# TWD Tax Services Ltd

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**NARPO Personal Tax issues**
**Personal Tax Allowances 2008109 (rates to be used from September 2008)**

| | | |
|---|---|---|
| Personal allowance less than 65 years | - | £6035 |
| Personal allowances 65 years or over | - | £9030 |
| Personal allowances 75 years or over | - | £9180 |

**Current rates of tax 2008/09**
The current rates of tax for pensions and earnings after personal allowances are: -

20% up to £34800
40% thereafter

The current rates of tax for savings income:

10% up to £2230 but only if pensions and earnings do not exceed this amount.
20% on either the amount over £2230 or the full amount depending upon pensions and earnings income.

**Budget changes from April 2008**
As I am sure you are all by now aware that the Chancellor abolished the starting rate of 10% for earnings and pensions and instead the first rate of tax is now 20%. This means that a loss of £2230 x 10% - £223 but this would not be gained back until income is chargeable at basic rate of £13380.

Example

| | 2007/08 | | 2008/09 |
|---|---|---|---|
| Starting rate | £2230 x 10% = £ 223 | | £0 |
| Basic Rate | £9000 x 22% = £1980 | | £11230 x 20% = **£2246** |
| | £11230 | **£2203** | |

| | | | |
|---|---|---|---|
| Starting rate | £2230 x 10% = £ 223 | | £0 |
| Basic rate | £11150 x 22% = £2453 | | £13380 x 20% = **£2676** |
| Total | £13380 | **£2676** | |

We all know how well this worked out for them!

To compensate for this they have now made a partial U turn, by increasing personal allowances for those under 65 years old by £600 to £6035 from the original £5435, they have given back £600 x 20% = £120. This still means that individuals who were worse off by between £120 and £223 will still be worse off.

The change will have no affect for higher rate taxpayers as the chancellor also reduced the new basic rate band from £36000 down to £34800. Thus the extra £600 personal allowances which at 40% gave £240 extra are outweighed by the additional tax due by the reduction in the basic rate band of £1200 which would now be taxed at 40% instead of 20% therefore collecting an additional £240.

**Tax codes**
Each tax year an individual is entitled to a personal tax allowance. For employees and pensioners this forms part of their main tax code which itself determines the amount an individual can earn in that tax year before tax starts to be deducted under Pay As You Earn. A number of deductions can be set against this allowance to reduce it and increase the tax paid at the pension or employment source against which it is operated. There are also a number of reliefs available to increase these allowances and reduce the tax paid.

**Deductions**
A tax code can include deductions such as underpayments of tax from earlier tax years, benefits in kind provided by an employer e.g. excessive mileage payments, car, car fuel and medical benefits among others. They can also include state pensions and state benefits such as JSA, incapacity benefit and bereavement allowance. The deductions included should represent the amounts received or to be received during the tax year, to ensure less allowances are available and therefore additional tax is collected to cover the tax due on the deductions. However, if an item is included into the .tax coding late in the tax year or if the amount included is insufficient then there will be an underpayment of tax relating to this item. If the deduction instead turns out to be excessive then a refund of the excess tax deducted will be due.

An example of a deduction creating problems is: -

Mr x receives Incapacity benefit which will add up to £3500 for 2008/09 if he continues to receive it until the year end. He starts to receive in June 2008. If this amount is included into the tax coding in June 2008, because of the way the tax tables work I of 3 things can happen

1) The code will be issued on a cumulative basis. The tax tables split everything in the code into 12 equal amounts (or 52 if weekly paid) and then charges tax on the amounts in total from April to June. In this case the client will pay tax immediately on 3/12$^{th}$'s of the payment (£3500 x 3/12$^{th}$'s = £875) when he has only received 1/10$^{th}$ of the annual payment (£3500 x 1/10$^{th}$ = £350). This is very rarely used.

2) The code will be issued on a special month I or week I basis meaning that the tax tables will still split everything in the code into 12 (or 52) equal amounts but it will only collect the tax due from June through to the following March, looking at each month or week in isolation. As this is only 10 months the tax collected will only represent 10/12$^{th}$ of the total tax due. The taxpayer will still owe the tax due on the remaining 2/12$^{th}$'s.

3) The final option is to include the full amount the client would have received if payments had been made for the full 12 months (£3500 x 12/10$^{th}$ = £4200) and to issue the tax code on the special month 1. This will then collect 10/12$^{th}$ of the annual sum which will be correct figure.

However, trying to explain option 3 to the vast majority of taxpayers is difficult as they only see that the deduction included in their tax code is for more than they are receiving and in many cases the tax office will opt for option 2.

