



# Tax manual

Tax queries, questions & answers

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## The different types of tax

### Income Tax on earnings, pensions and benefits

You pay Income Tax on:

- your wages if you're employed
- the profits from your business if you're self-employed
- your State Pension and any company or private pensions
- some benefits like Jobseeker's Allowance, Carer's Allowance and Incapacity Benefit

As well as paying Income Tax on your wages and on income from self-employment, you also have to pay National Insurance contributions (NICs).

If you're an employee, your employer operates PAYE (Pay As You Earn) and deducts tax and NICs from your wages. If you're self-employed you'll be responsible for paying your own tax and NICs and filling in your Self Assessment tax return.

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## What counts as taxable income?

Taxable income includes:

- earnings from employment
- earnings from self-employment
- most pensions income (State, company and personal pensions)
- interest on most savings
- income from shares (dividends)
- rental income
- income paid to you from a trust

### Investment income

Dividends on company shares - not including dividend income from ISAs.

### State benefits

The most common taxable state benefits are:

- Carer's Allowance
- Jobseeker's Allowance
- Employment and Support Allowance - 'contribution' based (if you have paid enough National Insurance contributions)
- Incapacity Benefit - from week 29
- Weekly Bereavement Allowance

### Rental income

- from a lodger in your only or family home if more than £4,250 a year (£2,215 if split jointly)
- from a second property

### Other taxable income

- pensioner bonds
- trust income

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## What counts as non-taxable income?

### State benefits

The most common non-taxable state benefits are:

- Disability Living Allowance
- Attendance Allowance
- lump sum Bereavement Payments
- Pension Credit
- free TV licence for over 75s
- Winter Fuel Payments and Christmas Bonus
- Housing Benefit
- Employment and Support Allowance - income based (if you haven't paid enough National Insurance contributions)
- first 28 weeks of Incapacity Benefit
- Income Support - certain payments
- Child Benefit
- Guardian's Allowance
- Maternity Allowance
- Industrial Injuries Benefit
- Severe Disablement Allowance
- War Widow's Pension
- Young Person's Bridging Allowance

### Interest on savings

- all ISAs
- Savings Certificates

### Rents

- first £4,250 a year from a lodger in your only or family home - £2,125 if split jointly

### Tax Credits

- Working Tax Credit
- Child Tax Credit

## Tax-free allowances

Nearly everyone who is resident in the UK for tax purposes receives a 'Personal Allowance', which is an amount of taxable income you're allowed to earn or receive each year tax-free.

This tax year (2011-12), the basic Personal Allowance - or tax-free amount - is £7,475. You may be entitled to a higher Personal Allowance if you're 65 or over.

If you're registered blind, or are unable to perform any work for which eyesight is essential, you can also claim the tax-free Blind Person's Allowance.

Income Tax is only due on taxable income that's above your tax-free allowances.

## Levels of Personal Allowance

The amount of your personal allowance depends on:

- your age
- your total income in the tax year

Total income means everything you receive from all taxable sources. That means you need to include things like pensions and interest on your savings in a building society before the tax has been taken off.

Income Tax allowances	2011-12	2012-13
Personal Allowance (1)	£7,475	£8,105
Income limit for Personal Allowance	£100,000	£100,000
Personal Allowance for people aged 65-74 (1)(2)	£9,940	£10,500
Personal Allowance for people aged 75 and over (1)(2)	£10,090	£10,660
Married Couple's Allowance (born before 6th April 1935 but aged under 75) (2)(3)(4)	Not applicable	Not applicable
Married Couple's Allowance (born before 6th April 1935 and aged 75 and over) (2) (3)	£7,295	£7,705
Income limit for age-related allowances	£24,000	£25,400
Minimum amount of Married Couple's Allowance	£2,800	£2,960
Blind Person's Allowance	£1,980	£2,100

If you become 65 or 75 during the year to 5 April 2012, you are entitled to the full allowance for that age group.

### **If you are 65 or over and your income is between £24,000 and £100,000**

If your income is over £24,000 (the income limit for age-related allowances) but not more than £100,000, your age-related Personal Allowance is reduced by half of the amount - £1 for every £2 - you have over the £24,000 limit, until the basic rate allowance is reached. So if, for example, you're 66 and have income of £24,500 - £500 over the limit - your age-related Personal Allowance is reduced by £250 to £9,690.

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## Allowances and reliefs that can reduce your Income Tax bill

If you're due to pay Income Tax, there are a number of deductible allowances and reliefs that can reduce your tax bill. These include:

- Married Couple's Allowance - the husband, wife or civil partner has to be born before 6 April 1935
- Maintenance Payment relief - either you or your former spouse or civil partner must have been born before 6 April 1935

Unlike the tax-free allowances, these aren't amounts of income you can receive tax-free. Rather they're amounts that can reduce your tax bill.

