chapter 1

Income tax computation

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Learning objectives

- Calculate taxable savings income, income from property, dividend income, taxed income and investment income
- Calculate total taxable income and the income tax payable or repayable for employees, company directors, partners and self employed individuals

Specific syllabus references for this chapter are 2(c) and 2(f).

Practical significance

It is very important to know which types of income are taxable and which are exempt. The complex structure of the UK tax system means that some income is paid after deduction of tax and some is paid gross and it is essential to understand how this works. Many taxpayers without a background in finance struggle with this concept and make errors when making income declarations and completing official forms.

UK charities rely heavily on individuals and companies using the Gift Aid system to boost their income. Making a Gift Aid declaration is a simple but effective way of increasing the value of your donation.

Stop and think

Do you understand your own tax bill? It is likely that you receive employment income and also maybe income from investments such as dividends or bank account deposits. Do you realise that you pay different rates of tax on different types of income? Are you paying the correct tax? Do you make a note of all payments you make to charity (and ensure such payments come under gift aid) to reduce your tax bill (if you are a 40% tax payer)?

Working context

The calculation of taxable income is an essential tool for an accountant in practice. Not only will this be useful at work, but it will also be useful in your personal life as many friends and relatives will assume that you can help them with their tax. Although most of the calculations will be performed by computer programme, there will be occasions when you need to check the figures and understanding the process will also help you check for reasonableness.

Syllabus links

In Chapter 2 of your Principles of Taxation study manual, you learnt about the basics of the Income Tax Computation. This included chargeable and exempt income, the computation of taxable income, the personal allowance, computing tax liability, Gift Aid and allowances for taxpayers aged 65 and over.

In this chapter, we review this knowledge and then extend it in relation to charges on income, further gifts to charity, income from jointly owned assets and more details about the allowances for taxpayers aged 65 and over.
Examination context

Exam requirements
In the examination candidates may be required to:

- Prepare an income tax computation for an individual
- Identify whether income is taxable or exempt
- Determine whether income is received net or gross
- Understand the treatment of gifts/payments to charities
- Allocate income from jointly held assets between spouses/civil partners
- Calculate the allowances available for individuals aged 65 and over

Examiner's comments on how students tackle questions
A methodical approach is required to prepare an income tax computation. Historically candidates have scored well on income tax computations if they know the pro forma computation and have worked their way down the question one step at a time.
Section overview

- Taxable persons are individuals, trustees and personal representatives.
- Some income is exempt from income tax, e.g., income from ISAs, certain VCT dividends, Premium Bond prizes.
- Income received net must be shown gross in the income tax computation.
- There are three types of income: Non-savings income, Savings income and Dividend income, each with its own rate of tax.
- There are 7 steps to calculating a person’s income tax liability.
- Taxable income is Net Income less the Personal Allowance.
- Tax payable or repayable is a person’s tax liability less tax deducted at source.

1.1 Taxable persons

Income tax is chargeable each tax year on:

- Individuals – every individual is treated as a separate taxable person (including children) and is liable to income tax on his or her own income
- Trustees – liable to income tax on income of the trust
- Personal representatives (executors or administrators) – liable to income tax on income from the estate of a deceased person

Children who are under 18 are taxable persons in their own right in the same way as adults. However, the income of most children is covered by their personal allowance and so no income tax is actually payable on it.

However, if the income is generated from a gift by a parent, this income is treated as the income of the parent, not the child, if it exceeds £100.

Transfers of income generating assets by a parent into the child’s name are therefore ineffective for utilising the child’s personal allowance. However, transfers by other relatives to a child are tax effective.

