M&G

Mastering the The 7 steps of the UK Income Tax calculation

Learning Objectives

By the end of this session, you will be able to:

Describe the Key elements of an individual's UK income tax calculation	Calculate the income tax liability for a UK individual	Explain how clients could take steps to reduce their tax liability

The UK income tax computation

1	work out total income
2	deduct allowable reliefs
3	deduct personal allowances
4	tax the income at appropriate rates
5	add up the tax
6	deduct tax reducers
7	add tax additions

Tax liability

STEP 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

Total income

PCLS

ISA income

Salary

Pension income

Benefits in Kind

Bank Interest

VCT dividends

Trading income

Capital Gains

Pension Death Benefits

Foreign income

UFPLS

Rental income

State Benefits

OEIC dividends

OEIC interest

Redundancy

NS&I Interest

Bond Gains

Bond withdrawals within TDA

Capital element of PLA

Partnership Profits

Trust income

DGT withdrawals

Total income

Salary ✓

Pension income ✓

Benefits in Kind ✓

PCLS

ISA income

Bank Interest ✓

Trading income ✓

VCT dividends

Pension Death Benefits

Foreign income

Capital Gains

UFPLS

OEIC dividends ✓

OEIC interest ✓

State Benefits

Rental income ✓

Redundancy

NS&I Interest

Bond Gains ✓

Bond withdrawals within TDA

Capital element of PLA

Partnership Profits ✓

Trust income ✓

DGT withdrawals

Total income

Salary

Pension income

Benefits in Kind

PCLS ❌

ISA income ❌

Pension Death Benefits

Foreign income

Capital Gains ❌

Trading income

Bank Interest

VCT dividends ❌

UFPLS

State Benefits

Rental income

OEIC dividends

OEIC interest

Redundancy

Bond Gains

Bond withdrawals within TDA ❌

Capital element of PLA ❌

Partnership Profits

Trust income

NS&I Interest

DGT withdrawals ❌

Total income

Salary

Pension income

PCLS

ISA income

Benefits in Kind

Bank Interest

VCT dividends

Trading income

Capital Gains

Pension Death Benefits ?

Foreign income ?

UFPLS ?

OEIC dividends

OEIC interest

State Benefits ?

Rental income

Redundancy ?

Bond Gains ?
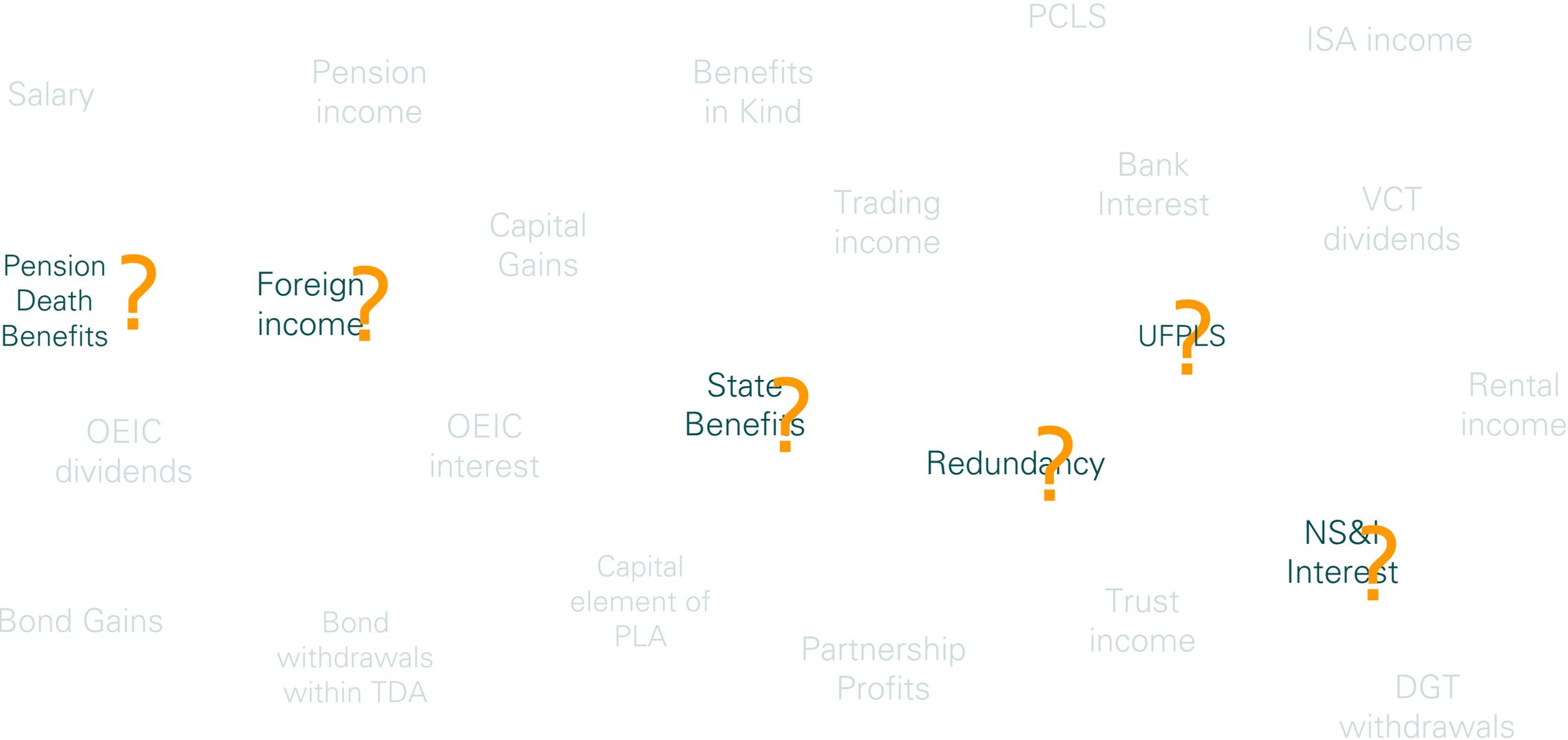
Bond withdrawals within TDA

Capital element of PLA

Partnership Profits

Trust income

NS&I Interest ?

