Personal Tax Computation – The 5 Step Plan to a Comprehensive Understanding
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The purpose of this article is to provide guidance to students on the preparation of the personal tax computation as required by the Formation 2: Taxation syllabus. It is important to note that the personal tax computation includes income tax, PRSI and USC. If an exam question asks you to prepare an "income tax computation" this usually means that PRSI and USC are to be ignored. Where the exam question states that PRSI and USC are to be ignored, time should not be wasted in calculating these amounts as there will not be any marks available.

Any discussion of the preparation of the personal tax computation must firstly focus on the importance of the Pro Forma Personal Tax Computation. This Pro Forma is used in practice and is based on the requirements of the relevant tax legislation. It is essential that students are completely familiar with its contents and presentation, as this is the required format for presentation of these computations in an exam. Additionally, and of great benefit to students, the Pro forma acts as a learning guide, as it ensures that you appreciate the rules applied to calculating the amount of income subject to tax.

Pro-forma Personal Tax Computation for 2017	**€**	**€**
Schedule D		
Case I		
Adjusted Case I profit	X	
Less: Case I/II losses forward (S382)	(X)	
Less: Capital allowances	(X)	
Less: Allowable retirement annuity contributions	(X)	X
Case II		
Adjusted Case II profit	X	
Less: Case I/II losses forward (S382)	(X)	
Less: Capital allowances	(X)	
Less: Allowable retirement annuity contributions	(X)	X
Case III		X
Case IV		X
Case V		
Irish rent after deduction of allowable expenses	X	
Less: Case V capital allowances	(X)	
Less: Case V losses forward	(X)	X

Schedule E		
Wages, salaries, bonus, directors fees, pensions	X	
Benefits in Kind	X	
Taxable lump sum	X	
Less employee occupational pension contributions	(X)	
Less allowable retirement annuity contributions	(X)	X
Schedule F		X
Gross Income		X
Less 'Certain' Deductions		
Case I/II losses of the current period (S381)	(X)	
Charges paid	(X)	(X)
Total Income		X
Less Personal Allowances/Reliefs		
▪ Nursing home fees	(X)	
▪ Permanent health insurance	(X)	
▪ Employed person taking care of incapacitated individual	(X)	
▪ EII Scheme	(X)	(X)
Taxable Income		X
Taxed as follows:		
Standard rate band @ 20%		X
Deposit Interest @ 39%		X
Balance @ 40%		X
		X
Less Non-refundable tax credits		(X)
		X
Add: Income tax deducted from payments made by the taxpayer		X
Add: PRSI		X
Add: USC		X
		X
Less Refundable tax credits		(X)
Net income tax due/(refundable)		X/(X)

The 5 Step Plan

In order to calculate an individual's tax liability for a year of assessment it will be necessary to:

1. Identify and correctly classify each source of income.
2. Determine and apply the correct basis of assessment for each source of income.
3. Identify and determine the amount of any exemptions, deductions or reliefs available and the manner in which these are given.
4. Calculate the total tax correctly applying the relevant rates and bands.
5. Determine the tax credits which may be used to reduce the tax liability.

The remainder of this article will focus on providing an overview for students on how to deal with each of the above five tasks.

1. Identify and correctly classify each source of income

You will notice that there are separate sections for each source of income in the Pro Forma computation. In answering exam questions, it will be important to identify the correct category so as to include the income in the right place in your computation.

More importantly, it is necessary to understand that income is classified into different Schedules for tax purposes because there are different rules for each category in determining:

- How much income is to be included in the tax computation for the year of assessment.
- The reliefs or exemptions, if any, which may be utilised against this income.
- In some cases, the rate of tax which will be charged on the income.

The various categories of income examinable are as follows:

Schedule D Case I	Trading income of self-employed individuals.
Schedule D Case II	Self-employment income from professions and vocations.
Schedule D Case III	Investment income not subject to a deduction of tax at source, income from foreign investments & other income not taxed at source.
Schedule D Case IV	Irish deposit interest & miscellaneous income not taxed under other Schedules.
Schedule D Case V	Irish rental income
Schedule E	Income from Irish employments; Irish pensions & certain DSP payments.
Schedule F	Dividends from Irish companies.

2. Determine and apply the correct basis of assessment for each source of income

The term 'basis of assessment' refers to the manner in which the amount of income to be assessed to tax in a given tax year is determined. The basis of assessment of income under each schedule differs and students need to be familiar with details of the rules for each schedule.

The following table provides a summary of the different basis of assessment for each source of income:

Schedule D Case I & II	The basis of assessment for Case I and Case II are the same. Self-employed individuals usually prepare accounts for the business for a 12 month period. The profit or loss as calculated for accounting purposes will need to be adjusted for tax purposes. In the case of partnerships, it

will be necessary to apportion the tax adjusted profits between the partners.

