



# ACCA TX UK Taxation FA 2018

Course Notes for Exams from June 2019 to  
March 2020

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Enquiries at [admin@accountancytube.com](mailto:admin@accountancytube.com)

**Instructor Name:**

**Faisal Farooq**

**B.Sc., ACCA, FPA**

**Email: [faisal@accountancytube.com](mailto:faisal@accountancytube.com)**

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These Notes cover the whole TX UK syllabus to pass this paper. Please use Exam Kit to practice questions indicated during the lectures.

**After finishing with your practice, register for Mock exam with Accountancytube which will be marked by Subject expert to assess your performance before exam. (Optional)**

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## Chapter No.1

### Income Tax Proforma



#### TAX YEAR

Income tax liability is calculated for each tax year. Tax year is from 6<sup>th</sup> April to 5<sup>th</sup> April. e.g. Tax year (18/19) is from 6<sup>th</sup> April 2018 to 5<sup>th</sup> April 2019.

#### INCOME TAX (FORMAT)

	<u>Non-Saving</u>	<u>Saving</u>	<u>Dividends</u>
Trading Income	XX		
Pensions	XX		
Interest Income (Note 1)		XX	
Property Income	XX		
Employment Income	XX		
Dividends (Note 8)			XX
	<hr/>	<hr/>	<hr/>
	XX	XX	XX
Less: Deductible Interest (Note 3)	(1)	(2)	(3)
	<hr/>	<hr/>	<hr/>
	XX	XX	XX
Less: Personal Allowance (Note 4)	(1)	(2)	(3)
	<hr/>	<hr/>	<hr/>
Taxable Income	XX	XX	XX
<u>Starting Rate Band</u> £1-£5000	20%	0%	7.5%
<u>Basic Band Rate</u> £5001-£34,500 (Note 6 & 7)	20%	20%	7.5%
<u>Higher Band Rate</u> £34,501 to £150,000 (Note 6 & 7)	40%	40%	32.5%
<u>Additional Band Rate</u> £150,001- above	45%	45%	38.1%
			<hr/>
Tax Liability			XX
<u>Less: Tax Deducted at source from income</u>			
PAYE			<hr/>
Income Tax Payable (Receivable)			(XX) XX/(XX)

## INCOME ON JOINTLY HELD PROPERTY

2

If property is held jointly 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)

### 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 exam. \_

### NOTE:2 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) £20000/year
- Child Benefit (it is the benefit paid to people who are responsible for caring at least one child)

### Note:3 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:4 PERSONAL ALLOWANCE (Given in Exam Tables)**



Personal Allowance is £11,850 (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)
Less: Gift Aid Donation (Gross)	<u>(XX)</u>
Adjusted Net Income	<u>XX</u>

**NOTE-B Adjustment to Personal Allowance of £11,850 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) x50%

Step # 3 Deduct this half of the excess amount from the personal allowance of £11,850 but the

Allowance should not be reduced below Nil (i.e. Zero)

**Exam Tip** # Personal allowance will be Nil if Adjusted Net Income is £123700 or more.

**Marriage Allowance:** Married individuals can transfer £1190 of their personal allowance to their spouse. It will not be added in normal personal allowance, instead tax liability will be reduced at the basic rate of tax e.g.  $1190 \times 20\% = £238$

**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:

Adjusted Net Income -50,000 X Child Benefit X 1%

100

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

**Note:6 GIFT AID DONATION**



Where a taxpayer pays charity under gift aid donation then the taxpayer only pays 80%(net) of the amount he wishes to pay under charity 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 tax payer pays donation under Gift Aid Scheme then tax benefit will be given as following:

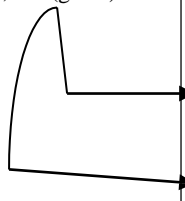
**Step #1** The amount paid by the tax payer will be grossed by (x100/80)

**Step #1** The basic rate band and higher rate band of the tax payer will be extended by the gross amount

**e.g.**

The taxpayer paid 8000 (net)

(x100/80) 10,000 (gross)



<u>Normal I. Tax Bands</u>		<u>EXTENDED I. Tax Bands</u>	
<u>Starting Band</u>		<u>Starting Band</u>	
1 ___ 5,000	(5,000)	1 ___ 5,000	(5,000)
<u>Basic Band</u>		<u>Basic Band</u>	
5,001 ___ 34,500	(28,500)	5,001 ___ 44,500	(39,500)
<u>Higher Band</u>		<u>Higher Band</u>	
34,501 ___ 150,000	(116,500)	44,501 ___ 160,000	(115,500)
<u>Additional Band</u>		<u>Additional Band</u>	
150,001 ___ above		160,001 ___ above	

**Note:7 PERSONAL PENSION CONTRIBUTIONS**

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 pay only pay £160 and the remaining £40 will be paid by HMRC.

If a taxpayer pays contribution under Personal Pension Scheme then tax benefit will be given as following:

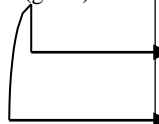
**Step #1** The amount paid by the tax payer will be grossed by (x100/80)

**Step #1** The basic rate band and higher rate band of the tax payer will be extended by the gross amount.

**e.g.**

The taxpayer paid 8000 (net)

(x100/80) 10,000(gross)



<u>Normal I. Tax Bands</u>		<u>EXTENDED I. Tax Bands</u>	
<u>Starting Band</u>		<u>Starting Band</u>	
1 ___ 5,000	(5,000)	1 ___ 5,000	(5,000)
<u>Basic Band</u>		<u>Basic Band</u>	
5,001 ___ 34,500	(28,500)	5,001 ___ 44,500	(39,500)
<u>Higher Band</u>		<u>Higher Band</u>	
34,501 ___ 150,000	(116,500)	44,501 ___ 160,000	(115,500)
<u>Additional Band</u>		<u>Additional Band</u>	
150,001 ___ above		160,001 ___ above	

**Note:8 Dividend Nil rate Band**

The first £2,000 of dividend income will be taxed at the rate of 0% . This £2,000 NRB is available to all taxpayers, regardless of their tax paying bands. However, the dividend NRB count towards the basic rate and higher rate thresholds.

**Watch Video Lecture for Chapter 1 Examples.**

Accountancytube.com

## Chapter No: 2

# RESIDENCE

A person is 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, following rules apply:

### Automatic Non-Residence Test

The following people will automatically be treated as Non UK Residents:

- 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 a 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 Resident Test

Subject to not meeting any of the automatic non-resident tests, the following people will automatically be treated as resident in 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 full time 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. Their active UK ties are as follow:

- Having a close family member in the UK
- Having a house in the UK which is made use of during the tax year
- Doing Substantial work in the UK (40 days or more , 3 hours a day)
- Being in the UK for more than 90 days during either of the two previous tax years.
- 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 ties they have according to the following table. Note: Following Table will be given in the Exam

<b>Days in UK</b>	<b>Previously Resident</b>	<b>Not Previously Resident</b>
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 ties (or more)	Resident if 2 UK ties (or more)
183 or more	Automatically Resident	Automatically resident



## EMPLOYMENT INCOME

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

### BONUS

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

## BENEFITS

### 1) Vouchers

All kind 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 Accommodation provided is JOB RELATED ACCOMODATION**

(Accommodation where employee is required to live)

Exempt

#### **CASE-2 Cost of Accommodation provided to employee is 75,000 or less**

Taxable Amount is higher of:

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

#### **CASE-3 Cost of Accommodation provided to employee is more than 75,000**

Taxable Amount is calculated as:

**Annual Value + (Cost of Accommodation or market value-75,000) x Official rate of Interest (2.5%)**

### 3) Expenses connected with Living Accommodation(e.g. heating,lighting,gardeners bill, repairing ,decorating 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 then whole amount is Taxable.
- > £10 per day outside UK is Exempt, if Exceed then whole amount is Taxable.