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### Tax-free Blind Person's Allowance

If you're certified blind and are on a local authority register of blind persons, or if you live in Scotland or Northern Ireland and are unable to perform any work for which eyesight is essential, you can claim Blind Person's Allowance. Like your Personal Allowance, this is an amount of income you can get without having to pay tax on it.

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### Married Couple's Allowance (includes civil partnerships)

If you're married or in a civil partnership, you or your partner may get Married Couple's Allowance if:

- you're living together
- you or your spouse/civil partner were born before 6 April 1935

There are special rules about who claims Married Couple's Allowance. The amount you'll receive depends on the level of the claimant's income. Your tax bill will be reduced by ten per cent of the amount of Married Couple's Allowance you can claim.

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### Maintenance Payments relief

You can get an allowance to reduce your tax bill for maintenance payments you make to your ex spouse or former civil partner if:

- you or your spouse or civil partner were born before 6 April 1935
- you're separated or divorced or the civil partnership has been dissolved and you're making the payments under a Court Order
- the payments are for the maintenance of your ex spouse or former civil partner - provided they aren't now remarried or in a new civil partnership - or for your children who are under 21

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### Other allowances, reliefs and expenses

You can get tax relief for different expenses, depending on whether you're an employee or director or self-employed.

#### Employees and directors

If you're an employee or a director you can get tax relief for business expenses you've paid for and if they were for the cost of:

- travelling you had to do in doing your job
- other expenses you had to meet in doing your job - and which related only to doing your job

The sort of expenses you might be able to get relief for include:

- travel and subsistence
- work tools or special clothing

- fees and subscriptions to professional bodies
- expenses of home working
- capital expenditure

### **Self-employed**

If you're self-employed you can get tax relief for all the business expenses you pay that are just for your business. If you pay for something you use for business and privately - like your phone - and the bill can be split, you can get relief for the bit that's just for your business.

Your business expenses might include:

- buying stock or materials and paying subcontractors
- business premises costs
- repairs and renewals
- motor and travelling
- advertising
- legal and professional fees
- general office costs

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### **Tax relief - pension contributions**

The government encourages you to save for your retirement by giving you tax relief on pension contributions. The way you get tax relief on pension contributions depends on whether you pay into a personal, public service or company pension scheme.

#### **Company or public service pension schemes**

Usually your employer takes the pension contributions from your pay before deducting tax - but not National Insurance contributions. You only pay tax on what's left. However some employers may choose to use the same method of paying contributions that personal pension scheme provider's use.

#### **Personal pensions**

You pay Income Tax on your earnings before any pension contribution, but the pension provider claims back tax from the government at the basic rate of 20 per cent. This means that for every £80 you pay into your pension, you end up with £100 in your pension pot.

If you're a higher rate taxpayer, you can claim the difference through your Self Assessment tax return or by making a claim by telephone or letter. If you're an additional rate taxpayer you'll have to claim the difference through your tax return.

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### **Tax relief on gifts to charity**

You can get tax relief if you make gifts to charity. You can do this in a number of different ways.

#### **Gift Aid**

Gift Aid offers a simple way to increase the value of your donation to charities and Community Amateur Sports Clubs (CASC). It allows the charity or CASC you support to reclaim basic rate tax (20 per cent) on your donation. If you pay tax at the higher rate you can claim the difference through your tax return or by making a claim by telephone or letter. If you're an additional rate taxpayer you'll have to claim the difference through your tax return.

#### **Payroll Giving**

If your employer offers the Payroll Giving scheme, you can use it to get tax relief automatically - at your highest income tax rate - on any donations you make to charity direct from your wages or pension pay packet.

#### **Giving assets to charity**

If you give certain assets to a charity you can claim tax relief and lower your tax bill. You can also claim tax relief if you sell the asset to a charity at less than its market value.

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## Tax allowances and reliefs for employees or directors

If you're an employee or director you might be able to get tax relief for business expenses you've paid for.

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### What counts as a 'tax-deductible' expense?

You can only get tax relief for business expenses you've paid for and if they were for the cost of:

- travelling you had to do in doing your job
- other expenses you had to pay in doing your job - and which related only to doing your job

You can't ask for tax relief if your employer has already reimbursed you for the expense and has agreed a dispensation with HM Revenue & Customs (HMRC).