Following the calculation of tax adjusted profits, it is necessary to determine the amount to be assessed to tax and there are different rules depending on which of the following circumstances apply:

- On-going business
- Business in commencement
- Business in cessation
- Change of accounting period end date.

The special rules which apply in the above scenarios relate only to the calculation of Case I and Case II income and do not apply to the other categories of income.

Schedule D Case III	Case III income is assessed to tax on the basis of income 'arising' in the tax year. For Case III purposes, 'arising' means when the income is received.
Schedule D Case IV	The basis of assessment of Case IV is normally the actual profits arising in the year of assessment. The most common source of Case IV income in exam questions is income received under deduction of tax i.e. Irish deposit interest. If an exam question provides the amount of the net interest received, it will be necessary to gross up the net amount in order to arrive at the "gross income" i.e. the actual profits arising in the year.
Schedule D Case V	Irish rental income is assessed to tax on the income 'arising' in the tax year. For Case V purposes, gross rental income arises when the lessor becomes entitled to receive the income. A proportion of any premium paid on a short lease will also be deemed to be income and is included in calculating gross rent. The legislation sets out the type of deductions which may be made from gross rent in arriving at the net surplus or deficit for each rental property. The aggregate of the surpluses and deficits for each property is assessed under Case V.
Schedule E	The statutory basis of assessment for employment income for tax years up to and including 2017 is the actual amount of income earned for the tax year, regardless of whether or not the income was received. (Note – the basis of assessment from 2018 onwards for most employees is the receipts basis).
Schedule F	The basis of assessment for Schedule F for a year of assessment is the dividends received in the tax year. In many cases the dividend received after the deduction of dividend withholding tax at 20%. Therefore it will be necessary to 'gross up' the amount of the dividend received in calculating income for Schedule F.

3. *Identify and determine the amount of any exemptions, deductions or reliefs available and the manner in which these are given*

The amount of tax payable by an individual depends on the income and personal circumstances of the individual. Income tax relief, which will reduce the amount of income tax payable by an individual is typically available by way of deduction in arriving at the individual's taxable income or by way of tax credit against the income tax liability. In certain cases, relief is available at source.

The Pro Forma Personal Tax computation contains three key headings:

- Gross Income
- Total Income
- Taxable Income

The meaning of these terms is explained below:

Gross Income	Income from all sources less deductions or losses specifically allowable against that source of income, i.e. losses forward, capital allowances, retirement annuity premiums.
Total Income	Gross income after deduction of certain 'charges', i.e. covenants and maintenance payments.
Taxable Income	Total income less personal allowances and reliefs allowable at the marginal rate of tax. These include, nursing home fees, permanent health insurance, payments to carers employed to take of incapacitated individual and EII scheme relief.

There are specific rules for determining whether or not a deduction is available and for calculating the amount of the deduction available. It is essential that students have a comprehensive understanding of the circumstances in which the deductions are available, the conditions that must be satisfied in order to claim them and the special computational rules that apply to each.

Exempt sources of income

Certain types of income are exempt from income tax. The exemption may depend on the personal circumstances of the individual or the source of income and the exemption may apply to some or all of the income. Examples of some of the exemptions examinable are as follows:

- Rent a room relief
- Income from child care services
- Income from leasing of farmland
- Artists income
- Age related income exemption and marginal relief
- Certain Department of Social Protection payments
- Certain benefits in kind

Each exemption has its own special conditions which must be satisfied in order for the exemption to apply. It is important to have a comprehensive understanding of the conditions to be satisfied in order to qualify for each exemption. The exemption from income tax does not automatically apply to USC or PRSI.

Example:

Billy has leased 50 acres of farmland land to a local farmer under a 16 year lease. The local farmer uses the land for the purposes of his farming trade and is not connected to Billy. The terms of the written lease agreement state that the annual rental income is €32,000.

In an exam, it would be necessary to apply the available exemption in the income tax computation and to provide a brief note to show that the conditions for the exemption have been satisfied. The purpose of the note is to demonstrate that the conditions have been considered and that the student has determined based on the information in the question that the relief applies. It would not be necessary to set out the detailed conditions of the relief.

In the income tax computation:	
Rental income from lease of farmland	32,000
Exemption for qualifying lease (Note 1)	(32,000)
Case V	0

In a note/workings either before or after the end of the income tax computation:

Note 1

Relief for certain income from leasing of farmland applies on the basis that the lease is in writing, is used by the lessee for the purpose of a farming trade and the lessor and lessee are not connected.

Tax relief at source (TRS)

Tax relief for mortgage interest and medical insurance premiums is granted at source. This means that the tax relief is granted by way of a reduction in the amount payable by the individual to the mortgage provider or the medical insurance provider.

