Income Tax

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2. Tax administration and compliance

2.1 Self-assessment

2.1.1 Introduction

Most taxpayers in the UK pay their tax via the PAYE system (see **Chapter 14**). For individuals who just have earnings, perhaps with minor amounts of investment income, there is usually no reason to file a tax return under self-assessment. Instead, HMRC may issue a P800 tax calculation after the tax year, or use simple assessment (see **2.5**), to adjust for any PAYE overpayments or shortfalls.

An individual who is self-employed, or who is receiving income that is not taxed, may be required to file a self-assessment return. HMRC state that a tax return must be filed if, in a tax year, an individual was:

- self-employed as a sole trader and earned more than £1,000 gross before the deduction of expenses and tax reliefs; or
- a partner in a business partnership.

A tax return must also be filed for a tax year if an individual:

- is a company director, unless all of the individual's income is taxed at source (e.g. under PAYE) and there is no tax liability;
- has annual income over £100,000;
- has income over £50,000 if the individual or his or her partner receives child benefit payments;
- has any other untaxed income such as:
  - income from land and property in the UK;
  - income from savings and investments, including dividends;
  - taxable foreign income;
  - taxable income from a trust or settlement;
  - commission or cash-in-hand payments; or
  - certain pension payments/charges; or
- has sold shares, property or other assets liable to CGT.

HMRC have a specific tool to enable an individual to check if he or she is required to file a tax return for a particular tax year – see below.

Any individual may choose to file a tax return if he or she wishes to do so. This may be the case, for example, if the individual wishes to claim tax relief for pension contributions or for donations made under gift aid, or to claim the seafarers' deduction (see **38.6.4**).

Income tax self-assessment (ITSA) is also relevant for partnerships (see **Chapter 16**) and for trusts (see **Chapter 41**).

Under self-assessment, the individual is responsible for creating his or her correct tax charge each tax year.

Law: TMA 1970

Guidance: https://www.gov.uk/check-if-you-need-tax-return; HMRC manuals: *Self assessment: The legal framework* (SALF); *Self assessment manual* (SAM); *Self assessment claims manual* (SACM)

2.1.2 Registration

Once it is established that an individual has to file a tax return, the first step is to register for self-assessment by completing form SA1. There are separate registration processes for self-employed individuals (see **Chapter 15**) and for partners (see **Chapter 16**).

If an individual has not received a notice to file a tax return, and starts receiving untaxed income or has a capital gain during a tax year, he or she should inform HMRC of this by 5 October following the end of the relevant tax year.

Once registered, there is no need for the individual to re-register every year, unless there has been a tax year for which the individual was not required to file a tax return.

After registering, the individual will receive a UTR (unique taxpayer reference – a 10-digit reference), which is needed to file a tax return.

A notice to file a return will usually be sent to the individual immediately after the end of the tax year. If no such notice is issued, the individual is free to file a voluntary return, in which case notice will be deemed to have been issued when HMRC receive the return. This means that such a return can never be late, so no late filing penalties arise in respect of a voluntary return.

Guidance: https://tinyurl.com/s4xyyvck (HMRC documents re registering for self-assessment); https://www.gov.uk/register-for-self-assessment

2.1.3 Filing

Once an individual has been issued with a notice to file a return for a tax year, there is a legal duty to do so by 31 January (or 31 October if submitting a paper tax return) following the relevant tax year.

However, if the notice is issued after 31 July following the tax year, the filing deadline may differ depending on when the notice is issued and whether the return is being filed online or in hard copy. The deadline will then be the later of:

- the usual 31 January/31 October deadline; or
- three months after the notice is issued (see **Appendix 1**).

An individual who believes that a tax return is not required for a tax year, but who has been issued with a notice to file a return, can ask HMRC to cancel this notice, which HMRC will do if they agree that no tax return is required (TMA 1970, s. 8B). This can be done after the filing deadline and, if cancelled, any late filing penalties charged will also be cancelled.

