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How to Save Tax 2017/2018

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Important Legal Notices:

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Disclaimer
Before reading or relying on the content of this tax guide please read the disclaimer.

About the Author & Taxcafe

Dr Nick Braun founded Taxcafe in 1999, along with his partner Aileen Smith. As the driving force behind the company, their aim is to provide affordable plain-English tax information for private individuals, business owners and professional advisers.

Over the past 17 years Taxcafe has become one of the best-known tax publishers in the UK and has won several prestigious business awards.

Nick has been a specialist tax writer since 1989, first in South Africa, where he edited the monthly *Tax Breaks* publication, and since 1999 in the UK, where he has authored several tax books including *Small Business Tax Saving Tactics, Pension Magic* and *Salary versus Dividends*.

Nick also has a PhD in economics from the University of Glasgow, where he was awarded the prestigious William Glen Scholarship and later became a Research Fellow.

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Introduction

Welcome to Taxcafe's *How to Save Tax 2017/2018*, our comprehensive tax planning guide for individuals and business owners.

This guide covers ALL the major tax announcements from the March 2017 Budget plus other important changes that have been made in recent times.

In Part 1 you will find out how much income tax and national insurance you will pay during the current tax year, plus lots of tax saving tips for salary earners, the self-employed, landlords and company directors.

You will also find out how to avoid the child benefit charge and how to cut your income tax bill by thousands of pounds by splitting your income with your spouse or partner and other members of your family.

Part 2 covers recent changes to the other big taxes: capital gains tax, inheritance tax, corporation tax and stamp duty land tax. Each chapter contains useful tax-saving tips.

Part 3 shows you how to enjoy bigger tax savings from tax shelters like ISAs, pensions, venture capital trusts, enterprise investment schemes and the seed enterprise investment scheme (SEIS).

You will also find a chapter containing a detailed list of amounts that are always TAX FREE!

Finally, in Part 4 we take a detailed look at all the other recent tax changes announced in recent Budgets, plus other important changes coming into force this year or in the near future.

The Current Tax Year

Some of the tax planning strategies discussed in this guide require action before the end of the tax year. The current tax year runs from 6 April 2017 to 5 April 2018. I refer to it throughout as 2017/18.

Part 1

Income Tax & National Insurance

Chapter 1

Income Tax

For the 2017/18 tax year, starting on 6 April 2017 and ending on 5 April 2018, most individuals pay income tax as follows:

- 0% on the first £11,500 Personal allowance
- 20% on the next £33,500 Basic-rate band
- 40% above £45,000 Higher-rate threshold

Generally speaking, if you earn more than £45,000 you are a higher-rate taxpayer, if you earn less you are a basic-rate taxpayer (see below for Scottish rates).

Example – Basic-Rate Taxpayer

John earns a salary of £30,000. His income tax for 2017/18 can be calculated as follows:

- *0% on the first £11,500 = £0*
- *20% on the next £18,500 = £3,700*

Total income tax bill: £3,700

Example – Higher-Rate Taxpayer

Jane is a sole trader and has profits of £60,000. Her income tax for 2017/18 can be calculated as follows:

- *0% on the first £11,500 = £0*
- *20% on the next £33,500 = £6,700*
- *40% on the final £15,000 = £6,000*

Total income tax bill: £12,700

Marriage Allowance

It is now possible to transfer 10% of your personal allowance to your spouse or civil partner (£1,150 during the current 2017/18 tax year).

Only basic-rate taxpayers can benefit from this tax break, so the potential tax saving is £230 (£1,150 x 20%).

Unmarried couples are excluded – this was David Cameron's rather feeble attempt to use the tax system to reward marriage.

Married couples can generally only benefit from this tax break if:

- One person earns less than £11,500 (not including savings interest under £5,000) and is therefore wasting some of their personal allowance

- The other person earns less than £45,000 (i.e. is a basic-rate taxpayer)

Both individuals must have been born on or after 6 April 1935.

You have to register to use it:

www.gov.uk/marriageallowance

Potential winners are married couples where one person does not work (e.g. full-time parents) or only has a part-time job.

Example

In 2017/18 Bill earns a salary of £30,000 and his wife Daphne earns £6,000 working part time. Daphne has £5,500 of unused personal allowance. She can transfer £1,150 of this to Bill which means Bill no longer has to pay tax on £1,150 of his income. This will save him £230 in tax (£1,150 x 20%).