## 5) Scholarships

Scholarships to employee or family member of employee are Taxable.



## 6) Removal Expenses ( Relocation Expenses)

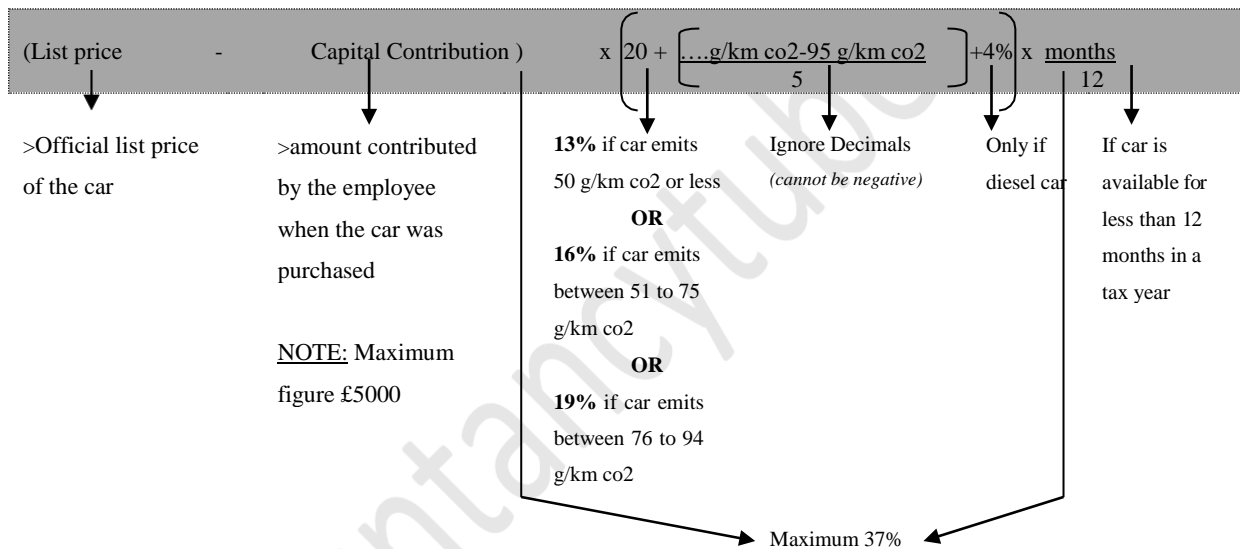
Upto 8,000 is exempt, excess is taxable.

## 7) Medical Insurance Premium

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

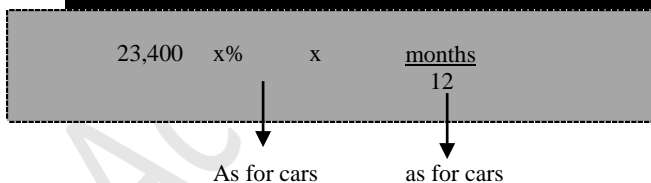
If employee is in UK for performance of duty, then the entire amount is taxable on the cost to the employer.

## 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 only) for fuel is not deductible.

### 1) 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]

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

Higher of:

1		2	
	Market value of asset when sold to employee		Market value of asset when first provided
<u>Less</u>	<u>Price paid by the employee</u> XXXX	<u>Less</u>	Amount already taxed on the asset
		<u>Less</u>	<u>Price paid by the employee</u> XXXX

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

The approved (allowed) mileage allowances are:

	<u>First 10,000 miles</u>	<u>Above 10,000 miles</u>
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

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

Note: if these employee receives less than the approved (allowed) mileage allowance then 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	:	<u>(xx)</u>
Benefit / (Allowable deductions)	:	<u>xx / (xx)</u>

**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**

$\frac{\text{Highest outstanding loan in tax year} + \text{Lowest outstanding loan in tax year}}{2} \times \frac{\text{Months}}{12} \times \text{Official rate } 2.5\%$

Less

Interest amount actually paid

**2) Strict Method (Accurate Method)**

Balance of loan outstanding in months x  $\frac{\text{Months}}{12} \times 2.5\%$  Off rate

Less:

Interest amount actually paid

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

**Exempt If:**

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

**14) Vans & Heavier commercial vehicles**

The annual scale charge is £3350 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 £633 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 up to 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	xx
<u>Less</u> Price paid by the employee	<u>(xx)</u>
	<u>X</u>

**20) Entertainment provided by third party**

Exempt

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

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

**22) Staff parties**

Cost per member per year is £150 or less than 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**

Up to £15,480 is Exempt, if exceeds 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**

Exempt

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

Exempt

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

Exempt

**36) Gift of goods from third party**

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

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

Exempt

**38) Trivial Benefits**

Exempt Up to £50 per employee per year. (Not for cash or cash vouchers)

**39) Medical treatment of Doctor's prescription or recommendation**

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

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

Taxable amount of benefit is **the cost to the employer.**

## **Accrued Income Scheme**

Whoever earns the interest on securities will have to pay tax.

- Sold before being paid interest (Cum interest)
- Sold after being paid interest (Ex Interest)

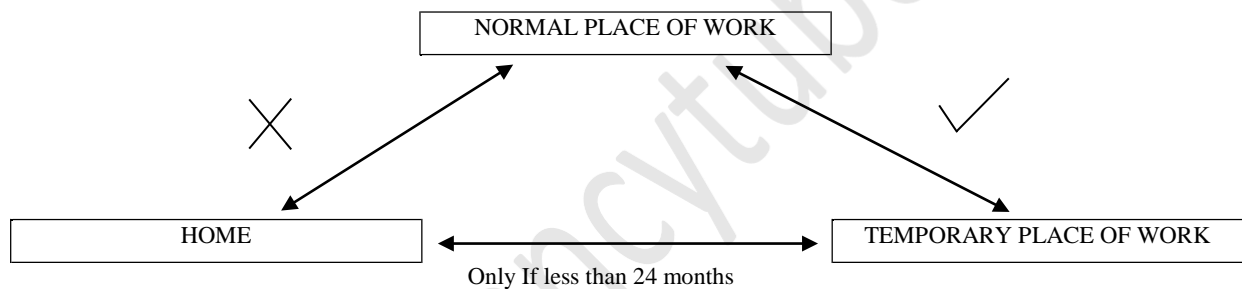
**Exam Tip:** Please consider Savings income nil rate band while calculating tax under accrued income scheme

## ALLOWABLE DEDUCTIONS

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If following expenses are paid by the employee himself then he can deduct these out of 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 partly or wholly at home.

### **NOTE:**

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

### EMPLOYMENT AND SELF-EMPLOYMENT

The following factors should be considered to distinguish between 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.

#### The PAYE System

Most tax in respect of employment income is deducted under PAYE system. It is the employer's duty to deduct income tax from the pay of his employees. HMRC normal tax code is 11,85L to employees who are entitled to Personal Allowance. PAYE tax code will be applied to the salary of the employee when calculating the amount of income tax that has to be paid each month under the PAYE system.

