**INCOME TAX**

**LECTURE 4 – A full income tax calculation**

**SLIDE 1**

Hello my name is Sarah Brooks. This online lecture relates to the subject area of taxation and is the fourth on-line lecture relating to income tax.

**SLIDE 2 – OUTCOMES**

By the end of this lecture you are going to be able to complete a full income tax calculation.

**SLIDE 3 – INCOME TAX LIABILITY EXAMPLE**

You will recall there are five stages that you need to work through to calculate the income tax liability of an individual. Firstly, you will calculate the total income. Secondly, you will calculate the net income and thirdly, you will calculate the taxable income. Once you have calculated the person’s taxable income the fourth stage is to separate the taxable income into separate sources, in other words, you need to work out from the taxable income figures, what is savings income, what is dividend income and what is NS&NDI. You then tax the NS&NDI, then the savings income and then you tax the dividend income. Finally, you will then add up all the figures to give the final income tax liability. Let’s look at a practical example of this (talk them through the example on screen). Have a go at calculating Sonia’s income tax liability.

**SLIDES 4 – ANSWER**

So, firstly we must start by calculating Sonia’s total income. Remember total income is her income from all sources, so here it will be £60,000 income from the partnership plus £2,000 interest and £6,000 dividend income giving a total of £68,000.

 Secondly, we must calculate Sonia’s net income by deducting allowable reliefs from her total income, which in this case is the £500 loan interest giving a net income figure of £67,500.

Thirdly, we need to deduct her personal allowance of £12,570 from her net income which gives her a taxable income of £54,930.

**SLIDE 5 – ANSWER**

Fourthly we must separate the different types of income so separating NSNDI from savings and dividend income. To do this we must deduct the savings of £2,000 and the dividends of £6,000 from the taxable income figure of £54,930 giving us a NSNDI figure of £46,930.

This tells us Sonia is a higher rate taxpayer as she has an income greater than £37,700.

**SLIDE 6 – ANSWER**

Having separated the types of income we must tax them at the appropriate rate starting with the NSNDI.

The first £37,700 of the NSNDI will be taxed at the basic rate of 20%, which is £7,540.

The remaining NSNDI, £9,230 will be taxed at the higher rate of 40% which is £3,692.

**SLIDE 7 – ANSWER**

Now we need to tax the savings income. As Sonia is a higher rate taxpayer, she receives a £500 personal savings allowance. The remaining £1,500 of savings income will be taxed at 40% which is £600.

Finally, we need to tax the dividend. Everyone, no matter whether they are a basic, higher or additional rate taxpayer receives a dividend allowance of £2,000. Sonia is a higher rate taxpayer and so the remaining £4,000 of the dividend will be taxed at 33.75% which is £1,350.

**SLIDE 8 – ANSWER**

The final step is to add the tax figures together from the NSNDI, savings and dividends as you can see on the slide which gives an overall tax liability of £13,182.

**SLIDE 9-INCOME TAX RECAP**

Well done you have just completed a full income tax calculation. As you have just seen income tax is taxed in slices, the first slice is the NS&NDI, the second the savings incomes and then the third and top slice is the dividend income. The rates of tax are different for each slice.

The scenario we have just looked at focused on Sonia who is a higher rate taxpayer. The NS&NDI used up the basic rate band of £37,700. This means then that all of the savings income and all of the dividend income was taxed at the higher rate. Let’s now consider a scenario where the NS&NDI has only used part of the basic rate band of £37,700 meaning that some of the basic rate band is available to offset against the savings income.

**SLIDE 10 – Question**

Imagine this scenario, your client is a self-employed Dog Groomer and she has taxable income of £40,000, £6,000 of which is savings income. Calculate Beverley’s tax liability on the savings income that Beverley receives.

**SLIDE 11**

Remember in this scenario you are only asked to calculate the tax liability on the **savings income.**

First then we note that Beverley has a total taxable income of £40,000. So, Beverley’s personal allowance of £12,570 has already been deducted from her total income. Her taxable income is £40,000. This makes Beverley a higher rate taxpayer as her taxable income is more than the basic rate band of £37,700.

We know on the facts that Beverley has savings income of £6,000. As a higher rate taxpayer Beverley has a personal savings allowance of £500. What that means is the first £500 of savings income is taxed at 0%.

Beverley’s NS&NDI IS £34,000. How we got to that figure is we took Beverley’s taxable income of £40,000 and deducted her savings income of £6,000.

Remember that Beverley’s basic rate band is £37,700 and we deduct from that her NS&NDI of £34,000 meaning there is £3,700 of her basic rate band left.

**Slide 12**

£34,000 of the £37,700 basic rate band has been used by Bev’s NS&NDI. Next then the savings income gets taxed. The first £500 of Beverley’s savings income is taxed at 0% as this is covered by Beverley’s PSA. You must make note that this £500 of PSA still uses up £500 of the basic rate band. HMRC are not generous enough for Beverley to tax the first £500 of her PSA at 0%. This £500 still “eats into” her basic rate band. This is a very important point to note. So, to recap, yes Beverley has a PSA which means £500 of her savings as a higher rate taxpayer is taxed at 0% but this still uses up £500 of her basic rate band. So, on that basis, £34,000 of the basic rate band is used by the NS&NDI, £500 of the basic rate band is used by the savings allowance, and so this leaves £3,200 of the basic rate band left to use. We now have £5,500 of the savings income left to tax. £3,200 of the remaining savings income is taxed at 20% as this sits within the remaining basic rate band. The remaining £2,300 of the savings income is taxed at the higher rate of 40% because there is nothing left of the basic rate band. This is a quirky point so please re listen and re read this slide before continuing to the next slide which gives a visual explanation of this point.

**Slide 13**

Here we have a visual of Beverley’s tax situation. Beverley has a basic rate band of £37,700. Beverley’s total taxable income is £40,000. At the bottom then we can see that £34,000 of the basic rate band has been used by Beverley’s NS&NDI which is taxed at 20%. We spoke about the fact that the first £500 of Beverley’s savings income is taxed at 0% but this still uses £500 of her basic rate band. This leaves Beverley with £3,200 of her basic rate band to tax part of her savings income at 20%. The overspill £2,300 gets taxed at 40%. We will be applying this principle in the small group session so please refer to this example and explanation when you get to question 2 in the income tax session.

**Slide 14**

Reminder to apply “the triangle” at q2 in the income tax SGS