1.2 Chargeable income and exempt income

The main types of chargeable income are:

- Income from employment (Employment income)
- Income from trades and professions (Trading income)
- Income from renting out property (Property income)
- Income from investments such as interest on loans and bank and building society accounts (Savings income)
- Income from investments such as dividends (Dividend income)
- Income from other sources (e.g., income from casual work) (Miscellaneous income)

The main types of exempt income are:

- Interest on National Savings Certificates
- Income from Individual Savings Accounts (ISAs)
- Dividends received on shares held in a Venture Capital Trust (VCT) so long as certain conditions are satisfied (see later in this text)
- Betting, lottery and Premium Bond winnings
Some social security benefits such as housing benefit and child benefit

Statutory redundancy pay and the first £30,000 of compensation received for loss of employment (see later in this text) [Hp52]

First £4,250 of gross annual rents from letting under the **rent-a-room** scheme (see later in this text)

Scholarships

Income tax repayment supplement

### 1.3 Income taxed at source and income received gross

Income received net must be shown gross in the income tax computation. Income which is received net includes:

- Interest on investments such as building society interest, most bank interest, debenture and other loan interest paid by UK companies (received net of 20% tax, gross up by 100/80)
- Patent royalties received (received net of 22% tax, gross up by 100/78)
- Employment income (taxed under PAYE, normally stated gross in the examination. PAYE deducted will be given as a separate figure)

Dividends from UK companies are received with a deemed 10% tax credit. The dividend must be grossed up by 100/90. The tax credit is not repayable, but can reduce income tax payable.

Income received gross includes:

- Property income
- Trading income
- Miscellaneous income
- National Savings and Investments (NS&I) Easy Access Savings Account and Investment Account interest
- Interest on government securities (gilt-edged securities/gilts) such as Exchequer Stock and Treasury Stock
- Interest received gross by an individual who has signed a declaration of non-taxpayer status and supplied a certificate to the bank/building society (self-certification); mainly used by children and pensioners
- Interest on non-commercial investments such as a loan between friends

### 1.4 Types of income

The three types of income are:

- **Non-savings income** (Employment income, Pension income, Taxable social security benefits, Trading income, Property income, Miscellaneous income)
- **Savings income** (Interest from investments)
- **Dividend income** (Dividends from UK companies)
1.5 Steps to calculating the income tax liability

To calculate a taxpayer’s income tax liability the following steps must be performed:

Step 1
Add together all types of chargeable income to give ‘**total income**’.

Step 2
Deduct reliefs, such as losses (Chapter 7) and gifts of assets to charities (Section 2.3 below) from the relevant component of ‘**total income**’ to give ‘**net income**’.

Step 3
Deduct the personal allowance from the relevant components of ‘**net income**’ to give ‘**taxable income**’.

The basis personal allowance for 2007/08 is £5,225. [Hp5]

The personal allowance is deducted from the different components of income in the following order:
- Non-savings income
- Savings income
- Dividend income

Step 4
Calculate tax at the applicable rates on the ‘**taxable income**’.

Tax on the three types of income is calculated in the following order:
- Non-savings income
- Savings income
- Dividend income

The rates of tax for 2007/08 are: [Hp1]

<table>
<thead>
<tr>
<th></th>
<th>Non-savings income</th>
<th>Savings income</th>
<th>Dividend income</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Starting rate</strong></td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Basic rate</strong></td>
<td>22%</td>
<td>20%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Higher rate</strong></td>
<td>40%</td>
<td>40%</td>
<td>32.5%</td>
</tr>
</tbody>
</table>

Step 5
Add together all amounts of tax at Step 4.

Step 6
From the Step 5 figure, deduct tax reductions such as Venture Capital Trust (VCT) relief, Enterprise Investment Scheme (EIS) relief (Chapter 2) and married couples allowance (Section 4.2 below).

Step 7
To the Step 6 figure, add certain other amounts of tax, such as the pensions annual allowance charge (Chapter 3).

The resulting figure is the ‘**income tax liability**’.

‘**Tax payable or repayable**’ is the amount of income tax payable by a taxpayer (or repayable to him) under self-assessment after reducing the ‘**income tax liability**’ by tax deducted at source, and increasing it by income tax retained, for example, on patent royalties paid (Chapter 5, Section 5.1).
### 1.6 Proforma income tax computation

The proforma income tax computation is as follows:

**A Taxpayer**

#### Income tax computation

**2007/08**

<table>
<thead>
<tr>
<th></th>
<th>Non-savings income £</th>
<th>Savings income £</th>
<th>Dividend income £</th>
<th>Total £</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment income</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property income</td>
<td>X</td>
<td>X</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>Total income</strong></td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td><strong>Reliefs</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Losses, gift of assets to charities</td>
<td>(X)</td>
<td>X</td>
<td>X</td>
<td>(X)</td>
</tr>
<tr>
<td><strong>Net income</strong></td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Personal allowance</td>
<td>(5,225)</td>
<td>X</td>
<td>X</td>
<td>(5,225)</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

