

## Introduction

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Income tax is a tax on income. If something is not income, it cannot be charged to income tax, although it may be liable to some other tax. It is possible that it could be not taxable at all. The Acts of Parliament that charge income tax do not contain a general definition of income. The courts, when they have been called upon to interpret tax legislation, have developed the principle that in order for something to be income it must have a source. Justice Rowlatt considered that income was 'something which is in the nature of interest or fruit as opposed to principal or tree'.

So, for example, the source of interest may be a bank or other investment account, the sources of earnings may be an employment, office, self-employment or partnership and the source of rental income will be land or property.

- Identification of the source is important in order to establish how income is taxed, as there are different rules for taxing different types of income.
- If no source can be identified then, unless the item is specifically deemed to be income by statute, it will not be taxable.

For example, a court has held that a punter is not taxable on gambling winnings as gambling is not sufficiently organised to be a trade, nor does it have any other source that is liable to income tax.

This section outlines:

- The different sources of taxable income and the rules for determining the amount of taxable income or profits from each source.
- How an individual's total income is taxed.
- The various tax allowances and deductions and the ways in which tax relief is given for them.
- How tax is paid.
- Some basic tax planning.

Income tax is charged for each tax year. A tax year runs from 6 April to the following 5 April.

In April 2005 the Inland Revenue merged with HM Customs and Excise to form HM Revenue and Customs (HMRC), which is now in charge of administering income tax as well as value added tax (VAT) and customs duties. Some tax forms and publications still refer to the Inland Revenue.

All the tax rules are stated as they apply to individuals who are resident and domiciled in the UK.

This section can only give an overview of this huge subject. More details of many of the areas mentioned can be found in the sections devoted to specific aspects of taxation.

## Types of income

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Different types of income have their own rules for calculating the amount of income that is taxable. The main categories of income for this purpose are:

- Income from land and buildings.
- Employment and pension income.
- Income from trades, professions and vocations (self-employment and partnerships).

- Savings and investment income, including dividends and interest.
- Miscellaneous income that does not fall within any of the above categories.

## Land and buildings

Profits from letting land and buildings are calculated by using ordinary accounting principles.

- Income from all land and properties is added together, regardless of the type of lease and whether the property is furnished or unfurnished.
- As well as rents, property income includes:
  - A proportion of any premium received from a lessee for a lease of less than 50 years. The rest of the premium is liable to capital gains tax (CGT). The proportions liable to each tax depend on the length of the lease: the shorter the lease, the greater the proportion of any premium that is taxed as income.
  - Payments for the use of furniture in a let property and for providing services to tenants.
  - Other payments to occupy or use land or to use any rights over the land, including car parking and filming rights.
- Expenses for all properties are added together and deducted from the total income from all properties. The expenses must be incurred by the person who is taxable on the rents and be of a revenue, not a capital, nature. For example, one cannot deduct the costs of altering or improving a property or of bringing it into a fit state for letting, as these costs are capital expenditure. Examples of deductible expenses are:
  - Repairs and maintenance.
  - Rent, rates, council tax, insurance and the cost of any services.
  - Managing agents' fees and the costs of rent collection and advertising for tenants.
  - Reasonable costs of travelling to the property in order to look after it or manage the lettings. If the property is far from the landlord's home, the full cost of visiting the property is unlikely to be deductible.
  - Interest on a loan to buy the property or to fund expenditure on it.
- Small amounts of income from letting part or all of an individual's only or main residence are not taxable. The limit is £4,250 a year, divisible equally between all the owners of the home.
- Profits must be calculated for a tax year (ending on 5 April). However, in practice accounts to 31 March are normally acceptable.

## Capital expenditure

Although capital expenditure is not deductible, some allowances are available. The allowances are deducted in calculating the net amount of income that is taxable.

If the property is furnished, a wear and tear allowance can be claimed to cover the cost of replacing furniture. The allowance is a standard 10% of the rent less any tenant's expenses that the landlord pays, such as council tax and water rates.

