

Taxation (10 questions spread across all the different taxation areas)

Tax Legislation

- Following the 'Budget', a Finance Bill is published which contains the taxation proposals that are to be debated in Parliament
- If, following debate, the Finance Bill is approved and receives Royal Assent, it becomes the Finance Act

Domicile

- Domicile refers to the country that a person treats as their permanent home or to which they plan to return
- Domicile of origin is determined at birth as the domicile of the father or if they are unmarried, the mother
- Domicile of choice is when a person chooses a new domicile by showing an intention to settle there permanently and severing their former connections
- Deemed domicile is when a person is not UK domiciled but has lived in the UK for 17 out of the last 20 years
- If a person is either UK domiciled or deemed domiciled their estate for inheritance tax purposes includes all worldwide assets
- If a person is neither UK domiciled or deemed domiciled at death the estate for inheritance tax purposes only includes assets held in the UK

Residence

- This affects a person's liability to pay income tax and capital gains tax.
- If a person is classified as resident or ordinarily resident they are liable for income tax and capital gains tax on income and capital gains made worldwide
- A person is classed as 'resident' if they:
 - Spend 183 days or more in UK during a tax year
- Ordinarily resident is someone who normally lives in the UK but who has not spent 183 or more days in the UK in the last tax year.

INCOME TAX

Income tax is based on income received throughout the whole tax year 6 April-5 April

The following examples of income are all liable for income tax

- Salary or wages, bonuses, commission, benefits in kind
- Tips
- Certain pension or retirement benefits
- Interest on bank accounts not including ISAs
- Dividends from shares
- Income from gilts
- Trust income
- Property rental income
- Income from copyright and patent
- The value of benefits in kind such as company cars if total income including the value of benefits in kind exceeds £8,500. This is based on a percentage of the car's list price and carbon dioxide emission rating. If fuel is also provided, a further taxable benefit applies

Some examples of income not liable for income tax are:

- The first £30,000 of redundancy payments
- Interest from National Savings Certificates
- Income from ISAs
- Educational grants
- Gambling proceeds
- Some social security benefits
- Benefits from Friendly Society Policies
- Covenanted or Gift Aid payments
- The proceeds from a qualifying life policy
- The capital element received from a purchased life annuity

Who is liable for Income Tax ?

- Everyone regardless of age
- Non taxpayers can complete form R85 to receive interest gross on certain things
- When a child receives income via a settlement from parents that will be treated as the parent's income for taxation purposes

Personal Allowances

- Everyone regardless of age has a personal allowance which is the amount you can earn before tax becomes payable.

Income Tax Allowances 2008-09	Amount	Limit
Personal Allowance	£6,035 (L)	No limit
Personal Allowance if you are aged 65 – 74	£9,030 (P)	£21,800
Personal Allowance if you are aged 75 and over	£9,180 (Y)	£21,800

Note: If your income is over the 'income limit', the age related allowance reduces by half of the amount (£1 for every £2) you have over that limit, until the basic rate allowance is reached (you'll always get the basic allowance, whatever the level of your income).

So if, for example, you're 66 and have an income of £22,300 (£500 over the limit) your age-related allowance would reduce by £250 to £8,780.

- Tax payers are allowed to make certain deductions from their gross income before assessing their tax liability including **pension contributions and allowable expenses incurred wholly for business reasons**
- After these deductions have been made, what is left is taxable income, which is then applied to the tax bands on the next page
- Married couples have an additional allowance where at least one spouse was born before 6 April 1935.
- There is also a Blind Person's Allowance (£1,800) in 2008-09 if a person is registered as blind with a local authority. This allowance can be transferred to a spouse even if they are not blind.

Income Tax Bands on earned income

Tax Band	Rate	From	To
Starting Rate	10%	Not available	
Basic Rate	20%	£1	£34,800
Higher Rate	40%	£34,801	Upwards

Income Tax on interest from Savings

- Please note that the starting rate or lower rate of 10% is still used for taxation of interest on savings only when their other non savings taxable income is not above £2,320.

Bank and Building Society interest will have tax deducted at source at 20%.

