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Tax Answers at a Glance

2009/2010
TAX YEAR

H.M.Williams Chartered Accountants
Best UK Tax Team Winner

This is an excerpt from Lawpack's book *Tax Answers at a Glance*.

To find out the latest ways to avoid tax and get tax-saving insider tips on how you can pay less tax this financial year, [click here](#).

Tax Answers at a Glance

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For convenience (and for no other reason) 'him', 'he' and 'his' have been used throughout and should be read to include 'her', 'she' and 'her'.

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CHAPTER 2

Income Tax

What is Income Tax and what do we pay it on?

It may sound strange, but Income Tax is actually a temporary annual tax that the Government decides to keep going by means of an annual Finance Bill. It was introduced in 1799 as a means of financing the Napoleonic Wars, but even though those wars are well past, Income Tax still seems to be with us.

Income Tax used to be divided into schedules, but it now comes under headings and these are:

- Trade profits (including all business profits)
- Property income
- Savings and investment income
- Miscellaneous income (covers income not falling under the other headings)
- Earnings and pension income (which includes taxable social security benefits)

It might be more relevant if we now look at what income is not taxed (i.e. what is tax free):

- Adoption Allowances
- Adult Placement Carers' Income
- Annuities from gallantry awards
- Attendance Allowance
- Bereavement Payments
- Betting, lottery and pools winnings, and raffle prizes
- Car parking benefits
- Child Benefit
- Child dependency additions
- Child Tax Credit
- Child Trust Funds
- Christmas bonuses paid by the state to pensioners
- Compensation for loss of employment of up to £30,000 (professional advice must be sought)
- Compensation for mis-sold personal pensions
- Council Tax Benefit
- Damages and compensation for personal injury, including interest
- Disability Living Allowance
- Educational Maintenance Allowance
- Foster Care Income
- Gifts for employees from third parties if they are under £250 a year
- Gratuities and bounties from the armed forces
- Guardian's Allowance
- Home improvement, repair and insulation grants
- Housing Benefit
- Incapacity Benefit (short-term – lower rate) for first 28 weeks
- Incentives for electronic communications
- Income Support
- Individual Savings Accounts (ISAs)
- Industrial injury benefits
- Insurance bond withdrawals of up to five per cent per year (this can be complicated and professional advice should be sought)
- Insurance policy payments (mortgage payment protection, permanent health, etc.)
- Interest from National Savings Certificates
- Interest on overpaid tax
- Interest on Tax Reserve Certificates
- Invalidity pensions

- Jobfinder's Grant
- Life assurance policy bonuses and profits
- Long-service awards of up to £50 for each year of service (for employees)
- Lump sums from an approved pension scheme
- Luncheon vouchers of up to 15p per day but cash would be taxable – this sum hasn't changed for 40 years!
- Maintenance or alimony payments
- Maternity Allowance
- Miners' Coal Allowance
- National Savings Bank interest of up to £70 per person on ordinary accounts. These accounts are no longer available but the exemption applies to existing account holders
- National Savings Certificates' increase in value
- Pension Credit
- Pensions from Austria or Germany to victims of Nazi persecution
- Personal equity plans (PEPs)
- Premium bond prizes
- Provident benefits paid by a trade union of up to £4,000 for lump-sum payments
- Purchased life annuities – capital element only
- Rent-a-room relief up to £4,250 a year
- Save As You Earn Schemes (SAYE) bonuses and interest
- Scholarship income and bursaries
- Severe Disablement Allowances
- Share option profits made under an SAYE option scheme – Capital Gains Tax may be payable
- Shares awarded under an approved Share Incentive Plan (professional advice must be sought)
- Social fund payments
- Statutory Redundancy Pay
- Strike and unemployment pay from a trade union
- Student Grants
- Suggestion scheme awards
- Training allowances for reserve forces
- Travel to work on a works bus
- TV licence payment
- Vaccine damage payment

- Venture Capital Trust dividends
- War Disablement Benefits
- War Widows' Pension
- Winter fuel payments
- Woodlands income
- Working Tax Credit

What is an annual Income Tax Return?

This is a form issued each year to about nine million taxpayers, the purpose of which is for them to list their income and tax relievable expenses and, if they wish to do it themselves, calculate the overall tax due and the dates by which it should be paid. It can now be completed and submitted online.