Company owners with dividend income have more scope than regular salaried employees to benefit from this tax giveaway (see the Taxcafe guide *Salary versus Dividends*).

Income between £100,000 and £123,000

Once your income exceeds £100,000 your income tax personal allowance is gradually taken away. It is reduced by £1 for every £2 you earn above £100,000. For example, if your income is £110,000 your personal allowance will be reduced by £5,000. If your income exceeds £123,000 this year you will have no personal allowance at all.

This is a real tax sting for those earning over £100,000. The personal allowance saves you up to £4,600 in tax if you are a higher-rate taxpayer (£11,500 x 40%).

Paying Tax at 60%

The effect of having your personal allowance taken away is that anyone earning between £100,000 and £123,000 faces a hefty marginal income tax rate of 60%.

For example, someone who earns £100,000 and receives an extra £10,000 will pay 40% tax on the extra income – £4,000. They'll also have their personal allowance reduced by £5,000, which means they'll have to pay an extra £2,000 in tax (£5,000 x 40%). Total tax on extra income: £6,000 which is 60%!

Income over £150,000

Once your income rises above £150,000 you start paying income tax at 45% on most types of income. This is known as the additional rate of tax.

What Income is Taxed at these Rates?

The above income tax rates apply to most types of income including:

- Salaries
- Self-employment profits (sole traders and partnerships)
- Rental profits
- Pensions

Some types of income (salaries and self-employment profits) are also subject to national insurance. So in the next few chapters we will examine the *total tax* payable by salary earners and the self employed, as well as company directors and landlords.

Some types of income (dividends and interest) are subject to different income tax rates.

Dividends

Many individuals receive dividends from stock market companies or from their own private companies. Dividends received from investments held inside an ISA or pension are, of course, tax free.

For taxable dividends the tax rates are lower than for other types of income. This is because dividends are paid out of companies' *after-tax* profits. In other words, dividend income is taxed twice.

The tax treatment of dividends has been completely changed with effect from 6 April 2016. Dividend tax credits have been abolished, so it is no longer necessary to gross up your dividends to calculate your tax. All tax calculations now work with 'cash' dividends only and are therefore a lot simpler. That's the good news. Unfortunately, new tax rates for cash dividends have also been introduced that are 7.5% higher than the previous ones.

However, the first £5,000 of dividend income you receive in 2017/18 is tax free thanks to the "dividend allowance". All taxpayers, regardless of income, can benefit from this allowance. Unfortunately, the dividend allowance will be cut to £2,000 in 2018/19 as part of a package of measures to raise more tax from business owners.

For those receiving dividends in excess of the dividend allowance, the following tax rates apply (old rates included for comparison):

	Old rates	**Current rates**
Basic-rate taxpayers	0%	7.5%
Higher-rate taxpayers	25%	32.5%
Additional-rate taxpayers	30.6%	38.1%

Dividends are always treated as the top slice of your income and are therefore subject to the highest possible tax rate.

Winners & Losers

The increase in dividend tax rates is designed to extract more tax from company owners who take most of their income as dividends (see Chapter 5).

The main beneficiaries are higher-rate taxpayers and additional-rate taxpayers who receive relatively small amounts of dividend income, typically from stock market investments. Previously, if their investments weren't sheltered in an ISA, pension or venture capital trust they would have paid 25% or 30.6% tax on ALL their dividend income. At present they can receive £5,000 tax free, although just £2,000 from 6 April 2018.

How the Dividend Allowance Works

The dividend allowance is not given as an additional standalone tax-free amount of £5,000. Instead it typically uses up some of your basic-rate band or higher-rate band.

The way to think about it is like this: dividends are always treated as the top slice of your income and taxed at your highest marginal rate. The dividend allowance exempts the bottom £5,000 of that income from tax.

So if you have dividend income taxed at both 7.5% and 32.5%, the dividend allowance will exempt some of the income taxed at 7.5%.

Example 1

In 2017/18 Brendan has pension income of £42,000 and dividend income of £6,000. The first £11,500 of his pension is covered by his personal allowance and the next £30,500 is taxed at 20%. This leaves him with £3,000 of basic-rate band remaining.

£5,000 of his dividend income is tax free. The first £3,000 uses up what's left of his basic-rate band (preventing him from paying 7.5% tax), leaving £2,000 of dividend allowance to use in the higher-rate band (preventing him from paying 32.5% tax). The final £1,000 of dividend income is taxed at the 32.5% higher rate.