Non taxpayer (NTP)	Can reclaim the tax paid or complete R85
Starting Rate taxpayer (LRTP)	Can reclaim 10% overpaid
Basic Rate taxpayer (BRTP)	No further liability
Higher Rate taxpayer (HRTP)	Must pay an additional 20%

- Because many depositors pay basic rate income tax, interest rates are often quoted net or after deduction of income tax.
- The gross rate can therefore be calculated by dividing the net interest rate by 0.8
- Therefore a net interest rate of $\frac{4.0}{0.8} =$ a gross interest rate of 5.0%

Income Tax on dividends

Tax Band	Rate	From	To
Basic Rate	10%	£1	£34,800
Higher Rate	32.5%	£34,801	Upwards

Dividend income received from shares will have tax deducted at 10%

Non taxpayer	Cannot reclaim this tax
Starting Rate taxpayer	Nothing further to pay
Basic Rate taxpayer	Nothing further to pay
Higher Rate taxpayer	Must pay an additional 22.5% of the grossed up dividend

- This time interest is deducted at source at 10% so the taxpayer receives an amount which is the net dividend with 10% having already been taken
- This time, the gross dividend can be calculated by dividing the net dividend by 0.9
- Therefore, a net dividend of $\frac{£100}{0.9} =$ a gross dividend of £111.11
- A higher rate taxpayer would have to pay a further 22.5% of this gross dividend making 32.5% tax paid in total.

Taxation of proceeds from a life assurance policy

- Premiums paid into a life assurance policy such as endowments are invested into different assets such as property, shares etc. All the benefits that come out of the policy are deemed to have already been taxed at 20% within the fund
- Policies such as these are regarded as 'qualifying' which means that the pay out from these policies is tax free. Endowments and other life assurance policies are regarded as 'qualifying'
- An additional tax liability may arise if the policy is 'non qualifying' if the person is a higher rate taxpayer
- In order to be qualifying, the policy must be:
 - Premiums payable for at least 10 years. If premiums cease within 10 years the policy becomes non qualifying.
 - Premiums in any one year must not exceed twice the premiums in any other year
 - The sum payable on death must be at least equal to 75% of the total premiums payable.

Collecting Income Tax

Employed

- If you are employed, income tax is paid by the employer under the PAYE scheme. HMRC will provide a tax code for each employee.
- Therefore tax is paid at source, which means that it is collected from the person who makes the payment(employer), rather than the recipient(employee)

Self Employed

- Sole traders and people in 'partnership' pay income tax directly to HMRC through declaring their 'net profit before tax ' eg after deducting fixed and variable costs.
- These figures can be either submitted directly to HMRC who will calculate the tax liability or they can calculate the tax liability themselves and send it to HMRC for approval – 'self assessment'.
- This needs to be done by 31st January following the end of that tax year.

Classification of Income

Previously different types of income used to be classified under different schedules(A,D,E & F).These have now been replaced by the following system.

- Income Tax (Earnings & Pensions) Act 2003
 - This covers mainly income from employment, previously classified under Schedule E.
- Income Tax (Trading and Other Income) Act 2005
 - This covers all other income that previously fell under the other schedules.

Calculation of Income Tax

Step 1 – Work out the total income for that tax year

Step 2 – Subtract deductions

- Self employed business expenses must be **wholly and exclusively for the trade**
- Employed business expenses must be **wholly, exclusively and necessarily for the job.**

Step 3 – Deduct the personal allowance

Step 4 – Apply the taxable income to the tax bands.

Example 1

Bob(42) has total income before allowances of £ 30,000. Calculate his income tax liability for the year 2008-09?

Deduct the personal allowance

£ 30,000
- 6,035
23,965

£ 23,965 is the amount of taxable income that is left. As this amount is less than £ 34,800 we know that there is no higher rate tax to pay.

So

23,965 @ 20% = **£ 4,793**

Example 2

Tina(39) has total income of £ 50,000 before allowances. Calculate her income tax liability for the year 2008-09 ?

Deduct the personal allowance

50,000
- 6,035

43,965

This is the amount of taxable income that is left. This time this amount is more than £34,800 so you know that there will be some higher rate tax to pay. The easiest way to do this is by working out the higher rate tax to begin with, which will be the excess of taxable income over the higher rate threshold (HRT)

So

43,965
- 34,800 (HRT)

9,165 @ 40% = **£ 3,666**

There is £ 34,800 left to be taxed at the basic rate

34,800 @ 20% = £ 6,960
£10,626

Note

If it is a higher rate tax calculation, for 2008-09, the basic rate amount will always be the same. Eg £6,960 will always be the same.

