two children)

Working Tax Credit Summary

Paid to claimant direct to their bank, building society or Post Office account.
Childcare element is paid to main carer, usually the mother of the child.
Payable for those in work who are on a low income and claimant must also be

- aged 16 and over, working at least 16 hours and responsible for a child OR
- aged 25 and over, working at least 30 hours OR
- aged 60 and over, not claiming benefits, working at least 16 hours OR
- have a disability that puts the claimant at a disadvantage

For couples it is joint working hours that count towards and the requirement is now 24 hours combined per week

If your joint working hours are fewer than 24 a week, you can still get Working Tax Credit if one of the following applies:

- one of you is aged 60 or over and working at least 16 hours a week
- one of you is disabled and working at least 16 hours a week
- one of you works at least 16 hours a week and the other person is entitled to Carer's Allowance - even if they don't get any payments because they receive other benefits instead
- one of you works at least 16 hours a week, and the other person is 'incapacitated', an in-patient in hospital, or in prison (serving a custodial sentence, or remanded in custody awaiting trial or sentence)

Payments reduced by 41p for every £1 of income in excess of £6,420
Childcare costs can be taken into account
Consists of several different elements

1.1.10.1 Taxation of a Bare Trust

A bare trust (sometimes known as an 'absolute trust') is one where the beneficiary has an immediate and absolute right to both the capital and income held in the trust. Someone who sets up a bare trust can be certain that the assets they set aside will go directly to the beneficiaries they intend. Once the trust has been set up, the beneficiaries cannot be changed.

The trust assets are held in the name of a trustee, but the trustee has no discretion over what income or capital to pass on to the beneficiary or beneficiaries.

Bare trusts are commonly used to transfer assets to minors. Trustees hold the assets on trust until the beneficiary is 18 in England and Wales, or 16 in Scotland. At this point, beneficiaries can demand that the trustees transfer the trust fund to them.

Income Tax	
Trustee	None.
Beneficiary	Tax is due at the Beneficiary's normal rate of tax. If the Beneficiary has any unused personal allowance, personal saving allowance or dividend allowance they can use it here. The Beneficiary must declare any trust income on their self assessment form.
Settlor	The Settlor will pay the tax if the beneficiary is their child, and the gross interest into the trust exceeds £100. This is known as the 'Parental Settlement Rules' and links back to the rules we saw in 1.5.3.

Capital Gains Tax	
Trustee	None.
Beneficiary	Tax is due if assets are sold within the fund. The annual exemption of £11,300can be used to offset the gain. The remaining gain is taxed at 10% / 20% depending on the Beneficiary's tax status (except for carried interest and chargeable gains on residential property which are taxed at 18% / 28%). The gain must be declared via self assessment.
Settlor	If the gift into trust gives rise to a capital gain, holdover relief can only be used if the gift is a business asset.

IHT	
Trustee	The gift into trust is a Potentially Exempt Transfer (a PET). No IHT is payable up front, but if the Settlor dies within 7 years of making the gift, and the value of the gift exceeds the available nil rate band, the Trustees pay IHT at 40% on the excess. Taper relief may available to reduce the tax payable if the gift was made over three years before death. If the Beneficiary dies, the value of the trust property is added to their estate on death. The Trustee is then liable for the proportion of tax due in relation to the trust property.
Beneficiary	None.
Settlor	The PET is outside their estate providing they survive 7 years. Prior to that it is still included in their estate and may use up some or all of their NRB for those 7 years. Any tax due on their death within 7 years is paid by Trustee's as above.

Caroline, age 17, is the sole beneficiary of a Bare Trust set up by her Granddad on 1st May 2012. The initial value of the gift into the trust was £400,000 after exemptions. Her Granddad had made no previous gifts.

In the current tax year the following events have taken place:

a) The trust has received a £200 interest payment from a bank deposit account.
b) The trust has sold a unit trust, realising a gain of £20,000.
c) Her Granddad dies on 30th April 2017.

Caroline has no other income or gains for the tax year.

What tax is payable on each of these events?

a) As Caroline has no other income she has her full personal allowance to use. So no income tax will be payable.

b) As Caroline has made no other gains she has her full annual CGT exemption to use. Remember that non taxpayers for income tax purposes pay CGT at 10% and cannot use any of their income tax personal allowance to offset any bill.

To work out the amount owed we deduct the annual exemption from the gain and multiply by 10%:

£20,000 - £11,300 = £8,700 @ 10% = £870

c) On the death of her Granddad his gift into the trust becomes chargeable to IHT as it was made within 7 years of his death. Because it was made within 3 and 4 years of his death we can apply taper relief and only 80% of the amount due is payable. As her Granddad had made no previous gifts, the full nil rate band is available to use against the PET.

£400,000 - £325,000 nil rate band = £75,000.

