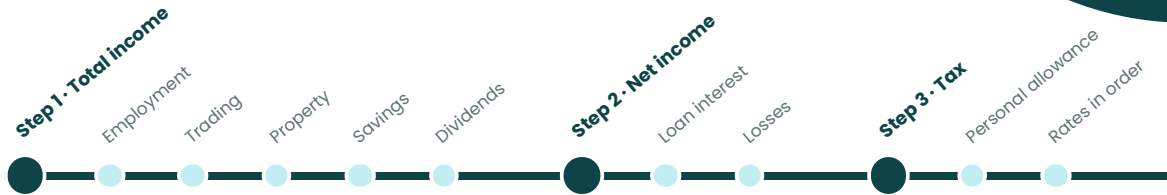


Income Tax Guide



2027 EDITION TAX YEAR 2026/27 • SQE1 AND SQE2



Is income tax in play in your scenario?

- **Employees:** yes, on salary and taxable benefits.
- **Sole traders:** yes, on their trading profits.
- **Partners:** yes, each on their share of the firm's profits.
- **Shareholders:** yes, on dividends, paid out of profits that have already borne corporation tax.
- **Lenders and debenture holders:** yes, on interest.
- **Personal representatives:** yes, on income the estate receives during the administration (FLK2).

Good to know

The tax year runs from 6 April to 5 April. This guide uses **2026/27**, the year in force at the law cut-offs for SQE1 January 2027 (11 September 2026) and July 2027 (12 March 2027), and for SQE2 January, April and July 2027.

In the exam, the SRA gives you the rates, allowances and thresholds a question needs. Know the method, and when each relief or exemption applies.

STEP 1 Calculate total income

Table 1: Income or capital?

INCOME: income tax	CAPITAL: capital gains tax, not income tax
Salary from a job	Selling a house
Profits of a trade (trading profits)	Selling shares
Rent	Selling business premises
Interest on savings and loans	
Dividends from shares	

Table 2: Total income gross figures, in tax order

1. Non-savings income (NSND)		
Employment income	Salary, bonus and taxable benefits, before PAYE	£
Trading income	Trading profit, from Table 3	£
Property income	Rent, less allowable expenses	£
2. Savings income		
Interest	Bank and building society interest (paid gross); interest on debentures and loans A company paying yearly interest to an individual (for example on a loan or an unlisted debenture) deducts 20% first: enter the gross amount here, and the tax in Table 9.	£
3. Dividend income		
Dividends	From company shares	£
TOTAL INCOME		£

*Leave out exempt income: income from ISAs, NS&I Savings Certificates, and Premium Bond and National Lottery prizes.

Table 3: Trading profit sole traders and partners, accruals basis

Chargeable receipts	Income from the trade: sales and fees (not capital receipts)	£
LESS		
Deductible expenses	Incurred wholly and exclusively for the trade, and not capital: rent, wages, stock, utilities...	£
LESS		
Capital allowances	Annual investment allowance: the first £1,000,000 spent on plant and machinery (not cars). Then 14% a year on the main pool (18% before 6 April 2026; a blended rate for a period spanning that date).	£
TRADING PROFIT		£

*Cash basis: Since 2024/25 the cash basis is the default for sole traders and for partnerships whose partners are all individuals (never LLPs): receipts less payments, with equipment other than cars deducted as an expense instead of capital allowances. A trader can opt out to the accruals basis shown here. *Partners: split the firm's profit using the profit-sharing arrangement; each partner is then taxed on their own share. *Which profits: the profits of the tax year itself (the tax year basis, since 2024/25). *Trading allowance: for sole traders, gross trading income up to £1,000 is tax-free; above that, they may deduct £1,000 instead of their actual expenses. It cannot be used for partnership income.