It is just the higher rate amount that will be different depending on how much their income is above the higher rate threshold (£34,800).

UNIT 1 - SECTION 1 – PART 2 – TAXATION

Question	Answer	Mark	Comments / Notes
1			
2			
3			
4			
5			
6			
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8			
9			
10			
11			
12			
13			
14			
15			
16			
17			
Total			
Result %			Result % = (Total / 17) x 100
NOW TRANSFER YOUR RESULT TO PERFORMANCE TRACKER 1			

Unit 1 - Section 1.2 - Taxation

- 1 Every year in March or April, a number of taxation measures are made in the budget. These then take effect as a result of the related:
- A Income and Corporation Taxes Act B Social Security Act
C Taxation Act D Finance Act
- 2 Marco is a resident of the UK and this is also the country in which he usually lives, although his country of domicile is Italy. On which one of the following would he not be expected to pay UK tax?
- A Income earned from renting his villa in Italy, but kept in an Italian bank
B Income earned from renting his villa, but brought back to the UK
C Tax on an inheritance left by his father in Italy
D Tax on capital gains from the sale of some shares on the New York stock exchange
- 3 An individual who normally lives in the UK, but has been working abroad for the last full tax year, will be categorised for tax purposes as:
- A resident B ordinarily resident
C deemed resident D habitually resident
- 4 When does a person acquire their domicile of origin?
- A at birth B at 18
C at 21 D at 16
- 5 Which one of the following payments will NOT be liable to income tax?
- A Interest from a building society postal account
B Income from company dividends
C Interest from a cash Individual Savings Account
D Income from Government loan stocks
- 6 Where an employee receives a termination payment on becoming redundant, up to what amount will the payment be free from income tax?
- A £20,000 B £25,000
C £30,000 D £35,000
- 7 Where a child receives an income from an arrangement made by his or her parents, how is this taxed?
- A As the child's personal income
B It is tax-free
C The first £70 is always tax free
D It will normally be added to the parent's income

- 8 What does the term ‘collecting income tax at source’ actually mean?**
- A The recipient pays the tax to the Inland Revenue before using the money
 B The tax is collected through the recipient’s tax return
 C The total income is automatically reduced by basic rate tax
 D The collection is from the person who makes the payment, not the recipient
- 9 For income tax purposes, self employed people are taxed on their:**
- A turnover
 B gross profit
 C net profit
 D personal drawings
- 10 Which one of the following individuals would be most likely considered a UK resident for tax purposes?**
- A Sandra who normally lives in France but spends two months a year on a farm in Scotland
 B Luigi who has a nine month contract in Essex with a telecom company commencing in April 2007.
 C Dmitri who has a seven month business consultancy contract in London commencing January 2007.
 D Bella who spends 180 days a year in the UK developing her Italian based design company
- 11 What is the total tax liability of a higher rate taxpayer on income earned from dividends?**
- A 32.5%
 B 22%
 C 40%
 D 22.5%
- 12 Terence is aged 38, married and has a gross income of £26,500 from his employment in the 2008/09 tax year. If he had no taxable benefits in kind, how much income tax did he pay?**
- A £4,579.50 B £4,814.00 C £4,341.00 D £4,093.00
- 13 Steven (age 35) has a taxable income of £28,000. He receives NO other income of any sort during the tax year 2008-09. As a single person, what is his tax liability?**
- A £4,914.00 B £5,600 C £5,162.00 D £5,195.00
- 14 What is the earliest time at which a UK resident can have a personal allowance for income tax purposes?**
- A From starting work
 B From age 16
 C From age 11
 D From birth

15 William is deemed to be resident in the UK for tax purposes in the previous tax year. What is the minimum number of days that he must have been in the UK in that tax year?

- A 1 day
- C 90 days
- B 183 days
- D 365 days

16 The precise definition of employee expenses that are used to reduce income tax liabilities is they MUST be specifically incurred wholly:

- A while doing the job
- B and exclusively while doing the job
- C and necessarily while doing the job
- D exclusively and necessarily while doing the job

17 Who is allowed to use expenses to reduce income tax liability?

- A employees
- B employees, partners and sole traders
- C sole traders only
- D sole traders and partners only