Taxation in the United Kingdom

Taxation in the United Kingdom may involve payments to a minimum of two different levels of government: **1)the central government (Her Majesty's Revenue and Customs)** and **2) local government.** Central government revenues come primarily from income tax, National Insurance contributions, value added tax, corporation tax and fuel duty.

Local government revenues come primarily from grants from central government funds, business rates in England and Wales, Council Tax and increasingly from fees and charges such as those from on-street parking. In the fiscal year 2007-08, total government revenue was 39.2 per cent of GDP, with net taxes and National Insurance contributions standing at 36.9 per cent of GDP—approximately £600 billion (using 2008 nominal GDP measured in dollars, and converting using 2009 conversion rate. GDP is the Gross Domestic Product which is an indicator to gauge the health of a countries' economy).

History

A uniform Land tax was introduced in England during the late 17th century. This formed the main source of government revenue throughout the rest of the 17th century, the 18th century and the early 19th century.

Income tax was announced in Britain by William Pitt the Younger in his budget of December 1798 and introduced in 1799, to pay for weapons and equipment in preparation for the Napoleonic Wars. Pitt's new graduated (progressive) income tax began at a levy of 2 old pence in the pound (1/120) on incomes over £60 (£5,348 as of 2014), and increased up to a maximum of 2 shillings (10%) on incomes of over £200. Pitt hoped that the new income tax would raise £10 million, but actual receipts for 1799 totaled just over £6 million.

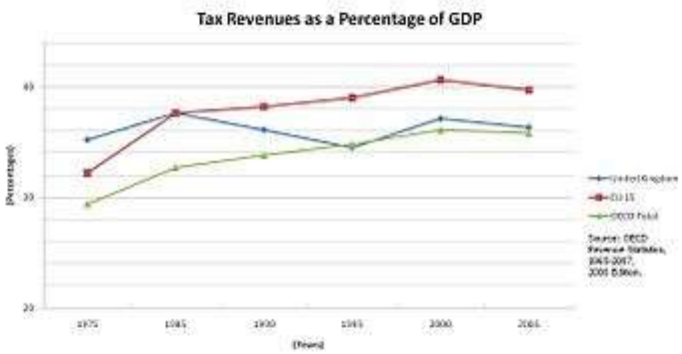
Income tax was levied under five schedules. Income not falling within those schedules was not taxed. The schedules were:

- Schedule A (tax on income from United Kingdom land)
- Schedule B (tax on commercial occupation of land)
- Schedule C (tax on income from public securities)
- Schedule D (tax on trading income, income from professions and vocations, interest, overseas income and casual income)
- Schedule E (tax on employment income)

Later a sixth Schedule, Schedule F (tax on United Kingdom dividend income) was added.

Pitt's income tax was levied from 1799 to 1802, when it was abolished by Henry Addington during the Peace of Amiens. Addington had taken over as prime minister in 1801, after Pitt's resignation over Catholic Emancipation. The income tax was reintroduced by Addington in 1803 when hostilities recommenced, but it was again abolished in 1816, one year after the Battle of Waterloo. The United Kingdom income tax was reintroduced by Sir Robert Peel in the Income Tax Act 1842. Peel, as a Conservative, had opposed income tax in the 1841 general election, but a growing budget deficit required a new source of funds. The new income tax, based on Addington's model, was imposed on incomes above £150 (£11,956 as of 2014).

United Kingdom income tax has changed over the years. Originally it taxed a person's income regardless of who was beneficially entitled to that income, but now a person owes tax only on income to which he or she is beneficially entitled. Most companies were taken out of the income tax net in 1965 when corporation tax was introduced. These changes were consolidated by the Income and Corporation Taxes Act 1970. Also the schedules under which tax is levied have changed. Schedule B was abolished in 1988, Schedule C in 1996 and Schedule E in 2003. For income tax purposes, the remaining schedules were superseded by the Income Tax (Trading and Other Income) Act 2005, which also repealed Schedule F completely. For corporation tax purposes, the Scheduler system was repealed and superseded by the Corporation Tax Act 2009 and Corporation Tax Act 2010. The highest rate of income tax peaked in the Second World War at 99.25%. It was slightly reduced after the war and was around 90% through the 1950s and 60s.



