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Personal tax interactive worksheet

Income tax computations

Based on the provisions of the Finance Act 2014

It will come as no surprise that the ability to calculate an individual's income tax liability for a tax year is a key skill of any tax professional.

In this module we'll look at the key points in computing an individual's income and tax liability for a tax year, and then we'll work through a detailed example. Finally we'll give you the opportunity to attempt a practice question.

Remember that you are provided with tax tables in the Personal tax assessment. These tables will give you data to help you put your answer together.

Here's an extract from the 2014/15 Tax Tables showing the income tax thresholds, bands and personal allowances.

Tax rates and bands		
	%	£
Basic rate	20	first 31,865
Higher rate	40	to 150,000
Additional rate	45	over 150,000

Savings income is taxed at 10%, 20%, 40 and 45%. (10% applies to a maximum of £2,880 of savings income only where non-savings income is below this limit.) Dividends are taxed at 10%, 32.5% and 37.5%.

Personal allowances	
	£
Personal allowance	10,000
Age allowance – ages 65 to 74	10,500
Age allowance – over 75	10,660
Income limit for age allowance	27,000

Key points

1. It is very important you become familiar with the taxable income pro-forma. Once you have become used to the pro-forma, you will be a lot more confident in answering income tax computation questions.
2. Set out below is an example pro-forma:

Pro-forma computation of taxable income

	£
Earned income	
Employed income - receipts basis	X
Self-employed income – current year basis	X
Investment income	
Savings income - receipts basis	X
Dividends received - receipts basis	X
Property rental income – receivable basis	X
Total income	<u>X</u>
Less reliefs (For example, self-employed losses)	(X)
Net income	<u>X</u>
Less Personal Allowance (PA)	(X)
Taxable income	<u>X</u> ===

Worked example

Sue had the following income in the 2014/15 tax year:

Gross salary	£39,000	(PAYE tax deducted £6,200)
Building society interest (received)	£800	
Dividend income (received)	£1,800	

Calculate Sue's taxable income and income tax payable for the 2014/15 tax year.

Let's see how to answer this question in simple steps.

Step 1 – Build the taxable income computation

Hint: Remember that taxable income should always be shown gross in the computation. Bank and building society interest is usually received after **deduction of tax at 20%** whilst dividends are received net of a **notional 10% tax credit**.

Using the pro-forma shown earlier, we have the following computation:

Sue: Taxable income for 2014/15		£
Earned income		
Employed income		39,000
Investment income		
Savings income (£800*100/80)		1,000
Dividends received (£1,800*100/90)		2,000
Total income		<u>42,000</u>
Less Personal Allowance (PA)		(10,000)
Taxable income		<u>32,000</u> ===

Step 2 – Calculate the income tax liability

We first need to deal with the non-savings income, followed by the savings income (excluding dividend income) and finally the dividend income.

Hint: The personal allowance is first deducted from the non-savings income then savings income (excluding dividend income) and lastly from the dividend income.

Non-savings income: (£39,000 - £10,000) x 20%	£5,800
Savings income: £1,000 x 20%	£200
Dividend income: £1,865 x 10%	£186.50
Dividend income: 135 x 32.5%	<u>£43.88</u>
Income tax liability	£6,230.38

Hint: Remember that dividend income is taxed at 10% in the basic rate tax band.

Step 3 – Calculate the income tax payable

Once you have calculated the income tax liability, to reach the income tax payable all you need to do is deduct the tax credit on dividends and then the tax deducted at source.

Income tax liability	£6,230.38
Less: Tax credit on dividends	£(200)
Less: Income tax deducted at source (£6,200 + £200)	£(6,400)
Income tax repayable	£369.62

Practice question

Kumar had the following income in the 2014/15 tax year:

Gross salary	£30,000	(tax deducted £4,450)
Building society interest (received)	£19,200	
Dividend income (received)	£270	

Calculate Kumar's taxable income and income tax payable for the 2014/15 tax year.

We've set out the calculation in steps to help you.



When you've attempted each step, you can check your calculation by clicking on the button to reveal the solution before moving onto the next step.

Step 1 – Build the taxable income computation

Click to display/hide the solution.

Solution

Kumar: Taxable income for 2014/15		£
Earned income		
Employed income		30,000
Investment income		
Savings income (£19,200*100/80)		24,000
Dividends received (£270*100/90)		300
Total income		<u>54,300</u>
Less Personal Allowance (PA)		(10,000)
Taxable income		<u><u>44,300</u></u>

Step 2 – Calculate the income tax liability

Click to display/hide the solution.

Solution

Non-savings income	
$(£30,000 - £10,000) = £20,000 \times 20\%$	£4,000
Savings income	
Firstly, the balance of the 20% band is used:	
$(£31,865 - £20,000) = £11,865 \times 20\%$	£2,373
Then, the balance is taxed at 40%:	
$(£24,000 - £11,865) \times 40\%$	£4,854
Dividend income	
$£300 \times 32.5\%$	<u>£98</u>
Income tax liability	<u>£11,325</u>

Step 3 – Calculate the income tax payable

Click to display/hide the solution.

Solution

Income tax liability	£11,325
Less: Tax credit on dividends	£(30)
Less: Income tax deducted at source ($£4,450 + £24,000 \times 20/100$)	<u>£(9,250)</u>
Income tax payable	<u>£2,045</u>