ACCA P6 UK Advanced Taxation (FA 2016)

For Exams up to March 2018

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Chapter No. 1

INCOME TAX

Tax year:

Income tax liability is calculated for each tax year. Tax year runs from 6th April to 5th April e.g. tax year 16/17 runs from 6th April 16 to 5th April 17.

Income tax format

Details	Non savings £	Savings £	Dividends £
Trading income	Xxx		
Pensions	Xxx		
Interest income (Note 1)		Xxx	
Dividends income			xxx
Other income	Xxx		
Property income	Xxx		
Employment income	Xxx		
Income from discretionary trust 100/55	Xxx		
Income from interest in possession trust paid out of			
Non savings income 100/80	Xxx		
Savings income 100/80		Xxx	
Dividends income 100/80			xxx
Less deductible interest (Note 2)	Xxx 1st	xxx 2nd	xxx 3rd
Net income (before personal allowance)	Xxx	xxx	xxx
Less personal allowance (Note 3)	Xxx 1st	Xxx 2nd	Xxx 3rd
Taxable income starting rate band £1-------£5000 (£5000)	20%	0%	0% For everyone
Basic rate band £5001-------£32,000 (£27,000)	20%	20%	7.5%
High rate band £32,001-------£150,000 (£118,000)	40%	40%	32.50%
Additional rate band £15000,1 ------- above	45%	45%	38.1%

Less:	Tax reducers: (use following order)		
30%	Investment in VCT (venture capital trust)		xxx
30%	Investment in EIS (enterprise investment share)	xxx	
50%	Investment in (seed enterprise investment schemes)		xxx
Tax liability			xxx
Less:	Tax deducted at source		
PAYE (pay as you earn) (paid on salary)			xxx
45% of gross income from discretionary trust		xxx	
20% of gross income from interest in possession trust		xxx	
Income tax payable (receivable)			xxx/(xx)

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Note: 1 Interest Income:

Interest income is always received grossed, so no grossing up is needed.
Interest income Nil rate band: interest income has nil rate band of £1000 in basic rate band & £500 in higher rate band, excess is taxable as per the rates given above.

Note: Savings Income Nil rate bands will be given in the exams

Note: 2 Deductible Interest

If loan is taken for any of the following purposes, then the interest paid on such loan can be deducted:

>Investment in Partnership

>Purchase of Plant & Machinery for Employment

>Investment in Employee-controlled Company

>Investment in Co-operative

Note: 3 Personal allowance (Given in Exam Tables)

Personal Allowance is £11,000 (if Adjusted Net Income is £100,000 or less)

Note – A Adjusted Net Income	**£**	
Total Net income (after deductible interest)		xx
Less: personal pension contribution (Gross)	(xx)	
Adjusted Net Income		xx

Note – B Adjustment to Personal allowance of £11,000 if Adjusted Net income exceeds £100,000.

- If the Adjusted Net Income exceeds £100,000 then:

Step # 1 Calculate the excess income i.e. (Adjusted Net Income – 100,000)
Step # 2 Reduce the excess amount to half i.e. (Adjusted Net Income – 100,000) x 50%
Step # 3 Deduct half of the excess amount from the personal allowance of £11,000.
But the allowance should not be reduced below Nil (i.e. zero)

> Exam Tip # Personal Allowance will be NIL if Adjusted Net Income is £ 122,000 or more

NOTE: 4 EXEMPT INCOME

The following income is exempt and must not be included in the format (just state that it is exempt)

- Income from Saving Certificates issued by National Saving & Investment bank
- Premium Bond Prizes
- Individual Saving Account (ISA) £15240/year
- Child Benefit (it is the benefit paid to people who are responsible for caring at least one child

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Note: 5 CHILD BENEFIT INCOME TAX CHARGE

An income tax charge has been introduced where a person received child benefit and his adjusted net income exceeds £50,000. If adjusted net income is between £50,000 and £60,000, then the income tax charge is:

$$\frac{\text{Adjusted Net Income} - 50{,}000}{100} \times \text{Child Benefit} \times 1\%$$

Where adjusted net income exceeds £60,000, then the income tax charge is equal to child benefit received.

Note: 6 Personal Pension Contributions (Given in Exam Tables)

When a taxpayer pays personal pension contributions then the taxpayer only pays 80% (net) of the amount he wishes to pay into his pension scheme, the remaining 20% is paid by HMRC. For example, if the taxpayer wishes to pay £200 then he will only pay £160 and the remaining £40 will be paid by HMRC.

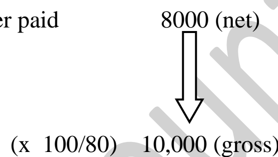
If a taxpayer pays contribution under personal pension scheme then the tax benefit will be given as following:-

Step # 1 The amount paid by the tax payer will be grossed by (x 100 / 80)

Step # 2 The basic rate band and higher rate band of the tax payer will be extended by the gross amount.

e.g.

The Tax payer paid 8000 (net)



(x 100/80) 10,000 (gross)

Original **I. Tax Bands**	**EXTENDED** **I. Tax Bands**
Starting Band	Starting Band
1 ------- 5,000 (5,000)	1 ------- 5,000 (5,000)
Basic Band	Basic Band
5,001 ---- 32,000 (27,000)	5,001 ---- 42,000 (37,000)
ADD	
Higher Band	Higher Band
32,001 --- 150,000 (118,000)	42,001 --- 160,000 (118,000)
ADD	
Additional Band	Additional Band
150,001 --- above (above)	160,001 --- above (above)

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INCOME OF MINOR CHILD

Income of £100 (gross) or less, which is directly transferred by a parent to minor child, will be treated as child's income. Income of more than £100 (gross), which is directly transferred from a parent to minor a child, will be treated as parent's income. This applies only to parents and not to any other relatives.

INCOME ON JOINTLY HELD PROPERLY

If property is jointly held by a married couple then income arising on that property will be taxed as if income is shared equally between the spouses (i.e. 50:50), unless they make a joint declaration to HMRC specifying the actual proportion of income sharing.

Example 1

For the tax year 2016–17, Peter has pension income of £8,000, savings income of £4,500 and dividend income of £9,000. Calculate His income tax liability.

Example 2

For the tax year 2016–17, Alam has pension income of £7,000 and savings income of £6,500. Calculate His income tax liability:

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Example Income Tax Format (chapter-1) – Comprehensive

Ali had the following income and Expenses during the tax year 16/17

Income	£
Employment income	80,000
Bank interest	20,000
Dividends	10,000
Income from discretionary trust	5,500
Income from life-Tenant Trust (paid out of non-saving income)	4,000
Child benefit	7,000
Expense:	
Interest paid on loan for partnership	12,000
Personal pension contribution paid (net)	16,000
Investment in venture capital trust (VCT)	20,000
Investment in enterprise investment scheme (EIS)	10,000
Investment in seed enterprise investment scheme (SEIS)	6,000

Requirement

Calculate the income tax payable by Ali in Tax year 16/17

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Chapter No 2

PENSIONS

TYPES OF PENSION SCHEMES

1) **Occupational pension scheme** (final salary schemes, defined benefit schemes)

Occupation pension scheme is a scheme operated by the employer for his employees.

2) **Personal pension scheme** (Money purchase schemes, defined contribution schemes)

Personal pension scheme is a pension scheme managed by taxpayer himself through some financial institutions like Banks and insurance companies.

Maximum contribution to pension scheme:

Any amount can be contributed by the taxpayer himself or any other on his behalf.

However, for tax relief purpose the **maximum contribution** that shall quality for tax relief is **higher of:**

a) UK relevant earning (Employment income, Trading income, income from furnished holiday lettings)

b) £3600

Note:

If the gross pension contribution exceeds the annual allowance then there shall be a tax charge on the excess contribution by adding it as an extra amount of non-saving income.

The annual allowance for tax year 14/15 and 16/17 is £40,000.

The annual allowance for 13/14 and earlier year was £50,000.

If an individual has any unused annual allowance in any of the previous three tax year then it can be paid in the tax year 15/16 without incurring a tax charge. The annual allowance in the current year is treated to be used first and then the unused annual allowance of previous three years will be treated as used on FIFO Basis.

Tapered Annual Allowance

For the tax year 2016–17 onwards, the normal annual allowance of £40,000 is reduced by £1 for every £2 by which a person's adjusted income exceeds £150,000.
Maximum it can reduce the allowance is to minimum of £10,000.
Exam Tip: person with adjusted income of £210,000 or more, will only be entitled to an annual allowance of £10,000 (40,000 – ((210,000 – 150,000)/2) = £10,000).

Note: Annual allowance will only be tapered where Threshold income (Net income – gross personal pension contribution) is more than £110,000

Tax Relief:

In order to take tax advantage on pension contributions, the pension scheme must be registered with HMRC.

OCCUPATIONAL PENSION CONTRIBUTION

Any amount contributed by the employee himself shall be deducted from his salary as **"Allowable Deduction"**

Any amount contributed by the employer for the employee shall be an exempt benefit.

PERSONAL PENSION CONTRIBUTION

The individual shall contribute 80% (net of basic rate tax) to his personal pension scheme while the remaining 20% shall be paid by HMRC to the pension provider.

The amount paid by the taxpayer (net) shall be grossed by (x 100/80) and the Basic rate band and higher rate band of the taxpayer shall be extended by this gross amount. This relief will be beneficial only to higher rate tax payers. Any amount contributed by the employer for the employee shall be exempt benefit.

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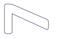

Pension benefits & life time allowance

Pension payments can only be received when an individual reaches a minimum pension age of 55 years old.

The maximum funds that can be accumulated in pension funds are limited to life-time allowance of £1,000,000. If funds are accumulated more than the life time allowance then there shall be a tax charge (Not in Syllabus).

The maximum amount that can be taken as a tax-free lump sum is limited to 25% of life-time allowance.

The rest of the funds accumulated in the pension funds must be taken as pension income and will be taxed as non-saving income in the tax year of receipt.

Comprehensive Example Pensions

Watch Video lecture for Example

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Enterprise investment scheme (EIS)

The enterprise investment scheme (EIS) is a scheme designed to promote high-risk unlisted trading companies raise finance by the issue of ordinary shares to individual investors. EIS investments are high risk because investments are made in unquoted companies which have less than 250 employees and gross assets less than £16m after investment.

Income tax relief: (tax reducer)

Individuals can claim a **tax reducer** of **30% of the amount subscribed for qualifying investments.**

Remember tax reducer can only reduce the tax liability to zero but cannot change tax liability into negative.

The maximum qualifying investment in EIS is £1,000,000 in a tax year 16/17 on which tax reducer can be claimed. If a taxpayer wishes to invest in excess then the investor may claim to have the shares treated as issued in previous tax year 15/16 and claim tax reducer in previous year.

Withdrawal of income tax relief

Shares must be held by an investor for at least three years if the income tax relief is not to be withdrawn.

If the shares are sold within three years of investment then tax relief will be withdrawn as follows:

a) If the disposal is not a bargain at arm's length then full amount of relief originally obtained is withdrawn.
b) If the disposal is a bargain at arm's length there is a withdrawal of tax relief calculated as: (sale proceeds x 30%).

CGT reliefs

CGT relief shall also be given where shares quality for income tax relief under the EIS:

- Where shares are disposed of after the three year period any gain is exempt from CGT.
- If the shares are disposed of within three years any gain is computed in the normal way.
- If EIS shares are disposed of at a loss at any time, the loss is allowable but the cost of the shares for calculation purpose is reduced by the amount of EIS relief given on the shares.

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The seed enterprise investment scheme (SEIS)

The seed enterprise investment scheme (SEIS) is a scheme also designed to promote high-risk unlisted trading companies raise finance by the issue of ordinary shares to individual investors. SEIS investments are high risk because investments are made in small sized unquoted companies which have less than 25 employees and gross assets less than £200,000.

Income tax relief: Tax reducer

Individuals can claim a **tax reducer** of **50% of the amount subscribed for qualifying investments.**

Remember tax reducer can only reduce the tax liability to zero but cannot change tax liability into negative.

The maximum qualifying investment in SEIS is £100,000 in a tax year 16/17 on which tax reducer can be claimed. If a taxpayer wishes to invest in excess then the investor may claim to have the shares treated as issued in previous year.

Capital Gain relief: Gain reducer

Individuals can claim to reduce 50% of the gain on sale of any asset if the proceeds on the sale of the asset are reinvested in SEIS.

Withdrawal of income tax and capital gain relief

Shares must be held by an investor for at least three years if the income tax relief is not to be withdrawn.

If the shares are sold within three years of investment then tax relief will be withdrawn as follows:

a) If the disposal is not a bargain at arm's length the full amount of relief originally obtained is withdrawn.
b) If the disposal is a bargain at arm's length there is a withdrawal of tax relief calculated as: (sale precedes x 50%)

Venture Capital Trusts (VCT)

VCT is a company listed on London stock Exchange that invests in small unquoted EIS type companies. To be HMRC approved, a VCT must satisfy certain conditions: the investment in VCT is moderately high risk investment.

Income tax relief: Tax reducer

Individuals can claim a **tax reducer** of **30% of the amount subscribed for qualifying investments.**

Remember tax reducer can only reduce the tax liability to zero but cannot change tax liability into negative.

The maximum qualifying investment in VCT is £200,000 in the tax year 16/17 on which tax reducer can be claimed.

Withdrawal of "Tax reducer" relief

Shares must be held by an investor for at least five years if the income tax relief is not to be withdrawn.

If the shares are sold within five years of investment then tax relief will be withdrawn as follows:

(a) If the disposal is not a bargain at arm's length the full amount of relief originally obtained is withdrawn.
(b) If the disposal is a bargain at arm's length there is a withdrawal of tax relief calculated as:

(Sale precedes x 30%)

Dividends received from VCT

Dividends received are tax free income (i.e. Exempt)

CGT reliefs

CGT is exempt on sale of shares of VCT. Capital losses on sale of VCT shares are not allowable.

Note: there is no minimum holding period requirement for the tax benefits of tax-free dividends and CGT exemption on VCT shares.

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Chapter No. 3

PROPERTY INCOME

Income		**£**
Rent (Accrual Basis)		xx
Premium		xx
Less: Expenses (accrual Basis)		
Repairs & Maintenance	(xx)	
Advertisement	(xx)	
Agents Fee/ Commission	(xx)	
Insurance	(xx)	
Water Rates	(xx)	
Bad Debts	(xx)	
Council Tax	(xx)	
Redecoration	(xx)	
Interest Paid on Loan	(xx)	
Other Revenue Expenses	(xx)	
Replacement Domestic items Relief	**(xx)**	
Profit / (Loss)	**xxx/ (xxx)**	

Note:

- Capital expenses are not allowed as property expenses.
- Depreciation is not allowed
- If there is property loss then it can be carry forward to set-off against.
- Property income of the future year.

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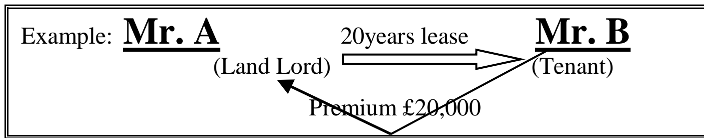
PREMIUM ON LEASES



Mr. A (Property Income)

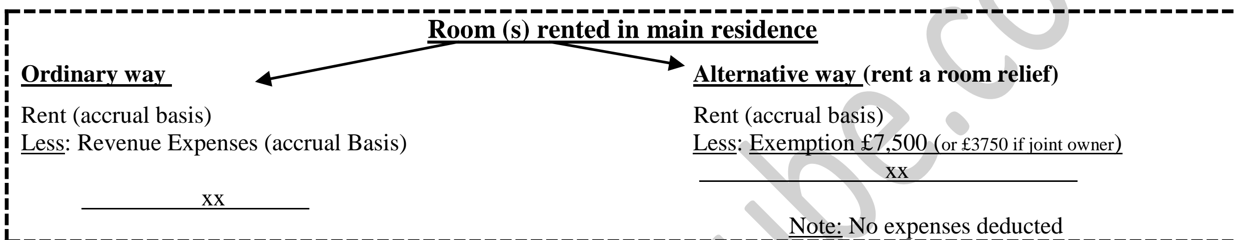
Premium xx

Less:

Premium x (n-1) x 2 % (xx)

Example
20,000
Less
20,000 x (20-1) x 2%
12,400

RENT A ROOM RELIEF



A taxpayer may choose to calculate his taxable income in ordinary way ignoring rent a room relief or he may elect the alternative basis that is "rent a room relief". It is advisable to choose the one which results in lower taxable income. An election to ignore the exemption or to elect for the alternative basis must be made by 31 January 2019 for 16/17 tax year which is 22 months after the end of the tax year concerned.

Example – rent a room relief

Alex has rented a furnished room in his main residence at a rent of £20,000 per annum throughout tax year 16/117. Alex incurred repair and maintenance cost of £300 in respect of the rented room.

Requirement

What is the taxable property income for Alex for the tax year 16/17?

Real estate investment trusts (REITs)

- Distributions from REITs out of property income are received by the shareholders after 20% Tax at source. These distributions are treated as property income instead of dividends for the shareholders.
- REITs can elect their property income and gains to be exempt form corporation tax.

Furnished Holiday Lettings (FHL)

All the following conditions must be met for a letting to qualify for furnished holiday lettings (FHL):

a) The letting must be furnished accommodation made on commercial basis.
b) The accommodation must be available for letting to public generally for atleast 210 days during the year.
c) The accommodation must be let to public generally for atleast 105 days during the year.
d) During the year the accommodation must not be let to same person for longer tern (31 days or more).

If there are long term occupations then it must not total more than 155 days in a year.

If a letting is classified as FHL then the following reliefs will be available:

1) Losses on FHL can only be carried forward to set off against profits on FHL in future years.
2) Capital allowances will be available on furniture instead of 10% "Replacement of Domestic items relief".
3) Income will qualify as relevant earning for pension contributions purpose.
4) Capital gain deferral reliefs (e.g. Rollover relief, gift relief etc.) will be available.

Note: the properties situated in both UK and EEA (European Economic Area) may qualify as FHL.

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Chapter No. 4

EMPLOYMENT INCOME

Salary
+
Bonus
+
Benefits
-
Amount paid by employee for benefit
-
Allowable deductions

Bonus

The mount of bonus is taxed in the tax year in which the employee becomes entitled (or paid) for bonus.

Benefits

1) Vouchers

All kinds of vouchers (e.g. Cash Vouchers, Credit Tokens, Credit Cards, Exchangeable Vouchers) provided to employee are TAXABLE on the cost to the employer.

2) Accommodation

Case-1 cost of Accommodation provided to employee is 75,000 or less

Taxable amount is calculated as higher of:

a) Annual value
b) Rent paid by the employer (if any)

Case –II Cost of accommodation provided to employee is more than 75,000

Taxable amount is calculated as:

Annual Value + [(cost of Accommodation or Market Value) – 75000) x Official rate of interest%]

Case-III Accommodation provided is "JOB RELATED ACCOMODATION" (Accommodation where employee is required to live)

Exempt

3) Expenses connected with living accommodation (e.g. heating, lighting, gardeners bill, repairing, decoration etc.)

All amount paid by employer is taxable.

4) Expenses reimbursed by employer when employee is away from home.

- £5 per day in UK is Exempt, if exceed than whole amount is taxable.
- £10 per day outside UK is exempt, if exceed than whole amount is taxable.