STEP 2

Deduct reliefs to find net income

Only if the scenario gives you one

Table 4: Net income

Total income	From Table 2	£
LESS		
Qualifying loan interest interest paid in the year	Interest on a loan used to (main cases): - buy a share in a partnership, or put money into it as capital or a loan, while a partner (not a limited partner); - buy plant or machinery for use in a partnership or the borrower's job (interest due within 3 years after the end of the period or tax year of the loan); - buy ordinary shares in, or lend to, a close company (not a close investment-holding company) in which the borrower owns more than 5%, or owns shares and works for most of their time; - pay inheritance tax before the grant (a loan to the personal representatives): interest for the first 12 months only. Never an overdraft or credit card.	£
Trading loss relief sole traders and partners	s64: against total income of the tax year of the loss, the previous year, or both. It uses as much income as the loss covers, even if the personal allowance is wasted. s72: a loss in the first 4 tax years of a trade, against total income of the 3 previous tax years, earliest first. s83: carried forward, against later profits of the same trade only. s89: a terminal loss (final 12 months), against profits of the same trade in the final tax year and the 3 before it.	£
NET INCOME		£

*Qualifying loan interest and loss relief set against total income (s64, s72) share one cap: the greater of £50,000 and 25% of adjusted total income. Any part of a loss set against profits of the same trade is not capped (always the case for s83 and s89).

STEP 3

Deduct the personal allowance, then apply the rates

Tax year 2026/27, England and Wales

Table 5: Taxable income

Net income	From Table 4	£
LESS		
Personal allowance	£12,570. Over £100,000 of adjusted net income, it falls by £1 for every £2, to nil at £125,140. The law sets it where it saves the most tax: normally against non-savings income first, then savings, then dividends.	£
TAXABLE INCOME		£
Split by type	Non-savings £ · Savings £ · Dividends £	

Table 6: Non-savings income taxed first, from the bottom

Band	Taxable income	Rate	Tax
Basic rate	First £37,700	20%	£
Higher rate	£37,701 to £125,140	40%	£
Additional rate	Over £125,140	45%	£

Table 7: Savings income taxed next, on top of non-savings income

Band	Taxable income	Rate	Tax
Starting rate	Up to £5,000, only if taxable non-savings income is under £5,000: the band shrinks £1 for every £1 of it	0%	£0
Personal savings allowance	£1,000 for a basic rate taxpayer, £500 for a higher rate taxpayer, nil for an additional rate taxpayer	0%	£0
Basic rate	Within the first £37,700	20%	£
Higher rate	£37,701 to £125,140	40%	£
Additional rate	Over £125,140	45%	£

Table 8: Dividend income taxed after savings income

Band	Taxable income	Rate	Tax
Dividend allowance	First £500 of dividends	0%	£0
Ordinary rate	Within the first £37,700	10.75%	£
Upper rate	£37,701 to £125,140	35.75%	£
Additional rate	Over £125,140	39.35%	£

Table 9: Tax to pay

Tax liability	Add up the tax in Tables 6, 7 and 8	£
LESS		
Tax already paid	PAYE, and tax deducted at source (such as 20% on company debenture interest)	£
TAX TO PAY (OR REPAY)		£

*The bands are shared: savings start where non-savings income stops, and dividends come after savings. Income taxed at 0% still uses up the bands. *A **higher rate taxpayer** has taxable income above £37,700; an **additional rate taxpayer**, above £125,140. Gift Aid and personal pension contributions extend the basic rate band. ***Wales:** Welsh taxpayers pay the Welsh rates on non-savings income. For 2026/27 the Senedd kept 10p in each band, so the totals are the same 20%, 40% and 45%. Savings and dividends are taxed at UK rates. ***Also check:** the marriage allowance (a spouse or civil partner whose income is below the personal allowance can transfer £1,260 of it to a partner who pays tax at the basic rate, cutting the partner's tax by up to £252) and the blind person's allowance (£3,250, added to the personal allowance).