**Retirement & P45**
Once a police officer retires, it's usual for them to start to receive a police pension and in many cases the personal tax allowances that had been set against the police officers earnings will be transferred to the pension payroll and are then used against the pension. But, in some cases when a retired police officer starts other employment their new employer may operate a tax code also including personal allowances. This meaning the

individual will have received too many tax allowances by the year end and will owe tax. The underpayment of tax may rise into thousands of pounds by the time the individual is made aware of the problem. At TWO tax services we have come across this and similar problems for numerous retired police officers.

**New employment & P46**
To solve this problem retired police officer are advised to complete a form P46 when taking on further employment. This allows them to sign a statement indicating they have an occupational pension and the new employer can then operate a Basic Rate tax coding to deduct tax at 22% from all earnings.

**Higher Rate Liability overall**
Further problems can still arise with this situation because, depending upon the level of pension and employment income which separately may be below the higher rate threshold, they may when added together increase the level of the individuals total income to above the higher rate threshold. This will mean again that insufficient tax is deducted and the retired police officer is again left with a bill at the year end.

**Basic Rate Restriction**
In order to prevent this situation arising in future years the tax office will normally include a basic rate restriction into the tax code, usually at the pension. They calculate this restriction based on the figures held for the previous year or estimates the individual will provide for them of total income for the current tax year. Effectively what this does is charge additional tax at the source at which it is operated to cover the higher rate liability.

Example 2008/09

| | |
|---|---|
| Pension income | £19010 |
| Employment income | £25000 |
| Total Income | £44010 |
| Less personal allowance | £ 6035 |
| Taxable | £37975 |
| Basic Rate limit | £34800 |
| Higher rate liability | £ 3175 |

Without a basic rate restriction the individual will have only paid tax at 20% on all income and will be liable to a further £3175 x 20% = £635 for the higher rate liability. I am sure that some of you will have come across this situation.

Another point to consider with higher rate liability is that once an individual becomes liable to tax at the higher rate on their pension or earnings they are then liable to additional tax on any investment income they receive. This can simply be interest received on bank or building society accounts from which tax at 20% has been deducted but on which tax is now due at 40%, or it can be dividend income on which tax is due at 32.5% but which carries only a 10% tax credit. Some individuals will have portfolios generating interest and dividends both in the UK and overseas. All this income needs to be declared in order to ensure the correct tax deductions are made.

**D0 Tax code**
In a situation where the level of the pension or employment income on it's own makes the individual liable to tax at 40% then the tax allowances should be set against this source and any other sources of employment or pension can be taxed on code D0 which deducts the full 40% tax due.

**Age Allowances**
If we turn now to age allowances, once an individual reaches 65 they become entitled to age related personal tax allowances and once they reach 75 these are increased further. However, these are effectively means tested and if and the individual income exceeds the income limit for the year which is currently £21800 the allowances are tapered down by £1 for every £2 the income exceeds the limit by. The reductions stop once the allowances have been reduced down to the basic personal tax allowances for the year which are currently £6035. The allowances are currently

65 - £9035 — reduced to basic at £26318
75 - £9180 — reduced to basic at £26390

**Professional subscriptions**
If an individual is a member of a professional body relating directly to their employment, they are able to claim tax relief on the amount of relevant subscriptions paid during the year. For police officers this would be Police Federation subscriptions, but once retired any payments are no longer related to employment and would not qualify. For other employments such as positions within the security industry, individuals may have to obtain a security licence and if the costs are not reimbursed by their employer they can also claim tax relief on this.

**Other expenses**
As Police officers are able to claim tax relief on an agreed expense for cleaning and maintaining their police uniforms as follows,

| | | |
|---|---|---|
| 2004/05 - 2006/07 | - | £55pa |
| 2007/08 | - | £110pa |
| 2008/09 | - | £140pa |

certain other employments which a retired police officer may undertake carry a similar relief. If items provided by new employers are classed as protective garments or bear a fixed employer name or logo, and they are responsible for cleaning and maintaining these items, an agreed amount of £60 pa expenses can be claim. Additionally, if they are required to provide any protective items or safety footwear which is not provided by their employer they may be able to claim tax relief on the costs incurred.

**Personal Pensions**
In April 2006 changes where made to the maximum amounts that an individual could pay into a pension scheme. Prior to April 2006 limits were set based on a percentage of earnings which would increase with the individual's age and reached a maximum of 40% once they were over 60, or £3600 pa if that was higher.

However, that all changed in April 2006 and now an individual can make payments equal to 100% of UK earnings or £3600 whichever is higher. There are still some limitations on an annual and a lifetime basis but these currently amount to £235 000 annually and £1.65 million lifetime, so will probably not affect most retired police officers.

Tax relief for these payments is given at source by the pension provider for basic rate taxpayers, in that the sum paid in amounts to 80% of the gross amount and the other 20% is reclaimed from HMRC. However, if an individual is liable to pay tax at 40% they can claim the additional 20% tax relief. This is usually included in the PAYE tax coding or can be claimed via the self assessment tax return.

