

*These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007*

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 2: Basic provisions

Overview

Chapter 2: Rates at which income tax is charged

Overview

34. This Chapter sets out all the rates of income tax and provides rules about the rates of tax at which income is charged. It is based on sections 1, 1A, 1B and 686(1A) of ICTA.
35. Two main principles are at work:
 - first, the rate of tax depends on the type of income concerned; and
 - second, income may be subject to progressively higher rates of tax depending on the overall amount of income of the person concerned.
36. The second principle applies only to individuals (subject to a special rule about the first £1,000 of trustees' trust rate income in Chapter 6 of Part 9 of this Act).

Section 6: The starting rate, basic rate and higher rate

37. This section sets out the main rates at which income tax is charged. It is based on section 1(2) of ICTA.
38. With some exceptions, notably savings and dividend income (see sections 12 and 13), any income of an individual is taxed at either the starting rate, the basic rate or the higher rate, depending on the level of the individual's income.
39. *Subsection (2)* specifies that the main rates are determined each year by Parliament.
40. Other rates at which income tax is charged do not have to be specified by Parliament annually and are instead set out in the sections signposted by *subsection (3)*.

Section 7: The savings rate

41. This section sets out the savings rate of income tax. It is based on section 1A(1B) of ICTA.
42. The "savings rate" is a new name for what is called "the lower rate" in the source legislation.

Section 8: The dividend ordinary rate and dividend upper rate

43. This section sets out these two rates of income tax that apply to dividend income. It is based on section 1B(2) of ICTA.

Section 9: The trust rate and dividend trust rate

44. This section sets out the two rates of income tax that apply, in particular, to accumulation or discretionary income of trustees. It is based on section 686(1A) of ICTA.
45. The “trust rate” is a new name for what is called “the rate applicable to trusts” in the source legislation.

Section 10: Income charged at the starting, basic and higher rates: individuals

46. This section sets out that the three main rates of income tax charged on the income of individuals are charged in three slices. It is based on section 1(2) of ICTA.
47. The first slice (*subsection (1)*) is income up to the starting rate limit – the starting rate band. The second slice (*subsection (2)*) is income between the starting rate limit and basic rate limit – the basic rate band. The third slice (*subsection (3)*) is income above the basic rate limit – the higher rate band.
48. *Subsection (4)* is a signpost to provisions that apply different rates of tax to certain types of income falling within each band. Income has to be placed in order so that the rates which would otherwise apply can be established. The rules on how this is to be done are in section 16.

Section 11: Income charged at the basic rate: other persons

49. This section charges tax at the basic rate on income of persons other than individuals. It is based on section 1(2) of ICTA.
50. Of the three main rates, only the basic rate applies. But other rates apply to specific sorts of income. In particular, savings income is charged at the savings rate and dividend income at the dividend ordinary rate. And income of discretionary and accumulation settlements is charged at the trust rates. There is a signpost to these exceptions in *subsection (2)*.

Section 12: Income charged at the savings rate

51. This section charges savings income at the savings rate to the extent that it would otherwise fall within the basic rate band. It is based on section 1A(1) of ICTA.
52. There are a number of exceptions that provide that certain savings income is charged differently, usually at the trust rate. These are signposted in *subsection (2)*.

Section 13: Income charged at the dividend ordinary and dividend upper rates: individuals

53. This section applies either the dividend ordinary rate or the dividend upper rate to dividend income of individuals. It is based on sections 1A(1), (1AA), (1A) and (4) and 1B(1) of ICTA.
54. To the extent that the dividend income (other than dividend income charged on the remittance basis) would otherwise fall within the starting rate or basic rate bands, *subsection (1)* provides that the dividend ordinary rate applies instead.
55. To the extent that the dividend income would otherwise fall within the higher rate band, *subsection (2)* provides that the dividend upper rate applies instead.
56. *Subsection (3)* provides that subsections (1) and (2) are subject to any provisions to the contrary.
57. “Dividend income” includes income chargeable under Chapter 5 or 6 of Part 4 of ITTOIA (see the definition in section 19). See *Change 1* in Annex 1.

Section 14: Income charged at the dividend ordinary rate: other persons

58. This section applies the dividend ordinary rate to dividend income of persons other than individuals. It is based on section 1A(1), (1A) and (4) of ICTA.
59. *Subsection (1)* applies the dividend ordinary rate in place of the basic rate to dividend income (other than dividend income charged on the remittance basis). A number of provisions which override this rule (typically to provide that one of the trust rates applies instead), are signposted by *subsection (2)*.

Section 15: Income charged at the trust rate and the dividend trust rate

60. This section provides a signpost to Chapters 3 to 6 of Part 9, which are about the circumstances in which income tax is charged at the trust rate and the dividend trust rate. It is new.

Section 16: Savings and dividend income to be treated as highest part of total income

61. This section provides the ordering rules that determine at what rate a particular type of income would be charged but for the sections imposing the savings rate or the dividend rates. It is based on section 1A(5) of ICTA.
62. *Subsection (2)* says that the rules apply for all other income tax purposes as well, except in the cases mentioned.
63. *Subsections (3) to (5)* contain the ordering rules. In essence, dividend income is the top part of income, savings income the middle part, and other income the lowest part.
64. *Subsection (6)* is a signpost to section 1012 which deals with the relationship between the rules in this section and other rules requiring particular income to be treated as the highest part.
65. *Subsection (7)* ensures that dividend income charged on the remittance basis does not count as dividend income for the purposes of this section.

Section 17: Repayment: tax paid at basic rate instead of starting or savings rate

66. This section allows a repayment claim outside Self Assessment if a person has suffered tax at the basic rate on income received and the person is only liable at the starting rate or the savings rate on that income. It is based on sections 1(6A) and 1A(6A) of ICTA.

Section 18: Meaning of “savings income”

67. This section defines “savings income”. It is based on section 1A(1AA), (2), (3) and (4) of ICTA.
68. The definition includes income on which personal representatives are liable under section 466 of ITTOIA (gains from contracts for life insurance etc), removing an anomaly in the source legislation. See *Change 2* in Annex 1.

Section 19: Meaning of “dividend income”

69. This section defines “dividend income”. It is based on section 1A(1AA), (2), (3) and (8) and section 1B(1) and (3) of ICTA.

Section 20: The starting rate limit and the basic rate limit

70. This section sets out the starting rate limit and the basic rate limit. It is based on section 1(2) to (3) of ICTA.

*These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007*

71. The figures used in this Act are those for 2006-07. They will be updated for 2007-08 by means of an indexation order.

Section 21: Indexation of the starting rate limit and the basic rate limit

72. This section provides for indexation of the starting rate and basic rate limits. It is based on section 1(4) to (6) of ICTA.
73. *Subsections (2) and (3)* set out in step form how to compute the limit for a given year by reference to the limit for the previous year and the percentage rise in the retail prices index. The words “unless Parliament otherwise determines” in section 1(4) have been omitted as it is always open to a Finance Act to disapply this provision, so no express provision to this effect is needed.
74. *Subsection (4)* is an administrative provision to reflect the fact that it is usually only known at the time of the Chancellor’s Budget speech whether statutory indexation will apply. This leaves insufficient time before the start of the tax year for employers to update their payroll systems. This rule gives employers until the first pay-day after 17 May to make the necessary changes.
75. *Subsection (5)* obliges the Treasury to specify the indexed amounts in a statutory instrument which must be made in the tax year before the tax year to which they are to apply.