Tax revenues as a percentage of GDP for the UK in comparison to the OECD and the EU 15.

In 1971 the top-rate of income tax on earned income was cut to 75%. A surcharge of 15% on investment income kept the top rate on that income at 90%. In 1974 this cut was partly reversed, and the top rate on earned income raised to 83%. With the investment income surcharge this raised the top rate on investment income to 98%, the highest permanent rate since the war. This applied to incomes over £20,000 (£176,477 as of 2014). In 1974, as many as 750,000 people were liable to pay the top-rate of income tax. Margaret Thatcher, who favoured indirect taxation, reduced personal income tax rates during the 1980s. In the first budget after her election victory in 1979, the top rate was reduced from 83% to 60% and the basic rate from 33% to 30%. The basic rate was also cut for three successive budgets - to 29% in the 1986 budget, 27% in 1987 and to 25% in 1988.[7] The top rate of income tax was cut to 40% in the 1988 budget. The investment income surcharge was abolished in 1985.

Subsequent governments reduced the basic rate further, down to its present level of 20% in 2007.Since 1976 (when it stood at 35%) the basic rate has been reduced by 15 percentage points. However, this reduction has been largely offset by increases in national insurance contributions and value added tax.

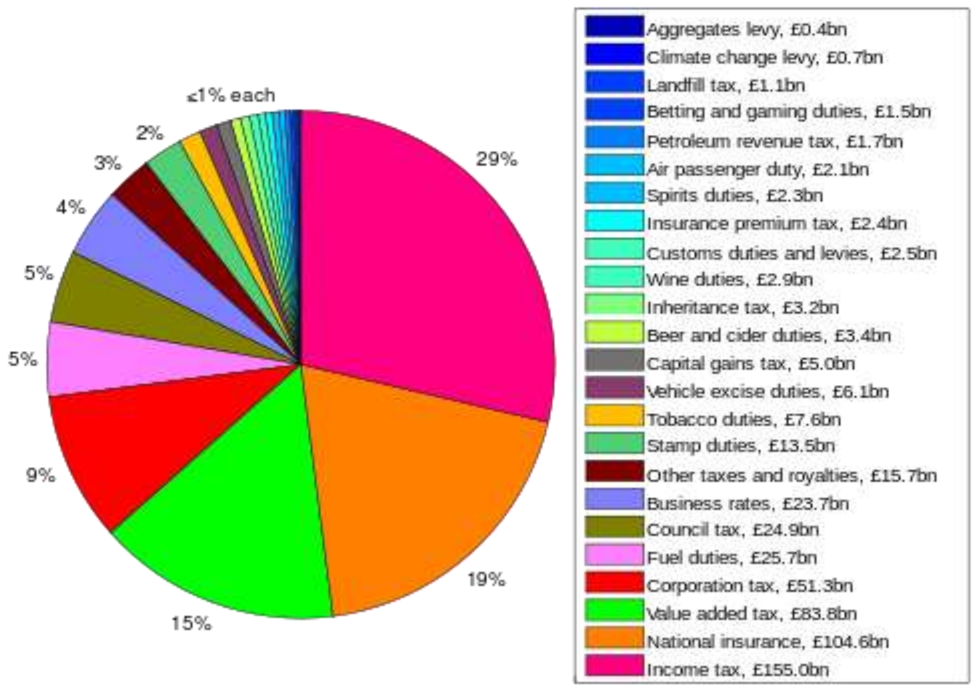
In 2010 a new top rate of 50% was introduced on income over £150,000. A predictable result of this was for people to disguise their income and revenue to the exchequer to go down. In the 2012 budget this rate was cut to 45%.

Business rates were introduced in England and Wales in 1990, and are a modernised version of a system of rating that dates back to the Elizabethan Poor Law of 1601. As such, business rates retain many previous features from, and follow some case law of, older forms of rating. The Finance Act 2004 introduced an income tax regime known as "pre-owned asset tax" which aims to reduce the use of common methods of inheritance tax avoidance.