DGT withdrawals

Total income   - D e b b ie

Debbie's finances are a bit complicated and you need to work out what her total income is for the tax year. What is going to be included?

Details	How much included?
Gross salary of £40,000. £2,000 pension into net pay scheme	£38,000
Redundancy payment £37,000	£7,000
VCT dividends of £750	£0
Dividends from equity OEIC holdings £3,000	£3,000
Interest from Saving OEIC £1,500	£1,500
Onshore bond gain £40,000 over 5 years so £8,000 slice	£40,000

Total income = £89,500

Total income   - Harry

Debbie's husband Harry isn't straightforward either!
What is going to be included in total income?

Details	How much included?
ISA withdrawals of £25,000	£0
National Savings Certificates Interest of £1,000	£0
Profit of £25,000 with allowable expenses of £5,000	£20,000
State pension of £10,000	£10,000
Taxable capital gain on sale of an OEIC of £15,000	£0
An UFPLS of £50,000	£37,500

Total income = £67,500

STEP 2

Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24... See sections 24A and 25 for further provision about the deduction of those reliefs.

The sum of the amounts of the components left after this step is "net income".

Allowable deductions

Accountants	Many and Varied	Don't confuse	There's a cap	Common ones
It's their world	Allowable losses, capital allowances etc	Step 3 & 6 more common in planning	greater of £50,000 or 25% of the individual's `adjusted total income'	Relief on making a claim pensions

The UK income tax computation

1	work out total income
2	deduct allowable reliefs

$=$ *"Net Income"*

Net income and the TAA

Threshold income

Section 228ZA(5) Finance Act 2004

An individual's threshold income is found by taking the following steps:

1. Start with the individual's Net income.
2. ADD The amount that would have been employment income but for the operation of a 'relevant salary sacrifice arrangement' made after 8 July 2015.
3. ADD The amount of that would have been employment income but for the operation of a 'relevant flexible remuneration arrangement' made after 8 July 2015
4. DEDUCT The gross amount of member contributions paid in the tax year using relief at source. That is the amount physically paid to the pension scheme plus the amount of basic rate relief claimable by the scheme administrator (see PTM044220).
5. DEDUCT The amount of any lump sum death benefit taxable as pension income of the recipient

Adjusted income

Section 228ZA(4) and paragraph 8(1) Schedule 36 Finance Act 2004

An individual's adjusted income is found by taking the following steps:

1. Start with the individual's Net income.
2. ADD the amount of any relief given under section 193(4) - claim for excess relief under a net pay arrangement - or 194(1) Finance Act 2004 – relief on making a claim (see PTM044240). Tax relief is given only when an individual claims it from HMRC. For individuals completing Self Assessment on the SA100 under the section 'Tax reliefs' this will be by completing box 3 for claims for excess relief or boxes 2 or 3 for relief on making a claim.
3. ADD the amount of member contributions paid via the net pay arrangement (see PTM044230) or with transitional corresponding relief (see PTM111500). Full tax relief will have been given in respect of these contributions by reducing the amount of the individual's employment income chargeable to tax.
4. ADD an amount equal to the individual's total pension input amount for the year minus the amount of member contributions paid in the tax year
5. DEDUCT the amount of any lump sum death benefit taxable as pension income of the recipient.

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"STEP 2 .5"