Some taxpayers (mostly employees and pensioners) are now being issued with a shorter, simpler Tax Return. The taxpayer won't need to calculate their own liability, even if the Tax Return is submitted to HM Revenue & Customs (HMRC) after 30 September.

Paper Tax Returns must be filed by 31 October or you will face a £100 penalty. Returns filed online must reach the Tax Office by 31 January.

How do I know if I have to fill out a Tax Return and how do I get hold of one?

Generally speaking, you will have to complete a Tax Return if you:

- are self-employed;
- are in partnership;
- are in receipt of income from land and property;
- are a director;
- incur taxable capital gains;
- are sent one (if HMRC issues a Tax Return, it has to be completed by the taxpayer).

If you are in any doubt, you should contact your local Tax Office, advise it of your circumstances, and get HMRC to confirm whether you should fill out a Tax Return.

If you need to get hold of a Tax Return, then you should contact the local Tax Office and ask it to send you one (better still, visit the offices).

A checklist of what to keep for your Tax Return is provided at Appendix 2.

What are Child Tax Credits and Working Tax Credits?

Warning: the whole subject of tax credits is extremely complicated. We have done our best to reduce it to its simplest elements but reading the following section needs a clear head.

Working Tax Credit (WTC) is for those with low incomes. It's a means-tested payment to top up the earnings of those in work. The qualifying conditions are as follows:

- You must work at least 16 hours a week if you have children or a disability, or are aged 50 plus and returning to work after a period on certain benefits.
- If you don't have children or a disability, you must be over 25 and working at least 30 hours a week.

Your total entitlement is calculated by adding together the basic element and any additional elements to which you are entitled.

WTC is paid directly to the person who is working 16 or more hours a week. Couples where both work 16 hours or more a week may choose which of them will receive it.

Child Tax Credits are paid directly to the main carer of the child or children. It's designed to combine the child support elements of the old Working Family Tax Credits, Income Support, Jobseeker's Allowance and Children's Tax Credit.

CTC can be claimed by families with at least one child, with an annual family income of up to £58,000. It provides support for:

- children until 1 September after their 16th birthday;
- children aged 16 to 19 who are in full-time 'non-advanced' education (i.e. studying for at least 12 hours a week and the course leads to A level, NVQ level 3, or below) and also those receiving approved training under unwaged work-based training programmes;
- children aged 16 to 19 who have left full-time education but don't have a job or training place and have registered with the Careers Service or Connexions Service, and are not claiming Income Support or tax credits in their own right.

What if my circumstances change?

You **must** tell the Tax Credit Office if:

- you marry or live with someone as a couple;
- you separate;
- you stop paying for childcare for at least four weeks, or childcare costs reduce by £10 a week for at least four weeks in a row.

You should tell it about the birth of a new child or when a child leaves full-time education. You should also tell it if your hours change to less than 16 a week or more than 29 hours a week. It's advisable to notify the Tax Office if your income increases by £25,000. A decrease in income should also be reported. These changes are important as any increase in tax credits will only be backdated for up to three months whereas any decrease will be backdated to the date of the change.

If you have not made a claim for Tax Credits before because your income was above £58,000, it may be worth making a protective claim. In the current economic climate, the employed are losing their jobs or being put onto shorter hours and the self-employed could see their profits decline sharply. As your Tax Credit claim can only be backdated 3 months, whilst making a protective claim for the year yields no benefit in the short term, it will entitle you to a full year's claim if your circumstances change for the worse.

What next?

HMRC will be renewing awards for the year ending 5 April 2010 and finalising new awards for the year ending 5 April 2009.

Credits for the year ending 5 April 2010 will be based on income for the year ending 5 April 2009. The following should be noted:

- If requested, details of income and circumstances should be submitted by 31 July 2009.
- The details you provide should relate to the period of the claim, which may not necessarily coincide with the tax year; for instance, if you had a baby during the year.

If you only receive the family element of CTC, you won't be asked to provide details of income and your claim will carry on as before. However, if your circumstances have changed, you must notify the Tax Credit Office. Remember, any increases in credits are only backdated for three months.

You can request a claim form by telephoning 0845 300 3900 or you can apply online at www.hmrc.gov.uk.

What are Pension Credits?

If you are aged 60 or over you may be eligible for the Pension Guarantee Credit if your weekly income is less than £130 (single person) or £198.45 (couple).

