

INCOME TAX

What is Income Tax?

Income Tax is a tax charged by the government on the money you earn. It's one of the main ways public services—like the NHS, education, transport and public safety—are funded in the UK.

You typically pay Income Tax on income such as:

- **Earnings from employment**
- **Profits if you're self-employed**
- **Most pensions** (state, company, and personal)
- **Rental income** (with some exemptions)
- **Benefits you get from your job**
- **Interest or dividends** above certain allowances

Not **all** income is taxable—some types are tax-free, like:

- The first £1,000 of self-employment or property income (trading/property allowance)
- ISA interest
- Premium bond wins
- Some state benefits

How Income Tax works (UK)

The UK uses a progressive tax system—different portions of your income are taxed at different rates.

A standard Personal Allowance (currently £12,570) applies before you start paying tax.

Above this allowance, tax bands apply, such as:

- **20%** basic rate
- **40%** higher rate
- **45%** additional rate

HMRC collects Income Tax mainly through:

- **PAYE (Pay As You Earn)** for employees and pension recipients
- **Self Assessment** if you're self-employed or have other taxable income



Why Income Tax exists?

Income Tax is one of the UK's largest revenue sources, contributing significantly to funding national services and government operations. In 2024/25, HMRC estimated income tax liability at £303bn, representing around 35% of total tax revenue.

Illustration Income Tax Calculation

Income Tax Calculation (Salary: £50,000)

Step 1: Personal Allowance

- First £12,570 tax-free
- Remaining taxable income:
 $£50,000 - £12,570 = £37,430$

Step 2: Income Tax Bands (England 2025/26 rules)

Your taxable income (£37,430) falls entirely within the basic rate band (20%), because the higher rate doesn't begin until £50,271.

Estimated Income tax: $20\% \times £37,430 = £7,486$

National Insurance (Class 1 Employee NI)

NI is charged on *weekly or monthly earnings*, but we can estimate annually.

Current NI thresholds & rates

- **£0 – £12,570:** 0%
- **£12,571 – £50,270:** 8% (main rate)
- Above £50,270: 2%
- Since your salary is **£50,000**, it falls entirely within the 8% band above the threshold

Taxable NI earnings:

$£50,000 - £12,570 = £37,430$

- Estimated NI and due:
 $8\% \times £37,430 = £2,994.40$



Estimated Take-Home pay: **£50,000 – £10,480.40 = £39,519.60 per year**
≈ £3,293 per month

Pension Contribution (Employee 5%)

Pension contribution:

5% of £50,000 = £2,500 per year, this is taken **before tax**, which reduces your taxable income.

Updated Income Tax Calculation:

Taxable income after pension; £50,000 – £2,500 = **£47,500**

Personal Allowance: £12,570 tax-free

Income taxable: £47,500 – £12,570 = **£34,930**

Income Tax (20% rate): 20% × £34,930 = **£6,986**

New Income Tax: £6,986 and without Pension contribution previously at £7,486)

Total deductions summary:

Deductions	Amount
Income Tax	£6,986
National Insurance	£2,994.40
Pension Contribution	£2,500
Total	£12,480.40
Updated Take-home pay	£50,000 – £12,480.40 = £37,519.60 per year ≈ £3,127 per month

Student Loan

Which student loan plan are you on?

In the UK, student loans are repaid differently depending on the plan you're assigned. The common plans are:

Plan 1



Repay 9% of income over **£22,015**

Plan 2

Repay 9% of income over **£27,295**

Plan 4 (Scotland)

Repay 9% of income over **£27,660**

Postgraduate Loan (PGL)

Repay 6% of income over **£21,000**

(This is often **in addition** to Plan 1 or 2 if you have both.)

Let's assume that: Student Loan (Plan 2) Calculation

Plan 2 Threshold

You repay **9% of income over £27,295.**

Your applicable income

£50,000 – £27,295 = **£22,705**

Repayment amount

9% × £22,705 = **£2,043.45 per year**

Student loan repayment: £2,043.4

Updated take-home pay

Deductions	Amount
Income Tax	£6,986
National Insurance	£2,994.40
Pension Contribution	£2,500
Student loan (Plan 2)	£2,043.45
Total	£14,523.85



Updated Take-home pay

**£50,000 – £14,523.85 =
 £35,476.15 per year
 ≈ £2,956 per month**

Benefits in kind

How benefits in kind will change this:

Most common BIKs (e.g., private medical, company car, gym, health screening) are taxable for you and usually not subject to employee NI; your employer pays Class 1A NI on them. In payroll terms, BIKs are either payrolled (tax collected during the year) or reported on a P11D (tax recovered via your code). Either way, the total tax you pay for the year is the same.

The tax effect (for you)

Let B = your annual taxable BIK value ("cash equivalent"):

- You still have £2,770 of headroom left in the basic-rate band (£37,700 – £34,930).
- So the first £2,770 of B is taxed at 20% (= up to £554 extra tax).
- Any B above £2,770 is taxed at 40%.
(Bands/allowance per 2025/26)

NI and student loan impact

- Employee NI: usually unchanged by most BIK (they're Class 1A for the employer, not Class 1 for you).
- Student loan (Plan 2): payroll deductions are based on NI-able pay. Typical BIKs (car, medical, etc.) do not increase your loan repayments. (Some cash/vouchers that carry Class 1 NIC would be exceptions.)

Note:

The £2,770 is the remaining part of your basic-rate tax band (20%) after your pension deduction has reduced your taxable income.

It comes directly from the UK income tax structure for 2025/26, where:

- The basic-rate band runs from £12,571 to £50,270
 → size of basic-rate band = £37,700

In your case we calculated your taxable income after pension:



- Salary: £50,000
- Less pension (5%): £2,500
- Less Personal Allowance: £12,570
- Taxable income = £34,930

Now compare this to the maximum amount that can be taxed at 20%:

- Basic-rate limit = £37,700
- Your taxable income = £34,930

Difference →

$$£37,700 - £34,930 = £2,770$$

End!