5) Scholarships

Scholarships to employees or family member of employees are taxable.

6) Removal expenses (Re-location Expenses)

Upto £8,000 is exempt, excess is taxable.

7) Medical insurance premium

If employee is outside UK for performance of duty, than exempt.

If employee is in UK for the performance of duty, then the entire amount is taxable on the cost to the employer.

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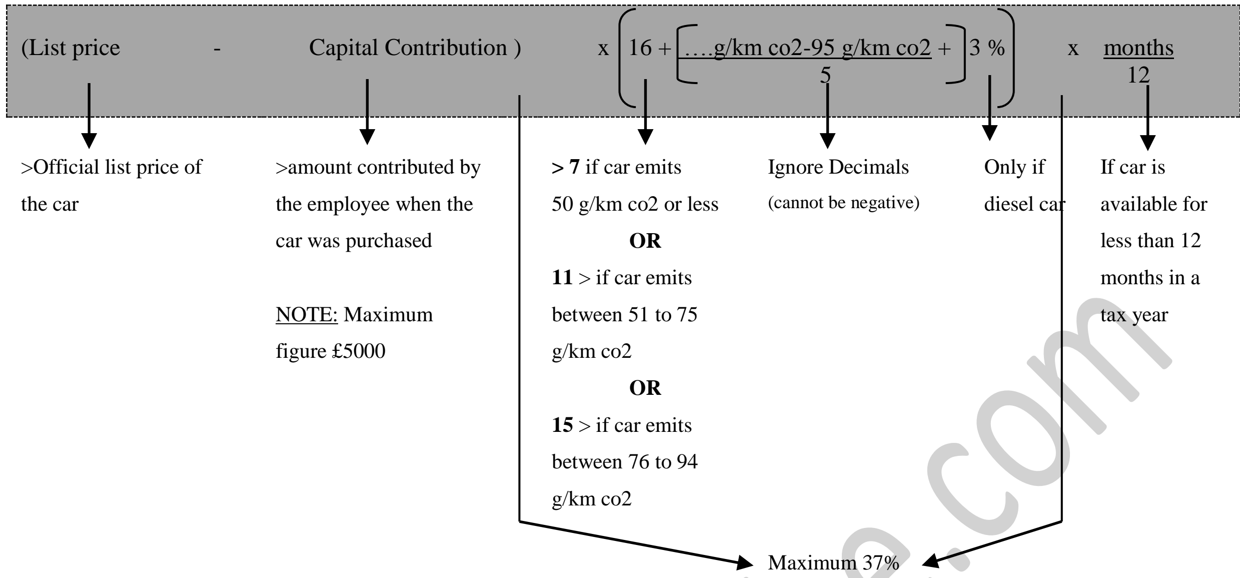
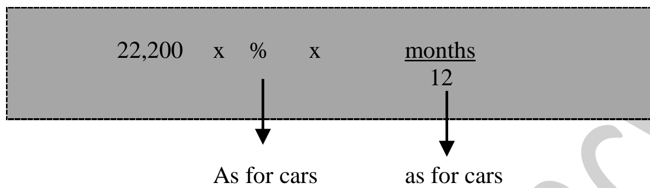
8) Cars



Note: Other benefits associated with the car which are insurance, repairs, maintenance, vehicle license are exempt.

9) Fuel for cars



Note: Contribution by employee of private usage for fuel is not deductible.

10) Use of other Assets (e.g. furniture, computer, T.V., Stereo system, camera………etc.)

20% X Market Value of asset when first provided.

[Note: This benefit will be reduced by (x month/12), if asset was provided for less than 12 months]

11) Other asset provided for use is subsequently purchased by the employee

Higher of:

1	2
Market value of asset when sold to employee Less Price paid by the employee Xxxx	Market value of asset when first provided Less Amount already taxed on the asset Less Price paid by the employee Xxxx

12) Approved Mileage Allowance (Milage allowance paid by employer to the employee who uses his own vehicle)

The approved (allowed) milage allowances are:

	First 10,000 miles	Above 10,000 miles
Cars	45 pence per mile	25 pence per mile
Motor-Cycle	24 pence per mile	24 pence per mile
Pedal-Cycle	20 pence per mile	20 pence per mile

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Amount up to approved (allowed) mileage allowance are Exempt, excess is taxable.

Note: if these employee receives less than the approved (allowed) mileage allowance than the amount less than the approved (allowed) mileage allowance can be treated as a deduction (negative allowance) for calculating employment income.

Formula to use	:	**£**
Allowance paid by employer	:	xx
Less: Approved Mileage Allowance	:	(xx)
Benefit / (Allowable deductions)	:	xx / (xx)

13) Beneficial Loans

Interest

If the employee pays interest to the employer less than the official rate of interest taxable amount is calculated using either of:

1) Average Method

$$\frac{\text{Highest outstanding loan in tax year} + \text{Lowest outstanding loan in tax year}}{2} \times \frac{\text{Months}}{12} \times \text{Official rate \%}$$

Less:

Interest amount actually paid

2) Strict (accurate) Method

$$\text{Balance of loan outstanding in months} \times \frac{\text{Months}}{12} \times \text{Official rate \%}$$

Less:

Interest amount actually paid

Note: If Question is silent then choose the lower of the two methods (unless said that HMRC opts for higher)

Exempt If:

The amount of loan is less than £ 10,000.

P6 – Employment Income (Basic Benefits)

Question:

James has been employed at an annual salary of £ 48,000 during tax year 16/17 & received the following benefits:

1) A diesel car with a list price of £ 25,000. The employer was able to buy the car at a discount and just paid £ 23,500 for it. The car had a 129 g/km co2 emission. James made a capital contribution of £7,000 at the time of purchase of car. The car was made available to James for his private journeys. James reimbursed his employer £50 per month for using the car privately and £20 per month for the provision of fuel.
2) The employer had provided James a computer laptop for his private since 6 April 2015 costing £ 250. On 5 October 2016, James purchased the laptop from his employer for £60, its market value then being £100.
3) During 6 April 2016 to 5 December 2016, James travelled on his own car for business journeys. His employer paid James £0.32 per mile for 14,000 miles travelled for business.
4) On 5 October 2016, James was provided with a cheap loan of £30,000 at 2% interest. James repaid £18,000 of the loan on 5 December 2016. The remaining loan was still outstanding at the end of tax year.

Requirement

Calculate the employment income for James for Tax year 16/17.

ANSWER (Note down the answer during class lecture)

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14) Vans & Heavier commercial vehicles

The annual scale charge is £3,170 if van is made available for private use of employee [NOTE: this benefit will be reduced by (x months/ 12), if van was provided for less than 12 month.

15) Fuel for vans

The annual scale charge is £ 598, if fuel is provided for private use of employee [Note: this benefit will be reduced by (x months/ 12). If van was provided for less than 12 months]

16) Mobile phones

Cost of upto one mobile phone is exempt. The cost of second and subsequent mobile phone is taxable as:-
20 % x Market value of mobile phone when first provided x months/ 12

17) Running cost & Top up vouchers for mobile phones

Running costs & top up vouchers of exempt mobile is exempt while all the cost is taxable if incurred on second and subsequent mobile phones.

18) Bicycle

Exempt

19) Sale of bicycle to employee

Taxable benefit is calculated as:

		£
	Market value of bicycle when sold	xxxx
Less	Price paid by the employee	(xxxx)
		xxxx

20) Entertainment provided by third party

Exempt

21) Non cash award for long service (given for service of 20 years or more)

Upto (£50 x Number of year of service) is Exempt, excess is Taxable.

22) Staff parties

Cost per member per year is £150 or less then Exempt, if exceed than whole amount is taxable.

23) Staff suggestion scheme

First £25 is exempt, excess is Taxable.

24) Employee attending full time course on employer expenses

Upto £15,480 is Exempt, if exceed then all amount is Taxable.

25) Sporting & recreational facilities provided to employees and not to general public

Exempt

26) Asset provided for performance of duties

Exempt

27) Welfare counseling

Exempt

28) Work place parking

Exempt

29) Work place nursery or playscheme

Exempt

30) Work related training

Exempt

31) Air miles coupon or car fuel coupons

Exempt

32) Cost of work buses & mini buses

Exempt

33) Employer provided uniform

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Exempt

34) Employer contribution for additional household cost incurred by employee working partly or wholly at home.

Exempt

35) Employee carrying a passenger in his own car

Upto 5c/m/passenger is Exempt, excess is Taxable.

36) Child care allowance

For basic rate taxpayer employee upto (£ 55 x Number of weeks) is exempt, excess is taxable.
For higher rate taxpayer employee upto (£ 28 x Number of weeks) is exempt, excess is taxable.
For additional rate taxpayer employee upto (£25 x Number of weeks) is exempt, excess is taxable
.

37) Transport/overnight cost where public transport is disrupted by industrial action

Exempt

38) Gift of goods form third party

£ 250 or less then exempt, if exceed then all amount is taxable.

39) <u>Trivial Benefit:</u>
Exempt Up to £50 per employee per year. (Not for cash or cash vouchers)

40) Eye care tests and corrective glasses for VDU use at work place

Exempt

41) Medical treatment of Doctor's prescription or recommendation

Upto £ 500 is exempt, if exceed then all amount is taxable.

42) Residual charge (for the benefit for which no specific rule is available)

Taxable amount of benefit is the cost to the employer.

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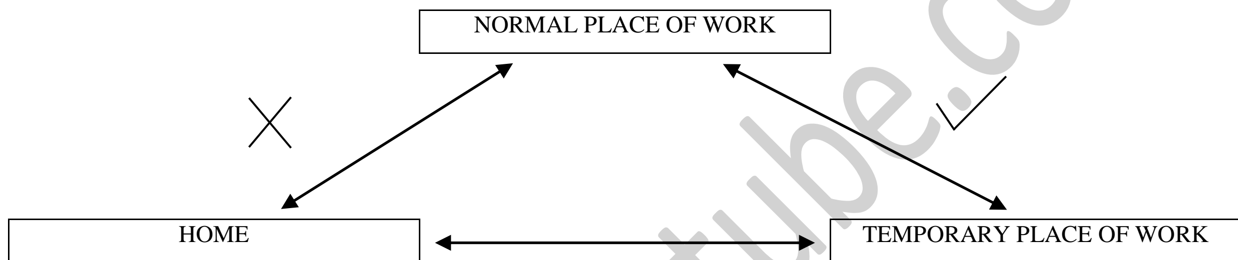
ALLOWABLE DEDUCTIONS

If following expenses are paid by the employee himself then he can deduct if from his salary as "Allowable deduction":-

1) Contribution to occupational pension scheme.
2) Subscription to professional bodies (e.g. ACCA, CIMA, ICAEW………..etc.)
3) Payment to charity made under payroll deduction scheme operated by employer.
4) Payment for liability incurred due to his employment.
5) Payment of premium for insurance to cover the liability to be incurred due to his employment.
6) Approved mileage allowance (for details see employment benefits)
7) Qualifying travel expense

- Travel expenses for travel between home and normal place of work (normal commuting cost) is not deductible.
- Travel expenses for travel between normal place of work and temporary place of work is deductible.
- Travel expenses for travel between home and temporary place of work is deductible if it is not more than continuous 24 months.



8) Cost of business telephone calls on private telephone is deductible but no part of the line rent can be deducted.
9) Appropriate proportion of cost on heating, lighting and council tax incurred by employee while working parly or wholly at home.

NOTE:

If the above mentioned expenses are paid by the employer then they will be an exempt benefit for the employee.

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National Insurance Contribution (NIC)

		%
Class 1 employee	£1 - £8060 per year	Nil
(Primary)	£8061 - £43,000 per year	12
	£43,001 and above per year	2
Class 1 employer	£1 - £8112 per year	Nil
(secondary)	£ 8113 and above per year	13.8
	(Employment Allowance £3,000 with Exception)	
Class 1A		13.8
Class 2	£ 2.80 per week	
	(Exempt if Accounting profit not more than £ 5,965 or receives state pension)	
Class 4	£1 - £8060 per year	Nil
	£ 8061 - £ 43,000 per year	9
	£ 43,001 and above per year	2

Class 1 (employee)

To be paid by employee on **SALARY, BONUS and excess mileage allowance** received from employer.

(Note: To be calculated on annual basis)

Class 1 (employer)

To be paid by employer on **SALARY, BONUS and excess mileage allowance** paid to employee. In 2016/17, **employer can claim £3,000 p.a. relief from their total class-1 NIC payments.**

(Note: To be calculated on annual basis)

Class 1 A

To be paid by employer on BENEFITs of employee.

Class 2

To be paid by self-employed.

Class 4

To be paid by self-employed on TAXABLE **ANNUAL PROFITs.**

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(Examples of Misc. Benefits & NIC)

Example – Comprehensive (Employment Income)

James has been employed at an annual salary of £48,000 during tax year 16/17 and received the following benefits:

1) Throughout tax year 16/17, a van costing £34,000 was provided to James for business as well as for private journeys. In addition he was also provided fuel for private journeys.
2) During tax year 16/1, James was provided with two mobile phones costing £200 each. The employer also paid the mobile phones bill of £100 each.
3) During tax year 16/17 the employer paid child care vouchers of £40 per week for 28 weeks.
4) During tax year 16/17, the employer also paid £1000 for James golf club membership.
5) James paid 10% of his basic salary in his occupational pension scheme.

Requirements:

a) Calculate the employment income for James for tax year 16/17.
b) Calculate the class-1 NIC to be paid by James for tax year 16/17.
c) Calculate the NIC to be paid by James's employer.

Example – NIC (Employment & Self-Employment)

Susan runs her own business and had taxable trading profits of £20,000 in tax year 16/17.

Hedrick is employed on an annual salary of £20,000 in tax year 16/17.

Requirement:

Calculate the NIC payable by Susan and Hedrick for the tax year 16/17.

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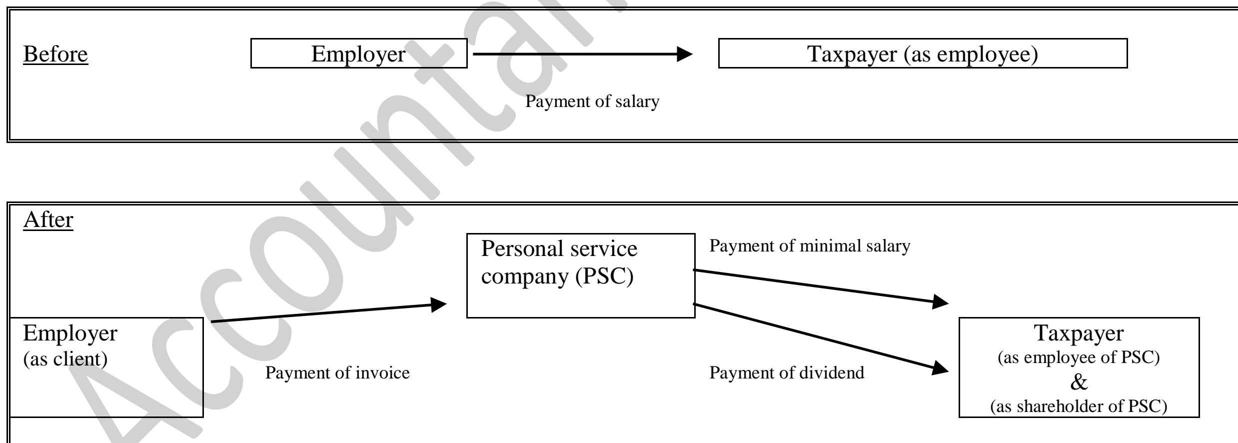
EMPLOYMENT AND SELF-EMPLOYMENT

The following factors should be considered to distinguish whether a person is employed or self-employed:

- Employment involves contract of service, whereas self-employment involves contract for services.
- The degree of control exercised over the person doing the work.
- Whether he must accept further work
- Whether the other party must provide further work
- Whether he provides his own equipment
- Whether he hires his own helpers
- What degree of financial risks he takes
- What degree of responsibility for the investment and management he has
- Whether he can profit from sound management
- Whether he can work when he chooses
- The wording used in any agreement between the parties.

PERSONAL SERVICE COMPANIES



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Taxpayers normally prefer to be classified as self-employed rather than employees as it results in less taxation and NIC. There are anti-avoidance rules (known as IR35 Provisions), which prevent employees avoiding tax and NIC through offering their services through an intermediary, such as "personal service company". Such personal service company may pay the worker minimal salary and pay as much as dividends resulting in an overall reduction in applicable income tax rates and NIC.

If an individual performs service for a client through to a contract between client and third party (personal service company) rather than a contract between client and the worker, such that if the service were to be performed by the worker under a contract between himself and client then he would have been regarded as employee then in such case; the payments to the worker will be subject to PAYE and NIC as if it was as follows:

		£
	Take 95% of all payments and benefits received from client	xx
Less:	Deduct expenses which are followed as allowable deductions	(xx)
Less:	Deduct expenses incurred for performance of duties	(xx)
Less:	Deduct capital allowances on plant and machinery used	(xx)
Less:	Deduct any salary and pension contributions and Employer's NIC paid by the third party (personal service company)	(xx)
		Xx
Less:	Deemed employer's NIC payment (Answer x 13.8 / 113.8)	(xx)
	Deemed Employment income	Xx

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Test-1

Time Allowed: 30min

Question

Susan worked for a full-time employment in UK during 5 October 2016 to 5 February 2017. Her UK income and Expenses during the tax year 16/17 are as follows:

	£
Income	
Other Income	50,000
Employment income (PAYE deducted £ 500)	8,000
Rent (Susan is joint owner of the property along with her husband)	32,000
Bank interest	27,000
Dividends	5,000
Child benefit	4,000
Income from discretionary trust	11,000
	£
Expenses	
Interest paid on loan for partnership	500
Personal pension contribution paid	4,000
Investment in SEIS Shares	100,000

Requirement

What is the tax payable by Susan for tax year 16/17? (10 Marks)

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Chapter No. 5

EMPLOYMENT INCOME: ADDITIONAL ASPECTS

Shares given to employees

If a director or an employee is given shares (or is sold shares for less than their market value), there is a charge on the difference between that market value and the amount (if any) which the director or employee pays for the shares.

Taxable benefit

	£
Market value of share	xx
Less: price paid by the employee	(xx)
	xx

Share options

Grant of share options

If a director or an employee is granted an option to acquire shares in future at a price set now, then there is no income tax charge on the grant of the option.

Exercise of share options

On the exercise of the option there is a charge as specific employment income on the market value of the shares after date of exercise minus the sum of what was paid for the option (if anything) and amount paid for the shares.

	£
Market value of shares at exercise	Xx
Less: price paid by the employee for options	(xx)
Less: price paid by the employee for shares	(xx)
	Xx

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SAYE share option schemes

A save as you earn (SAYE) share option scheme allows employees to save regular monthly for a fixed period and use the funds to take up options to buy shares free of income tax and NIC. Alternatively, they can simply take the cash saved.

- Employees can save a fixed monthly amount of between £5 and £500.
- The investments are made for three or five years, and a tax-free bonus is then added by the employer. The employee may either withdraw the money or leave it for two years. If he leaves it in the account, another tax-free bonus is added.
- At the withdrawal date, the employee may take the money in cash. Alternatively, he may use if to buy ordinary shares in his employer company.
- The price of these shares is fixed at the date the option was granted and must be atleast 80% of the market value of the shares at the time of grant.
- The only tax charge is to capital gains tax on the gain on the shares when they are finally sold.
- A scheme must be open to all employees and full-time directors, and on similar terms. However, a minimum service period (of upto 5 years) may be imposed as eligibility condition to join the scheme.
- The cost of setting up an SAYE scheme incurred by the company is a deductible trading expense.

