

INCOME TAX

how an individual's income is taxed – including sole traders and partners.

01 HOW IT WORKS – income is taxed in slices

Everyone gets the first **£12,570 tax-free**. Above that, income is cut into slices – and **each slice is taxed at its own rate**. A higher rate only ever applies to the part of the income above that line.

Example: Priya earns a salary of **£80,000**. She doesn't pay 40% on all of it – her income is taxed in three slices:

£12,570 0%	£37,700 20% – basic	£29,730 40% – higher
£0	$£37,700 \times 20\% = \text{£7,540}$	$£29,730 \times 40\% = \text{£11,892}$
£0 + £7,540 + £11,892		
Income tax £19,432		
That's about 24% of her income overall – not 40%.		

02 THE RATES – 2026/27

Always tax in this order, each sitting on top of the last:

1 Non-savings → 2 Savings → 3 Dividends

BAND	INCOME	NON-SAVINGS	SAVINGS	DIVIDENDS
Personal allowance	first £12,570	0%	0%	0%
Basic rate	£12,571 – £50,270	20%	20%	10.75%
Higher rate	£50,271 – £125,140	40%	40%	35.75%
Additional rate	over £125,140	45%	45%	39.35%

The bands are measured on **taxable income** (after the allowance): basic rate = the first £37,700, higher rate up to £125,140. The £50,270 figure assumes the full £12,570 allowance – the band does not shrink when the allowance does.

03 THE ALLOWANCES – slices taxed at 0%

ALLOWANCE	AMOUNT	HOW IT WORKS
Personal allowance	£12,570	Everyone gets it. Lost at £1 for every £2 of <i>adjusted net income</i> (net income less gross pension and Gift Aid payments) over £100,000 – gone at £125,140.
Starting rate for savings	up to £5,000	Savings at 0%. Reduced £1 for £1 by non-savings taxable income – so it only helps if other income is low.
Personal savings allowance	£1,000 / £500 / £0	£1,000 if all your income stays within the basic rate (up to £50,270) · £500 if any of it goes over £50,270 · £0 if any goes over £125,140. Use <i>total income</i> (before the allowance) to decide which band you reach – salary, savings and dividends all count.
Dividend allowance	£500	The first £500 of dividends at 0%, whatever the rate.

04 THE STEPS – putting it all together

1	Add up total income Everything taxable received in the tax year – trading profit, salary, rent, interest, dividends. Leave out exempt income such as ISA interest. Keep the three kinds separate: non-savings, savings, dividends .	<i>gives you</i> TOTAL INCOME
2	Take off any reliefs For example trading loss relief or qualifying interest payments (interest on a loan to buy into a partnership or company). Normally from non-savings income first – the law lets you allocate them wherever saves most tax.	<i>gives you</i> NET INCOME
3	Take off the £12,570 personal allowance Normally from non-savings income first, then savings, then dividends (again, wherever saves most tax). Adjusted net income over £100,000? Reduce it by £1 for every £2 over.	<i>gives you</i> TAXABLE INCOME
4	Tax the non-savings income Slice it into the bands, starting from the bottom: 20%, then 40%, then 45%.	<i>tax on</i> NON-SAVINGS
5	Tax the savings income It sits on top of the non-savings. First the £5,000 starting rate (if any), then the savings allowance, then the rest at the rate of the band it lands in.	<i>tax on</i> SAVINGS
6	Tax the dividends They sit on top of everything. The first £500 is at 0% (but still uses up band), then 10.75%, 35.75% or 39.35% depending on the band.	<i>tax on</i> DIVIDENDS
7	Add up steps 4, 5 and 6	<i>gives you</i> INCOME TAX

NON-SAVINGS → SAVINGS → DIVIDENDS · 20 / 40 / 45 · 0% SLICES STILL USE UP THE BAND

INCOME TAX

worked example – following the steps on page 1.

