

## TAX ON SAVINGS INCOME

Savings income (which includes all types of interest) paid net is taxed usually at source at 20%. Dividends on UK equities carry a (non repayable) tax credit of 10%. The intention is that only higher rate taxpayers should have to pay any additional tax, although 'starting rate' and non-taxpayers may be entitled to claim a tax refund.

### HIGHER RATE TAX PAYERS

For higher rate taxpayers, there is the question of how much of their savings income has to bear extra tax. In determining this, the general rule is that savings income is treated as the 'top slice' of income.

This is best illustrated by examples of individuals who have exactly the same savings income but different other income (for simplicity, treated as being after application of all allowances and the 10% starting rate tax band). The treatment of dividends is more complicated and they are therefore excluded.

Suppose the savings income is received as follows:

			Taxable
			gross
Bank interest	£1,600 net	(£400 tax deducted)	£2,000
Building society interest	£3,200 net	(£800 tax deducted)	£4,000
			<u>£6,000</u>
	Mr Smith	Mr Brown	Mr Green
Other taxable income	£10,000	£31,000	£37,000
Savings income	<u>£6,000</u>	<u>£6,000</u>	<u>£6,000</u>
Total taxable income	<u>£16,000</u>	<u>£37,000</u>	<u>£43,000</u>

Assume Higher Rate threshold is £36,000 for this example (2008/09 rates). Assume personal allowance used elsewhere.

Mr Smith's total taxable income is below the higher rate threshold of £36,000 and so he has no additional tax to pay. All his savings income will have been taxed at 20% only.

Mr Brown's total taxable income exceeds the higher rate threshold by £1,000, and so he will have additional tax of £200 to pay (£1,000 at 20%).

Because Mr Green's other taxable income already exceeds the higher rate threshold, his savings income will trigger additional tax of £1,200 (£6,000 at 20%). Mr Green's savings income will therefore have been taxed at 40%.

Different rules apply to share dividends falling into the Higher Rate band. The net dividend received is grossed up, and taxed at 32½% with a 10% tax credit for tax paid by the company, leaving a Higher Rate tax payer 22½% to pay on the element over the Higher Rate tax threshold. The 10% tax credit covers the basic rate tax due so there is no further tax due on dividends in the basic rate band.

## TAX ON SAVINGS INCOME *continued*

### LOWER RATE TAX PAYERS

From April 2008 the 10% starting rate tax band that applied to all kinds of income chargeable to Income Tax has been abolished. To offer a measure of relief to savers, a £2,230 (2007/08) 10% band exists for savings income. If an individual's taxable non-savings income is above this limit then the 10% savings rate will not be applicable.

Suppose the savings income is received as follows:

			Taxable gross
Bank interest	£160 net	(£40 tax deducted)	£200
Building society interest	£320 net	(£80 tax deducted)	£400
			<hr/> £600 <hr/>
	Mr Smith	Mr Brown	Mr Green
Other taxable income	£nil	£5,500	£10,000
Savings income	<u>£600</u>	<u>£600</u>	<u>£600</u>
Total taxable income	<u>£600</u>	<u>£6,100</u>	<u>£10,600</u>

Mr Smith's income is below the Personal Allowance level of £5,435 (2007/08) so he can reclaim all the tax paid at source, £600.

Mr Brown's savings income falls in the band of £5,435 to £7,665 (i.e. £5,435 + £2,230), so his savings will be charged at 10%. He claims a refund of £300.

Mr Green's non-savings income is over £7,665 so he claims no refund.

NB the above rules apply only for tax deducted at source on bank interest, building society interest and similar. The 10% tax credit given on investment income can never be reclaimed.

Please call us if you would like further information on this subject.

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