#### Tax

<table>
<thead>
<tr>
<th></th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Less: tax reductions (for example, married couples allowance)</td>
<td>(X)</td>
</tr>
<tr>
<td><strong>Income tax liability</strong></td>
<td>X</td>
</tr>
<tr>
<td>Less: tax deducted at source</td>
<td>(X)</td>
</tr>
<tr>
<td>Plus: tax retained on patent royalties paid</td>
<td>X</td>
</tr>
<tr>
<td><strong>Income tax payable</strong></td>
<td>X</td>
</tr>
</tbody>
</table>

The proforma will gradually be built up over the following chapters of the Study Manual.
Interactive question 1: Computation of tax payable  [Difficulty level: Moderate]

Michael was born in 1970. In the tax year 2007/08, Michael had the following income:

Gross salary £23,695 (PAYE deducted £3,788)

Property income £6,000

National Savings Certificates interest received on cashing in certificates £1,100

Betting winnings £500

Building society interest received £320

Bank deposit interest received £400

Dividends from UK companies £1,890

Requirement

Using the standard format below, compute the income tax payable by Michael for 2007/08.

Michael

Tax payable

<table>
<thead>
<tr>
<th>Non-savings income</th>
<th>Savings income</th>
<th>Dividend income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
</tbody>
</table>

Net income

Less: PA

Taxable income

Tax

£

Tax liability

Less: tax deducted at source

Tax payable

£

See Answer at the end of this chapter.
Worked example: Anita

Anita has a part-time cleaning job and earns £4,560 in 2007/08. She also received the following income:

- National Lottery scratch card winnings: £250
- Bank interest: £380
- Dividends from UK company: £549

Anita is aged 42.

Requirement

Calculate Anita’s income tax payable/repayable.

Solution

Anita

Income tax payable

<table>
<thead>
<tr>
<th>Non-savings income</th>
<th>Savings income</th>
<th>Dividend income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Employment income</td>
<td>4,560</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BI £380 × 100/80</td>
<td>475</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends</td>
<td>£549 × 100/90</td>
<td>610</td>
<td>5645</td>
</tr>
<tr>
<td>Net income</td>
<td>4,560</td>
<td>475</td>
<td>610</td>
</tr>
<tr>
<td>Less: PA</td>
<td>(4,560)</td>
<td>(475)</td>
<td>(190)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>NIL</td>
<td>NIL</td>
<td>420</td>
</tr>
</tbody>
</table>

Tax

- £420 × 10% = £42
- Less: tax credit on dividend (restricted) = £42
- £475 × 20% = £95

Repayable = £95

Note that the tax credit on dividends is set off first to ensure that the full amount of tax deducted from bank interest is recoverable. However, the excess tax credit of £19 (£61 – £42) is not recoverable.

2 Gifts to charity

Section overview

- Gift Aid gives tax relief for cash donations to charity.
- The payroll giving scheme allows employees to obtain tax relief on gifts to charity out of employment income.
- Gifts of certain shares and land to charity are deductible in computing net income.

2.1 Gift Aid

The Gift Aid Scheme gives tax relief for cash donations to charity. A gift aid declaration must be made.

Basic rate tax relief is given by deeming the gift aid donation to be made net of basic rate tax. Higher rate tax relief is given by extending the basic rate band by the amount of the grossed up gift aid donation, at Step 4.
An election can be made to carry back a gift aid donation to the previous tax year. This election must be made to HMRC no later than the date when the taxpayer files his tax return for the year and, in any event, no later than 31 January following the end of the tax year.

2.2 Payroll Giving Scheme

Employees can make donations to charity under an approved payroll giving scheme. The employer deducts the amount of the donation from the employee’s employment income. Income tax is then calculated on employment income after the deduction of the charitable donation. This gives income tax relief at the individual’s highest rate of tax. [Hp67]

2.3 Gifts of assets to charity

A deduction is given against total income at Step 2, if the whole of any beneficial interest in qualifying shares or securities is given, or sold at an undervalue, to a charity.