Sam is a sole trader. This tax year he has:

£45,000 TRADING PROFIT · NON-SAVINGS	£2,770 BANK INTEREST · SAVINGS	£6,000 DIVIDENDS
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No reliefs to claim. How much income tax does Sam pay?

1	Add up total income £45,000 + £2,770 + £6,000 Over £50,270, so Sam is a higher-rate taxpayer – his savings allowance is £500, not £1,000.	<i>gives you</i> TOTAL INCOME £53,770												
2	Take off any reliefs None to claim.	<i>gives you</i> NET INCOME £53,770												
3	Take off the £12,570 personal allowance Take it off the non-savings first. The allowance is all used up there, so the savings and dividends stay as they are: <table><tr><td>Non-savings</td><td>£45,000 – £12,570 =</td><td>£32,430</td></tr><tr><td>Savings</td><td></td><td>£2,770</td></tr><tr><td>Dividends</td><td></td><td>£6,000</td></tr><tr><td>Taxable income</td><td></td><td>£41,200</td></tr></table> These three amounts are what you tax in steps 4, 5 and 6.	Non-savings	£45,000 – £12,570 =	£32,430	Savings		£2,770	Dividends		£6,000	Taxable income		£41,200	<i>gives you</i> TAXABLE INCOME £41,200
Non-savings	£45,000 – £12,570 =	£32,430												
Savings		£2,770												
Dividends		£6,000												
Taxable income		£41,200												
4	Tax the non-savings income £32,430 × 20% Basic band left: £37,700 – £32,430 = £5,270	<i>tax on</i> NON-SAVINGS £6,486.00												
5	Tax the savings income Sam's non-savings taxable income (£32,430) is over £5,000, so there's no starting rate . He's a higher-rate taxpayer, so his savings allowance is £500 . <table><tr><td>£500</td><td>× 0% (savings allowance)</td><td>£0</td></tr><tr><td>£2,270</td><td>× 20% (basic rate)</td><td>£454</td></tr><tr><td>£2,770</td><td>total savings</td><td>£454</td></tr></table> Basic band left: £5,270 – £2,770 = £2,500	£500	× 0% (savings allowance)	£0	£2,270	× 20% (basic rate)	£454	£2,770	total savings	£454	<i>tax on</i> SAVINGS £454.00			
£500	× 0% (savings allowance)	£0												
£2,270	× 20% (basic rate)	£454												
£2,770	total savings	£454												
6	Tax the dividends The first £500 is covered by the dividend allowance. Only £2,500 of the basic band is left – the allowance uses £500 of it, leaving £2,000 at 10.75%. The rest goes into the higher rate. <table><tr><td>£500</td><td>× 0% (dividend allowance)</td><td>£0</td></tr><tr><td>£2,000</td><td>× 10.75% (basic rate)</td><td>£215</td></tr><tr><td>£3,500</td><td>× 35.75% (higher rate)</td><td>£1,251.25</td></tr><tr><td>£6,000</td><td>total dividends</td><td>£1,466.25</td></tr></table>	£500	× 0% (dividend allowance)	£0	£2,000	× 10.75% (basic rate)	£215	£3,500	× 35.75% (higher rate)	£1,251.25	£6,000	total dividends	£1,466.25	<i>tax on</i> DIVIDENDS £1,466.25
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£6,000	total dividends	£1,466.25												
7	Add up steps 4, 5 and 6 £6,486 + £454 + £1,466.25	<i>gives you</i> INCOME TAX £8,406.25												

WHERE PEOPLE GO WRONG

1. Giving Sam the £1,000 savings allowance. He's a higher-rate taxpayer, so only £500 – using £1,000 gives £8,306.25.
2. Forgetting the 0% slices use up the band – so taxing £2,500 of dividends at 10.75% instead of £2,000.
3. Taxing all the dividends at 10.75%. They sit on top, so they're the slice that crosses into the higher rate.

NON-SAVINGS → SAVINGS → DIVIDENDS · 20 / 40 / 45 · 0% SLICES STILL USE UP THE BAND