Components of the return

A self-assessment tax return is made up of a core tax return (SA100), to which various supplementary pages are added. These cover, for example:

- income from employment (SA102);
- income from self-employment (SA 103);
- income from UK property (SA105);
- additional information (SA101);
- foreign income (SA106);
- residence, remittance basis, etc. pages (SA109); and
- the tax calculation summary pages (SA110).

It is the individual's responsibility to complete and file the relevant pages depending on his or her circumstances.

Any claims or elections that an individual needs to make, can be done via the tax return.

HMRC guidance and online filing

There is HMRC guidance (SA150) on how to complete the core return, with separate guidance for each set of supplementary pages, and various helpsheets – see guidance note below.

Most taxpayers now file online. HMRC's website provides a basic tax return filing service, though certain individuals (e.g. non-residents) are unable to use this service as it does not include all the supplementary pages. In this situation, the individual will either need to engage an accountant/tax adviser to file the return or purchase commercial tax return software that has all the relevant supplementary pages.

Guidance: https://www.gov.uk/government/collections/self-assessment-helpsheets-main-self-assessment-tax-return

Short returns

A short tax return (SA200) can be filed by an individual who:

- was a paid employee or had taxable benefits or expense payments;
- was self-employed with an annual turnover of less than £85,000;
- was repaying a student loan and/or a postgraduate loan;
- received a UK pension (state, occupational or private) or a retirement annuity;
- received income from a purchased life annuity;
- received taxable state benefits such as jobseeker's allowance (see **Chapter 33**);
- had property income of less than £85,000 from rents or letting a room in the individual's home;
- received income from UK savings, such as interest from a bank or building society;
- received company dividends (including foreign dividends of up to £300); or
- wants to claim relief for gift aid payments.

In all other situations a full tax return has to be filed. Non-residents and individuals with a foreign domicile cannot file a short return.

Calculation of tax liability

Under self-assessment, the individual is responsible for calculating his or her tax liability for a tax year, as part of the return. If a paper return is filed before 31 October following the relevant tax year, HMRC will calculate the tax due if required. For those filing online, most tax return software packages automatically calculate the tax due.

3. The computation of income tax

3.1 Introduction

3.1.1 Overview

Income tax is charged on income earned by individuals in the UK. The sources of this income are varied and may include employment, pension and trading income from sole trading or partnership businesses, property income, income from investments such as interest or dividends, and other miscellaneous income such as royalties, other receipts from intellectual property, or income from trusts and estates.

Income is normally taxed on the amount that arises or is received (depending on the source of the income) in the tax year, which runs from 6 April to 5 April. A system of basis periods operates for trades, etc. (see **15.4**).

To calculate the tax due on the income assessable in the tax year, the legislation lists out seven steps (*Income Tax Act* 2007, s. 23).

3.1.2 The steps of the calculation

Step	Details
1	Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. The sum of those amounts is "total income". Each of those amounts is a "component" of total income. See *pro forma* for this step at **3.2.6.**
2	Deduct from the components the amount of any relief under a provision listed in s. 24 to which the taxpayer is entitled for the tax year (see deductible payments at **3.3**). The sum left after this step is "net income".
3	Deduct from the net income any allowances to which the taxpayer is entitled for the tax year, such as the personal allowance and blind person's allowance (see **3.4.1**).
4	Calculate the tax at each applicable rate on the amounts of the components left taxable after applying step three. See **3.5.1** for the tax rates and **3.5.4** for the *pro forma* for this step. If the taxpayer is a trustee, see **Chapter 41** for the applicable rates and techniques.
5	Add together the amounts of tax calculated at step four.

Step	Details (cont.)
6	Deduct from the amount of tax calculated at step five any "tax reducers" to which the taxpayer is entitled for the tax year (e.g. the married couple's allowance). See **3.6** for details.
7	*Add* to the amount of tax left after step six any amounts of tax for which the taxpayer is liable for the tax year, such as pension charges – e.g. annual allowance and lifetime allowance charges (see **Chapter 30**) – and the high income child benefit charge (see **33.5.6**). *Deduct* any amounts for which a deduction is due, such as amounts already paid by trustees or through PAYE. (Note that the reduction of the tax already paid at source is not an "official" step in the legislation but is essential in order to establish the correct tax payable figure.)