£75,000 @ 40% = £30,000
£30,000 @ 80% = £24,000

1.1.10.2 Taxation of an Interest in Possession Trust

An interest in possession trust is one where the beneficiary of a trust has an immediate and automatic right to the income from the trust.

The trustee must pass all of the income received, less any trustees' expenses, to the beneficiary. The beneficiary who receives income often doesn't have any rights over the capital held in such a trust.

The capital will normally pass to a different beneficiary or beneficiaries in the future.

Income Tax	
Trustee	Trustees pay tax as if they were a basic rate taxpayer but without the benefit of a personal allowance. Interest will either be received net of 20% or gross. In the case of the former, the liability of the trust is met, for the latter; the trustees will need to pay 20% of the gross via self assessment. Dividend income is liable to tax at 7.5%. Trustees do not receive and personal savings allowance or dividend allowance. For 2017/18, by concession, HMRC do not require trustees to notify them of savings interest if it is less than £100 and the trust has no other income. Any expenses of the trust are deducted from net income.
Beneficiary	**Where interest / dividends paid to the Trustees** The trustees must pay tax as above and the beneficiary will receive the net income, together with a tax credit for the tax already paid. The beneficiary will then be assessed for tax at their own tax rates, will be able to use their personal savings allowance and dividend allowance and the credit for tax already paid. Thus, they may be able to reclaim the tax paid by the trustees where that income falls within these allowances or if they are non- or starting rate taxpayers. **Where interest / dividends is paid direct to the beneficiary (i.e. it has been 'mandated' to them by the trustees)** No income tax is payable by the trustees and the interest / dividend is taxed as the income of the beneficiary (as above) without any tax credit.
Settlor	The Settlor only pays the tax if the beneficiary is their child, and the gross interest into the trust exceeds £100 or if it is a 'Settlor-Interested Trust', A 'Settlor-Interested Trust' is one where the Settlor or their spouse is a beneficiary.

Georgie, an additional rate taxpayer has received, via the Trustees, a £400 interest payment from an Interest in Possession Trust.

How much tax must he now pay via self assessment?

Tax paid by the Trustees = £500 x 20% = £100

Net interest payment = £400

To gross this up:

£400 / 0.8 = £500

As an additional rate taxpayer Georgie pays 45% on the gross interest payment, less the tax credit.

£500 @ 45% - £100 = £125

Capital Gains Tax	
Trustee	20% (except for chargeable gains on residential property which is at 28%) on disposals within the fund or when a transfer is made out of the trust to a Beneficiary. An annual exemption of up to £5650* can be used. (* This exemption is spread across all trusts created by the same Settlor, subject to a minimum of £1,130.) No CGT is due on the death of the life tenant, unless holdover relief was claimed when property was placed under trust, in which case it is now due.
Beneficiary	None
Settlor	Can claim holdover relief on any gain arising when property goes into trust providing it is not a 'Settlor-Interested Trust' or a 'Parental Settlement'.

Georgie is to receive the net proceeds from the sale of an OEIC holding within the trust. The gain made was £30,000.

How much will Georgie receive from the trust, assuming no other gains have been made in the same tax year and that the annual exemption is shared equally between two trusts in total?

The Trustees must pay CGT at 20% after deducting the available annual exemption from the gain:

Available exemption is the annual exemption for trusts divided by two:

£5,650 / 2 = £2,2825

£30,000 less £2,825 = £27,175

£27,175 @ 20% = £5,435

Georgie will therefore receive £30,000 less £5,435 = <u>£24,565</u>

IHT	
Pre 22.03.06 Gift into IIP trusts were classed as PETs.	Assets of the trust belong to the estate of the beneficiary with the interest in possession so on their death are included in their estate for IHT purposes. N.B. Any change in the beneficiary with the interest in possession after 6 October 2008 will be treated as a CLT and brings the trust into the Post 22.03.06 regime unless the beneficiary dies and the new beneficiary is their spouse.
Post 22.03.06 Gift into trust into IIP trusts are classed as Chargeable Lifetime Transfers (CLTs).	Assets of the trust do not form part of any of the estates of any of the beneficiaries.

1.1.10.3 Taxation of a Discretionary Trust

In a discretionary trust, the trustees have 'discretion' about how to use the trust's income. They may also have discretion about how to distribute the trust's capital. The trustees may also be able to 'accumulate' income - add it to capital.

Trustees may be able to decide:

- how much income and or capital is paid out, if any
- which beneficiary to make payments to
- how often the payments are made
- what, if any, conditions to impose on the recipients

Under the terms of the deed that creates the trust, there may be situations when the trustees have to use income for the benefit of particular beneficiaries. However, they may still retain discretion about how and when to pay. The extent of the trustees' discretion depends on the terms of the trust deed.

