

Example

James and Jemima have the following sources of income for 2007/08.

	£
James's salary	16,000
Profits from Jemima's business	18,000
Army disability pension (Jemima)*	2,300
Net bank savings (joint)	760
ISA dividend (joint)*	140
Rental income (joint)**	<u>3,500</u>
Total	<u>40,700</u>

James paid a net amount of £2,305 into a stakeholder pension, and he and Jemima jointly made net gift aid donations of £702.

Their initial 2008/09 tax credit award will be based on joint tax income for 2007/08 and is ascertained as follows:

Step one	
Investment income (bank savings)	
£760 x 100/80***	950
Property income (rental)**	<u>3,500</u>
Sub-total	4,450
Less threshold	<u>300</u>
Total	4,150
Step two	-
Employment income (James)	<u>16,000</u>
Step three	
Total of steps one and two	20,150
Step four	
Add trading income (Jemima)	<u>18,000</u>
Add to step three	38,150

Deductions

Grossed-up pension contribution (James)****	
- £2,305 x 100/78	2,955
Grossed-up gift aid donations****	
-£702 x 100/78	<u>900</u>
Less total deductions	<u>3,855</u>
Total joint income for tax credits	<u>34,295</u>

*Both Jemima's army disability pension and the joint ISA dividend are excluded income for tax credits.

**This is rental income from a separate property therefore not eligible for rent-a-room relief.

*** Gross income is used for tax credits, i.e. income before tax and national insurance contributions. Dividend income is paid net, after deduction of notional tax (also confusingly called a tax credit) at 20%. To arrive at the gross amount, therefore, apply the fraction 100/80 to the net payment.

****Gross income is used for tax credits, i.e. income before tax and national insurance contributions. Pension contributions and gift aid payments are made net by the contributor or donor and grossed up at the basic rate to find the gross amount. The basic rate of tax in 2007/08 was 22%, therefore the grossing up fraction applied to the net payment is 100/78.