CHAPTER 6

PERSONAL ALLOWANCES AND ELDERLY TAXPAYERS

6.1 Introduction

The personal allowance of £6,475 is available in the first instance to all UK resident individuals, including children, in 2010/11. ITA 2007, s. 35

Certain individuals who are not resident in the UK, most notably citizens of the European Union, are also entitled to a personal allowance. ITA 2007, s. 56

As we saw earlier, from 2010/11, where an individual's adjusted net income exceeds £100,000, their personal allowance will be reduced by £1 for every £2 of income above £100,000.

From 2010/11, personal allowances will no longer be available to an individual solely because they are a commonwealth citizen, although most non-resident commonwealth citizens will still be able to claim the allowance by other means, for example a double tax treaty.

A husband and wife are treated as separate persons under independent taxation and **each** will therefore receive a personal allowance to set against their own personal income.

A **blind person's allowance** for 2010/11 of £1,890 is available to reduce net income of a registered blind person in the UK. ITA 2007, s. 38

Finally, taxpayers over the age of 65, may receive an **age-related personal allowance**. These are higher personal allowances than those given to the under 65s.

All of the above allowances are contained within the tax tables included with this course.

6.2 Age allowances

For taxpayers aged **65** or over at the **end** of the tax year, an increased personal allowance of **£9,490** is available for **2010/11**. This means that a taxpayer who becomes 65 at some point during the tax year, will be entitled to the age-related allowances. ITA 2007, s. 36

If the taxpayer is 75 or over at the **end** of the tax year, the age-related allowance goes up to **£9,640**. These increased age allowances are given instead of the normal personal allowance of £6,475. ITA 2007, s. 37

Like the normal personal allowances, these age-related allowances are deducted from net income in order to arrive at taxable income and are deducted from non-savings income in priority to interest and dividends. However, there is a complication.

Personal Age Allowances (PAAs), are **restricted** if a taxpayer's **adjusted net income** exceeds a specified **income ceiling,** which for 2010/11 is **£22,900.** If a taxpayer's adjusted net income exceeds this ceiling, we reduce his age allowance by £1 for every £2 of income over and above the ceiling. ITA 2007, s. 36(2)

PAA (either £9,490 or £9,640)	X
Less: ½ x (Adjusted Net Income – £22,900)	(X)
Allowance given	X

One important thing to note here is that if a taxpayer has adjusted net income of not more than £100,000 the personal age allowance can never fall **below** the normal personal allowance of **£6,475.**

Illustration 1

Arthur is 73 and has the following income:

	£
State pension	8,500
Bank interest received	8,880
UK dividends	4,500

His personal age allowance for 2010/11 will be calculated as follows:

	£
Pension	8,500
Interest (x $\frac{100}{80}$)	11,100
Dividends (x $\frac{100}{90}$)	5,000
Net Income	£24,600

In this illustration net income and adjusted net income will be the same as Arthur has not made any gift aid donations (or personal pension contributions).

	£
PAA (>65)	9,490
Less: ½ (24,600 – 22,900)	(850)
PAA given	**£8,640**

From 2010/11, a taxpayer aged 65 or over with adjusted net income of over £100,000 will have the normal personal allowance restricted or withdrawn in the same way as a taxpayer aged under 65.

6.3 Married couples/Civil partners allowance

ITA 2007, s. 45

A married couples allowance (MCA) of £6,965 in 2010/11 is only available if **one** of the two spouses was **born before 6 April 1935**. In other words, it will be available where one of the spouses is aged 76 or over in 2010/11.

Since 5 December 2005, civil partners in a civil partnership formed as a result of the Civil Partnerships Act 2004 have **similar rights to married couples in respect of the MCA**. Relief will only be given if one of the civil partners was born before 6 April 1935.

Throughout this chapter we will continue to refer to the married couples/civil partners allowance as the married couples allowance (MCA).

The MCA is **not** given in the same way as normal personal allowances – i.e. we do **not** deduct the MCA from net income to arrive at taxable income. Instead, the MCA is a **tax reducer** and tax relief is given on the allowance at **a flat rate of 10%.**

Therefore, where a taxpayer is entitled to a married couples allowance, we multiply the allowance of £6,965 by **10%** to give **£696**, and we **reduce his tax liability by this amount**. This is why the relief is called a "tax reducer" - it reduces the tax liability in the bottom half of the income tax computation.

The other important thing to note about the MCA, is that for all marriages entered into before 5 December 2005 this tax reducer is given to the **husband** in the first instance. If the husband is unable to utilise his full MCA tax reducer, he can transfer the excess to his wife at the end of the tax year. ITA 2007, s. 51

For later marriages and civil partnerships relief initially goes to the member of the couple with the **higher total income** for the year. Where both couples have the same income in any one year, the couple must elect which of the two is entitled to the relief. It is possible to transfer relief to the other member of the couple if required. ITA 2007, s. 46

Couples married before 5 December 2005 may make a joint irrecoverable election for their entitlement to MCA to be determined under these new rules. The election must be made before the first tax year in which it is to have effect. ITA 2007, s. 44

Illustration 2

Arthur (see previous illustration) is married to Betty. Betty is 77. Her total income is £7,000.