The amount that an individual can deduct in calculating his net income is:

- The market value of the shares or securities at the date of disposal; plus
- Any incidental costs of disposing of the shares (broker’s fees, etc); less
- Any consideration given in return for disposing of the shares; and less
- The value of any other benefits received by the donor, or a person connected with the donor, in consequence of disposing of the shares.

The following are qualifying shares and securities for these purposes: [Hp122]

- Shares or securities listed on a recognised stock exchange (UK or otherwise);
- Shares or securities dealt with on a recognised stock exchange (UK or otherwise) (this definition appears to include Alternative Investment Market shares);
- Units in an authorised unit trust;
- Shares in an open-ended investment company;
- Holdings in certain foreign collective investment schemes.

Individuals can also claim a deduction in calculating net income, equal to the market value of any freehold or leasehold land or buildings given to a charity. Where land is sold at an undervalue, relief is given for the difference between market value and the price paid by the charity.

The deduction is given when calculating net income and is made from income in the following order:

- Non-savings income
- Savings income
- Dividend income

3 Independent taxation and jointly owned assets

Section overview

- Each individual is a separate taxable person.
- Income from assets owned by spouses/civil partners is usually split equally.
- A declaration of ownership in unequal proportions can be made.
- Income from jointly held shares in family companies is always split in accordance with actual ownership.
3.1 Independent taxation

Every individual is treated as a separate taxable person who is liable to income tax on his own income.

An income tax computation must be prepared for each spouse/civil partner, showing his or her own taxable income.

3.2 Jointly owned assets

A potential problem arises in deciding how spouses/civil partners are entitled to income received from a jointly held asset.

Special rules apply to allocate income where spouses/civil partners living together hold property jointly (eg a joint holding of shares, land or bank account).

The basic rule is that spouses/civil partners are deemed to own the property in equal proportions, irrespective of actual ownership. Therefore, joint income is normally divided equally between them (ie a 50/50 split).

If spouses/civil partners actually own the property in unequal proportions, they can make a declaration to HM Revenue & Customs (HMRC). This declaration is optional but, if made, each spouse/civil partner will be taxed on the income to which he or she is actually entitled.

Notice of the declaration must be sent to HMRC within 60 days of the declaration. A declaration cannot be made for an unequal split unless it is consistent with the owners’ actual entitlements. Therefore, if property is actually held jointly in equal proportions, it is not possible to make a declaration for any other split in order to save tax.

Income distributions (ie dividends) from shares in a family company which are jointly owned by spouses/civil partners will be taxed according to actual ownership. This income will not be automatically split equally between them.

4 Allowances for taxpayers aged 65 and over

Section overview

- Personal Age Allowance (PAA) is available to taxpayers aged 65 and over instead of the basic Personal Allowance.
- Gift Aid donations need to be taken into account when working out any reduction in PAA.
- Married Couples Allowance (MCA) is reduced in the same way as PAA if the taxpayer’s income exceeds a certain limit.
- MCA can be transferred from one spouse/civil partner to the other.

4.1 Personal Age Allowance (PAA)

The Personal Age Allowance is available to older taxpayers instead of the basic Personal Allowance, at Step 3.

There are two levels of Personal Age Allowance – a lower level for those aged 65 to 74 at the end of the tax year (£7,550 for 2007/08) and a higher level for those aged 75 and over at the end of the tax year (£7,690 for 2007/08). [Hp5]

Where the taxpayer’s net income exceeds £20,900 in 2007/08, the Personal Age Allowance is reduced by £1 for every £2 that the net income exceeds £20,900 until the amount of the basic Personal Allowance is reached.

The taxpayer’s net income for this purpose is reduced by the gross amount of any gift aid donation.
**Worked example: Personal Age Allowance**

Emily was born on 29 March 1935. Her net income for 2007/08 is £23,000 which is all non-savings income. Emily made a gift aid donation of £390 in December 2007.

**Requirement**

Compute Emily’s taxable income.

**Solution**

Emily is aged 73 on 5 April 2008.