Employers must submit information of salary payments to HMRC electronically on or before the date of salary payment. The employers with more than 250 employees must pay their PAYE payment electronically by 22nd of the month following the salary payment. In case of late filing of PAYE return a penalty of £400 will be imposed on the employer.

At the end of each tax year, the employer must provide each employee with a form P60. This shows total taxable earnings for the year, tax deducted, code number, NI number and the employer's name and address. The P60 must be provided by 31 May following the year of assessment.

Following the end of each tax year, the employer must send HMRC:

- a) By 19 May:
  - End of year Returns P14 (showing the same details P60)
  - Form P35 (summary of total tax and NI deducted for all employees)
- b) By 6 July :
  - Forms P11D (Benefits etc. for directors and employees)
  - Forms P11D (b) returns of Class 1A NICs (see Later in these notes)
  - Forms P90D benefits etc. for other employees)

**When Employee leaves the job, a form P45 is prepared by employer and is provided to the employee. This form shows the employee's taxable earning, PAYE deducted during tax year and his tax code. The employer should provide P45 to the employee by 31 May after the end of the tax year in which the employee left the job**

## PENSIONS

### TYPES OF PENSION SCHEMES

- 1) **Occupational pension scheme**
- 2) Occupational pension scheme is a scheme operated by the employer for his employees.
- 3) **Personal pension scheme**
- 4) Personal pension scheme is a pension scheme managed by taxpayer himself through some financial institutions like Bank 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 qualify 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.

There is lifetime limit of £1,030,000 which can be built in pension fund before it gets a further charge. (not examinable) The annual allowance for tax year 14/15 to 18/19 is £40,000.

Assumption should be made that annual allowance is £40,000 for previous years too.

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 18/19 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. Unused allowance will be wasted if individual was not a member of pension scheme in that specific year.

### Tapered Annual Allowance

The normal annual allowance of £40,000 is reduced by £1 for every £2 by which a person's adjusted income exceeds £150,000. It can reduce the allowance up 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  $(40,000 - ((210,000 - 150,000)/2) = £10,000)$ .

**Adjusted Income:** Net income plus any employee contributions to occupational pension schemes (these will have been deducted in calculating net income) plus any employer contributions to either occupational or personal pension schemes. For the self-employed, adjusted income will simply be net income.

### Tax Relief:

#### 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 exempt benefit.

#### PERSONAL PENSION CONTRIBUTION

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.



## PROPERTY INCOME

<u>Income</u>	<u>£</u>
Rent (Accrual Basis)	xx
Premium	xx
<b><u>Less: Expenses (accrual Basis)</u></b>	
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 (Note 1)	(xx)
Other Revenue Expenses	(xx)
<b>Replacement of Furniture Relief</b>	(xx)
<b>Profit / (Loss)</b>	<b><u>xxx/(xxx)</u></b>

**Note:**

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

**Replacement of Furniture Relief:**

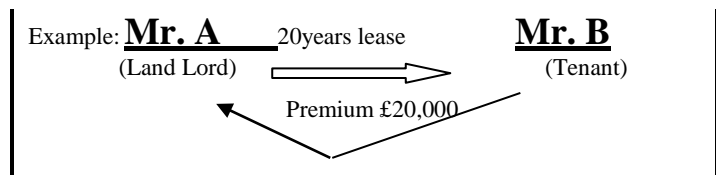
- Initial Cost of buying new furniture is not deductible only Cost of replacing old furniture is deductible
- Relief will be reduced by the proceeds of old asset sold.
- New & old asset must be same in order to get the relief & property need not be furnished to avail the relief
- Does not apply to FHL (See later in notes).

**Note 1: Interest on Loan**

Finance cost relief (such as mortgage interest) incurred on purchase or repair of residential property is restricted to 50% for current tax year 2018/19. This restriction only applies to individuals (except basic rate tax payers) and not to companies. Also there will be no restriction on FHL and property other than residential property. i.e. (commercial property).

Mark received 10000 annual rent and incurs 200 per month in expenses. He pays 3000 in annual mortgage interest. His other income is trading income of 70000. Calculate his Income tax liability.

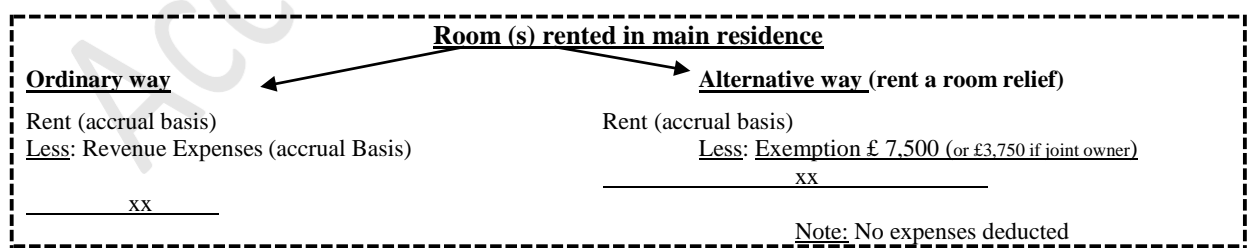
**PREMIUM ON LEASES**



<u>Mr. A (Property Income)</u>	
Premium :	XX
<i>Less:</i>	
Premium x (n-1) x 2 %	(xx)

Example  
 20,000    Less    20,000 x (20-1) = 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 2021 for 18/19 tax year, which is 22 months after the end of the tax year concerned.

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 at least 210 days during the year.
- c) The accommodation must be let to public generally for at least 105 days during the year.
- d) During the year the accommodation must not be let to same person for longer term (31 days or more).

If a letting is classified as FHL then its taxable income will be calculated according to trading profit rules which includes:

- 1) Capital allowances will be available on furniture instead of replacement of furniture relief (check with page 15)
- 2) Income will qualify as relevant earning for pension contributions purpose. (details in chapter 5)
- 3) Capital gain deferral reliefs (e.g. Rollover relief, gift relief etc.) will be available.(details in chapter 15)

If a taxpayer has more than one letting of which some are FHL while some are not then draw up two profit and loss accounts as if they are two separate property businesses. This is so that profit and losses treated as trade profits can be identified.

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## TRADING PROFIT ADJUSTMENTS

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

### 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 donee per year
- Gifts to customers which are food, drink, tobacco, vouchers irrespective of its cost
- Subscription and donation to political parties
- Private/personal Expenses
- Entertainment expenditure (for other than employees)
- Proprietor's salary or interest on capital
- Private elements of expenditure relating to proprietor's car, telephone...etc.
- Payments that constitute a criminal offense
- 15% of leasing charge of car emitting more than 130 g/km co2
- Loss on sale of asset (capital losses)

### ADD: Income not charged in accounts which are taxable

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

### 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

**NOTE: ANY EXPENSE NOT IN ABOVE LISTS MUST BE IGNORED as they are allowable**

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

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## TRADING PROFIT CALCULATIONS (CASH BASIS)

An optional Cash Basis of calculation is available to small business including sole traders and partnerships (not companies). A business can use cash basis of calculating trading profits if the turnover is less than 150,000.

