Personal tax factsheet

Introduction to personal tax computations

Administration

- Taxation administered by HM Revenue and Customs ("HMRC").
- Rules covering tax are contained in statute (=law). Law passed every year, Finance Act.
- Decisions reached by the Courts interpreting the law are known as case law.
- HMRC also issue guidance – Extra Statutory Concessions and Statements of Practice.
- Individuals pay tax on their income and capital gains in a tax year. The 2012/13 tax year runs from 6 April 2012 to 5 April 2013.

Taxes

- Income Tax – paid by individuals on their income. For example, employment, self-employment, property rental income or savings income.
- Capital Gains Tax – paid by individuals on their capital gains (such as a one-off profit from the sale of an asset).

Tax avoidance and tax evasion

- Tax evasion – any action taken to evade tax by illegal means. Risk of criminal prosecution.
- Examples of tax evasion – failing to declare income and claiming false expenses.
- Tax avoidance – taxpayer uses legitimate means to minimise his/her tax liability. For example, investing in a tax-free ISA (Individual Savings Account).

Principles of income tax

Sources of income

- Employment – weekly or monthly wages and bonuses.
- Self-employment – profits of running a business.
- Investments – interest on savings, dividends from shares and property rental income.

Exempt income – income not subject to Income Tax includes:

- interest on National Savings Certificates (NSC)
- income from Individual Savings Accounts (ISA)
- interest on delayed tax repayments (repayment supplements)
- prizes, lottery winnings and gambling winnings
- some social security benefits; for example, child benefit
- statutory redundancy pay.

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	X
Less reliefs (for example, self-employed losses)	(X)
Net income	X
Less Personal Allowance (PA)	(X)
Taxable income	**X**
	===

- All income to be shown gross. You may need to gross up some income received.
- Income received net:
  - Bank and building society interest, 'gross up' at $^{100}/_{80}$.

Tax rates and bands – for 2012/13 are provided in the exam.

Employment income

Earnings	£
Salary/bonus/**expense payments**/pensions	X
Benefits - non cash remuneration	X
	X
Less **Professional subscriptions**	(X)
Donations under **payroll giving** schemes	(X)
Occupational pension contributions	(X)
Less Other expenses – **travel expenses**	(X)
Assessable employment income	XX
	===

Benefits in kind

- **Exempt benefits** include
  - job related accommodation
  - removal expenses up to £8,000
  - provision of one mobile telephone.

- **Vehicle benefits**
  - Car benefit = List price when new x CO2 percentage.
  - Private car fuel benefit = £20,200 x CO2 percentage.
  - Van benefit = £3,000pa and private van fuel = £550pa.

- **Beneficial loans** – taxable if any of the loan is written off, or the loan is more than £5,000 in the year and at a rate of interest below the Official Rate of Interest (ORI).

- **Use and transfer of assets**
  - Use of asset benefit = 20% x open market value (OMV) when first made available.
  - Transfer of asset benefit = higher of the OMV on the date of gift and the OMV on the date when asset's use was first made available.

- **Accommodation**
  - Basic charge = Higher of the annual/rateable value and the rent paid.
  - Property cost more than £75,000, further charge = (Cost - £75,000) x ORI.

Authorised Mileage Allowance Payments (AMAP) for **business miles** are:

- car – first 10,000 miles at 45p, additional miles at 25p
- motorbike – all miles at 24p.   Bicycle – all miles at 20p.

Employed or self-employed? An individual is self-employed if he/she:

- runs own business and takes responsibility for its success or failure
- has several customers at the same time
- can decide how, when and where to do the work
- is free to hire other people to do the work
- provides the main items of equipment to do the work.

Employment income – supplementary pages

- Familiarise yourself with the supplementary pages.
- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting the correct figures into the appropriate boxes.