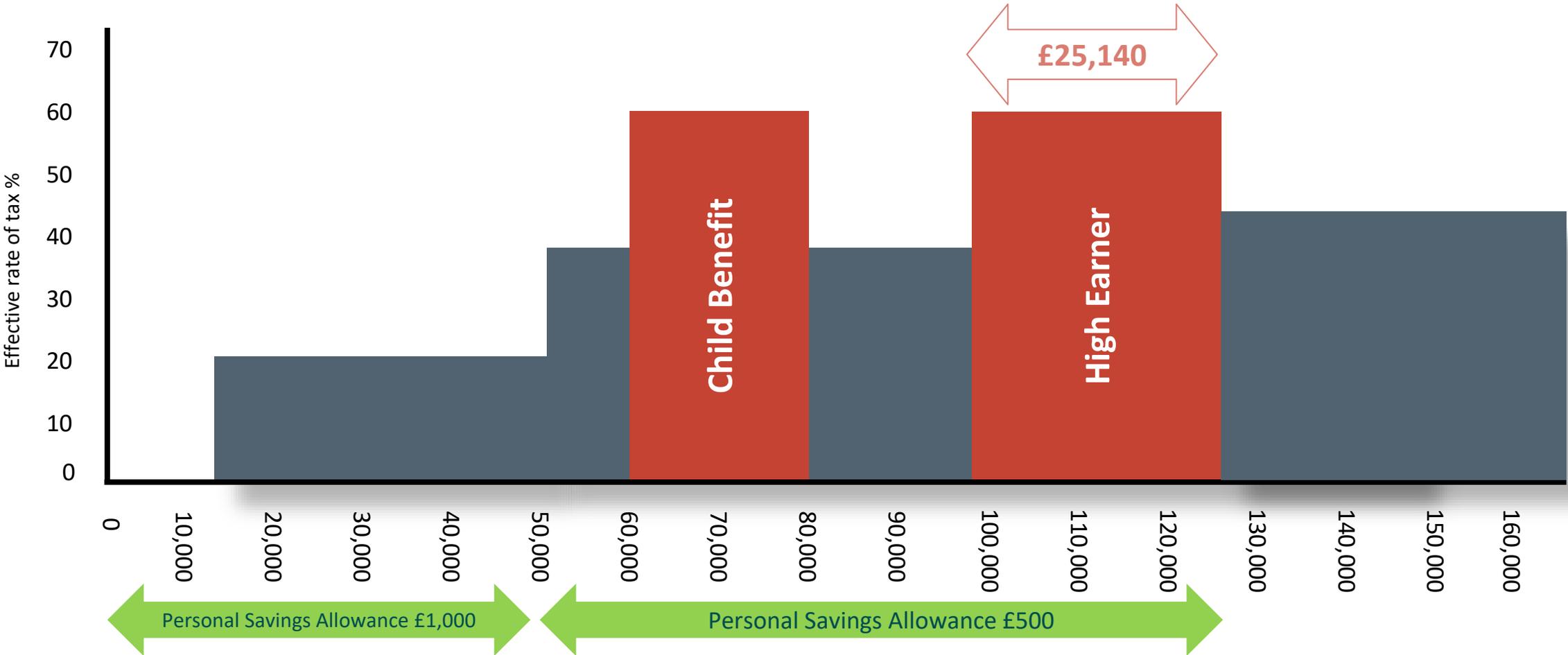### Adjusted Net Income

Adjusted Net Income

Adjusted Net Income
Net Income (after step 2)
<u>Less</u> Relief at Source pension (gross)
<u>Less</u> Gift Aid (gross)
<u>Add</u> Tax relief for certain union / police payments

Tax traps

Why pension contributions work

John, Kalpana and Lisa are all paid a salary of £120,000 p.a. and have no other income.

	John makes a £20,000 net pay contribution	Kalpana makes a £20,000 RAC contribution	Lisa makes a £16,000 RAS contribution
Step 1 Total income	£100,000	£120,000	£120,000
Step 2 Net income	£100,000	£100,000	£120,000
"Step 2.5" Adjusted Net Income	£100,000	£100,000	£100,000

STEP 3

Deduct from the amounts of the components left after
Step two any allowances to which the taxpayer is
entitled for the tax year...

See section 25 for further provision about the deduction
of those allowances.

Personal allowance

Who gets it?

- UK residents (those making a claim under the FIG regime lose it for the relevant tax year)

- Some non UK residents

How is it applied?

- Employed – via tax code

- Others – self assessment

Personal allowance

Who gets it?

- UK residents (those making a claim under the FIG regime lose it for the relevant tax year)

- Some non UK residents

How is it applied?

- Employed – via t...

...ssessment

Tax code and personal allowance are not the same thing!!

The UK income tax calculation

1	work out total income
2	deduct allowable reliefs
3	deduct personal allowances

= "Taxable Income"

Personal allowance

Who gets it?

How is it applied?

- UK residents (those making a claim under the FIG regime less...

- Employed – via t...

(2)   At Steps 2 and 3, deduct the reliefs and allowances in the way which will result in the greatest reduction in the taxpayer's liability to income tax.