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### Key allowances and reliefs

There are several reliefs that you might be able to get to reduce your tax bill. If you think you might be able to get any of the ones listed in this article you can find out more about them by following the links.

#### **Business mileage or fuel**

You may be able to get tax relief for business mileage when you use your own vehicle on business, or for fuel you buy when you use a company car. You can't claim, though, for your normal commuting costs.

#### **Professional fees and subscriptions**

You can ask for tax relief for the cost of fees and subscriptions you pay to some approved organisations - but only if you have to pay them, or if it's helpful for your work.

#### **Tools and specialist clothing**

If you have to provide small tools or buy specialist clothing for your work - like a uniform or protective clothing - you may be able to get tax relief for the cost of them.

#### **Capital allowances**

If you buy something like a filing cabinet or a desk for your work - called capital expenditure - you might be able to get capital allowances to help with the cost.

#### **Household expenses when working at home**

You may be able to get relief for some household expenses and some travelling costs if you work from home. You might also be able to get capital allowances for capital expenditure.

#### **Travel and subsistence costs**

You may be able to get relief for the cost of business travel - for example if you need to visit a client or go to a temporary workplace. You can also ask for relief for 'subsistence' - the cost of meals and overnight expenses.

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## Tax on company benefits

If you're employed and you receive non-cash benefits from your employer you will have to pay tax on them.

### **Taxable benefits**

Benefits that you might have to pay tax on include:

- company cars or vans
- fuel provided for your vehicle
- medical insurance
- living accommodation
- loans at low interest rates

## How much Income Tax you pay

After your allowable expenses and any tax-free allowances have been taken into account, the amount of tax you pay is calculated using different tax rates and a series of tax bands.

### Income Tax rates 2011-12 by tax band and type of income

Income Tax band	Income Tax rate on non savings income	Income Tax rate on savings	Income Tax rate on dividends
£0 to £2,560 Starting rate for savings	Not available	10%	Not applicable - see basic rate band
£0 to £35,000 Basic rate	20%	20%	10%
£35,001 to £150,000 Higher rate	40%	40%	32.5%
Over £150,000 Additional rate	50%	50%	42.5%

Because the rate of Income Tax you pay on savings is worked out after any non-savings income has been taken into account, if your non-savings income is less than the starting rate for savings limit (£2,560) - or if savings and investments are your only source of income - your savings income will be taxed at the 10 per cent starting rate up to the limit. But if you already have non-savings income which takes you above the starting rate, all of your savings will be taxed at the 20 per cent basic rate.

Remember, the tax band applies to your income after your tax allowances and any reliefs have been taken into account - you're not taxed on all of your income.

'Non savings income' includes income from employment or self-employment, most pension income and rental income.

'Dividends' means income from shares in UK companies. Savings and dividend income is added to your other taxable income and taxed last. This means you pay tax on these sorts of income based on your highest Income Tax band.

## Dividend tax rates 2011-12

There are three different Income Tax rates on UK dividends. The rate you pay depends on whether your overall taxable income (after allowances) falls within or above the basic or higher rate Income Tax limits.

The basic rate Income Tax limit is £35,000, and the higher rate Income Tax limit is £150,000, for the 2010-11 tax year.

### Dividend tax rates 2011-12

<b>Dividend income in relation to the basic rate or higher rate tax bands</b>	<b>Tax rate applied after deduction of Personal Allowance and any Blind Person's Allowance</b>
<b>Dividend income at or below the £35,000 basic rate tax limit</b>	10%
<b>Dividend income at or below the £150,000 higher rate tax limit</b>	32.5%
<b>Dividend income above the higher rate tax limit</b>	42.5%

It doesn't matter whether you get dividends from a company, unit trusts or open-ended investment companies, as all dividends are taxed the same way.

But bear in mind that interest distributions from unit trusts and open-ended investment companies are taxed at the rates for savings income - see below.

### Tax on savings income

There are four different Income Tax rates on savings income: 10 per cent, 20 per cent, 40 per cent or 50 per cent. The rate you pay depends on your overall taxable income.

## Understanding the dividend tax credit

Companies pay you dividends out of profits on which they have already paid - or are due to pay - tax. The tax credit takes account of this and is available to the shareholder to offset against any Income Tax that may be due on their 'dividend income'.

When adding up your overall taxable income you need to include the sum of the dividend(s) received and the tax credit(s). This income is called your 'dividend income'.

### How tax credits are worked out

The dividend you are paid represents 90 per cent of your 'dividend income'. The remaining 10 per cent of the dividend income is made up of the tax credit. Put another way, the tax credit represents 10 per cent of the 'dividend income'.