Property income

Property income

- Individual assessed on income less expenses for their property ‘business’ on an accruals basis. All of the individual’s property is ‘pooled’.
- Revenue expenditure includes:
  - standard repairs and redecoration
  - agent's commission and advertising for tenants
  - unpaid rental income (‘bad debts')
  - interest on loans taken out to buy the property
  - insurance of the property, council tax and water rates.

- Capital expenditure is not an allowable expense in calculating the property business profit/loss. This includes:
  - the initial cost of buying the property and the cost of improvements
  - the cost of the furniture (if the property is furnished).

- If the property is furnished, then a deduction for ‘wear and tear' is given:
  - 10% x (gross rental income - (council tax and water rates paid by landlord)).

- Losses on rental properties are relieved in order:
  - against profits from other properties rented out in the tax year
  - after this, if there is an overall loss for the year, it is carried forward and set against property ‘business’ profits of future tax years.

Rent-a-room relief - available to individuals who rent out part of their main residence as furnished accommodation.

- Relief available - rental income ignored as taxable income if no more than £4,250. If rental income greater than £4,250, only excess is taxed.
- No deduction for expenses is given in the above relief.
- Apply normal property income rules if rent-a-room relief not beneficial (for example, individual has a net rental loss for the year).

Furnished Holiday Lettings (FHL)

- Profits from FHLs are treated as trading income. Losses on FHLs can only be relieved against other income from the same FHL business.
- Relief from Capital Gains Tax may be available on the eventual sale of the property.
- Qualification as FHL depends upon the property fulfilling the following.
  - Situated in the UK or EEA (European Economic Area), furnished and let on a commercial basis.
  - Available for letting for at least 220 days (30 weeks) per tax year.
  - Actually let for at least 105 days (15 weeks) during that same tax year.
  - Not normally occupied by same person for a period of ‘long term occupation'.

Property income – supplementary pages

- Familiarise yourself with the supplementary pages.
- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting the correct figures into the appropriate boxes.

Investment income, reliefs and calculating income tax payable

Pro forma Income Tax computation

	£	£
Earned income		X
Savings income		
Building society interest (amount received x $^{100}/_{80}$)	X	
Bank interest (amount received x $^{100}/_{80}$)	X	
UK Government stock interest (received gross)	X	
NS&I Savings & Investment Accounts (received gross)	X	
		X
Dividend income		
Amount received x $^{100}/_{90}$		X
Other income – property income		X
Total income		X
Less Personal Allowance (PA)		(X)
Taxable income		X
		======
Income Tax		
On earned and other income		X
On savings income		X
On dividends		X
Income Tax liability		X
Less Tax suffered by deduction at source/tax credits on dividends		(X)
Income Tax payable		X
		======

2012/13 tax bands	**Other**	**Savings**	**Dividends**
Starting rate - £1 - £2,710*	n/a	10%	n/a
Basic rate - £1 - £34,370	20%	20%	10%
Higher rate - £34,371 - £150,000	40%	40%	32.5%
Additional rate - 150,001 and above	50%	50%	42.5%
Order in which bands are applied	1	2	3

- *Starting rate for savings income only and not available if non-savings income exceeds starting rate limit.
- Deemed 10% tax credit on dividend income is deductible against Income Tax liability in priority to actual tax suffered at source — non-taxpayers cannot reclaim a repayment of this tax credit.

Personal Allowances (PA) —for 2012/13 are provided in the exam.

- PA dependent upon individual's age. The higher allowances for those older than 65 are restricted if their income exceeds a certain limit (2012/13, limit = £25,400).

- Restriction = ½ x (income - £25,400). Restriction cannot reduce the personal allowance below the basic personal allowance (2012/13, £8,1005).

Pension payments and gift aid donations

Pension schemes

- Tax relief is given to employers/employees/self-employed persons on contributions into approved (registered) pension schemes.
- Types of pension scheme:
    - Occupational pension schemes = run by employers for employees.
    - Personal pension schemes = for individuals.