Company share option plans (CSOP)

An employee can be granted option to buy shares under a CSOP. There is no income tax or NIC on the grant of a company share option plan (CSOP) option.

There is also no income tax or NIC on an exercise taking place between three and ten years after the grant. (Tax exemption is lost if the exercise takes place before three years or after ten years of grant of options) only CGT will apply to the profit on disposal of the shares.

To obtain HMRC approval schemes must satisfy the following conditions.

- The price of the shares must not be less than their market value at the time of the grant of the option. The total market value of shares in option granted to an employee must not exceed £30,000.
- Scheme need not to be open to all employees. Also a minimum service period (of upto 18 months) may be imposed as a eligibility condition to join the scheme.
- If the company is a close company, then anyone who held 30% of the shares of the company in preceding 12 months must be excluded from the scheme.

The cost of setting up an CSOP scheme incurred by the company is a deductible trading expense.

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Enterprise Management Incentives (EMI)

This scheme is intended to encourage experienced people to 'take the plunge' and leave established careers in large companies for riskier jobs in smaller, start-up or developing firms.

- A qualifying company can grant each of its employee's options over shares worth upto £250,000 per employee at the time of grant, subject to a maximum of £3m in total.
- No income tax or national insurance is chargeable on either the grant or exercise of the option provided the exercise takes place within 10 years of the grant and the exercise price is the market value of the shares at the date of the grant.
- If the options are granted at a discount rather than market price, then there is an income tax and NIC on discount, calculated as:

(Market price at the time of grant – option exercise price)

- An employing company may set a target to be achieved before an option can be exercised. The target must clearly be defined at the time the option is granted.
- When the shares are sold, the gain is subject to CGT. The capital Grain will be calculated as (Sale proceeds – market price at the time of grant) and CGT will be calculated according to normal CGT rates.

Qualifying company:

The company can be quoted or unquoted and the company's gross assets must not exceed £30m. The company must not be under the control of any other company. The company must have less than 250 full-time equivalent employees at the time the options are granted.

Eligible Employees:

Employees must be employed by the company for atleast 25 hours a week. If any employee holds 30% of the shares of the company then they must be excluded from the scheme.

Share Incentive Plans (SIPs)

- Employers can give up to £3600 of 'free shares' a year to employees with no tax or NICs. Employer can set a performance criteria or target to be met in order to be eligible for free shares.
- Employees can purchase 'partnership shares' through deduction from salary upto lower of 10% of salary of £ 1800 in the tax year.
- Employers can award 'matching shares' free to employees who purchase partnership shares at a maximum ratio of 2:1.
- SIP scheme must be offered on similar terms to all employees who participate in the scheme.
- Employers offering free shares must offer a minimum amount to each employee on 'similar terms'. Shares must normally be held in a plan for at least 5 years.
- If shares are withdrawn before 5 years, there is a charge to income tax and NIC on the market value of the shares at the time of withdrawal.
- If shares are taken out of the plan after five years then there is no charge to income tax or NIC. Also if the shares are sold immediately then there is no CGT on it.
- Dividends of upto £1500 on shares in the plan are tax-free provided the dividends are used to acquire additional shares in the company, which are then held in the plan for 3 years.

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Payments on the termination of employment

Termination payments may be entirely exempt, partly exempt or entirely chargeable.

Exempt termination payments

The following payments on the termination of employment are exempt.

- Payments on account of injury, disability or accidental death
- Lump sum payments from registered pension schemes.
- Legal costs recovered by the employee from the employer following legal action to recover compensation for loss of employment.

Fully taxable termination payments

Payments to which the employee is contractually entitled are taxable in full including.

- Payments for work done (terminal bonuses), for doing extra work during a period of notice.
- Payments in lieu of notice where stated in the original contract extending a period of notice.
- A payment by one employer to induce an employee to take up employment with another employer.
- Payments from un registered pension schemes.
- An employee accepting a limitation on his future conduct or activities in return for a payment (restrictive covenant).

Partly taxable (partially exempt termination payments)

Other payments on termination are partly exempt: the first £30,000 is exempt any excess is taxable is specific employment income. These include.

- Ex GRATIA payments.
- Compensation for loss of office
- Payments for unfair dismissal
- Statutory redundancy pay
- Any benefits (e.g. car, mobile phone, computers…… etc.) provided calculated under normal benefits rules.

Employers have an obligation to report termination settlements to HMRC by 6 July following the tax year end.

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Chapter No. 6

TRADING PROFIT ADJUSTMENTS

ILLUSTRATIVE FORMAT		**£**
	Net profit before tax as per accounts	xxxx
ADD	: Expenditure charged in accounts which are not deductible	xxxx
ADD	: Income not charged in Accounts which are Taxable	xxxx
LESS	: Income/ Profit included in accounts which are not trading profits	(xxxx)
LESS	: Expenditure not charged in accounts which are deductible	(xxxx)
	Trading profits (adjusted for tax purpose)	xxxx

ADD : Expenditure charged in accounts which are not deductible (not allowable)

- Fines and penalties
- Depreciation
- Amortization
- General provisions for bad debts or for any other purpose
- Bad debts not related to trade
- Capital expenditure
- Fee incurred in acquiring new asset
- Fee incurred in issuing new shares
- Gifts to customers costing more than £50 per done per year
- Gifts to customers which are food, drink, tobacco, vouchers irrespective of its cost
- Subscription and donation to political parties
- Charitable donation not wholly and exclusively for trade purpose
- Entertainment expenditure (for other than employees)
- Proprietor's salary or interest on capital
- Private elements of expenditure relating to proprietor's car, telephone…etc.
- Damages paid not in connection with trade matter
- Payments that constitute a criminal offence
- 15% of leasing charge of car emitting more than 130 g/km co2
- Travelling expense to the trader's place of business by the proprietor
- Payment of class 1 (employee) NIC, class 2 NIC, class 4 NIC.
- Loss on sale of asset (capital losses)

ADD: Income not charged in accounts which is taxable

- Drawing of stock and assets by the proprietor at its market value

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LESS: Income/ Profit included in accounts which are not trading profits

- Profit on sale of asset (capital gains)
- Rental income from property (property income)
- Premium received on grant of lease (property income)
- Interest received (interest income) dividend received

LESS: expenditure not charged in accounts which are deductible (Allowable)

- Capital allowances
- Pre trade commencement expenditure incurred upto 7 years before start of trade.

Note: Rarely if deductible expenses are not included in accounts then it must be deducted.

Note: ANY EXPENSE NOT IN ABOVE LISTS MUST BE IGNORED AS THEY ARE ALLOWABLE.

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Question

Adjusted taxable trade profits

Here is the statement of profit or loss of John Dodd, a trader.

Statement of profit or loss for year ended 31 May 2013.

	£	£
Gross profit		79,500
Other income		
Bank interest received		500
Expenses		
Wages and salaries (N1)	47,000	
Rent and rates	12,000	
Depreciation	1,500	
Motor expenses – cars owned by business (N2)	5,000	
Motor expenses – cost of leased car co2 emissions 150g/km (N4)	500	
Entertainment expenses – customers	750	
Office expenses	1,350	
		(68,100)
Finance costs		
Interest payable on overdraft		(1,500)
Net profit		10,400

Notes:

1) Salaries include £10,000 paid to john Dodd's wife, Julie, who works part time in the business. If John had employed another person to do this work, John would have had to pay at least this amount.
2) Motor expenses on cars owned by the business are £3000 for John Dodd's car used 20% privately and £ 2000 for his part-time salesman's car used 40% privately.
3) Capital allowances are £ 860.
4) The lease of the car started on 1 May 2013. No private use on the leased car.

Compute the adjusted taxable trade profit for the year ended 31 May 2013. You should start with the net profit figure of £ 10,400 and indicate by the use of zero (0) any items which do not require adjustment.

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Answer

Adjusted taxable trading profit for the year ended 31 May 2013.

		£	£
Net profit			**10,400**
Add:	Wages and salaries	0	
	Rents and rates	0	
	Depreciation	1500	
	Trader private motor expenses (£ 3000 x 20%)	600	
	Salesman's car	0	
	Leased car cost disallowed (£500 x 15%)	75	
	Entertainment expenses customers	750	
	Office expenses	0	
	Interest payable on overdraft	0	
			2925
Deduct:			13,325
	Bank interest received	(500)	
	Capital allowances	(860)	
			(1360)
	Profit adjusted for tax purposes		11,965

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CHAPTER NO: 7 BASIS PERIOD

First basis period

- From start of the trade to 5 April.

Second basis period

(a) If the first accounting period is more than 12 months, then the basis period is last 12 months of first accounting period.

(b) If the first accounting period is less than 12 months, then the basis period is first 12 months of the trade.

(c)) If the first accounting period is equal to 12 months, then the basis period is same as first accounting period.

(d) If there are two 5 April's in the first accounting period, than the basis period is from 6 April to 5 April (i.e. the tax year)

(e) If the first accounting date is taxed in the first basis period than the second and subsequent basis periods is same as accounting periods.

Third basis period

- If the first accounting date is taxed in the second basis period than the third and subsequent basis periods is same as accounting periods. (i.e. if either of a,b,c of second basis period applied).
- If the first accounting date is not taxed in the second basis period, than the third basis period is the last 12 months of the first accounting period. (i.e. if d) of second basis period applied).

Subsequent basis periods

- Same as accounting periods

Last basis period

- When trade ends then the last basis periods ends on business cessation date. If last two accounting dates fall in the same tax year then combine the last two accounting periods.

Overlap profits

- When profits taxed more than once due to basis periods rules, than the excess profits taxed are known as overlap profits. Overlap profit relief will also be given in last basis period.

Overlap losses

- Losses are never overlapped due to basis period rules.

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CHANGE OF ACCOUNTING DATE (BASIS PERIODS)

Case-I	**When change of accounting date results in one SHORT PERIOD OF ACCOUNTS** (Less than 12 months accounting period)

RULE: The basis period for that year is 12 months to the new accounting date. Resulting in overlap profits, which will be added in previous overlap profits

Example: **Assume overlap profits of 6 months of $ 6000 at start of trade.**

Accounting periods	Profits	Basis period	Profits
1 Jan 2000 to 31 Dec 2000	3000	1 Jan 2000 to 31 Dec 2000	3000
1 Jan 2001 to 31 Dec 2001	4500	1 Jan 2001 to 31 Dec 2001	4500
1 Jan 2002 to 31 Dec 2002	4000	1 Jan 2002 to 31 Dec 2002	4000
1 Jan 2003 to 30 Jun 2003	**6000**	**1 Jul 2002 to 30 Jun 2003**	**8000**
1 Jul 2003 to 30 Jun 2004	8000	1 Jul 2003 to 30 Jun 2004	8000
1 Jul 2004 to 30 Jun 2005	5000	1 Jul 2004 to 30 Jun 2005	5000

	$	Months
(Assume) overlap profits of 6 months at start of trade	6000	6
ADD: Overlap profits due to change I accounting period	2000	6
	8000	12

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Case-II — **When changes of accounting date results in one SHORT PERIOD OF ACCOUNTS which results in TWO ACCOUNTING DATES in a tax year.**

RULE: The basis period for that year begins immediately from the beginning of previous accounting period and ends on the on the new accounting date. Resulting in basis period of more than 12 months, Overlap profits relief will be given upto months exceeding 12 months.

Example: **Assume overlap profits of 6 months of $ 6000 at start of trade.**

Accounting periods	Profits	Basis period	Profits
1 Jan 2000 to 31 Dec 2000	3000	1 Jan 2000 to 31 Dec 2000	3000
1 Jan 2001 to 31 Dec 2001	4500	1 Jan 2001 to 31 Dec 2001	4500
1 Jan 2002 to 31 Dec 2002	4000		
1 Jan 2003 to 31 Mar 2003	**6000**	**1 Jan 2002 to 31 Mar 2003**	**7000**
1 Apr 2003 to 31 Mar 2004	8000	1 Apr 2003 to 31 Mar 2004	8000
1 Arp 2004 to 31 Mar 2005	5000	1 Apr 2004 to 31 Mar 2005	5000

Overlap Profit Relief
Months exceeding 12 months = 3 months
Overlap profits at start of trade = 6 months = $ 6000
Thus overlap profits for 3 months would be [3/6 x 6000] 3000
Thus the profit for the basis period for the change would be [4000+6000-3000] 7000

Case-III — **When change of accounting date results in one LONG PERIOD OF ACCOUNTS** (More than 12 months accounting period)

RULE: The basis period for that year is same as the accounting period. Resulting in basis period of more than 12 months, Overlap profits relief will be given upto months exceeding 12 months.

Example: **Assume overlap profits of 6 months of $ 6000 at start of trade.**

Accounting periods	Profits	Basis period	Profits
1 Jan 2000 to 31 Dec 2000	3000	1 Jan 2000 to 31 Dec 2000	3000
1 Jan 2001 to 31 Dec 2001	4500	1 Jan 2001 to 31 Dec 2001	4500
1 Jan 2002 to 31 Mar 2003	**8000**	**1 Jan 2002 to 31 Mar 2003**	**5000**
1 Apr 2003 to 31 Mar 2004	8000	1 Apr 2003 to 31 Mar 2004	8000
1 Apr 2004 to 31 Mar 2005	5000	1 Apr 2004 to 31 Mar 2005	5000

Overlap Profit Relief:

Months exceeding 12 months = 3 months
Overlap profits at start of trade = 6 months = $6000
Thus overlap profits for 3 months would be [3/6 x 6000] 3000
Thus the profit for the basis period for the change would be [8000-3000] 5000

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Case-IV	When change of accounting date results in one LONG PERIOD OF ACCOUNTS which results in NO ACCOUNTING DATES in a tax year.

RULE: then the basis period will have to be manufactured i.e.

Step 1	Take the new accounting date	e.g.	30-Jun-04
Step 2	Deduct 12 months from this date	e.g.	30-Jun-03
Step 3	Basis period is 12 months to this date	e.g.	1 July 02 to 30 June 2003

Resulting in huge overlap profits, which will be added in previous overlap profits

Example: **Assume overlap profits of 6 months of $ 6000 at start of trade.**

Accounting periods	Profits	Basis period	Profits
1 Jan 2000 to 31 Dec 2000	3000	1 Jan 2000 to 31 Dec 2000	3000
1 Jan 2001 to 31 Dec 2001	4500	1 Jan 2001 to 31 Dec 2001	4500
1 Jan 2002 to 31 Dec 2002	6000	1 Jan 2002 to 31 Dec 2002	6000
1 Jan 2003 to 30 Jun 2004	**9000**	**1 Jul 2002 to 30 Jun 2003**	**6000**
1 Jul 2004 to 30 Jun 2005	8000	1 Jul 2003 to 30 Jun 2004	6000
1 Jul 2005 to 30 Jun 2006	5000	1 Jul 2004 to 30 Jun 2005	8000
		1 Jul 2005 to 30 Jun 2006	5000

	$	Months
(Assume) overlap profits of 6 months at start of trade	6000	6
ADD: Overlap profits due to change in accounting period	3000	6
	9000	12

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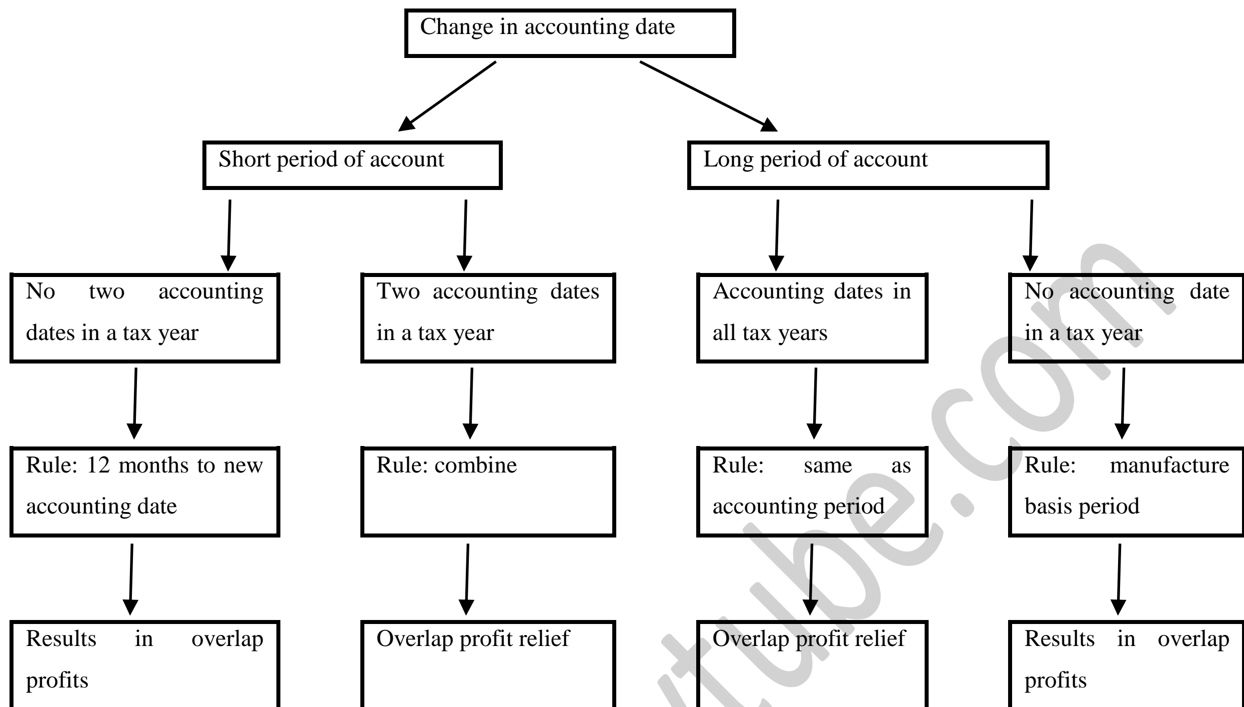
Mind map summary of change in accounting date – Basis period rules



Conditions for change in Accounting Date

The following conditions must be met before a change in accounting date in basis period can occur:

- The trader must notify HMRC by 31 January following the tax year in which the change is made. (31 January 2018 for a change made during 2016/17)
- The period of accounts resulting from the change must not exceed 18 months.
- There must have been no previous change of accounting date in the last 5 tax years.

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Chapter No. 8

CAPITAL ALLOWANCES (Plant & Machinery)

Written down allowance (WDA):

- A written down allowance (WDA) of 18% on reducing balance method is given on plant and machinery in each accounting period in the "Main Pool".
- WDA is 18% x $\frac{\text{months}}{12}$ if the accounting period is more than or less than 12 months.
- Full WDA is given in the year of purchase and no WDA in the year of sale.

Annual investment allowance (AIA)

- Business can claim an annual investment allowance (AIA) on the first £200,000 spent on plant and machinery.
- AIA is £200,000 x month /12, if the accounting period is more than or less than 12 months.
- After calculating AIA on plant and machinery purchased, WDA is also given on such plant and machinery
- AIA cannot be claimed on cars.