Trading Profit or loss under cash basis will be calculated as follows:

	<u>£</u>	<u>£</u>
<b><u>Cash Receipts in the Accounting period</u></b>		
>Sale of goods/Inventory	Xx	
>Sale of Plant and Machinery	<u>xx</u>	Xx
<b><u>Cash Payments in the Accounting Period</u></b>		
>Allowable Business Expenses	(xx)	
>Purchase of goods/inventories	(xx)	
>Purchase of Plant and Machinery	(xx)	
>Approved Mileage Allowance	<u>(xx)</u>	(xx)
Trading profit (or Loss)		<u>(xx)/(xx)</u>

**Note:** Under Cash Basis, No Capital Allowance is claimed and no Capital expenditure is added or deducted except sale or purchase of plant and machinery (excluding motor cars and land & building.)

**Note:** Under Cash Basis, only allowable business expenses can be deducted (see above) whereas not-allowable expenses cannot be deducted.

**Note:** Motor Expenses are allowed under Cash Basis whereas now Approved Mileage Allowance for Business Travel can also be deducted instead of motor expense.

## 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  $18\% \times \frac{\text{months}}{12}$  if the accounting period is more than or less than 12 months.
- No WDA is given on the plant & machinery disposed of in the accounting period (i.e. Full WDA in the year of purchase and no WDA in the year 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 (50 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.

### Special rate pool

- Expenditure on thermal insulation, solar panels, long life asset, features integral to a building and cars with co2 emission over 110 g/km are included in special rate pool (not in main pool).
- WDA of  $8\% \times \frac{\text{months}}{12}$  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

### **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 then the entire amount in the pool is written off instead of carrying forward.

### **Sets Purchased and Sold in the Same Accounting Period**

If an item of plant and machinery is purchased and sold in the same accounting period then no AIA or WDA can be claimed on such assets. However, balancing allowance or charge may be calculated on the sold assets.



## Capital allowances (Plant & Machinery)

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### Cars

- Cars emitting 50 g/km co<sub>2</sub> or less (low emission cars) are eligible for FYA of 100%.
- Cars emitting between 51 g/km co<sub>2</sub> and 110 g/km co<sub>2</sub> are added in the main pool.
- Cars emitting over 110 g/km co<sub>2</sub> 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.

### Short Life Assets

- These are the assets which the company wishes to sell within 8 years after the accounting period of purchase.
- The company may elect to keep such assets separate for calculations from plant & machinery pool. Such an election is called “de-pooling election” such an asset is called short life asset.
- AIA can be claimed against short life asset. It is advisable to claim AIA against Main Pool first and then against short life asset.
- WDA is 18 % ( or 8%) X months/12 if the accounting period is more than or less than 12 months.
- If such an asset is not sold within 8 years after the accounting period of purchase than after 8 years the Written down Value (WDV) of the short life asset will be transferred to the plant & machinery pool.
- Cars cannot be elected as Short Life Asset.

### Leased motor cars

Where CO<sub>2</sub> emissions of a leased motor car is more than 110 grams per kilometre then 15% of the leasing costs are disallowed in calculating taxable profits.

**Example – comprehensive**

Please Watch Video lecture for comprehensive example

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## BASIS PERIOD

### First basis period

- From start of the trade to next 5th April.

### Second basis period

- (1) If the first accounting period is more than 12 months, then the basis period is last 12 months of first accounting period.
- (2) If the first accounting period is less than 12 months, then the basis period is first 12 months of the trade.
- (3) If the first accounting period is equal to 12 months, then the basis period is same as first accounting period.
- (4) If there are two 5 April's in the first accounting period, then the basis period is from 6 April to 5 April (i.e. the tax year)
- (5) If the first accounting date is taxed in the first basis period then 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 then the third and subsequent basis periods is same as accounting periods. (i.e. if either of 1,2,3 of second basis period applied).
- If the first accounting date is not taxed in the second basis period, then the third basis period is the last 12 months of the first accounting period. (i.e. if (4) 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, then 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.

## 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 total profits of the future years. Losses may be carried forward for as many years until all the loss is relieved.

Carry forward (against total income)

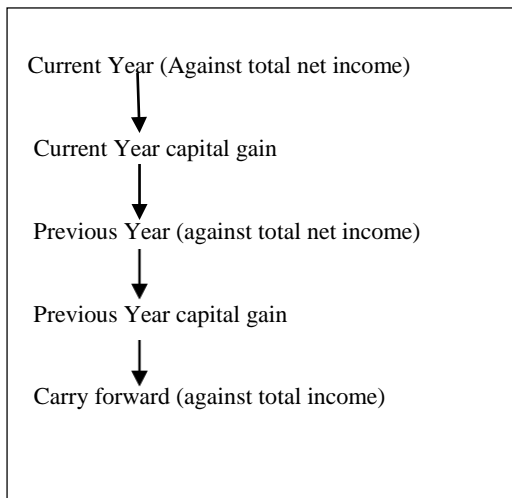
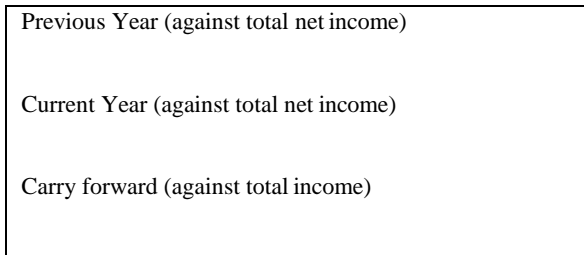
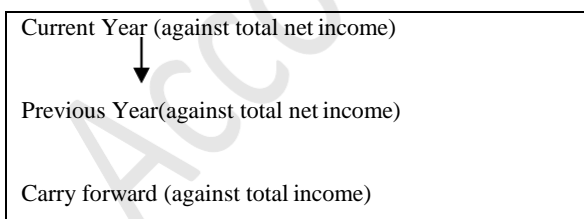
### Trading loss against Net Income

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 total profits of the future years.



### 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	:	(xx)
Overlap profits	:	(xx)
		_____
Terminal loss	:	<b>(xx)</b>
		_____

#### 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

## Chapter No.12

# PARTNERSHIP

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

**Note:**

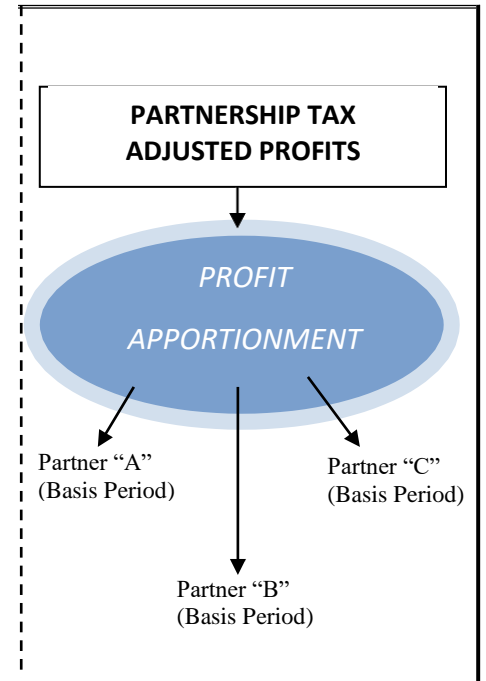
Profit sharing arrangements include:

- 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



## National Insurance Contribution (NIC)

		%
<b>Class 1 employee</b>	£1-£8424 per year	Nil
(Primary)	£8425-£46,350 per year	12
	£46,351 and above per year	2
<b>Class 1 employer</b>	£1-£8424 per year	Nil
(secondary)	£8425 and above per year	13.8
	(Employment Allowance £3,000)	
<b>Class 1A</b>		13.8
<b>Class 2</b>	£2.95 per week	
	(Exempt if Accounting profit not more than £6205 or receives state pension)	
<b>Class 4</b>	£1 - £8424 per year	Nil
	£8425 - £46,350 per year	9
	£46,351 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 2018/19, **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** to employees.