- Some non UK residents
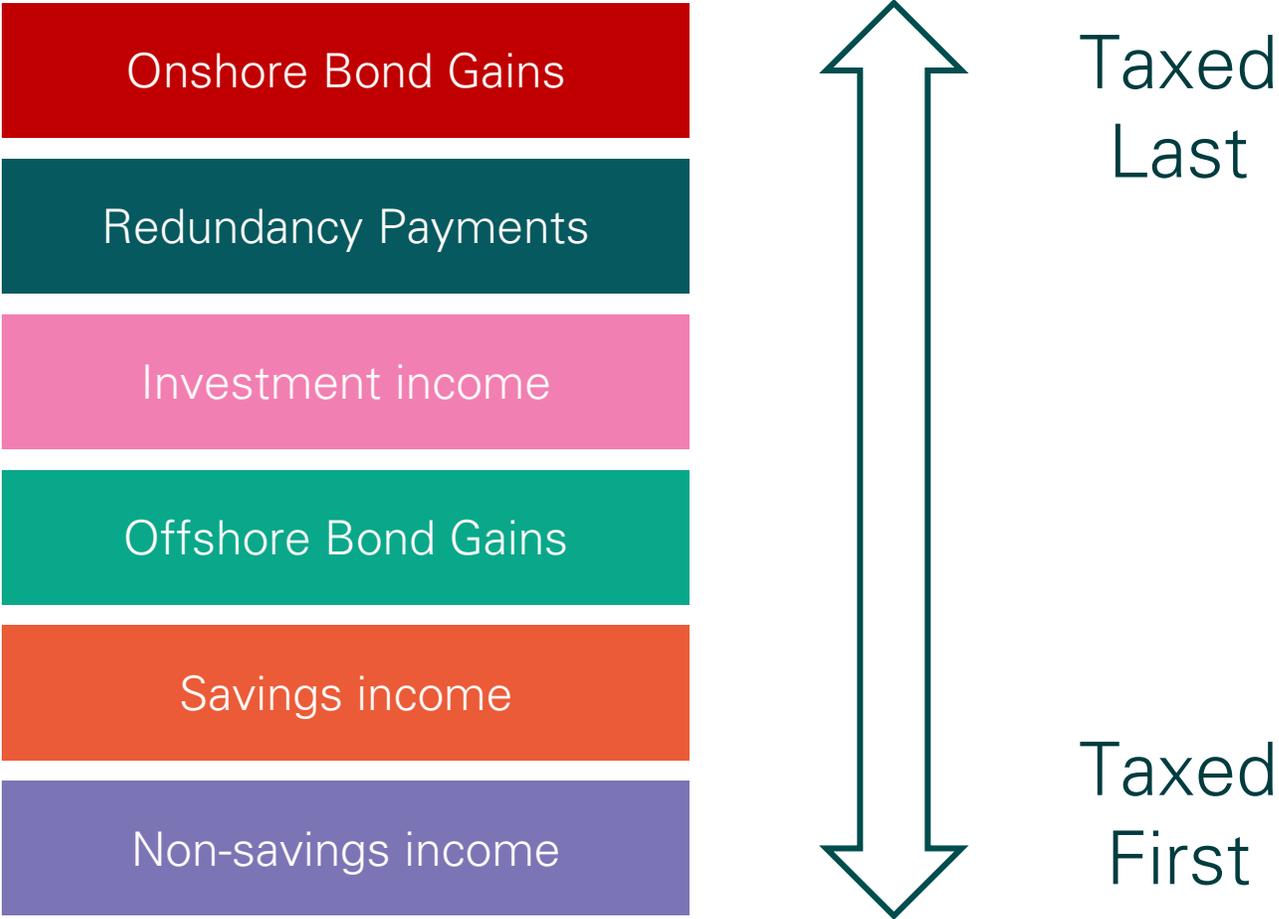
...assessment

STEP 4

Calculate tax at each applicable rate on the amounts of the components left after Step three.

See Chapter 2 of this Part for the rates at which income tax is charged and the income charged at particular rates

Order of tax

Onshore Bond Gains

Redundancy Payments

Investment income

Offshore Bond Gains

Savings income

Non-savings income

Taxed Last

Taxed First

Savings allowances

Taxable Income in statutory order

Personal Allowance

Starting Savings Rate

(up to £5,000)

Basic Rate

Personal Savings Allowance

(£1,000/ £500)

Higher Rate

Additional Rate
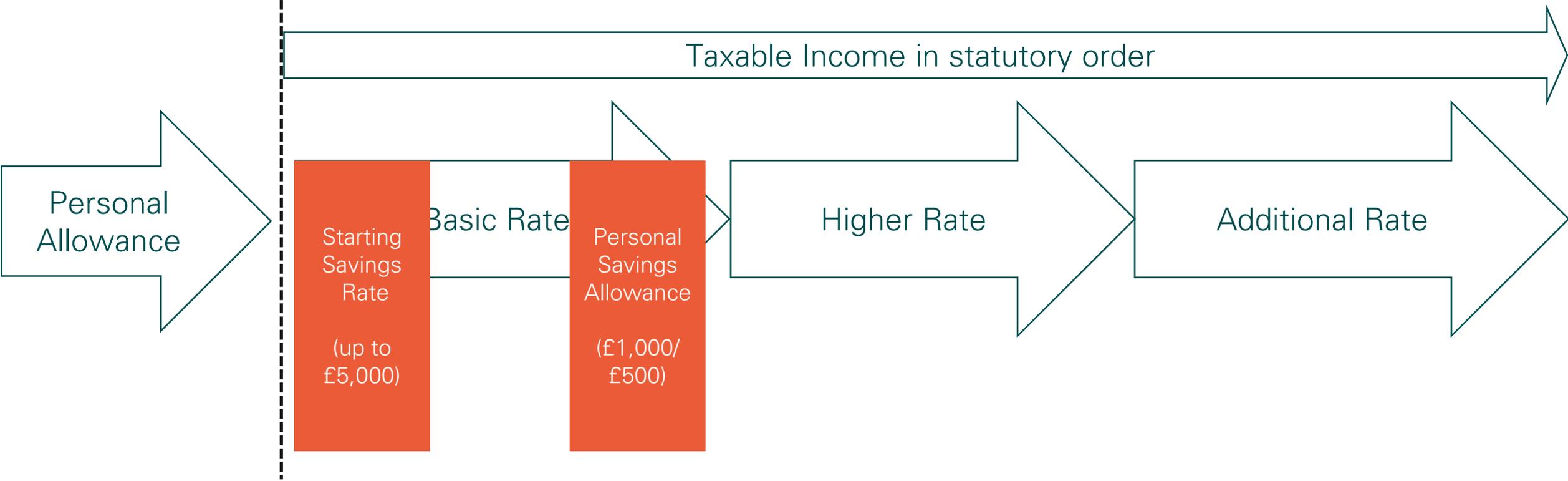
Dividend "allowance"

£2,000	£1,000	£500	£500
2022/23	2023/24	2024/25	2025/26

Beneficial ordering

Two twins Adam and Evie have identical income comprised of:

Salary	£10,000
Interest	£ 5,000
Dividends	£ 3,500

Adam decides to offset his personal allowance against his salary and interest

Evie decides to offset her personal allowance against her salary and dividends

Beneficial ordering

Adam

Taxable income	£5,930
Interest	£2,430
Dividends	£3,500

Source	Amount £	Band	Rate %	Tax due £
Interest	2,430	SR	0	0
Dividends	500	DNR	0	0
	3,000	BR	8.75	262.50
Tax liability				262.50

Evie

Taxable income	£5,930
Interest	£5,000
Dividends	£ 930

Source	Amount £	Band	Rate %	Tax due £
Interest	5,000	SR	0	0
Dividends	500	DNR	0	0
	430	BR	8.75	37.62
Tax liability				37.62