First year allowance (FYA)

- FYA of 100% available on purchase of car with a low emission (75 g/km co2 or less)
- FYA is not reduced or increased pro-rata like WDA and AIA if accounting period is short or long than 12 months.

Enhanced Capital Allowance (ECA):

- Expenditure on "energy saving" or" water saving plant and machinery" qualifies for 100% ECA

Special rate pool

- Expenditure on thermal insulation, solar panels, long life asset, features integral to a building and car with co2 emission over 130 g/km are included in special rate pool (not in main pool).
- WDA of 8% x months / 12 on reducing balance method is given on such assets.
- AIA is used against expenditure in the "special rate pool" first and then against main pool expenditure.

Note: Long life asset

These are assets with a working life of 25 years or more & costs more than £ 100,000.

Integral features to a building

- Electrical and lighting system
- Cold water system
- Space and water heating system
- Powered system of ventilation
- Powered system of cooling and air conditioning
- Lifts and escalators

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Plant & Machinery with private use

- If there is private usage of the plant & machinery by the proprietor (not employee) then capital allowance is calculated on full cost but only business proportion of the capital allowance (i.e. WDA, FYA, AIA) can be claimed in order to deduct it from trading profits (NOTE: Not applicable for companies)

Note: Such assets must be kept separate from other Plant & Machinery in calculations.

Balancing allowance / balancing charge

- On sale of a plant & machinery profit (balancing charge) or loss (balancing allowance) will be calculated.
- When an item of plant and machinery is sold then for calculation purpose the sale proceeds are taken as lower of sale proceeds and original cost.
- Normally profit (balancing charge) or loss (balancing allowance) will not be calculated for sale of assets in the pool unless all the assets in the pool are sold when business ceases.

Small Balance Claim

- If the Balance in the main pool or special rate pool before claiming WDA remains less than £1000 than the entire amount in the pool is written off instead of carrying forward.

Capital allowances (Plant & Machinery)

Cars

- Cars emitting 75 g/km co2 or less (low emission cars) are eligible for FYA of 100%.
- Cars emitting between 76 g/km co2 and 130 g/km co2 are added to the main pool.
- Cars emitting between over 130 g/km co2 are added in the special rate pool.
- If there is private usage of the car by the proprietor (not employee) then capital allowances is calculated on full cost but only business proportion of the capital allowance (i.e. WDA, FYA, AIA) can be claimed in order to deduct it from trading profits (NOTE: Not applicable for companies)

Note: Such Assets must be kept separate from other Plant & Machinery in calculations.

- No AIA is given on cars.

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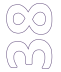

Example – comprehensive

Paul is a sole Trader. The balance as at 30 June 2015 for capital allowance purpose was:

	£
Main pool	20,000
Special rate pool	40,000
Laptop used by James (10% private use)	2,400
Car with 110 g/km co2 used by James (20% private use)	8,000

During the accounting period ended 31 Dec 2015, Paul made the following acquisition:

Date		£
15-9-2015	Car with 70 g/km co2 for use of salesman (10% private use)	20,000
20-10-2015	Car with 150 g/km co2 for business use	10,000
10-11-2015	Car with 120 g/km co2 for business use	9,000
15-11-2015	Van	100,000
25-12-2015	General plant	200,000
26-12-2015	Lifts for office building	250,000
27-12-2015	Solar panels for building	150,000
27-12-2015	Computer	12,000

During the accounting period ended 31 Dec 2015, Paul made the following disposals:

Date		£
26-12-2015	Car with 110 g/km co2 used by James (20% private use)	12,000

Requirement

Calculate the maximum capital allowances that James can claim for the period ended 31 Dec 2015.

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Chapter No. 9

TRADING LOSS RELIEFS (for individuals)

Carry forward trading loss relief

Trading losses not relieved may be carried forward to set-off against the first available trading profits of the future years. Losses may carry forward for as many years until all the loss is relieved.

Carry forward (against trading income)

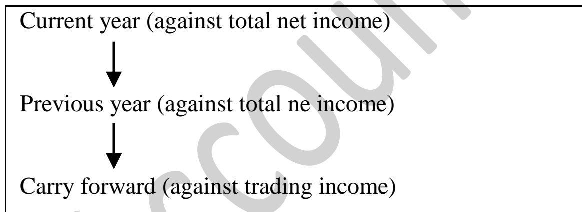
Trading loss against Net Income

Trading losses may be set-off against total net income of the current year and in addition or instead relief may be claimed against net income of preceding year.

A claim for loss must be made by 31 January which is approximately 22 months after the end of the tax year of loss. The taxpayer cannot choose the amount of loss to be relieved therefore personal allowance may be wasted. However the taxpayer may choose to claim full relief in the year of loss and then the remaining loss against preceding year, or full relief in the preceding year and the remaining loss in the year of loss.

Where loss relief is claimed against total net income of the tax year of loss or previous tax year, the taxpayer may claim a future relief to set-off loss against his chargeable gains (before Annual Exemption) of that tax year. The trading loss is first set-off against total net income and only excess loss is set against chargeable gains.

Trading losses not relieved in any other way may be carried forward to set-off against the first available trading profits of the future years.



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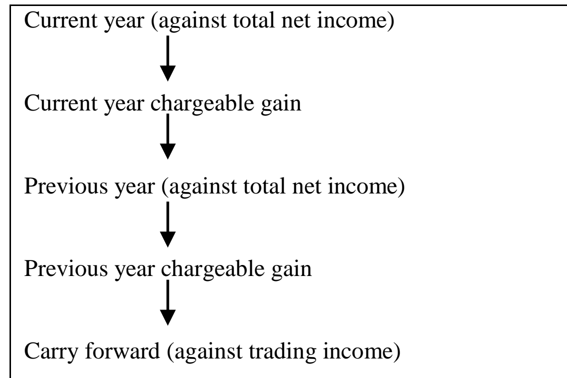

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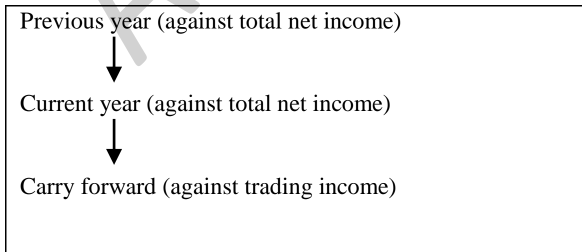

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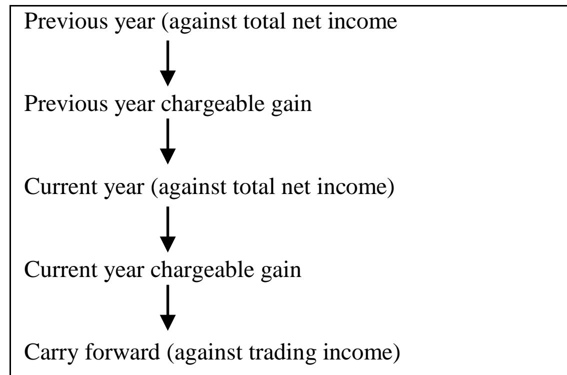

OR

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Trading losses in early years of trade

If the trading loss is incurred in any of the first Four Tax years of trade then the trading losses can be **carried back** against the **total net income** of previous **three tax years of FIFO basis.**

Trading losses in last 12 months of trade (Terminal loss relief)

If the trade ceases then Terminal Loss of last 12 month of the trade can be carried back against the trading income of previous three tax years on LIFO basis.

Terminal loss	:	£
Net trading loss in last 12 month of trade	: £	
Post 6 April (if profit then zero)	:(xx)	
Pre 6 April (if profit then zero)	:(xx)	
		(xx)
Overlap profits		(xx)
Terminal loss	:	**(xx)**

Choice between loss reliefs

- Early year loss relief is better than future year loss relief
- Best loss relief is in which maximum taxed in saved
- Best loss relief is in which least personal allowance is wasted

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Chapter No. 10

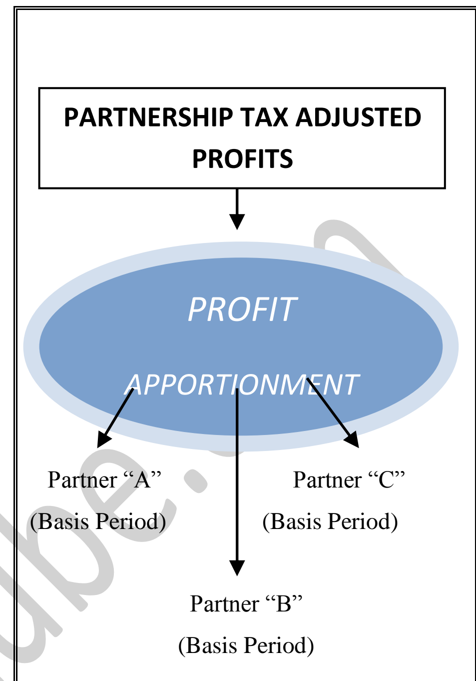
PARTNERSHIP

Step # 1 Partnership tax adjusted profits are apportioned among the partners according to their profit sharing arrangements.

Note:

Profit sharing arrangements include:

- Salaries of partners
- Profit sharing ratios



Step # 2 Once each partner gets his share of profits then each partner is taxed independently as sole proprietor.

i.e.

- Separate basis period
- Separate loss reliefs

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Chapter No. 11

RESIDENCE

A person I liable to UK tax if he is resident in the UK for a given tax year. To define whether a person is resident in a particular tax year or not the following rules apply:

Automatic Non-Residence Test

The following people will automatically be treated as not resident in the UK:

- A person who is in the UK for less than 16 days during a tax year.
- A person who is in the UK for less than 46 days during a tax year, and who has not been resident during the three previous tax years.
- A person who works full-time overseas, subject to them not being in the UK for more than 90 days during a tax year.

Automatic Residence Test

Subject to not meeting any of the automatic non-resident tests, the following people will automatically be treated as resident in the UK:

- A person who is in the UK for 183 days or more during a tax year.
- A person whose only home is in the UK.
- A person who carries out fulltime work in the UK.

UK Ties Test (Applied only if automatic tests could not define the residence)

Where a person's residence status cannot be determined by any of the automatic tests, then his/her status will be based on how many ties they have with the UK and how many days they stay in the UK during a tax year. There are five UK ties as follows:

- Having a close family (a spouse/civil partner or minor child) in the UK.
- Having a house in the UK which is made use of at-least 90 days during the tax year.
- Doing substantive work in the UK (40 days or more).
- Being in the UK for more than 90 days during either of the two previous tax year.
- Spending more time in the UK than in any other country in the tax year.

A day in the UK is any day in which a person is present in the UK at midnight.

A person's residence status is found by comparing the number of days they are in the UK during a tax year against how many UK ties they have according to the following table:

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Days in UK	Previously resident	Not previously resident
Less than 16	Automatically not resident	Automatically not resident
16 to 45	Resident if 4 UK ties (or more)	Automatically not resident
46 to 90	Resident if 3 UK ties (or more)	Resident if 4 UK ties
91 to 120	Resident if 2 UK ties (or more)	Resident if 3 UK ties (or more)
121 to 182	Resident if 1 UK tie (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically resident	Automatically resident

Note: This table will be given in the exam.

Domicile

A person is domiciled in the country of origin at birth; this is normally the domicile of his father. A person can change it to domicile of choice by immigrating to other country with his permanent home there.

General application of Tax Rules

Arising Basis: Income is taxed in the tax year in which it arises.

Remittance Basis: Income is taxed in the tax year in which it is brought (remitted) to the UK.

OVERSEAS INCOME ASPECTS

Resident	Domicile	Income in UK	Income outside UK
√	√	Arising Basis	Arising Basis
√		Arising Basis	Arising Basis (Remittance basis if claim made/ automatic)
		Arising Basis	Not Taxable

REMITTANCE BASIS

Remittance basis means a person is liable to UK tax on overseas income, only if the income is brought (remitted) to the UK. If remittance basis apply then any taxable overseas income remitted to UK will be taxed as non-saving income irrespective of the category of income remitted. Remittance includes money in form of cash, property and services acquired overseas from overseas income which is then brought into UK.

Automatic application of remittance basis

If an individual, who is UK resident but not UK domiciled, has unremitted non-UK income and gains of less than £2,000 arising in a tax year, the remittance basis will apply to that individual without the need for a claim to be made.

(Note: Individual, who are entitled to automatic remittance basis can claim personal allowance, annual exemption and will not be required to pay remittance basis charge).

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Claim for remittance basis

Generally, an individual who is UK resident but not UK domiciled is entitled to claim to be taxed on overseas income on the remittance basis. In a particular tax year, an individual who makes a claim for the remittance basis is not entitled to the personal allowance in income tax. An individual who makes a claim for the remittance basis is also not entitled to the annual exemption against chargeable gains.

Remittance basis charge

An individual who claims the remittance basis and is a long term UK resident, is required to pay to remittance basis charge on unremitted income and gains.

An individual is liable to the remittance basis charge if he:

- Claims the remittance basis for the tax year; and
- Is aged 18 or over in the tax year; and
- Has been UK resident for at least seven or more years preceding that tax year.

The remittance basis charge is £30,000 if the taxpayer had been resident for atleast 7 out of 9 preceding tax years.

The remittance basis charge is £60,000 if the taxpayer had been resident for atleast 12 out of 14 preceding tax years.

The individual is required to nominate unremitted non-UK income and gains on which the remittance basis charge applies.

Note: in each tax year, the individual can chose whether or not to claim the remittance basis.

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EMPLOYMENT INCOME ASPECTS

Travel expenses incurred by the employee for duties abroad

Travel expenses relating to employment duties abroad be deducted from earnings are allowable deductions in certain circumstances. A deduction is allowed for starting and finishing travel expenses. Starting travel expenses are those incurred by the employee in travelling from the UK to take up employment abroad and finishing travel expenses are those incurred by the employee in travelling to the UK on the termination of the employment. Two conditions to be met.

(i) The duties of the employment are performed wholly outside the UK.
(ii) The employee is resident in the UK.

Travel expenses borne by employer for employee's duty abroad.

There are a number of deductions which may be made from a person's earnings. The allowable deduction is generally equal to the amount included in the earnings as benefits.

- The first deduction relates to the provision of travel facilities for a journey made by the employee. The employee is absent from the UK wholly and exclusively for the purpose of performing the duties and the journey is from UK to a place outside the UK or a return journey following such a journey.
- There is also a deduction for the provision of travel facilities for a journey made by the employee's spouse or child (aged under 18 at the beginning of the outward journey). The employee's spouse/ child is either accompanying the employee at the beginning of the employment period or visiting the employee after his period of absence from the UK for a continuous period of at least 60 days. A deduction is not allowed for more than two outward and two return journeys by the same person in a tax year.

Double taxation relief (DTR)

The OECD model agreement (Double Taxation Agreements)

The taxation on a particular overseas income may be governed by any agreement in force among the two countries.

Unilateral credit relief

If no relief is available under a double taxation agreement, UK legislation provides for unilateral relief.

Foreign income must be included gross (i.e. including foreign tax) in the UK tax computation and then a double taxation relief is given for the foreign tax suffered (this is credit relief)., double taxation relief (DTR) is lower of:

a) UK tax on overseas gross income
b) Overseas tax on overseas gross income

Note: the UK tax on the foreign income is the difference between:

(a) The UK tax before DTR on all income including the foreign income.
(b) The UK tax on all income except the foreign income.

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Chapter No. 12, 13,14,15,16

CAPITAL GAIN TAX (CGT)

Basic calculations:

		£
	Sale	xx
Less	Incidental cost of sale	(xx)
Less	Cost	(xx)
Less	Enhancement expenditure	(xx)
	Gain/ (loss)	xx / (xx)

Where:

Sale:

It includes sale proceeds of the asset sold. If the sale is given as a gift or sold to connected person at less than the market value, then market value of the asset will be used as sale proceeds for calculation purpose.

Incidental cost of sale

There are selling cost including legal cost, commission paid, agency fee and advertisement.

Cost

This includes the purchase cost of the asset.

Enhancement expenditure

This is a capital cost incurred on asset after it was purchased due to which the value of the asset has enhanced.

ANNUAL EXEMPTION

- Annual exemption for tax year 16/17 is £11,100.
- Annual exemption is given to an individual to calculate his taxable gains.
- Companies do not get annual exemption.

CAPITAL GAIN TAX (CGT) PAYABLE BY INDIVIDUALS.

First the income tax bands are used to calculate the income tax. Any unused bands are used to calculate capital gain tax. Capital gain tax is 10% upto basic rate band and 20% on excess above basic rate band. CGT is paid by 31 January after the tax year. (31 Jan 2018 for tax year 16/17)

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EXCEPT ASSETS:

The sale of following assets is exempt from capital gain tax (CGT):

- Cars
- Investments in individual saving accounts (ISA)
- National saving certificates
- Gilt –edged securities (gilts)
- Qualifying corporate bonds (QCBs)

TRANSFER BETWEEN SPOUSES

Each spouse is taxed as separate individuals. Disposal of asset between spouses give rise to no gain no loss as the transferee is assumed to take over the asset at its Cost.

When the asset is eventually disposed to someone else other than spouse than the gain is calculated based on the original cost of purchase (not transfer).

Part disposal of asset

If an asset is part disposed then the allowable cost and enhancement expenditure for capital gain calculation will be calculated as follows:

$$\frac{A}{A + B} \times \text{cost (or enhancement expenditure)}$$

Where:

A = Market value of the part disposed (sale value)

B = Market value of the remainder part

ENTREPRENEUR'S RELIEF

Entrepreneur's relief is available on gains of following:

- Disposal of whole or part of a business owned atleast for one year before disposal. (Note: the business is sold as a going concern)
- Disposal of one or more business assets at the time when business ceases owned atleast for one year before disposal and the asset is sold within three years of trade cessation.
- Disposal of shares in a personal company (atleast 5% shareholding) and the individual is an officer or employee of the company. The company must be a trading company. Shares disposed must be owned atleast for one year before disposal.
- Disposal of goodwill to a close company by a related person

Related person: holds less than 5% holding or if hold more than 5%, will sell whole shareholding within 28 days to another company.(he must also hold less than 5% in another company)

CGT rate is 10% on gains qualifying for entrepreneur relief.

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Investor's Relief:
Entrepreneur's Relief has now been extended to external investors in trading companies which are not listed on a stock exchange. This investor's relief has its own separate £10 million lifetime limit, with qualifying gains being taxed at a rate of 10%.
To qualify for investors' relief, shares must be:

- Newly issued shares acquired by subscription.
- Owned for at least three years after 6 April 2016.
-

Residential property Gains

Residential property includes an interest in dwelling such as house or flat. It also includes interest in under construction residential property. It will be taxed at 18% & 28% for basic rate & higher rate respectively.

These residential property rates will apply where a gain arising from the disposal of residential property is not fully covered by the principal private residence exemption.

Tax planning for capital losses & annual exemptions

- Capital losses on assets must be first set off against gains on assets not qualifying for entrepreneur relief (preference should be given to residential property).
- Annual exemption must be first set-off against gains on assets not qualifying for entrepreneur relief (preference should be given to residential property).

ASSOCIATE DISPOSALS

An associate disposal is a disposal of asset owned by an individual which was used for atleast one year for the trade purpose by the partnership of which the individual is a partner.