Overview

Income tax forms the single largest source of revenues collected by the government. The second largest source of government revenue is National Insurance Contributions. The third largest source of government revenues is value added tax (VAT), and the fourth-largest is corporation tax.

Residence and domicile



United Kingdom source income is generally subject to United Kingdom taxation no matter the citizenship nor the place of residence of the individual nor the place of registration of the company.

For individuals this means the United Kingdom income tax liability of one who is neither resident nor ordinarily resident in the United Kingdom is limited to any tax deducted at source on UK income, together with tax on income from a trade or profession carried on through a permanent establishment in the United Kingdom and tax on rental income from United Kingdom real estate.

Individuals who are both resident and domiciled in the United Kingdom are additionally liable to taxation on their worldwide income and gains. For individuals resident, but not domiciled in the United Kingdom (a "non-dom"), foreign income and gains have historically been taxed on the remittance basis, that is to say, only income and gains remitted to the United Kingdom are taxed (for such people the

United Kingdom is sometimes called a tax haven). However from 6 April 2008, a (long term [resident 7 of previous 9 years]) non-dom wishing to retain the remittance basis is required to pay an annual tax of £30,000.

United Kingdom domiciled individuals who are not resident for three consecutive tax years are not liable for United Kingdom taxation on their worldwide income, and those who are not resident for five consecutive tax years are not liable for United Kingdom taxation on their worldwide capital gains. Anyone who stays in the United Kingdom for 183 or more days per year is resident.

Domicile here is a term with a technical meaning. Very roughly (and this is a considerable simplification) an individual is domiciled in the United Kingdom if he was born in the United Kingdom or if the United Kingdom is his permanent home, and is not a United Kingdom domicile if he was born outside of the UK and does not intend to remain permanently.

A company is resident in the United Kingdom if it is United Kingdom-incorporated or if its central management and control are in the United Kingdom (although in the former case a company could be resident in another jurisdiction in certain circumstances where a tax treaty applies).

Double taxation of income and gains may be avoided by an applicable double tax treaty - the United Kingdom has one of the largest networks of treaties of any country.

Examples of non-dom status

Most migrant workers (including those from within the EEA) would classify as non-doms. However, since the non-dom exemption applies only to income sourced from outside of the United Kingdom, the majority of people making use of the tax exemption are wealthy individuals with substantial income from outside of the United Kingdom (e.g. from foreign savings). Typical such individuals include senior company executives, bankers, lawyers, business owners and international recording artists.

The tax year

The tax year is sometimes also called the Fiscal Year. The Financial Year, used mainly for corporation tax purposes can be chosen by each company, and typically runs from 1 April to 31 March. Financial Year 2011 runs from 1 April 2010 to 31 March 2011, as Financial Years are named according to the calendar year in which they end.

The British Personal Tax year runs from 6 April - 5 April in the subsequent year.

Income tax

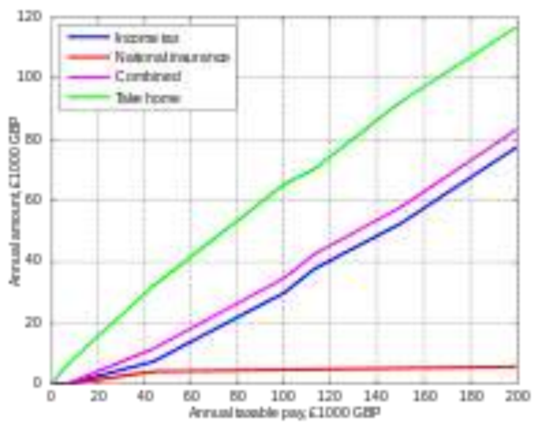
Income tax is the single largest source of government revenue, making up about 30% of the total, followed by National Insurance contributions at around 20%.