Devolved taxation

Belfast
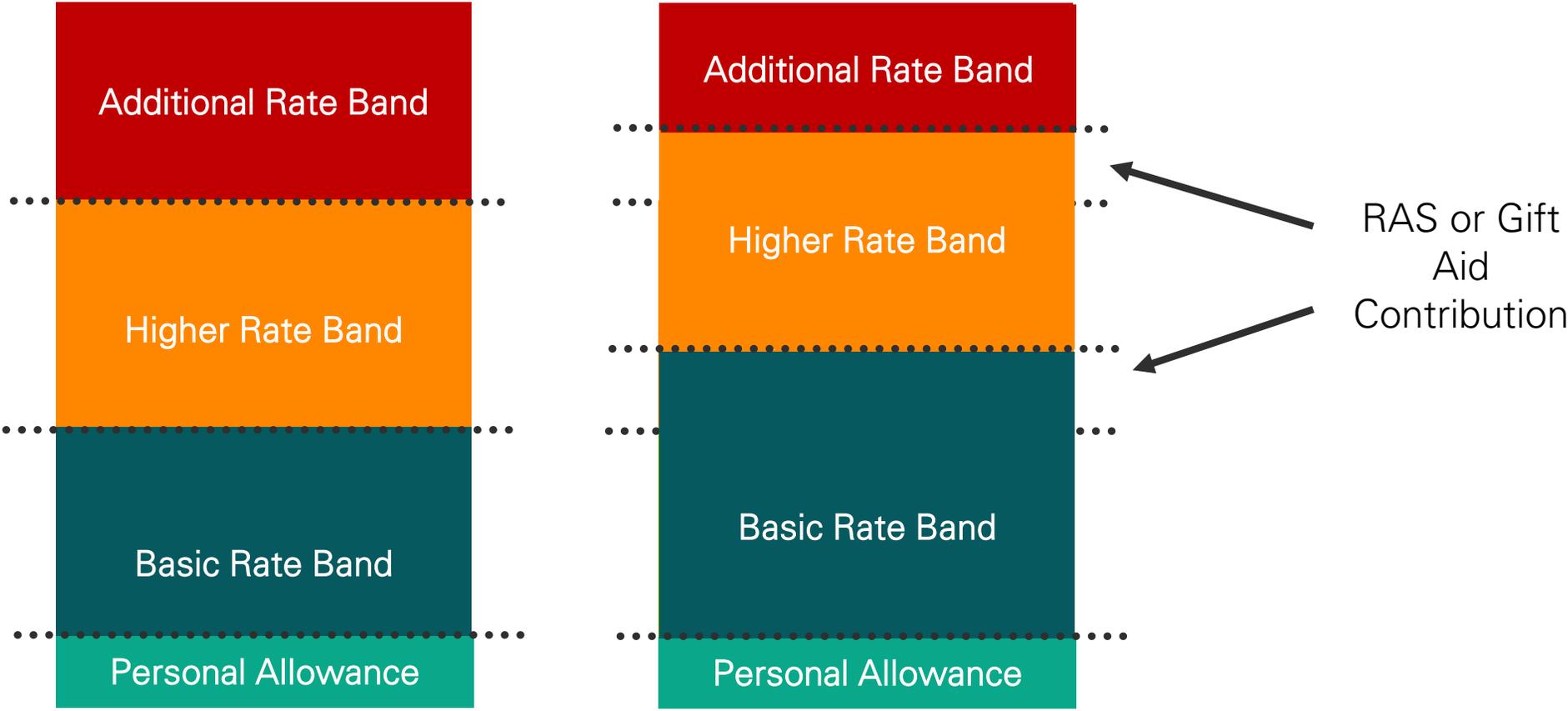No income tax powers

Edinburgh
Non savings, Non Dividend only

London
Non savings, Non Dividend (Eng & NI)
Savings
Dividends
Allowances (tax traps)
National Insurance
Capital Gains Tax
Corporation Tax

Cardiff
Non savings, Non Dividend only

Not all tax bands are equal

Upcoming tax rate changes

Savings Interest

- April 2027
- 2% increase for all
- 22% / 42% / 47%

Dividends

- April 2026
- 2% increase for basic and higher
- Additional not impacted
- 10.25% / 35.75% / 39.35%

Property Income

- April 2027
- Income for letting land or buildings
- Devolved
- 22% / 42% / 47%

STEP 5

Add together the amounts of tax calculated at step 4

STEP 6

Deduct from the amount of tax calculated at Step five any tax reductions to which the taxpayer is entitled for the tax year.

See sections 27 to 29 for further provision about the deduction of those tax reductions.

Tax reducers

5 things you need to know

Variety of reliefs not covered at step 2

Defined Order

Relief with highest saving comes first

Only available to the extent there is a liability

Double Taxation Agreements come last

Tax reducer examples

VCT / EIS

Investment
x
30%

VCT/EIS/SEIS income tax relief

	VCT	EIS	SEIS
Maximum Investment	£200,000	£1,000,000*	£200,000
Income tax relief	30%	30%	50%

*£2,000,000 if at least £1,000,000 is invested in knowledge intensive companies

VCT/EIS/SEIS income tax relief

	VCT	EIS	SEIS
Maximum Investment	£200,000	£1,000,000*	£200,000
Income tax relief	20% from 6th April 2026	30%	50%

*£2,000,000 if at least £1,000,000 is invested in knowledge intensive companies

VCT/EIS/SEIS income tax relief

In the current tax year Jane has taxable salary of £100,000.

Jane subscribes for £100,000 of EIS shares in the same tax year.

What is her income tax liability?

	Source	Amount £	Band	Rate %	Tax due £
	Salary	37,700	BR	20	7,540
Step 4		49,730	HR	40	19,892
Step 5	Total Tax				27,432
Step 6	EIS income tax relief £100,000 x 30%				27,432
	Tax liability				Nil

VCT/EIS/SEIS income tax relief

In the current tax year Jane has taxable salary of £100,000.

Jane subscribes for £100,000 of EIS shares in the same tax year.

What is her income tax liability?

Source	Amount £	Band	Rate %	Tax due £
Salary	37,700	BR	20	7,540
	49,730	HR	40	19,892
Total Tax				27,432
EIS incom...				27,432
				Nil

Step 4

Step 5

Step 6

Carry back excess relief?

Tax reducer examples

VCT / EIS

Investment
x
30%

Marriage Allowance

Up to 10% of unused Personal Allowance
X
20%

Marriage Allowance

David has pension income of £25,000 and interest of £1,500 from his savings account.

Mary has income of £10,000 and has made a claim to transfer 10% of her personal allowance to David.

After deduction of his **£12,570** personal allowance his taxable income is £13,930 for the tax year.

What is his tax liability?