### Class 2

To be paid by self-employed.

### Class 4

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

## Badges of Trade

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If a sale is 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.

g) **The taxpayer's intention**

If from the above mentioned factors it is still unclear whether the transaction is a trading activity or not then the taxpayer's intention shall be considered.

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## CAPITAL GAINS TAX (CGT)

### Basic calculations:

		£
	Sale	<b>xx</b>
<u>Less</u>	Incidental cost of sale	(xx)
<u>Less</u>	Cost	(xx)
<u>Less</u>	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.

**CAPITAL GAIN TAX (CGT) (individuals)**

(Complete format without Entrepreneur Relief)

		£	£
<b><u>Asset – A</u></b>			
	Sales	xx	
<u>Less</u>	Incidental cost of sales	(xx)	
<u>Less</u>	Cost	(xx)	
<u>Less</u>	Enhancement expenditure	(xx)	
	Gain	_____	xx
<b><u>Assets – B</u> (Qualifying for entrepreneur relief)</b>			
	Sale	xx	
<u>Less</u>	Incidental cost of sale	(xx)	
<u>Less</u>	Cost	(xx)	
<u>Less</u>	Enhancement expenditure	(xx)	
	Gain	_____	xx
<b><u>Asset – C</u> (Current year loss)</b>			
	Sales	xx	
<u>Less</u>	Incidental cost of sales	(xx)	
<u>Less</u>	Cost	(xx)	
<u>Less</u>	Enhancement expenditure	(xx)	
	Loss	_____	(xx)
			xx
<u>Less</u>	Capital losses brought forward (Upto the amount that annual exemption remains)		(xx)
	Chargeable gains		xx
	<u>Less:</u> Annual Exemption		(11,700)
	Taxable gains		_____
			xx
<b><u>Capital Gain Tax CGT</u></b>			
	Un-used remaining STARTING BAND @10%	Un-	
	used remaining BASIC BAND @10%		
	Un-used remaining HIGHER BAND @20%		
	Un-used remaining ADDITIONAL BAND @20%		

## **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% up to basic rate band and 20% on excess above the basic rate band.

CGT is paid by 31 January after the tax year. (31 Jan 2020 for tax year 18/19)

### **EXEMPT 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)

### **ENTREPRENEUR'S RELIEF**

Entrepreneur's relief is available on gains of following:

- Disposal of whole or part of a business owned at least 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 at least for one year before disposal and the asset is sold within three years of trade cessation.
- Disposal of shares in a personal company (at least 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 for at least one year before disposal.

*CGT rate is 10% on gains qualifying for entrepreneur relief and lifetime limit is 10,000,000.*

### **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 investors' 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.

### **TRANSFER BETWEEN SPOUSES**

Disposals and transfers of assets between spouses give rise to no gain no loss.

When the asset is eventually disposed to someone else other than spouse than the Gain is calculated based on the original cost of purchase (net 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

**CAPITAL GAIN TAX (CGT) (individuals)**

(Complete format)

Asset – sold	(Not qualifying for entrepreneur relief)	₹	₹	₹
	Sale	xx		
<u>Less</u>	Incidental cost of sale	(xx)		
<u>Less</u>	Cost	(xx)		
<u>Less</u>	Enhancement expenditure	(xx)		
	Gain			xx
<b>Assets – 2</b>	<b>(Qualifying for entrepreneur relief) + (investor relief)</b>			
	Sale	xx		
<u>Less</u>	Incidental cost of sale	(xx)		
<u>Less</u>	Cost	(xx)		
<u>Less</u>	Enhancement expenditure	(xx)		
	Gain		xx	xx
<b>Asset – 3</b>	<b>(Current year loss)</b>			
	Sale	xx		
<u>Less</u>	Incidental cost of sale	(xx)		
<u>Less</u>	Cost	(xx)		
<u>Less</u>	Enhancement expenditure	(xx)		
	Loss		(2)	(1)
			xx	xx
<u>Less</u>	Capital losses brought forward (Upto the amount that annual exemption remains)		(2)	(1)
	Chargeable gains		xx	xx
	Less: Annual Exemption <b>(11,300)</b>		(2)	(1)
	Taxable gains		xx	xx
	Capital gain tax (CGT)		@10%	@18%/10%
			@10%	Upto basic band @28%/20%
				Upto basic band

## **CHATELS**

- 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 chattel for less than £6000 and a gain arises**

Exempt

### **Sale of chattel for less than £6000 and a loss arises**

The loss is calculated assuming as if the sale was for £6000.

Note: the loss cannot be changed to gain but the loss can maximum be reduced to zero.

### **Sale of chattel for more than £6000 an a gain arises**

The Gain is restricted to maximum of  $5/3 \times (\text{gross proceeds} - 6000)$

### **Sale of chattel for more than £6000 and a loss arises**

Normal CGT calculations

### **Sale of chattel on which capital allowances had been claimed**

Capital gain is ZERO (no gain / no loss)

### **Intangible Assets**

Examples include copyrights, registered designs, patents etc.

When calculating capital gains on sale of such assets, its depreciated cost (NBV) should be used in CGT calculations instead of Cost. (Note: Depreciation is on straight line basis)

### **Principal Private Residence (PPR)**

A gain arising on the sale of an individual's only or main private residence (Principal Private Residence PPR) exempt up to:

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

- 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 was both preceded and followed by the period of actual occupation.

The period of deemed occupation:

- (a) Up to Three years of absence for any reason.
- (b) Any period spent Abroad for employment.
- (c) up to Four years of absence to live elsewhere due to his work (employment or self-employment)

- **Letting Relief**

The Principal Private Residence exemption is extended to gain accruing while the property is let:

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

- **Part of House used exclusively for Business Purpose**

If part of the house is used for Business purpose then PPR exemption will not be given to part of house used for Business purpose.

## DISPOSAL OF SHARES (INDIVIDUALS)

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### 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

These shares are treated in the same way as right shares except that the Bonus shares do not have cost.

### TAKE –Over/ Reorganization

If the shares are replaced with new holdings due to re-organization or take-over then the cost of previous shares are 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 the CGT purpose will be lower of:

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

2

## CHARGEABLE GAINS (company)



	£
<b>Sale</b>	Xx
Less: Incidental cost of sale	(xx)
Net proceeds	<hr/> Xx
<u>Less: Cost</u>	(xx)
<u>Less: Enhancement Expenditure</u>	(xx)
Un indexed gain	<hr/> Xx
<u>Less: indexation allowance on cost</u>	(xx)
<u>Less: Indexation Allowance on enhancement expenditure</u>	(xx)
Indexed gain	<hr/> Xx
<u>Less: current year capital loss</u>	(xx)
	<hr/> Xx
<u>Less: capital loss brought forward</u>	(xx)
Chargeable gain (note: companies do not get annual exempt amount)	<hr/> 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 be no indexation allowance.
- Calculation of indexation allowance is no longer examinable so you will be given indexation factor till December 2017 (up to three decimal places) which you will have to multiply with amount.
- There is no indexation allowance after December 2017

### FA 1985 Pool

- Three tracks are maintained:
  - 1) Number of shares
  - 2) Cost
  - 3) Indexed cost
- Indexed cost is updated by Index Rise (adding indexation Allowance) at each operative event  
Operative events are each subsequent purchase and sale of shares  
(The indexation allowance calculations in FA1985 pool are not rounded to three decimal places)
- When shares are sold then the cost and indexed cost of the shares in the share pool are apportioned according to number of shares sold in the pool.