### Dividend income at or below the £35,000 basic rate tax limit

<b>Dividend paid to you (represents 90% of the dividend income)</b>	<b>Tax credit (10% of the dividend income)</b>	<b>Dividend income (dividend paid plus tax credit)</b>
£63	£7	£70
£54	£6	£60
£90	£10	£100

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## **Paying tax on dividend income**

### **If you pay tax at or below the basic rate**

You have no tax to pay on your dividend income because the tax liability is 10 per cent - the same amount as the tax credit - as shown in the earlier tables.

### **If you pay tax at the higher rate**

You pay a total of 32.5 per cent tax on dividend income that falls above the basic rate Income Tax limit (£35,000 for the tax year 2011-12). In practice, however, you only owe 25 per cent of the dividend paid to you. This is because the first 10 per cent of the tax due on your dividend income is already covered by the tax credit.

### **If you pay tax at the additional rate**

From the 2011-12 tax year you pay a total of 42.5 per cent tax on dividend income that exceeds the higher rate Income Tax limit (currently £150,000). In practice, however, you only owe 36.1 per cent of the dividend paid to you. This is because the first 10 per cent of the tax due on your dividend income is already covered by the tax credit.

Note that dividend income, like savings income, is taxed after your non-savings income - for example, wages and self-employment profit - at your highest tax rate. For example, if it falls both sides of the £35,000 basic rate tax limit, it will be taxed partly at 10 per cent (and covered by the tax credit) and partly at 32.5 per cent (less the 10 per cent tax credit).

### **Declaring dividend income on your Self Assessment tax return**

If you normally complete a tax return you'll need to show the dividend income on it.

If you don't complete a tax return, but you have higher rate of tax to pay on your dividend income, you should contact your Tax Office.

## Capital Gains Tax

Capital Gains Tax is a tax on capital 'gains'. If, when you sell or give away an asset it has increased in value, you may be taxable on the 'gain' (profit). This doesn't apply when you sell personal belongings worth £6,000 or less or, in most cases, your main home.

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### When do I have to pay Capital Gains Tax?

You may have to pay Capital Gains Tax if, for example, you:

- sell, give away, exchange or otherwise dispose of (cease to own) an asset or part of an asset
- receive money from an asset - for example compensation for a damaged asset

You don't have to pay Capital Gains Tax on:

- your car
- your main home - provided certain conditions are met
- ISAs or PEPs
- UK Government gilts (bonds)
- personal belongings worth £6,000 or less when you sell them
- betting, lottery or pools winnings
- money which forms part of your income for Income Tax purposes

These are some points to bear in mind:

- if you are married or in a civil partnership and living together you can transfer assets to your husband, wife or civil partner without having to pay Capital Gains Tax
  - you can't give assets to your children or others or sell assets cheaply without having to consider Capital Gains Tax
  - if you make a loss you may be able to make a claim for that loss and deduct it from other gains, but only if the asset normally attracts Capital Gains Tax - for example you cannot set a loss on selling your car against gains from disposing of other assets
  - if someone dies and leaves their belongings to their beneficiaries, there is no Capital Gains Tax to pay at that time - however if an asset is later disposed of by a beneficiary, any Capital Gains Tax they may have to pay will be based on the difference between the market value at the time of death and the value at the time of disposal
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### How Capital Gains Tax is worked out

Capital Gains Tax is worked out for each tax year (which runs from 6 April one year to 5 April the following year). It is charged on the total of your taxable gains, after taking into account:

- certain costs and reliefs that can reduce or defer gains
- allowable losses you have made on assets to which normally Capital Gains Tax applies
- the Annual Exempt (tax-free) Amount - this is £10,600 for every individual in the tax year 2011-12

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## Tax on the sale or disposal of your main home

You do not have to pay tax as long as:

- you bought it, and incurred any expenditure on it, primarily to use it as your home rather than with a view to making a profit on its sale
- the property was your only home throughout the period you owned it (ignoring the last three years of ownership)
- you did actually use it as your home all the time that you owned it and, throughout that period, you did not use it for any purpose other than as a home for yourself, your family and no more than one lodger
- the garden and area of grounds sold with it does not exceed 5,000 square metres (about one and a quarter acres) including the site of the house

If you are married or in a civil partnership and not separated you and your spouse or civil partner can have only one such residence between you.

Even if all these conditions are not met, you may still be entitled to tax relief.

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## Tax on property that's not your main home

You will normally have a chargeable gain if your property is worth more than you paid for it when you sell or dispose of it. However, the first £10,600 of your total taxable gains are tax free (for the tax year 2011-12).