Anti-avoidance

The SRA also lists the scope of anti-avoidance provisions: the general anti-abuse rule (Finance Act 2013) lets HMRC counteract tax advantages from abusive arrangements, and the settlements rules tax a parent on income from capital they gave their minor, unmarried child, unless it is £100 or less a year.

EXAMPLE

Amir, a partner in a firm in England

Tax year 2026/27

Amir's share of the firm's trading profit is £56,000. He also has £1,400 of bank interest and £2,600 of dividends, and pays £1,500 of interest on the loan he took out to buy into the partnership.

Step 1: total income		
Share of the firm's trading profit (non-savings)		£56,000
Bank interest (savings)		£1,400
Dividends		£2,600
TOTAL INCOME		£60,000
Step 2: net income		
Less qualifying loan interest (loan to buy into the partnership)		(£1,500)
NET INCOME		£58,500
Step 3: taxable income and tax		
Less personal allowance (adjusted net income under £100,000)		(£12,570)
TAXABLE INCOME		£45,930
Of which non-savings £41,930, savings £1,400, dividends £2,600		
£37,700 non-savings income at the basic rate	20%	£7,540.00
£4,230 non-savings income at the higher rate	40%	£1,692.00
£500 savings income in the personal savings allowance	0%	£0.00
£900 savings income at the higher rate	40%	£360.00
£500 dividends in the dividend allowance	0%	£0.00
£2,100 dividends at the upper rate	35.75%	£750.75
Income tax liability, 2026/27		£10,342.75

Why it works out this way

- Taxable income of £45,930 goes above £37,700, so Amir is a **higher rate taxpayer**: his personal savings allowance is £500.
- His taxable non-savings income is over £5,000, so there is **no starting rate** for his savings.
- The dividends come last, in the higher rate band: after the £500 allowance they are taxed at the **upper rate**.

Exam traps

- 1 Start from **gross** income. Tax already paid comes off at the very end.
- 2 Keep the **order**: non-savings, then savings, then dividends.
- 3 Amounts taxed at **0%** still use up the bands.
- 4 Check the **personal savings allowance** against the taxpayer's top band.
- 5 Adjusted net income over £100,000? **Reduce the personal allowance** first.

Collection

Employees pay through PAYE, deducted by the employer. Sole traders and partners use Self Assessment: the online return and the balancing payment are due by 31 January after the tax year. They also make payments on account on 31 January and 31 July, each half of last year's Self Assessment tax (none if that was under £1,000, or if more than 80% of last year's tax was deducted at source).

Estates (FLK2)

Personal representatives pay income tax on estate income received during the administration: 20% on non-savings and savings income and 10.75% on dividends, with no personal allowance, personal savings allowance, starting rate or dividend allowance. If the estate's income for a tax year is £500 or less, none is due; over £500, all of it is taxable. Beneficiaries are taxed on the grossed-up income they receive, with a credit for the tax the PRs paid (form R185).

Heads-up: from 6 April 2027 (Finance Act 2026) savings rates rise to 22%, 42% and 47%; property income becomes its own slice after other non-savings income, at 22%, 42% and 47% (Wales: rates to be set by the Senedd); reliefs and the personal allowance go against income other than property, savings and dividends first; PRs pay 22% on savings and property income; companies deduct 22% from interest. These apply from 2027/28: not examined in SQE1 January or July 2027, but in SQE2 October 2027 (cut-off 28 June 2027). The Budget on 28 October 2026 falls before the July 2027 cut-off: check for changes with immediate effect.

Sources: SRA, SQE1 assessment specification (assessments from 1 September 2026) and SQE assessment dates; HMRC, Income Tax rates and allowances 2026 to 2027, and HMRC manuals; Income Tax Act 2007, Income Tax (Trading and Other Income) Act 2005, Capital Allowances Act 2001, Finance Act 2013 and Finance Act 2026 (legislation.gov.uk); Senedd, Welsh rates of income tax 2026-27. Checked on 2 October 2026.

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