## Roll – Over Relief

### Old business asset

	<b>£</b>
Sales	xx
<u>Less:</u> Cost	(xx)
	xx
<u>Less:</u> Indexation Allowance (if company)	(xx)
	xx
<u>Less:</u> Amount not Re-invested (chargeable gain)	(xyz)
Gain Roll-Over	abc

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

	<b>£</b>	<b>£</b>
Sales		xx
<u>Less:</u> <u>Base cost</u>		
Cost	xx	
<u>Less:</u> Roll over gain	(abc)	(xx)
		xx
<u>Less:</u> Indexation Allowance (if company)		(xx)
Chargeable gain		Xx

## Roll - over / Held – over relief

### Old business Asset

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

Frozen 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)

	<b>£</b>
Sales	Xx
<u>Less:</u> Cost	(xx)
	Xx
<u>Less:</u> Indexation Allowance (if company)	(xx)
Chargeable Gain	Xx
<u>Add:</u> Unfrozen Gains	abc
Total chargeable gain	xx

### Conditions for roll-over relief

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

- The old asset sold and the new asset bought both used in trade by person (or company) claiming roll-over relief.
- The old asset sold and the new assets bought both are either land & building or fixed plant and machinery.
- 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.
- The new asset is brought into use in the trade on its acquisition.

### Held – over relief

#### Destroyed Asset

		<u>£</u>
	Sales (Insurance + Scrap)	xx
<u>Less:</u>	Cost	(xx)
		<u>xx</u>
<u>Less:</u>	Indexation Allowance (if company)	(xx)
		<u>xx</u>
<u>Less:</u>	Amount not Re-invested (chargeable gain)	(xyz)
	Gain Held – Over	<u>abc</u>

#### Replacement Asset

		<u>£</u>	<u>£</u>
	Sales		xx
<u>Less:</u>	<u>Base Cost</u>		
	Cost	xx	
<u>Less:</u>	Held – over gain	(abc)	(xx)
			<u>xx</u>
<u>Less:</u>	Indexation Allowance (if company)		(xx)
	Total chargeable gain		<u>xx</u>

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

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**Question:****Gift relief**

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On 6 May 2018 Angelo sold to his son Dilshan, 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. Dilshan continued to run a business from the shop premises but decided to sell the shop in March 2019 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) Dilshan's gain**

	£
Proceeds	195,000
Less cost £(200,000 – 150,000) (MV less deferred gain)	(50,000)
Gain	145,000

**Question:****Rollover relief**

Williams 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 2015 (assumed RPI = 258.4), D Ltd sold the factory for £220,000. In November 2015, 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
$258.4 - 170.1 = 0.519 \times \text{£}120,000$	(62,280)
170.1	
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

**Question:****Asset Destroyed**

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Ravi bought an asset for £25,000. It was destroyed in July 2018. Insurance proceeds were £ 34,000, and Ravi spent £30,500 on a replacement asset in January 2019. Compute the gain immediately chargeable and the base cost of the new asset.

**Answer:**

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

**Question :****Gain differed into depreciating asset**

Alam bought a freehold shop for use in his business in June 2017 for £125,000. He sold it for £140,000 on 1 August 2018. On 10 July 2018, Alam bought some fixed plant and machinery to use in his business, costing £150,000. He then sells the plant and machinery for £167,000 on 19 November 2020. Show Alam's gains in relation to these transactions.

**Answer:****2018/19 – Gain differed**

	<b>£</b>
Proceeds of shop	140,000
Less cost	<u>(125,000)</u>
Gain	<u>15,000</u>

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

**2020/21 – Sale of plant and machinery**

	<b>£</b>
Proceeds	167,000
Less cost	<u>(150,000)</u>
Gain	<u>17,000</u>

Total gain chargeable on sale in 2020/21 (gain on plant and machinery plus deferred gain) (£15,000 + 17,000) = **£32,000**

## Self-Assessment

### Keeping of records

All records required to enable them 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

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:

- a) If return is filed within due date, then by 12 months after the actual Tax Return filing date.
- b) If return is late, then Quarter day ( 30 April or 31 July ,31 October or 31 Jan) after the anniversary of actual Tax Return filing date

A compliance check may be made if there is suspicion that the tax been incorrectly calculated. Compliance check may also be selected at random for an audit. In the course of his compliance checks the officer may require the taxpayer to produce documents, accounts or any other information required.

### Tax Evasion and Tax Avoidance

The 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 means.

### Ethical conduct by Tax Agent

Tax consultant should work with honesty and integrity.

Tax advisor must not assist to plan or commit any offense leading to tax evasion. Also Tax payer may be obliged to report under money laundering regulations if the client is suspected as such. If the client insists on dishonest conduct the tax consultant should cease to work for such a client and should notify HMRC.

HMRC can investigate dishonest conduct of Tax agents, and apply a penalty of £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.

### **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.

## **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 are 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 2019 for 2018/19.

### **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.

### **Penalties for late filing of tax return**

#### **Tax return is late upto 3 months.**

Penalty is £ 100

#### **Tax return is late by more than 3 months but upto 6 months.**

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

#### **Tax return is late by more than 6 months but up to 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

**APPEALS****Appeals to HMRC**

Appeals are made first to HMRC, If the taxpayer is not satisfied with HMRC than he may appeal to tax tribunal.

**Tribunal hearings**

The tribunal is made up of:

- a) First tier tribunal
- b) An upper tribunal

Normally, the case is first heard and decision given by first tier tribunal. A decision heard by the First tier Tribunal may be appealed to the Upper Tribunal. If the case is complex and involves high amount of tax then it can be directly heard by Upper Tribunal.

**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 within 4 years after the end of relevant tax year.

**Repayment of overpaid 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. This repayment supplement is tax free. (Rate of interest is 0.5% given in exam)



**Payment of income tax and capital gains tax**

DATE	PAYMENT
31 January in the tax year	1 <sup>st</sup> payment on account
31 July after the tax year	2 <sup>nd</sup> 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

$$\text{Relevant Amount} \times 50\% = \text{Payment on Account}$$

**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)

**Penalties on Late Balancing Payment of Tax**

Paid	Penalty
More than 30 days but Within 5 months after the due date	5%
More than 5 months but not more than 11 months after the due date	10%
More than 11 months after the due date	15%

## PENALTIES FOR ERRORS



There is a common penalty regime for errors 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 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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## 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 18/19)

(Nil Rate Band) first £325,000 Nil

(Residence NRB) first 125,000 (Note 1)

Excess 40% (Note: Half rate on lifetime tax)

### Residence Nil Rate Band:

- If an Individual die after (6<sup>th</sup> April 2017)
- and a property is left out to direct relative i.e. children or grandchildren
- and property include main residence

Then first 125,000 will be taxed at the rate of 0%.

Note: The residence nil rate band does not apply to lifetime transfers becoming chargeable because of the donor's death within seven years.