Example 2

In 2017/18 Julia has £45,000 of rental income and £6,000 of dividend income. Her rental income uses up her personal allowance and basic-rate band and takes her up to the higher-rate threshold.

The first £5,000 of her dividend income is covered by the dividend allowance, leaving £1,000 subject to tax at the 32.5% higher rate.

The dividend allowance does not use up her basic-rate band because none of her dividends fall into the basic-rate band.

Example 3

In 2017/18 Leon has a £130,000 salary and £50,000 dividend. With this much income his personal allowance is completely withdrawn.

The first £5,000 of his dividend income is covered by the new dividend allowance, leaving £15,000 taxed at the 32.5% higher rate.

Along with his salary this takes Leon up to the £150,000 additional-rate threshold. The final £30,000 of his dividend income is taxed at 38.1%.

Note, Leon has dividend income taxed at both the higher rate and additional rate. The dividend allowance reduces the amount of his dividend income taxed at the 32.5% higher rate.

Example 4

In 2017/18 Martin has a £100,000 salary, £50,000 of rental income and £50,000 of dividend income. With this much income his personal allowance is completely withdrawn.

His salary and rental income take him up to the £150,000 additional-rate threshold. The first £5,000 of his dividend income is covered by the new dividend allowance, leaving £45,000 taxed at the 38.1% additional rate.

The dividend allowance reduces the amount of his dividend income taxed at the additional rate.

Foreign Dividends

These days it's easy for stock market investors to buy shares in overseas companies, the most popular being US companies.

Foreign dividends are often subject to withholding tax – the overseas company will deduct tax before paying you the dividend. However, the UK has double tax treaties with many countries that reduce the amount of foreign tax payable (usually to 10% or 15%).

In the US the dividend withholding tax rate is normally 30%. However, in terms of the double tax agreement between the US and UK, the amount of withholding tax can be reduced to 15% by completing form W-8BEN, issued by the US Internal Revenue Service (IRS). Most online stockbrokers will handle these forms on your behalf so the process is relatively simple.

The double tax agreement also provides a specific exemption for pension schemes, which means US dividends can be received tax free if the shares are held inside your SIPP or another pension scheme. The double tax agreement does not, however, recognize ISAs. ISA investors are still subject to the 15% withholding tax.

If your overseas shares are held outside an ISA or SIPP you will also be subject to UK income tax on your overseas dividends. However, you may be able to claim Foreign Tax Credit Relief when you submit your tax return. This allows the overseas tax paid to be deducted from the amount of UK tax owing. However, the amount deducted cannot exceed the UK tax payable on the income.

Interest Income

Personal Savings Allowance

A new personal savings allowance came into effect on 6 April 2016. It introduces a 0% tax rate (the savings nil rate) for up to £1,000 of interest income if you're a basic-rate taxpayer and up to £500 if you're a higher-rate taxpayer. Additional-rate taxpayers do not receive this new allowance.

Income that falls within your savings allowance will still count towards your basic-rate or higher-rate limit and may therefore affect the level of savings allowance you're entitled to and the rate of tax payable on any savings income you receive in excess of this allowance.

As part of this change the automatic deduction of 20% income tax by banks and building societies on non-ISA savings has been halted. Any tax due on bank and building society interest will now be collected through the PAYE system.

Interest from peer-to-peer loans can also be sheltered from tax thanks to the new personal savings allowance.

Interest from open-ended investment companies, authorised unit trusts, investment trust companies and peer-to-peer loans will be paid without income tax being deducted from April 2017.

Of course, most individuals can shelter all of their interest income from tax by putting their money in a cash ISA.

However, the new personal savings allowance may give you the freedom to put your savings into an account that pays the most competitive interest rate, which may not be a cash ISA.

It may also free up more of your annual ISA allowance to invest in shares and equity funds, if that's what you prefer to do.

Furthermore, some interest income cannot be sheltered in an ISA. For example, if you sell your home and have a large cash lump sum or receive a big dividend from your company it may not be possible to put all the money into an ISA in one go (the annual ISA allowance is £20,000 in 2017/18).

Another group that may benefit from the new savings allowance are company owners who extract interest income from their companies. Getting your company to pay you interest can be extremely tax efficient.

Your company will get corporation tax relief on the payment and the income is potentially tax free in your hands (see *Salary versus Dividends* which contains a whole chapter on this subject).