	Source	Amount £	Band	Rate %	Tax due £
	Pension	12,430	BR	20	2,486
Step 4	Interest	1,000	PSA	0	0
		500	BR	20	100
Step 5	Total Tax				2,586
Step 6	Less marriage allowance 1,260 x 20%				252
	Tax liability				2,334

Tax reducer examples

VCT / EIS

Investment
x
30%

Marriage Allowance

Up to 10% of unused Personal Allowance X 20%

Onshore Bond Tax Credit

20% x gain **outside** personal allowance

Basic rate tax credit

Jimmy has salary of £25,000 and an onshore bond gain of £20,000. After deduction of his personal allowance his taxable income is £32,430 for the tax year.

What is his tax liability?

	Source	Amount £	Band	Rate %	Tax due £
	Salary	12,430	BR	20	2,486
Step 4	Bond Gain	1,000	PSA	0	0
		19,000	BR	20	3,800
Step 5	Total Tax				6,286
Step 6	Less tax credit				4,000
	Tax liability				2,286

Tax reducer examples

VCT / EIS

Investment
x
30%

Marriage Allowance

Up to 10% of unused Personal Allowance X 20%

Onshore Bond Tax Credit

20% x gain **outside** personal allowance

Top Slicing Relief

Complicated

Top slicing relief

Janine has salary of £25,000 and an onshore bond gain of £50,000 (over 5 years).

After deduction of her personal allowance her taxable income is £62,430 for the tax year.

What is her tax liability?

	Source	Amount £	Band	Rate %	Tax due £
	Salary	12,430	BR	20	2,486
Step 4	Bond Gain	500	PSA	0	0
		24,770	BR	20	4954
		24,730	HR	40	9,892
Step 5	Total Tax				17,332
Step 6	Less tax credit				10,000
	Less top slicing relief				4,846
	Tax liability				2,486

Top slicing relief

	Taxation of full gain		50,000			
					Tax	
	Personal Allowance	0	@	0%	0	
	Starting Rate	0	@	0%	0	
	Personal Savings Allowance	500	@	0%	0	
Step 1	Basic Rate	24,770	@	20%	4,954	
	Higher Rate	24,730	@	40%	9,892	
	Additional Rate	0	@	45%	0	
	Total Liability				14,846	
	Tax Credit				10,000	
Step 2	**Relieved liability on gain**				**£4,846**	

	Taxation of slice		10,000			
Step 3					**Tax**	
	Personal Allowance	0	@	0%	0	
	Starting Rate	0	@	0%	0	
	Personal Savings Allowance	1,000	@	0%	0	
	Basic Rate	9,000	@	20%	1,800	
	Higher Rate	0	@	40%	0	
Step 4	Additional Rate	0	@	45%	0	
	Total Liability				1,800	
	Tax Credit				2,000	
	Relieved Liability on Slice				£0	
	Derived years (N)				5.00	
	Relieved Liability on Slice x N				£0	

Top Slicing Relief

	Relieved liability on full gain	4846	a	
	Relieved Liability on Slice x N	0	b	
Step 5	**Top Slice Relief (a-b)**	**£4,846**		

Total tax on gain
less 20% tax

MINUS

Total tax on slice
Less 20% tax x "N"