The allowances available to the couple are as follows:

Arthur	PAA (as before)	£8,640
Betty	PAA (>75)	£9,640
Arthur	MCA = £6,965 Tax reducer @ 10%	 £696

Note that in the above illustration Betty is over 75, so she is entitled to the higher level of personal age allowance. This allowance is not subject to any restriction because her adjusted net income is less than £22,900.

Also, because Arthur and Betty are married and at least one of them was born before 6 April 1935, Arthur can claim the married couples age allowance.

Remember that we do not deduct the £6,965 from Arthur's net income. Instead we multiply the £6,965 by 10%, giving a tax reducer of £696 which is deducted from Arthur's tax liability for the year.

6.4 Excess restriction

Having considered personal age allowances and marriage allowances, the next important point is the issue of **"excess restriction".** Remember that in 2010/11 a personal age allowance cannot be restricted to fall below £6,475 where the taxpayer has adjusted net income of not more than £100,000.

Illustration 3

Fred is aged 76 and is married. His wife is 67. Fred has adjusted net income of £32,000 (all non-savings). Fred's personal age allowance is £9,640 and as Fred's adjusted net income exceeds the abatement threshold of £22,900, this allowance needs to be restricted by:

$$\tfrac{1}{2} \times £(32{,}000 - 22{,}900) = £4{,}550$$

Deducting this from the personal age allowance of £9,640 would give Fred an allowance of £5,090. However, the allowance given cannot fall below the normal personal allowance of £6,475.

This leaves us with an "excess restriction". HMRC wants to restrict Fred's personal allowances by £4,550.

However, Fred's personal age allowance of £9,640 has only been restricted down by £3,165 to £6,475. We therefore have an excess restriction as follows:

£4,550 – (9,640 – 6,475) = £1,385

This excess restriction of £1,385 is deducted from any married couples allowance to which Fred is entitled.

Fred's tax computation will be as follows:

	Non Savings
	£
Net Income	32,000
Less: PAA	(6,475)
Taxable income	£25,525
Tax	£
25,525 @ 20%	5,105
Less: marriage allowance (6,965 – 1,385) = 5,580 @ 10%	(558)
Tax due	**£4,547**

6.5 Other points

Elderly taxpayers are always entitled to a **minimum MCA of £2,670** which, when multiplied by 10% gives a minimum tax reducer of £267.

Therefore, in 2010/11 an elderly taxpayer with adjusted net income between £22,900 and £100,000 will not have their personal allowance reduced below the normal personal allowance of £6,475. Any excess restriction reduces the married couples allowance, but cannot reduce it below £2,670, so the minimum relief obtained will be a tax reducer of £267.

Where an individual eligible for the MCA has their personal allowance restricted or withdrawn due to adjusted net income in excess of £100,000 they will still be entitled to the minimum MCA.

MCAs must be **apportioned** for the year in which the elderly couple **get married.** The apportionment is on a monthly basis by counting any whole or part tax months (counting from 6th to 5th of a month) during which the couple have been married. This is the only time where MCAs are restricted. ITA 2007, s. 54

Illustration 4

An elderly couple, one aged 76 and the other aged 62, who get married on 29 January 2011 are entitled to claim married couples relief (assuming there is no restriction) as follows: MCAA tax reducer = £6,965 x $\frac{3}{12}$ x 10% = £174

There is no similar apportionment in the year of a couple's separation or in the year in which one of the spouses dies - here the MCA is available in full.

An individual cannot claim a MCA unless they were living with their spouse/civil partner for some part of the tax year. As such, the date of separation is important for income tax purposes, because if a couple are separated, (even though they are not legally divorced), the MCA cannot be claimed for the tax year after the year of separation and thereafter.

Example 1

Derek is 77 and has been married for over 40 years. His only income for 2010/11 is a pension from a former employer of £40,000.

Calculate the tax reducer in respect of his married couples allowance.

Example 2

Maurice (aged 76) married Freda (68) on 12 November 2010. Maurice's income for 2010/11 is:

	£
Rents from apartment in Paris	23,000
UK dividends	900

Freda has no income.

Calculate Maurice's MCA tax reducer.

Answer 1

	£
PAA (>75)	9,640
Less: ½ x (40,000 – 22,900)	(8,550)
	1,090
Cannot fall below normal PA	£6,475
MCAA	6,965
Less: excess restriction	
8,550 – (9,640 – 6,475)	(5,385)
	1,580
Minimum MCAA	2,670
Tax reducer @ 10%	**£267**

Answer 2

	Income £
Foreign income	23,000
Dividends ($\times \frac{100}{90}$)	1,000
Net Income	24,000
PAA (> 75)	9,640
Less ½ x £(24,000 – 22,900)	(550)
	9,090
MCAA	6,965
No excess restriction	
Tax reducer £6,965 @ 10% $\times \frac{5}{12}$ (apportion in year of marriage)	**£290**