If you are aged 65 or over you may be eligible for Pension Savings Credit if your weekly income is between £96 and £181 per week (single person) or between £153.40 and £266.00 (couple).

What counts as income?

State pension; occupational pension and private pensions; most Social Security benefits; net earnings from employment or self-employment less an allowance for half of any pension contributions made; and Working Tax Credits.

There is an ‘assumed income’ of £1 for every £500 (or part thereof) of capital you have over £6,000. From Autumn 2009 this is increasing to £10,000. If you live permanently in a Care Home, £10,000 of capital is already ignored.

More details are available from the Pension Service on 0800 99 1234.

How do I work out how much tax I have to pay and when to pay it?

If you have to complete a Tax Return, included in the package will be a tax calculation guide for you to follow. It’s not within the scope of this book to guide you through it (HMRC’s form does it pretty well for you), but the main thing to bear in mind is that if you get your Tax Return submitted by 30 September each year, HMRC will work out for you how much tax you have to pay and when you have to pay it.

In principle, you make two payments a year. On 31 January each year you will pay the balance of the previous year’s tax still owing plus one half of the previous year’s tax liability as a first payment on account for the following year.

On 31 July each year you will pay the second half of last year’s tax liability as a second payment on account. On 31 January following, you will find yourself paying any balance of tax that is due plus another payment on account based on this year’s total tax bill and so on.

If this all sounds very confusing, don’t worry, it is! The Government introduced self-assessment in 1997 with the intention that tax recording and calculations should be so simple that anybody could do it. If you ask most professional accountants nowadays, they would say that the current tax rules are so complicated they would find it very difficult to work out your tax liability if they didn’t have the services of a computer.

What self-assessment has done is remove a lot of the work that was previously done in Tax Offices and dump it either on the taxpayer’s own desk or, if the taxpayer is prepared to pay for it, in the offices of professional accountants, who now do the work that the Inspectors of Taxes formerly did.

In other words, self-assessment doesn't mean a simple calculation. It means 'It's up to you, mate, and don't blame us if we, HMRC, have made it difficult!'

What if my tax payments are late?

An interest charge is:

- automatic on late paid Income Tax, Class 4 National Insurance contributions and Capital Gains Tax;
- added to existing liabilities and treated as tax due and payable.

A surcharge applies to all amounts due in respect of the previous tax year on 31 January following the end of that tax year and not paid by 28 February. This is five per cent of the amount unpaid more than 28 days after the due date with a further five per cent of the amount unpaid more than six months after the due date. However, the taxpayer may appeal against a surcharge if they have a reasonable excuse.

What happens if I fail to complete a Tax Return on time?

If you are preparing a Tax Return, there is an automatic fixed £100 penalty (or 100 per cent of the unpaid tax if less) if your Tax Return is not filed by the statutory filing date, 31 January in the following year. There is a further fixed £100 penalty if the Return is not filed six months after the statutory filing date, i.e. following 31 July.

In addition, there are daily penalties (maximum £60 per day) which can be levied. Tax-g geared penalties may also be imposed where the tax is paid more than one month late.

What can I set against my tax bill?

There is no quick answer to this question because there is a whole range of deductions, allowances and reliefs that taxpayers can claim. In principle, everybody is entitled to a personal allowance (and there are a number of different types of personal allowance, including increased allowances for the elderly), but apart from that it all depends on your circumstances. The sorts of relief that we, as accountants, see our clients claiming and that we can claim on their behalf are as follows:

- Relief for losses in a business
- Relief for certain professional subscriptions and expenses
- Relief for personal pension contributions
- Relief for Gift Aid payments
- Relief for investments made under either the Venture Capital Trust or Enterprise Investment Schemes
- Blind Person's Allowance
- Relief for interest borrowed for certain purposes
- Business expenses
- Certain allowances against capital gains

We do advise you to read HMRC's guidance notes that come with your Tax Return carefully to be sure that you are claiming all of your relief, but it simply isn't possible to list them all in the space of a book that gives you quick and easy to comprehend answers.

What is the difference between earned and unearned income?

About 30 years ago it was better to be in receipt of earned income than unearned income because unearned income attracted investment income surcharge and there was a special earned income relief.

Nowadays it's better to be in receipt of unearned income because earned income (salaries, wages, benefits, etc.) is not only taxable but is also subject to National Insurance contributions.