Note: if the individual charged full market rent on the asset form the partnership then there will be no entrepreneur relief. If however, less than full market rent is charged for the asset then entrepreneur relief will be available on a just and reasonable basis. For example, if rent charged is 70% of the full market rent then entrepreneur relief will be available on 30% of the gain of the asset.

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CAPITAL GAIN TAX (CGT) (individuals)

(Complete format)

Asset – 1	(Not qualifying for entrepreneur relief)	£	£	£
	Sale	xx		
Less	Incidental cost of sale	(xx)		
Less	Cost	(xx)		
Less	Enhancement expenditure	(xx)		
	Gain			xx
Assets – 2	**(Qualifying for entrepreneur relief)**			
	+ (Investor's relief)			
	Sale	xx		
Less	Incidental cost of sale	(xx)		
Less	Cost	(xx)		
Less	Enhancement expenditure	(xx)		
	Gain		xx	
			xx	xx
Asset – 3	**(Current year loss)**			
	Sale	xx		
Less	Incidental cost of sale	(xx)		
Less	Cost	(xx)		
Less	Enhancement expenditure	(xx)		
	Loss		(2)	(1)
			xx	xx
Less	Capital losses brought forward (Upto the amount that annual exemption remains) **Note: if an individual dies he can carry back capital losses 3 years taking later year first, upto the amount that annual exemptions** Remains		(2)	(1)
	Chargeable gains		xx	xx
	Less: Annual Exemption **(11,100)**		(2)	(1)
	Taxable gains		xx	xx
	Capital gain tax (CGT)		@10%	@18%/10% Upto basic band
			@10%	@28%/20% above basic band

Note: CGT is calculated first on Assets qualifying for entrepreneur relief.

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CHATTELS

- Chattels is tangible moveable property
- Wasting chattel is a chattel whose useful life is less than 50 years.

Sale of wasting chattels

Exempt

Sale of non-wasting chattels

Gain is calculated in the normal way

Sale of asset on which capital allowances had been claimed

Capital gain is ZERO (no gain / no loss)

LEASES

Assignment of a lease with less than 50 years to run

When calculating CGT, the cost of such an asset will be

Original cost x x/y

Where

X = percentage for number of years left in lease to run **(will be given in exam question)**

Y = percentage of number of years the lease had to run when first acquired (will be given in exam question)

Negligible value claims

If an asset's value becomes negligible, a claim may be made to treat the asset as sold and immediately required it at its current market value. This claim will usually give rise to an allowable capital loss.

Share loss relief against general income

Relief is available for capital losses on shares of EIS companies against general income of the tax year of loss and / or preceding year.

A claim must be made by 31 January which is approximately 22 months after the tax year concerned.

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DISPOSAL OF SHARES

Share pool

- Consist of all the shares purchased before the date of disposal.
- Two tracks are maintained:

  1) Number of shares

  2) Cost

- When shares are sold then the cost of the shares in the share pool is apportioned according to number of shares sold in the pool.

Matching rules on sale of shares (individuals)

The shares sold will be matched in the following order:

1) Shares purchased on the same day
2) Shares purchased on the following 30 days of sale
3) Shares from share pool

Right share

The right shares are added in previous shareholding as normal acquisition in the share pool

Bonus shares

Treated in the same way as "right shares" except that Bonus shares do not have cost.

Reorganizations / take-over

If the shares are replaced with new holdings due to re-organization or take-over then the cost of previous shares ais apportioned to the new holdings using market values of new holdings.

Quoted shares gifted

When quoted shares are gifted, the sale value (Market value) for CGT purpose will be lower of:

a) Lower quoted price + 1/2 (higher quoted price – lower quoted price)
b) $\frac{\text{Highest marked bargain + lowest marked bargain}}{2}$

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CHARGEABLE GAINS (company)

	£
Sale	xx
Less: Incidental cost of sale	(xx)
Net proceeds	xx
Less: Cost	(xx)
Less: Enhancement Expenditure	(xx)
Un indexed gain	xx
Less: indexation allowance on cost	(xx)
Less: Indexation Allowance on enhancement expenditure	(xx)
Indexed gain	Xx
Less: current year capital loss	(xx)
	Xx
Less: capital loss brought forward	(xx)
Chargeable gain	xx

Indexation Allowance

- Companies get indexation allowance from the date of purchase to date of sale of an asset.
- Indexation allowance cannot change gain into loss. Thus if there is a gain then indexation allowance can maximum reduce the gain to zero.
- Indexation allowance cannot increase the loss. Thus if there is a loss then there shall not be indexation allowance.
- To calculate indexation allowance any one of the following formulae will be used.

Index cost less cost (or enhancement expenditure)

OR

Index factor x cost (or enhancement expenditure)

Index factor (upto three decimals) = $\frac{\text{RPI in the month of disposal (latest date) – RPI in the month of acquisition (earliest date)}}{\text{RPI in the month of acquisition (earliest date)}}$

DISPOSAL OF SUBSTANTIAL SHAREHOLDINGS (COMPANIES)

The gain on sale of shares by a company is exempt if the company has substantial shareholdings. Substantial holding is when a trading company holds 10% or more shareholding in another trading company. The exemption applies to disposal of part of the substantial shareholding If atleast 10% holding test have been met for a continuous twelve month in previous 2 years before the date of disposal.

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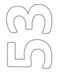
PRINCIPAL PRIVATE RESIDENCE (PPR)



A gain arising on the sale of an individual's only or main private residence (principal private residence PPR) is exempt upto:

$$\text{Gain} \times \frac{\text{Period of occupation}}{\text{Total period of ownership}}$$

- When calculating the period of occupation the last 18 months are always treated as period of occupation.
- Some period of absence may also be considered as occupied (Deemed Occupation) provided the period of absence was at some time both preceded and followed by the period of actual occupation.

(a) Upto three years of absence for any reason.
(b) Any period of absence to live abroad due to his employment.
(c) Upto four years of absence to live elsewhere due to his work (employment or self-employment).

- Garden / Lawn of upto half a hectare attached to the house, is also exempt under PPR relief.
- Where a person has more than one residence, he may elect for anyone to be treated as his main residence.
- Where a married couple lives together then only one residence may qualify as main residence for relief.
- If part of the residence is always used exclusively for business purpose then the gain attributable to that part is taxable and will not qualify for PPR.

Letting relief:

The principal private residence exemption is extended to gain accruing while the property is let-out. The letting exemption is lower of:

(a) Gain already exempt under PPR
(b) Gain remaining after PPR (letting part of the gain).
(c) £ 40,000

OVERSEAS ASPECTS OF CGT

- If a person is resident and domiciled in a tax year then he is liable to UK CGT on disposal of assets situated anywhere in the world on arising basis.
- If a person is resident but not UK domiciled in a tax year then he is liable to UK CGT on disposal of overseas asset unless he claims remittance basis (or it applies automatically), in this case be will only be liable to UK tax if the proceeds are remitted to the UK. An individual who claims remittance basis is not entitled to annual exemption. (For details see chapter on residence).
- For disposals of assets by the temporary non-residents, the assets disposed in the tax year of departure are taxed in the same tax year. Any subsequent disposals are taxed in the tax year of return.

Temporary nonresidents for CGT purpose are:

a) They are outside UK for less than 5 years from departure and return
b) They were UK resident for the four out of the seven years immediately before the year of departure.

Any asset bought and sold during the period of Non-Residence is exempt.

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Roll – Over Relief

Old business asset

		£
	Sale	Xx
Less:	Cost	(xx)
		Xx
Less:	Indexation Allowance (if company)	(xx)
		Xx
Less:	Amount not Re-invested (chargeable gain)	(xyz)
	Gain Roll-Over	abc

New Business Asset (NON-Depreciating e.g. Land, building)

		£	£
	Sale		xx
Less:	Base cost		
	Cost	xx	
Less:	Roll over gain	(abc)	(xx)
			xx
Less:	Indexation Allowance (if company)		(xx)
	Chargeable gain		xx

Roll - over / Held – over relief

Old business Asset

		£
	Sale	xx
Less:	Cost	(xx)
		xx
Less:	Indexation Allowance (if company)	(xx)
		xx
Less:	Amount not Re-invested (chargeable gain)	(xyz)
	Gain Roll-Over / Held – Over	abc

Freezed until earliest of:
- Sale of new asset
- 10 years
- New asset ceases to be business asset

New business asset (DEPRECIATING e.g. Plant & Machinery, Leased Asset)

		£
	Sale	Xx
Less:	Cost	(xx)
		Xx
Less:	Indexation Allowance (if company)	(xx)
	Chargeable Gain	Xx
Add:	Unfreezed Gains	abc
	Total chargeable gain	xx

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Conditions for roll-over relief

A gain may be rolled over (deferred) where proceeds on disposal of business asset are spent on replacement business asset. In order to roll-over, the following conditions must be met:

a) The old asset sold and the new asset bought both used in trade by person (or company) claiming roll-over relief.
b) The old asset sold and the new asset bought are both land and building or fixed plant and machinery.
c) Re-investment of the proceeds received on the disposal of old asset takes place in a period beginning one year before and ending three years after the date of disposal.

Gift Relief (on gift of business assets and shares of personal company)

Transferor		£	
	Sale (Market Value)	xx	
Less:	Cost	(xx)	
		xx	
Less:	Amount received in excess of cost (chargeable Gain)	(xyz)	
	Gain Held-over / Gift Relief	abc	
Transferee		£	£
	Sale		xx
Less:	Base cost		
	Cost (Market value)	xx	
Less:	Gift Relief	abc	(xx)
	Chargeable Gain		xx

Enterprise Investment Scheme (EIS) Deferral Relief

- An individual may defer a gain arising on any type of asset if he invests in EIS shares.
- The amount of gain that can be deferred is the lower of:
  a) The Gain of asset
  b) The amount subscribed in EIS shares
  c) The amount specified by the investor in his claim
- EIS deferral relief should be claimed within 4 years after the end of tax year when the gain to be deferred arose (5 April 2021) for disposal in 2016/17)
- The deferred gain will come into charge on either of the following events:
  a) Chargeable disposal of EIS shares
  b) The investor becoming non resident
  c) The shares ceasing to be eligible shares for EIS.

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Incorporation Relief (when the business is sold to company)

Incorporation relief is automatic (so no claim needs to be made). However, an individual can elect not to receive incorporation relief by 31 Jan which is approximately 34 months after the end of the tax year.

Old business asset

		£
	Sale (cast + shares)	xx
Less:	Cost	(xx)
		xx
Incorporation Relief	Gain x shares / (Cash + Shares)	(abc)
	Chargeable gain	(xyz)

Shares of company

		£	£
	Sale		xx
Less:	Base cost		
	Cost	xx	
Less:	Incorporation relief	(abc)	(xx)
	Gain		xx

Held – over relief

Destroyed Asset

		£
	Sale (Insurance)	xx
Less:	Cost	(xx)
		xx
Less:	Indexation Allowance (if company)	(xx)
		xx
Less:	Amount not Re-invested (chargeable gain)	(xyz)
	Gain Held – Over	abc

Replacement Asset

		£	£
	Sale		xx
Less:	Base Cost		
	Cost	xx	
Less:	Held – over gain	(abc)	(xx)
			xx
Less:	Indexation Allowance (if company)		(xx)
	Total chargeable gain		xx

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Dis-Incorporation Relief

Dis-incorporation applies when the shareholders decide that the company business be run as a sole proprietorship or partnership. Normally, if the company is dis-incorporated then for CGT purpose all the assets are sold to its shareholders at their market values resulting in capital gains chargeable to corporation tax. This capital gains can be avoided (Exempt) if dis-incorporation relief is claimed. Dis-incorporation relief can only be applied if all of the following conditions are fulfilled:

a) The business is transferred as a going concern
b) All the business assets except cash are transferred.
c) The total market value of land & building and goodwill is £100,000 or less at the time of transfer.
d) All the shareholders to whom the business is transferred had held their share in company for atleast for 12 months prior to the date of transfer.
e) The disincorporation will occur between, 1 April 2013 to 31 March 2018.

Badges of Trade

If a sale if to be distinguished that whether it is a trading transaction to be treated in income tax or it is an asset disposal which should be treated in capital gain tax then the following factors should be considered:

a) The subject matter

Whether a person is trading or not may be decided on the subject matter of the transaction. Some assets are held as an investment for their intrinsic value like paintings. But the subject matter may be that cannot be held as an investment instead it is a trading transaction like sale of 34,000,000 yards of aircraft linen or 1,000,000 rolls of toilet paper.

b) The frequency of transaction

If similar transactions are carried out frequently then it would indicate a business activity.

c) The length of ownership

If the asset sold was held for a long period of time then it indicates that it is an investment but if the length of ownership is small then it may be indicate a business activity.

d) Supplementary work and marketing

If steps are taken to make an asset more marketable then a trading motive may be indicated.

e) Profit motive

In the sale transaction if a profit motive is present than it is a strong indication of trading activity.

f) The way in which asset sold was acquired

If goods are deliberately acquired then it may be classified as trading. But if the goods were acquired unintentionally like by gift or inheritance than it is unlikely to be a trading activity.

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Chapter No: 17

NOTIFICATION OF LIABILITY TO INCOME TAX AND CGT

Individuals who are chargeable to income tax or CGT shall receive a notice to file a return from HMRC. An individual who does not receive a notice to file a return is required to give notice of chargeability to an officer of the revenue and customs within six months from the end of the tax year i.e. by 5 October 2017 for 2016/17.

Submission of tax returns

The tax return comprises a tax form, together with supplementary pages for particular source of income. The return can be filed electronic or paper return.

The time limit for submission of a paper return is later of:

- 31 October after the end of tax year.
- 3 months after notice to file the return.

The time limit for submission of an electronic tax return is later of:

- 31 January after the end of tax year
- 3 months after notice to file the return.

Keeping of records

All records required to enable then to make and deliver a correct tax return must be retained until 5 years after the 31 January following the tax year where the taxpayer is in business (e.g. a sole trader or partner or letting property) or 1 year after the 31 January following the tax year otherwise (e.g. an employee).

The maximum penalty for each failure to keep and retain records is £3,000 per tax year.

Corrections / amendments in tax return

A return may be amended by HMRC to correct any obvious error or omission in the return. The correction must be usually be made within nine months after the day on which the return was actually filed.

The taxpayer may amend his return (including the tax calculation) within twelve months after the filing date.

Compliance check on returns

An officer of the revenue and customs has a limited period within which to commence compliance check on a return or amendment. The officer must give written notice of his intention by 12 months after the tax return filing date.

Discovery assessments

If an officer of HMRC discovers that income or profits have been omitted from assessment, like any assessment has become insufficient or that any relief given is excessive, an assessment may be raised to recover the tax lost. The normal time limit for discovery assessment is 4 years after the end of the tax year, but it may be extended to 20 years where tax is lost due to deliberate understatement.

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DETERMINATIONS

If notice has been served on a taxpayer to submit a return but the return is submitted by the due filing date, an officer of HMRC may make a determination of the amount liable to income tax and CGT tax and of the tax due. Such a determination must be made to the best of the officer's information and belief, and is then treated as if it were a self-assessment. This enables the officer to seek payment of tax, including payments on account for the following year and to charge interest. The determination must be made by 31 January which is approximately 34 months after the end of tax year.

APPEALS

Appeals for direct taxes

Appeals for direct taxes are made first to HMRC. HMRC will assign a 'case worker' and the taxpayer may be asked for an 'internal review'. HMRC will carry out the review within 45days. The taxpayer must accept the review decision or he may appeal to the tribunal with 30 days.

Appeals for indirect taxes

Appeals for indirect taxes must be made directly to the tax tribunal.

Tribunal hearings

The tribunal is made up of:

a) First tier tribunal
b) An upper tribunal

The case is allocated to one of the case tracks:

1) Complex cases which will involve lengthy hearings and complex evidence will be heard by upper tribunal.
2) All other cases are heard by the first tier tribunal.

A decision heard by the first tier tribunal may be appealed to the upper tribunal. Normally, the decisions by the upper tribunal are binding on the taxpayer but the taxpayer may appeal to the court of appeal.

TAX EVASION and TAX AVOIDANCE

Tax evasion is illegal and involves reduction of tax liability by not providing information to HMRC or providing HMRC deliberately false information.

Tax avoidance involves minimization of tax liability by use of lawful meas.

Penalty on dishonest conduct by tax agent

HMRC can investigate dishonest conduct of tax agents, and apply a penalty of up to £50,000 where there has been dishonest conduct and the tax agent fails to supply the information or documents that HM Revenue and Customs has requested.

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If a client intends to evade the tax by providing false information on concealing any information then the tax agent should advise the client to disclose information with honesty and integrity. The tax agent must not be involved in tax evasion activities of client and must disengage from such a client.

Payment of income tax and capital gains tax

DATE	PAYMENT
31 January in the tax year	1st payment on account
31 July after the tax year	2nd payment on account
31 January after the tax year	Final balancing payment

Payment on Account

RELEVANT AMOUNT = previous year income tax + previous year class 4 NIC – previous year tax at source

Relevant Amount x 50% = Payment on Account

Final balancing amount

Current year income tax + current year class 4 NIC + current year CGT – current year tax at source – both payment on accounts

Interest on late paid tax

Interest is chargeable on late payment of both payments on account and balancing payments. In both cases interest runs from the due date until the day before the actual date of payment. (Rate of interest is 3% given in exam)

Interest on late final balancing payment

If the final balancing payment is paid late then there is a penalty of 5% if paid late upto five months.

If the final balancing payment is paid late then there is a penalty of 10% if paid late between five months to eleven months.

If the final balancing payment is paid late then there is a penalty of 15% if paid late more than 11 months.

Repayment of over paid tax and repayment supplement.

If the tax is overpaid then the tax is repaid when claimed along with interest on overpayment. Interest is paid by HMRC as repayment supplement which runs from the original date of payment to the day before the date of repayment is made. (Rate of interest is 0.5% given in exam) this repayment supplement is tax free.

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PAYMENT OF CGT BY INSTALLMENTS

- Usually CGT is payable by 31 January after the tax year. But CGT may be paid by installments if the consideration on disposal of asset is received over a period in excess of 18 months. In such case the installments may be paid over the period that consideration is received upto maximum of eight years. The amount of installments must be agreed with HMRC.
- CGT may also be paid by installments if disposal of an asset is by way of gift but gift relief is not available. The gift of asset must either be:

a) Land
b) Share of the quoted company in which donor had control before making the gift.
c) Shares of unquoted company

The installments will be paid as ten equal installments starting from the normal due date. An election for installments must be made by the taxpayer before the CGT becomes payable.

Penalties for late filing of tax return

Tax return late upto 3 months

Penalty is £ 100

Tax return late by more than 3 months but upto 6 months

Penalty is £100 + (£10 per day between 3 months to 6 months)

Tax return late by more than 6 months but upto 12 months

Penalty is greater of:

a) 5% of tax liability
b) £300

Tax return late by more than 12 months

Type of conduct	Penalty
Careless	Greater of: a) 5% of tax liability b) £300
Deliberate not concealed	Greater of: c) 70% of tax liability d) £300
Deliberate and concealed	Greater of: e) 100% of tax liability f) £300

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PENALTIES FOR ERRORS AND LATE NOTIFICATION

There is a common penalty regime for errors and late notification in tax returns, including income tax, CGT, NICs, corporation tax and VAT. Penalties range from 30% to 100% of the potential lost revenue.