- Instead of wear and tear allowance, the landlord can deduct the actual cost of renewing furniture and equipment, but not the initial cost of buying furniture that does not replace an existing item.
- If the letting is not residential, capital allowances are available for the cost of any equipment installed in the let property. For expenditure from 6 April 2008 up to £50,000

a year of expenditure on equipment is deductible in full against profits – the Annual Investment Allowance (AIA).

- Temporarily businesses incurring expenditure in excess of the AIA cap can claim a 40% first year allowance (FYA) instead of the writing down allowance (WDA). This is for the 12-month period beginning on 6 April 2009. The 100% allowance for designated energy-saving or environmentally beneficial plant or machinery (see below) continues alongside the temporary FYA.
- An annual WDA of 20% can be claimed on any balance of expenditure on equipment brought forward from previous years.
  - The rate is 10% instead of 20% if the equipment is an integral feature of the building, for example, electrical and water systems.
  - The balance brought forward is basically the original cost less the allowances previously given.
  - Balances brought forward of £1,000 or less can be deducted in full.
- In addition to the £50,000 AIA, expenditure on energy- or water-saving equipment qualifies for a 100% FYA.
- Capital allowances, as above, are also available for equipment that the landlord uses in managing the lettings, whether they are residential or non-residential, for example, a computer on which accounts are maintained or a car used to travel to the property.
  - If the asset is also used for other purposes, capital allowances are restricted by reference to the proportion of business use.
  - Cars do not qualify for the AIA, so, for cars with carbon dioxide (CO<sub>2</sub>) emissions of 160g/km or less, only 20% of the cost can be claimed in the year of purchase, and 20% of the balance brought forward in subsequent years. For cars with CO<sub>2</sub> emissions above 160g/km bought after 5 April 2009 the rate is 10%.
- A 100% flat conversion allowance is given on the cost of converting or renovating qualifying flats above business premises.

If capital allowances, including flat conversion allowances, are more than the net income less revenue expenses, the excess capital allowances can be deducted from the individual's other income (see page 11, "Deductions from income"). Excess wear and tear and renewals allowances cannot be deducted from other income.

## **Losses**

If an individual makes a loss on letting property, the loss is carried forward and set against property income in future years. It cannot be set against other income.

Losses must be used as soon as there is income to set them against, even if that income would not give rise to tax because the individual has other tax allowances to deduct. They cannot be saved up and used later.

## **Furnished holiday lettings**

Income from short-term lettings is treated more advantageously if the lettings satisfy certain rules.

The main condition is that the property should be available for letting for at least 140 days in the year and should actually be let for at least 70 of these days. Individual lettings must not be longer than 31 days for seven months of the year, including during the 70-day qualifying period.

The main income tax advantages of qualifying as furnished holiday lettings are:

- The income is net relevant earnings for pension purposes (see page 11, “Deductions from income” and page 1, “Income Tax Basics: income tax calculation”).
- Any losses can be deducted from other income.

There are also CGT advantages.

The 2009 Budget announced the abolition of the special rules for furnished holiday lettings from 6 April 2010.

## **Employment income**

Income received from an employment or the exercise of an office is taxable under the Income Tax (Earnings and Pensions) Act 2003.

Income from an office includes remuneration for acting as a company secretary or director. Such office-holders are not necessarily employees, but their income is taxable under the same rules as employment earnings.

### **Employed or self-employed**

Sometimes it is not clear whether an individual is an employee or self-employed.

Many disputes over employment status have gone to court over the years, and HMRC and others have published extensive guidance on the distinction between a contract of service (employment) and a contract for services (self-employment).

Generally, no single factor is conclusive but relevant matters include:

- Whether the worker can be said to be ‘in business’, taking business risks and able to profit from working more efficiently.
- The degree of control that the ‘employer’ exercises over the worker. High control is indicative of employment.
- Whether the worker can sub-contract the work to another person (indicative of self-employment) or must carry out the services personally (employment).
- Whether the worker works wholly or mainly for one employer.