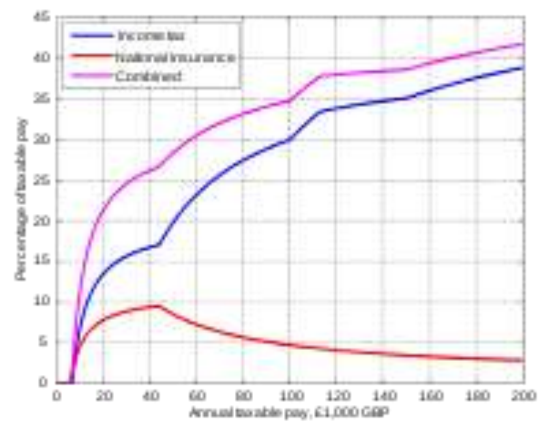
Each person has an income tax personal allowance, and income up to this amount in each tax year is free of tax. For the 2012/13 tax year, the tax-free allowance for under-65s with income less than £100,000 is £8105.

Any income above the personal allowance is taxed using a number of bands:

2014/15

Rate	Dividend income	Savings income	Other income (inc employment)	Band (above any personal allowance)
Basic rate	10%	20%	20%	£0 - £31,86
Higher rate	32.5%	40%	40%	£31,866- £150,000
Additional rate	37.5%	42.5%	45%	Over £150,000





This table reflects the removal of the 10% starting rate from April 2008, which also saw the 22% income tax rate drop to 20%. Alistair Darling announced in the 2009 budget (22 April 2009) that, from April 2010 there would be a new 50% income tax rate for those earning more than £150,000. Income threshold for high taxation rate on income was decreased to 32,011 in 2013.

For every £2 earned above £100,000, £1 of the personal allowance is lost. This means for incomes between £100,001 and £116,210 the marginal tax rate is 60%.

After consideration of employer and employee National Insurance contributions, the highest effective marginal top rate is 58% which is equal to the effective marginal top rate for 2011-12: that is, after the first £150,000, to pay an employee an additional £1,000 of taxable income costs the employer £1,138 and the employee receives £480 after deductions.

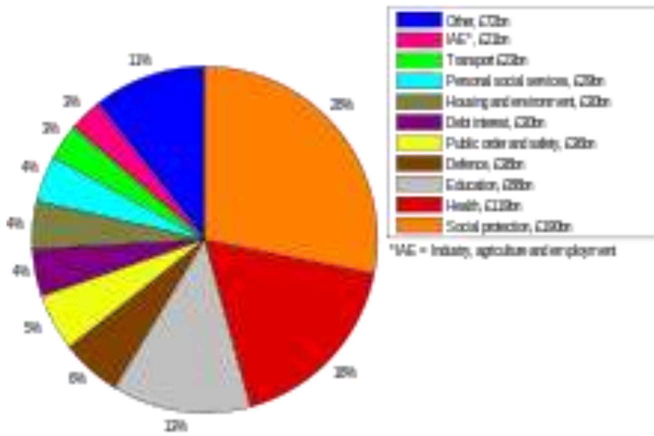
The taxpayer's income is assessed for tax according to a prescribed order, with income from employment using up the personal allowance and being taxed first, followed by savings income (from interest or otherwise unearned) and then dividends.

Foreign income of United Kingdom residents is taxed as United Kingdom income, but to prevent double taxation the United Kingdom has agreements with many countries to allow offset against United

Kingdom tax what is deemed paid abroad. These deemed amounts paid abroad are not necessarily as much as actually paid.

Rental income on a property investment business (such as a buy to let property) is taxed as other savings income, after allowing deductions including mortgage interest. The mortgage does not need to be secured against the property receiving the rent, subject to a maximum of the purchase prices of the property investment business properties (or the market value at the time they transferred into the business). Joint owners can decide how they divide income and expenses, as long as one does not make a profit and the other a loss. Losses can be brought forward to subsequent years.

Exemptions on Investment



UK central government expenditure projection for tax year 2009-2010, according to the 2009 Pre-Budget Report.

Certain investments carry a tax favoured status including:

- UK Government Bonds (Gilts)

While all income is taxable, gains are exempt for income tax purposes.

- National Savings and Investments

Certain investments via the state owned National Savings scheme are not subject to tax including Index linked Certificates (up to £15,000 per issue) and Premium Bonds, a scheme that issues monthly prizes in place of interest on individual holdings up to £30,000.