EQUALS

Top Slicing relief

Tax reducer examples

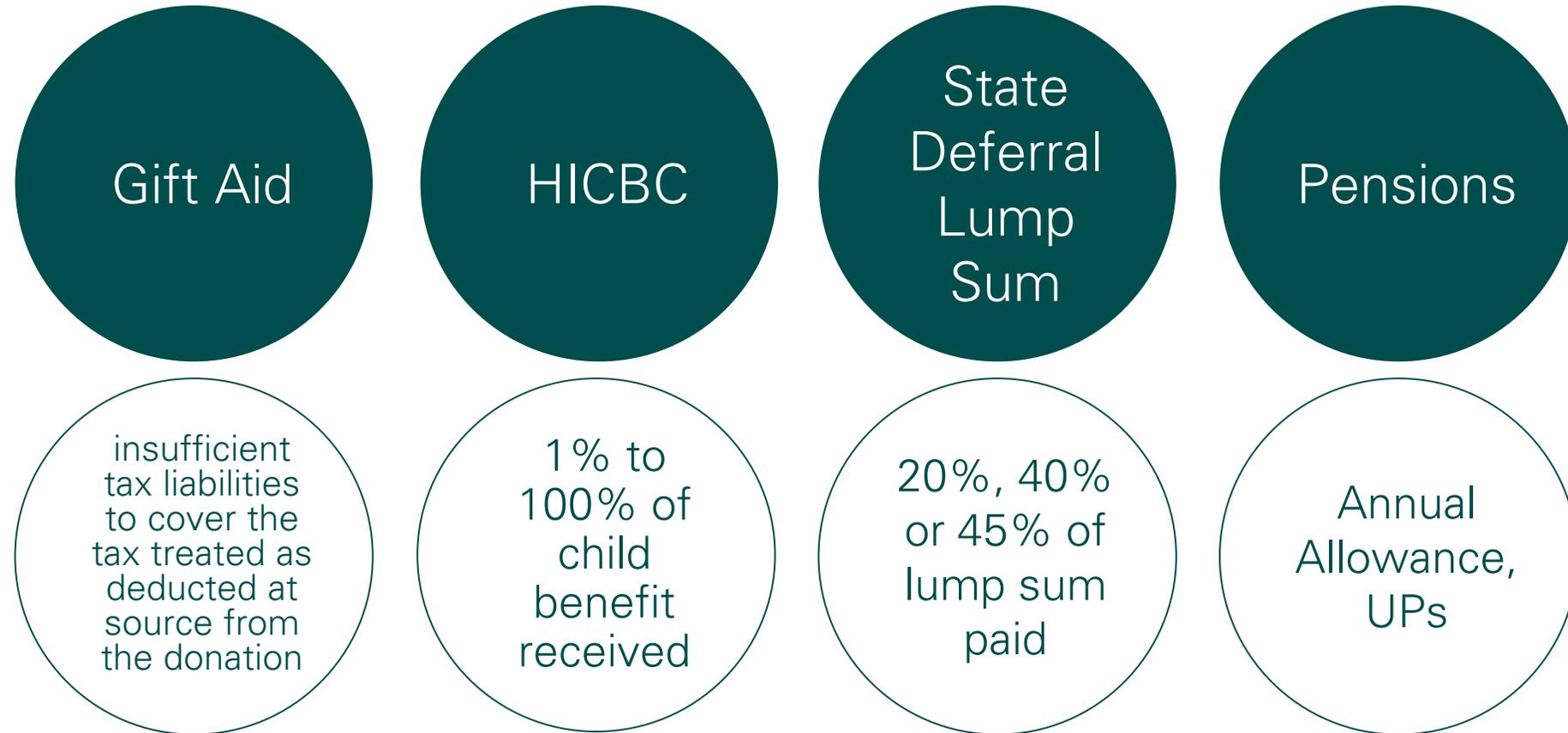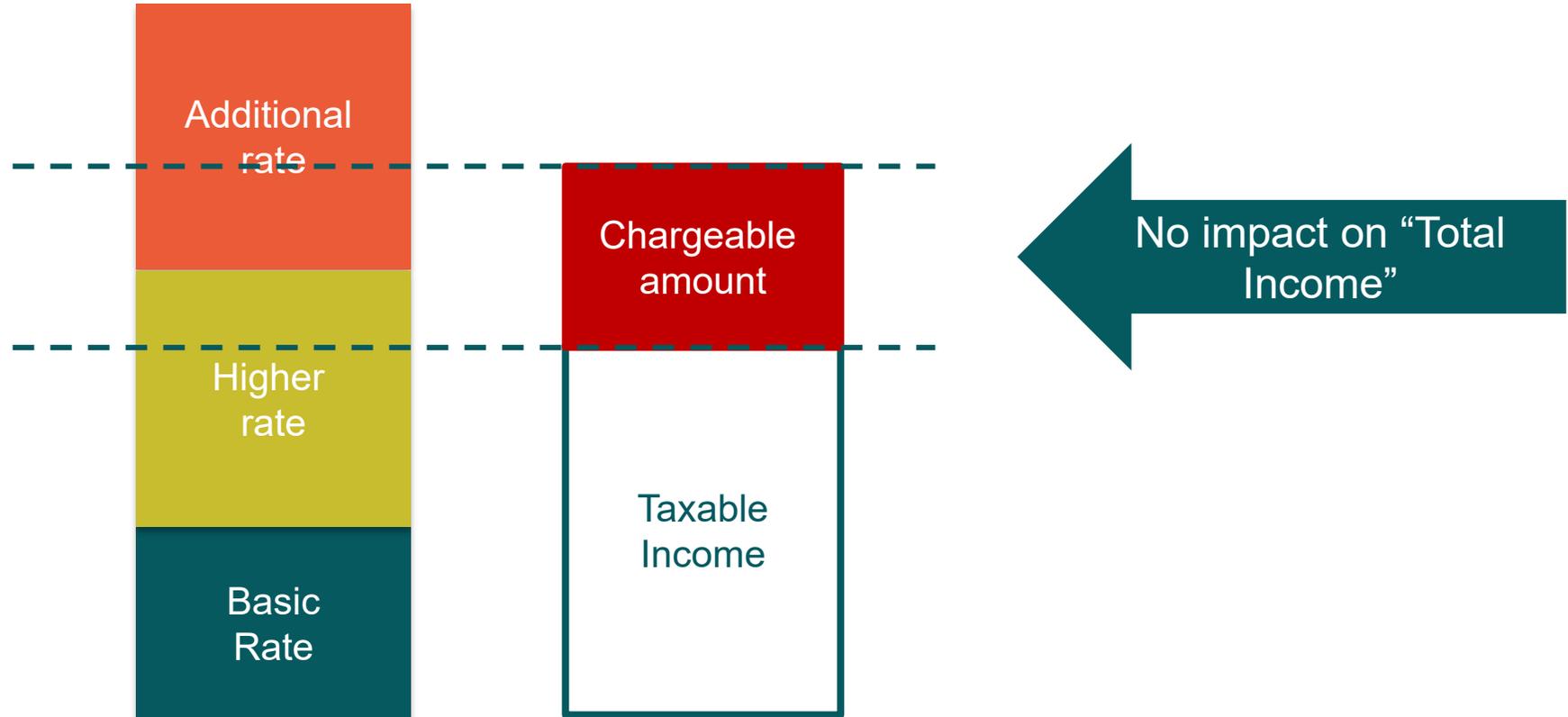| VCT / EIS	Marriage Allowance	Top Slicing Relief	Onshore Bond Tax Credit	Double Taxation Agreements
Investment x 30%	Up to 10% of unused Personal Allowance X 20%	Complicated	20% x gain **outside** personal allowance	Various

STEP 7

Add to the amount of tax left after Step 6 any amounts of tax for which the taxpayer is liable for the tax year under any provision listed in relation to the taxpayer in section 30.

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

Standalone tax charges

Gift Aid

insufficient tax liabilities to cover the tax treated as deducted at source from the donation

HICBC

1% to 100% of child benefit received

State Deferral Lump Sum

20%, 40% or 45% of lump sum paid

Pensions

Annual Allowance, UPs

Annual Allowance tax charge

Tax Relief Modeller Tool

Tax Year 2025/26

This tool is for UK financial advisers only.

Important information about this tool

This calculator is designed to give an estimation of a person's tax liability and also how pension contributions can have an effect on someone's tax position.
It does not take into account all the possible individual circumstances that may impact on the tax position of the individual.