### **What payments are taxable?**

Taxable employment income includes not only regular salary but also other cash payments, such as bonuses and sick pay, most lump sum payments to employees and the value of most benefits in kind.

- Some payments made on the termination of an employment are taxable in full; others are only taxable to the extent that they exceed £30,000. Payments in lieu of notice are generally taxable if the employment contract provides for them, or if the employee has a legal right to them or sometimes if they are an expectation in the circumstances.
- Statutory redundancy payments and any other payments an employer makes by reason of redundancy are tax-free up to £30,000.
- Damages for breach of the employment contract are tax-free up to £30,000. This could include a compensation payment where the employer did not give the employee proper notice and there was no entitlement to make payment in lieu of notice. The payment in lieu is then damages for the breach of contract. Payments for unfair dismissal are also tax-free up to £30,000.

- Payments in exchange for the employee giving a restrictive covenant, for example, not to work for a competitor, are fully taxable.
- If an employer pays a lump sum to an employee who is retiring, or is of retirement age, the tax liability depends on a number of factors and professional advice should be taken.
- If an employee receives more than one payment of which the first £30,000 is tax-free, the payments must be added together and a single £30,000 exemption deducted from the total.
- Lump sum payments when an employee takes up an employment are almost always taxable in full. This would include the employer paying off a student loan. Payments made in order to retain an employee are also taxable in full.
- Employees are sometimes allowed to acquire shares in their employer company on favourable terms. If the shares are acquired under an approved share scheme or share option scheme, there is generally no income tax charge. In other circumstances, employees who pay less than the market price for shares are generally taxed on the discount.
  - Income tax is payable at the time the employee acquires shares at a discount, whether or not the employee sells them immediately.
  - Employees may have to sell some of the shares in order to pay the tax.
  - There is no income tax when an employee is granted an option to acquire shares, whatever its terms. Income tax is charged only when the option is exercised (if shares are thereby bought at below their market value at the time of the exercise) or if the employee receives a payment for releasing the option or for any other reason associated with the option.
  - Special rules apply to shares in 'spin out' companies associated with research bodies, such as universities.
- Benefits in kind are subject to a large number of special rules for determining the amount on which the employee has to pay tax, depending on the nature of the benefit and whether an employee is a 'P11D employee'.
  - P11D employees include almost all directors and anyone else earning at a rate of £8,500 a year or more.
  - The figure of £8,500 must include the value of benefits and expenses.
  - P11D employees, but not other employees, are taxed on the cash equivalent of an asset being made available for their private use, for example, a company car.
  - How the cash equivalent is measured depends on the asset.
  - Some benefits are tax-free for all employees, for example, a staff canteen, employer-subsidised buses to work, employer's contributions to registered pension schemes, one mobile telephone for an employee, parking spaces, use of bicycles and some sports facilities.
  - Some benefits are taxable on all employees, not just P11D employees. The most important example is the provision by the employer of living accommodation (subject to some exceptions).

Further details on the taxation of benefits and expenses can be found on page 1, "Taxation of benefits in kind".

## How employment income is taxed

Employment income is taxable in the tax year in which it is received.

All cash payments, other than reimbursement of business expenses, and some non-cash payments are taxed under the PAYE system.

- The employer has to deduct tax under PAYE when the employee is entitled to receive payment.

In the case of a director, 'payment' includes a sum being made available to the director to draw upon, even if the director does not actually take the money out of the company.

- Every employee has a PAYE tax code. The tax code, used in conjunction with tax tables, is designed to ensure that the right amount of tax is deducted from the pay of most employees.

### Example

An employee below pension age, who has no benefits in kind, might have the PAYE code 647L at the start of 2009/10. This code, used in conjunction with the tax tables, will ensure that the employee is given the basic personal allowance (£6,475) and the basic rate tax band.

