

Level 4 Certificate
In
Self-Assessment Tax

2022/23

Lesson 1

SAMPLE

Order of Study

Lesson 1 – Introduction to self-assessment, employment income

Lesson 2 – Trading and Property income, Capital Allowances

Lesson 3 – Capital Gains Tax and Foreign income

The material contains a workbook at the end of the course book which should be practiced along with the main topics. We have added some basic practice questions as well as advanced questions.

Please note that the order of questions in the workbook does not necessarily follow the order of topics in the course as the more details you will learn, the more interaction between tax rules can be practiced. For example, Payment on Account for a partner in a partnership will touch multiple topics.

While it is certainly our goal to provide you with a comprehensive material the taxation system is vast, therefore it is best if you get familiar with the HMRC sources as early as possible and start using them along with your studies. You will find some help at the beginning of Lesson 1 on where to start.

Online Course Access:

We are also able to provide your course via a secured online platform. Students have indicated that 'hard copy' is their preferred method of study but if you would also like to have online access, please email brian@idealschools.co.uk, including your name, student number and course, we'll provide you with instruction.

Contents

LESSON 1

CHAPTER 1 INTRODUCTION TO SELF ASSESSMENT	9
HMRC	9
Finding Information	9
The UK Taxation System	13
Types of Taxable Income	14
Tax rates and thresholds	16
Income Tax Allowances	17
Income Taxed at Source	19
Savings income	19
Dividends from UK companies	20
Format of a Tax Computation	22
Changes in the utilisation of Personal Allowance	25
PROGRESS TEST 1	32
National Insurance	33
National Insurance for the Self-Employed	34
National Insurance Annual Maximum Contributions	35
Self-Assessment	38
Duties and Responsibilities of the Bookkeeper and Tax Agents	39
How to engage clients: Professional Clearance letter	39
How to engage clients: Letters of Engagement	40
How to engage clients: Becoming an agent	45
A: Your Business	45
B: Your services as Agent	47
The Tax Return	53
The Main Forms	55
The Simple Assessment	70
Deadlines	70
Records to be kept	71
Paying income tax and Payment on Account	72
Penalties	74
Enquires opened into the Tax Return	77
PROGRESS TEST 2	78
Contributions	79

Contributions to Pension Schemes	79
Auto Enrolment – Workplace Pensions	81
Charitable contributions – Gift Aid	82
Tax band extension	82
Reducing the Personal Allowance restriction	83
PROGRESS TEST 3	84
CHAPTER 2 INCOME FROM EMPLOYMENT.....	85
Tax Codes	85
Benefits in Kind	93
Taxable Benefits	94
Company car	94
Fuel Benefit	97
Pool cars	98
Van Benefit	98
Beneficial Employee Loans	99
Living Accommodation	100
Provision of Assets	101
Vouchers and other taxable benefits	102
Exempt Benefits	103
Allowable Deductions	105
Expenditure reimbursed	105
AMAP	105
Professional fees and subscriptions	106
Contributions to occupational pension schemes and Payroll Giving... ..	107
Business Travel and Subsistence	107
Termination Payments	108
High Income Child Benefit Charge	109
Tax return: SA102 Employment pages	111
PROGRESS TEST 4	114
Answers to progress tests	115
TUTOR MARKED ASSIGNMENT 1	120
LESSON 2	
CHAPTER 3	
INCOME FROM SELF EMPLOYMENT AND PARTNERSHIPS	5
Trading profits and losses	5

Trading Income.....	5
Business Expenses.....	7
Allowable and non-allowable expenses.....	7
Simplified Expenses.....	10
Trading Allowance.....	12
Cash Basis Accounting.....	13
Basis Periods.....	16
Trading Losses.....	18
Opening year losses.....	21
Terminal loss relief.....	21
Change of accounting dates (optional content).....	24
Grant Income – COVID-19 measures.....	27
SA103 – Self Employment pages.....	27
Partnerships.....	42
Partnership Returns.....	45
SA800 SA104.....	45
The Construction Industry Scheme.....	56
Contractors, Construction work.....	56
The Scheme.....	57
Subcontractors.....	57
CIS Deduction.....	58
PROGRESS TEST 1.....	61
CHAPTER 4 CAPITAL ALLOWANCES.....	62
Capital Allowances – Plant, machinery and equipment.....	62
Annual Investment Allowance (AIA).....	64
First Year Allowance (FYA).....	67
Writing-down Allowance (WDA).....	67
Capital Allowances on cars.....	69
Assets with an element of private use.....	70
Short Life Assets.....	71
Balancing Charges and Allowances.....	71
Calculating a Claim for Capital Allowances.....	73
The format of a Capital Allowance computation.....	74
Claiming Capital Allowances.....	75
Leases.....	76
Structures and Building Allowance – SBA.....	78
PROGRESS TEST 2.....	82