The grossed up gift aid donation is £390 \( \times \frac{100}{78} \) = £500

- **Personal Age Allowance**
  - £500

- **Less:** 
  - (\( \left[ £23,000 – £500 \right] - £20,900 \)) = £1,600 \( \times \frac{1}{2} \)
  - (800)

- **Reduced Personal Age Allowance**
  - £6,750

**Taxable income:**

- **Net income**
  - 23,000

- **Less: Personal Age Allowance**
  - (6,750)

- **Taxable income**
  - £16,250

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### 4.2 Married Couples Allowance (MCA)

There is an additional allowance available for older married couples and civil partners in the form of a tax reducer at a fixed rate of 10%, at Step 6 of the income tax computation. This is called the Married Couples Allowance (MCA).

A married man who married before 5 December 2005, whose wife is living with him during all or part of 2007/08, is entitled to MCA. The amount he is entitled to depends on the ages of the couple and the husband’s net income.

For civil partners and couples who married on or after 5 December 2005, the MCA is claimed by the spouse or civil partner who has the higher net income. The amount depends on the ages of the couple and net income of the spouse or civil partner with the higher income.

A taxpayer is entitled to make a claim for MCA if he or his spouse or civil partner was born before 6 April 1935 (ie aged 73 by 5 April 2008).

If the older of the taxpayer or his spouse/civil partner is aged 73 or 74 at 5 April 2008, the amount of the MCA is £6,285. [Hp5]

If the older of the taxpayer or his spouse/civil partner is aged 75 years or over at 5 April 2008, the amount of the MCA is £6,365.

When the relevant taxpayer’s net income exceeds £20,900 and the Personal Age Allowance has been reduced to £5,225, any excess income reduces the MCA in the same way as for the PAA. However, the MCA cannot be reduced below the minimum amount of £2,440.

**Worked example: Married Couples Age Allowance**

Simon was born on 19 July 1933. His net income for 2007/08 is £26,130. He married Jean, who was born on 22 August 1931, in January 2007. Jean has net income for 2007/08 of £12,380.

**Requirement**

Compute Simon’s Personal Age Allowance and Married Couples Allowance.
Solution

Simon is aged 74 on 5 April 2008. The MCA is therefore based on Jean’s age. However, Simon is the taxpayer entitled to claim the MCA since he has the higher net income in 2007/08 and the couple were married on or after 5 December 2005.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Age Allowance</td>
<td>£7,550</td>
</tr>
<tr>
<td>Less: (£26,130 – £20,900) = £5,230 × ½ = £2,615 restricted to (2,325)</td>
<td></td>
</tr>
<tr>
<td>Reduced Personal Age Allowance</td>
<td>£5,225</td>
</tr>
<tr>
<td>Married Couple Allowance</td>
<td>£6,365</td>
</tr>
<tr>
<td>Less: remainder of excess (£2,615 – £2,325)</td>
<td>(290)</td>
</tr>
<tr>
<td>Reduced Married Couples Allowance</td>
<td>£6,075</td>
</tr>
</tbody>
</table>

The spouse/civil partner who would not be entitled to claim the MCA may, independently of their spouse/civil partner, make a claim for half of the minimum amount of the MCA to be transferred to him or her. The claim must be made by the start of the tax year. Alternatively, the couple may jointly elect, again by the start of the tax year, to transfer half or all of the MCA to the spouse/civil partner who would not normally be entitled to it. For the year of marriage/civil partnership, an election can be made during the year.

In the year of marriage/civil partnership, the MCA is reduced by 1/12 for each complete tax month (running from the 6th of one month to the 5th of the following month) which has passed before the marriage/registration of the civil partnership.
Summary

Income tax
Taxable persons (individuals, trustees, PRs)
Chargeable and exempt income
Three types of income: non-savings, savings, dividend
7 steps to calculating the income tax liability
Tax payable: after tax deducted at source

Gifts to charity:
Gift Aid Scheme
Payroll giving
Shares/land

Spouses/civil partners:
Taxed independently
Jointly owned assets:
Treat as equal

Taxpayers aged 65 and over:
PAA
MCA

Self-test
Answer the following questions.

