

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.

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 in 2011-12, but different other income (for simplicity, treated as being after application of all allowances. 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)	<u>£4,000</u>
			<u>£6,000</u>

	Mr Smith	Mr Brown	Mr Green	Mr Jones
Other taxable income	£10,000	£33,800	£38,000	£1,000
Savings income	<u>£6,000</u>	<u>£6,000</u>	<u>£6,000</u>	<u>£6,000</u>
Total taxable income	<u>£16,000</u>	<u>£39,800</u>	<u>£44,000</u>	<u>£7,000</u>

Mr Smith’s total taxable income is below the higher rate threshold of £35,000 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 £4,800, and so he will have additional tax of £960 to pay (£4,800 at 20%). His savings income will have effectively been taxed at an average rate of 36%.

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%.

Where taxable other income does not exceed the starting rate limit, there is a 10% tax rate applicable to savings income. This is illustrated by Mr Jones above. Because the low level of his other taxable income is below the starting rate limit (£2,560), the balance of savings income up to starting rate limit (£2,560 - £1,000) is taxable at 10% only. This means the total tax on his savings is £1,044 (£1,560 at 10% plus £4,440 at 20%), an effective rate of 17.4%. He will be entitled to a refund of £156.

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