CHAPTER 5 INCOME FROM PROPERTY	83
Accrual Basis.....	83
Cash Basis	84
Property Income: Expenses and Allowances.....	84
Restriction of finance costs.....	85
Mileage – Direct method.....	90
Replacement of Domestic Items relief.....	91
Capital Allowances	92
Rent a Room	94
Property Allowance.....	94
Furnished Holiday Lettings	95
Lease Premiums.....	96
SA105 UK Property Pages	97
PROGRESS TEST 3	100
Answers to Progress Tests	101
TUTOR MARKED ASSIGNMENT	110
LESSON 3	
CHAPTER 6 CAPITAL GAINS TAX.....	5
Chargeable person, Connected persons.....	5
Annual Exemption, Rate of Capital Gains Tax	5
Exempt Disposals, Chargeable assets.....	6
Calculation of CGT.....	7
Part Disposals.....	8
Capital Losses.....	9
Chattels and Wasting Chattels.....	10
Shares and Securities for Individuals.....	11
Bonus issue, Rights issue	13
SA108 Capital Gains Summary pages.....	14
Reliefs for Individuals.....	19
Business Asset Disposal Relief.....	19
Rollover Relief.....	20
Gift Relief.....	22
Principal Private Residence Relief (PPR)	23
PROGRESS TEST 1	28

CHAPTER 7 OVERSEAS INCOME	29
Residence.....	29
Automatic Overseas Test	29
Automatic UK Residence Test.....	29
Sufficient Ties Test.....	30
Split Year Treatment	32
Domicile	33
By origin, by dependence, by choice	34
Arising basis – Remittance basis	35
Arising basis	35
Remittance basis	37
Double Taxation Agreements - reliefs	40
SA106 and SA109 Foreign and Remittance basis pages	43
PROGRESS TEST 2	54
Answers to Progress Tests	55
TUTOR MARKED ASSIGNMENT 3.....	57
TUTOR MARKED ASSIGNMENT 4.....	59
TUTOR MARKED ASSIGNMENT 5 – MOCK EXAM 1.....	62
TUTOR MARKED ASSIGNMENT 6 – MOCK EXAM 2.....	69

CHAPTER 1 INTRODUCTION TO SELF ASSESSMENT

HMRC

HMRC (Her Majesty's Revenue & Customs) is the government department which deals with all aspects of the UK's taxation system. The HMRC website (www.hmrc.gov.uk) is now integrated into the Government's own website (www.gov.uk) and provides a comprehensive database regarding government services and information.

The UK tax system is extremely complex, and you will need to refer to the HMRC website and other external sources throughout your studies for additional information.

The information in this course is valid for the Tax Year 2022/2023. The government previously introduced two budgets during the course of a tax year (6th April to 5th April the following year), this has been now reduced to one Spring Budget, changes to tax rules and regulations are frequently introduced in these budgets. Not all budget provisions, however, are always implemented as the parliamentary process frequently involves a degree of debate and subsequent alteration to what has been proposed in the budget. ***The result is that the application of tax legislation is something of a fluid picture and it is important that you refer to the HMRC website for further information on the detail we will cover in this course.***

Finding Information

For this course and generally in order to keep your professional knowledge up-to-date it is vital that you know what kind of information is available to you.

There are different tiers of information presented by HMRC

First Tier information – Introductory pages

This is the most basic and generic information which is primarily designed for the everyday taxpayer but also a good place to have a quick overview of the subject. You can easily navigate between pages or switch to an entirely new topic.

Second tier information – Collection sites (List of information)

These sites provide you with more options besides the introductory pages, you will also find more in-depth list of information about sub-topics, relevant help sheets and forms which we come back to later in the lesson.

First Tier information example



[Home](#) > [Money and tax](#) > [Income Tax](#)

Self Assessment tax returns

1. [Overview](#)
2. [Who must send a tax return](#)
3. [Sending a return](#)
4. [Deadlines](#)

5. [Penalties](#)
6. [If you need to change your return](#)
7. [How to get help](#)
8. [Returns for someone who has died](#)

Money and tax

[Register for Self Assessment](#)

[Sign in and file your Self Assessment tax return](#)

[Understand your Self Assessment tax bill](#)

[Pay your Self Assessment tax bill](#)

[More](#)

1. Overview

Self Assessment is a system HM Revenue and Customs (HMRC) uses to collect Income Tax.