The distinction between the two is not a key one nowadays, but one of the more obvious distinctions arises in the case of a director shareholder. If they are paid a salary, then both the company and the director must pay National Insurance contributions on that salary. The payment of £1,000 as earnings may result in about 40 per cent of that figure going to the Government. If that same person is paid a dividend out of taxed profits, no further tax will be due to the Government although, in due course, there will be tax payable by the director when it comes to completing the personal Tax Return, if they are a higher rate taxpayer.

Personal reliefs and allowances

The rates of the various personal reliefs and allowances for 2009/10 are as follows:

	£
Personal	6,475
Blind person's	1,890

Age	
Personal (age 65–74)	9,490
Married couple's (age 65–74) and born before 6 April 1935	*6,965
Personal (age 75 and over)	9,640
Married couple's (age 75 and over) and born before 6 April 1935	*6,965

* indicates allowances where tax relief is restricted to ten per cent

The income limit for age allowances is £22,900. The starting rate of 10% applies to the first £2,440, provided that non-savings income does not exceed this.

What tax relief can I claim against my payments of interest?

Opportunities to claim tax relief on payments of interest on loans are limited and are now restricted to the following:

- buying a share in a partnership or contributing capital to a partnership if you are a partner;
- buying shares in a close company (see page 120) or lending capital to it;
- buying plant and machinery for use in a job or partnership.

The interest paid (and not the capital) is deducted from your total income in the year of payment.

Can I get tax relief on my mortgage?

Unfortunately, since 5 April 2000, tax relief on mortgage interest payments has been withdrawn; this applies to both interest paid under MIRAS (mortgage interest relief at source) and otherwise. But see ‘What is the tax wheeze for buy-to-let investors?’ on page 92.

Is there a right time to get married for Income Tax purposes?

The Married Couple’s Allowance was withdrawn on 6 April 2000, except for those couples where either the husband or wife was aged 65 or more at 5 April 2000.

However, if you get married and you were over 65 on 5 April 2000 or your spouse was, you can claim 1/12th of the allowance for each month of the tax year concerned, starting with the month of marriage. So there is no ‘best time’ to get married for Income Tax purposes.

Is there a right time to get divorced or separated for Income Tax purposes?

For those who are still able to claim the Married Couple's Allowance, this is not reduced in the year when couples separate or in the year of death of either spouse. However, with it being so restricted as to its use, this matter is now of little consequence to parties when they divorce or separate.

What happens to someone's Income Tax affairs when they die?

When someone dies, they are entitled to their normal full year's worth of allowances. A Tax Return will need to be completed for the last period of life from 6 April up to the date of death and the tax worked out accordingly.

Income arising after death is treated as the income of the estate and becomes the responsibility of the trustees or executors. When the estate is distributed, both the capital and the income that has arisen since the date of death will be distributed according to the Will to the various beneficiaries and tax will be deducted from any income that has been received at the appropriate rate.

If you, as a beneficiary, are in receipt of income that has been credited to a deceased person's estate, then you will receive that income net of the appropriate rate tax and while you may have to pay higher rate tax on the income, there is also a chance that you might be able to claim some back or for there to be no adjustment at all. You should be issued with form R185 which shows the tax suffered.

What should one do about the income of children and Income Tax?

Children, from the moment they are born, are entitled to a personal

allowance and if they are in receipt of net income, apart from dividends, they are almost certainly entitled to a repayment of tax. Accordingly, where children are in receipt of income from which tax has been deducted, it's potentially refundable. Get a tax claim form from the Tax Office (note that it's called a 'tax claim' or R40 and not a Tax Return, but it amounts to the same thing). When you have completed it and sent it in, HMRC will either send a cheque in favour of the child or make a refund of tax straight to that child's own bank or building society account. The parent can also receive the refund on the child's behalf.

What are the most sensible sorts of investment for children for tax purposes?

The simplest answer is that savings accounts with building societies or banks that are in the children's names should pay the children interest gross (i.e. without tax deducted).

It's still quite permissible for children to hold shares in companies, even though the tax credits on the dividends are not refundable.

If the children don't have any investments and if the parents have surplus after-tax income of their own which they give to their children, this is usually tax free in the children's hands and, if the parents are particularly wealthy, is a very useful way of transferring income to them, so that the children can accumulate a sum that can then be invested. However, once the income from the source exceeds £100 p.a. it will be taxed in the hands of the parents. Where parents transfer their own shares to their children, if the children are under 18, the income arising on these shares will be regarded as belonging to the parents, so this doesn't save tax.