- The personal allowance and basic rate band are spread equally through the year, so that monthly paid employees are given one-twelfth of the allowance and tax band against each month's pay. Employees who do not work for the whole year might end up paying too much tax.
- If a tax code is increased during the year, the employee's tax is reduced to give effect to the extra personal allowance for each month (or week for weekly paid employees) before the increase is made.
- Employees who have little other income do not usually have to complete a tax return. Directors and those who have more complex tax affairs or substantial other income normally have to complete annual tax returns under the self-assessment system.
- Benefits in kind are not taxed under PAYE as such, but tax on them can be collected through PAYE by means of a deduction from the employee's tax code.
- National insurance is also collected through the PAYE system.
- Payments in the form of a 'readily convertible asset' must be taxed through PAYE. A readily convertible asset is one that the employee can easily turn into cash, for example, quoted shares and other investments that can be traded, or for which arrangements exist to enable the employee to sell them. The rules extend to several other kinds of asset that have in the past been used to try and circumvent the PAYE rules.
- Payments that involve the employer meeting a liability of an employee, such as paying an employee's own credit card bills, come under PAYE.

## Expenses

Some expenses can be deducted from employment income, but the rules are very restrictive.

Employers generally reimburse any expenses that an employee incurs in the course of carrying out employment duties. The employee will therefore usually have no net cost to claim against income.

- An employee can deduct any costs incurred in travelling for business purposes on behalf of their employer. The cost of travelling to a regular place of work is not deductible, and there are rules to determine what is a regular place of work, in borderline cases.

There is no net deduction where the employer reimburses the full cost.

- Employees who use their own cars, motorbikes or bicycles for business travel can deduct any shortfall between the mileage rate the employer pays and the appropriate statutory mileage rate.

#### **Example**

The statutory mileage rate for business travel by car is 40p a mile for the first 10,000 miles in the year, so if the employer only pays 35p and the employee does not do more than 10,000 miles, the employee can claim tax relief for 5p a mile.

If the employee is paid more than the statutory mileage rate, the difference is taxable.

- Most other expenses are only deductible if the employee can show that they incurred them wholly, exclusively and necessarily in the course of performing the duties of the employment.

This is a very strict test, and most expenses fail to qualify.

#### **Example**

Employees working at home might not be able to claim tax relief for the extra cost of heating and lighting, unless working at home is a requirement of the job rather than an option.

- There is a small concession for employees in homeworking schemes: they are not taxed on any reimbursement they receive from their employer of reasonable costs of working at home. But they still cannot claim any tax relief for costs that the employer does not reimburse.

## **Pensions**

Pensions from statutory pension schemes and pension arrangements registered by HMRC are taxable in the same way as employment income, and there are no deductions for expenses.

Lump sum payments from such schemes are generally not taxable.

## **Income from trades, professions and vocations**

Income tax is charged on the profits earned in an accounting period. Trades, professions and vocations are taxable under very similar rules. In the rest of this subsection 'trade' should be taken to include professions and vocations.

Profits are calculated by using ordinary accounting principles. Accounts must be drawn up on an accruals basis. This means:

- Income and expenses must be included in the accounts for the period in which the date of the invoice falls, rather than when the income is received or the expense is paid.
- Stock held at the year end and work-in-progress must be accounted for. Where service contracts are performed over a period, work-in-progress must now generally be included in the accounts at full billable value of the work done at the accounting date rather than at cost, as previously.

Accounts can be drawn up to any date in the year. Accounting periods are normally 12 months, but a shorter or longer accounting period can occur at the start or end of trading and when a trader makes a permanent change to their accounting date.

Most revenue expenses are deductible if they are incurred wholly and exclusively for the purposes of the trade. Loan and overdraft interest are generally deductible.

The costs of entertaining and gifts are not deductible.

Private expenditure is not deductible. Examples are ordinary clothing such as business suits and the trader's meals, except in conjunction with travel requiring overnight absence.

Depreciation is not deductible. Instead, capital allowances are given for purchases of equipment for the business. These allowances are given as a deduction in calculating taxable profits.