Tax is usually deducted automatically from wages, pensions and savings. People and businesses with other income must report it in a tax return.

If you need to send one, you fill it in after the end of the tax year (5 April) it applies to.

Sending your return

Log in and file your tax return online, or send a paper form.

<https://www.gov.uk/self-assessment-tax-returns>

Second Tier information example



[Home](#) > [Personal tax](#)

Personal tax

Self Assessment

☒ [Subscribe to email alerts](#)

[See latest changes to this content](#)

From: [HM Revenue & Customs](#), [HM Courts & Tribunals Service](#), and [Student Loans Company](#)

Quick links

[Sign in and file your Self Assessment tax return](#)

[Webinars and videos about Self Assessment](#)

Introduction

[Self Assessment tax returns](#)

[Check if you need to fill in a Self Assessment tax return](#)

Registering for Self Assessment

[Register for Self Assessment](#)

Filing a tax return

[Sign in and file your Self Assessment tax return](#)

[Self Assessment forms and helpsheets](#)

[Software for Self Assessment tax returns](#)

[Repaying your student loan](#)

<https://www.gov.uk/topic/personal-tax/self-assessment>

Third Tier Information – HMRC Internal Manuals

These manuals will be your primary source of information when you are looking for tax rules as they are detailed, continuously updated and give comprehensive guidance.

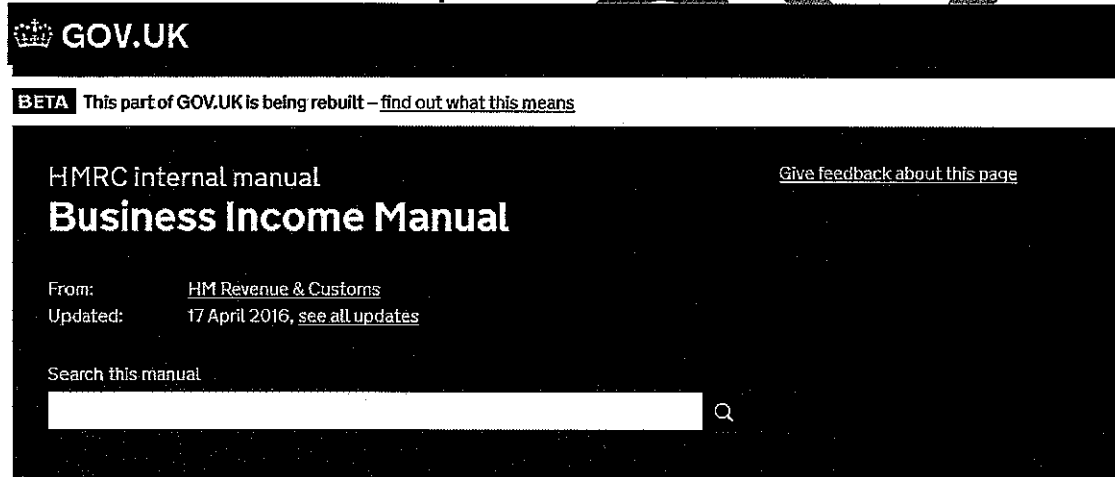
<https://www.gov.uk/government/collections/hmrc-manuals>

Each tax rule is clearly labelled indicating which manual it belongs to and the position in the manual itself. You can easily navigate in each manual by clicking on the relevant links or between pages in the bottom right corner. The old HMRC and the new GOV.uk sites were integrated therefore these manuals are transferred over to GOV.uk and changed aesthetic format.

The most relevant manuals to this course are:

- BIM** Business Income Manual
- PIM** Property Income Manual
- EIM** Employment Income Manual
- CA** Capital Allowance Manual
- PM** Partnership Manual

Third Tier information example:



GOV.UK

BETA This part of GOV.UK is being rebuilt – [find out what this means](#)

HMRC internal manual [Give feedback about this page](#)

Business Income Manual

From: HM Revenue & Customs
Updated: 17 April 2016, [see all updates](#)

Search this manual

[Contents](#)

Supplementary guidance on how to check tax calculations or work out the trading profits of a business for Self Assessment tax return.