Income Tax	
Trustee	Trusts benefit from £1,000 starting rate band* where dividend income charged at 7.5%, interest income and any other income at 20%. Thereafter all income is taxed at the trustee's rate which is 38.1% for dividend income and 45% for interest income. Trustees are not entitled to any personal saving allowance or dividend allowance. Expenses are deducted from gross higher rate income. (* This band is spread across all trusts created by the same Settlor, subject to a minimum of £200.)
Beneficiary	No tax due unless they receive a distribution from the trust 'Trust income' is deemed to be received net of 45% tax If the beneficiary is not an additional rate taxpayer then they can reclaim the appropriate amount of tax. Any distributions received will be treated as trust income, so cannot be set against a beneficiary's personal savings allowance or dividend allowance.
Settlor	The Settlor only pays the tax if the beneficiary is their child, and the gross interest into the trust exceeds £100 or if it is a 'Settlor-Interested Trust'

Damian, a basic rate taxpayer has received £3,000 trust income from a Discretionary Trust. How much tax can he claim back?

The £3,000 is received net of 45%. To gross this up we divide by 0.55:
£3,000 / 0.55 = £5,454.55

As a basic rate taxpayer Damian only owed 20% of this amount:
£5,454.55 @ 20% = £1,090.91

As £2,454.55 was deducted at source if we take £1,090.91 off this figure we arrive at the amount that Damian can reclaim via his self assessment.

£2,454.55 - £1,090.91 = £1,363.64

Capital Gains Tax	
Trustee	20% (except for chargeable gains on residential property which is at 28%) on disposals within the fund or when a transfer is made out of the trust to a Beneficiary. An annual exemption of up to £5,650 (see earlier note) can be used.
Beneficiary	Can claim holdover relief on receipt of an asset. Can have any losses transferred to them.
Settlor	Can claim holdover relief on any gain arising when property goes into trust providing it is not a 'Settlor-Interested Trust' or a 'Parental Settlement'.

IHT	
Immediate Charge	An immediate tax charge of 20% (25% if paid by the settlor) on lifetime transfers into trusts is payable if, after exemptions, their value exceeds the available nil rate band.
10 yearly Charge	There is a 10 yearly tax charge of 30% of the lifetime rate of 20% (i.e. 6%) on the value of trust assets in excess of the available nil rate band at that time.
Exit Charge	An exit charge when funds are taken out of the trust between anniversaries is payable if there was either an immediate or 10 yearly charge.

1.1.11 High Income Child Benefit charge

An individual may be liable to the charge if they or their partner have an individual annual income of more than £50,000 and one of them gets Child Benefit.

The amount of the tax charge will be based on the amount of Child Benefit and the level of what is known as "adjusted net income" which is total taxable income less certain tax reliefs received in a tax year (6 April to 5 April).

The tax charge will be 1% of the Child Benefit paid for every £100 of annual income in a tax year between £50,000 and £60,000.

Let's look at how this works:

Tessa's adjusted net income is £54,000. She is entitled to Child Benefit for two children of £447 for the period 5 January 2017 to 30 March 2017.

Her tax charge will be worked out as follows:

Step 1: Income over £50,000 = £4,000

Step 2: Determine the percentage: £4,000 / 100 = 40%

Step 3: Tax charge = £447 x 40% = £178

Let's look at what happens with a higher income figure:

Caroline's adjusted net income is £62,000. She is also entitled to Child Benefit for two children of £447 for the period 7 January 2015 to 5 April 2015.

Her tax charge will be worked out as follows:

Step 1: Income over £50,000 = £12,000

Step 2: Determine the percentage: £12,000 / 100 = 120% (BUT max 100%)

Step 3: Tax charge is limited to the amount of Child Benefit = £447 x 100% = £447

The impact of the charge is that for adjusted net income in a tax year of £60,000 or more, the Child Benefit is reduced to nil.

It is important to be careful for those individuals whose usual income is less than £50,000 pa but where, for example, they receive an end of year bonus which takes their adjusted net income over £50,000.

Clients can use the calculator on the HMRC website to estimate their tax charge and if they decide to continue to receive Child Benefit, they will have to declare these payments by:

- completing a tax return each year, or
- registering for Self Assessment (if not already registered)

Full details of the charge, who it affects and how it works can be found at www.gov.uk/child-benefit-tax-charge/overview

Personal Taxation Learning Outcome 1.1 (TAX1) – End of Module Test

Multiple Choice Questions

Question	Answer	
1.1.1 - Emily rents out a property in Croydon and wants to know which of her expenses are allowable for tax purposes. Which of the following expenses are NOT deemed to be allowable?	A.	Rates
	B.	Maintenance and repairs
	C.	Improvements and additions to the property
	D.	Interest payable on loan

1.1.2 - Chloe, an additional rate taxpayer, has received dividends of £6,000 from her UK shares and wants to know how much additional tax she will have to pay. You tell her...	A.	None
	B.	£450
	C.	£2,286
	D.	£381