- All businesses may claim a 100% allowance (the AIA) for up to £50,000 spent on qualifying plant and machinery in an accounting period.
- Businesses incurring expenditure in excess of this AIA cap can claim a 40% first year allowance (FYA) for such expenditure in the 12-month period that began on 6 April 2009.
- Some assets are placed in an expenditure pool at cost price, on which writing down allowances (WDAs) are calculated each year. When a pooled asset is sold, the proceeds are normally deducted from the pool balance. If the proceeds are greater than the pool balance, the excess is treated as a balancing charge and is added to the profits for the relevant year. An asset that qualifies for an FYA is only pooled after the first year.
- A reduced rate of WDA of 10% applies to certain expenditure including long-life assets, integral features and thermal insulation.
- When the balance in the 10% or 20% pool falls to £1,000 or less, the full amount may be written off in accounting periods commencing from April 2008.
- A 100% FYA is available for new cars bought and first registered after 5 April 2009 that have CO<sub>2</sub> emissions of up to 110 grams per kilometre (g/km).
- There is no AIA or FYA available for other cars. Cars purchased from 6 April 2009 are assigned to the 20% or 10% pool. Cars with CO<sub>2</sub> emissions not exceeding 160g/km purchased from 6 April attract 20% WDAs. Other cars only qualify for 10% WDAs.
- Capital allowances are restricted where an asset is also used privately.

### **Basis of assessment**

A self-employed individual is normally taxed or assessed on the profits of the accounting period ending in the tax year. For example, a person who draws up accounts for the 12 months to 30 June 2009 is taxable on the profits of those accounts in the tax year 2009/10.

The rules are modified when a person starts and ends self-employment.

- In the tax year in which self-employment starts, the individual is taxed on the profits earned in that tax year. For example, an individual who starts a business on 1 January 2010 will be taxed in 2009/10 on the profits from 1 January to 5 April 2010. If the accounts are drawn up to a later date, then they must be apportioned on a time basis.
- The second year's assessment is normally on:
  - The profits of the 12 months ending on the chosen accounting date in that tax year.
  - The profits of the first 12 months of trading where the accounting date is less than 12 months after the start of the business.
  - The profits of the tax year itself, where there is no accounting date ending in that year. This can occur if the business starts near the end of a tax year and has a long first accounting period, such as 1 March 2010 to 30 April 2011.
- The taxable profits in the final year of self-employment are those of the whole period since the end of the accounting period that was taxed in the previous tax year. This period could be nearly two years. For example, if an individual draws up accounts to 30 April each year and ceases self-employment on 31 March 2010, the assessment for 2008/09 will be on the profits for the year ending on 30 April 2008 and the assessment for 2009/10 will be on the profits for the period from 1 May 2008 to 31 March 2010.
- The rules for the first two years can result in some profits being taxed in both years. These are known as overlap profits. Relief for this double taxation is normally given against the assessment for the tax year in which the business ends.

### **Trading losses**

If a trader makes a loss in an accounting period, the assessment for the tax year in which that accounting period ends will be nil.

The loss can be carried forward and must then be deducted from subsequent trading profits as soon as such profits arise.

Alternatively, a trading loss can generally be deducted from other income of the tax year in which the accounting period of loss ends or from income of the previous tax year.

A temporary extension to this relief allows losses to be carried back up to three years. Only losses of the tax years 2008/09 and 2009/10 can be carried back more than one tax year. The amount of losses that can be carried back to the immediately preceding year is unlimited. After carry back to that year, a maximum of £50,000 of any unused losses for each of 2008/09 and 2009/10 is available for carry back to the earlier two years.

There are special rules for calculating the losses that can be deducted from other income where the loss occurs in the opening years of the trade. They ensure that the rules that may give rise to double taxation of profits, as explained above, do not also produce double tax relief for losses.

There is also provision for:

- Losses in the first four tax years of the trade to be carried back and deducted from income of the three previous tax years.
- Losses in the final 12 months of trading to be carried back and deducted from income of up to three tax years before the year of cessation.

## **Savings and investment income**

Savings and investment income includes:

- Bank and building society interest.
- Dividends from UK and overseas companies.
- Interest from fixed interest unit trusts.
- Interest from government securities (gilts) and corporate bonds.
- The interest content of purchased life annuities.