Tax relief on pension contributions

- Contributions into a personal pension scheme are made net of basic rate tax (20%).
- Basic rate tax payer receives tax relief at source.
- Personal pension schemes — higher rate tax relief is provided by extending the basic rate tax band by the gross Personal Pension Contributions (PPC).
- Occupational schemes — employer contributions not a benefit for the employee and employee contributions are an allowable deduction against employment income.

Charitable donations

- Payroll giving scheme — tax relief is obtained by deducting the amount from the salary before Income Tax is calculated.
- Gift aid donations — charitable cash donations to a charity by a UK resident. Deemed paid net of basic rate tax (20%). Higher rate tax relief provided as for PPCs (see above).

Introduction to chargeable gains

- Individual pays Capital Gains Tax (CGT) on net chargeable gains in a tax year.
- Individuals receive an annual exemption from CGT, 2012/13 £10,600.
- CGT is charged at 18% for basic rate tax payers and at 28% for higher rate tax payers.
- Gains/losses arise when a chargeable person makes a chargeable disposal of a chargeable asset.
- Chargeable person = individual.
- Chargeable disposal = sale, gift or loss/destruction of the whole or part of an asset. Exempt disposals — on death and gifts to approved charities.
- Chargeable asset = all assets unless exempt.
- Exempt assets:
    - Principal Private Residence (PPR).
    - Gilt-edged government securities and Qualifying corporate bonds (QCBs).
    - Motor cars.
    - Some chattels.
    - National Savings Certificates and Premium Bonds.
    - Medals awarded for valour.
    - Betting and lottery winnings.

Calculation of individual gains and losses

Calculation of individual gains/losses

	£	£
Consideration received		X
Less Incidental costs of sale		(X)
Net sale proceeds		NSP
Less Allowable expenditure		
- Acquisition cost	X	
- Incidental costs of acquisition	X	
- Enhancement expenditure	X	
		(Cost)
Gain/(Loss)		X/(X)
		=====

- Consideration received is usually sales proceeds, but market value will be used instead of actual consideration where the transaction is a gift or between connected persons.

- An individual is connected with their spouse, lineal relatives (and their spouses) and spouse's lineal relatives (and their spouses).

- Husband and wife/civil partner transfers — nil gain nil loss. Tax planning opportunity.

Part disposals - the cost allocated to the disposal = Cost x (A/(A+B))
A = consideration received on part disposal B = market value of the remainder of the asset

Chattels - tangible moveable object. Two types:

- Wasting – expected life of 50 years or less (such as racehorse or boat). CGT exempt.

- Non-wasting – expected life greater than 50 years (for example, antiques or jewellery). CGT = £6,000 rule (see below).

Buy / Sell	£6,000 or less	More than £6,000
Less than £6,000	Exempt	Allowable loss but proceeds are deemed = £6,000
More than £6,000	Normal calculation of the gain, then compare with 5/3 x (gross proceeds - £6,000) • Take the lower gain	Chargeable in full

Shares and securities

CGT on shares and securities

Disposal of shares and securities are subject to CGT except for listed government securities (gilt-edged securities or 'gilts'), qualifying corporate bonds (such as company loan notes/debentures) and shares held in an Individual Savings Account (ISA).

The identification rules

Used to determine which shares have been sold and so what acquisition cost can be deducted from the sale proceeds (for example, match the disposal and acquisition).

Disposals are matched:

- firstly, with acquisitions on the same day as the date of disposal
- secondly, with acquisitions made in the 30 days following the date of disposal (FIFO basis)
- thirdly, with shares from the share pool.

The share pool

- The share pool contains all shares of the same type acquired prior to the disposal date.
- Each acquisition is not kept separately, but is 'pooled' together with other acquisitions and a running total kept of the number of shares and the cost of those shares.
- When a disposal from the pool is made, the appropriate number of shares are taken from the pool along with the average cost of those shares.
- The gain on disposal is then calculated.

Bonus issues and rights issues

- Bonus issue – no adjustment to cost needed.
- Rights issue – adjustment to cost needed.