BIM00500	Introduction: contents
BIM14000	Taxation of trading income: contents
BIM20000	Meaning of trade: contents
BIM30000	Measuring the profits (general rules): contents
BIM40000	Measuring the profits (specific rules & practices) - receipts & deductions: contents
BIM50000	Measuring the profits (particular trades): contents

<https://www.gov.uk/hmrc-internal-manuals/business-income-manual>

Additional Information – Notices, leaflets, factsheets, booklets and webinars

The most important Notice is the VAT 700 Notice which has its own structure and you can find them alphabetically or numerically listed.

<https://www.gov.uk/government/collections/vat-notices-numerical-order>

Important and relevant booklets for our course are:

Booklet 480: Expenses and benefits – a tax guide

Booklet 340: Construction Industry Scheme

Although the information found on HMRC and GOV.uk website is not the law itself, it is common practice to act upon the guidance. Throughout the manuals you will find legal citations from the corresponding sections of the different acts like Income Tax (Trading and Other Income) Act 2005 abbreviated to ITTOIA 2005. <http://www.legislation.gov.uk>

When you are searching for help sheets, forms, booklets etc. you must open the one that says **2023**, this is the one to be used for 2022/23.

HMRC webinars are going to be an integral part of your continued professional development therefore it is extremely important that you follow all relevant webinars. There are 2 types of webinars, basic ones for the general public about topics such as motoring expenses for the self-employed the advanced webinars are for tax agents and are called HMRC Agent Talking Points.

All important and relevant sources for Agents can be found the following collection site:

<https://www.gov.uk/topic/dealing-with-hmrc/tax-agent-guidance>

We will shortly come back to the topic 'how to become an Agent' and we will discuss the Agent collection site as well.

The UK Taxation System

A full study of the UK tax system is out with the scope of this course but in order to consider the topic of self-assessment it is important to go over some of the basic elements of personal taxation.

The UK taxation system is a means by which the government raises finances to pay for its activities. These activities take the form of a variety of services and benefits provided nationally, such as defence, law and order, the NHS, social services etc.

As well as raising finance, which is usually its prime purpose, the taxation system can also be used for other social, economic or political purposes such as attempting to spread wealth more evenly by taxing those with larger incomes and increasing the resources of those with smaller incomes. The system is also used to encourage industrial concerns to move to certain areas of the country by allowing certain tax concessions to businesses moving into such areas; or to deter people from entering into certain activities or consuming certain commodities.

Almost everyone in the UK pays tax of one sort or another during most of their adult lives, and broadly speaking such tax can be identified as being either direct or indirect tax.

Direct tax is a tax which is levied directly on an individual. An example of this is income tax, by which all who have earned more than a certain amount of income pay a proportion of their income to the government. It is direct in that it is charged directly against our income and we have no choice with regard to paying it.

Indirect tax is a tax collected in a different way, such as on the purchase of goods. The most common of these is value added tax, or VAT. The principle is that a percentage is added to the price of goods we buy, and that percentage is eventually collected by the government. Duties on certain special goods such as alcohol, cigarettes and petrol are also indirect taxes and their effect is similar to VAT.

In this course we will be dealing solely with direct taxation.

The tax year

The year for which all income tax is charged or assessed runs from April 6th in one year to April 5th in the next year. This period is described as the tax year or fiscal year. The tax year for 2022/23 for instance would be April 6th 2022 – April 5th 2023.

Each year the Chancellor introduces to Parliament proposals for the changes he wishes to make to the tax system for the next tax year. They are first presented in what is usually known as the Budget Speech and are embodied in a Finance Bill, which after due discussion and consideration in the House of Commons, becomes a Finance Act, making it an Act of Parliament.

In the case of taxpayers whose only or main earnings are derived from their employment, the bulk of any tax they are due to pay will be calculated and deducted at source, so they will then receive their net pay (pay after tax has been deducted).

Taxes are levied by reference to percentage rates; in the case of income tax these are on a progressive scale, meaning that the rate increases as income increases. The rates rarely change from one year to the next however bands are often subject to change. The figures included in this lesson are current at the time of writing. As a result of significant changes regarding Scotland and Wales we will see that rates and thresholds have become more complex from 2018/19.

Types of Taxable Income

Taxable income can be broken down into the following main categories:

1. **Non-Savings Income** which includes employment income (incl. Benefit in Kind payments), pension income, income from business (i.e., trades & professions), profits from furnished holiday lettings and any other type of property income.
2. **Savings Income**, which includes interest from UK banks, building societies and company loan stock.
3. **Dividend Income**, which are payments shareholders receive from companies in which they invest.