### 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 donee 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 used.**

**Gifts in consideration of marriage**

Gifts in consideration of marriage are exempt up to:

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

**Exemptions applying to PET, CLT and Death Estate****Gifts /Transfer between spouses**

Any "transfer of value" between spouses is exempt.

**Normal expenditure out of income**

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

- It is made as part of the normal expenditure of the transfer.
- It was made out of income instead of capital, and
- It leaves the transferor with sufficient income to maintain his usual standard of living.

Examples includes child's school fees, payment of life assurance premiums, household monthly expenses etc.

**The Evaluation 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 before transfer	XX
Total value after transfer	(XX) _____
Diminution in value	XX

## **Lifetime tax on lifetime transfers (PETs & CLTs)**

### **Life time tax on PET**

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

### **Lifetime tax on CLT**

#### **If Transferee (Trust) pays tax**

When 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 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 20%.

### **Lifetime tax on CLT**

#### **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.

### **Advantages of making life time transfers**

- If a donor makes a PET, then it will be exempt from IHT and will remain exempt if 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 gift of that property, because if it becomes chargeable to IHT due to death within 7 years of making the transfer then 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 at least 3 years) will be available to reduce the tax.

### **Factors to consider when choosing assets to gift during life time**

- CGT implications arising as a result of gifting the asset during life time should be considered.
- 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.

### **Death tax on lifetime transfers (PETs & CLTs)**

If the transferor dies within seven years of making a PET it will become chargeable to death tax. Also, all CLTs made within seven years before the death will become chargeable for death tax. (Note: Remember calculating lifetime tax on CLTs first. Then move on to death tax, working through all CLTs and PETs in chronological order)

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

**Step-1** Look back seven years from the date of 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.

**Step-2** Any part of the CLT or PET covered by the nil rate band is taxed at 0%. Any part of the CLT or PET not covered by the nil rate band is charged at 40%. (Note: The gross value of CLT will be used which was worked out for computing lifetime tax.)

**Step-3** Reduce the death tax by **taper relief** (if applicable)

<b>Years between transfer and death</b>	<b>Taper relief (% reduction in death tax)</b>
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 to lifetime tax.

## DEATH TAX ON DEATH ESTATE

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

**Step-1** Compute the value of the death estate (Performa).

**Step-1** Look 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-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%.

## THE DEATH ESTATE (PROFORMA)

	£	£
Stocks and shares		X
Insurance policy proceeds		X
Personal chattels		X
Cash & Bank Balance		X
Land & Building		
Income Tax Refunds		
Less: debts due by deceased	X	
Funeral expenses	X	
		(X)
		X
Freehold property	X	
Less: mortgages	(X)	
		X
Net estate		X
		X
		(X)
Net 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 from 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.

## 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 rate band of £30,000, the unused proportion in percentage terms is therefore  $30,000/300,000 \times 100 = 10\%$ . If A dies when the nil rate band has changed to £325,000, then B's unused nil rate band is  $£325,000 \times 10\% = £32,500$ .

## Basic Tax Planning for IHT

The following basic tax planning may reduce or eliminate IHT:

- 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.



**Liability for IHT & Due Dates**

- For **life time tax on CLTs** , the due date is the late 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.
- Tax arising on the **Free Estate at Death** is payable by the Personal Representative (**PRs**) or Executors. The time limit for this is **6 months** from the end of the month in which the death occurred.
- Tax arising on death in respect of **PETs** is to be paid **by donee** within **six months** from the end of the month of death.
- **Additional Tax** arising on **CLTs** on death is to be paid **by donee** within **six months** from end of the month of death.

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## CORPORATION TAX PROFORMA

### Corporation tax format

	<u>Accounting period</u>	<u>£</u>
Trading profits		xx
Interest income		xx
Property income		xx
Capital gains	<u>xx</u>	xx
Less: Qualifying Charitable Donations		<u>(xx)</u>
<b>TAXABLE TOTAL PROFITS</b>		<b><u>xx</u></b>
<b>Corporation tax = taxable total profits x 19%</b>		

#### Note –1 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 –2 Trading profits

- Same profit adjustment rules (See income tax)
- Same capital allowances. (See income tax)

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

- No basis period rules.

#### Note –3 Property income

- As in Income Tax

#### Note –4 Capital gain

- As Seen Earlier

#### Note –5 Accounting period

- Companies pay tax according to the accounting period. See next chapter

**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

(e.g. Short period)	9 months	—————>	9 months
(e.g. Normal period)	12 months	—————>	12 months
(e.g. Long period)	18 months	—————>	12 months
		first 12 months	
		Remainder months	6 months

When long period is split into two Accounting periods then the income and expense is to be split using the following:

Trading profits	—————>	Time Basis
Capital Allowances	—————>	Calculated separately for each accounting period
Interest Income	—————>	The period to which it relates
Property Income	—————>	The period to which it relates
Capital Gains	—————>	Period in which asset is sold
Charitable Donations	—————>	Period in which paid

## Self-Assessment (companies)

### Returns

The return is due for filing 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

£ 1,500,000

[Taxable total profits + Dividends (excluding dividends from 51% subsidiaries)]

>

1 + No. of 51% Subsidiaries

<p>Large companies are required to pay corporation tax in installments. The amount of each installment is</p> <p><b>CT/n x 3</b></p> <p>Where:</p> <p>CT = Estimated corporation tax n = no. of months</p> <p>Large company is not required to pay by installments in the first year if it is large unless its profit exceeds £10 million</p> <p>Interest is paid by the company and/or HMRC on over / underpaid installments. The rate of underpaid tax is 2.75% and the rate of overpaid tax is 0.5%.</p>	<p><b><u>LARGE COMPANIES</u></b></p> <p>For 12 months accounting period</p> <p>Quarterly installments</p> <p><b><u>First installment</u></b></p> <p>14<sup>th</sup> of seventh month in the accounting period</p> <p><b><u>Second installment</u></b></p> <p>14<sup>th</sup> of tenth month in the accounting period</p> <p><b><u>Third installment</u></b></p> <p>14<sup>th</sup> of first month after the accounting period</p> <p><b><u>Fourth installment</u></b></p> <p>14<sup>th</sup> of fourth month after the accounting period</p>	<p><b><u>LARGE COMPANIES</u></b></p> <p>For less than 12 months accounting period</p> <p><b><u>First installment</u></b></p> <p>14<sup>th</sup> of seventh month from start of accounting period</p> <p><b><u>Subsequent installments</u></b></p> <p>14<sup>th</sup> of the month which is after three month interval of the previous installment</p> <p><b><u>Final installment</u></b> (Balancing payment)</p> <p>14<sup>th</sup> of fourth month after the accounting period</p> <p><b><u>Small and medium companies</u></b></p> <p>For 12 month accounting period or less</p> <p>Nine months and one day after the end of the accounting period</p>
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*Note: Compliance check, discovery assessment, determination, appeals, amendments of errors, penalties for late notification and penalties for errors are same as in chapter – 17*

### **Appeals**

The company can appeal to HMRC. HMRC will allocate a case officer. The case officer will conduct an internal review and give his decision within 45 days. If company wishes it can appeal to Tax Tribunal (as seen earlier). However appeal to the tax tribunal is expensive as compared to internal review by HMRC.