The Child Trust Fund is a tax-free savings scheme designed for children. The Government contributes £250 when the child is born and a further £250 (£500 for lower-income families) at the age of seven. Parents, family and friends can contribute a further £1,200 annually. The child is entitled to the fund at the age of 18 and there will be no restriction on how they use the money.

What are the rules for charitable giving and Income Tax?

- Gifts of money to charities attract tax relief under the Gift Aid scheme. The gift is treated as if it had been made after deduction of Income Tax at the basic rate. So if you give £80 to a charity, it can get £20 tax back. If you are a higher rate taxpayer, you can claim a further £20 of tax relief in your Tax Return.
- The Gift Aid certificate has been replaced by a simpler and more flexible Gift Aid declaration. If you turn to Appendix 5 you will see an example of this and how it works. However, remember this will only work if you have paid more tax than will be reclaimed by the charity. Otherwise, HMRC will send you a bill for the difference.
- There is a generous tax relief for gifts of certain investments and property to charity.

What is 'Payroll Giving'?

If their employer is registered under the Payroll Giving Scheme, employees can arrange a regular deduction from their pre-tax pay to go to a nominated charity, church or charitable association.

Employers need to sign an administration contract with an authorised Payroll Giving Agency. They do make a small administration charge that is either deducted from the donation or can be paid separately by the employer (around four to five per cent).

How do I reclaim overpaid tax?

If you are likely always to pay too much tax (through receiving no gross income, i.e. all your income suffers tax at source), HMRC will spot this and will no longer send you a form called a Tax Return, but a tax claim form instead. It amounts to the same thing but will probably be returnable to a Tax Office that deals solely with tax repayments.

If, on the other hand, you normally pay tax but in a certain year discover that you have overpaid, you can allocate some or all of your repayment to a charity – again, tick the relevant box on the Return. If you tick the appropriate box on that Tax Return, you can claim for the money to be refunded to you. If you leave the overpayment unrefunded, it will go to reduce your future year's tax payments. Generally speaking, the repayment will be processed quicker if paid directly into a bank/building society account rather than if paid by cheque.

What are the rules regarding pre-owned assets?

A free-standing tax charge applies to the benefit people get from the free or low-cost enjoyment of assets they formerly owned or provided the funds to purchase.

The charge applies to both tangible (land, property, possessions, etc.) and intangible assets.

This will primarily affect people who have entered into 'contrived arrangements' to dispose of valuable assets while retaining the ability to use them. This is most frequently encountered in Inheritance Tax avoidance schemes where property is given away.

There are specific exceptions to the charge:

- The property ceased to be owned before 18 March 1986.
- The property formerly owned is currently owned by your spouse.
- The property was sold at open market value and paid for in cash.
- The asset still forms part of the individual's estate for Inheritance Tax purposes under the Gift with Reservation rules.
- The asset was only owned by virtue of an inheritance which has subsequently been varied by agreement with the beneficiaries (i.e. a deed of variation).
- Any enjoyment of the asset is incidental, or arises after an out-and-out gift to a family member and comes to the benefit of the donor because of unforeseen changes in the donor's circumstances.

The amount of the tax charge will be based on the rental value for land and property, and five per cent of capital value for possessions and intangible assets, subject to a de minimis limit of £5,000.

As it may be impossible to withdraw from potentially complex transactions from the past, an election can be made to have the value of the asset included in the estate for Inheritance Tax purposes. This will avoid an Income Tax charge becoming due.

What might be the effect on my Council Tax banding if I work from home and use my home as an office?

If you are an employee, so long as your employer agrees that you can work from home (and whether or not your employer provides you with equipment to carry out such work), you may be entitled to seek a reduction in Council Tax on the ground that the room you use as an office can no longer be used, for example as a bedroom. It would be advisable for you not to hold business meetings at your home, because too many of those might constitute a change of use and cause other problems with your local council.

You may be interested to learn that one local council, having reduced the amount of Council Tax payable on such a house, sought to impose business rates on the part of the house used for business purposes. However, it failed in its endeavours and the local valuation office decided not to proceed with the case.

Also, using part of your main residence exclusively for business purposes will jeopardise your eligibility for Principal Private Residence relief, and may create a liability to Capital Gains Tax.