Calculation of capital gains tax

Net chargeable gains = total gains in the tax year after netting off any current year or brought forward losses and the annual exemption.

Annual Exemption (AE)

- AE cannot be carried forward or carried back.
- Current year losses must be netted off against current year gains before AE. This means AE can be wasted.
- Brought forward capital losses are set off against current year gains after AE, so AE is not wasted.

Chargeable gains – supplementary pages

- Familiarise yourself with the supplementary pages.
- The figures to enter into the tax return boxes will either be your own answers or will be provided in the information given in the question.
- The description labels given to the boxes on the supplementary pages will assist you in inserting figures into the appropriate box.
- Shares must be classified as listed (for example, ‘Plc’) or unlisted (such as ‘Ltd’).

Chargeable gains – reliefs

Use of CGT reliefs by an individual

		£
Gain in year		X
Less	Relief available in year	(X)
Gain pre losses and AE		X
Less	Current year losses	X
	Annual exemption	X
	Losses brought forward	X
Net Gain		X ===

Principal Private Residence (PPR) relief - an individual's main residence is exempt from Capital Gains Tax but in some cases some of the gain on disposal could be liable to CGT.

- PPR is restricted where there have been periods in which the owner has not lived in the property.
- PPR exemption = Gain x (Periods of occupation / Total period of ownership).
- 'Periods of occupation' =

  actual period of occupation
  +
  the last three years of ownership
  +
  up to three years of absence for any reason*
  +
  a period spent working abroad*
  +
  up to four years of absence while working in the UK*.

  *= deemed occupation only if preceded and followed by actual occupation.

Payment and administration

The return must be filed by:

- 31 October following the end of the tax year if filing a paper return
- 31 January following the end of the tax year if filing online.

Penalties for late filing

- Initial penalty for failing to file by 31 January - £100.
- If over 3 months late, additional £10 per day to a maximum of £900.
- Over 6 months late, further £300 penalty or 5% of the tax owing whichever is higher.
- If 12 months late, additional £300 penalty or 5% of the tax owing whichever is higher. Further penalties of up to 100% of the tax due can be raised in serious cases.

Disclosure and errors

- Taxpayer must notify HMRC if tax return is needed by 5 October following end of the tax year.
- Taxpayer can amend tax return within 12 months of filing date or make an overpayment relief claim within 4 years of the end of the tax year.

Payments on account (POA)

- Due 31 January (in tax year) and 31 July (after tax year end). Each instalment is 50% of the previous year's tax liability.
- Balancing payment made 31 January after tax year end.
- No POA due if last year's tax liability is less than £1,000 or greater than 80% of last year's liability was deducted at source.
- Can reduce POA if this year's liability expected to be less than last year's. Penalties will be charged if a deliberate incorrect claim is made.
- Capital Gains Tax (CGT) liability paid 31 January following the tax year end. No POA needed for CGT.

Interest on tax paid late/overpaid tax

- Interest charged daily on late payment. Overpayment of tax receives interest from HMRC. Interest received is non-taxable on individuals.
- Penalties are also imposed on individuals, 5% applied when balancing payments more than 30 days late plus a further 5% when six months late and a further 5% if still unpaid 12 months after the payment due date.

Enquiries and other penalties

- HMRC must give notice of an enquiry within 12 months of submission of return.
- Basis of enquiry – random or HMRC believe income/expenses misstated.
- Penalty for failure to keep proper records is up to £3,000.
- Penalties for incorrect return are - simple mistake 0%/fail to take reasonable care 30%/deliberate error 70-100%.

Duties and responsibilities of a tax adviser

- Maintain client confidentiality at all times.
- AAT members must adopt an ethical approach and maintain an objective outlook.
- Give timely and constructive advice to clients.
- Honest and professional conduct with HMRC.
- Penalties:
    - Assistance in making an incorrect return – adviser liable to £3,000 penalty.
    - Involvement in fraudulent evasion of Income Tax is a criminal offence.