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## Trading Losses (Companies)

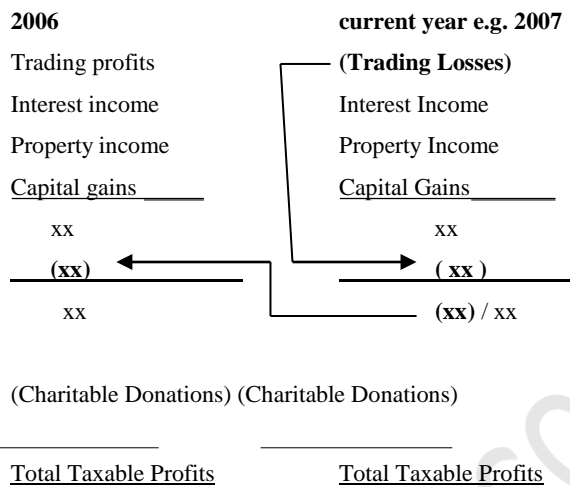
### TRADING LOSSES CARRY FORWARD

<u>Current year e.g. 2007</u>	<u>2008</u>	<u>2009</u>
<p>(trading Losses)</p> <p>Interest income</p> <p>Property income</p> <p>Capital gains</p> <p>(Charitable Donations)</p>	<p>Total profits</p> <p><b>(Trading Losses)</b></p> <p>Interest income</p> <p>Property income</p> <p>Capital gains</p> <p>(Charitable Donations)</p>	<p>Total profits</p> <p><b>(Trading Losses)</b></p> <p>Interest income</p> <p>Property income</p> <p>Capital gains</p> <p>(Charitable Donations)</p>
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 total profits of future years. Trading losses can be carried forward for as many years until all the loss is relieved. Qualifying charitable donations not relieved in the year in which it is incurred will remain unrelieved (wasted).

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



**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 is incurred will remain unrelieved (wasted).

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## GROUP LOSS RELIEF

### Group Relief Group

- The group relief provisions enable companies within a 75% group to transfer trading losses to other companies within the group.
- 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, excess qualifying donations to be surrendered between UK companies.
- Carry forward trading loss and property business loss can now be group relieved.
- Capital losses cannot be surrendered for group relief unless it's a CGT group (see next chapter).
- A claimant company can claim group relief against profits after all other loss reliefs including qualifying donations.

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## CAPITAL GAIN 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.

#### **Matching group gains and losses**

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

#### b) **Rollover relief**

If a member of Capital Gain Group disposes an asset eligible for roll-over relief then,

It may treat all of the group companies as a single unit for the purpose of claiming the roll-over relief.

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**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.

<b><u>Standard Rate</u></b>	<b>20%</b>	On most goods and services supplied	
<b><u>Zero rated</u></b>	<b>0%</b>	Non luxury food	Children’s clothes and footwear
		Books	Drugs and medicine
		Sewerage and water services	
<b><u>Exempt</u></b>		Banking services,	Betting and gambling
		Insurance,	Non profit-making education
		Health services	

**BASIC COMPUTATION**

	<b>£</b>
<b>OUTPUT VAT</b> (VAT charged on customers on supplies)	XX
<b>INPUT VAT</b> (VAT paid on purchases)	<u>(XX)</u>
<b>Net VAT Payable</b> (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)

$\text{VAT} = \text{VAT exclusive price} \times \text{VAT rate}$ $\text{VAT rate} = 20\%$
---

$\text{VAT} = \text{VAT inclusive price} \times \text{VAT fraction}$ $\text{VAT fraction} = (20/120 \text{ or } 1/6)$
---

## **Registration**

### **Compulsory Registration (Historical Test)**

Registration is compulsory if at the end of any month taxable supplies over the previous 12 months have exceeded £85,000. "Taxable supplies" is the VAT exclusive value of all zero rated and standard rated supplies. The person must notify HMRC within 30 days and will be registered from 1<sup>st</sup> of next month

### **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 £85,000 in the coming following 30 days.

### **Voluntary Registration**

A person may decide to become registered even if his taxable turnover falls below the registration limit. It will be advantageous to a trader as only registered person can recover the input tax he pays 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 control 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.
- 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 application to create, terminate, add to or remove a company from a VAT group may be made at any time.

## 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). A trader must notify with 30 days following the day ceasing to make taxable supplies.

### Voluntary Deregistration

A trader is eligible for deregistered if HMRC are satisfied that taxable supplies will not exceed £83,000 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 to be paid. This rule does not apply if the business is sold as a going concern to another taxable person.

### 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 along with payment must be submitted and VAT must be paid electronically within one month plus seven days after the end of VAT 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.

### The Tax Point

The tax point of each supply is the deemed date of supply. The tax point determines the VAT period in which output tax must be accounted for and credit for input tax will be allowed.

- The basic tax point is the date on which the goods are removed or made available to the customer.
- If VAT invoice is issued or payment is received before the basic tax point then this advance date will become the tax point.
- If the advance rule does not apply and if the VAT invoice is issued within 14 days after the basic tax point then the invoice date becomes the tax point.

## VAT Records

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Full VAT invoices must show the following:

- Supplier's name, address and VAT number
- Name and address of customer
- Tax point and invoice number
- Description of goods, type of supply and rate of VAT.
- Tax exclusive amount of each supply (unit price)
- Amount of VAT
- Rate of any cash or settlement discount offered.

All VAT records must be retained for Six Years by a registered person:

## TREATMENT OF DISCOUNTS

If a discount is offered for prompt payment then VAT is accounted for on the price after discount if the discount is actually taken by the customer

## Relief for Bad debts

Normally, VAT output tax is accounted for when an invoice issued.

If the sale becomes a bad debt, the seller has paid VAT to HM Revenue and Customs and never recovers this from the customer.

This position is addressed by the seller being able to claim VAT bad debts relief, provided:

- At least 6 months has elapsed since payment from the debtor was due: and
- The debt has been written off in the seller's books.

Relief is obtained by adding the Vat element to input tax.

## Imports, Exports, Acquisitions, Dispatches

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

The term Import refers to goods purchased with countries outside the EU. These are taxed at Standard Rate or Zero Rate as it would have been taxed as UK supplies.

The term dispatch refers to goods sold to countries in the EU. These are treated as Zero Rated Supplies.

The term Acquisitions refers to goods purchased from countries in the EU. These are taxed as both output VAT and input VAT at Standard Rate or Zero Rate as it would have been taxed as UK supplies. As same amount is to be written in both output and input VAT so the net effect is neutral

## The deduction of Input tax

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For input tax to be deductible the person must be a registered person and he 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 him in the course of his 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 a Car is used wholly for business purpose the 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 incurred on FUEL for business purpose is deductible as a input tax. But if the fuel is supplied by the business for and individual's private use (e.g employee) then the business may claim the input tax but must account for the output VAT according to Scale charge given in exam question
- VAT incurred on business Entertainment for UK customers.
- VAT on non-business items

## 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.

## **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.

Learn this table as it is not supplied in the exam.

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

### **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 seen earlier)

### **INTEREST ON UNPAID VAT**

Interest is charged on VAT paid after the due date.

## VAT 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
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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 total (tax inclusive) turnover. The percentage will depend upon the trade sector into which the business falls. No input vat is repaid. To join the scheme the business must have a taxable turnover of up to £150,000. After joining the scheme if the turnover exceeds £230,000 then the business must leave the scheme.

**Flat rate percentage for our current tax year is 16.5%.**

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



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## Chapter 18 Practice



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