Basic tax computation (simplified)

	£
Gross income from different sources	x
Less: Personal Allowance	(x)
Taxable income	x
Tax liability	x
Less: Tax suffered at source	(x)
Tax or tax refund due	x/(x)

Exempt Income

There are certain types of income which have no tax deducted at source and are outside of the scope of income tax. Such sources of income should be completely excluded from the tax computation, and you have to make sure that they are not featured in the tax return either.

1. Individual Savings Accounts (ISA) interest
2. Damages granted through personal injury or death
3. Scholarships and educational grants in certain situations
4. Prizes including: Premium Bond Prizes, Lottery and other gambling prizes

Taxable and tax-free state benefits

There are several types of tax-redistribution available for certain groups of individuals in need.

State benefits that are taxable

- the State Pension
- Jobseeker's Allowance
- Carer's Allowance
- Employment and Support Allowance (contribution based)
- Incapacity Benefit (from the 29th week)
- Bereavement Allowance
- pensions paid by the Industrial Death Benefit scheme
- Widowed Parent's Allowance
- Bereavement Allowance (previously Widow's pension)

Tax-free state benefits

The most common state benefits you don't have to pay Income Tax on are:

- Housing Benefit
- Employment and Support Allowance (income related)
- Income Support - though you may have to pay tax on Income Support if you're involved in a strike
- Working Tax Credit
- Child Tax Credit
- Disability Living Allowance (DLA) and Personal Independence Payment (PIP)
- Child Benefit (income based)
- Guardian's Allowance
- Attendance Allowance
- Pension Credit
- Winter Fuel Payments and Christmas Bonus
- free TV licence for over-75s
- lump-sum bereavement payments
- Maternity Allowance
- Industrial Injuries Benefit
- Severe Disablement Allowance
- Universal Credit
- War Widow's Pension
- Universal Credit

Tax rates and thresholds

In the tax year 2022/2023 the following income tax rates apply to non-savings income in the UK and Wales

Tax Band 2022/2023	Rate	Description
£0 - £37,700	20%	Basic Rate
£37,701 - £150,000	40%	Higher Rate
Over £150,000	45%	Additional Rate

In Scotland

Tax Band 2022/2023	Rate	Description
£0 - £2,162	19%	Starter Rate
£2,163 - £13,118	20%	Basic rate
£13,119 - £31,092	21%	Intermediate Rate
£31,093 - £150,000	41%	Higher Rate
Over £150,000	46%	Top Rate

As you can see there is a different set of thresholds for wages, pension, trading, property and other non-savings income in the UK and for Scotland resulting in a complicated situation

SRIT and Scottish tax bands apply to	Other UK tax bands apply to:
Income from employment	Dividend income
Profits from self-employment	Savings income
Rental income	Savings allowances
Pensions and state pension	Childcare vouchers
Marriage allowance	Capital gains
Tax relief on gift aid donations	
Tax relief on pension contributions	

*SRIT (Scottish Rate of Income Tax)

Income Tax Allowances

A certain amount of an individual's income is treated as tax free. This is done by providing a series of what are known as 'personal allowances'. These allowances cater for different people in different circumstances. To compute an individual's tax liability for a year we must first deduct the personal allowance from the net income. The balance is then taxed at the relevant rate. These personal allowances are detailed in the Finance Act every year and usually, though not always, change from year to year.

	2022/2023	2021/2022
Personal Allowance	12,570	12,570
Blind person's allowance	2,600	2,520
Income Limit		
Basic personal allowance (note 1)	100,000	100,000
Married couple's allowance	31,400	30,400
Married couples' allowance (note 2)		
Minimum amount	3,640	3,530
Maximum amount	9,415	9,125
Marriage Allowance (note 3)	1,260	1,260
Dividend Allowance (note 4)	2,000	2,000
Personal Savings Allowance		
Basic rate taxpayers	1,000	1,000
Higher rate taxpayers	500	500

- 1) The amount of the basic **Personal Allowance** is restricted when the income is above £100,000 by £1 for every £2 of income above the £100,000 threshold. This means that the personal allowance will be reduced to zero if the total income is £125,140 or more.

EXAMPLE

Total income: £112,000

Personal Allowance: $112,000 - 100,000 = 12,000 / 2 = 6,000$

→ $12,570 - 6,000 = £6,570$ can be utilised as PA

- 2) Tax relief for the **Married Couple's Allowance** is given at the rate of 10%, i.e., it is effectively a 'tax reducer'. At least one of the spouses must be born before 6 April 1935.

The married couples' allowance for 2022/23 is £9,415, giving a maximum tax reduction of £941.50, i.e., 10% of £9,415.