It should not be taken as offering advice or any recommendation.

You should be satisfied that the information you have entered into the calculator is correct, for example this tool will assume that any pension contributions and/or gift aid contributions are valid. You should ensure that the outputs are correct for your client.

Please note: This tool will not calculate the liability if there are transitional profits from the basis period alignment to tax years from 2023/24 to 2027/28.

The information in this modeller is based on our current understanding of legislation and HMRC practice as at March 2025 all which is subject to change without notice.

Please note that this tool will cease to operate at the end of the tax year displayed above. If you require a copy for your records we suggest you print a PDF of the pages required.

Every care has been taken as to its accuracy, but it must be appreciated that neither M&G nor its representatives can accept any responsibility for loss, however caused, suffered by any person who has acted or refrained from acting as a result of material contained in this tool. Certain areas have been omitted from this model for simplicity and ease of use including National Insurance, some sources of income and other reliefs, allowances and tax charges.

Important information about the calculations

Personal allowance is allocated to taxable income following the statutory order of income taxation, more beneficial ordering may be possible in some cases. Beneficial ordering is not applied to the top-slicing calculations.

The tool assumes any pension contributions and/or gift aid payments made are valid. Annual Allowance is not taken into account.

Gross pension contributions include net pay and relief on making a claim. They are allocated to any relevant earnings first and then allocated to redundancy payments.

Where the number of children is added the calculator assumes that child benefit is claimed. Child benefit is calculated using 52 weeks of child benefit claimed.

The "total income" displayed is based on the total inputs, the full amount of child benefit and before tax, gift aid and pension contributions.
The "bank balance" displayed is based on total inputs (excluding benefits in kind) less taxation, gift aid and pension contributions.

USE THE TOOL

Tax Relief Modeller Tool

Tax Year 2025/26

ABOUT YOUR CLIENT

What is the client's age?	Under 75
Scottish Tax Payer?	No
Number of Children - Only fill if Child Benefit is claimed	
Gift Aid (Gross amt)	

CHARGEABLE EVENTS - BOND GAINS

Onshore Gain 1	50,000	Years Gain 1 (N)	10	Slice 1	5,000
Onshore Gain 2		Years Gain 2 (N)		Slice 2	
Onshore Gain 3		Years Gain 3 (N)		Slice 3	
Onshore Gain 4		Years Gain 4 (N)		Slice 4	
Offshore Gain 1		Years Gain 1 (N)		Slice 1	
Offshore Gain 2		Years Gain 2 (N)		Slice 2	
Offshore Gain 3		Years Gain 3 (N)		Slice 3	
Offshore Gain 4		Years Gain 4 (N)		Slice 4	

INCOME SOURCES

Employment Income	35,000	Purchased Life Annuity Income	
Benefits in Kind		Gross Savings Interest	5,000
Taxable Self Employed Profits		Dividends	2,000
UFPLS (taxable element)		Capital Gains above the annual exempt amount	
Drawdown / Annuity Income / Scheme Pension Income		Taxable Redundancy Payment	
State Pension Income		Rental Income	

EXISTING PENSION CONTRIBUTIONS

Relief at Source (Net Amount)	
Contributions paid gross	

NEW PENSION CONTRIBUTIONS

Relief at Source (Net Amount)	
Contributions paid gross	

RESET

BEFORE NEW CONTRIBUTIONS		AFTER NEW CONTRIBUTIONS		DIFFERENCE	PENSION SUMMARY	
"Total Income"	£92,000	"Total Income"	£92,000	£0	Relevant Earnings	£35,000
Adjusted Net Income	£92,000	Adjusted Net Income	£92,000	£0	Contributions: Existing	£0
Personal Allowance	£12,570	Personal Allowance	£12,570	£0	New	£0
Personal Savings Allowance	£500	Personal Savings Allowance	£500	£0	Total	£0
Child Benefit Charge	£0	Child Benefit Charge	£0	£0		
Capital Gains Tax	£0	Capital Gains Tax	£0	£0		
Tax Liability	£5,517	**Tax Liability**	£5,517	£0	Effective Rate of Tax Relief (on new contributions)	**0.00%**
Bond Gains Summary		Bond Gains Summary				
Tax on gains	£18,346	Tax on gains	£18,346	£0		
Onshore Tax Credit	£10,000	Onshore Tax Credit	£10,000	£0	Please navigate between workings and inputs using the tabs at the bottom of the sheet.	
Top slicing relief	£8,346	Top slicing relief	£8,346	£0		
Liability	£0	Liability	£0	£0		
"Bank Balance"	£86,483	"Bank Balance"	£86,483	£0		

Learning Objectives

By the end of this session, you will be able to:

Describe the
Key elements of an
individual's UK income
tax calculation

Calculate the income
tax liability for a UK
individual

Explain how clients
could take steps
to reduce their
tax liability

Les Cameron Manager

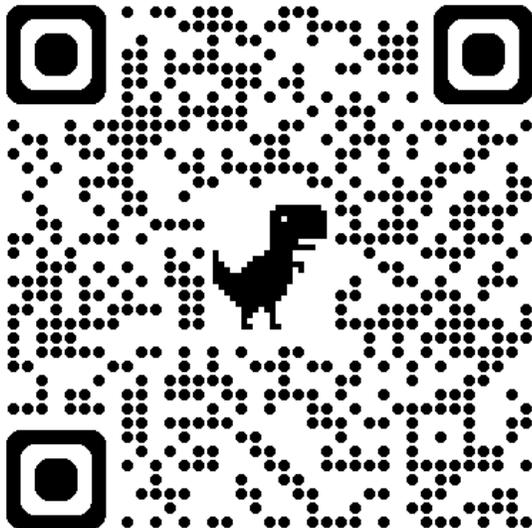Joined group: Feb 2023

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M&G for Advisers - Tech Matters

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Q & A

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Thank you

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