1. Marjorie is aged 22 and is a full-time student. In 2007/08, she received the following income:
   - Scholarship from university £350
   - Earnings from vacation work (gross, PAYE deducted £910) £4,990
   - Dividends from UK company shares £450

   How much tax is repayable to Marjorie?
   A £934
   B £910
   C £884
   D £960

2. Jerry is aged 40. His only source of income in 2007/08 was trading income of £30,000.
   In July 2007, Jerry gave some shares quoted on the London Stock Exchange worth £5,000 to a charity.

   What is Jerry’s taxable income?
   A £30,000
   B £25,000
   C £24,775
   D £19,775

3. Paul and Oliver are civil partners. They own a house which they let out. The house is owned 40% by Paul and 60% by Oliver.

   Which one of the following statements is true?
   A The property income must be taxed equally on Paul and Oliver
   B Paul and Oliver are taxed together on the property income because they are civil partners
   C Paul and Oliver can elect for the property income to be taxed 40% by Paul and 60% by Oliver
   D Paul and Oliver can elect for the property income to be taxed 60% on Paul and 40% on Oliver
4 Albert was born on 10 April 1932. During 2007/08, he received gross pension income of £17,000 and bank interest of £3,200. He paid £600 under the Gift Aid Scheme in September 2007.

What Personal Age Allowance is available to Albert?

A £7,500  
B £7,550  
C £7,640  
D £7,690

5 Richard was born on 22 August 1931. His net income for 2007/08 is £26,800. Richard has been married to Lucy for many years. Lucy, who was born 30 April 1935, has net income for 2007/08 of £27,000.

What Married Couples Allowance is available and who is it given to, assuming no election to transfer it has been made?

A Lucy £5,560  
B Lucy £5,640  
C Richard £5,880  
D Richard £5,780

6 Toby and Jane

Toby and Jane are married.

Toby was born on 13 November 1934 and Jane was born on 19 June 1931.

In the tax year 2007/08, Toby and Jane had the following income:

<table>
<thead>
<tr>
<th>Toby</th>
<th>Jane</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension (gross) 20,000</td>
<td>13,000</td>
</tr>
<tr>
<td>(tax deducted) 2,540</td>
<td>970</td>
</tr>
<tr>
<td>Building society interest received 1,200</td>
<td>240</td>
</tr>
<tr>
<td>Dividends from UK companies 1,800</td>
<td>2,700</td>
</tr>
<tr>
<td>ISA dividends 1,500</td>
<td></td>
</tr>
<tr>
<td>Premium bond winnings</td>
<td>200</td>
</tr>
<tr>
<td>Property income 5,600</td>
<td>2,400</td>
</tr>
</tbody>
</table>

The property income is derived from a house which Toby and Jane own together in the proportions 70:30.

In December 2007, Toby made a gift aid donation of £1,170. In March 2008, Jane gave quoted shares worth £2,500 to a charity.

No elections have been made.

**Requirement**

Calculate the tax payable by Toby and Jane. (10 marks)

Now, go back to the Learning Objectives in the introduction. If you are satisfied you have achieved these objectives, please tick them off.
Technical reference

Legislation
References are to Income and Tax Act 2007 (ITA 2007) unless otherwise stated

Payroll Giving Scheme
Income Tax (Earnings and Pensions) Act 2003 ss.713 – 715

Gifts of shares/land to charity
s.431

Jointly owned assets
ss.836-837

Personal allowances
ss.35-37

Married couples allowance
Ss.45-46

HMRC manual references

Relief Instructions Manual (http://www.hmrc.gov.uk/manuals/remanual/index.htm)

Gift aid relief: outline of the relief
RE1830


This technical reference section is designed to assist you when you are working in the office. It should help you know where to look for further information on the topics covered in this chapter. You will not be examined on the contents of this section in your examination.
Answers to Self-test

1  B – £910

Marjorie
Income tax repayable

<table>
<thead>
<tr>
<th>Non-savings income</th>
<th>Dividend income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Employment income</td>
<td>4,990</td>
<td></td>
</tr>
<tr>
<td>Dividends £450 × 100/90</td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>(4,990)</td>
<td>(235)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>NIL</td>
<td>265</td>
</tr>
</tbody>
</table>

Scholarship is exempt from income tax.