1.1.3 - Abigail has received £700 in interest from her bank deposit account. She is a higher rate taxpayer. How much tax will she have to pay?	A.	£280
	B.	£80
	C.	None
	D.	£140

1.1.4 - The trustees of a discretionary trust receive interest of £750 and other non-dividend income of £500. How much income tax do the trustees pay?	A.	£562.50
	B.	£250
	C.	£112.50
	D.	£312.50

1.1.5 - Kimmie has taken a loan out to pay an Inheritance Tax bill. She borrowed £60,000 at a rate of 4%. Which of the following statements is correct?	A.	She will be able to reduce her income subject to tax by £2,400.
	B.	She is eligible for relief on the loan until it is repaid in full.
	C.	She will pay £2,400 less tax.
	D.	Tax relief is restricted to two years from making the loan.

1.1.6 - During the 2017/18 tax year, after all reliefs and her personal allowances, Amy has earned income of £1,780 and savings income of £5,000. Which ONE of the following is correct in respect of the tax treatment of her savings income?	A.	She will not have any income charged at the Savings Starting Rate charge as she has earned income
	B.	All the savings income will be charged at 0% as it falls within the threshold of £5,000
	C.	Her earned income will be taken into account, which after deducting the personal savings allowance leaves £3,220 to be charged at the Starting Rate
	D.	All her income (earned & savings) will be charged at the basic rate of 20%

1.1.7 - During the 2017/18 tax year, on top of her earned income of £20,000, Davinia will receive, after all reliefs and her personal allowance, a dividend of £6,000 from an OEIC. Which ONE of the following is correct in respect of her resultant tax liability on the dividend? She will....	A.	be able to reclaim any tax deducted
	B.	Pay tax of £600
	C.	Pay tax of £75
	D.	have to pay the difference between any tax credit and her marginal (basic) rate

1.1.8 - Which of the following is NOT a method of receiving tax relief on a pension payment?	A.	Relief at source
	B.	Qualifying relief
	C.	Net pay arrangement
	D.	Relief by making a claim

1.1.9 - Toby is a higher rate tax payer contributing to a personal pension plan, what will be the tax situation regarding his contribution?	A.	His contribution will benefit from 20% tax relief at source; he will then receive a further 25% rebate from HMRC
	B.	He will receive 40% tax relief at source
	C.	He will not receive any tax relief at source, but will be able to reclaim full amount through self assessment
	D.	His contribution will benefit from 20% tax relief at source, he will then receive further tax relief by extending his basic and higher rate tax limits

1.1.10 - Alison has a diesel company car with 195g CO2 emissions, what percentage of the cars value will she be charged for taxable benefit	A.	36%
	B.	39%
	C.	38%
	D.	37%

- **End of Questions** -

Answers

Question	Answer	
1.1.1 - Emily rents out a property in Croydon and wants to know which of her expenses are allowable for tax purposes. Which of the following expenses are NOT deemed to be allowable?	C	Improvements and additions to the property
1.1.2 - Chloe, an additional rate taxpayer, has received dividends of £6,000 from her UK shares and wants to know how much additional tax she will have to pay. You tell her...	D	£381
1.1.3 - Abigail has received £700 in interest from her bank deposit account. She is a higher rate taxpayer. How much income tax will she have to pay?	B	£80
1.1.4 - The trustees of a discretionary trust receive interest of £750 and other non-dividend income of £500. How much income tax do the trustees pay?	D	£312.50
1.1.5 - Kimmie has taken a loan out to pay an Inheritance Tax bill. She borrowed £60,000 at a rate of 4%. Which of the following statements is correct?	A	She will be able to reduce her income subject to tax by £2,400.

1.1.6 - During the 2017/18 tax year, after all reliefs and allowances, Amy has earned income of £1,780 and savings income of £5,000. Which ONE of the following is correct in respect of the tax treatment of her savings income?	C	Her earned income will be taken into account, which after deducting the personal savings allowance leaves £3,220 to be charged at the Starting Rate
1.1.7 - During the 2017/8 tax year, on top of her earned income of £20,000, Davinia will receive, after all reliefs and allowances, a dividend of £6,000 from an OEIC. Which ONE of the following is correct in respect of her resultant tax liability on the dividend? She will....	C	Pay tax of £75
1.1.8 - Which of the following is NOT a method of receiving tax relief on a pension payment?	D	Relief by making a claim
1.1.9 - Toby is a higher rate tax payer contributing to a personal pension plan, what will be the tax situation regarding his contribution?	D	His contribution will benefit from 20% tax relief at source, he will then receive further tax relief by extending his basic and higher rate tax limits
1.1.10 - Alison has a diesel company car with 195g CO2 emissions, what percentage of the cars value will she be charged for taxable benefit	D	37%