The married couple's allowance is reduced if the claimant's adjusted net income exceeds £31,400. However, the allowance is never reduced to less than a certain amount, this amount is £3,640 for 2022/23. This means that the minimum amount of the tax reduction will be £364 i.e. 10% of £3,640.

Whereas the personal allowance and blind person's allowance are both deducted from net income when calculating taxable income, the married couple's allowance is not utilised until the amount of income tax due on the taxpayers' taxable income has been calculated. The married couple's allowance is then given by reducing the tax liability by 10% of the amount of the allowance, as described above.

The Married Couple's Allowance cannot create a refund - it merely reduces the tax liability to nil.

- 3) **Marriage Allowance** is an allowance available for married couples or couples in a civil partnership who both were born after 6 April 1935. Marriage Allowance allows a partner or spouse to transfer 10% of their own Personal Allowance (rounded up) e.g. £1,260 of his or her Personal Allowance to their husband, wife or civil partner - if they earn more than the giving spouse or partner. The tax savings for 2022/23 therefore 20% of £1,260 = £252

One can get Marriage Allowance if all the following apply:

- Married or in a civil partnership
- The giving spouse or partner doesn't earn anything, or their income is under £12,570
- The receiving spouse or partner income is between £12,571 and £50,270. For Scottish taxpayers no more than the upper threshold of the intermediate band.

One can still apply for Marriage Allowance if their partner:

- Is currently receiving a pension
- lives abroad - if the spouse receives a Personal Allowance.

An application must be sent to HMRC to receive the marriage allowance and will be put in place until it is cancelled or there is a change in circumstances (e.g. death, income level change). The application can be completed online via gov.uk or via self-assessment.

A Marriage Allowance can create a refund.

We will get back to the Dividend and Personal Savings allowances shortly, showing how the income tax is calculated.

Income Taxed at Source

Employment income / PAYE

The PAYE system involves the employer in deducting tax from each employee's weekly or monthly pay before the employee receives it. What is given to the employee is the net amount after tax. This is by far the most convenient system for most employees, as they do not have to save money to be able to pay a yearly tax bill. Instead, they know that their tax bill has already been paid and their full net pay is available for them to use.

The basis of the assessment for employment income under PAYE:

Gross income received
 (salaries, wages, bonuses, commissions, fees, tips)
 + *Value of Benefits in Kind (BiK) taxable benefits*
 - *Allowable deductions (subscriptions, AMAP etc.)*

Income from employment

Income from employment and other sources is assessed as gross, the tax (PAYE) already paid on this type of income will be deducted at the end of the income tax computation as 'tax deducted at source'.

We will get back to the details of these receipts and deductions later in our course material at the Employment income chapter.

Savings income

Income from savings (interest) are received from the following sources:

- UK banks and building societies
- National Savings, interest, and credit union accounts
- Interest distributions from unit trusts, investment trusts and open-ended investment companies but not dividends!
- Government securities (Gilts)
- Purchased life annuity payments

Interest is assessed in the tax year it is received. From 6 April 2016 any interest received is mostly at gross value, which rather complicates the tax calculation, as aside from the **starting rate allowance of 0%** for savings income; the **Personal Savings Allowance (PSA)** is also applicable depending on the taxpayers income.

Savings income is taxed at the income tax rates and according to the UK income tax bands.

Tax Band 2022/23	Rate	Description
£0 - £5,000	0%	Starting rate for Savings*
£0 - £37,700	20%	Basic Rate
£37,701 - £150,000	40%	Higher Rate
Over £150,000	45%	Additional Rate

*The **0% starting rate** applies to savings income only. If the **non-savings income after considering the Personal Allowances** is above £5,000 the 0% starting rate for savings will not apply. (Example to follow shortly)

Exempt savings income such as an ISA does not count towards the PSA.

The PSA does count towards your tax band - it is not an additional tax-free item.

Certain types of savings/interest income might be still receivable net of tax for example interest received by Directors on loans provided to their company, in this case you must gross up the savings income and deduct the 20% tax suffered at source at the end of the calculation just like PAYE

EXAMPLE 1

A taxpayer has received £8,000 savings income **net** of tax.