The full amount of income is taxable without any deductions for expenses. Interest is taxable in the year in which it is received or credited to an account.

Most savings income arising in the UK, though not dividends, has tax deducted at 20%, so that the recipient receives 80% of the gross income. However, in some cases interest is normally paid without tax deducted, ie it is paid gross, namely:

- On certain deposits of £50,000 or more.
- Where the recipient is not resident in the UK.
- Where the recipient is not liable to tax and has requested gross payment, for example, if their income is less than the personal allowance.
- On government securities (unless the recipient asks to have tax deducted) and on many National Savings and Investments products.

Dividends from UK companies, UK investment trusts, most unit trusts and open-ended investment companies (OEICs) come with a tax credit equal to one-ninth of the dividend payment. This is equivalent to 10% of the dividend plus the tax credit. The tax credit on UK dividends cannot be reclaimed should it exceed the income tax owed for the year.

The dividend and tax credit together form the gross taxable dividend income. Dividends are taxed in the tax year in which they arise.

Since 6 April 2008 UK residents who hold a less than 10% shareholding in a non-UK company have also been entitled to a non-repayable tax credit of one-ninth of the dividend.

- Nationals of the European Economic Area (the EU states plus Norway, Iceland and Liechtenstein) are likewise entitled.
- From 22 April 2009 almost overseas dividends carry a tax credit.

Income payments from unit trusts and OEICs that hold over 60% of their assets in fixed interest securities and/or cash are treated as interest, with a reclaimable 20% tax deduction.

## **Other income**

There are all sorts of other receipts of income that do not fall within the main categories but are nevertheless taxable.

Examples are:

- Payments of commission where the recipient is not carrying on a trade or profession of which they would be income.
- Payments for services provided otherwise than in the course of a trade, profession or employment.

- Gains on some offshore life insurance policies.
- Beneficiaries' income from estates in administration.
- Income taxed under various provisions against tax avoidance, for example, the pre-owned assets tax that targets inheritance tax (IHT) avoidance.

In general the type of income referred to in this section is taxable in the tax year in which it arises, no deductions being allowed.

## Taxable income

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After calculating the taxable income from each source in the tax year, one must:

- Add all the different amounts of income together, giving total income.
- Deduct those amounts for which tax relief is given by deduction from income.
- Deduct personal allowances.

Some tax reliefs are not given as a deduction from total income but in the course of calculating the tax. These are covered on page 1, "Income Tax Basics: income tax calculation".

## Deductions from income

The main deductions from total income are:

- Trading losses where a claim is made to set them against other income.
- Capital allowances to the extent that they exceed letting income. These will generally be for flat conversion allowances.

Eligibility for these allowances is covered in "Land and buildings" on page 2.

- Qualifying interest payments (see below).
- Contributions to former retirement annuity plans where the provider does not operate tax relief at source (see below).
- Gifts to charities of land, buildings, shares and securities. The value of the donated asset is deducted.
  - Shares or securities must be listed or dealt in on a recognised stock exchange, including the Alternative Investment Market (AIM), or investments in authorised unit trusts or OEICs, or holdings in foreign collective investment schemes.
  - Land and buildings must be in the UK and may be freehold or leasehold.

## Qualifying interest payments

Interest can be deducted from income if the loan is taken out for a qualifying purpose. It is the purpose of the loan that is important, not the asset on which it is secured.

The main qualifying purposes are:

- Purchase of shares in a close company or to finance loans to a close company.

- Broadly a company is 'close' if it is controlled by five or fewer shareholders, or by its directors regardless of their number.
- The borrower must own more than 5% of the shares, or must work for the greater part of their time in the management of the company's business, or both.
- Tax relief is not given for interest if the loan is used to buy shares on which enterprise investment scheme (EIS) relief is claimed (see page 1, "Income Tax Basics: income tax calculation").
- Buying an interest in, or making a loan to, a partnership. The borrower must be a partner.
- To buy plant and machinery for use in a business. But interest relief is not available to an employee on a loan to buy a car.
- Payment of IHT.
  - Tax relief is given only for interest paid in the year following the making of the loan.
  - The borrower must be a personal representative of the deceased.