**Gift aid**
When an individual makes payments to a charity in the vast majority of cases these will qualify as gift aid. For basic rate taxpayers this means that the charity will be able to claim a further 20% tax relief on the gift, however as this is less than the previous relief of 22% a transitional relief has been set up for gifts made between 6 April 2008 and 5 April 2011 meaning they will continue to receive 22% tax relief.

For higher rate taxpayers an additional 20% relief is available and can be claimed in the same way as the personal pension relief either by tax coding or by self assessment.

**Landlords**
I would now like to turn to the issue of rental income. It is a common misconception that if the landlord does not make a profit from renting the property they will not be required to complete a self assessment tax return or disclose the information to the tax office. In fact this type of income should always be declared and only in certain cases will an annual return not be required.

In a large number of cases individuals may be making a profit in tax terms because even though they are using the rents received to pay the mortgage, if that mortgage is a capital repayment mortgage then he will be gaining equity in the property with every mortgage payment made. It is for this reason that **only** the interest element of the mortgage payments is allowable for deduction for tax purposes.

In other cases the individual may be making a small loss over a number of years and if this has not been declared and claimed then it may not be utilised should the client subsequently start to make a profit.

We have come across a number of cases in which clients have had rental income from UK or overseas properties and held the belief that they did not need to declare it. In some cases they have incurred large amounts of interest and penalties due to non-disclosure.

**Capital Gains Tax**
A further point with regard to landlords is the capital gains aspect. Once a property is sold a capital gains charge will arise on the sale proceeds minus the cost and there is now a standard tax rate of 18% of the gain arising for sales after 5th April 2008. With the large increase in prices within the housing market over the last few years this can create some very substantial gains. Even if the individual did not receive a tax return it is their responsibility to advise the tax office that they will need a tax return and this must be done by 5th October following the tax year in which the property was sold. The return must be completed and the CGT paid by 31st January of the following year.

Capital gains can arise on a variety of different disposal such as shares or on gifts made and it is always wise to get professional advice before selling or making a gift of a valuable asset.

**Self Employment**
Some of the pitfalls of self employment are that there are many requirements such as making sure you register with both National Insurance and the Tax Office within 3 months of becoming self employed. This can be done by simply by telephone or by completing a form CWFI which can be obtained from a tax office or website. This will ensure that your self employment records are set up and that you are allocated a unique reference under which to submit any accounts and returns. Failure to meet this deadline can result in penalties.

In addition, as a self employed individual you are required to keep good records of income and expenditure and keep receipts and invoices to substantiate the accounts, which should be retained for at least 6 years. It is also recommended that you set up a business bank account to ensure you business income and expenditure can be tracked separately from you personal affairs. It is always wise to obtain professional advice and a bookkeeper or book-keeping software are useful and help keep accountancy costs down.

Our sister company TWD Accountants Ltd offer accountancy services for as little as £169 + VAT for a first year client who has kept good books.

**NIC**

Once registered as self employed payments of class 2 NIC will be requested and these are currently £2.30 pw. Payments can be made weekly, monthly or quarterly. Additionally, if the profit from self employment exceeds £5435 class 4 NIC will be due at 8% on any amount over this and below £40040. Anything over this attracts 1% class 4 NIC.

National Insurance is payable until the end of the accounting period in which an individual becomes 65 years old.

**Self Assessment**

A misconception with self assessment is that once the tax return has been filed and the tax calculation issued that is the end of the matter. The fact is that in a number of cases this can be only the beginning.

All self assessment returns are processed as they arrive in the tax office with no investigation by anyone with any tax knowledge. It is then at a later point that the return may be picked for review either randomly or because something in the tax calculation has alerted them to a potential problem. So we find individuals believing they have correctly completed their return and have the tax calculation to prove it, only to find out months later that they were wrong and items they claimed are not allowable meaning they must now pay back tax previously refunded or they owe tax never paid.

**Self assessment deadlines**

The deadline date for the self assessment returns to be filed is 31st October for manually submitted returns or 31st January following the tax year end, if filed online.

**Self assessment enqury**

Up to 5th April 2008 the tax office had 12 months from the 31st January filing deadline in which to open an enquiry into any part of the return, so for 2006/07 returns submitted anytime up to 31st January 2008 the deadline for any enquiry is 31st January 2009.

From 6th April 2008, for 2008/09 self assessment returns onwards, the deadline has changed to 12 months from the date you filed the return. So if you file your return on May 2008 the enquiry window closes for H M Revenue & Customs on 1st May 2009.

However, the tax office has the ability to go back up to 20 years if they find that an individual has undisclosed income.

TWD tax services and TWD Accountants offer fixed fee services to individuals such as these who have insufficient tax knowledge to be able to deal with their tax return or accounts and who may fall foul of the enquiry system.