Task: Gross up the savings income for income tax purposes

$$8,000 / 80 \times 100 = 10,000$$

$$\text{Tax deducted at source: } 10,000 - 8,000 = 2,000$$

EXEMPT Savings income

Individual Savings Account (ISAs)

In 2022/23 one can save up to a subscription limit of £20,000 with adult ISA and enjoy the following benefits:

- ISA interest is exempt of income tax
- Gains from investments are exempt from Capital Gains Tax
- Withdrawals of money from the ISA can be done at any time

There are 4 types of ISAs:

- Cash ISAs
- Stocks and shares ISAs
- Innovative finance ISAs
- Lifetime ISA

Lifetime ISA: The Lifetime ISA is a longer-term tax-free savings account that gives taxpayers a government bonus of 25% of the money they put in, up to a maximum of £1,000 a year. Taxpayers can save up to £4,000 a year and can continue to pay into it until they reach 50. The account can stay open after then, but they can't make any more payments into it.

The taxpayer can withdraw the funds held in his Lifetime ISA before he is 60, but he'll have to pay a withdrawal charge of 25% of the amount he withdraws.

One can save into any type of ISAs but only 1 of each type. The £20,000 subscription limit is a **combined limit to all ISAs**.

While ISAs are generally available for UK residents aged 18 or over (16 for cash ISA) **Junior ISA** is for children under 18. Junior ISAs can be cash or stocks and shares ISAs similarly to general ISAs maximum 1 of each with a

maximum subscription limit of £9,000 for 2022/23 (a significant increase from £4,368 in 2019/20)

National Savings and Interest

There are quite a few products offered that are tax free however caution should be exercised as there are products which are taxable!

Tax free products:

- Premium bond prize
- Direct ISA (partly exempt due to threshold)
- Junior ISA (partly exempt due to threshold)

Taxable products:

- Direct Saver
- Income Bonds
- Investment Account
- Guaranteed Bonds

For more information, please visit the NS&I site via the following link: <https://www.nsandi.com/interest-rates>

Dividends from UK Companies

From the tax year 2016/17 dividends no longer have tax credit attached to them. Instead **Dividend Allowance** is available for taxpayers. In 2018/19 the dividend allowance dropped from £5,000 to £2,000. From 6 April 2023, the dividend allowance will be £1,000 and from 6 April 2024, the allowance is dropping further to £500.00.

Dividends are classed as neither savings income nor non-savings income, rather they constitute as a third layer, which is treated as the top slice of taxable income and is taxed at different rates in the same tax bands.

Dividend Allowance means that the first £2,000 dividend income is tax free, no matter which tax band it falls into. It is very important to note that the dividend allowance **does count towards** the tax band, therefore it is not an additional free amount rather part of the tax band. (We will show some examples on how to calculate this).

UK and Scotland:

Tax Band	Dividend £	Dividend rate
Dividend Allowance	2,000	0 %
Basic rate	0 – 37,700	8.75 %
Higher rate	37,700 – 150,000	33.75 %
Additional rate	150,000 +	39.35 %

Format of a Tax Computation (UK)

1. Set up columns headed Total Income; Non-Savings Income; Savings Income; and Dividend Income.
Enter gross figures in each column, add up to get total income, and deduct personal allowance from both the total income and non-savings income columns to get **taxable income**. Pay attention to Personal Allowance Restrictions!
2. Calculate tax by firstly dealing with **non-savings income**. Any non-savings income up to £37,700 is taxed at 20%. Any further non savings income up to £150,000 is taxed at 40%. Additional income above is taxed at 45%.

3. Next deal with **savings income**. One of two situations may arise:

Situation A: After taking the Personal Allowance (PA) into consideration, if the non-savings income is below £5,000 then any savings income up to £5,000 is taxed at 0%. (If we have £1,000 non-savings income after PA has been deducted, then the first £4,000 of savings income will be taxed at 0%. $£5,000 - £1,000 = £4,000$). The rest of the savings will benefit from the £1,000/500 Personal Savings Allowance (PSA) that is available for basic/higher rate taxpayers.

Situation B: After taking the PA into consideration, if the non-savings income takes up the first £5,000 income entirely, then the starting rate of 0% won't apply, however the PSA of £1,000 is available for basic rate taxpayers and £500 is available for higher rate taxpayers. No PSA is available for additional rate taxpayers

4. Next, we deal with **dividend income**. We have already considered the non-savings and savings income. If the total from these sources (including the starting rate and PSA) adds up to less than the basic band threshold, then we still have 'room' in the basic tax band that we can use. The first £2,000 dividend income is tax free regardless of which band it falls into however please note that the Dividend Allowance also counts towards the taxpayer's tax band. Any Dividend income that remains after the allowance has been used will fall into the basic band and will be taxed at 8.75% until the basic band has been used up. If the basic rate band has already been used by the non-savings and savings income, then dividend income will be taxed at 33.75% between £37,701 (it is actually £37,700.01) and £150,000; if both the basic band and higher band are taken up by the aggregate of the non-savings and savings income, the dividend income will automatically fall into the additional band above £150,000 and will be taxed at 39.35%.
5. Aggregate the tax calculated to arrive at the **total tax liability**.
6. Deduct **tax suffered at source** (PAYE, tax on savings received net)
7. The remaining figure is the amount of tax the taxpayer is still **due to pay**. If he has overpaid, then a **refund** is available.

