

# Guide to Personal Taxation

**Income Tax is charged on all income arising in the UK. An additional complication is that UK residents may also be liable for Income Tax on income arising from overseas sources, dependent upon individual circumstances.**

Personal allowances are deducted from income before calculating Income Tax. Additional allowances such as age-related personal allowance and age-related married couples allowance may also help to reduce the Income Tax payable.

Married couples are treated as individuals for the purpose of Income Tax, and have their own allowances and rates. For 2008-09, the basic personal allowance is £5,435. This is how much you can earn in the tax year before you start to pay Income Tax.

Income Tax is a progressive or graduated tax - it increases as a percentage of income as your income gets larger. Generally you pay Income Tax at the basic rate of 20% on the first £36,000 you earn over and above the personal allowance. Above £36,000 you pay the higher rate of 40%.

To be a higher rate taxpayer you would have to be earning a gross annual income of more than £41,435 (assuming you are under 65, with no adjustments to your personal allowance), but you would, of course, already be paying tax at 20% within the basic rate band.

## What about interest and dividends?

Most investment income is taxed at 20% when your total income, minus allowances and reliefs, is not more than the basic rate limit, which is currently £36,000 (tax year 2008-09). Exceptions are dividends from UK companies and rents. If your income exceeds £36,000 (over and above your personal allowance) then you are a higher rate taxpayer and will have to pay 40% tax on that part of your gross investment income which is above the basic rate limit.

Savings income is usually received after 20% tax has been deducted at source. There is a 10% starting rate for savings income only, with a limit of £2,320. If your taxable non-savings income is above this limit then the 10% rate does not apply.

If you are a basic rate taxpayer then you will have no more tax to pay. If you are a higher rate taxpayer you will be liable to pay a further 20% of gross savings income above the basic rate limit. If you are a non-taxpayer you may opt to have the interest on your savings paid to you gross.



Taxed savings income includes bank and building society interest, annuities, and interest on Government stocks if you choose. Un-taxed savings income includes some National Savings Bank income and interest on Government stocks.

Share dividends form the 'top-slice' of taxable income - this means you face tax on dividends at your highest rate of taxation. UK dividends are paid with a 10% tax credit. If your total income falls within the basic rate limit there is no further tax liability. However, higher rate taxpayers are liable to tax at 32.5% on that part of the dividend falling above the higher rate limit. For non-taxpayers the 10% tax credit is not reclaimable.

## Capital Gains Tax

When you sell a possession (or in the jargon 'dispose of an asset') you are potentially liable for Capital Gains Tax (CGT). Normally the method of disposal is a sale, but it may also be compensation for loss or damage to the asset or a gift. Some windfall payments are also included. The first £9,600 of your 'net gain' during the 2008-09 tax year is free of CGT.

Any gain you make over £9,600 is taxed at a flat rate of 18%.

Gains on certain assets are free of Capital Gains Tax (CGT). They include:

- Your main residence
- Government securities
- Qualifying corporate bonds
- National Savings certificates
- Individual Savings Accounts (ISAs)
- Life assurance policies
- Betting and lottery wins
- Compensation or damage awards

The only reduction to the 18% CGT rate is entrepreneurs' relief, which may be available in respect of gains made on the disposal of:

- All or part of a trading business the individual carries on alone or in partnership;
- Assets of the individual's or partnership's trading business following the cessation of the business;
- Shares in (and securities of) the individual's "personal" trading company (or holding company of a trading group);
- Assets owned by the individual and used by his / her "personal" trading company (or group) or trading partnership.

The first £1 million of gains that qualify for relief will be charged to CGT at an effective rate of 10%. Gains in excess of £1 million will be charged to CGT at the rate of 18%. Claims for entrepreneurs' relief on qualifying may be made on more than one occasion up to a 'lifetime' limit of £1 million.

Trustees will be able to claim relief on certain disposals of business assets and company shares and securities where a "qualifying beneficiary" has a qualifying interest in the business in question. Trustees must make claims jointly with the "qualifying beneficiary". Any relief given on the trustees' gains will reduce a beneficiary's £1 million lifetime limit on relief.

## Inheritance Tax

All of us may leave an Inheritance Tax (IHT) liability if the value of our estate on death exceeds £312,000 (tax year 2008-09) or £624,000 for married couples or those in a civil partnership.

Estates over this 'nil rate band limit' will attract tax at 40% on the balance. For example if you are single and your estate is worth £412,000 the tax liability will be 40% of £100,000 (the difference between the nil rate band of £312,000 and the total value of the estate) and your estate's tax bill would be £40,000.

A range of gifts that you may make are exempt from Inheritance Tax considerations. On top of the various exemptions come the most important IHT get-out clauses, the potentially exempt transfers, which apply to any gifts you make above the exemption limits. Providing you survive seven years from the date of your gift, this gift will be exempt from IHT. If a gift becomes chargeable because of your death within seven years, then, in some instances, taper relief may reduce the tax payable.

Be aware that if you gift an asset but retain the benefit it may be treated as still forming part of your estate on death. If you made a gift of property but continued to live in it rent-free or retained a benefit then you may face an Income Tax charge on an annual basis on the benefit you are receiving and the property may still qualify for IHT.

Whatever your age there are steps you may take to help reduce the amount the taxman can claim when you die. Expert and efficient tax planning together with professional independent financial advice is the answer.

If you have trust arrangements in place or are considering using them it is vitally important that you take independent financial advice to make sure they are tax efficient.

Through the proper organisation of your affairs, together with independent financial advice, it can be easier than you may think to mitigate your IHT liability while retaining control of your assets.