The result is the taxpayer's liability to income tax for the tax year.

These steps can be summarised as two stages:

- First, all the income must be accumulated, any deductible reliefs and personal allowances subtracted and the "taxable income" found. This is an important figure and is also used in other taxes such as capital gains tax as a reference for calculating tax due.
- Once the taxable income is known, the second stage is to apply the appropriate tax rates to each component of the taxable income. This stage may also encompass allowances, such as the savings and dividend allowances outlined in **Chapters 23** and **24**.

Once calculated, this income tax will be collected either through the PAYE system, if the individual is employed or in receipt of a pension, and/or through the self-assessment tax return submitted by the taxpayer annually, or through simple assessment (see **2.5**).

Law: ITA 2007, s. 23

3.2 Step one – calculating the taxable income

3.2.1 Introduction

Calculating the income is the first step outlined by ITA 2007, s. 23.

Essentially this step is to establish the amounts of income on which the individual is to be charged income tax. The sum of these amounts is the "total income". To determine what is taxable it is essential first to know what is exempt.

3.2.2 Exempt income

Many sources of income are exempt from income tax. The following sources of income do not need to be included in a taxpayer's self-assessment tax return as they are exempt:

- certain types of income from National Savings and Investments (NS&I), such as winnings on the premium bonds, and interest from NS&I certificates;
- income from specified investment plans, such as individual savings accounts (ISAs);
- income from savings-related share option (SAYE) schemes;
- dividends paid on the first £200,000 purchased of venture capital trust (VCT) shares;
- income from "free of tax to residents abroad" (FOTRA) securities;
- the exempt capital element of purchased life annuities;
- certain annual payments;
- certain types of other income, such as income from winnings and betting, gaming or lotteries;
- some social security benefits, for example universal credit, housing benefit, and winter fuel allowance for pensioners (although jobseeker's allowances are taxable);
- child benefit (but there may be a high income child benefit charge – see **3.7.1**); and
- certain scholarship awards.

Income arising on money and investments in a child trust fund account is also exempt from tax.

Law: ITEPA 2003, s. 677; ITTOIA 2005, s. 692, 709, 776; SI 1998/1870
Guidance: SAIM 11120

3.2.3 Chargeable income

To establish the total chargeable income to be taxed, the first stage is to separate the various items of income into their appropriate category, according to the source of the income. It will not matter if the individual's income is from a UK or a non-UK source, as the worldwide income of a

UK tax resident will be taxable. See **Chapters 34-40** for more information on the taxation of foreign income.

All income is generally from one of three sources: non-savings, savings or dividend income. The need to split the income into the different sources arises from the fact that each source has different tax rules associated with it; either different tax rates (in the case of dividends) or different rules and methods are applied to each source to calculate the tax due.

3.2.4 Non-savings income

The first category of income is non-savings and non-dividend income, shortened to "non-savings income". Examples are employment income, trading income, property income, pension income, royalties, and income from discretionary trusts and estates.

Employment income covers both basic salary received and any extras such as benefits in kind and annual bonuses (see **Chapters 5-14**).

Trading income covers income from a profession or vocation as well as income from a merchandising or manufacturing business. Trading income could be from a sole trader or a partnership share. More information on such sources can be found in **Chapters 15-19**.

Property income is taxed net of any deductible expenses (see **Chapters 26-28**).

More information on pension income, and on state and other benefits, can be found at **Chapters 29-33**.

3.2.5 Savings income

The second source is savings income, mostly interest from banks and building societies (see **Chapter 23**).

3.2.6 Dividend income and other sources

The third source is dividend income (see **Chapter 24**).

Sometimes there might be a fourth source. This is for income that must be taxed at the individual's highest rate of income, such as the charge for pension contributions above the annual allowance (see **Chapter 30**).

Law: ITEPA 2003, s. 677; ITTOIA 2005, s. 692, 709, 776; SI 1998/1870
Guidance: SAIM 11120