Remember: These sources are not taxed separately rather you must add them up to calculate the total taxable income and then decide which income will fall into which tax band **strictly following the order**. The total income is also the base for considering the Personal Allowance restriction.

If you are learn visually, imagine 3 buckets labelled basic band, higher band, and additional band. The buckets each have a maximum capacity of the tax bands i.e., the basic band bucket can hold 37,700, the higher band bucket can hold $150,000 - 37,700 = 112,300$, this means that if we start filling up a bucket and it becomes full then, that is it, we will have to start filling up the next one. The additional band bucket is bottomless and so everything else that doesn't fit into the first 2 will automatically go there.

Of course, this is a rather simplified example, as you will have other rules to follow, but it is an excellent way to help understand the mechanics of taxation and tax bands.

Template of income tax calculation

	Total	Non savings	Savings	Dividend
Employment income (incl. BiK)	x	x		
Pension	x	x		
Trading income	x	x		
Property income	x	x		
Savings	x		x	
Dividend	x			x
<i>Less qualifying interest*</i>	(x)	(x)		
Net Income	x	x	x	x
Less: Personal Allowance	(x)	(x)		
Taxable Income	x	x	x	x

Income tax due (calculation)

Non savings income	x @ 20%	x
	x @ 40%	x
	x @ 45%	x
Savings	x (starting rate) @ 0%	x
	PSA £1,000 or 500 @ 0%	x
	x @ 20%	x
	x @ 40%	x
	x @ 45%	x
Dividend	DA £2,000 @ 0%	x
	x @ 8.75%	x
	x @ 33.75%	x
	x @ 39.35%	x
	Tax Liability:	x
Less Tax deducted at source		
PAYE suffered		(x)
Tax deducted on savings		(x)
Total tax due		x/(x)

Tutor note: No matter how small or simple a calculation may seem you should always stick to this format to avoid mistakes. The template also helps you create good habits.

*Qualifying interest is outside of the syllabus however this covers for example interest suffered on qualifying loans to buy into a partnership, buy plant and machinery for own partnerships and employment or buy shares in a close company.

Always calculate tax by rounding down to 2 decimal places.
In the following examples, we have not shown the 2 d.p. where there were no pence, in the exam if it is a round number, please show it as £XXX.00

Changes in the utilisation of Personal Allowance

Before the 2017/18 tax year the personal allowance was deducted from net income to arrive at the taxable income in the strict order of non-savings income first, then savings income, and lastly from dividend income.

The Income Tax Act 2007 section 25 says: '...deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax'.

For taxation, the order to calculate income tax did not change, and is still in the same strict order. However, the order which we can set off the allowances, namely, the Personal Allowance (PA), has now changed, and can be used alongside the Personal Savings Allowance (PSA) and the Dividend Allowance (DA) to reach the 'greatest reduction in the taxpayer's liability to income tax'.

This means that in some cases it will be more advantageous to set off the PA against the dividend income rather than the non-savings income. We will consider this through examples.

Let us now work through different scenarios reflecting the various situations that can arise.

Tutor note: It does not matter how simple a question looks; you should always use the suggested format on the previous page to avoid pitfalls of the income tax computation. Please go to the Workbook at the end of the practice material so that you may practice further tasks on each topic. Those who learn by doing should do this at the end of each topic.

WORKED EXAMPLES – UK Tax calculations

EXAMPLE 1 – basic calculation

A taxpayer with basic Personal Allowance (PA) has £78,000 trading income.

Task: Calculate the income tax payable.

	Total	Non savings
Trading income	78,000	78,000
Net Income	78,000	78,000
Less: Personal Allowance	(12,570)	(12,570)
Taxable Income	65,430	65,430
Income tax due (calculation)		
Non savings income	37,700 @20%	7,540
	65,430 - 37,700 @40%	11,092
	Tax Liability:	18,632
Total tax due		18,632

The total income is £78,000, therefore we do not have to consider restriction on the PA as their income is below £100,000.