- **Individual Savings Accounts**

Interest is paid tax-free, while dividends are paid along with a tax credit to the investor which can then be offset against dividend tax due. For a basic rate tax payer this means they have no tax to pay on a dividend. There is no overall limit on how much a person can have invested in ISA accounts, but additional investments are currently limited to £11,280 per person per year: a maximum of £5,640 in cash funds, with the balance being allocated either to mutual funds (Units Trusts and OEICs) or individual self-selected shares.

- **Pension funds**

These have the same tax treatment as ISAs in terms of growth. Full tax relief is also given at the individual's marginal rate on contributions or, in the case of an employer contributions, it is treated as an expense and is not taxed on the employee as a benefit in kind. Aside from a tax free lump sum of 25% of the fund, benefits taken from pension funds are taxable.

- **Venture Capital Trusts**

These are investments in smaller companies or funds of holdings in such companies over a minimum term of five years. These are not taxable and qualify for 30% tax relief against an individual's income.

- **Enterprise Investment Schemes**

A non taxable investment into smaller company shares over three years that qualifies for 20% tax relief. The facility also allows an individual to defer capital gains liabilities (these gains can be stripped out in future years using the annual CGT allowance.)

- **Insurance bonds**

These include offshore and onshore investment bonds issued by insurance companies. The main difference between the two is that corporation tax paid by the onshore bond means that gains in the onshore bond are treated as if basic rate tax has been paid (this cannot be reclaimed by zero or starting rate tax payers). With both versions up to 5% for each complete year of investment can be taken without an immediate tax liability (subject to a maximum total of 100% of the original investment). On this basis, investors can plan an income stream while deferring any chargeable withdrawals until they are on a lower rate of tax, are no longer a United Kingdom resident, or their death.

- **Offshore trusts and companies**

Trusts can be offshore if all trustees are non-resident. Such trusts can own foreign-operated companies. Corporation tax rates can be lower in some countries and where we still have double taxation treaties. However, since anti-avoidance rules have been introduced for taxation of trusts, these structures are not advantageous for someone who will remain resident.

Exceptions

Many holdings and income from them are exempt for "historical reasons". These include:

- Special, low tax arrangements for the monarchy, such as the arrangement used by the British Royal Family to avoid inheritance taxation.
- Reduced income tax for special classes of person. For instance non-doms, who are resident in the United Kingdom but not "domiciled", are not subject to UK income tax on their non-UK income.[24]

- An Act of Parliament to protect the Earl of Abingdon and his “heirs and assignees” from paying income tax on the tolls on the Swinford Toll Bridge.
- The income of charities is usually exempt from United Kingdom income tax.[25]

Inheritance tax

Main article: Inheritance Tax (United Kingdom)

Inheritance tax is levied on "transfers of value", meaning:

1. the estates of deceased persons;
2. gifts made within seven years of death (known as Potentially Exempt Transfers or "PETs");
3. "lifetime chargeable transfers", meaning transfers into certain types of trust. See Taxation of trusts (United Kingdom).

The first slice of cumulative transfers of value (known as the "nil rate band") is free of tax. This threshold is currently set at £325,000 (tax year 2012/13) and has recently failed to keep up with house price inflation with the result that some 6 million households currently fall within the scope of inheritance tax. Over this threshold the rate is 40% on death or 36 per cent if the estate qualifies for a reduced rate as a result of a charitable donation. Since October 2007, married couples and registered civil partners can effectively increase the threshold on their estate when the second partner dies - to as much as £650,000 in 2012-13. Their executors or personal representatives must transfer the first spouse or civil partner's unused Inheritance Tax threshold or 'nil rate band' to the second spouse or civil partner when they die.

Transfers of value between United Kingdom-domiciled spouses are exempt from tax. Recent changes to the tax brought in by the Finance Act 2008 mean that nil-rate bands are transferable between spouses to reduce this burden - something which previously could only be done by setting up complex trusts.

Gifts made more than seven years prior to death are not taxed; if they are made between three and seven years before death a tapered inheritance tax rate applies. There are some important exceptions to this treatment: the most important is the "reservation of benefit rule", which says that a gift is ineffective for inheritance tax purposes if the giver benefits from the asset in any way after the gift (for example, by gifting a house but continuing to live in it).