As tax relief is granted at source, the individual is not required to file a tax return after the end of the tax year in order to claim the reliefs due or, in the case of PAYE workers, they are not required to seek an adjustment to their tax credits during the tax year in order to claim the reliefs.

Example:

A gross annual medical insurance premium of €500 qualifies for relief at 20%, i.e. €100. The individual receives the relief at the time of payment and therefore only pays €400, (€500 gross medical insurance less €100 tax relief). Since the tax relief is granted at source, there is no adjustment required to the personal tax computation. In an exam question, therefore, it will be necessary to note that no adjustment is required to the personal tax computation as follows:

In the income tax computation:	
Non-refundable tax credits:	
Medical insurance premium - TRS	0

Or In a note/workings either before or after the end of the income tax computation:

Note 1

Relief for medical insurance premiums is granted at source.

4. Calculate the total tax correctly applying the relevant rates and bands

The standard rate band or standard rate cut-off point refers to the amount of income taxable at the standard rate of income tax (20% for 2017). The applicable standard rate band in a given scenario depends on an individual's personal circumstances, i.e. whether the individual is single, single with dependent children, widowed, widowed with dependent children, married, and, if married, whether he or she is the sole earner.

The standard rate bands for 2017, for each of these scenarios, are as follows:

Single/Widowed without dependent children	€33,800
Single/Widowed with dependent children	€37,800
Married – one income	€42,800
Married – dual income	€67,600*

The standard rate tax band for a married couple jointly assessed is €42,800 for 2017. However, where both spouses have taxable income for the tax year, the standard rate tax band may be increased by the lower of the €24,800 and the other spouse's income. This means that the maximum standard rate band for married persons is €67,600. This limit will be reached provided the higher earning spouse has taxable income of at least €42,800 and the lower earning spouse has taxable income of at least €24,800. If the lower earning spouse's income is less than €24,800 for the tax year, then the increase in the standard rate band above €42,800 is restricted to the amount of that spouse's income.

Example:

Paddy and Mary are married and jointly assessed to income tax. Mary has taxable income of €60,000 and Paddy has taxable income of €20,000. The gross tax before allowing for tax credits is calculated as follows:

	Income	Rate	Income tax
Standard rate band married person	€42,800	20%	€8,560
Increase in standard rate band	€20,000	20%	€4,000
Balance	€17,200	40%	€6,880
Total	€80,000		€19,440

Note that, the total amount of income taxed at 20% is €62,800 and not €67,600. This is because the second source of income was not sufficient to benefit from the full amount of the increase in the standard rate band.

5. Determine the tax credits which may be used to reduce the tax liability.

Tax credits reduce the amount of income tax payable and are either refundable or non-refundable. Where a tax credit is non-refundable, this means that the credit cannot generate a refund of tax.

Example

Joe's only source of income is €5,000 in dividends which he received under deduction of DWT. The income tax computation for Joe is as follows:

Taxable Income	5,000
Income tax at 20%	1,000
Non-refundable tax credits	
Personal tax credit	(1,000)
Refundable Tax Credit – DWT paid	(1,000)
Refund due	(1,000)

Note – the personal tax credit is €1,650, however Joe can only utilise €1,000 of this credit. As this tax credit is non-refundable, he cannot have a refund of the balance of the tax credit of €650)

Reference tables are provided in each exam which set out an abbreviated list of tax credits available. Not all tax credits are listed, i.e. those related to expenditure on medical expenses or third level fees. Some of the tax credits require conditions to be satisfied in order for the individual to claim the tax credit and some of the tax credits are restricted by reference to either income amounts or expenditure amounts. The conditions and restrictions are not generally provided in an exam and students must have a comprehensive understanding of the applicable rules in order to ensure that the tax credit is given where due and restricted when applicable.

Example:

During 2017, Brendan paid €9,200 for a master's degree in Trinity College Dublin.

In an exam it would be necessary to calculate the amount of the credit available in respect of the above expenditure. It would not be necessary to detail all of the conditions which need to be satisfied.

Working

The qualifying fee for each course is restricted to €7,000	
Fees paid	€9,2000
Maximum qualifying	€7,000
Less disregard amount	(€3,000)
Amount qualifying for relief	€4,000
Tax credit at 20%	€800

In an exam, there are often easy marks available for correctly identifying and calculating the amount of tax credits due. Therefore, it is worth taking the time to study the available tax credits and to be familiar with what information is provided in the reference tables and importantly what information is not provided.

Conclusion

In terms of exam preparation, students should note that there will always be an income tax computation question and students are advised to practice as many questions as possible so as to develop a proficiency in applying the income tax rules to exam type scenarios and setting out answers in the prescribed format.