Maximum amount of the penalty

The amount of the penalty for error is based on the potential lost revenue (PLR) to HMRC as a result of the error. The maximum amount of the penalty for error depends on the type of error:

Type of error	Maximum penalty payable (% of PLR)
Careless	30%
Deliberate not concealed	70%
Deliberate and concealed	100%

Minimum amount of penalties

A penalty for error may be reduced if the taxpayer tells HMRC about the error. this is called a disclosure. The reduction depends on the circumstances of the disclosure and the help that the tax payer given to HMRC in relation to the disclosure.

An unprompted disclosure is one made at a time when the taxpayer has no reason to believe that HMRC has discovered the error. Otherwise, the disclosure will be a prompted disclosure. The minimum penalties that can be imposed are as follows:

Type of error	Unprompted (% of PLR)	Prompted (% of PLR)
Careless	0%	15%
Deliberate not concealed	20%	35%
Deliberate and concealed	30%	50%

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Question : Asset Destroyed

David bought an asset for £25,000. It was destroyed in July 2016. Insurance proceeds were £34,000, and David spent £30,500 on a replacement asset in January 2017. Compute the gain immediately chargeable and the base cost of the new asset.

Answer:

	£
Proceeds	34,000
Less cost	(25,000)
Gain	9,000
Gain immediately chargeable £ (34,000 – 30,500)	3,500
Deduction from base cost	5,500
The base cost of the new asset is £ (30,500 – 5,500) = £25,000	

Question: Gain deferred into depreciating asset

Norma bought a freehold shop for use in her business in June 2015 for £125,000. She sold it for £140,000 on 1 August 2016. On 10 July 2016, Norma bought some fixed plant and machinery to use in her business, costing £150,000. She then sells the plant and machinery for £167,000 on 19 November 2018. Show Norma's gains in relation to these transactions.

Answer:

2016/17 – Gain deferred

	£
Proceeds of shop	140,000
Less cost	(125,000)
Gain	15,000

This gain is deferred in relation to the purchase of the plant and machinery as all the proceeds have been reinvested.

2018/19 – Sale of plant and machinery

	£
Proceeds	167,000
Less cost	150,000
Gain	17,000

Total gain chargeable on sale in 2018/19 (gain on plant and machinery plus deffered gain) £(15,000 + 17,000) = **£32,000**

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Question: Gift relief

On 6 May 2016 Angelo sold to his son Michael a freehold shop valued at £200,000 for £50,000, and claimed gift relief. Angelo had originally purchased the shop from which he had run his business for £30,000. Michael continued to run a business from the shop premises but decided to sell the shop in March 2017 for £195,000. Compute any chargeable gains arising.

Answer:

a) Angelo's gain		
		£
	Proceeds (market value)	200,000
	Less cost	(30,000)
	Gain	170,000
	Less gain deferred (balance)	(150,000)
	Chargeable gain £(50,000 – 30,000) (actual proceeds less actual cost)	20,000
b) Michael's gain		
		£
	Proceeds	195,000
	Less cost £(200,000 – 150,000) (MV less deferred gain)	(50,000)
	Gain	145,000

Question: Rollover relief

D Ltd acquired a factory in April 2000 (RPI = 170.1) at a cost of 120,000. It used the factory in its trade throughout the period of its ownership.

In August 2016 (assumed RPI = 258.4), D Ltd sold the factory for £220,000. In November 2016, it acquired another factory at a cost of £190,000.

Calculate the gain chargeable on the sale of the factory and the base cost of the second factory.

Answer:

Chargeable gain on sale of first factory	
	£
Proceeds	220,000
Less cost	(120,000)
Unindexed gain	100,000
$\frac{258.4 - 170.1}{170.1}$ = 0.519 x £120,000	(62,280)
Indexed gain	37,720
Less rollover relief (balancing figure)	(7,720)
Chargeable gain: amount not reinvested £(220,000 -190,000)	30,000
Base cost of second factory	
	£
Cost of second factory	190,000
Less rolled over gain	(7,720)
Base cost	182,280

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Chapter No.18,19,20

INHERITANCE TAX (IHT)

All transfers of assets (worldwide) made by persons domiciled in the UK, whether during lifetime or on death are within the charge to IHT.Chargeable person for IHT purposes are individuals and trustees.
There are two main chargeable occasions for individuals:

a) Gifts made in the lifetime of the donor (lifetime transfers), and
b) Assets transferred on death, for example when property is left in a will (death estate).

Inheritance tax rate (tax year 16/17)

(Nil Rate Band) first £325,000	Nil
Excess	40% (Note: Half rate on lifetime tax)

Life time transfers

There are two types of life time transfers for IHT purpose:

a) **Potentially exempt transfer (PET)** is a lifetime transfer or gift by an individual to any other individual.
b) **Chargeable lifetime transfer (CLT)** is a life time transfer or gift to a trust.

A PET is exempt from IHT when made, and will remain so if the transferor survives for at least seven years from making the gift. If the transferor dies within seven years of making the gift, it will become chargeable to IHT.

EXEMPTIONS

Exemptions applying to PET only:

The small gifts exemptions

Outright gifts to individuals totaling £250 or less per done in any one tax year are exempt. If gifts total more than £250 the whole amount is chargeable. A donor can give up to £250 each year to each of as many donees as he wishes.

Exemptions applying to PET and CLT only:

The annual exemption (AE)

The first £3,000 of value transferred in a tax year is exempt from IHT. The annual exemption is used only after all other exemption is used up by PET as well as CLTs.

Any unused portion of the annual exemption is carried forward for one year only. Only use it in the following year after that year's own annual exemption has been sued.

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Normal expenditure out of income

Inheritance tax is a tax on transfers of capital, not income. A transfer of value is exempt if:

a) It is made as part of the normal expenditure of the transferor
b) Expenditure is made out of income instead of capital and
c) It leaves the transferor with sufficient income to maintain his usual standard of living.

This exemption can cover regular payments out of income such as a child's school fees or the payment of life assurance premiums on a policy for someone else.

Gifts on Occasion of marriage

Gifts on occasion of marriage are exempt up to:

a) £5,000 if from a parent of a party to the marriage
b) £2,500 if from a remote ancestor (Grand Parents)
c) £ 1,000 if from any other person.

Exemptions applying to PET, CLT and Death Estate

Gifts between spouses

Any transfers of value between spouses are exempt provided the transferee is domiciled in the UK at the time of transfer. The exemption covers both lifetime gifts and death estate. A simple planning point follows from this exemption as spouses may avoid IHT if each makes a will leaving his property to the other.

If the transferor spouse is domiciled in the UK but the transferee spouse is not domiciled in the UK, the exemption is limited to a cumulative total of £325,000, but any gift in excess of £325,000 cumulative total will be a PET.

Other exempt transfers

- Transfers to UK charities are exempt from inheritance tax.
- Gifts to a qualifying political party are exempt. A political party qualifies if, at the general election preceding the transfer of value, either:

a) At least two member were elected to the house of commons, or
b) One member was elected and the party pooled at least 150,000 votes.

- Gift for national purposes are exempt. (eligible recipients include museums and art galleries)

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Lifetime tax on lifetime transfers (PETs & CLTs)

There is no lifetime tax on PET (There is only death tax on PET if donor dies within seven years of making PET)

Life time tax on CLT

If transferee (Trust) pays tax

When a CLT is made and the transferee (i.e. the trustees) pays the lifetime tax, follow these steps to work out the lifetime IHT on it:

Step-1 Look back seven years from the date of the transfer to see if any other CLT,s have been made and calculate how much of nil rate band is used while how much is remaining.

Step-2 Any part of the CLT covered by the nil rate band is taxed at 0%. Any part of the CLT not covered by the nil rate band is charged at 20%.

If Transferor (Individual) pays tax

When a CLT is made and the transferor (i.e. the individual) pays the lifetime tax, follow these steps to work out the lifetime IHT on it:

Step-1 Look back seven years from the date of the transfer to see if any other CLTs have been made and calculate how much of nil rate band is used while how much is remaining.

Step-2 Any part of the CLT covered by the nil rate band is taxed at 0%. Any part of the CLT not covered by the nil rate band is charged at (x20/80 or in other words 25%)

Step-3 Work out the gross transfer by adding the net transfer and the tax together. This is the gross value of the CLT on which death tax will be calculated if the transferor dies within seven years.

Death tax on lifetime transfers (PETs & CLTs)

If the transferor dies within seven year of making a PET it will become chargeable to death tax. Also all CTSs made within seven years before the death will become chargeable for death tax.

Follow these steps to work out the death tax on PETs and CLTs:

Step-1 Compute the value of the CLT and PET. The gross value of CLT will be used which was worked out for computing lifetime tax.

Step-2 Look back seven years from the date of the each transfer to see if any other chargeable transfers CLT or PET (if within seven years of death) were made. If so, these transfers use up the nil rate band available for the current transfer. Work out the value of any nil rate band remaining.

Setp-3 Any part of the CLT covered by the nil rate band is taxed at 0%. Any part of the CLT not covered by the nil rate band is charged at 40%.

Step-4 Reduce the death tax by **taper relief** (if applicable)

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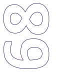

Years between transfer and death	Taper relief (% reduction in death tax)
3 years or less	0%
More than 3 but less than 4	20%
More than 4 but less than 5	40%
More than 5 but less than 6	60%
More than 6 but less than 7	80%`

Step-5 Deduct any lifetime tax paid (This will only be applicable for CLT). The death tax may be reduced to nil, but there is no repayment of lifetime tax.

THE VALUATION OF ASSETS FOR IHT PURPOSES

Diminution in value

The measure of value of transfer (whether lifetime or at death) is always the loss to the transferor (the diminution in value of his estate), not the amount gained by the transferee.

	£
Total value of an estate of transferor before transfer	XX
Total value of an estate of transferor after transfer	(XX)
Diminution in value	XX

Valuing related property

For IHT purpose, related property must be valued as a proportion of the value of the whole of the related property (only if it gives higher value than diminution in value)

Related property of an individual must be valued including the property of **Spouse**, property given to **charity**, property given to **political party** & property given to **national body.**

When part or whole of the related property is sold then the value of transfer for IHT purpose will be higher of:

a) Value of transfer without related party rules (using diminution in value)
b) Value of transfer using related party rules (Learn the method in class Lecture)

Quoted shares and securities

Inheritance tax valuations are done on the same basis as for CGT is taking the lower of:

a) Lower quoted price + ¼ (higher quoted price – lower quoted price)
b) Highest marked bargain + lowest marked bargain

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Unquoted shares and securities:

The value of unquoted shares will be given in exam question.

Unit trusts

Units in authorized unit trusts are valued at the managers' bid price (the lower of the two published prices).

Life assurance policies

- Where a person's estate includes a life policy which matures on his death, the proceeds payable to his personal representatives must be included in his estate for IHT purposes.
- But where a person's estate includes a life policy which matures on the death of someone else, the open market value must be included in his estate.

Overseas property

The basis of valuation is the same as for UK property. Overseas debts are deductible.

If the property passes on death, the costs of administering and realizing overseas property are deductible up to a maximum of 5% of the gross value of the property.

Business property relief (BPR)

BPR can reduce the values of assets by 100% or 50%.

Relevant business property is:

a) Property consisting of a business or an interest (such as a partnership share) in a business.
b) Securities of a company which are unquoted and which gave the transferor control of the company immediately before the transfer (control may be achieved by taking into account related property)
c) Any unquoted shares (not securities) in a company.
d) Shares or securities of a company which are quoted and which the transferor had control immediately before the transfer (control may be achieved by taking into account related property).
e) Any land & building or plant & machinery which, immediately before the transfer, were used for the purposes of a business carried on by a company of which the transferor had control, or by a partnership of which he was then a partner.

Shares or securities on the AIM count as unquoted.

The BPR reliefs available are percentage reductions in the value transferred: 100% for assets within Para (a), (b) or (c) above, and 50% for assets within paragraph (d) or (e) above. Relevant business property for BPR purpose excludes assets of a company which were not used for business.

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Conditions for BPR (Applicable on PET, CLT and DEATH ESTATE)

BPR is only available if the relevant business property:

a) Was owned by the transferor for at least the two years preceding the transfer, or
b) Replaced other relevant business property, where the combined period of ownership of both sets of property was at least two out of the last five years.

BPR is still available even if the transferor cannot fulfill either of the criteria if when the property was acquired it was eligible for BPR and the transfer was made on death.

Non-qualifying businesses for PBR

BPR is not available if the business consists wholly or mainly of:

a) Dealing in securities, stocks and shares
b) Dealing in land or buildings
c) Making or holding investments (including land which is let)

AGRICULTURAL PROPERTY RELIEF (APR)

APR usually reduced a transfer of agricultural property by 100% of agricultural value.

APR works like BPR in reducing the value being transferred by a certain percentage before any exemptions, APR is given before BPR.

Conditions for relief (applicable for PET, CLT and Death Estate)

For relief to apply the transferor must either:

a) Own the property and have occupied it themselves for the purpose of agriculture for the two years before the transfer (i.e. thy farm the land themselves), or
b) Own the property for at least the seven years before the transfer, during which it must have been occupied for the purposes of agriculture by either the transferor or a tenant (i.e. the property is let out).

If the property transferred replaces other agricultural property, the condition will be satisfied provided that:

a) The transferor has occupied the properties for the purposes of agriculture for at least two out of the last five years, or
b) The transferor has owned the properties (and somebody has occupied them for agricultural purposes) for at least seven out of the last ten years.

APR is still available even if the transferor cannot fulfill either of the criteria if when the property was acquired it was eligible for APR and the transfer was made on death.

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THE DEATH ESTATE (PROFORMA)

	£	£
Personality		
Stocks and shares		X
Insurance policy proceeds		X
Personal chattels		X
Cash		X
Less: debts due by deceased	X	
Funeral expenses	X	
		(X)
Realty		X
Freehold property (keep UK and foreign property separate)	X	
Less: mortgages	(X)	
Net estate		X
		X
Gifts with reservation		X
Chargeable estate		X

DEBTS AND FUNERAL EXPENSES

The rules on debts are as follows:

- Only debts incurred by the deceased bona fide and for full consideration may be deducted. Therefore gambling debts and debts on promises without consideration are not deductible.
- Rent and similar amounts which accrue day by day should be accrued up to the date of death.
- Taxes to the date of death may be deducted as they are a liability imposed by law.
- Debts incurred by the executor are not allowed. If a debt is charged on a specific property it is deductible primarily form that property; a mortgage on freehold property is therefore deductible from that freehold.
- Debts contracted abroad must first be deducted from non-UK property. If the foreign debts exceed the value of the foreign property the excess is allowed as a deduction from UK property.
- Reasonable funeral expenses may be deducted
- The cost of a tombstone is deductible.

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DEATH TAX ON DEATH ESTATE

In order to calculate the tax on the death estate, use the following steps:

Step-1 Lock back seven years from the date of death to see if any CLTs or PETs which have become chargeable have been made. If so, these transfers use up the nil rate band available for the death estate. Work out the value of any nil rate band still available.

Step-2 Compute the value of the death estate (Proforma)

Step-3 any part of the death estate covered by the nil rate band is taxed at 0%. Any part of the death estate not covered by the nil rate band is charged at 40%. Deduct relevant reliefs from the death tax (e.g. quick session relief – see below)

TRANSFER OF UNUSED NIL RATE BAND

If a person who has died had a spouse, who died earlier, with any unused band on his/her death. Then the nil rate band on the later death will be increased by the unused % of nil-rate band of the earlier death. An election to claim unused nil rate band of the spouse must be made within two years of death.

For example, if the nil rate band at B's death was £300,000 and B had an unused nil rate band of £30,000, the unused proportion in percentage terms is therefore 30,000/300,000 x 100 = 10%. If A dies when the nil rate band has changed to £325,000, then B's unused nil rate band is £325,000 x 10% = £32,500.

GROSSING UP GIFTS ON DEATH

The value of UK death estate must be grossed up on a death before computing death tax when the UK death estate is transferred to chargeable persons and the residue is left to the exempt recipient. This can happen when the residue is left to the exempt recipient like spouse or charity.

Chargeable amount (in excess of the nil band) x 40/60

If proportions of UK death estate is transferred to spouse and other exempt and chargeable persons and the residue is left to a chargeable person then no grossing up is required.

Foreign property needs not be grossed up.

REDUCED IHT RATE ON DEATH ESTATE

If 10% or more of the net death estate (assets less liabilities less exemptions less reliefs less the available nil rate threshold but before charity exemption) is left to the charity than the death tax rate on death estate is reduced to 36% instead of 40%.

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GIFTS WITH RESERVATION

There are rules to prevent the avoidance of IHT by the making of gifts while reserving some benefit. The obvious example is a gift of a home to the donor's children but with the donor continuing to live in it rent free. Another example is a gift of income – producing assets, for example shares, but with the income continuing to be received by the donor.

Where a gift with reservation is made, it is treated in the same way as any other gift at the time it is made (as a PET or CLT, as appropriate). However, special rules apply on the death of the donor.

a) If the reservation still exists at the date of the donor's death, the asset is included in the donor's estate at its value at time of death (not its value at the date the gift was made).
b) If the reservation ceases within the seven years before death, then the gift is treated as a PET made at the time the reservation ceased. The annual exemption cannot be used against such a PET.

There are exceptions to the gifts with reservation rules as follows.

a) A gift will not be treated as being with reservation if full consideration is given and the property is land or chattels. For example, an individual might give away his house and continue to live in it, but pay a full market rent.
b) A gift will not be treated as being with reservation if the circumstances of the donor change in a way that was unforeseen at the time of the original gift and the benefit provided by the donee to the donor only represents reasonable provision for the care and maintenance of the donor, being an elderly or infirm relative.

OVERSEAS ASPECTS

DOUBLE TAXATION RELIEF (DTR)

DTR applies to transfers (during lifetime and on death) of assets situated overseas which suffer tax overseas as well as IHT in the UK.

Double taxation relief is lower of:

a) UK IHT on overseas gross assets
b) Overseas IHT on overseas gross assets

THE ADMINISTRATION OF IHT

IHT is administered by HMRC inheritance tax.

ACCOUNTS

The personal representatives (PRs) or Executor must deliver an account with 6 months following the end of the month in which death occurred.

DUE DATES

- For CLTs the due date is the later of:

a) 30 April just after the end of the tax year of the transfer.
b) Six months after the end of the month of the transfer.

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Interest runs from the due date, if the payment is late.

- Tax arising on the free estate at death (and on gifts with reservation is the reservation still existed at death) is payable with 6 months from the end of the month is which the death occurred. Interest runs from six months after the end of the month when death occurred.
- Tax arising on death in respect of PETs and CLTs with additional tax is payable within six months from the end of the month of death, and interest runs from this due date.

The installment option

IHT on certain property can be paid by ten equal annual installments. The first installment is due for payment on the normal due date followed by remaining nine equal annual installments.

The installment option applies to:

- Land and buildings
- Shares or securities in a quoted company controlled by the transferor immediately before the transfer
- Shares in an unquoted company representing at least 10% of the issued share capital and valued for IHT purposes at not less than £20,000.
- A business or an interest in a business (proprietorship or partnership)

If the property is sold then all outstanding tax must be paid.

ALTERING DISPOSITIONS MADE ON DEATH.

There are two main ways in which dispositions on death may be altered:

- By application to the courts
- By means of a voluntary variation or a disclaimer of a legacy.