Interest on loans to buy let property is deductible directly from letting income. Similarly, interest on money that a trader borrows for use in a trade is a trading deduction.

### **Pension contributions**

Most individuals aged below 75 can make single or regular tax-relievable contributions into a personal pension.

It is not necessary to have relevant UK earnings (broadly income from employment or self-employment).

- Any individual under age 75 who has relevant UK earnings in the year can contribute to a personal pension.
- The maximum amount on which an individual can claim tax relief in any tax year is the greater of £3,600 and the amount of the individual's relevant UK earnings that are chargeable to income tax for the tax year.
- Individuals who have no relevant UK earnings can contribute up to £3,600 gross to a registered personal pension, subject to a residence condition. Relief can only be given if the pension scheme operates tax relief at source.
- There is a lifetime allowance on an individual's tax-exempt pension fund of £1.75 million in 2009/10.
- There is also an annual allowance on the increase in an individual's tax-relieved pension savings of £245,000 in 2009/10. A 40% tax charge on any excess is levied on the individual, although this will not normally apply in the year when benefits are drawn.
- The annual allowance of £245,000 and the lifetime allowance of £1.75 million will rise to £255,000 and £1.8 million respectively in 2010/11 and then stay at those levels for a further five years.

Tax relief for pension payments is given in three ways.

- An employee's payments to the employer's registered occupational pension plan are normally deducted from pay before calculating tax, and so the employee does not have to claim tax relief on them.

Rarely, an employee might make payments that exceed earnings from that employment for the year. Tax relief for the excess is given by deduction from total income.

- Most payments to personal pension schemes are paid net of 20% tax. This gives basic rate tax relief at source. Any higher rate tax relief due is given in the course of calculating the tax. This is explained in "Income Tax Basics: income tax calculation".
- Most providers of former retirement annuity contracts do not operate tax relief at source, and contributions to them are deducted in arriving at total income. Retirement annuity contracts were pension plans that started before 1 July 1988. They are now generally subject to the same rules as personal pensions.

## **Personal allowances**

All UK residents and certain non-residents are entitled to deduct the basic personal allowance from their income, regardless of age.

For 2009/10, the allowance is £6,475.

The 2009 Budget announced that the basic personal allowance would be gradually reduced to nil for individuals with 'adjusted net income' (broadly total income less certain deductions) over £100,000. The allowance will be reduced by £1 for each £2 of income over £100,000.

## **Age allowances**

The personal allowance is increased for taxpayers who are 65 or over at any point in the tax year, subject to an income limit.

For 2009/10, the allowances are:

- Age 65 to 74: £9,490.
- Age 75 and over: £9,640.
- The portions of these allowances in excess of the basic allowance are reduced by £1 for every £2 of total income over £22,900 in 2009/10.
- Total income has a modified meaning for this calculation. It is income from all sources less:
  - The deductions listed on page 11.
  - The gross amount of any donations to charity under gift aid. The payment to the charity will be the gross donation less 20% basic rate tax, but it is the full gross amount that is deducted here.
  - The gross amount of any pension payments where relief at source is given. The payment into the pension plan is the gross amount less 20% basic rate tax.
- The result of this calculation is that a 65-year-old will receive only the basic personal allowance if total income is £28,930 or more.
- For a 75-year-old the personal allowance is reduced to the basic £6,475 once total income is £29,230 or more.
- The withdrawal of the age allowances is equivalent to an effective tax rate of 1.5 times the normal rate on income in the withdrawal band.

## **Blind person's allowance**

Registered blind people are entitled to deduct an allowance of £1,890 (2009/10) in addition to their personal allowance.

## **Married couple's and civil partners' allowances**

Allowances for married couples and civil partners (where at least one partner was born before 6 April 1935) are given in the course of calculating the tax (see page 1, "Income Tax Basics: income tax calculation").

*This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at September 2009, which are subject to change.*