Council Tax

Main article: Council Tax

Council tax is the system of local taxation used in England, Scotland and Wales to part fund the services provided by local government in each country. It was introduced in 1993 by the Local Government Finance Act 1992, as a successor to the unpopular Community Charge ("poll tax"), which had (briefly) replaced the Rates system. The basis for the tax is residential property, with discounts for single people. As of 2008, the average annual levy on a property in England was £1,146. In 2006/2007 council tax in England amounted to £22.4 billion and an additional £10.8 billion in sales, fees and charges,

Sales taxes and duties

Value added tax

Main article: Value Added Tax (United Kingdom)

The third largest source of government revenues is value added tax (VAT), charged at 20% on supplies of goods and services. It is therefore a tax on consumer expenditure.

Certain goods and services are exempt from VAT, and others are subject to VAT at a lower rate of 5% (the reduced rate, such as domestic gas supplies) or 0% ("zero-rated", such as most food and children's clothing). Exemptions are intended to relieve the tax burden on essentials while placing the full tax on luxuries, but disputes based on fine distinctions arise, such as the notorious "Jaffa Cake Case" which hinged on whether Jaffa Cakes were classed as (zero-rated) cakes—as was eventually decided—or (fully taxed) chocolate-covered biscuits. Until 2001, VAT was charged at the full rate on sanitary towels.

It was introduced in 1973, in consequence of Britain's entry to the European Economic Community, at a standard rate of 10%. In July 1974, the standard rate became 8%, and from October that year petrol was taxed at a new higher rate of 25%. In the budget of April 1975 the higher rate was extended to a wide range of "luxury" goods. In the budget of April 1976 the 25% higher rate was reduced to 12.5%. On 18 June 1979, the higher rate was scrapped and VAT set at a single rate of 15%. In 1991 this became 17.5%, though when domestic fuel and power was added to the scheme in 1994, it was charged at a new, lower rate of 8%. In September 1997 this lower rate was reduced to 5%, and was extended to cover various energy-saving materials (from 1 July 1998), sanitary protection (from 1 January 2001), children's car seats (from 1 April 2001), conversion and renovation of certain residential properties (from 12 May 2001), contraceptives (from 1 July 2006) and smoking cessation products (from 1 July 2007).

On 1 December 2008, VAT was reduced to 15%, as a reaction to the late-2000s recession, by Chancellor Alistair Darling.

On 1 January 2010 VAT returned to 17.5%.

On 4 January 2011 VAT was raised to 20% by Chancellor George Osborne, where it remains.

Excise duties

Excise duties are charged on, amongst other things, motor fuel, alcohol, tobacco, betting and vehicles.

Stamp duty

Stamp duty is charged on the transfer of shares and certain securities at a rate of 0.5%. Modernised versions of stamp duty, stamp duty land tax and stamp duty reserve tax, are charged respectively on the transfer of real property and shares and securities, at rates of up to 4% and 0.5% respectively.

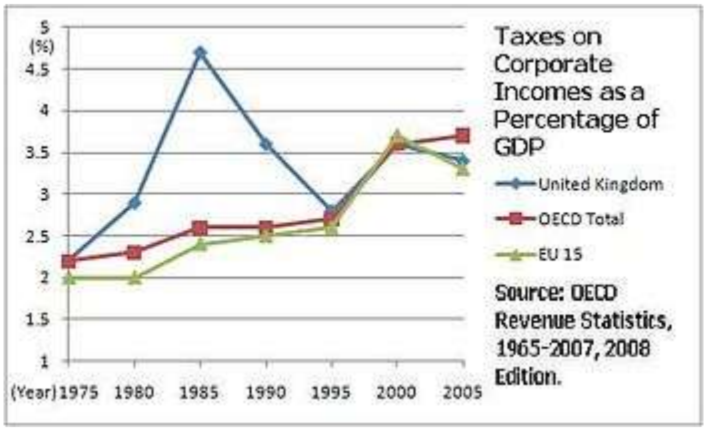
Motoring taxation

Main article: Motoring taxation in the United Kingdom

Motoring taxes include: fuel duty (which itself also attracts VAT), and vehicle excise duty. Other fees and charges include the London congestion charge, various statutory fees including that for the compulsory vehicle test and that for vehicle registration, and in some areas on-street parking (as well as associated charges for violations).