Tax

£265 × 10%
Less: tax credit on dividend (restricted)
PAYE
Repayable

Note that the tax credit on dividends is set off first to ensure that the full amount of PAYE is recoverable. However, the excess tax credit of £24 (£50 – £26) is not recoverable.

2  D – £19,775

Jerry
Taxable income

<table>
<thead>
<tr>
<th>Non-savings income</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
</tr>
<tr>
<td>Trading income</td>
</tr>
<tr>
<td>Less: gift of quoted shares to charity</td>
</tr>
<tr>
<td>Net income</td>
</tr>
<tr>
<td>Less: PA</td>
</tr>
<tr>
<td>Taxable income</td>
</tr>
</tbody>
</table>

Statement A is incorrect because, although the property income will usually be taxed equally on Paul and Oliver, they can make an election for them to be taxed in accordance with their actual shares.

Statement B is incorrect because all individuals are independent taxpayers liable for tax on their own income.

Statement D is incorrect because the election for unequal shares can only be made to reflect the actual shares in which the property is held.
4 D – £7,690

Albert is aged 75 on 5 April 2008.

Net income adjusted for gift aid is:

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension</td>
<td>17,000</td>
</tr>
<tr>
<td>Bank interest £3,200× 100/80</td>
<td>4,000</td>
</tr>
<tr>
<td>Net income</td>
<td>21,000</td>
</tr>
<tr>
<td>Less: gift aid £600× 100/78</td>
<td>(769)</td>
</tr>
<tr>
<td>Adjusted net income</td>
<td>(20,231)</td>
</tr>
</tbody>
</table>

Since the adjusted net income does not exceed the limit of £20,900, there is no adjustment in the Personal Age Allowance.

PAA (aged 75 and over) £7,690

5 C – Richard £5,880

Since Richard and Lucy were married before 5 December 2005, Richard as the married man is entitled to the MCA. The allowance is based on Richard’s age since he is the elder of the couple.

Richard is aged 76 on 5 April 2008.

<table>
<thead>
<tr>
<th>Description</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal Age Allowance</td>
<td>7,690</td>
</tr>
<tr>
<td>Less: (£26,800 – £20,900) = £5,900 × 1/2 = £2,950 restricted to</td>
<td>(2,465)</td>
</tr>
<tr>
<td>Reduced Personal Age Allowance</td>
<td>5,225</td>
</tr>
<tr>
<td>Married Couple Allowance</td>
<td>6,365</td>
</tr>
<tr>
<td>Less: remainder of excess (£2,950 – £2,465)</td>
<td>(485)</td>
</tr>
<tr>
<td>Reduced Married Couples Allowance</td>
<td>5,880</td>
</tr>
</tbody>
</table>

6 Toby

**Tax payable**

<table>
<thead>
<tr>
<th>Non-savings Income</th>
<th>Savings income</th>
<th>Dividend Income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Pension income</td>
<td>20,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property income (N2)</td>
<td>4,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BSI £1,200× 100/80</td>
<td></td>
<td>1,500</td>
<td></td>
</tr>
<tr>
<td>Dividends £1,800× 100/90</td>
<td></td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>24,000</td>
<td>1,500</td>
<td>2,000</td>
</tr>
<tr>
<td>Less: PAA (W1)</td>
<td>(5,225)</td>
<td></td>
<td>(5,225)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>18,775</td>
<td>1,500</td>
<td>2,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22,275</td>
</tr>
</tbody>
</table>

Notes

1. ISA investment income is exempt from income tax.

2. Property income from jointly owned property is taxed equally on a married couple unless an election is made to reflect actual ownership. Therefore each owner is taxed on (£5,600 + £2,400) = £8,000/2 = £4,000.
INCOME TAX COMPUTATION

**Tax**

<table>
<thead>
<tr>
<th>Income</th>
<th>Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>£2,230</td>
<td>10%</td>
<td>£223</td>
</tr>
<tr>
<td>£16,545</td>
<td>22%</td>
<td>£3,640</td>
</tr>
<tr>
<td>£1,500</td>
<td>20%</td>
<td>£300</td>
</tr>
<tr>
<td>£2,000</td>
<td>10%</td>
<td>£200</td>
</tr>
<tr>
<td><strong>£22,275</strong></td>
<td></td>
<td><strong>£4,363</strong></td>
</tr>
</tbody>
</table>