Application to the courts may be made if the family and dependents of the deceased feel that the will has not made adequate provision for them. Any changes to the will made in this way will be treated for IHT purposes as if made by the deceased when writing his will.

Within two years of a death, the terms of a will can be changed in writing, either by a variation of the terms of the will made by the persons who benefit or could benefit under the dispositions, or by a disclaimer of legacy, with the change being effective for IHT purposes. Inheritance tax will be calculated as if the terms contained in the variation replaced those in the will.

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Advantages of making life time transfers

- If a donor makes a PET, then it will be exempt from IHT and will remain exempt is the donor dies after 7 years of making the PET.
- If a donor makes CLT and survives for 7 years after making the CLT. Then the overall IHT will have been reduced as there will be no additional IHT on death.
- The availability of annual exemptions, small gift exemptions and marriage exemptions are available to reduce the value of life time transfers for IHT purpose.
- If the value of the property to be transferred is appreciating in value then it is advisable to make life time of that property, because if it becomes chargeable to IHT due to death with 7 years of making the transfer them its value for IHT will be fixed at the time of gift.
- If the donor does not survive for 7 years after making life time transfer and the lifetime transfer are taxed on death then taper relief(provided the donor survives for atleast 3 years) will be available to reduce the tax.

Factors to consider when choosing assets to gift during life time

- If should be considered that whether or not significant CGT will arise as a result of gifting the asset during life time. Therefore, the availability of CGT exemption and gift relief should be considered before making decision to gift the asset.
- It should be considered that whether the donor can afford to make the gift. It is important to consider that after making the gifts whether the donor will be able to live comfortably, particularly in old age.
- Donor must make maximum use of exemptions like marriage exemptions and annual exemptions by considering appropriate time for making gifts.
- Donor should make gifts in early life so that there is less chance of PET becoming chargeable to IHT.
- Donor should consider making the use of available nil rate band when transferring to trust. A transfer not exceeding the available nil rate band will not give rise to life time tax.
- Donor should consider making a gift to grandchildren instead of children thus skipping a generation and resulting reduction or elimination in IHT.

IHT & CGT CONSEQUENCES

IHT	CGT
PET (Gift of asset to individual) during life time	CGT payable in tax year of transfer, market value will be taken as sale proceeds. Gift relief may be claimed.
CLT (Transfer of asset to in Trust) during life time	CGT payable in tax year of transfer, market value will be taken as sale proceeds. Gift relief may be claimed.
PET (additional tax on death within seven years)	No CGT
CLT (additional tax on death within seven years)	No CGT
Death Estate (Transfers on death)	No CGT
Gift with reservation (life time)	CGT payable in tax year of transfer, market value will be taken as sale proceeds. Gifts relief may be claimed.
Gift with reservation (on death)	No CGT

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Chapter No. 21

TRUSTs

IHT CHARGE ON DISCRETIONARY TRUST

The property in the trust is known as 'relevant property'. So long as it remains relevant property it is subject to the principal charge on every tenth anniversary form the start of the trust. If relevant property leaves the trust, an exit charge arises.

The principal charge

IHT is changed on the value of the property in the trust at each tenth anniversary of the trust. The IHT principal charge rate is 6% (30% of the lifetime rate of 20%) of the value of property in the trust at the tenth anniversary.

Exit charge before first principal charge

If relevant property leaves the trust before ten years of creating a trust then the exit charge IHT is 6% (30%) of the lifetime rate of 20%) of the value of property at the time relevant property leaves the trust.

Exit charge after a principal charge

If a property leaves the trust after principal charge then IHT charge is 6% (30% of the lifetime rate of 20%) of the value of property reduced by a fraction that reflects the time elapsed since the tenth anniversary. The fraction is x/40, where x is the number of complete quarters since the last tenth anniversary.

Examiner has said that students will not be expected to perform a computation of principal charge and exit charge in the exam.

STAMP DUTIES

Stamp duty on share and securities

Transfers of shares through stock transfer form are charged to stamp duty at 0.5%of the consideration. The duty is rounded up to the nearest £5. It is payable by the purchaser.

Example: What is the stamp duty on share sold at a value of £5,769?

Answer: £5769 x 0.5% = £30

Stamp Duty Reserve Tax (SDRT)

Transfers of shares electronically through electronic system called CREST are charged to stamp duty reserve tax at 0.5% of sale consideration. It is payable by the purchaser.

Example: What is the stamp duty reserve tax on shares sold through CREST at a value of £5,769?

Answer: £5769 x 0.5% = £ 28.85

Stamp duty Land Tax (SDLT)

Stamp duty land tax applies to land transactions. A land transaction is a transfer of land or an interest in land. SDLT is generally payable as a percentage of the consideration paid for the land. It is payable by the purchaser. SDLT is payable within 30 days of transaction. Interest runs on late paid tax.

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Rate (%)	Non-Residential
0	Upto £150,000
2	£150,001 - £250,000
5	£250,001 - above

Note: SDLT is calculated in the same way as income tax (i.e. banding rules).

Example: what is the stamp duty land tax on purchase of a shop valued at £350,000?

150,000*0% = 0

250,000-150,000=100,000*2% = 2000

350,000=250,000=100,000*5% = 5000

Answer: 0+2000+5000 = £7,000.

Rate (%)	Residential
0	Upto £125,000
2	£125,001 – £250,000
5	£250,001 – £925,000
10	£925,001 - £1500,000
12	£1500,001 & above

Note: SDLT is calculated in the same way as income tax (i.e. banding rules).

Example: What is the stamp duty land tax on purchase of a house valued at £350,000?

125000*0% = 0

250000-125000=125000*2%= 2500

350000-250000=150000*5%= 7500

Answer: 0+2500+7500=£10,000

Higher rate:

Additional rate of 3% will apply if individual buys 2nd property (it's not replacement of 1st property) or if company buys the property (even if it's first property).

If individual disposes off old property within 3 years of purchase of new property, then claim could be made to refund the additional tax paid. (Higher rate does not apply if consideration is less than £40,000)

Exemptions to stamp duties on transfers with no consideration

If there is transfer of shares or land with no chargeable consideration (Gift or charity) then there is no charge to stamp duty tax.

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Chapter No. 22, 23, 24,25,26,27

CORPORATION TAX

Corporation tax format

	Accounting period	£
	Trading profits	xx
	Interest income	xx
	Property income	xx
	Capital gains	xx
		xx
Less: Qualifying Charitable Donations		(xx)
TAXABLE TOTAL PROFITS		**XX**

Corporation tax = taxable total profits x 20%

Note - 1 Dividends

- Companies do not pay tax on dividends received from other UK and non-UK companies.

Note – 2 Interest income

- Companies receive interest gross, therefore no grossing up is required.
- If companies pay interest on loan other than for trade purpose then non-trade interest paid is deducted from interest income (this is called non-trade loan relationship).
- Remember interest paid for loan taken for trade purpose is deducted from trading profits.

Note – 3 Trading profits

- Same profit adjustment rules (as for income tax)
- Same capital allowances. (as seen earlier)

The only difference is that there will be no separate treatment for "cars with private use"

- No basis period rules.

Note – 4 Property income

- As seen in income tax

Note – 5 Capital gain

- As in chapter – as seen earlier

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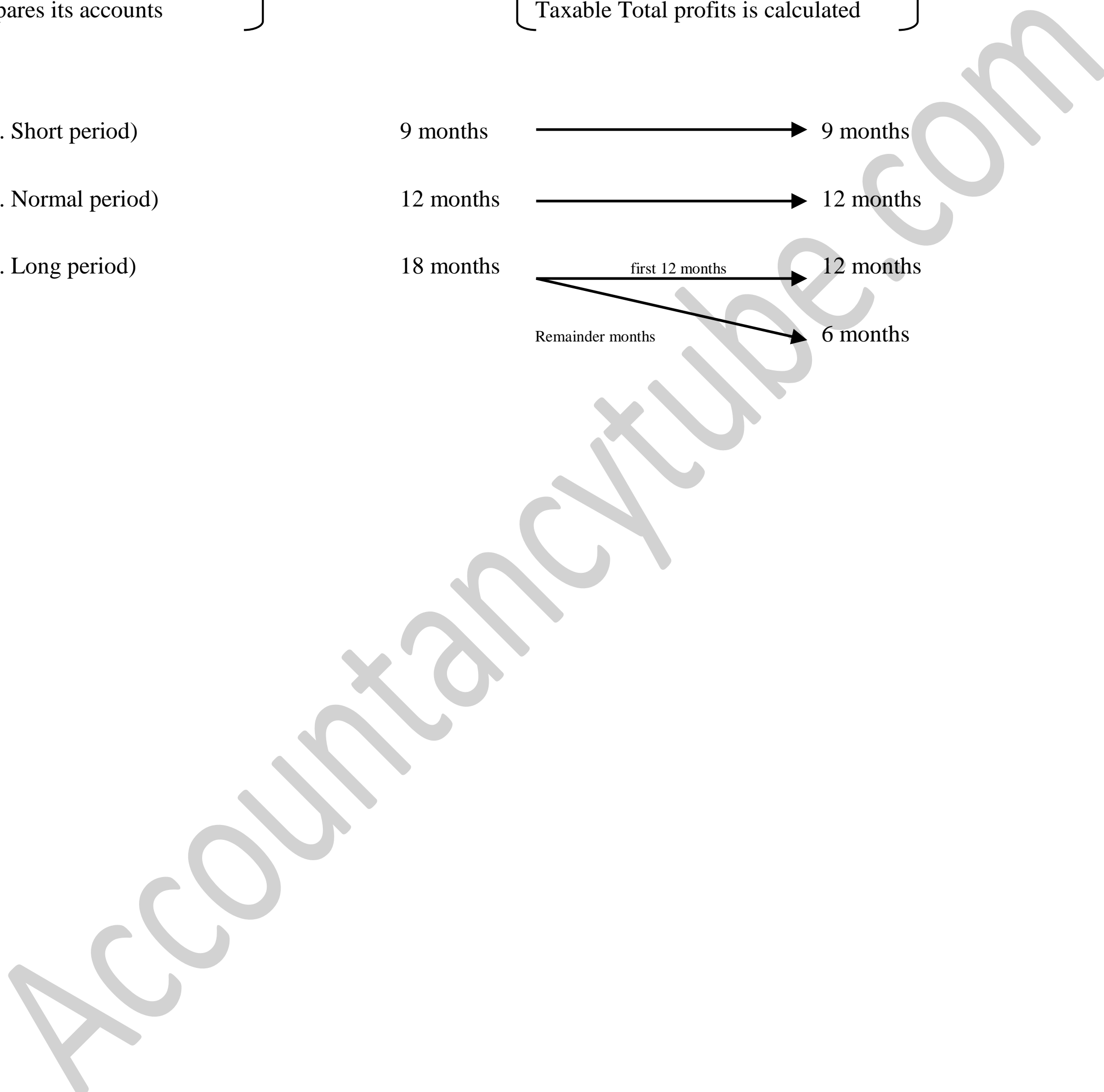
Note – 6 Accounting period

- Companies pay tax according to the accounting period.
- If the period of accounts prepared by the company is more than 12 months then the period is split into first 12 months and the remainder months.

Period of Accounts	**Accounting Period**
Period for which company Prepares its accounts	Period according to which Taxable Total profits is calculated

	Period of Accounts		Accounting Period
(e.g. Short period)	9 months	→	9 months
(e.g. Normal period)	12 months	→	12 months
(e.g. Long period)	18 months	first 12 months →	12 months
		Remainder months →	6 months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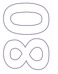

Self-Assessment (companies)

Returns

The return is due for filling on or before 12 months after the end of the accounting period to which return relates, failure to submit the return on time will result in penalty as follows:

Return late by	Penalty (for first & second consecutive failure)	Penalty (third & subsequent consecutive failure)
Upto three months	£100	£500
More than three months upto six months	£200	£1,000
More than six months upto 12 months	£200 + 10% of tax	£1000 + 10% of tax
More than twelve months	£200 + 20% of tax	£1000 + 20% of tax

Companies must keep records until six years from the end of the accounting period.

Payment of corporation tax

Large company

$$\text{[Taxable total profits + Gross dividends (excluding dividends from 51\% subsidiaries)]} > \frac{£1500{,}000}{1 + \text{No. of 51\% Subsidiaries}}$$

Large companies are required to pay corporation tax in installments. The amount of each installment is **CT/n x 3** Where: CT = Estimated corporation tax n = no. of months Large company is not required to pay by installments in the first year if it is large unless its profit exceeds £10 million Interest is paid by the company and/or HMRC on over / underpaid installments. The rate of underpaid tax is 3% and the rate of overpaid tax is 0.5%.	**LARGE COMPANIES** For 12 months accounting period Quarterly installments **First installment** 14th of seventh month in the accounting period **Second installment** 14th of tenth month in the accounting period **Third installment** 14th of first month after the accounting period **Fourth installment** 14th of fourth month after the accounting period	**LARGE COMPANIES** For less than 12 months accounting period **First installment** 14th of seventh month from start of accounting period **Subsequent installments** 14th of the month which is after three month interval of the previous installment **Final installment** (Balancing payment) 14th of fourth month after the accounting period **Small and medium companies** For 12 month accounting period or less Nine months and one day after the end of the accounting period

Note: Compliance check, discovery assessment, determination, appeals, amendments of errors, penalties for late notification and penalties for errors are same as in chapter – 15

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ADDITIONAL ASPECTS OF CORPORATION TAX

Goodwill

Amortization of goodwill is not an allowable expense. If a company has deducted amortization of goodwill then it must be added back in calculating company's profit.

Gains/losses arising on goodwill are recognized for tax purposes on the same basis as they are recognized in the accounts **(profit or loss on sale of asset = sale proceeds of asset – net book value of asset),** which means that it will be taxed as trading income instead of capital gains.

Patent box

A new scheme has been introduced in relation to patent profits in order to encourage companies to develop and exploit patents. The broad effect of the scheme is to tax profits arising in respect of patents at a lower rate of corporation tax. This scheme is available to companies that carry on qualifying development in relation to a patent and is optional. The scheme is applies to all profits relating to the exploitation of patents and royalty income arising directly from the patents. It also applies to a proportion of the profit on the sale of products where a patent has been exploited with in the production process.

In FY16, only 80% of patent profits are taxed at effective 10% rate.

Transfer pricing

The transfer pricing legislation restricts the freedom for group companies to buy and sell goods or services at whatever price. There is anti-avoidance legislation which requires the profit to be computed as if the transactions had been carried out at arm's length (Market Value) and not at the price actually used.

RESEARCH AND DEVELOPMENT RELIEF

R&D relief for SMEs

R&D relief for SME's is given by allowing the company to claim 230% of the expenditure as a deduction instead of the actual cost.

If a company that qualifies for SME R&D relief makes a trading loss, it may claim a tax credit which will entitle it to an immediate repayment. The credit is 14.5% of the lower of:

a) The trading loss or
b) 230% of qualifying R &D expenditure.

R&D RELIEF FOR LARGE COMPANIES

R&D relief for large companies is given as a tax credit of 11% of the expenditure as a deduction from corporation tax liability. First the 11% tax credit is treated as income to increase company's tax liability then this 11% tax credit is deducted from the total corporation tax to reduce the company's corporation tax liability.

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Enhanced Capital Allowance (ECA):

Expenditure on "energy saving" or" water saving plant and machinery" qualifies for 100% ECA

If company incur losses it can claim what is known as "first year tax credit" where company can surrender tax losses attributable to ECA's for a cash payment instead of 100% ECA.

First year tax credit is 19% of the loss surrendered subject to a maximum of

Higher of:

- Total of PAYE & NIC for period of loss
- £250,000

Personal accountability of senior accounting officer of large company

If a company has turnover of £200 million and / or a balance sheet total of more than £2 billion, then the company's senior accounting officer will have personal accountability for ensuring that the financial systems of the company are adequately maintained to accurately report taxable profits and gains of the company. Failure to comply with the requirements will result in a penalty applicable to senior accounting officer of £5,000. The company must notify HMRC, the identity of the senior accounting officer of the company.

Group payment arrangements

Where more than one company in a group is liable to pay tax by installments then the group of companies may make arrangements for installments to be paid by one company (the nominated company).

Employee shareholder

Employee shareholder is an employee who gives up certain employment rights like remuneration, unfair dismissal compensation, and statutory redundancy pay in exchange for employer company shares. The following conditions must be fulfilled:

- Employee and employer both agree to the terms of employee shareholder.
- Employer must give a written statement that he/she is employee shareholder.
- Employer must give employee atleast £2,000 worth of shares
- Employee will not pay for shares
- If employee obtains relevant advise from independent adviser then its cost will be paid by company
- Employee must wait for atleast 7 days of taking advice before accepting or rejecting shares.

If an employee accepts shares of the company as employee shareholding employment then:

- There will be income tax charge on the employee if the employee holds less than 25% of the issued shares of the company. The taxable employment benefit will be calculated as (Market value of shares - £2,000).
- On disposal of shares at a gain, the first £50,000 (lifetime limit £100,000) worth of shares are exempt, whereas disposal of excess shares will result in capital gain calculated in the normal way.
- On disposal of shares at a lost, this loss will not be allowable.

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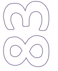

Management expenses of Investment Company

Investment Company is any company whose business consists wholly or partly in making investment. The principal overhead of the investment business will be the cost of running the business which is called management expenses. These are generally deductible expenses in computing taxable profits. An unrelieved excess of such expenses in one accounting period may be carried forward as management expenses of the following accounting period and, if still unrelieved, the future accounting periods.

Corporation tax is applied to "companies with investment business" in the normal way.

CLOSE COMPANIES

Broadly, a close company is one that is under the control of either five or fewer shareholders or any number of its shareholding directors. Shareholders and "shareholding directors" are known as 'participators'. Direct relatives and business partners of the participator are known as 'associates'.

When a close company makes a loan to one of its participators or an associate it must make a tax payment to HMRC equal to 32.5% of the loan. If the loan is repaid, HMRC will repay this tax charge.

When all or part of the loan is repaid by the participator to the company, or the company writes off all or part of the loan, then the company can reclaim all or a corresponding part of the tax charge paid over to HMRC.

If the loan is later written off then the amount of loan written off is treated as the participator's dividend income and is included within his total income accordingly.

Benefits (e.g. Car) given by a close company to participators and their associates who does not work for the company are treated as receiving dividends from the company. The amount of the deemed dividend is the amount calculated under normal benefit rules.

The purchase by a company of its own shares

Income treatment

If a company buys its own shares for more than the amount originally subscribed, general tax rules state that there is a distribution of the excess. Recipients of such distributions are treated in the same way as recipients of ordinary dividends for income tax. The shareholder will also pay capital gain tax on the shares sold to the company (the sale proceeds will be the original subscription value of the shares).

Capital treatment

However, a capital gains tax disposal automatically occur rather than an income distribution, when an unquoted trading company buys back its own shares in order to benefit its trade and certain other conditions are satisfied.

The 'benefit to the trade' test will be satisfied where:

- A dissident and disruptive shareholder is bought out
- The proprietor wishes to retire to make way for new management
- An outside investor who provided equity wishes to withdraw his investment
- A shareholder dies and his personal representatives do not which to retain his shares.