Business taxes

Corporate Tax



UK corporate tax revenue as a percentage of GDP compared to the OECD and the EU 15.

Corporation tax is a tax levied in the United Kingdom on the profits made by companies and on the profits of permanent establishments of non-UK resident companies and associations that trade in the EU.

Corporation tax forms the fourth-largest source of government revenue (after income, NIC, and VAT). Prior to the tax's enactment on 1 April 1965, companies and individuals paid the same income tax, with an additional profits tax levied on companies. The Finance Act 1965[37] replaced this structure for companies and associations with a single corporate tax, which borrowed its basic structure and rules from the income tax system. Since 1997, the United Kingdom's Tax Law Rewrite Project has been modernising the United Kingdom's tax legislation, starting with income tax, while the legislation imposing corporation tax has itself been amended; the rules governing income tax and corporation tax have thus diverged.

Business rates

Business rates is the commonly used name of non-domestic rates, a United Kingdom rate or tax charged to occupiers of non-domestic property. Business rates form part of the funding for local government, and are collected by them, but rather than receipts being retained directly they are pooled centrally and then redistributed. In 2005/06, £19.9 billion was collected in business rates, representing 4.35% of the total United Kingdom tax income.

Business rates are a property tax, where each non-domestic property is assessed with a rateable value, expressed in pounds. The rateable value broadly represents the annual rent the property could have been let for on a particular valuation date according to a set of assumptions. The actual bill payable is then calculated using a multiplier set by central government, and applying any reliefs.

Business and personal taxes

Some taxes are, depending on the circumstances, paid by both individuals and companies and government

National Insurance contributions

The second largest source of government revenues is National Insurance contributions (NICs). NICs are payable by employees, employers and the self-employed and in the 2010-2011 tax year £96.5 billion was raised, 21.5% of the total collected by HMRC.

Employees and employers pay contributions according to a complex classification based on employment type and income. Class 1 (employed persons) NIC is charged at several rates depending on various income thresholds and a number of other factors including age, the type of occupational pension scheme contributed to by the employee and/or employer and whether or not the employee is an ocean-going mariner. Certain married women who opted to pay reduced contributions (in return for reduced benefits) prior to 1977 retain this right for historical reasons.

Employers also pay contributions on many benefits in kind provided to employees (such as company cars), and on tax liabilities met on behalf of employees via a "PAYE Settlement Agreement".

There are separate arrangements for self-employed persons, who are normally liable to Class 2 flat rate NIC and Class 4 earnings-related NIC, and for some voluntary sector workers.

Capital gains tax

Capital gains are subject to tax at 18 or 28% (for individuals) or at the applicable marginal rate of corporation tax (for companies).

The basic principle is the same for individuals and companies - the tax applies only on the disposal of a capital asset, and the amount of the gain is calculated as the difference between the disposal proceeds and the "base cost", being the original purchase price plus allowable related expenditure. However, from 6 April 2008, the rate and reliefs applicable to the chargeable gain differ between individuals and companies. Companies apply "indexation relief" to the base cost, increasing it in accordance with the Retail Prices Index so that (broadly speaking) the gain is calculated on a post-inflation basis (with different rules apply for gains accrued prior to March 1982). The gain is then subject to tax at the applicable marginal rate of corporation tax.

Individuals are taxed at a flat rate of 18% (or since 22 June 2010, 28% for higher rate taxpayers) with no indexation relief. However, if claiming Entrepreneurs' Relief the rate remains 10%. Capital losses from prior years can be brought forward.

Expenditure on a business (such as a property business) made by an individual can be claimed as an allowance against Capital Gains. Whether expenditure is claimable against income (potentially reducing income tax) or capital (potentially reducing capital gains tax) depends on whether there was improvement of the property: if there was none, it is against income; if there was some, then it is against capital.

Transfers between husband and wife or between civil partners do not crystallise a capital gain, but instead transfer the purchase price (book cost). Otherwise, transfers made as gifts are treated for CGT purposes as being made at the market value at the date of transfer.