Less: MCA £6,140 × 10% (W2) (614)
Tax liability 3,749
Less tax deducted at source
Pension tax (2,540)
£1,500 × 20% (300)
£2,000 × 10% (200)
Tax payable 709

**WORKINGS**

1. Toby is aged 73 on 5 April 2008.

   - **£**
     - Personal Age Allowance 7,550
     - Less: (£[27,500 – 1,500] – £20,900) = £5,100 × ½ = £2,550 restricted to (2,325)
     - Reduced Personal Age Allowance 5,225

   **Note:** Gift aid is £1,500 (£1,170 × 100/78)

2. Toby will be entitled to the MCA because Toby and Jane were married before 5 December 2005 and Toby is the married man.

   The allowance will be based on Jane's age as she is the older (aged 76 on 5 April 2008).

   - **£**
     - Married Couple Allowance 6,365
     - Less: remainder of excess (£2,550 – £2,325) (225)
     - Reduced Married Couples Allowance 6,140

**Jane**

**Tax payable**

<table>
<thead>
<tr>
<th>Income</th>
<th>Non-savings income</th>
<th>Savings income</th>
<th>Dividend income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension Income</td>
<td>13,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Income</td>
<td>4,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BSI £240 × 100/80</td>
<td></td>
<td>300</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dividends £2,700 × 100/90</td>
<td></td>
<td></td>
<td>3,000</td>
<td></td>
</tr>
<tr>
<td>Less: gift to charity</td>
<td>(2,500)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net income</td>
<td>14,500</td>
<td>300</td>
<td>3,000</td>
<td>17,800</td>
</tr>
<tr>
<td>Less: PAA</td>
<td>(7,690)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable income</td>
<td>6,810</td>
<td>300</td>
<td>3,000</td>
<td>10,110</td>
</tr>
<tr>
<td>Description</td>
<td>Amount</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>---------------------------</td>
<td>--------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£2,230 × 10%</td>
<td>223</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£4,580 × 22%</td>
<td>1,008</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£300 × 20%</td>
<td>60</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£3,000 × 10%</td>
<td>300</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,591</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax liability</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less tax deducted at source</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pension tax</td>
<td>(970)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£300 × 20%</td>
<td>(60)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£3,000 × 10%</td>
<td>(300)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Tax payable</strong></td>
<td><strong>261</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Premium bond winnings are exempt from income tax.
### Answer to Interactive question 1

**Michael**

**Tax payable**

<table>
<thead>
<tr>
<th>Non-savings income</th>
<th>Savings income</th>
<th>Dividend income</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£</td>
<td>£</td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Employment Income</td>
<td>23,695</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property Income</td>
<td>6,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>BSI £320 × 100/80</td>
<td></td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Bank interest £400 × 100/80</td>
<td></td>
<td>500</td>
<td></td>
</tr>
<tr>
<td>Dividends £1,890 × 100/90</td>
<td></td>
<td></td>
<td>2,100</td>
</tr>
<tr>
<td>Net income</td>
<td>29,695</td>
<td>900</td>
<td>2,100</td>
</tr>
<tr>
<td>Less: PA</td>
<td>(5,225)</td>
<td></td>
<td>(5,225)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>24,470</td>
<td>900</td>
<td>2,100</td>
</tr>
</tbody>
</table>

**Tax**

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>£2,230 × 10%</td>
</tr>
<tr>
<td>£22,240 × 22%</td>
</tr>
<tr>
<td>£900 × 20%</td>
</tr>
<tr>
<td>£2,100 × 10%</td>
</tr>
<tr>
<td>£27,390</td>
</tr>
</tbody>
</table>

**Tax liability**

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,506</td>
</tr>
</tbody>
</table>

**Less tax deducted at source**

<table>
<thead>
<tr>
<th>PAYE</th>
</tr>
</thead>
<tbody>
<tr>
<td>(3,788)</td>
</tr>
</tbody>
</table>

| £900 × 20%         | (180)           |
| £2,100 × 10%       | (210)           |

**Tax payable**

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,328</td>
</tr>
</tbody>
</table>

Interest on National Savings Certificates and betting winnings are exempt from income tax.