It's worth bearing in mind that:

- when working out the chargeable gain you can deduct some of the costs of buying, selling and improving the property
- if you have made a loss on the property, you may be able to set that off against other chargeable gains you may have
- if you are living together you can transfer property to your husband, wife or civil partner without having to pay Capital Gains Tax
- if you give it or sell it cheaply to your children or to others, you may be liable to pay Capital Gains Tax

## Tax on rental income

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### Tax on residential lettings

Letting residential investment property is treated as running a business - even if you only let out one property. And if you let out more than one property in the UK, they'll all be treated as a single business. Whether you let one or several properties, you're taxed on the overall 'net profit'. You work this out by:

- adding together all your rental income
- adding together all your allowable expenses
- taking the allowable expenses away from the income

Working out your net profit like this means that you can offset a loss from one property against the profit from others. Your net profit counts as part of your overall taxable income.

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### The 'Rent a Room' scheme

If you are letting furnished accommodation in your own home to a lodger and your total receipts (rent plus income from meals, laundry service, etc) are £4,250 or below (£2,125 if letting jointly), you can get this income tax-free under the 'Rent a Room' scheme.

You'll have to pay tax on anything over £4,250. Or you can choose not to use the scheme if you'd prefer to pay tax under the rules for residential lettings.

#### Letting all or part of your home

If you let your home while you live somewhere else, your profits from the rent are worked out and taxed in the same way as for residential investment lettings.

The same rules apply if you let part of your home outside the 'Rent a Room' scheme. If you let part of your home this way, you can include a percentage of household costs like gas and electricity when you work out your allowable expenses.

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### Tax on furnished holiday lettings

If you let out a furnished holiday home in the UK or in the European Economic Area (EEA), the tax rules for these furnished holiday lettings are different from the rules for residential lettings. The rules let you:

- reduce your profit by claiming 'capital allowances' for the cost of furniture and fixtures that you provide inside the property you let
- offset any losses against your overall income - not just against your rental income

Also, when you sell the property you may be able to take advantage of extra reliefs that'll bring down your Capital Gains Tax bill.

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### Tax on overseas property lettings

You'll have to pay tax on income you get from overseas property lettings (whether you bring the money into the UK or not) if you are 'resident, ordinarily resident and domiciled' in the UK. If you are 'resident' but either 'not ordinarily resident' or 'not domiciled' in the UK you may only have to pay tax on any money you bring into the UK. For an explanation of these terms and to find out more read our main article.

If you've already paid foreign tax on your letting income, you can usually offset this against the UK tax you'll have to pay on it.

## Tax on buying property

If you buy a property in the UK over a certain purchase price you have to pay Stamp Duty Land Tax (SDLT). This is charged on all purchases of houses, flats and other land and buildings.

### What is Stamp Duty Land Tax?

SDLT replaced Stamp Duty in December 2003 and is a tax on the purchase price of land and buildings. When you buy a property or take on a lease you may have to pay SDLT.

### Paying SDLT

If you buy either a freehold or a leasehold property and the purchase price is more than £125,000, you pay SDLT of between one and four per cent of the whole purchase price. See the table below for more detail.

If the purchase price is £125,000 or less you don't pay any SDLT.

The £125,000 threshold for when you start to pay SDLT was introduced again on 1 January 2010. The previous starting rate was £175,000 - for purchases made between 3 September 2008 and 31 December 2009.

#### First-time buyers

If you are a first-time buyer the threshold for when you start to pay SDLT is £250,000. This is only if you have never owned a house or flat in the UK or anywhere else in the world. If you are buying with someone else they must never have owned property before either. This higher threshold applies to purchases made on or after 25 March 2010 and before 25 March 2012.

Purchase price of residential property	Rate of SDLT (percentage of the total purchase price)
£0 - £125,000	0%
£125,001 - £250,000	1%
£250,001 - £500,000	3%
£500,001-£1,000,000	4%
Over £1M-£2M	5%
Over £2M From 22 March 2012	7%
Over £2M (Purchased by certain persons including corporate bodies) from 21 March 2012	15%

### SDLT Disadvantaged Areas Relief

If you buy property in an area designated by the government as 'disadvantaged' you may qualify for Disadvantaged Areas Relief. In this case the threshold for SDLT is £150,000.

Disadvantaged Areas Relief did not apply for residential property purchases between 3 September 2008 and 31 December 2009 inclusive. The threshold during that period was £175,000 which is higher than the previous Disadvantaged Areas Relief threshold.

You can check the HMRC website to see if the property you are buying is in an area designated as disadvantaged. (You'll need to scroll down to use the postcode search tool.)