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The conditions to be satisfied by the vendor shareholder are as follows:

a) They must be resident and ordinary resident in the UK when the purchase is made.
b) The shares must have been owned by the vendor or his/her spouse throughout the five years preceding the purchase. If one of the spouses dies then the ownership period should be three years instead of five years.
c) The vendor and his/her spouse must be a result of the purchase have their interest in the company's share capital reduced to 75% or less of their interest before the disposal.
d) The vendor must not hold more than 30% of the ordinary share capital.

The capital gains tax disposal also occurs where a company purchases shares to enable the vendor to pay any inheritance tax arising on a death (the 'benefit to the trade' test and the above conditions do not then apply).

Overseas Matters for Companies

Company residence

A company is resident in the UK if it is incorporated in the UK or if it's central management and control are exercised in the UK. Central management and control are usually treated as exercised where the board of directors meets. A UK resident company is subject to corporation tax on its worldwide profits.

Permanente establishment (PE) abroad

The profits of a foreign permanent establishment (includes a branch, office, factory) of a UK resident company, are treated as part of the profits of the UK company and are normally included in its computation of trading profits. A UK company may make an election to exempt the profits and losses of all of its overseas PEs from UK corporation tax. If such an election is made then to all overseas PE and no loss relief will be given if incurred by overseas PE. It is advisable to consider double taxation relief (DTR) before making such an election.

Double taxation relief (DTR)

A permanent establishment (PE) may be subject to overseas taxes as well as to UK corporation tax on the same profits. Double taxation relief is available in respect of the foreign tax suffered. Double taxation relief is lower of:

a) UK tax on overseas gross income
b) Overseas tax on overseas gross income

Controlled Foreign Companies (CFC)

A controlled foreign company (CFC) is a company which is resident outside UK but is controlled by UK residents (individual or companies). If UK residents (individual or companies) have shareholding of 50% or more in the company then it will be controlled by UK residents.

Income profits (not gains) of a CFC are apportioned to UK resident companies (not individuals) entitled to at least 25% of those profits. UK corporation tax will be paid on the apportioned profits.

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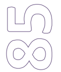

CFC charge will be reduced by "creditable tax" which is aggregate of the following

- Any DTR which would be available if CFC's chargeable profits were chargeable to UK corporation tax under normal rules
- Income tax deducted at source on income received by CFC
- Corporation tax payable in the UK on any CFC income taxable in this country

The profits of CFC will not be chargeable to UK tax if any one of the following conditions applies:

- The tax paid in overseas by the CFC is at least 75% of the amount of ax the CFC would have paid in the UK if it were UK resident.
- The CFC's profits do not exceed £500,000 and its non-trading income does not exceed £50,000.

Corporation Tax (Trading Losses)

TRADING LOSSES CARRY FORWARD

Current year e.g. 2013	**2014**	**2015**
(trading Losses)	Trading profits	Trading profits
Interest income	**(Trading Losses)**	**(Trading Losses)**
Other income	Interest income	Interest income
Foreign income	Other income	Other income
Property income	Foreign income	Foreign income
Capital gains	Property income	Property income
	Capital gains	Capital gains
(Qualifying donations)	(Qualifying donations)	(Qualifying donations)
Total taxable profits	Total taxable profits	Total taxable profits

Note:

Trading losses not relieved in the current year can be carried forward to set-off against first available trading profits of future years. Trading losses can be carried forward for as many years until all the loss is relieved. Qualifying donations not relieved in the year in which it was incurred will remain unrelieved (wasted).

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Trading losses against total income (current year & carry back relief)

	2012	current year e.g. 2013
	Trading profits	**(Trading Losses)**
	Interest income	Interest Income
	Other income	Other Income
	Foreign income	Foreign Income
	Property income	Property Income
	Capital gains	Capital Gains
	xx	xx
Trading losses	**(xx)**	**(xx)**
	xx	**(xx)** / xx
	(Qualifying donations)	(Qualifying donations)
	Total Taxable Profits	Total Taxable Profits

Note:

Trading losses can be set-off against total income (before Gift aid donations) of the current year. If the company wishes, it can further carry back its trading loss balance, if any, against total income of previous 12 months. Any trading loss not relieved in current year and previous year can be carried forward against trading profits of future years. The claim for the loss relief should be made within 2 years from the end of accounting period in which loss occurred.

Terminal loss relief

If the trade ceases then the Trading losses of last 12 months of the trade can be carried back to set off against total income of previous 36 months on LIFO basis.

Qualifying donations not relieved in the year it was incurred will remain unrelieved (wasted).

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RELIEF FOR DEFICIT ON NON-TRADE LOAN RELATIONSHIP

A non-trade loan interest deficit may be set off against any profit of the same accounting period.

Any unrelieved non trade deficit is carried forward to set off against any non-trading profits of future years.

OTHER LOSS RELIEF'S

Capital loss: Capital losses can only be set against gains in the same or future accounting periods.

Property Losses: Property income losses are first set-off against any other income and gains for the current year. Any losses unrelieved are carried forward to set off against any income of future years.

RESTRICTIONS ON LOSS RELIEF

Carry forward loss relief is only available against profits arising from the same trade in which loss incurred. Trading losses may be restricted where there is a change in ownership of company and there is either:

- Change in nature of trade within three years before or three years after the change in ownership

OR

- After the change of ownership there is considerable revival of company's trading activities.

If the restriction applies then any losses before change cannot be carried forward after the date of change. Similarly, any losses after change cannot be carried back before the date of change.

CHOICE FOR LOSS RELIEFS

- The earlier the loss is relieved the better it is, as the future is uncertain.
- An attempt should be made to waste least gift aid donations.

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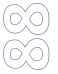

GROUPS

Group Relief Group

- The group relief provisions enable companies within a 75% group to transfer trading losses to other companies within the group, in order to set these against taxable profits and reduce the group's overall corporation tax liability.
- Within a 75% group, surrendering company can specify an amount of current period trading losses, excess property business losses, excess non-trade loan relationship deficits, and excess qualifying donations to be surrendered between UK companies.
- Capital losses cannot be surrendered for group relief (see next chapter).
- A claimant company can claim group relief against total taxable profits after using its own loss reliefs.
- The surrendered losses under group relief can only be surrendered against the profits of corresponding accounting period. Only current period losses are available for group relief.
- Losses cannot be surrendered to or from non-UK resident companies.

CONSORTIUM RELIEF

Definition

A company is owned by a consortium (also known as a consortium owned company) if:

75% or more of its ordinary share capital is owned by companies (consortium members) none of which has a holding of less than 5%.

- A consortium owned company can surrender losses in proportion to the stakes of the members of the consortium. Thus if a member holds 10% of the shares in the company, upto 10% of the company's losses can be surrendered to that member.
- Consortium relief can also flow downwards. A consortium member may surrender its losses to set against its share of the consortium owned company's profits. So, a member with a 25% stake in the consortium owned company can surrender losses to cover upto 25% of the company's profits.
- Losses cannot be surrendered to or from non-UK resident companies.

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CAPITAL GAINS GROUP

Definition

Companies are in a capital gains group if:

a) At each level, there is a 75% holding, and
b) The top company has an effective interest of over 50% in the group companies.

Reliefs available to capital gain group

a) Intra-group transfers

Companies in a capital gains group make intra-group transfers of chargeable assets without a chargeable gain or an allowable loss arising. No election is needed, as this relief is compulsory. The assets are deemed to be transferred at such a price as will give the transferor no gain and no loss (Transfer price = cost + Indexation Allowance).

b) Matching group gains and losses

Companies within a capital gain group can transfer capital gains and capital losses to each other.

c) Rollover relief

Rollover relief is available in a capital gains group if a member of a capital gains group disposes of an asset eligible for capital gains rollover relief it may treat all of the group companies as a single unit for the purpose of claiming such relief. Acquisitions by other group members within the qualifying period of one year before the disposal to three years afterwards may therefore be matched with the disposal by other group company.

De-grouping charge of company leaving the group

If a company in the capital gain group leaves the group while it owns assets transferred to it by another group member within previous six years then “De-grouping Charge” arises.

The Gain or Loss will be calculated using market value of the inter-group transferred asset at the time it was transferred between group companies. This de-grouping charge is paid by the company who sold the shares of departing company.

Annual Investment Allowance (AIA) in group of companies.

A group of companies where there is direct or indirect shareholding relationship of 50% or more is entitled to a single annual investment allowance (AIA) between group companies.

Companies may allocate the AIA between then as they think fit.

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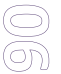

Chapter No. 28, 29,30

VALUE ADDED TAX (VAT)

VAT is charged on taxable supplies of goods and services in the UK by taxable persons in the course of their business.

Standard Rate	**20%**	On most goods and services supplied	
Zero rated	**0%**	Non luxury food	Children's clothes and footwear
		Books	Drugs and medicine
		Sewerage and water services	
Exempt		Financial services,	Betting and gamming
		Insurance,	Non profit-making education
		Health services	

Reduced rated supply: **5%**

- Supply of Fuel for domestic use
- Supply of services of Installing energy saving material to homes

BASIC COMPUTATION

	£
OUTPUT VAT (VAT charged to customers or supplies)	XX
INPUT VAT (VAT paid on purchases)	(XX)
Net VAT Payable / (Recoverable)	XX/(XX)

NOTE: Exempt suppliers cannot recover input tax and must shoulder the burden of the VAT paid.

The value of supply

VAT exclusive price + VAT = Consideration (VAT inclusive price)

VAT = VAT exclusive price x VAT rate
VAT rate = 20%

VAT = VAT inclusive price x VAT fraction
VAT fraction = (20/120 or 1/6)

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Registration

Compulsory Registration (Historical Test)

Registration is compulsory if at the end of any month taxable supplies over the previous 12 months have exceeded £83,000. "Taxable supplies" is the VAT exclusive value of all zero rated and standard rated supplies. The person must notify HMRC within 30 days. Registration will be effective from end of month following the end of the 12 month period or from an earlier agreed date.

Compulsory Registration (Future Test)

A person is also liable to be registered if at any time there are reasonable grounds for believing that his taxable supplies will exceed £83,000 in the following 30 days.

Voluntary Registration

A person may decide to become registered even if their taxable turnover falls below the registration limit. It will be advantageous to a trader as only registered person can recover the input tax they pay on purchases.

Group Registration

Companies under common control may apply for group registration. Two or more companies are eligible to be treated as members of a group provided each of them is established in the UK and:

- One of them control each of the others, or
- One person (individual or a holding company) controls all of them, or
- Two or more persons carrying on a business in partnership controls all of them.

The effects and advantages of group registration are as follows:

- Each VAT group must appoint a representative member who must account for the group's output tax and input tax, thus simplifying VAT accounting and allowing payments and repayments of VAT to be netted off. However, all members of the group are jointly and severally liable for any VAT due from the representative member.
- Any supply of goods or services by a member of the group to another member of the group is disregarded for VAT purposes, reducing the VAT accounting required.
- Any other supply of goods or services by or to a group member is treated as a supply by or to the representative member.
- Any VAT payable on the import of goods by a group member is payable by the representative member

Any application to create, terminate, add to or remove a company from a VAT group may be made at any time.

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Deregistration

Compulsory deregistration

A trader may be compulsorily deregistered if HMRC are satisfied that he no longer makes or intends to make taxable supplies (Standard rated or Zero rated).

Voluntary Deregistration

A trader is eligible for deregistered if HMRC are satisfied that taxable supplies will not exceed £81,000 in the following one year period.

Consequences of deregistration

On deregistration, VAT is chargeable on all stocks and capital assets in the business on which input tax was claimed. If chargeable VAT is £1,000 or less then it need not be paid. This rule does not apply if the business is sold as a going concern to another taxable person.

Pre-Registration Input VAT

Normally VAT incurred before registration cannot be accounted for as input VAT.

If the conditions below are satisfied then it can be treated as input tax.

Goods

- The goods must be acquired for business purposes and should not be sold or consumed prior to registration i.e. should still be in stock.
- The goods have not been acquired more than four years prior to registration.

Services

- The services must be supplied for business purposes.
- The services should not have been supplied more than six months prior to registration.

VAT periods:

The VAT period (also known as Tax period) is the period covered by a VAT return. It is usually three calendar months (quarterly returns). VAT return must be submitted and VAT must be paid within one month plus seven days after the period.

Certain businesses may submit an annual VAT return under the annual accounting scheme (see later).

Refunds of overpaid VAT

There is a four year time limit on the right to reclaim overpaid VAT.

VAT Records

All VAT records must be retained for six years by a registered person.

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TREATMENT OF DISCOUNTS

If a discount is offered for prompt payment then VAT is calculated on discounted price only if discount is taken by the customer.

Relief for Bad debts

Normally, VAT output tax is accounted for when an invoice is issued. If the sale becomes a bad debt and the seller has paid VAT to HM Revenue and Customs then it can be recovered if at least 6 months has elapsed since payment from the debtor was due.

Land and buildings

- The construction of new dwellings or buildings to be used for residential or charitable purpose is zero-rated.
- The sale of the freehold of a 'new' commercial building is standard-rated the definition of 'new' is less than three years old. The construction of commercial buildings is also standard-rated.
- Other sales and leases of land and buildings are exempt.

Owners may elect 'waiving the exemption' to treat sales and leases of land and commercial buildings as taxable instead of exempt. The owner must be registered for VAT in order to make the election. The election replaces an exempt supply with a standard rated one, usually to enable the recovery of input VAT.

A taxpayer may make a 'real estate election' (REE) instead of making separate elections for each property they own. If a taxpayer makes a (REE), they will be treated as having made the election for each property they acquire, although they may revoke the option on a particular property known as "cooling off" provision.

The deduction of Input tax

For input tax to be deductible the person must be a registered person and they must hold the VAT invoices of the supplies made to him. The distinction between capital and revenue does not apply to VAT as a registered person can claim all the input VAT on supplies to them in the course of their business.

Non-Deductible input VAT

The following input VAT is not deductible:

- VAT incurred on purchase of motor cars not wholly for business purpose is not deductible. If VAT is incurred on purchase of a car wholly for business use then input VAT is recoverable.

However the VAT incurred on repair and maintenance of the car is wholly deductible and no apportionment for private use is required.

- VAT on business entertainment to UK customers.
- VAT on non-business items

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PARTIAL EXEMPTION & INPUT TAX

Where a person makes a mixture of taxable and exempt supplies, they are partially exempt, and not all of their input tax is recoverable because some of it is attributable to exempt supplies. For a trader who is partially exempt input tax must be apportioned between that relating to taxable supplies (recoverable) and that relating to exempt supplies. The standard method of attributing input tax is as follows:

Step-1 Calculate how much of the input tax relates to making taxable supplies: this input tax is deductible in full.

Step- 2 Calculate how much of the input tax relates to making exempt supplies: this is exempt input tax.

Step -3 Calculate how much of any residual (i.e. remaining) input tax is recoverable using the percentage:

$$\frac{\text{Taxable turnover excluding VAT}}{\text{Total turnover excluding VAT}} \times 100\% \quad \text{(rounded up)}$$

Where the residual input tax does not exceed £400,000, the figure is rounded up to the nearest whole percentage. Otherwise, the figure is rounded to two decimal places.

Where the input VAT wholly attributable to exempt supplies plus the residual VAT attributed to exempt supplies (i.e. the total of exempt input tax) fulfills one of the following test, then all input VAT is recoverable.

Test-1: Total input VAT is £625 or less a month on average, and value of exempt supplies is 50% or less than of total supplies.

Test -2: Total input VAT less input VAT directly attributable to taxable supplies is £625 or less a month on average, and value of exempt supplies is 50% or less than of total supplies.

Test-3: Input VAT wholly attributable to exempt supplies plus the residual VAT attributed to exempt supplies (i.e. the total of exempt input tax) is £625 or less a month on average, and it is 50% or less than of total input VAT.

Capital goods scheme

The capital goods scheme (CGS) applies to:

- **Computers, boat & aircrafts costing £50,000 or more, which are dealt with over 5 VAT years, and**
- **Land and building costing £ 250,000 or more, which are dealt with over 10 VAT years.**

In first year	Input VAT recoverable = (cost of purchase x 20%) x (% use in first year)
In subsequent years (each year)	Input VAT (recoverable) or payable = (cost of purchase x 20%) x (% use in first year - % use in that year) x (1/5 or 1/10)
In year of sale	Input VAT (recoverable or payable = (cost of purchase x 20%) x (100% - highest % use in any year) x (remaining years / 5 or remaining years / 10)

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IMPORTS, EXPORTS, ACQUISITIONS, DESPATCHES

The term **Export** refers to goods sold to countries outside the EU. These are treated as Zero-rated supplies.

The term **Import** refers to goods purchased from countries outside the EU. These are taxed at standard rate to Zero rate as it would have been taxed as UK supplies.

The term **Dispatch** refers to good sold to countries in the EU. These are treated as Zero rated supplies.

The term **Acquisitions** refers to goods purchased from countries within the EU. These are taxed at standard rate or zero rate as it would have been taxed as UK supplies. The same amount of VAT will be written in Input tax and Output tax so that the net VAT is neutral.

Penalties

The default surcharge

If a taxable person submits a late VAT return, or submits a return on time but makes late payment of the VAT due, then a default has occurred. In this case, the HMRC may issue a "surcharge liability notice" which would specify the surcharge period – which lasts for 12 months. If within this 'period' the taxable person concerned makes a further default, a default surcharge is also levied which is calculated as 'a percentage' of tax paid late. This table is not supplied in the exam.

Default involving late payment of VAT in the surcharge period	Surcharge as a % of the VAT outstanding at the due date
1st default	2%
2nd default	5%
3rd default	10%
4th or more default	15%

Penalty for errors

Penalties on errors shall be same as for income tax errors depending on prompted or unprompted disclosure of potential lost revenue (as see earlier)

INTEREST ON UNPAID VAT

Interest is charged on VAT paid after the due date.

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SPECIAL SCHEMES

Cash accounting scheme

According to this scheme the VAT is accounted for on the basis of cash receipts and payments rather than on the basis of invoices issued and received (therefore automatic bad debt relief).

The following conditions must be satisfied to enter the scheme:

- Taxable turnover not exceeding £1,350,000 per annum.
- If the taxable turnover exceeds £1,600,000 the trader will have to exit the scheme.

Annual accounting scheme

An 'annual' accounting scheme is available whereby a single VAT return is filed for a 12 month period (normally, the accounting period of the business). The annual return must be filed within two months of the end of the return period. Normally, nine payments on account (each calculated on 10% of previous year's net VAT liability) are made at the end of months 4 to 12 of the year. A balancing payment (or repayment) is made when the return is filed. A trader can join the scheme if his taxable turnover (exclusive of VAT) for the 12 months starting on their application to join the scheme is not expected to exceed £1,350,000. If the taxable turnover exceeds £1,600,000 the trader will have to exit the scheme.

Flat rate scheme:

Sale (VAT inclusive) x Flat rate % = VAT paid to HMRC

An optional flat rate scheme has been introduced aimed at simplifying the way in which small business calculate their VAT liability. To calculate the VAT liability, simply apply a flat rate percentage on total (tax inclusive) turnover. The percentage will depend upon the trade sector in which the business falls. No input vat is repaid.

To join the scheme the business must have a taxable turnover of upto £150,000. After joining the scheme if the turnover exceeds £230,000 then the business must leave the scheme.

(Note: a 1% reduction off the flat rate can be made by a business in their first year of VAT registration)

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